Connecting Civil Societies III: An Asia-Europe Dialogue on Economy and Society

17-18 October 2008 | Beijing, China

Edited by Ronan Lenihan & Sol Iglesias

Conference Proceedings
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Asia-Europe Foundation, 2010

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Connecting Civil Societies III:  
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Introduction

Disturbances in the world economy have an impact on society, particularly its most vulnerable sectors. In the face of these challenges, the regions of Asia and Europe must address certain important questions. What are the identifiable benefits and potential risks of regional integration? What role can Asia-Europe co-operation play? The responses form the raison d’être of the Asia-Europe Meeting (ASEM) process, in 2008 comprising 57% of the world’s population and 59% of the world’s GDP. Each ASEM summit presents opportunities for bringing pressing societal issues to the attention of the leaders of 43 of the world’s countries and two of its most dynamic regional bodies. A significant feature of the ASEM process is its creation of the Asia-Europe Foundation (ASEF), created to bridge civil society between the two regions and act as a conduit for dialogue between civil society and governments.

A key document of the 6th ASEM Summit in Helsinki in 2006 entitled “The Future of ASEM”, which sets the directions for ASEM after passing the milestone of its first decade, leaders “(encourage) ASEM partners to more actively consider the recommendations resulting from ASEF’s activities with a view to sustaining and increasing public interest and support for the ASEM process.”

For these reasons, the Connecting Civil Societies series continues to play a pivotal role as an accompaniment of the ASEM summit events.

Before the ASEM V Summit in 2004, the inaugural conference brought a broad range of civil society actors onto one platform as the largest ever informal consultation on governance, environment, education, inter-cultural dialogue, economic & social issues, and regionalisation themes. The meeting simultaneously afforded the opportunity for various sectors from both regions to build co-operation. Back to back with the ASEM VI Summit celebrating ASEM’s 10th anniversary in 2006, the Connecting Civil Societies II was on the theme "ASEM at 10"--a broad introspective and prospective dialogue on Asia-Europe relations that also brought the Asia-Europe Business Forum and Asia-Europe People’s Forum on a common platform for the first time with other civil society groups, building on the potential for more regular dialogue and interaction.

* Asia-Europe Business Forum is a meeting of business leaders, created to strengthen economic co-operation between the business sectors of Asia and Europe. The Asia-Europe Peoples’ Forum is an inter-regional network of civil society and social movements across Asia and Europe. Both fora organise their respective summit events on the sidelines of the ASEM summits.
While the 6th ASEM Summit was centred on assessing the achievements of ASEM’s first decade, the 7th Summit in Beijing—which took place in one of the world’s most important engines of economic activity—was expected to advance the ASEM process and demonstrate a significant and tangible impact for its peoples. ASEM 7 strengthened inter-regional co-operation during a period of major pressing socio-economic issues facing both Asia and Europe. The ASEM 7 agenda sought to promote issues such as creating common and sustained economic development, international development co-operation (in conjunction with the Millennium Development Goals), and policy dialogue and capacity building to combat financial instability. Therefore, at a time when economic turbulence in the financial and currency markets sent tremors across the economies of Asia and Europe, the theme of the third Connecting Civil Societies event proposed an Asia-Europe Dialogue on the threats facing the world economic and social stability. The conference was organised in partnership with the Research Centre for Sustainable Development – Chinese Academy of Social Sciences (CASS), United Nations University – Comparative Regional Integration Studies (UNU-CRIS), Irish Institute of Chinese Studies – University College Cork (UCC).

The conference was designed to analyse the benefits and risks of regional integration and Asia-Europe co-operation. More specifically the conference reported to the ASEM leaders on an economic and social agenda for ASEM to help better understand the most prevalent socio-economic threats facing the two regions. This report was achieved by formulating key recommendations through a multi-stakeholder process to prepare ASEM to tackle these major issues.

At present there is an expressed need for more involvement of civil society actors in the ASEM process. A move to increase civil society involvement offers ASEM participants newer fresher approaches to issues and also enhances the legitimacy of ASEM in the public eye. Given this push for greater civil society access to ASEM, the ASEF Connecting Civil Societies series remains as a key platform for the ASEM process to engage with civil society’s leaders and another key avenue for high level policy recommendations. 2010 sees the turn of Belgium, as EU presidency holder, to host the ASEM VIII Summit in Brussels. This summit represents a major landmark in the 14 years of the ASEM process as this year ASEM welcomes the membership of Australia, New Zealand and Russia. In the face of this expansion and the continued fall out of the economic crises, the ASEM hosts have reached out to civil society once more and will support ASEF for the 4th instalment of the Connecting Civil Societies conference. The conference, a partnership between ASEF, Singapore Institute for International Affairs (SIIA), International Institute for Asian Affairs (IIAS), European Policy Centre (EPC) with the support of the Belgian Ministry of Foreign Affairs, will be held in the two days prior to the Summit will garner recommendations from multi-stakeholder dialogue on a range of issues to be conveyed as a contribution to the ASEM 8 Summit.
Keynote Speech by
H. E. Ambassador Herve Ladsous,
French Ambassador to China

ASEM undoubtedly is a unique and original organisation – it is not only a Government exercise but also something involving business and civil society. With such varied experiences of its members, the discussion here today will be very valuable exactly when our high leaders get together under the auspices of the People’s Republic of China. We must be thankful to my old friend and accomplice Ambassador Wang (ASEM Senior Official for China) for the fantastic work that has gone into making this meeting a success.

Twelve years ago, two very distinguished people got together, Minister Lee Kuan Yew of Singapore and President Jacques Chirac of France. They came up with the joint brainchild which was ASEM and already then the question was asked whether the forum, bringing together Asia and Europe, was relevant. It was an act of faith at the time, only sustained by the possibilities it could afford. It has proven over the years to have been an act of vision and indeed one that becomes more relevant every year, proving that the choice was a wise one. Why is it that presently these meetings have an increased relevance? If you look at the very basics, Europe and Asia are probably the two regions of the world most heavily dependent on foreign trade - heavily dependent on imported energy and raw materials, and on the transfer of technologies, both eastwardly and westward. Both are also clearly aware of environmental concerns as the threats associated have been apparent to both regions for some time. And Europe and Asia have suffered heavily due to the financial crisis, even though a product of North America. To put it bluntly Europe and Asia are responsible for 60% of the world’s GDP – that makes the regions relevant on a global scale outside local realms of influence and affords great weight to discussions we have together, such as this forum.

Working in an organisation with 43 governments as well as two international entities (ASEAN Secretariat and the EU) is not easy. If we can achieve consensus however, given the extraordinary cross-section that comprises our group, the benefits are immeasurable. Nations from the North and South, from East and West; some heavily-developed, some underdeveloped and others developing; liberal market-orientated countries, state-controlled economies; this combined diversity and experience affords us an even more prominent role. If we can achieve consensus it will also reflect what can be done in the wider spectrum of the international community.

So allow me to forward just a few thoughts on those topics which are to be discussed at the dialogue. First thanks must be given to Ambassador Wang and his colleagues for agreeing to bring the financial crisis to the fore front of the agenda – discussing other topics would have been perceived as bizarre with financial issues looming over any discussion. It is here, it is a massive issue and we have to act.
But how do we act? As we speak, France, as holders of the EU Presidency, are working tirelessly over
the past few days, weeks and months to make progress towards a common consensus. The strategy
that produces the consensus must start from the premise that this downward spiral cannot continue
to go on.

First and foremost, within our society we have to ensure the safety of our financial markets, our
financial institutions, etc. We are in a global world; we cannot do away with the idea of international
markets, we must look at their regulation and their governance. We are essentially therefore working
in concentric circles. Aware of this, the first initiative taken by President Sarkozy was to have a G7
meeting held in conjunction with a meeting of the European countries taking part in the G7. After long
discussion, policy measures were thus worked out
within the fifteen countries comprising the Euro group,
with input from the G7 and that was the subject matter
of the European Council meeting yesterday. These policy
measures from the Euro Group were then presented to
the twenty seven EU member countries, and accepted
yesterday in Brussels.*

We now move towards the International Community, where the goal is to have, ideally before the end
of the year, a summit meeting of the G8. This meeting will also include the very large emerging
economies and that of course includes first and foremost China. We must see how we best to reform
the international financial system to make it more sustainable, less dependent on the vagaries of the
operators, improve the governance systems and improve on some of the totally unacceptable
practises corrupting the system. How is it that the CEO of a major Bank can lose billions of his
customers and countries money, yet still receive the so-called golden parachute payments? This is
unacceptable and the outrage of the public on this being allowed morally is correct; we have to work
on the system that allowed this to arise. It is also a wonderful opportunity as seen from the ASEM
community because we, together as major financial operators in Asia and Europe, can bring about
some consensus ideas and pre-consensus ideas on this pressing issue.

