Emerging and developing nations are very susceptible to shocks caused by the interrupted capital flow. In this regard, future jolts which will affect the European Union, strongly risk being the catalyst of a substantial upheaval on the front of capital movements across the globe. The only perspective – however quite benign and highly probable – of Greece exiting the EU would thus provoke a massive exodus of liquidities outside Greek banks toward Germany, while precipitating a worldwide stampede outside assets deemed “at risk”. If the economies of regional blocks are obviously subjected to multiple shocks, the responsibilities of inflow or outflow of capital are fundamental in reestablishing growth or in the advent of the recession. The Irish resurrection – following the liquidation of its banking system – is indeed beholden first and foremost to the strict control of foreign exchange, the rest of which was established with the consent of the IMF. As for emerging countries, their dependence on the inflows of capital well documented. Nations (like the U.S.) which regularly need short-term liquidity to financier their deficits are therefore threatened down to their vital powers in the event of capital flight, following a sharp reversal in their economic conditions or political pressures (we think, of course, of China and its massive Treasury bills holdings). That is why the best placed countries and regions of tomorrow which can amortize the inevitable shocks to come and, thus, benefit from a more stable growth will be those which will have implemented an arsenal of preventive measures regulating these flows while neutralizing certain speculation directly impacting these movements of capital. Capital flow transitioning globally and freely is actually very harmful for economies – mainly on developing ones – and must therefore be restrained to smooth out financial shocks.

Indeed, nothing replaces preemptive regulations which will reduce definitively erratic fluctuations on public accounts and which will protect upstream our economies. It is therefore the entire system which must be redesigned, or at the very least, reviewed through another prism, that of global imbalances and their corollary, namely a reform of the international monetary system whose objective would be to allocate capital more equitably. Under this optic, why would countries affected by a deficit in their balance of payments not levy a tax on the inflows of capital from nations with which they maintain a bilateral deficit? Under
this new interpretation, nations, benefiting from substantial surpluses in their current accounts, would thus actively participate in readjusting or compensating these imbalances. It is certainly clearly more complicated a priori to regulate capital flow than to influence trade surpluses and deficits. However, chasing massive deficits of the balance of payments between countries and regions would embrace the entire spectrum of imbalances which are the source of financial shocks and economic slowdowns. Nothing will be obviously accomplished without world cooperation and it is urgent to act. New economic and econometric research indicates that regulating capital would breathe a good dose of calm into markets. A recent study by the Bank of England – which cannot be accused of protectionism! – found a general increase in the financial and economic conditions if there was an international coordination of foreign exchange control. Finally, the IMF has data in sufficient quantities which attest that emerging nations which best resisted the crisis are also those which introduced before 2007 true regulation. It is therefore the political will to challenge the rules at the root of global investment and trade agreements which today are still lacking. Only a narrow and unequivocal coordination between industrialized nations, with integrated economies, and developing nations would regulate the two sides of capital so as to ensure stable growth. One of the fundamental lessons of this crisis is that the regulator may also be carried away by catastrophes. The mere mention of the Madoff name is in this regard sufficient to give him a lesson in modesty... As the error is human, regulation rarely succeeds in swimming against the current of established trends. As regulation further imposes common rules for the economy of the country, regional block or even the entire world, it is the entire system which has become weakened if the regulator errs.

Concerned with transparency, preoccupied with avoiding excessive risk taking and protecting investors, the regulator may, nevertheless, fail under the weight of too many complex laws. Such an example is the “Dodd-Frank” law, passed in 2010 in the U.S. whose objective – praised by all – was to prevent financial abusive behaviors and to allow authorities to seize – even dismantle – behemoth institutions, “too big to fail”. However, how do we act rapidly and optimally within a context where this legal text comprises 850 pages, i.e. more than twenty times more than the famous “Glass-Steagall” law adopted on the heels of 1929? The regulations alone (of the Dodd-Frank legislation) likely to include risky corporate transactions for bank capital – the famous “Volcker rules” – include 382 issues and 1,420 sub-issues! Certain explanations or clarifications of this law concerning technical points are also laid out in hundreds of pages. So that not even the regulator can claim to have read this law in its entirety... or understood it! Of the rest, only a third of the legislation is now in effect since, even by the own admission of Sheila
Blair, the former head of the FDIC (the U.S. regulator), this reform “se noie dans un océan de complexité”! Statistics published by a think tank, the “Sunlight Foundation” revealed an absurd number of consultation meetings about this reform between U.S. regulatory agencies and the largest financial institutions. Thus we are talking about 181 meetings organized over a two-year period with Goldman Sachs, 175 with JP Morgan Chase and 150 with Morgan Stanley, during which these banks tried by any means to influence and make the famous Dodd-Frank law more flexible with the obvious intention of gutting it its essential substance. Among some of the examples, Dodd-Frank is part of an increasingly more tortuous regulatory process whose key characteristic is however to create voids and blanks exploited by those who strive to violate these laws with impunity. Finally, did the U.S. Justice Department not abandon all legal proceedings against Goldman Sachs for the alleged subprime embezzlement in August 2012? Hasn’t the long investigation lasting four years on market manipulation of money charged to JP Morgan not been in legal limbo since the summer of 2012? Of the rest, this hypercomplexity is also disastrous for the economy itself, like this other example of a U.S. law passed in 2002 to fight against the “Enron” type of fraud, the Sarbanes-Oxley law. This led to an absurd result to discourage businesses strongly from raising funds on the stock market. With the initial objective of encouraging transparency, in reality this law accelerated the opacity of new companies that were no more than 12% in 2011 wishing to be publicly traded as opposed to 67% in 2002. The context, like financial products, is certainly more and more sophisticated. However, the regulator and the legislator should not fall into the trap of complexity which is precisely the trend of the world of finance. They should, on the contrary, fight with the assistance of simple and unequivocal regulations, with the singular priority being always the protection of their economic fabric. Since “more the state degrades, the more numerous are the laws”, said Tacite.

