GLOBALISATION, THE GLOBAL FINANCIAL CRISIS AND THE REINVENTION OF THE STATE

This article analyses the nature of globalisation and how it has been affected by the Global Financial Crisis. It considers the relationship with imperialism and the Washington Consensus. It reflects on events since 2008, the decline of the West, the limits of global governance and the role of the state and central banks. In this changing world, there is a need for greater leadership, co-operation and an adequate voice for emerging economies in international institutions. This presents challenges for conventional wisdom and requires a broad inter-disciplinary approach.

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I. Globalisation

1 Globalisation is a word which has been in circulation since about 1962[1] and is used to describe complex processes of economic and social change making things global in nature or scope. The emphasis is usually on internationalisation, although sometimes distinctions are drawn between globalised localism and localised globalism.[2] Another theme is standardisation, particularly manifest in the ubiquity of US fast-food outlets, which is an example of globalised localism.[3] Localised globalism, on the other hand, is the influence of transnational practices

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1 *A Supplement for the Oxford English Dictionary* (R W Burchfield ed) (Clarendon Press, 1972) vol 1, A–G, p 1240.

2 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at p 179.

3 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at p 179.

on local conditions.[4] Some of the processes involved in globalisation such as international trade are not new.[5] Others are, particularly modern communication technology,[6] and the overall result is sometimes paradoxical and difficult to pin down. Indeed, it can be argued that there is not one globalisation, but many.[7] There has been a tendency in the last 20 years to think mainly of economic globalisation, but social and political globalisation are also important and have deep cultural consequences.[8]

2 Globalisation has been linked with capitalism and imperialism in the past but the Global Financial Crisis ("GFC") has thrown that into question. Early views of globalisation in the first decade after 1990 saw globalisation as reducing the significance of the nation state.[9] Again, the GFC has cast doubt on that and we have seen the resurgence of the nation state as regulator, investor and sometimes economic saviour.[10] At the same time, there has been a need for greater international co-operation.[11] Here then are many paradoxes.

3 In this paper, we consider each of the three concepts of globalisation, the GFC and the state and their complex interrelationship.

A. Globalisation of the mind

4 Professor Harry Arthurs, the distinguished Canadian academic, has referred to "globalisation of the mind". He argues that it "involves a change in our social values and in our fundamental understandings about what role law does play and should play in society. Globalisation is, in other words, an ideology".[12] He argues that beneath this ideology lies a bedrock assumption that governments which interfere with the

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4 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at p 179.

5 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011) at p 57 *ff*.

6 Peter Dicken, *Global Shift-Reshaping the Global Economic Map in the 21st Century* (Sage, 4th Ed, 2003) ch 4.

7 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at p 178.

8 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at pp 165–166; Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011) at p 23 *ff*.

9 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011) ch 4.

10 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011) at p 67.

11 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011) ch 5.

12 Harry Arthurs, "Law and Learning in an Era of Globalisation" (2009) 10 *German Law Journal* 629 at 632.

free flow of goods, services, capital and information (but not people) impair their capacity to maintain a dynamic economy.[13]

B. *Globalisation and imperialism*

5 The complex processes currently summed up in the word "globalisation" have their antecedents in imperialism, another ideology, and some writers see a conceptual overlap.[14] Although there were earlier empires, the phrase is normally associated with the colonial expansion of European powers in the 18th and 19th centuries.[15] Imperialism was regarded by Lenin as the highest stage of capitalism.[16] He relied substantially on the book *Imperialism*[17] by the English Fabian writer, J A Hobson, who had reported the Boer War for the *Manchester Guardian*.[18] Hobson drew attention to the astonishing fact that the UK in the course of a single generation added an area of 4,754,000 square miles and a population estimated at 88,000,000 to its domains.[19] He also referred to the actions of other European powers and the late entry of the US.[20] The second surprising fact was that the UK's imperial policy had no appreciable influence on the determination of its external trade.[21] Indeed, the greatest increase was with its industrial enemies and fellow colonisers.[22] The import trade with the US alone was greater than that of the whole of the colonies.[23] At the same time, imperialism was an outlet for the migration of populations, but he thought this could be exaggerated.[24] "The new Empire is even more barren for settlement than

13 Harry Arthurs, "Law and Learning in an Era of Globalisation" (2009) 10 *German Law Journal* 629 at 632.
14 See, *eg*, James Petras & Henry Veltmeyer, *Globalisation Unmasked: Imperialism in the 21st Century* (Zed Books, 2001).
15 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011) at p 57 *ff*.
16 V I Lenin, *Imperialism: The Highest Stage of Capitalism* (Foreign Language Press, 1975).
17 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm>.
18 See J A Hobson, *The War in South Africa: Its Causes and Effects* (Nisbet, 1900).
19 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch I.
20 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch I.
21 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch II.
22 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch II.
23 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch II.
24 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch III.

for profitable trade".[25] How then was the UK induced to embark on such an unsound business? Hobson thought that the business interests of the nation as a whole were subordinated to those of certain sectional interest for private gain.[26] It was good business for certain classes and certain trades, in particular the City of London and capital investment.[27] "The growing cosmopolitanisation of capital is the greatest economic change of this generation".[28] Every advanced industrial nation is tending to place a larger share of its capital outside the limits of its own political area in foreign countries or in colonies, and to draw a growing income from this source.[29] The modern foreign policy of the UK was primarily a struggle for profitable markets of investment. The same was true of the other countries mentioned, including the US.[30]

6 The US engaged in some of these activities in Puerto Rico, Hawaii and the Philippines but operated under the illusion that it did not "do empire".[31] This was a firm belief of Franklin D Roosevelt who, as a Harvard student, had sponsored the Boer Relief Fund[32] and had a deep antipathy to European colonialism,[33] unlike his cousin and predecessor as President, Theodore Roosevelt.[34] This antipathy strongly influenced his policies in the Second World War.[35] Nevertheless, the dominant role of the US in the Cold War after 1945 and particularly after 1990 has represented a hegemony resembling imperialism in some ways.[36] It is this latter day hegemony that has led to a US-dominated view of globalisation before the GFC.[37] The US legitimated this by asserting that everyone was a winner from globalisation whereas the GFC showed that

25 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch III.
26 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch V.
27 J A Hobson, *Imperialism, A Study* (1902) Marxists' Internet Archive <http://www.marxists.org/archive/hobson/1902/imperialism/index.htm> ch V. See also P J Cain & A G Hopkins, *British Imperialism 1688–2000* (Longman, 2nd Ed, 2002) ch 6.
28 J A Hobson, *The War in South Africa: Its Causes and Effects* (Nisbet, 1900).
29 J A Hobson, *The War in South Africa: Its Causes and Effects* (Nisbet, 1900) ch V.
30 J A Hobson, *The War in South Africa: Its Causes and Effects* (Nisbet, 1900).
31 See Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) at p 1.
32 See Heidi Macpherson, Britain and the Americas: Culture, Politics and History (ABC CLIO, 2005) at p 159.
33 Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) at p 78.
34 Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) at p 73.
35 Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) at p 84 *ff*.
36 Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) chs 2–3.
37 Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) at p 25. See Z Brzezinski, *Second Chance – Three Presidents and the Crisis of American* Superpower (Basic Books, 2007) at pp 183–184.

there are winners and losers and that the West can end up on the losing side.[38] This was obscured for a time by the rhetoric of G W Bush.[39] The term "new imperialism" has been used to describe the "Neocon" approach[40] of the G W Bush administration after September 11, 2001 and caused the US to lose legitimacy in the war on terror.[41] It also contributed to the growth of an anti-globalisation movement.[42]

7 An interesting recent development has been the communist literature in the West about "The Rise of Chinese Imperialism".[43] It has been argued that:[44]

> … China has turned the crisis of US and EU finance capital and the global recession into an opportunity to export its own finance capital and to establish imperialist spheres of influence. As a result, China is now entering directly into competition with the existing imperialist powers as an emerging imperialist rival, in particular posing a major challenge to the US, the UK, Germany and France and Japan.

8 The advantage of China over rivals is said to be that China is able to develop its imperialist character from its ability to use the Chinese proletariat as a super exploited proletariat.[45] The Chinese government rejects these arguments by maintaining that the collective welfare of the country is more important than individual citizen's

38 See Stephen D King, *Losing Control – The Emerging Threats to Western Prosperity* (Yale University Press, 2010) at p 239 *ff*.

39 See *The New Imperialists – Ideologies of Empire* (Colin Mooers ed) (OneWorld, 2006) chs 1 and 6.

40 On the "Neoconservatism" of G W Bush, see also, for example, *Hegemony or Empire? The Redefinition of US Power under George W Bush* (Charles-Philippe David & David Grondin eds) (Ashgate, 2006).

41 Bernard Porter, *Empire and Superempire – Britain, America and the World* (Yale University Press, 2006) at pp 118, 151.

42 See, for example, Andrew Gamble, *The Spectre at the Feast: Capitalist Crisis and the Politics of Recession* (Palgrave Macmillan, 2009) at p 159 *ff*.

