

I Still Haven't Found What I'm Looking For

Financial Reform and the Real Economy
20th Annual Hyman P. Minsky Conference
April 15, 2011

Nobody Could Know?

You walk into the room
With your pencil in your hand
You see somebody naked
And you say, "Who is that man ?"
You try so hard
But you don't understand
Just what you'll say
When you get home.

Because something is happening here
But you don't know what it is
Do you, Mister Jones ?

“Financial crises are the catalyst for turning the globalization cycle. In such crises, assessments of the future, which form the basis of monetary valuations, change very quickly. An inability to put a correct price on an asset leads to the breakdown of markets the erosion of confidence. Banks, businesses and even individuals no longer trust each other. The effect on social cohesion is devastating. Collapsing values also have a spillover effect, which intensifies the process of disintegration: they fundamentally alter immaterial values as well. Hence the globalization collapse becomes a story of changing values in both the usual senses of the term, as monetary and ideal values are shaken.”

The Creation and Destruction of Value by Harold James

Financiers

- The Stewards of our Future?
- The Nerve Center of the Economy
- The Wise and Prudent?
- Forward Looking and Disciplined?

What Needs Reform?

- Ideas That Underpin Our Maps of Our World?
- The Financial System Itself?
- The Government Decision Making Process?

The State of Financial Theory

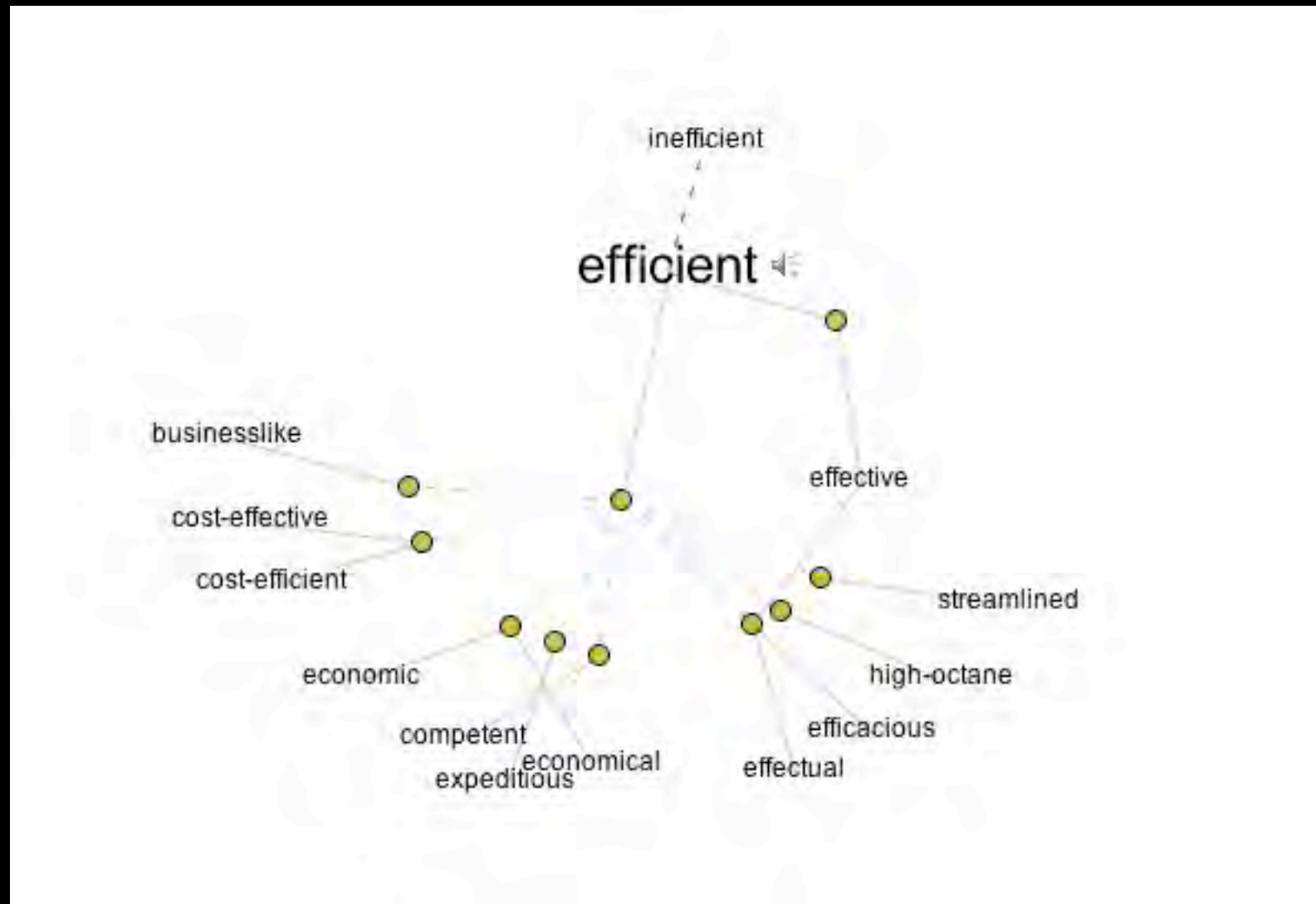


Tommaso's Question*

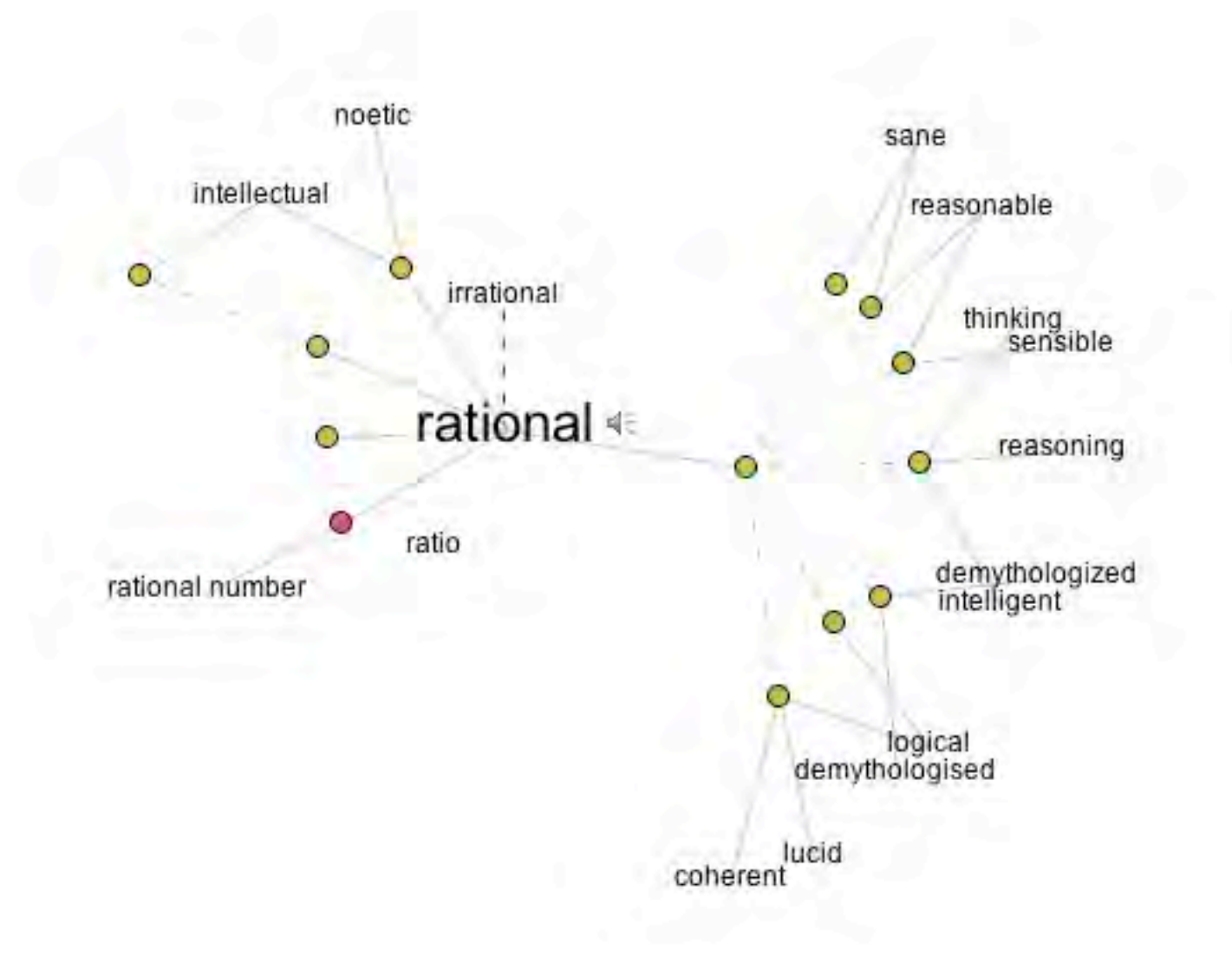
The question we have not yet answered was whether this was a crisis of specific institutions or a crisis of markets and systems?

