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CHAPTER 5

**FINANCIAL STABILITY  
AS A GLOBAL PUBLIC GOOD AND  
RELEVANT SYSTEMIC REGULATION  
AS A PROBLEM OF COLLECTIVE ACTION**

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## Financial stability as a global public good and relevant systemic regulation as a problem of collective action / Chapter 5

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### Abstract

Liberalisation-privatisation policies and public-private partnership developments in numerous economies in the last four decades gave rise to a reorganisation of public services through market mechanisms which mainly rested on market prices' movements. Most of rules and actions in markets were shaped and assessed according to economic efficiency criteria that relied on the assumption that free-market mechanisms could achieve a socially optimal situation. This process systematically moved capitalist economies from the post-World-War-II period's state-interventionism-based production/distribution schemes (the so-called Fordist era) to market-friendly and less conservative economic policies. Therefore, the social provisioning process (the production, the financing, the use and the assessment) was reformed under market efficiency criteria. In the wake of the 2007-2008 global crisis, this chapter seeks to assess the consistency of such an evolution through an institutionalist analysis on a peculiar area of the economics, the finance and financial relationships. The path of economic development is closely determined by financial markets' evolution. This makes that public action as well as private strategies are all relying on a given financial framework and on its sustainability as well. This latter is very dependent on the stability of market operations. This chapter then suggests an alternative approach to financial economics by adopting a public service and collective action view of the working of financial markets in a globalised environment. In this aim, it argues that financial stability is a peculiar (global) public good that every member of society needs, but no one can provide at individual level. Financial stability then requires a specific public service organisation that must design and manage the production and maintenance of financial activities (going from the bank credit to enterprises and households to financial intermediation activities, including pure speculative operations) through collective action in order to ensure a socially coherent working of financial markets.

**Keywords:** collective action; financial crisis; financial stability; public goods; regulation policy

**JEL-Codes:** G01, G18, H41

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## Introduction

In the last decades, generalised liberalisation-privatisation policies and public-private partnership developments in most market-based economies gave rise to a reorganisation of numerous public services through market-related mechanisms and devices. Those mechanisms mainly rest on market prices' up and down movements to balance private and decentralised decisions-related supply and demand. Most private and public aims, rules and actions are shaped and assessed according to economic efficiency criteria<sup>1</sup> that rely on the assumption that free-market mechanisms could achieve a socially optimal situation. This process systematically moved capitalist economies from the post-World-War-II period's state-interventionism-based production/distribution schemes (the so-called Fordist era) to market-friendly and less restrictive economic policies. Therefore, the social provisioning process (the production, the financing, the use and the assessment of socially required activities/products) is reshaped under market efficiency criteria. The evolution of the production and conservation operations of common resources also followed a similar direction. After several decades of implementation and numerous resulting crises, this ideological movement and subsequent policies pose today a challenge to the economics of public services and social/collective action.

Since the 1980s the implementation of market-friendly policies in major capitalist economies removed restrictive public regulation from the financial markets operations' perimeter and led to generalised financial liberalisation. Financial regulation was therefore mainly regarded as a market process to be developed and implemented through private actors' strategies, the very role of public authorities being limited to the legal incentives that would impose transparency and disclosure on market institutions (such as banks and financial intermediaries). Those incentives are rules and regulations that should aim at ensuring reliable disclosure of financial information and creating standards financial actors must comply with. Market-dependent self-regulation then became the dominant regulatory schema through the Internal Ratings Based (IRB) approach and rating agencies assessment process. The supervision of the soundness of financial positions was then assumed to be guaranteed under the responsibility of the private profit-seeking position-makers themselves. The privatisation of financial supervision can therefore be regarded as a very crucial transformation of modern capitalism in the last four decades. However, the consistency of such a transformation with the characteristics of capitalism has to be called into question in the wake of the systemic global catastrophe of 2007-2008.

This chapter seeks to contribute to this issue by developing an institutionalist analysis on a peculiar area of the economics related to finance and financial relationships. This area is usually not studied as a public and social economy-related issue but rather as a

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<sup>1</sup> From the perspective of methodological individualism this roughly means "getting more gain with less cost". This is assumed to result in a socially optimal situation without restrictive public and collective action in markets.

pure market-relations-originated mechanism. So as this chapter maintains, finance can be seen as a core constituent of a capitalist society which is a monetary economy in essence. It then operates on monetary dynamics and continuously generates financial relationships among actors. Therefore, economic organisation of society is closely related to the organisation of monetary and financial markets and the path of economic development is closely determined by financial markets' evolution. This makes that public action as well as private strategies are all relying on a given financial framework but also on its sustainability. This latter is very dependent on market operations stability.

