

Euphoric Credit and Finance: **Merchandising time**

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Queen's question « **Why did no one see the crisis coming?** »

“It is difficult to recall a greater example of wishful thinking combined with hubris.” ...

- “...But the difficulty was seeing the risk to the system as a whole rather than to any specific financial instrument or loan...”
- .. “People trusted the banks whose boards and senior executives were packed with globally recruited talent and their non-executive directors included those with proven track records in public life...”
- ...”They believed that the financial wizards had found new and clever ways of managing risks.”...
- ... a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole.

Quotations from a letter sent by the British Academy to Queen on the 22th of July 2009 answering the question posed by her Majesty during her visit to London School of Economics on the 5th of November 2008



Crisis or Accident ?

As in case of every accident, there is many suspects and plenty to blame:

- “laws of history” – determinism, cycles
- Are “finance professionals” to blame ??;
- Is shareholders’ appetite the culprit??;
- And what about economic and finance theories ??;
- Insufficient internal and external controls ??;
- Absence of regulatory teeth, self-satisfaction (and possible capture) of the regulators?

It seems that this crisis has many causes (Aristotelian multi-causality) possibly reinforcing one another => this is a systemic crisis

- Break down of a “systemic logic” which has to be revamped
- Exhausted model of “progressive” where “economic growth = happiness”



« Confusion de confusions » José de la Vega (1688)

Three major confusions deepened during the Euphoric (1974-2007) decades

(1) Between Future and Present

- Leveraging the future for the sake of the present
- Endogenous time vs. exogenous time

Today the future for some of us is empty

(2) Between Ends and Means

- More instead of “better”
- Ethos of Efficiency – obsession of ROI, ROE, etc...

(3) Between Reality and Virtuality

- The dominance of the two dimensional world of “risk and return” – between quantity and reality

**The visible effects: process of
« financiarisation »**



« Finance = trade in promises »

Jean-Noël Giraud 2001

- Changing functions of finance in the economy:
 - Traditional function : Allocate capital - productive efficiency
 - ☞ « real economy » flows of savings, investments and returns
 - ☞ issuers' & bankers' traditional business
 - Modern function: Allocate & trade risks/rewards – discount the future and turn it into present (value)
 - ☞ Management of existing liquid assets
 - ☞ Traders' and advisors business (capital gains)
 - ☞ Take care of existential fears (risk less society)



The promise of financial euphoria

« The expansion of the financial economy is a mere reflection of the tyranny of the real economy. **Indeed, the tyranny of the real economy causes a lot of harm in many different places.** It hampers the freedom of action of individuals. It forces them to cope with risks that jeopardise the well deserved rewards of their daily labour. It entails government intervention, which can be even more destructive.

...Today, the **international financial economy removes the viscosity of the real economy.** It puts economic agents in a position of responsibility by ensuring that they have the opportunity to accept those risks they are able to manage through the exercise of their particular skills. » (p5&8)

☞ *In 1999, Eric Briys one of the raising stars of financial theory, publishes « La mondailisation financière : enfer ou paradis » later translated as « The Fishermann and the Rhinoceros »*



Financialisation

Financialisation is a systemic , socio-economic process:

- Creation on the basis of any possible fragment of ownership (material or legal) a **financial asset** (**financial capital**) governed by the newly discovered “laws” of financial markets, the entitled to returns and characterised by a level of risk;
- Is ongoing extension of the instruments and fields governed by the arbitraging of exit opportunities at the expense of commitment and partnership;
 - ☞ *victory of “capital gain” view over the “flow of return view”*
 - ☞ *acceleration and shortening of perspectives: time as succession of independent “moments”*
- Much more than only the growth of the financial sector (usual structural change);



