

Joseph Straus
Editor



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The Role of Law and Ethics in the Globalized Economy

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The Role of Law and Ethics in the Globalized Economy

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Preface

International conferences are not organized overnight—especially not when high ranking personalities from politics, business and academia should be offered an adequate platform for addressing and discussing highly relevant contemporary issues. The conference on “*The Role of Law and Ethics in the Globalized Economy*,” which took place on May 22 and 23, 2008 in the Bavarian Academy of Sciences and Humanities in Munich, was no exception. When the first preparations started at the end of 2006, neither the subprime crises nor the general crises of the global financial system, whose shock waves have rocked the financial businesses in subsequent months, were known; nor were they predictable or even imaginable. Based on our monitoring of the globalization process and its apparent impact—not only on the economic and technological environment, but also on the social environment—it was appropriate for the conference to begin by serving as a platform for analysing the *status quo* of the process of globalization, as relevant to politics, business and academia, and for exploring how the interest groups in those domains cope with the challenges of globalization. In the end, however, the purpose of the conference was to produce proposals for conditions for “upwards” global competition, meaning that minimum conditions should be worked out to enable people to live and labour humanely. Such conditions would be those which should help avoid otherwise inevitable frictions in society, both nationally and internationally.

From the very beginning it has been apparent that such conditions cannot be achieved internationally without some minimal norm setting, no matter how difficult the achievement of the necessary international consensus might be. From the developments in the 1990s, when the World Trade Organization (WTO) was established and international treaties such as the General Agreement on Tariffs and Trade (GATT 1994), the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), the General Agreement on Trade in Services (GATS) or the Agreement on Trade Related Investment Measures (TRIMS), were adopted, we have learned that even major conflicts of interests between states can be mastered and obstacles, which had long prevented the necessary consensus, overcome. Why then could not rules complementing those which already form the legal network and basis for the globalized economy also be adopted in areas such as corporate finance, banking, labour or environmental law, where they are either inexistent or entirely inefficient. Apparent conflicts of interests may explain the difficulties but they cannot be accepted as a permanent justification. Developments that preceded the establishment of WTO were also heavily loaded with conflicting interests, but the concomitant problems were eventually mastered.

Preparatory discussions have revealed, however, that even if the international legislator may sooner or later succeed in setting minimal mandatory legal rules and standards in the areas of interest, that accomplishment would not entirely suffice. Laws, be they national, regional or truly international, can regulate human behaviour only to a certain extent. Rules that are too far reaching or too bureaucratic are counterproductive; but the idea that one could regulate optimally is also not a real-

istic one. Fair and responsible business behaviour is and should also be an issue of ethics and morals. How difficult it was to include the role of ethics as an aspect of the topics of the conference became clear when a very renowned economist, who was invited to join the steering and planning group for the conference, simply replied that he did not feel competent when it came to ethics. It could well be that too many economists might have felt that way in the past, i.e., being incompetent in this area. In feeling that way they have all overlooked or ignored Franklin Delano Roosevelt, who once observed: “We have always known that heedless self-interest was bad morals; We now know that it is bad economics.”¹ So we stuck to the idea that the conference should also address the issue of ethics as an inseparable part of the general theme. However, because of the sub-prime crisis, a part of the program was later on redirected to a more specific analysis of the causes, the consequences and possible solutions of this threatening phenomenon.

Since May of 2008, nearly overnight, many things have happened. The impact of most of them on the world economy was, unfortunately, bad; and it put not only the globalization process and the phenomena surrounding it under extreme pressure, but at least for some, the entire system, i.e., the capitalism itself, in question. What in May seemed unthinkable, without warning, at least for those who had ignored Paul Krugman’s Blogs, suddenly became hard reality. In the real world, the United States Government focussed on buying tainted assets from banks and the Europeans started to inject capital into their banking systems. The venerable periodical, *The Economist*, urged policy makers to act together “to cushion the economic fall out,” while commodity prices plunged and inflation risks dramatically receded across the rich world.² Furthermore, John Maynard Keynes and his *The General Theory of Employment, Interest and Money* inspired Ed Crooks to title an article in *The Financial Times* “A Prophet Reborn – Keynes’ ideas for saving capitalism from itself look increasingly relevant,” in which one can *inter alia* read the puzzling sentence: “When George W. Bush said his administration’s plan to take equity in banks was ‘not intended to take over the free market, but preserve it,’ he could have been quoting Keynes directly.”³ Similarly, Clive Crooks titled one of his contributions as “Back in Business – The Return of Big Government: Could private-sector failings and middle-class anxiety lead to a redrawing of America’s social contract? Obstacles both fiscal and cultural stand in the way.”⁴ Whether the present crisis will bring about fundamental changes of capitalism remains to be seen, but is unlikely and hopefully not necessary.

It may well be, however, that the failures of the present crisis of the financial system, which has already swung over to the real economy, like those which Keynes had observed for the big depression of the 1930s, have narrow, maybe even surprisingly narrow, technical causes, comparable to what Keynes in the 1930s called the

¹ Quoted from Paul Krugman’s Blog in the *New York Times* of January 25, 2008.

² Saving the system – at last a glimmer of hope, but more boldness is needed to avert a global economic catastrophe, *The Economist* of October 11, 2008, p. 13 (at 14).

³ Of October 18, 2008, p. 9.

⁴ Financial Times of October 16, 2008, p. 9.

famous “magnet (alternator) trouble.” Krugman in his introduction to a new edition of the “General Theory” observed as follows: “And because Keynes saw the causes of mass unemployment as narrow and technical, he argued that the problem’s solution could also be narrow and technical. The system needed a new alternator but there was no need to replace the whole car.”⁵ Since 1930s the means for repair, also thanks modern information and communication technologies, have developed tremendously and have made international concerted actions easier, though not easy. We have already witnessed a number of them. Let us hope that we see the present “alternator” fitted before the output in rich economies seriously shrinks, let alone collapses.

This will not work without a more tightly, not only nationally but also internationally, regulated system. However, a significant part of that system will also have to pay attention, either implicitly or explicitly, to ethics and morals, which the collapsed system has ignored, and it will also have to do so in legal terms: There is definitely something wrong in the system, in legal as well as ethical and moral terms, if it allows, or even worse, offers incentives, for one to earn enormous, one could even say obscene, amounts of money⁶ without taking any personal financial risk. Loosing the money of others has had no negative consequences for the culprits or, put differently, there have even been even obscene “positive” consequences, namely receiving additional millions as golden hand shakes.⁷ The question should be allowed: Does the system suffer a lack of, or at least a shortage of, true capitalists – liable for losses in case of miscalculating risks. Is it by chance that “truly” privately owned banks, such as Sal. Oppenheim, where personal liability exists, have not or have been much less, affected by the present financial crisis and have, by all means, not been a cause for the crisis.⁸ Maybe such “pedestrian” thoughts on making managers true and liable capitalists, and not only speculative owners of shares acquired through bonuses, could be a helpful first step in the right direction, although not really an inventive one. For writing such risky words, one is encouraged by the recently oft reproduced quote from Keynes, that: “Words ought to be a little wild, for they are the assaults of thoughts on the unthinking.”⁹

In the light of these most current and alarming developments, the results of the May Conference may appear overly modest and prudent. However, being modest

⁵ Accessible under <http://www.pkarchive.org/economy/GeneralTheoryKeynesIntro.html> (last visited on October 22, 2008).

⁶ According to Krugman the best paid Hedge-Fund manager of the USA had earned in one year as much as all teachers of the State of New York in three years. (Cf. F. Schirmacher, Was uns arm gemacht hat, FAZ.NET of October 13, 2008).

⁷ Cf. Micheal Steen, Anger at Fortis €4m pay-off, Financial Times of October 23, 2008, p. 15, reporting on bonus payment to Gilbert Mittler, the sacked chief financial officer, which the Belgium Prime Minister Yves Leterme called “frankly scandalous”. Leterme also added: “I’m making another appeal to the sense of morality of people in the financial and banking sector, this must stop.”

⁸ According to information received from a Department Director of Sal.Oppenheim. Cf. also Annual Report for 2007.

⁹ Quoted from Ed Crooks, A Prophet Reborn, Financial Times of October 18, 2008 p. 9.

and prudent in times of storms must not be a handicap, since the overall credo of all prominent speakers and panellists clearly was that more well thought through and internationally effective regulation is needed in practically all areas addressed and which present global challenges—be it global warming, environment in general, human rights and migration, be it international finance, corporate business, or more specific areas of law. Here the international or at least regional communities of states should demonstrate determination for more aggressive forward oriented actions and should be alert not to act too late. Speakers from European politics also made it clear that they see no acceptable alternative to a “social market economy” as an economic regulatory system which activates the strengths of the market and competition, which provides incentives for achievement and personal initiative, and which triggers enormous dynamics in the economy—but which is also a system that calls for solidarity with citizens. No less clear was the confession of the importance of ethical standards for the behaviour of corporate players in the international arena. International codes of conduct, corporate citizenship guidelines for sensitive areas and management procedures, as well as guidelines on differential pricing, on soft licensing and on knowledge sharing and access to information, were identified as badly needed and also in the very best interest of the corporate players involved. Thanks to the most profound knowledge of all speakers in their respective areas, the conference has generated valuable information in a number of areas concerning the challenges, as well as possible solutions, for politics, businesses and academia. In view of the developments which followed May 2008, the results of the conference have gained in weight and importance. At least for the area of international finance, it has become common sense to call for binding international rules and standards.

The conference was structured into six sessions. Apart from the first session, devoted to the response of politics to the challenge to globalization, in which two keynote speeches by active prominent politicians were delivered, in each session a keynote speech was followed by a panel discussion and statements from the panellists. This structure is retained in this book, i.e., each respective speech is followed by two statements from the panel.

I would like to express my sincere thanks to all those who have contributed to the success of this conference. I should start with the Members of the Steering Group for the Conference, Dr. Francis Gurry, Director General of the World Intellectual Property Organization, Dr. Jürgen Hofmann, Ministerialdirigent, Bavarian State Ministry of Economic Affairs, Professors Kenneth Dam, Prabhu Gupta, Klaus Leisinger and Alain Pompidou. Without their profound knowledge and engagement it would not have been possible to bring together such an eminent group of speakers and panellists and also not to identify some of the many burning issues of the contemporary globalization process.

Special thanks go to the Bavarian Ministry of Economic Affairs, Infrastructure, Transport and Technology, and Minister Ms. Emilia Müller, for having accepted the role of a co-organizer of the conference. Thanks to the Ministry, many things became possible, including a wonderful reception in the Munich Residence, hosted by Minister Christa Stewens, Vice Minister President of the Bavarian Government. Thanks go also to Professor Felix Unger, President of the European Academy of

Sciences and Arts, the third co-organizer of the conference, for continuous encouragement and support.

This conference could not have been organized in such a perfect way without my collaborators and assistants Nina Klunker, Simon Klopschinski, Wolrad Prinz zu Waldeck und Pyrmont, and Clara Sattler de Sousa e Brito, who have devoted many hours of their time in this endeavour. Georg Rauh was helpful in preparing the manuscript for the print, and Professor Kelvin W. Willoughby for English language check. I should also not forget my secretariat with Daniela Pfeuffer and Monika Fröschke, on whom I could always rely and who merit special thanks for their continuous help and devotion. Last but not least, I have to thank the Max Planck Gesellschaft, without whose financial support the conference could not have been realized.

Joseph Straus, October 2008

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Opening Addresses

Joseph Straus

Excellency Professor Danilo Türk, President of the Republic of Slovenia,
Excellency Dr. Günther Beckstein, Minister President of the Free State of Bavaria,

Professor Dietmar Willoweit, President of the Bavarian Academy of Sciences and Humanities, so to say, the Landlord of all of us for these one and a half days

Ladies and Gentlemen, dear distinguished speakers and panellists, dear guests:

I have the special honour, privilege and pleasure to open this International Conference on “The Role of Law and Ethics in the Globalized Economy”.

Globalization, although truly an old phenomenon, in the recent two decades has taken a new form and has reached a new dimension as well as a new quality. Nonetheless, many problems accompanying this old phenomenon have not fundamentally changed. Let me briefly illustrate this remark with a few quotes.

Winston Churchill, then member of the Liberal Party at its congress in Glasgow in 1906, i.e. 102 years ago, commented the then globalization process as follows:

“I do not want to see impaired the vigour of competition, but we can do much to mitigate the consequences of failure. We want to draw a line below which we will not allow persons to live and labour, yet above which they may compete with all their manhood. We want to have free competition upwards; we decline to allow competition to run downwards.”¹

Some 100 years later, President Bill Clinton in his first major international economic speech emphasized that “the United States must compete not retreat.” In an interview which Bill Clinton gave last year the Financial Times, he made his two most pressing preoccupations clear – “tackling global warming, and making globalization work for the poor in the developing world and for the middle classes in the US and elsewhere in the rich world.”²

Professor Laurence Summers, a former US Secretary of the Treasury under President Clinton, recently wrote inter alia:

“The most important reason for doubting that an increasingly successful integrated global economy will benefit US workers (and those of other industrial countries) is the weakening of the link between the success of nation’s workers and the success of both its trading partners and its companies.”

¹ Quoted from P. Addison, *Churchill the Unexpected Hero*, Oxford 2005, p. 40.

² According to E. Luce and Ch. Freeland, *Philanthropic Clinton* stresses the “right thing”, *Financial Times* of September 24, 2007 (p. 3).

“The domestic component of a strategy to promote healthy globalization must rely on strengthening efforts to reduce inequality and insecurity. The international component must focus on the interests of working people in all countries, in addition to the current emphasis on the priorities of global corporations.”

“A decoupling of the interests of businesses and nations may be inevitable; a decoupling of international economic policies and the interests of American workers is not.”³

“The twin arguments that globalization is inevitable and protectionism is counterproductive for almost everyone have the great virtue of being correct – but they do not provide much consolidation for the losers.”⁴

Dr. Horst Köhler, the President of the Federal Republic of Germany, has recently been quoted in the *Financial Times* as having commented the sub-prime crisis as follows:

“The only good thing about this crisis is that it has made clear to any thinking, responsible person in the sector that international financial markets have developed into a monster that must be put back in its place.

We need more severe and efficient regulation, higher capital requirements to underpin financial trades, more transparency and a global institution, to independently oversee the stability of the international financial system.”⁵

Finally let me quote Sir Evelyn de Rothschild, from his very recent contribution in the *Financial Times* of May 2, 2008:

“Financial services and banking should set the very highest standards for ethical behaviour. Ethics is not only a question of acting correctly. It is a matter of not trying to avoid regulation even if one thinks one can get away with it.”⁶

The aim of this conference, in short, is to find out how law and ethics can ensure that in the future we will be witnessing a global competition upwards with no losers at all, in order to avoid otherwise inevitable frictions in the society, nationally, but also internationally.

I am confident that our prominent and distinguished speakers and panellists from politics, industry and academia will make a valuable and substantial contribution to this aim.

I am giving now the floor to Professor Wolfrum, Professor Willoweit and Professor Unger to extend to you their welcome addresses.

³ L. Summers, A strategy to promote healthy globalization, *Financial Times* of May 5, 2008 (p. 11).

⁴ L. Summers, The global middle cries out for reassurance, *Financial Times* of October 29, 2006 (p. 11).

⁵ Quoted from B. Benoit and J. Wilson, Köhler attacks markets “monster”, *Financial Times* of May 15, 2008 (p. 1).

⁶ E. de Rothschild, Ethical standards must be restored in finance, *Financial Times* of May, 9, 2008 (p. 11).

Rüdiger Wolfrum

Mr. President,
Mr. Prime Minister,
Excellencies,
Colleagues, Ladies and Gentlemen,

It gives me great pleasure and is an honor for me to welcome you all on behalf of the Max Planck Society for the Advancement of Sciences to this topical conference on the role of law and ethics in the globalized economy. As already indicated the topic is well chosen and the Max Planck Society has significant interest in it. Globalization is a phenomenon – a process whose amplitude, implications and nature are contested. Generally speaking it can be described as a multi-faceted process of expansion of human activities to the entire globe and assorted cognitive frames of reference. The most significant contribution of this process is the expansion and integration of the world economy. This has resulted in the dominance of multinational corporations, an increasing role for international organizations and an increased flow of capital. It has to be taken into consideration, though, that the phenomenon of globalization is normatively charged. Different views exist concerning its desirability, sustainability and – and this brings me to the topic of this conference – whether this development can or should be regulated.

In this context it has to be taken into account that globalization has provided – or resulted in – major changes in the distribution of power between different actors. In particular the position of the state, the traditional actor in international relations, has been weakened and its ability to serve as a neutral arbiter between various competing interests.

Why does the Max Planck Society have a keen interest in this development?

Firstly, this development calls for fundamental research on an interdisciplinary level, and Max Planck Institutes of the Humanities Section are well placed to do so. Secondly, the Max Planck Society is not only a spectator but also a player in this field. Science is, by its very nature, international as far as the results achieved are concerned and increasingly so concerning the personnel. For example, 25 % of the Max Planck Directors are of non-German origin. The Society runs Institutes outside Germany, such as in Rome, Nijmegen, Florence and Shanghai. Advanced plans exist for the establishment further institutions abroad such as in Florida, Spain and India. Thirdly, as a matter of consequence, the Max Planck Society is interested in harmonizing the ethical standards governing scientific research world wide. The discrepancies which exist in this respect are one of the hindrances for a truly international research.

Therefore we expect much of this Conference which perhaps will start a series of conferences covering the aspect from different points of view.

Thank you very much for your attention, all the best success for this Conference, and my thanks again as well as my admiration to the organizers.

Dietmar Willoweit

Dear Ladies and Gentlemen,

as the president of the Bavarian Academy it is for me more than a duty, but an honour to welcome high representatives of European politics, especially

The President of the Republic of Slovenia and now President of the European Council, Professor Danilo Türk, and
The Primeminister of Bavaria, Dr. Günther Beckstein.

The Bavarian Academy is an academy not only of sciences, but also, if not mainly, of humanities. Law and Ethics are very well represented and have a long standing tradition. The Bavarian Academy was founded by the elector Maximilian Joseph III. in 1759. This leads to times of philosophical dispute, scientific discussion, a European academic movement, in short, to times of enlightenment. By the time of six months after the founding, 88 fellows had been chosen from all backgrounds humanities and sciences had to offer: medical doctors, natural scientists, astronomers, theologians, jurists, philosophers, historians, philologists and of course economists. The Academy became a centre of research and thinking, not only to enrich our knowledge, but to improve circumstances of life. Please forgive me to hint on our 250th anniversary next year,

Since then major changes have taken place in the research area. I don't have to mention these in detail, just some milestones: the Bavarian university came from Landshut to Munich in 1826, the Kaiser-Wilhelm-Gesellschaft, later Max-Plank-Gesellschaft was founded in 1911. During the changes of nearly 250 years, our academy has retained the mission to supervise especially long lasting research projects such as the observation of climate change, movement of continents, in humanities fundamental work editions or special dictionaries that are unique in the world.

The academy has also retained its mission to facilitate discourse. Today, we are curious to hear about the special topic of law and ethics in a globalised economy. Of course, there are certain rules, that guide the every day activity of our global economy, but they are not the focus of public discussion. What are these rules like? It is a very wise endeavour to discuss how the global economy not only works, but how it should be organised, keeping law and ethics in mind. Is it up to think tanks such as academies to develop together with politicians guidelines and limits for economic progress – or can the global market be left to itself and its own mechanisms?

Welcome to a conference with such a controversial and explosive topic. I wish for this conference a lot of vivid discussions and interesting results and I hope, that the Bayerische Akademie der Wissenschaften can contribute to this by hosting and fostering this event.

Seien Sie alle herzlich willkommen!

Felix Unger

Dear President of State Prof. Türk,
sehr geehrter Herr Ministerpräsident Dr. Beckstein,
dear Ladies and Gentlemen,

we all have to thank Prof. Straus very cordially for all his endeavours organizing such an outstanding great meeting and we as Academy are very pleased that this is the result of a cooperation between the Max-Planck-Institute and the European Academy of Sciences and Arts where Mr. Straus is Dean of our Class Social Sciences. It is generous of the Bavarian Academy of Sciences hosting us in these rooms. I extend our greetings to Prof. Willoweit, the President of the Bavarian Academy and Prof. Wolfrum, Vice-President of the Max Planck Society.

Prof. Straus entitled this meeting “Conference on the Role of Law and Ethics in the Globalized Economy”. This is a very important issue. Ethics and economy have not to be understood being controversial. They are standing complementary to each other and are part of our culture. Prof. Straus has organized this topic, which is reflecting the work within our Academy too. We try to be with our 1.300 members in seven classes interdisciplinary, transnationally and building up bridges. Ethics gives a great deal of interdisciplinarity, when going globally it is essential in our society.

The globe is round and can be approached as every problem from different sides, right, left, down, up, how we deal with man, where we would like to go, there is no hindrance. All our problems have a global accentuation. It is evident that every new development is producing discomfort in our society, nicely expressed by Shakespeare in Hamlet “It seems that the world is out of all”. But we have to take the chances in a global society in a global village and to bring those problems to a human dimension. And therefore the ethics are playing a major role, how we see man in our society. Unbalanced economy makes discomfort, expressed by unemployment and poverty. When we consider that at the on hand side we find CEOs with an annual salary of 3,7 billion dollars and the hunger of Africa can be overcome with 500 millions, this is an imbalance in our society. And when CEOs are awarded by re-engineering, meaning discharging thousand of people and creating unemployment, this demands a new responsibility in our doing.

Otherwise the desert will grow as Nietzsche was saying and leading to a human poverty which is the source of a political revolution. In looking back on our history we had several revolutions nurtured when the gap between poor and rich has been too large.

We are grateful to Prof. Straus for addressing those important topics. I am completely optimistic that we can overcome global problems when we have the human dimension in mind, and when we are acting interdisciplinary showing the problems, acting transnationally solving the problems for building up bridges to overcome problems. This will nurture the spirit creating one world, on human world for all especially for our grandchildren.

Prof. Straus, thank you very much and now I will say in the official language of our Academy: “plenum apertum”.

Session I

Globalization and the Responsible Political Decision Making

Danilo Türk

1. Introduction

Ten years ago, in 1998, book shops in New York reported an interesting phenomenon: The list of bestsellers included an unexpected entry – the Communist Manifesto by Karl Marx and Friedrich Engels, a booklet published originally in London in 1848, exactly a century and a half earlier.

Why did this happen? The answer is really quite simple. Late 1990s were the time of unrest generated by the debate on globalization and, therefore, readers were increasingly looking for explanations, new and old. The following lines from the Communist Manifesto became fashionable:

“Constant revolutionising of production, uninterrupted disturbance of all social conditions, everlasting uncertainty and agitation distinguish the bourgeois epoch from all the previous ones ...” And, a few lines down we read: “The need for constantly expanding market for its products chases the bourgeoisie over the whole surface of the globe. It must nestle everywhere, settle everywhere, establish connexions everywhere. The bourgeoisie has through its exploitation of the world market given a cosmopolitan character to production and consumption in every country.”¹

The dramatic nature of that narrative corresponds well to the contemporary excitement with globalization. The realization that the drama of globalization is not nearly as new as it was felt in the 1990s was an important element of the contemporary discourse.

Obviously, the quoted Marxist text is not the only text of the nineteenth century which reminds us that globalization started much earlier and received one of its earlier surges with the industrial revolution. The difference between the globalization of today and its earlier periods is that the processes of today affect a much larger number of people around the world and that effects are felt immediately. Therefore, the nineteenth century definition, while still relevant, has to be amended.

The debate on the nature of globalization continues. There are globalization optimists like Thomas Friedman who believe that the world is flat and that modern technology is creating a situation in which the playing field is being levelled. This, according to optimists, provides comparable opportunities to everyone in the world and a great future to all.

But there are many sceptics, especially among the historians, who warn against technological optimism and point out that a century ago, electricity brought more

¹ Tucker, *The Marx-Engels Reader*, 1. ed. 1978, 476.

dramatic change into the daily lives and into modes of production than computers have done in our era. However, that great technological change did not secure prosperity for all and did not prevent the political upheavals which took place in the 20th century. The world has learned, time and again, that new technologies and economic opportunities do not automatically translate into greater freedom or more durable peace. The optimism of the end of the 19th century was followed by the disaster of World War I, which, among other things, effectively ended the era of the global domination of Europe, hitherto the undisputable leader in technology, economics and diplomacy.

The political management of the world at the time was clearly inadequate and that inadequacy had to have consequences, rather severe, as it turned out. Political decision making is autonomous.

Obviously, this is not a new realization. In every historical period the political responses to a new technological and economic have been autonomous. While over a longer period of time, politics may also change, it neither becomes absolute nor loses its autonomy. Therefore it is natural that the organizers of this conference look for political responses to globalization as an independent question.

2. The awareness of globalization in the politics of today

Following the period of globalization enthusiasm, more recent analyses include the realization that globalization creates new or exacerbates some of the old dangers and that the fruits of globalization are distributed unevenly, which again creates new problems. Policy makers have to take these realizations seriously. Which dangers have to be given priority and tackled immediately? What can be done to remedy the injustice accompanying the process of globalization?

Setting the international agenda on the issues of dangers and injustices of globalization is an important task involving both international and national leaders. And it is, essentially, political in nature. Should the issue of global warming enjoy the status of supreme priority? What are the nature of and the remedies for the rising food prices? Which of the ongoing armed conflicts should be resolved immediately so as to prevent their spreading or their generally corrosive effects? Which among them are ready for solution? These are some of the difficult questions which need to be decided at the international level.

The national leaders have worries of their own. The perception in the public, meaning among the voters in democratic societies, that globalization brings threats and risks, is often stronger than the perception of opportunities arising from globalization. Hence the need to persuade the people that globalization is here to stay and that it calls for adjustment.

Often such efforts to persuade need to be accompanied by acts of demonstration that national needs and interests will be protected. Protection, obviously, does not mean isolation, but it can imply fairly strict measures such as restrictions on import limitations, restrictions on export of food products or limitations on immigration of people. Protectionist impulses in international trade are never very far away from the minds of voters and, therefore, from the minds of policy-makers.

One can distinguish two approaches to protection of national interest in the era of globalization. The first could be described as “negative protection”. The policy maker defines those objects, situations or consequences which are deemed undesirable and have to be prevented. Given its defensive nature, this approach is obviously far from optimal. It limits the choice of the measures to be taken to prohibitions and passive posture. Defence is rarely an optimal strategy – either in war or in peace. A more active, albeit not necessarily “aggressive” approach, is frequently called for.

The second approach could be described as one relying on “active protection”. In those policy areas where active approach is possible it should certainly be encouraged. That approach focuses on the identification of criteria of acceptability and desirability and builds policy measures around them – encouraging certain types of exchange while implicitly rejecting others.

3. An example of decision making, in particular within the EU, with regard to migration

Migration – a feature of globalization – provides ample examples of both types of policy making. In some countries of immigration the prevailing policy approach rests on prevention of immigration. The phenomenon of migration is seen as undesirable or dangerous and can be tolerated only under strict conditions.

The positive approach taken in other countries derives from the realization that immigration is needed and that it should be encouraged and managed as a matter of principle, allowing for a negative or preventive approach in a minority of cases. The positive approach presupposes that new skills, new knowledge and new labour force can contribute to further development for all.

In the European Union countries the immigration policies differ from country to country. This is not an ideal situation and does not correspond well to the need for a coherent political and policy response of the European Union in the era of globalization.

Why does the EU need a coherent policy of immigration?

Migration is a necessary part of globalization. Policy making and political preparation of decisions has to be taken at several levels. In addition to the national level decisions, there is a need to strengthen the EU policy making. The objective to develop a common European system of asylum by the year 2010 seems indispensable. The European Union should be able to present a coordinated set of policies to the UN bodies, such as the UN High Commissioner on Refugees and overcome the current situation in which the High Commissioner has to complain about the lack of a coherent EU policy and a wide variety of divergent national policies. The EU should also strengthen its role in the UN High-Level Dialogue on Migration.

Europe as a whole is ageing and will not be able to play its global role without effective population policies in its entire area. These policies will include the need for management of immigration. Europe needs newly arrived people, positive in their spirit and capable to do their part in the creation of prosperity for all. Obviously, management of immigration will have to include a mix of measures to assist

in the process of integration of immigrants. Economic prosperity and upward social mobility of immigrants are important in this context. Integration will also require access to good quality education, including linguistic education, and access to universities.

Migration is an example of the sensitivity to be taken into account in the political response to an issue characterizing globalization. It also points to the need for realism, another fundamental requirement of politics. Policy approaches need to mature and in sensitive areas this may take time.

This brings me to two further examples from the work of the European Union at present. The European Union is often confronted with demands for decisions on immediate action and others which require persistence. Often both types of decisions must be taken simultaneously and have global impact. EU is increasingly a global player. And in some cases it is expected to be a global leader.

4. The EU as a global player and a global leader: two examples

4.1 Global warming

Few will dispute the need for international actors to demonstrate a sense of urgency in action intended to mitigate the effects of global warming. It is also accepted that the EU as the major economic engine of globalization and the most sophisticated economic player should be in the lead. Earlier this year the European Commission has defined specific objectives for the reduction of green house gas emissions in the EU countries. Let me remind that the Commission proposed to achieve, by 2020, a 20% green house gas reduction compared to the levels of 1990. This should be achieved as an independent commitment. A more ambitious objective has been proposed as a part of a global agreement to be concluded by the end of next year, 2009. In that case, the EU would be prepared, according to the proposal by the European Commission, to achieve as much as a 30% reduction in the same time frame.

Here we see an ambitious objective, a serious challenge to politics and policy making in our era of globalization and a genuinely ethical question. The ambitious nature of the proposal of the EU Commission is welcome because it offers a clear and transformative vision of global policy making in the matters of environment, accepting the premise that incrementalism is no longer sufficient. Transformative policies are called for. Making such policies means taking leadership.

However, suggestions are already heard that the quoted objectives are not entirely realistic, that one needs to listen to major industries, as they may lose their competitive edge if exposed to severe obligations, and that especially now when the global growth is slowing down and competition is becoming harsher a more gradual approach is called for. These are all valid considerations. However, they leave us with an ethical dilemma: What kind of arguments should dominate decision making in such a fundamental area as global warming? My answer is that all involved have to make a fundamental choice: transformation or incrementalism. If incrementalism will not do and transformation comes with a price, we need to discuss the price and see how to make it acceptable.

This, obviously, is not a technical issue. It is deeply political and ethical, one which calls for moral and political leadership. Will the EU be able to mobilize itself for such a leadership? This will be clear within a year or so. What makes this case particularly interesting is the fact that the entire world, the globalized world of today, looks towards the European Union and its challenge of leadership. Let us hope that the EU will respond with a sense of vision and ambition worthy of a world leader.

4.2 Human rights

Another area of globalization where the EU leadership is being tested, albeit – rightly or wrongly – with a lesser sense of urgency, is human rights. EU's commitment to human rights is beyond doubt. With the expected entry into force of the Lisbon Reform Treaty the whole spectrum of civil, political, economic, social and cultural rights of EU citizens and residents embodied in the Charter of Fundamental rights of the European Union will become also legally binding.

At the same time, the global picture is not encouraging. Massive, systematic and persistent violations of human rights continue in many parts of the world. Some among these violations are a result of ruthless pursuit of economic gain, irrespective of the needs of the local populations and environment. The poor and the indigenous peoples are especially placed at risk of dispossession, starvation, and, in some cases, even extinction. Armed conflicts in parts of Africa and Asia continue to produce atrocities amounting to crimes against humanity.

These features, too, are among the characteristics of the globalized world. Which are ways to real improvements? The international action in the field of human rights has hitherto focused on the creation of legal norms and procedures, which have already established a tightly knit web of legal regulation. But implementation does not depend solely on legal norms and procedures. The world needs effective models of sustainable growth, committed diplomatic and political action in favour of human rights and, wherever necessary, appropriate humanitarian assistance.

Political responses to globalization cannot be complete without action in the mentioned areas.

EU bodies should devote more energy to global issues of human rights. In particular, the European Parliament provides an opportunity for regular hearings, discussions and policy advice directed towards global improvement of human rights. It is to be understood that after the disappearance of cold war motivations for human rights action the world awaits more- not less – vigorous action. This is simply because human rights have become the critical test of development in almost all societies in the world.

In addition to direct action in favour of human rights, the EU member states and EU bodies have to do more to strengthen the United Nations and its mechanisms. The recently established Human Rights Council is still developing its modus operandi. Its effort to establish a system of universal periodic review of human rights is promising, but still at an initial stage and its effectiveness remains to be seen. Its

action in the face of massive and systematic violations of human rights is not sufficiently comprehensive. This may be remedied over time. But this will happen only with the leadership of those UN member states which are committed to human rights and prepared to invest expertise, diplomatic skills and financial resources in the appropriate UN programs. In reality, this cannot happen without the EU and its member states.

International action in the field of human rights will also require further creative thinking about the concept of human rights. The existing legally defined concept does not cover the entirety of needs of the realization of human rights. Instruments such as good governance programmes and programmes for the strengthening of the judiciary are important for the implementation of human rights and must be supported where they exist and designed where they have not been established yet. The process of implementation of human rights has to become more sensitive to the collective context of the rights of the individual, such as the family and the ethnic or religious community to which the individuals belong. Proper contextualization of the international decision-making in the field of human rights will be an essential task of the implementation effort in this field in the coming decades.

And finally, no international programme of action for human rights can be complete without resolute support for international criminal justice. The legal evolution of the past two decades has made international criminal justice its newest and most ambitious chapter. In a globalized world even criminal jurisdiction cannot be fully monopolized by states. In the future one can visualize expansion of international criminal jurisdiction from war crimes and crimes against humanity to encompass also drug trafficking and certain types of terrorism. But this expansion will not happen without prior success in the existing areas, related to the most heinous crimes committed in the course of armed conflicts.

5. Conclusion

A thought on the international criminal justice seems appropriate as the final theme of this statement. The quality of globalization can and should be measured and human rights represent one of the measurements that should be applied. Globalization will be considered as good if it helps spreading prosperity and improved standards of human well being and freedom.

The challenge for politics is also there. Will the international community – in the form of the UN – and other international actors, including the EU, be able to generate enough support so that the instruments of implementation of human rights and international criminal justice will become effective? If this happens, we shall know that the process of globalization has reached a mature stage. If it does not, we shall know that globalization relates mainly to technological evolution and economic integration. But that is not really new. Karl Marx and Friedrich Engels were writing about that aspect of globalization more than a century and a half ago.

The Challenge of Globalization and the Response of Politics

*Günther Beckstein**

1. Introduction

I would like to thank you for inviting me, and welcome you all warmly to Munich. In addressing globalization, the Max-Planck-Institute for Intellectual Property, Competition and Tax Law is addressing an issue which has accompanied us for a while yet still remains topical.

The object of the conference, to discuss the various facets of the complex process of globalization, is well chosen. Owing to its substantial interdisciplinary competence, the Max Planck Society is the right institution to tackle this difficult issue. Hence the Max Planck Society again rises to the challenge of acting as a significant stimulus for the economy, academia and politics alike.

I welcome the opportunity to come here today and contribute to this major conference. I will present the response of Bavarian politics to the challenges of globalization. Bavaria, as part of the Federal Republic of Germany, is of course embedded in national politics. However, we do have considerable scope for manoeuvre in several important political areas.

2. Globalization today

Globalization is a politically intended, technically driven and economically meaningful process. It has picked up in pace in recent years:

World trade has grown steadily in double-digit percentage figures. In 2006 the worldwide exports amounted to USD 11.8 trillion, 15% above the figure for the preceding year. Foreign direct investments reached a value of USD 1.2 trillion in 2006, an increase of one third from the preceding year. Last year growth was slower especially owing to turbulences on the capital markets. However, there is no indication of a reversal of the trend.

With a share of 38% in the overall global exportation of goods, Europe has the largest share of all regions in the world.

In 2006 Germany was again the largest exporter of goods worldwide, with a volume of USD 1.11 trillion. The USA is ranked second with USD 1.04 trillion, and China is ranked third with USD 976 billion. This shows just how intensely Germany with its population of 82 million is enmeshed in the global economy. A free global economy is one essential prerequisite for our prosperity and for jobs in our country.

* The spoken words prevail. German language version is authorized. Translated from the German original by Catriona Thomas, MA, Karlsruhe.

The rise of numerous threshold countries, the steady increase in the international division of work and closer interweavement of markets result in tremendous changes to the global economy. International competition becomes more intense at all levels.

3. How do we have to respond?

I would like to give two answers to this question here today:

Firstly, we have to accept global competition. Secondly, we have to participate in drawing up the rules of the globalization game.

3.1 Global competition

It is clear that we cannot avoid competition. Calls for protective barriers harm Germany as an export nation. Withdrawal from the global economy is not a realistic option, but would result in unimaginable turbulences and a massive decrease in prosperity. The proposals made by the opponents of globalization are unrealistic.

The only option is for the enterprises and citizens of Bavaria and Germany to rise to the challenge of international competition. This is initially a mental process which is not easy for those who do not feel completely up to competition. Change also triggers anxiety among the population, not only in Germany. But the fact is that in the past we have coped well with international competition. Bavaria has the potential to succeed within globalization also in future. In addition, an economically strong country can also shape the process of change to a much better degree.

3.2 Drawing up the rules of globalization

The enterprises have to bear the main burden. The relevant vocabulary is familiar: increase in competitiveness, innovations in processes and products, rationalization, reductions in costs, accessing of markets and so forth. Bavarian and German enterprises have repeatedly proven their performance capacity and demonstrated that they are fit for international competition.

Employees also face major challenges: increased commitment, overtime, further training, life-long learning, flexibility, career changes, and mobility. I am very proud of the Bavarian workers, they are making a tremendous contribution! If necessary, even the trade unions in Bavaria are willing to accept change and exercise restraint as regards wages and salaries.

The industrial site of Bavaria, Germany as a whole and Europe all face particular challenges. Economic politics at all government levels has to set the signals correctly. Enterprises and employees alike have to receive appropriate assistance. Politics is not powerless in times of globalization. Quite the opposite! Good economic policies can improve site factors and have an enormous impact!

3.2.1 Social market economy vs. anglo-saxon capitalism

In my view the first question concerns the issue of a regulatory policy model. Can our social market economy keep up with Anglo-Saxon capitalism, which also provides orientation for many Asian countries? I believe the answer to this question is “YES”!

A social market economy is an economic regulatory system which activates the strengths of the market and competition, which provides incentives for achievement and personal initiative, and which triggers tremendous economic dynamics.

However, a social market economy is also a system which calls for solidarity within the population. It creates the best link between economic efficiency and reliable social security. This is consistent with our culture and our mentality, as well as our Christian concept of human nature.

Anglo-Saxon capitalism cannot serve as our model. In the social market economy that I stand for the focus lies on the human being, not on profits or capital. However, we do have to take care not to drift in another direction: the gilded memories of former East Germany in some quarters cause me considerable worry. The more socialist elements and elements of a planned economy are introduced, the less general prosperity will be achieved.

Every economist keeps one eye on demand and one eye on supply. To be specific: alleviating the burden on citizens results in increased demand. The creation of favourable framework conditions for enterprises results in a better supply situation. Price mechanisms and competition regulate supply and demand. The state only intervenes where the results are undesirable for society. This is the essence of a social market economy!

3.2.2 Bavaria's achievements

In past years the state of Bavaria has been able to develop considerable dynamics on this basis. The results generated by the Bavarian economic policies have been very impressive:

Bavaria always belongs to the top group in Germany as regards economic growth, which was 2.8% in Bavaria last year and therefore the strongest in Germany. Bavaria does not have to fear an international comparison either: our growth figures for 2006 and 2007 were higher than those for the USA, Japan and Switzerland.

The Bavarian unemployment rate was 4.4% in April. We are always second-placed in Germany behind Baden-Württemberg. What is important to me is that all regions of Bavaria can profit from the high employment rates. This goal has been achieved: of the 27 regions of Bavaria listed by the labour exchange, 21 had an unemployment rate of below 5%.

Bavaria has the most start-ups and the most patent applications of all German states. In 2007 Bavarian enterprises achieved the 14th consecutive export record. “Made in Bavaria” has in the meantime established itself as a premium trademark slogan.

Bavaria is the first federal state to have restructured its public finances. The Bavarian budget has been balanced since 2006 so that Standard & Poor's awarded us a top triple-A rating. Nor will the balanced budget be put in question in future.

How did we get there?

Bavarian economic policy success strategies have repeatedly proven to be correct. They have proved their worth within the globalization process. I would like to focus on five elements in particular:

3.2.2.1 Placing our trust in SME

One of Bavaria's trademarks is a healthy mixture of major, medium-sized and small businesses. SMEs are an eminently important factor for the Bavarian macro-economy:

SMEs represent a culture of willingness to achieve coupled with independence and entrepreneurship. SMEs ensure the stability of our economy, they remain loyal to their chosen industrial sites, and they represent a special relationship between employers and employees.

For this reason Bavarian government naturally seeks to ensure that its economic policy decisions have a positive impact on SMEs. A pivotal approach in this respect is to balance out any size-related disadvantages insofar as possible.

As early as 1974 Bavaria introduced the first legislation in Germany for the advancement of SMEs. The legislation was recently revised and adjusted so as to better accommodate the needs of SMEs. The most important changes are intensified advice for businesses, improved promotion of exports, a revision of public procurement procedures in line with the needs of SMEs, and additional support for the financing of SMEs.

These measures are tailored to the specific needs of small and SMEs. I do believe that we can thus provide effective support for the positive development of SMEs in Bavaria.

3.2.2.2 Consistent regional advancement

Bavaria as a whole will only have a prosperous future if its regions are not left behind. The objective pursued by the Bavarian government is that people everywhere in Bavaria continue to have good prospects for the future. We seek a positive development in the competitiveness, the quality of life and the perspectives for the future throughout all regions of Bavaria.

Clearly, Munich and Nuremberg are the economic motors that play a particular role in Bavaria. However, 60% of the Bavarian population lives in rural areas, where there are also outstanding achievements. It is the aim of Bavarian politics to provide equivalent – not identical – living conditions in town and country alike.

