October 2015
Vol. 6 Ed. 9

The Bulletin

Official monetary and financial institutions ▪ Asset management ▪ Global money and credit

Fed falters
Yellen's wavering

Meghnad Desai on US interest rate nerves
Mojmir Hampl on why Europe needs Britain
Kingsley Chiedu Moghalu on Buhari's challenges
Rakesh Mohan on US and Brics IMF roles
David Owen on restructuring Europe
David Smith on Pope Francis' economic voice

OMFIF

Fed falters

The Federal Reserve's reluctance to raise interest rates – a result of fears about an emerging markets slowdown, especially in China – has considerable systemic implications. America's monetary policy-makers are taking seriously the world outside the US . The same attention needs to be paid to global economic governance. Not only the developing countries but also the US need a higher IMF quota. Europe would be the loser. ■

Book review

William Keegan finds *Capitalism: Money, Morals and Markets* by FT journalist and OMFIF Chairman John Plender a 'beautifully written' and rigorous examination of capitalism. Plender lines up former Fed Reserve Chair Alan Greenspan for serious criticism, and reaches a damning verdict on his faith in the efficiency of markets. Politicians, particularly those who repealed the Glass-Steagall Act, attract only slightly less censure. Unlike some critics, he does not lay all the blame at the doors of the banks – at least not the commercial banks. Keegan's verdict: 'A delight to read'. ■

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International monetary policy

Change is overdue for IMF governance	Rakesh Mohan	7
Why international coordination matters	Rakesh Mohan	9
Fed sets the stage for lift-off later this year	Darrell Delamaide	10
Risk aversion is risky	Meghnad Desai	11

Europe

ECB shifts towards transparency	Frank Westermann	5
Restructuring Europe in interests of all	David Owen & David Marsh	12
Overshadowing Greece and refugees	Mojmir Hampl	13
Greece starts debtor v. creditor campaign	David Marsh	13

Emerging markets

Now Buhari's hard work really begins	Kingsley Chiedu Moghalu	14
Papal voice on economic stage	David Smith	17

Book review

An unholy mixture	William Keegan	18

Eichel spells out ECB options

An unusual Anglo-German alliance on new policies for the European Central Bank has been forged with an intervention at an OMFIF meeting in London by Hans Eichel, German finance minister 1999-2005.

Eichel, who was in government in the early years of the euro under Chancellor Gerhard Schröder, was responsible for economic restructuring under the Agenda 2010 programme.

At a workshop on 'New ways forward for the European Central Bank' on 29 September Eichel urged the ECB to focus its €60bn-a-month QE programme on supporting infrastructure projects and small and medium-sized businesses.

Eichel's plan, which he has advocated privately for several months, is similar to the 'People's QE' proposals by Jeremy Corbyn, the new UK Labour Opposition party leader, for the Bank of England directly to fund government-directed investment in infrastructure.

Similar ideas for targeted central bank efforts to spur lending for infrastructure and small businesses have been voiced by Adam Posen, a former independent member of the Bank of England monetary policy committee, and Paul Marshall, a hedge fund owner in London.

Eichel proposed that the ECB should lend to public sector and regional banks, targeting areas of the economy that can accelerate growth, possibly using infrastructure assets and other similar securities as collateral, as a way of increasing the effectiveness of its quantitative easing efforts. ■

Lending proposal: Hans Eichel and OMFIF's European Central Bank report

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EDITORIAL

Governance and growth on Lima agenda

There is plenty to occupy minds at the October annual meetings of the International Monetary Fund and World Bank in Lima. China has implanted itself in the top echelons of the world economy and finance, yet has been at the centre of perturbation over what appears to be a larger-than-expected economic slowdown.

Showing a degree of sensitivity to global economic developments that many critics (wrongly) claim it never hitherto embodied, the Federal Reserve is still prevaricating over what appears to be an inevitable rise in interest rates, nine years after the last one. Europe has stabilised after a lull in the summer outbreak of Greek thunder and lightning – although all parties accept that bad weather will resume again before the sun shines.

We devote the October 2015 Bulletin to the interplay of forces between world governance and the still fragile progress of the world economy. The Fed's hesitation over interest rate 'lift-off' may have been justified on monetary grounds; from a psychological point of view, it was a flawed decision, since the Fed's fears, now on full view, can be much more readily transmitted to others.

In a masterful historical summary of the imbalances over individual economies' size and IMF representation, Rakesh Mohan, executive director for India at the Fund, sets out the reasons why Europe, in particular, needs to relinquish voting weight in coming years. 'The centre of gravity of the global economy is shifting back towards Asia from the North Atlantic. Yet there is little evidence of this change reflected in the framework of global economic governance, where we see a stalemate over the international financial institutions,' he writes. 'The impasse seems to indicate the advanced economies' reluctance to countenance broader governance changes, despite these momentous shifts.'

Darrell Delamaide emphasises that Yellen's 'No' (heavily backed by the rest of the FOMC rate-deciding committee) does not bind her hands for the rest of the year. Meghnad Desai, co-author with David Marsh of a blunt 31 August commentary listing 10 points why the Fed should lift rates now, writes flatly that the Fed's nervousness over 'lift-off' was a mistake that heightens the danger of another 2008-style crash. He calls on readers to prepare for a coming storm.

We list the protagonists in the forthcoming debtor versus creditor skirmish in Europe over the Greek bail-out package, where the overall aims, but not individual steps towards implementation, have been agreed. Newly reconfirmed Prime Minister Alexis Tsipras will be exploring new methods of maximising access to funds while minimising a further economic squeeze.

Fresh challenges are on display elsewhere. Kingsley Chiedu Moghalu comments on the first cabinet appointment – after months of waiting – by Nigerian President Muhammadu Buhari. Pope Francis has visited the US, underlining his wish to make a deep imprint on the global economic stage, the subject of a penetrating commentary by David Smith.

David Cameron, the UK prime minister, is preparing for a referendum by 2017 on whether Britain will remain in the EU. David Owen and David Marsh write that restructuring the EU into a euro bloc and a wider grouping enshrining the principles of the single market would be a helpful policy not just for the UK but for the rest of the EU.

Mojmir Hampl, deputy governor of the Czech National Bank, warns that Britain's decision will have significant repercussions for the whole continent. William Keegan explains how OMFIF Chairman John Plender's latest book shows that capitalism contains not so much the seeds of its own destruction; more the seeds of its own recurrent crises. Of this truth, in Lima and beyond, there will be no shortage of evidence. ■

ECB shifts towards transparency

Data release clarifies key indicator on balance of payments

Frank Westermann, Advisory Board

The European Central Bank has decided to release data on intra-euro system claims and liabilities among national central banks that had accumulated since the 2007 financial crisis under the Target-2 system, which reached a peak of more than €1tn for crisis-hit countries.

The Target-2 claims and liabilities have attracted controversy since summer 2011, when Hans-Werner Sinn, president of Germany's Munich-based Ifo research institute, started a debate on the ECB's role in Europe's financial crisis. Pointing towards these claims and liabilities on NCB balance sheets, he argued there was a 'stealth bail-out', unnoticed by the general public and ignored by European parliaments.

The lack of a common database was a major shortcoming in the subsequent debate. In a research article, Sinn and his Ifo colleague Timo Wollmershäuser were the first to illustrate how data from the International Monetary Fund can be used to approximate the Target-2 balances. However, these data came with a delay of several weeks and were accessible only to subscribers to the IMF's statistical database.

Regardless of which side observers and analysts take in the debate, the ECB step is a welcome move towards transparency. The balances are a key indicator of Europe's balance of payments position and a barometer of financial stability.

In October 2011, the Institute of Empirical Economic Research at Osnabrück University started collecting data from NCBs based on their published monthly balances, released in different formats and according to varying schedules. Only a few NCBs explicitly identified the Target-2 balances. The Bundesbank initially included them in a composite balance sheet position called 'other items'.

Although the Institute was able to report the number with relatively high precision, some of the values relied on estimates and others differed with respect to the publication date. Also the data lacked the authority of an official institution, needed for research and business use. This shortcoming has now been rectified. As of September, the ECB is providing these numbers in a common data base. ■

Frank Westermann is Professor of International Economic Policy and Director of the Institute of Empirical Economic Research, Osnabrück University.

ADVISORY BOARD

Omfif welcomes a new member to the advisory board, David Suratgar. His appointment takes the number of Advisory Board members to 171.

David Suratgar is an international lawyer and banker with more than 40 years of experience. He has advised governments, central banks, privatisation commissions and state agencies, with a focus on Africa and Latin America. He is a former deputy chairman of Deutsche Morgan Grenfell, where he ran the project finance and international advisory departments. He serves as chairman of Masawara, as chairman of the Emerging Markets Managed Accounts, and as a member of the Advisory Board, XPV Capital, the Canadian investment company for the water industry.

