

FAIRNESS IN INTERNATIONAL FINANCING

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In the 2004 Compendium of the Social Doctrine of the Church, the paramount importance of investment financing for real economic growth and the fundamentally positive role of the financial markets and their internationalization are rightly stressed; at the same time, however, attention is drawn to the risks of crisis posed by the greater mobility of capital and by the loosening of the links with the real economic world:

‘...the experience of history teaches that without adequate financial systems, economic growth would not have taken place. The large-scale investments typical of modern market economies would have been impossible without the fundamental mediatory role played by financial markets, which, among other things, engendered an appreciation of the positive functions of saving in the overall development of the economic and social system. If the creation of what is called ‘the global capital market’ has brought benefits, thanks to the fact that the greater mobility of capital allows the productive sector easier access to resources, on the other hand it has also increased the risk of financial crises...’. (no. 368)

SOME SHIFTS OF EMPHASIS IN RISK POTENTIAL

In the course of the past few decades, the focal points of the potential for international financial crises have shifted. Unlike the situation in the sixties, seventies and eighties of the last century, for some time now the potential for international financial crises has not resided primarily in exchange risk. And in recent years the excessive public debt of many developing nations has been reduced or rescheduled, particularly in a number of especially impoverished countries, by means of joint efforts on the part of donors and recipients of capital, whilst others have accomplished this by

their own efforts. At the same time the activities of the financial markets have changed substantially. With the growing modernization of techniques and marketing channels (especially through the creation of derivatives), the increasing globalization of fields of action and new communications facilities, the main potential for financial crises has shifted more and more to the private financial sector, and to the risks of contagion inherent in it. Accordingly, international discussions have for some time been focussing increasingly on the issue of how to preserve the stability of the private financial system in this changing environment.

These shifts of emphasis in risk potential have also had implications for both duties and efforts at the international level. To be sure, the IMF still exercises a surveillance function, especially for the macro development of its member states, whereas the level of its former highly conditional lending is much reduced nowadays. The World Bank and other international development banks continue to concentrate mainly on financing projects in developing nations. For the oversight over private financial markets, on the other hand, there is no international supervisory organization with direct and comprehensive responsibility. Primarily through the agency of the BIS in Basel, however, with the global cooperation of central banks organised there, as well as through the Financial Stability Forum set up by the G-7 in 1999, a number of Round Tables of national and international supervisory bodies that are striving to coordinate national supervisory activities in the private financial markets and to devise appropriate regulatory frameworks and codes of conduct have now come into being.

FAIRNESS IN INTERNATIONAL FINANCING

As I interpret it, the concept of fairness in international financing comprises, besides respecting the general requirements of social justice, behaviour that takes due account of the generally accepted and applied rules and practices in effect in the financial markets. Thus, the fairness concept involves, in particular, the following aspects and considerations:

- fairness in reconciling divergent interests (especially prices and deadlines) between capital donors and capital recipients;
- fairness with respect to maintaining the lasting viability of the financial markets, and to avoiding crises;
- fairness in resolving, and dealing with, specific and systemic crises.

As regards the fair reconciling of the divergent interests of capital

donors and capital recipients, in the light of past experience, open access to the markets and the application of, as far as possible, identical conditions are of paramount importance. Fundamental lode-outs or partial limitations of markets are contrary to the requirement of fairness, as are the privileging of individual suppliers or demanders, let alone offers of bribes to decision-makers. The appropriate transparency of the terms demanded and agreed may be of mounting importance for all interested parties (including competitors) and to the lasting viability of the financial markets.

The concept of fairness requires those concerned, in particular, to give due consideration in their actions to the lasting viability of the relevant market segment. In this context (especially in the case of financial transactions), consideration of the time horizon of the deal on both sides, and of the mutual disclosure of risks, is of key significance. At the same time, the risk of contagion from other segments of the market must also be borne in mind.

