

## Towards Financial Stability: Myth or Reality?

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It has been just over ten years since the default of the US merchant bank Lehmann Brothers<sup>1</sup>, an event that, in addition to setting off the fiercest economic crisis since the times of the Great Depression<sup>2</sup> of 1929, gave rise to a chain of situations capable of producing, first of all, a true and proper wave of financial instability and, then, political and social instability due to the particular impact that it had on the real economy.

In fact, the crisis led to a global recession<sup>3</sup> without precedent, which was followed by a sovereign debt crisis in the European Union<sup>4</sup> that was so serious that it threatened the survival of the Euro and the Economic and Monetary Union underlying it<sup>5</sup>. The economic instability that followed on a global scale then hit the weaker nations, like North Africa and the Middle East and in turn was the cause of the popular uprisings that characterized the well-known *Arab Spring*<sup>6</sup>.

Furthermore, in Europe it caused a kind of migratory crisis<sup>7</sup>, with tens of thousands of people, in the search for asylum and better living

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<sup>1</sup> On Lehman brother's default see CHEN R.T. (et al.), *Liquidity, Leverage and Lehman: A Structural Analysis of Financial Institutions in Crisis*, in *Journal of banking and Finance*, vol 45, 2014, pp. 117-139.

<sup>2</sup> FRONCZACK J., *A Rabble of Dead Money: The Great Crash of The Global depression 1929-1939*, in *Reviews of American History*, vol. 46, n. 3, 2018, pp. 483-489.

<sup>3</sup> DAL BIANCO S. (et. al), *The Impact of The Global Financial Crisis and The Role of External and Internal Factors in Emerging Countries*, in *Emerging Markets Finance and Trade*, vol. 53, n. 2, 2017, pp. 229-249.

<sup>4</sup> MEEGAN A. (et.al), *Financial Market spill overs during the Quantitative Easing Programmes of the Global Financial Crisis (2007-2009) and the European Debt Crisis*, in *Journal of International Financial Markets Institutions and Money*, vol. 56, 2018, pp. 128-148.

<sup>5</sup> PERONI G., *La Crisi dell'Euro: limiti e rimedi dell'unione economica e monetaria*, Milano, 2012.

<sup>6</sup> BAYAT A., *Revolution without Revolutionaries: Making Sense of the Arab Spring*, in *International journal of Middle East Studies*, vol 50. N. 3, 2018 pp. 613-614.

<sup>7</sup> ROLENC J. M., *Do Recent International crises represent the "end of Globalization"?* 16 The International Conference on Globalization and its Socio Economic Consequences, 2016, pp. 1872-1879.

conditions, starting to push against the borders of the European Union, generating new fears among European citizens, transforming the political structure of the Old continent. In fact, in the face of the threat of a future dominated by economic and political uncertainty, first of all British voters decided to throw themselves into the “void” of *Brexit*, and then US citizens chose a questionable businessman as their President. The French, on the other hand, when they elected Macron in 2017, decided to reject the entire political class of their country, placing their faith in a person that became head of a party created for the occasion and practically out of nothing. Germany, too, in trusting in Angela Merkel for the fourth time, witnessed something that had not happened since the end of the Second World War, namely the entry of an extreme right-wing party into Parliament with a number of representatives, which at the same time became the strongest opposition party. And lastly, in March 2018, Italian voters got rid of the old center-left and center-right parties, creating what some have defined as the Italian “Third Republic”.

These events, to which many others could also be added (such as the Venezuelan crisis or the more new debt crisis in Argentina) are an expression of the will of several large cross-sections of the population to not only get rid of the “old” to make room for the “new”, but, above all, to put an end to years of economic austerity, used excessively to regain faith in the markets and, therefore, their stability<sup>8</sup>.

This desire can be certainly be shared together with that of no longer wanting to be hostage to economic events and to be living in a constant state of precarious equilibrium. Nevertheless, one cannot help but observe how the economic, political and social changes of recent years have followed one another and continue to follow one another at an overwhelming pace and that the responses given up to now at both national and supranational level have, unfortunately, not been enough to satisfy people’s natural need for greater economic and social security.

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<sup>8</sup> CAVAGHAN R., O’ DWYER, M. *European economic Governance in 2017: A Recovery for Whom*, in *Journal of Common Market Studies*, vol .56, 2018, pp. 96-108.

