

Anything that is too
big to fail is too big to
exist simon johnson

[Finance](#)



A. What does this mean? What are its implications? Before the 2009 financial crisis banks were convinced that they were "too big to fail"

Before the 2009 crisis, banks were convinced they were too important to fail in the sense that their importance in the market was such that the states could not afford to drop them. Indeed governments can't let any bank fail because of systemic risk and the need to maintain the confidence in the market and between banks.

So the banks favored the short-term profitability without thinking of the long term consequences of their decisions because they were convinced they could not fail. The banks then took advantage of their importance and jeopardized the entire economy

That's what Simon Johnson then explained by saying that "nothing that is too big to fail is too big to exist". The main lesson of this crisis is that it's no longer possible to leave as much power in those institutions, indeed it's essential to reduce their size and their influence on the economy so that no further institution can be "too big to fail"

B. How is this concept related to Moral Hazard?

Moral Hazard occurs "when a party insulated from risk behaves differently than it would behave if it were fully exposed to the risk". In that definition of moral hazard the idea of risk is very present, so we can easily see how this concept is related to the financial system and the banks.

Indeed Moral hazard is the idea that banks could take unnecessary risks because they believe they "are too big to fail" and would be bailed out in future
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crises. So moral hazard shows us how dangerous it is to have such important banks.

Thus the solution is to reduce the Moral hazard and the only way to achieve that goal is to allow banks to fail but governments can't permit banks to fail because of their side. Thus in order to resolve that dilemma we got to have smaller banks with less power so that if one bank fail the systemic risk will be reduce.

And if the leaders and managements of banking institutions have to face the consequences of their actions like any other company we can assume that they will act more responsibly and they will think of the long term viability more than the sort term rentability of their banks.