Catholic Social Doctrine and Human Rights
Pontifical Academy of Social Sciences, Acta 15, Vatican City 2010
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GLOBALISATION AND THE PRESENT CRISIS

HANS TIETMEYER

Not only has the present financial and economic crisis now assumed global proportions, its causes and course so far are likewise linked, to a significant degree, with the progressive globalisation above all of the financial markets over the past few decades. However, mono causal analyses should be treated with caution. An objective analysis has to take into account both the diverse causalities and the various driving forces behind the crisis which, despite all regional differences, is global.

Some Remarks on Analysing the Causes

Especially the current public debate on the origins of the crisis is dominated by simplistic arguments which address only a part of the wider reality. Thus many commentators have attempted to heap the blame on misguided financial managers and inept supervisory authorities. Such oversimplifications then often lead to generalisations and populist pronouncements about a supposed general failure of the markets, the universal advance of 'casino capitalism' and wholesale errors in the fields of economic and fiscal policy. While there is a kernel of truth in most of these accusations, such sweeping generalisations are of little help when it comes to diagnosing the causes or prescribing the necessary therapy. I believe that a broader and deeper analysis of the causalities and interconnections is needed before we can start drawing any conclusions. In my brief talk, however, I can only highlight few points which, in my opinion, deserve to be analysed in greater depth.

I view the following five points as the main causes of and reasons for the emergence of the current crisis.

1) Following the progressive easing of national restrictions – especially for financial markets – in most industrial countries and many

emerging economies, the development of financial activities themselves was galvanised, in particular from the early 1990s onwards, by the new information and communications technologies. Financial markets were now able to operate globally without time lags, which increasingly made them frontrunners of globalisation.

2) These progressively integrating markets also increasingly undermined the existing national regulations and prudential rules for financial institutions. The supervisory authorities of the G10 countries, in particular, made a timely attempt to counter the growing regulatory arbitrage through informal cooperation under the Basel Accord. This met with relatively limited success, however, not least on account of the divergent viewpoints of the national authorities. Even the establishment of the Financial Stability Forum in 1999, which I myself initiated, did not produce sufficient progress. Both the idea of expanding its membership beyond the G7 or G10 to embrace the G20 group, as I proposed, and of giving it a more far reaching mandate were rejected, mainly because of opposition from the Anglo-Saxon countries. This blocking of more far-reaching international cooperation meant that, in the wake of the growing internationalisation of the financial markets, the existing national prudential rules were increasingly eroded and considerably scaled back in many countries as a result of international competitive pressure.

3) The widespread use of new technologies and the erosion of many existing rules and controls, in turn, increasingly transformed financial market activities. This was reflected in investment banking, in particular, not just in a considerable growth in the number of market players. The banking sector as a whole concurrently experienced a fundamental transformation in what had previously been its dominant activities. The traditional 'buy and hold' business of the banks and financial institutions gave way more and more to an 'originate and distribute' model for certificates. The upshot of this was a growing loss of transparency about the spread and aggregation of risks, both for the banks themselves and also for their customers. Although the rating agencies graded these new products, they were undoubtedly often too generous in the grades they assigned.

4) This was compounded by the increasing use of mark-to-market valuation methods, especially from the 1990s onwards. At the same

time, the publication of quarterly results with a correspondingly short-term horizon became more and more prevalent. Some countries in continental Europe had long opposed this type of accounting and valuation owing to the associated procyclical effects. In practice, however, the Anglo-Saxon view increasingly prevailed. The outcome of this is now clear. This approach to accounting and valuation first artificially bloated values on the financial markets and then massively exaggerated the step slide in the prices of financial products.

5) Besides the points cited, major errors in macroeconomic policy undoubtedly played a part in the emergence of the crisis. In particular, the longstanding build-up of huge global current account imbalances (especially between the USA and a number of large emerging economies) not only made artificially high growth possible over a period of many years, most notably in the countries concerned but was also accompanied by an extreme expansion of global liquidity, which was reinforced by the strong build-up of US dollar currency reserves. For a prolonged period this massive expansion of liquidity did not lead to any exorbitant global inflation, above all because international competition was becoming of the international financial markets that I mentioned earlier. This extreme expansion of liquidity is, above all, the result of an unrealistic *de facto* fixing of exchange rate parties, especially between the USA and Asian countries but, in my assessment, also results in part from a clearly too accommodating monetary policy stance, especially of the US Fed, which was supplemented by granting very generous financing to homebuyers.

