THE FINANCIAL CRISIS, A PROBLEM OF ECONOMIC ETHICS AND OF MORALITY?

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"I used to think that the world is shaped with love"
Hilmar Kopper, banker, Former Deutsche Bank President

Rezumat

Mulți experți interesați în explicarea şi înțelegerea profunzimii ultimei crize financiare, care este încă departe de a fi rezolvată, au mers dincolo de aparențele surprinse de ştiința economică. Este mai mult decât sigur că bula de pe piața imobiliară americană a fost numai detonatorul unui mecanism mult mai complex construit în timp în spatele scenei sistemului financiar. Două lucruri sunt mai uşor de perceput, lipsa de reglementări cuprinzătoare dar care să nu supraîncarce, şi produsele financiare sofisticate înțelese mai puțin chiar şi de managerii instituțiilor financiare care le folosesc. O întrebare rămâne încă: cine a fost efectiv responsabil de explozia şi natura schimbătoare a produselor derivate, întrucât nu este totdeauna de vină inovația în fiecare sector de activitate umană? Atunci când criza a erupt, vorbeam de produse financiare toxice cu o capacitate imensă de a contamina întregul glob. Când lucrurile s-au mai calmar puțin, am început să le denumim produse financiare exotice, iar acum există un vag simțământ de uitare a impactului pe care l-au produs, concentrându-ne pe noile reglementări de care este nevoie în sistemul financiar global, lăsând la o parte comportamentul uman. Ceea ce vedem este că lumea financiară a devenit imensă în comparație cu economia reală şi, precum spunea un fost bancher cu multă experiență, volume imense de bani caută profituri şi mai mari, producând şi mai mulți bani din nimic. Această reflecție simplă ne

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aduce la etica economică şi la moralitatea din sistemul financiar complet inversate față de situația normală, dacă ne uităm la mişcarea anticiclică între politica bonusurilor şi pierderile sau nereuşita unor bănci din ultimii ani. Legătura poate fi găsită în managementul hazardat al riscului pe piețele foarte expuse la asimetria informației, hazardului moral şi comportamentului de turmă.

Acest articol este doar rădăcina inspiratoare a unui studiu cuprinzător dedicat banilor la nivel global, în căutarea a ceea ce putem numi pregătirea lumii ca să gândească diferit despre integrarea financiară globală.

Abstract

Many experts interested in explaining and understanding the deepness of latest financial crisis, far away yet to be solved, have gone beyond the appearances capture only by the economic science. It is more than sure that bubble on US prime rate real estate market was a only the detonator of much more complex mechanism built in time behind the scene of the financial system. Two things are more perceivable, the lack of comprehensive, but not overburdened, regulations and the sophisticated financial products less understood even by the managers of the financial institutions using them. A question still remains. Who was actually in charge with the explosion and the changing nature of the derivatives products, as innovation in every field of human activity is not always to be blamed? When the crisis burst, we were talking about toxic financial products with a huge capability to contaminate the entire globe. When the things became a little calmer, we started to call them exotic financial products and now it is a vague feeling of forgetting about the bad impact they produced, focusing ourselves on the new and more needed regulation of the global financial system, leaving aside the human behavior. What we see is that financial world became huge as compared with the real economy and, as a long time and well experienced former banker said, huge money are looking for more huge yields, producing more money out of nothing. That simple thought brings us to the ethic in economics and morality in the financial system, completely reversed from the normality, if just have a look to the anti cycle movement between the bonus policy and the losses or failures of some banks in the latest years. The connection is to be found in the risky management of the risks in very exposed markets to the information asymmetry, moral hazard and herd behavior.

We let you know that this article is an inspiring root for an extensive study dedicated to the global money, in search of what we may call the preparedness of the world to think differently about the global financial integration.

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We are living the time of an increasing resentment towards the financial industry. It engulfs from the simple people who saves, to the upper classes saving for new investments and maybe for fortune. No state of facts, under the conditions in which the fight for transparency, as basic trait of the economic democracy, and not only, becomes increasingly fierce, brought about so much confusion as the last financial crisis.

The answer to the emerged confusion was that the people saving because they were educated so, or because they want to spend in the future, while not losing the value of their money, want explanations, although they don't have advanced knowledge, and this thing happens because the confidence in the financial system is dropping, the confidence in what the people expected the banks to do with their money, some of them going into thundery bankruptcies. Wrath has its forms of manifestation: from the pace full Wall Street occupation to the trap-letter sent to Josef Ackermann, president of the Deutsche Bank.

Briefly, we are talking of excesses in the broadest meaning of the word, the most concrete ones being in the nature of financial products and deceiving incentives promoted by the financial institutions: high, fast yields. The meaning of the obligation to secure the savings turned into risking the money by those people who, in their market play, forgot their duty towards the depositors to the banks, who had brought money from "sound" sources: work incomes, pensions, capital gains etc.