Financialisation

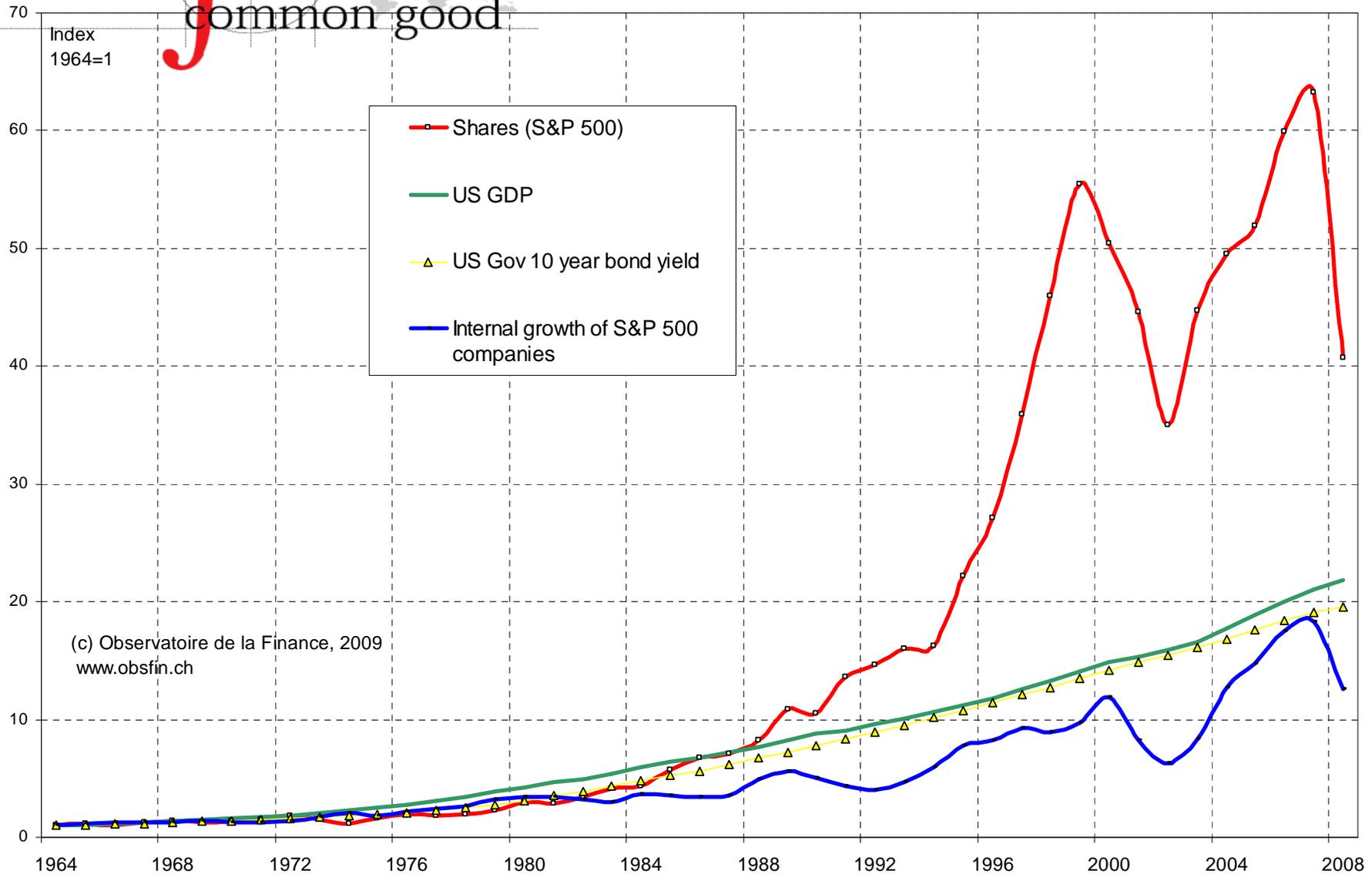
Financialisation was a – tentative - answer to a growing demand (in the North) for risk management and returns:

- Risk management: beyond classical insurance: the promises of the **risk-less society**;
- Returns: **Life without labour – rentiers eternal dream/illusion**

Financialisation : search for low-correlated assets, notably in located the South

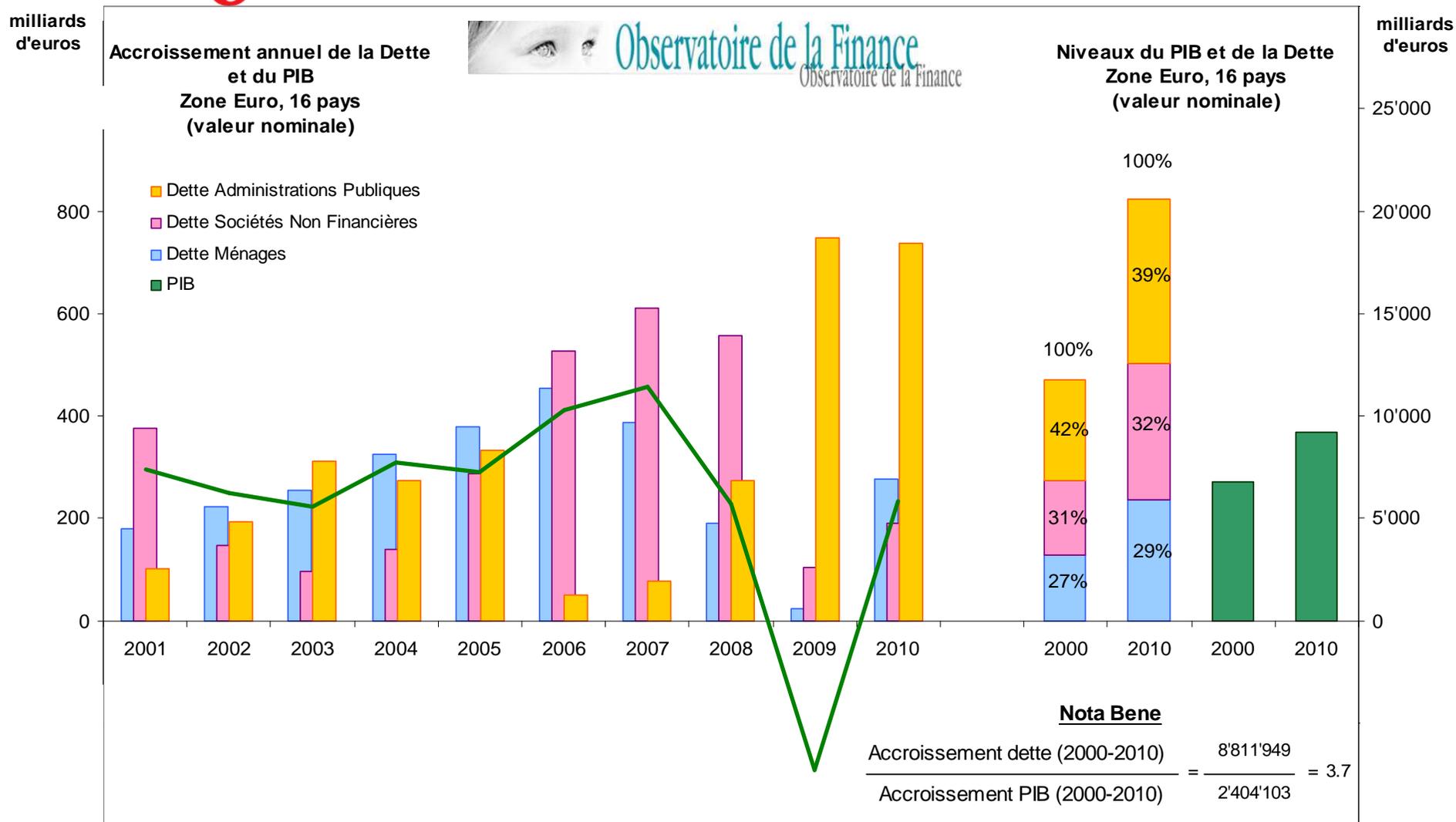
Financialisation is not only a technical/financial reality

