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Interview: Is there still scope for the free market?

Helen Disney, the CEO and Founder of the Stockholm Network, a pan-European think tank and network, last week addressed a business breakfast organised by The Malta Business Weekly at Le Meridien St Julians Hotel and Spa.



Much of the blame for the recent financial crisis has been laid at the door of free markets. How much do you think that markets are at fault?

Markets are the result of human activity and are therefore just as flawed and imperfect as we are. But that does not mean that more government is any better a solution. We also now face a danger in the way we choose to respond to our current circumstances. When times are hard, it is easy to forget that the liberal economic system – flawed as it may sometimes be – is the only one we know that actually works. The last thing we need is to retreat into protectionism and trade barriers if we want our economies to recover and to remain competitive.

What caused the crisis and does it differ from previous downturns?

The current financial crisis followed on from a boom in oil, food and house prices, leading to a collapse in financial markets and the banking sector, and linked to a bursting bubble in residential property markets. This economic cycle of boom and bust is long established. However, this crisis differs in both the scope and interconnectedness of markets leading to a much harder fall and a more widespread impact around the globe.

How optimistic should we be about an economic recovery?

It would be impossible now to argue that markets were working perfectly before the financial crisis and that this situation is nothing more than a global bust, larger in scale but not fundamentally different from previous busts. So, although in all likelihood markets will recover eventually, it is just not clear yet how long or how deep the recession will be. And some of the answers depend very much on governments' response to the crisis.

Should governments have intervened to rescue failing banks?

Whether we like it or not, the world seems to have shown it is not prepared to accept the risks of bank failure. To quote from British politician Vince Cable's recent book *The Storm* which encapsulates this view: "Sophisticated, modern financial markets have become in many respects a public good, providing not just conventional banking but a system for pensions, house purchases and industrial finance that, in today's democracies, will not be allowed to collapse. A better approach is to say that since key firms cannot be allowed to fail, they must be more effectively regulated."

Many economically liberal commentators have argued that the greater our belief in free markets, the greater the need for effective regulation. Without it, there will be too much instability and too much opportunity for excess risk taking so we need to strike the best possible balance between setting the rules of the game fairly and then allowing markets to do the rest. However, regulation needs to be well targeted and to have specific

objectives – especially to avoid the danger of this crisis providing for a “regulators charter” - something which is already being discussed at the EU level with the proposal to create both a European Systemic Risk Council and a European System of Financial Supervisors.

Banks do, however, need to be regulated differently from other firms because the impact of their failure can be systemic.

What specific measures should governments take to reform financial market regulation?

Experts have taken a variety of positions on what should be done. They include:

- Increased transparency – banks should publish more information to the market, for example
- Risk management – we may need to reduce actions that are based on more speculative instruments
- Stricter capital adequacy requirements (for example, reforming the Basel II Accords)
- Greater accountability (including of senior management of banks) and
- A higher level of supervision and monitoring by central banks and regulators (particularly of banks that have been de facto nationalised)

What are the dangers of more regulation?

Although better regulation is now being touted as a holy grail, it is not clear that regulators were any more able to predict the current crash than the markets were. This is not a reason for inaction but it is a reason to be very careful in not over-regulating to try to prevent what cannot be prevented.

Many elements of the crisis have rightly provoked enormous anger including the spectacle of large rewards for failure in the form of bankers’ bonuses and pension entitlements. Even so, regulation will not be able to address many of the public’s complaints. Bankers will continue to earn high salaries and the government should not intervene in private contracts, however vitriolic the public mood becomes.

Should we still have faith in free markets and, if so, why?

Wealth creation – The more economically liberal a country is, the greater chance it has of becoming prosperous and attaining a higher standard of living and higher life expectancy – people in countries with the freest economies are nearly 10 times better off than those in the least free and, perhaps even more importantly, they live more than 20 years longer.

Freedom - As Milton Friedman said: “Underlying most arguments against the free market is a lack of belief in freedom itself.” One of the greatest benefits of the free market is inherent in the phrase itself. Consumers are free to buy whatever they like and in whatever amounts. Decisions about what to produce, for whom to produce and in what quantities to buy are determined by market forces and voluntary exchange rather than via decisions taken by the State.

Choice - The free market and the free price system make an enormous variety of goods from around the world available to consumers, offering a choice that would have been unthinkable in the past. The free market also gives the largest possible scope to entrepreneurs, who risk capital to allocate resources in order to satisfy the future desires of consumers as efficiently as possible.

Innovation - A free, competitive market rewards and stimulates technological innovation allowing the innovator to get a head start in satisfying consumer wants in new and creative ways. Just think of the many inventions and innovations that would not have

been produced without the spur of market forces.

The ability of the market to harness human ingenuity and to allow us all to specialise in what we do best, brings untold progress and prosperity to us all. Without trade and markets we would all be very much more isolated and a great deal poorer so we should think very hard before biting the hand that feeds us.