This chapter then suggests an alternative approach to financial economics by adopting a public service and collective action view of the working of financial markets in a globalised environment. It considers finance as a public utility and financial stability as a specific public good, and assesses the possibility and capacity of public structures to shape and supervise financial regulation in a way that would lead to a more stable and viable society. Therefore, in order to grasp the very nature of financial regulation, some minimal characteristics of public goods are identified at the international level as global public goods. This identification leads to regard financial stability (and global financial stability as well) as a (global) public good and relevant financial regulation as a collective action problem. Financial stability then requires a specific public service organisation that must design and manage the production and maintenance of financial activities through collective action in order to ensure a socially coherent working of markets.

The first part of the analysis maintains that financialised capitalism and self-regulation-based financial markets do not fit for economic viability and societal development since deregulated finance fuels speculative activities at the expense of productive ones and results in degenerated market mechanisms. The second part draws upon the core characteristics of a monetary capitalist economy to suggest that financial stability must be treated as a public good which should be managed and supervised by non-market-dependent public regulation and supervision to keep markets within the limits of common welfare objectives. The third part points to some alternative regulatory principles – seen as a collective action problem – that could make financial markets' work in a consistent way with regard to systemic stability. The last part concludes.

## **1. Liberalised finance and self-regulation as sources of instability**

Structural changes in financial markets started in the late 1970s and contributed to the modification of the traditional banking and financial activities. Change came from both the liability side (for instance, money market mutual funds), and the asset side (public capital markets) of bank balance sheets. The financial engineering on securitisation and associated derivative instruments were generalised and structurally changed the financial sector. Regulators were behind this change since they initiated the process through specific institutional choices - the roots of the new

liberal era - that shaped economic policies for decades. Indeed, liberalisation was promoted by regulators all around the world and especially in advanced economies. From 1987, the US Federal Reserve allowed banks to intervene in securities market including derivatives and asset-backed securities. Some years later, the Gramm-Leach-Bliley Act in November 1999 repealed the Glass-Steagall Act of 1934 that had separated commercial banks and investment banks and prevented operations on securities in the aftermath of the Great Collapse of 1929. The Commodity Futures Modernisation Act of 2000 partially put derivatives out of the supervision mechanisms since it was asserted that without regulatory interference, market actors could design effective diversification against risks and reduce the cost of financing of economic activities (Quinn, 2009). Similar institutional and legal changes started to be implemented in major advanced and emerging economies from the mid-1980s, confirming the worldwide liberalisation/deregulation of financial markets. It was argued that regulatory constraints-free markets would be more innovative and able to conceive relevant self-adjustment processes and means against market risks.<sup>2</sup> The argument behind was that widened activities would allow banks to diversify and then to reduce their risks (Barth *et al.*, 2000). Enlarged market strategies of rational agents were considered as the most effective means of allocation of resources in the economy. Obviously, banks' innovations changed economic conditions and developed various forms of product and process innovations. This led banks, financial intermediaries and their clients to undertake micro-efficiency and individual-profitability based strategies without restrictive public constraint and systemic-coherence control. Most of monetary and financial innovations increased the elasticity of finance affecting the functioning of the economic engine. This process has been generalised thanks to the opening up and liberalisation of financial markets led under market-friendly regulatory reforms. In such an environment, expected to generate enlarged innovations and then to improve the conditions of financing of the real economy, banks and financial institutions but also real sector corporations were engaged into high-return promising speculative strategies. Investment and management aims, means and practices were changed in favour of short-term huge speculative gains and resulted in a black hole between real economic activities and financial markets. Most economic decisions were directed towards speculative short-sighted strategies under the incentives of free and innovative financial markets without necessarily being connected to the long-term expectations about the evolution of the productive system.

Financial markets and innovations allowed agents to speculate easily on expected further speculative rents through the use of several financial products.<sup>3</sup> Mainly relying

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<sup>2</sup> After all, as it was stated –and formally proved- by Arrow and Debreu (1954) and by Arrow and Hahn (1971), in a perfectly competitive Walrasian world, market prices are sufficient to achieve a socially (Pareto) optimal solution through individuals' demand and supply.

