



Financial regulatory reform: A Maginot line?

A year ago, immediately following the crash of Wall Street, nationalization of European banks, and TARP bailouts in the US, governments around the world were struck with a zealous enthusiasm to regulate — or more accurately, reregulate — the financial sector.

Now, more than a year has passed but not much has been done. Other than tinker with some rules on executive compensation (which is really not the issue at all), governments have been distracted by other issues like health care reform and carbon emissions.

Those calling loudest for tough new regulations on banks and financial institutions have been frustrated with government inaction. But they should save their lobbying efforts for more constructive causes. Reregulation may in fact be needed, but it's not the lack of regulation that is wholly to blame for the mess in 2008 and 2009. And, in fact, tough new regulations may be even worse if they prop up a false sense of security.

Regulation may be what war buffs would call a Maginot Line. Back in the Second World War, France intended to keep out the invading Germans by establishing a line of defence along the border, which was called the Maginot Line, after the French minister of defence André Maginot. However, it was strategically ineffective as the Germans went around the line, invaded Belgium and proceeded relatively unobstructed.

The events that led to the near-collapse of the global financial system in September 2008 weren't caused simply by a lack of good regulation.

Events were motivated by politics, greed, and a lack of financial literacy. And none of these things will go away because of new regulations.

American politics was partially to blame for the enormous over-build in the housing market and the real estate bubble of 2003-06. We like to beat up George W. Bush and former fed chairman Alan Greenspan for prompting the gluttony in housing, but it actually started with Bill Clinton and policies promoting home ownership in the 1990s. It was reasoned that home ownership was good for America, good for voters, and good for Washington. Following the tech bubble meltdown and 9/11, ridiculously low interest rates kept the housing monster satisfied and prices kept rising. Then things turned sour, and the market skidded into the ditch.

Good old-fashioned greed is also to blame for the crisis of 2008. It doesn't matter to which religious text or historic documents you adhere, greed has been with the human race since the dawn of time. The lax regulations in place may have made it a bit easier to be greedy and get away with it, but like the Germans and the Maginot Line, greed can move around almost anything that stands in its way.

But some of the blame also lies with US consumers, many of whom did nothing particularly wrong except for the fact that they didn't understand the terms and conditions of their mortgages. Financial illiteracy is a serious problem. Sure, it could be argued that mortgage lenders and brokers had a responsibility to ensure homebuyers

clearly understood that their monthly payments would "reset" at some point, and that, given their income levels, the banks would eventually foreclose. Consumers, however, can't be let off the hook entirely. They need to take ultimate responsibility for their over-consumption of housing. That will require more education and literacy about financial topics like mortgages.

Through the storm, Canada's banking sector remained the envy of the global financial community. But even Bank of Canada Governor Mark Carney and Finance Minister Jim Flaherty have worried recently about rising levels of household debt and potential problems homebuyers could see when mortgage rates start to rise. Tier-1 capital held by Canadian banks is in excellent shape, but if Canada wants to keep up with the Big Boys of the financial world, it may have to put up with new regulations and tighter restrictions as well (even though we've been setting the example to follow).

A tighter regulatory regime for global financial institutions can be expected at some point. Canada may well be affected in some way. But those pushing for reforms shouldn't get their hopes up too high that the problem will be solved once and for all. Like the Maginot Line, the regulatory regime may only provide an illusion of protection. Greed will find a way to circumvent any new set of rules.

Todd Hirsch is the Calgary-based senior economist for ATB Financial. He addressed the World Heavy Oil Congress during the business portion of the main conference in Porlamar, Venezuela.

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