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The Political Economy of Financial Regulation Policies Following the Global Crisis

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ABSTRACT

This paper analyses the efficiency of financial regulation reforms that are being supported in a variety of theoretical approaches after the 2007/2008 global crisis. The main challenges that prevent the efficiency of the reforms are; (i) Maintaining the Basel approach that is argued to have led to the financial crisis, (ii) its limited content, (iii) its lack of global and national financial infrastructure, (iv) not being designed in a framework that comprises the macro policies. Due to the reasons mentioned above, this paper argues that the regulation policy can neither fulfill its stability role nor its distributive role and that in this way, it restructures forthcoming crisis, not the financial sector. In order to prevent crises, a critical approach is required on the mode of regulation of the economy and a reorganization of capitalism is necessary on a larger scale.

Keywords: Government Policy and Regulation, Financial Crises, Crisis Management
JEL Classifications: G18, G01, H12

1. INTRODUCTION

The 2007/2008 global crisis has indicated a big decline in the world economy with regards to many economic indicators such as economic growth, the increase of unemployment and public debts. While growth rates were 4% and 2.6% for developed countries before the global crisis in the year 2007, these ratios have fallen respectively to −2.2% and −3.8% (UNCTAD, 2013. p. 2). While the unemployment rate was lower than 5% in the Unites States of America (USA) in the year 2007, it has reach its peak level with 10% at the end of the year 2009 and could only fall back to 7.6% by mid-2013. As to the European Union, the unemployment rate that was 7.2% in the year 2009 reached 11% in the year 2013 (UNCTAD, 2013. p. 11). The bailout policies of states devoted to private financial institutions have increased the monetary base as well as the debt burden of states. The results of these policies might be observed in the financial statements of central banks. Between August 2007 - which marks the beginning of the crisis - and the end of 2012, the financial statement of the Federal Reserve Bank of the USA grew by 221% while the financial statement of the European Central Bank grew by 241% (UNCTAD, 2013. p. 113).

During the post-crisis period, regulations concerning the financial system have become a current issue since the global crisis, which had led to the related economic problems, had derived from the financial sector to a large extent. Although the tools and methods used were differing, regulations had been supported by a large academia, in order to prevent a similar situation in the future (Caprio, 2013; Daripa et al., 2013; Epstein, 2010; Baker, 2010; Davis and Karim, 2010; Wade, 2009; Persaud, 2008).

Financial regulation means the establishment of institutions and rules concerning financial markets by public authorities, with the purpose of orienting sources in the direction of certain objectives, due to the regulatory function of state. Together with globalization, nowadays the related institutions and rules are being established under the financial governance structure of International Governance Institutions such as the International Monetary Fund (IMF) the World Bank (WB), the World Trade Organization (WTO) and the Financial Stability Board (FSB), besides national states. Thus, financial regulations shall be examined within their financial governance structure. This situation requires comprehensive political transformations on national as well as global levels.

Although the necessity to strengthen the financial system with financial regulations is being accepted by a large academia after the global crisis, studies shall be conducted to understand how much progress has been made in this field, what have been the impacts of these practices on the financial sector since the crisis, what shall be the characteristics of financial regulations to prevent the repetition of similar crises?

In order to answer these questions, the development of theoretical approaches on financial regulation has first been addressed in this paper. Then, policy implementation topics during the period following the global crisis have been examined. When the variety of financial market institutions and instruments is considered, financial regulation policies have to be addressed on a comprehensive scale. During the post-crisis period, academicians and policy makers have started to focus on a large discussion which also comprises the Basel standards and policy proposals have come to the agenda in this field. This paper does not address in detail all the regulation proposals and their theoretical basis. In accordance with the objective of the paper, particular importance has been attached to the implemented regulation policies and their efficiency as well as their impacts on the financial sector. The practices in the USA and England have been basically explained, while a limited focus has been given to the differences in policy implementations among countries, in order to keep the dimensions of the paper at a certain level.

2. FINANCIAL REGULATIONS IN THE HISTORICAL AND THEORETICAL FRAMEWORK

As a practice of the interventionist role of the state in the economy after the Second World War, financial regulations have been widely used, the capital controls being in the first place. However, in the 1970s the Monetarist approach has been accepted as the effective economic theory and in this respect, the role of the state has been defined as just providing the continuity of the system and strengthening competitive markets (Friedman, 1988). In this framework, the decrease of state interventions in financial markets have been brought to the agenda with financial liberalization policies and this process led to the gradual elimination of financial regulations.

The theory of practices aimed at eliminating financial regulations is based on the financial repression analysis. The analysis argues that financial markets and financial market structures play important roles in economic growth and development. Increasing the interest rates to their balance level with financial liberalization would orientate the savings from non-productive actives to the banking sector and make it possible to use them in more productive fields. According to this theory, during this process the increasing savings provide a more efficient use of sources for investment purposes. Furthermore, the liberalization of credit markets which were being held under pressure would enable the development of financial markets and the diversification of market instruments. A financial deepening to be realized in this way and the monetarization of the economy would ensure the economic growth and the development of the financial system (McKinnon, 1973).

