



OESTERREICHISCHE NATIONALBANK  
EUROSYSTEM

# Growth in Transition Money and the Financial System

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## **FINANCIAL CRISIS AND OPPORTUNITY**

**Green Investment is one Solution for two Crises**  
**Chance to Build Global and Accountable Institutions**  
**Finance Serving the Society**

*Shock Absorption versus Shock Origination*

*Intermediation versus Extraction of Rents and Resources*

*Risk Transformation versus Risk Transfer*

## MAKING FINANCE SERVE SOCIETY

**Benjamin Friedman: “ *We are desperately missing any real discussion of what function our financial system is supposed to perform and how well it is doing that job – and, just as important, at what cost* „**

**Any regulatory reform should be built on a **normative view** of which financial system serves society best in terms of overall welfare and equity.**

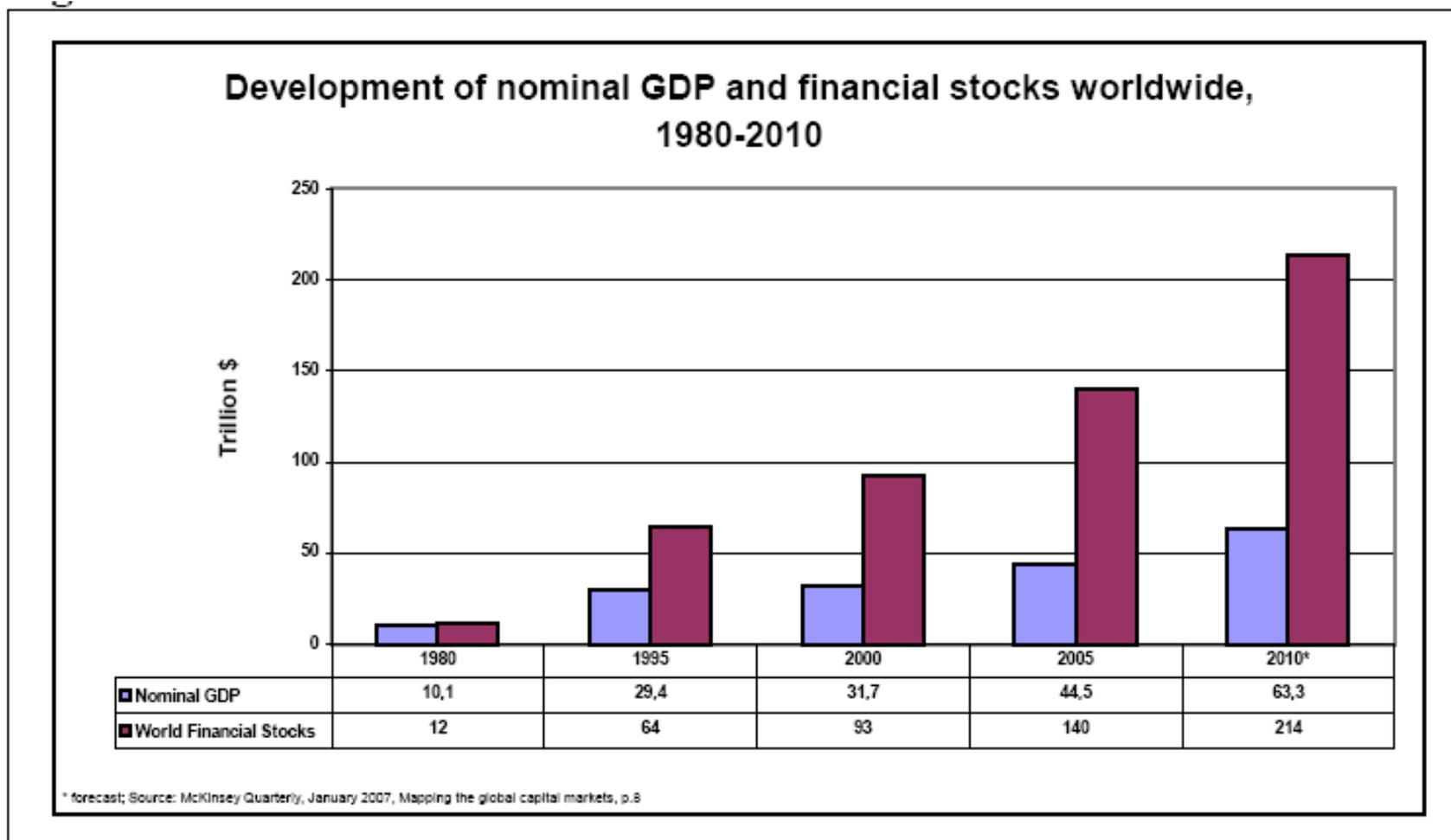
**Today, reform initiatives are mainly based on identifying some of the regulatory loopholes.**