Leverage US: "real" vs. financial

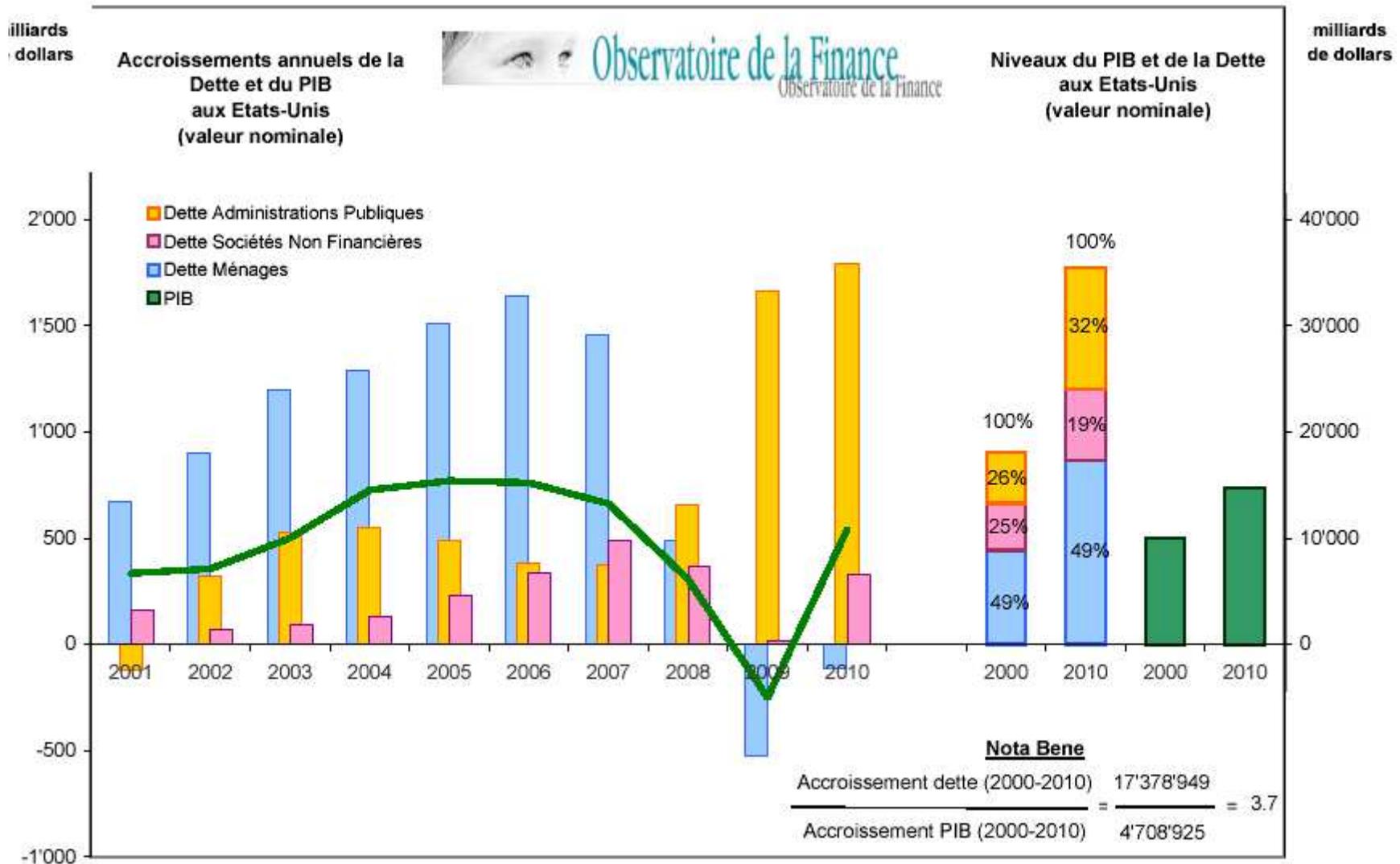


Source: Observatoire de la Finance, données primaires: Thomson Financial; et prof. Robert Shiller [<http://www.irrationalexuberance.com>]