Policies for rural areas have to mobilize local potential. The Bavarian government provides significant impulses, for example by supporting the development of data highways in rural areas. Everyone and every entrepreneur has to be connected to the world, no matter where he or she lives in Bavaria. Rural areas have to be up-to-date technologically in order to be competitive within the globalization process.

When awarding business investment grants the emphasis is placed on Eastern and Northern Bavaria. The investment grant differential vis-à-vis the Czech Republic was limited to a maximum of 20% in order to prevent migration from the region.

3.2.2.3 High-Tech orientation

Bavaria offers not only the best possible assistance for medium-sized businesses and comprehensive regional support. A further brand is set by the government's technology policies. Bavaria is a high-tech state which places its bets on innovation and modern technologies. Bavaria thrives on the ideas of its citizens, on a spirit of inventiveness, research and entrepreneurship. Bavaria thrives on the creative potential that slumbers in every one of us.

The competitive advantages that are repeatedly attained in Bavaria, and that we need, are only possible on the basis of innovation and technical achievements. Competitive advantages alone enable the creation of new jobs. We can only be more expensive to the extent that we are better! This is why the Bavarian government particularly supports technical progress.

Following the major programs Bavaria Future Initiative and the High-Tech Initiative involving approximately EUR 4.2 billion for science and research during the 1990s, it is now important to further expand the existing strengths in Bavaria. This is the aim of the Allianz Bayern Innovativ. The focal idea behind this cluster strategy is to create a tight-knit network between business and science. This will speed up the transition of research results into enterprises and lead to innovations which enterprises can develop into new, marketable products. The platform for the cluster was erected with EUR 50 million.

The investment program Bavaria 2020 is the next step. A further EUR 100 million will be devoted especially to development clusters, and EUR 850 million to universities, research and innovation. To these amounts are added the recently released Transrapid resources, a further EUR 500 million. I will present a corresponding innovation package this summer, on top of the regular budget.

The portion of research and development expenditure in the GDP is currently 3% in Bavaria, giving the state an excellent position both nationally and internationally. However, we must not be satisfied with this. Other countries are catching up. We aim to raise the portion of research and development expenditure in the GDP to 3.6% by 2020 – a difficult but feasible target!

We aim to belong to the most innovative regions in Europe. We want the multitude of ideas in Bavaria to be developed into products here, and we want the globally competitive jobs to be created here.

Our cluster strategy will trigger a dynamic process. The transfer of technology will pick up in pace. Research results will lead more rapidly to marketable applications. The cluster strategy will thus generate new products, new markets and new jobs in Bavaria. It will enable enterprises to hold their own on national and international markets while operating out of the industrial site of Bavaria.

3.2.2.4 *Education and academia*

“A country’s competitiveness starts not on the factory floor or in the engineering lab. It starts in the classroom.” This has been acknowledged for over 100 years. It is a quote from Henry Ford, founder of the US automobile industry.

The phrase remains true today: nowadays, when knowledge is growing explosively and high-tech processes and globalization result in ever-tougher requirements in all professions, an excellent education is more important than ever.

We are therefore further developing our achievement-oriented education system. The structured school system in Bavaria offers young persons differentiated support and a choice of schools according to ability. The outstanding endorsements for Bavaria in the PISA and other studies are confirmation of our approach.

Our interest lies in offering the best possible education opportunities to everyone so that the best possible options give everyone a chance to discover and develop their talents and abilities. We wish to provide further individual support for the talented and the less talented. We also place additional emphasis on up-bringing, on virtues such as punctuality and reliability.

Our universities enjoy an outstanding international reputation. With the two Munich universities, Bavaria is the site of two of the three elite universities in Germany. Other Bavarian universities were also awarded excellent positions in the rankings. Students benefit from 38,000 newly created university places and 3,000 jobs – a considerable expansion of capacities.

3.2.2.5 *Expanding the infrastructure*

Bavaria will continue to afford high priority to the development of its infrastructure in line with needs. This applies to roads, railways, waterways and air traffic. As an export-oriented state and as a state situated in central Europe, we depend on efficient travel connections in all directions.

Bavaria is the site of numerous foreign enterprises, in recent years of companies doing business with Eastern Europe out of our state. This requires good international travel connections both incoming and outgoing, especially for air travel.

4. **Shaping the rules of globalization**

I initially asked how Bavarian politics has to respond to the tougher competition generated by the globalization process. The first answer was: improve site conditions, as discussed in detail above.

However, this answer only holds true as long as international competition is fair. Hence the second answer is: We have to participate in shaping the rules of the globalization game. We have to ensure that the conditions of trade and business are fair. Governments and internationally recognized institutions such as the WTO are responsible for the rules of the game. Bavaria is able to participate through the German government and the European Union.

The rules of the international markets are far-reaching and in many cases also possess enforcement mechanisms. Due to the rapid pace of growth, however, these

mechanisms have not always kicked in swiftly enough on all occasions. Let me provide some examples:

In many threshold countries the social and environmental standards do not correspond with the level in Europe. Opinions throughout the world on which standards are important and desirable differ widely, while there is however agreement on minimum standards.

Global agreements exist in order to combat unacceptable forms of exploitation such as child labour. To this end the International Labour Organization enters into binding agreements on certain social standards with its 180 member states. The agreements have to be ratified by the individual member states. And here lies the problem: China, India and several other countries lag behind on the ratification of several agreements.

There are also numerous initiatives within the context of Corporate Social Responsibility: the OECD Guidelines for Multinational Enterprises, the UN norms on corporate responsibility, the global reporting guidelines on sustainable development, the environment management norm ISO 14001 and the communications and learning platform “Global Compact” initiated by the former UN Secretary General Kofi Annan.

The objective of these norms and standards is to obtain from businesses a voluntary undertaking of compliance with minimum social and ecological standards. The control of these mechanisms is left to the market, which means consumers are called on. Many NGOs provide transparency by calling attention to grave violations. Seals of quality can also help to improve transparency.

Product piracy is a further grave problem of unfair world trade. International trade in pirate trademark products has reached dramatic dimensions in recent years. To an increasing degree not only everyday consumer goods are affected, but also high-tech products. This causes massive harm to the Bavarian economy.

Here again: the majority of the WTO member states have in the meantime adopted provisions laying down minimum standards for intellectual property rights. China has even oriented its efforts to the German legislation. In practice the difficulties lie in applying the laws and in the enforcement of rights.

The European Union is taking significant measures in order to protect intellectual property vis-à-vis non-EU countries. Bavaria has repeatedly called for improvements at the national and the European level. Currently the focus lies on measures taken by the customs authorities. In accordance with its motto “cooperation instead of confrontation”, the EU is also attempting to influence non-EU countries, and first successes have ensued.

5. Conclusion

In sum: the regulations and mechanisms for fair competition are already in place. Basically speaking, the problems arise in enforcing these mechanisms. It is therefore the responsibility of the individual countries to recognize social and environmental standards. One of the decisive political responsibilities in future will be to implement such social and environmental standards in the sense of the internation-

alization of the social market economy. Bilateral free trade agreements do not constitute a panacea, but, rather, an initial pragmatic solution in many cases. This was one of the outcomes of an expert hearing held in Munich at the start of the year.

I am confident that things are going in the right direction. As regards environmental protection, for example, the Kyoto Protocol has demonstrated a global adjustment of views.

Ladies and gentlemen,

Bavaria is one of the winners in the globalization process. Our export rate of 50% is clear proof of this. The Bavarian government will work hard so that Bavaria continues to profit from globalization in future. We are presently enjoying the right tail wind due to the positive economic trend. If we also succeed in improving the international enforcement of existing legal provisions, our positive economic development will surely continue.

The Challenge of Globalization and the Response of Industry

Andreas Barner

1. Historical Development

1.1 Overview

Globalization as a means to improve the situation be it of individuals or of nations be it through goods or science has been in use for many centuries if not as long as 5000 years ago. The long range trade routes appeared first in the 3rd millennium BC when Sumerians in Mesopotamia traded with the Harappan civilization of the Indus valley, probably one of the oldest known examples. Other examples, such as Crete and the Minoic culture where silver ware of Crete origin was found in Egypt or Byblos, or as far as the coast of Spain.

Over many centuries international trade routes such as the long distance trading along the silk road, the spice route, the tea route or the salt route, had developed. Undoubtedly being appreciated and intensely used for the exchange of goods by the people in their time.

1.2 Science and education

Let us turn for a minute to science and education:

When the first universities were founded in Europe they were European and not national in their approach. The close interaction between the university academicians in Europe can be exemplified by the development of a European rather than a local science of law. The other example may well be medicine, where the science or medical art was developed by the Greek, to a certain extent conserved by the Romans and then brought into the Arabic countries. Following further development by Arabic and Byzantine physicians, after the so called “dark ages” in Europe, where medical knowledge was essentially lost, the conserved medical knowledge was brought back from the Arabic countries primarily via Spain in the 13th century and the Byzantine knowledge through one of the oldest universities of Europe, the university of Salerno in Italy.

1.3 Globalization – a new phenomenon?

I'm fully aware that these historic roots of globalization, of international cooperation as well as of international trade, are being viewed much more positively than the consequences of today's globalization. But, it cannot be said that globalization is a truly new phenomenon.

Looking at the extensive international trade and the exchange of culture in particular starting again with the renaissance, it is not surprising that as early as the second half of the 18th century a British economist, David Ricardo, argued the case that even if a country could produce everything more efficiently than an other country, it would reap gains from specializing in what it was best at producing and trading with other nations. This theory of comparative advantage is in the center of the argument in favor of globalization of economies in that it proposes that basically everybody is better off if trade does take place – at least as long as everybody, or more correctly every nation can do something they do better than another country, i.e. that they are able to participate in the trade and are able to participate in its benefits. This theory also suggests that barriers to free exchange of goods, services and work or in other words, any type of barrier is counterproductive as regards the benefits of the “comparative advantage”.

2. Globalization in the present

Let me turn to the title of the presentation “The challenge of globalization and the response of industry” – this supposes for industry, globalization is a challenge. Let me categorize the industries for a minute into those, which primarily are science-based where research and development, production and marketing of highly sophisticated products takes place and those, which are primarily producing goods, i.e. where the production aspect dominates. The former industries, i.e. the science based companies will always use for research and development global i. e. international approaches, since science, as it has been the case for many centuries, is international in nature. Scientific progress will be taken up wherever it comes from and the competitive advantage may well be to intelligently and rapidly take up new insights, use them, add potentially own intellectual property and provide a product.

2.1 Science based industries

Those science based industries by nature of the dominance of international availability of science will have competition from many countries of the world. As examples, may serve the biotech or the IT industry where China, India or Asian countries are in fierce competition to the more established countries such as Japan, United States and Europe. Similarly, companies producing generic versions of drugs have been built up in many countries around the world. More chemically defined pharmaceutical industry, because of the large capital requirement for chemical production but also for their research facilities has been internationalized to a lesser extent. Nonetheless, a very interesting example for globalization is the chemical industry where 20-30 years ago in Europe and US, in particular in Germany and the United States, the classical large scale chemistry was done. Later, these for the pharmaceutical industry called “starting materials” were produced in India and today China is probably the country with the highest growth rates of the world wide production volume for this classical large scale chemistry. This fits well to large investments of chemical companies such as BASF in China.

For those industries, which I called science-based companies, production is not the driving factor and in consequence one can find them in all countries with high enough education levels and trained work force, but in general only parts which are subject to mass production may be outsourced and will be produced in countries with lower wages. Under certain circumstances as was the case in a recently in Germany intensively debated case of the Finish mobile phone producer Nokia, subsidies may influence the decision where to build or maintain a factory. Very obviously, subsidies lead to in the long run wrong incentives for globalization.

2.2 Production based industries

As said above, the situation is different in industries where classical production on the one hand is in need of significant capital investments on the other hand a significant work force of compared to the science based industry not to the same extent educated people is characteristic. For such an industry labour costs may be the dominant and decisive factor and globalization does mean to move the production totally or significant parts of it to countries with lower wages. Many examples from a variety of industries can be given. Per se, there is nothing wrong with moving working places from higher income countries to lower income countries – labor costs are lower in those countries, because scarcity of labor is less pronounced. One of the most important factors for globalization is due to competition of companies among themselves. Optimal cost structures is one of the most relevant areas of competition. The debate about moving working places will and has to be, however, about labor conditions about social security systems about taxes. If, however, a company adheres to all national rules and also lives up to a set of principles guaranteeing adequate labor conditions and environmental protection nothing speaks against building up factories in lower income countries. Human beings independent of the country, the gender, the religion do have the same right for work all over the globe.

2.3 Conclusion

The first conclusion I would like to draw is that the response of industry to globalization is for very obvious reasons the following: industry continues and necessarily does have to take part in the globalization. Secondly, it has become obvious from the examples of Biotech companies or Generic companies that have been given, countries with lower income but good educational systems are in today's world rapidly and positively taking part in globalization – generics from India for example are being sold today all over the world. So the response of industry in both, the developed as well as the lower income countries has been the same: both saw the necessity to take part in globalization efforts with consequences we all tend to like: lower prices for similarly good products.

3. Globalization in detail

What we need, however, is to look as to whether a set of rules would be necessary in defining applicable moral and ethical standards to be adhered to in order to safeguard globalization. Such a set of standards still needs to be developed and this is the inherent difficulty, needs to be such that the economical advantage of globalization is not gained at a prize which is problematic for either the lower or the higher income countries. In other words, as the German President Horst Köhler put it, the world does need world internal politics.

The question as to whether globalization per se is good or bad for the world as a whole needs to be answered unequivocally and in all likelihood more research is necessary to answer the question ultimately. Even though, consensus appears to be that globalization itself has been good for the vast majority of people around the globe.

3.1 Pros

Those, in favor of globalization would quote numbers suggesting that poverty has decreased internationally at the same time when world trade has increased. One major example being China or many of the Asian countries.

3.2 Cons

Those, who primarily see the problems associated with globalization argue that inequality in wealth has increased substantially; both within nations as well as across nations. The result being that even in developed and economically strong countries the number of people considered to be poor is increasing. Germany may serve as an example where statistics suggest that today 30 % of children would fall under the definition of being poor. The annual UN human development report would suggest that the inequality in health, education, unemployment is continuing to increase.

While countries of southern and eastern Europe and the former states of the Soviet Union as well as Asian countries have economically made distinct progress in particular in percent of the GDP per capita, the group of economically to a lesser extent developed countries still benefited through a real increase over the last 20 – 30 years in terms of income measured as percent of GDP, there is the disturbing fact, that in particular Sub-Saharan countries in Africa did not develop so positively. The Sub-Saharan Africa benefits least from the development of the worldwide economy – HIV/Aids with infection rates as high as 50 % of the child bearing women in a country like Botswana – have made the situation distinctly worse. Secondly, illiteracy rates in these countries have been and continue to be higher than in e. g. the Asian countries. Thirdly, democracy in this area has not been the preferred political system, on the contrary power frequently is being maintained through armed forces and human rights are not being guaranteed – even though, admittedly, one of the fastest growing countries, China, does not stand for democracy, as we are used to it, either. Fourthly, and this may be decisive, continuity and stability of political

systems, of the public administration and decisions taken are in general not be given. These are to say the least not ideal circumstances for economic development.

3.3 The pharmaceutical industry and the HIV/AIDS crisis

To analyse the response of industry further, beyond the general insight that industry basically always will participate in globalization, let us look at the response of pharmaceutical industry, a truly globally acting industry to the HIV/AIDS crisis. Admittedly, HIV and Aids are a very specific topic and may be independent of globalization but well suitable to exemplify what I believe is necessary: governance principles which ensure that globalization between countries is developing in a similar fashion as was the case for the development of social market economies within countries, guaranteeing that certain boundaries are adhered to despite benefiting from a free market system and its inherent competition.

When the HI Virus was detected the search for a treatment began and pharmaceutical industry had been requested by governments, medical associations as well as activist groups to provide as rapidly as possible treatments. It has been interesting to note, that in these early phases quite a number of companies involved in HIV research decided to withdraw from this research area – some because research proved to be more difficult than expected, most of the companies however due to the public pressure they did not want to be exposed to. Suffice it to say, that the research efforts lead within less than a decade to a number of different substance classes and medications. Their use, primarily their use in combination in a dramatic and convincing way decreased HIV and Aids mortality and morbidity from 1997 onwards. They were the primary reason that this disease could be changed from an acutely lethal to a though still dramatic but chronic condition. While in developed countries prevention programs and treatment programs successfully reduced mortality and decreased the number of newly infected patients, the real tragedy developed in Africa and other poor countries around the globe where the vast majority of HIV positive patients could be found and could not be treated – the financial means as well as the infrastructure were not available. Twenty two of the estimated 26 mio patients infected internationally with the HI virus do live in sub-Saharan Africa.

How did industry respond to this indeed tragic development? Today and this is the good news, we can say that the response of industry has been remarkable. All research based companies have made their drugs available independent of the patent status, basically close to production costs or allowed generic companies to produce and sell drugs in the least developed countries. This approach one might want to develop beyond treatment of HIV and Aids, i. e. pharmaceutical companies should make patent protected medications available at about production costs for the least developed countries. A prerequisite for this, already successfully adopted for HIV medication is that on a world-wide basis, there is agreement that a tiered pricing system is broadly being accepted. A tiered pricing system allows for higher prices in the developed world of which R&D of pharmaceutical companies is being financed and low prices in the poorer parts of the world with the guarantee of avoid-

ance of re-importation. Secondly, functioning and endorsable patent protection as a means of ensuring exclusivity for a certain time in the developed part of the world is an absolute must. It has to be admitted that it took pharmaceutical industry long may be too long until finally, the clear and simple position on providing accelerated access at low prices to HIV/Aids treatments has become reality. It will still be a way to go until industry will adopt what can be formulated as the broader principle to apply the same philosophy also for other patent protected drugs. But without any question this is a necessary principle for globalization, most importantly, however, for an ethically acceptable human development.

3.4 Boehringer Ingelheims contribution to mother/child protection

Let me add the example of Boehringer Ingelheim in the prevention of mother-to-child transmission of HIV/AIDS. When it was understood through clinical research work that Boehringer Ingelheim had a product available on the market which drastically would reduce the mother to child transmission during birth, Boehringer Ingelheim decided to make the drug Viramune (nevirapine) free of charge available to all developing countries for the indication prevention of mother-to-child transmission. Since one pill of the drug given to the mother during labor and one drop of the drug as suspension given to the new born does reduce the mother-to-child transmission rate by 50 %, the medication was particularly suitable for settings where mothers would see a medical professional only at the time of giving birth. In the meantime this program has very successfully developed in cooperation with the WHO and a number of NGOs and brought benefit to many children in the poorest countries.

I believe that the response of the pharmaceutical industry in the HIV / AIDS area is a good example of the development of the right response to globalization. Other examples of pharmaceutical industry work, is the research in neglected diseases, is help in other diseases such as river blindness is the search for medications in therapeutic areas where only the least developed countries do benefit.

4. Conclusion

Let me summarize,

- Globalization is not a development of the recent years, but may have been present for centuries.
- Globalization appears to benefit many human beings, a number of nations in Asia above all China do serve as prime examples.
- For globalization certain governance rules on a world-wide basis (Weltinnenpolitik, worlds internal politics) have to be developed in order to safeguard the, in principle, positive and valuable development and to ensure that inequality in income distribution across nations and within nations is not becoming a problematic consequence.
- Industry will continue to benefit from globalization and, in consequence, will continue to participate in globalization. But it is important that industry is willing

to adhere to self set principles and to the governance principles, which need to be developed.

- The concrete example of the response of the pharmaceutical industry in the HIV/AIDS crisis, may serve as a good example as regards the attitude to make drugs independent of their patent status available at low prices and as regards the good cooperation between different foundations, governments and the industry to ensure availability of drugs.

In a world where information is basically available every moment at any place of the globe, industry, government and interested parties need to ensure that globalization benefits in the end all and that not a minority be it within nations or across nations is paying a very high price. I do believe that in the end the benefits of globalization today as was the case in the past outweigh by far the risks. Symposia as the one today are one of the small steps to ensure that the world moves towards good governance principles. In other words, if globalization is frequently compared with a tiger then let's ensure that tiger is being tamed somewhat without loosing its positive energy.

Session II

The Role of Corporations in Shaping Globalization with a Human Face

Klaus M. Leisinger

1. Brave new world

Globalization facilitated and intensified economic, cultural, and political ties across national borders. This resulted in a more open world offering significant opportunities for those participating in global economic exchange. However, as to be expected, socio-economic change of such magnitude and complexity has also resulted in new challenges, be it with regard to the global environmental cost, social disparities, or structural changes creating burdens on people who could not adapt to them. Associated with the enormous expansion of corporate activities, there were also cases of illegal and illegitimate corporate acts.

Observers who focus on the negative aspects of globalization have the impression that the world is suffering from a capitalism that is increasingly contemptuous of human rights, destructive of the environment, and harmful to democracy.¹ This capitalism, in the view of many authors, appeals to the basest human instincts: greed and lack of consideration if not ruthlessness with regard to the needs of the community. For them it is inherent to a capitalist system that immoral actions and selfishness are rewarded. As they see it, transnational corporations, in particular, unscrupulously exploit a situation in which the nation state's monopoly on regulatory authority has been softened up by globalization and there is global competition for optimal investment conditions. Protesting this development and asking for more and sharper regulation is, in the eyes of a growing number of people in modern societies, a legitimate form of self-defense against what they see as a global social and environmental epidemic from which only a few privileged profiteers stand to benefit while the vast majority of people suffer negative consequences.

In parallel with the development of this view, many countries are witnessing an erosion of trust in the state and its competence to correct, let alone prevent, distorted social and ecological developments. Precisely when people are longing for a "strong state," there is a decline in trust in the state's ability to be strong.

¹ See, e.g., in the context of actual or alleged corporate human rights violations: www.reports-and-materials.org/Ruggie-scope-patterns-of-alleged-abuse-Apr-2008.pdf. See also: Klein, *No Logo: Taking Aim at the Brand Bullies*, 2000; Barker/Mander (eds.), *Does Globalization Help the Poor?* International Forum on Globalization, 2001; Korten, *Globalizing Civil Society. Reclaiming Our Right to Power*, 1998. For a carefully discriminating consideration of the costs and benefits of globalization, see Batterson/Weidenbaum, *The Pros and Cons of Globalization*, Center for the Study of American Business, 2001; as well as Streeben, *Globalization. Threat or Opportunity*, 2001.

Out of this climate of no confidence, non-governmental organizations (NGOs) rise like phoenixes out of the ashes of the burned reputation of other actors: about 65 percent of people in industrial countries believe that NGOs act in the best interests of society. Only 52 percent trust national governments, and as few as 38 percent trust multinational business organizations.² This overall disquiet in society is reflected partly also in the public support of the free market system: in many countries, support is eroding.³ And, even worse, the confidence that democracy is the appropriate political principle to solve the social and distributional problems associated with open global markets has also started to fade in at least some countries.⁴

2. How real is reality?

The effects of globalization and international corporate engagement are substantially more subtle than the one-sided picture just painted. As to be expected with complex processes in a globally circular interdependent whole, there is a great deal of light. But as with any social change, there are winners and losers and there is also some shadow. The focus of the analysis of globalization depends almost entirely on the standpoint of the observer: tell me what you want to show and I will find publications you can draw on to support your hypotheses. For the assessment of corporate morality, the same applies: tell me whether you want to show gross corporate breaches of the laws governing morality or a showpiece of corporate responsibility and I will provide you with appropriate case studies – or at least with anecdotal evidence.

The economic balance of globalization since 1980 is empirically measurable and looks positive overall: the profits of companies were not purchased in a zero-sum game through the losses of all other actors; they facilitated significant economic growth stimulus through linkage effects from which hundreds of millions of people benefited. The national economies of developing countries (home to about 3 billion people) participating in globalization grew in the 1990s and in this decade almost twice as fast as those of OECD countries; in the same period, the economic growth rate of non-globalizing developing countries was only half that of OECD countries.⁵ The relevant local economic, social, and ecological effects, as to be expected, depended to a significant extent on the quality of the social, tax, and education policies of these nations, as well as on other factors of “good governance.”⁶ In all countries of the world, legislation lays down the fundamental require-

² See GlobeScan: Corporate Social Responsibility Monitor, www.globalscan.com.

³ See www.worldpublicopinion.org/pipa/pdf/apr08/Free_Markets_April08_pr.pdf.

⁴ See Spiegel Online July 3, 2008: www.spiegel.de/politik/deutschland/0,1518,563013,00.html.

⁵ See, Dollar D. / Kraay A.: Spreading the Wealth. In *Foreign Affairs*, Vol. 81 (2002), No. 1, pp. 120–33.

⁶ See Son H.H. / Kakwani N.: Global Estimates of Pro-Poor Growth. In: *World Development*, Vol. 36 (2008), No. 6, pp. 1048–66; see also Grosse M. / Harttgen K. / Klasen St.: Measuring Pro-Poor Growth in Non-Income Dimensions. In: *World Development* Vol. 36 (2008), No. 6, pp. 1021–47; this has been known for a long time: see Wolf M.: *The Morality of the Market*. In: *Foreign Policy*, Sept./Oct. 2003, pp. 47–50.

ments that corporations must fulfill. Poor laws or deficits in enforcement, however, do not mean companies have no responsibilities. On the contrary, it is exactly under such circumstances that they are expected to demonstrate responsibility – we will come to that later. In almost all globalizing countries, business engagement has brought innovation as well as new competences and skills and has created substantial employment and income and thus contributed significantly to poverty reduction.⁷ Globalization has generally intensified competition, which has had very positive consequences for consumers – but it also had negative repercussions on companies that were beaten by competitors and had to close down.

As far as the morality of corporate activity is concerned, it cannot be denied that in the context of globalization there have been, and probably still are, highly ignominious examples of corporate misconduct – even criminal activity.⁸ Relevant case studies are the empirical backbone of the multitude of publications that are critical of globalization and of the deep disquiet in large sections of society.⁹ As the prevention of illegal and illegitimate corporate activity is in the best interests of serious-minded companies, grossly immoral or even criminal corporate activity should be denounced not only by critics but also at the corporate level. But scandals such as those revealed on various websites are the exception to the rule: the balance of the impact of multinational corporate engagement, according to an analysis of impartial sources such as the Economic and Social Council of the UN, is overwhelmingly positive.¹⁰

Corporate misdeeds that cast doubt on business activities as such are not politically desirable nor do they make good sense for societal welfare. Successful entrepreneurial engagement is one of the most important drivers of economic growth. Economic growth increases choice, widens opportunities, and renders all other development efforts easier to achieve.¹¹ This is true for industrial as well as developing countries. By creating employment and income, providing technical and managerial skills, generating social benefits, paying taxes, contributing to pension funds, and deriving innovative solutions to economic, social, and environmental problems, corporate management can be a substantial force for good: “It is compa-

⁷ See Dollar D. / Kraay A.: Spreading the Wealth, in: *Foreign Affairs*, Vol. 81 (2002), No. 1, pp. 120–33. While absolute poverty decreased, disparities of income increased. See Wade R.H.: Is Globalization Reducing Poverty and Inequality? In: *World Development*, Vol. 32 (2004), No. 4, pp. 567–89.

⁸ See, e.g., www.corpwatch.org.

⁹ See Internet sites such as www.attac.org, www.ifg.org, and www.corpwatch.org as well as the News Monitor of “Business for Social Responsibility” at www.bsr.org.

¹⁰ See the various annual World Investment Reports of the UN.

¹¹ Birchenhall J.A.: Economic Development and the Escape from High Mortality. In: *World Development*, Vol. 35 (2007), No. 4, pp. 543–68; for policy interventions to make economic growth more “pro poor,” see Grosse M. / Harttgen K. / Klasen St.: Measuring Pro Poor Growth in Non-Income Dimensions. In: *World Development*, Vol. 36 (2008), No. 6, pp. 1021–47. For the record, policies to improve income distribution in the context of economic growth will help to “lift more boats.” For the introduction of this debate, see Chenery. H.: *Redistribution with Growth*. Oxford University Press / World Bank, New York 1974.

nies, not abstract economic forces or governments, which create and distribute most of a society's wealth, innovate, trade, and raise living standards."¹²

Accepting the fact that there are corporate crimes and cases of irresponsibility, it is not entrepreneurial engagement *per se* that is desirable. Only entrepreneurial engagement conducted in a responsible manner can make the impact on the common good positive. Collateral damage of a social, environmental, or political kind can tip the development balance sheet to the negative side. This brings us to the subject of corporate responsibility.

3. Corporate responsibility for globalization with a human face

In "the good old days" things seemed to be much easier: Companies were expected to be profitable, adhere to the law, provide jobs, and pay taxes. Milton Friedman's famous phrase "the business of business is business" is frequently quoted in this respect.¹³ The quote, however, is often not used in the appropriate context: Friedman argues in his book *Capitalism and Freedom* that "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits *so long as it stays within the rules of the game*, which is to say, engages in open and free competition without deception or fraud."¹⁴

With regard to today's corporate responsibility debate, clearly the business of business is still business – but "the rules of the game" have changed significantly. Profits, as understood today by enlightened managers, are sustained proceeds from corporate activities pursued in a responsible way. Sustained earnings can only be realized if and when a company uses its resources in a socially responsible, environmentally sustainable, and politically acceptable way. Under such conditions the well-being of a company is in harmony with the creation of a society's welfare. Profits are *not* the isolated corporate objective (because you could, for example, increase a pharmaceutical company's profits this year by cutting research investments, which are the precondition for future profits, and the same applies for environmental investments and social standards). Profits as understood here are the aggregate indicator that a company is successful in a comprehensive sense and over time.

Whether or not corporate profits are perceived to be legitimate (not only legal) depends on a specific society's understanding of the corporate rights and obligations that are part of and make up the fabric of the social contract. In today's mature societies, the "rules of the game" that Milton Friedman referred to 45 years ago have evolved with growing economic welfare. Today, most citizens of modern societies (who are the employees, customers, and shareholders of companies) continue to expect good financial business results – but *not* in isolation from good social, environmental, and political performance. As the public perception of acting

¹² Birkinshaw J. / Piramal G. (eds.): Sumantra Goshal on Management: A Force for Good. FT Prentice Hall, Harlow UK 2005, p. 2.

¹³ Friedman M.: The Social Responsibility of Business Is to Increase its Profits (see www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html).

¹⁴ Friedman M.: *Capitalism and Freedom* (Fortieth Anniversary Edition). University of Chicago Press, Chicago / London 2002, p. 133.

responsibly is perceived to have a beneficial impact on the companies concerned, more and more firms are bringing corporate responsibility elements into their business strategy and core competences.

Corporate responsibility endeavors can follow a variety of principles, and the past 10 to 15 years have seen a range of them emerging, with the three most important being the United Nations Global Compact,¹⁵ the OECD Guidelines for Multinational Enterprises,¹⁶ and the Caux Roundtable Principles.¹⁷ Whatever principles a corporation accepts as a compass for its own philosophy, experience shows that successful efforts to shift corporate responsibility from good intentions to actual management depends on actions on two levels:

- On the *institutional* level, action has to be taken in the sense of defining a basic value frame by answering essential questions such as, What are our values? What is our mission? What is our corporate governance structure? How do we make decisions in dilemma situations? What – when in doubt – has priority? For what areas are we responsible? Where are the limits? And so on.
- But as business is done by actual human beings, the *personal* dimension is equally important – that is, the hiring, selecting, promoting, educating, sensitizing, and encouraging of managers to translate the value frame into practical action and apply the respective normative criteria when making decisions.

4. The UN Global Compact as a framework for corporate responsibility reflections

Launched by United Nations Secretary-General Kofi Annan, the UN Global Compact (UNGC) is a corporate responsibility initiative based on the conviction that weaving universal values into the fabric of open global markets and corporate practices will help advance broad societal goals. By 2008, more than 4,500 companies from all regions of the world, along with many international labor and civil society organizations, were involved with the UNGC. The Global Compact covers internationally accepted norms in the areas of human rights, labor standards, environmental care, and anti-corruption efforts.

Companies committing to these norms must incorporate them into their corporate policies and management processes. In addition, they should strive to extend adherence to the UNGC philosophy to at least their most important third parties (such as companies in the supply chain, joint venture partners, or others within their defined sphere of influence).¹⁸ They must report once a year to the UN Global

¹⁵ See www.unglobalcompact.org.

¹⁶ See www.oecd.org/document/28/0,3343,en_2649_34889_2397532_1_1_1_1,00.html.

¹⁷ See www.cauxroundtable.org/documents/Principles%20for%20Business.PDF.

¹⁸ See Leisinger K.M.: Capitalism with a Human Face. In: Journal of Corporate Citizenship, Vol. 28 (winter 2007), pp.113–32. The result of the Special Representative for Business and Human Rights, John Ruggie, shed new light on the definition of “sphere of influence“ in the context of the two UNGC human rights principles; see www.reports-and-materials.org/Ruggie-companion-report-15-May-2008.pdf.

Compact head office about their efforts to implement the 10 principles in their daily business activities. Companies who do not report are taken off the list of signatories.

The baseline for responsible corporate conduct are the 10 principles that participating companies are expected *to embrace, support, and enact in their sphere of influence*:

“Human Rights

Principle 1. Businesses should support and respect the protection of internationally proclaimed human rights; and

Principle 2. make sure they are not complicit in human rights abuses.

Labor

Principle 3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

Principle 4. the elimination of all forms of forced and compulsory labour;

Principle 5. the effective abolition of child labour; and

Principle 6. the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7. Business should support a precautionary approach to environmental challenges;

Principle 8. undertake initiatives to promote greater environmental responsibility; and

Principle 9. encourage the development and diffusion of environmentally friendly technologies.

Transparency and Anti-corruption

Principle 10. Businesses should work against corruption in all its forms, including extortion and bribery.”

5. Define “the right thing,” set goals, and use management processes to achieve these

For companies competing with integrity, the basic question has already been answered: Through their normal business strategy and with their core competences they want to be “part of the solution” not “part of the problem.” For such companies, illegal conduct and willful harm to human beings or the environment are simply not acceptable options. The Global Compact principles, however, provide only a grid for reflection, not the precise content of a corporate responsibility strategy. Management must determine what exactly it is willing to be held accountable for.

Socrates once surmised that the “truth” is in every human being, he or she just needs to recognize it. Here, moral philosophical discourse has been assigned a “midwife” function to give birth to truth. Self-critical reflection on corporate responsibility in the light of the Global Compact principles can perform precisely this function for companies: all core business ethics aspects are covered by the 10

principles. Questions such as the following help to analyze the corporate state of responsibility affairs:

- What, in the light of the 10 principles and beyond legal compliance, are our main weaknesses and vulnerabilities with regard to human-rights-related issues and labor and environmental standards as well as in relation to anti-corruption?
- How do we concretely apply the “sphere of influence” concept within which we acknowledge responsibility for human-rights-related, social, and environmental standards, and where do we draw the limits?
- Who are our relevant stakeholders, and what are their stakes and expectations? What are the processes for communicating with them?
- How do we proceed if the expectations of civil society conflict with those of the financial community? What is the general approach to solving dilemmas that arise between financial gain and responsible behavior?
- What does “support and respect the protection of internationally proclaimed human rights” mean in the area of economic, social, and cultural rights? This question remains unanswered in the recent Ruggie Report¹⁹ and yet is one of the most pressing in terms of public expectations vis-à-vis poor countries.

Reflection on the answers to such questions by top management is, in my experience, the single most important element of any corporate responsibility process. Dialogue with internal and external stakeholders helps to reach informed decisions about the content, scope, and limits of corporate responsibilities. Through dialogues with relevant stakeholders, management becomes familiar with the pluralism of societal demands and gets challenged by values, concerns, views of the world, and perceptions of corporate obligations that may differ substantially from its own. Such learning experiences are likely to enhance the social competence of corporate management. These dialogues are in the best of all worlds a two-way street: civil society stakeholders, too, have the opportunity to learn about the mind-set of management and how they make decisions against a background of business fundamentals, and hence they can better assess where there are limits and non-negotiable essentials for profit-oriented corporations.

Decisions in the context of value issues such as corporate responsibilities are usually taken as the result of three steps: making the right value choice, assessing the facts, and choosing the right norms.

5.1 Making the right value choice

Controversy over what constitutes the *right thing to do* generally arises from the fact that different parties base their norms on diverging values, personal experiences, and vested interests (often held implicitly). What one group holds to be of highest importance, another may dismiss as a minor issue. For example, financial analysts – although increasingly appreciative of “triple-bottom-line” philosophy – still focus predominantly on the profitability data of businesses when determining

¹⁹ For details, see www.business-humanrights.org/Gettingstarted/UNSpecialRepresentative.

benchmarks for measuring best-in-class. In marked contrast, for those engaged in the fight against the diseases of poverty, profitability issues are of secondary concern when it comes, for example, to ensuring access to drugs for the 2.5 billion people living in absolute poverty. Those who must meet the expectations of financial markets will inevitably question the logic of giving away products at cost or for free – even more so if general or open-ended commitments are requested. The fact that a business manager has to do what is economically right does not make him or her morally inferior to those requesting free medication for the world’s poor. Business corporations and NGOs have different tasks to fulfill – both are important. Sustainable solutions for complex issues, however, involve all relevant stakeholders and their resources, and corporations are just one player among many and thus can only offer some of the “tesserae” for the composition of the “solution mosaic.”

5.2 Assessing the facts

Even where there is broad consensus over a given fact, such as that the quality of human life with good health is a precondition for human development, conflicts may arise over who is in charge of doing what. And even if this is clear, the *perception* of crucial issues might be different than the *facts*. Take the controversy over patents and their impact on lack of access to medicines for poor people in developing countries as a case in point. The argument that patents are the main obstacle impeding access to medicines for people living in poverty is not borne out by the facts. Of the 319 products on the World Health Organization’s Model List of Essential Drugs, only 17 are patentable (5 percent) – and most are not actually patented, bringing the overall amount of patented essential drugs to 1.4 percent, of which most are concentrated on larger markets.²⁰ Those who argue that patents are the main problem for the poor in developing countries tend to ignore or at least underestimate the importance of other critical access issues: the lack of doctors, nurses, and laboratories for appropriate diagnosis; the lack of logistical essentials (e.g., peripheral warehouses and refrigerators); the lack of general health infrastructure (to reduce walking distances for sick people to reach health centers); and, last but not least, an assurance of patient compliance with complex and long-term therapies – especially in cases of stigmatized diseases (HIV, TB, leprosy) where lack of compliance can result in resistance to available drugs.

5.3 Choosing the right norms

The essence of moral discourse is that it indicates to duty bearers the right course of action. Moral norms are more likely to be filled with practical life if and for as long as they appear self-evident to the party who is expected to act. This applies also to corporate responsibility norms. And yet, management must make decisions on concrete deliverables: What should a company *reasonably* do beyond legal compliance? While it is evidently morally wrong to accept or initiate human rights viola-

²⁰ Attaran A.: How do Patents and Economic Policies Affect Access to Essential Medicines in Developing Countries? In: Health Affairs, Vol. 23 (2004), No. 3 (May/June), pp. 155–66.

tions for the sake of increasing profits, many issues arise in a subtle, complex, and multifaceted way. This is not only the case where local legal and judicial culture allow for acts or omissions as a result of a specific cultural environment that might be looked on as “backward” by western observers. It is also the case in areas where the problems endured by the 2.5 billion people living in poverty cannot be solved through market mechanisms as the people in question do not have the necessary purchasing power.

A telling example in this regard is the perceived corporate obligation to fulfill the “right to health” of poor people. It is relatively easy to impose political demands on “Big Pharma” by highlighting the misery of those living in absolute poverty while criticizing the size of corporate profits. It is less easy to shoulder the cost of meeting the needs of patients who lack the purchasing power to buy medicines through markets. The “right to health” debate demonstrates clearly how moral oversimplification can distort a complex human development challenge – and how such distortion affects the way responsible corporate conduct is perceived.²¹

Other examples are found in the area of child labor. The ethically justifiable stance seems clear – but assuming the appropriate social responsibility in a given context is inherently complex. Organizations such as Save the Children point out that well-meaning western endeavors to protect children from child labor can in practice put children and their families in an even worse situation. This is why Save the Children recommends a differentiating approach between work that is harmful to a child’s development and work that will contribute positively to his or her development and perhaps combine the latter with offers of education and training.²²

Other areas where people with good intentions can differ in their approaches are, for instance, the handling of problems in the corporate sphere of influence: Should a company abandon cooperation with a third party that is not living up to expected norms or instead initiate improvement processes that may involve living with deficits for some time?

These difficulties notwithstanding, once corporate moral norms have been established they have to be translated into codes of conduct and corporate responsibility guidelines. Thereafter, the implementation process is “business as usual” – that is, making use of normal corporate management procedures (e.g., target setting, performance appraisals, compliance monitoring, verification, and reporting).

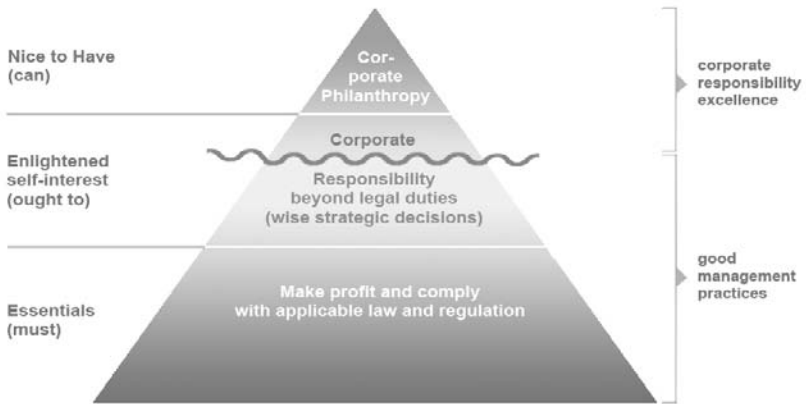
²¹ For a detailed analysis of the right to health debate in a corporate context, see Leisinger K.M.: The Right to Health – A Duty for Whom? In: Global Compact Quarterly Issue 2, New York 2005, available at www.enebuilder.net/globalcompact/e_article000375786.cfm?x=b11,b3hPg0VQ,w.