*Tommaso Padoa-Schioppa In Conversation with Adair Turner

Words As Mirage I



Words As Myth

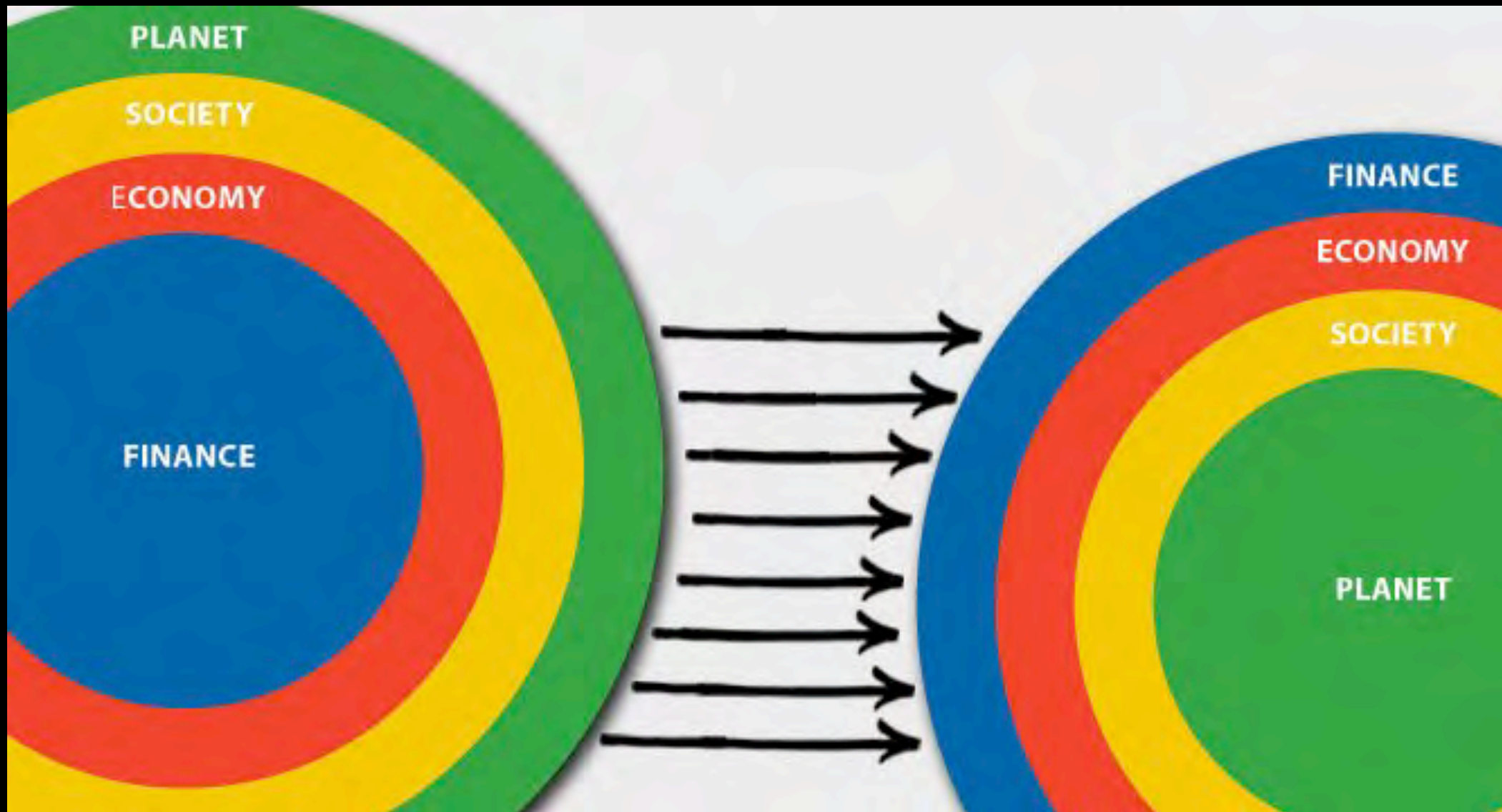


Tobin's Efficiency

- Information Arbitrage Efficiency
- Fundamental Valuation Efficiency
- Insurance Efficiency
- Functional Efficiency

From The Efficiency of Financial Markets, Lloyds Bank Review July 1984 pp. 1-15.

Inversion



What Do Citizens Have a Right to Expect From Their Government Regarding Financial Reform

- Protection from Usury- Consumer
- Protection from Bailout- Taxpayer
- Protection from Undue Resistance to Resolution of Overhangs

What Are the Flaws in Financial Structure?

- Excessive Leverage
- Complexity
- Intertwined-TDTR(Too Dangerous to Resolve)
- Regulatory Avoidance- Shadow Banking

