Mojmír Hampl: Financial strangulation?

Article by Mr Mojmír Hampl, Vice Governor of the Czech National Bank and a member of the EU's Economic and Financial Committee, published in The Wall Street Journal, Prague, 2 December 2008.

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Don't rush to change all the fire regulations while the actual fire is still raging.

The reaction to the financial crisis should not be worse than the crisis itself. This is the mantra I've been repeating to myself – while shaking my head in disbelief at many ideas surfacing in the European and global debate on the "postcrisis" shape of the financial universe.

The list of proposals that have appeared on the table so far is long and ranges from attempts to ban short-selling and regulate credit default swap markets to toughening up supervision of credit rating agencies, hedge funds or the whole sphere of structured financing. Capping executive pay – the easiest target for anyone searching for cheap political capital – is of course included. So are state efforts to micromanage banks, such as French attempts to set numerical targets for lending by recapitalized banks. For many people, these measures are the tolerable or even necessary by-products of fixing the crisis.

At the top of the list, then, looms a concept of a brand-new, omnipotent, global (or at least European) super-regulator that would undoubtedly do everything better next time.

In general, most of these ideas are heading in the same direction: toward greater regulation and centralization of the financial sector, and toward less competition and a greater public-sector presence in the financial industry from now on.

These thoughts – often presented in soft "Eurospeak" so as not to sound too alarming – seem as if their proponents thought them up long ago and were just waiting for a good opportunity to unveil them as miracle cures for all the financial world's ills and woes.

It is as if we hadn't all known for years that unfortunately – in the world in general, and the financial one in particular – there are no such things as perfect rules, perfect regulation or, above all, perfect certainty. It is as if we'd forgotten that competition, rivalry, profit opportunities and staff motivation are not the spawn of the devil but do a lot of good.

More important, the private part of the financial universe is being presented as a self-evident culprit of the crisis, while the role of the state faces much less scrutiny. The question of whether monetary authorities, prior to the crisis, properly regulated interest rates as a key price in the economy attracts much less attention in the debate than it should. The same is true for the question of whether the existing store of individual countries' supervision tools was used correctly and adequately before the crisis.

This is interesting, as the crisis poses some new challenges and questions. Should monetary policy try to stabilize a broader set of indicators in the future, not just prices of consumer goods, but also real-estate or other asset prices? Does it make sense to have a separate currency but not to have an autonomous monetary policy, like the Baltic countries and Bulgaria, or to have a separate currency but not to have an effective lender of last resort, like Iceland? Doesn't the system of exchange-rate pegs, quasi-pegs or currency boards increase imbalances of those who are pegged, and thus their vulnerability in a crisis? These questions are important, but they are not being properly discussed in the current debate.

Many forget that the state's role in the financial sector is already huge. Central banks, finance ministries and various state agencies across the globe do regulate and supervise the financial industry more, not less, than many other industries. Yet that is precisely why every further tightening of the screws should be carefully considered and analyzed, not adopted

under pressure or threat, hastily or imprudently. One should bear in mind that regulation never distinguishes the bad banks from the good ones. And even this crisis has revealed that many financial institutions are in good shape and coping with its consequences quite well.

Although many people won't admit it, new rules being drawn up today will radically affect the financial market tomorrow and beyond. That's the way it goes: Times of crisis permit dramatic and rapid changes that would not be implementable, or even thinkable, under normal circumstances. But when the dust settles, it is very difficult to reverse them.

All thinking people in the financial sector should want to ensure that the rash solutions adopted in the present bad times, many of which will do little or no good anyway, do not in the long run generate much worse times for the industry, and hence its clients.

Putting out a fire is one thing. But improving the fire regulations is quite another. Certainly a large fire can provide inspiration for future fire prevention. But it is by no means wise to fight the fire while simultaneously changing in haste all the fire regulations.

The risks of such an approach are considerable, especially if the public – as well as part of the industry itself – increasingly accepts the dogma that the financial sector provides quasi-public or even purely public goods and services.

I'm sure that a thoughtful discussion about the causes of the crisis and ways how to prevent them in the future would require much more time, cool-headedness and, above all, more input from academics and trained professionals and less from politicians and European bureaucrats.

Maybe I'm a bit skeptical. But I have a very vivid imagination influenced also by the tragic ex-communist and state interventionist experience of the Czech Republic. And my imagination allows me to foresee some extreme scenarios.

One day, when we are forced to wait in endless queues or pay bribes just to be issued with a credit card, when account statements arrive only sporadically and four months late, when we have to stand in long lines to be served by bored staff who are only there on Monday from 10 a.m. till 1 p.m. (with an hour off for lunch), when we witness strikes by nationalized financial-sector workers and the banks are closed for the duration, when we see credit committees full of unmotivated state employees and politicians whose positions are secure thanks to state-owned golden shares in each bank – perhaps then we will understand what it means to turn the financial universe into a public-sector-like industry. Then we will truly have bad times all the time, not just now and again. But then it will be too late to think about whether, at the time of the crisis, we got a bit carried away with the state's role in the financial industry.

We should think twice before we create, in the financial sphere, a twin to the infamous Common Agricultural Policy. An EU "Common Banking Policy" would be equally disastrous in the long run, and equally hard to get rid of. Let's not go there.