**Reform initiatives will not put finance at the service of the economy and society but are instead meant to **return to the status quo ante**.**

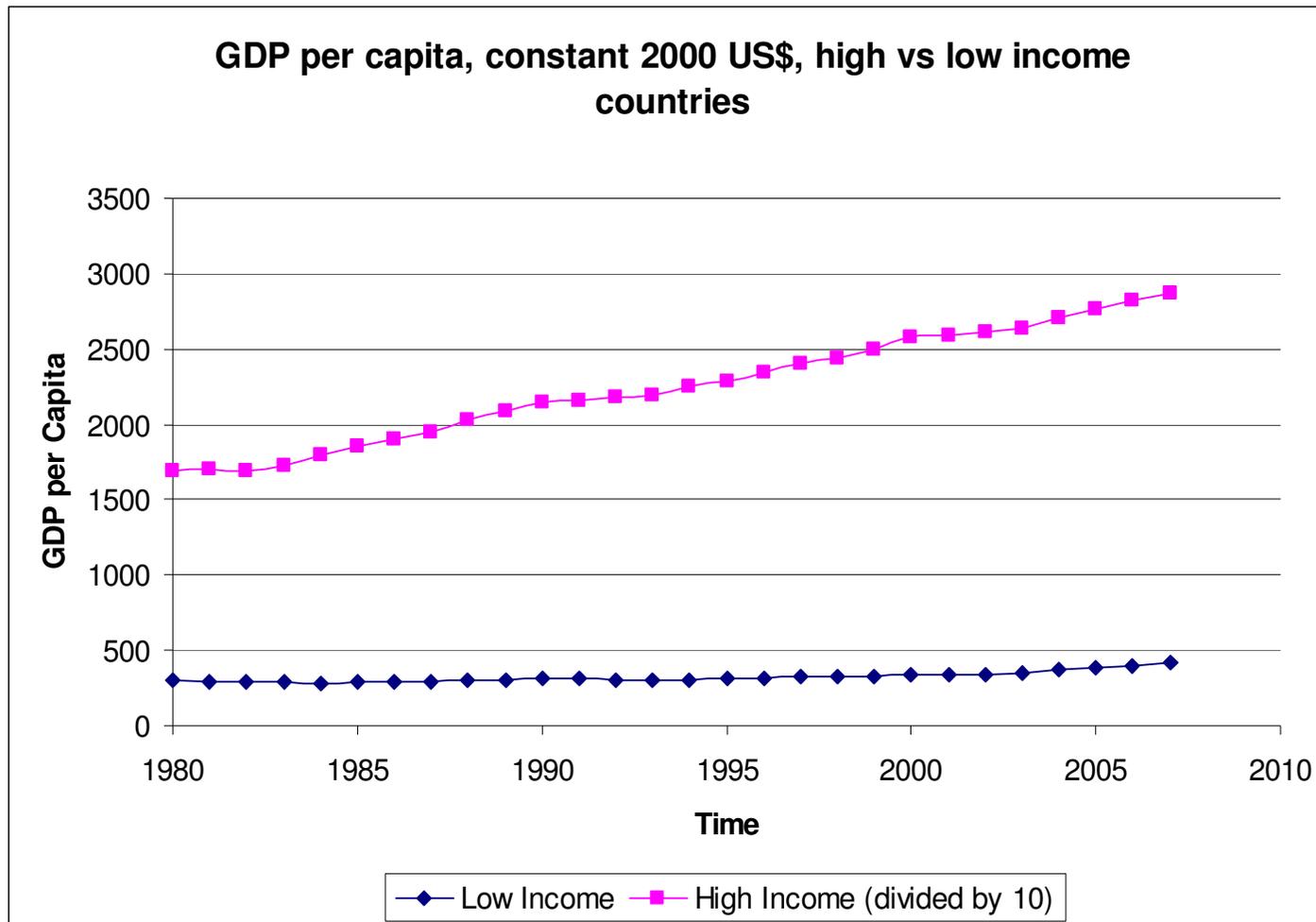
**They are not suitable to avoid financial crises in the future, because they do not address the systemic and structural roots of the crisis.**

