**The crisis of financial capitalism**  
*Catherine Mathieu and Henri Sterdyniak*

The financial capitalism deep crisis which started in 2007 has put an end to 12 years of robust world economic growth. The roots of the crisis are macroeconomic imbalances. It is a crisis of national strategies targeting wage pressure offset by competitiveness gains or the development of finance, through which financial bubbles and increased borrowing boosted consumption. Financial globalization generated unsustainable imbalances and market instability. Extraordinary rates of return for huge capital stocks can be obtained only through assets bubbles bursting periodically. Financial mathematics failed to reduce and spread out risks. The crisis highlights the risky strategy of banks circumventing prudential ratios and investing hugely on financial markets. The article discusses reforms proposals for a better functioning of the world economy. These should include national macroeconomic strategies, global economic governance, banks and financial markets regulation.


*JEL classification:* E44, F02, G01.

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**Income distribution and macroeconomic instability**  
*Looking for the structural reasons of the financial crisis*  
*Jean-Luc Gaffard et Francesco Saraceno*

The dimensions of the financial crisis, and the perverse mechanisms that were at its origin, cannot hide the real dimension of today’s troubles. The longstanding trend in redistribution of personal revenues, that accompanied the development of the new economy, has created the conditions for a structural reduction of aggregate demand, production and employment. This has been initially hidden by mounting debt of the poorer households, that proved unsustainable and ultimately led to today’s crisis.


*JEL classification:* E23, E24, E25.
Are financial markets efficient? 
*The case of the foreign exchange market*

Antoine Bouveret and Gabrielle Di Fillipo

This article analyses foreign exchange market efficiency. It reviews the concept of efficiency as defined by Fama (1965). Aiming to overcome the internal contradictions of Fama’s definition, three definitions of efficiency are outlined: fundamental efficiency, macroeconomic efficiency and speculative efficiency. Empirical tests associated to each form of efficiency are then performed. Results show that three forms of efficiency prevail in the foreign exchange market according to the time horizon considered. The foreign exchange market can be characterised by pure inefficiency in the short run (between 1 month and 1 year), speculative efficiency in the medium term (between 1 year and 2 years) and macroeconomic efficiency in the long run (from 5 years on). The latest form of efficiency is however accepted with some reserves. Fundamental efficiency—Fama’s definition of efficiency—is rejected at every horizon. The last part of the article explains the empirical results by developing a theoretical model based on heterogeneous agents.

*Keywords*: Foreign Exchange Market Efficiency, Fundamental Efficiency, Speculative Efficiency, Macroeconomic Efficiency, Equilibrium Exchange Rate, Cointegration, Out-of-Sample Forecast, Heterogeneous Agents Model.

*JEL classification*: G14, G15.

From the financial chaos to the economic K.O.

Christophe Blot and Xavier Timbeau

Since the 9th of August 2007, the world has been living under intensive financial distress, which led to recession. The financial turmoil finds its origins in the US subprime market. It has been transmitted to the whole financial system, and especially to the investment banks around the world through, the high degree of securitization that boosted financial development for a few years. In September 2008, Lehman Brothers went bankrupt triggering a major stress on the interbank and stock markets. Henceforth, households and non financial firms suffered from major wealth losses and from the tightening of financial conditions. Consumption and investment are decreasing leading industrialised and developing countries to a recession, which may be long lasting as the recovery would be curbed by the need to restore financial soundness.

*Keywords*: Financial crisis, Recession.

*JEL classification*: E44, G01.
Banks in crisis
Mathieu Plane and Georges Pujals

Firstly, this article analyse the mechanism which drove to the actual situation: assets depreciation, market value losses, fall of profits and States plan to avoid the bankruptcy of the financial system. The article also describes the process of consolidation within the national banking industries through the development of mergers and acquisitions operations and non strategic assets sales. In the last part, we try to learn lessons from the crisis for banking organizations: redistribution of power between financial institutions, redefinition of banking activities and overbid of stockholders’ equities. The last lesson concerns the new banking model with the disappearance of investment banks for the benefit of a specific model of universal bank drawing outlines of the bank of tomorrow anchored in its fundamental.


JEL classification: G15, G21, G28, G34.

Pension funds: The hidden side of the financial crisis
Paola Monperrus-Veroni

Prefunded retirement accounts will be adversely affected by the current financial turmoil and neither private pension backlash nor government bail outs cannot be ruled out. This paper aims at identifying the sensitivity to market risk of pre-funded pension provisions in selected European countries and in the United States. It provides a thorough description of the risk-sharing features of pension plan designs and their implications for funding requirements. After having qualitatively characterised the sensitivity of private pension systems to market risk, it runs a stress-test simulating the impact of changes in market conditions on funding ratios across countries. The impact of the « perfect storm » of the period 2001-2003 and of the present crisis on pension funds’ solvability is analysed as well as the first answers provided by the different countries.

Keywords: Pension funds. Solvability ratios. Sensitivity analysis.

JEL classification: J32, G23, G32.