Secondly, the issue of food security is very interesting especially in light of the financial crises. Food
Security is no longer highlighted in this financial zeitgeist. Indeed some prices for staple foods have
actually fallen, wheat and oil being two especially notable examples. The oncoming recession plays its
part in the picture; nevertheless the structural problems are still clearly evident – this global issue will
undoubtedly regain our attention sooner rather than later. This begs the question; can we really afford

* The meeting referred to took place on the 16th of October 2009. The Council of the European Union is the principal
decision-making institution of the European Union (EU). The Council is composed of twenty-seven national ministers
(one per state). The Union's law is limited to specific policy areas, however it does override national law. As the Union
operates on supranational and intergovernmental platforms, in some areas the Council is superior to the Parliament,
having only to consult to get assent from the body. In many areas, however, the Union uses the legislative process of
codecision procedure, in which the two bodies are equal in power.
to let the market be the final judge in view of its apparent failure in the last year? The International Food Trade accounts for only 10% of overall production, however it dictates the local price of a ton of wheat or soya bean sold on the market and this fact encourages speculation and disparities between real and market price. This failure has to be addressed – the global agricultural system will only function with the successful interaction of at least twenty factors, be they technical, economic or social. If anyone of the twenty factors is missing, then there will be systematic failures which will leave many of the neediest in peril.

Agricultural is a problem not solved in one week or one month. You need several years to get new processes and productions underway and best practices to be embedded – let me be clear these are my views and hopes as a global citizen, and not that of the French Government. A re-examination of the international world order with regard to provision of food would now be timely I believe. The UN Food and Agriculture Organisation (FAO) are doing a very credible job in its own way, but perhaps more could be done towards a long-term sustainable vision. This vision should include what it is that we want to achieve and to do away with; especially some shocking concerns that food products should be turned energy. Does it make sense for poor, malnourished people to produce crops that provide gasoline to feed more Sports Utility Vehicles, as their only means of survival? Agriculture has been the core of our civilization for thousands of years and thus it will remain – food will always be a basic human need.

Energy security will also be one of the central issues for the twenty first century. Individual countries in both Asia and Europe which do not have presently sufficient oil, or in the future sustainable clean energy, of their own will be faced with very major challenges providing for their citizens. Is it right that we should therefore ‘compete’ on the International markets; is it right that we fight to get the better oil fields in different regions around the globe? Would it not work better if we worked together to provide clean sustainable energy, and divide fossil fuels fairly, while they are still in use? In other regions of the world - Africa and the Middle East - would it not be in the interest of all societies to work co-operatively? At the same time we must examine and explore all alternatives, in particular nuclear energy, where advancements have allowed cleaner energy and a clear, while not preferable, solution to carbon emissions. Previously foregoing nuclear energy as an option, China has embarked on a new initiative which will bring its installed nuclear facilitators capacity from about six GW right now, to 50 or 60 in twenty years – this means three new nuclear tranches a year. India is developing this technology quickly also, and with the change of the nuclear supply’s group rules, expansion in the sub-continent will follow the great strides that China is presently taking. South East Asian countries such as Indonesia, Vietnam and Thailand have embraced this energy source also. Nuclear energy is safe, stable, provides large amounts of energy for a long term and produces little greenhouse gases. This is essential given the sheer amount of energy which will be needed over the next fifteen or twenty
years. Dialogue between our two regions is essential if we are to ensure sustainable growth, and
dialogue on energy security is of the utmost importance. It is an interesting debate we can have, even
if we cannot agree on figures for the reduction of carbon emissions. Nor is it essential to agree on how
to transfer technology in the fields. What is important is to agree on how to deal with our future, fairly and
adequately.

Developments have been very promising and it is an illustration of how Asians and Europeans can
build things together. Pragmatism must always be at the forefront of our minds, however.
Globalisation has affected our societies both positively and negatively, but within a globalised world
now do we live. Certainties in the past are no longer certainties today. Many Europeans now fear for
our way of life; a fear that has been a concern for a century; a fear that cannot restrain us from action,
radical if needed. Europeans and Asians can find solutions to the problems we face, let’s do so
together.
ASEM has been courting for many years' partnerships that involve government, business and civil society, to unite and strengthen efforts to address global issues. We have today a prime example of collaboration of all the social sectors that form an integral part of ASEM. Civil society is actively involved in the advancement of ASEM in Asia and Europe, and has played an important and constructive role – a valued contribution and one which ensures all efforts will be made to build a closer partnership between the government and civil society. The ASEM Summit 2008 is held against the backdrop of a global financial crisis, coupled with pressing issues, ranging from food security to surging energy prices. These global challenges affect not only the economic well-being of our societies, but also threaten the stability of the world we live in. Ambassador Ladsous commented on the role of ASEM, ‘it is neither very good nor very bad but something in between’ – most importantly though ASEM is playing an integral role.

Preparing for this summit more than a year ago, the first thing that came to mind was how to make ASEM more relevant to Asia and Europe. In our discussions, the conclusion was reached that the Summit should tackle head on the pressing global challenges, including food and energy security, disaster preparedness, sustainable development, climate change, MDGs, social cohesion as well as trade and investment. As we clarified the topics however, it became apparent amongst the senior officials of ASEM that the agenda would have to be fluid to gain the most from the discussion; it would have to be re-adjusted with the developments of the world’s situation.

Predictably our foresight was justified. The largest global issue is now clearly the financial crisis and thus we readjusted our agenda to reflect the changing reality. All these challenges are nonetheless interwoven with the present crisis, and still of the utmost importance in the development of the world. With regard to food security, there is a Chinese saying, 'To the common people the question of food is as big as heaven', - the most important thing for their continued existence. Oil of course creates problems of its own and without it, rich and poor would find it difficult to progress. Trade protectionism, which is threatening a wholesale return, would also slow progress and hold back our efforts in promoting trade and investment. Climate change and sustainable development are global issues and finding a solution for them will define the future of the world. All these issues require our concerted efforts.
As a host China hopes that the summit will deepen the substantial and mutually beneficial cooperation between Asia and Europe. We hope that the leaders of Asia and Europe will use this opportunity to have in-depth discussions on the issue and also coordinating policies to tackle global issues that confront us, with particular emphasis on the financial crises at this meeting of ASEM. A strong signal needs to be sent to the rest of the world that the leaders of Asia and Europe not only care about what is happening in the world today but are also determined to take all the necessary measures to deal with these issues. With words and deeds, especially deeds, we will be able to tide over the crisis, but what action can we take is the responsibility of our esteemed leaders.

China identifies three things as essential. First we must inject confidence into the minds of the people. Confidence at this moment is more precious than gold and money. History reminds us that with the onset of a crisis such as this, if people have confidence they can always find ways and means to deal with the problems they encounter. Second you must get you own house in order. If China manages to maintain smooth and continued domestic economic growth, this will provide a stabilising factor not only to the region, but to the world economy, and help all nations to overcome the financial crisis. The final thing that China has identified as essential and will undertake in the coming months is cooperation in the international community. Engagement on the international level is a clear priority for China in helping to solve the problems that have arisen, and China intends to take its place as a responsible member of the world community again in an attempt to solve them. When Asia was hit by its last financial crisis, China did not devalue its currency – a factor globally recognised that helped to stabilise the financial market in Asia during the period. China will thus have a similar attitude, on a more important magnitude due to its growth over the intervening period. China is happy to begin its contribution by hosting this event.
The Ongoing Financial Market Crisis: How could it happen and what is the appropriate response?

Mr. Klaus Regling,
Chief Executive, European Financial Stability Facility†

Two fundamental questions face us today in terms of the financial market crisis - firstly how could these crises happen and what is the appropriate response? It is important we take a step back and see the real reasons behind the current crisis. It is clear that our market economy will always have a crisis from time to time - we should have no illusions about that - nevertheless it is the task of the public sector to make sure that the crises are not too deep and not too costly and that they do not happen too frequently.