REPORT LAUNCH

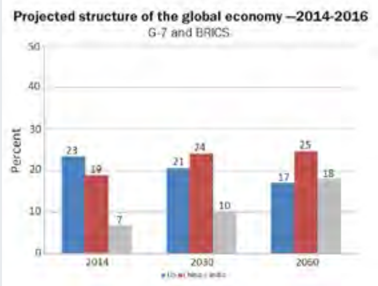
Experts discuss ECB future

OMFIF launched its 'Future of the European Central Bank' report at a roundtable on 29 September in London. The report clarifies six key questions on the role of the ECB. At the launch Hans Eichel, former German finance minister called on the ECB to refocus its quantitative easing programme on lending for infrastructure projects and small and medium-sized businesses (see p. 3). For a copy of the report please email editorial@omfif.org.

CITY LECTURE

Mohan favours IMF quota reform for US, Brics

The US and developing countries should expand their International Monetary Fund quotas and voting power at the expense of Europe, Rakesh Mohan, executive director at the IMF for India, Sri Lanka, Bangladesh and Bhutan, said in an OMFIF City Lecture in London on 4 September. Mohan showed that China and India would each have a larger share of the global economy than the US by 2060 (graph, right). He criticised delays in the US Congress in implementing IMF structural changes as showing the 'reluctance of advanced economies to transferring power to emerging market economies'. For a shortened version of the lecture see p. 7, 8 and 9.



SEMINAR

The role of GPIs in enhancing African development

On 15 September OMFIF held its inaugural Africa Public Investors Meeting at Innholders' Hall in London. A total of 43 delegates heard from panel experts and took part in discussions. Sessions included the role of public investors in Africa; harnessing Africa's natural resources in the interests of wider prosperity; bridging Africa's infrastructure financing gap; and future precepts for improving the effectiveness of investments and accelerating structural change.

Global Public Investors hold about $29tn in assets under management, and represent a potentially significant input into Africa both in terms of size and long-term stability.

The meeting echoed the sentiments expressed at the OMFIF Second Meeting in Africa, held in Port Louis in November 2012, where participants focused on the potential that global capital flows from sources of long-term stable finance like pension funds could have on the development of African nations if continental, regional and national bodies could make a sufficiently attractive proposition. In a low yield, low interest-rate environment where there is difficulty securing reasonable returns, executives are actively examining investment in Africa. In a post-QE environment, hedge funds and asset managers have found that the traditional path of geographical diversification for investment is less appealing, demonstrated in recent weeks by declines in US and Asian markets. Large sovereign funds and some Canadian public pension funds had moved into infrastructure and were increasingly examining and investing in frontier emerging markets and illiquid assets – a trend that was likely to continue.

African investment: Louis Kasekende, Deputy Governor, Bank of Uganda (left), with Mthuli Ncube, Senior Adviser to the President, Eastern and Southern African Trade and Development Bank

Change is overdue for IMF governance

Why Brics countries and US need greater representation

Rakesh Mohan, IMF Executive Board Member

The world is on the cusp of an epochal change in global economic power, not seen during the past 200–250 years since the start of the industrial revolution.

The centre of gravity of the global economy is shifting back towards Asia from the North Atlantic. Yet there is little evidence of this change being reflected in the framework of global economic governance, where we see a stalemate over the international financial institutions, in particular the International Monetary Fund. The impasse seems to indicate the advanced economies' reluctance to countenance broader governance changes, despite these momentous economic shifts.

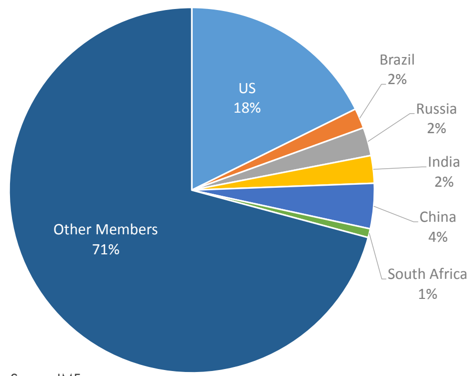
The international financial organisations remain dominated by the advanced economies. IMF reforms have been held up by the US administration's inability to obtain approval from Congress for doubling the IMF's quota resources, and changes in its voting and quota structures that the IMF's board of governors agreed under the 2010 review process (the Fund's 14th).

This congressional blockage is doubly unfortunate because the US was the principal architect of the 2010 accord. The US has 17.7% of IMF quota shares and hence an effective veto over important decisions that require a 'super-majority' of 85% (Chart 1).

The creation of new institutions led by emerging and developing economies, particularly by the Brics countries (Brazil, Russia, India, China and South Africa), such as the Asian Infrastructure Investment Bank, the New Development Bank Brics and Currency Reserve Arrangement, is indicative of these countries' dissatisfaction with the framework. Prospective changes in quotas and voting shares would lead to reduction in the shares of the European countries, which retain disproportionate weights in the IMF despite a shrinking share of global GDP (Chart 2). US leadership of the international institutions remains of great value, and it is important that the US retains its dominant position. The Bretton Woods institutions owe their founding to US vision after the second world war. US financial markets continue to be the most dominant in depth and efficiency – and the dollar is the dominant reserve currency and will remain so for the foreseeable future. Although the role of the emerging economic powers is increasing, their soft power is not rising at the same pace, underlining the importance of keeping US leadership.

Chart 1: US holds veto position

Current IMF quota shares



Source: IMF

Economic weight shifts

The global economic structure was broadly stable from 1945 until the turn of the millennium. The advanced economies' share in global GDP was around 60% through that period though there were changes in relative weights among the advanced economies themselves, particularly related to Germany and Japan (Tables 1 and 2).

Change since 2000 has gathered pace, with economic weight shifting from the North Atlantic to Asia. This is expected to accelerate further over the next couple of decades. So changes in global economic governance will have to be more substantive than the current incremental change envisaged.

The global GDP shares of emerging and developing economies is expected to increase from 40% in 2000 to over 60% by 2020 in purchasing power parity terms and from 20 to 40% in market exchange rate terms. The G7 countries' share in global GDP (PPP) is expected to fall from about 44% in 2000 to about 30% by 2020, with a corresponding increase in the share of Brics from 19% in 2000 to 33% in 2020 – part of much bigger changes expected up to 2060 (Chart 3).

The emerging economies' demand for better representation must be seen against the backdrop of the North Atlantic financial crisis that originated with US sub-prime troubles in mid-2007.

The crisis has led to stagnation and weakness in the mature economies, whereas emerging economies recorded strong growth, albeit with some recent moderation.

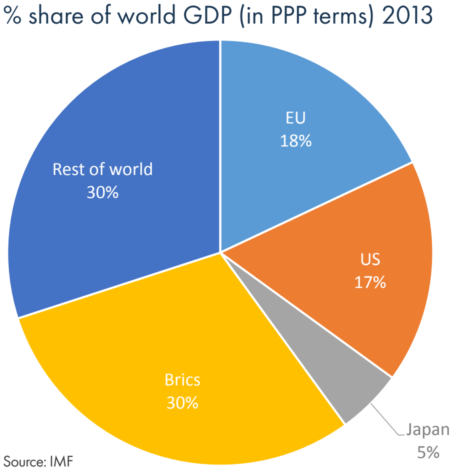
The Brics countries, particularly China and India, are acquiring large economic weights because of population size, despite relatively low per capita incomes. Greater participation in global economic governance will require greater assumption of responsibility. The transfer of governance roles needs to be tempered by the relative lack of sophistication and size of economic institutions in these aspiring countries. But we can expect that this gap will be bridged before too long.

Financial globalisation is unlikely to be reversed. As the world recovers from the 2008–09 turbulence, other crises will erupt.

As normalisation takes place from the unconventional excessively accommodative policies practised in much of the developed world, and the large debt overhang that exists, the eruption of financial instability in some parts of the world would not be surprising in the near and medium term.

Chart 2: Divison of global GDP

% share of world GDP (in PPP terms) 2013



Source: IMF

Table 1: The case for a larger share for Brics countries

GDP shares and current and proposed quotas

Source: IMF	Current Quota Share (20081)	Proposed Quota Share 14th Review2 (2010)	2013 Data Update[3]		
			Calculated Quota Share[4]	GDP (PPP) Share	GDP (MER) share
US	17.7	17.4	14.5	16.7	22.1
European Union	32.0	30.4	27.6	17.9	23.8
BRICS	11.5	14.8	20.0	29.5	21.0

1. Existing quota share last adjusted in 2003.
2. Yet to be implemented.
3. Data update based on latest data available for 2013.
4. Calculated quota share based on formula used for 14th review.

As the emerging economies have grown individually and collectively, and as international financial markets have become more interconnected, resolving successive crises will need large international resources. The IMF is likely to be more not less necessary for its roles in preserving financial stability and as a lender of last resort. To perform effectively, the Fund must have adequate permanent quota resources to retain and enhance its credibility and legitimacy.