From the financial crisis to the recession
A comparison between France and the United States
Christophe Blot, Sabine Le Bayon, Matthieu Lemoine and Sandrine Levasseur

The current financial crisis has now led to a fall in real output and the downturn is yet expected to last for some time. The aim of our paper is to analyse and quantify the impact financial crisis on the French and the United States economies. We first present the shocks characterising at best financial crisis and explain how they come
through the real economy. The remaining of the contribution is devoted to the empirical work based on a VAR model. Structural shocks are identified using the generalised approach of Pesaran and Shin (1998) which does not require ad hoc assumptions on how shocks come through the system contemporaneously. Most of impulse responses to shocks are found theoretically consistent and statistically significant. Finally, the historical decompositions show that past and current financial shocks contribute significantly to the declines in the economic activity in France and in the United States.

**Keywords**: Financial crises. Business cycles. VAR models.

**JEL classification**: E44, G01

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**The central banks confronted with the crisis**

*Guilhem Bentoglio and Guillaume Guidoni*

Since the beginning of the financial crisis in August 2007, exceptional needs for liquidity have pushed central banks to unprecedented action, all over the world. Before September 2008, the Fed was forced to innovate, distributing more liquidity at longer-term horizon. With a more modern and flexible framework, the ECB made it easier for banks to access liquidity without changing the overall amount. After September 2008, the risks of deflation and banking systemic crisis led to more radical action: sharp cuts in interest rates and unconventional measures (unsterilized liquidity injection, credit easing with balance sheet expansion and asset purchasing). The ECB has moved slower than the Fed. Timely reaction, when compared to previous crisis, prevented from market collapse and a complete freeze of the credit channel. Deflation issues prevail in the short-term, but inflation risks in the longer-term will make exit strategy crucial.

**Keywords**: Monetary policy. Quantitative easing. Credit easing. Financial stability.

**JEL classification**: E58, E52, G01

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**A short handbook on how to recover from the crisis and escape sinking**

*Christophe Blot, Jérôme Creel, Christine Rifflart and Danielle Schweisguth*

This article reviews financial crises of the 20ieth century and delivers a chronology based on a multi-criteria methodology: historical context, economic and financial disequilibria before the crisis emerged, short and medium run policies to recover. Recommendations for the present crisis ensue from successes and failures of past remedies. We do not only investigate the “Great depression” of the
1930s and the Japanese crisis of the 1990s, but also the Savings and loans’ of the 1980s as well as the Scandinavian countries’ of the 1990s. Our conclusion is that there is no such thing as an optimal policy for escaping the crisis. Public commitment is all the more complex that a trade-off exists between imminent systemic risks and future costs related to moral hazard and unsustainable public finances. Finally, we claim that emergency is required.

JEL classification: E63, G01, G18.

After the G20 summits, towards a new international financial architecture?
André Cartapanis

After a brief survey of the main determinants of the international financial crisis, this article evaluates the conclusions of the G20 meetings (Washington Summit, 15 November 2008; London Summit, 2 April 2009) in the field of international financial rules, in focusing on the macro-prudential orientation of banking regulations and stressing the political obstacles that may arise in adoption of a new architecture of global finance.

Keywords: Financial crisis. Banking regulation. International financial architecture.
JEL Classification: F5, G15, G18.

Which banking system in the wake of the financial crisis?
Jean-Paul Pollin

In this paper we intend to consider the possible and desirable evolutions of banking systems in the wake of the financial crisis. We recall at first the mishaps related to securitization which induced failures in the process of selection and monitoring of borrowers. Then we show that suggested solutions aiming to strengthen banking regulation are complicated by the mixing of traditional banking and capital market activities, within the same institution. That’s why we think that a more radical but simpler and less risky answer should consist to separate again these different functions. However that may be, market activities should be less important and less profitable in the medium term. Banks will find their future profit opportunities in the deepening of their customer’s relationships rather than in market activities. We conclude that public authorities must encourage this return to fundamentals of traditional banking and try to hamper the building up of mega-banks dangerous for financial stability.

Keywords: Intermediation. Securitization. Originate and distribute. Banking regulation.
Classification JEL: G21, G24, G28.
Europe in crises
Jérôme Creel, Eloi Laurent and Jacques Le Cacheux

This article tries to analyse the situation and the economic policy response of the European Union in the global crisis. It successively focuses on the two dimensions of the European problem: the lack of coordination between euro area member states and the failure of solidarity between old and new member states, the latter being hardly hit because of their peripheral position and growth strategy. For each dimension, the analysis will concentrate on economic and financial aspects, but European institutional and law issues put forward by the crisis situation will also be studied.


The ‘Shadow Gn’: The ways out of the crisis and the building of a more cohesive world
Jean-Paul Fitoussi and Joseph Stiglitz

The G’s are meeting at a critical moment in economic and social history. They will confront the gravest economic and social crisis in almost 80 years. To paraphrase Keynes, the destiny of the world is in the hands of the members of the G’s. They could act in such a way that would allow us to get out of this situation, creating a future where growth is more sustainable, friendlier to the environment, and where its fruits would be distributed in a more equitable way, both within and among countries. If they don’t they will bear an enormous responsibility.

That is why a group of 'experts', constituted under the leadership of Joseph Stiglitz and Jean-Paul Fitoussi, with no commitments other that of being citizens of the world, decided to meet to reflect on what could be done, hoping that from their reflection some useful recommendations to the powerful of this world would emerge. The paper present the main results of the two group meetings who take place in New York at Columbia University on 4-5 February 2009 and in Rome on 6-7 May 2009.

Classification JEL: E6, F3, F5.
Keywords: Gn. « Shadow Gn ». Global crisis. Financial crisis. Global governance.