The Governance of Globalisation
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TOWARD A FEW ETHICAL PRINCIPLES FOR THE GOVERNANCE OF FINANCIAL GLOBALISATION

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I. General remarks

Like E. Malinvaud I am of the opinion that the Church could formulate some ethical principles for the governance of financial globalisation. It would in my view, however, be necessary to restrict such a formulation to some fundamental and general orientations and to avoid detailed comments on procedural and institutional solutions. Although I personally support the general line of Malinvaud's note a statement by the Church should not go as far in addressing the procedural and institutional problems and giving concrete answers to his detailed and mostly appropriate questions.

II. Some comments to the content of the individual chapters

II.1. *What would just finances be?*

I agree: The settlement of financial contracts as well as their implementation must always be done in a fair way by both partners. Taking advantage of the naivety or distress of one side would run against the principle of fairness. And in this context: Accurate information is of crucial importance. Precise information for financial development is, however, in many cases very difficult, because of the often long time horizon and the potential impact of unforeseeable events. So certain risk-premiums are in financial markets normal and appropriate. It is true – as Malinvaud mentions – that strict adherence to the terms of the contract can in special cases be unfair. The reference to the term 'natural justice' in comparison to 'legal justice' can, however, open the door for misuse too. In my view we should be very cautious with such a counterbalance. On the other hand I agree with his ethical condemnation of an artificial creation of risks or an artificial gambling, especially in cases where both sides do not have the necessary expertise.

I also fully agree that appropriate transparency and information duties are of crucial importance for the proper functioning of today's financial markets, which due to the growing use of securities and risk-splitting are becoming more and more anonymous. Because of the fast growing internationalisation of these more and more anonymous financial activities and institutions national rules and laws and their national execution are no longer enough. Rules must increasingly be executed also at the international level via international cooperation of national authorities. For this purpose the development of common standards and the international cooperation of supervisors and jurisdiction-authorities are of growing importance.

II.2. *The trend carrying on to financial globalisation*

To the historical development I would like to make only three short comments:

– The collapse of the fixed-exchange-rate system of Bretton Woods was mainly the consequence of divergent macroeconomic policies in the most developed industrial countries. Flexible exchange rates are unavoidable as long as this can and likely will happen in future too.

– Also in Europe the policies of the EU Member Countries diverged often seriously till the beginning of the nineties. After full liberalisation of capital movement as a consequence of establishing the so-called 'internal market' and the growing willingness of countries to give up monetary sovereignty the decision to move into an Economic and Monetary Union was taken by the Maastricht Treaty. With the move into this Union the EMU Countries transferred a substantial part of their national policies to the supranational level in Europe.

– The grouping of countries into three groups (industrial countries, poor countries and emerging countries) is not without problems. There are not only huge differences within the groups, there can also be big changes aver time.

II.3. *Financial globalisation between industrial countries*

I am convinced: The future of globalisation will bring new dimensions of problems for the financial markets in the industrialised countries too as we can see already today.

In the past the financial markets of the industrial countries were mainly faced with exchange-rate volatilities. Besides this sort of volatility the industrial countries might be faced more and more with another dimension of problems on their financial markets. The growing internationalisation and dominance of securities has produced – as already mentioned – a much broader anonymous risk-distribution. On the one hand this development reduces a lot of direct risks between the real economy and the directly involved financial institutions. On the other hand the worldwide distribution of risks increases not only the potential for contagion effects; it can also enlarge worldwide uncertainties and multiply negative sentiments in critical periods.

To avoid such effects in the future precautionary activities in the following areas are of the utmost importance:

– Monetary policy especially in the leading countries must do better than in the past to hinder the development of bubbles on the financial markets.

– All countries must develop efficient supervision systems including efficient transsectoral and transnational cooperation. I share Malinvaud's view that there should be no room for exempt zones.

– Of crucial importance is in all countries an appropriate transparency on behalf of the private sector as well as of the public sector.

II.4. *'Poor Countries' in the global finance*

The so-called 'poor countries' are not only differing in their economic status but also in the origins and causes of their poorness. Besides climate, natural resources, traditions, education, heritages of colonisation and so on, very often also the lack of appropriate governance and political leadership is playing a big role.

Public and private aid via transfer of capital and the help of individuals or groups is in most cases necessary and the Church should encourage such help. But this of course is not enough. The countries themselves must also create conditions for attracting private capital from outside. Foreign Direct Investment (FDI) can and must play an important role in economic development too. It will do so, however, only, if there is inside the country appropriate and realistic governance based on reliable rules. The same has to be said for debt forgiveness. Even the HIPC–Initiative of the IMF and World Bank can only contribute to more and lasting wealth for the people if the freed resources are used in a really productive way. Debt relief is clearly not a panacea. It is true, the Monterrey Consensus has published a lot of well drafted theses. But words alone cannot help very much.

