

Regulation of Financial Markets,

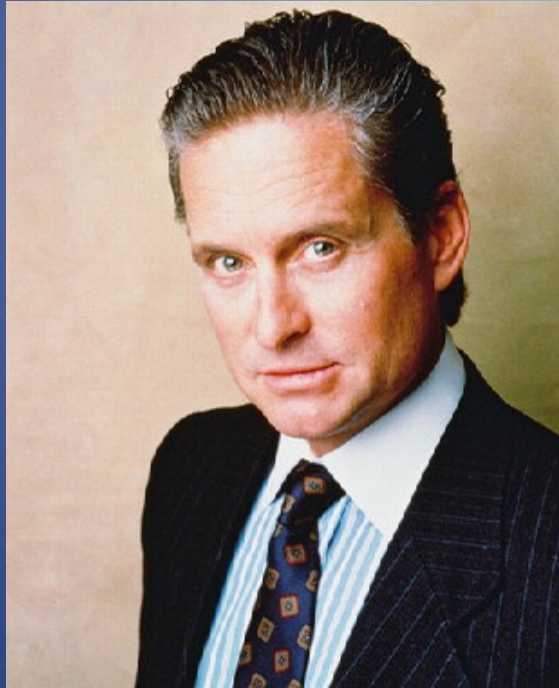
Simon Smelt,

ANU, Centre for Law & Economics

Greed



Greed



Greed

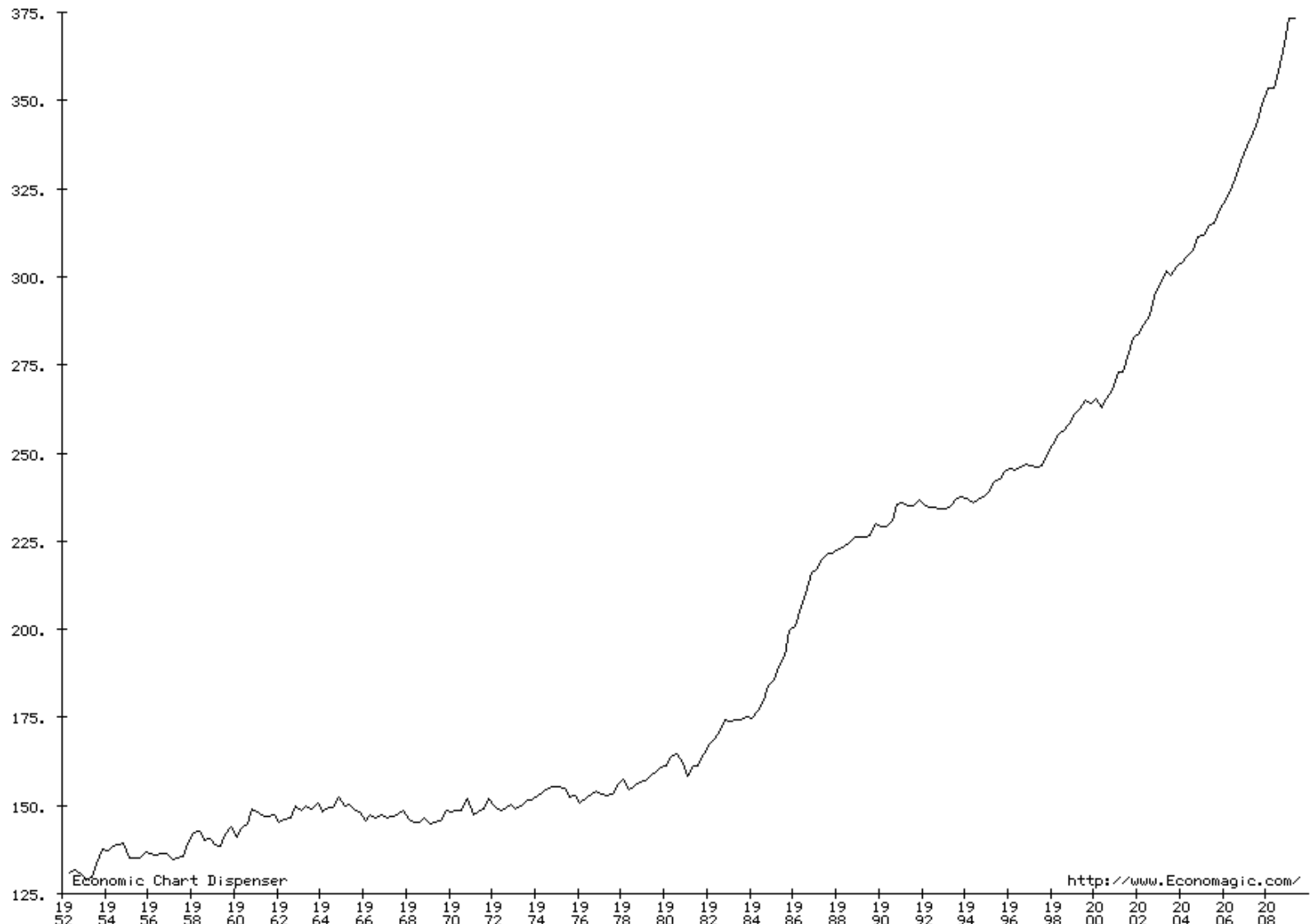


- commutative justice
- distributive justice
- social justice

Solidarity and mutual trust

Caritas In Veritate

Total Credit Market Debt as a Percent of GDP



“This time is different”

“As long as the music is playing, you’ve got to get up and dance. We’re still dancing.”