**Among these causing factors, that have reinforced each other, the surging inequalities that had built up before the financial crisis lie at the heart of the crisis.**

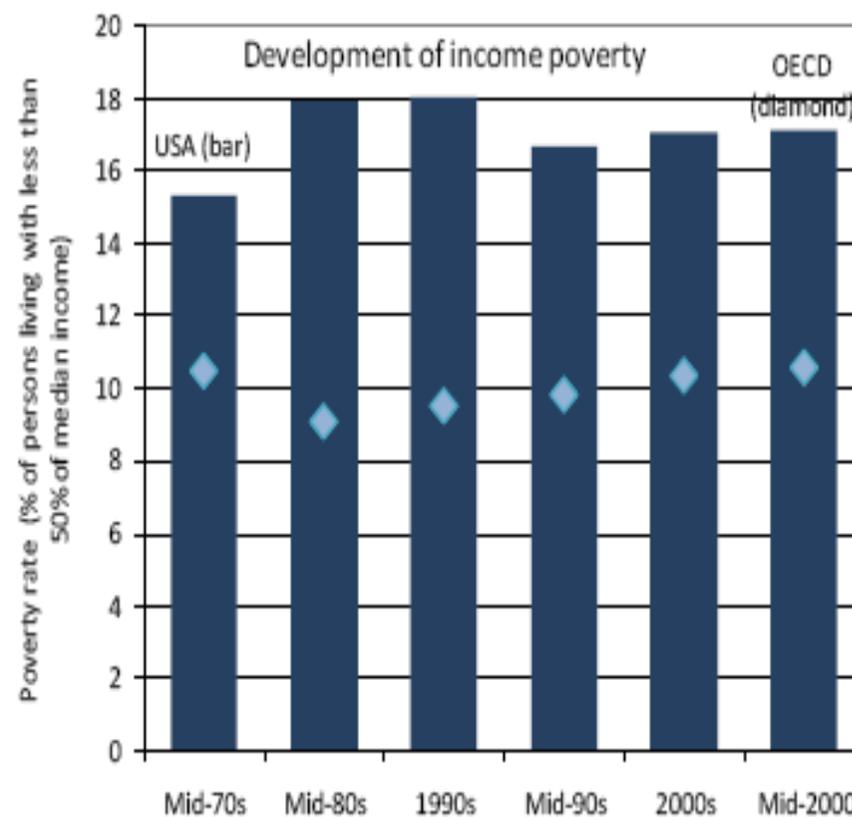
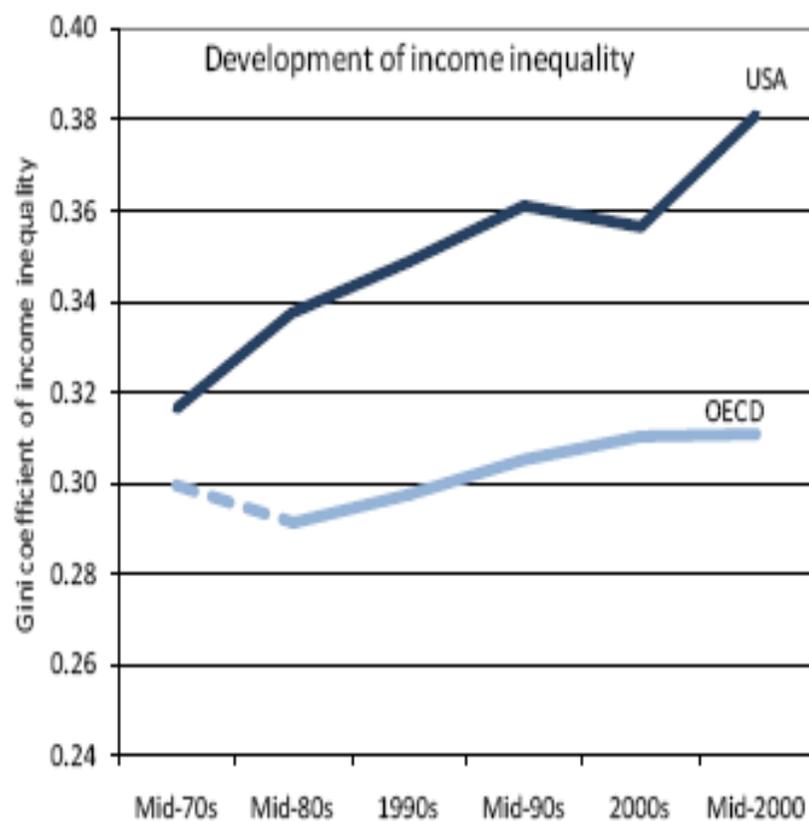
## Global crisis background: rising inequality