²² See www.savethechildren.org.

6. A practical approach to corporate responsibilities

To operationalize the concept of corporate responsibility, a Dahrendorf model with three levels of classification can be used, consisting of a *must* dimension, an *ought to* dimension, and a *can* dimension – each with specific moral qualities and material content.²³

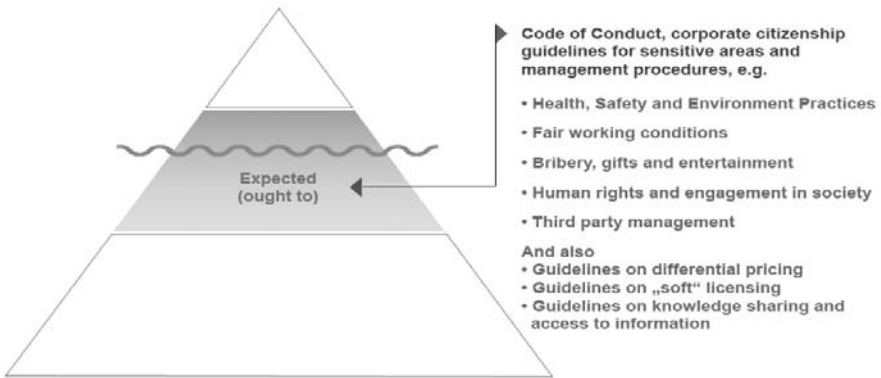
The Hierarchy of Corporate Responsibilities



The *must dimension* covers non-negotiable corporate duties that include, for example, compliance with national laws and regulations. This includes protection of the environment as well as the health and safety of employees, customers, and neighbors according to applicable law. Other duties in the must dimension are to meet the expectations of shareholders and employees: shareholders expect a fair return on their investment and employees expect fair wages. Corporate societal responsibility essentials include job creation, tax payments, and contributions to insurance and pension funds. If companies provide training and further education on the job, employees improve their employability and value in the job market. The goods and services made available through markets provide society with many different kinds of social value. In the case of pharmaceutical corporations, for example, this would be medicines that reduce the severity of diseases, protect life by reducing morbidity, improve the quality of life for patients (less pain, less disability, fewer side effects), and, last but not least, allow for a (relatively) normal private and professional life.

²³ For an approach distinguishing social norms according to different degrees of obligation, see Dahrendorf R.: *Homo Sociologicus*. Opladen, Cologne 1959, p. 24 et seq.; for a similar differentiation of corporate responsibilities, see Carroll A.B.: *Business & Society. Ethics and Stakeholder Management*. South-Western Publishing Co., Cincinnati, 2nd edition 1993, p. 35.

The Hierarchy of Corporate Responsibilities



The *ought to* dimension refers to the aspects over and above legal compliance that are commonly expected by people in modern societies. In countries where the quality of law is state-of-the-art and enforced, legality can be deemed to satisfy in large measure the requirements of responsible corporate conduct. In regions where this is not the case, however, responsible companies will exceed legal minima by applying higher corporate norms, for example through the use of state-of-the-art environmental technology and social policies, *even where* local law would permit lower standards.²⁴

Corporations can create significant social and economic value through their expertise and core competences, whether by applying cutting-edge technologies (in the fight against global warming, for instance), by requesting suppliers to improve their business practices, or by setting a good example for emulation by customers, consumers, and other stakeholders. Additional deliverables in the “ought to” dimension of corporate responsibility do, of course, differ from sector to sector. For pharmaceutical companies, “access to medicines” issues for poor patients in developing countries are of utmost importance.²⁵ Therefore guidelines on differential pricing, “soft” licensing, and knowledge sharing will be part of the “ought to” dimension – or, depending on the corporate culture, of the “can” dimension.

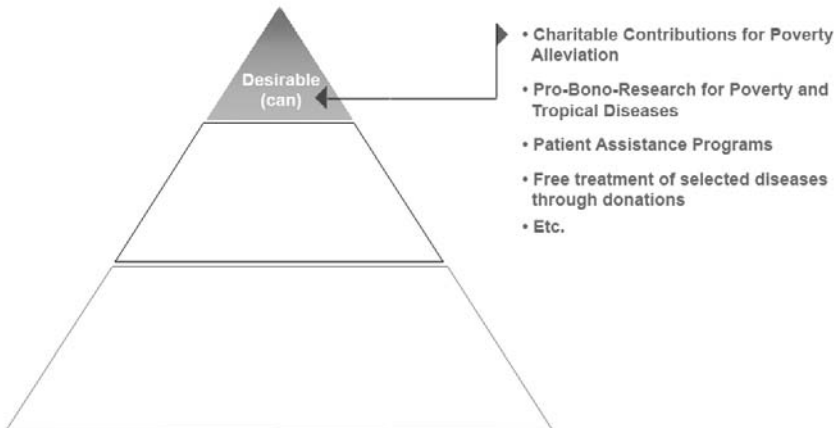
²⁴ See in this context the old Kantian differentiation between “legality” and “morality”; Kant I.: Introduction into the Metaphysic of Morals. I. The Relation of the Faculties of the Human Mind to the Moral Laws: “The laws of freedom, as distinguished from the laws of nature, are moral laws. So far as they refer only to external actions and their lawfulness, they are called juridical; but if they also require that, as laws, they shall themselves be the determining principles of our actions, they are ethical. The agreement of an action with juridical laws is its legality; the agreement of an action with ethical laws is its morality.” See etext.library.adelaide.edu.au/k/kant/immanuel/k16m/k16m6.html.

²⁵ See www.reports-and-materials.org/Leisinger-Corporate-Responsibilities-for-Access-to-Medicines-Apr-2008.pdf.

The *can dimension* of corporate responsibility is not demanded either by law or by industry standards. It encompasses socially desirable duties that a company assumes from its own understanding of itself as a *Good Corporate Citizen*. The observance of “can” standards or of corresponding recommendations for action is always *complementary and by no means a substitute* for compliance with “must” and “ought to” standards. Contributions in the “can” dimension can lead to substantial advantages for the beneficiaries, for example through *corporate philanthropy* – activities beyond the usual field of operations of a company and not associated with any direct company advantages or measurable financial return. Work in this field should be guided by the criteria of need and impact, not by superficial PR aspects. Sustainably successful philanthropic or even development policy work as a rule is extremely complex and hardly ever leads in the short term to visible success that would be suitable for PR events. Many stakeholders who are critical of corporate behavior also regard corporate philanthropy with some skepticism, because this type of work is carried out exclusively on a voluntary basis. These companies could, so the skeptic’s argument goes, either cut back or completely abandon this philanthropic work if, for example, the business climate became tougher and the appropriate resources were no longer available.

The contribution of a respectable company in this area is predictable and sustainable – Novartis has been engaged in corporate philanthropy for nearly 30 years. In the face of widespread poverty throughout the world and the associated suffering and injustice, almost any activity of a charitable nature is to be welcomed.²⁶

The Hierarchy of Corporate Responsibilities



²⁶ See Leisinger K.M.: Corporate Philanthropy: The “Top of the Pyramid.” In: Business and Society Review, Vol. 112 (2007), No. 3 (fall), pp. 315–42.

In all these areas there are no “silver bullets” available, and in most cases it is not one size of answer that fits all questions. Corporate management will in many cases have to reflect on what is appropriate in a given situation. The process by which corporate management reflects on what to do and where to set limits will bring up a variety of highly specific issues that would probably not otherwise come to light. If properly done, an open-minded SWOT analysis can bring elements to management’s attention that otherwise might be considered marginal niche issues beyond the purview of the corporate “silo.” A quick search on the Internet highlights numerous incidences where corporate management’s perception of potential issues was at odds with that of civil society. Key words for respective areas are “human rights and business” issues, “supply chain responsibilities,” and “fairness issues” (e.g., with regard to discrimination of any kind or remuneration).

To give one specific example: Companies under normal circumstances will look at *competitive* remuneration to attract the most competent and educated employees. In emerging economies, they might be confronted with *minimum wages* imposed by the state – for instance, for workers in production facilities, on farms, or in particular industrial sectors. Appropriate reflection on corporate duties in the context of economic rights, however, will lead management to the concept of *living wages*, raising an entirely new set of questions:²⁷

- What is a reasonable definition of a “living wage” and who determines the right “basket”?
- What constitutes fair content for the “basic needs” reference basket? Should it, for example, contain savings or contributions to social security institutions?
- Which parts of a social package considered “normal” in the corporation’s home country (such as a pension fund) should a company “export” through its business practices to developing countries with very different average income levels and institutional settings?

²⁷ Living wages, even as a dynamic concept, refer to a “basic needs” basket, which is defined along relatively narrow parameters. Whatever remuneration goes beyond these parameters must be justified by corporate desire to hire better than average workers and employees and not by social idealism. Although critics will argue otherwise, several UN World Investment Reports have established that, as a rule, transnational corporations with their headquarters in Europe or the US pay much higher salaries and wages and offer substantially more benefits. This could also be viewed as a problem, as it attracts the best national talents and hence puts national firms at a competitive disadvantage. Another argument to be taken seriously in this context is the fact that most workplaces in the industrial sector pay substantially higher incomes than those in subsistence agriculture or local handicraft – hence, caution must be applied when comparing remuneration packages. See as a company specific case study: Brokatzky-Geiger J. / Sapru R. / Streib M.: Implementing a Living Wage Globally – The Novartis Approach. In: UN Global Compact / UN High Commissioner for Human Rights (eds.): Embedding Human Rights in Business Practice II. New York / Geneva 2007.

7. Why become involved beyond legal compliance?

While management has no option when it comes to adhering to laws and regulations, and while "good management practices" may be driven by enlightened self-interest, corporate citizenship deliverables above and beyond a certain standard remain at the sole discretion of management. From a purely economic point of view, it could be argued that every dollar spent on corporate responsibility beyond legal requirements and basic standards of decency is a dollar diverted from activity that could potentially generate profits.

In other words, there are opportunity costs associated with corporate responsibilities that extend beyond legal compliance and even more so beyond conventional *good management practices*. They could become quantified in the form of benefits not realized through alternative investments. Doubt over the question of whether companies should go out of their way to define and promote wider self-chosen objectives is part of the standard corporate social responsibility literature. Why should a company consider corporate responsibility criteria in addition to laws, conventions, and the pursuit of the company's own interests? First, quite simply, because it is the right thing to do!

From a moral and social perspective, it is desirable that, as corporate citizens, companies show "good" and "fair" behavior in terms of living up to socially and environmentally responsible standards and respecting the principles of the Universal Declaration of Human Rights within their sphere of influence. Companies and managers doing what is "the right thing to do" for the sake of it give categorical – not hypothetical – priority to all corporate responsibility aspects, be they human-rights-related, social, or environmental. Therefore they set their own higher standards if and when the letter of the law must be considered insufficient. Such companies also practice enlightened restraint with regard to activities that are morally ambivalent. If this leads to increased costs or to a loss of sales or market share, if it leads to additional investment and in the end maybe lower profits, this will be accepted out of the value premise that illegitimate (or even illegal) activities as a matter of principle are not an option.

Such companies will, in addition to observing existing laws, national regulations, the spirit of international norms, as well as their own corporate responsibility guidelines, also engage in discourse with critical stakeholders. They do this to remain sensitized to the need to respect the rights of others and to review their own claims through consensus-oriented discourse. Out of the same motives, these companies will create a corporate culture that is well disposed toward constructive criticism. They also know that human weaknesses are a reality and that even practices that in the past were seen as morally justified could be in need of correction in the light of new findings. The constructive approach to dissent is appreciated and fostered as an internal learning experience.

The motivating power to keep a company consistently improving usually comes in such cases from a corresponding inner attitude of the top management. Applying responsibility philosophy is in most cases not a "free lunch": companies that "do the right thing" for intrinsic reasons may encounter incomprehension and rejection in

an environment focused on financial quarterly results. The “costs” of morally motivated efforts in all areas are usually relatively clearly quantifiable as additional costs or as a relinquishment of sales. Any benefit that may occur as a result of responsibility-driven efforts is measurable only in rare cases in the short term, and often not at all. The avoided cost burden due to accidents, strikes, public criticism, or additional political regulation is just as difficult to measure as environmental damage that did not arise as a result of relevant investments. Share prices, too, can mostly be explained more by general bullish or bearish movements on the U.S. stock market and sector-specific preferences than by the moral quality of specific corporate activity. Of course, it is possible, with after-the-fact reference to concrete cases such as Enron, WorldCom, and Tyco, to argue that “if you think compliance with ethical criteria is expensive, try non-compliance.” Nevertheless, it would be dishonest not to admit to quantification problems of ethically legitimized activity.

Yet there is some evidence to suggest that legitimized corporate activity – at least in the long term – also has business advantages. Moral actions and self-interest are not mutually exclusive – and therefore ethically considered action is also *strategically the right choice*.

8. The “business case” for corporate responsibility

The willingness to bear responsibility and be held accountable for it is not only of intrinsic value, it can also lead to measurable advantages for the company.

8.1 Reduction of reputation and the costs of friction

In the world of Internet and SMS communication, there is a high risk that any corporate responsibility deficit – even if it occurs in the furthest corners of Earth – will become globally known, and this could lead to great damage for the company’s reputation. If the corporate activity that comes to light is perceived as illegitimate, whether it is illegal or not, it usually results in financial compensation and legal costs, as well as friction with the social environment. Whether a critically engaged public demonstrates in front of factory gates, or NGOs set up “wailing walls,” or the media exert pressure through critical reporting – for the company concerned this always means a reputation problem and often a decline in social acceptance. Criticism from outside means that management capacity is tied up in defensive activities and that the “heads” are not free to take advantage of opportunities on the market and to shape the future. Where the negative impression is created that the culpable “Goliath” is treating the innocent “David” in a contemptuous manner, sympathy for the company is lost and can be regained only at very high cost.

There is evidence to suggest that the reputation of a company can become a competitive advantage because a positive coefficient is created in the form of a sympathy affinity. This is for example the case where a company offers products and services that are comparable in quality, price, and usefulness with those of other companies (me-too products). Where a company name or brand triggers positive

associations for sensitive citizens, it helps a company as these consumers make their purchasing decisions.²⁸ In this logic, negative headlines have negative business consequences.

8.2 Motivation of employees and competitive advantage on the jobs market

When a company is perceived as acting illegitimately, this usually also has also negative effects on company morale and job satisfaction.²⁹ In the medium and long term, this can result in valuable, talented, quality-conscious employees looking for job opportunities elsewhere. Since talented employees are today regarded as the most valuable asset of a company, unethical behavior cannot be seen from this perspective to be in the company's interest. Evidence also suggests that for the top graduates of universities, the good reputation of a company plays an important role in the choice of their future employer.³⁰ Where corporate activity is perceived as ethically correct behavior, job satisfaction and the employee's identification with the company increase in a good working atmosphere. Both have a measurably positive effect on company performance.

Job motivation increases in companies where applied responsibility ethics is an integral part of the "moral corporate identity," which – as the cultural whole of the company's values, thinking, and decision-making patterns, behavior, and structures – gives employees a positive sense of "us." People in their jobs are working for something they can personally and totally identify with and that they can talk with pride to their families and friends about. These employees will release different kinds of energy from that which keeps people working at jobs for purely financial reasons. The efficiency of a company also increases when employees can normally trust in their colleagues and managers to act morally instead of trying to find clever ways around the rules.

8.3 Attractiveness of the company for ethically oriented investors

Despite – or perhaps even because of – discussions about shareholder value that are tainted with the negative flavor of balance sheet fraud, companies today are no longer measured exclusively by what they produce but also by what they represent.

²⁸ Pruzan P.: Corporate Reputation: Image and Identity. In *Corporate Reputation Review*, Vol. 4 (2001), No. 1, pp. 50–64.

²⁹ Hian Chye Koh / El'fred A.Y. Boo: The Link between Organizational Ethics and Job Satisfaction: A Study of Managers in Singapore. In *Journal of Business Ethics*, Vol. 29 (2001), No. 4, pp. 309 *et seq.* In Singapore, there were above all three factors that played a role: the support of top management for ethical activities, the "ethical climate" in the organization, and the association of ethical activity and career success.

³⁰ Bradshaw D.: Family Values Replace the Dash for Cash. In *Financial Times*, 25 May 1998; Larsen T. / Sørensen M.: Top Leaders Boycott Unethical Companies. In *Borsens Nyhedsmagasinet* No. 1 (2001), p. 14 *et seq.*; Pruzan P.: Corporate Reputation: Image and Identity. In *Corporate Reputation Review*, Vol. 4 (2001), No. 1, p. 53 *et seq.*

There are periodicals that deal with best practices in the context of the ethical performance of companies³¹ and thus set transparent standards for the competition in this respect. Principles for responsible investment become more and more part and parcel of financial allocation decisions:³² A large and growing number of pension funds and other institutional investors look not only at short-term gains but also at how these gains were achieved.³³ Estimates of the financial power of ethically oriented investors today run to over \$10,000 billion – with otherwise equally good business performance investment, sums of this order of magnitude can make a significant difference in the share price.

American management consultants such as Charles Fombrun (CEO of the Reputation Institute³⁴) estimate that up to 30 percent of shareholder value can be attributed to the good reputation of a company; other estimates³⁵ are considerably more conservative. The question of whether it is possible to achieve a brilliant performance both in financial and in social and ecological terms has been answered:³⁶ ethical investment funds perform at least no worse on the equity markets than funds that apply wider-ranging investment criteria.³⁷ Both provide evidence of at least the medium-term and long-term business compatibility of ethically legitimized corporate activity.³⁸

The reputation of a company, defined as the sum of perceptions of all stakeholders, is a complex construct and in most cases the result of many years of development work. It can be ruined by a few determinedly inadequate activities. When members of top management are led away in handcuffs in front of television cameras, “business” problems are secondary. Once a company appears on the list of the Ten Worst Corporations that U.S. critics such as Russell Mokhiber and Robert Weissman publish every year, or it shows up in the publications of *Corporate Crime Watch*,³⁹ huge problems of legitimacy and reputation emerge – with direct consequences on the product markets, regardless of whether the perception within the

³¹ Ethical Performance – Best Practices, can be ordered at publisher@ethicalperformance.com.

³² See www.unglobalcompact.org/docs/issues_doc/Financial_markets/PRI_Brochure_electronic_version.pdf.

³³ For the discussion on criteria, see Mackenzie C.: The Choice of Criteria in Ethical Investment. In *Business Ethics: A European Review*, Vol. 7 (1998), No. 2 (April), pp. 81–86.

³⁴ See www.reputationinstitute.com and *Corporate Reputation Review*, Vol. 1 (2001), No. 4.

³⁵ See, e.g., Cumming L.S.: The Financial Performance of Ethical Investment Trusts: An Australian Perspective. In *Journal of Business Ethics*, Vol. 25 (2000), pp. 79–92, and Moore G.: Corporate Social and Financial Performance: An Investigation in the U.K. Supermarket Industry. In *Journal of Business Ethics*, Vol. 34 (2001), No. 3–4, pp. 299–315.

³⁶ See, e.g., King M.J.: Sustainability: Advantaged or Disadvantaged? Do Organisations that Deliver Value to All Stakeholders Produce Superior Financial Performance? In *The Journal of Corporate Citizenship Issue 3* (autumn 2001), pp. 99–125; see also in this context the performance of Novartis.

³⁷ Murphy E.: The Best Corporate Citizens Perform Better Financially. In *Business Ethics*. Vol. 16 (2002), No. 2 (March/April), pp. 8–13.

³⁸ Cummings L.S.: The Financial Performance of Ethical Investment Trusts: An Australian Perspective. In *Journal of Business Ethics*, Vol. 25 (2000), pp. 79–92.

³⁹ See www.corporatewatch.org as well as www.polarisinstitute.com, www.ethicalconsumer.org, or www.publiccitizen.org.

company matches the perception outside or not. As long ago as in Ancient Greece, the stoicist school of philosophy pointed out that it is not the facts that unsettle people, but opinions about the facts.

8.4 Preserving corporate freedom

Decision-makers in companies often complain of an excessively dense jungle of regulations, with laws, directives, and legal requirements. The mass of regulations in Europe is constantly being named as a reason for investments and facilities shifting abroad; excessive regulation, according to many entrepreneurs, is jeopardizing the position of Europe as a place to do business. And the problem is not only EU bureaucracy, which is well known for defining standards for the curvature of bananas or the size of toilet seats, suggesting that such complaints are well founded.

In particular, companies that – owing to a high degree of regulatory control – depend for their success on a political environment well disposed toward them are in an especially difficult position. They can only achieve long-term success on the product markets if they are viewed on the public “image markets” as legitimate actors who, as part of the solution rather than part of the problem, contribute to the common good with their activities. Image risks, in this way, become an integral part of operational risks. In such a situation, legitimacy management – in the sense of striving to achieve recognition for actions – also becomes a prerequisite for successful marketing efforts from an ethical viewpoint.

However correct the criticism of excessive regulation, it has to be put into perspective by demanding an appropriate degree of responsibility. The price that all social actors – including companies – have to pay for their freedom of action through less interference by the state must not be anarchy. Freedom is always freedom within the constraints of responsibility. It only has a truly liberating effect when combined with benefits in return at the level of ethically motivated obligations. Anyone who wants to avoid farther-reaching regulation of business activities and to help correct misguided legal developments has to behave responsibly in a sustainable manner. There is no better moment to call for more political controls, stricter legal requirements, and thus also more state bureaucracy than when there is a wave of outrage among people about evident illegal or indisputably illegitimate corporate activity. The political reaction to the 2008 financial crisis is a telling example in this respect.

8.5 Creating competitive advantages

Innovation, efficiency, effectiveness, and the ability to make the most of market potential as well as to properly assess (financial!) risks and interpret the signs of the times correctly, as well as the art of cutting costs and spending at the right place and at the right time, will retain their immense importance in the future as indispensable virtues in business. An additional element, however, will become increasingly important: the ethical quality of entrepreneurial activity. It could become a new, solid basis for future competitiveness. The greater the prosperity achieved by a society, the more important immaterial values become – and the

more customers there will be who take an interest in the social, ecological, and political quality of the actions of a company whose goods they purchase. Recent studies, for instance, estimate that about half the consumers in Denmark want to see ethical criteria being met when they make their purchasing decisions.⁴⁰

At least for enlightened companies, corporate success today involves more than simply quarterly profits. Profit-making is to a company what food is to a human being – an absolute necessity. The several hundred billion Dollar losses of major banks leading to the near collapse of the global financial system demonstrate the non-negotiable importance of wise corporate leaderships pursuing profitable business. But no reasonable person will define his or her purpose in life as exclusively the intake of food. By the same token, enlightened companies seek legitimacy for their profit-making not only on the basis of a value-added for society. The reputation of a company is increasingly becoming one of its most valuable assets, even if it does not appear directly in the balance sheet – but this is likely to change in the very near future in view of the substantial efforts being made in the field of social responsibility reporting. The judgment of society that gives justification to a company's reputation depends essentially on whether that company is perceived as contributing to the realization of social values.

Satisfaction of customer needs in the broader sense, responsible dealing with people – not only as a means to the end of higher productivity, but as an intrinsic value – as well as protection of the environment are important stones in the mosaic of “sustainable corporate success.” A corporate culture in which such a view of things has been internalized by employees is one of the most important building blocks for present and future success. This is also the view of managers in companies.

There is a lot of empirical evidence to support the theory of Niklas Luhmann, according to which people react to what they increasingly see as insecurity and risks by demanding greater morality.⁴¹ The kind of dynamic structural change processes that accompany globalization will at least preserve, if not strengthen, feelings of insecurity. For this reason, too, applied business ethics in the sense of good corporate responsibility performance will to a growing extent become a new and solid basis of corporate competition and in the process will transcend the boundaries of classical markets.

For companies that make serious and sustained efforts to combine their contest for the highest profitability with the commitment to corporate responsibility, new dimensions of corporate success can open up.

⁴⁰ Pruzan P.: Corporate Reputation: Image and Identity. In *Corporate Reputation Review*, Vol. 4 (2001), No. 1, p. 51; Hjulmand K.: *Det umuliges kunst: Politik og den politiske forbruger*. Chapter 2, Copenhagen 1997.

⁴¹ Luhmann N.: *Die Gesellschaft der Gesellschaft*. Suhrkamp. Frankfurt am Main, 2, Auflage 1999, pp. 396 *et seq.*

Panel Statements

Personalities Make the Difference

Robert W. MacGregor

“The Role of the Corporation in Shaping Globalization with a Human Face” is a timely and important topic because Corporations are shaping Globalization as the major international players. Many articulate voices are being heard by a growing angry public that the face of the Corporation is harming people and the planet. Too many believe Business lacks a human face.

As you know, we have a Presidential election underway in my country. To listen to the two leading Democrat candidates, even sometimes the Republicans and the media, you hear strident criticism of abusive pharmaceutical companies, greedy insurance firms, profit gouging oil companies, unethical business lobbyists controlling Washington legislation. Now the banking and financial industry is being tarred and feathered with the sub-prime meltdown. If I was Corporate America as well as global companies worldwide, I'd be very worried about the anti-business legislation, which may well be enacted after the election. Some of this sharp criticism of business is warranted, but some of it is pandering to other interest groups and some of it is just wrong headed and using business as a scapegoat for global problems with many causes. Business needs to get its act together. As I try to make sense of what's happening locally and on the world scene, I want to do my part in contributing to a useful dialogue and solutions.

When you get older, after a long productive career, it's time to look back and respond to the pertinent question: what have I learned that is significant and worth sharing? What lessons would be useful to groups like this? Foremost, I learned the values of leaders count. Too much of our current values focus on “me” not “we.” We've become a greed-oriented society. We need leaders with core values oriented on the good of others.

You don't know me, but I've had a privileged career. Often I tell groups I've had the best jobs of anyone. These occurred in several cities – Minneapolis, Chicago, Kansas City and overseas in Lebanon, Egypt and Africa.

- In each position I was doing useful assignments –yes with a human face for business
- In each position we produced substantial useful results. I don't like to spin my wheels, but results turn me on. They were accomplished because I had the privilege of working with the top business and government leaders. Leaders with strong community centered values. I've had the privilege of reporting to some 25 C.E.O.'s of Americas best companies and worked closely with some our most senior government leaders, all of whom had clout.
- I was privileged because most of the time I enjoyed going to work, not everyday was a “bowl of cherries”, but most of my career has been enjoyable.

Therefore, I will talk quickly about this career, selecting experiences related directly to the topic.

First let me set the stage by going back in history to the depression era. The 1930's were tough times. The former Chairman of General Foods Clarence Francis said: "In the 1930's we should recall, business was the whipping boy of the Great Depression. Government was transcendent while business was blamed for the nations ills: unemployment, poverty, and everything but the dust storms and crop failures." American business was put on trial. The critics dramatized this issue by a poster – "a stern finger pointing executive admonished viewers to believe that what's good for business is good for you." Then, however, some top business leaders woke up and formed a group – the C.E.D. (Committee for Economic Development) and altered the wording: "what's good for the U.S.A. is good for business." We could phrase it today, "what's good for the world is good for business." A growing group of enlightened business leaders emerged after the depression days, who were convinced that business had the primary responsibility for staving off a postwar economic disaster by responsive pro-activity to address societal issues. Business became the post war engine of prosperity with a human face.

These leaders helped establish:

- The Bretton Woods Conference at the end World War II;
- A new International Monetary System with lowered tariffs and barriers,
- Supported the Joint Economic Committee of Congress, headed by my former friend Vice President Hubert Humphrey.

Paul Hoffman, former President of the Studebaker Corporation and the first administrator of the Marshall plan, said "The problems of our country and those of our world are so closely interrelated that most of them can only be solved if we accept and act on the idea that our world ,in many vital respects, is one indivisible community." He called many years ago for the greatest possible degree of international cooperation. He summoned business leaders to bring this influence together in positive ways to promote global prosperity and the strengthening of peace in the world. We need this spirit and kind of leadership today.

Another prominent leader, Ralph Flanders, President of a major manufacturing firm and President of the Boston Federal Reserve Bank said, "The overriding imperative is to provide meaningful jobs as one major step toward alleviating the problem of poverty. Business must be in the lead. Unemployment is the most serious problem we face." Donald David, President of several major food companies and later a Harvard Professor as well as other business leaders added to their leadership plate, "primary ethical and value issues in economics, and raised the question of the proper use of power."

Many have elevated the issue of power. Today the most powerful institution in the world is business controlling the most resources; employing the most workers, including the most talented and best paid. They're sitting on the Boards of Societies most influential institutions – Universities, Foundations etc. Business has great power.

This brings me back to my career. After four terms as a leader in government on the Minneapolis City Council, I was hired by the most important firm in Minneapolis: the Dayton Hudson Corporation, where I served as Vice President of the Corporation and Executive Director of their foundation (which had a major responsibility for corporate citizenship). One of the divisions of the company, that was created when I was there by Douglas Dayton, whom I saw the other day, was Target. Target is now the name of the parent company and the second largest and most prosperous of all U.S. retailers. The company last year had sales of some 60 billion dollars and employed 366,000. The early founder of the company, George Draper Dayton, and his business philosophy has had a profound influence on my career. He was a devout Calvinist Presbyterian. Dayton believed God gave him a talent to make money and be a powerful business person. With this power he strongly believed God held him to a higher standard, to use his power for the good of citizens and customers of his company.

Clarence Walton, the former Dean of Columbia Graduate School of Business said, "The American Business Man in real sense was profoundly influenced by three European Priests: John Calvin, John Locke, and Adam Smith." Let me just remind you, Calvin provided a theology which could justify business. Some will recall that the early Christian tradition was marked by a skepticism toward anyone engaged in commerce. Calvin gave business a *Values Motivational Basis*, including frugality, hard work, perseverance, the possible sign of "God's blessing", and the idea of accountability. With power comes responsibility for actions. Of course Adam Smith reminds us, "capitalism works best on a moral foundation." Calvinist morality placed a high priority on personal obligations toward the poor and less fortunate and honest business dealings.

Many years ago, George Draper Dayton (whose grandson founded Target) gave a commencement address at my alma mater; Macalester College, a small liberal arts college in Minnesota (Kofi Annan is also a graduate of Macalester). The title of the address was "*Success by Contribution, Not by Acquisition.*"

He was a very generous person supporting higher education, the poor and many other good works. He laid the foundation for a very successful and useful company. Much of the founding philosophy (the 5% pre tax policy of giving back to the community) is still being followed by Target today. When I went to work for the company my bosses-Bruce and Ken Dayton- explained how the company perceived their mission: "Think of the company as a circle and a box. In the square we'll hire the very best people and manage in the best professional way with honest dealings for employees and customers. But this box is placed in a circle. The circle is the community, therefore we will use our profits and management to build healthy communities. We will all do better in healthy communities. Yes even our cash registers will ring more often in healthy communities." Today it's the world. They set up a special Environmental Department reporting to the Chairman with the charge to build healthy communities where their stores were located. George Draper Dayton, who believed in tithing- set aside 5% of the pre-tax profits(which was the maximum allowed for tax purposes) for the foundation to use to build healthy communities. There were only two companies originally using 5% for this purpose: S.H. Green

Stamps and Dayton Hudson. The Daytons provided the leadership to organize a 5% club in Minneapolis of corporate givers, which is now called the Keystone Club, and is administered by the Chamber of Commerce. It now has some 270 membered firms in the Twin Cities. President Kenneth Dayton took this idea across the country and there are now 5% and 2% clubs in a number of major cities. I had a major responsibility for this program. Managers were held to high standards and given tough business and profit objectives to achieve. They were also measured carefully on their community participation. For example, what were they doing on a Chamber of Commerce Board – to use the influence of business to solve the most pressing problems in the community? They were measured on their community service. Our department was given the responsibility to monitor this process. The Dayton brother's application of their grandfather's theology impressed me. I liked what Kenneth Dayton said when he was President of Dayton Hudson (perhaps the best retail firm for the U.S.), "I happen to think that being a C.E.O. for a Corporation, large or small, is every bit as high a calling as being an educator, or being in the field of religion, medicine, law or any occupation. The C.E.O. has the opportunity to impact a community more than almost anyone else, and therefore it is an incredibly high calling and opportunity to make this community and this nation (today the world) a better place." He went on to say: "I believe the only reason for this existence of the free enterprise system is to serve society, therefore I believe that every business must define for itself how it will serve society. Profit is a reward for serving society well." Remember these words contained the guiding philosophy of the head of Target, one of American's most important retail firms. This value system should be discussed in business classes today preparing our future business leaders. I'm worried when I read in the Financial Times last week; M.B.A. business students cheat more than other university disciplines. I don't believe this but it sounded alarm bells. Our firm was a leader on many social and environmental fronts, including leading in many successful and good government initiatives. We were leading funders of the arts. We promoted the best of urban planning and job creation.

Time doesn't permit, but I could tell similar stories of my work in Chicago, where I was President of Chicago United, an active group of Chicago's most powerful C.E.O.'s. This was their most important Civic Assignment. They each had a key high profile assistant who had community responsibilities. We worked closely with Mayor Daley and the city's top officials. We had Clout! We literally took over the School System: its board, its finances, the training of their 500 Principals, started a K-12 in classroom, initiated career education effort, putting business executives in the classrooms. We turned around their Economic Development Authority. We ran the largest On the Job Training Program in the country. We were responsible for the nations largest Summer Jobs Program for Youths. We started and strengthened Minority Businesses. We turned around Public Housing. Job creation and enhancement was front and center. Yes, we were very effective in turning around Chicago, which is known as Clout City. The business community and the mayor working together accomplished great things for Chicago.

The values of leaders do count. In Kansas City, I was hired as President of The Greater Kansas City Chamber of Commerce to turn around this troubled city. The results of value centered leaders from companies like Sprint, Hallmark, Yellow Freight, the Banks, Utilities and Construction Industry were amazing. In partnership with the mayor and other senior government leaders, we improved substantially the health of the community. The business leaders through the Chamber became the lobbyist in government centers for the best of the community and quality of life. Job creation again was given high priority.

Later I turned to volunteering in developing countries, using my career experiences. This included working with I.E.S.C. (International Executive Service Corps) that worked with business leaders on major projects in South Africa, Lebanon, Egypt (turning around the City of Alexandria), and Mauritius; with minor efforts in Kenya and Ethiopia. This organization, I.E.S.C. was founded by David Rockefeller and other top business people.

Let me briefly outline a significant business success involving the Country of Mauritius, where I had the responsibility of reorganizing the oldest Chamber of Commerce in the Indian Ocean. In discussions at night with visitors, I learned much about the abuse of corruption into many business dealings in Africa, the Middle East and Asia. I decided this was an opportune time to establish a global set of ethical business principles. Therefore, I went back to Minnesota where I was serving as President of the Minnesota Center for Corporate Responsibility (MCCR). We assembled leaders from global companies like 3M, Cargil, Honeywell, Metronics, and others to put in writing our Minnesota Values of doing business in ethical ways. I received an invitation to make a presentation in Switzerland to a global business leadership group called the Caux Round Table. At the meeting were top executives; like the Chairman of Canon, Nestle, the future Chair of Nissan, the outgoing Chair of Honda, Fritz Phillips; the founder of the large Phillips Company, and top leaders from U.S. Companies. The results were most encouraging. They adopted our report and asked me to chair a global business group to prepare the *Caux Round Table Principles for Business*. They cover our Company Values for all stakeholders and responsibility for customers, employees, competitors, suppliers and the community. We cover corruption, honest dealing and the environment. They are now in some 16 languages and are among the most widely circulated in the world today.

The Chairman of the Caux Round Table, Win Wallin – the former Chairman of Medronics Inc.- developed a useful paper entitled: *The Greatest Responsibility to the World Business Community – Making it Possible for Poor Nations to Share Prosperity*. Last month, Win Wallin shared this paper with Bill Gates.

Secretary General of the U.N., Kofi Annan, speaking at the World Business Summit Davos, challenged global business leaders to join forces with the U.N. to address major global issues. With partners like the International Chamber, they developed the Nine Principles of the Global Compact. I had the privilege of being appointed by the Chair of the International Chamber of Commerce to represent him at meetings around the world on the U.N. Global Compact. What I've discovered is that the kind of Values Business People have, matters greatly. I'm impressed with a

new book by Doug Lennich and Fred Kiet, who consult with leaders of major U.S. and global firms. Doug Lennich still serves as Executive Vice President of American Express financial. They make the case that we all have *Moral Intelligence In Our DNA*.

I don't have time to elaborate on this, but they make a convincing argument supported by the well known writer, Steven Covey, "We are all hard wired to be moral." We are born that way -to be moral- but we're also flawed and can stray from that moral underpinning. They make the case that the major religions of the world all preach common values; responsibility, respect, the golden rule, caring for other living things and the environment, justice, honesty, and integrity.

I'm still working on a business project with Caux Round Table formulating the Common Principles we have in Islam and the Christian Judaic Faiths. This is becoming more a business issue, because religion is important in Middle East and Asian cultures, where religion is significant to Muslim business people. The former Chairman of Canon, R. Kaku, developed a compatible set of ideas now incorporated in our Caux Round Table Principles for Business called "Kyosei – Working in Harmony for the Common Good, Reducing Social and Economic Threats to World Peace and Security."

The issues on our table today are immense, affecting the quality of communities around the world. The challenge for business is to organize, to use its power for the good of citizens around the world. The good news is that I believe business can and must perform a leadership role with global institutions, and address our most pressing issues affecting the global quality of life on this precious planet. It's in everyone's self interest. It's also the right thing to do. Business does have enormous power to act responsibly and address the global issues with a human face. Business leaders in their self interest and citizens everywhere must bring the best moral values to the table. If we really want to exercise our power for the best of our children and future generations, business with their thinking platforms must show the way. We do have immense ingenuity and power to prepare a brighter future.

I've had the privilege of working at the top with moral business leaders and witnessing what "values centered" leaders can do in positive ways. The great need today is for moral leadership from business, to reshape the human face of business. We've done it before. The need is ever greater today. Where are the new giants of Business today? Where are the Dayton, Kakus, the Wallins, and depression era leaders? It's time to wake up and give our best moral leadership.

We're all challenged to do our part. Thank you!

Corporate Responsibility – Essential!

Bertram Huber

Everybody in business is bearing responsibility, and indeed in a dual if not even multiple role. On the one hand there is responsibility for the business. But at the same time, there is of course responsibility for the own family, the own children. So, in a wider scale, this turns kind of automatically into responsibility for society. Society, though, today cannot any longer be perceived as national or regional only. We are facing society in a global way today.

Even though it can be considered as a good start, mere adherence to laws and regulations only, e. g. by observing constraints from labour laws or by avoiding illegal tax evasion, in a way that might be called legalistic, appears not to be enough. Additionally required there is an adequate, decent, well – as said above – responsible behaviour; in German I would probably use the term “anständig”.

Let me try to exemplify this with the company I am working for (and bearing responsibility in), Robert Bosch GmbH, Stuttgart. The company’s founder, Robert Bosch, started early on with the effort to establish harmony between the strive for entrepreneurial success and social orientation. In his own words: “It was not always easy to keep the right balance between the entrepreneur who has to survive and the socially oriented businessman, i. e. employer who wanted to leave to its associates a decent salary.” (1936).

Today, in addition to, and at the same time as part of, societal issues, in the interest of acceptable living circumstances and even in the interest of survival of mankind, much focus needs to be put on environmental topics. This is why Bosch is spending more than 40 % of its R&D budget for developing products which protect the environment and save resources. In 2007 alone such spendings ascended to over 1.5 billion €

At the same time, activities to protect the environment, such as heat recovery, reduction of use of water and electrical energy, avoidance of using solvents, in the company’s manufacturing activities are applied in all locations around the globe. The same standards are required from our suppliers. All of this coincides with a slogan we have been using for many years: Sicher, Sauber, Sparsam (Safe, Clean, Economical).

The present Chairman of the Bosch Board of Management, Franz Fehrenbach, when taking over in 2003, was well in line with the founder’s commitment when he stated: “To keep the balance between securing the company in the long run and both social and ecological requirements I see as my core responsibility as Chairman of the Board of Management of Bosch.”

From all of this it flows quite naturally that Bosch is a member of international networks such as Global Compact (U.N.O.), World Business Council for Sustainable Development and Transparency International. At the same time, the company

is very serious in expecting and, where need be, enforcing compliance from its associates. Beyond that, there are quite a number of further scientific and social activities of the company as well as upon initiative of its associates, the details of which, for time constraints, shall not be elaborated further.

At the end of the day, it needs to be mentioned that the industrial enterprise Bosch is by vast majority owned by a charitable foundation (Robert Bosch Stiftung GmbH) which concentrates its activities largely on science, research, health care, understanding among nations and people, education and culture.

To summarize, responsibility, as outlined at the beginning, is a reality within Bosch, comprising the company, its associates and its shareholders.

Before concluding, allow me to focus on my personal responsibility within Bosch for the field of Intellectual Property. There has been in recent years a lot of public discussion – which occasionally has turned out somewhat one-sided. Let me cite the field of pharmaceutical products – not a field of Bosch's activities. There, early on, the call for compulsory licensing and free transfer of technology was heard. In such type of discussions and arguments, it appears to me, often the context of responsibilities was neglected: There is a public responsibility to solve health problems, especially in developing countries; such responsibility naturally bears very much on the shoulders of the developed, "saturated" countries. It cannot be shifted, though, to the respective producing companies alone, which with their heavy investment into multi-billion €(or – a bit more – USD) R&D projects.

In public perception, there is a noticeable lack of distinction of the basic apportionment of responsibilities between the public and the private sector. In saying so, there shall be, of course, no subtraction whatsoever from the level of responsibility demanded from anybody whatever function she or he may fill. It simply does not make sense to overburden the private sector, or just parts thereof, in a way which obviously cannot work.

Comparable "excessive" expectations have already been uttered vis-à-vis the medical devices and the environmental industries. What of course is needed, from both the governments and the industry, are creative programs and adequate price policies, such as tiered pricing systems (as described earlier by Herr Barner of Boehringer).