Citibank President, July 2007

"Regulation of derivatives transactions that are privately negotiated by professionals is unnecessary"

Alan Greenspan, 1998

"The problem is not that the contracts failed. Rather, the people using them got greedy. A lack of integrity spawned the crisis."

Alan Greenspan, 2008

"Regulation of derivatives transactions that are privately negotiated by professionals is unnecessary"

Alan Greenspan, 1998

"The problem is not that the contracts failed. Rather, the people using them got greedy. A lack of integrity spawned the crisis."

Alan Greenspan, 2008

THE WALL STREET JOURNAL.

Shock: Greed Found on Wall Street

Contractual man (Oliver Williamson):

- asymmetric information
- incomplete contracting
- myopia
- opportunism
- satisficing

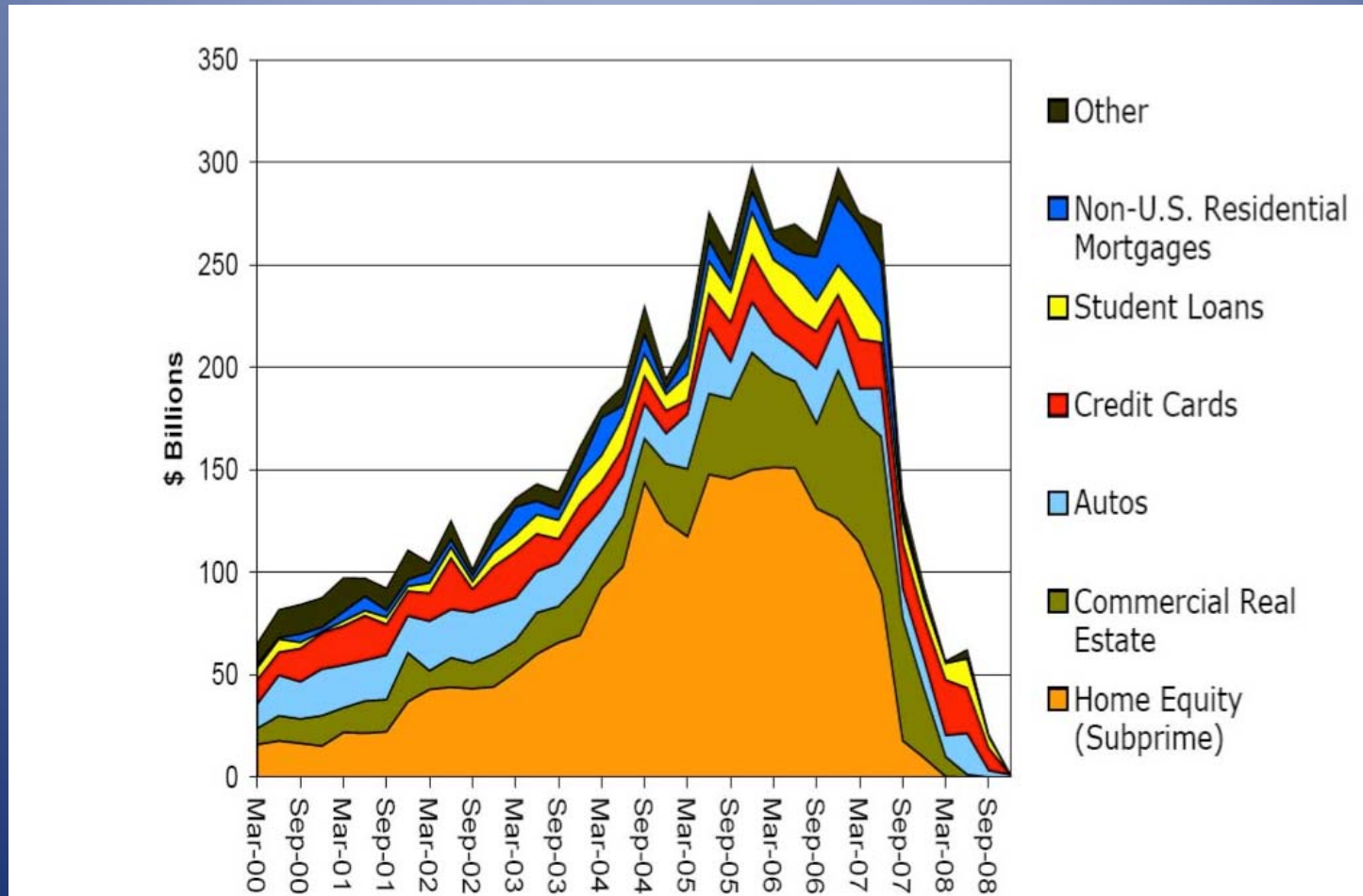
Bounded rationality: contracting defines the boundaries of both greed and risk

Study: Better regulated and better governed banks ***more likely*** to be in trouble.