<sup>3</sup> Adrian and Shin (2010: 2-3) document that before the liberalisation period of the 1980s the traditional banking was dominant as banks and savings institutions were the major holders of home mortgages. But with the emergence of securitisation, banks entered in an innovation process creating or working with some institutions to which they sold their mortgage assets which were financed by issuing mortgage-backed

on speculative financial returns, financial markets fed a consumer-debt supported financial growth more than productive, income-based/demand-supported real economic growth. Crotty (2009) points to new financial products and processes - such as the CDOs - as the practical operating devices of such a growth. Those latter offered high returns and also carried top ratings that permitted buyers to have access to credit cheaply. This gave rise to what is now usually called the financialisation of the economy which can be defined as the transformation of the traditional long-term financing and technical advice activity of banks and financial intermediaries -that were aiming at supporting productive entrepreneurial engagements-, into (usually) very short-sighted (speculative) portfolio operations. The entire economy passed from long-term bank/financial engagements-based system to a short-term rapid profitability-seeking market-based system. Hence, financialisation sustained a new speculative regime: a speculative rent economy without real growth since the financial efficiency criteria (the realisation of rapid and high returns on investment that was totally decoupled from long-term productive perspectives) overcame other objectives such as sustainable long-term growth, employment and better distribution of revenues to strengthen demand on markets. Such a transformation resulted in a “financier dominated finance” that generated several flaws such as recurrent systemic instabilities, short-sighted market strategies at the expense of long-term productive activities and increasing inequalities that undermined the achievement of social goals in the real economy (Epstein *et al.*, 2009).

Financialised economy rests on the adjustment mechanisms of micro-rationality models. Systemic stability is assumed to be satisfied by decentralised procedures of self-regulation which should be established on market incentives, supported by market-friendly legal institutions. Opposed to the prudential regulation, this model pleads for self-control of the soundness of banks’ market activities and assumes that private agents have the capacity and rationale for managing and checking by themselves the appropriateness of the riskiness of their market engagements.<sup>4</sup> It also assumes that self-regulation can make compatible market efficiency and systemic stability since the market mechanisms could offer better financial soundness control compared with other alternative public mechanisms of regulation and then be able to achieve financial stability. The only condition for this framework is the establishment of an appropriate legal frame that should set up “good institutions” so that the mechanisms of spontaneous regulation do work perfectly and insure the resilience of economies against exogenous shocks: “This institutional structure is a schema of incentives that rely on rules of transparent management that must improve the disclosure of information about the characteristics of products and involved establishments. In this way, the various parties would be incited to bigger responsibility to prevent market sanctions. In search of a reputation, private actors,

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securities (MBSs) by those intermediaries. In 2007, those market-based assets (more than 16 trillion dollars) became larger than the total assets on banks’ balance sheets (less than 17 trillion at that time).

<sup>4</sup> It is indeed assumed that free markets (and then market prices) would allow self-regulation mechanisms to produce necessary and sufficient information and effectively direct behaviour of decentralised actors towards equilibrium decisions.

who also become “controllers” of and for the market, would produce reliable information for investors, reducing the need for a (extra-market) public regulation” (Ülgen, 2015a: 376).<sup>5</sup>

The self-regulation model has also developed on the principles-based regulatory framework, for instance, in the UK financial system where the Financial Services Authority (FSA) established its supervision in order to give firms increased flexibility to decide more often for themselves what business processes and controls they should operate. This consisted of letting market actors undertake their activities without suffering from restrictive rules and bans arguing that such a regulatory model would enhance market’s innovative dynamics: “Continuous innovation and new product development are important ways in which the financial services industry generates benefits for consumers and markets. It is important that regulation can respond rapidly to the pace of change in markets and so allow them to continue to develop for the benefit of their users. We believe regulation that focuses on outcomes rather than prescription is more likely to support this development and innovation. Any set of prescriptive rules is unable to address changing market circumstances and practices at all times, and it inevitably delays, and in some instances prevents, innovation.” (FSA, 2007: 6)

Elaborated on a very confused efficiency criterion resting on the quick and high return of funds invested in financial markets, financialised accumulation regime - very short-termist and highly sensitive to market reversals - revealed to be highly unsustainable. Although liberalised financial markets and related innovations could give some positive results for some institutions and individuals such as better *individual* risk coverage, further portfolio diversification possibilities, new ways and means to engage in high-profit seeking financial positions, etc., they do not result in a stable and sustainable macroeconomic situation. In line with this assertion, Ülgen (2017a: 227) states that “one could assert that financial markets were really efficient during the financialisation process-led boom of the 2000s in their capacity to ‘enrich’ financiers and speculators without any concern regarding economic development (but only till 2007). This criterion has prevailed ever since over every economic and social decision and has determined the conditions of financing private as well as public spending. But such efficiency seems also to pervert productive economic structures by preventing agents from long-term engagements and inciting them to look for speculative opportunities. Relevant at individuals’ micro level, free market incentives turn out to be harmful, if not catastrophic, at macro-systemic level.”