After the crises experienced in the 1990s, new-Keynesians have started to bring the first comprehensive criticisms on the financial liberalization theory. According to these theoreticians, crises might be explained with fundamental market failures of the system, not with market disruptions and deficiencies defended by liberal economists. According to Stiglitz, financial markets are commonly defined with market failures. According to this approach, markets are encompassed with uncertainty, lack of information and risks and therefore the efficient markets hypothesis[1] of the neo-classical theory which suggests that the existing information are reflected on the prices is not valid (Stiglitz, 1985). As to Stiglitz, this market failure is due to the fact that the social risk is not equal to the private risk in these markets. In other words, the market cannot price efficiently the private risk. In this case, if the market is left to its own devices, it would accumulate more risks than it is socially effective. According to Stiglitz, market participants that focus much on short time periods and tend to a large extent towards the way other market participants would act can be cited as examples to those situations which are an indicator of market irrationality. As to Stiglitz, the systemic risk that emerges as a result of financial decisions made under the influence of these speculative structures and the blockage this risk causes are the most important justifications of interventions such as taxes or regulations aimed at capital flows (Stiglitz, 1998).

Besides stability, the Keynesian approach also focuses on the income distribution impacts of financial regulation. Although the market ensures the efficient resource allocation that is possible under the ideal conditions, the income distribution ensured by the market might not be efficient. Therefore, according to Stiglitz "one of the most important objectives of state interventions to financial markets is to restore misallocations" (Stiglitz and Uy, 1996. p. 250).

Following the global crisis, it might be observed that a consensus has been reached on the recognition of a market failure in the financial sector which necessitates the state intervention, although its degree might vary from one country to another. However, as pointed out by Picciotto (2009), the spreading of formal regulation has a national focus but these regulations have been developed as an international process through regulators and experts that develop the principles and standards. At the same time, some of these rules have been developed by international governance institutions such as the IMF, the WB, the WTO and the FSB. Thus, the crisis has opened a new door for many researchers into the analysis of the objectives, functions and contradictions of these institutions and their economic governance rules. These rules and institutions are commonly related with politics and power relations. Especially, the old discussion on power relations in finance, which dates back to Kindleberger (1988) has become even more vital in today's world where money and trade get globalized increasingly. In this framework, it has been argued that the failure of the financial governance system in regulating the power of the financial sector has been another characteristic of the financial crisis. The arbitrage power of big banks, investment institutions and hedge funds,

1 The efficient market hypothesis assumes that financial markets would continually establish equilibrium asset prices based on the available information concerning the main economic indicators.

necessitates that these enterprises undertake an extreme risk on the existing liquidity (Dimsky, 2010). These risks are the risks of each economy and even more, the risks of the global system.

The approaches that are based on this framework argue that the reason of the financial crisis is not just a financial market failure. According to these approaches, failure is at the centre of the economic mechanism. The state has implemented free market policies and transferred its auditing and regulation power to the banking lobby and organized business environments. Transferring the regulative function of the state to these groups-which are denominated as the predictor class by Galbraith - has led to the uncontrolled growth of financial derivatives, tax heavens, investment strategies (carry trade) which benefit from the regulative arbitrage and the interest rate difference which is used in the foreign exchange (FX) market (Galbraith, 2009).

Another approach which has become prominent with its crisis theories during the post-global crisis period is the Marxist approach. This approach analyses the nature of the capitalist system, which is prone to crises, and the role of the state in this system. It brings up to the agenda a perspective suggesting that the global crisis is not just a regulation crisis, but that it is the global crisis of the capitalist system (Bonefeld and Holloway, 1995).

According to this approach, the capital has to be re-allocated continuously to productive investments in order to maintain its level and widen. The widening of the capital is the descriptive phase of the global accumulation phase, during which the capital is in search of new areas in order to realize the surplus value or the profit (Sawaya, 2010). If the capital cannot find ways to continue its valuation process in the real production area, fictive valuation mechanisms shall be created. At this phase, the role of the state in reshaping capitalist social relations as a whole becomes prominent. In this sense; "a regular intervention of state managers, the establishment of international regimes and institutions" (Burnham, 2001) gain importance. Consequently, according to this approach, approaches that focus on the circularity of the financial system that is targeted by the speculation or regulation policy based on imperfect knowledge have to rely on the criticism of the capitalist system.

3. FINANCIAL REGULATION REFORMS

The fact that the model implemented in the world starting from the 1970s with the gradual deregulation of markets has commonly led to crises in developing country groups has been attributed to the inadequacy of institutions in the related countries and their failures in policy implementation. On the other hand, it has been commonly argued that the reason of the 2007/2008 global crisis experienced in the developed economies - where these problems are assumed as non-existing - has arisen from formal regulation policies that are based on the Basel model. Since 130 years, this model has caused a bank panic in Western countries for the first time. The theoretical framework and practices on which this approach is based are to a large extent, the different forms of micro-prudential regulations that lean on the efficient market hypothesis. However, during the 2007/2008 crisis, it has been observed that even though financial agents act in accordance with the micro-prudential approach, they cannot guarantee the stability of the system as a whole (Baker, 2010).