One point seems to me very important: The poor countries as well as many emerging countries need more access to the markets for agricultural products in the industrialised countries. Without a better division of labor also in this area it will be very difficult for poor countries to stimulate and improve their economic development.

II.5. *Difficulties peculiar to emerging countries*

Most of the financial crisis faced by the emerging countries in the eighties and nineties had indeed – as Malinvaud rightly points out – one important origin in the fact that the domestic financial systems were not sufficiently prepared to face the consequences of an early opening to the international markets.

Besides this fact there was, however, in most cases also another deficiency: I mean too rigid or too long a fixation of the exchange rate to the dollar or another world currency. I have been many times a critic of the IMF for recommending at the same time full liberalisation of capital movement and the fixing of the exchange rates. Fixing the exchange rate can borrow for some time credibility on the markets. But this borrowed credibility must be replaced in due time by building up one's own credibility. If this is not the case, the fixing of the exchange rate can end in collapse.

No doubt, emerging countries need enough inflow of capital. But taking into account the risk of collapsing this inflow should not be based and stimulated by a fixing of the exchange rate on an artificial base. Between full floating and rigid fixing of the exchange rate there are also solutions in between: Gradual adjustments, basket orientations, wider bands and so on, probably combined with some indirect influence an capital movements (as for example Chile did).

II.6. *Toward an ethical framework for emerging countries*

I support fully the ethical requirements mentioned by Malinvaud for the residents (households and firms) and for the national authorities in the emerging countries.

As far as the international financial institutions (IFIs) and their activities are concerned we should not underestimate the reform steps already undertaken in the last years. The new MD of the IMF, Horst Köhler, presented a year ago an interesting paper at a conference in Washington on 'Humanising the Global Economy' sponsored by the Canadian, the Latin-American and the US Conference of Catholic Bishops. In this paper he commented on the lessons learned by the IMF and elaborated on the reform-process and the changes already undertaken in the activities of the Fund. Besides these reform activities inside the IMF one should not underestimate the work of the Financial Stability Forum (FSF) established by the G7.

Of course there are still weaknesses in the global governance of financial markets and the international institutions especially in the area of formal legitimacy. It is, however, important not to put the effectiveness of decision-making in the international institutions and informal cooperation circles at risk. The experience with the UN procedures is not encouraging.

It is difficult to select the right themes in this area for a possible statement of the Church. I agree with Malinvaud: There would be no problem in endorsing the Camdessus condemnation of unscrupulous behaviour which hinders the transparency of markets. There is in my view also no problem in underlining the need that loans to the emerging countries should be based on fair conditions. But can the Church really comment on appropriate expiry dates, interest rates, currency selection, negotiation and execution procedures and so on?

Besides some general comments on what fairness in this area means, I see here a chance for giving more detailed orientations to the following points.

I have personally supported for a long time the inclusion of 'Collective Action Clauses' (CACs) in bond contracts for negotiation in case of serious difficulties faced by the borrower. I am happy to see that this idea is now gaining support not only by the political authorities but also by the banking community. Extending such a negotiation clause to any unforeseen change in business conditions could, however, open the door for undermining almost every contract.

The other point which is not mentioned in the paper is the 'Sovereign Debt Restructuring Mechanism' (SDRM) – a Chapter 11 – like solution for sovereigns proposed by Ann Krüger. In the meantime it has become clear that this proposal is not only opposed by most banks in the industrialised world but also by most of the emerging countries themselves. They fear that such a mechanism could undermine their credit standing and could produce even higher interest burdens for them. Without their consent I do not see a realistic chance for an approval of such a mechanism.

As regards the two most important criticisms on principles inspiring the policies applied by the IFIs – mentioned by Malinvaud – my short comments are as follows:

– On the unconditional demand for full freedom of capital transactions I have already made my reservation. However, there is no simple alternative in the direction of more official control. Freedom of capital movement is clearly a benefit if appropriate conditions are there.

– As far as the demand for balancing the budget is concerned, there is also not a simple answer. If there were an undisputed definition of 'structural deficit' or of 'financing productive investment' I could imagine a more flexible definition of balancing the budget. A dose of pragmatism might in some cases be appropriate. However, one should not underestimate the risk of losing confidence by the investors. Regaining the confidence of the investors in a crisis situation is of the utmost importance. A positive statement by the IMF alone will not compensate for the lack of confidence.