The price of this direction of the financial ethics, opposed to the risk stimulated by the "herd effect" (why, if some people risk and gain, can't we risk more and more) was the explosion of the speculative bubble which was forced-grown between the dynamics of the real economy and the financial economy, the latter being reduced to "making money directly from money", without the ingredient of work, which brings value added by the production of non-financial goods and services.

The discrepancy of dynamics is explained by the analysis as an objective phenomenon of the moment. Regulation cannot match the speed of the financial transactions and of the financial innovation, with the information technology which enable the transactions, with the reality that the whole globe is a playground for the brokers, plus the fact that never before there has been so much money (much of it worthless) in circulation.

Other two facts show the slow speed of regulation: the difference between the generations of the people doing financial transactions, with relevance in taking the risk, and the fact that the involved people don't necessarily have economic background or even higher education. This is a reality about which the old and educated bankers, from a different stage, say that the traditional discipline can never be reinstated. The people can just get used to such reality, for which not only the bankers are accountable. From their point of view, any regulation of the international financial system, which continues the tradition, will only increase further the tension on the financial markets.

A claimed cause of the current crisis, which "inspired" the exacerbation of the ethic-less behaviour of the financial system, originates in an ethic decision, of state policy, adopted out of the desire of two US Presidents – Bill Clinton and George W. Bush – that every US citizen has its own dwelling, including the people who couldn't afford it, particularly after the money became cheaper after 9/11. "Could the banks refrain from such bid business?" rightfully asked Hilmar Kopper, banker, former Deutsche Bank President.

We will keep referring to the perception of this personality, exposed in an interview for „*Der Spiegel*", due his power to synthesize an experience lived by an experimented banker spanning over 55 years of banking activity. What Kopper shows in his interview helps us in our endeavour regarding the aspects of ethics and morality.

Different media said that regulation is not liked by the young generation working in the financial system, because it would make them lose from the huge global financial field, while the actual incentives they may offer to the depositors, particularly to those with political responsibilities, they may influence the behaviour of the politic and inspire options of the legislative. This is one of the causes which question the finality of the measures taken by the European Union and by G-20 in matter of global uniform financial regulation, because any spatial differentiation will degenerate into a competition which will antagonize further the policy decision-makers of the states.

A problem of economic ethics which draws attention to the economic mechanism within the current paradigm of the maximal liberalizations, particularly of the capital flows, is the size of the discrepancy between the real economy and the financial one: in 2011, the global GDP amounted to 70,000 billion US dollars, while the financial economy amounted to 1,007,000 billion US dollars, which supports Kopper's idea that, whether we like it or not, the purpose of the financial industry became increasingly to transform the "*money into money, more money*". Generalising, we may say that the virtual world, although a necessity of modernity, is cut from reality. Such discrepancy goes unnoticed in terms of long-term effects as long as we think that the banks actually only respond to the demands of the real economy by granting credits.

Kopper also refers to the selectivity of the bank's clients, giving priority to the large funds – average businesses starting from more than 50 million Euros. This fact shows not just the orientation towards large target groups – financial entities holding important funds, which bring large profits from fewer clients, while being arrogant towards the smaller clients, involved in the real economy. Didn't they always say that the small and medium enterprises are those making the real economy work, or that in the USA, this type of business contributes by 90% to the GDP, which is also valid for other advanced European economies? Indeed, the clientele of the systemic banks consists of giant clients, in terms of financial power, and their failure has the known consequences.

The daily transactions of the giant give boundless dimensions to the financial markets, and the build-up of yields, small as percentage, but applied to large amounts, lead to huge accumulations. The funds operating in this manner can no longer be considered to represent the capital in its classical meaning, because they are just seeking yields. Furthermore, these funds, mainly the hedging funds, the sovereign funds, the pension funds, are administered by a small number of specialists who usually don't work with bankers or banks. This is another type of distortion of the global financial system, which makes it impossible to apply the existing regulations and which are difficult to control or survey, not to speak of the fact that they have nothing in common with the support of the real economy, compared to the old times when they were providing the capital for investments in the production of goods and services.

What measures of limiting can be applied to such inertia of a moving, virtual mass of money, in what they are calling the **real time of globalization**? Of course, the nature of these limitations can only be ethic or moral, as authentic capitalists and rational financial analysts say. However, we must not forget that as long as the markets allow such transactions, they cannot be stopped. It is such funds which started speculations with the basic products, while not investing anything in their production, because their "concern" is to make more money. Such speculations shadow the fundamentals of the demand and offer of real goods in terms of the utility and level of the price which allows the correct allocation of the resources for the production of high value added goods. On the other hand, they lead to the artificial increase of the prices downstream, as it was the case of the fuels and agro-food raw materials, to the artificial induction of inflation of the offer side, which not even the central bank cannot control.

