*Unearned and Unshared Prosperity are Unsustainable**

V. K. Sharma

As is invariably the case with any major crisis, the ongoing global financial and economic crisis, including lately, of course, the eurozone crisis, have unleashed a passionate debate over the design of a new architecture of finance, capitalism and globalisation. However, the trouble has been not so much with the inter-temporally evolved architecture of finance, capitalism and globalisation as really with how it was actually worked in practice. The apocalyptic denouement, almost bordering on a veritable global financial and economic nuclear winter, happened not because the existing systems and best practices failed but because those responsible for implementing, and enforcing, them failed them! After all, of all risks to regulators and regulatees alike, human resources risk is by far the most serious as it is the source of all risks as confirmed by the ongoing financial and economic cataclysm. Effective and credible systems are not about right architecture but about right people for right people can make a wrong architecture work while wrong people can't make even a right architecture work ! This 'right people-wrong people' trade-off is substantively, and effectively, about 'ethics-expediency' trade-off, with the overwhelming anecdotal evidence of 'expediency' prevailing over 'ethics' ! The crux of the matter is what we need is not more, or less, regulation, but good regulation, and governance. This has been the undoing of regulators/ supervisors and financial firms/banks alike. But unfortunately broad-spectrum and generic failure of an inertial regulatory and supervisory system worldwide, especially in the West, precipitated the unprecedented global financial crisis and the resulting great recession. This regulatory and supervisory inertia and imperviousness to the early warning signals of unprecedented underpricing of risk, which were galore, and aplenty, pre-crisis, is graphically epitomised by the most no-holds-barred acknowledgement of this – though it came much later only recently – was when Donald Kohn, former Vice Chairman of the US Federal Reserve apologised by saying, 'The cops were not on the beat, resulting in the worst economic recession and loss of millions of jobs'! At the end of the day, the problem is not not knowing the problem, but knowing it and dithering, agonising over choices, temporising, procrastinating and doing nothing credible, timely, tangible and decisive about it. In other words, in my considered opinion, we don't really have to rethink capitalism and globalisation, for paraphrasing John Ruskin, what finally matters is not knowing what must be done but actually doing what must be done and doing it when it must be done !!

2. The cataclysmic financial crisis has thrown into sharp relief, as never before, the critical and important role of 'asset price' inflation/asset bubbles also, as opposed to that of shop floor/products/services inflation alone, as a key variable, in monetary policy response. For what happened was unprecedented in that with monetary policy focused only on traditional CPI, interest rates were kept low in spite of exploding prices of assets like real estate/property, credit assets, equity and commodities. And this was all made possible because of the huge pre-crisis current account surpluses in China and other Emerging Market Economies (EMEs), and huge private capital inflows into EMEs in excess of their current account deficits, getting recycled back as official capital flows into government bonds of reserve currency countries, especially the USA, resulting in compression of long-term yields which, in turn, translated into lower long-term interest rates even for the riskier asset classes

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mentioned above. This chasing of yield, due to global savings glut, in turn, led to a veritable credit bubble, characterised by unprecedented underpricing of risk as reflected in the all-time-low risk premia with junk bonds spreads becoming indistinguishable from investment grade debt! Such a low interest rate environment coupled with luxuriant supply of liquidity, created enabling environment for excessive leverage and risk taking. This financial syndrome was a classical case of ''too much' and 'too little' – too much liquidity, too much leverage, too much complex financial engineering, too little return for risk, too little understanding of risks'. This syndrome of too much of arcane rocket science and financial alchemy in the financial sector, almost entirely for its own sake to almost complete exclusion of the needs of the real sector, created a massive 'financial sector – real sector imbalance' which, being, intrinsically unsustainable, culminated eventually into the now-all-too-familiar apocalyptic denouement.