Reflection:
‘It is clear that our market economy will always have a crisis from time to time – we should have no illusions about that’

So we have to learn lessons from these and thus we will examine it from an economist’s point of view. The crisis may seem like a good opportunity to get rid of the financial markets or the market economy in general, or stop globalisation, but pursuing such a policy would undoubtedly be counterproductive as we will see. We will take an economist’s point of view, but not one too close to the crisis - we will follow one that is deeply rooted in European traditions and the European traditions are that we look at this more long term. We have often complained about the apparent US short-termism in policy making. The belief in Europe is that for markets to function well we need a strong state, and a strong government - small but strong in certain areas. Otherwise it is not good for the market, the economy or economic growth – and this will be our approach to the market. While we will elude to recent developments in the financial markets this will not be the basis of the study. However it would be good to state quick calculation from the IMF on how much this crisis might cost - the IMF’s most recent estimate claims upwards of $1.4Trillion, which in dollar terms would make it the most expensive recession of all time (see Fig. 2).

† Mr. Regling was EU Fellow at the Lee Kuan Yew School of Public Policy at the time this paper was presented.
**Figure 2: Comparison of Financial Crises**

**COMPARISON OF FINANCIAL CRISSES**

![Chart showing comparison of financial crises with metrics: Bank losses in billions of U.S. Dollars, other financials, and percent of GDP. Sources: IMF Global Financial Stability Report.](chart1)

**Figure 3: Real GDP Growth**

**REAL GDP GROWTH**

![Chart showing real GDP growth with changes in percent for different regions and years. Sources: IMF, October 2008.](chart2)
The Goldilocks economy is clearly evident (Fig. 3) in the most recent forecast from the IMF on the economic outlook and here you see that compared to the years 2004 to 2007. We can see the downturn in all regions of the world of about two to three percentage points and this is a combination of many things - it is not only the financial market crisis. To some extent a normal cyclical economic slowdown after so many good years was overdue anyway and would have happened, but on top of that you had high inflation partly caused by the long period of high growth rates, particularly as it in energy and food prices. All that contributed to the slowdown but it is reinforced by the financial market crises.

The most recent IMF scenario - the baseline scenario in the IMF - shows there are clear downside risks if the financial market crisis does not slow down soon, if the measures that have been taken do not work as intended - the the situation will get worse, this is at the moment the baseline scenario, and a real possibility.

**Figure 4: Nine Reasons**

<table>
<thead>
<tr>
<th>Nine Reasons for the Financial Market Crisis</th>
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</thead>
<tbody>
<tr>
<td>1. Ten years of generous liquidity creation by central banks</td>
</tr>
<tr>
<td>2. Global Imbalances</td>
</tr>
<tr>
<td>3. Benign inflation environment</td>
</tr>
<tr>
<td>4. A long period of low interest rates results in a search for a yield, low risk aversion and high leverage</td>
</tr>
<tr>
<td>5. Technological change allowed the development of new, complex financial markets instruments</td>
</tr>
<tr>
<td>6. Credit Rating agencies misjudged risks</td>
</tr>
<tr>
<td>7. With securisation and the originate-and-distribute model, credit worthiness was no longer assessed</td>
</tr>
<tr>
<td>8. Incentive structure for senior managers in financial institutions encouraged short-term risk taking</td>
</tr>
<tr>
<td>9. Problems in the supervisory and regulatory framework: gaps and pro-cyclicality</td>
</tr>
</tbody>
</table>

We will discuss nine reasons (Fig. 4) that have contributed to the Financial Market Crisis. Most of the points you find here are global in nature, they apply to not only the US and EU, but the extent to which different countries around the world are affected by these causes differs greatly - but the purpose of this talk is not to lay blame. We will show that many things contributed to the crisis, it would be far too simple to blame only Alan Greenspan, to blame only the lack of regulation, to blame only the credit rating agencies - all of them played a role but each individual point has to be seen in context and how they contributed to the overall crisis.
First there was too much liquidity creation, too much monetary creation over the last ten to fifteen years and all major central banks around the world contributed to this. Interest rates were too low for too long, and this was highlighted by the chief economist for the IMF two years ago - but nobody listened. Too much liquidity was created and in this process investors neglected the risks involved in searching for higher yields. Two examples can illustrate how the system failed. First the Federal Reserve kept interest rates too low - they went down to 1% early this decade. This was maybe the right response after 9/11 but the problem was that it was kept low even after growth in the United States returned from potential growth to trend growth. Thus the option to lower interest rates as an emergency response when there was a real crisis was unavailable. The US and the FED were not the only ones guilty in this liquidity creation - countries like China, the Gulf States and initially also Japan, pegged their currencies formally or informally to the US dollar at overly weak levels and then intervened massively to keep their exchange rates at low levels. Thus when Central Banks of these nations intervened in the exchange markets, primary liquidity was created, so this added to the excess liquidity in the world economy. Also by pegging their currencies to the US dollar, some of the booming economies, such as China and Gulf States, imported their monetary stance from the US - the monetary policy perhaps was appropriate for the US during this period of low growth but it was too loose for these booming economies.

All this was reinforced by what economists call global imbalances. Global imbalances can be described by the fact that the US for a very long time has had a current account deficit and some other countries as a counterpart, mainly in Asia, have a large and growing current account surplus. The root cause for that were over consumption in the US and excess savings in Asia - not over production, as has been argued but actually over consumption in the United States. The nations that accumulated large surpluses on their current accounts had to invest the money somewhere. A lot of it went to the US, much of it to Freddie Mae and Fannie Mac and thus it made it easy to refinance. Again it kept interest rates low, and put pressure on interest rates. Of course this has to be gauged against our third point - that these developments all happened in a very special environment.

Until late last year, the world economy had an exceptional period of low inflation. This benign inflation period prevented what would have normally happened when the first two trends occur - normally they would have resided in high inflation and that would have been compensated by this special environment - which was a result of globalisation and its heightened competition. It meant the integration of the labour force of several hundred million people in China, India and Russia into the world economy as which kept labour costs low. During the second half of the nineties we also had a
strong but temporary productivity surge in the US economy, which also kept prices and costs down. Thus within this particular period, problems coming from the liquidity creation and global imbalances could continue longer than they normally would have.

The long period of low interest rates resulted in the search for yield – and investors of course look for yields. Investors looking to invest peoples retirements savings want to get reasonable returns for their customers and this led to low risk aversion and to high leverage. High leverage means that investors use additional borrowing to invest more to leverage their capital. And never before have we seen so much leverage in the world economy than in the last decade. This process of strong credit expansion/rising leverage was facilitated by other structural developments on financial markets and also failures in the supervisory regime. Furthermore there was also a specific changes in another respect during the period; particularly fast technological change. Financial markets and technological change influence each other immensely. Thus change has driven globalisation and world trade and it has also played a role in finance and in creating the successes in financial markets that we have seen. It is evident that without the technological change it would not have been possible to develop the complex financial market products that we have seen since the nineties. They required very powerful computers - some computers run for days to develop these products – and this would not have been possible thirty years ago. It was another unique factor during this last decade, so the derivatives, the “financial weapons of mass destruction” as Warren Buffett calls them, were developed because they became feasible technologically. The problem is that most board members of banks do not have PHDs in maths, which one would need to understand these derivatives.

Credit rating agencies also cannot escape blame - they played an important role in creating these problems. The role of credit rating agencies has changed significantly over the last ten to fifteen years. They attributed ‘Triple A’ rating to some of these new complex instruments and did not really grasp that some of these derivatives could not be traded and there was not enough liquidity in the market when problems arose. It was crucial to some of the financial powerhouses that credit rating agencies gave ‘Triple A’ ratings to certain tranche of these complex products because certain investors pension funds are only allowed to invest in ‘Triple A’ rated products. The credit rating agencies it seemed had a conflict of interest because they gave advice to some of these companies to develop these products, and they received a fee for that, and then they turned around and rated these new products again for a fee. They should definitely be held accountable for their role in the current crisis.
Over the past ten to twenty years we have moved to a more securitised world and the behaviour of banks has changed. We have moved away from the traditional banking model, which you find still in Europe more so than the US where banks stick to the ‘Three C’s’ - they make a real Credit analysis, they look at the Customer and they make a decision whether the Client (borrower) can really serve the loan. In a securitised world this doesn’t happen anymore, banks act as an originator of a loan, they then put many loans together and sell them on the markets and so they believe they do not have these loans on their books anymore. Therefore they are not very interested in making an expensive credit analysis - without this process the subprime crises in the US would not have happened. It is not a coincidence that this did not go that far at all in Europe, except in the UK and perhaps in Ireland. Europe for the most part still upholds the old banking model and thus there is less exposure to subprime mortgages. We cannot talk about the banking crisis without bankers of course – and the incentives for senior bank managers were distorted towards short term risk taking. These bankers are not there to deal with the implications; and of course they do not have to pay back their bonuses.