The global crisis has established an increasing consensus on the fact that the regulations related to the auditing and monitoring of each bank based on Basel model are necessary but not sufficient for financial stability at the micro level (Davis and Karim, 2010) and macro-prudential regulations have been brought to the agenda. Macro-prudential instruments are designed according to the risk contribution each institution makes at a certain time at the system-scale or according to how to total risk evolves in time (Borio, 2009). Instruments of the first type include instruments such as capital requirements, insurance premiums. Instruments of the second type concern the establishment of counter-cyclical capital buffers for banks and financial institutions. They have for objective to bring a restriction on extreme risk taking and herding. They are devoted to decrease the immanent circularity of the financial system.

Following the global crisis, the Basel Committee on Banking Supervision has put into practice a higher capital requirements (increasing the quality and level of capital) and leverage ratio (constraining leverage) in the framework of Basel III (Table 1). Also, the committee has put into practice some rules having for objective to strengthen the liquidity supports (mitigate of systemic risk) of financial institutions that are active at the international scale. To this end, it has brought two instruments to measure the liquidity risk (the liquidity coverage ratio and the net stable funding ratio). Especially, net stable funding ratio would encourage banks to use long-term sources which are more stable than short term funding instruments (Saidenberg, 2011). A macro prudential element of the Basel III capital framework is the requirement that in good times, banks should build up buffers – A capital conservation buffer and a countercyclical buffer that can be drawn down in periods of stress (The Bank for International Settlements [BIS], 2011. p. 112).

The global crisis has contributed to the inclusion of swap and derivative markets to the regulation basin in the USA for the first time. With new regulations in the framework of the Consumer Protection Act, swap dealers or swap market participants have become subject to new regulations and reporting requirements. This law has also included over the counter derivatives within the regulative framework.

In order to resolve the insufficiency of auditing in financial markets following the crisis, some regulations have been made in order to improve the financial infrastructure. Broad reforms on the financial infrastructure have been realized in the UK. Following the global crisis, the UK has been one of the countries that was at the centre of criticisms concerning the inadequacies and failures of the Financial Stability Authority (FSA) which is its own financial monitoring and auditing institution. The FSA has been abolished since it was being criticized for not being able to prevent the credit inflation and the boom that followed it and the risky transactions of banks. Instead, two regulative authorities have been established. These institutions are the Financial Conduct Authority (FCA) which

Table 1: Financial regulations on financial sector

Financial sector	Regulation	Theoretical base	Policy
Actor			
Banks	Prudential regulation	Market failures	Basel I (capital ratios) and Basel II (capital requirement)
	Microprudential	Moral hazard, too big to fail, incomplete contracts, information frictions, co-ordinations problem, failure of risk management	Basel III (higher capital requirement: The minimum requirement of common equity increases from 2% to 4.5% of risk-weighted assets. Leverage ratio: Non-risk-based leverage ratio. Likidity supervisory Standard: A LCR and a net stable funding ratio)
	Macroprudential regulation regime	Systemic risks	Capital conservation buffer (at 2.5% of common equity) Countercyclical buffer (at 0-2.5% of common equity)
Investment banks, insurance companies, hedge fuds, money market funds	-	Markets failures	-
Markets			
Capital flows	Capital controls	Boom-boost cycle	-
OTC markets	Improve transpareny	Information failures	BIS
Swaps and derivatives	Monitor over-the-counter and swaps	Speculative motive	Consumer protection act (US)
Financial infrastructure	FSB	Coordination	Global level
	FCA versus PRA (FPC, SRU)	Systemic risks	UK
	Resolution Authority FPC	Information failures	Capital buffers, capital requirements, time varying leverage ratios (UK)
	Financial Research Office		Collecting data on financial system, Consumer protection Act (US)
	ESA	Systemic risks	European financial markets (EU)

Sources: Author. LCR: Likidity coverage ratio, OTC: Over the counter, FSB: Financial stability board, FCA: Financial conduct authority, PRA: Prudential regulation authority, FPC: Financial policy committee, SRU: Special resolution unit

has been established in April 2013 as an independent board and the Prudential Regulation Authority (PRA) that would function as a department of the Central Bank. The FCA is responsible for protecting the investor, improving market integration and encouraging efficient competition. The PRA is principally responsible for monitoring financial service companies (banks, insurance companies, big investment companies) and ensuring the stability of the English financial system.

PRA is composed of the Financial Policy Committee (FPC) and the Special Resolution Unit (SRU). The FPC, which has been established in the year 2014, has for main objective to define, monitor and decrease the systemic risk. It has two powers; giving orders and recommendations to the PRA and FCA for establishing the macro-prudential instruments. These instruments are the counter-cyclical capital buffers, sectoral capital requirements, the time-varying leverage ratios. On the other hand, the SRU is a special resolution regime that has been brought for bankrupt banks with the banking law in the year 2009 (Dariels and Thornton, 2015). The SRU has brought to the system a safety net that might decrease the costs that financial institution bankrupts would impose on the public sector.