43 Humanist Workers for Revolutionary Socialism, *The Rise of Chinese Imperialism – How it has Exacerbated the Decay of World Capitalism, and the Implications for the Class Struggle Today* (9 March 2010) <http://www.humanistsforrevolutionarysocialism.org/Publications/China_Pamphlet.pdf>.

44 Humanist Workers for Revolutionary Socialism, *The Rise of Chinese Imperialism – How it has Exacerbated the Decay of World Capitalism, and the Implications for the Class Struggle Today* (9 March 2010) <http://www.humanistsforrevolutionarysocialism.org/Publications/China_Pamphlet.pdf > pp 7, 15. Even Hilary Clinton has referred to this "new colonialism" in Africa recently, see *Clinton warns against "new colonialism" in Africa* (Reuters, 11 June 2011) <http://www.reuters.com/article/2011/06/11/us-clinton-africa-idUSTRE75A0RI20110611>.

45 Humanist Workers for Revolutionary Socialism, *The Rise of Chinese Imperialism – How it has Exacerbated the Decay of World Capitalism, and the Implications for the Class Struggle Today* (9 March 2010) <http://www.humanistsforrevolutionarysocialism.org/Publications/China_Pamphlet.pdf > p 4.

rights.[46] The party controlled All-China Federation of Trade Unions is supposed to protect workers' rights and independent trade unions are illegal.[47] Reforms of workers' rights have been carried out but the enforcement is problematic.[48] Nevertheless, there has been dramatic improvement in the lives of hundreds of millions of Chinese.[49] To do this in a large developing country of over 1.3 billion is a massive and complex economic and political task. Jiang Zemin said in 2000:[50]

> To raise the living standard of the people constantly is the basic starting point and the final goal of all work of our Party. With the constant improvement of their livelihood the people will support the leadership of the Chinese Communist Party and the socialist system even more wholeheartedly, and devote themselves to the reform and opening-up and the modernization drive with even more confidence, and the ruling foundation of our party will be increasingly consolidated.

C. Globalisation or globalisations

9 The Portuguese lawyer and sociologist Boaventura de Sousa Santos describes the globalisation process as "multifactored phenomena with economic, social, political, cultural, religious and legal dimensions, all interlinked in a complex fashion".[51] He emphasises the paradoxical character of these processes, how they manifest universality on the one hand and localisation on the other.[52]

10 He argues there are many globalisations and refers to an attempt by hegemonies or social groups or states to dominate discussion and impose their own conception as an inexorable process.[53] In this, globalisation has both a descriptive and a prescriptive component.[54] The

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46 See, for example, Andrew Charlton, "Bitter Fruits: China's Twelfth Five-Year Plan" *The Monthly* (June 2011) at p 21.

47 See Humanist Workers for Revolutionary Socialism, *The Rise of Chinese Imperialism – How it has Exacerbated the Decay of World Capitalism, and the Implications for the Class Struggle Today* (9 March 2010) <http://www.humanistsforrevolutionarysocialism.org/Publications/China_Pamphlet.pdf>.

48 Humanist Workers for Revolutionary Socialism, *The Rise of Chinese Imperialism – How it has Exacerbated the Decay of World Capitalism, and the Implications for the Class Struggle Today* (9 March 2010) <http://www.humanistsforrevolutionarysocialism.org/Publications/China_Pamphlet.pdf>.

49 See C Fred Bergsten *et al*, *China: The Balance Sheet* (Public Affairs, 2003) ch 3.

50 Jiang Zemin, *On the Three Represents* (Foreign Languages Press, 2001) at pp 83–84.

51 Boaventura de Sousa Santos, "The Process of Globalisation" (*Eurozine*, 22 August 2002) <http://www.eurozine.com/articles/2002-08-22-santos-en.html> 2/47.

52 Boaventura de Sousa Santos, "The Process of Globalisation" (*Eurozine*, 22 August 2002) <http://www.eurozine.com/articles/2002-08-22-santos-en.html> 16/47.

53 Boaventura de Sousa Santos, "The Process of Globalisation" (*Eurozine*, 22 August 2002) <http://www.eurozine.com/articles/2002-08-22-santos-en.html> 20/47.

54 Boaventura de Sousa Santos, "The Process of Globalisation" (*Eurozine*, 22 August 2002) <http://www.eurozine.com/articles/2002-08-22-santos-en.html> 32/47.

prescription is anchored in the hegemonic consensus. He refers to the Washington Consensus. This is based on four major ideas: (1) the consensus of the liberal economy, (2) the consensus of the weak state, (3) the consensus of liberal democracy, and (4) the consensus of the rule of law.[55]

11 The origins of the Washington Consensus seem to be linked with neo-liberal developments from the 1970s onwards and the US's attempts to influence them overseas.[56] It is interesting how economic theories of the "Law Matters" thesis reflect this.[57]

12 Historians differ as to the precise historical sequence of globalisation.[58] Some trace it back to the Spanish and Portuguese conquests of the New World and the reaction to the inflationary consequences of importation of gold and silver. There is broad agreement that the industrial revolution led to the second chapter which continued to the breakdown caused by the First World War. The next chapter was from 1945 until the collapse of the USSR in 1990.[59]

13 This period is characterised by the following diverse phenomena:

(a) the eventual breakdown of the World International Monetary Order agreed at Bretton Woods in 1944;

(b) the growth of multinational and transnational corporations and enterprise since 1945;

(c) the rapid development of computers and telecommunications and the resulting reduction in trading costs on international capital markets;

(d) the international financial revolution;

(e) the rise of international institutional investors;

(f) capital market imbalances caused by differences in savings rates and investment opportunities and international

55 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at p 314.

56 Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002) at p 315.

57 Rafael La Porta, Florencio Lopez-de-Silanes & A Shleifer, "Corporate Ownership Around the World" (1999) 54 *Journal of Finance* 471. For a valuable discussion, see B Cheffins, "Corporate Law and Ownership Structure: A Darwinian Link?" (2002) 25(2) UNSWLJ 346.

58 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011).

59 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011).

trade imbalances such as the Organisation of Petroleum Exporting Countries ("OPEC") and later Japanese surpluses;

(g) the collapse of communism in the former USSR and Eastern Europe;

(h) the growth of corporatisation and privatisation of public enterprise;

(i) the growth of regionalism with such bodies as the EU and the North American Free Trade Agreement ("NAFTA"), and the attempts to activate an Asia-Pacific region through the Asia-Pacific Economic Council ("APEC");

(j) the industrialisation of the Third World; and

(k) the growth of world markets and the spread of transnational production.[60]

Some of the events described are interlinked, but sometimes the question of causation is complex.

14 Those events led to the golden age of globalisation, which arguably ended with the GFC in 2008–2009. It was marked by:

(a) the dominance of the West through the G7 group of countries and the dominance of the West by the US;

(b) falling trade barriers and increasing international competition; and

(c) the rise of some developing countries such as China and India, which have vast economic potential.

15 What was new about these processes was the extent to which time and space were compressed by new technologies, and the impact this has had on the patterns of financing corporations and spreading risk in investment.[61] Cross border capital flows after the removal of exchange control in many countries have produced the result of an unconstrained global capital market which sits uneasily with the present proliferation of nation states. The lack of a coherent international regulation of capital markets represents a source of short-term volatility as well as a long-term threat to economic and political order. China has been able to take advantage of this market while still practising tight

60 J H Farrar, *Corporate Governance: Theories, Principles and Practice* (Oxford University Press, 3rd Ed, 2008) at p 535.

61 J A Grundfest, "Internationalisation of the World's Securities Markets: Economic Causes and Regulatory Consequences" (1990) 4 *Journal of Financial Services Research* 349; R O'Brien, *Global Financial Integration: The End of Geography* (Royal Institute of International Affairs, 1992).

internal controls. Conversely, the US dollar has been weakened and can no longer serve as the world's reserve currency indefinitely. Hence the call for a world currency echoing earlier views of Keynes.[62] Keynes in the 1940s put forward the idea of the Bancor, whose value would be based on the value of 30 representative commodities. This idea was rejected but the special drawing rights introduced by the IMF fulfil something of this role, although their value is based on a basket of currencies rather than commodities. They are not currency nor in fact a claim on the IMF, but simply claims on currencies of IMF members which can be used in limited ways.

16 Before the GFC, the conventional wisdom had become:

(a) transnational trumps national;

(b) markets trump politics;

(c) the law's mission was to make the world safe for markets; and

(d) the best kind of law limits regulatory intervention and promotes self-regulation.[63]

17 This had arguably reshaped the constitutional matrix of separation of powers in western societies. It restricted the powers of national legislatures, enhanced the power of the executive and business interests and enlarged the power of the Judiciary to referee boundary disputes. It has subjected the nation state to international bodies and led in some respects to global law without a state.

18 The GFC has dented the US hegemony and led to the G20 and the Seoul Consensus of 2010, which put the emphasis on development. The six core principles of this Consensus are:

(a) focus on economic growth;

(b) global development partnership;

(c) global or regional systemic issues;

(d) private sector participation;

62 John Maynard Keynes, "Proposals for an International Clearing Union" (1942) in *The Collected Works of John Maynard Keynes* (D M Moggridge ed) (Macmillan, 1980) vol 25, Activities 1940–1944, pp 168–195.

