Can we future-proof against another financial crisis?

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The study looks at how to avoid another financial crisis.

(PhysOrg.com) -- On the day that the UK emerges from the recession, an Oxford University study warns that by continuing to test and future-proof individual banks without considering the resilience of the financial system as a whole, we run the risk of making the same mistakes again.

The 80-page study 'Beyond the Financial Crisis', led by Dr Angela Wilkinson from the Institute for Science, Innovation and Society at the Saďd Business School, reassesses the real causes and nature of the financial crisis and concludes that it was not a one-off event but heralds the prospect of other systemic failures in the financial markets.

The standard model of economics is defunct, according to Dr Wilkinson. She said: 'We cannot continue entrenched habits without continuing to succumb to the pitfalls in linear, deterministic and probabilistic approaches to futures thinking and analysis.

'A lack of systemic and reflective strategic foresight, combined with overconfidence in quantitative analysis, made the financial system "blind". Most of the actors in the system chose not to see what was going on or to question it.'

The report sets out alternative approaches to understanding what really happened and recommends a different approach to risk. It highlights what it calls the collective 'flawed thinking' of those working in the financial world and proposes a way to better prepare for an uncertain future. It offers a way to use scenario planning in a different way - as an effective process for different stakeholders to explore situations where the thinking and action is paralysed, not so much by the lack of information, but rather because of contradictory truths about what should and can be done.

The report offers two alternative scenarios. The first, called 'Growth', explores what might happen when the system is put back on track. In this scenario, national governments focus on restoring capital liquidity and trust in the financial system by 'making the invisible hand more visible'. Systemic risks are anticipated, wider externalities are priced, and certain debts are managed. Growth concludes that a greener growth path and a more risk-controlled financial system might paradoxically lead to other systems becoming less stable and more fragile.

The other scenario called 'Health' sees the financial crisis as another 'nail in the coffin' of 20th century approaches to mainstream economic assumptions and risk management. It explores what might happen if the financial system is managed as part of a wider ecology or system. This story explores the challenges of enabling systemic resilience and the prospects of a slower-growth world. The scenario highlights how coping with complexity in a more interdependent world requires rethinking and transformation - of systems, institutions and routine concepts.

The authors suggest these two scenarios can be a starting point for relevant groups who want to address the uncertainties of tomorrow's financial world. The scenarios have already been used, for the opening keynote address and engagement session of the World Economic Symposium, in Germany in 2009, and in 2009 at a Financial Innovation Laboratory which included the Institute of Chartered Accountants for England and Wales.

Dr Wilkinson said: 'Otherwise, it warns that we could well wake up in a next crisis, and wonder why we didn't at least imagine it as a plausible future before it struck.'

Dr Wilkinson is Director of the Oxford Scenarios Programme, which teaches students how to map out strategic options for the future and identify an 'early warning system' for organisations.

Provided by Oxford University

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