

# Thought Leaders— The Financial Crisis

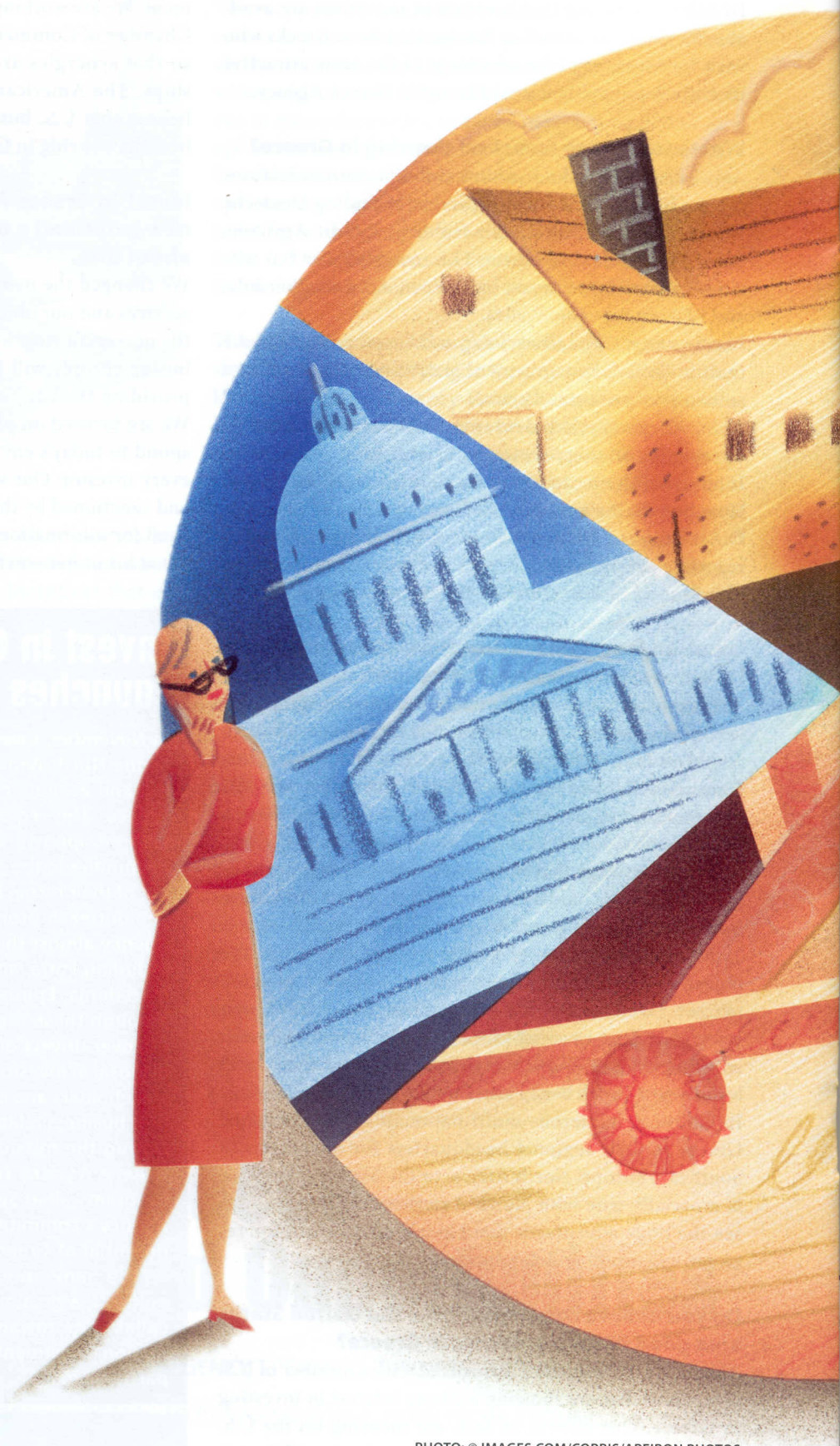
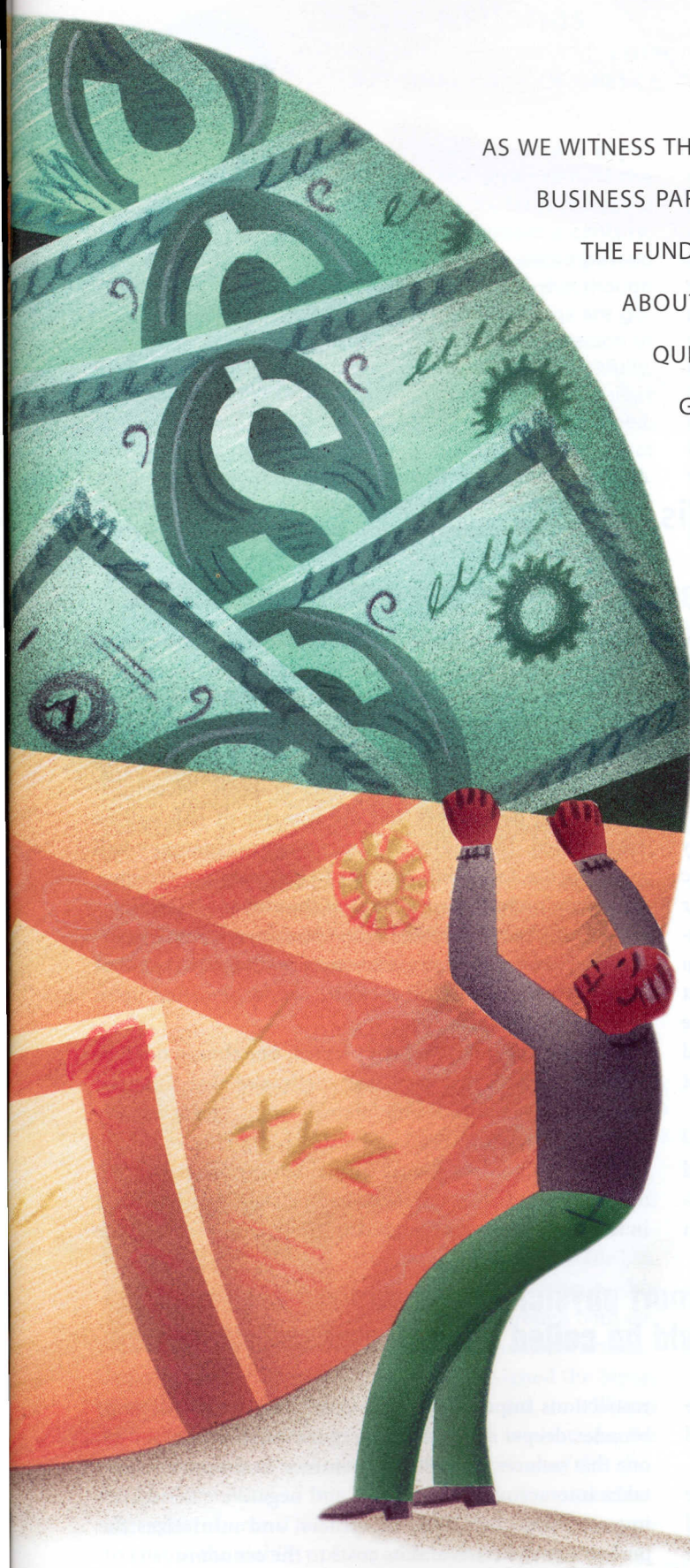