63 Harry Arthurs, "Law and Learning in an Era of Globalisation" (2009) 10 *German Law Journal* 629 at 632.

(e) complementarity; and

(f) outcome orientation.[64]

19 The effect of the recent events has been, first, to refute the determinist fallacy that was linked with US hegemony which involved confusing the causes of globalisation with its effects. Secondly, it marks a redefinition of North and South as centres of influence. We shall return to these points later but let us look at the GFC in more detail.

II. Globalisation and the global financial crisis

A. The nature and causes of the GFC

20 The GFC is the third financial crisis since the beginning of modern globalisation commencing with the collapse of the USSR. In its consequences it is more than a financial crisis. It is an economic and political crisis, which may be of the nature of a paradigm shift.[65] Modern globalisation cast the US in the role of lead player and this lacked the institutional support that characterised the Bretton Woods Agreement. A number of factors that have contributed to the GFC are discussed below.

(1) The US subprime mortgage crisis

21 The widely felt impact of the US housing bubble, and the crisis in the US subprime mortgage market, are some of the lessons of the impact of globalisation. The factors contributing to the subprime mortgage crisis are well-known.[66] Perhaps the first of these factors was the US government's housing policy, and the creation of institutions such as Freddie Mac and Fannie Mae, that supported US policy. A second factor was the lowering of standards in the home mortgage market, where "subprime" customers obtained loans.[67] Repayment risks were seen to be minimal because of the belief in the security underlying home mortgages – it was assumed that house prices would always

64 G20 Seoul Summit 2010, "Seoul Development Consensus for Shared Growth" (11–12 November 2010) <http://www.g20.utoronto.ca/2010/g20seoul-consensus.html> (accessed August 2012).

65 See Kevin Davis, "Regulatory Reform Post the Global Financial Crisis: An Overview" Report for Melbourne APEC Finance Centre, Australasian APEC Study Centre at RMIT University (March 2011).

66 See, for example, Charles R Morris, *The Two Trillion Dollar Meltdown* (Black Inc, 2009) at pp 65–72 and Ross Garnaut, *The Great Crash of 2008* (Melbourne University Press, 2009) at pp 1–23.

67 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at pp 423–424.

increase.[68] A third contributing factor was the lack of contact between lenders and borrowers, as most transactions were brokered by mortgage originators, who had little personal interest in the repayment of the mortgage.[69] A fourth factor was the absence of adequate regulation of home mortgages.[70] Ultimately, along with a number of other factors, the inability of "subprime" customers to repay their home mortgages led to a worldwide economic crisis.

(2) Securitisation of mortgages and financial innovation[71]

22 The practice of securitisation, a financial innovation that originated in the 1990s, contributed significantly to the crisis. Collaterised debt obligations and other instruments and securitised products were intended to minimise investor risk, and make investments safer. However, because of their complexity and inherent nature, these products ended up spreading risk. Home mortgages were used increasingly in sophisticated financial products through securitisation.[72] Mortgage repayments became the security for investment products sold to institutional investors.[73]

23 The result of the need for higher yields led to increased financial innovation in investment products.[74] There was an abundance of new acronyms as "financial institutions converted their loans into mortgage or asset backed securities ("ABS"), subsequently turned into collateralised debt obligations ("CDO")[75] often via off-balance special purpose vehicles ("SPV") and structured investment vehicles ("SIV"), generating a dramatic expansion of leverage within the financial system as a

68 The 2005 statement of Frank Nothaft, then chief economist of Freddie Mac, is telling: "I don't foresee any national decline in home price values. Freddie Mac's analysis of single family houses over the last half century hasn't shown a single year in which the national average housing price has gone down" Australian Graduate School of Management, "Anatomy of a credit crisis" (22 October 2010) <http://www.agsm.edu.au/bobm/iows/timeline.pdf> p 11.

69 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at pp 423–424.

70 Poor disclosure standards were an important factor. See Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p 9.

71 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p xviii.

72 Vince Cable, *The Storm: The World Economic Crisis and What It Means* (Atlantic Books, 2009) at pp 32–36.

73 Vince Cable, *The Storm: The World Economic Crisis and What It Means* (Atlantic Books, 2009) at pp 32–36.

74 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 7.

75 For an excellent discussion of CDOs, see Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at pp 127–155.

whole".[76] As a consequence, credit expanded, and the belief held by investors that risks were spread, in turn led to more leverage and more risky financial products.[77] A lack of transparency in the make-up of these complex financial products exacerbated the situation.

(3) The globalised financial system and globalisation

24 A relaxing of capital controls and a reduction of exchange controls fuelled globalisation.[78] Cross-border investment was encouraged and facilitated through the work of international organisations such as the WTO, the World Bank and the IMF. Barriers to cross-border trade and investment continued to drop towards the end of the 20th century. The result was that banks and financial institutions outside of the borders of the US were exposed quickly and deeply to the US domestic subprime mortgage crisis.

(4) Excessive borrowing and risky investments

25 The word "leverage" has become closely associated with the financial crisis. Institutions and investors indulged in high levels of borrowing and investments that exposed them to risk. Many investments were risky because of their underlying complexity, and their lack of transparency made it difficult to accurately gauge the value of the underlying assets.[79] This was exacerbated by the role of the credit rating agencies, which is discussed below.[80]

26 As mentioned, many investment products had their origin in the need for higher returns. Interest rates had been low for an extended period of time, and investors were keen to obtain higher investment yields.

(5) Regulatory and supervisory failures in the light of financial innovation

27 Regulators and supervisors have been blamed for their failures in detecting the problems in financial products and the financial

76 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at pp 7–8.
77 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 8.
78 See generally, Philip Arestis & Santonu Basu, "Financial Globalization: Some Conceptual Problems" Working Paper No 360, Levy Economics Institute of Bard College, New York (October 2002).
79 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at pp 7–8.
80 See para 32 below.

system.[81] The first factor to consider is the dominant philosophy at the time – a belief in self-regulation and regulation by the market. For many years, this paradigm had led to economic growth and prosperity. For example, Alan Greenspan said that there was effectively no difference between market regulation and federal regulation.[82] He (and others) concluded that federal (or governmental) regulation was not essential, maybe even undesirable.

28 The second factor to consider is that the focus of the existing regulation, mostly prompted by the Basel II Capital Accord, was focused on the capital needs of financial institutions. Regulators neglected the role of liquidity.[83] The ability of financial firms to manage their own risks was overestimated. Similarly, the capital that they should hold was underestimated.[84] Also, central banks were ill-prepared for the changes in the needs of banks and were pushed into new terrain when supporting banks during the GFC.[85]

(6) Failures of governments and the global system

29 Governments were ill prepared for the shocks and impact of the GFC. The subprime mortgage crisis precipitated a credit crunch when financial institutions were no longer prepared to lend to each other. It was not foreseen that the interbank capital markets would freeze up, and there were no contingency plans. The result was that governments virtually had no choice but to provide the necessary assistance to institutions through much-maligned bailouts and loans. Governments were criticised for socialising private debt and threatening the very tenets of the liberal capitalist underpinnings of the modern financial system.[86]

30 The inter-connectedness of the global financial system played an important role in many respects. First, the fact that many financial institutions operate internationally now makes systemic risk an

81 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p xviii.
82 Australian Graduate School of Management, "Anatomy of a credit crisis" (22 October 2010) <http://www.agsm.edu.au/bobm/iows/timeline.pdf> p 7.
83 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 9.
84 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 8.
85 Bank for International Settlements, "The future of central banking under post-crisis mandates" BIS Paper No 55, Bank for International Settlements (January 2011) at p 8.
86 For example, Henry Paulson, then Treasury Secretary of the United States, said in 2008 that raw capitalism was dead. See Andy Serwer & Allan Sloan, "How Financial Madness Overtook Wall Street" *Time* (online) 2008 <http://www.time.com/time/magazine/article/0,9171,1842294,00.html> (accessed August 2012).

international issue. Insufficient attention was paid to international financial institutions of systemic importance.[87] Second, through financial globalisation and technological advancement, a financial crisis in one country can now easily spread to and affect other countries. Third, domestic decisions, such as the decision of the US government not to provide a bailout package for Lehman Brothers, and the decision of the UK's Financial Services Authority ("FSA") not to approve the purchase of Lehman Brothers by Barclays, inevitably had implications beyond the borders of the decision-maker. This was an expensive and painful lesson for all involved.[88] The question arises as to what extent domestic decisions should have the welfare of the international system at heart, especially as such considerations would impact national sovereignty. Fourth, in the global financial crisis, governments felt compelled to provide whatever assistance they could to private institutions in the name of the public good and the public benefit.[89] Fifth, over many years, the focus has been predominantly on micro-economic issues, not macro-economic issues.[90] Systemic stability, and in particular international systemic stability, had been neglected.

(7) Corporate governance and risk management failures

31 Failures of governments in dealing with the crisis were mirrored in the failures of those at the helm of important financial institutions. Basel II and many country-specific prudential regulations focused on principles, not specifics, leaving the detail, and final decisions, in the hands of the organisations themselves. The effectiveness of principles-based regulation has been questioned after the GFC.[91] In the organisations, however, there was inadequate risk-management, and overall poor corporate governance.[92] This was evidenced on a number of levels, not least so in the controversial practices of executive compensation. High levels of executive compensation and bonuses correlated with

87 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p xviii.

