According to Denis Kessler, while the liberalisation and globalisation of economies over the last twenty-five years has accentuated cycles, the current crisis is predominantly due to inappropriate budgetary and monetary policies. For SCOR’s Chairman and CEO, structural imbalances have not yet been resolved and may ultimately heighten populism and protectionism.

Over the last twenty-five years, finance has undergone unprecedented development, but also several crises, one of which was of major proportions. What is your overall judgment of this period?

First of all, we should remember that the financial cycle is what could be called a “natural” cycle, taking place in all periods of history. We always tend to consider a cycle to be abnormal or dissenting, the ‘norm’ being stability or consistency. Financial stability has never existed! Market economies are intrinsically cyclical.

We have been experiencing a financial cycle, along with all its associated fluctuations, since the early 1980s. And we can confirm that, regardless of the new regulations that enter into force, there will be new cycles in the future. This is particularly because cycles are in part self-supporting, alternating periods of massive credit and debt expansion and periods of debt reduction, with more or less brutal corrections.

Have these cycles gained momentum in recent years?

The major structural change of recent decades is globalisation. There are many more countries with market economies, leading to more interactions, and therefore more fluctuations. This has been the case in banking, a sector in which business previously had a mainly national dimension and has now taken on a global scope. This is particularly the case for corporate and investment banking. Globalisation has led to an increased number of players and extended markets that interact and fuel fluctuations. Combined with the liberalisation of economies, this interaction accentuates the cycle. The current financial crisis is definitely the first global crisis in history. Yet, ultimately, the financial market remains the best means to allocate resources between those in need of capital and those offering it. The fluctuations it causes are the price to pay to reach this optimum allocation process. One lesson that we can learn from the last twenty-five years is that regulation, and prudential regulation in particular, does not impede cycles. Restrictive laws and rules are always put into place in the heat of a crisis. Sooner or later, however, they end up being revised when we realise that they have pernicious economic effects. Regulation almost always comes in one crisis too late. It may have helped to curb the current crisis, but it will not prevent a future crisis which will have its own causes and consequences.
How is this latest crisis specific?

It is the first global crisis due to the increasing level of interaction between economic players. Before 2008, very few people were in favour of creating global supervisory institutions to handle, identify and regulate global crises. For example, the G20 was only created in November 2008, following the collapse of Lehman Brothers; the IMF did not bring in reforms until after the crisis began and common European banking supervision is only being set for this year – fourteen years after the Euro changeover. In the face of this global financial crisis, coordination between national supervisors and regulators has been both slow in coming and somewhat chaotic. Metaphorically speaking, the fire-fighters were not completely prepared for the global fire. No action plan was ready to tackle a crisis of this scale, which seems ludicrous in retrospect. As a result, the responsibility was squarely put on the shoulders of the markets for political reasons, while the delay in setting up supranational regulatory institutions to ensure improved supervision was entirely the fault of regulators and public authorities. I must insist, however, that this may have mitigated the financial crisis but would not have prevented it.

Do you believe that the ‘financialisation’ of the economy has gone too far?

Finance is not a goal in itself. Above all, it is used to allocate resources to economic players’ various investment needs by selecting projects and quantifying their risks. It has played its part in financing the economy, while monetary policy supported an excessive expansion of credit, benefiting economic operators whose solvency proved to be questionable. It even financed the increasing deficits of governments who were quick to use the markets before pointing the finger at them when they saw their solvency eroded and their spreads increased. It would be a mistake to think that the current cycle is mainly due to the development of financial markets. The instability and current difficulties are above all a result of extremely inappropriate monetary and budgetary policies. The debt bubbles that have occurred in recent years were initially caused by monetary policy, in particular that rolled out by the American Federal Reserve under the leadership of Alan Greenspan, leading to a massive surge in debt among American economic players. Southern European countries used and abused the low interest rates that enabled the creation of the Euro. Since 2008, we have been witnessing a new monetary bubble instigated by major Western central banks registering profits on average three times higher than before! This is then translated into a financial bubble as the available liquidity is then invested in the form of financial securities, as we can see with the current boom of equity markets, rather than spending or savings. Once again, we are in the process of creating the next cycle by attempting to reduce the current one.

