Viewpoints on Financial Culture (1)

Finance and the Modern Economy

The great leader who embarked on the modernization of China, Deng Xiaoping, once said: “Finance is very important, it is the nucleus of the modern economy”. In saying this, Deng obviously wanted very much to emphasize the importance of finance to economic development, as an integral part of his modernization initiative for China. Indeed, finance is essential for the effective functioning of any economy. Manufacturers need funds to buy raw materials and invest in machinery, to pay wages to workers, to rent factory space for production, and to arrange for the delivery of manufactured products to distributors. Home buyers need mortgages. Retailers need money to pay rent, maintain adequate stock of the consumer products that they sell, etc. Investors, on the other hand, want to mobilize the surplus money that they have and receive a return for it that, in their opinion, is commensurate with the risks being taken, instead of placing it unproductively and perhaps riskily under their mattresses. The more effective finance is in satisfying these needs, the greater is the potential of the economy to grow and develop for the general benefit of its community.

But I do have doubts about the appropriateness of emphasizing the importance of finance by describing it as “the nucleus of the modern economy”. The description gives the unfortunate impression that the modern economy lives around finance, which of course is not, and should not be, the case. Finance serves or evolves around the economy, not the other way round. Regrettably, however, this critical aspect of finance is generally not given the attention that it deserves, whether in politics, in policy-making, in the finance industry and among the many users of financial services. The finance industry, in particular, has largely forgotten about this fundamental purpose of its existence. Those involved, indeed, think that finance is the most important sector of the economy, perhaps because their remuneration packages are the most attractive in money terms and because they are in control of other people's money, being in a position to decide where money comes from and where it goes to in the economy. This sentiment is regrettably shared by the community at large, recognizing the finance industry as where big and smart money is made quickly.

However, there really is no need for finance if there is not an economy to serve. Yet the mesmeric power of money has led to finance attaining a life of its own, very much disconnected from the core of the economy. This life is, interestingly, characterized by fast cars and complicated mathematical models, fat bonuses and mysterious acronyms, palatial offices and attentive individuals with their eyes glued to a myriad of forever blinking screens, trying to make a quick and big fortune. It is, regrettably, also characterized invariably, as we observe in the contemporary history of finance, by financial crises that were very damaging to the economy and debilitating to the community. Yes, this life of its own for finance provides employment to many and makes a lot of dreams come true, at least for the luckier ones. But clearly questions must be asked by all concerned—the politicians, the authorities, the finance industry, and the users of financial services—as to whether this outcome is in the public interest, in other words, whether finance, as now structured, is serving the economy as well as it should. The lifestyle of finance is certainly a colorful one, so is the lifestyle of those playing a role in defining its current, questionable structure. And that colorful lifestyle is ultimately paid for by the community at large, as users of financial services. The guardians of the public interest have a clear responsibility to ensure that finance serves the economy fairly and effectively.

The authorities have clearly not been idling in recent years. It has been almost a decade since the global financial crisis made in Wall Street erupted in 2007-08, and its debilitating consequences are still being felt in some economies. The response of the law enforcement agencies, led by those in the US, has been the criminalization and the rather forceful imposition of hefty fines in respect of identified behavioral aberrations of financial institutions in the past. At the same time, the financial authorities have been introducing and enforcing more stringent regulatory requirements on financial institutions that typically increase their costs of doing business, in terms of needing more capital and liquidity, and a much bigger and more expensive role for “Big Brother” in monitoring, surveillance, and compliance against misconduct. Again, footing the bill for all this ultimately is the community at large, as users of financial services. Surely there should be a more effective approach to ensuring that the finance industry better serves the economy in a sustainable manner through making it less self-serving and more oriented towards achieving the purpose of its existence, in other words, through a change of culture in finance.

This series of Viewpoints on Financial Culture attempts to revisit and remind readers the fundamental role of finance in the economy; to examine how ineffectively this role is being performed by the modern-day financial system; to identify the root causes for the current unhappy state of affairs in finance; and to recommend ways for the authorities and the industry, for the public good, to resolve what is very much a deep-rooted cultural problem in finance. These are presented, as much as possible, in simple and practical terms in order to facilitate a wider understanding of the delicate matters involved across different categories of stakeholders of finance, in the hope of gaining greater support for the much needed cultural change in finance. Another reason for adopting this layman’s approach is to introduce effectively the underlying conceptual issues in finance, which are not adequately covered in textbooks on finance, to those freshly exposed to the field of finance in universities, in the hope of enabling them to identify and avoid the dangerous pitfalls along their future career paths in finance.

Joseph Yam
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