88 For a first person account from the coalface, see Henry M Paulson, Jr, *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* (Business Plus, 2010) at pp 178–249. For a British perspective, see Alistair Darling, *Back from the Brink* (Atlantic Books, 2011) at pp 110–155.

89 In the title to his book, Paulson describes the actions as a "race to stop the collapse of the global financial system": Henry M Paulson, Jr, *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* (Business Plus, 2010).

90 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 11.

91 Principles based regulation has been criticised after the GFC. See, for example, Julia Black, "The Rise, Fall and Fate of Principles Based Regulation" Working Paper No 17/2010, Social Sciences Research Network (21 November 2010).

92 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p xviii.

short-term gains[93] and encouraged risky investment practices. Also, as the testimony of Goldman Sachs before Congress revealed, it had become normal practice for institutions to simultaneously promote products to clients and hedge against expected losses from those products themselves.[94] Third, poor corporate governance also led to inadequate risk assessment[95] and a failure on the part of organisations to hold sufficient capital.[96] Part of the problem lay in the lack of transparency of the financial products. The obscurity of the true financial positions of organisations and the quality of their securities fuelled the credit crunch, resulting in a freezing of the interbank lending market.[97]

(8) Failure of credit rating agencies

32 Credit rating agencies failed to provide accurate ratings of financial products that could have disclosed the risk attached to these products.[98] Credit ratings agencies are not regulated entities. Further, contrary to good governance principles, the issuers of the securities generally paid for the rating.[99] Inevitably, ratings may have favoured the issuer, and may not have adequately protected the purchasers of the securities.

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93 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 10.

94 Goldman Sachs, however, vigorously denied that they had betted against their clients. See, for example, the transcript of the discussion in Congress: <http://transcripts.cnn.com/TRANSCRIPTS/1004/27/jkusa.01.html>. The prepared testimony of Goldman Sachs representatives are available from <http://www2.goldmansachs.com/search/search.gscgi>.

95 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p xviii.

96 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 8. There was "a misunderstanding of the interaction between credit and liquidity and a failure to verify fully the leverage of institutions were among the most important". This resulted in "an overestimation of the ability of financial firms as a whole to manage their risks, and a corresponding underestimation of the capital they should hold".

97 The events of the credit crunch in September 2008 are described in the Financial Crisis Inquiry Commission's *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at pp 353–386.

98 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Public Affairs, 2011) at p xxv. For example, AAA credit ratings were given to the senior tranches of structured financial products. Previously, only government bonds and some corporate bonds would have qualified for such ratings. The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 9.

99 The issuer-pays model has been criticised for creating a conflict of interests. See the de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 9.

(9) Build-up of the shadow banking system

33 Financial innovation did not only arise in financial products. The shadow banking system has grown significantly in recent years.[100] Importantly, hedge funds and investment banks did not fall under the same regulatory scheme as banks. Consequently, investment banks were ineligible for liquidity assistance from the central bank, and during the GFC, Morgan Stanley and Goldman Sachs converted into banks in order to obtain emergency liquidity assistance. Generally, an investment bank was not the typical institution that would likely suffer from a "run-on-the-bank", requiring liquidity assistance from the central bank, or an institution that could lead to a financial crisis. Importantly, inadequate regulation of the shadow banking system precipitated the crisis. Further, the international scope of this crisis, as well as the wide range of institutions affected (insurers, hedge and mortgage funds and even car manufacturers) that were brought within its scope, distinguished this crisis.

B. The immediate aftermath of the GFC

(1) Sovereign crises – Economic and political

34 For states, the experiences of their individual economic crises ranged in severity with varying social and political impacts, as was the case, for example, in Iceland, Ireland and, more recently, Greece.

35 In Iceland, in a span of six months, "its currency … collapsed, its largest banks … failed and [were] nationalised, and its economy … imploded".[101] This sparked immediate social unrest through protests, which transformed into political instability. Eventually, the government was toppled. Ultimately, former Prime Minister Geir Haarde faced a court for failing to prevent the economy's sudden crash.[102]

36 Ireland changed from the so-called "Celtic Tiger" with the second highest GDP in the EU in 1994[103] to a struggling nation. Ultimately, Ireland was forced to accept a €85bn bailout by the IMF and EU,

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100 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 8.

101 Jonas Moody, "Global Financial Crisis Claims Iceland" *Time* (online, 21 January 2009) <http://www.time.com/time/world/article/0,8599,1874036,00.html>.

102 "Iceland's former PM to face court over financial crisis" *The Telegraph* (online, 29 September 2010) <http://www.telegraph.co.uk/news/worldnews/europe/iceland/8031622/Icelands-former-PM-to-face-court-over-financial-crisis.html>.

103 David Smith, *The Age of Instability: The Global Financial Crisis and What Comes Next* (Profile Books, 2011) at p 189.

guaranteed by four years of rigid fiscal austerity measures.[104] Over 100,000 people took to the Dublin streets to protest the bailout, marking one of the largest demonstrations in Irish history.[105] In the 2011 election, voters punished the ruling Fianna Fáil party, which was reduced from 71 seats to an all-time low of 20 seats in Parliament.[106]

37 In 2007, Greece became the epicentre of Europe's sovereign debt crisis:[107]

> It may be argued that the financial crisis gave rise to a constitutional crisis in the EU whose consequences have exacerbated the difficulties already experienced in the aftermath of the recent enlargements. Indeed, the last enlargement raised numerous questions, of both an economic and a political nature. … [T]he financial crisis acted as a catalyst to all already-existing structural economic problems in the EU and its Member States.

38 Greece accepted a first rescue package of €110bn in 2011[108] and a further rescue package in the region of €130bn in February 2012 in order to prevent sovereign default and a further crisis.[109] On several occasions, protests erupted in Greece as a result of austerity measures imposed as conditions to the rescue packages,[110] including one which claimed the lives of three bank employees.[111] The instability through the Greek streets has been matched by the instability in its Parliament. However, after surviving a narrow vote of confidence,[112] then Greek Prime Minister George Papandreao successfully moved the adoption

104 Henry McDonald & Andrew Clark, "Ireland Bailout Protest Draws 100,000 to Dublin Streets" *The Guardian* (online, 27 November 2010) <http://www.guardian.co.uk/business/2010/nov/27/ireland-bailout-dublin-protest>.

105 Henry McDonald & Andrew Clark, "Ireland Bailout Protest Draws 100,000 to Dublin Streets' *The Guardian* (online, 27 November 2010) <http://www.guardian.co.uk/business/2010/nov/27/ireland-bailout-dublin-protest>.

106 Miriam Lord, "Angry Electorate Coldly Voted to Liquidate Fianna Fáil" *Irish Times* (online, 2 February 2011) <http://www.irishtimes.com/newspaper/frontpage/2011/0228/1224291011457.html>.

107 Leila Simona Talani, "Conclusion" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) at p 258.

108 Gabi Thesing & Flavia Krause-Jackson, "Greece Faces 'Unprecedented' Cuts as $159B Rescue Nears" Bloomberg (online, 3 May 2010) <http://www.bloomberg.com/news/2010-05-02/greece-faces-unprecedented-cuts-as-159b-rescue-nears.html>.

109 Nils Pratley, "Greece Bailout: Six Key Elements of the Deal", *The Guardian* (online, 21 February 2012) <http://www.guardian.co.uk/business/2012/feb/21/greece-bailout-key-elements-deal>.

110 Louise Armistead, "Violence in Athens over Greek Debt Crisis" *The Telegraph* (online, 15 June 2011) <http://www.telegraph.co.uk/finance/economics/gilts/8578282/Violence-in-Athens-over-Greek-debt-crisis.html>.

111 Dan Bilefsky, "Three Reported Killed in Greek Protests" *New York Times* (online, 5 May 2010 <http://www.nytimes.com/2010/05/06/world/europe/06greece.html?src=me>.

112 "Greek Government Survives Confidence Vote" BBC (online, 22 June 2011) <http://www.bbc.co.uk/news/world-13869428>.

of a budget to institute substantial spending cuts and restructuring in mid-2011.[113] He has since been replaced (in November 2011) by Lucas Papademos, a former central banker.[114]

39 The Greek crisis was in part due to a lack of fiscal discipline and excessive government borrowing. Although government borrowing ballooned after the height of the GFC in 2008,[115] the role of serious external imbalances cannot be disregarded.[116] An important lesson from the experience of Greece is how vulnerable the European Monetary Union is in essence.[117] Opinions regarding the need for Greece to withdraw from the European Union, or for a split in the European Monetary Union abound.[118]

40 At the time of writing, the Eurozone crisis has not been resolved. The IMF has warned of a possible depression should a solution to problems in the Eurozone (and elsewhere) not be found.[119]

41 In May 2010, the European Financial Stability Facility was created,[120] and the members entered into the new Euro Plus

113 Natalie Weeks & Marcus Bensasson, "Papandreou clinches votes for second Greek budget bill" Bloomberg (online, 30 June 2011) <http://www.bloomberg.com/news/2011-06-30/papandreou-wins-enough-votes-to-pass-greek-budget-bill-ensuring-bailout.html>.