Self-regulation-based financial systems display some crucial paradoxes that prevent them from achieving a stable economic growth process. In a market-dependent regulatory framework, market activities of self-interested actors are evaluated by the actors themselves. Rating agencies, for instance, play two conflictual roles since they

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<sup>5</sup> Even if sometimes public interventions might be needed, they should remain emergency-last-resort measures. Such an assertion lies in the belief that financial crises are stochastic phenomena, some unpredictable accidents, and do not require regular public oversight.

must check the soundness of market activities of banks whereas they also advise banks in the conception and marketing of new products whose riskiness should be assessed by the same agencies! Consequently, banks and financial intermediaries are both clients and partners of the assessors, the rating agencies. The regulatory role of rating agencies is then melted down “into their economic interests as advisors and also as rent-seeking partners of banks. Self-regulation then makes regulators and regulated agents match in an utter confusion and puts the regulatory system out of the domain of systemic stability” Ülgen (2017a: 232). Such a liberal model of regulation removes the necessary separation between the assessor and the assessed assuming that stability can be self-assessed and self-maintained. This means that stability does not matter since markets are always seen as self-adjusting magic. In such an environment, strategies of banks and rating agencies lie in pro-cyclical behaviour encouraging financial growth during boom periods and sharply stopping it when distress is felt in the way well documented by Minsky (1986).

The regulatory game between public authorities and market actors seems to be a perpetual cycle of opportunistic bargaining balancing between euphoric growth periods and systemic catastrophes: “At work it is what academics call a “two-period game.” In period one, large financial institutions demand deregulation. Then, in period two, they demand government bailouts, saying that otherwise the real economy will be taken down along with the financial institutions on which the economy depends. That is called mitigation of loss, and it means in period one that people take too much risk, if they think they have the political power in period two to induce society to mitigate their losses. This too-big-to-fail structure means, in the absence of systemic change, we are likely to have more crises like the recent one” (Corporation 20/20, 2009: 7).

So, the stabilisation of the economy requires a more relevant analysis of the characteristics of money/finance-based capitalist structures and calls for alternative approaches to financial regulation.

## **2. Monetary economy and financial stability as a specific public good**

Monetary and financial relations are at the core of market-based capitalist economies since every economic transaction involves the use of money and occasions various financial operations. A very specific feature a monetary economy lies in the financing process of decentralised private economic decisions that rests on debt-creation-circulation-repayment cycle. In this “endogenous money” environment (Wray, 2007), two major constraints frame the economic activities: financing constraint<sup>6</sup> and the repayment constraint.<sup>7</sup> This leads to the use of financial products/processes in markets to make actors able to undertake activities in a continuous way through the future positions notwithstanding their current asset/liability position). Those

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<sup>6</sup> That is, the need to finance economic actors’ plans, leading to credit/debt relations, mainly between banks and spending units (mainly, entrepreneurs).

<sup>7</sup> Following the first constraint, debts created to finance activities must be repaid.

constraints are society-wide and are mainly organised through profit-seeking markets. In this picture, money is the name of the payment system which is a set of rules and mechanisms that govern the creation, circulation and repayment conditions of private debts mainly generated through the financing of entrepreneurial expectations. Those debts flow through the entire economy and are used as money.<sup>8</sup> Consequently, money has some specific characteristics. First, it is ambivalent such that it is a private decisions-related, individual and decentralised action system. At the same time, it is accepted and used as the general means of payment and settlement within entire society and hence it must stand as a public system of account, payment and repayment. It must then rest on a non-market reference to keep its economy wide validity though created in a private way. That is why the payment system is hierarchised under the supervision of a public anchor for all market transactions -the central bank- that ultimately centralises bank accounts (then private debts to be repaid) as the social settlement process. Money is also transversal since everything and everyone are everywhere directly/indirectly involved in monetary (debt) relations without necessarily taking directly part in the monetary and financial operations through which the economy does usually evolve. Monetary and financial relations have then a peculiar nature since they concern the whole society and its viability conditions. Every member of a given economic society is a part of those relations even though she/he is not plainly involved in related economic relations. Directly or indirectly everyone uses money and contributes to financial operations and is under the burden of the systemic consequences of market operations (but also of the related policy decisions). Credit-Debt relations involve every one within society. Although related to private decisions and interests, money and subsequent financial relations have societal consequences. From this perspective, money and finance may be seen as public utilities the provision of which often requires specific policies and intervention of the public power that must play the role of referee and stand outside of the private and decentralised market relations in order to organise, supervise and regulate the production, the use and the evolution of the monetary/financial system.