Especially in the financing of large-scale projects, market participants must likewise be aware of their simultaneous responsibility for preserving the viability of the entire system. In view of the absence of binding international official rules and supervisory regulations for the lasting viability of the financial markets, the compilation of, and compliance with, joint international codes of behaviour and of decision-making are of growing significance.

Should specific or even systemic crises nonetheless occur, the concept of fairness is mandatory in coping with such crises. The standard for assigning fair shares must depend on both the failures of individual participants and their lasting importance for restoring viability to the system. In the final analysis, the decisive factor must be primarily responsibility for the future.

FAIRNESS IN INTERNATIONAL FINANCING FOR DEVELOPING NATIONS

The main speaker at this session, Prof. Luis Ernesto Derbez Bautista, has devoted himself in the paper he has delivered today primarily to the topic of the fairness and unfairness of the financial markets especially for developing nations, and has drawn attention mainly to recent trends in the financial markets and to the risks thus posed to developing nations. I should like to comment briefly on some of the issues he has raised and conclusions he has drawn.

1. Mounting Risks Owing to Market Innovations

Prof. Derbez Bautista has rightly drawn attention to the explosive escalation of market activity, especially as regards derivatives. However, these innovations have not only vastly enlarged the dimensions of the financial markets. Besides new financing opportunities, they have also created new risks, both for directly and indirectly affected borrowers and lenders and for the long-term stability of the financial system. So as to safeguard the durable viability of the financial markets, and to prevent – as far as possible – an unfair distribution of the risks, enhanced supervisory activity and international cooperation among national supervisory authorities, along with additional prophylactic measures (especially on the part of the major players among the private financial institutions) are imperative.

2. No One-Sided Unfairness to Developing Nations

Prof. Derbez Bautista is also quite right to point out that the explosive escalation of the financial markets has brought, and is still bringing, the developing nations greater risks and difficulties as well as enhanced opportunities. This is because most developing nations are particularly dependent on the external financing of their investments and on borrowing in foreign currencies.

However, unlike Prof. Derbez Bautista, I do not regard this distribution of risk as a one-sided unfairness to developing nations, since industrial nations may likewise be affected in the event of wrong policies. True, I concur in his criticism of some overly one-sided calls by the IMF and World Bank in the nineties for a rapid liberalization of capital movements – calls which were inadequately associated with major prerequisites. After all, in several of the developing nations addressed at that time, the domestic preconditions were not yet ripe for such liberalization. But this observation must not observe the fact that many of the earlier financial crisis in developing nations were mainly due to mistakes made by the affected countries themselves. That is true, in particular, of many of the earlier crises in Latin America and Asia. In most cases, a fixed or semi-fixed exchange-rate policy which was inconsistent with the domestic policy was being pursued at the time. The fixing of exchange rates, inconsistent economic policies and capital liberalization – that is an unstable triangle, and gives rise to a credibility problem which may suddenly lead to undue speculation, and thus to crisis-generating capital movements and financing problems. On account of their

often large proportions of external and foreign-currency financing, developing nations may be hit particularly hard by such trends. However, in principle that applies also to many industrial nations if their currency is not sufficiently stable, as a number of crises in Europe, too, have shown in the past.

3. Multiple Causes of Pent-Up International Imbalances

Prof. Derbez Bautista likewise rightly draws attention to the particular risks and potentially unfair effects facing developing nations on account of pent-up external imbalances. Especially in the United States, a substantial part of private and public consumption has for some time been financed by borrowing abroad. Although it is true that such external financing of a considerable part of US domestic demand has fostered world trade, and thus also growth and prosperity in many developing nations, at the same time the risk of a sudden change or even a reversal in financial flows, and of new protectionist interventions in world trade, has increased, and may well evolve to the detriment of developing and emerging nations, as well as of other industrial countries. However, the causes of this accumulation of dangerous risks are to be sought not only in the United States. In substantial measure, they are also due to unilateral policies of nominal exchange-rate stabilization and to the excessive accumulation of foreign exchange reserves in China, Japan and the OPEC countries. Hence these nations, too, bear part of the responsibility for today's problematic global imbalances, and for their adjustment without undue drawbacks for other developing and industrial nations.

