The international financial system is a powerful infrastructure which, through its functioning, makes it possible to bridge the gap between surplus and deficit units at the international level. The system, in the course of the two decades preceding the crisis, has become much more ‘international’ and its evolution has been driven by major international banks that have grown in size, become more active abroad and more complex in terms of business mix. The governance of this system lagged far behind; it has been held by national authorities, with a poor degree of coordination at the international level. Difference in regulation and different approaches in supervision and crisis management have determined ‘governance gaps’ that the crisis has clearly highlighted.

In the course of the crisis a new approach has been developed. First of all, the principle that the governance of an ‘international financial system’ should be ‘international’ has been accepted by all major countries. The new set of rules governing the international financial system has therefore been designed under the guidance of international bodies.

Secondly, new rules have been developed trying to cover preceding weakness in any field of financial activity (regulation of banks, derivatives markets, rating agencies, hedge funds…).

The process is ongoing and its implementation is made much more difficult by the economic and financial conditions in major Western economies. Low growth and budget deficits make it more complex to implement reforms which, in all likelihood, will raise the overall cost of financial intermediation.
Editoria scientifica
ENRICO COTTA RAMUSINO

The International Financial System
from Crisis to Reform

Pavia University Press
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Introduction

The financial crisis, with its effects on the economy and therefore also on daily life, has greatly monopolised the interest of researchers and market participants, determining an extraordinary flow of research and publications on this subject.

The effort to interpret events, single out responsibilities, point out solutions for various problems and, in particular, tracing different regulations for the financial industry, has involved specialists in different disciplines and from various backgrounds. Each of the above, thanks to knowledge and experience gained professionally, has attempted to give an interpretative contribution, by proposing directions to tackle the new problems which surfaced with the crisis. By now, we have ample literature and excellent contributions on the subject. As is natural, each author attempted to tackle the subject by examining most significant or more familiar aspects, on the basis of personal knowledge and experience.

Within this framework, Enrico Cotta Ramusino’s contribution is distinguished by a systemic approach, its purpose being the overall financial industry in its complexity and declension by major international financial centres. All the big issues proposed by the crisis are dealt with and contain a wealth of data and analysis. The unusual completeness of this work can also be seen in the huge quantity of documents regarding projects and re-regulation action at the international level, with special attention paid to the measures adopted in Europe and the United States, but also as regards the rather incisive measures taken in Switzerland.

It is interesting to see how, thanks to wide-ranging information, this book in some way gives regulators their dues. They are certainly to be blamed for the lack of effectiveness shown in opposing unorthodox behaviour, causing total lack of trust by market participants, therefore of markets, but they cannot be accused of not having reacted. Public opinion’s conviction that regulator behaviour continues to be distinguished by complete inertia has, by now, become deep-rooted. They are considered incapable of timely reaction in defining new rules of the game, rules which would rapidly be able to ensure the collective well-being represented by financial stability. The book provides evidence that this widespread opinion is groundless. This work, requiring enormous patience and covering global aspects, is documented with precision, sets forth a variety of problems in all their complexity, explains solutions chosen and often discusses various alternatives examined. Regulation of the financial industry must continuously search for solutions able to simultaneously meet stability requirements on one side and the need to support economic activity on the other. Substantially, we are dealing with two
different objectives, as reducing instability risks inevitably involves a decrease in economic support. It follows that there is a need for continuous research to find a point of equilibrium between two different objectives, both deserving protection. This task is made even harder by the pressure put on by organised interests, aiming at defending and possibly enlarging their operative frameworks, even to the detriment of the interest of all.

Heated controversy inevitably arising each time new rules for the financial industry are made public, bear witness to the depth of the conflicts created by this activity. The particular virulence of debates on these issues is further fed and weighed down by single ideological options, as regards choices. Viewpoints drawing inspiration from extreme liberalism on the one hand, and those featuring a strongly state-governed set up on the other, have often taken the place of more rational assessments, based on the objective analysis of problems, weighing advantages and limits of the various feasible solutions, without considering a priori positions.

