Response to crises: plus çà change…

"Why did no one see it coming?" asked Queen Elizabeth II at a visit to the LSE. That was indeed the first question to ask about the biggest financial crisis since World War II. Professor Garicano answered: *"At every stage, someone was relying on somedbody else and everyone thought they were doing the right thing."*[1] No, really? Chalk this up to the fact that too many economists are conformists, and that mainstream media and the establishment do not usually listen to dissenters. More broadly, large parts of business and financial sectors (populated by economists) have no interest in sending warning signals.

The Chinese definition of crisis means both "Threat" and "Opportunity." For all the real threats they are made of, crises are also an opportunity to depart from business as usual, to try something else, and reinvent economic and societal models. Especially when these are broken. As Nobel Prize winner Paul Krugman wraps it up: *"When depression economics prevails, the usual rules of economic policy no longer apply: Virtue becomes vice, caution is risky and prudence is folly."*[2] Unfortunately, to paraphrase Keynes, the difficulty lies not so much in developing new ideas as in escaping old ones –at least the ones that have not worked. What we have witnessed in the wake of the biggest financial and economic crisis in decades was not very encouraging. The time was ripe for seizing opportunities to REFORM the system. Unfortunately, in many cases, it has been a relief for the ones who wanted to maintain the status quo. A missed opportunity, as even some among the conservatives were ready -or forced to- change their mindset. It was amusing to read a former Reagan's Treasury Secretary arguing in support of at least temporary banks' nationalizations.[3] Talking about the TARP he had to put in place, the then U.S. Treasury Secretary -and former Goldman Sachs CEO- Hank Paulson admitted: *"We did things that under normal circumstances would have been and are objectionable but are better than the alternative."*[4] The then newly elected French president made a U-turn contrasting with his pro-business agenda and started ranting (not for long, though) on the abuses of financiers. How ironic it was then to see The Economist asking *"what should governments do?"* to face the looming *"misery of mass employment"* instead of its more usual call for market forces.[5]

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1 *"The Queen asks why no one saw the credit crunch coming"* (Daily Telegraph, November 5, 2008).

2 *"Depression Economics Returns"*: column in the New York Times (November 14, 2008). Read also the updated version of his simply put yet witty book *"The Return of Depression Economics and the Crisis of 2008"* (Penguin, 2009). A few months later, Krugman also regretted *"The big dither"* of Obama's administration (New York Times, March 6, 2009). A couple of years later, he lambasted Eurozone austerity policies.

3 James Baker: *"How Washington can prevent 'zombie banks'"* (Financial Times, March 2, 2009).

4 *"Paulson rues shortage of firepower as battle raged"*: interview with Krishna Guha in the Financial Times (December 31, 2008).

5 In: *"The jobs crisis"* (March 14, 2009). We write ironic because of the usual free-market and conservative leanings of the ever-smart London weekly.

Seven examples -each of them referring directly to a deadly sin- picked among dozens these last years- show piecemeal changes here and (the return to) business as usual there.

- The financial sector, and investment banking in particular, is now much more concentrated than before the subprime crisis. Bear Stearns and Lehman Brothers have disappeared, and Merrill Lynch was acquired by Bank of America, but over the last years the top ten investment banks (of which five from the U.S.) have remained the same, and concentrate unprecedented financial power. Even in France, rather less affected by the mortgage crisis, one of the first consequences of the turmoil was the merger of Banque Populaire with Caisse d'Epargne. This was a bit surprising as these not much involved in financial sector risky bets.[6] The benefits of this consolidation for shareholders, customers, and other stakeholders are not obvious.

- In 2011, German banks were the most exposed among foreign ones to the sovereign debt of Greece, Ireland, Portugal, and Spain, second only to the banks from the countries of origin. Germany's exposure was less serious in the case of Italy, yet it still ranked in the top three of foreign banks. One-third of the Irish debt and one-quarter of the Portuguese one was in the hands of German banks.[7] Some may ask what they have been doing so far from the banks of the Main river. And some still wonder why Frau Merkel wants to rescue the Eurozone and the euro at all cost.

- Basel III is now on its way to better regulate bank's capital adequacy and risk management. That is for the good news.[8] Besides the fact that it took some time to come to agreement (not least due to lobbying efforts from financiers who had gone to hell -yet with golden handshakes- and then gone back to business), enforcement will take some time, and some loopholes might already open doors for future crises. For example, Karel Lannoo, chief executive of CEPS, points to the limited role of the leverage ratio designed to limit banks' risk-taking, the reliance on credit ratings, and excessively positive bias towards real estate exposure, among other weak points.[9] We are not far from the causes of the first great financial crisis in the 21st century, which were precisely the reason for setting up Basel III.

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6 See tables, diagrams and comments about the banks' fate before and after the crisis in the Financial Times: *"Bank rankings. The fearsome become the fallen"* (March 23, 2009); and The Guardian: *"Questions of trust at the heart of a banking revival"* (March 25, 2009). For updates, use e.g. investment banking league tables, published by Thomson Reuters and http://markets.ft.com/investmentBanking.