Finally we come to the supervisory and regulatory systems and it is clear today, obviously, that the regulatory system has many gaps, many weaknesses, and many problems. We have seen the general trend over the last twenty years, some say since Reagan and Thatcher introduced lighter regulation, of big gaps occurring in the regulation. We know from examples that certain activities were undertaken by banks off the balance sheet and supervisors allowed it in most countries, with some exceptions - these off balance sheet activities in Spain were not allowed by the central banks as they act also as a supervisor of the system. Supervisors thus had a choice, but normally they were too generous. We know that investment banks were insufficiently supervised; we know that companies - AIG being the largest example - began to act to some extent as hedge funds. We now know that their activities were not supervised efficiently because the oversight was provided by the New York State local insurance supervisory, who probably didn’t know much about banking.

Also the last word on this slide is very important, Pro-cyclicality, we know that some of the accounting tools designed over the last number of years are very pro-cyclical. This is not at the origin of the crisis but we know that pro-cyclicality makes the crisis much worse due fair value account. This refers to how market participants and investors must mark to market everyday, so when the market turns down or doesn’t function there is no real price. It becomes very difficult to find a fair price and it adds permanently to the losses that are being made. It is also pro-cyclicality on the way up and that nobody complained about over the last few years, during good times this pro-cyclicality of the rules, this mark to market meant that profits were too strong. It all looked too nice and we are seeing the result of that at the moment.
These points are in some sense very interesting, as Europe has often in the past called for less short termism, more longer term approaches in accounting/ in supervision. The ECB for instance objected to the fair value accounting earlier this decade but in the end everybody gave into the US and that is one lesson that we can learn from. If Asia could support Europe more with these questions and again I believe that Asia have a more longer term and sustainable approach, which is more aligned to the European approach, then it would be possible to move to a better less vulnerable system.

So one main purpose of the nine items in Figure 4 is to demonstrate that many factors contributed to the crises, it is not right to look at one or the other or to blame one over the other. All of these nine slides are linked. So what is the appropriate policy response, and I think one has to look at the short term, medium term and long term.

**Figure 5: Short-Term Actions**

- From Central Banks
  - Emergency liquidity
  - Broader range of collateral
  - Currency swaps
  - Close international cooperation

- From Supervisors
  - Ban on Short-selling

- From Ministries of Finance
  - Nationalization
  - Re-capitalization
  - Guarantees
  - Buying of toxic assets

In the long term obviously it is absolutely necessary to prevent the collapse of the financial markets because that would be very costly for the real economy. However the short term actions in Figure 5 are actions that have been taken over the last few weeks. The first actions from Central Banks since August/September last year has seen an emergence in liquidity. Central Banks have broadened the range of collateral, there currencies swaps between the major central banks are now billing hundreds of billions of dollars. Importantly the international cooperation of central banks have become much closer over the last few months and that is positive, one example, we all saw last week when there was a coordinated interest rate cut between all the major central banks. And what I found particularly interesting was that the Peoples Bank of China joined this interest rate for the first time. Supervisors also acted, finance ministries of course and that really means budgetary resources have come with
different rescue plans, obviously the US $700 billion plan springs to mind. Also the Europeans adopted on the 12th of October 2008, which is a more comprehensive plan that has elements of the last four lines of the figure 5 referring to elements of nationalisation, recapitalisation, government guarantees and buying up of toxic assets.

As you heard this morning the US are moving a little bit in this European direction, that makes the $700 billion package a little bit more comprehensive. It is important to realise that although we are talking about an enormous sum of money, about 2 thousand billion in Europe potentially, when you add up all the guarantees. Not all the initial costs will be relevant for the budget, developments will depend very much on how the interventions are structured, we have examples from the past, like Sweden. In the early nineties, when massive state intervention was required, that cost nearly 10% of GDP. In exchange for these actions, governments receive assets from the banks including partly the banks themselves, in Sweden when the situation normalised within a few years, and these assets were again privatised there was no nett costs, however it may not always go that smoothly.

It is important to remember that not all the numbers you see in the news papers at the moment, represent real budgetary costs that the tax payer must pay for. These are just the short term, and we need to worry about the medium and the long term. The medium term and long term measures are decisive to create a system that will be less vulnerable in the future, as I said in the beginning, we will not have a world without crises of course we do want them to happen too often and to be too deep.

*Figure 6: Medium-Term Responses*

- Work of EU Finance Ministers (Ecofin), Financial Stability Forum (FSF), Bank for International Settlements (BIS), International Accounting Standard Board (IASB) closely coordinated to:
  - Enhance transparency
  - Close existing gaps in the system
  - Reduce possibilities for regulatory arbitray
  - Reduce pro-cyclicality
  - Strengthen oversight over credit rating agencies
- Establish a common platform for trading + settlements of derivatives
- Market response from the Institute of International Finance (IIF):
  - Voluntary Code of Conduct on
    - Improved risk management
    - Transparency and disclosure
    - Compensation policies
There is a lot of work going on here, I cannot go into the details as the European finance ministry have been working on this for months, also the financial stability forum, which is basically a G7 forum, is very active at the international level. The Bank for International Settlements (BIS) ties in all major finance centres, including China, Hong Kong, and Singapore are very active at looking at medium term solutions. The accounting board importantly to reduce pro-cyclicality of accounting rules are also active. As they should be, the objective is to enhance transparency, to close the gaps in the system. One of the major medium term actions that needs to be ensured is the reduction in the possibility for regulatory arbitrage, which sounds complicated but really means that banks worked around the regulation and used legal loop holes to save capital, that needs to be eliminated and pro-cyclicality needs to be reduced.

As for credit rating agencies, we need stronger oversight, certainly to avoid conflict of interest. We need to find a way to deal with derivatives, because at the moment they are not supervised anywhere. They are traded privately over the counter and there are proposals out from the fed reserve bank of New York for more than half a year already, to create a centralised exchange where credit ratings and derivatives can be traded which would also make it easier to supervise what is happening. We also see some reaction from the industry itself and this importantly includes some important ideas on how to deal with the compensation of bank managers so their behaviour does not lead to excessive risk taking.

**Figure 7: Long-Term Issues**

- **Developing a stronger macro-economic policy framework:**
  - Consider asset price developments in monetary policy framework
  - Avoid exchange rate policies that contribute to overheating
  - Make fiscal policy less pro-cyclical

- **Developing a system of macro-prudential regulation**
Longer term issues, they are closer to my heart as an economist, they are hardly discussed anywhere these days as we are preoccupied with the short term problems, they are mainly discussed at the BIS, a little bit where I come from in the EC. They mainly deal with the macroeconomic policy framework, and if you remember I started off by saying that monetary policy was too loose, for a long period of time, interest rates were too loose. In my view inflation targeting is not sufficient as it ignores asset price movements and therefore can easily lead to bubbles, because inflation targeting means that central banks tried to keep headline inflation low, that world the last ten years but in the process central banks somehow accepted that different types of bubbles developed. Firstly in the stock markets, until the stock market crashed in 2001, in commodities, in bond markets, in the housing markets and that was one result of the too narrow focus on inflation targeting, the monetary policy framework needs to be reconsidered.

The ECB, allow me to say this as a European, I think has a better track record, because the ECB has a so-called two pillar strategy for deciding monetary policy, it has often been criticised for that from Anglo-Saxon economist, who say that you have only one instrument, focus only on headline inflation, but the ECB always argued that we also have to look monetary developments, liquidity developments as a second pillar. We have to lean against the wind if we think a bubble is developing and I think that turns out to be the right policy. We also need the policy framework that deals with the global imbalances that I spoke about at the beginning. This means that surplus countries, current account surplus countries with a booming economy cannot peg their currencies to a weakening currency, and should not import relatively loose monetary policy and this includes China and some other Asian countries, so that might be something for the conclusions tomorrow. On the fiscal policy side, we see also that it has been pro-cyclical and it needs to be strengthened. And we need to make sure that regulators take a broader view of the world economy, typically bank supervisor’s focus loan by loan, they go to banks and look at the loan book and try to assess if everything is ok and the individual loan will not lead to a problem. What they have typically neglected is to look at the overall macro-economic situation, where external indebtedness, current account deficits, strong credit expansion can lead to so-called macro risks, which they have not really included in their assessments. So that is another area for the longer term, which is not easy.

