Good Finance
Why we need a new concept of finance

SUMMARY
Societies need finance for economic welfare, and progress is almost impossible without a well-functioning financial system. After the industrial revolution, countries with more effective financial systems developed faster and today the global landscape of economic well-being evinces this historical fact. However, since 1980s, misoriented waves of deregulation led to a giant industry of finance, size of which cannot be explained by any measure of economic growth and global trade. Today, finance has mostly turned into a game in itself and often become more harmful than useful for societies. Unless we reset our concept of finance to serve its essential purposes for the good of the whole society, the future of global social order will be under a continual threat of chaos.

KEY MESSAGES
• The size of financial markets and the level of global financial flows are too big to be explained by real investment and trade. By and large, origins and trading of financial assets are often disconnected from real economic activity.
• There is too much debt and too little equity in corporate, household and public finances. Too much debt is a call for defaults, crises, and subsequent social trauma.
• The financial system has become too complex and opaque, hindering good corporate governance and effective supervision.
• Despite all technological advances and lessons from recent financial crises, academia and policy makers resist updating their mindsets and tools.
• A decade into the global financial crisis, all and even more of the reasons that led to the crisis are still much alive today. More scarily, people’s trust in finance and governments’ handling of financial systems has been eroded – domestically and globally.
In order not to have recurrent financial crises, which are always socially damaging and cause political instability, the world needs a new paradigm of finance. We need to formulate a new “social contract” between regulators/policy-makers and financial markets/people. This contract should redefine the role of finance in our lives and the real purpose of regulation and economic policies.

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Any financial contract with unfair terms of sharing risks and returns between two parties is bound to end with eventual default of either side. Most modern debt and debt-based contracts are so, and this is probably what is meant by “the dark side of debt.” All past crises have proven this fact. Therefore, the choice between debt and equity must be re-studied. All public policies and regulation must be clear on reducing dependence on debt and leveling the playing field between debt and equity. Household debt for short-term spending on consumption should not be encouraged.

Widely used models of risk are largely mathematical and they carry the risk of missing structural changes in markets and mathematically unmeasurable uncertainties of geo-politics, natural events, changes in social behaviour and technological disruptions. The distinction between mathematically modellable risks and mathematically unmeasurable uncertainties must be made clear and a new holistic approach to risk management must be developed.

Instead of the current institution-based and fragmented approach to financial regulation, a functional approach is much needed. This calls for a single regulator for all of banking, insurance and capital markets. This approach would prevent unintended consequences such as uncontrolled growth in non-bank credit when bank credit is subdued.

Financial regulation should favor long-termism against short-termism. This calls for effective stakeholder engagement for good corporate governance and accepting that supervisors cannot do what stakeholders should be doing for themselves. In particular, pension funds, insurance funds and mutual funds should not be “pushed” to be short-termist. Integrity and care for reputation must be incentivized by regulation, directly or indirectly.

Central banking should be re-positioned to pay due attention to other public policies and financial regulation, reformulate monetary policy to consider the inner structures of the real economy, and recognize that most relations in today’s markets are systemic and inter-connected. Monetary policy and fiscal policy must work in harmony, and both have to be significantly revised in light of new facts.

FINANCIAL LAW AND POLICY RECOMMENDATIONS
**POLICY RECOMMENDATIONS FOR EDUCATION**

- Although financial literacy of ordinary people may be good, this popular approach cannot even get close to achieving the desired goal of disciplining the industry. What the world needs is not a population good in counting money, but properly educated professionals to properly manage other people’s money. This calls for an overall revision of financial education at universities. We should teach students standard finance, mathematics and technology, maybe even at more advanced levels than today. But, most importantly, we should first teach why finance exists in societies, its purposes and functions, and how they are expected to serve the society at large.

**CONCLUSION**

The financial industry has evolved into a self-serving complex system sustainable only through a continually increasing supply of credit. The first step towards good finance is to break the growing vicious cycle of credit and debt. Short of this, regulation can never save the system, and it will always have to save the firms at the expense of the people. In a properly regulated industry, fates of firms are determined in free markets, not by governments.

We cannot design a model of good finance without re-studying the basic assumptions and set of tools of finance and economics. Global discussion at all levels is imminently necessary to reassess the role of finance in our lives. This book hopes to be a first step to this end.
Just as we need good food for good health, so too do we need ‘good finance’ for social and economic wellness.

In this book, Vedat Akgiray presents a timely critique of extreme financialisation, of the economics profession’s flawed modelling approach and the continuing blind faith in the efficient market hypothesis.

Outlining the causes of financial crises and their socioeconomic effects, Good Finance puts the issues into perspective. It offers a clear platform upon which our current concept of finance can be revised for the good of society.

Vedat Akgiray is currently a Professor of Finance and Director of the Center for Corporate Governance at Bogazici University in Istanbul. He directed the doctoral program in finance from 1992 to 2009, the M.S. Program in Financial Engineering from 2002 to 2009. He has advised more than eighty graduate students, published and presented more than one hundred academic papers. From 2009 to 2013, he served as the Chairman of the Capital Markets Board of Turkey. He led the team designing and writing the new Capital Markets Law of 2012. During his tenure at the CMB, he also served on the IOSCO Board, the FSB of G20, and the Monitoring Board of the IFRS Foundation. He actively participated in re-designing the international regulatory architecture after the 2008 crisis.


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