7 Source: *"Goldman Sachs publishes list of banks exposed to PIIGS"* on www.investmenteurope.net (July 14, 2011).

8 By the way, let us point out that the U.S. has never implemented Basel II.

9 Karel Lannoo: *"Rulemakers in Europe must flex muscles on Basel III"* (Financial Times, January 31, 2012). CEPS is the Centre for European Policy Studies (www.ceps.eu).

- *"Is Facebook a Bubble?"* asked Fast Company magazine in January 2011, one year prior to the company's planned IPO. The social media company was valued at $50 billion (with a little help from Goldman Sachs). *"More than a bubble, Facebook is a manifestation of the rational excesses that only the financial markets are capable of when confronted with something without precedents and more importantly unexpected,"* says Luigi La Ferla, of an investment advisory services company, referring more than implicitly to the dot-com bubble.[10]

- In 2010, 3,100 of the largest companies were producing sustainability or corporate responsibility reports, compared with about 300 in 1996.[11] That makes a welcome change. Now back to business as usual. In April 2010, Walmart's chairman declared that *"What Walmart has done is approach (sustainability) from a business standpoint and not from a point of altruism."* One cannot reproach a company management for putting business -and profit- at the top. But what happens when citizen responsibility clashes with the (single) bottom line?[12] While the company's 2011 *"Global Responsibility Report"* emphasizes that it has met 15 of its sustainability commitments, its greenhouse gas emissions and its waste disposal have kept on increasing over the last two years. Making money comes first.

- Originally located in Anglo-Saxon economies and the financial sector, the extravagant bonuses -heavily criticized in the post-Enron and late-2000s crisis- are not only still alive out there, but have now spread to other countries and industries. Even the more egalitarian cultures are succumbing to bonus charms –and devastating effects: for the year 2011, Volkswagen's CEO earned a total of €17.5 million, while the head of the French advertising group Publicis was entitled to receive a €16 million bonus. Twenty years ago, such announcements would have raised a storm of protest on both sides of the Rhine. And stock options, which epitomize short-termism, selfishness and greed altogether have remained a key compensation component across large corporations.

- To avoid deeper recession, stimulate growth, and decrease unemployment, many policymakers have gone for subsidizing industries of the past, instead of orienting economic and social policies towards sustainable development, the climate challenge, and planet conservation.[13] One of the best-worst examples is the subsidization of automakers and users, e.g. "Cash for Clunkers" in the U.S. or "Bonus-Malus" in France. In the latter

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[10] *"Is Facebook a Bubble?"* (Fast Company, January 28, 2011).

[11] Figures provided by Patrick Eastwood, managing partner at Further (London), in the Financial Times (October 4, 2010).

[12] *"Walmart Says Environmental Initiatives About Money, Not Brand Image"* (April 13, 2010), and *"Walmart Accused of Greenwashing"* (March 8, 2012), on www.environmentalleader.com.

[13] As it was advocated by Joseph Stiglitz and Nicholas Stern in the Financial Times: *"Obama's chance to lead the green recovery"* (March 2, 2009).

case, from early in 2008, cars with carbon emissions above certain target have been more taxed. A well-intentioned measure which has resulted in… an increase of CO_2 emissions over the last years! Carmakers produced -and polluted- more, people bought more cars (mainly more polluting diesel cars), and used their car more often because it was more economical.[14] Hardly green growth, that is. More trivially, one of Formula One major sponsors in 2007 was the Dutch financial group ING, who withdrew in the wake of the financial crisis and its bailout by the government. In 2012, two of the main sponsors are Allianz, the German insurance group, and Santander, the Spanish bank. Responsible driving, probably.

Piecemeal changes are necessary but not sufficient. Capitalism needs to be reformed, and that goes beyond the usual fine-tuning and mitigation measures. Even some of its enthusiastic supporters now admit that the system in its current form no longer fits this world. As the head of a Danish pharmaceutical company puts it in his annual letter: *"It seems more like a crisis of confidence –confidence in our financial systems, in our democracies' ability to agree on long-term solutions, and in ourselves and each other."*[15] Even a conservative prime minister, David Cameron, now refers to *"moral capitalism"* and pleads for *"rebalancing"* the economy towards less financial activities, while Barack Obama called for *"making stuff"* instead of *"phoney financial profits."* Klaus Schwab, the founder of Davos World Economic Forum, said in January 2012: *"We must recognize that solving problems in the context of outdated and crumbling models will only dig us deeper into the hole."*[16] You read well, this statement does not come from a disciple of Karl Marx or Antonio Gramsci! Radical changes and a major overhaul should be on the agenda of policymakers, businesspeople, and all stakeholders involved.

The economic system must be reinvented. New models of society have to be invented. It is about going BACK to the roots; going AGAINST and bucking the system where and when necessary; going BEYOND capitalism (exploring alternatives towards more diverse economies); and going OUT of it, when possible.

Excerpt from ***"The Seven Deadly Sins of Capitalism"***, by Mike Guillaume (Searching Finance, 2012)

[14] A good summary of the unintended consequences was made in the French monthly L'Expansion (mars 2012), which mentions an increase of CO_2 emissions by 170 kilotonnes per quarter in 2008 only.
[15] Novo Nordisk annual report 2011.
[16] Cited on *"Capitalism in current form no longer fits world: WEF's Schwab"* on http://news.xinhuanet.com (January 18, 2012).