The interventions made by the states in the bankrupt of important financial institutions during the global crisis have resulted in big losses for tax payers. As in the UK, it is expected that an efficient authority (the Resolution Authority) might prevent these losses within the dispute resolution regime. Thanks to these regulations, the Central Bank has acquired more control on the functioning of the financial system in England. Furthermore, together with the new institutions, the authority responsible for the auditing of the financial service sector has been clearly defined (Bank of England, 2009).

4. EVALUATION OF FINANCIAL REGULATION REFORMS

4.1. Basic Principles of Financial Regulations

As seen in global crisis, intense competition among mega-banks forced bank management into extending leveraged activities, through financial innovation and the use of off-balance sheet trades leading to continuous expansion of available credit. Especially, financial institutions in the USA and UK developed strategies so as to increase their profits by carrying out high leveraged financial transaction. Provided the financial sources through securitization and financial derivatives are excluded from balance sheet, the firms' leverage ratio will not reflect the truth (Uzun and Yıldıran, 2013). However, Basel III leverage ratio of 3% of non-weighted assets is widely seen as very weak constraint on bank risk seeking. Furthermore, the leverage ratio is consigned to being a mere monitoring benchmark rather than as a frontline regulatory requirement (Avgouleas and Cullen, 2014).

At the same time, the approach based on Basel standards has been frequently criticized due to its complexity. According to Caprio

(2013) who perceives crises partly as a direct consequence of the Basel standards' approach, although capital ratios that are risk weighted are especially the main source of complexity in this approach, this topic has not been discussed during reforms. According to Caprio (2013. p. 32), giving a priority to simple rules might make a difference. Restrictions on the debt-to-income ratio and the loan-to-value ratio and upper limits on credit expansion and FX debts might be efficient for restricting price inflations during the expansionary phase of the economy. A well-designed "contingent convertible debt requirement" might provide a continuous support to tax payers who deposit funds in the bank. More importantly, this requirement might serve to control banks that attempt to increase their risks even at high capital levels.

What is even more important is how capital ratios based only on equities would isolate the economy from banking crises. Macro-prudential regulations are fictionalized on the banking system. However, the sources of the risk treated by macro-prudential regulations and their transmission mechanisms have to cover all the elements of the financial system, including intermediaries, markets and the infrastructure (Hartman, 2010).

Although reducing the risks posed by financial institutions that are systemic in a global context is seen as a high priority by the international regulatory community, Basel III does not fully address the externalities or spillover effects that these financial institutions generate (BIS, 2011). Basel approach, which does not regulate big financial institutions other than banks, creates an asymmetric structure. It is indicated that especially together with the new regulations, important financial institutions are still not dissuaded from the risks they bring to the financial system and that the consumer protection law that has been prepared after the global crisis in the USA has created some adverse incentives in this respect. This law is being criticized since it does not establish a regulative structure by predicting to regulate investment banks, insurance companies, pension funds and money market funds as banks. However, these institutions have played important roles during the crisis by creating credit (Richardson, 2011). The financial crisis might be characterized as an example of the final stage of the boom and bust pattern may have had its origin - at least in large part-in the development of new financial product (Colander et al., 263) by these institutions.

This issue has a vital importance on the ground massive failure of risk management. Stulz (2009) presents the detail analyses on how world's largest financial institutions has failed to carry out its responsibilities on risk management since the collapse of long-term capital management. However, according to Stulz (2009. p. 60) effective risk management does not provide a guarantee against failure. "Even in companies with the best risk management people and systems, large losses can and will occur as long as taking risk of large losses increases expected profits sufficiently for top management to be willing to take risk."

In the meantime, insurance companies and Hedge funds are the firms for which regulatory instruments and objectives differ sharply from those appropriate to banks. For instance, insurance companies tend to have very different risk characteristics from those of banks, particularly regarding likidity (BIS, 2011. p. 78). In order to make an important progress on this topic, a model has been suggested to measure the contribution of a financial institution to the systemic risk. Then these measurements might be used in the model for determining dissuasive mechanisms such as taxes to be implemented to these institutions (Acharya, 2010).

IMF supports the view that co-risk models can help policy makers to better regulate institutions. Also, IMF accepts that in the fact of cross-market and cross-country linkage more attention should be paid to the systemic implication. IMF proposed a risk-based regulation. This approach based on instituting "systemic-risk-based capital surcharges," applying levies that are related to institutions' contribution to systemic risk, or even limiting the size of certain business activities (IMF, 2010. p. 63). The main problem of monitoring global systemic linkages is non-existency of relevant data[2]. IMF admits of priority in such agreements in with gathering of relevant data. This might possible for a country by itself to undertake effective surveillance of potentially cross-border systemic linkage (IMF, 2009. p. 105).

As a tool for systemic risks, capital controls came to the agenda for the first time after the crises experienced in the 1990s following the financial liberalization, in what concerns the capital flows that have been canalized to developing countries (Epstein et al., 2008). Financial governance institutions have emphasized the negative aspects of capital controls but it has been observed that this approach has been moderated during the global crisis. IMF's new "institutional approach" with the global crisis recognizes the need to regulate capital flows. According to this approach, it has been suggested to re-use counter-cyclical regulations against capital inflows and outflows. This approach change has not been reflected on recommendations at the national level. It has been argued that financial deepening is more efficient than regulative interventions against the dangers of cross-border financial activity (Gabor, 2015. p. 3).