What would probably help in general, and this is why it is specifically suggested, are as widely as possible generally accepted "Codes of Conduct" – not just directed to the public to appear "good" but seriously intended and enforced in practice. For the Intellectual Property field, some time ago a Code of Conduct ("Model Patent Owner Behaviours") has been elaborated by the U. S. Intellectual Property Owners Association (IPO), calling for a fair, adequate, moderate approach when enforcing IPRs. This could be followed by other Codes of Conduct in other comparable fields, such as filing of patents.

At the end of the day, as a simple but convincing answer alike, I always suggest the "mirror test": In the morning, after getting up, have a look into the mirror in your bathroom and judge yourself, whether or not you are looking into the face of a person with an adequate, decent and fair approach in all of its business and personal activities.

Discussion

There is no doubt whatsoever that the rule of law is an indispensable prerequisite. Still, there should be no overregulation as it sometimes tends to get lost in details and then often hinders the originally intended objectives. But it remains clear that regulations can change behaviours.

The “democratic part” of our global society, the Non-Governmental Organisations (NGO), play a very important role as well. One fundamental problem, however, lies in the fact that it appears that they operate in many cases too little fact based. Profound expertise instead of firm conviction, if not to say ideological one-sidedness, would further solution-finding dramatically.

There is also a need for more international agreements. WTO, TRIPS and others have played a very positive role in helping the economies develop in many parts of the world – not completely eliminating all types of undesired distortions, but making possible substantial steps forward. This should be extended to other fields, like labour and social standards. The lack of “strong” sanction mechanisms should not serve as a counterargument, as we should not underestimate the efficiency of sanction and boycott mechanisms, as are available under WTO, and the power of public opinion.

Session III

Towards Creating the Right Kind of Globalisation – Why it does not happen, and what to do about it

Prabhu Guptara

1. Introduction

Our global economy, though marked by deep and urgent social and ecological problems, is underpinned by law and ethics. So it is self-evident that our social and ecological problems must be related in some way to at least some of our existing legal and ethical concepts and practices. It is also self-evident that while there are cultural differences in values and ethics¹, the right kind of globalisation would ameliorate rather than exacerbate social and ecological challenges, as our boom-bust economy does by its very nature².

I will first outline the four key issues in our globalising economy; second, explore the background to some of these issues as well as six consequences for our day; third, consider the flouting of law around the world today, exploring the roots of the phenomenon; and, fourth, present some proposals for creating the right kind of globalisation.

2. Four key issues in our globalising economy

2.1 Our unprecedented wealth

The first thing to understand about today's economy is its historically unprecedented wealth. Kings and emperors of past years had splendid buildings but,

¹ Guptara, *Ethics Across Cultures*, Journal of the Royal Society for the Encouragement of the Arts Commerce and Manufactures, 1998, issue 2, pp. 30-32. For an excellent discussion of a globally-acceptable definition of "integrity", see *Reporting with Integrity*, Institute of Chartered Accountants of England and Wales, 2007.

² For the details of the argument concerning the source and effects of a boom-bust economy, see Guptara, *Was Niemand Sehen Will: Die Folgen Eines Auf Zins Beruhenden Weltwirtschaftssystems*, in Weis/Spitzeck, (eds.), *Der Geldkomplex: Kritische Reflexion unseres Geldsystems und mögliche Zukunftsszenarien*, 2008. Banks, insurers and investment houses have faced a crisis since summer 2007. They have "recorded more than \$400bn (£203bn, €257bn) in losses ... (and have) been forced to raise \$300bn-plus in capital at bargain basement prices," (*Financial Times*, 26 June 2008). Since 2006, approximately 100 million people have been pushed into poverty as a result of increased food prices, according to Vikram Nehru, the World Bank's Director of Poverty Reduction and Economic Management and Acting Chief Economist for East Asia. The deep logic of religious and quasi-religious (i.e. market-fundamentalist) convictions has deeply influenced people's ethical responses to globalisation. Research by Peter Berger and Benjamin Freedman demonstrates that those who seek solutions to the adverse effects of globalisation, tend to be those who embrace progressive forms of classical religious traditions – e.g. Stuckelberger, *Chances and Challenges for ICT*, *International Review on Information Ethics*, July 2008, issue no. 2.

thinking of variety and quantity of food, clothes, entertainment or housing, their actual standard of living did not match that of even most middle-class people in developed countries today. Technological developments enable us to produce far more than humanity needs of everything from potato chips to computer chips, from clothes to homes and buildings, from rice and wheat, through beer and wine, to aeroplanes and cars. In car production alone, we have 30% over-capacity world-wide (a calculation from the height of the boom, before taking into consideration the factories coming on stream in countries such as Brazil, China and India). In steel, chronic overcapacity forced down prices by more than 2% annually for the 25 years to 2002 – though there has been an increase in the prices of all metals, partly as a result of what I fear will be a temporary boom in demand, and partly due to speculators. In fibre-glass cables, we have already laid enough to have theoretically unlimited capacity to transfer images and content across the globe.

The *positive* effect of such capacity to over-produce is that the only remaining obstacle to the abolition of absolute and even relative poverty is value-systems that allow the emergence and/or sustenance of kleptocracies that keep people in thrall, as in most parts of Asia, Africa, Eastern Europe and Latin America. Robbers, thieves and murderers also ruled in pre-Reformation Europe – but the people here freed themselves, so there is cause for hope for similar liberation elsewhere.

The *negative* effect of our capacity to over-produce is that, in marketing terms, 'it is war out there'. With global over-supply (whether of banks, postal systems, manufacturing capacity, or education providers), there will necessarily be bankruptcies and/ or consolidation – indeed, as I have argued elsewhere, right across industries³.

Further, as a consequence of our capacity to over-produce, the basic assumption of the whole of economic theory, resource scarcity, is being called into question. There only two kinds of 'scarcity' that are left. First, energy – though we should be able to overcome that, given the theoretically unlimited amounts of solar, wind, wave, and geothermal energy available – once we develop sufficiently efficient ways of harnessing those. Second, the capacity to recycle our waste products, such as batteries and nuclear waste. One key hindrance to addressing social and environmental costs is that they are not taken into account in risk-analyses, company balance sheets and national GDP accounting. Elites fight hard to privatise economic gains and socialise environmental costs. However, social and environmental costs can be properly represented in accounts, not merely by means of some sort of 'environmental audit' accompanying the accounts, but a co-ordinated change in accounting laws and practices at least in the USA and Europe. Fortunately, work has already begun on this⁴, though sceptics would say that we have a long way to go before we get anything like agreement within countries, let alone across them.

³ Gupta, *Managers Lives, Work and Careers in the Twenty First Century*, in Cooper (ed.) *Leadership and Management in the 21st Century*, Oxford University Press, 2005.

⁴ See, for example: www.beyond-gdp.eu; and www.epa.gov/opptintr/library/pubs/archive/acct-archive/pubs/final.pdf; Letmathe/Doost, *Environmental cost accounting and auditing*, *Managerial Auditing Journal*, 2000, 15/8, pp. 424 -431.

‘Green taxes’ are creeping in, but are primarily ways for governments to raise additional income without any commitment to devote the resulting revenues to ‘green’ matters. Moreover, most such taxes are at present are both marginal and inappropriate⁵. There are cultural, psychological, social and political matters involved here – but such reform in accounting law and accounting ethics is the first key need.

2.2 Our unprecedented poverty

By contrast, the second issue in our globalised economy is unprecedented poverty. Never earlier in history have so many people lived in absolute poverty – something like a third of humanity, two billion people, live on less than two dollars a day. The percentage is undoubtedly smaller than it has ever been, but that abstraction does not dent the fact of the sheer numbers in today’s grinding poverty. Earlier, poverty had the consolation of community. Most people were in the mess together and were not actually starving, as they lived on the land. Further, the rich did not live entirely in their own ghettos, isolated from the poor as they do today, and the gap between the rich and the poor was in any case nowhere near as large as it is now. The new poverty hurts because the people who rummage the rubbish bins for food do so in sight (really or virtually) of multi-billionaires. Nothing wrong with having multi-billionaires of course – more joy to them! – but can a global society really tolerate existence holding nothing but *avoidable* suffering for other human beings? In times before the power of machines and ICT (the Information and Communication Technologies), widespread human hunger was ‘merely’ an unavoidable tragedy. Today, with the possibilities and actualities of over-production, human deprivation is not only a tragedy, it is also a scandal.

What would it cost to provide a minimally-humane standard of living to the two billion who are underprivileged? Actually, not that much, and certainly not as much as it costs to provide research, development, manufacture, maintenance, supply and deployment for the arms industry alone⁶. I am not a peacenik; I point to a slightly

⁵ The Economist now favours encouraging alternative energy sources by ‘taxing carbon (even knowing that places like China and India will not) and removing subsidies that favour fossil fuels’ (‘The Future of Energy’, 19 June 2008). The massive subsidies heaped on the oil, coal, gas and nuclear industries, if shifted to production tax credits, can accelerate the growth of renewable energy, as can lower taxes on incomes and payrolls, while taxing waste, pollution, planned obsolescence and resource depletion. Windfall taxes on energy company profits would help too, especially if they could be offset against investments in alternative technologies, or in new supplies or facilities. See also: www.house.gov/stupak.

⁶ The US spends some \$700 billion per year on defence – almost as much as the rest of the world put together. Dwight D. Eisenhower once pointed out that “Every gun that is made, every warship launched, every rocket fired signifies, in the final sense, a theft from those who hunger and are not fed, those who are cold and are not clothed. The world in arms is not spending money alone. It is spending the sweat of its labourers, the genius of its scientists, the hopes of its children... This is not a way of life at all, in any true sense. Under the cloud of threatening war, it is humanity hanging from a cross of iron.” (in “The Chance for Peace” address delivered before the American Society of Newspaper Editors, April 16, 1953; available at: http://www.eisenhower.archives.gov/speeches/Chance_For_Peace.html).

better balance that, if achieved, would dramatically diminish the probability of wars. Wars are usually started by elites to buttress or extend their power at the cost of the average person in the regions they dominate. However, even a cursory glance at today's war zones and poverty levels demonstrates that the material circumstances of a region may play a significant part in encouraging or discouraging wars.

2.3 Ecological problems

The third issue for our globalised economy is our ecological problems. Though a minority of scientists doubt the relationship between the nature of the global economy and global ecology – e.g. in the area of global warming – the majority of scientists seem to agree that there may well be some relationship. In any case, most of us aspire to be responsible citizens. Providing incentives for global companies to move from the developed world to the developing world in order to escape taxes, dump waste, and evade pension, health and safety obligations is not entirely sensible for a globalising world where unhappy social, political, economic or ecological situations impact not only near neighbours but also distant countries. For example, the plume from the 1986 Chernobyl disaster in Ukraine spread over parts of the western Soviet Union, Eastern Europe, Western Europe, Northern Europe and even eastern North America! The 1997 forest fires in Indonesia created a haze problem not only for that country but also for Singapore, Malaysia and other countries⁷. Piracy is another area which is related to poverty, and terrorism may also have some roots in poverty⁸.

2.4 Volatility

The fourth issue in our economy is volatility. Some people used to theorise that if national barriers, information opacity, subsidies and distortions such as in tax regimes were swept away, the global economy would function more or less smoothly. By contrast, it is quite clear that the more globalisation we have (at least globalisation of the current sort), the more volatile the economy becomes. Since the fall of the Berlin Wall, a marker for the current phase of globalisation, we have seen many more booms and busts in the economy than earlier. So the key issue in our economy is NOT growth, as is constantly chanted like a mantra by the high priests of orthodoxy. Thanks to the mesmerisation of our society by that chant, we are now

⁷ Dauvergne, "The Political Economy of Indonesia's 1997 Forest Fires", *Australian Journal of International Affairs*, 52 no. 1, April 1998, pp. 13-18; Glover/Jessup (eds.), *Indonesia's Fires and Haze: The Cost of Catastrophe*, Singapore, ISEAS, 1999.

⁸ Tan/Boutin (eds.), *Non-traditional Security Issues in Southeast Asia*, Singapore, Select Publishers for the Institute of Defence and Strategic Studies, 2001; Djalal, *Piracy and the Challenges of Cooperative Security and Enforcement Policy*, *Indonesian Quarterly*, 30 no. 2, 2002, pp. 106-116; Liss, *Maritime Piracy in Southeast Asia*, in Singh/Chin (eds.), *Southeast Asian Affairs 2003*, Singapore, ISEAS, 2003, pp. 52-70; Warren, *Iranun and Balangingi: Globalization, Maritime Raiding and the Birth of Ethnicity*, Singapore, Singapore University Press, 2002; Young/Valencia, *Conflation of Piracy and Terrorism in Southeast Asia: Rectitude and Utility*, *Contemporary Southeast Asia*, 35 no. 2, August 2003, pp. 269-283.

in our second global bout of stagflation. The first-ever bout of global stagflation, which lasted some ten years, was ended by President Reagan's formula of reducing the growth of government spending, reducing marginal tax rates on income from labour and capital, reducing government regulation of the economy, and controlling the money supply (in order to reduce inflation). The global economy has been following the first three precepts ever since his time – though, since the dot com bust, the USA has been printing more and more money.

Monetary manipulation is a game that most countries can play. Not surprisingly, most countries joined in, led by China and India. With the money supply growing at about 10% a year, there is simply too much money in the world. Inflation is the natural and necessary consequence. In spite of all that governments can do to try to hoodwink us into looking only at official measures of inflation, we all know that the official 'basket' does not measure the reality of the price of housing, transport, medical, legal or school bills. All of us could see 'crazy' prices being paid – whether for companies, real estate or works of art. There was a fundamental disconnect between the fancies invented by the elite⁹ and the real experience of humanity. Well, reality struck! It is not clear whether printing yet more money – the same as giving more poison to a sick person – is going to get the global economy back to any kind of health. The painful medicine, control of the money supply, will need to be given. At present, the authorities continue to print more money while trying to reduce the speed of movement of this money by raising the interest rate. But the quantity of money is one thing, the speed at which it might move is another. The two are related but should not be confused.

Is it possible to have a globalising economy that is not marked by extreme wealth, extreme poverty, and unacceptable levels of environmental damage as well as unacceptable levels of volatility? To answer that question, it is necessary to have a bit of background.

3. How did we get here?

Throughout recorded history, there was not much to choose, except occasionally, between the different geographical parts of the world: all were marked by relative ignorance, poverty, and material exploitation by elites on the basis of brute force compounded by legal systems they created or manipulated for their benefit¹⁰. Naturally, some rulers were relatively enlightened while others were mere looters. This was historically the 'normal' situation.

⁹ Consider Alan Greenspan's invention and promotion of the idea that the dot.coms had created a "New Economy" – which ended in the "dot.com bust"; and his urging US borrowers to jump to adjustable rate mortgages, hailing the new derivatives as "financial innovations that spread risk to those able to bear it" – which ended in the "sub-prime crisis".

¹⁰ Since 1989, the antics of Silvio Berlusconi, the Italian politician, entrepreneur and media promoter, are a case study in how to manipulate the law. Similar studies can be carried out of the actions of many current politicians from Mugabe through Putin, to the European Commission and the European Parliament which continues to flout the popular will as expressed in referenda in the Netherlands, France and Ireland.

The first part of the world to escape that historically ‘normal’ situation was Northern Europe – and that was entirely due to the Protestant Reformation, to which we owe in fact everything that we value in our modern world, in contradistinction to the pre-Protestant world. Among other things, the Protestant Reformation resulted in an unprecedented entity, the nation state, in which individuals were no longer subjects but acquired the dignity of citizenship. In principle, the Reformation also produced freedom of thought (including the freedom to be an atheist or agnostic). It produced the first societies marked by that peculiar combination (the rule of law, a serious work ethic, and modest lifestyles) which led to the accumulation of wealth among ordinary people. This was allied with the notion of civic responsibility, summed up in the dictum: ‘Earn as much as you can, save as much as you can, give away as much as you can’.

Perhaps the greatest achievement of the Reformation was the inculcation of mass education and a culture of debate (and of loving one’s enemy). This caused not only democracy to flourish on a sustainable basis for the first time in history, but also gave birth to modern science – which laid the basis for continuing material progress. Though scholars such as Weber, Tawney and Millendorfer¹¹ have studied aspects of this, scholarship has paid little attention to the concatenation of the above factors that led Europe, from being one of the poorest parts of the world, from times immemorial and right up to the sixteenth century, into becoming one of the richest parts of the world by the start of the nineteenth century. For that startling fact, there is no intellectually satisfactory explanation other than that which I have just put forward – at least, none that I have seen (I should, at this point, make it clear that, though I follow Jesus the Lord, I am a Hindu).

Though nation states provided Europe with a framework for progress, these were and remain contested spaces, fought over by reformers on the one hand, and on the other hand by the old exploitative elites, whom I call ‘establishmentarians’. However, members of the old elite have themselves occasionally become reformers. Some among them were probably mere pragmatists (e.g. Bismarck, various royal families, and the post-WWII Conservative Party in the UK), while others were drawn to action by values and ethics (e.g. William Wilberforce and his Clapham Circle, whose titanic achievements were to abolish the slave trade and, more important, to clean up Britain which was one of the most corrupt countries in the world and became through their efforts one of the cleanest, most transparent, and most

¹¹ Max Weber’s most influential work is *The Protestant Ethic and the Spirit of Capitalism*, available in several translations from 1904 onwards. However, *Max Weber on Law and Economy and Society* (first translated in 1954) is certainly most interesting in the context of our topic, as is R. H. Tawney’s *Religion and the Rise of Capitalism*, first published in 1926 and now available in numerous editions. Millendorfer, *Hemmfaktoren einer gerechten industriellen Entwicklung*, in *„Vereinigung der Politologen an der Hochschule für Politik“*, München (eds.): *Energie und Gerechtigkeit*, Interdisz. Reihe Nr. 6, Minerva Publikation, München, pp. 64-101; Millendorfer/Gaspari, *Immaterielle und materielle Faktoren der Entwicklung. Ansätze zu einer allgemeinen Produktionsfunktion*. *Zeitschrift für Nationalökonomie* 1971, 31, pp. 81-120; Millendorfer/Gaspari, *Konturen einer Wende. Strategien für die Zukunft*, 1978.

reliable countries¹²). In addition to such members of the old elites who betrayed their exploitative heritage, there were officially-NON-Protestant reformers (including, today, even Roman Catholics). Indeed, as can be seen from the history of countries outside Europe and North America, most reformers came from backgrounds other than Christian. For example, in India, apart from the initial impetus provided by the work of Ziegenbalg and Carey (who laid most of the cultural foundation for the emergence of India as a nation¹³), most of the reformers were Hindus¹⁴. In the same way, contemporary reformers in the Middle East, whatever we think of the kinds of reforms that they are introducing, or would like to introduce, are all Muslims. One could, in fact, provide examples of major reformers in the context of their own societies from all around the world, with people from Buddhist, Shinto, Confucian, Communist, and Tribal backgrounds.

We may put it briefly thus: the Protestant Reformation made northern Europe uniquely hopeful, in contrast to the perennial fatalism of the world before then, leading to the birth of notion of ‘progress’ and of ‘modernity’. This became secularised, and led to a wave of reformation across most parts of the world. The unreformed elites (‘establishmentarians’) were forced to concede to the reformers point after creeping point in the fields of education, science, technology, business, institutions, social structure, politics, law, and so on – to the great advantage of most people around the world. We thus had three centuries of reformation.

By the 1970s and 1980s, however, we have something strange: the old starts becoming the new! In other words, the space between the old unreformed but defeated establishmentarians and the victorious reformers starts getting muddled, specifically in the West. New spokespeople for the old establishmentarians, the ‘Neo-Olds’, start presenting the traditional values of the old elite as ‘modern’ values – e.g. they start presenting as ‘modern’ the idea that ‘greed is good’ or that ‘the prime purpose of life is to acquire as much as you can’. Let me emphasise the difference between the establishmentarians and the Neo-Olds: the establishmentarians fought unsuccessfully against the reformers to preserve their power, pelf and perquisites; the Neo-Olds arose from the largely-defeated establishmentarians, and fought back against the reformers in order to take power again and to reverse the reformers’ achievements in social justice, political freedoms, cultural balance, and so on.

From the 1980s, we see the triumph of these Neo-Olds, starting in the USA under President Reagan, jumping across the ocean to the UK with Prime Minister Thatcher, and hence to the whole world. One result was that tax systems were

¹² Tomkins, William Wilberforce – A Biography, 2007; HEYCK, The Transformation of Intellectual Life in Victorian England, 1982; BRIGGS, The Age of Improvement: 1783-1867, 2nd ed. 2000.

¹³ Mangalwadi, William Carey, 1997/Sing, Bartholomeus, Ziegenbalg, 1999.

¹⁴ Raja Rammohan Roy, Keshub Chandra Sen, Swami Vivekananda, Swami Dayananand Saraswati, Mahatma Phule, Mahatma Gandhi, Dr. S. Radhakrishnan, and so on. Reformers, not influenced by the West to the same extent, though influenced by Islam and Christianity, include Kabir (the 15th century hymn writer and religious reformer), Guru Nanak (the founder of Sikhism), and Swami Narayana (the Gujarati founder of a sect named after him).

changed to favour the rich and disadvantage the middle class: in just seven years, the income tax rates of the top personal tax bracket dropped from 70% to 28%; on the other hand, the effective tax rates on the lower two income quintiles increased, as did payroll taxes. With the sub-prime crisis and the global credit crunch¹⁵, are we at the end of the wave of global triumph of the philosophy of the Neo-Olds? In any case, the period from the 1980s to the present might be called the period of the Triumph of the Neo-Olds, or the Revenge of the Non-Reformed.

Meanwhile, the sovereignty of the nation state has been diffused because of developments in science, technology, industry, business, law and politics, so that the contested space is no longer simply within nation states, it is now also across nation states, in the new international institutions, as well as in the struggles for the kinds of new international institutions that might be built. Instead of having a world marked only by a sort of civil war between reformers and Neo-Olds within countries, we now have what may be, somewhat exaggeratedly, described as a 'global civil war' between reformers and Neo-Olds.

The first consequence of this history is that there is a question regarding the future of cross-border institutions (the media, the UN and its bodies, the British Commonwealth, the European Union, et. al.) which have been built since WWII on the basis of reformist ethics, for example in their rules and codes of conduct¹⁶. Will such institutions continue to deliver the blessings of the Protestant Reformation to the world, or will there be a sort of 'global strikeback', for example by conglomerations of non-democratic states allowed to become as powerful as democratic states? Or by the media returning to the role they had in Pre-Reformation Europe – that of a sort of opium, similar to the role of circuses in the Roman Empire, delivering entertainment to console and distract the masses? Whatever may happen in the future to the cross-border institutions whose basic structure was up to now settled in favour of reform, there are also many emerging issues, at present perceived as 'marginal', which are still to be settled. These could become central in the relatively near future – e.g. robots, nanotechnology and transhumanism¹⁷.

The second thing to comprehend, regarding the current state of the 'global civil war', is the sub-prime crisis, which is covered in detail elsewhere in this volume. I will say only that the entire phenomenon was caused by the domination of the Neo-Olds over the last quarter century. If the philosophies and ideologies of the Neo-Olds have their comeuppance as a result of the crisis, that will provide the only basis on which the roots of the crisis can be addressed. Those are also, by the way, the roots of financial, political and social crises that will otherwise be upon us.

¹⁵ The sub-prime crisis has now affected some 8% of global GDP, versus 3% that was affected by the LTCM crisis, and 10% that was affected by the Japanese crisis in the 1980s.

¹⁶ Though multilateralism is nowadays often about achieving agreement at least on the lowest common denominator. In contrast, globalisation is driven by the latest innovation in technology.

¹⁷ Gupta, Will Japanese Robots Rule the World by 2020?, <http://www.theglobalist.com/DBWeb/StoryId.aspx?StoryId=5084>; 'Will Robots Take You're your Job?', <http://www.ethix.org/article.php?id=334>; Cameron/Mitchell, Nanoscale: Issues and Perspectives for the Nano Century, 2007.

The third matter to comprehend, in the context of the current state of the ‘global civil war’, is the struggle for what kind of World Trade Organisation we should have. Much of our global challenge in the matters of ecology and social injustice goes back to the creation of the North Atlantic Free Trade Agreement (NAFTA) – the ideological precursor of the kind of World Trade Organisation (WTO) we have. The key personalities in relation to that treaty were President Clinton and Vice-President Al Gore. They had touted, as part of their election platform, a pledge to sign the NAFTA Treaty only if it included environmental and human safeguards. However, they abandoned those commitments, and Clinton signed into being a NAFTA that specifically excluded environmental and social considerations (details, for example, in Jeff Faux’s *The Global Class War*, Wiley, 2006). Meanwhile, Al Gore has now disgracefully been awarded the Nobel Prize, even though he has never acknowledged his own contribution to environmental disaster. In any case, the main struggle regarding the new WTO treaty is the inclusion or exclusion of environmental and social justice questions. For example, agriculture needs to be taken out of the remit of the WTO – or to be left in, but with the duty of ensuring that local production is always preferred to imports from distant places. But perhaps the latter point will now be taken care of by natural forces, so to speak, if energy and therefore transport costs continue to become more and more expensive¹⁸.

¹⁸ Gazprom, for example, has predicted that the oil price will reach \$250 a barrel in 2009; my own view is that, while supply constraints and rising demand have effected and will effect the price, much of the price rise since 2005 is due to speculation (<http://www.prabhuguptara.blogspot.com>); specifically the entries for 9 May, 3 June and 11 June 2008). The urgent priority of curbing speculation is shown by the fact that 630 hedge funds and others had futures contracts worth \$8 trillion for oil alone in 2007. Esoteric derivatives (CDOs, SIVs, CDSs) were of the value of \$62 trillion in 2007. Daily currency trading is of the order of \$2 trillion. Money, an important invention, retains its usefulness only if it is a more or less accurate gauge of the value of the products and services in the real economy. Pyramiding paper or electronic “assets” inevitably leads to busts and write-downs, dislocating not only speculators but also the rest of the economy – with additional new pressures on the poor and on the environment. Most expert testimony from independent financial players, to the US Congress Energy and Commerce Committee and the Joint Economic Committee of the House and Senate in 2008, agrees that if the Commodities Futures Trading Commission (CFTC) were to implement moves such as 50% margin requirements (and full disclosure of hedge funds, of the volume of “paper barrels” versus real barrels of oil, and of institutional investor positions in the oil and commodities futures markets) the price of oil would drop to somewhere between \$70-100 per barrel within 30 days. “Financial sectors of the US, UK and other market economies (have) metastasized – just as they (did) prior to the Wall Street Crash of 1929. In Britain, finance represents 25% of GDP and over 20% in the USA. Too many people are now employed in trading, borrowing and financial engineering, rather than in producing real goods and services” (Henderson, Hazel ‘Changing Games in the Global Casino’, InterPress Service, 2008, available at www.ethicalmarkets.com). The single most helpful step would be to curb the \$260 billion in index funds tied to oil and other commodities – or repealing the “Enron loophole” passed in 2000 that de-regulated energy trading in the USA. The world’s central banks are mainly preoccupied with manipulating interest rates. However, they could also increase the capital reserves which must be held by banks and, further, raise margin requirements on stock purchases, forward trades and leveraged finance transactions. Additional reforms which are needed in the global financial casino include greater transparency and oversight of hedge funds, private equity and sovereign wealth funds.

The fourth thing we need to note is that we live in a world where companies grow bigger and bigger while unprecedented opportunities exist for niche companies to be set up, whether by a handful of people or by an individual. Life is possible for companies at both ends of the scale! But what is difficult for companies is life in the middle. In every industry, we see middle-sized companies being squeezed out – and middle-sized companies are what provide the bulk of jobs.

The fifth thing we need to note is a parallel in society: the middle **class** is being eliminated (the growth of the middle class in China and India is a different phenomenon, needing another discussion). What is under threat in the West is the future of the middle – whether economically, socially, politically, or technologically.

Sixth, as the influence of Protestant and other reformers has waned under the impact of the Neo-Olds, we have had an efflorescence of lawlessness even in what used to be the ‘Protestant heartlands’ of the USA and Europe¹⁹. ‘Legal nihilism’ is a term coined by Russia’s President Dmitry Medvedev to describe widespread disrespect for the law at all levels of Russian society. A former law professor, President Medvedev has promised to make law and order a top priority, for example calling for legislation to rein in ‘reiderstvo’ – the lucrative business of paying a publicly known scale of ‘fees’ to various law enforcement and court officials in order to bankrupt or take over a company. The ‘administrative’ work involved costs only around \$300,000 dollars. What is not known is how much has to be paid to politicians and others. And if it is the politicians themselves doing the takeover, presumably they have to share at least some crumbs with others in the system. One imagines that the crumbs have to be relatively large if the company is the size of Yukos or TNK-BP or Hermitage Capital Management. But even relatively small companies, on Russia’s scale, must be tempting – according to the Russian Chamber of Commerce & Industry, some 8,000 companies a year are targets of ‘reiderstvo’.

What is President Medvedev’s solution to such rampant manipulation of the law by political, criminal and business groups? Among other things, the Russian Parliament is debating a twenty-year jail sentence for raiders who acquire companies illegally. However, when the judicial system is itself corrupted, it is not clear that any legislative measure is going to ameliorate a disease that is deeper than can be tackled by mere legislation. The disease is, in fact, cultural.

In other words, the question that President Medvedev does not ask is: what are the cultural roots of Russia’s lawlessness? As long as he does not ask that question, find sufficiently insightful answers, and thereby put in place an effective programme to combat those roots, he has no hope of actually doing anything about cultural lawlessness, however noble his intentions.

So what are the roots of a whole culture that is lawless? Clearly, in Russia’s case, the other-worldly tradition of the Orthodox Church has something to do with it, because it not only failed to instil in the elite a culture of compliance with the teachings of Jesus the Lord, but also actively colluded in creating that culture of elite

¹⁹ Skillen, *Rule of Law Succumbs to Torture*, Capital Commentary, June 6, 2008 (available also at: <http://www.cpjustice.org/content/rule-law-succumbs-torture-safety>).

lawlessness. A second contributor to Russia's cultural lawlessness is its Communist heritage. The 'law' was whatever the current clique in power SAID was the law, and this continues to be the situation. A third contributor to cultural lawlessness is the sort of capitalism Russia has put in place: a Darwinist or jungle capitalism arising primarily from the ideology of theorists such as Milton Friedman, and not from any overwhelming sense of morality, justice or what is humane. There are doubtless additional significant contributors to 'legal nihilism' in Russia and countries within its erstwhile empire.

In other countries, highly different reasons are either responsible or contributory. For example, in India, it is the 'Hinduism' typified by the Vishwa Hindu Parishad. In countries such as Sri Lanka, Myanmar/ Burma, Thailand and Cambodia, it is the quiescent and other-worldly Buddhism of the majority population. In the Philippines, it is the Romanism of its majority. In Africa, it is primarily tribalism and the other-worldliness of the local religions. The reasons for my denigration of 'other-worldly religions' are documented (probably insufficiently!) elsewhere²⁰.

However, you may wonder about the role of a 'this worldly religion' (Islam) and why THAT does not seem to end up today delivering the rule of law in any sense that results in flourishing of humankind. Let me briefly note that, as Islam cavils at the essential point of whether morality is absolute or relative in relation to the spread of Islam, Muslims have made various compromises in terms of law, ethics and morality in order to spread Islam (much as the Roman, Orthodox and Anglican churches have, and have Hindu and Buddhist traditions). Once Islam is established in any society, it has so far shown a tendency towards stasis (just as have the other traditions just named). It is only in the last few decades that there has been any widespread attempt at Muslim self-criticism and reform (not always in a desirable direction, principally because such self-criticism and reform have been in response to what Muslims have perceived as the 'threat' of modernity – or, in our terms, Protestantism²¹). That seems to me the principal reason why the actual results of contemporary Muslim reform movements have been either a mixed blessing or overall negative so far, although they could have ended up (and could still end up) being positive.

Examples of non-Protestant traditions (though all influenced by the Bible in various ways) that provided some minimal respect for law at least for a time, have been:

²⁰ Guptara, *Indian Spirituality*, 1984.

²¹ Wilson, *The Reform Islam Needs*, City Journal (USA), 2002; available at: http://www.city-journal.org/html/12_4_the_reform_islam.html; see also <http://frontpagemag.com/Articles/Read.aspx?GUID=2ABD8FD8-75BD-4B90-8DC5-F9D8AD1D8DE4>; Stückelberger, Calvin, Calvinism and Capitalism, in Dommen/Bratt (eds.), *John Calvin Rediscovered: The Impact of His Social and Economic Thought*, 2008.

- Maoism in China,
- Japan’s ‘catching up’ movement, starting under the Tokugawa Shogunate and the Meiji oligarchy in the eighteenth century but more fully under direct American tutelage after World War II, and
- simple nationalism (such as in India under the influence of Mahatma Phule, Mahatma Gandhi and Dr. Ambedkar).

However, a glance at the 2006 ‘Rule of Law Index’²² – a measure of the extent to which agents have confidence in and abide by the rules of society – shows that countries which were most strongly influenced by the Reformation (that is, North America, Europe, Australia and New Zealand) are the areas that are even today those that are most substantially under the rule of law.

I come now to the matter of the key additional reforms that are needed if globalisation is to avoid creating an inhumane, and to create instead a humane, future.

4. Seven steps to the right kind of globalisation

Summarising my argument up to this point: the issue is not globalisation as such, but rather the kind of globalisation we have had so far. Nor is the issue merely law and ethics, but the kind of law and ethics that is involved. Remedying such matters involves working at a level rather deeper than mere globalisation, law or ethics. It involves working at the level of culture and structure. So here are my proposals for that purpose:

4.1 Realistic optimism vs. fatalistic pessimism

Our culture needs to be focused again on a realistic optimism not a fatalistic pessimism. The trend has been in the opposite direction, as is well-documented by Oliver Bennett in his book, *Cultural Pessimism: Narratives of Decline in the Post-modern World* (Edinburgh University Press, U.K., 2001). Cultural pessimism arises with the conviction that the culture of a nation, a civilisation or of humanity itself is in a process of irreversible decline. Surveying the history of pessimism, Bennett concludes that it will be difficult to turn the tide of contemporary pessimism. It is precisely that difficult task that must be tackled.

4.2 Education for nurturing citizenship and genuine personal fulfilment

We need to restore education to its function of nurturing citizenship and genuine personal fulfilment – and move away from the present function of training people for employment by the elite. This will involve restoring the function of enabling

²² http://info.worldbank.org/governance/wgi2007/worldmap_start.asp?allcountries=1 then choose ‘Rule of Law’ and click on ‘Submit Choices. Good governance is the key to economic and social progress, so the key question is: why do some countries get good governance and others do not? Essentially, this has to do with the extent to which the elites are willing to take the wider, rather than an exclusively self-interested view.

individuals to think for themselves, not merely to learn by rote in order to pass exams and gain certificates or college/ university degrees. It will mean moving from presently-dominant ‘merely technical’ training, even in subjects such as economics and IT, to education in the widest sense, reincorporating history, literature and philosophy. It is striking how much freedom of thought has been lost even at the doctoral level and at faculty level in universities where, increasingly, one has to follow what is perceived to be ‘politically correct’, in disciplines as diverse as economics, sociology, anthropology, psychology and even science, in order to be hired and then to be granted tenure. Indeed, even tenured faculty have been hounded from their positions because of their views.

Contemporary educators as well as people in government like to point out how successful we are at education, but fail to observe that we have redefined educational success in such a way that it is empty and meaningless from the viewpoint of nourishing an open, democratic and fulfilling culture. Educational excellence needs to be defined once again to include and emphasise responsibility, not individual greed and collective consumerism. More broadly, there needs to be a cultural inculcation of the notion of ‘enough’ specifically in matters of economics, business and money. The restoration of Sunday as a day of rest, and of limited trading hours during the rest of the week, would in addition go an enormous way towards reducing stress and stress-related diseases – which are now the largest killers, present in epidemic proportions, though it is politically incorrect to recognise their existence.

What else is being done to reverse the present trend towards extreme greed and individualism consequent upon the triumph of the Neo-Olds and the decline of reformism? There is the strategy favoured by the media: naming and shaming the ‘fat cats’. This sport no doubt can contribute to circulation and ratings, but little else.

4.3 Truth-telling and the media

The media needs to be restored to the function of truth-telling, by removing the obsession with entertainment – partly by global quantity controls, and partly by introducing competition for the commercial sector from socially-sponsored media responsible for quality alone. Britain could have had such a situation, but the elites there have weakened public broadcasting by requiring the BBC to compete with commercial television in entertainment and ratings. As long as budgets were adequate for top-quality productions, the BBC could compete even in entertainment but, as budgets were squeezed, the BBC too has increasingly produced the broadcasting equivalent of candy or aspirin. Public broadcasting needs to be strengthened even in the U.K. by such a dual system as I propose – and mandated worldwide. At present, in most parts of the world, media provide only government propaganda and/ or elite propaganda. Of course the media must entertain! But the central question is: do the media allow space for debate, discussion, thinking – or do they squeeze out the space for it?

4.4 Direct democracy

Political parties and representative democracy should now be abolished, and direct democracy installed instead, because the system of political parties has proven open to manipulation and vicious behaviour²³, and because direct democracy increases transparency while saving costs (taxpayers do not need to pay for an expensive body of legislators!). We already have the technical means for direct voting on all issues. We even have the technical means to identify and ascertain the way each vote is cast. This will militate against anonymity, but anonymity is not an essential part of democracy: responsibility is what is essential. A primary part of responsibility is identifying where you stand on any issue on which you care to take a position. Even in Switzerland, the home of direct democracy, I find a reluctance to recognise that the system of having parties is what creates deadlocks – and a tendency to blame direct democracy instead! But as issues are liberated from party considerations, it becomes much easier to reach decisions, as well as to enable effective implementation.

4.5 Free fundamental and applied research

Fundamental and even applied research needs to be liberated from the trammels of private sponsorship. Many react negatively to such a proposal on grounds of efficiency. However, efficiency is less important than the consequences of research for humanity: it does not matter how efficient my car is, if I am driving in the wrong direction! Science and technology are more and more divorced from real human needs: perhaps 98% of worldwide research money goes into the obsessions and problems of the rich, who are certainly by any measure no more than one sixth of the world population. I would not expect only one sixth of research money to be devoted to their needs and desires. In fact, I don't expect even one third or one half, but perhaps sixty or seventy percent would be fair – 98% certainly does not make sense. However, I agree with the need for efficiency, and believe that we will get it by global mechanisms for ensuring greater competition and commercial freedom for products and services.

²³ Consider the way in which Swiss politics is developing, with the vituperation over the position and reactions to Justice Minister Eveline Widmer-Schlumpf, who has the support of Switzerland's six other (multi-party) Cabinet Ministers but disagrees with her own party on a certain issue. The vindictiveness of her party's leadership has gone to the extent of expelling the whole of the party's organisation in the Kanton of Graubunden, which also supports the Justice Minister. Such vituperation can be seen also in the response to the resignation of the UK (Conservative Party) Shadow Home Secretary, David Davis, on what he considers a matter of principle. Senior members of his party signalled that Mr Davis 'will not be offered a fast route back to the front bench' (!). This is not an isolated incident. See also: Gupta, *The Future of Democracy: An Indian Perspective*, in Hahn et al (eds.), *Erreicht oder reicht uns die Demokratie?*, 2004.

4.6 Global minimum wage

A global minimum wage and/or guarantees need to be introduced for food, clothes and shelter. Today, this is not particularly costly and can certainly be easily afforded. That needs to be combined with re-establishing the middle class worldwide (we have a global elite but not a global middle class). In turn, that can only be accomplished by redefining work and strengthening the family, for example moving worldwide from the current marriage penalty to a premium for nurturing children, with encouragement and celebration of parents who bear and bring up children, and do not send the mother out to work in pursuit of illusory material gains²⁴).

4.7 Fundamental reforms

Fundamental reforms are needed if the global economy is to avoid becoming an enslaving economy. Not all of the following reforms may be needed – some may be too extreme or not be radical enough for you. Each of us must come to our own conclusions and work for whatever reform(s) we think are necessary.

Usury is so fundamental an error in the global economy that it needs to be abolished²⁵. *Fiat currencies* are another²⁶. But we also have corporation law that encourages irresponsible behaviour with which managements must struggle as best they can²⁷. We have a *stock exchange system*²⁸ that encourages short-termism, and (most crucial) a *global culture of greed and fear* which is the basic cause. To illustrate: the charging of interest is contrary to Sharia (Islamic) law²⁹ but, as the rise of a substantial usury-based banking industry in Muslim-majority Middle Eastern countries shows, ways are found to pay lenders to lend. Indeed, funds from Muslim sources have not been un-prominent in leveraged finance (a sophisticated form of gambling, which is forbidden by the Koran). Why is this? As someone once put it, the heart of our problems is the problem of the human heart. Our problems in the

²⁴ Johnson, Even Middle Class Children Are Suffering From Neglect, <http://www.spectator.co.uk/i/the-magazine/features/767376/even-middleclass-children-are-suffering-from-neglect.shtml>; Carlson, Third Ways: How Bulgarian Greens, Swedish Housewives, and Beer-Swilling Englishmen Created Family-Centered Economies—And Why They Disappeared, 2007; Fox-Genovese, Marriage: The Dream That Refuses to Die, 2008.

²⁵ Guptara, Was Niemand Sehen Will: Die Folgen Eines Auf Zins Beruhenden Weltwirtschafts-systems, in Weis/Spitzeck (eds.), *Der Geldkomplex: Kritische Reflexion unseres Geldsystems und mögliche Zukunftsszenarien*, 2008.

²⁶ Kennedy, *Interest and Inflation Free Money*, 1995; Boyle, *The Money Changers: Currency Reform from Aristotle to E-Cash*, 2003.

²⁷ Cleaver et. al., *Tomorrow's Company*, 1995; Goyder, *Living Tomorrow's Company*, 1998; Sadler, *Building Tomorrow's Company: A Guide to Sustainable Business Success*, 2002; Goyder et. al., *Tomorrow's Global Company: The challenges and choices report of the conference*, 2005; Cleverly et. al., *Tomorrow's Global Company: Challenges and Choices*, *Tomorrow's Company*, 2007; Schluter et. al., *The 'R' Factor*, 1993, and *Jubilee Manifesto*, 2005.

