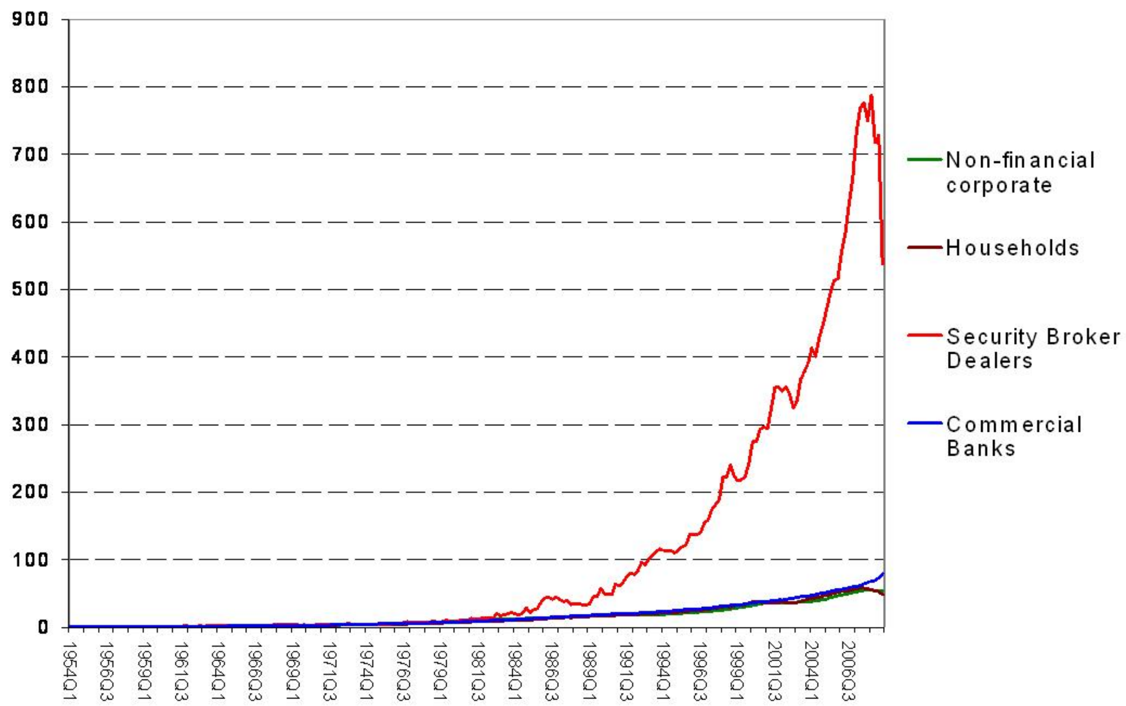
4. Concluding remarks

The organizing theme of this paper has been the overall systemic impact of long versus short intermediation chains. Long intermediation chains have been associated with the rapid development of the securitized, market-based financial system in the United States. I have argued that long intermediation chains carry costs in terms of greater amplitude of fluctuations in the boom bust cycle of leverage and balance sheet size. Shorter intermediation chains carry benefits for stability of the financial system.

For the financial industry, the key question is to what extent the rapid development of securitization and the market-based system can be regarded as the norm, or a long, but ultimately temporary stage in the development of a more sustainable financial system. Figures 12 and 13 show the growth of four sectors in the United States (non-financial corporate sector, household sector, commercial banking sector and the secuity broker-dealer sector) taken from the Federal Reserve's Flow of Funds accounts. The series are normalized so that the size in Q1 1954 is set equal to 1. Most sectors grew to roughly 80 times its size in 1954, but the broker dealer sector grew to around 800 times its 1954 level, before collapsing in the current crisis. Figure 13 is the same chart, but in log scale. The greater detail afforded by the chart in log scale reveals that the securities sector kept pace with the rest of the economy until around 1980, but then started a growth spurt that outstripped the other sectors. On the eve of the crisis, the securities sector had grown to around ten times its size relative to the other sectors in the economy. Clearly, such a pace of growth could not go on forever. Even under an optimstic scenario, the growth of the securities sector would have tapered off to a more sustainable pace to keep in step with the rest of the economy.

Figure 12
Growth of four US sectors (1954Q1 =1)



Source: Flow of Funds, Federal Reserve