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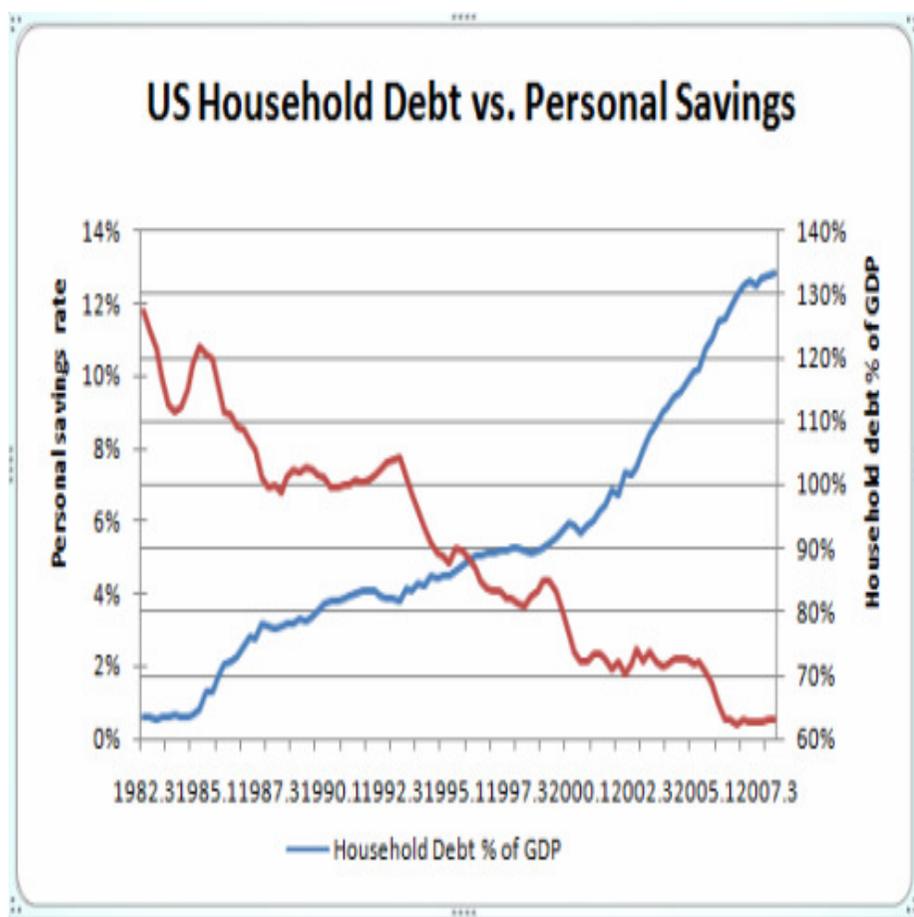


## Global crisis background: rising inequality



Source: *Growing Unequal?*, OECD 2008. Income is disposable household income adjusted for household size.