²⁸ Michie, *The London Stock Exchange: A History*, 1999; Guptara, *Floor Wars: Trading Places*, in *Quantum: Finance in Perspective quarterly*, Qatar, Issue 1, 2007.

²⁹ Buckley, *Teachings on Usury in Judaism, Christianity and Islam*, 2000.

outside world emerge from our problems in our insides. Moses and Jesus, for example, pointed this out long ago. We ignore the solutions provided – not only to our individual disadvantage, but also to the endangering of the whole of the world.

The kinds of steps I mention above are intended to be building blocks in a concerted campaign to stop the spread of the sort of unfettered greed which has taken hold in the Anglo-American parts of the world since the time of President Reagan and Prime Minister Thatcher. That sort of capitalism may have been acceptable then from a purely economic point of view, and might still be acceptable today if we did not live in a globalising economy: there are advantages and disadvantages to every financial and economic mechanism. Today, however, we need to develop a new movement for ‘*world capitalism*’ based on

- the best of the human-capitalist tradition of Europe,
- the risk-friendly capitalism of the USA and UK, and
- the new requirement for social justice and for environmental and emotional care worldwide.

5. Chances of creating the right sort of globalisation

What *is* the chance of creating the right sort of globalisation? As far as I can see, the chance is an *open* one. Our individual and collective decisions each day can continue the momentum towards the wrong kind of globalisation – or, equally, they can help create the right kind of globalisation. There is hope because human beings are not predestined or pre-programmed to be slaves. In fact, the contrary is the case: freedom finds an echo in every human heart, and it is never too late to choose to pay the price of freedom.

Those who are prepared to pay the price should be aware that reformation arises from two sorts of energy

- A *negative* energy of outrage against perceived wrongs, and a *positive* energy of striving towards goals that are perceived to be universally desirable.
- Both forms of energy have their roots in *social, psychological and spiritual sources* – and these are systematically undermined and marginalised in our dominantly Neo-Old culture, so that the drive for the right kind of globalisation is vitiated and weakened. A restoration of such energy itself depends on the sorts of reforms I have indicated.

Stephen Marglin’s book: *The Dismal Science: How Thinking Like an Economist Undermines Community* (Harvard University Press, 2008) points out that we all think like economists nowadays. This sort of thinking undermines community, families, businesses and nations. This was perhaps why traditional wisdom, whether in Europe, India, Japan, or Africa consigned the business class to the bottom of ‘respectable’ society (priests and nobility had a higher place – tribal societies of course did not accept any merchants at all). Till recently, it seemed as if the relative advantages of our global system worked to all our benefit. Now it is clear that the disadvantages outweigh the benefits. To those who want to see, the facts are clear.

Regretfully, there are none so blind as those who do not *want* to see, fearful that seeing might cause them to question their own attitudes, beliefs – indeed the very ground of their beings, their souls and personalities. However, such seeing and such questioning can be the secret of a new beginning. Perhaps that is what Jesus the Lord was talking about when he declared that it is something extraordinary, something supernatural, something from God himself, that enables us to be willing to lose our self-interest, to die to ourselves, to be born again (*The Gospel of John*, Chapter 3, verses 1-21). At least, that is one Hindu's view of it.

In any case, we need to rediscover what he meant, and we need the resulting birth of a new generation of reformers who will continue the work of the now-unknown Anabaptists and well-known folk such as Luther and Calvin. It is eventually to such reformers that we owe today's universal literacy and the knowledge revolution, the birth of modern science and technology, the rule of law and the possibility of prosperity for the average person, our political freedoms, our concept of the family and of women's rights, of heroism and of environmental care. To William Wilberforce and his Clapham Circle, in the 19th century, we owe the breathtaking vision of a cleaned-up and responsible polity and economy. Together, these reformers created everything that we understand by the term 'modern civilisation'. What more do we need today, what remains for the new generation of twenty-first century reformers to accomplish? Just as the early Reformers rejected the authoritarianism of the Roman Catholic Church, we need today to reject the totalitarian stranglehold of our current global financial and economic approach and mind-set if we are to create the right kind of globalisation. Just as Wilberforce created alliances and institutions to clean up public and economic life, so we need to create new alliances and new institutions to clean up the current form of globalisation so that it is transformed from an agent of massive blessing for a few, into becoming an agent of massive blessing for everyone.

When I talk along these lines, well-meaning people say to me, 'Professor Gupta, are you not being a little idealistic?'. I reply that when an unknown business executive called Peter Eigen started calling for the elimination of financial corruption and backhanders from the global economy, lots of people thought he was a dreamer – till the work of Transparency International starting having an impact. When Princess Diana starting calling for an international ban on the use of anti-personnel landmines, almost everyone thought: 'Another wild idea from someone out of touch with reality'. But, dear colleagues, God has given us a real world with real limits, though we also impose artificial limits as a result of our fears and anxieties. Within real limits, we can dream new worlds into being. The question is whether our dreams are ideals or nightmares – and we can tell the difference by whether they will create a world of freedom and opportunity for the vast mass of humanity.

Law and ethics in our globalised economy face two principal challenges: first, the challenge of the Neo-Olds or the New-Lawbreakers, modelled, encouraged and enabled by leaders from President Reagan to President Clinton, and from Prime Minister Thatcher to President Putin and Robert Mugabe; and second, the subtle as well as massive challenge of creating an appropriate culture of law and ethics for

our globalised world. We have today a clear choice between entrenching an existing global system that already works primarily for the benefit of the elite³⁰, and creating a culture that is to the benefit of humanity as a whole but especially the poor and disadvantaged. We are constantly fed the propaganda that what is good for the elite is also good for the poor and disadvantaged – even though both theory and experience tell us this is not only false, but is a lie.

The first culture WITH a respect for law was, clearly, Jewish culture, where even kings and emperors had to be subject to the law, understood as God's law. Rulers could not simply make up laws suiting their whim, fancy or benefit. However, when kings failed to submit to the law and resorted to manipulating the law, the Jewish understanding is that God allowed the consequences of such manipulation to take their course – exile from their land with consequences down to our time.

The second historical culture with a respect for the law was created by a rediscovery of the Hebrew tradition, as the Bible was studied from say the 11th century and led to the rise of what came to be known, from the 16th century, as Protestant or Reform movements – protesting against the political, legal, social, military and economic manipulation of Roman Catholicism. Naturally, the Reformers were as human as the rest of us. They too were occasionally (or a lot of the time!) selfish, manipulative, exploitative and the rest. However, as long as they studied and attempted to implement the teachings of the Bible, they received from it standards, inspiration, challenge and rebuke that led to the continued reformation of society – specifically, the separation of Church and State, and the division of powers within the state, for the first time in history, which is what led to the secularisation of progress, which blessed (and blesses) the whole world as long as the world's elites were and are willing to heed what is right.

Though the teachings of the Bible were increasingly rejected by the West's elite from the 1880s, that rejection had little impact on the material culture of the West till the rejection attained society-wide proportions as a result of the rise of mass education from the 1950s under the guidance of the now-Godless elites.

³⁰ The richest 2 per cent of adults own more than half the world's wealth, according to a most comprehensive study of personal assets by the World Institute for Development Economics Research of the UN University, published in December 2006. The richest 10 per cent of adults accounted for 85 per cent of assets. The bottom 50 per cent of the world's adults owned barely 1 per cent of global wealth. One of the authors of the report, James Davies, Professor of Economics at the University of Western Ontario, said: "Income inequality has been rising for the past 20 to 25 years and we think that is true for inequality in the distribution of wealth". The trend continues: according to The World Wealth Report 2008, a study compiled by Merrill Lynch and Capgemini, the world's richest people expanded their assets by more than 9 per cent last year to USD 40,700 billion. A simple way of improving the state of the world would be to require the richest 500 individuals in each country to invest say 1% of their earnings in a micro-finance fund of their choice in their own country. Additionally, but eliminating duplication, the richest 500 individuals in the world could be required to invest say 2% of their earnings into a microfinance fund of their choice in any of the Least Developed Countries.

Not surprisingly, the West's 'progress' has become increasingly inhumane since then³¹.

There is now a reaction against materialism and Godlessness. The only problem is that many of the new believers are culturally, politically, economically and technologically illiterate, resulting in initiatives that have been irrelevant, collusive or, in any case, so far ineffective. However, they are learning from their mistakes and becoming better co-ordinated and educated, not only among themselves but also with others who are likeminded on particular issues. Though there are some totalitarian-type reactions, the prospects for a positive and humane resolution (rather than a totalitarian resolution) of the current global civil war are at present bright.

There remains the question of which side the new global elites will choose, and which side the now-global masses will choose. Together, the new global elites and the new global masses can make choices that put in place the genuine rule of law globally for the first time in history. What is quite clear, even from the few aspects that we have been able to explore, of the spiritual, psychological, and cultural sources of the transforming power that has actually confronted legal and ethical challenges successfully in the past, is that reformation is possible once again today.

What would that mean in legal terms? If Sharia law is inhumane because it ultimately appeals to force rather than to discussion or persuasion, and if EU law is opaque, heavy and ineffective, what we need is global law that is transparent, light and effective – and is, above all, seen to be just.

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³¹ One in 32 American adults is either behind bars or on probation or parole, according to the results of a Pew Charitable Trust report released in February 2008: http://www.pewcenter-onthestates.org/report_detail.aspx?id=35904.

Schumacher, To Live and Work; Amartya Sen, Moral Codes and Economic Success; Tom Sine, Mustard Seed vs. McWorld; John F Sleeman, Economic Crisis; Russell Sparkes, The Ethical Investor; Russell Sparkes, Socially Responsible Investment: A Global Revolution; John E Stapleford, Bulls, Bears and Golden Calves; John P Tiemstra (Ed), Reforming Economics; and Douglas Vickers, Economics and Man.

Panel Statements

Global Tax Competition and Tax Cooperation

Stanisław Soltysinski

1. Introduction

Tax avoidance and the abuses of the tax havens is a worldwide problem. It was recently epitomized by Mr. Zumwinkel scandal. The former head of the Deutsche Post was prosecuted and charged for tax frauds committed by way of channeling money to Liechtenstein, a prominent European tax haven. Tax authorities in Germany, Italy and U.K. boast that they have obtained names of hundreds of rich taxpayers who hid their money benefits in the small Alpine jurisdiction encouraged by the Liechtenstein banking secrecy laws and the family foundation scheme concept, which has a reputation of a nearly perfect tax avoidance instrument for rich families trying to avoid income and inheritance taxes.

The German Tax Union, an advocacy group, estimates that Germany loses at least 30 billion Euros per year due to tax evasion.¹ The scale of tax avoidance by multinational companies and individual taxpayers in Britain is estimated at £ 25 billion per year.²

The accounting solutions aimed at reducing taxes and widespread practices of exploiting loopholes are undermining government revenues, in particular, in less developed countries, which lack expertise and trained civil servants to verify tax returns involving complicated intra-group payments. Christian Aid, a leading non-governmental organization providing assistance to poor countries, alleges that the illegal tax evasion by companies is depriving the developing world of USD 160 billion a year, which could prevent the death of 1.000 children every day. The charity blames the secrecy offered by tax havens, including Switzerland and Monaco, “for the widespread abuses and accuses the big accountancy firms of facilitating the evasion”.³ The tax evasion practices and policies of tax havens are being criticized not only by charitable institutions, trade unions and leftist parties. A recent United Nations’ report argues that responsible tax regimes must be put in place in order to help achieving the Millenium Development Goals of cutting poverty by half by 2015. Center and center right parties in Germany, U.K. and Italy are concerned that the recent tax scandals could trigger a rise in public dissatisfaction with the business establishment and, in particular, banks and other financial institutions. Characteristically, the incumbent German President running for reelection recently blamed international banks calling them “monsters” that failed to

¹ Dougherty/Lander, Tax Scandal in Germany Fans Complaints of Inequity, The New York Times of February 18, 2008.

² Inman, Government Goes Back on Corporation Tax Report, The Guardian, May 12, 2008.

³ Seager/Inman, Tax Evasion Costs the Live of 1,000 Children a Day, The Gardian of May 12, 2008.

apologize their clients for their mishandling of financial markets. Similarly, the British Prime Minister has found itself between the opposing pressures of the business leaders advocating tax cuts and the TUC criticism of tax avoidance by companies.⁴ The TUC report “The Missing Billions” argues that if only a fraction of the missing tax were collected, it would finance many vital public services such as education and health in the U.K.⁵

2. Tax havens: Parasites or useful facilitators?

Tax havens are no or single digit income tax countries, which offer secret banking services and other tax avoidance solutions such as anonymous partnerships, limited liability companies or family foundations not requiring charitable purpose. Angel Gurría, the Secretary General of OECD, characterized tax havens as jurisdiction characterized by strict bank secrecy and a policy or practice of non-cooperation in tax avoidance cases. In his opinion such practices allow them to prosper to the detriment of the integrity of the global financial system and “such behavior is no longer acceptable.”⁶

Tax havens serve no longer exclusively multinational corporations, wealthy individuals, gun-runners or terrorists. They have become more popular, and more widely used both by corporations and upper-middle-class professionals. Through the use of electronic banking and credit cards, they have become accessible to millions of taxpayers around the world.

Some experts argue that tax havens play a positive role by lowering taxation both in their jurisdictions and elsewhere. Furthermore, they improve standard of living across the board, thus helping to strengthen global economy.⁷ A recent paper suggests that some tax havens have become centers for financial services and a higher economic activity in those countries is associated with higher business activities in nearby non-haven countries.⁸

Critics accuse tax havens of worsening poverty and inequality by allowing rich individuals and institutions to violate laws of these jurisdictions where the wealth was created. There is enough evidence that the critics are basically right. Tax evasion is a crime, it is a theft from your fellow citizens. Tax havens that help to circumvent foreign tax laws enjoy high income per capita by engaging in parasitic practices helping and abetting foreigners to commit not only tax crimes.

Apart from violating the law, tax avoidance results in massive transfer of wealth to tax havens at the expense of the wealth creating countries. The scale of frequently

⁴ Brendan, TUC General Secretary, said in February that unpaid tax costs every British worker £ 1,000 per year.

⁵ Seager/Inman, note 4, supra.

⁶ An interview with Mr. A. Gurría quoted by the Financial Times, February 21st, 2008.

⁷ Mitchel, Which is the Bigger Challenge: Tax Havens or High Taxes?, The Wall Street Journal Online, April 10, 2008, http://online.wsj.com/public/article_printSB120593814650448571.html.

⁸ Desai/Foley, The Demand for Tax Haven Operations, 2008, Journal of Public Economics, No. 3, at pp. 513-531.

illegal transfers to tiny tax havens is staggering. In 2007 only Caymans represented USD 1.5 trillion of the global hedge funds business. The proposition that such jurisdictions positively contribute to a fair tax competition is a total fallacy. Which nations could effectively compete with a 1-3 percent or sometimes “zero” income tax laws?

The argument that some tax havens have become centers of financial operations and are widely used by multinational firms are convincing but the question arises whether the world economy needs centers of financial expertise how to practice tax avoidance? Desai and Foley have not proved that financial institutions in London, New York, Frankfurt or Tokyo would not be able to satisfy the legitimate needs of clients who prefer to choose Bermuda, Liechtenstein or Caymans largely, if not exclusively, for tax avoidance reasons.

Indeed, some tax havens have become centers of financial and legal talents. As Perez-Navarro said, OECD did not want to put tax havens out of business but to pressure them to adopt transparent regulations and cooperate with foreign countries to prosecute tax dodgers.

In the past, such tax havens like Switzerland enabled citizens of oppressive regimes to hide their legitimately earned assets against the threat of confiscation by totalitarian regimes. However, this record of functioning as a fair shelter for the oppressed was later overshadowed by helping African dictators, turning blind eyes to money illegally transferred from Russia and Eastern Europe, not to mention abusing the assets of victims of the Second World War until pressured by the Jewish organizations to account for such assets. The practice of Swiss banks has improved considerably. Their willingness to cooperate with foreign revenue officials prosecutors, and judges shows that there is a ground for a compromise. But even today, at least some Swiss cantons and financial institutions continue to follow policies of encouraging multinationals and rich foreign individuals to transfer their assets solely for the purpose of “optimization”. But due to absence of global or even OECD rules in this field the demarcation line between legitimate tax optimization and illegal or unfair tax avoidance by way of transferring income to tax heavens is by no means clear.

One should also agree that tax havens ought to have a reasonable margin of discretion in refusing to cooperate with a foreign government for legitimate public policy considerations (e.g. when the foreign jurisdiction’s judicial system is materially imperfect).

3. Tax and fairness of tax competition

Questions about fairness of tax competition among states are quite topical, indeed. While the E.U. authorities may coordinate some tax policies (for instance, VAT), in principle, the Member States are permitted to compete in the field of income tax laws and taxation of capital gains. Tax competition should not be discouraged provided it is transparent and fair. The latter concept is not easy to define like the idea of fairness in other competitive areas. Flat nineteen or fifteen percent income tax laws passed in many new E.U. Member States and former republics of the

Soviet Union may be viewed as too low from German, French or Scandinavian perspective, but they should not be considered as unfair as long as they are transparent and equally available to all doing business in a given jurisdiction. Indeed, they may be viewed as too low from a moral perspective (i.e. in light of values long promoted by social democratic or Christian moral codes of conduct). However, they are not intrinsically unfair or parasitic. To the contrary, unlike tax haven laws, they are aimed at stimulating business activity, they lower tax evasion and promote healthy tax competition among countries. But perhaps, in a distant future the levels of income and capital gains taxation will have to be coordinated in the E.U.

The outcry about tax evasion caused by the recent Lichtenstein scandals prompted OECD countries to discuss joint efforts to discipline “uncooperative havens”. But several observers doubt whether such joint action will produce effects. There is also a whiff of hypocrisy about the advocated assault on tax havens by leading OECD countries such as the U.S., U.K. or Switzerland which employ or tolerate practices that can hardly be characterized as fair tax competition schemes. Thus, for instance, the U.S. State of Delaware is one of the world’s leading providers of anonymous companies in the world. Delaware limited liability companies may not only be anonymous but tax free as long as they derive income from doing business abroad.

London has become the Mecca of the rich from all countries due to the 10% capital gains for non-resident oligarchs (“non-doms”). Now, there are proposals that the “non-doms” should pay a flat £ 30,000 after seven years (!). The British Government has allegedly recently retreated on a demand for transparency from non-resident individuals to reveal all their assets. The fear of imposing transparency on such individuals like Russian oligarchs and Middle East oil sheiks has produced a “rainbow” coalition of the City, Confederation of British Industry and the left leaning Lord Mayor of London, all criticizing the Government that the new rule threatens the prosperity of the whole country. As one British commentator observed tax avoidance has become almost a civic duty and “is becoming a new British human right”.⁹ Clearly, Her Majesty Government has been taking care of such “orphans” of globalization like Russian oligarchs and sheiks of the Persian Gulf.

Some Member States compete for attracting multinational companies and earning the characterization of “tax havens”. The Netherlands is an example. According to a report of Tax Justice Network, the Dutch 2007 Tax Act had created the legal basis for a number of tax avoidance constructions.¹⁰ The publication lists several examples of loopholes:

⁹ Toynbee, Fairness is Forgotten in a Culture of Tax Avoidance that Shames Britain, *The Guardian* of February 29, 2008.

¹⁰ http://tax_justice.blogspot.com/2008/02/dutch-multinationals-hardly-pay-any-tax.html.

- (i) Some forms of hybrid capital qualified as equity in the Netherlands are classified as loans in other countries, including France. Related interest payments are deductible abroad but considered as tax-exempt dividends in the Netherlands.
- (ii) A group interest tax formula, which has not yet entered into force because it is being investigated by the E.U. Commission, provides for a reduced 5 per cent payment on intra-group interest income.
- (iii) U.S. multinationals can use the so-called BV1/BV2 solutions, with two Dutch corporations of which one is classified as a transparent entity by the U.S. Revenue authorities, deducting interest in the Netherlands or abroad, while the corresponding interest income is not taxed in any jurisdiction.

A recent publication of the Canadian Government¹¹ indicates that “[i]ncreasingly, governments are recognizing that they must either act to limit the erosion of their domestic tax basis by creative international tax planners, or to increase the share of taxes borne by their citizens and small businesses”.¹² The issue of unfairness of tax regimes and policies creates tensions and conflicts not only between countries but also in internal relations.

A right kind of globalization requires discussing not only traditional WTO issues like competition in goods, services and IP rights but also rules on tax competition and cooperation in this field.

4. What can be done in this field? Possible solutions

First, the OECD countries or at least the E.U. and the U.S. should agree on common policies vis-à-vis tax havens aimed at imposing disciplines limiting tax frauds. Once a consensus is reached in the OECD its members could “persuade” the non-cooperative “havens” to change their policies. Many tax havens are dependent territories of former colonial powers such as the U.K. or the Netherlands.

Second, OECD countries should agree themselves to eliminate unfair tax competition practices. As already mentioned, reaching a consensus in this field will not be easy. Basically, tax schemes aimed at offering tax free or almost tax free status to foreigners or foreign entities, which transfer their assets to a tax “purgatory” country, frequently characterized as non-resident individuals or non-resident companies, can hardly be viewed as fair tax competition practices. They are aimed at absorbing wealth created abroad in exchange for granting a privileged tax statutes in a country which, practically, does not bear the social and environmental costs of the creation of the wealth absorbed from abroad. British tax laws for the rich non-residents or similar tax schemes in Switzerland and Monaco are typical examples of such parasitic practices. They are subject to criticism also from the fairness perspective of the larger tax havens, whose economy is not concentrated or serving tax

¹¹ Department of Finance of Canada, International Tax Avoidance and Tax Havens, <http://www.fingc.ca/news07/data/07-041-2e.html>

¹² Ibid at p. 1.

dodgers. In a recent English editorial the question was raised whether it is fair to offer a flat low level taxes to rich foreigners while imposing three times higher taxes on British citizens.¹³

Third, OECD and later on, perhaps all WTO members should agree at least on promoting transparency and eliminating rules which function as schemes aimed at aiding and abetting tax fraudulent practices. It should be stressed, for instance, that the shield of corporate anonymity is offered not only in well-known tax havens, such as Cayman Islands and Liechtenstein but also by some U.S. states, in particular, by the State of Delaware.

Fourth, OECD should initiate discussions about first identification and subsequently elimination of unfair tax planning structures which enable a taxpayer to deduct expenses twice for what is economically the same expense (so-called “double dips”) or tax avoidance techniques generically known as “tower structures”. The distinctive aspect of such a solution is its exploitation of hybrid entities which are characterized as partnership in country A, where they are not taxed, and as corporations in country B, where they are subject to taxation. Some OECD countries, for instance, U.S, Canada, France and Japan have already introduced measures aimed at eliminating “double dips” and other unfair tax avoidance techniques.

Canada announced that it will conclude no new tax treaty, nor update an existing treaty, unless her partner country agrees to observe the highest international standards of tax information exchange. However, it would be useful to have regional if not global rules defining and promoting such fair standards.

Finally, a consensus would be welcomed about the controversial issue of circumvention of tax laws. The concept of circumvention of law is recognized in other fields of law. Should tax laws constitute an exception? It is interesting to note that the E.U. Directive No. 90/434¹⁴ allows Member States to refuse tax benefits in case a given transaction was entered exclusively for tax avoidance reasons and the taxpayer is unable to prove to the contrary. The European Court of Justice ruled that the concept of circumvention of tax laws is consistent with the Treaty but a tax authority of a Member State may apply it only if a given country implemented the anti-abusive provisions of the directive.¹⁵ Some Member States have not complied with this requirement, thus encouraging companies and individuals to benefit from tax “optimization” techniques.

The problem of imposing disciplines on tax havens has become an issue which is widely discussed in the aftermath of the global financial crisis but the first summit of G-20 group held in Washington D.C. shows that reaching a compromise in this field will not be easy.

¹³ Toynbee, note 9 supra.

¹⁴ Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member State, OJ L 225, 20.8.1990, pp. 1-5.

¹⁵ Case of A. Leur-Bloem Decision of the E.C.I. of 17 July, 1997, ECR [1997] I-416.

Improving Process of Globalization: Role of WTO

Harsha Vardhana Singh

In any large scale process which has widespread effects, such as globalization, we will find both major opportunities and major concerns. The process of globalization has evoked strong views, both in favour and against. There are various views, including for instance that there is nothing new about globalization, that globalization is fundamentally changing the socio-economic situation, there has been a “death of distance”, there are major adverse changes taking place, and that there are multiple opportunities available to people and nations.

To address the topic of this session, I feel that instead of looking at the details of why the right kind of globalization does not happen, it is more useful to have a positive approach and consider the factors which will help build the right kind of globalization.

As my starting point, I want to use the six guide posts that President Horst Kohler had provided a few years ago to help achieve better globalization. These include:

- a) Must recognize that globalization requires formulating “global domestic policy”.

Increasing interdependence requires as a minimum that each country give more consideration to the consequences of its actions on others.

Many problems can no longer be solved without multilateral cooperation.

- b) Multilateral solutions can only work if they do not undermine national self-responsibility.

Countries have to recognize even more strongly that good governance, the rule of law, and fight against corruption are essential for good investment climate and effective poverty reduction.

- c) While the market has proven itself as the best coordinating mechanism between free agents, the market forces alone will not suffice.

Therefore, we need an international regulatory framework for globalization, with stable and predictable rules and effective institutions.

- d) The social dimension of globalization has to be given more consideration.

- e) We must ensure that globalization is not misunderstood as imposing a global harmonization of economic and social models.

- f) Good progress in the desired direction requires a global ethic:

There should be a basic consensus concerning existing binding values, absolute standards, and personal convictions.

The ethics must respect human rights but also convey the idea that rights go hand in hand with duties.

The growing inter-dependence among nations together with these guideposts show very clearly that the way forward for good globalization is through a multilateral framework, while developing a clear idea on what needs to be done to achieve these objectives domestically. For this, we need both domestic and international institutions and mechanisms. Since there are many specific areas to deal with, it may be necessary to establish different institutions to work on specific issues.

For a large number of countries, key objectives that will come up in most multilateral contexts will be addressing poverty, boosting growth and managing the distribution of economic benefits to the population so that there is inclusive growth. If poverty is not addressed, it can be a threat to peace and stability of the international system. The right kind of globalization has therefore to help countries also address growth and poverty alleviation.

It is significant in this context that very recently, we have the Report of the Commission on Growth and Development. This report, titled *The Growth Report: Strategies for Sustained Growth and Inclusive Development*, is a report by 19 highly experienced and highly placed policy, government and business leaders to identify the factors which have led to rapid and inclusive growth in 13 economies¹ that have grown at an average of 7 per cent or more per year for 25 years or longer. The main conclusions of the Commission regarding growth include, *inter alia*, that:

- growth is a crucial part of poverty reduction and the improvement of people’s lives. It is a long term challenge that requires leadership, persistence, stamina, pragmatism, transparency and the support of the population.
- growth requires engagement with the global economy to import knowledge and technology, to access markets, and to generate a strong export sector – critical in the early stages of growth.
- growth must be inclusive, and it is important to share the benefits of globalization, providing access to the underserved, and dealing with issues of gender inclusiveness.
- growth requires high rates of investment. Investment in education and health are particularly important.

The Commission has thus said that countries need to link themselves tightly to the global economy as a way to boost jobs through exports and to import technology and investment. In addition, the countries which achieved high growth maintained macroeconomic stability, had high levels of savings and investment, flexible domestic markets and “credible” governments.

We again see at least two relevant points for going in the right direction in a globalized world. One, the need to interact with the global economy, which in turn indicates the importance of a stable and predictable multilateral system. Second, domestic efforts are a crucial part of any initiative, and thus any multilateral system

¹ These countries were Botswana, Brazil, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Malta, Oman, Singapore, Taiwan and Thailand.

must provide for the possibility of meeting different domestic aspirations and concerns.

In this context, I will focus on the appropriate multilateral framework which is required for taking us towards the right kind of globalization. Any such appropriate framework should have the following criteria.

- a) Non-discrimination: Different Members of a multilateral framework should get the same treatment in same situation, and the most favoured treatment given to any nation should be given to all Members.
- b) Assurance of policy response: The framework should provide a stable and predictable policy regime which increases the certainty of the conditions under which nations interact with each other.
- c) Decision to not be restrictive: the framework should facilitate economic interaction and continue to provide increased opportunities.
- d) Special and differential treatment for developing countries: The developing countries should be distinguished from developed countries in view of their different ability to take on obligations under a multilateral system. The developing countries should have lower levels of obligations, i.e. they should have special and differential treatment in the system.
- e) Technical Assistance: In addition to special and differential treatment, developing countries need technical assistance to improve their capacity for benefiting from any system. There should be a programme of technical assistance to these countries, which caters to the specific and differentiated requirements of different countries.
- f) If reasons justify deviation from the disciplines of the system to meet specific domestic objectives then the multilateral framework should allow for this possibility under agreed conditions.
- g) Transparency and Notification: Members of any such system should know about the relevant laws, regulations and policy actions of other Members. For this purpose, there should be a system of notifying such matters to the other Members of the multilateral system.
- h) Bodies to manage, monitor and conduct surveillance: The multilateral system should have established specific Bodies to monitor and conduct surveillance in the areas covered by that system. These Bodies can provide a forum to discuss matters of concern, inform Members of relevant developments, seek information on issues of interest, and monitor developments which affect the interests of various Members in the system.
- i) Credible Dispute Settlement Mechanism: With a large membership, there will be times when Members interpret any provision or condition of the system in different ways. These situations could lead to a dispute, and it is necessary to have a credible dispute settlement system.

You will agree with me that in a process of globalization and international interaction and co-operation, these principles or criteria are necessary for a multilateral system that takes Member countries in the right direction. It is noteworthy that the multilateral trading system that is encompassed in the World Trade Organization (WTO)

embodies all these principles. It is a system which has been formulated by a diverse group of Member countries, taking account of their mutual interests, strengths and weaknesses.

It is important that such a system should be strengthened further, based on mutual interest of the Members. That is the attempt which is being made at present through the ongoing Doha Round of trade negotiations, aimed at getting a result on the Doha Development Agenda. An important part of this process is that the views of various groups of like-minded countries, especially developing countries are being expressed clearly and the process is inclusive in terms of these different countries and positions.

Further, there is another initiative at WTO, namely Aid for Trade, which aims at increasing the funds available for addressing demand-led needs felt by developing countries. The aim is to augment the capacity (human, technical and infrastructural) to take advantage of the multiple opportunities that the multilateral system provides, and to help countries adjust to ongoing changes in the globalized world, including through new Agreements that may take place.

We need to recognize the strengths and the desirable criteria that are encompassed in the WTO system, and should help with the ongoing efforts to improve the system in the ongoing Round of negotiations. Our efforts should be to ensure that such improvements continue to take place as the global situation changes. But you will agree that these efforts have to build upon the already desirable structure which exists. It is systems such as these, together with relevant domestic efforts, that will take us towards the right kind of globalization.

Session IV

The Subprime Crisis and Financial Regulation: An International Perspective

Kenneth W. Dam

Just at the time I began my work in Germany last summer on comparative financial regulation, the subprime mortgage crisis erupted. What was a rather abstruse field of law and finance took on an immediacy both in the United States and in Germany. The effects in Germany on German banks have been profound.

1. Banks in the United States

The history of banking in the United States is exceedingly complicated. Beginning in the 19th century we have had a dual banking system, in which both states and the national government could and did charter banks. Many states had quite restrictive branching restrictions. Eventually through federal law this preposterous imitation of small town America gave way to economic reality. Today, thanks to 1994 legislation, banks can merge and branch on a countrywide basis.

Consequently, the number of banks in our highly decentralized system fell from over 14,000 to about 7,000 and is continuing to fall. An interesting example of the change is that Bank of America, an historically renowned San Francisco bank, is now headquartered in North Carolina and employs more than 200,000 people as a result of a major bank merger movement, having become the second largest U.S. bank.

Universal banking, as it is known in Germany where a bank can engage in all kinds of lending and securities businesses, was not known in the United States until quite recently. It is true that universal banking was common in the United States prior to 1933. But it was then outlawed by Congress, which blamed universal banking for the Great Depression. As a result two separate financial services industries grew up, commercial banking for loans and investment banking for securities. But in a development that took the entire decade of the 1990s, the United States returned more or less to universal banking. Today, for example, Citibank is not only a huge commercial bank but one of the largest underwriters of securities in the United States.

2. Banking regulation

Although the U.S. has a dual banking system, a state bank of any size will nevertheless be regulated by a national regulatory agency. But we have not just one but five different banking regulatory agencies. The result is a “fragmentation” of U.S. regulation that has serious consequences for global financial stability.

What are those five agencies?

- a) The Office of the Comptroller of the Currency – the *OCC* – for nationally chartered banks.
- b) The Federal Reserve – for state-chartered banks that are members of the Federal Reserve system.
- c) The Federal Deposit Insurance Corporation – the *FDIC* – for state-chartered banks that are *not* members of the Federal Reserve system.
- d) The Office of Thrift Supervision (*OTS*) – for so-called “thrifts”. They correspond more or less to German Sparkassen, though in the United States they are privately owned. Not all thrifts, however, are small or local. Washington Mutual, the largest thrift, is the fifth largest bank in the country measured by deposits.
- e) The National Credit Union Administration (NCUA) for credit unions, which usually service only employees of a employer or members of a union.

In addition, the U.S. has firms usually not thought of as banks but which offer checking accounts and money transfer services – for example, brokerage firms handling securities transactions – and their regulation is entirely different. And then there are investment banks such as Goldman, Sachs that for large business customers are much like a bank, but they are not regulated as a bank because they do not take consumer deposits. Recent events, especially the “bailout” this past March of Bear, Stearns through actions of the Federal Reserve, have raised questions whether any financial entity, even though not a bank, that enjoys even tacit government guarantees should not be subject to regulation, perhaps by still a sixth regulatory agency.

In the home mortgage arena, there are a large number of small firms that merely originate mortgage loans, often selling them to banks. Many of these mortgage companies are quite small, perhaps having only a single store front much like a German apothecary. The low underwriting standards of these mortgage companies have played a role in the low quality of many mortgages in the present crisis. Yet these non-bank mortgage companies are essentially unregulated.

The big five bank regulators– the *OCC*, the Fed, the *FDIC*, the *OTS* and the *NCUA* – are so-called independent agencies. The *OCC*, for example, may be in the cabinet-level Department of the Treasury, but that is a statement essentially about real estate. By Act of Congress the Secretary of the Treasury has no authority over the Comptroller’s policies and decisions. Coordination among these five bank regulators is normally at arms-length and entirely voluntary.

What’s wrong with this pluralistic and decentralized system, since decentralization of power is normally thought to be a good thing? First of all, the decentralization of regulation exists only because the statutory mandate of each regulatory agency is different, the differences being mostly accidents of history. Second, each bank can choose its own regulator just by switching from federal to state charter (or vice-versa), or by becoming a member of the Fed or dropping Fed membership, or other relatively minor changes.

Third, under an economic structure that has evolved in the last decade, a conglomerate banking institution can lend to borrowers from its commercial bank

subsidiary or its investment banking subsidiary or its brokerage subsidiary. The regulation is different for each part of the conglomerate bank.

3. A better way to regulate?

Isn't there a better way? The United Kingdom in 1997 moved to establish a single financial regulatory agency, the Financial Services Agency ("FSA"). The institution became a model for many other countries. Germany followed the UK model in 2002.

The FSA model provides a single regulator not just for banks but also for securities (which is regulated by a separate agency in the United States, the Securities and Exchange Commission). And an FSA also regulates derivatives, which in the U.S. is done by still another agency, the Commodity Futures Trading Commission (CFTC). In contrast to the FSA model, the United States with its five banking agencies, an SEC and a CFTC has a dysfunctional regulatory structure, which has come to public attention largely because of the current crisis in the securitization of mortgages which involves both banking and securities.

Since these various regulatory agencies are "independent" and not required to take direction from the U.S. Treasury, the Treasury has awakened to the fact that when everyone is in control of some small piece of a problem, nobody is really in control. In March of this year the Treasury released a 218 page "Blueprint" for regulatory reorganization.

Despite the ambition of the Treasury Blueprint, there are strong political reasons for doubting that such a consolidation will occur promptly or perhaps at all.

Of course, reorganization does not guarantee improved results, particularly when the problems go beyond regulation. The British FSA, together with the British Treasury and the Bank of England, faced major problems in coordinating among themselves in connection with the Northern Rock bank collapse last year. In the end, Northern Rock had to be nationalized.

Moreover, there is little support in the United States, even within the U.S. Treasury, for doing what the FSA model presupposes, namely, bring banking, securities, derivatives, and insurance regulation into a single agency. Banking regulation would be consolidated in one agency. Securities regulation would simply be merged with the regulation of derivatives. And insurance would continue to be regulated by separately by the 50 states, though a optional national charter would be created, which many large insurance companies would presumably choose.

4. Why regulate banks at all?

One of the fears raised among thoughtful financial experts by the fierce public reaction to the present international financial crisis is that new regulation will be introduced that will do more harm than good. In order to assess proposals for change, it is therefore useful to consider the reasons that have lead all countries to regulate banks.

The principal justification for regulation of the banking sector involves the confluence of a few main factors. First, a healthy financial sector is crucial to the stability and growth of the entire economy of a country. And second, the banking part of the financial sector is peculiarly prone to crises. Every decade the banking sector experiences a crisis in one or more major countries. In the last two decades we have seen the savings and loan crisis in the United States, the Swedish banking crisis, the Asian financial crisis, and the long-lasting Japanese non-performing loan problem.

Why are banks so vulnerable? First, banks are thinly capitalized compared to other kinds of corporations. A characteristic joke runs, “What is the difference between banks and hedge funds?” Answer: “Banks are more highly leveraged.”

A second factor is that banking profitability tends to depend on borrowing short and lending long. Clearly that strategy enhances profitability, since normally the interest rate curve slopes upward, with short-term rates being lower than long-term rates. But sometimes the curve is flat or even inverted, and then banks face financial difficulties. And in economic downturns, the default rate of bank borrowers rises; as a result banks, becoming perceived as riskier, may face rising funding costs in their short-term borrowing.

Thin capitalization, together with a “borrow-short, lend-long strategy,” seems to be necessary for a bank’s profitability. In order to assure that banks did not become insolvent and hence default on their obligations to their depositors, capital adequacy became a principal form of bank regulation. Capital had to be adequate to assure that a bank could pay off its creditors – principally its consumer depositors – at all times.

Today Basel I and Basel II are international agreements to ensure that all countries have capital adequacy regulation.

A further purpose of bank regulation is financial stability. Financial stability is one of those things that is best defined by what happens when we don’t have it. Financial **instability** involves the collapse or weakness of one bank leading to the collapse or weakness of other banks—in short, systemic failure of the banking system. Various popular terms are used to describe this process. Americans and Germans talk about the domino effect. The British call it “knock-on” effects.

5. The subprime issue in Europe

The subprime crisis has led to severe effects in a number of countries. The spread of the subprime mortgage problem from the United States to Germany is a good illustration of the domino effect in which financial instability can spread not just from one bank to another but from one country to another.

Though the problem originated in the United States, the resulting weakness and even failure in Germany of several Landesbanken (masked, to be sure, by forced mergers of Landesbanken), the quadruple bailout of IKB, and the big losses of private sector banks – even Deutsche Bank, which initially appeared to have avoided the problem – have captured public attention. My conclusion is that in the present globalized financial world, worldwide financial stability must be a cooper-

ative effort by national regulatory bodies, involving both buyers and sellers of securitized products. German banks bought the subprime mortgage securities apparently without knowing or caring exactly what they were buying. They did so because the *prospective* returns were relatively high. The Sachsen Landesbank, which later had to be merged with another Landesbank, went so far as to create a special unit in Dublin, of all places, to carry out trading in these mortgage-backed securities. Moreover, in considering recommendations concerning bank-sponsored off-balance sheet entities, such as SIVs and conduits, it is useful to consider their use by investing and not just originating banks. As C.A.E. Goodhart, a leading British expert, has pointed out: “German Landesbanken, IKB and Sachsen...had conduits [and] their conduits were many times the size of their own available capital stock. With the decline of the value of assets in their conduits, in effect these Landesbanken had to be saved by a bailout by their respective regional governments.” Hence, it would be wrong to assume that regulatory reform is primarily about changes required in U.S. law or that these changes would affect operations of only U.S. banks.

6. The securitization process

Let us pause to look in greater detail at what these securitized transactions were. Once upon a time, banks lent money to homebuyers, and the banks took a mortgage as collateral for mortgage loans. The banks then held these mortgage-backed loans to maturity, making their profit on the interest payments.

Today American banks prefer fee income rather than interest income. In lending with homes as security, what the American banks often do is to make (or buy) a large number of such mortgage loans, and then package them together in securities, using the underlying packaged mortgages as collateral. The securities are therefore called mortgage-backed securities (MBS). The process of securitization results in the bank being able to charge a fee for securitization, and thus translate long-term interest income into immediate fee income. Thus, income is accelerated and, more important, no reserves need be held against fee income under capital adequacy regulation, including Basel I and the newer Basel II. Although it would be too simple to say that Basel I led to securitization, there is little doubt that Basel I made securitization more attractive. Fee income avoids capital adequacy requirements, most simply because as soon as assets are securitized, no assets remain on the balance sheet of the originating banks.

One term that is important for understanding financial newspapers is the word “subprime.” One can think of “subprime” as meaning less than investment grade. The securities are sold in tranches, in the highest tranche, the underlying mortgages would not normally be subprime at all. The highest tranche is normally rated AAA, the highest rating, but lower tranches are of lesser and lesser quality. Of course, the lower the quality, the higher the interest income paid and hence many purchasers bought the lower quality tranches and these purchasers, including some in Germany, have been the first to suffer when overstretched American homeowners default on their mortgages.