So in conclusion, there are many reasons for the crises, they are all linked, so do not blame just the one or the other, we need a comprehensive policy response therefore, basically all the nine points need to be addressed. The work has started and if it is successful then we will have a smaller financial sector, I think that is quite necessary. It had become too big, there were excesses, we need a smaller system with less credit and less leverage. It should become more transparent, it also means it will become less profitable, I think all of us will not worry about that. We had a situation where earlier this decade, when you look at all the profits from the financial sector in the US, it accounted for 40% of all the total profits of the corporate sector of the US 40% for financials, despite the fact that the financial sectors contributed 5% to US GDP. So there were clear excesses this must be reduced.
This divergence is painful, that is what we see at the moment, we have to make sure through public action that there is no panic that makes it worse, but this diverging is not without costs and that is the price to pay, we have to get through it but then the system will be less vulnerable in the future.
The Wall Street Collapse and Its Implications for Europe and Asia: the View from Civil Society

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Civil Society talks in different voices and I think I will be talking in the voice of the global justice movement also known as the anti-globalisation movement. Flying to New York recently I had the same feeling I had when flying to Beirut two years ago at the height of the Israeli bombing, to that of a war zone.

The immigration official upon hearing that I was a professor of political economy said, “I guess you will be revising all those text books”. He was quite resentful. The bus driver commented “Good morning folks. New York is still here but Wall Street has gone the way of the Twin Towers”. The usually cheerful morning shows, opened bleakly attributing the Wall Street crash to the fat cats of Wall Street who turned into pigs. The worst week ever on Wall Street has seen scathing commentary in the press, the disappearance of investor wealth, the collapse of very prominent banks, and the effective nationalisation of Wall Street. Eight and a half trillion dollars in total market capitalisation lost in one year and the usual explanations no longer suffice; extraordinary events demand extraordinary explanations. The worst is not yet over if anything is clear from the contradictory manoeuvres over the past three weeks - allowing Lehman Brothers to collapse, while taking over American Insurance Group and engineering the Bank of Americas takeover of Merrill Lynch. Proposing to buy up the banks bad assets and advocating their partial nationalisation will only deepen the crisis even further.

There is no strategy to deal with the crisis beyond practical responses, similar to how a fire department would respond to a conflagration, some say. The moves from the US and European governments amount to desperate efforts to shore up confidence in the system, to prevent the erosion of trust in the banks and other financial institutions, to prevent a massive bank run such as that which triggered the great depression of 1929. The financial crisis has spread to Europe and Asia, and it is no longer something that only affects banks that hold sub-prime securities they bought from US institutions. It is now a question of fear overcoming mistrust - banks don’t want to lend to one
another because they do not know who among them is overexposed to the toxic sub-prime securities; or they want to hold onto cash and other secure assets to defend themselves from an unpredictable conflagration. Depositors have growing fears whether their money is safe in the bank.

In this crisis no bank, even the seemingly impregnable, is safe from a rung; in a rung no bank is solvent. What caused the collapse of global capitalism’s nerve centre? - Was it greed? Yes. Klaus Schwab, the organiser of the World Economic Forum at Davos, remarked to his clients at this yearly global elite jamboree in the Swiss Alps earlier this year, ‘we have to pay for the sins of the past’. Was it a case of Wall Street outsmarting itself? Definitely. Financial speculators outsmarted themselves by creating more and more complex financial contracts, like derivatives which would securitize and make money from all kinds of risk. Derivatives might be labelled spectral or ghostly contracts; these are contracts that enable gambling and making money from the risk associated with an underlying asset - that is on the price of that asset rising or falling without trading the asset itself. Derivatives include exotic futures, instruments such as credit default swaps that enable investors to bet on the odds that the banks own corporate borrowers will not be able to pay their debts. This is the unregulated, multi-trillion dollar trade that brought down AIG. And on December 17th 2005 when the international financial review announced its 2005, annual awards, one of the securities industry’s most prestigious awards programmes, announced, “Lehman Brothers not only have maintained its overall market presence but also led the charge into developing new products and tailoring transactions to suit borrower’s needs. Lehman Bros is the most innovative in the preferred space just doing things that you won’t see elsewhere”.

Warren Buffet, the grand speculator, who eliminated derivatives from his investment fund, described derivatives in 2003 as ‘financial weapons of mass destruction devised by madmen’, whom he also recently defined as ‘Geeks bearing formulas’. The truth is that graduates of the U.S business schools like Stanford and Harvard brought us this crisis. While everyone acknowledges the lack of regulation, Wall Street’s capacity to innovate and turn out more and more sophisticated financial instruments, had run ahead of the governments’ regulatory capability. This is not because the government was incapable of regulating but because the dominant neo-liberal laissez-faire attitude prevented government from devising effected mechanisms with which to regulate.
The massive trading in derivatives helped precipitate this crisis and the man who did the most to prevent the regulation of derivatives was Alan Greenspan, the former chair of the Federal Reserve Board, who believed that the derivatives market would regulate itself. The US Congress agreed with Greenspan and passed a law excluding derivatives from being regulated by the Securities and Exchange Commission in 2000. The regulation it must be noted was not just a Republican initiative—it was a very bi-partisan campaign led by Wall Streeter Robin Gruben, Bill Clinton’s treasvagaries. In addition to Mr. Gruben, Bill Clinton’s treasury secretary, the Clinton administration, congressional democrats, were also strong supporters of another law, which helped further the current crisis, the repeal of the Glass Stiegel Act that prevented commercial banks from also being investment banks. There was something more systemic happening though, as another grand speculator, George Soros, noted, “What we are going through is the crisis of the financial system ... the giant circulatory system of a global capitalist system that is coming apart at the seams”.

Reflection:

‘What we are going through is the crisis of the financial system ... the giant circulatory system of a global capitalist system that is coming apart at the seams’.

~ George Soros

To elaborate on the Soros’ insight, what we are seeing is the intensification of one of the central crises or contradictions of global capitalism, which is also known as over accumulation or over capacity. This is the tendency for capitalism to build up tremendous productive capacity that outruns the populations’ capacity to consume, owing to social inequalities that limit popular purchasing power thus eroding profitability. This has plenty to do with the current meltdown but to understand the connections we must go back in time to the period from 1945 to 1975 to the supposed golden age of contemporary capitalism. This was a period of rapid growth in both the centre economies and the under-developed economies, one that was triggered by the massive reconstruction of Europe and East Asia after the Second World War and partly by the new socio-economic arrangements that were institutionalised by the Keynesian state. Key among the latter was strong state controls over market activity, aggressive use of fiscal and monetary policy to minimise inflation and recession and a regime of relatively high wages to stimulate and maintain demand.

So what went wrong? The spirit of high growth came to an end in the mid-70s, when the centre economies were seized by stagflation, meaning the co-existence of low growth with high inflation, was not supposed to happen under neo-classical economics. Stagflation, however, was but a symptom of deeper causes. The reconstruction of Germany and Japan for one and the rapid growth of industrialising economies like Brazil, Taiwan and South Korea also added tremendous new productive capacity and increased global competition. Inequalities within countries and globally, limited growth and purchasing demand. Thus profitability eroded and this was aggravated by the oil price rises of the 70s.
So how did capitalism try to solve the conundrum of over-production? Capital tried three escape routes. The first was neo-liberal restructuring, that took the form of Reaganism and Thatcherism in the global economic North and structural adjustments in the South. The aim was to invigorate capital accumulation, firstly by removing state restraints on growth use and flow on capital and growth; and, secondly by redistributing income from the poor and the middle classes to the rich on the theory that the rich would then be motivated to invest and re-ignite the economic growth. The problem with this formula was that it was restricting demand while not necessarily inducing the rich to invest, spurring production. In fact, it would be more profitable to invest in speculation than neo-liberal restructuring, which was generally accepted in both North and South in the 1980’s and 1990’s and had a poor record in terms of global growth. Global growth averaged 1.1% in the 1990s, averaged 1.4% in the 1980s, whereas it averaged 1.8% in the 1960s and 2.4% in the 1970s, when state interventionist policies were dominant. Neo-liberal restructuring could not shake off stagnation.