114 Jack Ewing, "New Greek Leader Trusted but Untested" *New York Times* (online, 10 November 2011) <http://www.nytimes.com/2011/11/11/world/europe/new-greek-leader-lucas-papademos-trusted-but-untested.html?_r=1&ref=jackewing#>.

115 "*What really caused the eurozone crisis?*" BBC (online, 22 December 2011) <http://www.bbc.co.uk/news/business-16301630?print+true>.

116 Antimo Verde, "The Greek Debt Crisis: Causes, Policy Responses and Consequences" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 143 at p 147.

117 Antimo Verde, "The Greek Debt Crisis: Causes, Policy Responses and Consequences" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 143 at p 150.

118 See the examples quoted by Antimo Verde in Antimo Verde, "The Greek Debt Crisis: Causes, Policy Responses and Consequences" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 143 at p 153.

119 Christine Lagarde, "Global Challenges in 2012", speech delivered at the *Deutsche Gesellschaft für Auswärtige Politik e.V* (DGAP) German Council for Foreign Relations, Berlin (23 January 2012). She stated: "But what we must *all* understand is that this is a defining moment. It is not about saving any one country or region. It is about saving the world from a downward economic spiral. It is about avoiding a 1930s moment, in which inaction, insularity, and rigid ideology combined to cause a collapse in global demand. The longer we wait, the worse it will get. The only solution is to move forward together. Our collective economic future depends on it."

120 Antimo Verde, "The Greek Debt Crisis: Causes, Policy Responses and Consequences" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 143 at p 155.

Pact.[121] Member states are under important restrictions that curtail member sovereignty through strict "no bail-out" provisions. Officially, a member who fails to implement the agreed European fiscal rules and then suffers a domestic financial crisis will not be able to benefit from the assistance of a Eurozone bailout.[122] A loss of fiscal sovereignty may be the last step in full integration in the European Union.[123] One of the key problems in the EU, as illustrated by the Greek crisis, has been identified as an "insufficient degree of political integration between its members".[124] The policy framework of the European Monetary Union has its limits,[125] and its sustainability over the long-term has also been questioned.[126] Part of that problem lies in the lack of solidarity, and perhaps even hostility, member states displayed when faced with the Greek crisis.[127]

42 In the US, although it did not lead to an immediate political crisis for President Obama, the debate preceding Congress's ultimate approval of a raised debt ceiling for the US is evidence of deep divisions in the largest economy in the West. Approval was finally granted with some reluctance notwithstanding Treasury Secretary Timothy Geithner's warnings of the serious threat that a possible default by the US on its obligations would likely have disastrous consequences.[128]

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121 See European Council, "Statement by the Euro Area Heads of State or Government" (9 December 2011) <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/126658.pdf. See further generally, J M Barroso, "Taking Stock of the Euro Plus Pact" Presentation to the European Council, Brussels, 9 December 2011 <http://ec.europa.eu/europe2020/pdf/euro_plus_pact_presentation_december_2011_en.pdf>.

122 Antimo Verde, "The Greek Debt Crisis: Causes, Policy Responses and Consequences" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 143 at p 155.

123 Pedro Gustavo Teixeira, "The Regulation of the European Financial Market after the Crisis" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) 9 at 22. Note, in particular, Figure 1.2, the "onion layers" of the intergration of the single EU financial market.

124 Leila Simona Talani, "Conclusion" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 258 at p 259.

125 Leila Simona Talani, "Conclusion" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 258 at p 259.

126 Leila Simona Talani, "Conclusion" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 258 at p 259.

127 Leila Simona Talani, "Conclusion" in *Europe and the Financial Crisis* (Pomeo Della Posta & Leila Simona Talani eds) (Palgrave Macmillan, 2011) p 258 at p 259.

128 Letter from Timothy Geithner to The Honourable Harry Reid, Majority Leader, United States Senate, 26 January 2011 <http://www.treasury.gov/connect/blog/Pages/letter.aspx>. On 16 July 2011, the US Treasury also used all four of the extraordinary measures available to it to extend the US Borrowing Authority until 2 August 2011. US Department of the Treasury, "Update: As Previously Announced, Treasury to Employ Final Extraordinary Measure to Extend US Borrowing Authority Until August 2" (press release, 15 July 2011).

(2) The need to build up international institutions

43 The GFC showed that globalisation in the financial markets was not adequately matched by globalisation in regulation, and that international institutions needed more clout. Even though the stability of the international financial system raised concerns, no one took the lead in coordinating action effectively.[129]

44 The rise of the G20 from a Financial Ministers' forum to become the lead player in the international conversation during and in the aftermath of the GFC highlights the need for the 21st century regulatory framework to be more inclusive. The G20 membership includes important developing countries, such as China, India and South Africa.[130] Importantly, the G20 increased the role of the Financial Stability Forum, by reconstituting it as the Financial Stability Board and tasking it with greater responsibility.

45 On an international level, the Financial Stability Board now fulfils a critical role, beyond the scope of its predecessor, the Financial Stability Forum. It has been positioned by the G20 to be at the centre of both international and national dialogue, and it provides a point of connection for governments and international bodies of experts (for example, the International Organization of Securities Commissions ("IOSCO")), as well as institutions such as the IMF and the World Bank.[131] The Financial Stability Board has progressed significantly with the tasks imposed on it by the G20.[132] The areas of focus include capital and liquidity standards, the mitigation of procyclicality, addressing systemically important financial institutions and the development of macroprudential frameworks and tools. Furthermore, progress has been made in improving the OTC derivatives markets, compensation practices, and the strengthening of accounting standards, and the adherence to international supervisory and regulatory standards.[133] Similarly, although the IMF was criticised for failing to adequately warn

129 The de Larosière Group Report, High-Level Group on Financial Supervision in the EU (25 February 2009) at p 11.

130 G20 Members (2012) G20 <http://www.g20.org/index.php/en/members> (accessed August 2012).

131 See the excellent chart in Howard Davies & David Green, *Global Financial Regulation: The Essential Guide* (Polity Press, 2008) at p 33.

132 Financial Stability Board, *Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability* <http://www.financial stabilityboard.org/publications/r_110219.pdf> (accessed August 2012). See also Financial Stability Board, *Progress since the Washington Summit in the Implementation of the G20 Recommendations for Strengthening Financial Stability* <http://www.financialstabilityboard.org/publications/r_101111b.pdf>.

133 Financial Stability Board, *Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability* <http://www.financial stabilityboard.org/publications/r_110219.pdf> (accessed August 2012)

of the impending GFC, its role and focus has now been enlarged, and changes have been implemented to improve representation.[134]

(3) Work on systemically important financial institutions

46 A key issue for central banks and regulators is systematically important financial institutions ("SIFIs").[135] The Financial Stability Board has been addressing systemically important financial institutions and the systemic risk posed by them. The recommendations so far are as follows:[136]

(a) a resolution framework should be created and other measures taken to ensure that problems concerning all financial institutions can be resolved safely, quickly and without destabilising the financial system and exposing the taxpayer to the risks of loss;

(b) a requirement that SIFIs and initially in particular global SIFIs ("G-SIFIs") have higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system;

(c) more intensive supervisory oversight for financial institutions which may pose systemic risk is needed;

(d) robust core financial market infrastructures should be created to reduce contagion risk from the failure of individual institutions; and

(e) other supplementary prudential and other requirements as determined by the national authorities.

134 In particular, the 2008 Quota and Voice Reforms of the International Monetary Fund entered into effect on 3 March 2011. Further reforms proposed in 2010 will further improve the position of developing countries and emerging market economies at the IMF. IMF, "The IMF's 2008 Quota and Voice Reforms Take Effect" (press release 11/64, 3 March 2011) <http://www.imf.org/external/np/sec/pr/2011/pr1164.htm>.

135 For a survey of views on the concept of "Systemically Important Financial Institutions" ("SIFI"), see International Monetary Fund, Bank for International Settlements and Financial Stability Board, "Guidance to Assess the Systemic Importance of Financial Instruments, Markets and Investments: Initial Considerations – A Background Paper" Report to the G-20 Finance Ministers and Central Bank Governors, Financial Stability Board, International Monetary Fund and Bank for International Settlements (28 October 2009) <http://www.financialstabilityboard.org/publications/r_091107d.pdf>.

136 Financial Stability Board, *Progress since the Washington Summit in the Implementation of the G20 Recommendations for Strengthening Financial Stability*, p 6 <http://www.financialstabilityboard.org/publications/r_101111b.pdf> (accessed August 2012).

Some of these recommendations have already been adopted by domestic legislatures whether consequent upon the FSB's recommendation, or out of their own initiative.

47 The Basel Committee on Banking Supervision, an international standard-setting body for the prudential requirements for financial institutions, is developing a methodology for the identification of banks that are systemically important from a global perspective.

48 Agreement was reached on Basel III at the end of 2010 by the members of the Basel Committee on Banking Supervision, and some amendments were made in June 2011. As with previous Basel Accords, the implementation of Basel III internationally will be spread over a number of years, with full compliance only expected around 2018.