As a strategy the securitization of mortgages can be quite profitable, but it is vulnerable to crisis. At least three things can go wrong: the costs of borrowing can go up, access to borrowing can dry up, or the assets bought with borrowed money can fall in value. All three have happened at various times over the last year. Since these three things have all happened in this crisis, the capital adequacy approach enshrined in Basel I and carried over, with modifications, into Basel II needs to be reexamined.

Quite aside from any imperfections in Basel I and II, the capital adequacy approach to bank regulation cannot deal adequately with the problem. First of all, on the originating side, it is important to observe that many of the institutions that made the mortgage loans are not banks in the regulatory sense and are not subject to bank regulation. Rather, as previously mentioned, a great many are mortgage companies that normally never did hold mortgages to maturity. In the past, they originated the mortgage loans and sold them to commercial banks that then held them for investment, but they more recently decided to securitize them. But even as to such mortgage loans, one could say that the capital adequacy approach incorporated in the two Basel agreements is in part the cause of the problem because those two agreements give such a strong incentive to turn interest income into fee income through securitization.

In any event, bank regulation of the selling banks raises only one set of relevant issues. The securitization process also has some worrisome aspects not yet dealt with adequately in the bank regulation process. These aspects have to do with the regulated institutions that buy the securities. Obviously buying banks have to pay for the securities, and under the Basel approach and under national rules capital would need to be maintained with respect to such assets. Not to worry! The buying banks can place these securities off balance sheet in special purpose conduits, usually called Structured Investment Vehicles, or SIVs. On the theory that the SIVs are not banks (even though they are “bank-sponsored”) and the securities are not loans but just investments by a non-bank, most banking authorities have not until this point attempted to exercise jurisdiction directly over SIVs.

SIVs in the eyes of the originating banks are primarily a funding vehicle. The SIVs sell commercial paper (that is, short-term paper) to institutional investors such as money market funds in order to buy U.S.-origin mortgage-backed securities. In order to sell the commercial paper at a reasonable price, the SIVs pledge the mortgage-backed securities they are in the process of purchasing as collateral.

Worries did not arise publicly until, suddenly, some purchasers of the mortgage-backed commercial paper from the SIVs refused to roll over the commercial paper as it became due because of growing concerns about the value of the mortgage collateral. The rating agencies had been concerned in issuing their ratings only with whether interest and principal on the mortgage-backed securities would be paid when due, not whether the SIVs would be able to roll over the short-term commercial paper with which they financed the mortgage-backed securities while seeking to sell them to ultimate investors. Once the commercial paper market began to refuse to roll the paper over, the SIVs had no alternative but to sell at whatever price available the mortgage-backed securities they had bought with the expiring

commercial paper. The result of these sales was that as the commercial paper markets began to seize up, the prices of the mortgage-backed securities began to plunge even for highly rated securities. A cycle followed in which the process fed on itself. Investing banks and other institutions began to have to announce write-offs of their existing holdings under accounting rules that required them to mark to market their securities. (Mark to market simply refers to rules requiring current market prices, rather than historical cost, to value assets.)

7. Recommendations

I shall now discuss recommendations about how to proceed to prevent occurrence of the types of international problems represented by the subprime crisis.

Recommendations have recently been published by various international bodies, including the Financial Stability Forum and the Basel Committee on Banking Supervision, as well as by a leading private sector group (the Institute of International Finance), and, to a limited extent, by the U.S. Treasury in its previously discussed Blueprint.

Here are my own thoughts on various possible actions:

7.1 Securitization

Do *not* try to stop securitization. This financial innovation has been an important technique for financing enterprise in the United States since at least 1980. It is heavily used by U.S. business for financing current operations through, for example, the securitization of accounts receivable in order to improve cash flow. The positive results of securitization include not merely diversification of risks beyond the banking sector but also increased availability of funds for normal business expansion.

7.2 Securitization in housing

Do *not* even try to limit securitization in the case of housing. Some decades ago virtually all finance of individual home purchases in the United States was provided from within the local community. Not only was that an inefficient arrangement, but it was also unfair because poor people, especially racial and ethnic minorities, found home financing both hard to obtain but unduly expensive.

7.3 Off-Balance Sheet Entities

The feature of securitization that has received the most criticism is the use of off-balance sheet entities. These are the SIVs and other conduits that are entities sponsored but not owned by banks. They are by design poorly capitalized and often highly leveraged. But it would be a mistake to prohibit their use. The populist notion one reads in the press that they are a “shadow financial system” is a distortion of reality. (Everyone in the financial world either knows or can easily find the sponsoring bank for any SIV.) Their purpose is to create a bankruptcy

firewall between the mortgage loan originator and the investor, so that an investor cannot bring an action for nonpayment against the originator. In the jargon of finance, they are “bankruptcy remote.” The elimination of off-balance sheet entities would likely put an end to securitization even for uncontroversial uses. Perhaps a bankruptcy firewall seems unfair to the investors, but investors who did any “due diligence” would be well aware of the firewall when they bought the securities.

7.4 Capital adequacy requirements

A related issue is whether banks maintained sufficient capital for their off-balance-sheet exposures, whether contractual or implicit. (By contractual exposures I refer to side commitments by originating banks made to guarantee the debt issued by their SIVs or the securities sold by their SIVs.) By implicit exposures, I refer to the fact that a number of banks took SIV assets back onto their own balance sheets not for contractual but for reputational reasons. The U.S. Treasury in its Blueprint recommended that regulators “adopt policies that provide incentives to hold capital and liquidity cushions commensurate with firms’ exposures (both on and off-balance sheet) to adverse market events.” The Financial Stability Forum made similar recommendations.

The basic issue is whether the capital requirements for a bank should be any different just because it put assets into an off-balance sheet entity. I would say not automatically different, but that is not the currently fashionable regulatory approach. The tendency now among regulators is to think in terms of allowing national regulators to exercise discretion concerning required capital under so-called Pillar 2 of Basel II. Naturally, regulatory agencies prefer discretion to the use of rules. To be sure, rules can be drafted around by innovative financiers and their clever lawyers, but that is true in all fields of public regulation. The trade-off between rules and discretion is a central theme in the law. Naturally the present trend toward regulatory discretion involves dissatisfaction with the actual working of the rules of Basel I and II, but the question is whether regulators can do a better job making decisions on a one-off basis than by enforcing known and agreed upon rules.

7.5 Transparency

Whatever the best answer to off-balance sheet entities from the standpoint of bank regulation, securitizations necessarily involve securities, and therefore the question of transparency for the benefit of investors must be faced. One issue with regard to the subprime crisis is whether the relationship between the originating financial institutions and the off-balance sheet vehicles was sufficiently disclosed to investors. I feel confident that the European banks that bought the subprime securities knew quite well what was involved. If the bankers involved are to be faulted, it is for greed, not for stupidity or for ignorance of the use of SIVs and conduits.

Nevertheless, the securities laws require certain disclosures, and I am confident that there will be private litigation under the securities laws, at least in the United States, based on nondisclosure or fraudulent disclosure with regard to subprime securities. And of course those laws should be enforced.

I mentioned earlier that some banks made side deals to guarantee securities sold by SIVs to investors. The failure to disclose these contractual guarantees did not hurt the investors directly. But such cases do illustrate the possibility that the use of off-balance sheet vehicles coupled with nondisclosed contractual guarantees should be a concern of bank regulators and perhaps of securities regulators as well. One obvious recommendation is that originating banks should be required to consolidate onto the banks' books off-balance sheet entities when such contractual guarantees exist.

7.6 Rating agencies

Perhaps the feature of securitization that has received the most public attention in the United States is the granting of AAA (triple A) ratings by the rating agencies, such as Standard and Poor's, Moody's and Fitch. Charges have been made of conflict of interest because it is the issuer, not the investor who pays for the ratings. The fact is that ratings have value to investors, but nonetheless a subscription model under which institutional investors pay on a calendar basis for ratings has been tried and has failed to generate sufficient revenues to support the rating process.

A more problematical concern is that in recent years rating agencies have generated a large proportion of their revenues by their consulting services; as part of their consulting services, rating agencies give issuers advice on how to qualify for higher ratings. And rating agencies certainly help issuers to structure their offerings to obtain higher ratings by advising on various kinds of what are called "credit enhancements."

Perhaps the most problematical aspect of ratings is that an investment grade rating for securities is required by statute for some kinds of institutional investors, such as pension funds, to buy the securities. And Basel II actually encourages banks to use ratings. Legislation and regulations thus encourage the outsourcing to rating agencies of due diligence. Why should we therefore be surprised that investors failed to do their own due diligence?

Another problem with ratings is that they do not address several important issues. First, rating agencies rate only the issuer's capacity to pay principal and interest when due. The probable price performance of the securities is ignored, despite the fact that under mark-to-market accounting most of the losses experienced to date have involved price fluctuations. The use of mark-to-market valuations has produced a large share of the turmoil in financial markets. These circumstances suggest that some of the attention now being directed at credit rating agencies would be better directed at mark-to-market accounting principles.

7.7 Is mark-to-market accounting a cause of financial instability?

A long-term issue is whether the use of mark-to-market valuation is always wise in the banking industry. On the one hand, it has the virtue of being more objective than management's subjective assessment of "fair value." But on the other hand, it may produce a self-reinforcing panic in financial markets as writedowns based on falling secondary market prices cause institutional investors to sell still further securities, thereby further depressing market prices and causing increased losses to be booked under the mark-to-market principle.

When interest rates rise in the economy, or when recession causes increased defaults, the resulting decline in mark-to-market valuations can cause turbulence in financial markets. Specifically, the writedown of values under mark-to-market accounting can create (or at least some observers so fear) a contagious cycle of writedowns. The decline in asset values can be quite large compared to a bank's core capital, and a number of the world's major banks have already had to seek major infusions of capital. It might be argued that the thinness of bank capitalization, coupled with mark-to-market accounting, explains why a 10 percent decline in stock market values rarely causes distress in financial markets, whereas a 10 percent decline in U.S. house values explains the worldwide subprime crisis.

The resulting dilemma for standard setters and regulators – whether to prefer mark-to-market transparency or be more concerned with market reactions – does not detract from a key simple point: namely, that the only logical argument for historical cost is that it lends itself to precise determination. However, the mark-to-market rule has thrown up the problem of what one does when there is no current market for a security, which may often be the case in the residential mortgage-backed securities market where thousands of securitized offerings may be sold each year and there may be no liquid market and perhaps no market at all comparable to the secondary market for equity securities and for many corporate bonds. The absence of a secondary or any other public market for such securities is a special problem in times of financial crisis, but it may be a frequent problem even in "good times." Once market participants come to mistrust ratings, it is difficult to value a residential mortgage-backed security offering without valuing the underlying individual mortgages – a Herculean task for investors and even a major challenge for rating agencies.

7.8 The tranche system

Securitization involves pooling of a large number of mortgages loans of varying quality within a single security, with the mortgage loans grouped by tranche according to likelihood of default. The highest tranche is designed to likelihood of default for an AAA rating, even though none of the mortgage loans was individually of AAA quality. How is such a result possible? The structure depends on the concept of credit enhancement. In addition to guarantees from specialized insurance companies, a principal way of achieving this enhancement is to use the remaining loans as security.

This is possible through application of the “waterfall” principle. All of the interest receipts for all of the tranches are collected, and then transferred to the highest tranche investors first to the extent needed to satisfy their contractual claims to principal and interest. Only when all of the highest tranche investors are paid is anything paid to the next highest tranche. This procedure is then followed on down the tranches – hence, the waterfall analogy. In fact, the middle tranches are commonly called mezzanine tranches and the lowest tranches “equity” tranches, the latter by analogy to equity investors who receive dividends only when all creditors’ claims are satisfied.

What is not generally known is which tranches European banks, such as the German Landesbanken, that were most affected by the subprime crisis actually bought, since many of these banks were obviously reaching for yield, it is doubtful that they always bought the top tranche. So they may have gone down the waterfall until they found a yield that met their ambitions. Of course, once the seize-up in credit markets began and the SIVs were not able to finance new securities, even the prices of the AAA securities undoubtedly fell and under the market-to-market principle generated a loss for the buyers. But these mark-to-market losses need not have reflected actual defaults on AAA securities.

7.9 Underwriting standards

Another issue that has captured great public attention in the United States is the lax underwriting standards at the stage of the initial mortgage loans to subprime buyers. Not only did many of the American non-bank originators purposely fail to exercise ordinary banking prudence, but fraud was undoubtedly involved in some cases. We can be sure that the U.S. Administration and the U.S. Congress will be focused on this aspect of subprime mortgages in the months ahead.

8. U.S.-European cooperation

I started my analysis by describing the fragmented U.S. system of bank regulation and the further fragmentation that arises from separate regulation of banks and securities. I contrasted the European unification of these sectors in some, but by no means all, EU countries through consolidation under FSAs.

The EU suffers from a different kind of fragmentation, at least in so far as transatlantic securities markets are concerned. The regulation of new instruments like subprime securities and of securitization generally are questions for the members states, and the European Central Bank has little to say about regulatory, as opposed to monetary, issues. Even the European Union has rarely concerned itself with bank regulation except insofar as such regulation might interfere with a major EU goal – the increase of cross-border banking as a way of speeding the creation of a single European financial market; the EU has not until very recently been involved in financial stability issues.

So how do the EU countries interact with the United States to deal with the downsides of securitization and with future financial innovations? For all kinds of

reasons, the G-7 no longer has the convening power and prestige that it had in the Bretton Woods fixed exchange rate period. And complex regulatory problems do not lend themselves to occasional weekend meetings and quickly drafted communiqués. In short, the U.S. and the EU do not yet have mechanisms for grappling with complex, detailed financial issues.

Today the focus of attention in governments is on the Basel Committee on Banking Supervision. This is an international body that provides a forum for national regulatory officials to meet to work on matters such as the improvement of Basel II. But the Basel Committee is at most regulators talking to regulators.

An international body of regulators cannot meet the challenges of present-day financial crises. Despite the rise of China and India and Brazil, challenges such as we now face are going to have to be dealt with through European-U.S. agreement and cooperation. Right now we do not have the institutions to talk to each other on a bilateral basis in concrete and expert depth. And until we both overcome our respective fragmentation problems, we will not be about to deal effectively with financial stability issues.

Panel Statements

Does the World Need TRIPS-like Instruments in Other Areas of Commerce and Finance?

Herbert Kronke

1. Introduction

'TRIPS-like' is a metaphor which readily comes to mind in Munich, the world capital of the community of intellectual property law scholars. What does it stand for? With the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) the WTO established a parallel system of regulatory protection of intellectual property rights – relatively detailed, systematic, based on substantive protection standards and providing for means of enforcement – side by side to the traditional convention system (Paris, Berne, etc).

Apart from the institutional and procedural framework, the treaty sets forth substantive standards regarding the availability, the scope and the use of intellectual property rights as well as rules on the private enforcement of those rights, i.e. remedies and procedures available to their holders in cases of violations, which Contracting States have to provide.

The underlying rationale is that world trade law does not want to facilitate any trade but only trade in goods and services which are not subsidised, dumped or fruit of the violation of intellectual property rights.

However, intellectual property rights, as designed and protected by the TRIPS Agreement, are not absolute. Their content may be shaped and their exercise may be limited with a view to achieving certain economic and social objectives. Articles 7 and 8 of the Agreement, the provisions defining the objectives of the system and its guiding principles, serve at the same time as basis for member States' authority to embed the ways right-holders may make use of their individual legal position in collectively formulated policies. In other words, this paper is obviously expected to address the fundamental issue of the relationship between private law, and more specifically commercial law, on the one hand and public international trade law and regulatory law on the other hand. It is necessarily also about non-level playing fields in international commerce and finance, a phenomenon a private-law formulating agency such as UNIDROIT encounters routinely in carrying out its mandate.

The foregoing permits to re-phrase the query this contribution to our panel is called upon to answer as follows: do we need multilaterally negotiated, shaped, defined and recognised substantive property rights (i.e. the faculty to act in asserting individual rights such as, e.g., a claim or legal title to assets as well as the right to dispose of them by way of transactions based on the freedom of contract/party autonomy, albeit regulated so as to be in compliance with societal goals) in other areas of commercial activity? The answer is 'yes', and it is submitted that this will

not happen necessarily – or only partly – in the context of the WTO although the States' obligations under the WTO treaty will certainly have an impact.

The adjective in the title of this inquiry, 'TRIPS-like', also demands to establish the motivation of the TRIPS, both the 'positive' guarantees and the 'negative' constraints provided for in the Agreement. It was the unhappiness of developed countries with elaborate IP legislation in place at home with low standards of protection elsewhere. Introducing TRIPS-like instruments in other areas of commerce and finance means, therefore, developing harmonised substantive principles and rules defining and protecting rights available to participants in international commercial transactions. In extending the above mentioned rationale underlying the TRIPS Agreement and the motivation for its concrete features the hypothesis would need to be that the international community does not want to facilitate any economic activity but only such activity that is not fruit of violating standards set for the protection of parties to commercial transactions or investors exposed to specific risks flowing from the cross-border character of financial markets. Or again, fruit of the lack of a level playing field as regards private-law rules protecting individuals in being the masters of their destiny and their commercial dealings with others.

Finally, in defining the terms of reference for this panel it is useful to contrast the TRIPS Agreement with the General Agreement on Trade in Services (GATS). The latter establishes neither individual rights (or standards for the establishment and the recognition of such rights) nor even a framework for private transactions nor does it harmonise the relevant regulatory laws in member States; it only imposes non-discrimination of and market access for non-nationals. The obvious question, therefore, is whether the GATS should move in the direction of the TRIPS Agreement. And the answer, again, would appear to be 'yes' in the medium term, but only following transactional commercial law and its globally harmonised development or modernisation. The sequence is critical. As has happened with intellectual property rights, first we need robust legal positions of individuals and businesses in domestic law, where possible or necessary developed in an internationally harmonised fashion. And only then does it make sense to provide for the WTO's political umbrella enshrined in rules of public international law.

2. Areas of international commerce and finance where TRIPS-like standards and guarantees are deemed to exist

2.1 Sale of goods and the general law of contractual obligations

The history of the law of contracts is a process of trial and error as to how far the freedom of the parties to a specific transaction to shape its content goes and where collectively defined limits and standards may, or must, be imposed. This is true for national legal systems and for transnational commercial law in the sense of both international uniform law and (domestic or international) conflict of laws. To the extent that legal systems recognise freedom of contract and party autonomy no further substantive private-law standards are needed. Contracts for the sale of goods

being the paradigm for commercial transactions, the 1980 United Nations Convention on Contracts for the International Sales of Goods (CISG) – an instrument covering a significant percentage of trade in manufactured goods, but, by virtue of the traders’ using their liberty to contract out of the Convention’s regime altogether, not commodities – has been examined as to its potential to be part of an international ‘economic constitution’ (*Wirtschaftsverfassung*) based on private law¹. The CISG does indeed recognise the parties’ freedom to derogate from its (dispositive) provisions and to establish their own programme of rights and obligations. This does not entail that the ‘law of the jungle’ replaces the orderly balancing of private rights and public interests where transactions are transcending the closed system of a national market and its legal framework. The enforceability of relevant regulatory law is, in many legal systems, guaranteed by conflict-of-laws doctrines such as the applicability of interventionist mandatory rules irrespective of the otherwise governing law², and the exceptions to the rule of freedom of contract based on public policy (*ordre public*) provide for adequate safety valves or even an emergency brake. What is politically – or philosophically – noteworthy is that, beyond international instruments dealing with specific types of transaction (sale, leasing, factoring, secured transactions), there do not seem to be sufficient incentives for Governments to actively pursue the recognition of freedom of contract as such at the global level. In other words, there are, for the time being, larger pockets on the world map where freedom of contract and property rights – for non-nationals and nationals alike and therefore reminiscent of the situation with respect to intellectual property rights prior to the advent of treaty law – are insufficiently protected than areas where identifiable lacunae in the regulatory set-up would pose a threat to a sound equilibrium of private rights and public policy.

2.2 Trade in services: general aspects

The GATS objective of facilitating various modes of providing services across borders are being pursued based on the principles of MFN treatment, national treatment, private enforceability of those rights in national courts under the *lex fori* and transparency. As already mentioned, the treaty does not create or recognise individual legal positions but addresses the conditions under which commercial transactions may be entered into.

¹ Drexl, WTO und Privatrecht, in Ott/Schäfer (eds.), *Vereinheitlichung und Diversität des Zivilrechts in transnationalen Wirtschaftsräumen*, 2002, 333 (346 et seq.); More specifically on the relationship between private international law (conflict of laws) and the WTO system, Roth, *Welthandelsordnung und IPR*, in: Heintschel von Heinegg et al. (eds.), *Entschädigung nach bewaffneten Konflikten – Die Konstitutionalisierung der Welthandelsordnung*, *Berichte der Deutschen Gesellschaft für Völkerrecht* 40, 2003, p. 331.

² Cfr. Symposium Max-Planck-Institut für ausländisches und internationales Privat- und Wirtschaftsrecht with contributions by Drobnič, Basedow, Siehr, Rigaux, Lowe, Mestmäcker, *RabelsZ* 52 (1988) pp. 1 – 302; Schnyder, *Wirtschaftskollisionsrecht*, 1990; Basedow, *Souveraineté territoriale et globalisation des marchés; le domaine d’application des lois contre les restrictions de la concurrence*, *Rec. Cours* 264 (1998), 9; Kronke, *Capital Markets and Conflict of Laws*, *Rec. Cours* 286 (2000), 245 (282 et seq.).

2.3 Specific types of services

2.3.1 Transportation: the carriage of goods and passengers

Again, this being pure contract law one might argue that no concerted legislative action is needed unless, that is, one considers an aggressive drive to seek universal recognition of the principle of freedom of contract as worthwhile an undertaking as the protection of intellectual property. What is fundamentally different as compared to the sale of goods is that the carriage of goods and passengers has at all times and in all economic and legal environments operated in highly regulated markets. Consequently, both global and regional action are focusing on gradually deregulating the markets concerned.

2.3.2 Financial services

Certain types of financial services, such as insurance or straightforward banking services, are bi-lateral in nature. They are merely contractual; no third party effects are at issue. Again, apart from careful monitoring the evolution of specific regulatory requirements and options, such as prudential carve-outs, compliance periods and market-access commitments that have to be negotiated on a case-by-case basis, this is a subject-matter area where nothing more – and nothing less – than freedom of contract is called for.

2.4 Secured transactions

An area where transnational commercial law enshrined in treaties has rapidly advanced over the past decade are secured transactions, notably for the financing of high-value mobile infrastructure equipment. The 2001 Cape Town Convention on International Interests in Mobile Equipment and its industry-specific protocols (the 2001 Protocol on Matters Specific to Aircraft Equipment and 2007 Luxembourg Protocol on Matters Specific to Railway Rolling Stock) established a robust and predictable regimen on the taking of security in its three basic forms (retention of title, lease, classic security agreement) which is for the first time based on unfettered freedom of contract and the protection of the security taker's (seller's, lessor's, financier's) proprietary interests. It is a particularly fitting example in our wider context of the search for 'the right kind of globalisation', as it was negotiated with the objective of leading to a win-win situation between security providers – typically located in developing countries – and security takers – typically located in industrialised countries. The large number of Contracting States from the developing world³ and the measurable benefits they were able to reap from the instrument, which in turn were given the blessing by an agreement of the export credit agencies under the aegis of the OECD, in the meantime provide evidence for the theoretical soundness and the practical effects of transnational law reform in this field.

³ See the updated status table at www.unidroit.org.

3. Areas of international commerce where individual rights and regulatory frameworks are insufficiently developed

3.1 Securities

A huge leap from the least problematic area, the law of contracts, to the arguably most complex one: an area where not only (bi-lateral) contractual relationships but also questions regarding property in the strict sense, i.e. legal status, and, moreover, sensitive branches of the law such as securities law, insolvency law and, albeit only marginally, company law are intertwined, each of them until recently no-go zones for the private-law formulating agencies tasked with the – ideally harmonised – modernisation of commercial law: the law of acquiring, holding, disposing of and using securities, i.e. financial instruments such as shares and bonds.

There are certain similarities (but also very significant differences) with intellectual property rights. Today, securities are, firstly, overwhelmingly de-materialised, i.e. not certificated, not tangible, and/or immobilised. After they have been issued by the issuer, e.g. a German company or the US Treasury, they are held by a Central Securities Depository. That entails that they are, secondly, not moved (delivered) when one investor acquires them from the issuer or a bank or broker or from another investor. They are held not physically but credited to securities accounts which the investor maintains with an intermediary, e.g. his bank. Consequently, acquisitions and dispositions are effected by credits and debits to those accounts. Thirdly, securities held by an intermediary are (in most systems) held in pools in which all investors who are customers of that intermediary participate (e.g. conceptualized as co-ownership) – a stark contrast with intellectual property rights. Fourthly, the investor's direct intermediary very often maintains securities accounts with other intermediaries, one tier after another, up the chain and across national frontiers until one arrives at the Central Securities Depository in whose books and accounts the entire issue is immobilised. Fifthly, in most legal systems each intermediary knows nothing about movements, i.e. transactions resulting in credits and debits, at levels above or below but follows instructions from and has – and wants to have – rights and duties only vis-à-vis its direct customer/account holder.

Not entirely unlike the situation in the world of intellectual property rights, globally speaking, only a minority of legal systems have any or any significant body of rules defining and adequately protecting the legal position of the 'owners' of securities, governing their rights and duties, the intermediaries' rights and duties and ensuring that the so-called post-trade aspects of transactions on securities markets (acquisition, disposition, use of securities as collateral), i.e. clearing, settlement, custody, find functionally sound solutions. And this unsatisfactory state of affairs has persisted notwithstanding the fact that we are talking here about transactions worth 2 trillion USD per day, i.e. the world's total GDP every 20 trading days.

What makes it still more grave: even legal systems which have refined their legal infrastructure in the sense that they have developed – or tweaked – old law so as to provide containers for new facts and new operational patterns, e.g. English,

German or Japanese law, may be internally sound (if they continued to be insular and closed systems) but they are not internationally compatible, even in cases of closely related systems such as Germany and Japan or Germany and France. Yet holding patterns (tiers of intermediaries in a chain between the issuer and the ultimate investor) are almost invariably trans-border or may become so at any moment.

The consequences, illustrated drastically first in failures of domestic systems and then internationally in court cases arising out of the collapse of Robert Maxwell's empire⁴, are

- Legal uncertainty, in particular grossly inadequate investor protection;
- Inefficiencies;
- Systemic risks.

Not surprisingly, all observers of the scene (BIS, IMF, central banks and securities markets regulators, the association of the world's major financial institutions known as 'Group of Thirty', the European Commission) have identified the problems and risks and called for the development of a harmonised body of substantive rules governing the individual legal positions of investors and intermediaries, the structure of transactions and providing for operational safeguards designed to protect the soundness and the integrity of the system.

Three layers of reactions can be identified: first, accelerated reform of national rules, starting in the US and, most recently, in Japan and Switzerland. Second, the development of a conflict-of-laws convention – i.e. an instrument providing for rules that determine the domestic law applicable to dealings in intermediated securities, the 2006 Hague Securities Convention⁵. Third, and given that the majority of legal systems does not – yet – have internally sound and internationally compatible law covering the relevant issues inevitably and most urgently, a draft UNIDROIT Convention on Substantive Rules Regarding Intermediated Securities, which will be adopted by a Diplomatic Conference this September in Geneva.

With respect to the Hague Convention, only two remarks. It is freedom of contract, party autonomy, which provides for the basic connecting factor: the investor/account holder and the intermediary/account provider determine in their account agreement the law applicable to the proprietary aspects contemplated in the Convention. Such was the agreed solution, but after the US and Switzerland had signed, regulatory instincts (or competition concerns in regulatory disguise) subsequently prevailed in other quarters, and the question now is how do freedom of contract and regulatory constraints (not unlike those behind Articles 7 and 8 of the TRIPS Agreement) relate to each other? And what needs to be done so as to not sacrifice one on the altar of the other?

⁴ *Macmillan Inc v Bishopsgate Investment Trust plc and others* (No 3) [1995] 1 WLR 978.

⁵ Hague Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary, which was adopted in 2002 but bears the date of the year when it was signed by the first negotiating State, i.e. 2006. For a detailed analysis, see Goode/Kanda/Kreuzer/Bernasconi, *Hague Securities Convention – Explanatory Report*, Martinus Nijhoff Publishers: The Hague, 2005.

With respect to the draft UNIDROIT Convention⁶, I shall not embark on explaining in detail how the daunting task of modernising harmonisation was technically approached – and the goal achieved – in an area where domestic systems were built on hugely diverse conceptual analyses, including contract law, property law and trust law, although this will, if successful, open a new era in comparative and transnational commercial law. Just one point because it will lead us into another area where TRIPS-like instruments may before long be needed: company law. At the outset, a number of Governments demanded that the draft UNIDROIT Convention refrain from touching upon corporate law *tout court*. But it quickly became clear that that was impossible. At least two issues needed to be addressed. First, Contracting States must permit holding of securities through intermediaries. Second, an intermediary must be able to vote in shareholders' meetings according to its various account holders' differing instructions even if the intermediary, on the company's register, is the (only) nominee shareholder. Currently this is not allowed in many jurisdictions.

3.2 Foreign shareholders' rights in company law

Since discussions of that issue as well as previous discussions about the need for so-called 'global shares' unearthed a whole range of discriminations to which foreign shareholders are subject in many jurisdictions (e.g. regarding voting by proxy, unequal voting rights or voting weight; disclosure and communication requirements), important market participants voiced support for UNIDROIT to tackle this subject-matter area as part of its next triennial work programme (2009-2011). Not only does this make a lot of sense analytically and in terms of the rational employment of resources as it would be the continuation of work in the sense of drilling a little deeper at one particular point. There is also clearly a parallel to the law of intellectual property. Nationals of one country are not protected in their individual legal position by the laws of another country; their choice is between not engaging or being discriminated against.

Alas, for the time being, it will not be tackled because of the recently surfacing mammoth foreign shareholders, better known as Sovereign Wealth Funds. The matter would now appear to be too politicized to be capable of being addressed from a private-law point of view. An interesting insight, however, that there are – contrary to the hypothesis on sequence suggested as a general rule *supra 1, in fine* – also areas where the political issues need to be resolved and the public-international law framework needs to be in place prior to the creation or perfection of individual private-law based positions.

⁶ Draft Convention on Substantive Rules regarding Intermediated Securities, Study 78. All documents accessible at www.unidroit.org under 'Work in Progress'.

3.3 Unfair trade practices

Although in a number of jurisdictions this branch of the law is closely related to IP-laws, e.g. in the sense that the latter with respect to certain fact patterns are viewed as *leges speciales* whereas unfair-trade-practices legislation is *lex specialis*, there is no perceptible move – at least to the eyes of the non-specialist – in the direction of internationally standardized concepts of what is ‘fair’ and the recognition of individual legal positions based on any such standards. And it is my hunch – again, a non-specialist’s guess – that the situation will remain unchanged in the foreseeable future. It is submitted that, in these matters, what an eminent faculty colleague of our chairman and myself calls ‘cultural identity’⁷ comes into play – easily as much, if not more, as the invisible hand of economics.

4. Liberalization, domestic tensions, multilateral regulation, and justice

Larry Summers, former US Secretary of the Treasury, former President of Harvard University and distinguished economist, publishes regularly in the ‘Financial Times’. Two columns that appeared on 28 April and 5 May 2008 triggered reactions from other distinguished economists and led some of them to conclude that (a) a liberal international economic order was losing intellectual support, and (b) that developing economies should be worried.

In sync with at least two contenders in the race for the White House, his columns suggest – or at least lend themselves to being interpreted this way – , couched in appealing distributional terms, that where globalisation creates competition for the US which in turn threatens standards of living of American workers, globalisation should be attenuated. However, the problem Professor Summers and others identify, the hyper-mobility of capital, was an outcome that he and the US Government as well as many other Governments and intergovernmental bodies actively promoted. And it would appear to be undeniable that the best line of defence for protecting workers has to be primarily domestic – through progressive taxation, improving education, strengthening the bargaining position of labour and refining the social safety nets. From the point of view of developing economies it is wholly inappropriate – to avoid stronger language – to tweak the rules through international regulatory harmonisation designed to bolster the fraying consensus among our middle classes in favour of globalisation. As Philip Stephens, another prominent editorialist of the ‘Financial Times’, recently pointed out, there are some uncomfortable truths for a new world of ‘them’ and ‘us’. Indeed, a willingness to see that this is a transformational moment that demands that we look at this world, its economics and the economy’s legal infrastructure entirely afresh has yet to emerge. The terms of what constitutes just globalisation – and that includes decisions as to where we need universal recognition of standardised private-law positions – cannot be determined

⁷ Jayme, *Identité culturelle et intégration: le droit international privé postmoderne*, Rec. Cours 251 (1995), 9.

unilaterally but only co-operatively. Is it by coincidence only that the rights of foreign shareholders mentioned above were to become a priority on our work programme – if we had acted two or three years ago – but that they are now being removed from centre stage – now that the foreign shareholders are coming in from the South and from the East?

Strategic consistency and intellectual honesty in defining what needs to be done domestically – be it within a country or a Regional Economic Integration Organisation – and what can be achieved multilaterally (and, if so, by which means of private/transactional law and/or public international trade law) is called for. Reacting out of frustration or in moments of crisis is not functional.

The Future of Banking Regulation*

David H. McIlroy

1. Introduction

The banking crisis of 2007/08 saw a combination of new conditions give rise to reminders of old truths about the rationale for banking regulation. The crisis reminded politicians that banks are special. The collapse of no other sort of financial institution has the capacity to create queues of people standing in a line waiting to get their money. The collapse of no other sort of financial institution has such an immediate and dramatic effect on the real economy.

The crisis reminded commentators that, in reality as opposed to in economic theory, the bigger banks at least, enjoy the benefit of a guarantee from governments so that, even if their shareholders lose out, their depositors will be fully compensated so that systemic risk does not occur.¹ The German government may have been forced by the European Commission to waive its legal guarantee of the publicly owned Landesbanks in Germany, but the economic reality is that deposits with large banks, whether privately or publicly owned, enjoy the benefit of an implicit government guarantee.

Finally, the crisis reminded everyone that, in the end, banks are regulated because of worries about risk. And the reminder of that fact presents us with a problem: the problem that we discovered no-one knew or could calculate the risk profile associated with securitized products. The banks did not know, the buyers did not know, everyone was relying on the credit reference agencies and their computer programs (or at least Moody's) were wrong.

The credit crisis of the second half of 2007 was caused by a combination of local conditions and banks' responses to global regulation. The global regulation in question was the First Basel Capital Accord ('Basel I'), which required banks to hold specified amounts of capital in reserve against loans made in certain broad categories. Banks had responded to this regulation by securitization, by bundling up loans to private customers and companies, and selling these to one another on the inter-bank market. These securitized loans are often referred to as asset-backed securities (ABSs) and are then sold on as more complex financial instruments as collateralised

* A similar version of this contribution has been published in the *Journal of Banking Regulation*.

¹ Smithers argued in 'Why banks' regulatory capital requirements need to be raised', *Butterworth's Journal of International Banking and Financial Law*, 2008, at 83, that this guarantee applies to all banks. It does not, as the depositors of BCCI know to their cost. The point is, however, a sound one with regard to large banks and banks with strategic importance in certain sectors of the economy.

debt obligations (CDOs).² As the loans were removed from the banks' balance sheet, so the banks were enabled to make further advances. Better still, thanks to tranching and with the imprimatur of the credit ratings agencies, banks were enabled to devise securitised products which enjoyed AAA grade ratings even though the underlying securities were of far lower grade.

Of course, as the mediaeval alchemists discovered, the process of turning lead into gold is fraught with danger. At the root of the web of inter-bank loans were still the primary debts, those owed by private customers and companies. If enough of those customers defaulted, the banks holding those securitized loans might have difficulties repaying their debts. The gold of the inter-bank debt or CDOs would turn out to be fool's gold, worth little more than lead.

In a further complication, what had been lauded as one of the strengths of financial deregulation proved to be precisely its Achilles heel. Financial deregulation meant that even banks with limited foreign operations could access credit markets across the globe. What was not foreseen was that precisely because those markets had become so interdependent, a problem originating in one of them could cause all the markets to close simultaneously.

Effective banking supervision is all about the management of risk. The problem is that the current regulatory structure has allowed the development of significant practices in the market where the self-interest of market participants has given rise to unacceptable systemic risks.

The question is: what, if any, constrictions on private profit-making are justified in order to prevent the public costs of a systemic failure in the financial markets? There is always a risk of over-regulation in response to a financial crisis, and I am arguing for three modest regulatory changes.

Those three regulatory changes are designed to respond to three imperatives when designing bank regulation. First, the imperative to ensure that, so far as is possible, regulation aligns economic and regulatory incentives. Second, the imperative to ensure that, so far as is possible, the degree of risk being taken by banks is capable of verification by supervisors. Third, the imperative to ensure that, whilst responsive to market conditions, the effects of regulation are not excessively pro-cyclical.

² CDOs can be made up of a number of different asset-backed securities, so mortgage-backed securities could be mixed with investment-grade bonds and leveraged loans, which are then divided into different tranches of varying seniority, each having its own repayment and interest-earning terms, and each being given its own credit rating to represent the degree of risk thought by a credit rating agency to be involved in the particular CDO. A more detailed explanation of tranching can be found at paragraphs 58 to 63 of the House of Commons Treasury Committee's Financial Stability and Transparency 6th report (March 2008).

2. Three areas for reform:

- a) *Minimise the moral hazard involved in the ‘originate and distribute’ model of banking.* By preventing banks from selling all the risk in products that they originated. Keep them co-insuring those products to the level of, say, 20%.
- b) *Transparency of risk in financial products is essential if regulation is to work*
Only permit derivatives and ABSs to be traded by banks if the risk can be identified and accurately quantified.
- c) *Reform Basel II so that it is not so pro-cyclical*
This may mean requiring more capital than banks want to hold in the good times, but it will cushion them against having to liquidate assets in the bad times, thereby deepening the crisis.

2.1 Minimise the moral hazard involved in the ‘originate and distribute’ model of banking

Traditionally, banks lent money to companies and to people who wanted a mortgage, and then the banks collected the repayments of that money for themselves. There was therefore an ongoing relationship between the bank which lent the money and the customer who borrowed the money. The fact of this ongoing relationship meant that the bank had a direct financial interest in making sure that the customer was likely to be able to repay the money. This model of banking is now being described as “originate and hold” because the bank which originates the loan holds on to the loan. The direct relationship between the original customer and the originating bank is maintained throughout the life of the loan.

In the 1970s, U.S. government-backed social mortgage lenders, Fannie Mae (Federal National Mortgage Association), Ginnie Mae (Government National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation), started using a different model. They would make loans on generous terms to people who would otherwise have found it difficult to get a mortgage and, rather than waiting for those loans to be repaid over the lifetime of the loan, would sell on the loans to commercial financial institutions. Those loans were attractive to commercial financial institutions because, if the borrowers could not repay the loans, the U.S. government had guaranteed their repayment. By selling on their loans, Fannie Mae, Ginnie Mae and Freddie Mac received cash up front instead of having to wait for the loans to be repaid. This meant that they could lend more money more quickly to other borrowers. This new model of banking is called the ‘originate and distribute’ model, because the bank which originates the loan then distributes the loan to other banks, so that, whether the customer knows it or not, the banks who are expecting to be repaid are not the bank which originally made the loan.

It did not take private banks long to realise that what Fannie Mae and Freddie Mac were doing, they could also do. Banks would bundle together mortgage loans and sell them on to other banks. By doing this, some banks were able to grow their business far faster than their depositor base or shareholder investment would otherwise have allowed. Northern Rock expanded its business rapidly by making mort-

gage loans, selling them on to other banks, using the money received from the other banks to make more mortgage loans and then repeating the cycle. Changes in the ways banks were regulated, reached in an international agreement called the Basel Capital Accord in 1988, encouraged this practice, but it really exploded between 2003 and 2006 when the percentage of mortgage-backed securities issued by private sector banks increased from 24% of those issued in the USA to 60%.³

The result was that by the summer of 2007, banks all over the world had bought bundles of American mortgage loans from those American banks which had made them in the first place. Then house prices began to drop in the U.S.A. Banks suddenly realised that if enough American borrowers could not repay their mortgages then there was a real risk that they would not be repaid on the loans they had bought. No-one knew how much the mortgage debt they had bought was worth. It might even be worthless. Banks stopped lending to one another. So when Northern Rock in the summer of 2007 went to the markets to ask to borrow more money to finance its business, it found that the markets had all closed. As a last resort, it went to the Bank of England to borrow money. Once the BBC had broken the news that Northern Rock had received a loan from the Bank of England as lender of last resort, retail depositors lost confidence in Northern Rock. Queues formed outside its branches, and Britain was in the grip of its first run on a bank in over a century.

Inherent in the 'originate and distribute' model of banking, as currently practised, are two key issues: the problem of mis-selling and the problem of information asymmetry. Under the 'originate and hold' model of banking, the originating bank and the original borrower have a direct relationship, and one in which the originating bank is directly interested in the question of whether the borrower will be able to repay the loan. Under the 'originate and distribute' model of banking, the aim of the bank which has made the loan is to sell the loan to another bank. The originating bank has no direct interest in making sure that the borrower is able to repay the loan because, if the borrower is unable to make the repayments, it will be another bank which loses out. Of course, a bank which becomes known for making reckless loans may find it difficult to sell them on, but that fact may not be discovered for several years, by which time the people at the bank who sold the loans in the first place will have collected their bonuses and may well have moved on.

The 'originate and distribute' model of banking creates a serious problem of moral hazard. The originating bank does not have sufficient incentive to be careful in who it loans to and as to how much it loans.⁴ The ultimate holder of the risk, the end user, is likely to be too far down the investment chain to be able to monitor the quality of the loan effectively.⁵ The 'originate and distribute' model of banking

³ House of Commons Treasury Committee Financial Stability and Transparency sixth report (February 2008), para.46 . 19.

⁴ Joint report by the Treasury, the Bank of England and the FSA Financial stability and depositor protection: strengthening the framework (January 2008) Cm 7308 para. 2.53.