The second escape route global capital took to counter stagnation was extensive accumulation or globalisation, or the rapid integration of semi-capitalist, non-capitalist, or pre-capitalist areas into the global market economy. Rosa Luxembourg, the famous German radical economist, saw this long ago, as necessary to share up the rate of profit in the metropolitan economies. By gaining access to cheap labour, new although limited markets, new sources of cheap agriculture and raw material products, and by bringing in new areas for investment in infrastructure integration, profit and growth are accomplished by trade liberalisation, therefore removing barriers to the mobility of global capital and abolishing barriers to global investment. China is the most prominent face, of a non-capitalist to be integrated into the global capitalist economy over the past 25 years. To counter their declining profits, a sizable number of the fortune 50 corporations as well as Europe’s top corporations have moved a significant part of their operations to China to take advantage of so-called “China price”, referring to the so-called advantage deriving from China’s seemingly inexhaustible cheap labour. By the middle of the first decade of the 21st Century, roughly 40% to 50% of the profits of U.S corporations were derived from their operations and sales abroad, especially from China. The problem with the escape route from stagnation is that it exacerbates the problem of overproduction because it adds to productive capacity, a tremendous amount of manufacturing capacity has been added in China over the last 25 years, and this has had a depressing effect on prices and profits. Not surprisingly by around 1997, the profits of U.S corporations stopped growing according to one calculation, the profit rate of the fortune 500 went from 7.2% in 1960-1969 to 5.3% in 1980-1990, to 2.3% in 1990-1999, to 1.3% in 2000-2002. By the end of the 1990s according to the economist, with excess capacity in almost every industry, the gap between productive capacity and sales was the largest since the great depression.
Given the limited gains in countering the depressive impact of over production by a neo-liberal restructuring and globalisation the third escape route became very critical for maintaining and raising profitability, financialisation. In the Ivory tower of neo-classical economics, the financial system is over the mechanism by which the savers or those with surplus funds are joined with entrepreneurs who have need of their funds to invest in production. In the real world of late, capitalism with an investment in industry and agriculture yielding low profits owing to over-capacity large amounts of surplus funds are circulating and being invested and reinvested in the financial sector. That is the financial sector is turning on itself. The result is a hyper active financial economy and a stagnant real economy.

As one financial executive notes, ‘there has been a decreasing disconnect between the real and financial economies in the last few years, the real economy has grown but nothing like that of the financial economy, until it imploded’. This observer does not tell us is that the disconnect between the real and the financial economy is not accidental. The financial economy exploded precisely to make up for the stagnation owing to the over production in the real economy. I think this shows the difference between the financial and manufacturing sectors, the higher profitability in the financial sector, profits as a percentage of GDP over the last few years.

There were problems with financialization as an escape route. Well the problem with investing in the financial sector operations is that it is tantamount to squeezing value out of already created value. It may create profit but it does not create new value, only industry, agriculture, trade and services can create new value, as profit is not invested nor is it based on value that is created. Investment operations become very volatile and the prices of stocks, bonds and other forms of investment can
depart very radically from their real value. The stock of internet start up firms keeps on rising, driven mainly by upwardly spirally financial evaluations and then crash. Profits then depend on taking advantage of upward price departures from the value of commodities and then selling before reality enforces a correction. The radical rise of prices of an asset for beyond real values is what is called the formation of a bubble. However financialization is so volatile due to profitability being dependent on speculative coups. It is not surprising that the financial sector lurches from one bubble to the other or from one speculative mania to another, as it is driven by speculative mania. Finance driven capitalism has experienced about one hundred financial crises since the capital markets were deregulated and liberalised in the 1980s according to the Carnegie Endowment. Prior to the current Wall Street meltdown, the most explosive have been the Mexican crises 1994-1995, the Asian financial crises 1997-1998, the Russian crises in 1998, the Wall St Collapse of 2001 and the Argentine financial collapse of 2002 respectively. Indeed Bill Clinton’s Treasury Secretary Robert Gruben predicted, ‘Five years ago it became clear that future financial crises are almost surely inevitable and will be even more severe’.

But how do bubbles, form, grow and burst? In an examination of the Asian financial crises we can pick out some clear indicators towards the collapse. First capital accounting and financial liberalisation had been undertaken in the region at the urging of the IMF and the U.S treasury department. Secondly the entry of foreign funds seeking quick and high returns meant that they were drawn towards the real estate and the stock market to make that quick turnover, and as more entered, the situation escalated. Thirdly certain nations in the region saw an over investment in their markets that created a fall in stock and real estate prices, leading to a panicked withdrawal of those funds in 1997. One hundred Billion dollars left the East Asian countries in a few weeks. Next came the bailout of foreign speculators of the IMI and then came the collapse of the real economy and the subsequent recession throughout Asia in 1998. Finally and most importantly though, despite massive stabilisation efforts to impose both national and global regulation of the financial system initiatives were opposed on ideological grounds by the actors involved in the collapse.

Thus how did we come to this current bubble and crisis? It has its roots in the technology bubble of the 1990s, when the prices of stocks of internet start-ups sky rocketed and collapsed resulting in the loss of seven trillion dollars’ worth of assets in the recession of 2001-2002. The loose monetary policies of the US Federal Reserve under Alan Greenspan had encouraged the technology bubble and when it collapsed into a recession Greenspan tried to counter long term recession, by cutting the prime rate of lending to forty five year low by 1 % in June 2003 and kept it there for over a year. This had the effect of encouraging another bubble - the real estate bubble. As early as 2002, progressive economists were warning about the real estate bubble, however and as late as 2005, the Council of
Economic Advisors chairman, Ben Bernanke, attributed the rise in U.S housing prices to ‘strong economic fundamentals instead of speculative activity’. There is little wonder that the eminent Princeton graduate was caught completely off guard when the sub-prime crises broke in the summer of 2007.

The dynamics of this bubble that allowed it to grow are described by one of key market players, George Soros, ‘mortgage institutions encourage mortgage holders to refinance their mortgages and withdraw their excess equity, they lowered their lending standards and re-introduced products such as adjustable promotional rates, all of which encourage speculation in residential units, with a consequent rise in prices’. What the economist was describing was that he subprime mortgage crises was not a case of supply out running real demand. The demand was largely fabricated by speculative mania, on the part of developers and financiers that wanted to make foreign money, most of it of Asian and Chinese origin that flooded the US in the last decade. Big ticket mortgages were aggressively sold to millions who would not normally afford them, by offering low teaser interest rates that would later be readjusted to jack up payments to the new home owners. On its own this would have caused problems in the housing sector only when the bubble burst, but because the assets were then securitised and converted into spectral or ghostly commodities called collateralised debt obligations (CDO’s) that allowed speculation on the odds that the mortgages would not be paid, it had systemic consequences. Thus as they were traded by the mortgage originators working with different actors who understated risk, so as to offload them as quickly as possible to other banks and other institutional investors, the toxicity spread. The institutions, in turn, offloaded their securities onto other banks in Asia and Europe and other foreign financial institutions and globalised the issue. The idea was to make a sale quickly, make a tidy profit, while foisting the risk on the unfortunates down the line, with few realising it could bring down the entire system – it was hard to row against the system however as profits were made quickly and easily, and the risk was borne by the hundreds of thousands of institutional and individual investors who bought the securities in good faith.

Thus when interest rates were raised on the subprime loads, adjustable mortgage and other housing loans, adjustable mortgages the system collapsed. There are about six million subprime mortgages outstanding, of which 40% are likely to go into default in the next two years, Soares estimates. Five million defaults will occur over the next several years. However securities based on these mortgages, whose value runs into trillions of dollars, have already been injected like viruses into the global financial system. Global capitalism’s gigantic circulatory system has been fatally infected and as with a silent plague, the exact amount fatally infected will remain unknown until it is too late, due to the whole financial system becoming so non-transparent owing to lack of regulation. How could Wall St Titans collapse like a house of cards? The list of companies affected show the global character of this crisis – AIG has many subsidiary insurance firms in Asia, such as Philimlife in the Philippines. We can safely say that there will be more bankruptcies and government takeovers at European and Asian banks and institution, joining their troubled U.S counterparts in either being allowed to fail, propped
up or taken over by government. Wall Street will deepen and prolong the U.S recession and affect Asia and Europe growth rates long into the future. Asia will definitely suffer as most countries are greatly dependent on the US market for their exports - China’s capacity to counteract the recent recessionary impact is limited since China’s main foreign investor is the U.S and it imports huge amounts of raw materials and intermediate goods that it uses for its exports to the U.S, Japan, Korea and South East Asia. Globalisation has now made de-coupling impossible - US, China and East Asia are like three prisoners bound together in a chain gang.

Therefore the Wall Street meltdown is not only due to greed and to lack of government regulation of a hyperactive sector, it stems ultimately from the crises of over-production that has plagued global capitalisation since the mid seventies financialization of investment activity that has become one of the escape routes from stagnation - the other two being neo-liberal restructuring and globalisation. But financialization has been proven to be a dangerous road leading to speculative bubbles; it leads to the temporary prosperity of a few, but it ultimately ends in corporate collapse and a recession in the real economy. How deep and long will this recession be? Will this recession tip over into a depression, and of course how do we get out of this recession? Neo-liberal market policies and globalisation, the policies got us into the mess in the first place, will not provide the answer. The silver lining however for civil society in this, is the discrediting and delegitimizing of free market ideology, the globalist paradigm and the ivory tower neo-classical economies that is blind to the development in the real world. The reaction of civil society groups throughout the world to the crisis has been a volatile one where outrage and frustration are mixed with hope - outrage at the greed of Wall Street; frustration at the fact that we have been long warning about the dangers of globalisation and deregulation. Hopefully civil society will now be presented with an opportunity to push for a transformation of the dysfunctional global economic system.