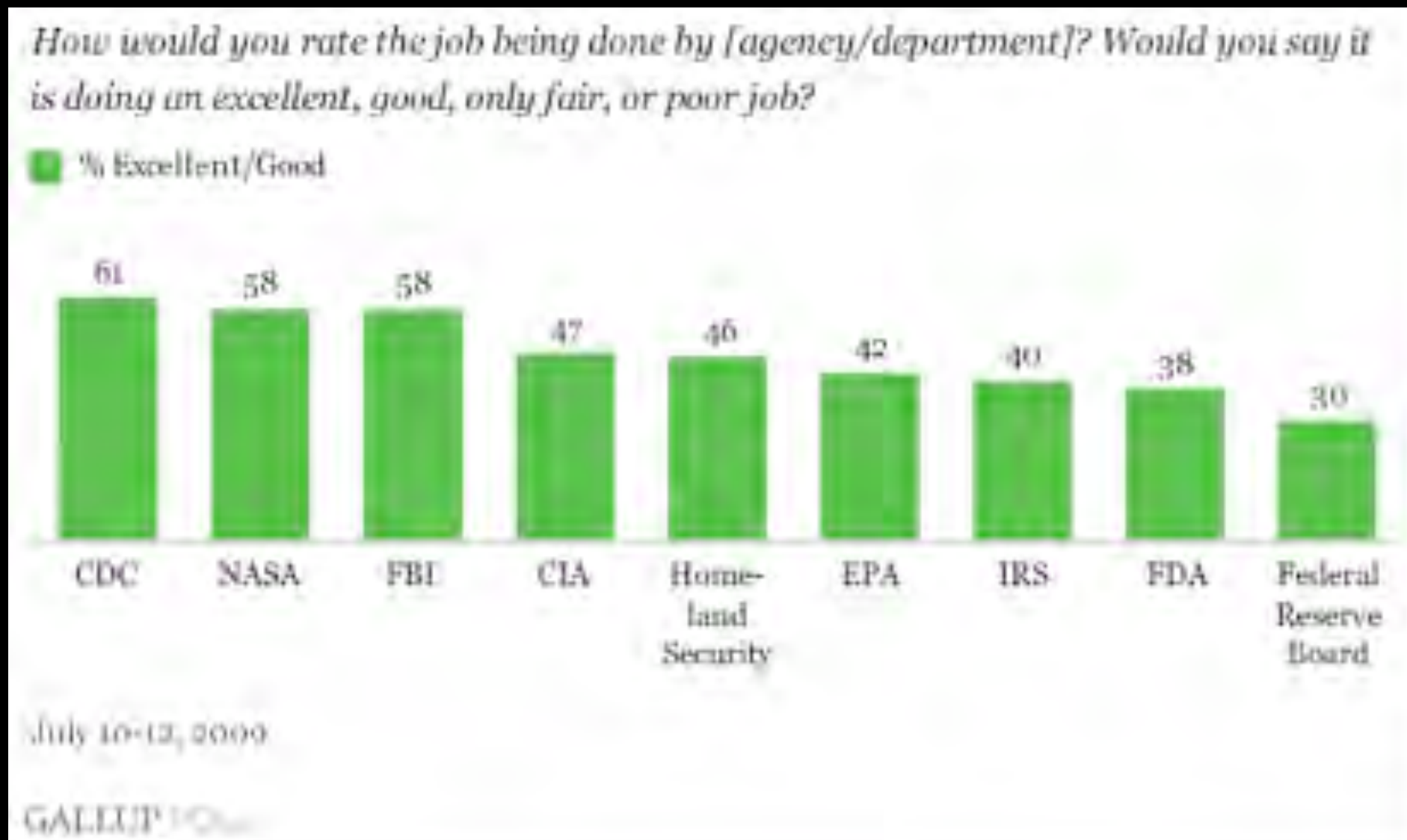
Flaws Continued

- Derivatives Concentration on SIFI Balance Sheets
- Off Balance Sheet Risk and Impact on Leverage
- Reporting Systems are Inadequate
 - What do you mean you are doing stress tests now!!