## Growing indebtedness – global imbalances



## **MAKING FINANCE SERVE SOCIETY**

### **Intermediation versus Extraction of Rents and Resources**

**The financial system has performed rather poorly in fulfilling its intermediation function, the transfer of financial resources to the most productive investments. It created its own circular flows and extracted rents from the real sector.**

**At the peak of the boom in 2007, 40% of all corporate profits in the United States were accruing to the financial sector, which accounted for 7% of overall GDP.**

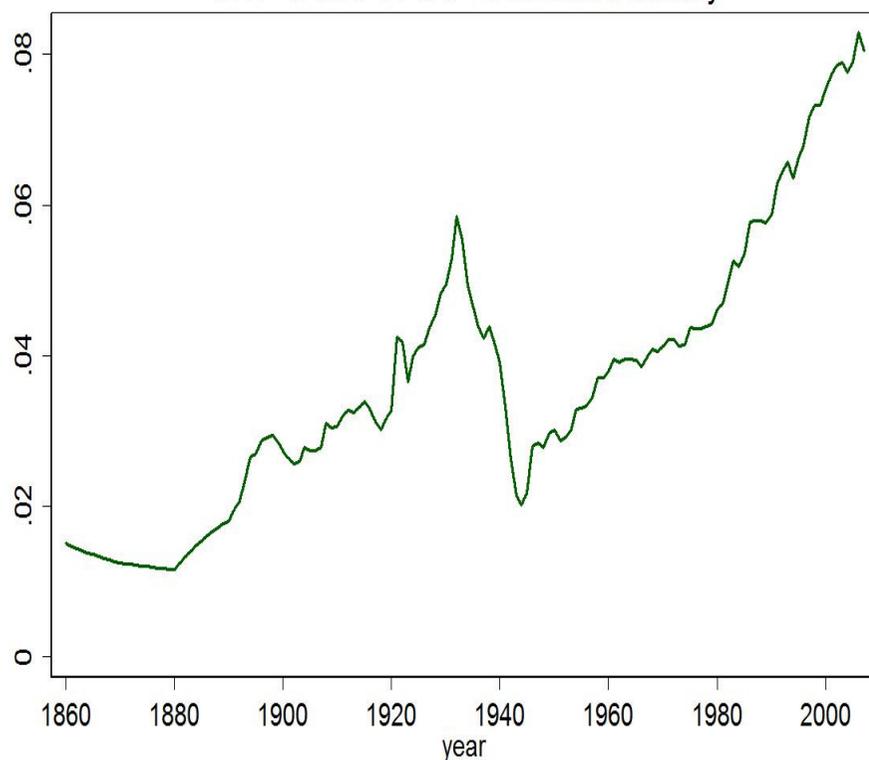
**Another issue connected to size is the too-big-to-fail problem that generates conditions for systemic importance and bailout prerogatives.**

**The intransparency and complexity of financial innovations add to the global interconnectedness.**

**Much of this internationalization is driven by regulatory arbitrage and tax arbitrage-driven complexity which is socially harmful.**