Capital controls that have not been brought to the agenda due to their possibility to weaken financial integration might be functional for a steady growing financial sector and financial stability. Actually, it is necessary to create a good balance between financial integration and financial stability. Thus, taxes or regulations aimed at capital flows should be design according to the dynamics of risk in the market.

4.2. Functioning of the Financial System; Openness, Transparency, Accountability

According to a report studying the main issues concerning the efficient implementation of macro-prudential regulations entitled "A Progressive Program for Economic Recovery and Financial Reconstruction" (2008. p. 17); "For any serious regulatory reform to work, however, at least two conditions must be met. First, financial institutions must come under much more significant regulatory oversight that demands absolute transparency in operations to avoid fraud and other forms of financial malpractice.

2 An initiative has just started for harmonization of key OTC derivatives data (BIS, Harmonization of key OTC derivatives data elements, Consultative Report, September 2015).

Second, the financial regulatory institutions must have the capacity, authority and desire to implement and enforce these."

Absolute openness and transparency in the financial system operations is the most important obstacle in the implementation of regulative reforms. Nowadays it is possible to avoid many regulations brought to the banking system by keeping the accounts off-shore. It is possible to abstain from financial regulations by tending towards other markets where these regulations are inadequate and making some short-term loaning/borrowing or off-balance sheet transactions. Large banks typically draw substantial income from shadow banking activities. Some of the risks of these activities are still not being addressed because of call for a high degree of coordination across regulatory agencies, both within and across national boundaries (BIS, 2011. p. 79).

The global crisis, during which all these mechanisms were operative, showed that the system based on formal monitoring and auditing was inefficient. The Basel committee focuses on the information of the regulator or auditor. When the dynamic structure of finance tends towards unofficial operations, the regulator shall use the discretionary power given to it and go beyond the static regulation rules and catch them. Such a discretionary power shall be designed together with accountability. Another important focal point of regulation shall be to increase openness in the banking system. The basic functions of the regulator shall be to ensure that banks give more information, to have them guarantee the accuracy of this information and to apply penalty rules in case of inadequate and wrong information (Caprio, 2013. p. 35).

As in the UK, the establishment of new institutions holding more auditing power and responsibility in the financial infrastructure would secure the attainability of information and enforce the auditing structure. Nevertheless, in order to ensure openness and take into consideration national discrepancies, it seems necessary to shape the global infrastructure together with national practices. Especially developing countries shall have the elasticity to start different practices that are convenient to their own economic and financial structures.

4.3. Financial Infrastructure

After the 2007-08 crises the most important change in the governance of international financial standards has been the transformation of the Financial Stability Forum (FSF) into the FSB, so as to comprise the G20 countries. In addition to G7 countries, the FSF included the representatives of institutions such as the IMF, the WB, BIS. Although the FSB has become more inclusivist under its new organization after global crisis in order to coordinate the international regulations, it still excludes many developing countries from the decision making process. Besides, two important problems concerning the efficiency of the institution in financial regulation are indicated;

1. While the new organization of the FSB can prevent direct capture against the criticisms concerning the regulatory capture area where the regulation loses its efficiency under the pressure of powerful actors, the problem continues since members are not represented equally
2. The FSB does not bring a more efficient and effective mechanism for financial monitoring and auditing. The main objective in the establishment of the FSB is to prevent that crises decrease efforts aimed at encouraging international financial standards and that international financial regulations get even more divided (Helleiner, 2010).

Moreover, the rules of the global financial system as well as the rules of international financial governance institutions that are not easy to handle and shape the functioning dynamics are forming an obstacle to the regulation policy. Especially, the rules that have been put into force by economic governance institutions after Bretton Woods seem to have restricted the policy space of national authorities. This situation reveals that regulations have to be designed within the global financial governance structure.

For example, the rules of international governance institutions concerning financial infrastructure have restricted to a large extent a possible division in financial regulations. The WTO Financial Services Agreement reached in December 1997 (GATT), restricts national policy preferences by bringing comprehensive and binding obligations to liberalize international economic flows (Picciotto, 2007). According to the rules taking place in the General Agreement on Trade in Services annex covering financial services, if a country has committed to give permission to certain activities of foreign financial institutions, it cannot impose any prudential regulation (Ghosh, 2010; Gallagher and Stanley, 2013).

Similarly, the Trade in Services Agreement puts countries into a position precluding financial regulation, although some financial market failures exist. This agreement is assumed to be kept as confidential and classified information for 5 years after its entry into force. The financial services in the draft agreement have been defined in the most comprehensive manner. In this respect, the agreement comprises stock market operations, asset management, brokering, derivative market activities, financial information supply and consultancy services and similar activities, besides banking activities.

With regards to the functioning of the global system, the most ideal situation would be to make regulations under an approach on which an agreement has been reached at the international level in order to minimize the regulative arbitrage opportunities and maintain the national market share. This situation is the most important justification forming the inconvenience of applying in a single country specifically regulations and generally capital controls. The regulated actors have the capability to tend towards prohibited activities in non-regulated areas. In order to decrease the interests in tending towards the other side of the financial system or other locations, it is more efficient to consider capital controls continually as a variable rather than to perform capital controls and abolish them (Caprio, 2013. p. 37).

