

Unlocking credit essay



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The atrophy of the credit markets can be viewed as an outgrowth of the larger banking crisis, which is, itself, compounded of various strands of fiduciary collapse. In Chapter Three, “Determinants and Characteristics of Banking Crises,” attention is given to possible solutions to the credit freeze and banking crisis, but the solutions are regarded as being both multiple and inter-dependent, so that enacting policies to reverse the present trends and get the credit markets moving again is a process which will involve complex challenges.

One aspect of the current crises which makes reparation of the credit markets more difficult is the fact that, “Crisis episodes are typically associated with a dramatic weakening of balance sheets, on the side of both banks and borrowers. To the extent that banks represent a major source of financing, credit contraction due to plummeting net worth may lead to a forced reduction of investment and consumption spending” (Banking, 29) and this type of contraction can be very difficult to reverse.

Chapter Three, “Determinants and Characteristics of Banking Crises,” argues that there are two major categories of concern relative to the crisis and these aspects may be identified as “moral hazard” and “liquidity” (Banking, 30). In the area of “moral hazard,” the determinants of how moral hazard impacts the credit and banking crises is based on “A set of macroeconomic variables and banking variables” (Banking, 32), which by necessity must be “addressed both by attacking the sources of the problem and shoring up enforcement of regulation and supervision” (Banking, 32).

Of the idea of regulation, the authors propose that “ The latter is crucial” (Banking, 32) in order to shore up confidence and belief in the market systems and credit systems themselves.

For example, a single issue like bank-concentration has contributed to the overall financial crises and the credit freeze; however, the fact of bank-concentration “ shares both moral hazard and liquidity arguments” (Banking, 34) and therefore cannot be “ solved” by a unilateral approach.

Because any banking crises carries with it the risk of causing “ a major disruption in economic activity” (Banking, 29), such disruptions ultimately cause the weakening of assets for both borrowers and banks and in this way, the contraction at both ends of the “ balance sheet” becomes more or less stagnant. In other words, “ A meltdown of the payments system” (Banking, 29) can cause “ a resulting collapse in output” (Banking, 29) and that is what is being faced in the current credit crises.

As mentioned, any approach toward rebuilding the credit market must focus not only on liquidity issues but issues of moral hazard as well.

The former may be much easier than the latter to deal with, considering it is de-regulation which has allowed issues of moral hazard to rise as the primary impetus for collapse in the credit markets, so it is the moral hazard aspect of the current crisis which has both generated and sustained the liquidity crisis. Many questions arise from a close reading of Chapter Three and some of the questions seem not only rudimentary, but self-evident.

For instance, on the issue of “moral hazard,” why should there not be regulatory bodies whose sole function is to maintain the moral “rectitude” and functionality of the financial systems? This process seems to have devolved to the Treasury Secretary and the President, which is problematic in that accountability may be desired but not applicable in these cases. Another question which comes to mind is that of the currently considered “retroactive” taxes, or repeal of the top-income tax breaks which were put into policy by the Bush administration.

How will the reality of higher corporate taxes impact the moral hazard issues relative to the current crisis? And finally, with the infusion of cash which the banks have received why has there been no corresponding loosening of the liquidity crisis? If cash-infusions are not capable of jump-starting the credit markets, does this not prove the authors’ point in Chapter Three that calls for a solution of not only liquidity, but moral issues as well?