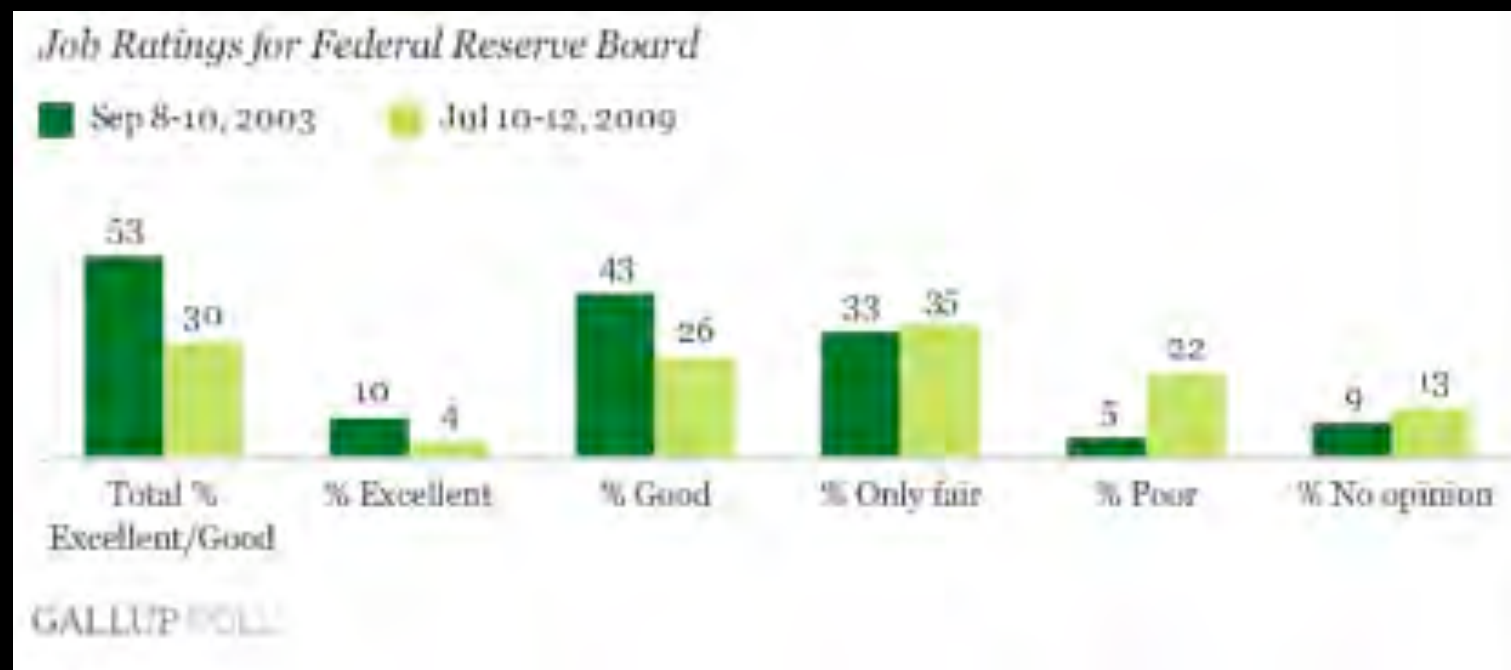
Faith in the Fed

- New Powers as Cure?
 - Some Say They Did Not Use the Powers They Had
 - Yet We Did All Learn From 2008

Trust



Deterioration



Bernie Sanders' Peek

- Fed Balance Sheet Look Reveals:
 - Fed Did A Tremendous Job Improvising in Crisis
 - Fed and Other Regulators were not on the Job in the 5 Years Prior
 - Information Sanders Requested Should Have Been Part of the Public and Legislature's Awareness When We Debated Dodd Frank

Fed as Scapegoat

- Making the Best of a Dysfunctional System
- Rules are Bought and Sold
- Congress Fears Being Responsible for Bailouts
- Regulatory Budgets and Appointments
- Fed Made to Pay Ransom

Failures of the State

- Money Politics and the Deterioration of Enforcement
- The Opportunity Cost of Doing Good
- Fear of Bailouts in Legislature

Dodd Frank as Forbearance

- High Margin Activities Needed to Rebuild Balance Sheets
- Credit Card Interest Rates Unsustainable
- Pretending 2nd Mortgages and Home Equity Lines are valuable (approx 85 cents on the dollar) when 1st Mortgages are Underwater