Nevertheless, global regulations shall be designed so as to include national discrepancies. Since no progress could be made in counter-cyclical regulations after the crisis, it is expected that boom-bust cycles, which are the main source of the problem, get repeated in the future (Persaud, 2008). These regulations, especially controls on capital inflows and outflows, are of vital importance in developing countries which are more subject to

Table 2: Main indicators on Global Financial System (2000-2013) (Billion dollars and in percent of GDP)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Global capital markets[1]	-	-	150,437	130,341	152,327	165,130	194,462	241,089	221,494	242,264	256,900	259,212	273,768	286,584
World GDP	33,291	33,123	32,163	36,319	41,257	44,595	48,434	54,840	61,218	57,920	63,074	70,220	72,105	75,470
Global capital markets (in percent of GDP)	-	-	467.7	358.9	369.2	370.3	401.5	439.6	361.8	418.3	407.3	369.1	397.7	379.7
Banks														
Banks assets	-	-	-	47,834	57,315	-	74,435	95,768	104,712	103,755	107,774	113,735	121,946	126,744
Bank profitability (in percent)														
Return on assets														
UK[2]	0.9	0.6	0.7	0.5	0.7	0.8	0.5	0.4	−0.4	0.0	0.3	0.3	0.2	0.2
USA	1.2[2]	1.1[2]	1.4[2]	1.4[3]	1.3[3]	1.3[3]	1.3[3]	1.1[3]	0.3[3]	0.2[3]	0.9[3]	1.2[3]	1.4[3]	1.6[3]
Return on equity														
UK[2]	14.0	9.2	10.9	19.0	10.97	11.8	8.98	6.2	−10.3	−0.1	6.9	6.1	3.4	4.2
USA	14.0[2]	12.9[2]	15.0[2]	15.8[3]	13.2[3]	12.7[3]	12.3[3]	10.5[3]	3.3[3]	1.7[3]	6.9[3]	9.6[3]	11.6[3]	13.2[3]
Capital adequacy (in percent)														
Regulatory capital to risk-weighted assets														
UK[2]	11.8	12.2	12.5	12.4	12.7	12.8	12.9	12.6	12.9	13.3	15.94	15.7	17.1	19.6
USA	11.7[5]	12.4[5]	12.5[5]	12.7[5]	13.2[3]	13.0[3]	13.0[3]	12.8[3]	12.5[3]	13.9[3]	14.8[3]	14.7[3]	14.5[3]	14.4[3]
Bank capital to assets														
UK[2]	6.5	6.6	6.7	6.8	7.0	6.1	6.1	5.5	4.4	5.4	5.4	5.1	5.5	6.3
USA	8.2[5]	8.9[5]	9.0[5]	9.0[5]	10.3[3]	10.3[3]	10.5[3]	10.5[3]	10.5[3]	9.6[3]	12.7	12.2	12.0	11.8
World export[9]								6.0	2.4	−13.3	14.0	5.2	1.8	
UK export of Financial services	20	19	20	28	37	42	51	74	72	58	53	62	59	62
USA export of Financial services	22	21	24	27	36	39	47	61	63	64	72	78	76	83

Sources; IMF, Global Financial Stability Report 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015. Datas for the export of financial services; http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx.; Data for bank capital to assets ratio between 2010 and 2013; datawordbank.org April. [Last retrieved on 2015 Dec 19]. [1]Sum of the stock market capitalization, debt securities (bond and equities) and bank assets, [2]June, [3]September, [4]December, [5]March, [6]November, [7]Includes mortgage banks and building society, [8]Before tax, [9]UNCTAD, Trade and Development report, Annual percentage change. IMF: International Monetary Fund, GDP: Gross domestic product

capital inflows and outflows. In these countries, the banking system does not incorporate toxic assets and shadow banking transactions compared to countries where the financial sector is developed. Global regulations have to take into consideration such national discrepancies.

Here the essential point is that even though developing countries have an adequate accounting, monitoring and auditing system as well as a legal infrastructure, Basel standards do not constitute an appropriate capital standard as a prudential instrument against the volatility of capital flows for those countries. One of the most important inadequacies of these standards is that they misevaluate the risk characteristics of developing countries. Standards do create some incentives for the banks of those countries towards taking extreme risks. The fact that those countries do not have a competitive capital market is another factor that suppresses the benefit of a capital standard for banks. Therefore, it has been argued that deposit requirements might be beneficial in those countries (Rojas-Suarez, 2008. p. 252).

Similarly, Caprio (2013. p. 29) advocates that not making any change in Basel standards approach would bring more severe crises in the future. According to him, priority shall be given to increase the role of Asian and developing countries in the Basel Committee for making a change in the regulation approach. A new group (the Bali Committee) responsible for the macro-prudential regulations shall be formed with these countries. This group shall remove risk weighting and adapt simple, un-weighted capital and leverage ratios.

In this framework, it is possible to argue that designing together capital controls and prudential domestic regulations under the umbrella of global governance, by making distinctions according to the structural characteristics of countries might increase the efficiency of both policy instruments and decrease application costs.