So it is essential that its quota resources are increased regularly, in line with the expanding size of the global economy and financial markets. Moreover, such regular quota reviews would also ensure that the emerging powers get their rightful share in the IMF's governance, extending its evolution since 1950 (Table 1 and 2). Decisions on IMF governance and the use of IMF resources can no longer be made in the clubs of the G7 and G10: some of the action has already shifted to the G20.

> **"The US is most under-represented in the Fund in relation to its share of GDP – mirroring developing countries**

The IMF's governance structure has to become more inclusive. The US needs to retain its role, in its own as well as the wider international interest. As US Secretary of the Treasury Jack Lew noted in March 2015: 'A well-resourced and effective IMF is indispensable to achieving our economic and national security interests, protecting the health of the US economy and enhancing the prosperity of America's workers.'

European countries remain overweight, with the 'advanced Europe' group (European Union, Norway and Switzerland) taking a third of board seats, and more than a third of board voting power: the relative constancy of their quota shares is striking, since their share in GDP is falling consistently (Chart 4).

Furthermore, the Bretton Woods institutions since inception have been headed by European nationals in the IMF and US nationals in the World Bank. This pattern has continued for almost seven decades now. It appears that there was an informal agreement that the World Bank would be headed by a US national, and the implicit understanding was that the IMF would be headed by a non-US national; somehow, over time, this got transformed to a European national heading the IMF on a continuous basis. Thus, nationality has turned out to be the guiding criterion to head the Bretton Woods organisations and nationals of other countries, irrespective of merit, have been excluded. This must be corrected. Other institutions such as the World Trade Organisation have shown the way; there is no reason why the Fund cannot find procedures that could result in the same outcome.

US needs to retake leadership

Global economic governance is at a crossroads. The economy has become more complex and interconnected, as international trade has become virtually free across the board as a consequence of multilateral trade rounds, and as capital accounts open further.

Table 2: Advanced countries remain in lead in IMF changes since 1950

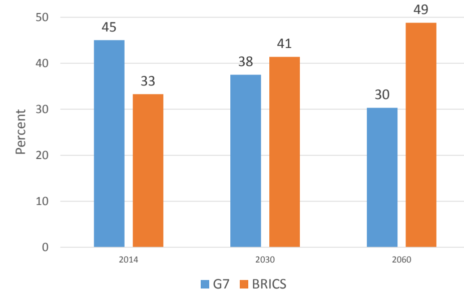
IMF quota shares (%) for top 13 nations

		1950		1980		2000		2012
1	US	32.0	US	21.2	US	17.6	US	17.7
2	UK	15.1	UK	7.4	Japan	6.3	Japan	6.6
3	Taiwan	6.4	Germany	5.4	Germany	6.2	Germany	6.1
4	France	6.1	France	4.8	France	5.1	France	4.5
5	India	4.7	Japan	4.2	UK	5.1	UK	4.5
6	Canada	3.5	Canada	3.4	Italy	3.3	China	4.0
7	Netherlands	3.2	Italy	3.1	Saudi Arabia	3.3	Italy	3.3
8	Belgium	2.6	China	3.0	Canada	3.0	Saudi Arabia	2.9
9	Australia	2.3	India	2.9	Russia	2.8	Canada	2.7
10	Italy	2.1	Netherlands	2.4	Netherlands	2.4	Russia	2.5
11	Brazil	1.7	Belgium	2.2	China	2.2	India	2.4
12	South Africa	1.2	Australia	2.0	Belgium	2.2	Netherlands	2.2
13	Mexico	1.0	Saudi Arabia	1.7	India	2.0	Belgium	1.9

Source: IFS, IMF

Chart 3: Brics nations overtake G7

Projected global economy 2014–60



Source: IMF

The best way out of this impasse would be for the US to retake leadership in the IMF and global economic governance through an immediate congressional approval of the long-postponed 14th review.

If the US believes that the IMF is important for the smooth functioning of the global economy, in which it has a large stake, it must make it clear that it is in favour of discussions on and consequent approval of the next five-year review (the 15th), which should in normal circumstances have been approved by end of 2015. And the US should support other such quota reviews in the years and decades to come. Further ahead, reviews of IMF quotas and governance need to be more radical – with significant implications for overall quota and voting shares. In addition to the under-representation of the Brics, the country that is most under-represented in relation to its share in global GDP is the US. Whereas the GDP shares of the US and EU are broadly comparable (16.7 and 17.9% in PPP terms, respectively), the calculated quota share of the US, based on the latest 2013 data, would be 14.5%, compared with 27.6% for the EU (based on the current quota formula).

Correction of this imbalance in favour of the US is important in obtaining congressional approval for future quota reviews. The existing quota formula will need revision to accomplish this. If an appropriate correction is carried out, it would postpone by some years the prospect of the US quota share dropping below the important 15% threshold. This provides a further reason why protecting the US quota share should be a priority – a matter that concerns not simply the US, but also the entire international community. ■

Professor Rakesh Mohan is an Executive Director on the IMF Board, representing India, Sri Lanka, Bangladesh and Bhutan, and a member of the OMFIF Advisory Board. Based on Rakesh Mohan and Muneesh Kapur, 'Emerging Powers and Global Governance: Whither the IMF?', IMF Working Paper (forthcoming 2015).

Why international coordination matters

An interconnected world needs a resilient IMF

As global economic, monetary and financial systems have evolved over the IMF's history of 70 years, and as dominant western economic policy orthodoxy has changed, so has the role of the IMF, *writes Rakesh Mohan*. But the need for the Fund as a central coordinating institution remains as strong as ever. A prime factor has been much freer capital flows from the 1990s onwards, opening of capital accounts and overall financial liberalisation in advanced as well as emerging and developing economies. The result has been an increase in financial interconnectedness – and, with this, larger rescue programmes (Chart 5).

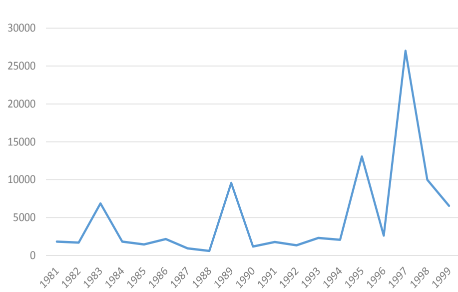
In 1981, India needed a programme of only about $5bn to solve its economic crisis at that time. Recent IMF programmes for small countries like Portugal, Ireland and Greece have each exceeded $25bn. These countries have needed so much money that European institutions have had to supplement IMF resources, so that the IMF has been much the junior partner in these programmes in terms of resources, and possibly in programme design.

When the IMF was founded in 1944, international financial flows were mainly related to trade financing: private sector financial flows were of limited scope and importance. The Bretton Woods system did not envisage free capital flows. Until the 1980s, there were relatively few financial, banking and debt crises: the drawing of IMF resources by member countries was limited to 100% of their respective quotas, and only 25% in one year.

With the breakdown of Bretton Woods in 1973, and the advent of floating exchange rates and free private capital flows, and the oil price rises of 1973 and 1979, the frequency and seriousness of financial crises increased. Between 1970 and 2011, according to Jack Boorman, a former IMF adviser, there were 147 systemic banking crises, 218 currency crises, and 66 sovereign debt crises. Until 2007, the vast majority of these crises occurred in emerging and developing economies.

Chart 5: The cost of crises increases

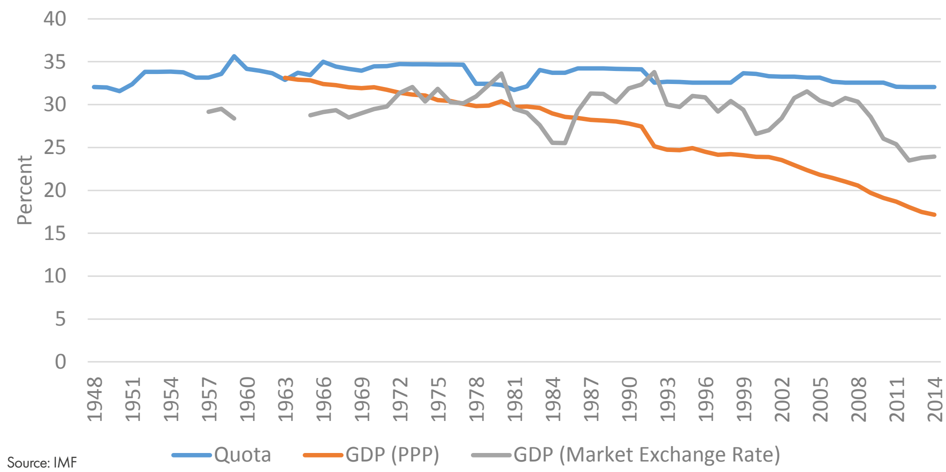
Size of IMF rescue packages



Source: IMF

Chart 4: EU nations' share of global GDP falls but IMF quota remains static

European Union quotas and GDP (shares in world total)



Source: IMF

IMF member countries could be grouped in two relatively distinct categories: debtor countries (most emerging economies) and creditor countries (mostly advanced economies). It was natural that the advanced grouping would have a more dominant governance role. These distinctions were blurred at times, but have become more so since 2008. There have been more than 20 systemic banking crises since 2008, mostly in advanced countries. Consequently, many emerging market economies are now counted among the creditors, and advanced economies among the debtor countries group.

