

## CHATHAM HOUSE ANNUAL MEMBER'S CONFERENCE 2008

### Global Futures: Globalization at the Tipping Point?

Ladies and gentlemen, change is very rapid.

My formal speech, prepared last *week*, is already obsolete *today*. I am thus compelled to speak informally, although I understand this perspective is rather scary for both the Italian Ambassador and my friends here: after all, you should know, I am under their strict control!

I feel – we all feel – as if we were living in a **video game**.

When you are in a video game you are facing a **monster**: you fight the monster, you win, and you go on to the next level. But then, after the victory, just when you are really trying to relax, another monster, bigger than the former one, arrives .

Today, there are **seven** of these monsters:

- ✓ the **first** monster was the sub prime crisis, and it was managed.
- ✓ the **second** was the collapse of the credit markets.
- ✓ the **third** was the bankruptcy of major banking institutions.
- ✓ the **fourth** was the collapse of stock markets.

Now, hidden around the corner, there are the **fifth monster** - credit cards - the **sixth** - possible corporate bankruptcy on bond redemptions - as well as the **seventh**: hedge and equity funds: the implosion, the possible implosion, of credit default swaps (CDS). As you may see, there are seven shocks in a row, with combined effects.

In a common video game, when you are tired of it, you can simply turn it off. But **this** game, the **real** one, is not yet over.

The **financial crisis**. My point of view is that finance is the most visible phenomenon, alas it is not correct to speak of financial crisis only.

My view is that it is appropriate to speak both of **(i)** crisis of the core system and **(ii)** global crisis.

My view, indeed, is that a **global** crisis has **global** causes. The crisis is global because it has spanned across the globe: from America to Europe, from Asia to Latin America. It is global in another sense, too. It is global because its very roots are in the globalisation process.

Throughout history, the opening of large spaces, the elimination of physical distances constitute a common cause for turmoil. This was the case, some centuries ago, of the **geographic** discovery of America, and it is now the same with the **economic** discovery of Asia.

My personal view is very simple: this kind of process is fundamentally positive, nevertheless this kind of process should have its proper, temperate, dimension.

I may quote the French historian Fernand Braudel, who theorized the “longue durées” as opposed to short time lapses. When a process is profound, its development takes decades and decades: the time of a human life, the time of a generation following another generation.

This, yet, was not the case of the current globalisation wave. The whole process was compressed, and eventually burst, within just a few years. Straight after the collapse of the Berlin Wall, the World Trade Organisation “Initial Act” was formalized in Marrakesh in 1994. In 1995 I wrote a book, whose title was “The Ghost of Poverty”. The message of that book was that capital was flowing out to Asia, whilst our destiny was to become an importer of poverty. In 2001, 11<sup>th</sup> December 2001 - another fatal event - a few years after Marrakesh, China joined the WTO.

The crisis' inception can be dated back in 2007. As you may see, we are still speaking of a very limited time distance between the start and today's crisis.

And my personal point of view, once again, is very simple: globalisation is a tremendous, positive opportunity. However, globalisation was too fast, too quick, too soon, and involved too much leverage, too much debt. The combination of short time and huge debt was – and still is - a negative factor, with Asia producing low-price goods, and America buying on the basis of internal and external debt.

This, is the crisis' platform. On this platform the new “**techno-finance**” was applied, increasing imbalances within globalisation.

It's common in this kind of process to produce imbalances for the social, cultural and economic environment. But today's finance – “techno-finance - was the engine and the accelerating factor of the process. Moreover, while creating the illusion of huge wealth, it generated the opposite.

Within this framework, true capitalism degenerates, being affected by four main diseases.

**First disease:** over the centuries bankers collected money on trust and lent money at their own risk, properly evaluated. The new “techno-finance”, mainly the so called **OTD** (Originate to Distribute) technique, breaks off with the tradition and the fundamentals, creating the illusion that risk doesn't exist. The risk could be fragmented, securitised, and sold. Paradoxically, according to the OTD method, **the more you sell new products, financial products, the less you risk**, and, accordingly, **the more you gain**.

**Second disease:** shadow finance. Somebody is speaking of “deregulation”, and, in fact, a lot of deregulation was pursued. Mainly in America, not in Europe: from 1993 to 2001 three main US bills increased financial deregulation. The last was the famous “commodity futures modernisation act”, which put this sector out of any legal control. But my view is a different one. We are not speaking **only** of deregulation but we are obliged to speak of **absence of regulation**, because of the geo-political structure of the world, as designed by globalisation itself. In this world you can move from a legal and formal jurisdiction to

another formal but not real jurisdiction. So you can cherry-pick legal systems. One system is effective; the other one apparently is a jurisdiction but in fact is the opposite, areas of the world where the unique rule is the absence of rules. So, I'm not speaking of deregulation but of the very possibility to enter in the kingdom of a-nomia (from the Greek ανομια, "absence of rules").