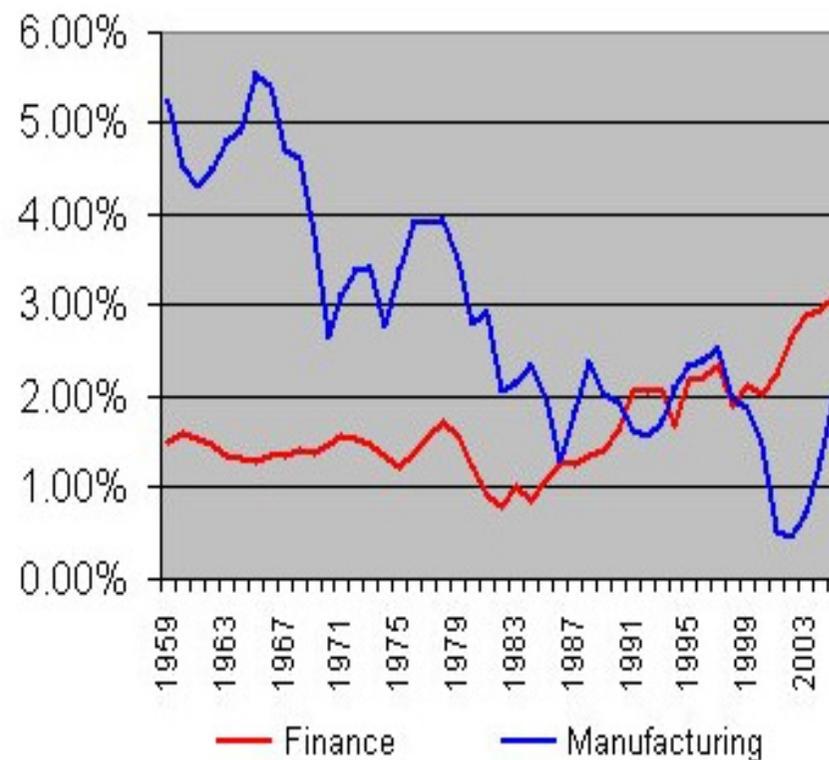
# Financialization

GDP share of US Financial Industry



Source: Philippon, 2008

Profits as Percent of GDP



## **MAKING FINANCE SERVE SOCIETY**

### **Shock Absorption versus Shock Origination**

**A financial system that subordinates its business practices to the interests of the various building blocks of shareholder value turns out to be a **source of shocks rather than a shock absorber.****

**Reliance on external ratings in risk assessment and mark-to-market valuation in accounting should be reduced.**

**Some argue that executives' compensation and bonus schedules should not be based on profits at all, even if derived from long-term averages. Instead, they should be based on indicators reflecting systemic financial stability?**

**Compatibility of Shareholder-value orientation and systemic stability?**

## **MAKING FINANCE SERVE SOCIETY**

### **Risk Transformation Versus Risk Transfer**

**Financial intermediaries have increasingly developed instruments that allow them to transfer risk instead of transforming it.**

**Particularly harmful were the recent innovations in securitization that led to a new generation of increasingly arcane products that were used to manufacture safe bonds out of risky ones – with the support of rating agencies.**

**Hyman Minsky (2009) argued already in 1987 that securitization plays a crucial role in the globalization of finance and in the evolution of interconnectedness and vulnerability of the global financial system.**

**Many of the innovations of the last two or three decades have led to excessive intermediation and an increase in overall leverage, interconnectedness and systemic risk.**

## CONCLUSION

It is widely recognized that financial stability as well as the provision of an infrastructure to the finance of investment and consumption opportunities are **global public goods**. The financial sector is of **strategic public interest**.

The core of the financial sector should be built by **‘public services banking’**.

Financial market regulation is mainly conducted by expert committees beyond the political sphere.

The same applies to today’s global regulatory reform that **excludes those who are affected most by financial crises**: workers, minorities, women and representatives from the civil society and low developed countries.

**Without democratization of financial market regulation, a new financial system is out of the reach.**

## FINANCIAL CRISIS AND OPPORTUNITY

**Overall - on a global scale - the immediate crisis response to revive growth and employment was timely and substantial.**

**But some maintain that this must be combined with building the foundations for the modern economies of the 21st century, by investing in transport infrastructure, renewable energy research and development, education as well as in social infrastructure, such as health care, unemployment insurance and poverty alleviation.**

**In starker terms, it is a question of reviving the status quo ante or transforming our socio-economic systems fit for the future.**

**The latter however requires the same kind of bold initiative as undertaken by Roosevelt's New Deal in the 1930s, but at the global scale and embracing a wider vision. An expanded vision is critical to the lasting success of a world economic recovery.**

**There are few episodes in history when a crisis could be successfully converted into opportunity.**

## **CRISIS AND OPPORTUNITY**

### **Green Investment is one Solution for two Crisis**

**Financial Crisis is often used as an excuse to break climate change commitments**

**UN Secretary General Ban Ki-Moon: „Green New Deal“**

**Many countries are allocating a sizeable proportion of their fiscal stimulus packages to investment in low-carbon economy**

**China: 40%, South Korea: 80%, US: 12%, France: 20%, Germany: 13%**

**In many countries the fiscal packages could be better targeted and used to stimulate the new, [renewable-energy growth sector](#) and help to initiate a technological revolution which creates sustainable growth now and in the future.**

## **CRISIS AND OPPORTUNITY**

### **Chance to Build Global and Accountable Institutions**

**The crisis has uncovered the weaknesses of the current international financial architecture**

**Whether history books will mark the financial crisis as the start of building a 21st-century global-governance system is still to be seen.**

**The G-20 Process can be regarded as important starting points in this direction.**

**But in the medium term, the process of globalisation of politics has to become more inclusive**

Thank you for your attention !