Weakness of inflation targeting

In addition, the North Atlantic financial crisis called into question the dominant economic paradigm – characterised by the 'Washington consensus' of free cross-border capital flows, fully flexible exchange rates, and complete faith in the efficacy of markets and capitalism. It highlighted, too, weaknesses in the dominant paradigm of macroeconomic management for central banks – inflation targeting.

Inflation-targeting regimes led to central banks focusing only on a narrow objective (price stability defined low and stable inflation rates) for monetary policy supported by a single instrument (policy interest rate). In the process, other key complementary central banking responsibilities – like financial regulation and supervision and public debt management – were either entrusted to specialised authorities outside the central bank or were given relatively little attention. Strong microprudential supervision was believed to contribute to effective financial stability at the macro level. For nearly two decades, this was a period of the Great Moderation – a time in which financial imbalances built up in the economy, ending up with the 2008 crisis. The upheaval is often dubbed as a global financial crisis. But it originated in the North Atlantic economies; other economies were not its source, although they were hit by it. This enhanced interconnectedness has raised the need for international coordination. The gold standard was an anchor before the first world war, characterised by free capital flows and fixed exchange rates. But the successful pursuit of the gold standard needed implicit global cooperation among the major economic powers. The difficulties were perhaps lowered by the need to organise cooperation among a relatively small group comprising the European countries and North America. The rest of the world did not matter and was, in any case, under colonial domination.

The system broke down between the wars, characterised by hyperinflation in Germany, the Great Depression, beggar-thy-neighbour and protectionist policies, and ascendancy of fiscal policy. This period of economic chaos provided an impetus towards developing a robust global economic order for high and stable growth. The Bretton Woods conference, dominated by the US and UK, provided a forum for these discussions, which led to the creation of three major international financial institutions – the IMF, the World Bank and later, the General Agreement on Tariffs and Trade and the World Trade Organisation. World economic thought and economic dynamics have changed. But the principles behind the IMF's creation remain valid more than 70 years later. ■

The views expressed in these two articles are those of Prof. Rakesh Mohan and do not necessarily represent the views of the IMF, its Executive Board, or IMF management, or of the authorities he represents.

Fed sets the stage for lift-off later this year

Hawks, doves seem united on taking action soon

Darrell Delamaide, US Editor

Conventional wisdom is that the Federal Reserve will take its initial step in raising rates at one of the policy-making meetings followed by a press conference, so that Fed chair Janet Yellen can provide context.

This is why anticipation was high for the September meeting, and inaction then has now shifted the focus to December, the next Federal Open Market Committee meeting with a press conference scheduled to follow.

But Yellen has been at pains to provide the context for the rate hike ahead of time and it is conceivable that lift-off will take place in October, even without a scheduled press conference. If she felt a need to communicate further context, she could do so via a conference call with journalists or an ad hoc press conference.

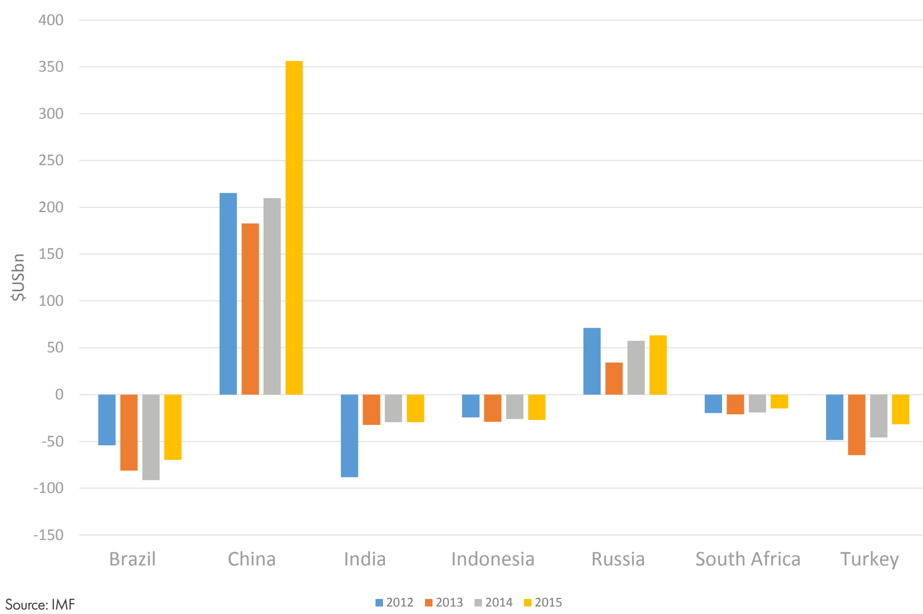
It seems from her remarks and those made by other Fed policy-makers after the September meeting that they have been taken aback by the negative reaction to the panel's non-decision. There has been a growing unison across the hawk–dove spectrum that it is time to begin the process of normalisation. Though Yellen indicated in her September press conference that market volatility resulting from lower growth prospects in China gave the Fed pause, recent remarks from policy-makers suggest that this concern will not keep them from acting. A number of developing countries, even those with current account deficits that need financing, appear to be resigned to Fed action (Chart 1). In any case, Yellen has set the stage for lift-off with her nuanced remarks at the September press conference and in a major address at the University of Massachusetts in Amherst toward the end of the month.

What her Fedspeak boils down to is that the central bank feels the need to overshoot the mark on lowering unemployment in order to speed up the process of bringing inflation up to its 2% target. At the same time, it cannot delay monetary tightening too long because it wants to proceed at a measured pace and not be forced into more abrupt – and disruptive – action if inflation catches up too fast.

So, Yellen said in her Amherst speech, FOMC participants expect the jobless rate to sink below the target of around 5% and inflation to move back towards 2% once 'temporary' dampeners, such as lower oil prices, abate. She concludes that this expectation is why 'most of my colleagues and I anticipate that it will likely be appropriate to raise the target range for the federal funds rate sometime later this year'.

Chart 1: Developing economies poised for impact of a US rate hike

Current account balance ($bn)



Source: IMF

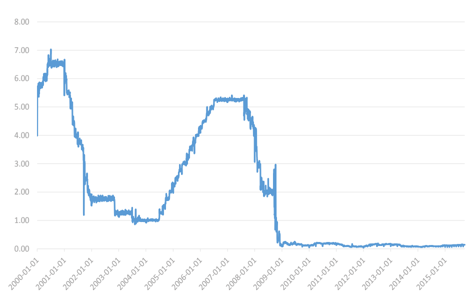
Richmond Fed President Jeffrey Lacker was the lone dissenter at the September meeting. In a comment explaining his dissent, Lacker noted that real short-term rates are below negative 1%. 'Such exceptionally low real interest rates are unlikely to be appropriate for an economy with persistently strong consumption growth and tightening labour markets,' he said. 'Even after a quarter-point increase, interest rates would remain exceptionally low, providing ample support for economic growth.'

He acknowledged that the recovery has been 'disappointing' compared to historical averages. 'Nevertheless, US economic conditions have improved quite significantly over the last six years,' he said. 'It's time to recognise the substantial progress that has been achieved and align rates accordingly.'

St. Louis Fed chief James Bullard (non-voter), who has urged action sooner rather than later for most of this year, emphasised in a presentation in St. Louis that 'once normalisation begins, policy will remain extremely accommodative through the medium term'. He complained that judging by the market reaction the Fed's failure to act in September 'created rather than reduced global macroeconomic uncertainty'.

Chart 2: Time for a rise?

The Fed rate 2000–15



Source: FRED

The case for normalisation is strong, he argued, for the simple reason that 'the committee's goals have essentially been met, but the committee's policy settings remain stuck in emergency mode'.

And even John Williams (voter), the head of the San Francisco Fed who is as dovish as they come, came down in favour of action soon, dismissing some of the 'hand-wringing' over China as 'downright apocalyptic'.

'I don't see the situation as dire,' he said in New York. On the US front, he noted 'we're in a very different place now than when we first instituted extremely accommodative policy in 2009'. Given that there are long and variable lags in monetary policy, 'an earlier start to raising rates would allow us to engineer a smoother, more gradual process of policy normalisation'.

Delaying and raising rates too late, he added 'would force us into the position of a steep and abrupt hike, which doesn't leave much room for manoeuvre'. ■

Darrell Delamaide is a writer and editor based in Washington DC.

