

The Challenges of the Credit Crunch and Beyond

From the Board

Now that times of market euphoria and economic growth have been replaced by a sub-prime crisis, expanding into a credit crunch and undermining growth prospects in the United States and elsewhere, one sees another face of globalization than the one with which we were familiar. This process of interpenetration and interdependence at the world level, both economically and culturally, now causes the American housing market's overexposure to sub-prime debtors to affect global credit markets and, ultimately, output across the globe. Of course, in spite of forecasts of reduced growth, it cannot be ruled out that China and India have "decoupled" to such an extent that they can sustain growth levels which, even if diminished, still continue to underpin the lifting out of poverty of billions of people. (Whether Africa, a promising upcoming market with governance issues and major strife and ethnic cleansing in certain parts, can escape the downturn is more debatable). Indeed, while diminished growth and market volatility may instil fear and even depression amongst market participants, politicians and the media in the North, their effects will be most acutely felt among the nearly one billion people living at less than \$1 a day, most of whom live in the South. For people whose very existence hinges upon a trickling down of growth or on imaginative investments "at the bottom of the pyramid",¹ the fuss we make of diminished growth must seem futile. After all, a reduction in growth is still growth, but at reduced speed and from levels that must be the envy of fellow human beings for whom hunger and sickness from curable diseases are the order of the day. In this vein, the obsession with growth figures seems a collective delusion among economists and policymakers alike. Emphasizing figures may seem natural for economists but narrowly looking at GDP data only must be a kind of myopia that we can do without. It certainly does not make us happy.²

Turning to the effects of economic turbulence on regulation, an immediate trend towards another kind of "decoupling" can be discerned. Calls for protectionism are becoming louder. The French President seems inclined to make derogatory remarks about competition and has made clear that a major bank is to remain in French hands in spite of heavy losses due to alleged rogue trading (and the management's subsequent fire sales in markets that were tumbling down), losses that possibly cover other losses that would have had to be ac-

1. See: *Base of the Pyramid Learning Lab Network* at: http://www.bopnetwork.org/front_page.

2. See, among others, Richard Layard, *Happiness: Lessons from a New Science*, London, 2005.

counted for. For the leader of a State which has been adept at fostering national champions whose power is felt across Europe, without accepting takeovers of France's own (energy, telecom, dairy even) giants, this is a bad example, to say the least. The usual scapegoats are in for more fire. On the other side of the Rhine, senior politicians have in the past called private equity firms "locusts" and more recently kept insisting on regulation of hedge funds. On the other side of the Ocean, investments by Sovereign Wealth Funds (SWFs) have been looked at with askance, even though they came to the rescue of major investment banks bleeding from huge losses. There are, indeed, valid concerns about capitalism as evidenced by private equity, hedge funds and SWFs. Transparency, good governance and the issue of reciprocally open markets call for action, possibly regulatory action. The IMF has already been entrusted with the task of seeking to establish a code of conduct for SWFs. The calls for erecting barriers and keeping out 'the others' do not only undermine the abovementioned lessened growth prospects but, more importantly, undermine the current fabric of economic interdependence. They come at a time when the dogma of the free market and liberalization is on the wane, anyway, thereby increasing a trend towards nostalgia and autarky of times long passed. The rare calls for open markets recently heard³ provide a welcome change of tune in the cacophony of accusations directed at outsiders and unknowns.

