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Design rules for more resilient banking systems☆

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Abstract

Effective financial policy design should incorporate design principles encouraging financial activity and innovation while discouraging excessive risk-taking, into an inclusive, environmental approach to financial system governance. Examining banking systems in Australia, Brazil, Canada and China – whose financial systems proved more resilient than those in the US and much of Europe in the recent global financial crisis – helps us to uncover design rules which strengthen the financial environment and enhance financial resilience. In effect, policy-makers in these four countries struck an oligopolistic bargain with their domestic top banks. This bargain established national banking boundaries behind which indigenous national banks developed, protected banks from foreign competition and threat of acquisition, and enabled banks to pursue lower risk banking business. In return, banks acted as stewards of their financial environments. This bargain recognized the interlinked, network nature of financial risk and integrated governmental regulation with private actor governance structures.

Keywords: Institutional design; Banking policy; Financial risk; Financial regulation and governance; Design principles; Design rules

1. Resilience and risk in financial systems

A Saturday Evening Post editorial of December, 1928, lauded American bankers for being

> The stewards of our whole intricate credit system: and, for the most part, their sense of obligation and their feelings of responsibility for the maintenance of that system in a high state of adequacy and efficiency are as lofty as the motives of other professional men.

Needless to say this opinion died a tragic death in the United States [US] within a year, after the Wall Street crash of 1929. But does this opinion hold still hold some validity in other countries' financial systems? Can a sense of stewardship be engineered into financial systems? This paper suggests these questions may be answered by examining why resilience in financial systems was more robust in Australia, Brazil, Canada and China after the Global Financial Crises [GFC]. I define resilience in financial systems as the capacity to weather financial shocks and perturbations with minimal disruption in an abbreviated timeframe. For simple comparison purposes, Chart 1 plots GDP, unemployment and government gross debt for these four countries compared with the United States over the period 2003–2013. With the onset of the GFC, the US suffered the greatest spikes down and up in GDP growth and unemployment, respectively.

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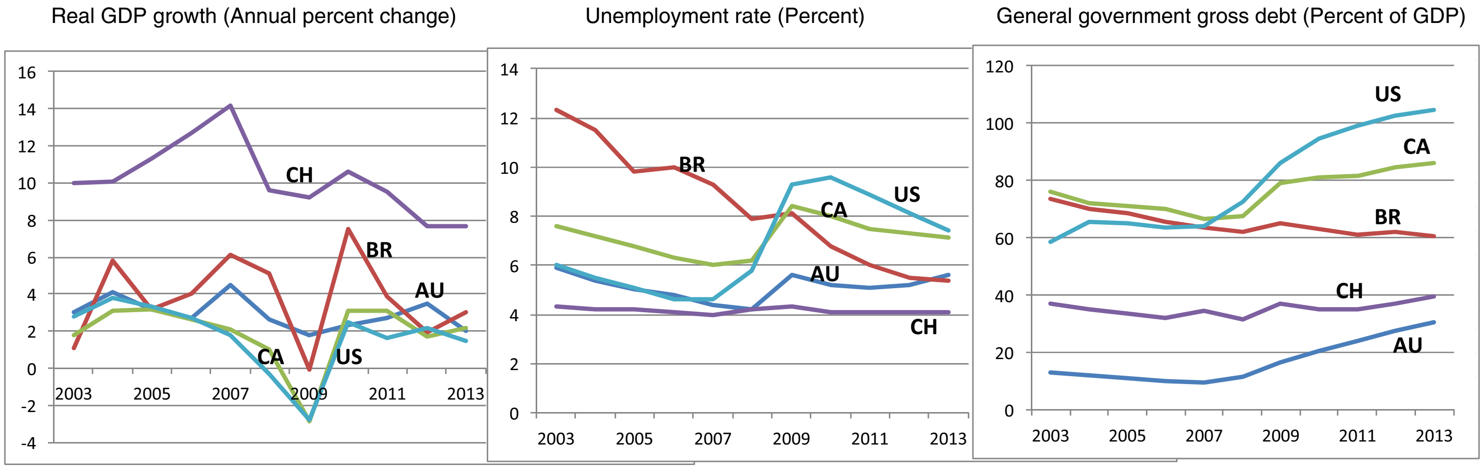

Chart 1. GDP, unemployment and government gross debt comparison. Australia, Brazil. Canada. China, United States. 2003–2013.
Source: IMF.