Risk aversion is risky

Fed has enhanced danger of another crash

Meghnad Desai, Chairman, Advisory Board

The Fed chickened out, after all the debates and discussions, by not raising interest rates on 17 September. We are invited to wait for the next time and a rerun of the same procedure. This is another example where a central bank, in this case the world's most important, has not learnt the lessons of 2008. By postponing the rate rise, even by a modest 25 basis points, the Fed has enhanced the dangers of another crash.

Let us hope I am wrong, but we have had nearly seven years of quantitative easing, zero interest rates in developed economy markets and excess liquidity. In the overall economic picture, and despite current low inflation, the effects in exacerbating financial instability are already starting to appear.

In the years preceding the crash, the Fed and other central banks concentrated on the inflation–unemployment trade-off.

The lodestar was the Taylor Rule, setting down in a somewhat mechanistic way the interlinkage between interest rates and prevailing economic conditions, a sort of a born-again Phillips Curve that mapped the historical relationship between inflation and unemployment.

The spirit of John Taylor and William Phillips guided the Fed when it last increased interest rates in the two years up to 2006 on the grounds of inflation fears – but, as we now know, the tightening measures were too little and too late to quell the imbalances building up in the system.

Endless nail-biting induces uncertainty

As we at OMFIF have written (Commentary, 31 August), a rate rise would have charted the beginning of a long-term adjustment of monetary policy to the twin dangers of rising inflation pressures and financial instability that will eventually ensue from past easy money policies.

A number of mainstream commentators (and even, perhaps in somewhat repressed form, Janet Yellen herself) seem to agree that endless nail-biting over the Fed's first upward move for nine years is itself a factor inducing uncertainty.

Just as we predicted a month ago, postponing the rise because of worries about world economic disorder has diminished faith in recovery and policy normalisation.

> **"The Fed has heightened rather than reduced the prospects of a crisis. Data on US growth and unemployment are looking strong and Yellen is promising a rate rise soon**

The domestic parameters which are the main criteria governing the Fed's policy behaviour have now largely moved into line with pre-set conditions for an interest rate increase. The bout of nerves over China and other emerging market economies (the good news is that India may be an oasis of calm in the present troubled scene) has been overdone.

What the central bankers missed was that manipulating the rate of interest to stem inflation may have assured price stability but it did nothing to guarantee financial stability. The Fed under Alan Greenspan kept the interest rate low for a very long time. This sowed the seeds of financial instability.

There was a bubble in the housing market with sub-prime mortgages and M&A activities with outrageous valuations.

The crash when it came did a lot of damage to the real economy as much as to the financial system. It is striking that thoughtful central bankers such as the Reserve Bank of Australia's Glenn Stevens (OMFIF City Lecture, 30 June) have been saying that, over the next 10 years, financial stability may rank alongside price stability as an equal part of central banks' operating mandates.

Yet again the Fed has invoked problems of flow variables – income and unemployment – rather than stock variables – the high level of household indebtedness, bubbles in equity markets and, once again, M&A valuations which make no sense.

The latest episode is the proposed purchase of SABMiller by Anheuser-Busch InBev to create a $275bn company, a whimsical nonsense that would associate the largest international brewer with one of the world's worst takeover deals.

Fed conscious of world beyond its boundaries

One of the reasons advanced for the Fed's non-action is that it was aware of the implications of its actions on the global economy. It is even said that this was a first for Yellen's Fed. But history shows that this is not the first time the Fed has been conscious of the world beyond its boundaries.

Normally the Americans follow the adage of John Connally, President Richard Nixon's treasury secretary: 'The dollar is our currency and your problem.' But even so the Plaza Accord that quelled the dollar's rise in 1985 was an international gesture. Greenspan acted quickly in 1998 when the Asian crisis began to affect the rouble and cut interest rates to provide liquidity. That averted a prolonged crisis that would have hit western economies. Timely intervention was of the essence.

In the latest decision, the Fed has heightened rather than reduced the prospects of a crisis. Data on US growth and unemployment are looking strong and Yellen is promising a rate rise soon. But who knows whether the Fed can grasp the nettle and move out of its zero rate trap – or whether it will again procrastinate?

The dangers this time around are serious. In the previous crisis, it was the western developed economies which behaved in an irresponsible way, failing to regulate their financial systems.

The Asian and other emerging economies regulated their markets successfully though they violated IMF norms.

This time we have seen China suffering from a burst bubble in the Shanghai stock market. China has invited doubts about the accuracy of its growth statistics and its failure to communicate the purpose behind its exchange rate depreciation.

There is speculation about whether China will export its (growth) recession westwards. Capital outflow from China has accelerated. Falling commodity prices have affected all the economies – such as many African countries – which thrived on exporting to China.

The short-run prospect is one of recession. Low growth and low inflation will persist. If the Fed continues to be risk averse, it may drag other central banks with it.

There is little chance now of central banks unravelling all the bond purchases they made under QE. We may have to wait longer for interest rates to return to realistic levels.

This may make borrowers happy and bond markets buoyant. But the second crisis becomes more likely. Take cover from the approaching storm. ■

Meghnad Desai is Emeritus Professor of Economics at the London School of Economics and Political Science.

Restructuring Europe in interests of all

Why Britain must safeguard its single market rights

David Owen and David Marsh

The European Union must make serious structural changes to convince its member states' electorates that it can overcome its formidable problems. An important way forward would be to restructure the EU into two distinct but interrelated elements: the euro area and a non-euro area grouping, which would include the single market of the existing European Economic Area comprising all EU member states plus Norway, Iceland and Liechtenstein.

Such a restructuring would not be a massive task, but it would bring great reward. It would make European arrangements more cohesive and efficient, enhancing European companies' possibilities to become more competitive on the world stage – which would be in the overall interest of the EU. Recognising the realities of the EU's 'variable geometry' that has been evolving for 20 years, this refashioning would have the ancillary benefit of easing the task of keeping the UK in the EU in the referendum that will take place in 2016 or 2017.

A UK departure from the EU would be an extremely serious setback, for the UK as well as for the rest of the EU, with profound economic and geopolitical consequences. The whole of the EU should make every effort to prevent that from happening.

Under the proposed restructuring, the euro grouping would go forward with the much enhanced degree of political, economic and social integration needed to repair the evident flaws of economic and monetary union and make the single currency work. Those countries, like the UK, which have no intention of joining the euro (either over an indefinite period, or in the next few years) would be formally placed in the non-euro area.

Under safeguards that would be couched in legally binding language, they would have access to all the benefits and opportunities available in the European single market – the EU's main success story during the first 50 years and an achievement that must be kept alive in future. Crucially, they would be shielded from any obligation to intervene in the dealings of, or provide financial assistance to, the euro area member states with regard to measures to shore up the euro, since such matters would be issues for the euro members alone.

A foretaste of potential difficulties was provided in July when Britain and other non-

EU milestone: New edition of Owen's book *Europe Restructured: The Eurozone Crisis and the UK Referendum* is available on Amazon

euro states faced pressure from the other EU members to provide assistance to Greece under the European Financial Stability Mechanism, a scheme linking all EU member states funded by the EU budget to which Britain contributes.

> **"The serious economic difficulties of the euro area and the geopolitical problems of wider Europe are inextricably linked to the UK referendum**

At present, Britain and other non-euro states can be outvoted over use of this fund under qualified majority voting procedures; in future, a proposed 'double majority' system should prevent non-euro countries being forced to bow to the wishes of a euro-area-based majority over such issues.

The euro area is moving towards significant reforms involving new executive powers at the euro area level, complemented by stronger accountability – for example, towards the creation of a euro area grouping within the European Parliament and 'a euro Commissioner' focusing on fiscal policy as well as growth, investment and job creation.

The UK has no problems with any of these suggestions, provided that when an ever more integrated euro area emerges and starts to vote en bloc within the single market, a non-euro area voting majority can be established to prevent euro area domination of the single market. A further element of the proposed restructuring would be that the three non-EU EEA adherents (Norway, Iceland and Liechtenstein), at present not full voting members, would along with any new members be offered full voting rights under QMV.

Another change would be that a wider Europe would be offered membership of the non-euro grouping, starting with invitations to Turkey, already an associate EU member. This would involve all the advantages and obligations of full EEA membership except that such countries would not be offered the freedom of movement of people and labour within the EU. Such an opt-out would be available for EU countries like the UK that have no intention of joining the euro area and already control their own borders, not being part of the Schengen open border grouping within the EU. Switzerland would negotiate, as it is already in the process of doing with the Commission, EEA membership, or come in with the same offer to Turkey.

The euro area remains in the midst of an economic crisis. Greece's problems are not resolved; the French and Italian economies are still not grappling with the need for radical change; there are weaknesses in other euro area economies.