The problem of ethics and morality of the globalized financial system is about to capture the **phenomenon of emergence**. The economic analysts speak of the **lower opportunities of the emergent countries to go on with this process**. In other work we defined emergence not as a phenomenon intrinsic to the countries labelled in this way, rather as a properly sought purpose induced not for the sake of the development of those countries, but for the sake of yields, of higher surpluses, however, not by normal saving. We are also watching the **return of a general process of impoverishment** generated not by factors similar to those of the 1960-1980 years of the past century, but the decisions of dealers from London, New York or Chicago.

Of course, many deny a direct correlation between the speculations and the mentioned effects, while not denying that the speculations exacerbate such phenomena. The empirical researches are to support or deny the idea that the movement of prices – even if this is done with the purpose to find reserve assets, other than "other currencies" – is influenced by such speculations. We must accept the fact that the markets have compensation force, but they don't guarantee that this mechanism is the result of a correct human behaviour, just as there are realities which proved that neither the human decency can stop a roller started by speculations.

What can regulation do in such situations? The G-20 (with the presence of the European Union) stated loudly, and from ethic reasons, that the players must obey rules, and that the money need rules, all this being the responsibility of the states. However, the states are represented by state people whose behaviour is under the influence of the finances. We end talking of the values fundamenting an order, and what we see is that things get farther and farther from the basic elements which define any order, which means that the solution must be sought starting from this level.

And yet, speaking of the financial ethics, we see that the banking system, the best regulated one, is amending the reality. This is case of the expansion of credits given without a correct risk management, the higher number of unsolvable debtors, the higher rates of provisions until they are recapitalized.

"Is it to blame on the fact that morality is an impediment in the financial industry" were wondering Georg Masolo and Thomas Tuma, reporters for *Der Spiegel*.

It is clear that the financial system too evolves under the pressure of the professional competition from the most various fields, not just professional bankers, but workers in the most diverse professions related to innovation, mathematics, IT etc., and even under the pressure of the risk intuition. As Josef Ackerman, the acting President of Deutsch Bank was noticing, the bankers would better keep remembering that "putting the reputation of the institution at risk is much worse than losing a business".

However, we cannot overlook that the financial system is led by the principle of making profit, which is undeniable, even from the necessity of the noble criterion of its stability given by the proper adequacy of the capital in relation with solvability and liquidity. If we take into consideration the aspects we already mentioned when speaking of the ethics of the financial system, the huge amounts of money they administrate, the fact that a lot of money is traded just to make even more money, that in this way the financial systems move even farther from financing the real economy, then, we can only accept the conclusion of the bankers that **morality is an impediment** in the operation of the financial system when it comes to competition and success.

Of course, the need for financing the real economy has other reasons and it is conditioned by the conjuncture of the markets for non-financial goods and services, meaning by a solvable demand. Nobody takes credits just for the sake of taking credits, without having the prospects of a sufficiently high profit enabling to return the loan and to have money left for future uses. If crediting is not working, than the money holders cannot be prevented from finding other placements for that money, just like an excess of credits will call the central bank to use of instruments to sterilize the liquidity – market operations and RMO – in order to immobilize temporary resources of the commercial banks, just to avoid the stimulation of inflation. We also must consider the fact that the crediting operation is no longer the traditional one as long as the commercial banks are seeking ways to diffuse their risks using securitizing instruments, many of which eventually became toxic derivatives.

In these innovative evolutions, which may have started correctly from the need of a better risk management, we need to seek the place of morality within the financial system, even if it considered an impediment to the financial performance. The border of morality has certainly kept moving between the traditional culture of the refusal of the banks to enter doubtful business in terms of their effects on capital adequacy and bank's reputation, and the objective of making as much profit as possible. Therefore, in practice, the financial system uses the best lawyers in defence of this border.

Kopper's interview is representative in many ways for the subject of morality, because he has extensive experience in this field. He stated that morality within the financial system is demonstrable, particularly currently, by a good expertise in writing, just to make sure that all the legal aspects are covered. Indeed, it is known that the transactions using exclusively money usually as a precarious, versatile business. However, we may have reached the situation when we ask ourselves whether morality, speaking of moving its border towards the area closer to obscuring the knowledge of the financial instruments from the public at large, can be justified just by the legality of the business with money, or whether it should also include something unwritten, but intrinsic to the human behaviour of the people administrating a lot of money.

The financial world is penetrated, due to the progress in the technology of communication, by a language which is deficient not just due to the "easiness of expression" caused by the need for speed and synthesis, but also due to the gap of knowledge between the people on both sides of the desk from a financial institution. We are thus speaking of an asymmetry of information, the unequal knowledge of a financial instrument in use, although people say that not even those officers from the financial institution actually working with these instruments don't know them properly.