Growth leveraged by debt - Euro zone



The same in US



Données Primaires : OCDE et Banque de France
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Long term returns on assets below 1%
Finance is a fragile Industry – BIS AR 2010

Profitability and leverage												
Medians across years and institutions												
	Return on assets ¹				Return on equity ²				Leverage ³			
	95–09	95–00	01–07	08–09	95–09	95–00	01–07	08–09	95–09	95–00	01–07	08–09
Banks	0.6	0.7	0.7	0.2	12.2	13.3	12.8	3.2	18.3	17.8	19.1	17.4
Non-bank financials	0.9	1.0	1.0	0.5	11.2	12.3	11.4	5.4	12.1	12.5	12.1	10.8
Non-financials	3.2	3.0	3.4	2.8	11.7	10.9	12.8	9.8	3.0	3.0	3.0	2.9



Transactionitis

Ethos of efficiency pushed to its extremes

Flexibility – lowering “transaction costs”

- Progressive sterilisation, instrumentalisation of any relation
 - ☞ *In finance – the subprimes*
 - ☞ *In employment relations; in inter-enterprise-relations*
 - ☞ *In start-ups and spin-offs*
 - ☞ *Even in academia; Not to speak of private life*

Exit threat undermines trust, community and kills creativity

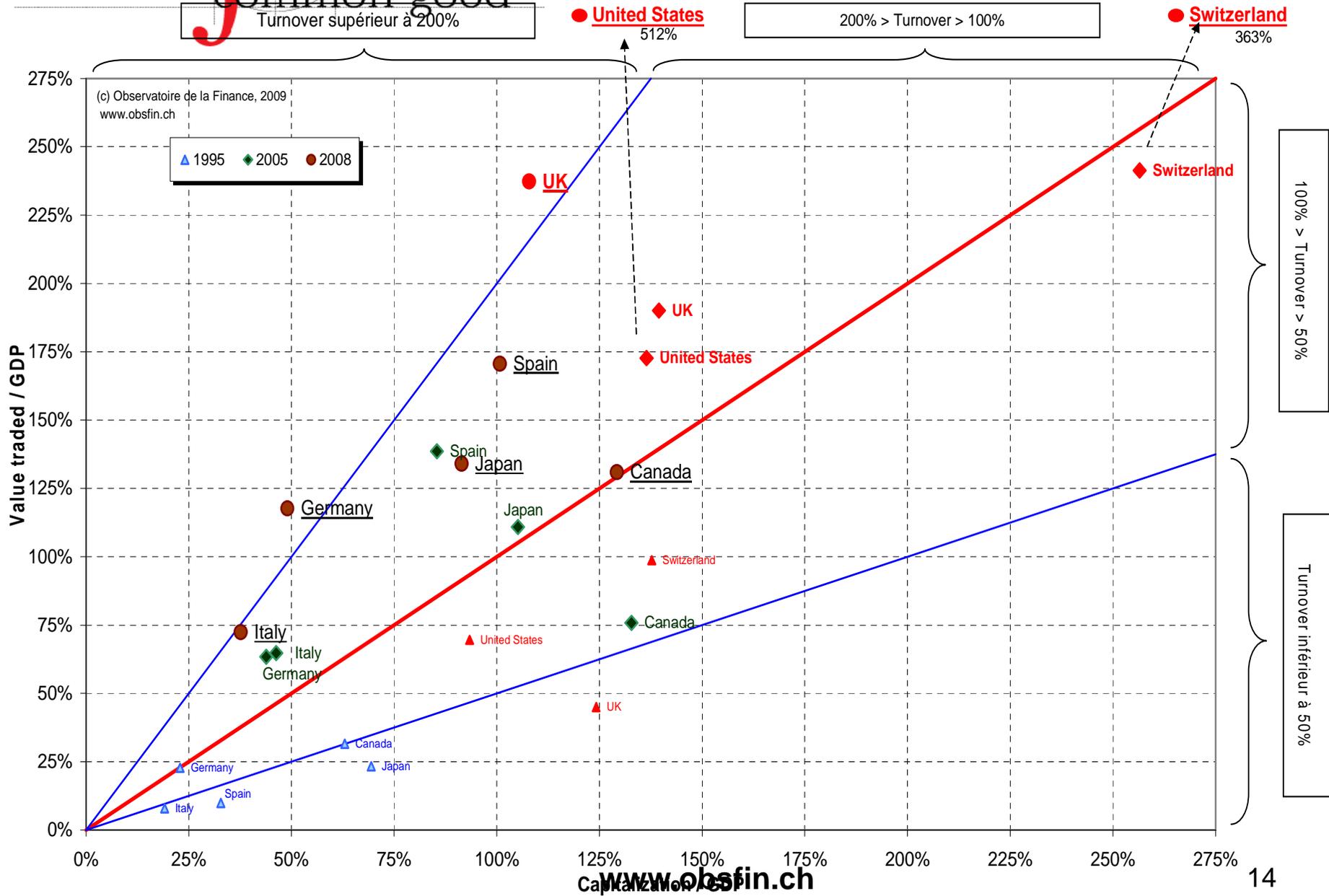
- Permanent focus on «exit » conditions, i.e. on liquidity;
- Permanent search for valuation of already achieved
- Attention diverted from the purpose
- Risk management becomes an obsession