4.4. The Necessity of a Broader Perspective

Although there is a general consensus in bringing back the regulation policy after the global crisis, in order to control speculations with micro and macro instruments, reforms have been terminated with moderate revisions and the finance sector continued to expand following the crisis (Ghosh, 2014).

As seen from the Table 2, the magnitude of global capital markets sustained to grow during 2000s after a moderate decline in global

crisis. The global capital markets grew faster than world gross domestic product (GDP), as a result of this, the ratio of GDP remained high levels, and reached at highest level in 2002 as 467.7 in percent of GDP. The global capital markets held assets that are worth almost 4 times more than world GDP (Table 2). The growth of global capital markets from 2002 to 2013 is also shown in Figure 1. The risks that rapid growth of capital markets and expansion of lending were further exacerbated by the nature of financial institutions lending and investment strategies.

The growth of FX and financial derivatives has changed widely of institutional peculiarities of world economy. For example, while the volume of the daily FX transaction was only 82 billions dollars in 1980, has reached to 5345 billion dollars in 2013. This extraordinary growth of the FX transaction is nearly nothing to the with the growth of the financing in trade. The ratio of the export in FX transaction which shows the part of FX transaction using financing of the exports is only 2.4 in 2001 and even drops more after and the level is only 1.7 in 2013 (Table 3).

The growth of over-the-counter derivatives in between 2001 and 2013 is nearly 7 times and almost unaffected by the crisis.

Figure 1: Global capital markets and world gross domestic product (billion dollars)

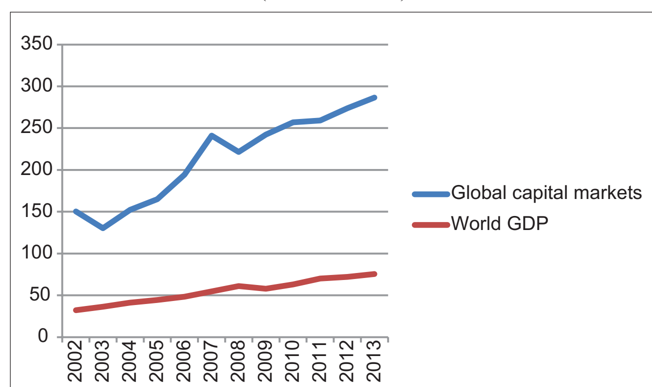

Table 3 shows a rapid rate of growth to a value of almost 693 trillion dollars in 2013. Related to this growth, according to Bryan and Rafferty (2011), there is a momentum in accumulation that exists beyond bubbles and lax regulation. They noted in Bryan and Rafferty (2011. p. 213-214).

In financial markets where institutions are looking for yield and to diversify asset portfolios, derivatives were especially attractive. With exchange rates and interest rates volatile, cash itself being necessarily denominated in a particular currency embodies significant risks. With interest rates on US Trasury bonds pushed to low levels, their rate of return was not compensating for the risk of a volatile dollar. Trading in derivatives and securities became the predictable response and investment in household income streams provided a new site for investment opportunities. The acquisition of derivatives as part of the strategy of diversification itself generated an innate search for yield.

The effect of the global crises on especially US and UK bank profitability is spectacular during the global crisis, but short-lived. Related to bank profitability, both return on assets and return on equity declined considerably in the UK and USA. Especially in the UK, the rates declined in between 2007 and 2008 from 0.4 to −0.4 and from 6.2 to −10.3 respectively. In the UK and the US, the ratio of return on equity has recovered rapidly since 2010. While the return on assets in the US has reached at pre-crisis level since 2011, the rates in the UK has not reached pre-crisis levet yet (Table 2).

The evidences on the impacts of regulation policies on banks shows that roughly half of the drop in cross-border claims of bank can be attributed to regulatory changes (IMF, 2015. p. 67). At the same time, banks in the US have strengthened of their capital ratios following the publication of the US stress tests in early 2009 as shown in the Table 2. On the other hand, global indicators on bank assets indicate a growing trend in UK and US since 2010.

Table 3: Main indicators on capital flows, global FX markets and derivatives (2000-2014) (billion dollars and in percent of GDP)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
FDI net inflows UK	122.1	53.8	25.5	27.6	57.3	252.6	203.6	209.5	253.4	14.5	66.7	27.0	46.7	35.0
FDI net inflows US	321.2	167.0	84.3	63.7	145.9	138.3	294.2	340.0	322.7	153.7	259.3	257.4	232.0	287.1
Portfolio equity net inflows/UK	191.7	22.5	2.3	32.6	3.5	12.4	−18.2	−20.1	71.7	72.8	−10.8	−13.9	−11.7	48.0
Portfolio equity net inflows/US	193.6	121.4	54.0	33.9	61.7	89.2	145.4	275.6	126.8	219.3	178.9	123.3	239.0	−67.4
OTC derivative[1]		99,755	127,564	169,678	220,058	281,493	369,906	516,407	683,725	604,622	582,655	647,547	639,396	692,908
FX turnover/daily	-	1239	-	-	1934	-	-	3324	-	-	3971	-	-	5345
FX turnover/annual[2]	-	307,500	-	-	483,500	-	-	831,000	-	-	992,750	-	-	1,336,250
World export[4]	7885	7614	7994	9323	11,310	12,870	14,849	17,307	19,747	15,783	18,713	22,178	22,446	23,114
World export/FX turnover	-	2.4	-	-	2.3	-	-	2.0	-	-	1.8	-	-	1.7
World export[3]		−1.0	5.0	6.0	11.0	5.0	8.0	6.0	2.4	−13.3	14.0	5.1	2.0	2.6
World output growth[3]	4.0	1.5	1.8	2.5	4.1	3.4	4.0	4.0	1.5	−2.1	4.1	2.8	2.2	2.4

