



# **Political Economy of Financial Markets**

## **Report to the Financial Market Policies Foundation on the Political Economy of Financial Markets Programme, August 2016**

### **1. Introduction**

The Political Economy of Financial Markets programme ('PEFM') was established at the University of Oxford in October 2012, with a two-year grant from the Financial Market Policies Foundation ('FMPF'), followed by further support from FMPF through September 2016. It was envisaged as having an initial horizon of five years, after which its future and rationale would be reviewed. PEFM is based at the European Studies Centre of St Antony's College. The activities of the programme have been documented in six-monthly reports to the FMPF Trustees, and are more fully illustrated on the PEFM website ([www.sant.ox.ac.uk/pefm](http://www.sant.ox.ac.uk/pefm)).

The main objective of the programme is to shed light on the way in which institutions, including macroeconomic policy frameworks, interact with financial markets. In the wake of the global and euro area crises, it seeks to promote a better understanding of financial markets and to contribute to improved policy formulation and execution in the future. Within this overall set of concerns, the focus of the programme has so far been on four main topics: financial integration in Europe and the governance of the euro area; the role of macroeconomic and macroprudential policies in forestalling financial crises; spillover effects from major economies to emerging markets; and the impact of regulation, including regulatory capture, and challenges posed by shadow banking and institutional diversification.

In October 2014, the focus of the programme was broadened to include work on restoring trust in the financial system, under the general heading of Ethics and Finance (EF). This work is financed separately from the work financed by FMPF. In April 2016, the programme's mainstream focus expanded further to include the implications of the evolving political structure of Europe and the European Union for economic and financial markets.

## 2. Main Activities during 2012-16

The main activities organised under the auspices of the programme have been as follows:

- Weekly seminars open to the university and the public, as launched by the flagship Michaelmas Term 2013 seminar series 'Banking on the Future'. It is notable that these seminars have attracted a substantial number of graduate students and university staff, and have also regularly drawn in interested parties from outside the university - for example, from LSE, UCL, Warwick University, Oxford Analytica, and private financial institutions.
- Invitation roundtables to discuss more specialist issues in an academic setting, such as the May 2013 workshop on macroeconomic issues; the February 2014 international roundtable on spillovers from advanced economy financial policies; the March 2014 workshop on the governance of the euro area, and the March 2015 conference on the Eurozone crisis.
- A high level two-day conference on the Future of Europe in April 2016, exploring the economic, financial and political implications of the evolving structure of Europe ahead of the Brexit referendum. This two-day conference was organized in collaboration with the Oxford Martin School, the Oxford Centre for Global History, and Citi Group (which contributed to some of its funding), and brought in eminent scholars from across Europe and also from the USA.
- Preparation of research papers and policy briefs on financial market issues, which have been very well-received in academic and policy-maker circles, and are posted on the PEFM website. For example, members of the PEFM team conducted seminars on the paper 'Avoiding Future Crises in the Euro Area' at the European Commission, the European Stability Mechanism, and H.M. Treasury. This research output included the publication of an initial book on the topic of restoring trust in the financial system.<sup>1</sup> The authors have given seminars on the book in Oxford, at the Bank of England, and at a gathering organised by the Finance Foundation, and have met to discuss its implications with both Minouche Shafik, Deputy Governor of the Bank of England, and Andy Haldane, Chief Economist of the Bank of England.
- Outreach to British and international policy-makers through seminars in advanced economies and through regional workshops with emerging market countries. For example, members of PEFM presented PEFM-related papers at IMF-Chatham House conferences in both Washington DC and London in 2014. Professor David Vines (Acting Director) gave lectures and presentations on divers PEFM-related topics at the Australian National University, at the Tsinghua University (China), in Washington DC and at the University of Copenhagen.

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<sup>1</sup> *Capital Failure: Restoring Trust in the Financial Services Industry*, edited by Nicholas Morris and David Vines, published by Oxford University Press, August 2014.

- Outreach to the public through open lectures at other universities and colleges, and through the availability on the website of podcasts of the some major seminars held in Oxford. The programme also has an active blog, Facebook page, and Twitter account.

The programme has been able to attract speakers and panellists of high quality from academia, officialdom, and market institutions. These have included Professors Sir John Vickers, Patricia Clavin, Kevin O'Rourke and Colin Mayer; the managing director of the European Stability Mechanism (Klaus Regling); a Deputy Managing Director of the IMF (Minouche Shafik – now Deputy Governor of the Bank of England); the Director for Macrofinancial Affairs at the European Commission; the Chief Economist of the EBRD; the Deputy National Security Advisor at the White House; as well as leading economists from the investment bank and hedge fund community in London.

PEFM continues to bank on its now well-defined *image de marque*, and the intention is to maintain the broad lines and priorities of the programme through 2016/17.

### 3. State of Progress on Main Workstreams and Plans for 2016/17

The main themes pursued during 2014-16 (highlighted in the periodic output matrices) have proved a rich basis for research and policy discussion, and have been very well-received by policy-makers as well as the academic community. In official bodies such as (inter alia) the IMF, the European Commission, the European Stability Mechanism, the German Federal Ministry of Finance, and HM Treasury, recent research outputs have been very much appreciated. This outreach is now extending to include emerging market policy-makers and the Bank of England. Through academic roundtables, links are also deepening with leading figures in continental as well as UK universities, including experts on law, history and political science, in addition to economics.

