Konrad-Adenauer-Stiftung e.V.

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www.kas.de/london

kas-uk@kas.de

"The way out of the financial crises"

Abstract paper from the Konrad Adenauer Foundation experts conference

„Exit from the Financial Market crises"

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Over the past two years, the world has been confronted with the worst financial and economic crisis since the 1930's the effects of which have sent shock waves around Europe and beyond. Defaults on sub-prime mortgages and a broader housing bubble in the US unveiled a web of inter-connected and complex credit arrangements between the world's financial institutions. As the crisis deepened and inter-bank lending dried up, the system fell like a pack of cards culminating in the collapse of Lehman Brothers. Credit lines locked up turning the financial crisis into an economic crisis during which economies shrank at rates unprecedented in the post war period. Governments bailed out banks and injected huge fiscal stimuli, measures which themselves revealed systemic weaknesses and indebtedness in some countries. As sovereign debt increased and became excessive, higher risk premiums attached to refinancing served only to highlight these national vulnerabilities.

The Konrad-Adenauer-Stiftung's high-level expert group met against this background. Its starting point was the fact that currency devaluation within the Eurozone does not represent a solution to this problem of national indebtedness making the question of how we find a way out of the financial, economic and sovereign debt crises more pressing. What follows is a summary of the content and the tenor of the discussions and should serve as an input into the current debate.

1. Neither the financial nor the sovereign debt crisis is over. The solution, however, cannot be expected to come from just one place. Everyone must play their part: politicians, banks, businesses, the social partners, regulatory authorities, auditors and the ratings agencies.

2. National governments are under extreme pressure to reduce budget deficits. But this must not be done at the expense of the embryonic recovery. All public expenditure needs to be closely scrutinized and structured in such a way as to ensure long term economic growth and take into account the consequences of an aging population. Education and training and research and development should be prioritized but equally this expenditure carefully evaluated to ensure that it is effective. Stronger Small and Medium-sized Enterprises will help to fuel growth. Public expenditure needs to be undertaken cautiously so as to avoid "crowding out" of the private sector. It is vital that people's trust in politics is rebuilt but democratic legitimacy will only be restored if politicians behave with integrity and put in place mechanisms for effective dialogue with their constituents.

3. The European Union should not become a "Transfer Union" using taxation in one country to pay for debt in another. Indeed, the European Union should be doing more to foster fair competition between member states. National parliaments must remain responsible for their own budgets but this makes better coordination and transparency amongst EU member states all the more necessary in the future.

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4. Solidarity between Member States, particularly in times of crisis is vital but this needs to be within clear parameters. Governments are accountable to the electorate and accordingly must be able to justify their policies and actions. This applies as much to those countries currently embarking on severe austerity measures as it does to those nations whose own financial resources are being made available to others.

5. Substantial effort needs to be put into establishing new regulatory mechanisms. But this is not a licence to create more regulation. Rather, "smart" regulation should target increased transparency if it is to be truly effective.

6. New Basel III guidelines are to be welcomed as a first step leading, as they will, to an improved capital buffer for banks and, hence, greater stability over time. A precondition for this, however, is that all countries implement the Basel III recommendations in order both to create a level playing field and to avoid future global crises caused by lax regulation as the current one has been. It is particularly important that the US legislates to introduce the guidelines in full and does not shy away from participating international regulatory agreements, as was the case with Basel II.

7. Banks must re-focus on increasing supply of credit to businesses. The phrase, "Too big to fail" needs to be re-examined while hedge funds and private equity, markets that are currently only subject to light-touch regulation, need to be placed within a tighter regulatory and supervisory framework.

8. Like politicians, banks have a huge task ahead of them to regain people's confidence. They must implement their own internal checks and balances and enhance the supervisory role of owners and shareholders. Clear delineation of responsibility and accountability need to be combined with an appropriate and robust approach to bonuses and business ethics.

9. The mantra that the upside rests with banks while the downside is with taxpayers is not sustainable and old-style bank rescues are unimaginable in the future. Risk needs to be mitigated such future failures do not present a risk to the stability of the entire financial system. And any future bail-outs if required must be at a lower cost to the taxpayer. Clearly Basel III guidelines and any increased supervisory role for shareholders or regulators will help this process but rescuing a bank should not mean rescuing the Directors/Management Board.

10. The ECB must resume its original role – that of maintaining the stability of the Euro. Re-financing troubled Member States does not fall within its remit. Any consolidation of national debt needs to be undertaken with extreme caution with appropriate exit routes built in. A key part of this is a Europe-wide mechanism that enables national debt to be restructured in a controlled way while enabling the ECB's early exit.

Impressum

Konrad Adenauer Stiftung e.V.
Auslandsbüro Großbritannien
und Irland

63D Eccleston Square
London SW1V 1PH
United Kingdom
Telefon
+44 20 7834 4119
Telefon
+44 20 7834 4134