

Taming international capital flows

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German-British Forum Conference, Hamburg, 5 November 2008

I deem it highly commendable to put this topic on the Agenda of our conference.

This topic has been neglected in identifying the structural forces or weaknesses of our present order and, of course, the mess we're in! Without capital flows that are indeed, by and large, untamed the present world-wide crises could not have happened!

For many years, the financial network of the capitalist world, especially in New York and London, has done an incredibly intensive amount of work, especially by lobbying, to remove almost all barriers to capital mobility in the Western World. The Holy Grail was identified and found and embedded in statutes, legal groundwork, constitutions and treaties, i.e. Lisbon. For example the EU Treaty forbids capital restrictions and allows them only under very narrowly defined circumstances (see Art. 56 – 60). 166 IMF-members have accepted the obligations of Art. VIII.

The removal of capital restrictions was made a precondition for nations to get admitted and was forced upon states in need of international solidarity. When President Clinton signed into law “The Financial Services Modernization Act” of October 1999 he removed the last pillar of the Glass-Steagall Law of 1934. Every part of the world was finally pried open to receive capital transfers from every other part of the world. Presidents Nixon and Reagan had started deregulating the US economy in 1973 and freed capital movements, whether representing real resources or not, virtual or not. Ploughed into productive use or not, committed to staying for a certain period of time or not. It was done in the name of efficient allocation and aimed at improving the welfare of everybody in the world, especially the masters and owners of the financial institutions of the world, especially the most venerated “sacred cow” called “shareholder value”.

Since then the whole world has been swamped with incredibly large sums of money, mainly created by the cooperation of a wide network of financial institutions, banks being the main pillar. Two American founding fathers come to mind: Benjamin Franklin's famous dictum: “Money makes money. And the money that money makes makes more money”. And his friend Thomas Jefferson knew early what was going to happen and he warned: “Banks are more dangerous than standing armies.”

It should be known and borne in mind that the country in the foreground, the USA, did not swamp the world with money and money surrogates of the most refined nature because of its inner strength and cohesion in terms of home generated savings: On the contrary: The savings ratio of the US stands at 0.4 %, the lowest in the world; in brotherly Great Britain at 1.1 %, compared with 11.2 % in Germany and 16 % in France. In addition, I stress again, it is one of the totally misleading myths of our times that money which crosses borderlines is supposed to allocate resources in the most efficient way. We know, for example, that more than 80 percent of portfolio investments are speculative by nature and that more than half of them are what we might call “shy” -- meaning that they stay at most only one week in the country they want to make happy.

When the final steps were taken in the US to do away with restrictions, Paul Volcker in 1987 – shortly before he stepped down from the Fed and handed over to Alan Greenspan, a man whose role in the whole affair has been, to say the least, ignominious – remarked that the so called “outside checks on corporate misbehaviour” that had been agreed upon wouldn’t work. He expressed his fear that lenders would recklessly lower loan standards in pursuit of lucrative securities offerings and market bad loans to the public. As it turned out, and this was an inevitable consequence of America’s insatiable demand for foreign credit, this marketing action took place in an unparalleled way with the *international* public.

We all are particularly concerned about the accompanying “Wirtschaftsgesinnung” or “Zeitgeist”. It has been a long way from the protestant work ethic (Max Weber) to the presently dominant all-pervasive laissez-faire ideology. I am reminded of what old Professor Charles Gulick from Berkeley used to say: "Leave everything to laissez-faire in the certainty that it will go to hell". Can “going to hell” of a derailed capitalism be avoided after massive concerted central bank support in effect since July 2007, supplemented now by a still larger multinational state rescue package of truly historic proportions? We do hope so.

To a large extent these deplorable developments are the result of human nature let loose: what Wilhelm Röpke called the immoral consequences of competition everywhere. The race between those who use money for the sake of making ever more money – a systemic and highly contagious sickness – and those who use money for the sake of creating more productive economies, has been won by the money vultures. There are now more maximising profit-driven societies than at any time in history. Without exception these countries “enjoy” an ever growing re-distribution of income and wealth in favour of the already beati possidentes whose spending

habits concentrate on luxury and speculation with all the negative consequences for a mass-demand-driven economy!

