The financial crisis - causes & cures

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The financial crisis has exposed several flaws in the institutional structures, incentive systems, regulations and supervisory structures of financial markets. The European Trade Union Institute, the Friedrich Ebert Stiftung and Bertelsmann Stiftung have teamed up with Re-Define to publish this well-timed book which cuts through the technical jargon of financial reform underway in the EU and US, using easily understood metaphors and explains the working of the financial system, the causes of the crisis and the concepts and justifications for financial reform.

The financial system is at the heart of the modern market economy. When the system works well, it allocates resources in a way that maximises productivity of the economy. When it falters, the whole economy seizes up. Because finance is so critical, governments have stepped in repeatedly to rescue and support the system when it has a heart attack. This safety net constitutes one side of the social contract that society has with finance. Regulation is the other side of this contract.

In order to ensure that finance continues to oil the wheels of the real economy without taking undue advantage of the safety net it enjoys, it is imperative that other stakeholders in society hold the financial system to account through well-designed regulation. The fundamental role of the financial system must be restored, which consists in intermediation, allocation and transfer of capital to productive, and ultimately, social use.

While the current crisis has been blamed on greedy bankers and captured regulators it can just as easily be attributed to compliant stakeholders who did not bother to understand what was going on in the financial system to hold it to account. It was in the interest of those working in the sector to say that it was too complicated to understand so they would be left alone to do as they please. Outsiders bought this line and assumed that those earning million dollar bonuses knew what they were doing and were doing a good job. Clearly this was not the case. The transfer of credit risk to society at large must stop and the basic banking function must be restored.

The crisis has clearly exposed several flaws in the institutional structures, incentive systems, regulations and supervisory
structures of financial markets and shown that the financial sector is far too important to be left alone. Financial system reforms are being discussed not just in the European Union but also in the US and in international bodies such as the G-20, IMF and the Financial Stability Board. These discussions may appear complex and confusing and there is nothing the financial sector would like better than for social stakeholders such as trade unions, non governmental organizations, consumer groups and other parts of the civil society not to actively engage in the reform effort. We must not let this happen.

This publication is targeted at non-specialist stakeholders such as trade unions, NGOs and consumer groups, with a strong interest in holding the financial system to account and in ensuring that the reforms being enacted are sufficient and effective in getting the financial system to serve the real economy.