⁵ See paragraphs 169 to 178 of the House of Commons Treasury Committee Financial stability and transparency 6th report (March 2008).

encourages reckless lending.⁶ Reckless lending has serious consequences, and the recent sub-prime crisis has demonstrated that those adverse consequences are both systemic and, if the loans are sold around the world, global in scope. Reckless lending means borrowers are lent money they cannot afford to repay. They then buy houses they cannot afford to live in, spend money on consumer goods they cannot afford, and when they fail to make their mortgage repayments, suffer the consequences, often including family break-up, which accompany serious debt. Reckless mortgage lending also affects everyone in society, driving house prices upwards beyond a point which is sustainable.

The economic consequences of the on-sale, via securitization, of 100% of the original loan are disastrous. At the very least, originating banks ought to be required to retain 20% of the risk in relation to the original loan, so that they have sufficient incentive to take proper precautions to see if the borrower can afford to make the repayments.⁷ In relation to more complex forms of securitization, where the repackaged loans have been divided up into different tranches as CDOs, the originating bank ought to be required to hold on to a greater percentage of the so-called equity tranche, i.e. the riskiest portion of the loans, which bears the highest risk of non-repayment.⁸

2.2 Transparency of risk in financial products is essential if regulation is to work

John Moulton, head of the private equity firm Alchemy Partners, used the opening speech at SuperReturn 2008, the private equity industry's international conference, to criticise the banks. He said 'They bought all this rubbish themselves, most of which their senior managers didn't understand, and they have been left holding the baby with unsaleable, overpriced, over-enthusiastic debt.'⁹ The thing that is culpable is that banks allowed a vast amount of money to be gambled on products *which their senior managers didn't understand*.

A similar criticism was made by the House of Commons Treasury Committee. Having taken evidence from Lord Aldington, Chairman of the London branch of Deutsche Bank, it expressed surprise and concern that

'the Chairman of the UK branch of a leading investment bank could not explain to us what a CDO is, a financial product in which he told us that his organisation deals. ... If the creators and originators of complex financial instruments have only a limited

⁶ Something recognised by both the Governor of the Bank of England and the Chairman of the Federal Reserve Board, see paragraphs 79 to 82 of the House of Commons Treasury Committee Financial stability and transparency 6th report (March 2008).

⁷ Such a requirement would also have the advantage of being easy to verify. This is important as the US mortgages which underlay many securitized products were sold by banks who could have any one of five different regulators or by mortgage providers who were subject to no regulation.

⁸ A reform recommended by Professor Buiters in his evidence to the House of Commons Treasury Committee Financial Stability and Transparency 6th report (March 2008), para. 177, 62.

⁹ Daily Telegraph, 27th February 2003, B3.

understanding of these products then it raises serious questions about how investors in these products can possibly understand such complex products and the risks involved in such investment decisions.¹⁰

In his evidence to the House of Commons Treasury Committee, Professor Buitert went even further. He said that many securitized structures were ‘ludicrously complex’ and that it was doubtful whether even the sellers and designers of these products knew what they were selling.¹¹ The result, concluded the Committee, was that there was increased opacity in the financial system, with attendant ambiguity about where risk was borne.¹²

A similar observation was made by Hertz, Hamilton and Ruiz, writing specifically about the Structured Investment Vehicles (SIVs) through which banks obtain off balance sheet financing for their securitized debt. They speak of ‘The inherent lack of transparency as to where the ultimate extent of the financial exposure rests and the quantum of the exposure, due to the complexity of the structures and the products’¹³ and recognise that the consequence of this has been ‘to heighten the level of concern and uncertainty’ leading to a prolonged liquidity drought in the markets.

Apart from the use of securitization to lessen the impact of regulatory capital requirements, the economic justification for securitization must be that it enables risk to be distributed efficiently. As Mr Alexandre Lamfalussy, former General Director of the Bank for International Settlements, explained at a speech given in Brussels on 23rd January 2008: ‘until this crisis most market participants and a number of weighty officials argued that the [“originate and distribute”] model (just as securitization) increased the efficiency of our system and that it had a stabilising effect on our global system, by diminishing the concentration of risk on the banking sector and distributing those risks more widely.’¹⁴ This justification can only hold if market participants are able to price that risk accurately and identify which market participants bear what degree of risk.

The market closure seen since August 2007 has been due to a widespread concern that it is impossible to accurately price the risk attached to many of the collateralised debt obligations which have been sold. The problem is compounded by the fact that investors, including the banks themselves, do not yet believe that the

¹⁰ House of Commons Treasury Committee Financial Stability and Transparency 6th report (March 2008), para. 39, 17.

¹¹ House of Commons Treasury Committee Financial Stability and Transparency 6th report (March 2008), para. 157, 55. A similar view was expressed by the Governor of the Bank of England in a speech to the Northern Ireland Chamber of Commerce in Belfast on 9th October 2007.

¹² House of Commons Treasury Committee Financial Stability and Transparency 6th report (March 2008), para. 159, 56.

¹³ Hertz/Hamilton/Ruiz, SIVs: is the party over?, 23 *Butterworth’s Journal of International Banking and Financial Law* 2008, 3.

¹⁴ Lamfalussy, Looking Beyond the Current Credit Crisis, speech at the meeting of the Economic and Monetary Affairs Committee of the European Parliament with national parliaments, Brussels, 23rd January 2008.

banks have accurately identified the true level of the risks to which they are exposed. It depends on the purchaser having accurate information about the risk profile of the CDO which it is being sold.

A market fundamentalist might conclude that following this episode, there simply will not be any appetite in the market in future for products of the complexity of some of the CDO-squareds.¹⁵ It is doubtful whether such a conviction will be borne out when the next quest for yield begins in the market. In any event, the issue is not just whether investors understand the risk inherent in the CDO products which they are buying. The whole point of regulatory capital requirements and banking supervision is that the risks which banks are taking on have to be monitored by public authorities in the public interest. That must involve the public authorities being able to verify, without inordinate effort, the true level of the risks to which the bank is exposed. Where this cannot be done, the bank's authorisation should be placed in jeopardy, as it is not being operated in a way which is sound and prudent.

Transparency of risk in relation to the financial products in which a bank is dealing is imperative if banking regulation is to work. Banks must be able to demonstrate to the regulators how they have calculated the risks to which they are exposed and regulators must be able to verify, without undue cost or effort, that information.

To achieve transparency of risk, securitized products must either be standardized or, if this cannot be accomplished, banks should be forbidden from dealing in products whose risk profile is unascertainable or uncertain. When the idea of banning certain complex financial products has been mooted, it has suggested that this would be pointless since innovators in the financial markets would simply devise different products which were not banned and so get round the restrictions. Such an objection can, however, be overcome. It is true that any black list of banned products is vulnerable to such a manoeuvre. The alternative is not to black list banned products but to give banks a white list of permitted products and to restrict their activities to those products. There is a clear historical precedent for this in the Glass-Steagall Act 1933 by which banks in the USA were restricted to certain activities following the Great Depression.

In response to the immediate complaints by banks that such regulation would be an unfair restriction of their ability to maximise their profits, the answer is yes, this is a restriction on their ability to maximise their profits, but no, it would not be in principle unfair. Those banks which are too big to fail already in practice enjoy a substantial benefit in their ability to attract funds and in conducting their affairs in the marketplace from the fact that, everybody knows, if they were to find themselves in trouble, governments would be forced to bail them out. Northern Rock proves the point. Banning certain activities on the grounds that they are too risky is an acceptable price for the state, as a prudent surety, to require for its implicit guarantee of such banks.

¹⁵ As explained to the House of Commons Treasury Committee, 'a CDO-squared is a derivative structure designed to give investors exposure to a CDO', para 38, p.16 of its 6th report on Financial Stability and Transparency.

I am not advocating imposing a white list of financial products on banks at the present time. It may, however, be necessary to consider doing so if initiatives such as the Basel Committee's paper on fair value measurement do not provide sufficient transparency of risk.¹⁶

2.3 Reform Basel II so that it is not so pro-cyclical

The third reform proposed takes account of a different consequence of the sub-prime crisis: the problem of the pro-cyclical nature of capital requirements under the Second Basel Capital Accord ('Basel II').

The 1988 First Basel Capital Accord ('Basel I') was introduced because it was recognized by central banks, first in the UK and the USA, and then throughout the Western world, that left to themselves, banks were likely to hold less capital in reserve than was socially desirable. The First Basel Capital Accord was intended to deal with this problem by requiring banks to hold specified reserves of capital, calculated in accordance with a specific formula.

However, the First Basel Capital Accord was widely criticized for the crudeness of its risk weightings, which gave rise to distortions in the market. Under the First Basel Capital Accord, a bank was required to set aside the same amount of capital for a £100 million loan to an AAA rated corporate borrower as for a £100 million portfolio of loans to small start-up businesses, even though statistics show that the risk of lending to the latter is hundreds of times more hazardous than lending to the former. Corporate lending was given a 100% risk weighting and mortgage lending a 50% risk weighting; so that it was more attractive to grant mortgage loans than to finance corporate borrowing, even though corporate lending is more likely to produce jobs and excessive mortgage lending will lead to property bubbles.¹⁷

Moreover, the mere existence of the capital requirements placed a limit on banks' business activities, and securitization became seen as an essential way of offloading loans in order to free up regulatory capital so that further loans could be made.

Under the Second Basel Capital Accord, the risk weightings used are more sophisticated, and hence, more complicated. Whilst most banks have to accept the risk weightings determined by the regulator, those banks perceived to have sound credit risk management techniques may use their own internal ratings to calculate the probability of default.

Although it had nothing to do with its collapse, it is worth noting in passing that on 29 June 2007, Northern Rock was told by the FSA that its application for a Basel II waiver had been approved, thereby enabling it to use its own internal ratings to calculate its regulatory capital requirements.¹⁸ Northern Rock's immediate response

¹⁶ Basel Committee 'Fair value measurement and modelling: an assessment of challenges and lessons learned from the market stress' (June 2008), available on-line at www.bis.org/pub/bcbs137.pdf.

¹⁷ Stiglitz, *Globalization and its Discontents*, 2002, 101.

¹⁸ House of Commons Treasury Committee Green Paper *The Run on the Rock* (January 2008) para. 43, 25.

to the news was to announce an increase in its interim dividend of 30.3%. Its Chief Executive, Mr Adam Applegarth explained that the increase in dividend was possible because Northern Rock's internal ratings regarded the risk attached to its mortgage book at 15% rather than the standard 50% because of the quality of the loan book.¹⁹

Such a dramatic difference between the standard risk weighting and the one applied by Northern Rock internally is not just evidence of the prudence of Northern Rock's lending, it is also illustrative of a problem with Basel II. Capital requirements under Basel II are pro-cyclical. The UK Treasury, Bank of England and Financial Services Authority have recognised that 'cyclical downgrades in internal ratings could cause minimum capital requirements to rise significantly, potentially prompting banks to tighten credit supply.'²⁰ In January 2007, well before the sub-prime crisis had become front page news, Graeme McLellan was writing that under Basel II, 'regulatory capital costs will become far more volatile and could go either up or down on a regular basis'.²¹

For all their crudeness, the regulatory capital requirements under Basel I were neutral with regard to the economic cycle. Loans to corporations and on residential property were rated at 100% and 50% respectively, in the good times as well as the bad.

Under Basel II, where credit ratings are used as part of even the standard risk weighting process of the regulators, if a company loses its AAA rating, then any bank which has loaned to it has to adjust its capital accordingly. The same applies to AAA rated securitised products. In the case of a general economic downturn, then a bank may be faced with a situation in which the majority of its loans have to be downgraded simultaneously with consequent pressure on its regulatory capital requirements. It is not far-fetched to imagine a bank having to sell assets to meet its regulatory capital requirements in such circumstances. Banks are therefore potentially forced to sell assets in a falling market, thereby deepening the economic slump and possibly creating further strain on their regulatory capital requirements leading to the need for further fire-sales.

This is not just a theoretical possibility, British sub-prime lender London Scottish Bank was left with a £12.7 million regulatory capital shortfall in January 2008 and had to agree with the Financial Service Authority's demands that it scale back its lending business radically, in order to continue trading.²²

In the wake of announcing their losses caused by the crisis, other banks such as UBS, Royal Bank of Scotland, Fortis, Barclays and HBOS have all had to resort to rights issues and or investments from sovereign wealth funds in order to re-build their regulatory capital. The scale of these requests for further capital: £13.5bn

¹⁹ House of Commons Treasury Committee Green Paper *The Run on the Rock* (January 2008) para. 44, 25.

²⁰ Joint report by the Treasury, the Bank of England and the FSA *Financial stability and depositor protection: strengthening the framework* (January 2008) Cm 7308 box 2.2.

²¹ McLellan, *In Practice: Basel II – market liquidity and borrower issues*, *Butterworth's Journal of International Banking and Financial Law* 2007, 39.

²² *City AM*, 20th February 2008, 4.

(£7bn by way of rights issue, £6bn from sovereign wealth funds), £12bn, £6.3bn, £4.5bn and £4bn respectively, indicates, in at least the first two cases, that the amount of regulatory capital held by the banks prior to the crisis was based on some overly optimistic calculations. Raising capital from shareholders was seen by these banks as either preferable to or necessary in addition to selling assets in a falling market, in order to re-build their regulatory capital.

If there is not to be a return to the flat ratings of Basel I, then the efforts should be made to mute the pro-cyclical nature of the Basel II capital requirements, by “cushioning” the effects of a market downturn. One way of doing this would be for supervisors to flatten the graph, so that the discount in terms of regulatory capital for lending to AAA rated borrowers is reduced, so that each drop in the credit rating leads to only a modest adjustment in the bank’s capital requirements. Additionally, supervisors should act early to require banks to hold more capital than the minimum 8% required under Basel II so that in the event of a sudden market downturn banks are not immediately in danger of crossing the minimum regulatory capital threshold.²³

Another possibility, suggested by Kenneth Dam, is to allow banks not to have to mark securitized products to market in times when the markets are effectively closed. Such a possibility would need to be examined carefully as, whilst it might enable banks to ride out a market crisis without needing to sell assets at depressed prices to raise regulatory capital, it might also allow them to disguise losses contrary to the general principle of market disclosure.

3. Conclusions

There are undoubtedly economic costs to the restrictions on banks’ activities being proposed in this paper. That is, however, the case with all regulatory and supervisory requirements placed on banks. The issue is whether those costs are justified. Put bluntly, are the constrictions on private profit-making justified in order to prevent the public costs of systemic failure in the financial markets? In this paper, I have argued that the current banking crisis has revealed three areas in which private pursuit of profit has given rise to unacceptably high external costs. Allowing banks to securitize and sell on their loans without bearing any continuing risk on those loans has encouraged insufficient discipline in terms of the loans made. Leaving the structure of collateralized debt obligations to the markets has resulted in opaque financial products, and such disguised risk ought to be anathema in properly regulated markets. Finally, attempts to free up regulatory capital by allowing banks greater flexibility in calculating the risk weightings on the loans they have made have proved counter-productive, as they are too pro-cyclical, and therefore tend to exacerbate any economic downturn.

²³ Proposals of this type were announced by the Basel Committee in its press release on 16 April 2008 ‘Basel Committee on Banking Supervision announces steps to strengthen the resilience of the banking system’, accessed on-line at <http://www.bis.org/press/p080416.htm>.

The remedy need not be as drastic as turning back the clock. Banks ought, however, to continue to bear some portion of the risk on the loans they have originated, to encourage them to be careful about the loans they make in the first place. Collateralized debt obligations need to be transparent, so that the person who bears the risk can be easily identified. The Basel II approach to risk weighting needs to be reviewed so that the pro-cyclical effects, if not eliminated are at least 'cushioned'. If these changes are made, then we may hope that global financial markets will operate in ways which are more sustainable in the long term.

Session V

Regions Response to Globalization

Emilia Müller

1. Cosmopolitan Bavaria

Global competition is, and will remain, a mega-theme for industry, politics and society. Bavaria offers a suitable framework for the globalization congress:

- We are a cosmopolitan state.
- Our economy is integrated to a very high degree in the international specialization of labour.
- Munich is one of the “hot spots” of the global economy, starting
 - from the presence of an impressive number of international corporations,
 - through high-technology competence, which is present here in concentrated form
 - right up to the Oktoberfest, when hundreds of thousands of visitors from all over the world come together on the Theresienwiese every year.

For a long time, Bavaria’s economic policy has been confronted with the challenges of globalization – with its opportunities, as well as its uncomfortable aspects.

So I very much welcome the fact that this panel is entitled “Regions Response to Globalization”. Let me comment on this from the perspective of our Bavarian experiences.

2. Increasing globalization in range and intensity

For us globalization is not a new phenomenon. The first approaches to this go far back in history. But the internationalization of business activity has made enormous gains in range and intensity. The global integration of the markets for goods, services and finance has long since reached new, epoch-making dimensions.

2.1 Process of globalization is continuing

I expect that globalization will continue to advance. This will be ensured by constant progress in transport and in the field of modern information and communications technology.

In the Eighties, it was the triad of North America, Western Europe and Japan which still dominated our economic thinking; since the Nineties, further competitive national economies have entered the arena, above all, the Central and Eastern-European states, Russia, China and India, which are integrating themselves into the global economy at a great pace.

Europeanization and globalization are not “events decided by fate alone”, but also the result of deliberate political decisions. In this context, I should like to mention the establishment of the European internal market, the EU enlargement to the east or the WTO negotiations.

2.2 Effects of globalization on regions

The effects of globalization on regions are ambivalent. On the one hand, there is a wealth of new opportunities opening up:

2.2.1 Opportunities

1. For a state like Bavaria this includes, for the most part, an increased sales potential in the field of know-how intensive, complex goods and services in new markets. So, in the past 15 years, Bavaria’s exports have more than tripled, from 50 billion Euros to more than 150 billion Euros.
2. Regions with good locational conditions can profit from the inflow of capital, know-how and jobs through foreign investments. Bavaria also owes a good part of its economic strength to the presence of foreign companies.
3. For our consumers, global competition has, in many cases, brought about “top products at rock bottom prices”.

Bavaria is integrated intensely into the global economy. In recent years, our economy has received **strong impulses from the global economic upturn**. Without this momentum, our economic development would have been a lot less dynamic.

2.2.2 Risks

It would, on the other hand, be dishonest to trivialize or to fail to mention the unpleasant effects of globalization. Fact is:

1. Competition among companies for market shares and competition among regions for investments, jobs and tax revenues is becoming fiercer.
2. Most of all, it is becoming increasingly difficult to keep simple, labour-intensive production facilities and services in the high-wage regions of the Western world. They are being replaced by cut-price imports from low wage countries or are migrating to those countries as part of the offshoring process. As a region that shares a border with a low wage country in the east, we in Bavaria are noticeably affected by this.
3. The pressure to adapt on company managements, employees and economic players is increasing.
4. As the current sub-prime crisis shows, national problems develop much faster into international problems in the global economy.

2.3 No automatically positive effect for regions

To sum up the situation from the point of view of the regions, globalization makes the world richer on the whole. But this does not mean that all regions automatically become richer. Regions can also lose through globalization.

In the Western countries, these are mainly regions in which traditional jobs in industry are being shed on a large scale without appropriate compensation through new industrial value creation or attractive additional jobs in the service sector.

Politicians have to fight hard to ensure that a region is among the globalization winners. Regions are by no means damned to “helplessness” in the global competition among locations, even if some competences in terms of economic policy have long been located at national or supranational level.

On the contrary: more than ever, their framework policy is crucial when it comes to positively shaping the future. They share a large part of the responsibility for creating first-class locational conditions that carry conviction on a global scale.

How can regions succeed in being among the globalization winners in the twenty-first century?

3. A ‘no’ to protectionism

It certainly does not help a region

- to draw up horror scenarios about globalization
- to lament about the negative consequences of global competition
- to demand local patriotism from companies.

Complaining does not solve any problems.

Appeals to “patriotism” fall less and less on fertile ground with managers who have to meet the profit expectations of foreign shareholders.

Attempts to seal off domestic markets from irksome foreign competition by means of customs duties and non-tariff barriers are not practical.

Essentially, we must fight against a retreat to “fortress Europe” and in favour of the principle of open markets. Protectionism gives rise to countermeasures, stifles the power to innovate and leads to a standstill and slow decline in the medium and long term. Protectionism is not an option for a region that is so export-oriented and has such a large export volume as Bavaria.

We are relying on further progress in the liberalization of the European internal market as well as on freedom in the international markets. The successful completion of the Doha Development Agenda of the World Trade Organization is of vital interest to Bavaria.

4. An offensive approach to globalization

The necessary logical conclusion resulting from this plea for open markets is an offensive strategy in economic policy:

The markets, companies, production facilities and jobs that we are constantly losing in global competition must be replaced continually by something new. “New products, new services, new companies, new markets” are the goal. Or, to take up a Korean proverb: “You must ride the tiger in order not to be eaten by it”.

The high-wage regions of the Western world must be increasingly innovative, productive and better to justify higher prices. The economic consequence will otherwise be:

- a) falling wages and salaries, a reduction in social services, lower environmental standards and
- b) increasing unemployment.

In our region, we are condemned to take a “high-road approach”. Or else we shall have to face the threat of lasting economic stagnation or social tensions.

Those who take a closer look at innovative power and dynamics in Europe will suspect, however, that taking the high-road approach will be anything but a leisurely stroll. As we all know, at the Lisbon Summit in March 2000, the EU dedicated itself to the intrepid aim of “becoming the most competitive knowledge-based economy in the world”. The old continent is of course still miles away from that.

5. Five-point response

I should like to present our Bavarian response to global competition in five points:

1. strengthening innovative power
2. fostering internationalisation
3. investing in education and training
4. securing the energy supply and
5. developing infrastructure.

Let me go into these points in more detail:

5.1 Strengthening innovative power

1. Maintaining an edge through innovation is our goal. We are therefore providing government incentives to boost and to accompany the necessary innovation processes in industry and to help as many companies as possible to acquire a unique position in global competition.

This includes the further development of university and non-university research as well as a broad technology transfer to small and medium-sized enterprises. Both must lead to the development and production of technologically sophisticated, first-class quality, new products and services.

Our main opportunities for growth and employment lie in complex system solutions. During the past 15 years Bavaria has therefore invested billions in high-tech initiatives and the internationalization of industry.

At present, priority goes to the promotion of our companies' technological competitiveness in nineteen clusters through systematic networking between science and industry.

We are well aware that cost cutting and reduction in personnel are not enough to hold one's own in global competition in the long term.

An innovation strategy of this kind needs to be safeguarded by the protection of intellectual property. This is why we are taking assertive action against product piracy!

5.2 Fostering internationalization

2. We shall remain constant in our efforts to foster the internationalization of our industry. Above all, we want to assist our small and medium-sized companies to make use of the opportunities of globalization.

Above and beyond this, a targeted modernization policy also means supporting technology-oriented start-up companies and accompanying small and medium-sized enterprises in new markets abroad.

This includes the deliberate acquisition of foreign high-tech enterprises and highly efficient service-sector companies to improve overall economic results.

Export successes on the international markets make a major contribution to securing existing jobs and to creating new ones. Our industry meanwhile has an export quota of 50 percent. In the last ten years, the export turnover of small and medium sized enterprises has doubled to 30 percent.

5.3 Education as a mega-topic

3. To be able to step up our innovation policy we attach the greatest priority to education. Top economic performance calls for top qualifications in terms of know-how, craftsmanship, key competences and entrepreneurial spirit.

More than ever, the entire system of school education, academic education and occupational training needs to teach these skills. From the employees' point of view, the general line must be: "getting fit for competition" through qualifications. Education and continuing education are mega-topics of the twenty-first century.

We want to make use of, and promote women's competences in a better way. Our aim is, not least, to educate, train and keep "high-performance elites", as well as making it easier for high performers to come and work here.

5.4 A secure, affordable, climate-friendly power supply

4. In view of rising energy prices and our great dependence on imports, the energy question is a topic of central importance for us.

Bavaria favours a secure, affordable and climate-friendly power supply. We shall save energy and increase energy efficiency even further. We are promoting the development and use of renewable energy to the best of our ability. It is planned to increase their share in the ultimate consumption of energy to more than 20 percent by 2020, and to between 25 and 30 percent in electricity consumption.

Even so, this cannot be done without nuclear energy, which contributes around 60 percent to the generation of electricity in Bavaria. The operational life of the nuclear power stations needs to be extended. Without nuclear energy, there is the threat of serious supply risks, massive increases in the price of electricity and increased CO₂ emissions.

We need nuclear energy as a bridge to an energy-supply industry based mainly on new technologies and renewable energies. A part of the profits resulting from the extension of the stations' operational life should be made available for a fund for financing energy research and development projects.

5.5 Developing infrastructure

5. Globalization also means increasing mobility. Exports and imports require transports. This is of special relevance to Bavaria as a transit region. We take account of this through investments in the development and modernization of the transport infrastructure. This applies to road and rail, as well as to waterways, ports and airports.

Also of great importance in the global competition among locations is a first-class telecommunications infrastructure. So we are also working flat out on an area-wide broadband supply.

5.6 Quick adaption to changes

On the whole, our companies require the freedom to be able to develop and adapt quickly to changes in international competition. This means fighting superfluous bureaucracy, the reduction of unnecessary regulations and the streamlining of planning and approval procedures. To these must be added job-market flexibility.

There must be a possibility to transfer workers more quickly from sectors shrinking under the pressure of global competition to sectors that are expanding. Despite all the progress that has been made, there can be no doubt that we still have a lot to catch up on in Germany.

6. Outlook

In the last decades, Bavaria has developed from an agrarian state into one of the most economically powerful regions in Europe, and even in the world.

- For a long time the growth of our industry has been above average.
- Traditionally we are deeply in the black in terms of our foreign trade balance.
- Prosperity in the region is high.
- We have succeeded in more than fully compensating for jobs we have lost in global competition through new ones.
- At present unemployment now stands at only 4.4 percent; and the tendency is falling.

We shall hold to our offensive course in response to globalization. So I am confident that Bavaria will be among the winners of globalization in future as well!

Panel Statements

Munich as a Knowledge Hub

Reinhard Wiczorek

In the debate surrounding globalization, distinctions are often drawn between the regions that stand to win and those that stand to lose. Clearly, the traditional industrialized nations in particular feel that their hitherto dominant position is under threat. More sober analysis nevertheless reveals that, at least at the present time, the German economy as a whole, and especially heavily export-oriented regions such as Munich, unquestionably rank among the beneficiaries of globalization, whose development is reflected primarily in the rapid pace of growth in world trade.

The export successes scored by Munich's industry speak for themselves. Between 1996 and 2006, the region's manufacturing industry saw its foreign sales more than double from 15.4 billion euros to 34.1 billion euros. Especially for the service sector too, globalization is spawning a series of new, fast-growing business fields in which Munich's economy is excellently placed. The spectrum ranges from scientific consulting to the export of healthcare services.

Munich is also blessed in that it has scarcely felt the impact of global shifts in production locations triggered by the structural upheavals that traditional branches of industry know only too well. Contrary to the impression often given by reports in the media, Germany in general – and Munich in particular – are suffering much less than other countries from the practice of “corporate offshoring”. There are several reasons why this is so: Real wages have fallen in recent years. The infrastructure remains as outstanding as ever. The work force is highly qualified – German engineering is still very highly regarded. And, in Munich, there is the added benefit of a richly diverse, well-balanced economy.

True, the region has witnessed very high-profile transfers of both companies and production operations. BenQ and Siemens spring to mind, for example. For the employees, these moves were disastrous. Nor was the underlying business logic always readily apparent. Despite such setbacks, however, the overall trend in employment in the Munich region remains positive. The number of employees who pay compulsory social insurance contributions is relatively constant and the overall number of gainfully employed persons in the Munich region is still pointing up (2003: 1,482,000; 2005: 1,504,000; Empirica forecast for 2010: 1,532,406; Empirica forecast for 2015: 1,562,302).

Having said that, one cannot deny that there is indeed a darker side to globalization. Pollution, the rising consumption of natural resources and climate change are confronting the developed and the developing world alike with huge problems. This is a natural consequence of growing prosperity in those countries that, ultimately, are merely following in our economic footsteps.

On a social level too, global competition often leads to less desirable consequences. Germany's ability to compete on the world's markets has been won in part

at the expense of increasing inequality in the distribution of income in this country. A recent DIW study found that the middle classes in particular – those people whose income is between 70 and 150 percent of the national average – are coming under the severest pressure. The number of German citizens who belong to this social stratum dropped from 62 percent in 2000 to 54 percent in 2006. This shrinkage is attributable to the decline in real incomes in recent years, cutbacks in social insurance systems and Germany's latest tax reforms. Quite obviously, globalization has made it very difficult indeed to strike the right balance between competitiveness and equitable income distribution.

When we think of social problems, we tend to focus on the problems in our own developed countries. In developing economies, however, while globalization and progress are bringing prosperity to many and reducing poverty, it also at times gives rise to inhumane working conditions that harm human health, damage the environment and even exploit child labor.

What can we, in our cities and regions, do about these problems? Sadly, calls for social responsibility are of only very limited use as we seek to cement the loyalty of local industry to a given region. Companies must therefore find something in their region that is not easy to substitute. To put the question another way: What can local and regional organizations in particular do to maintain a sharp competitive edge without neglecting their responsibility for a form of sustainable development that does not cause undue social hardships?

- One option that will definitely not help regions where wages and costs are high is to compete with other regions by offering subsidies in order to help attract new investors and/or preserve structures that are no longer competitive. Countless examples have shown that investors in such regions create jobs only for as long as they receive grants and subsidies. As soon as these taps are turned off, they move on to less expensive regions – in many cases to Eastern Europe, where wages are far lower but qualifications are remarkably high.
- When we speak of infrastructure, we do not mean only the physical infrastructure that, in the Munich metropolitan region, certainly stands up to any international comparison (although we too cannot afford to rest on our laurels). The success of Munich's airport and exhibition center, for instance, is rooted in their quality and their ability to compete in the international arena – two factors that make them vitally important to all companies based in this region. Munich's road and rail connectivity too is singularly impressive, even though the faster expansion of those European rail networks that are of relevance to Munich would certainly be conceivable. The region's local passenger transport system too is of a quality that one perhaps only appreciates when one knows the grim reality that prevails in other European cities. We also take our smooth-running energy supply and efficient public services largely for granted – and find it hard to imagine that they could ever pose problems.
- Infrastructure necessarily also includes the smooth operation of a region's institutions. International comparisons often reduce this factor to a question of how long it takes to obtain approvals. Yet issues such as the reliability and integrity of

administrative organizations (are procedures transparent? are they free from corruption?) are naturally just as important – as is an effective legal system to ensure that patent and trademark owners can successfully defend their rights, for example. We hardly notice these issues because they quite simply work. However, negative experience of these factors in other countries often lead companies to return home.

- The Lisbon criteria: Investing 4 percent of GDP in research and development is not a dogma. It merely points us in the right direction. Munich already meets the 4 percent target. However, to enable the EU as a whole to catch up, an economic powerhouse such as the Bavarian capital – which boasts one of Europe’s most modern industrial structures – must naturally set its sights considerably higher.
- Existing knowledge resources must be leveraged while new ones are added. The guideline “Munich as a knowledge hub” describes a number of lead projects in the realms of infrastructure, public relations work and collaboration. Infrastructure facilities especially the planned “house of knowledge/science” are increasingly being conceived of as “knowledge repositories” – central venues where Munich’s scientific community can meet, engage in dialogue and showcase its activities. Yet another aspect of infrastructure is the creation of accommodation for students. This is one of the most pressing problems facing the city right now. Public relations activities must do more to engage in dialogue with the local population. They must spell out the relationship between science and urban society, the everyday environment in which we live. A marketing strategy should draw even greater national and international attention to Munich’s specific strengths as a knowledge hub. Lead projects in the field of collaboration aim to provide administrative assistance to students and guest researchers who are new to the city. They also encourage local government to become more open to the world of science and not to limit itself to existing activities such as the award of university prizes and individual work orders.
- Fierce global competition for talented individuals is harsh reality in this day and age. Munich is fortunate enough to be able to attract and retain such talent. One can always do more, however: International and foreign schools, for example, usefully complement but do not compete with existing educational establishments. The internationalization of Munich’s universities too is already underway, although we still lag some way behind our Anglo-American counterparts on this score.
- We cannot afford to leave valuable potential untapped. For a variety of reasons, our education system fails to reach too many of our foreign residents in particular. As a result, these individuals never realize their full potential. Activating these dormant resources is a tremendous challenge, but also a tremendous opportunity for the region’s development.
- Social development and the entire social climate play an important role at any location. A prosperous region where peace reigns and where there are no “no-go areas” will have a far lower crime rate. Everyone – from managers and their families to workers and employees on every level and indeed the whole population – stands to benefit. Economic and social policies are important, as is the corporate

sector, of course. But regional and local government too must play their part. Munich has understood this – and has launched an employment and qualification program to respond to the impact of structural change on the work force. In order to preserve a state of social equilibrium, the City of Munich goes beyond the requirements of law in a number of areas. Unlike other cities, the Bavarian capital remains committed to the housing sector, for example. It is also driving the development of social and care facilities, especially for children, and is assembling a package of focused offerings to make life in Munich easier for families in particular.

- In a region that enjoys a healthy environment – with clean air, clean soil and clean water – sustainable development is in the interests of everyone who lives and works here. As such, it is a potent factor of influence on the business climate. In terms of environmental protection, Munich’s local government sets an enviable example. It is the first in Germany to have set up its own environmental protection department, which in turn is flanked by many voluntary information, consulting and promotion services plus a host of initiatives and organizations that serve private individuals and the corporate sector alike. Examples include ÖKOPROFIT (the ecological project for integrated environmental technology); the (operational) mobility management project; the local authority’s (RGU) climate protection program (which subsidizes house owners to promote building insulation, energy efficiency and the use of renewable energy sources); the Climate Protection Alliance; BenE (which educates people about sustainable development); the Construction Center; and the Ecological Training Center. At the same time, high environmental standards create ideal conditions in which industries and services that focus on environmental technology and climate protection can flourish and grow. Many of these firms, incidentally, are major exporters.
- If it is bold enough to look beyond its own backyard, so to speak, any local or regional government can support fair trade in its role as a source of procurement demand. Here again, Munich sets a good example: In a ground-breaking resolution, the city council approved a motion not to buy any products whose manufacture involves the exploitation of child labor.

Heterogeneous Response of Countries in Transition to the Globalization Challenge

Andrzej Olechowski

For the countries of my region – the so-called former Socialist world – globalization is understood first and foremost as integration into the world system. After the collapse of authoritarian systems of one-party rule and central planning these countries faced a formidable challenge of how to join the world system from which they had been separated for years not only by tight border controls and barriers, but also by incompatibility of their domestic systems. In other words – how to move from autarky (political and economic) to globalization.

They reacted to that challenge in two, very different ways.¹ One group of countries chose a path of swift and comprehensive reforms fundamentally transforming their political and economic systems. They asked to join NATO and the European Union and undertook to fulfill the conditions set by them. I will call these countries the “Brussels group”, as they decided to (re-) join the world via the established models and institutions of the West. Another group of countries set on a way of selective and gradual reforms aimed at developing their own models, different from those in the West. Rather than integrating with established organizations they have created the Commonwealth of Independent States. I will call them the “Moscow group”. The results obtained by these two groups in terms of how well they have integrated with the world system are strikingly different. Let me present them in three points.

1. The Brussels group (which includes the ten post-communist countries that are already members of the EU and Croatia on its way to membership), has met with significant success. Thorough political and economic reforms resulted in systems which are identical or very similar to the systems in the countries which form the core of the world system. In every country of that group, from Poland to Bulgaria, political systems are based on democratic principles – human rights, free elections, rule of law. In each of them, from Latvia to Romania, institutions essential for the market economy are up and running – independent central banks, stock exchanges, guarantees of private property rights, laws enabling free movement of goods, services, capital and people. For sure, some elements are still missing, others are still rough on the edges (as, for example, weak judiciary systems), but the resemblance with the core of the global system cannot be denied.

Not surprisingly the Brussels group has been very (even spectacularly) successful in linking up with the global economy. It’s exports have been growing,

¹ See Kaminski/Kaminski, *Korupcja rzadów: kraje postkomunistyczne wobec globalizacji* (Corruption of governance: post-communist countries and globalization), 2004.

year after year, at double digit levels. Foreign direct investment – which is also a proxy for integration into the global production networks – have been flowing to that group at significant levels (in per capita terms these countries have received in the period of 1992–2004 about US\$ 2.2 thousand). The share of skilled labor and capital intensive exports in total exports has been also on the increase (and is now at about 47%). In brief, they have fully plugged into global markets.

2. On the other hand the results obtained by the Moscow group (which includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine, Uzbekistan) are not impressive. Their political systems are quite dissimilar from the liberal democracy standard. In consequence, they are perceived by investors as not robust, transparent and stable enough for deep, long term economic partnerships. Their economic systems are also far from what is necessary to participate fully in the global economy. European Bank of Reconstruction and Development measures reforms in prices, foreign trade, exchange regimes and privatization. The value of its indicator for the Moscow group is only 35 while for the Brussels group it is almost double, 65 of the institutional level achieved by highest developed economies.

Not surprisingly, in terms of performance the Moscow group is well behind the Brussels countries. Their exports are growing slower. The level of foreign investment is five times lower – only 410 dollars. According to the World Bank study, the share of skilled labor and capital intensive exports in total exports is only one half of that for the Brussels countries – 26%.² The Moscow group has obviously not joined global production networks yet.

3. Large differences between the two groups are also present in popular views on globalization, in people's attitudes towards globalization and its basic features. In the Brussels group the EU memberships have brought about very tangible and significant benefits to almost everyone – from high economic growth rates, new job opportunities at home and abroad, down to direct payments to the farmers. Furthermore, almost every Pole or Czech has now somebody abroad (like the nobility in the belle époque), some maintain relations with foreigners on a daily basis. As Karl Schloge observes: “people in Berlin or Warsaw share the space of the same experiences, time flows for them at the same pace, they benefit from the same facilities”. Amazing! A huge and happy change for the societies which for decades were tightly insulated from the outside world, where foreign travel was among the most desired luxuries.

Not surprisingly the public in the new member states is enthusiastic about the European Union. Approval rates for the EU are (according to the Eurobarometer survey) in the 70's percentage for the Czech Republic and Hungary and in the 80's percentage for Poland and Slovakia. What is very important, is that the EU is perceived in these countries as a springboard to globalization (and not as a shield from it as in many of the “old EU” countries) – therefore, a part of that enthusiasm

² See “Linkages between Foreign Direct Investment and Trade Flows,” in: From Disintegration to Integration: Eastern Europe and the former Soviet Union in International Trade, The World Bank, Washington, D.C., 2006.

applies to the key features of globalization as well. Thus, according to The Pew Global Attitudes Project (2007)³, about 77% of Poles believe that impact of foreign trade is good, 60% are positive about foreign companies (17 points more than in 2002), and 68% are positive about free market in general (24 points more than 5 years earlier!). 49% believe that the national government has too much control (28% in 2002) and while 77% observe that our way of life is being lost only 62% believe it should be protected.

When Russians are asked the same questions, they give different answers. 82% of them believe that trade is good, but that is 4 points less than in 2002. Only about half is positive about foreign companies and free market in general. Only about every third Russian believes that national government has too much control. And while two-thirds believe that national way of life is being lost, three-fourths say it must be protected.

Finally a note of caution. What the Brussels group has seen until now was the sunny side of globalization. Cheap imports, low inflation and low interest rates, foreign travel and new jobs. Lots of new jobs. No serious pressures on wages, no offshoring of jobs, no immigration to talk about. So, while today we are free of the “globalization Angst” it may come at some future time. If and when, only time will tell.

³ See <http://pewglobal.org/reports/pdf/258.pdf>.

Experiences and Actions of the Committee of the Regions of the European Union

Gerhard Stahl

Dear Chair and Colleagues,
Ladies and Gentlemen,

I sincerely thank the organisers for the opportunity to attend this engaging debate. As Secretary General of the Committee of the Regions, I could not expect a better offer for preparing our Open Days 2008, taking place in Brussels next October. The Sixth edition of the Open Days will exactly go under the title “Regions and cities in a challenging world” and we will network 217 regions and cities from 32 countries around today’s topics.

Here, I would like to use my short intervention in order to touch upon four main topics:

- the scope of globalisation and the benefits of the European project;
- the specific challenges for the regions;
- the possible responses;
- the contribution from the Committee of the Regions

I believe we must start addressing the scope of globalisation by considering the very specific benefits of the European project: strength in Unity, strength in Diversity.

We are strong when united, as the creation of the largest Single market in the world demonstrates us. This market constitutes already a critical mass for attracting foreign investments and for creating the condition for an European offer of excellence in different sectors.

We have a single currency, the EURO, which grants us a certain stability and protection against external shocks and has become the second reserve currency in the world. It has also become a strong engine for structural and microeconomic change in the EU.

The EMU has already answered the question raised by Prof. Straus in his yesterday’s intervention. In the EMU, business and companies are less and less attracted to a national basis, but increasingly oriented towards a European home market.

Europe and its regions are also strong because of diversity: we can count on a unique puzzle of people, culture, languages, which is our natural software for reaching out across the world.

Our governments are used to master the challenges of life and production in so different territorial conditions: maritime areas, mountain, urban and rural, as examples.

However, we must also acknowledge problems and difficulties:

- Internally, we have highly increased the level of internal competition, without adapting our national systems of flexicurity and governance.
- Externally, we have to find a coherent way to deal with world trade and the globalized financial markets, by adopting the common European interest as the main driver within a power game where counts scale.

Furthermore, we need more ambitious European investment projects and better horizontal/vertical coordination on employment and microeconomic policy.

The Lisbon Agenda has missed roots on the ground. Regions and Cities, when better involved could improve the overall European economic governance and performance, since they are facing major challenges and are developing innovative local solutions.

