ROLE OF BANKS IN THE ECONOMY

EBF-FBF TAX CONFERENCE

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ROLE OF BANKS IN THE ECONOMY

1. What is a bank?
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- No generally accepted definition available
- An evolving activity through history
- Banking services in general:
  - Forex
  - Payments
  - Deposits/loans
  - Fiduciary services
  - Financial markets activity and support
1. What is a bank?

- No generally accepted definition available
- An evolving activity through history
- “banking services” in general
- Banking services is a dynamic concept; “a bank” is a legal concept: dangerous dichotomy
- Often linked with specific public support mechanisms such as LOLR and deposit guarantee
- The surprisingly narrow definition in EU: “credit institution”, not “bank”
EU DEFINITION OF “CREDIT INSTITUTION”

CRR, Art. 4

“Credit institution” means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.

CRD IV, Art. 2

Long list of institutions in each Member State to which the CRD will not apply despite their “credit institution” activity
EU DEFINITION OF “CREDIT INSTITUTION”

The extremely narrow definition of “credit institution” opens the door for “narrow banking” regulation. An open debate about this issue should be welcomed.
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1. What is a bank?
2. How banking services and banks adapted to new needs of society: the last 50 years
3. How banking services and banks adapted to the new needs of society: the last 50 years

- from banks for the elite (and saving banks for the mass) to mass banking thanks to technology and increasing wealth;
- complex products as a solution for managing the new risks in the 1970’s (end of Bretton Woods);
- the tendency to more “market solutions” since the 1980’s as populations get wealthier and balance sheet risks become too big;
- the shift to “self banking” because of price competition and technological developments;
- the development of international banks and worldwide interconnection given globalization and the need for international financial services
- the recent development of shadow banks and non-banks for financial services
3. How banking services and banks adapted to the new needs of society: the last 50 years

The solutions of the past do not necessarily solve the problems of today;

The adaptive capacity of banks to new risks is essential;

What banks have continued to do is:

- Management, transformation and absorption of financial risks
- Providing solutions for new financial needs using
  - Up to date technologies
- Diversification of portfolios and businesses
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3. Banks as an (in)direct instrument of public policy
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- many extreme cases in history: free market if possible, political power if needed
  - John Law in France (18th century)
  - massive bank nationalizations
  - role of banks in geopolitical conflicts
  - 9/11 and fight on terrorism
- even the “independent” (central) bank is an illusion in crisis
- banks as transmission channel for monetary policy
- also involved in taxation processes
  - collecting taxes (inherent to the function of money)
  - monitoring tax- and related behavior of clients (money laundering)
  - reporting about tax and related client behavior: a bridge too far, given the fiduciary functions?
- more to come: macro prudential supervision (potentially more intrusive than tax)
3. Banks as an (in)direct instrument of public policy

Where are the limits?

– when the “public” intervention is in conflict with the “raison d’être” of banks
– when it is possible and cheaper to avoid the banking channel by using unregulated alternative channels

HAVE WE REACHED THE LIMITS?
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4. The future environment of banks and banking services
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- complexity is there to stay as the environment gets increasingly complex and uncertain

- finance will continue to grow faster than the real economy: a challenge for regulators and governments, an opportunity for banks

- technology will continue to challenge old models, including even currency: the end of bank monopolies, and of the control mechanisms of nation states

- globalization will lead to a fundamental change in the world financial framework, bringing in new risks (and opportunities) and potentially chaos during the transition
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5. The future role of banks in the economy
5. The future role of banks in the economy

the regulatory framework is evolving from a protective harness to a stifling straitjacket: no longer the best place to develop financial services?
– extreme risk aversion of the regulatory framework for banks will put the burden or risk somewhere else; a challenge for society
– solutions for the financial challenges of society in the future will be difficult to develop within the banking system if regulation is not adapted: a problem for society and for banks
– marginalizing banks will also destroy their value as transmission channel for policy

NEED FOR A BALANCED REGULATORY/SUPERVISORY FRAMEWORK
CONCLUSION

- The definition of banks needs to be clarified. It should not be limited to “access to (illusionary) deposit guarantee schemes”;
- The creative and adaptive capabilities of banks have to be supported by the regulatory framework, not stifled;
- Banks have always been, and will always be used as a tool for public policy. The more the “nation state” is under stress, the more it will use banks: limits have to be clarified;
- Banks should recognize their social responsibility and act likewise. Regulation will never achieve that and could even be counter productive.

THERE IS WORK TO BE DONE
THANK YOU