Second in line for their share of responsibility are governments. The current problems in Greece, Spain, Italy and France can be explained by the extent of their deficit and debt. For example, France has had a government deficit since 1975! We cannot blame the markets for having encouraged a government debt bubble when this is due to poor management by nations. It is also a paradox to criticise markets while we absolutely need them to finance our Social Security bodies or local authorities.

We recover from crises. The real estate crisis of the early 1990s resulted in record losses for a number of French financial institutions, developers went into receivership and the real estate market was thought to have died a death. In fact it re-established itself and recovered. During the crisis in Asia, no-one believed that the affected countries would ever see a return to long-term development.
Yet they have never been better than they are today! There are therefore market-based regulation mechanisms that correct their own excesses by influencing prices and quantities. That said, we must also ensure that the vulnerable are protected from the consequences of these fluctuations. Deposit guarantee funds are necessary, for example, to protect depositors and to stop these fluctuations from having devastating social effects, by mitigating the systemic risk inherent to the banking system.

**In which fields has finance brought about progress?**

The initial aim of all financial innovations is to come up with solutions to increasingly complex applications for financing, and to provide coverage against increasingly stochastic risks. They also stem from the shortcomings of financial regulation. In insurance, for example, the CAT bonds created around fifteen years ago were a major innovation. These securities, which have high returns but for which the principal is not redeemable if a major disaster actually occurs, have significantly increased the capacity to absorb major loss events such as hurricanes and earthquakes. A country like Japan now enjoys much more protection thanks to this type of innovative financing. Hybrid debts, another innovation, are comparable to quasi-equity instruments as they combine elements of conventional debt and equity. They have notably enabled banks and insurance companies to strengthen their solvency margins without diluting their shareholder base. There are many other examples of innovations that have been made possible through the development of all sorts of equity options markets.

**Out of all the major economic changes of the last twenty-five years, which do you think have had the most impact?**

China joining the World Trade Organization (WTO) at the end of 2001 was a historic event. Its membership should have been conditioned by the convertibility of the Yuan. Yet this was part of the IMF’s remit, which chose not to speak out when the WTO was negotiating the free flow of trade. Many of the world’s current imbalances are due to this failure. Once again, the responsibility lies with politicians who should have imposed the gradual lifting of currency exchange and capital movement restrictions. I believe that free trade in goods depends on the freedom of currency exchanges. A global imbalance was created, with trade surpluses on one side and deficits on the other. There is no adjustment, simply because the market is not playing. Chinese trade surpluses lead to a current account surplus, expressed by an accumulation of Dollars, invested in the form of United States Treasury securities, thus allowing the USA to continue with its extremely lax budgetary policy. If China stopped purchasing these securities, we would be at risk of a major bond crash of global proportions. Regulatory errors and monetary or budgetary policies often lead to repercussions that are much more serious than those caused by market operators...

**When the Euro was created, many feared that it would not survive in the event of insufficient European growth. In the end, the Euro went on to become a base currency while European economies are struggling...**

In 1992, when the Maastricht Treaty was signed, I supported the single currency, while stating, like others, that it required a convergence of economic and fiscal policies. This condition has been forgotten! Politicians always act too late and then blame finance and the economy, both very convenient scapegoats. The European crisis can be explained above all by the lack of economic
convergence within the Eurozone, and its premature and poorly-managed enlargement. Countries like Greece should never have joined the Eurozone. They enjoyed extremely low interest rates and budgetary subsidies without implementing the necessary economic adjustments. It would have been better for all to strengthen the European Union before extending it.

What are the main challenges for the years to come?

When crises are long-term, the “Three P” phenomenon can be observed: populism, protectionism and (poor) patriotism. If the crisis goes on for too long because of a lack of order in government finance, we could be subject to a new global split, like the one that followed the 1929 crisis, with States tempted to withdraw into themselves rather than trying to reach cooperative international solutions. History teaches us that there is a rise in populism towards the end of a crisis, pretty much throughout the world. History also shows us that nothing is irreversible. This major movement towards economic openness of the last quarter of a century could be reversed. There are many examples: the United Kingdom may leave the European Union. The Euro is believed to be irreversible but strong tensions are reappearing, putting it in danger once again. On a global scale, trade wars and currency wars are felt more keenly. And the words “national” and “sovereign” are once again being bandied about in political speeches, striking an increasing chord among citizens. No-one can rule out the possibility that the crisis could lead to exacerbated social tensions in some countries.