**Third disease:** deviation from the ordinary legal patterns. I am a law professor with a continental background, and I use to think of the **joint stock company** as the archetypical form of corporation and legal vehicle of capitalism: its share capital and the overall structure of the company are the base of our capitalistic culture. The whole system of contours, legal, media, is based on this scheme, the scheme of corporation. On the contrary, the new finance is out of this main and basic scheme. I am speaking of hedge funds and private equity funds. The most dynamic, the most strategic part of the current capitalism is outside the original legal system. You can establish this kind of new legal vehicles, so-called private equity and hedge funds, in shadow jurisdictions; in addition, you can enter in the kingdom of anomia, another thing is to use schemes which abide from the basic scheme of the corporation.

**Fourth disease:** a Franciscan friar – friar Luca Pacioli - a lot of years ago invented the so-called "double-entry bookkeeping system", "double-entry" accounting. And the double entry accounting system is based on two pillars: balance sheet and profit and loss accounts. This mechanism was historically and ordinarily working on the base of **both** pillars. The evolution - my feeling is the **degeneration** - is to consider only the second one, to work considering only the results coming from the profit and loss accounts, paying no attention to the balance sheet. The world of the balance sheet is the **world of the values**. I am speaking of patrimony, tangible, but I'm also speaking of intangible. The history of the company, the mission of the company, the social, industrial, moral mission of the company, summing the past, the present and the future are in it. The Balance Sheet contains the mission of capitalism. If you cancel this document, if you look only to the profit and loss account, you are transforming the culture of capitalism. You are inventing another kind of capitalism, the "instant capitalism". The "take-away" capitalism, in the name of "shareholder value", legitimates you to extract the values accumulated in the patrimony, and to go away. We could recall a very old discussion, the discussion on **power**

without **property**, and transfer it on the current time: today, we are speaking of **profit** without **property**.

In these terms, my view is a new kind of regulation is required. We must introduce some regulation. Not necessarily more regulation: the old regulation could be sufficient, the original spirit of capitalism.

What to do?

I will try to conclude speaking of new institutions. Nobody knows what could happen this week. I have scientific ignorance, I know that I don't know what could happen in Washington at the next G20 meeting, or next year. Nobody knows. Everybody says something new must be done, but I look and it's easy to understand that we're facing two scenarios. The first one: in Naples they say: <**Ha da passà 'a nuttata**> : the night will be over, eventually. This means "business as usual": it could be sufficient to wait for a possible future. We may just introduce some informal regulation, just an example, using the "Stability forum", and this could be enough.

Another scenario is more intense, and, in my opinion more responsible. Obviously I am strongly in favour of the first one, but my feeling is that it is not enough: we are living no happy days at all. So it could be that another scenario is required.

A lot of years ago I was in favour of a new Bretton Woods. Now the idea of Bretton Woods is quite popular. And, honestly, the situation could require something similar. Bretton Woods was a treaty, a multilateral treaty, not exactly multilateral because a lot of delegations were convinced to sign the format. Anyway, it was a fantastic solution.

That Treaty generated two political bodies, the World Bank and the IMF, the monetary fund. After three decades the Treaty is disappearing, but appears another political body, G7, in one more year, in 1975. And this combination, three bodies, was very efficient for decades and decades. But the formula was based on a simple assumption; the G7 at that time, and into the last decade, was controlling about 80% of the GDP, was based on a unique linguistic code, English, on a unique monetary code, the dollar, on a unique political code, our democracy. Now the situation is – not the opposite – but quite

different. The G7 plus Russia, G8, controls only about 50% of the GDP. The currencies are two – dollar and euro - and the language is still the same, English, but we are facing on the other part of the world (non G8 countries) a mosaic of political systems where we find everything. We find democracies with our virtues, democracies with the opposite, countries like Russia with imperialism plus mercantilism; it's difficult to understand the difference between the East India company and Gazprom, or to interpret China, which combines both communism and mercantilism. The old formula cannot work in this world. And my personal feeling is it could be difficult, after the opening of Pandora's Box, it could be difficult to simply close it. Also, with billions and billions of people arriving on the scene of the history, it could be difficult to tell them to go back home. We must invent something new and this something has to be political. So my point of view is that first we need something new, **political**: a "G8 plus", a G20 perhaps. We are neutral, but something political, trying to draft a new treaty, not limited to capitals and finance but possibly extended to exchange rates, agricultural or social environment has to be done. And on this base, we may be able to face the new century. Thank you very much.