SOME CONCLUSIONS FOR NATIONAL POLICIES

With respect to the operation of present-day financial markets and their further practical evolution and increasing globalization, the demand for international fairness has to take due account of numerous dimensions. One-sided assessments are no good here. In my opinion, above all the following points are essential to the achievement of the requisite fairness in international investment and financing:

1. Sustained and Credible National Policies

Present-day financial markets, with their generally global dimensions and frequently highly volatile investment policies, more than ever before

necessitate domestic national policies and modes of conduct that are Consistent, Continuous and Credible (the three Cs). That goes not only for developing and emerging nations, but also for already largely developed industrial countries. On such a basis, stable international monetary groupings can then be brought about, as the experience with the Euro goes to show. By contrast, given the divergent interest and preferences of many countries, I do not regard a global supranational currency sometimes called for by certain commentators as being realizable and desirable in the foreseeable future.

2. Stepping-Up International Cooperation

Besides a more credible orientation of national policies, a progressive further development of international cooperation in the monetary and financial sphere is of particular significance:

– The national financial supervisory authorities must continue and further refine the international cooperation that they have started. To bridge the contradiction between the growing global activities of market players, on the one hand, and for the foreseeable future prevalent national sovereignty of supervisory authorities, on the other, progressive informal cooperation, and the introduction and exploitation of greater transparency, are most likely to yield real progress towards what is – in substance – a joint set of regulations. In particular, the evolution of codes of behaviour and guidelines, as well as commitments to greater transparency, which may at the same time perform a kind of controlling function, can play a useful role, judging by past experience.

– Furthermore, the monetary policies of the national and in some cases also the international central banks must continue to be conducted credibly, and sufficiently foreseeably for the financial markets. They must not be conducted in a short term orientated way given the fairness required for the lasting functioning of the financial markets.

3. The Further Evolution of Financial Development Aid

Besides the as-fair-as-possible working of the financial markets, the financial development aid granted by developed nations will continue to be significant in future, especially for specific development projects. Specifically on grounds of fairness, however, such aid should be increasingly concentrated on conspicuously poor countries, and shaped in such a way that

it manifestly helps durably to overcome poverty and to develop a country's national and competitive economic activity. Development aid must support the lasting development of the poor countries and not privilege special groups of people or politicians.

THE ROLE OF THE CHURCH AND THE DEFINITION OF JUSTICE AND FAIRNESS

Replying to the question 'What is justice?', Pope Benedict XVI rightly said in his encyclical *Deus Caritas Est*: 'The problem is one of practical reason, but if reason is to be exercised properly, it must undergo constant purification, since it can never be completely free of the danger of a certain ethical blindness caused by the dazzling effect of power and special interests'. And a few sentences further he added: 'The Church cannot and must not take upon herself the political battle to bring about the justest society possible. She cannot and must not replace the State...She has to play her part through rational argument, and she has to reawaken the spiritual energy without which justice, which always demands sacrifice, cannot prevail and prosper. A just society must be the achievement of politics, not of the Church' (n. 28a).

Speaking as a cardinal, Josef Ratzinger, addressing businessmen here in Rome in 1985, drew attention to the connection between ethics and a knowledge of economic relationship: 'A morality which believes that it can be disregard the laws of economics is not morality but rather moralism, i.e. the opposite of morality. An objectivity which believes it can be disregard ethics is a failure to appreciate human reality, and therefore a lack of objectivity'.

The demand for fairness for the financial markets today and tomorrow likewise calls for a stance on the part of policy-makers and financial market participants alike which is geared both to ethical principles and to the exigencies of the markets.