If there is a case for increased regulation, for instance in respect of credit agencies or the Basel II regulatory framework just implemented, a joint approach is needed. Calls by Germany for its own reinforced financial market legislation,⁴ apparent increases in fines for French banks not implementing compliance requirements with *toute rigueur*⁵ and new instruments for the Financial Services Authority in London⁶ may each have their own merits but they may very well undermine the internal market if not harmonised at the EU level. A European approach is necessary, if at all possible, aligned across the Atlantic with the United States and, reaching out further, with other major economies. The increased separation of banking supervision from central banking seen lately and the EU approach of home State control (which implies a State-centred rather than a Europe-wide scope of supervision) are both up for

3. See Charlie McCreevy (European Commissioner for Internal Market and Services), *The Importance of Open Markets*, speech before the Council of British Chambers of Commerce in Continental Europe (COBCOE), London (GB), 10 January 2008, at: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/4&format=HTML&aged=0&language=EN&guiLanguage=en>; and Robert M. Kimmitt (Deputy Secretary of the U.S. Department of the Treasury), *Public Footprints in Private Markets – Sovereign Wealth Funds and the World Economy*, Foreign Affairs, January/February 2008, 119-130.

4. *Berlin eyes tighter bank regulations*, Financial Times, 6 February 2008.

5. *Paris eyes swingeing fines for lax banks*, Financial Times, 5 February 2008.

6. *Financial stability and depositor protection: strengthening the framework*, a joint consultation by the Financial Services Authority, the Bank of England and the UK Treasury, January 2008, at: http://www.fsa.gov.uk/pubs/cp/JointCP_banking_stability.pdf.

rethinking. Europe cannot continue to rely on stress tests, recently conducted, on secret Memoranda of Understanding⁷ and on repeating the mantra of improving the Lamfalussy method of regulation.⁸ It is time for a more fundamental rethink, taking on board suggestions from the banking industry itself and from the odd wise politician⁹ for reduced reporting requirements (to a single supervisor who then distributes data among a college of supervisors), for a single European rulebook, for European responsibilities to be included in the mandate of national supervisors, for binding decision-making among national supervisors when assembled in colleges overseeing financial institutions with systemic importance for several Member States and, indeed, for a European regulatory body, closely associated with the European Central Bank. This goes (far) beyond the current thinking in the Ecofin Council. Imaginative solutions are required.

As said, if it would be possible to proceed in line with the United States, this would be preferable, the transatlantic gulf being too wide as it is. Last fall, this was underlined by the immediate negative comments of a US government official on the well-reasoned decision by the Court of First Instance in the Microsoft case¹⁰. The European regulatory approach seems to have appeal, if not in the United States, at least not in competition issues, then elsewhere. This appeal concerns competition, with many jurisdictions following the EU approach,¹¹ and relates to central banking, with Economic and Monetary Union in Europe being emulated elsewhere. The cooperation among central banks has, ultimately, been well orchestrated and effective in overcoming ex-

7. See the ECB's press release of 18 May 2005 announcing a *Memorandum of Understanding on co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis situations*, which 'will not be a public document', at: http://www.ecb.int/press/pr/date/2005/html/pr050518_1.en.html.
8. The four-level approach to financial sector regulation and supervision proposed in 2001 by a Committee of Wise Men chaired by André Lamfalussy, former BIS General Manager and President of the European Monetary Institute, the precursor to the ECB, consists of (level 1:) framework principles, enshrined in basic EU legislation adopted according to normal legislative procedure, (level 2:) implementation of this legislation into detailed rules, adopted by the Commission after consultation of the regulatory committees, (level 3:) enhanced cooperation and networking of supervisory authorities in order to ensure a uniform approach in all Member States when applying this legislation and (level 4:) strengthened enforcement of implementation, with a central role for the Commission in overseeing the implementation; see: http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.
9. Letter of the Italian Minister of the Treasury of 26 November 2007 to the Chairman of the Ecofin Council of Ministers, at: http://www.telegraph.co.uk/money/graphics/2007/12/04/italian_letter.pdf.
10. Judgment of the CFI of 17 September 2007 in Case T-201/04 (*Microsoft v. Commission*), nyr.
11. See Neelie Kroes (European Commissioner for Competition Policy), *European Competition Policy in the age of globalisation – towards a global competition order?*, speech at the First Symposium in Innsbruck, Forschungsinstitut für Wirtschaftsverfassung und Wettbewerb (FIW), Innsbruck, 7 February 2008 at: <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/61&format=HTML&aged=0&language=EN&guiLanguage=en>.