The immorality in this case resides in the appraisal of the way in which the clients have been fooled, from criticisms of the competitors in front of close friends just for the sake of showing own aptitudes. Kopper says that such manner of speaking must have probably existed all along the banking history, but there were three essential differences which shocked him: they were not stored in servers own by other people, which could use them as evidence for hearings; didn't have the current, malicious, tough and irreverent tone; and were not a generalised phenomenon.

More recently, we met suspicions of immorality within the financial institutions, as an increasing negative reaction addressed to the banks from the fiscal paradises or to those with reputation. In one case it is about protecting the clients having clear tax evasion intensions, but whose accounts and names are kept secret, while in the other case (ten banks, among which RBS, Société Générale, Credit Suisse) are suspected of manipulating the LIBOR (*London Interbank Offered Rate*) and TIBOR (*Tokio Interbank Offered Rate*) interest rates in order to make more expensive credits in Swiss Francs and Japanese Yens, or the transactions with derived instruments, obviously in favour of the bank profits. The casuistic seems to grow larger, but the foe time being the system immorality is "cleaned" by fines, which only apparently are smarting.

Is the regulation claimed by everybody, including by the politicians attending the highest forums (European Council, G-20, Davos Forum, IMF meetings etc.), the solution to the fading ethics and morality within the financial system? And in this case, which is the acceptable proportionality between the level of profit and the morality of creating it by the mere rolling of the financial instruments?

Many people think these are mere political statements calming things down, only to continue thereafter on the same track with some tiny cosmetic touches. A solution closer to the expected effect should be related to what characterizes the international order in the field of financial order. Either they are written as treaties or assumed regulations, or they are voluntarily observed by education in general and by the professional education, in particular, the agreements in any field must be observed (*pacta sunt servanda*), according to a consensual moral which succeeded to change the world to the better for past 400 years from the Westphalia peace.

We cannot end the subject without looking “into the eyes” of the famous rating agencies, which have actually monopolised the “evaluation” of financial system’s morality by what they are calling protection of the investors. Just days before the start of the financial crisis or before the crash of some systemic financial institutions, these agencies were releasing top investment ratings, only to intrigue the whole world thereafter. The monopoly situation, maybe the good performance up to a moment, and even the privileged position of a low number of these agencies, allowed the ratings issued by Moody`s, Fitch or Standard and Poor`s, to provide guarantees and peace to the investors.

As of 2007, all these rating agencies experienced a major crisis of credibility which, for less known reasons, is fuelled by themselves. It all started with “rating some toxic financial instruments with the Investment grade“, said T. Iordache, mathematician and financial analyst with 15 years of experience on Wall Street (“Rating Agencies, the end of an era”, Forbes, 2012). Unfortunately, in exchange of fees whose size cannot be overlooked, they protected the issuers of doubtful financial instruments, not the investors.

The bitterness on the rating agencies went, but with no effects, as far as their discontinuation, banning from rating some countries confronted with sovereign debts, the intention of the European Union to establish its own rating agency, all this showing the loss of credibility in a very sensitive area. Something was certainly wrong with their professionalism, since some people even resigned. However, their activity went on and it causes trouble because of the loss of rating by all the countries experiencing financial problems with relevance on the financial market. More consistent analyses claim that the newer verdicts of the rating agencies are passing through a confusing, contradictory area, they make the markets nervous by the criteria which are not applied uniformly and by arbitrary interpretations. A significant example of the “end of the road” for the rating agencies is the lack of logic for a 4.5 time higher cost of assuming the governmental obligations for France than for the USA, under the conditions in which France had the best rating, while the USA didn’t. We come back thus to the same tormenting question: are the indicators to be blamed because they are badly built and irrelevant in certain conditions, or are the people interpreting them to be blamed because they make the interpretations as they please, according to deviant competencies, etc.?

The financial crisis revealed a major defection pertaining to the human behaviour, of the forgotten subject of the economic science, overlooked because of an exaggerated concern for the object of economy, which is anyhow complex and not deciphered to the last consequence. We don’t think that the illusion of the material, amorphous, limited economic resources can bring added value by themselves without merging them with the human qualities. However, as the human work is closely linked to a behaviour determined by behavioural values, it means that the human practician must be brought back to the values if ethics and morality, and we think this is not a mere problem of regulation or of introducing a tax on financial transactions.

A tax has primarily a fiscal nature, or of fine if we use another perception, which enables us to say that the fines have never been a factor of education, rather a factor of bitterness, with effects of escalation. The subject of the tax on the financial transactions seems to be a new box of Pandora. It may prove to be another impediment for the much expected economic growth. My opinion is that not the free movement of the available financial resources is the cause of the evil, but the people doing this, and the way they are doing it.