Geopolitical tensions abound, particularly in the east and the south. Britain has no wish to potentially destabilise the EU further by voting to leave. But having no meaningful negotiation risks Brexit.

The economic difficulties of the euro area and the geopolitical problems of wider Europe are inextricably linked to the UK referendum. Opinion polls, which have lately shown a tendency towards a 'No' vote, are no guide at present to the outcome.

Safeguarding Britain's position in the single market, set in place by the Single European Act of 1986, fully supported by all the political parties then represented in the Commons, would be an important step towards preparing the way for a crucially important 'Yes'. ■

David Owen was British Secretary of State for Foreign and Commonwealth Affairs (1977–79), and is an OMFIF Advisory Board member. The 2015 edition of 'Europe Restructured' is available as an ebook. David Marsh is Managing Director of OMFIF.

Overshadowing Greece and refugees

UK referendum will be Europe's biggest test

Mojmir Hampl, Deputy Governor, Czech National Bank

The most critical stress test still lies ahead for the European Union and the project of European integration. This claim may seem overblown in the light of the refugee crisis and still smouldering Greek turbulence – as if it were not enough that both the euro and the Schengen Area are proving (to the detriment of all, inside and out) to work only reasonably well in good times. In bad times they are clearly not sufficiently robust.

Yet I'm convinced that the forthcoming British referendum on EU membership, set to take place within the next two years, is of far greater importance for the EU.

I am talking not so much about the political repercussions of the Yes/No vote on the internal integrity of Britain itself and the division of powers and manner of government there, however great these may be. I refer, rather, to the consequences for continental Europe, which many are studiously ignoring.

From my own experience of numerous debates in Europe, I am well aware of Britain's importance in taking positions often in sensible counterbalance to others'. I may not always agree with the UK, but I have to take it seriously. I sense instinctively that there is no substitute of comparable strength. In the long run Britain's EU membership makes the European integration project more balanced and meaningful for us all.

It irritates me to see the debate on the UK referendum in continental Europe sliding so often from realism into sermonising.

Britain is called upon to 'make the right decision' or 'face the consequences'. This is a very continental – and also very un-British – way of thinking.

I therefore welcome the decision of the European Commission to create a 'task force for strategic issues related to the UK referendum', headed by Jonathan Faull, a British veteran of the European integration process.

Decision about the entire EU

The task force may not have the snappiest name, nor, perhaps, is it institutionally appropriate for the Commission to take such a step, but at least someone is symbolically acknowledging that they know what is at stake.

The decision of the British public will, like it or not, be a decision about the rest of us, about the entire EU. The British have an important ally on their side: history. For at least 200 years, this, the oldest, most resilient and most stable democracy in Europe, has – through various twists and turns – made the right decisions at key moments in history. It has stood on the right side. Napoleon, Wilhelm II, Hitler, Stalin: each time Britain has stood systematically – and sometimes entirely alone – on the side of freedom, reason and tolerance against despots, false messiahs and aggressive megalomaniacs capable of destroying Europe. History tells us that this corrective trait of the British often serves as a last resort for Europe.

I could add provocatively that during the recent Great Recession it was again the Anglo-Saxon world which decided quickly and resolutely to implement the right policy – a massive monetary easing – at a time when the risks of inaction were potentially limitless. The same cannot be said in our continental Europe. So, let's drop the sermonising, stop fuming at the British and wise up. If the Britons say the EU isn't good enough for them, can it be good enough for anyone else? ■

Mojmír Hampl is Deputy Governor, Czech National Bank.

Greece starts a debtor v. creditor campaign that Germany is expected to lose

The chances of any enduring stability in Greece are not high. But Greece's manifest weakness is its strength. The renewed election victory on 20 September by Alexis Tsipras' left-wing Syriza party, ushering in another Greek coalition to enact the country's newly agreed €86bn bail-out package, offers the best chance of relative stability in coming months, *writes David Marsh*.

Tsipras is retaining as finance minister Euclid Tsakalotos, the mild-mannered Oxford-trained economist, to continue euro area negotiations over enacting the bail-out. Greece's parlous political and economic position delivers precisely the reason why Tsipras will once again be using fears of Greek instability to drive hard bargains with creditors – and why (led by Germany and France, with varying degrees of enthusiasm and distaste) they will succumb.

In the creditor versus debtor campaign starting in Europe, we will see four sets of people taking up position around negotiating tables.

In one corner sits Tsipras, a reluctant convert to the spending cuts, tax rises and market liberalisation demanded by creditors. Tsipras may well interpret his new mandate as a signal that he can take a tough line with creditors over the bail-out details.

Facing the Greek debtors are the creditor countries, a diverse grouping. Germany's habitually orthodox line on budget cuts is in disarray, hard hit by the effects of the world economic slowdown and the European migration crisis. Italy and France, waging long-standing, not-so-covert guerrilla warfare against German rigour, will be using Tspiras' strengthened position as a means of reining back their own deficit reduction commitments. In a third corner is the European

Victory salute: Alexis Tsipras remains Greece's leader

Central Bank, likely to adopt an exacting stance on Greece's fulfilment of budgetary commitments in return for bringing the country into the bank's €60bn-a-month programme of euro area-wide (apart from Greece) asset purchases under the QE measures started in March.

In the fourth corner is the International Monetary Fund. It will participate in the latest bail-out package only if the creditors agree substantial debt relief for Greece in coming months, through fresh cuts in (already low) interest rates and a stretching out of repayments until late in the 21st century. ■

Now Buhari's hard work really begins

Nigeria's cabinet starts to take shape

Kingsley Chiedu Moghalu, Advisory Board

After a delay of nearly four months, Nigeria's newly-elected President Muhammadu Buhari has started to name his ministers – beginning with himself as Minister of Petroleum Resources.

Although the pace of announcements has been slow, the news is welcome – but now the hard work really begins.

Boko Haram, though significantly weakened, has wreaked havoc in Nigeria's northeast region, which needs to be rebuilt. Corruption is systemic. The economy, battered by external shocks from an excessive reliance on crude oil revenues, is facing sustained headwinds from low oil prices and the country's failure to save for a rainy day while the price of Brent crude was above $100 (it was $42.23 at its lowest point so far this year on 24 August).

The country remains deeply divided along ethnic and religious fault lines. Nigeria is still in search of nationhood and its politics remains largely a contest by ethnic nationalities for winner-takes-all political power that is deployed not for a great national vision, but for sectarian patronage networks. Add the problem of deep cleavages within Buhari's ruling party, the All Progressives Congress, and the new leader's challenges are nearly complete.

Buhari needs to justify his slow start by ensuring that his cabinet, whenever it is compiled, performs to match the high expectations set for it. He and his team must tackle Nigeria's problems with a sophisticated understanding of how the problems and the solutions are interlinked.

The great benefit of Buhari's presidency has been the stirrings in the national ethos of a shift away from institutionalised corruption and a lack of consequence for non-performance in public service to one where his leadership example has inspired many citizens to fall in line. Many of these people are doubtless playing to the gallery. The real task is to build a system and institutions that will outlast Buhari's presidency.

Getting the balance right between a cult of personality worship and de-personalised reforms of the system will be important. But contemporary Nigerian history has demonstrated that the values and the competence of its leaders matter. Nigeria's sustained progress requires a leadership succession that takes the country into the future on the basis of a new national ethos and genuine economic transformation. The fleeting blessings of commodity boom cycles will no longer do.

Awaiting appointments: Muhammadu Buhari, who was elected in May but who still has not named his full cabinet Picture: Getty Images

The country's economy presents complex challenges. It seems clear that the policy direction will be towards a strong role for the state in economic policy, even while welcoming private business and investment. This is partly evident from Buhari's reluctance so far to abolish wasteful petroleum subsidies in the belief that to do so would hurt the poor. But in reality the subsidies are not effective, and benefit the rich more than the poor.

> **"Buhari must act on the need to devolve more powers, responsibility and accountability to the constitutional parts of Nigeria's dysfunctional federal structure**

Buhari would achieve far more by abolishing them and targeting the resulting savings at conditional cash transfers to the very poor, based on clear criteria. The Central Bank of Nigeria's measures to manage the depletion of foreign reserves through strict controls on foreign exchange transactions, instituted in order to avoid further currency devaluations, point to rising nationalism in economic policy. As a result, the US investment bank JPMorgan has removed Nigeria from the bank's Government Bond Index Emerging Markets. True believers in the efficient market hypothesis have expressed concern, but it is noteworthy that emerging market giants such as China and India were not listed in the index in the first place. While the recent actions and statements of the Central Bank of Nigeria have affected perceptions in financial markets about its independence, the need for central banks to work independently surely also encompasses independence from vested private sector interests including foreign portfolio investors.

