

ECONOMIC RATIONALISM and THE PUBLIC INTEREST

“Economic rationalism”, which has been described by Australian economist John Quiggan as **“a sphere of (commercial) activity in which moral considerations, beyond the rule of business probity dictated by enlightened self-interest, have no role to play”**, is under considerable pressure. While the term means different things to different people, it is generally identified with the school of thought that favours a free market economy, privatization of government enterprises, lower taxes, small government and light regulation of financial markets

One of the principal supporters of “economic rationalism” was the American economist Milton Friedman (1912-2006). During the 1960s and 1970s Friedman’s views were rejected by most mainstream economists, but gained ascendancy in the 1980s and 1990s, especially in the USA, the UK and some other western economies (including Australia), coinciding with fall of communism in Eastern Europe and the USSR.

Since that time, Friedman’s neo-liberal views on how the world’s economies should operate have heavily influenced the evolution of the capitalist system. Former US Federal Reserve Board Chairman Alan Greenspan said that Friedman’s ideas **“were sufficiently original to materially alter the direction of civilization”**.

However, the dire and frightening events of the last few months may well result in the adoption of a new (back to the future) direction, including the re-introduction of the heavy hand of prescriptive regulation of financial markets. As an indication of things to come, Lord “Red Adair” Turner (recently appointed Chairman of the UK’s Financial Services Authority) said:

“What has gone wrong with the world’s financial system is not just a few minor things and it can’t be tidied up by a little more disclosure or a little more transparency. At an international level we need to work out what went wrong and what are the integrated set of actions to make sure this doesn’t happen in the future”.

Typical angry responses from the public in the UK included:

“What the financial sector needs is a complete overhaul. Greed has been allowed to overtake integrity, decency and right decisions for too long and in too many areas from the various mis-sellings to the current debacle. A strong, independent Financial Services Authority is what’s needed to bring order and restore confidence, not a self-serving rescue (for the politicians and bankers)”.

While the Australian financial services sector seems to have avoided the worst of the crisis, it is highly likely that there will be ‘reforms’ in the regulatory system in this country. The process has already started. At the time of writing this article, regulations had been introduced temporarily banning ‘short selling’. It remains to be seen just how tough and wide-ranging the rest of the reforms will be; however, the most important

outcome must be a substantial improvement in the way in which the system deals with consumers of financial products and services.

History shows that 'tough reforms' always achieve positive comments from the tabloid media, but they usually fall short in achieving outstanding results for consumers. The reason for this is that legislation simply creates a regulatory and administrative framework which can influence, but cannot force, product manufacturers to think and act ethically.

The real problem (to which Lord Turner alludes above) is the industry's unwillingness to directly face the difficult issues that really matter, such as conflicts of interest. So that when mis-selling of financial products happens (including the mis-selling of property finance loans), the highly remunerated lawyers and accountants who typically populate the boards of institutions are usually quick to blame a few 'bad apples' in their sales force; whereas they should be blaming themselves for a lack of moral leadership.

Rarely is it recognized that substantial responsibility for the industry's shortcomings actually lies with directors who have encouraged (or at least have passively cooperated with) financial product mis-selling practices, all in the name of reaching sales and profitability targets. Of course, the sales people must take some responsibility for their own actions, but the principal players in the drama are the directors 'at the big end of town' who should have known better.

The capitalist world's crisis of 2008 presents an opportunity for the leaders of the financial services industry to think deeply about some fundamental principles. Is the industry simply a gaggle of amoral and asocial profit-driven sellers of products (devoid of Quiggan's 'moral considerations'); or is it an industry that should accept its responsibilities to a wider society and seek to act in the public interest?

If the industry concludes that it is the former, economic rationalism will have won the day, and the consumers of financial products will be the poorer for it.

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