In consultation with the Academic Steering Committee, these research themes have been broadened and adapted over the programme's first four years, and some comment on each is warranted as an indication of firming priorities for the year ahead. The plans for future work are italicised at the end of each subsection below.

On **financial integration and EMU governance**, the initial work on financial flows in Europe was discussed in a number of workshops and laid a basis to consider desirable changes to the economic and political governance of the euro area. The major academic event in this workstream was an academic roundtable in 2014 (now published, which brought together in Oxford leading academics, officials and market participants from several European countries. This was followed by another (closed) round-table discussion in 2015. *The main priority in the period ahead will be to continue to examine this area, in light of the changes now taking place in the European Union and the consequences of Brexit, and to aim for a continuing impact in policy circles.*

In depth analysis of conjunctural and developing **macroeconomic and macroprudential policies** from a more global perspective has also been pursued under several workstreams and

seminars in the first four years of the programme. Russell Kincaid, Valerie Herzberg and Max Watson did a considerable amount of work during 2012-14, some of which is now published, and there have been a number of subsequent follow up seminars. In addition, a book was published in 2015 on the political economy of South East Europe, authored by PEFM associates, which included work on the use of macroprudential tools in that region.<sup>2</sup> The theme of this series has been to ask how macroprudential policies fit in the overall policy armoury of countries, and what can be expected of them in practice – with successive papers considering the contexts of global policy coordination, the euro area, and emerging markets. *A priority is to continue to disseminate this material, including in regional fora that are planned in the period ahead.*

Closely related to the work on macroeconomic and macroprudential policies has been the workstream on **monetary and regulatory spillovers from advanced economies**. In February 2014, PEFM worked closely with the Blavatnik School of Government and the Global Economic Governance Programme (GEG) to organise an international roundtable in Oxford on this topic. According to the IMF participant (Deputy Director of Policy at the IMF), the findings of this workshop helped provide a wake-up call to the official community on specific problems in ‘frontier markets’ and also the growing risks of systemic fragmentation. A joint PEFM/GEG workshop report was prepared and published ahead of the 2014 IMF-World Bank Spring Meetings, with a view to influencing policy-makers. In March 2015, a joint high level PEFM/GEG seminar on Finance in Africa was held in Oxford, and a report on this was published in June. *In the period ahead there may be follow-up research and events in this area.*

Work in the area of **financial sector regulation** began with research on Regulatory Capture. This was presented at an academic roundtable organised by the Foundation for Law, Justice and Society, and subsequently published by them as a Policy Brief. These findings were also included at a conference in Vienna in May 2014 on the future of the EU Banking Union, organised by the Austrian National Bank for Eurosystem officials, bankers and academics.<sup>3</sup> The reform of financial sector regulation has been a dominating theme in the weekly seminars that PEFM has been holding at St. Antony’s College. *This workstream is expected to continue to be a key feature of PEFM’s work in the period ahead.*

The approach of the Brexit referendum in 2016 prompted PEFM to organize a two-day high level conference on the **Future of Europe**, and its implications for economic and financial markets. This two-day multidisciplinary conference, which attracted some very distinguished speakers from across Europe and the USA as well as collaboration across many institutions, was extremely successful and well received. With Brexit now confirmed by the referendum, profound political, economic and financial changes are in prospect in Europe and globally.

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<sup>2</sup> Economic and Policy Foundations for Growth in South East Europe, by Messrs. Bennett, Kincaid, Sanfey and Watson, Macmillan, 2015.

<sup>3</sup> The paper was subsequently published in the associated conference volume by the Austrian National Bank, in its proceedings of the 42<sup>nd</sup> Economic Conference - *Toward a European Banking Union: Taking Stock*.

PEFM intends to hold a sequel high level conference on the Future of Europe in the summer of 2017, in order to assess ongoing developments and provide input into the policy debate.

The Academic Steering Committee has encouraged **outreach** the development of systematic links with the various centres of specific expertise in Oxford and elsewhere. PEFM has collaborated extensively with GEG, including with GEG's 10<sup>th</sup> Annual Lecture, and (as noted above) a roundtable on Finance in Africa took place in March 2015, and more recently with the Oxford Martin School and the Oxford Centre for Global History. In addition, PEFM has collaborated with Chatham House, as well as with official bodies like the UK Treasury, the Bank of England, the ECB and the IMF. Synergies with other regional centres (Asian, Middle East, Russian & Eurasian) will be continue to be explored in addition to the existing relationship with SEESOX and the ESC. With the impending arrival of a new ex-IMF staff member and his association with PEFM during 2016/17, PEFM hopes to develop its nascent Working Paper series under which, for example, the ideas of speakers and promising doctoral students can be given a preliminary exposure in the public domain. Throughout PEFM's outreach work, the principle will be that views should conform on the priority for debate on the issues PEFM has chosen to focus on, rather than conform on content or policy recommendations.<sup>4</sup>

In terms of **management**, PEFM's launch and first two years were conducted under the stewardship of Max Watson as Director (and founder) until the onset of his terminal illness in 2014. Professor David Vines agreed to take over as Acting Director in 2014, with the support of Adam Bennett as Deputy Director, and the programme's leadership in the second two year phase was provided by this management team. It is envisaged that this management arrangement will continue through this envisaged fifth and final year of the programme's first five year horizon.

**Adam Bennett and David Vines**

**St Antony's College, Oxford, August 2016**

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<sup>4</sup> In other words, there would not be a single PEFM-endorsed message, but rather a plethora of opinions expressed under the PEFM rubric and defined scope. PEFM would thereby function more like a college than a political force.