The real test of strategic economic nationalism will be how long it takes Nigeria to achieve a diversified industrial economy that can support the value of its currency and reduce the structural impact of the current dependence on commodities. Nigeria's economic potential is hobbled largely by political factors that create perverse incentives for the wrong policy approaches. Buhari must act on the need to devolve more powers, responsibility and accountability to the constituent parts of Nigeria's dysfunctional federal structure. Excessive powers are concentrated in the federal government in Abuja, and the country's states are little more than mendicant supplicants for oil revenues at the feet of the national government.

Constitutional amendments that create incentives for real sector economic activity in the states and regions – as opposed to the prevailing mentality of 'sharing' a vanishing 'national cake' of oil patrimony – is the path to both true economic transformation for Africa's bellwether country and the unity in diversity it sorely needs. Thinking through these policy dilemmas is not a job for one man.

The buck stops with the president, but Buhari needs a strong and credible team. That's why he needs to complete his cabinet as soon as possible. ■

Kingsley Chiedu Moghalu was deputy governor of the Central Bank of Nigeria (2009–14) and is a professor at the Fletcher School at Tufts University. He is a member of the OMFIF Advisory Board.

Papal voice on economic stage

Francis' assault on 'oppressive lending'

David Smith, Advisory Board

Pope Francis, in his six-day visit to the US, appeared to be basking in a tidal wave of adulation bordering on adoration. In discussing economics, he ran into the no-holds-barred culture of the 'American way' – but only the deaf or delusional could imagine that the pontiff was espousing free market capitalism or economic globalisation.

President Barack Obama went to the airport to greet him, an extraordinary gesture designed to show gratitude for his mediation in bringing rapprochement with Cuba. As he held Washington and New York spellbound, Francis' deft juggling of spirituality, politics and economics emphasised his ambition to carve out a major global role on central issues of world economics.

This Pope is no newcomer to political combat. There is no doubt where he stands: on the side of the debtors, the downtrodden and the economically repressed.

His speech at the United Nations in New York summed it up.

He did not single out the World Bank, or the IMF, but the global system. He argued, to rapturous applause from the African and Latin American delegations: 'The international financial agencies should care for the sustainable development of countries and must ensure that they are not subjected to oppressive lending regimes… which, far from promoting progress, subject people to greater poverty, exclusion, and dependence.'

Not everyone agrees. On the day of his arrival the Wall Street Journal lamented the Pope's embrace of 'the progressive political agenda of income redistribution'. Right-wing commentator George Will, not a man to deal in ambiguities, defined the Pope's economic thinking as 'impeccably fashionable, demonstrably false and deeply reactionary, ideas that would devastate the poor on whose behalf he purports to speak… Americans cannot simultaneously honour him and celebrate our nation's premises'.

> **"Above and beyond our plans, we are dealing with men and women who live, struggle, and suffer, and are often forced to live in great poverty, deprived of all rights**

Before the US Congress, Francis chose his language and tone carefully. This was mild indeed from a man who has denounced unfettered capitalism in the past. 'Business is a noble vocation,' he said, to quiet applause from the Republicans on Capitol Hill. 'But it must serve the common good, of shared prosperity and respect for the environment.' Democrats loved that.

The meat of his Washington message lay in his plea for cooperation among mankind, a long way from the day-to-day rancour that typifies the Congress. 'Such cooperation is a powerful resource in the battle to eliminate new forms of slavery, born of grave injustice which can be overcome only by new policies and new forms of social inclusion.'

And then there was the sentence omitted from his speech, only for the official transcript to show what he was supposed to say: 'If politics must truly be at the service of the human being, it follows that politics cannot be a slave to the economy and finance.'

That line, and the thinking behind it, became the talking-point as he flew to the United Nations. Then at the UN, before the General Assembly, speaking in his native Spanish, the Pope let his message rip. Politics and economics, he argued, had a sacred duty to humanity: 'Above and beyond our plans and programmes, we are dealing with men and women who live, struggle, and suffer, and are often forced to live in great poverty, deprived of all rights.' The economy of 'exclusion' has been the clarion call of this papacy so far, 'a complete denial of the human fraternity' as he defined it. The Pope's balancing act won acclaim. 'I didn't hear from him an alternative philosophy of politics and economics,' to quote one veteran Republican Congressman. 'What I did hear was a moral obligation to the poor and disadvantaged, and it's on that fundamental policy level that he got his message through.' ■

David Smith, is an OMFIF Advisory Board Member, a former White House correspondent, and represented the UN Secretary-General in the Americas 2004–14.

OMFIF Press to launch latest book – *The Convergence of Nations*

Underlining its commitment to deeper research on Africa, OMFIF Press will be publishing *The Convergence of Nations: Why Africa's Time is Now,* a compilation of international analysis and opinion on the continent's political, economic and social realities. Jean-Claude Bastos de Morais, founder of the Quantum Global Group, leads a team from across the continent illuminating Africa's opportunities and challenges.

In a search for an appropriate cover design, OMFIF ran a competition for an original work of art to be produced by African nationals living in Africa. An international panel of six judges which was chaired by OMFIF Advisory Board Chairman Meghnad Desai awarded the first prize of £1,000 to Kenyan pharmacist and amateur artist Shivani Shah for her strongly evocative depiction of Africa, which fuses different media in a way that expresses convergence and solidarity.

In the artist's own words: 'The use of red symbolises man's most primitive instincts of self-preservation; gold and silver evoke the tremendous wealth found throughout Africa; and the 3-D effect of the wires shows the increasing importance of the internet and mobile technology.' ■

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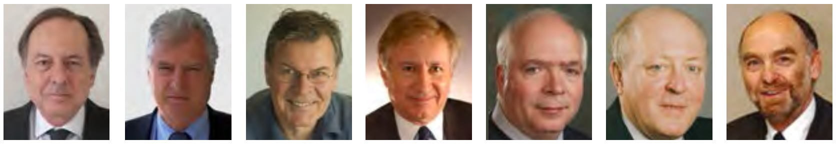

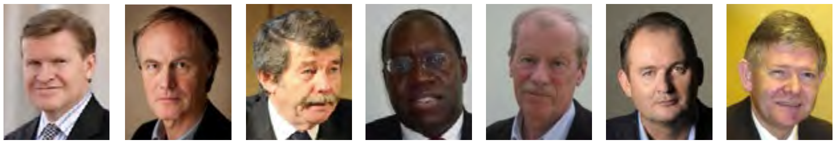

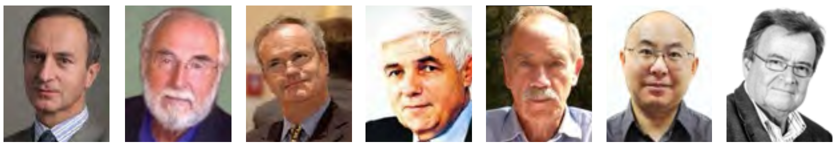

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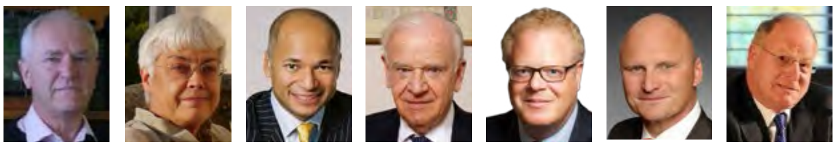