Sources: UNCTAD, World Investment Report, 2001, 2006, 2010, 2014; for porfolio equity net inflows and FDI net inflows: worldbankdata.org; for FX and derivatives: BIS Triennial Survey 2013, April. [1]Global OTC derivatives markets consist of FX contracts, interest rate contracts, equity-linked contracts, commodity contracts, credit derivatives and other derivatives; data shows an amounts outstanding, the end of June, [2]Daily FX turnover multiply by 250, [3]UNCTAD, Trade and Development Report, Annual Percentage Change, [4]IMF, World Economic Outlook, Goods and Services. FX: Foreign exchange, IMF: International Monetary Fund, GDP: Gross domestic product, FDI: Foreign direct investment, OTC: Over-the-counter

Moreover, the cross-border financial services are the biggest source of foreign currency and profitability in developed central capitalist countries within the global governance structure. The export of financial services in both UK and US grows almost continual after slight decline in 2009 (Table 2).

This situation necessitates to explain the post-Fordism developments in the structural dynamics of economies and to understand the new accumulation strategies of the capital. The USA and England have been the countries where the established financial institutions have taken the highest advantage from cancelling the restrictions on capital inflows and outflows and transactions. The financial institutions of these countries have successfully colonized new international markets and they have sent profits to their own countries. The growth of derivative markets and especially securitization have turned money forms into commodities and rendered possible their sales. Thus, finance has become a new process of value creation (Christophers, 2013. p. 236). In those countries, an important part of the growth in the profits of the financial sector has been based on the demand arising from overseas countries (Christophers, 2013. p. 264).

According to Caprio (2013), in spite of the role played by international capital flows and macro policies during the crisis, regulators of the international financial system would not be able to take a significant result unless an improvement is made in those areas. The basic structure which guarantees the stability of the global system in the short-term might be ensured in the mid-term with an inclusivist regulation where the real and financial sectors take place together. At this stage, indirect suggestions such as the Tobin tax which restrains directly the cross-border mobility of finance or slows down the financial sector and creates some time and policy space for nation states, is an efficient instrument in global regulation. Such instruments are also crucial for distribution purposes (Balseven and ve Erdoğdu, 2005; Erdoğdu and Balseven, 2006).

In spite of the International Framework Settled on Bank, Basel III indirectly canalize to the systematic risk born by internationally active banks. There should be restraint on excessive bank competition and tightening of prudential regulation and also a curb on financial product which are deemed difficult to evaluate and monitor. Many developing countries less sophisticated financial systems escaped the contagion effects from the crisis in more elaborate financial systems of the west. Unlike USA, developing countries do not have shadow banking systems of any size nor did their bank hold complex toxic assets. This could be partly resistance of them from crisis and creates self-restraint (Chowdhury, 2015). This opens up policy agendas about strategies to identification and being held in limited size of financial products that prevent extending leveraged activities in developed countries through financial innovations.

Lastly, the most frequently mentioned issue in both literature and policy implementation is power relation in finance hard to find solution in the future (Balseven, 2010). The institutional foundations of becoming dominant of finance can be find in the policies implemented since 1980s in UK and USA. These policies have been reshaped of economies in the framework of post-Bretton Woods rules, as already suggested.

5. CONCLUSION

The 2007/2008 global crisis seems to be the most striking evidence of our century, exposing the unrealistic nature of the auto-regulative financial market model. The instability and crisis caused by non-regulated financial markets or financial markets that have not been sufficiently regulated have demonstrated that the financial regulation issue is not inherent to developing countries.

The financial reforms made in the financial sector following the global crisis have been shaped so as to strengthen financial standards with a comprehensive practice, without making any division in the international financial system.

On the other hand, what has been less discussed is whether the related standards are efficient or not. Especially, the new Basel standards, which are one of the most important novelties of regulation reforms, are being criticized for having rendered even more complex a structure that was already complex. Reforms that continued the approach based on Basel standards have made moderate changes and new additions in the institutional structure.

Basel standards shall involve a simpler and more efficient approach. Furthermore, in order to be efficient, the regulation policy shall comprise all the instruments and markets and shall regulate the national and global infrastructures together. Another topic which was less prominent in discussions concerning financial regulation theories and practices following the crisis is capital flows and macro-economic policies. The problem is not just a regulation issue. No matter how well financial regulations are designed, an efficient implementation is only possible when consistent macro-economic policies accompany it.

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