At the recently concluded Asia-Europe people’s forum, participants drafted an alternative programme for reform.

- Introduce full scale socialisation of banks, not just nationalisation of bad assets
- Institutionalise full transparency within the financial system through the opening of the books to the public to be facilitated by citizen and worker oversight bodies
- Introduce parliamentarian and citizen oversight of the existing system
- Apply social and environmental criteria to all lending including proper business purpose
- Prioritise lending to meet social and environmental needs, at the least possible interest rates
- Safeguard migrant remittances to their families and introduce legislation to restrict charges and transfers.
• Ensure independent central banks; make them autonomous but publicly accountable institutions.
• Create people bared banking institutions; reintroduce stringent capital control as well as currency transactions like dolmen taxes.
• Cancel the debt of all developing countries to enable them to have resources to protect their populations from the developing recession or depression.

In other words bail out the people and not solely the banks. Civil society organisations now know that their demands will not be granted, but merely by demanding them from governments we will see whether politics is still frozen by the recent events. It is hoped that people will be more susceptible to mobilisation around radical programmes as the crises of legitimacy of neo-liberalism, globalisation and capitalism deepens. There is a sense that we are entering an era of great danger mixed with great possibilities for policy change. At no other period have the words of the great Italian thinker, Antonio Gramsci, been more relevant that today, ‘We have to balance the pessimism of the intellect with the optimism of the will’. Having said this we are in fact entering into unchartered territories and legislators and civil society alike will need to be aware of this.
Asia and Europe together represent 60% of the world’s GDP, underscoring the importance of the two regions in the world economy. This situation cuts both ways however: in this time of economic turbulence, the destructive impact of the sub-prime crisis in the US financial markets last year has metamorphosed into a financial and banking cyclone that has now sucked in Europe and Asia. The two-day conference Connecting Civil Societies III: “An Asia-Europe Dialogue on Economy and Society” began on 17th October, just as Chinese Foreign Minister Yang Jiechi announced the preceding day that the global financial crisis would be the first priority of the 7th ASEM Summit among other issues. Bringing together 50 participants from government, NGO, media, academic/research and business sectors, the conference was organised by the Asia-Europe Foundation, the Research Center for Sustainable Development of the Chinese Academy of Social Sciences, the Irish Institute for Chinese Studies of University College Cork and the United Nations University Centre for Regional Integration Studies—in co-operation with the Asia-Europe People’s Forum and the Asia-Europe Business Forum and with support from the European Commission.

In all the discussions, the invited experts emphasised the linkages between the three issues: food security, energy security and financial market stability. The three crises are inter-related; they may also be related to what we can call a crisis in climate change, a crisis in sustainable development, widening inequalities and stagnation in the fight against poverty. There are serious consequences of all these crises for human security, human rights, democracy, gender equality and global decision-making in dealing with all these challenges.

Policies to address all these challenges should be based on sound analysis of the factors behind these crises. In this conference, an intense debate took place about the underlying factors. Experts and sectoral representatives exchanged views and came to some agreement, but disagreement about fundamentals remained—particularly on the analysis of the causes and prescriptions for the current financial crisis. However, it was generally undisputed that current policy approaches have so far resulted in some serious failures and new approaches are due. Some consensus seemed to emerge, among which include the following key messages:

1. Concerned actors need to distinguish between and among: firstly, short-term emergency and crisis management; secondly, medium-term policy formulation in order to improve policies; and, thirdly and ultimately, institutional reform.
2. Sometimes policies are well-intended and do have positive effects in initial stages but turn out badly later on.

- For instance, in the field of finance, the securitisation of mortgages, introduction of the sub-prime model, and also the initial policy advice that was given during the 1997 Asian financial crisis for governments to leave the markets to correct themselves with minimal government intervention.
- Other examples in the field of energy include dam construction for hydro-power which can have negative social consequences for the people living in the areas or negative ecological consequences— if the government and investors are not compelled to effectively mitigate such harmful kinds of impact.
- Another example was in trade and food security such as export levies on grain to protect consumers with negative consequence on global production.

We agree that there is a relationship between the real economy and the financial sphere. Imbalances in the real economy due to distorted production patterns, and market failures may give rise to excessive market volatility. On the other hand, financial speculation may give rise to a distortion of the allocation of investments. We did not agree on the exact nature of all these relationships. The key message to ASEM leaders was to continue the analyses of all these distortions and these imbalances, not only of markets but of public policy-making.

The purpose of criticism is not to apportion blame but to consider opportunity cost and benefits in a timely way to design integrated policies, as well as to regularly review practises and correct them on the basis of newly-emerging insights.

3. With regard to enhancement of international institutions:
   a. There is a need for more intensified intra-Asian integration and co-operation, in particular in the fields of energy, climate change, and finance.
      - *Intra-regional* cooperation is a prerequisite for better *inter-regional* co-operation to address the consequences of global challenges.
      - Examples have been mentioned, for instance, Asian swap arrangements in international finance or intra-Asian co-operation in the field of renewable energy.
   b. It was very strongly emphasised for actual need to strengthen multilateral co-operation including some reform of world multilateral institutions such as the G8, the UN Food and Agriculture Organisation, among others. Some suggestions were made to reform G8 relations. Another suggestion was the reform of the IMF to make it more representative and less dominated by some countries in order to make it more credible.
   c. New mechanisms to oversee and regulate the global, cross-boundary financial institutions operating on financial markets must be developed.
d. Finally, the need to create a crisis management mechanism within ASEM was suggested.

4. As far as institutions were concerned, through all the discussions, there was a clearly strong desire to include business and civil society in policy design, policy making and in particular in the review of the consequences of specific policies in order to change the policies on the basis of those reviews, appraisals and assessments. This is necessary in order to make policies more effective. There is also a need for business and grassroots organisations to call for accountability and transparency in public policy-making.

The discussion took place in the midst of the current international financial crisis. The world has seen a number of global financial crises in the past: the financial crisis following the rise of oil prices in 1973, for instance. However, some countries and the international community used these crises as a reason not to implement their commitments in other fields. There is a fear that the present financial crisis will obscure other global priorities such as those on energy transition, food security, climate change, poverty alleviation and meeting of the Millennium Development Goals.

One definitive message to the ASEM Summit from the conference was: Leaders, not losing sight of the on-going crises and the need for regional and inter-regional responses to these common problems, maintain your commitments to enhancing broader human security.

Messages and Recommendations on the Financial Crisis, Food Security and Energy

On managing the current global financial crisis

1. ASEM should promote greater co-operation in monetary and financial affairs within Asia and Europe and between the two regions. Such co-operation should be built on existing regional arrangements and initiatives such as the Chiang Mai Initiative.

2. Asia and Europe should work on improving their economic policy frameworks to make their economies less vulnerable, less pro-cyclical and more sustainable. In this context countries with large current account surplus should take measures to promote domestic demand.

3. ASEM should take all appropriate measures to restore trust and confidence in the financial system. A good example is to identify a role that Sovereign Wealth Funds (SWF) can play in stabilising the financial systems. While national security is a legitimate concern but it should not be a pretext for protectionist policies of the recipient countries. It is important therefore that owners of SWF and recipient countries adopt certain generally accepted principles and practises such as ‘Santiago Principles’ and the OECD investment policy principles.
4. Asia and Europe reject short-termism and should encourage the development of a longer term oriented, sustainable financial system with an appropriate regulatory and supervisory framework in the public interest.

5. Asia and Europe should support all initiatives to ensure transparency and accountability with regard to the activities of bankers, regulators, accountants and credit rating agencies.

6. Asia and Europe should set-up a mechanism to consider the long-term challenges faced by financial markets, which should involve all stakeholders, including representatives from civil society.

On ensuring long-term food security

ASEM Leaders are called upon:
1. **not** to allow the financial crisis to divert their attention from addressing the worsening food crisis with all its implications;

2. to remain committed to reducing poverty given the direct link between food security and poverty alleviation;

3. to consider the serious impact of export-oriented agriculture for rural sectors and on the environment;

4. to furthermore consider the impact of protectionism in the agricultural sector on global food security;

5. to enhance their efforts to reform UN agencies, in particular the Food and Agriculture Organisation (FAO) in order to more effectively address the food security challenge.