Since the whole world is on fire, we are all concerned and ask: What can and should be done to put out the flames and build a new monetary world order?"

The ongoing debate reveals where policy measures should be implemented. It has also become clear that the breadth and complexity of the manifold intertwined causes and consequences of delayed policy actions may be hard or even impossible to solve within our generation!

All measures aimed at enhancing transparency and increasing supervision do help to tame capital mobility. It must be our ambition to squeeze a large part of the laissez-faire Zeitgeist "geinie" back into the famous bottle. Relying on state guidance and intervention seems to have been accepted at last by the financial community – at least by large parts of it (but not all: we are following the examples of Barclays and Deutsche with interest) . Their cooperation and goodwill is essential. We need the financial community itself to provide constructive proposals: at present they have been conspicuously absent. A way must be found to single out productive capital transfers from the non-productive, purely capitalist-selfish flow of capital. The world needs to accept that worldwide capital mobility requires worldwide supervision and limitations.

I want to state my position with regard to policy failures and central problem areas we should focus on:

1) When studying the Tietmeyer proposal establishing the Financial Stability Forum in 1999 and subsequent papers put out by the FSF one is forced to conclude: We must put a large part of the blame also on the doorsteps of the major political players, mainly the US and Great Britain, who refused to pay heed and take suggested remedial action in time. The positive aspect is that the groundwork has been provided to develop a reform package without much quarrelling and controversial time-consuming debates.

2) I strongly plead to reach agreement on a common reform platform of the EU – especially of the Euro-Zone, before our top politicians travel to Washington for the summit soon! Whenever – if not now – should the Common Currency and its institutions live up to all the promises and expectations made by their founding fathers?

Which leads me to my third point:

3) The ECB needs to take over additional responsibilities for banks in the Euro area in the fields of coordinating financial supervision and bringing into its fold all hitherto unregulated financial institutions. This of course requires delicate coordination with the authorities in London. The

ECB should be asked to make more use of its minimum-reserve-instrument in order to curb the credit-generating power of the financial networks. The bank should be expected to raise the alarm early when bubbles develop and to prick the balloon whether economic or political interests like it or not. All this is compatible with demands to work the interest rate instrument in order to help stimulate expansion.

Whether it seems to be necessary or not to establish a *Wirtschaftsregierung* – the famous “*gouvernement économique*” as a counterpart to an even more powerful ECB depends to my understanding entirely on what it is supposed to govern. In this respect clarifications are absolutely necessary, especially in the field of determining aggregate demand policy in the EU.

4) As far as immediate regular activities are required and seem politically feasible I name my favourite areas of concern: Speculative attacks on the stock market (like shortselling) should be forbidden, like credit packaging. There can be no doubt that this practice waters down the capital basis of the banks participating and undermines the Central Bank’s policy to harness risky credit expansion. In addition I ask why does the civilized world need and accept “carry trades”?

It should no longer be a matter of controversy that banking incentive systems which are as indecent as they are counter productive need an overhaul, as do the accounting-procedures and Basel II provisions which without doubt have intensified the world crisis.

5) However the paramount challenge to politicians and regulators alike is handling the slow-down of economic activity everywhere in the world. If this trend can’t be stopped, the prospects of effective reforms and sound economic growth, economic and political stability are dim at best: I should say terrible! To increase aggregate demand in the field of public and private investment as well as consumption is a task of the first order. Design and coordination of policy measures should start in Europe and get intertwined with programs in the US and the other big players in the world like China, Russia and Brazil. The IMF should be entrusted with this job.

My topic has dealt with “*The Taming of the Shrew*”. In this Shakespeare play unmanageable Caterina (nowadays personified by unwilling bank and business managers and politicians) finally gives in to Petruccio and turns into an easy-to-handle, reasonable, responsible pussycat who loves to behave according to the morals and demands of her time!

In line with the precepts of the Bard, I force myself to suspend my normal refined pessimism and believe that our decision makers and economic agents are up to the challenges to manage the most serious, far-reaching economic crisis that we have faced since World War II.