Paradoxically, the liberalisation of financial markets increases the need for public oversight since it results in a system wide financialisation with continuous and permanent effects on the economy: “In a market-based financial system, banking and capital market developments are inseparable, and fluctuations in financial conditions have a far-reaching impact on the workings of the real economy” (Adrian & Shin, 2010: 5). Therefore, financial system’s stability appears to be a general concern that should be regarded at macro level. Could it then be held as a public good whose provision would call for extra-market public management?

The analyses and debates on the public goods are closely related to the theories developed on government interventions within the economy. It is assumed that when a good is public, it cannot be efficiently (in a sufficient quantity and quality to satisfy

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<sup>8</sup> That is, as general means of payment and settlement.

needs related to its availability at the society level) produced by private market mechanisms through decentralised maximum profit-seeking rational individual decisions. Even though one could assume that in a competitive market *à la Arrow-Debreu*, market incentives would suffice to let private economic agents produce (private) goods and services in an efficient way (at lower costs-prices and higher quantities, maximising consumers' satisfaction), Samuelson (1954: 388) maintained that "decentralised spontaneous solution" does not exist to provide public goods in a socially efficient way: "no decentralised price pricing system can serve to determine optimally these levels of collective consumption". However, there is no common agreement within the economics profession and some analyses argue that the publicness of a good is not a sufficient condition to maintain that this good must be produced by the public sector to ensure the efficiency of its production (Holcombe, 1997).

In his seminal article of 1954, Samuelson identifies public goods as collective consumption goods that all enjoy in common "in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good. (p. 387)." Samuelson (Ibid: 389) points to "the *jointness of demand* intrinsic to the very concept of collective goods" such that once produced for some consumers, the public good can be consumed by additional consumers at no additional cost. He then argues that no decentralised pricing system can serve to determine the optimum values of collective consumption.

Musgrave (1959) suggests another simple criterion, the exclusion, in order to identify publicness of a good, that is, whether or not someone can be excluded from benefiting once the good is produced. This could give, for Musgrave, a clear division of society into private and public goods. Beyond the exclusion, the general definition given by Musgrave (1959: 44) brings forth an essential issue: a public good is a good the *inherent quality of which requires public production*. From this perspective, the inherent quality (or features) of financial stability rests on its macro/systemic nature which cannot be provided solely through micro safety mechanisms. First, the information and perspective required for thinking of macro-stability are not available at individual's level. Secondly, individuals cannot undertake decentralised and partial micro operations to make stability sure at systemic level.

Public goods are conceived as crucial to the community but for the most part they cannot be adequately addressed by separate private individuals' optimisation plans. In the line with those works and in an eclectic way, the literature usually identifies public goods through two characteristics that would distinguish them from (normal) private goods such that one cannot expect an appropriate provision of those goods through the market mechanisms. Public goods are non-excludable and non-rival (Cornes & Sandler, 1994). Non-excludable because once provided to one individual, they remain available to all. Non-rival because their consumption by one individual will not reduce the quantity or the quality available to other individuals. However, Kaul *et al.* (2003: 80) maintain that since society can modify the (non)rivalry and

(non)excludability of a good's benefits, "Goods often become private or public as a result of deliberate policy choices". From this point of view, the criteria used to identify public goods must only be regarded as some possible definition elements. The ultimate position of an activity within a given economy as a public or a private good will depend on the characteristics of the good with regard to the characteristics (aims and values) of society within which its production is expected or required. Viability, sustainability, welfare and wellbeing of citizens, ideological and political constraints, etc., interfere and affect the appropriate definition of a good as a public or private good. For example, Malkin and Aaron (1991) argue that the boundary between private and public goods is socially constructed. Marmolo (1999) maintains that the publicness of a good depends on utility interdependencies across demanders, shifting the analysis from non-excludability and joint consumption to utility interdependence. However, Cornes and Sandler (1994) note that the social construction of the concept does not prevent the specific characteristics of the goods such as (non)rivalry and (non)excludability and that those characteristics are the determinants in the identification process of the nature of a given good. Drawing upon Olson's analysis of the problems of provision of public goods (Olson, 1965), Ostrom (1990, 2003) argues that the debate on the public-private distinction of goods is ultimately related to "collective action problems" such that whereas individuals would all benefit from the provision of a good or an activity, they cannot realise it alone at their individual level given the costs associated to such a good or action. The solution relies then on the possibility of collective provision-collective action of the good or activity but raises the question of how to do it in a relevant manner to give members of the action the expected results.