We recommend ASEM Leaders to
1. Address the food security challenge in their talks in Beijing;

2. **Mandate** their relevant Agriculture, Environment and Development Ministers to meet as soon as possible in order to address these issues and more specifically support the following:
   a. innovative inputs and inter-regional exchanges;
   b. the exchange of best practise including the impact of chemical fertilisers and pesticides;
   c. the education of women and girls in Asia given their key role in rural development;
   d. research on the impact of climate change on agriculture and food production.
3. Facilitate greater transparency in the processes leading to Free Trade Agreement negotiations, and especially in Asia we recommend greater involvement of civil society and better access to information.

4. Ensure that the development of Biofuels shall not occur at the expense of food security at the national and international level.

5. Enhance the role of the Asia Europe Foundation in order to address the issue of food security with all stakeholders including the media.

On energy security and co-operating on climate change

1. The lead taken by the EU in the field of climate change is applauded. However, there is fear that at the end of the first period of implementation period of the Kyoto Protocol, the Annex 1 countries member states will not live up to their commitments.
   a. If Europe does not meet its commitments, other countries (particularly developing and emerging countries in Asia) might rightly question Europe’s credibility and be dis-incentivised against commitments in the implementation period following 2012.
   b. To avoid this major step backwards, European and Asian countries are urged to ensure far-reaching and binding agreements at the 15th UNFCCC Conference of Parties in 2009, to ensure that emission reductions follow a patterns set by the Inter-governmental Panel on Climate Change.
   c. These commitments should be ambitious, and they should not be diluted by policies that would enable countries shying away from cuts in carbon emissions to resort to policies oriented toward mere absorbing or trading emissions.

2. European and Asian countries should work together towards transition to low carbon energy. Europe can set an example to be followed by others but that example should be discussed with governments and business in Asian countries, so as to enhance their credibility, feasibility as well as their effects.

3. In this respect, close cooperation should take place between European and Asian countries in sectors such as:
   a. the design, production and standards-setting of energy efficient consumer durables, many of which are produced in Asia for the European market;
   b. the development of third generation biofuels that are not grain-based;
   c. technology developments and standard-setting for renewable energy and construction.
4. ASEM fora dealing with trade facilitation and investment action programmes should focus explicitly on fostering energy efficient and sustainable energy-based investment, production and trade patterns.

Recommendations regarding government, business, media & NGO co-operation

We call upon ASEM leaders to:

1. Continue their efforts to prioritise specific Europe/Asia common challenges such as the financial crisis, food and energy security;
2. Create a crisis response mechanism within ASEM, involving a small number of members;
3. Enhance the roles of the various existing mechanisms and networks such as the Asia-Europe Foundation, the Asia-Europe Business Forum and the Asia-Europe People’s Forum;
4. Promote other networks between Asia and Europe.
5. Consider strengthening the role of ASEF in the implementation of their activities.

In co-operation with business groups:

1. ASEM in tandem with the business communities should establish programmes to facilitate youth exchange between the two regions.
2. ASEM can forge stronger links among the two regions business communities by strengthening the role of the Asia Europe Business Forum (AEBF).

In co-operation with the media:

1. ASEM should promote greater exchange between media outlets and professionals to strengthen the relationship between existing institutes and media organisations, for example Asia Pacific Broadcasting Union (ABU) and the European Broadcasting Union (EBU).
2. ASEM should expand existing media research initiatives to promote greater understanding of the two regions.

In co-operation with NGOs, mass organisations, grassroots organisations and citizen’s associations:

1. ASEM governments need to engage civil society directly in its activities through more regularised and structured mechanisms e.g. a contact point for civil society in each ASEM government through an open door policy that accepts legitimate civil society concerns, that represents a plurality of voices and that respects freedom of expression and access to information.
2. ASEM governments need to be more accountable to their people and, at least, their parliaments
with respect to the dialogue, recommendations and any decisions made at the ASEM level.

3. ASEM governments need to consider social protection in crafting policies and consider the most vulnerable sectors and the disadvantaged, whether it be on financial, energy or food security policies or other policy concerns.

This report was prepared with the conference Main Rapporteur, Dr. Jan Pronk, former UN Special Representative of the Secretary-General to Sudan and former Special Envoy of the UN Secretary-General to the World Summit for Sustainable Development and the following workshop rapporteurs: Dr. Raymond Atje, Head, Economics Department, Centre for Strategic and International Studies (Indonesia), Mr. Ou Virak, Director, Cambodian Center for Human Rights and Alliance for Freedom of Expression; Mr. Richard Werly, Journalist, Le Temps.

The views and opinions expressed herein do not necessarily reflect those of the conference organisers.

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About the Asia-Europe Foundation

The Asia-Europe Foundation (ASEF) promotes greater mutual understanding between Asia and Europe through intellectual, cultural and people-to-people exchanges. Through ASEF, civil society concerns are included as a vital component of deliberations of the Asia-Europe Meeting (ASEM). ASEF was established in February 1997 by the participating governments of ASEM and has since implemented over 450 projects, engaging over 15,000 direct participants as well as reaching out to a much wider audience in Asia and Europe.

www.asef.org

ASEM now brings together 43 member states (Austria, Belgium, Brunei Darussalam, Bulgaria, Cambodia, China, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Indonesia, India, Ireland, Italy, Japan, Korea, Laos, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Mongolia, Myanmar, the Netherlands, Pakistan, the Philippines, Poland, Portugal, Romania, Singapore, Slovakia, Slovenia, Spain, Sweden, Thailand, United Kingdom, Vietnam) plus the European Commission and the ASEAN Secretariat.

www.aseminfoboard.org
About the Partners

Research Centre for Sustainable Development - Chinese Academy of Social Sciences

Research Centre for Sustainable Development (RCSD), one of the research centres under the Chinese Academy of Social Sciences (CASS) umbrella, officially known as the think tank of the Chinese government on Climate change and environmental issues. RCSD was established in 1997 in response to the need in China for its pursuit to sustainable development, specializing policy related research mainly at national and international levels, providing policy input and advice to the government through academic and policy related and case specific research activities. In 2005, the Centre was merged with the CASS Centre for Urban and Environmental Studies, bringing in expertise in urban planning, urban economy and development issues. For more information, please visit http://www.rcsd.org.cn/

Centre for Comparative Regional Integration Studies, United Nations University

The United Nations University - Comparative Regional Integration Studies (UNU-CRIS) is a research and training unit of the United Nations University. UNU-CRIS specialises in studying the processes and consequences of regional integration and cooperation. Established in Bruges in 2001, the centre is a research and training programme of the United Nations University. UNU is a global network of centres engaged in research and capacity development to support the universal goals of the UN and generate new knowledge and ideas by providing a framework to bring together leading scholars from around the world to tackle pressing global problems. http://www.cris.unu.edu/

Irish Institute of Chinese Studies, University College Cork

In June 2006, the Irish Institute of Chinese Studies was established at University College Cork. It seeks to develop a distinctive research profile and fosters links with partners in Asia, Europe and United States. It offers a range of research degrees including MPhil, PhD and Visiting Scholars programmes, which aim to initiate and develop programmes of social science and humanity-led research on contemporary China. Research areas include: Politics, regulation and governance in Greater China and the International relations between China, Asia and the West; Human rights, education and society; gender inequality in education, workforce and society; urban and rural and minorities development; Popular culture and language; media and mass communication; Business, management and investment, economic growth dynamics and sustainable development Globalisation and regionalism; Cultural adaptation and social integration of Chinese students in Irish higher education; Chinese Sport, Asian Sport and Olympic Studies. http://www.ucc.ie/en/DepartmentsCentresandUnits/ChineseStudies/

In co-operation with the
Asia-Europe People’s Forum and the Asia-Europe Business Forum

With the support of the European Commission
The Connecting Civil Societies III conference was organized in the lead up to the 7th ASEM Summit in Beijing in October 2008. The conference offered a unique platform to exchange experiences and share expertise on the global crises surrounding food security, oil prices and financial market instability in the context of Asia-Europe Dialogue.

The co-organisers of this conference, the Asia-Europe Foundation (ASEF), the Research Centre for Sustainable Development - Chinese Academy of Social Science (RCSD -CASS), the United Nations University – Centre for Comparative Regional Integration Studies (UNU-CRIS), and the Irish Institute for Chinese Studies – University College Cork (IICS-UCC), brought together over 60 high level international representatives from NGOs, the business community, academe, and the media from across Asia and Europe to discuss the major economic and social issues facing the two regions.

This conference proceedings publication features a selection of the keynote presentations from the conference, as well as the conference report as submitted to ASEM leaders prior to the summit.