3. Significantly, the above pre-2007 story of massive and unprecedented current account imbalances was almost replicated in the current on-going eurozone crisis with large and persistent current account imbalances between the core, proxied by Germany, and the Netherlands, and the crisis-hit periphery, with the surpluses of the core being almost mirror image of the current account deficits of the periphery. Indeed, it is noteworthy that current account surpluses of the core increased dramatically after the launch of the single currency because of significant depreciation of the real exchange rate in the core and appreciation of the real exchange rate in the periphery. Such large, and persistent, current account imbalances between the core and the periphery would not have been possible but for the explicit moral hazard of fixed and stable exchange rates created by the single currency because the respective national currencies of the periphery would have depreciated in real terms resulting in timely automatic rebalancing of the current account imbalances! Incidentally, but significantly, these current account imbalances between the 'core' and the 'periphery' are, to an extent, the result of post-1999 fiscal convergence to fiscal divergence story in the eurozone for, unless, net private savings offset it, fiscal deficit typically tends to spill over into current account deficit and, therefore, post-euro launch, there ought to have been a credible, effective and functioning institutional enforcement mechanism to ensure ongoing compliance on Maastricht fiscal parameters. Of course, this post-1999 fiscal convergence to fiscal divergence story in the 'periphery' would not have mattered if, like in the case of Japan, net private savings more than offset the comparable net public dissaving (fiscal deficit) of -9.5 per cent ! So the way out of the current crisis is unwinding these imbalances through higher productivity and competitiveness in the periphery relative to the core. This is exactly what happened post-crisis in the case of unwinding of the imbalances between China, on the one hand, and the United States, on the other, with the United States current account deficit halving from almost 6 per cent in 2007 to 3 per cent currently and that of China's current account surplus shrinking steeply from 10 per cent in 2007 to 2.6 per cent currently ! Thus, in the framework of 'unearned – unshared prosperity', it was the case of 'unearned' prosperity for the 'deficit' periphery and 'unshared' prosperity for the 'surplus' core ! But as in the case of China and the United States, there is some good news that real wages in Germany have gone up by 3 per cent and those in Greece have gone down by 7 per cent. Going forward, this then holds the promise of unwinding such imbalances by export of goods and services from the 'periphery' and import of goods and services by the 'core'.

4. As I said, these large and persistent current account imbalances represented 'unearned' prosperity for deficit reserve currency countries and 'unshared' prosperity for surplus countries. Such a global economic order was inherently unsustainable, and unstable, from the word go. But the greatest good, and the highest virtue, as it were, of sustainable

globalisation is that, it does not permit, except in the very short-term, 'unearned' and 'unshared' prosperity but delivers 'sustainable prosperity' only if they are 'earned' and 'shared' prosperity! And mind you, 'unearned' and 'unshared' prosperity are no socialistic/egalitarian platitudinal rhetoric but pretty compelling real-politik and geo-economic imperatives given the current irreversibly globalised and, increasingly integrated, and interdependent, world. Sustainable globalisation is about macroeconomic equilibrium, balance and harmony. In fact, the whole thing can be likened to cosmic balance/equilibrium/harmony where stars, suns, planets, all orbit within the inviolable discipline of their elliptical orbits which do not permit deviant behaviour beyond the shortest and the longest distance from suns and stars of orbiting planets ! Any deviant behaviour/conduct, inconsistent with the cosmic harmonious balance and equilibrium, will invite, and inflict, extremely retributive backlash; the more severe and prolonged the disequilibrium and imbalance, the more wrenching and excruciating will be the resulting pain as is currently being experienced, especially in the euro zone, where, it is no brainer to see that, in the event of the break-up of the euro, it is the surplus/creditor 'core' that has far more to lose than the deficit/debtor 'periphery'! For if the surplus/creditor 'core' exit the euro, value of what is left of the euro will be worth much less in terms of national currencies of the exiting surplus/creditor countries. On the other hand, if the deficit/debtor 'periphery' exit, they will simply default on their euro-denominated debt owed to the surplus/creditor 'core' because of the collapse of their national currencies against the euro! In other words, in sustainable globalisation, there can be both winners, and losers, only in the short-term, for such is the nature of sustainable globalisation that, in the long-term, there can only be all winners and no losers! To conclude, therefore, if we earn and share, we prosper together, and if we don't, we perish together!!