Within large enterprises extreme proceduralisation

- Reporting and control,
- De-personnalisation of everything
- Knowledge management
- No room for ethics because no room for sense

Social and control costs skyrocket – limits to efficiency

Transactionitis





Can/should financialisation be harnessed?

Discussion will go on for a long time:

Economists – mechanical problem (accident) or fatality
«financial cycle» ;

Ethical perspective – human errors/misbehaviours

Natural limits for «borrowing the future» is a financial crisis,
simply because it «cleans the books» - the Jubilee

Deleveraging: would free the future of many at the expense of
destroying the (past) savings of also many.

Massive deleveraging is redistributive, can only succeed when
it is «just» and systemic.

NB: The 1930 restructuring of WWI reparations came too late



bien commun
common good

finance &
commun

Observatoire de la Finance
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For finance

that serves the common good

**Manifesto of Observatoire de la Finance
(2009)**

In March 2008 the Observatoire de la Finance published its manifesto entitled 'For finance that serves the common good'. Below is a second version of this manifesto that takes account of the many comments received over the past year and reflects what has become only too apparent during that year – namely, the widespread reluctance to see the crisis as anything but a mere cyclical upheaval, the helplessness of both the public and the private sector in the face of it, and the failure of purely technical measures to control it.

Today we must regain control of the future before it is too late – reverse the financialization process and ensure that finance once again operates in the interests of human dignity and progress. The manifesto aims to alert men and women of good will to the danger that threatens our precious economic and political freedom because we have succumbed to the illusion that 'greed is good'. Even if 'greed' may appear to boost economic efficiency, it can only do so by profoundly undermining the very foundations of society: trust, respect and solidarity.

*The journal **Finance & the Common Good/Bien Commun** and the Observatoire de la Finance website (www.obsfin.ch) are now available to those who wish to further explore and flesh out the ideas put forward in this manifesto. Please send your contributions to manifeste@obsfin.ch.*

www.ubsim.ch

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<http://www.obsfin.ch/Document/2011-ENG-Manifeste%20de%20l%27Observatoire.pdf>



**Thank you for your
attention!!**

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