Usually, researches on public goods are related to environmental concerns or security issues. It is also usually admitted in the economics profession that market is able to price everything in an efficient way but in some "residual" cases (the contingencies) it may fail to provide goods. Those cases are often called market failures and would justify State (or public) intervention within the economy. But to date (globally) enlarged financial markets and recurrent financial instabilities that threaten regularly the smooth working of market-based economies all around the world make that regulation of financial markets and the design of financial stability become a collective concern that does not seem to be adequately produced by decentralised market actions thanks to self-regulatory practices. Ülgen (2017b) documents that market-dependent self-regulation -as a core liberal finance rule- reveals to be unable to deal financial instability which must be handled at a systemic level as a public good. This would require public regulation and action mechanisms to maintain society within some viability limits and ensure a smooth working of the economy.

Once common rules and socially optimal design are established by some collective action-public decision mechanisms, they are available to each actor as every individual and institution can get benefit from without suffering its huge and locally uncertain production costs. Therefore consumption (or use) of the stability by one individual/institution in no way reduces its qualitative and quantitative availability to

others. It is obvious that the collective action problems of public goods apply to global public goods to an even larger extent: “Even if there is general agreement that the potential gains from international concerted action are great, there is no supranational government authority to devise and impose solutions as the norm at the national level (e.g. taxation, regulation, market creation)” (Sagasti & Bezanson, 2001: iv). At the global level, the problem is of the same nature but the difficulty of resolution might be slightly intensified and augmented as the interconnectedness and interdependence among different countries, different financial markets, and numerous economic and political national, regional and international problems gained ground. Nordhaus (2005) defines global public goods as goods whose impacts are indivisibly spread around the entire globe and points to international interdependence issue that underlines the problem of international coordination: “Many critical issues facing humanity today - global warming and ozone depletion, banking crises (...) are ones whose effects are global and resist the control of both markets and national governments. (...) Global public goods differ from other economic issues because there is no workable mechanism for resolving these issues efficiently and effectively. (...) If problems arise for global public goods, such as global warming or nuclear proliferation, there is no market or government mechanism that contains both political means and appropriate incentives to implement an efficient outcome. Markets can work wonders, but they routinely fail to solve the problems caused by global public goods.” (Nordhaus, 2010: 1)

Shirakawa (2012) defines public goods as the goods markets depend on and which are not provided spontaneously by markets and global public goods as those needed for the global economy to function properly. The global public good in this case would be the avoidance of financial crisis, as it has significant non-excludability and non-rivalrous characteristics and considerable crossborder spill-overs. (Sagasti & Bezanson, 2001)

From this perspective, the international monetary and financial system’s (IMFS) stability can be seen as a genuine international/global public good. Indeed, the IMFS is a set of rules and practices that govern the way(s) debts could be honoured and paid among nations with different currencies in the aim of ensuring the viability of international economic relations. When the system works well (in a smooth and stable way), all countries get gain from international flows of products and capital. But when it breaks down, nations become unable to sustain high levels of trade and investment. Therefore, all have an interest in reforms that would improve the system for the global public benefit but not many people care for or are prepared to pay for. Camdessus (1999) states that the IMFS as a global public good is essentially the same system for everyone: “If it works well, all countries have the opportunity to benefit; if it works badly, all are likely to suffer. Hence, all have an interest in reforms that will improve the system for the global public benefit. And, as is so frequently true for public goods, not many people care for, and even fewer are prepared to pay for, its improvement even if many comment about it.”

Ülgen (2017a: 222) thus maintain: “The crucial core role of financial stability in the capitalist economy has once more been emphasised by the disastrous consequences of the 2007-08 crisis. This crisis has also shown that with an increasing number of transnational financial institutions and banks around the world, financial stability should be thought of in terms of various links and interconnectedness among institutions and countries (...) Hence, financial stability must be regarded as a public good and assessed at a global level, since it does not stop at individual or national borders. The change of perspective then arises a specific collective action problem with regard to the design and implementation of relevant (and global) regulation and supervision mechanisms.