Study: Banking troubles ***not*** related to size or direction of international capital flows.



US: New Issuance of Asset Backed Securities, 6 monthly



Regulatory failure

Regulatory capture

Regulatory arbitrage

Moral hazard

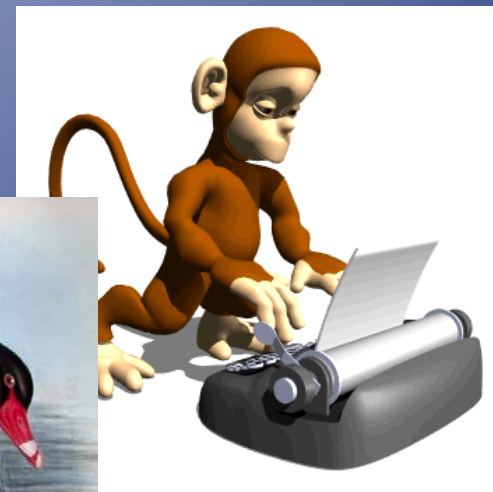
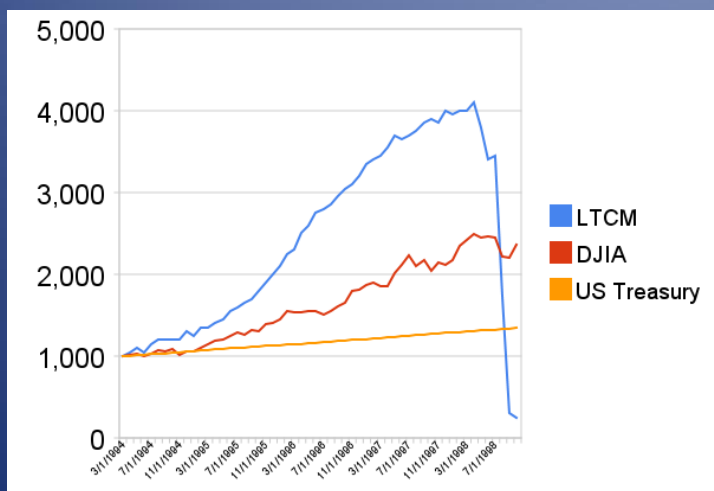
Regulation of Financial Markets, Simon Smelt, ANU, Centre for Law & Economics

Moral hazard:

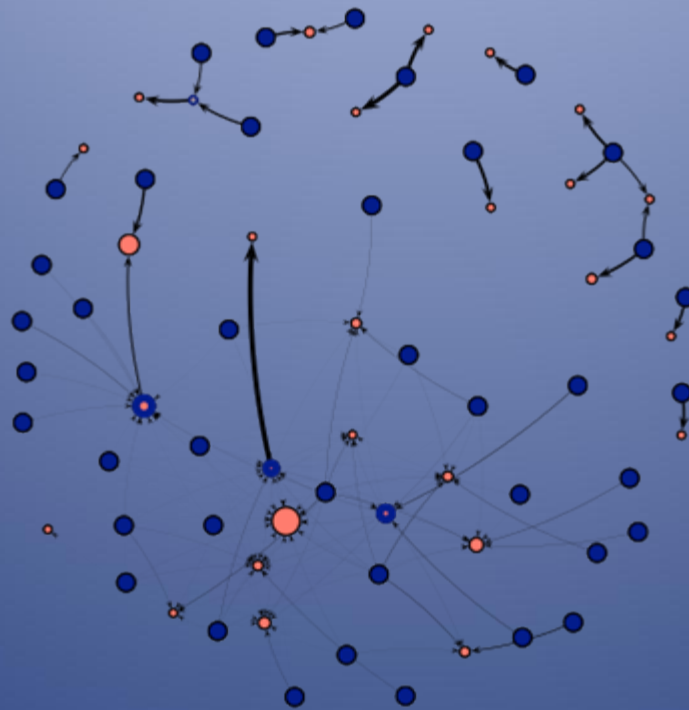
- from financial sector
- from social justice objectives

Risk modelling:

- weak incentives
- belief in modelling
- complexity



Systemic risk > network management



Search for liquidity > looser contracting.
+ complexity of packages

Trust in

- self
- reputation of counter-parties
- risk modelling and labelling

Too much trust!

Failure of commutative justice

Examples:

- MERS: “straw man”
- futures: betting against own product and own customers

Trust in bi-lateral contracting based on a
framework of law

is part of

Society's internal forms of solidarity and
mutual trust

which gives

Commutative justice

Top down regulation of financial markets:

- imposed
- regulatory arbitrage
- study: requires buy-in
- study: no first best form evident
- has previously failed (capture, info problems, compliance costs, etc.)
- hard to adapt

Common Law:

- moral framework for handling greed and risk
- for mutual benefit of contracting parties
- sought after for commercial purposes:
“choice of law” clauses
- study: capital market and investor protection strongest under Common Law jurisdictions
- adaptive

Day to Day Ethics.
Keep It Simple