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Good Global Financial Governance: Institutional Challenges

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1. Introduction

- **good governance**
  - importance of the institutional framework
  - excluding opportunism and moral hazard

- **global financial markets**
  - financial institutions (banks etc.)
  - national public actors
  - supranational actors (e.g. EU)
  - international actors (e.G. IMF)

2. Methodology

- **New Institutional Economics**
  - scarcity of resources, methodological individualism, self-interested rational behaviour
  - transaction costs, bounded rationality (based on behavioural economics), opportunism

- **Normative approach**
  - hypothetical consent under the veil of uncertainty: searching for win win-solutions (contractarian approach); search for mutual-benefit
  - not welfare maximisation (utilitarian approach)

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3. Analysing bad governance of global financial markets (1)

- **Opportunism**
  - ex ante-opportunism (information asymmetries)
  - ex post-opportunism (incomplete contracts, specific investments)

- **Moral hazard**
  - asymmetry between profits and loss bearing
  - externalising costs

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3. Analysing bad governance of global financial markets (2)

- **Opportunism (financial institutions)**
  - information asymmetry in financial markets
  - ex post-opportunism: ex post erosion of the capital basis

- **Moral hazard (financial institutions)**
  - management compensation: wrong incentives
  - exploiting the systemic risk

3. Analysing bad governance of global financial markets (3)

- **Opportunism (public actors)**
  - ex post changes of incomplete contracts : bail-out of a EU-Member States on the condition of structural fiscal reforms, which are not being fulfilled
  - ex post changes of incomplete contracts : sovereign bond purchases of ECB under conditions, which are later on not fulfilled

- **Moral hazard (public actors)**
  - Accumulation of public deficits expecting a bail-out

4. Ethical challenges

- **Opportunism of private and public actors**
  - is causing externalities for citizens (e.g. unfavourable conditions for customers)
  - is causing instability of international financial markets (e.g. in the interbank market)

- **Moral hazard of private and public actors**
  - is causing costs for citizens (burdens fo tax- payers in net-payer-Member States)
  - is destroying mutual trust (endangering the European integration model)

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5. Search for win win-solutions

- **Regulation of international financial markets (Basel III)**
  - Eliminating incentives for opportunism and moral hazard
  - Problem: nation states as regulators, which are players in the markets they regulate (example: no minimum capital requirements for sovereign bond purchases)

- **Bail-outs in the light of a non-existing insolvency law for sovereign debtors**
  - impossibility of creating insolvency law for sovereign debtors under the regime of supermajority in the IMF and the unanimity rule in public international law
  - substitutes for insolvency law for sovereign debtors: London and Paris Club procedures

6. Ethics of good global financial governance

- **‚Institutional ethics' aiming at minimising opportunism and moral hazard**
  - the importance of the institutional framework
  - institution-building by actors who play the game under the rules to be created

- **Value-oriented management and public policy**
  - common understanding of the rules of the game (Suchanek-approach)
  - intrinsic motivation: building mutual trust (and reducing transaction costs)

7. Outlook (1)

- **Prioritisation**
  - Basel III
  - London Club reforms

- **Dilemma structures**
  - National governments as institution-builders
  - But: the actors are not governments, but individual actors representing their constituency as citizens' agents (methodological individualism)
  - Citizens as principals
  - Reforming public governance strengthening principals

7. Outlook (2)

- **Individual ethics and institutional ethics**

  - individual ethics is developing normative standards for moral and ethical behaviour of individual actors
  - institutional ethics if focussing on the institutional framework in order to create a system of sanctions and incentives which enables individual moral behaviour
  - individual ethics without institutional ethics cannot protect individual actors behaving according to high moral standards to be exploited by others who do not follow these standards
  - Individual ethics and institutional ethics are complementing each other