49 Basel III responds directly to some of the problems experienced before and during the GFC, some of which were at times even cited as causes of (or at best, contributing factors to) the GFC. In particular, the Basel Committee has attempted to strengthen the resilience of banks and the global banking system, in accordance with the mandate given to it at the Pittsburgh Summit of the G20:[137]

(a) In particular, banks will be required to hold more and higher quality capital, with the minimum capital requirements being raised. The Tier 1 Capital Ratio has been increased from 4% to 6%, which is a large increase, given that Tier 1 Capital is the "best' capital, and has to be readily available if needed.

(b) In addition, a new capital buffer, referred to as the Capital Conservation Buffer, has been introduced, together with a countercyclical buffer – both initiatives are intended to make financial institutions more resilient in time of stress, thereby making institutional failure and consequently systemic risk, less likely. The aim of the countercyclical buffer is to build up capital in good times so that in periods of crisis or stress, this capital is available to the institution.

(c) As from January 2015, banks will also be required to implement a liquidity coverage ratio. The objective of this ratio is to ensure that, in the event of a crisis or "stress scenario", sufficient liquid assets are available to allow the bank to survive for a period of one month. Lack of liquidity was one of the serious problems in the GFC, a problem exacerbated during the credit crunch when banks stopped lending to each other.

137 Basel Committee on Banking Supervision, "Basel Committee's response to the financial crisis: Response to the G20" Report, Bank for International Settlements, October 2010, p 1 <http://www.bis.org/publ/bcbs179.htm>.

(d) Basel III also introduces a leverage ratio of 3% which supports the new measures in respect of capital and liquidity. The objective is to prevent banks taking excessive risk.

(e) The Basel Committee also points out that in Basel III, there are overall stronger standards applicable to supervision, public disclosure and risk management.[138]

Basel III has been described as a "comprehensive set of reform measures"[139] when compared to Basel II, in that not only have previous regulations been amended, but significant new provisions have been introduced.

50 It is important to note that individual countries have to decide whether they will adopt Basel III. For example, Australia has already indicated that it will adopt Basel III, notwithstanding some technical difficulties. In the G20 Communiqué of February 2011, the members of the G20 commit to the implementation of Basel III.[140] Given the political power of the G20, it is therefore conceivable that Basel III will also find support in countries who are not members of the Basel Committee on Banking Supervision ("BCBS").

51 The technical difficulties in implementing Basel III should, however, be respected – not all countries and all organisations will be in a position to implement Basel III without difficulty, or without significant adjustment. The increased responsibility of banks in respect of reporting requirements will affect the technology and systems that they implement and use, and it will likely be a gradual process, and a slow one at that.

52 Basel III cannot be seen as a "solution" to possible financial crises, and it is unlikely that, on its own, it will prevent future crises. In fact, a crisis may even arise before it has been fully implemented.

53 The International Association of Insurance Supervisors is involved in a similar exercise for the insurance sector. Work is also going on at the IMF.

138 Basel Committee on Banking Supervision, "Basel Committee's response to the financial crisis: Response to the G20" Report, Bank for International Settlements, October 2010, pp 2, 8 <http://www.bis.org/publ/bcbs179.htm>.

139 Bank for International Settlements, "International regulatory framework for banks (Basel III)" <http://www.bis.org/bcbs/basel3.htm>.

140 G20, "Communiqué Meeting of Finance Ministers and Central Bank Governors, Paris, 18–19 February 2011" (Communiqué, 18–19 February 2011) <http://www.g20.org/Documents2011/02/COMMUNIQUE-G20_MGM%20_18-19_February_2011.pdf>.

54 The regulatory system in the US has been based around industry specific federal supervisors with additional supervisors at state level. One of the lessons learnt in the GFC was that there was poor coordination between these different regulators. There is ongoing debate about an improved system with particular emphasis on "systemically important financial institutions". These are identified by the following characteristics:[141]

(a) the financial system's interdependence with the firm;

(b) the firm's size;

(c) its level of leverage;

(d) its reliance on short term funding; and

(e) its importance as a source of credit and liquidity to other market participants.

55 Professor Lawrence J White of New York University, in an article poignantly entitled "US Financial Regulation: A Hopeless Tangle, of Complexity for a Purpose",[142] described the US system as follows:[143]

- There are five federal regulators of depository institutions as well as one or more regulator in each of the 50 states. The states also regulate lenders and mortgage originators that are not depositories;
- There is a separate federal agency that has the responsibility for regulating Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System;
- There are two federal regulators of the securities markets and financial instruments, as well as 50 state regulators (and 50 state attorneys general, who are prepared to bring lawsuits against securities firms on behalf of their respective states' citizens);
- The regulation of insurance companies is exclusively the domain of the 50 states;
- Pension funds are regulated by two federal agencies, and, again, the 50 states also have a say;
- Consumer fraud in financial products can be the responsibility of yet another federal agency, as well as the 50 states.

141 See Brad Gans, "Regulatory Implications of the Global Financial Crisis" Working Paper No 102, 05/2009, Institute for Law and Finance, Goethe University, 10.

142 Lawrence J White, "US Financial Regulation: A Hopeless Tangle, or Complexity for a Purpose?" Q Finance <http://www.qfinance.com/regulation-best-practice>.

143 Lawrence J White, "US Financial Regulation: A Hopeless Tangle, or Complexity for a Purpose?" Q Finance, p 2 <http://www.qfinance.com/regulation-best-practice>.

56 There are overlapping responsibilities and jurisdictional disputes throughout this framework. The Dodd-Frank Act,[144] which seeks to limit the damage caused by the failure of large financial institutions, enables the removal of the administration of a SIFI from court supervised administration under the Bankruptcy Code to administration by the "orderly liquidation authority" under the Federal Deposit Insurance Corporation.[145]

57 The UK also suffered financial market turmoil which necessitated prompt action for regulation of banks and the creation of special insolvency regimes for banks. This led to the Banking (Special Provisions) Act 2008,[146] which was later replaced by the Banking Act 2009,[147] whose key provisions came into force on 21 February 2009. This was part of a larger regulatory reform package. Key elements of the 2009 Act are stabilisation options: transfers to a private sector purchaser, a bridge bank and temporary public ownership. The supervisory system is much simpler than the US model with just one supervisor. There is a new regime for bank insolvency, as well as a requirement of "living wills". The purpose of the latter is threefold:

(a) pre-resolution to allow banks to restructure their operations before they get into difficulty;

(b) in resolution to provide blueprints for break up; and

(c) post-resolution to smooth out problems in the aftermath of failure.

In essence, it involves disclosure and a plan for resolution.[148]

58 The two insolvency procedures bank administration and bank insolvency are new but not drastically different from existing insolvency procedures.

59 The objectives of the Financial Services Authority in the UK were redefined by the Financial Services Act 2010[149] but the coalition

144 The Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (Public Law 111-203, HR 4173) Title II.
145 See David Skeel, *The New Financial Deal* (John Wiley & Sons Inc, 2011) chs 7 and 8.
146 c 2.
147 c 1.
148 The main purpose of a living will has been described as giving "the *ex ante* effect, as in real life". Emilios Avgouleas, Charles Goodhart & Dirk Schoenmaker, "Living Wills as a Catalyst for Action" Working Paper No 10-09, Wharton Financial Institutions Centre (February 2010) at p 3 <http://fic.wharton.upenn.edu/fic/papers/10/10-09.pdf> (accessed August 2012).
149 c 28.

government intends to replace it by a Prudential Regulation Authority under the aegis of the Bank of England.[150]

60 Work on complex financial conglomerates is difficult because of their nature at domestic level. The problem is compounded at international level, and in a globalised world, the work must be carried out with a greater degree of urgency than seems to be currently happening. As Dr Hu has written: "If we fail to understand the systemic implications of large complex financial firms, the global financial system will likely continue to be haunted by the 'too big and too interconnected to fail' syndrome for years to come."[151] There is doubt as to the efficacy of the Dodd-Frank reforms[152] and the UK reforms,[153] and whether any governance agency has the sophistication to deal with a complex financial conglomerate in a crisis situation. There is an urgent need for a framework for international co-operation or coordination.[154] If we cannot have complete universalism let us at least have some system of modified universalism dealing with cross-border cases on a case by case basis and using "living wills" for those cases where universalism cannot be applied.[155] As it is, we seem to have "wasted the crisis".[156]

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150 Bank of England and Financial Services Authority, "The Bank of England, Prudential Regulation Authority – Our approach to banking supervision" (May 2011) <http://www.bankofengland.co.uk/publications/other/financialstability/uk_reg_framework/pra_approach.pdf>.

151 *The Future of Money* (Oliver Chittenden ed) (Virgin Books, 2010) at p 32.

152 See Jeffery N Gordon & Christopher Muller, "Confronting Financial Crisis: Dodd-Frank's Dangers and the Case for a Systemic Emergency Fund" (2011) 28 *Yale Journal on Regulation* 151.

153 See Clifford Chance, "The Banking Act 2009: Implications for the Financial Markets" Briefing Note May 2009 and HM Treasury, "A New Approach to Financial Regulation – Building a Stronger System" (Cm 8012, February 2011). See also David G Mayes, "Banking Crisis Resolution Policy – Lessons from Recent Experience" CESifo Working Paper No 2823 (October 2009) at pp 19–27. This provides a useful summary.