From this point of view too, this book deserves special appreciation. Considerations on various issues are always carried out with great equilibrium and are never based on mechanical use of rigid interpretative models. The entire book bears witness to rationality and equilibrium which translates into a continuously clear exposition of facts, typical of an author writing with perfect command of the issues and clarity of ideas.

On reading the text, we get an overall comforting picture regarding re-regulation of the sector. The great number of interventions, the careful analysis of different issues, the caution and progression in proposing solutions emerge clearly and bear witness to the formidable joint effort made by regulators with different competences representing all leading countries.

The theoretical model for reference, prudential supervision, is substantially also confirmed by this aggregate of measures. As compared to the past, intervention corresponding to the logics of structural supervision also emerge. This kind of control, which absolutely dominated in the past, has been drastically reorganised at the end of the last century. Experience has shown how this choice, while being generally shared, ignored the strong points of the past (structural) approach, only underlining limits and inefficiencies they caused. The return of these instruments must be considered as evidence of a less ideological approach on the issue of control. Obviously, confrontation and disagreement are permissible, as regards relative weight to ascribe to the two different regulation models. On assessing experience accrued with equilibrium, we must however acknowledge that both models can contribute to achievement of stability and efficiency objectives in the financial industry. The latter finds its main reason for existence in its capacity to curb risks which market participants in various sectors transfer to intermediaries. Real economy seeks answers for its own safety requirements by transferring risks of all kinds to the financial system (credit risk, market risk, settlement risk, operating risk, etc.). Compensation received by intermediaries represents, to a great extent, payment for having assumed these burdens. By over-simplifying, we could say that the financial industry ‘sells safety’ to counterparts in various categories (households, companies, public bodies). Consequently, its reason for existence is totally inconsistent with production of instability, therefore, of uncertainty. The system must not,
in any case whatsoever, transfer risks to counterparts, thereby creating stability crises. On the contrary, it should be able to absorb and transform the risks which real economy physiologically creates on performing its activities. On this subject, we must recall that shouldering this responsibility can only take place within certain limits. It is unreasonable to ascribe the financial industry with the task of containing every kind of risk created by economic activity in the name of the latter’s supremacy. We are dealing with a practically impossible objective to achieve, further to being destabilising, regulation also being indispensable to protect these illusions.

We must be aware of the fact that there are limits as to what we can ask of the financial industry and of the risks it has to knowingly face. It is certainly unimaginable that financial intermediaries could guarantee stability even in situations of insolvency through public debt. The financial industry itself, in order to achieve various risk transformation processes, needs to be anchored. The State, by means of its institutions, typically the Treasury and the Central Bank, performs this role. Should it transform from being a supporting structure to becoming an instability factor, the overall foundations of the system’s architecture would irremediably collapse.

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Il sistema finanziario internazionale tra crisi e riforme

Enrico Cotta Ramusino

Italian Abstract

Il lavoro esamina la crisi finanziaria, iniziata nel 2007 e tuttora in corso, e le conseguenti riforme finalizzate a rimuovere le carenze che ne hanno determinato l’esplosione.

Il primo capitolo analizza lo sviluppo del sistema finanziario nel corso dei vent’anni che hanno preceduto la crisi, illustrandone le caratteristiche principali: la crescita dimensionale e conglomerale dei maggiori operatori finanziari, la tendenza generalizzata alla liberalizzazione delle attività finanziarie e la tolleranza nei confronti dell’assunzione di maggiori livelli di rischio. Nei capitoli successivi viene descritto il processo di riforma concertato a livello internazionale al fine di ripristinare condizioni di stabilità nel funzionamento del sistema. Vengono descritti e discussi, in sequenza, gli interventi, regolamentari e di vigilanza, attuati e in corso di definizione, su tutte le principali aree dell’attività finanziaria, dalle banche ai contratti derivati, dalle agenzie di rating agli hedge funds, dalle norme sul funzionamento dei mercati all’executive compensation. Nelle conclusioni vengono esaminate la possibile efficacia delle riforme descritte e le difficoltà connesse alla loro implementazione nell’attuale contesto economico-finanziario dei maggiori Paesi occidentali.