It is now largely undisputed that the outbreak of the crisis originated primarily in the United States. Although the subprime crisis in the USA quickly also exposed the accumulated shortcomings in other financial markets – including in Germany – it was and indisputably remains the key trigger of the worldwide crisis. The surprising collapse of Lehmann Brothers investment bank in September 2008 undoubtedly unleashed a global crisis of confidence on the financial markets, the termination and repercussions of which still cannot be foreseen.

There is much to suggest that, for the first time since the 1930s, we are dealing with a global crisis that will leave behind a lasting mark on the real economy in many ways and pose new challenges to the globalisation process.

New Challenges for Policymakers

The new dimension of the crisis and the diverse new causalities also pose new challenges worldwide, especially for policymakers. The G20 declaration in London of 2 April 2009, in particular, has now documented the major economies' willingness to cooperate internationally. This essentially concerns the following four areas of action going forward.

> 1) First of all, restoring the functional viability of the financial markets as a whole has to take centre stage. The large central banks, in particular, have worked hard to prevent an acute collapse of the financial markets, in some cases by taking forceful and innovative monetary policy measures, since as early as August 2007. During the course of 2008, the political authorities of almost all countries strove injections in order to at least keep the 'systemically relevant' banks and financial institutions afloat and restore the functional viability of their domestic financial system. To date the measures have been predominantly successful, although the definitive outcome will only become clear during the next years.
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> 2) The slump in the real economy that has now become apparent worldwide far exceeds all the cyclical downturns of the past few decades. Policymakers, especially in the large economies, were therefore called upon to take stabilizing countermeasures. The multiplicity and scale of the initiatives launched so far demonstrate that the risk of further growth losses and rising unemployment have largely been taken seriously by the policymakers, even though one might question the programmes' composition and suitability in some cases. Another key issue is to ensure a timely exit from the current intervention strategy, which is solely justifiable as a temporary measure and harbours substantial risks, especially regarding its impact on the level of public debt.
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> 3) An absolutely crucial need is to extend and improve, throughout the world, the prudential rules for banks and financial markets and their governance. It is gratifying that the G20 summit in London initiated major guidelines and institutional improvements. This includes not only enlarging the membership of the aforementioned Financial Stability Forum but also transforming it into a Financial Stability Board and thereby upgrading its political status. However, only the

coming years will show whether this reorientation and improvement in the rule-setting procedure will yield more effective results.

4) Another important objective, at least in the longer term, is to further develop the international monetary system and its key bodies, the IMF and World Bank. Besides organisational matters and the political orientations given so far, the hitherto dominant role of the US dollar will also increasingly come under the spotlight in this context. In the short term, however, I cannot see any proposals concerning unresolved questions of institutional architecture or the reserve currency issue that are capable of winning a consensus. The controversies revealed in other areas in connection with organising cooperation at the UN level show how difficult it is to find globally acceptable and practicable solutions. The growing globalisation of the markets means that longer-term, more far-reaching solutions are inevitable, however. In particular, the instrument of mandatory disclosure can and should play an increasing role in this context for the necessary supervision of the markets.

CONCLUDING REMARK

The current global financial and economic crisis, which has by no means been overcome yet, has made it abundantly clear that the ongoing functioning of the financial markets, in particular, requires a durable, internationally effective regulatory framework. However important the globalisation of markets may be for security freedom and fostering global prosperity, it is also requires a minimum of consistency, continuity and, thus, credibility in the underlying policy framework. And the market players also have to respect this framework in reality.

Furthermore, in the context of an increasingly globalised world, freedom in the markets also imposes an obligation of individual responsibility for public welfare on all market participates. Not least the owners and managers who take the key entrepreneurial decisions must be mindful of their responsibility for maintaining the ongoing functional viability of the system and its fair and just operation. This is the only way in which a free-market system can continue to ensure the necessary degree of social justice in future. Appropriate codes of conduct should therefore be drawn up for economic and political decision-makers to stimulate the necessary consciousness of their responsibilities.

All things considered, the current crisis will be holding the attention of policymakers and economic agents for a long time to come. The German Bishops' Conference discussed this topic back in early March 2009 and published a corresponding communiqué. I believe that our Academy, too, should deal with this subject in greater depth at its next session.