The Fourth Cohesion Report (May 2007) identifies some common challenges

- The Demographic challenge: population is declining and aging:
85 EU regions are already experiencing absolute population decline.
Within this picture the position of the German Länder is particularly delicate, since 7 Länder registered an absolute population decline between 1995 and 2004.
- Globalisation: competitive pressures are mounting with asymmetric impacts on industries and regional economies: in a number of regions, employment is highly concentrated in those sectors more exposed to competition from emerging economies, like textiles, clothing and basic metals.
- Climate change: it has asymmetric impact across regions
At EU level, 7% of people live at risk of floods and among them there are a relevant number of Germans. On the other hands 9% of population live at risk of draughts.
- Skills and employability: the less developed regions of the EU27 can count on only 14% of population in working age having tertiary qualification.
- Public finance and financial markets: Regions and cities are leading public financial players, being responsible for more than 60% of total public investment in Europe, and some of them are also owners of public banks (savings banks). This brings more responsibility versus more sophisticated financial products, fast-changing financial markets and increased budget discipline.

Confronted with such challenges, which type of responses do we then need?

Here, I would like to avoid a long shopping-list of measures, but rather concentrate on two main guiding principles: 1) Vision and Leadership; 2) Multi-Level Governance.

What we need for Europe in 2020 or 2030? Which level of political ambition?

In order to answers we have to look back to our past. What would be Europe today if we had not decided to have a Single Market during the 80s or the Euro during the 90s. However, we have to realize that the EMU is still a halfway house where in quite a number of areas the implementation has not yet succeeded.

Which is the “Euro-like” project we need to shape by 2010 in order to deliver later on? Is it a stronger Energy and Climate policy? Is it a more European social policy on Flexicurity?

We probably need to intervene in many sectors. And we need that in certain areas Europe goes beyond pure open coordination methods and equips itself with the necessary communitarian mechanisms to face its future challenges well in time.

In other areas, we have to implement the subsidiarity principle and to equip the decentralized level with the instrument allowing it to provide answers. In other words, this is the debate about Multi-level governance. I recall here the Berlin Declaration at the occasion of the 50 Years Celebration of the Rome Treaty: “There are many goals which we cannot achieve on our own, but only in concert. Tasks are shared between the European Union, the Member States and their regions and local authorities”.

The current model of European governance is too tightly restricted between the European and the national level and we overlook the emergence of a third dimension. We seriously need a thorough debate on the contribution from the different level of governments to the European project, intended both in its internal realisation than in its external projection.

Europe lives through a very key political momentum. The new Treaty introduces the objective of Territorial Cohesion, it gives recognition to the value of regional diversities and enhances the role of local and regional authorities within the principle of subsidiarity. Meantime, the Schengen area and the EURO club are enlarging.

This is a unique occasion to rethink “spaces” across and beyond Europe.

We need to strengthen synergies across institutional layers and territories, through solidarity, multi-level governance, subsidiarity, integration of policies, territorial cooperation.

For doing that, we need however new tools. I would like in particular to signal you a brand new legal instrument: the European Grouping of Territorial Cooperation (EGTC), whose birth and current development has been strongly supported by the CoR.

Some interesting EGTC-type experiences are already taking shape in this direction: the Greater Region, the Alpes-Méditerranée Euroregion, the Pyrénées-Med Euroregion, etc. EGTC is just one of the possible new governance formats that we need to experiment to deliver European projects, which bring global aspirations and keep local touch.

Let me finish by signalling three concrete contributions from the CoR in this context.

1. The EU-China dialogue

The CoR is actively promoting, via the EU China Forum, a policy dialogue on the role of local and regional government. During the Open Days 2008, a meeting with experts from European regions who have close links with China, will take place.

2. European Neighbourhood Policy and EuroMed Partnership

Within the relaunch of the EuroMed Partnership, the CoR has engaged itself to put into place a political body which represents local and regional authorities from Euromediterranean countries on an equal footing. Furthermore the CoR is creating Interregional Groups in order to foster the Black Sea Synergy initiative, the Baltic Sea cooperation and the networking in the Northern Europe and Russia area.

3. Development policy

The CoR is raising the profile of decentralised cooperation and is co-organising the next European Development Days under the French Presidency.

I would like to conclude by recalling that the CoR will celebrate its 15th anniversary in 2009. The Committee is fully aware of how globalisation is shaping life and economy within regions and cities and how addressing the new emerging and large scale challenges demands new institutional and governance solution.

I am therefore confident that the future role of regions reflected in the development of our Institution will increasingly focus on these crucial questions and that our political contribution can make a difference within the European debate.

Session VI

Challenges of Globalization for Science and Research

Hubert Markl

1. Globalization Challenges

Globalization challenges the economies and social systems of all nations, the financial markets, the media, politics, the law: in fact everything and everyone and everywhere – how then could the sciences be exempt from it? We have to ask us therefore: Does globalization affect the sciences all over the world in any new, any special way? Of course, a thousandfold increase in the number of scientists active in research since less than ten generations must in itself change this world, not only thoroughly increase the total output of science, especially so since this has been a cumulative increase: nothing that has been found out to be true will ever be lost, or maybe only temporarily and in some regions so!

Will Karl Marx finally (as other philosophers long before him) have been right: will quantity change into quality? Human ability to permanently store knowledge and to let science grow even faster by the interaction of scholars and students from so many disciplines and of all times and all nations, will further increase the impact of this knowledge, the more so, since human populations still keep growing – 75 millions per year now –, since both consumption of resources (you might also call it: greed!) and economic achievements relentlessly increase, and since the sciences – from biomedical to natural sciences, from technology to informatics and so forth – crucially impact this growth by their own increases of theoretical knowledge and of its practical applications. How could these processes, how could globalization therefore not challenge the sciences?

But how does it do so and what is it that provides the greatest challenges in the first place? Let the biologist start by considering what animal this is, *Homo sapiens*, the human being, the knowledgeable animal, or you might even say: the beast that knows, or even more precisely – the beast that is self-aware of its knowledge! There can be little doubt about it: human beings are different from all other animals, you might say: they are unique! Not only are they different from all other living organisms and unique in the sense that the lion or the mouse, the daisy or the primrose are each unique. The human beings are truly exceptional in an entire new sense. Above all, they differ as individuals profoundly from each other. Their individuality is not only accidental, deriving from random genetic variation among them as in almost all other animals. Individuality is the most fundamental characteristic of human nature. Their genes may hold them together as a natural species with a common gene pool as they do in other species. But they can only provide the stage for the particular unfolding of human individual development, especially of their individual brains, their individual thinking and of their individual behaviour, which some 20-30000 genes could never fully control. This is deeply influenced and really

formed by their unique personal experiences, which make every grown-up human being a unique exemplar of *Homo sapiens*, since none of them equals the other, not even identical clones. As said before they may all be different, but as such they are of equal worth, – whether of any race, any gender, any age, any culture, any creed. They may not all be the same in their potentials and differ in their behaviours, quite the opposite: they vary a lot in their capabilities and appearances. But nobody can be regarded as higher qualified or of lower value before they have developed their individual faculties and have demonstrated them to themselves and to others. And above all of that, they are equal in being unique individuals of the human species, they have an unalienable value in themselves – touchable only by themselves!

2. Humankind – the singular species

Still they are held together as members of a single, a singular species. It is their common gene pool, their assembly of genomes, which at the same time sets them apart from all others and unifies them. They are also subdivided extensively into races and even more so into cultures, each having their own distinctive common mores, common fate and history, common language, common laws and common governance, common habits of eating, drinking, marrying or reproducing. All that makes peoples and nations still quite differing, but there is a communality to all members of a nation beyond their individuality thus bundled, and even more so to the whole species, the genetic or natural species of humankind.

But the demarcations between these cultures are more and more and faster and faster due to rapid globalization breaking down, with human beings becoming more intensely aware both of their individual uniqueness and of their basic normative equality as members of one genetic humankind, globally being the same wherever they may have settled and struggled in their peculiar cultural adaptations, as different as they may be as individuals and due to their cultural diversity. Travel and migration between populations and nations grows, transcends all borders of nation states and continents, and leads to a mostly fruitful (and only occasionally also dreadful) intermingling of cultures and races. What is left over, in an amalgamation of humans from all over the world, which we recognize by the term “globalization”, where very soon nothing counts – except for personal ties and familiarities – then individual differences of capabilities, ambitions and achievements of persons. Now they are held together not only by their common ancestry and by their nature, i.e. by their genetic endowment, but by the more and more acutely felt need for common rules of conduct based in a common ethics, and by laws which are valid for all of them without exception, just because they are all members of the human species. Laws which are taking notice of human individual differences notwithstanding their equal value, but at the same time providing an equal framework of norms, which all of them have to respect, and above all guaranteed freedom and common human rights for all of them. Thus, though globalization is certainly nothing new for humankind – it approaches by its new wave almost like a tsunami, at least in the mind of some observers.

3. Globalized sciences – the common human brain

Science is just one of the areas of human endeavour, which this globalization of all the fields brings about: of the economy, the financial services, supplies of food, energy and raw materials of all kind, of traffic and transportation, to mention just a few of the most important. But in a very specific way, Science (written with a large capital S) and Research, leading to its knowledge, are – next to the arts – probably the most readily and fully globalized human capacities, and certainly they are the ones, without the help of which a humankind of 6, 8 or 10 billions of people could never survive on the surface of this earth. It is at the same time the most destructive activity of the human brain, that is: the organ which makes us all different and individualized in the first place. The sciences altogether might be called the common human brain, or rather the outcome, the efforts of billions of them, dead or alive, and memorized forever – or at least as long the human species will survive – in the knowledge of the living people and in the books or other enduring means of storage of human thought in their libraries of every kind.

Science is, in addition, the most relentlessly growing human activity – by less than 1 to more than 7 %, depending on different nations, – to which all its practitioners contribute, whatever their race, or gender, or cultural origin or personal creed or religion may be. Mind you, all these may try to influence what science has to tell us. But the rules according to which scientific knowledge is tested and proven are such that they are struggling to keep independent of all these efforts of influences, at least on the long run. Science strives to attain true and reliable knowledge about this world and only that knowledge will survive the brutal quest for veracity, which can stand up against every effort to put it to trial. Therefore, reliable scientific knowledge cannot only be contributed by all human beings – even though probably not by all alike and equally true and available for all of them without difference of national interest, cultural proclivities (or rather: prejudices!) or personal profits. Science is therefore at the same time useful for every human being alive, but at the personal service to none of them, no individual, no group of them, no nation, no company and no trust (unless we let them by patent laws make private use of some of this intellectual property for a limited time in order to make up for the costs of their inquiry).

This human uniqueness to be capable of fully globalized science and of its knowledge has consequences:

- On principle, every human being can enrich it by its own efforts or by communal scientific research;
- Again on principle, no law – one might jokingly say: with the exception of the three laws of thermodynamics! – can restrict or force the pursuit of scientific knowledge, even though we know only too well, that human laws, and just as well ethical norms, may sometimes hinder or even fully try to forbid it. Therefore it follows from this that,
- What is scientifically knowable will eventually be known, at least by some people and maybe with much delay; and what is knowable cannot be made

unknown again on the long run, whatever forces are applied, because the truth will – hopefully! – always be rediscovered.

Scientific knowledge is therefore nothing that may be added or mimicked like some particular musical or pictorial style, or as well be neglected. As long as there are human beings alive, with human, i.e. with knowledge-seeking minds and brains – and in consequence with human hands and technology deriving from them – there will be scientific knowledge and it will prevail, because it conforms to reality (and if not, it should have never been regarded as science in the first place!).

Sometimes, this insight may seem quite menacing, especially since it is science, which not only cures diseases or tries to rescue the needing from predicaments of all kind, but it is also scientific knowledge which allows to develop weapons and means which may even endanger the future survival of humankind. As much as ethics and laws may try to curtail this in order to make the unthinkable never possible, it is at the same time true that such knowledge will forever be part and parcel of the human endowment, which some may call the human predicament, – and the potential readiness to make use of this scientific knowledge. Whatever we know of our natural heritage and of our cultural achievements, they make clear – as does the historical experience – that the thinking ape, the thoughtful ape, i.e. the human primate, will need every effort of reigning these powers in, which are available to him and her, but science will provide them, whatever we try, and only insightful knowledge about our nature can force us to rule in the dangers, which the self-organized, genetically scaffolded brains of billions of people can produce. It is, as if we lived and had to live on the fertile slopes of a volcano which can always erupt if we even for one second fail to make use of our best efforts to keep it safe – but still if may erupt nevertheless!

4. Human migration: the “old” globalization

But let me first say a few more words about globalisation. Many people think that this is not only a new buzzword, but also a new phenomenon. It is not. It is one of the oldest characteristics of this ever restless primate species to which we belong. In addition, it is a process which has gone through many stages of development in prehistory and history. You might call it as a slow – about 1 km per year, after all done by foot with all their human belongings – but relentless migration. A migration without boundaries – except too wide the sea, too high the mountains, or too broad a desert – was it for the first sparse populations out of Africa some hundred of thousand years ago and again and again for our forebears in search for new food and space. Around the whole inhabitable earth, and since this is a globe, you are finally ending the boundless migration where you initially came from, for instance the Bantu Africans, the Dutch and the British in South Africa a couple of hundred years ago. But that was only the first wave of globalization.

In all times, it has already been mostly a migration of people across boundaries, and this continues to these very days, when we talk about a trickling infiltration again out of Africa and elsewhere. Man is a migrating species *par excellence* – Man

the Migrator, you might call him: *Homo migrans*. You may build the mightiest possible walls or the highest fences – but there is always, maybe not a human, but in the end a humane way across and around nations fencing a nation in.

Nowadays, it finally seems like an ongoing migration beyond all bounds: instantaneous, worldwide and covered on-line by the media. Were it formerly mostly only people – but already with them ideas, cultivars, technologies – who migrated in search of a better future elsewhere, it is mostly capital in our economically ruled times and with more and more access to the internet – well over 200 million users both in the United States and in China now! – all over the globe which travels. This is a migration not in kilometres per years but in virtual money per millisecond in the computer network and recesses (or, as some might call them: the cess-pools!) of the financial markets. Always somewhat more slowly followed by the real economy of production, transportation, consumption (but often with indentured itinerant working people connected with it that have to migrate for new food and new jobs as in former times). Thus it came around the globe in many waves: first, the hunters and gatherers out of Africa maybe a million, certainly hundreds and tens of thousand years ago, spilling all over Asia, Australia and Europe and finally also into the Americas. Then, there was the Neolithic agricultural revolution, bringing domesticated plants and animals with it, from several centres in the old and new worlds, but most importantly from the New East to Europe and from Indian and Chinese centres of cultivation bringing the new cultivars and cultures to large regions of Asia.

Following that, during the Little Ice Ages, there was the spill over of the starving and suffering overpopulation from Europe, mostly preceded by explorers who carried with them the banners of Christianity, but mostly for the sake of an insatiable quest for profit: from gold and precious stones, to spices and tropical goods, but mostly for food and space as ever, killing or subduing the weaker indigenous populations discovered and scientifically described, and populating Neo-Europe – the Americas, Australia, New Zealand, South Africa and so on – with millions and millions of people from the population surpluses of European nations – probably more than 50 millions altogether. If that was not globalization – the second wave of it –, even if then called colonization, I do not know what globalization really means.

This followed by the mixed blessing of the Industrial Revolution and the economic upheavals of global markets, carried by ships and railroads, and finally by air planes in an ever-faster race for added values; going along with the expansion of the ideas of governance and social organization, which try to safeguard the underlying entangled web of economical and financial markets, and of always new ideas – innovation is the buzzword – driven by them together with the sciences, entangled as ever a global ecosphere could have been by millions of natural species.

There can be no doubt: all this expanding, migrating and networking, this third, this tsunamilike wave of globalization, finding its congenial expression in the ever-growing fusion of nations-states, free-market zones, governments and economic trusts, would never have been possible, as well as the population growth of the human species which comes already close to seven billions, – truly beyond all

bounds, as one may anxiously record, – without the reliable knowledge provided by science and research. With research meaning nothing else but science in progress, a never-ending quest for new frontiers, for better, for more reliable knowledge about the world in which we exist, and the never-ending efforts to solve the problems, mostly produced by the always limited scientific and practical knowledge of our predecessors, in order to mitigate the consequences of the incredible success, some may even say: the unbearable success of the human species – that thoughtful, if not that considerate ape!

Without doubt there are consequences of these processes of globalization, driven by ever-increasing scientific knowledge and research by millions of busy-bodies – actually above all: busy minds! – profound ones, unexpected ones, irrepressible and perpetual ones and mostly irreversible and even profligate ones. You may name these consequences “challenges” alright, comprising both chances for progress (of which kind, however?) and risks endangering even this successful species and with it the biosphere of the whole globalized globe. Therefore, when addressing these challenges we have at the same time to face the ways to limit what no one can want – even if it may sometimes seem as inevitable or even further serving science and research.

5. The consequences of the “new” globalization of sciences

What are these consequences, what are these challenges, these chances and these dangers of the final globalization of science and research? Because it should be clear: the knowledge provided by science is there to remain as long as human beings are there, but its consequences may even continue, if humans were no longer to be on this earth!

The first of these consequences is therefore that for the whole of humankind, since there is no way of stopping or ending scientific knowledge and future science-based technology. Maybe it is possible that one or the other nation will try to stop them, by swearing to abstain from the spirits of science and by returning to the hardship and poverty of post ages – Germany may be in a good position to do so, if some of its political parties have their will, even if they always will promise a promised land – but this is only a local disturbance in an stream, relentlessly pushing forward also in the future. If it is the deepest conviction of true science that truth must prevail, there can be no way around it in the long run, and those who by all means try to work against it, do so at their own peril and detriment and will eventually have to fail . This does not mean that some methods of exploration, though on principle possible, like forced experiments on humans, cannot and should not be forbidden and completely suppressed: I will come to that later. Of course, it is up to the democratic lawmaker and to the judges, up to the Supreme Court, to decide about admissible ways to knowledge and its applications. But the victory of scientific rational thinking, – as opposed to magical or mythological practices to explain the occurrences in the physical world, – has become inevitable and inescapable, even though not all humans may be willing or able to grasp it. Mythological knowledge has to be believed, scientific knowledge can be proven, and more importantly: it can be

empirically disproved! Mythological faith can only be renounced, scientific statements and arguments can be refuted. This is the first consequence.

It has a corollary going with it, although. Science can be taught and must be taught in every generation, patiently and sometimes even painstakingly, because all healthy human minds (and those not indoctrinated against it) can at least understand the gist of it, the basic points of its arguments. Those nations who make a sincere effort to provide the means for such teaching – like China, like India, like Israel etc. – will develop more successfully and solve their problems more efficiently than those who regard scientific teaching with disdain and neglect it therefore. Again – when listening carefully what some politicians try to tell us, while they try to reform the school system, – it may be that Germany, in order to make schools easier and more amusing to the majority of pupils and students, has some chance to go the second way.

Learning by example and by practical experience is good. But it will never reach very far without tested and quantitative scientific theory behind it. As Immanuel Kant is said to have remarked: “A reliable theory is the most practical thing in the world!” It is one way, to approach the world casuistically and from one’s own experiences; but that is not the scientific way of understanding it more deeply. Unless our children are taught probability distributions and the properties of whole populations of phenomena; or the differences between correlation and causal relationship; or how models and predictions, as quantitative and reliable as they may seem, crucially depend on the parameters and the numerical values given to them; they will not be able to approach this world rationally by experimentation and logical arguments, and they will be stuck forever in the preconceptions of their personal or communal (cultural) beliefs, instead of succeeding to transcend them and to find reliable knowledge. Not only the results of such scientific understanding of the world are to be taught – after all they may be erroneously believed and soon to be superseded by more reliable facts and theories. The methods of scientific exploration and understanding, of testing and refuting hypotheses by incontrovertible evidence and logical arguments have just as well to be taught. Most important: science admits, it should always do so at least, when it does not know an answer. This is one thing that all the religions of this world have not learned to admit to this day. They all pretend to know all the answers, that is after all what they are here for. Science has to admit its doubts, or rather it should do so. When it does not know an answer to a question, it should teach this.

We call the application of such experimental and logical techniques research, and just as true scientific knowledge will never disappear, research will go on as long as there are inquisitive human minds and as long as they are confronted with problems to be solved. Not only is such continuation of research inevitable – we call it “scientific progress”, which should never be confounded with the moral progress of humans and their societies! – it is also necessary as long as problems arise in the world around us, and as well as among each other, even if we are ourselves more often than not the cause of such problems, for instance by our productive and consumptive habits. The major consequence of the sciences is therefore more

science, the major challenges of and for science arise from research which aims to overcome the problems caused by it!

6. Human knowledge – the common good

It is indeed a most consequential challenge of globalization for science and technology and for further research adding to its knowledge, that the methods and results of them are available to every intelligent human being, who cares to use them. That means also: available to every nation all over the world, since, as again Immanuel Kant and Descartes before him remarked, intelligent judgement is a most equally distributed capability of all human beings. And not only in a long process taking much time – but almost instantaneously, through the accomplishments of the World Wide Web and the Internet. It is also true that patent laws, covering all kinds of technical inventions, try to put law and order into this use of science and research. They may curtail the free exploitation of inventions, by making applicants pay for their usage, but at the same time they make all these inventions open – patent – to everyone interested in them.

There is no privileged or secret scientific knowledge, because on the long run everyone in this world can find it out. Whatever can be discovered by humans will be discovered, sooner or later, by oneself or by a competitor. It is true, that only rich nations can afford satellites, multi-meter telescopes, or accelerators measuring kilometres around or along: but what is found out by them will be publicly available to everyone interested in almost no time, through cooperative sharing, espionage or through the free internet. In other words: it will be globalized knowledge in very short time, indeed! The biggest challenge for every nation of the world is therefore that its own science and research will keep up with this steadily rising water-level of knowledge, because those who try to resist it, will soon learn the hard way that getting under water leaves them terribly little time or space for breathing!

This in itself is a major challenge for the human efforts to make live liveable in a sustainable biosphere, that is, a major challenge for those ethical rules and legal norms which try to put order into our lives and at the same time guarantee their freedom. As it were, this may even be the greatest challenge of and for globalized science and research: to find ways to mitigate its unexpected and unwanted consequences, while deriving much-needed help and much wanted profit from its innovative results.

Morals and laws: is this not another form of science, even if we talk about the “moral sciences” and about the “social sciences”, which include, at least according to some practitioners, also the “legal sciences”? On the one side one should not mind too much the “idols of the theatre” (or in modern language: of the media) “where man (and women!) discuss words and not matter”, as Francis Bacon has once put it so aptly; on the other side, there is an important difference between the natural sciences and the other endeavours of the creative human mind: while it is clear that the “laws of nature” are found (or even made, as some believe), by humans, the reality in which they are tested, proven or refuted may be a mentally

constructed one, but one that cannot be changed *ad libitum* by us humans, which is one of the gravest errors of extreme cultural relativism! It is the bedrock of our knowledge about the existing world, which may be explored by the scientific minds, but not hallucinated by them or different cultural styles of thinking (or if really so, it will soon be found out: by the tools of science!).

The moral and legal sciences are, however, even if more than half a dozen Max-Planck-Institutes carry them in their titles and if we have been invited by a distinguished member of one of the most famous of them, not all of this kind of the natural sciences. Not, that they were less scholarly and erudite: quite the contrary is true (like at our Institutes of Mathematics, which are again different from the natural sciences): their logic and argumentation is certainly no less intricate and forceful than any chemical or physical investigation can ever be. But they are human-made social institutions, which impress one – next to the megacities – as probably some of the most advanced products of human culture (though some laws and some decisions by some judges might sometime sow doubts about that into one’s heart!).

What is even more important: the arguments and norms by ethics and by the legal profession can never be decided or refuted by referring to the state of affairs, the “is” of natural reality: they are basically derived from some “oughts”, which – though some may root them in heavenly wisdom, others in evolutionary selection – are valid only insofar as believed and accepted by the majority of human people in a society, most certainly so in the written laws of constitutionally controlled legal systems. Maybe that some of the rulings of lawmakers and judges both humble or supreme, may sometimes be derived from fundamental norms and values by the judges ultimate competence to apply “the right of unlimited interpretation” (“das Recht zur unbegrenzten Auslegung” – as my former colleague Bernd Rüthers has named – and at times castigated – it). As long as a human community, as legally organized in a nation state (or in a supranational legitimate institution) with a majority puts trust in this legal system and is willing to follow its rulings, they are valid as “the laws of the land”, as they say, and thus have the ultimate power to decide disputed matters. This is not a scientific decision, – even though it needs a lot of sharp thoughtfulness to make the law free from contradictions – as proven by logic or experiment. It even may come from a 3:2 ruling, but it counts (even though academic disputes about them may never come to an end)!

7. The scientific view of the world

What does all that have to do with the challenges of globalized science and research, you may ask? Very much so, since – as already explained – science from itself has the irrepressible urge to find out the truth about everything “existing under the sun” (and sometimes even under the moon by night). It can never stand still and find from itself the moral or legal limits, which have to be imposed on it, in order to make them bearable by the people who after all pay for it. In other words: which can make it a servant to the goals of good human life and not its master. Science is, as it were, by itself blind and hard-hearted against human needs and fears, since it

pursues only the goal of reliable knowledge. It cannot produce moral rules or legal norms but can only conform to them, maybe sometimes only grudgingly, – or in some cases even revolt against them.

The challenges of a world-wide unified scientific view of this world of the human species living in it together with uncounted numbers of other organisms, are the challenges of truly limitless means for institutions which have the competence and power to define such limits. It is nonsense, if these institutions, maybe in order to make their arguments more convincing, refer to god-given or natural or evolutionary norms which we should have to follow. Firstly, because gods tend to speak quite differently to their different followers; and secondly, because nature (or rather “Nature” written with a capital N) cannot have an interest in human affairs, since it does not even exist as a person. The only way, how ethics and the law can meet the challenges of existing science and of on-going research, is to find out what is supported by moral and legal arguments which are so urgent to convince the majority of its people. If science and research in the future became more and more globalized, the greatest challenges for the moral and legal experts is to find those rules and norms which a world-wide human population of whatever race, gender, nationality, religion, culture or profession finds convincing enough to accept and to follow them. This may seem like a tall order for our disputing experts, but it should provide them with an unending impetus for their peace-saving, social-engineering work.

The development of the natural sciences may suffer or be fostered by these efforts here or there, but in the long run they will have to follow the rulings by a human sovereign, that will finally comprise all continents, nations and cultures. There will be, no doubt, many setbacks on this way to a truly globalized and unified world, and some say, the earth will get rid of its inhabitants long before they find these common, sustainable solutions to their on-going competitions and quarrels. May be so. But if not, than it will be only through these normative sciences that science and research can contribute to the human well-being and that of a living biosphere. They should not ask for the help of the natural sciences, to meet this difficult challenge, because these have to struggle already enough to keep their house in good order. Because we should never forget, that the survival of the global humankind will crucially depend on all of them doing there job – knowledge – right: which is to do more research to solve our mental and material problems, of course within the limits of norms guiding their efforts. Therefore, the normative professions are well advised to let the natural sciences and their research flourish enough for them to worry about the norms limiting them – and not the other way around. The “normative sciences” are there, as it were, in order to lead the “natural sciences” from reliable knowledge, which only they can provide, to true wisdom, in order to make them truly humane sciences, that means: lead beyond nature. Because both of them are not there to serve “natural laws” or “legal paragraphs”, but to serve the sovereign humankind, which will forever depend on both of them.

Panel Statements

The Emphasis Should be on Advantages not on Challenges of Globalization

Russell K. Osgood

It is a pleasure and an honor to be here in Munich for this interesting and thought provoking conference on globalization organized efficiently by Prof. Dr. Joseph Straus and his many able associates. It is a particular honor to follow Prof. Hubert Markl, former president of the Max Planck Society, on the program. I wish to start with two preliminary observations that arise from the sad experience, for me, of witnessing a very negative U.S. presidential campaign on the Democratic side in terms of attacking the perceived ills of “globalization.”

My first observation is that I am not sure that different people are referring to the same thing when they use the term “globalization.” Frequently, it seems as though all of the undesirable effects of economic and technological change are blamed on this amorphous and undefined thing. Some intend the term to refer to free trade while others mean enhanced and prevalent international economic contacts, and, finally, some mean it to refer to the unregulated flow of capital across national boundaries.

My second preliminary observation is really an effort by me to disclose a bias on my part for globalization, for free trade and also for the free flow of capital goods. I believe these forces are the best guarantees in the long run for a harmonious world order in which all nations and people are able to compete freely and achieve prosperity.

Having stated my observations I admit to some discouragement based on listening to many of the preceding speakers at this conference excluding *inter alia* Dr. Andrzej Olechowski from Poland. The common assumption of these speakers has been that globalization or globalized free trade has produced only or primarily “problems” which need to be dealt with by adopting market dampening subsidies, special regimes of protection, and social insurance schemes that will inhibit or even prevent the improvement and development of an efficient world market in goods and services. I realize that this is the mood of the day but if, like me, you believe in neo-classical economics this is a sad and unwise mood and set of developments.

So, in the context of my own belief in the value of free international markets and regimes (both of ideas and goods and services) I have been asked to comment on the “challenges” to science and research of the globalized economy. I puzzled over this word, “challenges,” and decided I wanted to change it to “advantages” because I believe the advantages of globalization for science and research have been significant, preponderant, and maybe even total.

Science and research have benefited enormously from the improvement of and growth in international communication and cross-fertilization. The internet and improved international travel have created and nurtured a vibrant community of

researchers who share research freely and frequently. At my own College, for instance, one of our senior biology faculty members has co-authors in Poland, Spain and France for his research as part of the revision of a major treatise on the taxonomy of North American *collembola* (a wingless hexapod with antenna.) They share files daily. Our faculty member uses Chinese and other international students as research assistants and they use these experiences as a springboard to graduate study at the finest institutions in the world. This is a small part of a much larger story in which science and research has leapt across borders, languages, and other barriers to the great benefit of science and also world harmony.

While science and research have thrived in the world of growing global economy interconnectedness, it remains true that there is always a tension between protecting scientists' or researchers' work product (whether by patents or otherwise) and the need and desire to promote the wide availability of the fruits of such science when they are life-saving drugs. This is particularly true when the world is dealing with an epidemic like AIDs that needs to be arrested before nations and continents are depopulated. The TRIPs agreement (http://www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm) was a solid international achievement that helped to improve the world wide protection of scientific work product and other intellectual property rights but has also contributed to a climate in which discussions were held to secure drugs at reduced prices for those most in need in the AIDs crisis. More needs to be done and as the world continues to become more globally inter-related even more will need to be done to protect researchers and their funders from misappropriation while providing safety valve access in dire situations.

Finally, science and research benefits from the current mix of approaches, public and private funding; basic and applied projects; small scale and large labs. It is currently the vogue, particularly in the United States, as represented by the Gates Foundation, to focus on "big" diseases or problems and applied research efforts rather than basic research aimed at more foundational investigations. Both are valid but the current heavy public emphasis on the applied end with a focus on headline diseases and problems is not a good long-term strategy. The best long-term strategy is a mix of funding approaches and research strategies carried out in multiple competing labs and locales. Successful science research comes from unexpected places at unexpected times and frequently builds on the mistakes, failures, and dead-ends of the past. We should try to ensure that state governments, like Bavaria; federal governments, like Germany; foundations, like Novartis Foundation and the Max Planck Institute; and private companies like Smith Glaxo Kline, all are funding researchers working with different hunches, differing approaches, and varying goals. In the long run this will maximize success.

Finally, I will admit that there are a few "challenges" for science and research in a globalized economy. We do not want everyone on every street corner to have a nuclear weapon ready to detonate if he/she is unhappy about something or other. So, law, and to some extent meta-legal ethical norms, need to be applied in developing very limited rules of an international and national character to help control things that are conceived to be dangerous. There is, of course, a danger in this as some will see things like embryonic stem cell research as dangerous and seek to ban them. My

own belief is that there should be few such rules and the applications in particular cases should be guided by advisory boards composed of scientists who have been around a while.

Thanks again to the Max Planck Institute for the opportunity to come to this conference, to participate, and to help contribute to the understanding of the great benefits of our increasingly globalized economy.

In Need of an Ethic and Legal Framework to Secure International Cooperation

Sir Brian Heap

A relevant feature of globalization has been the remarkable evolution in universities particularly in science and research. They are now seen not only as creators of knowledge and sources of learning and education but also as drivers of innovation. Universities are international by nature and the scale of their activities and investments and the free flow of individuals are increasing rather than declining as exemplified by work on the human genome, climate change, infectious diseases, particle colliders, large data sets and many other fields. Science that comes from curiosity-driven research needs to be protected because it is the life-blood of new initiatives and business opportunities, and it fosters a rich source of the skills required to translate new knowledge into practice.

Returns of commercialisation, though substantial, may not reach the size of golden eggs that are expected to solve the financial problems of a modern university. The revenue from MIT's intellectual property amounted to about 5% of its research budget in 2007. At Cambridge in the UK, the University and its Colleges, Press and Assessment employ 11,700 people, support 77,000 jobs and have a direct expenditure of nearly £1bn. With a substantial venture capital scene there has been a steady growth in the flow of knowledge into industry not only locally but also nationally and internationally (152 invention disclosures, 58 patents filed, 61 licences granted, 28 new start-up companies, 82 consultancy contracts, and 4 spin-out companies created annually). Features such as these serve to emphasise the importance of legal and ethical considerations for, as Pope John Paul II argued, 'the pre-eminence of the profit motive in conducting scientific research ultimately means that science is deprived of its epistemological character, according to which its primary goal is discovery of the truth. The risk is that when research takes a utilitarian turn, its speculative dimension, which is the inner dynamic of man's intellectual journey, will be diminished or stifled'.

But there is a reverse way in which we can see how science and research influence globalization, or rather fails to have a desirable effect.

Science and research have been telling us for some time that global climate change presents a serious problem for humankind. As a result the Kyoto Protocol was formulated and came into force in 2005 with 175 parties ratifying it by November 2007. The Protocol encompassed several measures to reduce greenhouse gas emissions but as an international measure of governance it has proved to be a largely symbolic failure. Various loopholes and limitations have been exploited and the overall outcome has been a miserable failure with cumulative carbon emissions of +4480 m metric tonnes instead of an intended reduction of -770.

A second international failure has been the attempt to address the problem posed by galloping population growth. Scientists and demographers have warned that while global population growth rate has actually declined since 1970 from about 2% to about 1.5% today, this rate is now applied to a much larger population of about 6 bn than in 1970 so that the added yearly increments are larger. More than 90% of the world's population growth is occurring in developing countries in Asia, Africa and Latin America where the rates of natural increase vary from 1.4% in Asia to 2.6% in Africa. In developing countries the number of women in child-bearing years increases by about 24 million annually, and the number of women in developing countries of child-bearing age (15 to 49 years) has increased much faster (2.3% per annum) than the world population growth rate. This means that if couples began having just two children on average today, world population would still grow from 5.8 billion to more than 8 billion, the result of the demographers' so-called 'population momentum'.

In 1994 the International Conference on Population and Development in Cairo signalled the seriousness of the global population growth rate, and in 2007 an All Party Report from Westminster (2007) concluded that failure to address the importance of universal access to family planning will mean that the United Nations Millennium Development Goals will not be met, yet another international failure. These Goals include the promotion of gender equality and empowerment of women (a crucial step in the control of fertility); improvements in maternal health (41% pregnancies unwanted); eradication of extreme poverty and hunger (number of people living on less than 1\$ per day is rising in sub-Saharan countries and parts of S Asia); universal primary education (under 50% of pupils complete primary level in Sub-Saharan Africa); infectious disease control (disease exacerbated by poverty); and environmental sustainability (effects of climate change aggravated by a high consumption of water for food production, and water shortages in two-thirds of the world's population).

The cost of meeting the broad agenda outlined at the Cairo Conference (1994) was £12bn annually (adjusted for inflation). Today, more than £1bn pa is required, but over the past decade family planning programmes have stalled and the actual support from international donors has declined to only £100m pa largely because the reduced contributions from the USA Administration. It is notable that in those developing countries where birth rate has fallen, between 25 to 40% of economic growth is attributable to demographic change making the empowerment of women and family planning a highly effective investment.

A third international failure concerns food security. Science and research has warned that while food production over the past 50 years has increased faster than population growth rates modern agricultural practices are unsustainable in the long run. The World Food Summit held in Rome in 1996 aimed to renew global commitment to the fight against hunger, yet today we find serious concerns about food security once again in the light of rising costs of production and the impact of natural disasters in key regions such as drought in Africa and Australasia and flooding in South East Asia. The 20th century is full of examples of governments undermining the food security of their own nations – sometimes intentionally. The

most recent international assessment concurs that ‘agriculture is not just about putting things in the ground and then harvesting them...it is increasingly about the social and environmental variables that will in large part determine the future capacity of agriculture to provide for eight or nine billion people in a manner that is sustainable’ (The International Assessment of Agricultural Knowledge, Science and Technology for Development , IAASTD, 2008).

History reveals a litany of failures in the ability of the international community to respond to issues such as population growth and food security, and there are signs that we are in danger of heading towards another failure with climate change since all three are intimately linked. Each of these failures has one thing in common – the failure of global cooperation in the face of legal and ethical dilemmas many of which are derived from socio-political and religious disparities. Ever since the Enlightenment and the industrial revolution human society has been defined by competition, a central theme in this conference, which leads to environmental unsustainability, rather than cooperation. Central to all modern biology, however, is the shift towards the question – why do we cooperate? Some theorise that the ability to cooperate is one of the main reasons why humans have managed to survive in almost every ecosystem on Earth, but we urgently need an ethic and legal framework that would facilitate such a priority.

Valorization of Knowledge – A Key to Success

Alain Pompidou

Globalization in sciences and research stems from two factors, an overflow of information and ideas and an extension of the geographical area for scientific collaboration as well as an enlargement of networking. The consequences of these factors are (1) a relocalisation of science and research, (2) a relocalisation of financing for R&D, (3) a relocalisation of production, (4) an enlargement of market share and (5) a relativisation of ethical approaches related to cultural diversities.

To establish science and research policies in a globalized economy, there is a necessity to make a distinction between the elaboration of knowledge and the use of such knowledge. This involves intermediate steps which are related to the validation of concepts by laboratories in research performing organisations or enterprises and a properly adjusted capital investment policy including a properly balanced sharing of intellectual property revenues.

Science has no border. The elaboration of knowledge is a fate of humanity. Flashes of genius are necessary, but new technologies developments in physics, biology, universe exploration and earth observation bring an enlargement of the scope and capacities for scientists. They are more and more using converging technologies. The necessity to think and to anticipate is more than ever necessary. This implies to identify and promote excellence, while keeping in mind the ethical context.

As innovation is a too broad concept, I shall limit my contribution today to the valorisation of knowledge. The objectives are to transform ideas into commercial products for the benefit of humanity. This is the point where the controversial role of patents must be addressed because of their ethical aspects. Some scientists consider that patents have a blocking effect on the evolution of science by granting an unacceptable monopoly to the inventor. There is a kind of misconception about patent policy because patents can be considered as having a regulatory and catalysing effect. They are regulative because patent protection provided by the different patent laws brings legal certainty and support for future capital investments. Their catalysing effect is the disclosure of the invention through publication which promotes the emergence of new ideas among scientists and engineers. Innovation feeds innovation.

Ethical aspects are involved in both ways because the ethical approach is a filter for the use of patents in terms of marketing and elaboration of further ideas or concepts for new technologies. Thus patents are the transmission belt between scientific and technological knowledge and the market economy.

Patents will avoid a world governed by secrecy and trade secrets in a globalized economy. Therefore, it is time to integrate intellectual property policy as a global, sustainable, competitive advantage.

But we may not address this issue blindly. Three years ago, the European Patent Office (EPO) engaged in a study of “scenarios for the future” based on one hundred interviews of protagonists and antagonists of the patent system from all over the world. Among these conflicting views, the key question was to find the proper balance between four major scenarios at the global level including four major drivers: (1) society’s concerns, (2) the technological boom, (3) market share and (4) geopolitics involving policy decision makers.

We now have a better point of view in this moving landscape of what the tendencies will be for 2025. It is thus necessary to identify the proper balance between commerce and society, developed and developing countries, the interest of high tech SMEs and multinationals and beliefs and convictions related to ethics. This kind of approach needs a quick reaction to unforeseen breakthrough in knowledge or technologies.

Patent publications are now available not only on extensive data bases but on specific electronic servers like open-ip.org and others. They will define global market places in order to give an opportunity to capital investors and firms to improve patent portfolios and to get competitive advantages. But a globalized science and research need a better harmonization of the globalized economy.

Beside the moral acceptance of new methods in Biology for procreation or malignity prediction of human tumours or for agro-cultural food processes, one of the major ethical issues is the access to new products which open new market share. In 2006, the World Bank explored possible scenarios for the next 25 years of globalisation. In the developing world, annual per capita income growth is predicted to accelerate to 3, 1% from 2, 1% since 1980. As a result, “a global middle class” will emerge. By 2030 trade will probably has increased more than three fold, the developing countries will account for half of the global expansion in trade. This should take into account that some of them will be more successful than others.

Some more important explanatory factors are technological changes which increase the rewards of skilled workers in relation to the unskilled. This has two consequences: (1) Further enhancing the role of women in society which would also protect those with the fewest opportunities; (2) training workers on services in public health or electronic business and, at the same time, preparing the promotion of elites in science and technology for both genders.

Nevertheless, an undesirable outcome related to a rising global integration is the harassment of our environment. Rapid growth makes it harder to achieve common global goals like climate change or containment of infectious diseases. Such international problems require multilateral policy solutions where scientists and researchers can contribute a large amount of expertise in order to enlighten policy decision makers.

If we look at the European region, Europe will keep its influential position in this global context provided it becomes one of the economical players of the globalized game. This will only be possible if Europe is not left on the sidewalk because of lacking scientists and researchers as well as economical power. Thus, Europe urgently needs to fill the gap between the elaboration of knowledge where its specific skills are still recognized and the economical valorisation of this

knowledge where more and more capital investment is coming from outside Europe. This is one of the major challenges of Europe in the globalized knowledge economy and where Europe, with all its old cultural differences, will be able to highlight the ethical approach necessary for a sustainable development of the planet.