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Three issues at the core of the crisis

- The pre-crisis "state of (macro)theory"
- The evolution (or involution) of the global financial system (esp. in its mother country the US)
- The failure of the pre-crisis theory to understand the new global financial system and devise a correct framework for policy making.

The theoretical and policy challenges of the global financial system

- Instability of leverage
- Connectivity
- **Is there a future for the bank?**

The good old days of plain vanilla finance

- Intermediaries were distinguished, and clearly **distinguishable**, between bank and non-bank intermediaries
- **Banks were "special"**
 - > they collected funds (mostly) in the form of short-term, sight money deposits,
 - > and lent them out (mostly) in the form of long-term, personal, non-marketable loans
- Banks deserved **special regulation**
 - > central bank's jurisdiction
 - > **tight separation** of banking from other large-scale financial market operations.

Global financial conglomerates

- wide-scope function and product **diversification**
- coexistence of **market and non-market instruments** on both sides of their balance sheet
- strategic pursuit of **large globalized dimension** and operation scale
- governance structure of **large public companies** with sharp separation between ownership and control

A look at accounts

- a high share of **marketable financial assets** with respect to direct loans (more than 40%)
- large recourse to **short-term marketable liabilities** with respect to deposits
- high returns from market transactions *vis-à-vis* **low direct intermediation margins**
- **high leverage** (beyond 30)
- heavy personnel costs, low dividends, strong growth of dimension and of **stock-market value**

- GFC appear to be engaged in making (a lot of) money through financial trading by means of others' money.
- **The rest of society** is also legitimately concerned that that GFC mega profits are commensurate to their actual financial services for welfare and growth

Economic theory and economic profession

- The EMH and the Greenspan Era:
they have all the right information, they know what they are doing, if they make profits it's because they are using money in the best way for the economy too.
- Another game in town: the IHH
 - > **banks are special** because they manage "special" (but ubiquitous) risks
 - > **asymmetric information:** the outcome of a loan depends on *unobservable characteristics or actions* of the borrower
 - > **"counterparty risk"**, that is, *idiosyncratic risk* arising from a *bilateral relationship* with an *individual borrower*.

The awakening from the Greenspan Era

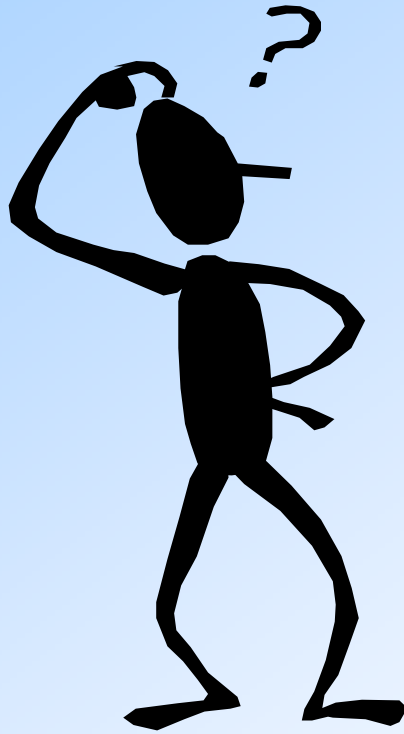
- Under the IHH, what is good for financiers may not be good for society
- Large-scale securitization of personal loans was (is) a wrong idea
- Financial efficiency needs someone who actively takes care of **screening, monitoring and auditing** final users of funds.

Methodological thoughts

How has it happened that most of the profession, and in particular the élite of mainstream macroeconomists, turned their back to the new theories of imperfect capital markets and **embraced acritically** the increasingly trembling EMH?

Is there a future for "the" bank?

- A most powerful driver of the threat on "true" banking is just **competition**
- The dissolution of banking would represent a **colossal market failure**, which would deprive the economy of a fundamental allocation mechanism.
- A market failure calls for **public policy** to intervene.
How?
 - > dimensional limitations, firewalls, Basel II reforms miss the point
 - > **back to Glass-Steagall?**



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