Fix the regulatory flaws in our fragile financial system, or risk another crisis

OVER the past 800 years governments have consistently had a role in financial crises – either causing them (for example, by defaulting on their debts), or by failing to control excessive borrowing and risk-taking in the private sector.

The US Financial Crisis Inquiry Commission found that the main causes of the 2008 crisis were avoidable failures of corporate governance and policy. Yet the system remains fragile, inefficient, and dangerous. Despite reforms put in place after crises, bankers, politicians, and regulators consistently overstate the system's health and the effectiveness of new rules.

Doing more to prevent crises requires the political will to address the underlying flaws in the system. But governments' relationships with their country's financial sector can often be too close to enable substantial reform. Financial institutions themselves, meanwhile, have little incentive to change.

As it stands, poorly-designed regulation continues to allow the largest institutions to borrow on privileged terms and remain opaque, while fears of another "Lehman moment" mean that, in the event of a crisis, policymakers are likely to ensure that ordinary depositors are paid in full to prevent system collapse.

This situation normalises recklessness. As we have seen in the past, by the time problems are visible, they can easily escalate. Individuals lack the right expertise and are unable to bring about meaningful change even if they know or sense that something is wrong.

The dysfunction of governance and policy is among the reasons that ordinary people are currently turning away from capitalism as a system. This situation fuels polarisation that can enable populist demagogues to manipulate public anger away from these issues.

Economic analyses do not always help if, as is often the case, they are obscure or seem to justify the sys-

tem. Focusing on how to respond to sudden "shocks" obscures the possibility of reducing the likelihood of crises without sacrificing the system's benefits.

The financial sector illustrates prevalent corporate governance problems elsewhere. Carillion, for example, used accounting tricks and other tactics to hide its weakness, digging itself into a hole that caused more collateral harm when it finally collapsed.

Meanwhile tech companies' abuse or carelessness with personal data has caused identity theft and helped spread propaganda and fake news.

If the global financial crisis wasn't enough to drive effective reforms, what will work to ensure that corporations serve society without causing unnecessary harm? Will the backlash against Facebook, for example, force long-term change to Big Tech, or better data security? The next financial crisis may well start from a massive cyber attack.

Fortunately, we need not abandon capitalism to make it work better. The obstacles to change, while challenging, are man-made. We must question dubious assumptions and demand that policymakers create and enforce proper rules.

The increasing influence of activist investors and customers over large corporations, along with grassroots campaigns enabled by social media, offer some hope. Change will require public awareness and collective empowerment to take control away from narrow interests and hold those in power accountable.

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