

Jon Emaldi Abasolo

# BANKING AND FINANCIAL CRISES

Can a never-ending story change?

1630

1720

1929

1987

2000

2007



2<sup>nd</sup> revised edition



Desclée De Brouwer



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DESCLÉE DE BROUWER

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## To my family

I will only mention the closest, beginning with Ane, the driving force of a project which includes Garazi, Julen, Iur, Arrate, David, Irati and fairly soon another newcomer. Also closest are Maria Dolores, Mikel, Borja, Eli, Aitor, Ana, Iker, Argizka, Ander, Ane Maite, Oscar, Miren, Jorge, Mariló and Juanma. And those who are with us, but not present, Ane's father, Jaime, and my parents, Maite and Jon.

A short list in a big family is not that short, I'm afraid.

I must also thank Joseba Madariaga, who enrolled me in DBS and has encouraged once and again the approach I follow in this book. And Josu Irigoyen, my boss in the Studies Department of Caja Laboral, where I learned to investigate off the beaten track.





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## Foreword

Jon Emaldi was born in Portugalete (Bizkaia) in 1959. Married to Ane Pereira, his colleague and best friend from university times. They have two daughters, two sons-in-law and two young grandchildren.

A cooperativist at heart, during his university degree in Business Administration his first contact with cooperativism was a course on Basque Cooperativism in University of Deusto's Sociology faculty. He began his career in the International Studies Department of Leeds Polytechnic, now Leeds Metropolitan University. With the help of Maria Moissa, a highly motivating professor in Leeds Poly, he got to know the British Coop, including a visit in 1982 to Rochdale in Manchester. Soon after his pilgrimage to the birthplace of the modern cooperative movement, he began his long career in LABORAL kutxa, the cooperative bank of the MONDRAGON Group: he joined Caja Laboral –now LABORAL kutxa– in 1983. He has been working there in different fields of the banking industry, from marketing to strategy, from retail network to quality management.

This text aims to be an educational book. Its first target is to provide a textbook to his students of Finance at Deusto Business School–DBS, trying to transmit a critical view on the explanations usually given about the recurring crises, and by doing so he follows the thesis of some great economists, past and present, like John Kenneth Galbraith or Carmen Reinhart, who concluded that the real causes of financial and banking crises seldom appear. In most episodes, partakers, policymakers, regulators, and investors large and small, feel more at ease sharing explanations, or justifications, which could be grouped under the label of the *“This-Time-Is-Different”* syndrome, as Carmen Reinhart and her co-author Kenneth Rogoff have very convincingly shown.

Carmen M Reinhart, at present Vice President and Chief Economist of the World Bank Group, has grown strong roots in Basque soil. She was invested Doctor Honoris Causa in Economics at Euskal Herriko Unibertsitatea –the Basque Public University– in 2012. Her roots in the Basque Country are not rhetorical, as she has planted in the *arboretum* of the University a sprout

of the *Tree of Gernika*, the main symbol of Basque traditions and values. Those traditional values are *freedom, and solidarity* and *defence of the people next-door* while at the same time *openness to the world at large. Ethics of work well done* as well. Together with sound and healthy *scepticism*, not bad ingredients to work on controlling economic bubbles and manias.

## Introduction to this 2nd edition

When they read it in 2021 close friends of mine found that I have named chapter 3 of this book in a too strong and gloomy way: *On the next coming financial crisis*. Unfortunately, we have seen in March 2023 that crises in the US and European banking sectors have covered again front pages of every economic newspaper and online network. And this is worst, they happened unexpectedly. To control financial and banking crises we need reforms coming from an *intellectual revolution*, in the words of Mervyn King, Governor of the Bank of England during the Great Financial crisis of 2007. And in a new section 3.5. *Some ideas on different approaches to controlling financial crises* I defend that this change begins inside the banks themselves. It means changing behaviours, which are the external manifestations of a culture more risk-averse, also more respectful of our environment, more participative, democratic and encouraging employee loyalty and innovation, and more customer-centered.

I also have to add many thanks to my colleagues in Laboral kutxa Inmaculada Gallastegui and Javier Alli for their comments and corrections.



# 1

## The Crises of the Past

*“Any history of the classical tradition in economics must, after considering the essential ideas, examine the way it was defended. There is, to be sure, a defense implicit in the explanation of the system itself; economic theory combines interpretation with justification”* (Galbraith 1991, 113).

Along the book we will cover different financial and banking crises. A useful classification given in Reinhart and Rogoff 2011 differentiates several financial crises:

- *Sovereign defaults after debt crisis.* The government fails to meet payments on its external or internal obligations, or both.
- *Banking crisis.* Typically, the national banking sector has become insolvent after heavy investment losses, bank panics, or both.
- *Exchange rate crisis.* The value of a country’s currency falls despite a government guarantee that it would never happen.
- *High inflation crisis.* Unexpected increases in inflation are equivalent to default, because inflation allows public and private debtors to repay in currency which has a much lower purchasing power than before.

Reinhart and Rogoff, and most authors, focus on significant crises, such as inflation periods over 20% yearly, currency clashes or debasements over 15%, bank runs that lead to the closure, merging or takeover by the public sector of important financial institutions, debt crises followed by state defaults.

### 1.1. The stylized facts on financial crises according to Galbraith

The term *stylized facts* was introduced by Nikolas Kaldor in 1961, on a debate about economic growth theory. He understood that theory should begin with a summary of the most relevant facts. Kaldor said that economists should be free to start off with a simplified view of the facts