So the current easing of pressure on markets may be short-lived?

Contrary to what can be heard right now, few of the major structural problems have been resolved. There are still imbalances, in Europe and across the globe, as shown by the recession that has hit many countries and the continued “fiscal cliff” debates in the USA. If the crisis continues, the solutions will no longer come from the economy or finance, but from politicians’ ability to manage populations who face massive unemployment and a drop in standards of living, and who do not always identify the real causes of the recession. These are worrying times, as major upheavals very often take place during such phases of a crisis, rather than at the onset. The problem is initially financial, then monetary, then economic, before becoming ultimately social and political. This is the classic chain of events. In Greece, for example, events have taken a more political turn from what was originally economic: the country’s politicians and institutions will have to show their ability to get Greece out of this rut.

Out of all the current imbalances, you very often mention the lack of actions to curb government spending in France...

The tensions and problems are also a result of the unequal distribution of the cost of the crisis. In France, the public sector has been spared by the crisis up to now. Salaries and pension plans have not been modified; employment figures have even continued to rise. The brunt of the crisis is borne mainly by investors, savers, private-sector companies and their employees, or former employees. Investors and savers thus bear a large share of the cost of the crisis. Their assets have lost value due to the extremely low interest rates decided by the central banks. We are currently in a situation of financial repression resulting in a massive reallocation of wealth, which is particularly detrimental to savers and primarily favours States, and consequently the banking system.
Is this the price to pay for economic recovery?

If it is, we should be pleased about it. Yet it could also lead to a new financial bubble, or deteriorate into a bond crash. It is too early to know, even though the low-rate monetary policy cannot last forever and an increase in rates is always difficult to date and control.

How do you feel the French economy is faring in general?

The main issues are well known: the State, public finance, taxation and social welfare systems are in need of far-reaching reforms. This major task is always announced, and is always put off. We must not forget capital formation incentives. One of the major problems in France is the decreasing amount of capital. All capital sources have dried up. There are not enough financial investors, prudential regulations such as Basel 3 and Solvency 2 are deterring institutional investors from investing in equities. Family capitalism has been severely penalised by thirty years of wealth and inheritance tax. The State no longer has the means to invest in the public sector. We have not created a pension fund. We now discourage the allocation of free shares and stock options, and even profit-sharing and participation, which will reduce the number of employee shareholders. We’ve got it all wrong! As a result, the only source of capital that seems to be booming in France is foreign financial investment. Not to create new production capacity, but to invest in successful French companies. We must raise awareness of this lack of national capital. We cannot sustainably establish a country’s economic development without capital. This is why the debt crisis could be severe in France, as we have little equity to mitigate it. The USA, on the contrary, should overcome the crisis earlier and come out stronger for it, because its financial structures fuel its companies’ equity.

How can companies continue to develop against this backdrop?

In the last twenty-five years, we have seen a gradual disconnection between French production sites and French companies. This is illustrated perfectly by the debates on the location of major groups’ business activities. These groups have gone global, calling CAC 40 or even SBF 120 companies “French” does not really mean much anymore. Production sites, shareholders and customers are now largely foreign. German companies are certainly highly international, but they have kept more production sites open in Germany and export from there. Thanks to this, Germany has a very positive trade balance, unlike France. Our competitiveness has suffered terribly due to the erroneous economic folly of reducing the working week, and the excessive burdens of administrative structures and taxation and other levies. It takes too much energy to reform our structures, particularly in the public sector. Many business leaders look abroad, and the SMEs who cannot relocate must often look for a buyer. This gradual downward trend is particularly difficult to reverse as there are no political safety nets, due to the massive influence on decisions enjoyed by those who have a strong aversion to risk-taking and who prefer government control and failure to act. Weighed down by taxes, contributions and regulations, I fear that civil society is unfortunately starting to lose hope.

Interview by Valérie Nau

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Quotations in the article:
Page 2: “If the crisis goes on for too long because of a lack of order in government finance, States could be tempted to withdraw into themselves rather than trying to reach cooperative solutions.”

Page 3: “History shows us that nothing is irreversible. This major movement towards economic openness of the last quarter of a century could be reversed.”

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