154 See the PowerPoint slides of John L Douglas, "Too Big to Fail – Do We Need Special Rules for Bank Resolution?" Lecture delivered at the Institute for Law and Finance, Goethe University, Frankfurt am Main, November 2010 < http://www.ilf-frankfurt.de/uploads/media/Lecture_-_J._Douglas_-_Treatment_Of_Creditors_In_Bank_Insolvencies.pdf>. See also David Skeel, *The New Financial Deal* (John Wiley & Sons Inc, 2011) at pp 177, 186. Further, see Basel Committee on Banking Supervision, "Report and Recommendations of the Cross-border Bank Resolution Group" Report, Bank for International Settlements, 18 March 2010, p 34 <http://www.bis.org/publ/bcbs169.pdf>. For an earlier argument to this effect, see Hal Scott, "Multinational Bank Insolvencies: The United States and BCCI" ch 34 in *Current Developments in International and Comparative Corporate Insolvency Law* (Jacob Ziegel ed) (Clarendon Press, 1994) at pp 733, 744–745.

155 See Charles A E Goodhart, "Foreword" in *Cross Border Bank Insolvency* (Rosa M Lastra ed) (Oxford University Press, 2011) at p vii.

156 See Richard Portes, "Wasting the Crisis: The G20's Role in Financial Sector Reform, GlobalAsia" September 2010 <http://www.globalasia.org/V5N3_Fall_2010/Richard_Portes.html>.

(4) A change in the role of central banks – A focus on financial stability

61 The GFC has highlighted the importance of the protection and regulation of financial stability. It seems likely that central banks may increasingly be responsible for domestic financial stability. The GFC has, however, highlighted that national financial stability can no longer be the only focus and because of globalisation, financial stability should be ensured at international level.

62 Central banks have been placed in the spotlight to an unprecedented extent, not just in the immediate reactions to the crisis, but also in potential new roles in financial stability after the GFC. We therefore consider central banks and their roles in more detail here.

63 The relationship between central banks and the state is interesting for this discussion for a number of reasons.

64 First, central banks play an essential and prominent role in responding to a financial crisis. They are often the first involved in the resolution of a financial crisis, frequently as lender of last resort to a bank with liquidity problems. Their involvement furthermore extends beyond the most critical part of the crisis through their role in guarding price stability. Central banks are generally independent from government, and do not form part of the executive arm of government, whilst they perform critically important functions in the public interest (leading to a so-called "democratic deficit" where non-elected officials make decisions of a public nature).[157]

65 Second, the focus of central banks has for many years been price stability,[158] which has sometimes been described as the preservation of the integrity and purchasing power of a nation's money.[159] Price stability is achieved through inflation targeting, and using interest rate policy to keep inflation in check. Whilst central banks have been very successful in the pursuit of price stability, the GFC has indicated that price stability may not be the only, or even the most important function that a central bank has or should have. After the GFC, it has become evident that price

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157 Sylvester Eijffinger & Jakob de Haan, "The Political Economy of Central-Bank Independence" Special Papers in International Economics No 19, International Finance Section, Department of Economics, Princeton University (May 1996) at p 15.

158 Bank for International Settlements, "Issues in the Governance of Central Banks" Report from the Central Bank Governance Group (May 2009) at p 5.

159 Ben S Bernanke, "The Benefits of Price Stability", speech delivered at the Center for Economic Policy Studies on the occasion of the Fifth Anniversary of the Woodrow Wilson School of Public and International Affairs, Princeton University, Princeton (24 February 2006) <http://www.federalreserve.gov/newsevents/speech/bernanke20060224a.htm>.

stability did not provide financial stability. Many central banks consider, at least implicitly, that they also have a responsibility for financial stability.[160] This is evidenced through the increasing number of financial stability reports published by central banks.[161] The real existence and importance of an explicit mandate of central banks for maintaining financial stability should be investigated. Should a responsibility for financial stability be or become an objective of central banks, the legal framework in which they operate, as well as the tools at their disposal, may require changes.

66 Third, the GFC highlighted the interconnectedness of the financial world, but a "dark side" of globalisation has also been revealed: whilst financial internationalisation or globalisation seemed to provide some of the biggest advantages for the globalised world, it also had the potential to destroy those benefits.[162] Central banks are domestic institutions, but their roles in the international financial arena may have to be reconsidered. There is concern that the effect of the growth in national/domestic regulation and legislation may be detrimental to international finance, and the positive aspects of globalisation.[163]

(5) A plethora of domestic legislation and regulation

67 Notwithstanding calls for international co-operation and commensurable regulation, but perhaps understandably, given the mandate of national governments, national governments have promoted important pieces of new legislation,[164] such as the US Dodd-Frank Act[165]

160 Bank for International Settlements, "International regulatory framework for banks (Basel III)" p 25 <http://www.bis.org/bcbs/basel3.htm>.

161 Jakob de Haan & Sander Oosterloo, "Transparency and accountability of central banks in their role of financial stability supervisor in OECD countries" (2006) 22(3) *European Journal of Law and Economics* 255 at 263.

162 Otto Hieronymi, "From 'Global Finance' to the Crisis of Globalization" in *Globalization and the Reform of the International Banking and Monetary System* (Otto Hieronymi ed) (Palgrave Macmillan Studies in Banking and Financial Institutions, 2009) at pp 1, 25.

163 Otto Hieronymi, "From 'Global Finance' to the Crisis of Globalization" in *Globalization and the Reform of the International Banking and Monetary System* (Otto Hieronymi ed) (Palgrave Macmillan Studies in Banking and Financial Institutions, 2009) at p 57. It is emphasised that "today, there is an urgent need for a truly international spirit and approach to creating a stable and efficient international subsidiarity (*sic*) rather than the concepts of centralization and uniformization (*sic*). Internationalism means that where there is international activity, there is also a need for common legislation and basic rules of behaviour. It is not simply meant for the rule of the biggest and strongest".

164 Domestic responses were often *ad hoc* and indicative of a lack of knowledge about what could happen next. See Kevin Davis, "Regulatory Reform Post the Global Financial Crisis: An Overview" Report for Melbourne APEC Finance Centre, Australasian APEC Study Centre at RMIT University (March 2011).

165 Public Law 111-203, HR 4173.

and the UK Banking Act.[166] These arose out of necessity and frustration at the speed of attempting to arrive at an international solution. These events have led to debate about the changing role of the state and the rise of state capitalism.

III. The changing role of the State

68 The modern state grew from diverse origins. Some were literally nation states which were often kingdoms or principalities. Some were city states. Some resulted from the breakup of empires. Some are multinational states made up of more than one nation. The UK and the old USSR are examples. Some city states are becoming global states like Singapore, which seeks a role of arbitrageur between other states. Some states like the UK and US host international financial centres which operate with a degree of autonomy as *de facto* offshore islands. Conversely, a number of states have sovereign wealth funds.

A. The role of the State

69 The traditional roles of the State are:[167]

(a) to maintain social order or declare war;

(b) to define property rights;

(c) to provide for administration of justice;

(d) to provide public goods;

(e) to regulate markets;

(f) to tax; and

(g) to redistribute wealth through welfare programmes.

70 The growth of the modern welfare state has resulted in an increased role for the State which has led to increased taxation.

71 The Washington Consensus and conceptions of globalisation advocated by bodies like the IMF and the Organization for Economic Co-operation and Development ("OECD") before 2008 fostered the

166 c 1.

167 Compare Sir John Salmond, *Jurisprudence* (Sweet & Maxwell, 7th Ed, 1924) ch V, pp 141, 144–145.

idea of a retreat of the State.[168] This manifested itself in the following ways:[169]

(a) privatisation;

(b) outsourcing;

(c) a race to the bottom by cutting taxes and deregulating;

(d) the impacts of global finance on domestic economies;

(e) the impact on global systems of production;

(f) the bypassing of central governments;

(g) the transfer of policy-making in certain areas to supra-natural bodies; and

(h) the emphasis on self-regulation.

72 The role of the State shifted to meta-governance of the economy in the sense of steering, resourcing and assuming accountability in state-owned enterprise and matters such as competition.[170]

73 The Washington Consensus taken up by the IMF, World Bank and OECD led to a commercialisation of the State.[171] This took various forms which included corporatisation, privatisation and outsourcing. It was thought that greater efficiency and reduced cost would result. At the same time, global systems of production undermined the state's power to regulate the market.

74 In the early 1990s, writers like Kenichi Ohmae[172] argued that nation states were becoming the local authorities of the global system. They were increasingly subject to the decisions and movement of international capital. This was a pro-business, anti-politics agenda and represented a temporary triumph of the political right following on from the mixed experiences of monetarism in the 1980s.

168 See Boaventura de Sousa Santos, *Toward a New Legal Common Sense* (LexisNexis Butterworths, 2nd Ed, 2002); Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011).

169 Stephen Bell & Andrew Hindmoor, *Rethinking Governance – The Centrality of the State in Modern Society* (Cambridge University Press, 2009) ch 3, p 123.

