

Bertrand Badré: A second chance to fix finance

Despite progress since the 2008 financial crisis, reforms of the financial sector have been fragmented rather than fundamental. In particular, the system still lacks the effective holistic regulations needed to encourage the optimal global allocation of capital, **write Bertrand Badré and Laurence Daziano**



A largely unreformed financial system

In December 2018, US stocks recorded their biggest monthly decline since the subprime mortgage crisis. The sharp fall reflected current concerns about slower economic growth, higher interest rates, Brexit, a possible US-China trade war, and rising geopolitical uncertainty. But the recent equity-market volatility has been made worse by a global financial system that remains largely unreformed more than a decade after the 2008 crisis.

To be sure, preventing the entire financial system from collapsing in the wake of the crisis was a success in itself. But, despite some further progress since then, reforms have been fragmented rather than fundamental. The financial system still lacks the effective holistic regulations needed to encourage the optimal global allocation of capital. Should this trend continue, we risk ignoring Winston Churchill's maxim that one should "never let a good crisis go to waste."

To ensure that we don't, a more far-reaching reform of global finance, led by the G20 Financial Stability Board, is needed. Such an overhaul should address several key priorities.

A longer-term vision

For starters, we must promote a global and long-term vision for finance. The persistence of the financial system's bias toward short-term results is reflected in its accounting and reporting practices, profit targets, and remuneration structure. Activist funds are adding to these pressures on companies. Despite the importance of balancing a long-term approach to building value with the need for shorter-term returns, the financial system remains far too skewed toward the near term.

A better allocation of capital is vital

If left unchecked, this short-term focus will hamper real progress and the ability to allocate financial resources optimally. A better allocation of capital is vital for industrial development, building new markets, and providing a stable framework in which companies can develop. Such outcomes will best position us to meet major twenty-first-century challenges, in particular, global warming and inequality.

A revised framework is needed

Furthermore, promoting the ethos of "do good and do well" would incentivize financial-market actors to invest for the long term, which among other things would reassure people about the use of their savings. Milton Friedman's dictum that the sole social responsibility of business is to maximize profits is no longer entirely valid. The focus on profits must be complemented by considerations attuned to current realities. What is needed is a revised framework for using finance to advance the common good.

The inability to bring finance under control remains a source of structural instability

Policymakers also must recognize that, although the banking system is probably safer than in 2008, financial-market risks are arguably higher. As the International Monetary Fund recently noted, leverage worldwide has increased to a level exceeding that of the pre-crisis period, while the excess liquidity created by central banks' quantitative easing raises the possibility of further destabilization when QE outside the US ends. The inability to bring finance under control remains a source of structural instability and could contribute to an even bigger crisis in the future. As European Central Bank Executive Board member Benoît Cœuré said recently, "The crisis machine is still there."

Finally, any comprehensive reform of global finance must aim to rebuild people's trust in the system – one of the goals that French President Emmanuel Macron rightly set for the G7 this year. Restoring trust in finance is essential at a time when liberal democracies are increasingly

challenged by the rise of populism and hostility to elites in all sectors. Establishing a more inclusive and responsible financial system would be a first step in the long process of reconciling the public with financial institutions and the people who run them.

Much more needs to be done

Ten years ago, the subprime crisis gave the world an opportunity to do just that. For a time, almost everything was open to debate. Although some progress and critical global commitments have been made since then, much more needs to be done. With the economic outlook uncertain and populism on the rise, we need to make further decisive changes now.

If we can be bold and finish the job, we will have a chance to maintain our trajectory on climate change and sustainable development, and to start addressing social and economic inequality. And maybe, just maybe, we can rekindle trust in a revamped financial system that is fit to meet the big emerging challenges of the twenty-first century.

This article was first published on [Project Syndicate on 4 February 2019](#)

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