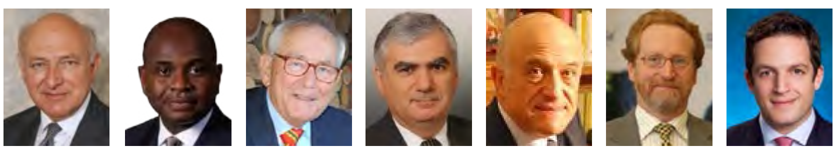

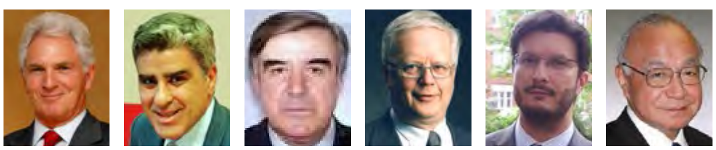

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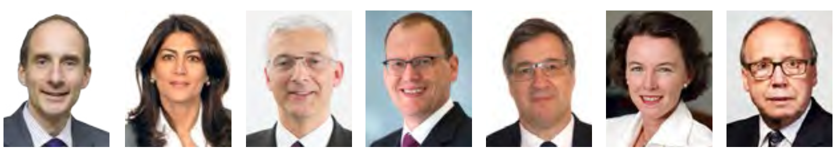
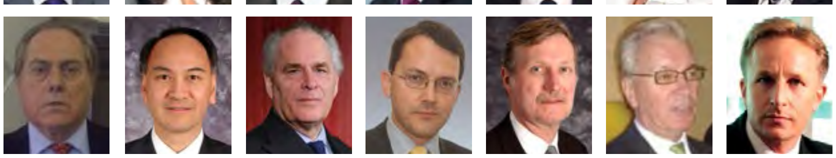
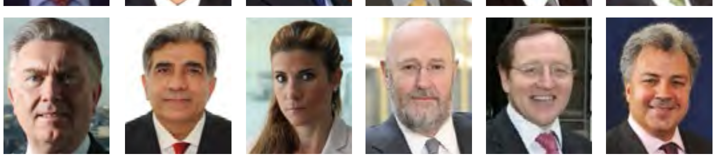
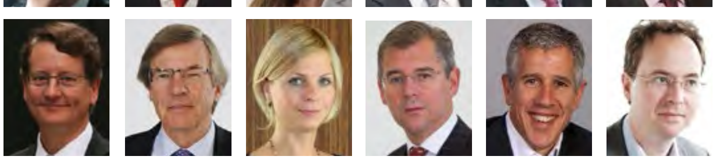
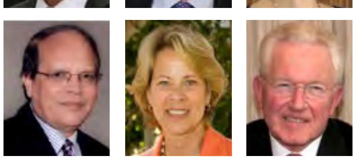
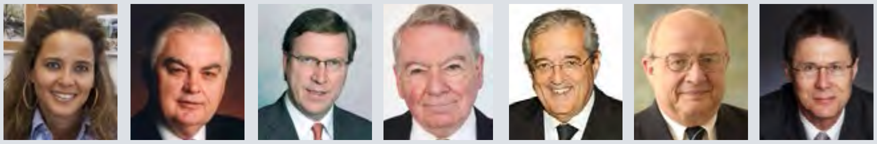






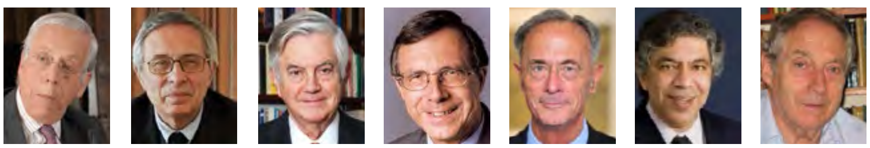


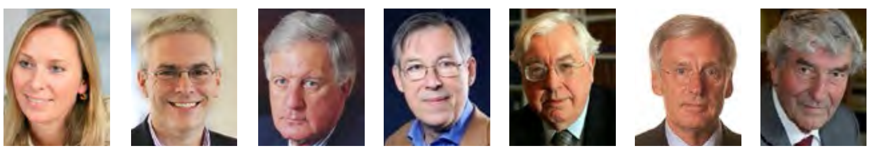


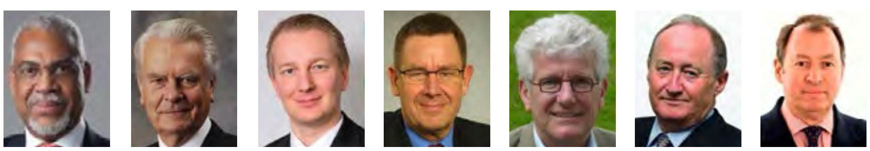


EDUCATION & RESEARCH

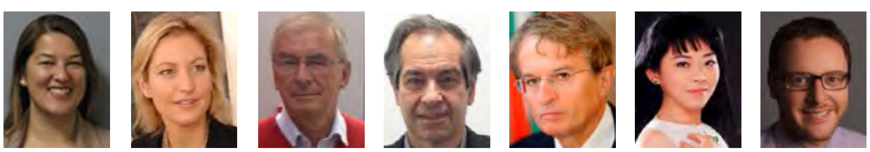
PUBLIC POLICY

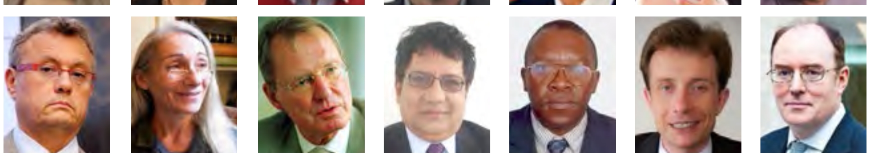


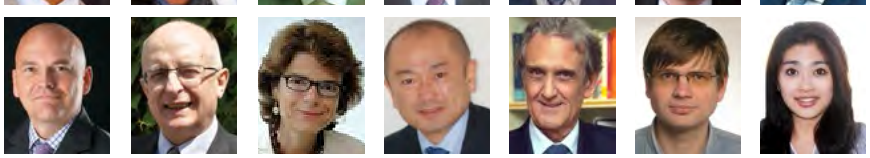




ECONOMICS & INDUSTRY







An unholy mixture

The problem of morals and markets

William Keegan, Advisory Board

In May I was on a panel at the Chalke Valley History Festival discussing the topic: 'Capitalism in crisis: where next?' The other panelists were the economists Peter Oppenheimer and Nicholas Crafts. I think our chairman, the biographer and broadcaster Michael Crick, was mildly disappointed when, in response to his opening question – whether, after the financial crisis and its repercussions any of us thought the end of capitalism was in sight – we all responded with a firm 'no'.

What everybody was agreed on was that, although the collapse of Soviet communism had been good news for capitalism, the system was in serious need of reform, as indicated by that crisis, the Great Recession.

Now, one of the great achievements of the financial crisis and the Great Recession has been to give a boost to the tree felling industry, as a necessary preparation for the onslaught of books on the subject. Some of these have been unashamedly designed for the initiated only; others have been aimed at the general reader but have not necessarily proved as lucid as intended. John Plender is a highly distinguished financial journalist, and a man with practical experience of entrepreneurship and the City (he is also Chairman of OMFIF) and in *Capitalism: Money, Morals and Markets*, Plender has employed all his talents and experience to great advantage. *Capitalism* is beautifully written and should appeal to the general reader as well as the initiated.

Seeds of recurrent crises

For this reviewer one of the recurring joys of the book was the strong impression that, unlike some of the stuff emerging from some modern historians, this book does not give the irritating impression that it was written by teams of researchers, or that the wonderfully apposite quotations – many of them literary – are the product of 'search engines' as opposed to the wide reading of the author over the years.

The author does not pull his punches, but is fair-minded, with few sounds of axes being ground. There is obligatory coverage of Marx, Keynes and Schumpeter. Marx famously thought capitalism contained the seeds of its own destruction; Keynes devoted much of his life's work to trying to save capitalism; Schumpeter – a senior member of the 'Austrian School' – passionately believed in capitalism, but respected Marx and feared that capitalism would evolve into bureaucratic socialism. What Plender explains so vividly is not that capitalism contains the seeds of its own destruction, but the seeds of its own recurrent crises.

Plender speaks up for entrepreneurs, but has his eyes open. 'Here' he writes 'is one of the great paradoxes of capitalism. However dubious their business practices, the robber barons indisputably drove one of the fastest periods of economic growth in US history.' What really concerns him is the way that 'to put it crudely, capitalism has been hijacked by the banks'. He adds: 'That is not how it was meant to work. The only question is how long it will take before the system blows up again.'

Greenspan censured

But, unlike some critics, he does not lay all the blame at the doors of the banks – at least not the commercial banks. Central bankers, in particular former Federal Reserve Chairman Alan Greenspan, come in for serious censure, as do politicians – in the US they are known as 'lawmakers', but the tragic thing was that they were essentially law-breakers when, in 1999, they repealed the Glass-Steagall Act of 1933, which had been the sensible response to the Great Crash of 1929 and its aftermath.

The criticism of Greenspan, his belief in the 'efficient markets hypothesis', and his erratic approach to 'bubbles' is damning: Plender observes that the so-called 'maestro' sidelined staff members who were more prescient. Again, the central banks became obsessed by inflation targeting, turning a blind eye to the warnings of the Bank for International Settlements about asset prices. How ironical that the BIS is known as the central bankers' bank!

Plender argues that, for all the volumes of space they take up, the new regulatory efforts to control the excesses of the banking system do not go nearly far enough. And he is highly critical of the way that executive compensation, in both banks and big business generally, is still so skewed in favour of the short term approach which rewards executives at the expense of long term investment. 'When finance becomes increasingly remote from servicing industry and commerce, it is time to watch out. And when it becomes disproportionately large in relation to the economy, it needs to be cut down to size.' Plender has a nice macroeconomic point when he notes that the redistribution of income to the rich in recent years means that they may have enough to satisfy their needs, but their combined expenditure is not enough to boost western economies suffering from a deficiency of demand. In his final chapter Plender declares: 'I am, with caveats, pro-business and pro-capitalism.' But he ends this rigorous examination of capitalism on a pessimistic note: 'With politicians in thrall to the business and banking lobbies, the representatives of the people... are most unlikely to curb the excesses of an inherently unstable system through more stringent and coherent regulation.' ■

William Keegan is Senior Economics Commentator at the Observer, and a member of the OMFIF Advisory Board.