170 See Stephen Bell & Andrew Hindmoor, *Rethinking Governance – The Centrality of the State in Modern Society* (Cambridge University Press, 2009) at p 39 *ff*. See also P Hirst, G Thompson & S Bromley, *Globalisation in Question* (Polity, 3rd Ed, 2009) at p 235 *ff*.

171 Stephen Bell & Andrew Hindmoor, *Rethinking Governance – The Centrality of the State in Modern Society* (Cambridge University Press, 2009) ch 6.

172 Kenichi Ohmae, *The End of the Nation State – The Rise of Regional Economies* (Harper Collins Publishers, 1995).

75 In the decade since 11 September 2001, the West has been distracted by the war against terrorism and the costly invasion of Iraq and Afghanistan. Coupled with deregulation, the result has been an increase in debt, considerable errors of judgment and a dangerous state of affairs.

76 This has weakened the West, particularly the US and the UK. At the same time, Asian countries, scarred by their earlier experiences in the Asian financial crisis, have become much stronger. So too has Germany, which is benefiting from China's interest in its export products.

B. The impact of the GFC

77 The GFC challenged much of the wisdom of the last two decades.[173] Deregulation has been seen to be a policy carried too far. Self-regulation has been seen to have its limitations in the Enron era and then the GFC. The need has been felt for state capital to fill gaps in liquidity during the GFC. Systems that espoused state capitalism have been seen to have prospered at the expense of those that espoused market capitalism.

78 What is the present situation regarding globalisation? The dominance of the West has been challenged and may have ended. The G20 represents a sharing of power with other economies (including developing economies) with differing interests. Whether state capitalism will prevail over market capitalism in the middle to long term is debatable, but this requires intelligent planning by market economies. Globalisation is a dynamic process and there is every reason to think that it can adapt to these new realities.

79 The second question is the future shape of regulation. It was not simply the free market which failed in 2008 to 2009. Our systems of regulation also failed.[174] There was lack of coordination of banking, securities and insurance regulation. So far, there has been considerable debate but comparatively little action.

173 See, for example, Richard A Posner, *The Crisis of Capitalist Democracy* (Harvard University Press, 2010).
174 Richard A Posner, *The Crisis of Capitalist Democracy* (Harvard University Press, 2010) at p 173.

80 On the lessons to be drawn from the GFC:[175]

> The main lessons that we can learn from the GFC are:
>
> - no two crises are exactly alike;
> - the first step in a crisis is to ensure stability of the system;
> - regulators must be flexible to respond to an emerging crisis while recognising that they cannot manage it;
> - regulators need to develop a global early warning system to identify asset bubbles and excesses in domestic and/or international markets and the systemic risk implications;
> - there needs to be improved cross-border data sharing and cooperation;
> - regulators must take into account the global nature of the present system and its complications;
> - regulatory reform must not overreact or be overambitious;
> - derivatives need special attention in terms of regulation, disclosure and risk management;
> - credit rating agencies need supervision; and
> - the Financial Stability Board as the place where all the regulators and other important roleplayers meet has an important role as an international coordinating body.

These lessons lead to the need for new institutions, or new functions for existing institutions, and a new approach to regulation.

81 The idea of a new Bretton Woods Agreement has not been pursued. Instead, there has been a strengthening of existing institutions, notably the Financial Stability Forum ("FSF"), now the Financial Stability Board ("FSB") and IOSCO.

82 There appears to be no departure from the principles of the system prior to the GFC, and no change to the conceptual framework or philosophy, but only improvements to existing infrastructure and legislative frameworks. The main themes of the new approach to regulation after the GFC appear to be:[176]

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175 John H Farrar, Louise Parsons & Pieter I Joubert, "The Development of an Appropriate Regulatory Response to the Global Financial Crisis" (2009) 21(3) *Bond Law Review* 1 at 37.

176 John H Farrar, Louise Parsons & Pieter I Joubert, "The Development of an Appropriate Regulatory Response to the Global Financial Crisis" (2009) 21(3) *Bond Law Review* 1 at 38.

- a greater focus on macro-prudential risks across the financial system which takes account of banks, shadow banks and private capital;
- greater emphasis on shared information on financial markets;
- a campaign to reduce regulatory arbitrage;
- some greater regulation of hedge funds;
- standardisation of credit derivatives markets and central clearing systems;
- agreed action against uncooperative tax havens;
- improved standards for valuation of financial instruments; and
- more effective oversight of credit rating agencies.

83 The third question is the role of the State. Are we to see a return to the activist state and state capitalism, or is this simply a passing phase?

84 Are our concepts in any event out of date in an era of global networks and supply chains?[177] Multinationals already rival nation states in size and importance.[178] Transnational manufacturing distorts the value of exports for states. Transfer pricing is a sophisticated game which they play. There is an emerging class of international executives who do not necessarily have firm national allegiances. This is particularly true in the West but less true in China.

85 All the signs are that China has the capacity in the next 50 years to overtake the US as the dominant state, provided it can manage its internal weaknesses.[179] So far it has done well and recently, the West, particularly the US, has done badly. It would be ironic if the ultimate beneficiary of globalisation and international capitalism is a nominally communist state practicing state capitalism. This itself raises an interesting fundamental question as to whether Western democracy is compatible with globalisation and the latest mutations of international capitalism. As Joseph Stiglitz said, economic globalisation has outpaced political globalisation.[180] He has also said:[181]

177 Robert J Holton, *Globalisation and the Nation State* (Palgrave Macmillan, 2nd Ed, 2011).
178 M Gabel, H Bruner, *Global Inc, An Atlas of the Multinational Corporation* (The New Press, 2003) at p 2.
179 G Chance, *China and the Credit Crisis – The Emergence of a New World Order* (John Wiley & Sons (Asia), 2010); G Steingart, *The War for Wealth: The True Story of Globalization, or Why the Flat World is Broken* (McGraw Hill, 2008).
180 Joseph Stiglitz, *Making Globalisation Work* (Penguin Books, 2006) at p 269.
181 Joseph Stiglitz, *Making Globalisation Work* (Penguin Books, 2006) at p 21.

> We have a chaotic, uncoordinated system of global governance without global government, an array of institutions and agreements dealing with a series of problems, from global warming to international trade and capital flows. Finance ministers discuss global finance matters at the IMF, paying little heed to how their decisions affect the environment or global health. Environment ministers may call for something to be done about global warming, but they lack the resources to back up those calls.
>
> There is a clear need for strong international institutions to deal with the challenges posed by economic globalisation; yet today confidence in existing institutions is weak.

86 Lastly, to whom is the market, accountable? This is the question to which President Nicolas Sarkozy of France alluded at the World Economic Forum in Davos in January 2010 when he said:[182]

> We are not asking ourselves what will replace capitalism, but what kind of capitalism we want … From the moment we accepted the idea that the market was always right and that no other opposing factors need be taken into account globalisation skidded out of control … This was not a crisis in globalisation. This was a crisis of globalisation … What remains to be done is to bring into being a new growth model, invent a new linkage between public action and private initiative … The G20 foreshadows the planetary governance of the twenty-first century. It symbolizes the return of politics whose legitimacy was denied by unregulated globalisation. In just one year, we have seen a genuine revolution in mentalities. For the first time in history, the heads of state and government of the world's twenty largest economic powers decided together on the measures that must be taken to combat a world crisis. They committed themselves, together, to adopting common rules that will radically change the way the world economy operates.

87 While one can debate certain parts of his reasoning, this is a frank avowal of the role of the state and politics in the scheme of global governance.

IV. Conclusion

88 We need to see globalisation as a loose concept that embraces many different conceptions and think of it in a flexible, dynamic and indeterminist way. We need to be aware of its latent ideological characteristics and the way in which it refers to complex phenomena in flux. We need to see the US dominated globalisation as one of many globalisations. In so far as we have a world capitalist system of a sort, we

182 President Nicolas Sarkozy, speech delivered at the World Economic Forum Annual Meeting, 17 January 2010.

must accept the likelihood of recurrent crises but should plan to protect ourselves against their worst aspects. This requires action at both national and international level. So far, we have had panic stricken reaction at national level and slow progress in terms of international regulation. At the same time, faith in the Washington Consensus has been shattered and we must adjust to a very different world. In this world, the Third World demands a greater voice.

89 As John Maynard Keynes wrote in *The General Theory of Employment, Interest and Money*: "The difficulty lies, not in the new ideas, but in escaping from the old ones, which ramify, for those brought up as most of us have been, into every corner of our mind."[183] Globalisation events have delivered great benefits but comes with large costs. The West has faltered badly in the GFC and cannot go on expecting the Third World to keep them in the manner to which they have grown accustomed. They must share wealth and a voice in international affairs and be prepared to compete on more equal and transparent terms. Globalisation involves risks but if the international systems of trade and finance disintegrate through protectionism, financial collapse or war, the future will be even bleaker for all of us.[184] We need to rediscover the principles of leadership and co-operation that existed for a short time at the Bretton Woods Conference in 1944 and we need to adapt.

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183 John Maynard Keynes, *The General Theory of Employment, Interest and Money* (Palgrave Macmillan, 1936) preface, at p viii.

184 Stephen D King, *Losing Control: The Emerging Threats to Western Prosperity* (Yale University Press, 2010) at p 245.