treme liquidity shortages without – in my view – the general liquidity provision leading to moral hazard.¹² Still, the difference between the Fed (with its triple mandate of maximum employment, stable prices and moderate interest rates) and the ECB (with price stability as its primary objective, only having to support economic policies in the EU as a secondary goal) came sharply into focus in their approach to the downward edge of output. The transatlantic divide is also apparent in financial markets supervision where a more principles-based approach, firmly planted upon strict EU-wide rules, seems better suited to business and society. Apart from the obvious political and cultural differences, the area of financial sanctions comes to mind as another area in which the divide between America and Europe has grown recently. The CFI may have been far too lenient towards policymakers when it was called upon to uphold fundamental human rights of “targets” of financial sanctions against alleged terrorists;¹³ a new approach may be on the horizon. Advocate General Miguel Poirares Maduro has proposed to reinstate a level of security for the individual, which may be at variance with the policy approach *outré-atlantique*.¹⁴ Of course, the new President of the United States may be inclined to follow a less strident approach than the current administration under the Patriot Act. In any event, the US elections will make history with either a woman or an Afro-American as possible candidates for the Democratic Party.

This might be the opening of a new era in relations between Europe and America, and between America and the world. We are in need of change, not only at the political level or in our economic thinking, but also in our human behavior. The tendency to fall back into destructive habits, of thinking and acting, when confronted with major challenges, should and can be overcome. It should be overcome because of the immense challenges ahead: climate change, energy supply and conservation, the Millennium Development Goals¹⁵ whose realisation is crucial for the well-being of those already mentioned at the bottom of the pyramid, and the vexed issue of living together on one planet as people of so many beliefs and cultures. This European Year of Intercultural Dialogue can assist in informing, inspiring and bridging apparent differences.

12. See: Christian Noyer, *No moral hazard: the banks are doing their job*, Financial Times, 18 September 2007.
13. Judgments of 21 September 2005 in Case T-315/01 (*Kadi v. Council and Commission*), [2005] ECR II-3649 and in Case T-306/01 (*Yusuf and Al Barakaat v. Council and Commission*), [2005] ECR II-3533, and judgment of 12 July 2006 in Case T-253/02 (*Chafiq Ayadi v. Commission*), [2006] ECR II-2139.
14. In his Opinion of 16 January 2008 in Case C-402/05 P (*Kadi v. Council and Commission*), the AG finds that proper judicial review proceedings should apply in the Community even when it implements UN Security Council resolutions. He suggests that the ECJ set aside in respect of the appellant Regulation 881/2002 implementing the UNSC resolution on sanctions against terrorists.
15. The United Nations Millennium Development Goals at: <http://www.un.org/millenniumgoals/>.

Hopeful initiatives show the way.¹⁶ Our hitherto destructive habits can be overcome because humans are capable of far more than they imagine. Capable of building a highly complex, technically advanced global society, we can likewise harness our capacities to build the governing structures for such a society, sorely lacking thus far, and to evolve towards higher levels of inclusiveness and interconnectedness. In this area, it is Americans who lead the way with recent publications on innovative ways of facing challenges in enterprises, organisations and societies¹⁷.

R.S., February, 2008

16. For instance, *The Alliance of Civilisations*, established at the initiative of two European nations (Spain and Turkey) under the auspices of the United Nations (see: <http://www.unaoc.org/>) and the *Earth Charter*, a global consensus statement on ethics and values for a sustainable future (<http://www.earthcharter.org/>). See, also: www.tv111.eu.
17. Adam Kahane, *Solving Tough Problems: An Open Way of Talking, Listening, and Creating New Realities*, San Francisco, 2004; Peter Senge, C. Otto Scharmer, Joe Jaworski, Betty Sue Flowers, *Presence-Exploring Profound Change in People, Organizations and Society*, London, 2004.