Concerned with transparency, preoccupied with avoiding excessive risk taking and protecting investors, the regulator may, nevertheless, fail under the weight of too many complex laws. Such an example is the “Dodd-Frank” law, passed in 2010 in the U.S. whose objective – praised by all – was to prevent financial abusive behaviors and to allow authorities to seize – even dismantle – behemoth institutions, “too big to fail”. However, how do we act rapidly and optimally when this legal text comprises 850 pages, i.e. more than twenty times more than the famous “Glass-Steagall” law adopted on the heels of 1929? The regulations alone (of the Dodd-Frank legislation) likely to include risky corporate transactions for bank capital – the famous “Volcker rules” – include 382 issues and 1420 sub-issues! Some explanations or clarifications of this law on technical points are also laid out in hundreds of pages. Even the
regulator claims that it has not read this law in its entirety... or understand it! Moreover, only a third of this legislation is now in effect since, as even admitted by Sheila Blair, former head of the FDIC (the U.S. regulator), this reform “is buried in an ocean of complexity”! Statistics published by a think tank, the “Sunlight Foundation” revealed an absurd number of consultation meetings about this reform between U.S. regulatory agencies and the largest financial establishments. Thus we are talking about 181 meetings organized over a two-year period with Goldman Sachs, 175 with JP Morgan Chase and 150 with Morgan Stanley, during which these banks tried by any means to influence and make the famous Dodd-Frank law more flexible with the obvious intention of gutting it of its essential substance. Among some of the examples, Dodd-Frank is part of an increasingly more tortuous regulatory process whose key characteristic is however to create voids and blanks exploited by those who strive to violate these laws with impunity. The context, like financial products, is certainly more and more sophisticated. However, the regulator and the legislator should not fall into the trap of complexity which is precisely the trend of the world of finance. They should, on the contrary, fight with the assistance of simple and unequivocal regulations, with the singular priority being always the protection of their economic fabric. Moreover, the scission of banking activities between commercial and retail establishments – whose deposits are covered by government guarantee – and the banks which deal with investments and speculation proves in this respect to be indispensable. The Volcker rules were indeed likely to remedy this, still less complex to interpret and apply a 298-page legal text! In comparison with the simplicity of the now defunct 1933 Glass-Steagall law, repealed in 1999, and which only had 37 pages... How does the legislator expect to make an unequivocal distinction between the banks which invest for their own account on the one hand and those which only carry out client instructions on the other hand? The effective line of demarcation between these two types of operations are a matter of interpretation and intention, with the knowledge that an establishment, or a trader, can quickly change – even cheat – by passing from one to the other according to its interest, even mood? Didn’t the Libor scandal actually reveal that the UBS traders in London were challenging one another over who could manipulate this rate the most? Therefore it is exclusively – almost mechanically – when Glass-Steagall was abolished that the volume of transactions exploded. These over-the-counter transactions, opaque and unregulated deals were only able to prosper when this law was repealed. As Glass-Steagall deprived investment banks from banking deposits – and therefore from financing at a cheap price –, its collateral effect was naturally to limit the increase of their puts, and therefore their risks. All the while increasing and diversifying the number of stakeholders in the
Regulation: Deconstruct and Stabilize

financial markets, thus becoming more liquid. While the repeal of the Glass-Steagall law would permit the rise in power of investment banks that were then able to develop a myriad of new financial instruments beyond the control of any regulatory agency. This separation between commercial banks and investment banks will thus allow the financial markets to become resilient, in the hope that the next conflagration will not be as dramatic as that of 2007-2008. While restraining considerably the power of banks which will by necessity have different objectives and priorities, even divergent. It is therefore vital today, in the interest of the real economy but also to save the financial sector from itself, to proceed without delay to limit the power of banks.