### **3. A common regulatory framework for public goods**

The public goods approach upon which this chapter draws assumes that the public agency/government in charge acts in the public interest (the benevolent public regulator/welfare state) in the provision of such goods.<sup>9</sup>

Financial stability is a public good to be produced by a public-organised mechanism with regard to two objectives: allowing markets to adopt system-coherent behaviour and ensuring a smooth working of the economy in order to give private economic agents a stable horizon to undertake decentralised activities. The creed is therefore: “Macro (systemic) financial stability is a prerequisite for stable and durable micro-efficient market behaviour”.<sup>10</sup> Ülgen (2017a: 233) argues, in a Minskyian way, that financial system’s stability relies on a consistent financial regulation which is not only private-incentives producing regulation but must also be a macro-consistency seeking framework because: “If there is no macro-stability, there cannot be micro-initiatives able to push economies toward a growth path.”

The problem is how to organise a relevant regulatory framework to make the provision of such a good (financial stability) possible and consistent with the characteristics of monetary market-based economies. Some specific constraints related to the globalization of the world economies affect possible reform proposals. Helleiner (2009: 7-8) notes in this regard that: “In the early 1940s, the focus was entirely on enabling states to regulate the international movement of financial capital at their borders with capital controls if they so wished. International financial regulation, in other words, was a synonym for curtailing the international capital mobility. Today, the phrase has a different meaning. Over the past few decades, financial markets around the world have become more and more integrated, driven by the liberalization of capital controls and various technological and market innovations.”

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<sup>9</sup> I adopt this hypothesis also in order to avoid the temporal inconsistency problem which remains beyond the scope of this article at its present stage.

<sup>10</sup> Mullineux (2013: 87) maintains, from a corporate governance perspective, that well governed financial firms are more likely to serve the common good “in the sense that general conditions are achieved that are to everyone's advantage and they thus benefit society as a whole, or ‘the public good’.”

To date, the aim of public supervision is not to curtail international capital mobility but to ensure that it will be directed towards socially efficient uses. However, in a market-based and mainly private decision-guided economy, to be socially acceptable, trustworthy and able to keep monetary and financial system in trust for society, the regulatory system must remain external to market relations and actors, and should not be designed to ensure that no individual institution/firm ever fails (Bank of England, 2014). It should aim at protecting the integrity and the survival of the financial system and the economy when some individual institutions/firms fail, that is, to guarantee that these failures will not bring the entire system in their wake (Ülgen, 2017a). Given the general constraint of systemic and global financial stability, the objection of Hardin (1968) related to the “Tragedy of the Commons” such that “common goods availability plummets mainly because of the public management of such goods”, does not hold. The under-provision (or the lack of) financial stability comes, on the contrary, from the lack of publicly organised and supervised regulation in financialised economies. That is, financial turmoil rests on flawed institutional framework that let private actors organise market soundness through the use of decentralised (and privatised) self-adjustment mechanisms. This flaw holds at national and international levels. At a national level, it is related to the liberalisation of markets and privatisation of financial regulation/supervision; at the international level, it rests on the absence of effective multilateral financial cooperation and coordination. Regular meetings of “GXX” look like much more diplomatic holiday trips than meetings aiming at reforming regulatory rules and systems in order to reduce the propensity of the capitalist finance to provoke global systemic catastrophes and to improve the capacity and ability of financial markets to finance job and innovation creating economic activities.

Provided that money and finance are essential elements of capitalist economies and must support productive activities in a long-term perspective and provided that their continuous and stable functioning (availability, transparency, reproducibility) is required to ensure a viable economy, and that liberalised and self-regulated financial markets are not able to fulfil such conditions, it becomes obvious that a regulatory-supervisory framework must be designed at the (macro) systemic level and without the burden of vested interests in order to guarantee the production of public utilities (finance and financing of the economy) and of public goods (financial system’s stability). Such goods are produced by a common/public process, financial regulation, which must deal with collective action problem. Successful advocacy involves producing collective global responses and promoting the worldwide production of financial stability as a global public good.