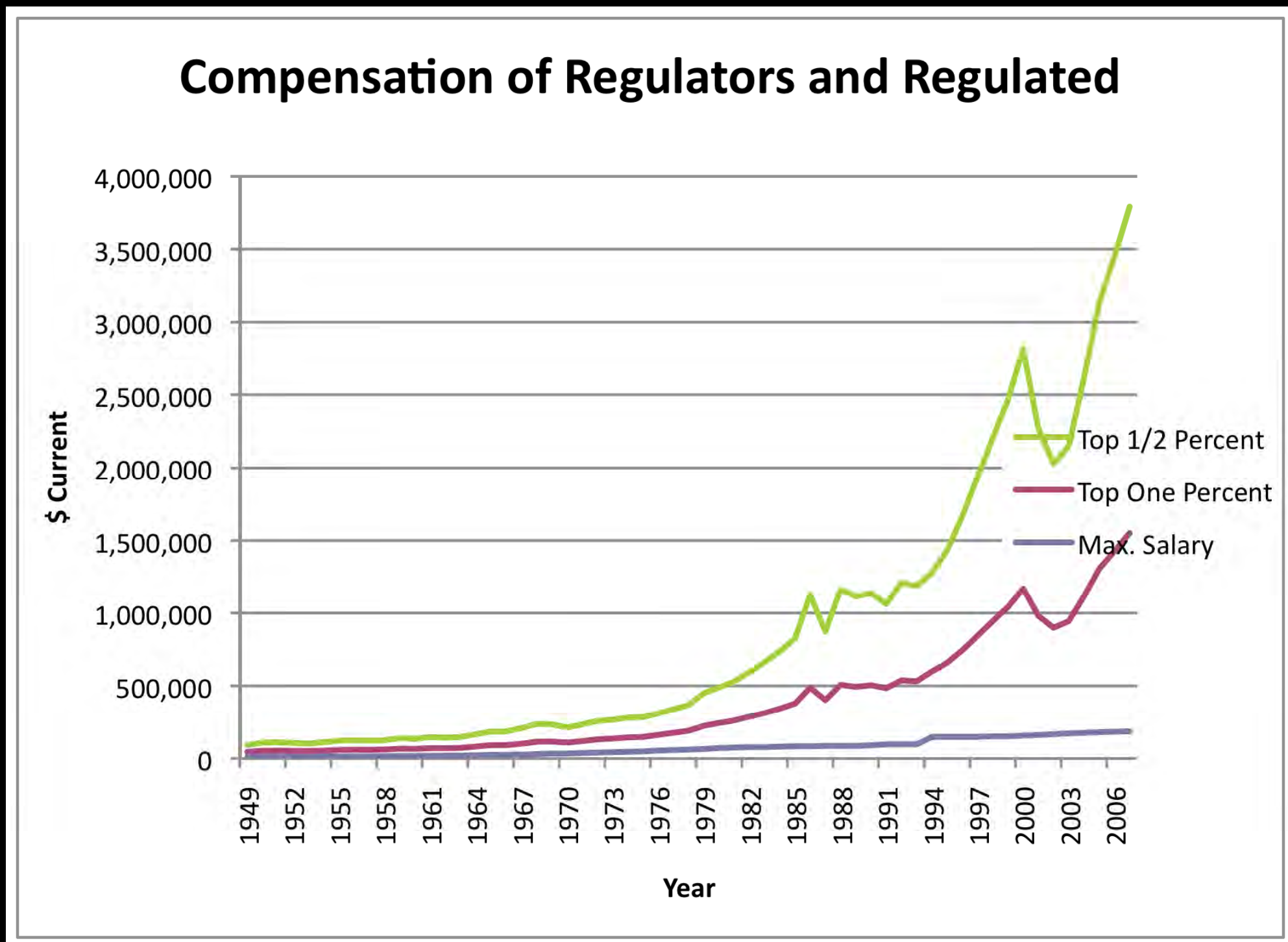
Harold James on the Importance of Power Politics

“When a systemic economic crisis erupts, there is a possibility that it will lead to the elimination of political institutions that lack legitimacy or cannot accommodate the new stresses and expectations. But more often, political institutions have a different pathology and instead of fading away become malignant, dysfunctional, and aggressive.”

The Logic of Collective Action?



The Opportunity Cost of Doing Good: Salaries of Regulators Compared with Incomes of the Regulated Over Time: **Enforcement-Bubble** **Amplifying Feedback Loop**



Rules and Enforcement

- Political Reform of Money Politics-
Corporations are Not Natural Persons
- A Well Paid, Resource-Supported Civil Service
- Government Need Not Fail Unless We Want it Too(And Some Do)
- How Do We Rebuild Trust??

Great Work Has Been Done by Senior Civil Servants Worldwide

- BCBS-BCCl and Cross Border Bankruptcy Resolution Regimes
- IMF and FSF(B) on OTC Derivatives and LCFI Resolution(See Schinasi Study)
- Exposure and Regulatory Mapping
- Much of This was Done Well Before Crisis

But It Is Rarely Implemented

Rituals of False Security

- On the policy front, this confused precision creates the illusion that a minor adjustment in the standard policy framework will prevent future crises, and by doing so it leaves us overly exposed to the new and unexpected.

But We Have to Think Much Bigger (And
Rigorously)