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An illustration on the left side of the page depicts a man in a purple shirt and green pants, reaching upwards with both hands towards a large, circular, green-tinted graphic. This graphic is filled with various financial and economic symbols, including dollar signs, gears, and abstract patterns. The background of the entire page is a light, textured green.

AS WE WITNESS THE MOST SEVERE FINANCIAL CRISIS OF OUR TIME, BUSINESS PARTNERS ASKS THOUGHT LEADERS IN GREECE IF THE FUNDAMENTAL BELIEFS AND ASSUMPTIONS WE HOLD ABOUT HOW OUR ECONOMY OPERATES SHOULD BE QUESTIONED. READ THE ANSWERS OF ECONOMISTS GIKAS HARDOUVELIS AND PAUL MYLONAS, AMBASSADOR DANIEL SPECKHARD, BUSINESS LEADERS DIONYSIOS SP. FILIOTIS, GEORGE CONSTANTELIS, LAVRENTIS LAVRENTIADIS, AND THINK TANK DIRECTOR DR. THANOS DOKOS FOR INSIGHTS INTO TODAY'S CHALLENGING ENVIRONMENT.

**“ In the midst of the current global financial turmoil, some commentators are saying the fundamentals of the market economy system should be altered—more regulation, more controls, more government intervention. How do you respond to such suggestions? ”**





## Gikas Hardouvelis

CHIEF ECONOMIST  
EUROBANK

A globalized economy requires a new architecture of global rules and coordinated supervision. Gordon Brown's current lead at coordinating the European governments on tackling the unraveling crisis foreshadows the urgent need for preventive supervisory coordination well after the crisis is over. Regulatory broadening and deepening on a global scale will become the new reality in the years to come. I also foresee a higher tolerance for a more activist short-run discretionary fiscal policy, but in a way that does not sacrifice long-run macroeconomic stability. A new era of active government intervention in the private sector is unlikely to occur. The Stability and Growth Pact in Europe, for example, would probably become more flexible but in a way that does not negate its long-run disciplining role on politicians. Regulatory broadening is essential in order to avoid regulatory arbitrage and the potential of instability generated by financial players that operate on the fringes of regulation and undo the regulatory restrictions on mainstream

banks, so that they avoid the stricter capital requirements that emanate from lending to low quality borrowers. Regulatory deepening will steal the attention in the intermediate run as regulators are likely to first tackle the obvious gaps in the existing regulation. Event risk will be reassessed with stricter capital standards. Securitization, credit derivatives and the transfer of risk will be reexamined. Illiquidity of assets and transparency will come to the forefront. Issues of corporate governance, which are included in Pillar II of the current Basel regulation, will be emphasized more. Mature economists, instead of only smart physicists and mathematicians that develop fancy statistical models, would be called upon to assess overall risk.

Yet, amidst the new regulatory fervor, one should not lose sight of the fact that capital is costly and that financial crises of the magnitude and intensity we presently observe only happen in advanced and stable economies once in a life time. Regulators should not underestimate the ability of the private sector to always be one step ahead of them in finding ways around regulatory restrictions when those

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players. Recall, for example, that the crisis began in the over-leveraged U.S. shadow banking system, which lacked the appropriate supervision, before it spread to the banking system across the Atlantic. Recall also that AIG, the rescued insurance company with AAA rating, had sold \$300 billion worth of insurance contracts to European

restrictions impose too much cost. The right balance of broader, deeper and less costly regulation should be found, one that reduces conflicting incentives, is not pro-cyclical, takes into account the positive and negative externalities imposed from one FI to the others, and minimizes the probability of a crisis and its costs to the economy.