Foundations of contemporary regulatory frameworks lie in the problem of individual incentives-compatible mechanism design that would seek at pushing individuals to reveal their true preferences with regard to the provision of a public good and its financing by everyone. So, if the state can exert enough authority and pressure on market actors, it can constraint public to participate in the financing of the good and then free the issue from the individuals incentive constraints. With regard to this

problem, Bierbrauer and Hellwig (2015: 1-2) argue that in a large economy, the problem of finding an individually incentive-compatible mechanism for public-good provision is trivial. Because no one person individually is able to affect the level of public-good provision, no one person is ever “pivotal” (as it is in a small economy – F. Ü). For individual incentive compatibility, it therefore suffices to have payments that are independent of what people say. If the preferences that a person expresses neither have an effect on the public-good provision level nor on the payments that the person has to make, she may as well report her preferences truthfully.” Indeed, in such a system of public good provision, the individual’s payment is independent of what she/he declares and what individual declares is deemed to have no effect whatsoever, individual may tell her/his true preference. To put in force this kind of institutional mechanism, a specific system of coercion and supervision might be required to incite market actors to adopt collectively expected strategies and to check their effective behaviour comparing it with the values of the system. On this issue Olson (1965: 2) argues that “unless the number of individuals is quite small or unless there is coercion or some special device to make individuals act in their common interest, *rational, self-interested individuals will not act to achieve their common or group interests.*” In this same way, Hardin (1968: 1247) points to the role of coercive rules in the relationship between responsibility and engagements: “social arrangements that produce responsibility are arrangements that create coercion (...).”

Hence putting a halt to the system-harming process of privatisation of financial control and supervision is a necessary direction to cure recurrent economic/financial instabilities. This calls for alternative collective regulation mechanisms that should seek societal-stability and economic viability in the aim of attaining a society-wide consistent level of economic activity. In this vein, Velasquez (1992) states that in the absence of an international enforcement agency, multinational corporations operating in a competitive international environment cannot be said to have a moral obligation to contribute to the international common good, provided that interactions are non-repetitive and provided effective signals of agent reliability are not possible. Pointing out that the conclusion that multinationals have no moral obligations in these areas is deplorable, the author urges the establishment of an international enforcement agency. The prerequisite for a sustainable provision of financial stability as a global public good is the organisation of a super-national body of regulation and supervision in accordance with the national supervision authorities to be gathered around a new financial framework that should redesign markets, determine subsequent incentives and control mechanisms advocating constructive freedom of actors against speculative folly of ideologies.

## Conclusion

This chapter sought to find some relevant answers to one of the major issues that arose in the wake of the 2007-2008 global catastrophe: how to redesign financial markets (actors, strategies, aims, rules) and what regulatory system should and could be framed in order to improve and secure the working of markets. Therefore, the chapter developed a specific analytic stance from the perspective of global public goods and argued that financial stability must be seen as a public good whose production and maintenance should mainly rely on extra-market public mechanisms in order to ensure the viability of international economic relations without suffering recurrent financial crises.

It appears that, after a decade of debates and analyses, things do not seem to structurally change, old oppositions dominating a recessive world economy. Required system-recovery measures, beyond some quantitative easing policies and standardised monetarist inflation-targeting discourses to tame Keynesian spending policies, relies on a necessary theoretical change that must put forth the monetary characteristics of market-based economies and point to the crucial role and high fragility of financial operations within the economic development process. Therefore, the consistent organisation of financial markets calls for a public utility-public good approach to financial regulation and financial stability. Reforms should lead to assess the societal consistency of a financial system regarding its capacity to prevent crisis-prone speculative banking/finance and to serve job-creating productive needs. An alternative societal efficiency paradigm should then be substituted to the consensual market (economic) efficiency criterion, and help to reshape alternative rules, policies and incentives according to society's common (economic and human) development objectives.

In the production of this peculiar public good, a peculiar public service, the regulation-supervision of financial markets that must take the form of collective action irrespective of the private actors' interests, is required. Consequently, macro-prudential regulation-based principles must be substituted for micro-regulation schemas at a global level aiming at preventing short-sighted speculative activities and must regard financial stability as a whole since micro-regulatory frameworks cannot address the systemic instability issues and take into account counter-cyclical and systemic needs to stabilise the whole economy. But the design, establishment and implementation of the rule of constrained financial (non-market-dependent) regulation and tight and regular public supervision mechanisms -as major financial global public utilities- require a stronger super-national coordination/cooperation agency which must aim at strengthening -in a transparent and durable way- the conditions of provisioning of a peculiar global public good, financial stability, essential for economic and social sustainability. From this point of view, financialised economies pose huge theoretical and practical challenges to the economics of public services and collective action. In this vein, Epstein *et al.* (2009: 144) maintain that: "Thus it will be crucial to develop *social governance structures* to prevent "finance

without financiers" from becoming "finance FOR financiers". These social governance structures will need to have several components, including democratic governance by those effected by the financial institutions' actions, strong financial regulation over-all to prevent massive gaps in practices between publicly oriented financial firms and the market, and compensation and/or tax schemes which reduce the benefits in the system for destructive financial practices."

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