Hence, large cross-sections of the population have decided to support political movements that, in an attempt to offer new economic security to those that voted for them, welcome the possibility of questioning several of the fundamental cornerstones of the current international legal - economic and trade order, namely the “*pacta sunt servanda*” rule, the multilateral method and the principle of non-discrimination.<sup>9</sup>

The failure to respect the aforesaid principles, as is the case, for example, with the US administration on the subject of the application of duties on China or Mexico, or the desire to no longer respect the Stability and Growth Pact<sup>10</sup>, as is the case with Italy, not only means breaking WTO law in the former case and EU law in the latter case, but also represents a conscious desire to destabilize economic and trade relations as we know them up to now in order to create an alleged new international economic system that appears at first sight to be based on economic nationalism and therefore, on dangerous protectionist policies already witnessed in the past and that characterized the first part of the last century.

The international economic order that has seen the definitive emergence of the neo-liberal system, through the capitalist model underlying it, and that has conquered a large part of the planet by beating and moving even into Russia and China, bastions of the economic models inspired by communist ideology, is therefore in crisis today and along with

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<sup>9</sup> With reference to the multilateral method applied to international relations see GRAHAM E., *Money and Multilateralism: How Funding Rules Constitute IO Governance*, in *International theory*, vol. 7, n. 1, 2015, pp.162-194; MILEWICZ K.M., ELSIG M., *The Hidden World of Multilateralism: Treaty Commitments of Newly Democratized States in Europe*, in *International Studies Quarterly*, vol. 58, n. 2, 2014, pp.322-335. On the topic of non discrimination see SALDARRIAGA M.A.C., *Sustainable Production and Trade Discrimination: An Analysis of the WTO Jurisprudence*, in *Anuario Colombiano de Derecho Internacional*, 2018, pp. 221-258; HUBER M., *No discrimination and The Role of Regulatory Purpose in International trade and Investment Law*, in *Journal of International Economic Law*, vol. 20, n. 2, pp. 431-445.

<sup>10</sup> BUTI M., EIJFFINGER S., FRANCO D. *Revisiting Emu's Stability Pact: A Pragmatic Way Forward*. In *Oxford Review of Economic Policy*, 2003, pp. 100-111; CREEL J, SARACENO J., *Automatic stabilization, discretionary policy and the Stability Pact*, in Creel J, Sawyer MC (eds) *Current Thinking on Fiscal Policy*. Palgrave Mc Millan New York, 2009, pp. 112-44.

this, first and foremost, the system of rules represented by the WTO<sup>11</sup>, thanks to which a single global market of goods and services has been progressively established starting from 1994, when the related constitutive agreement was signed.

Nevertheless, said system has not made any significant progress in the regulation of international trade for years and since the Doha round<sup>12</sup> of 2003 in particular. In fact, no response has been found to crucial issues such as those related to social, environmental and fiscal dumping<sup>13</sup>, at the core of the profound asymmetry that has characterized trade relations between states over the last twenty years.

Downward competition between States with regard to environmental protection and the safeguarding of economic and social rights, as well as the taxation of income, inevitably results in the threatening of certain social entitlements that in western countries have been taken for granted.

On the basis of the above, it appears that the critical analysis of capitalism, at the core of neo-liberalism, attributable to Marxist thought, may still make the insight into why the aforesaid profit-driven system has created and triggered forces that it is unfamiliar with and can no longer dominate<sup>14</sup> relevant today. Forces that, in this day and age, are no longer the rebellions of the oppressed working classes of the past, but increasingly larger cross-sections of the population that are suffering a constant and progressive decline in their wellbeing and related economic and social rights as a result of the economic crisis, and added to these

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<sup>11</sup> QURESHI A.H., *The World Trade Organization. Implementing International Trade Norms*, Manchester & New York, 1996; J. JACKSON, *The World Trading System: Law and Policy of International Economic Relations*, London, 1997.

<sup>12</sup> VINCENT P., *Les résultats de la quatrième conférence ministérielle de l'Omc-vers un cycle du développement?* in *Revue Belge de Droit International*, 2003, p. 111 ss; Doha Work Programme, *Decision adopted by the General Council on 1 August 2004*, see the web page <http://www.wto.org>

<sup>13</sup> SANTA MARIA A., *Le dumping et les subventionnées dans la cadre du droit international et du droit des Communautés européennes*, in *Le droit international à l'heure de sa codification*, in *Etudes en l'honneur de Roberto Ago*, vol. IV, Milano, 1987, p. 295 ss.

<sup>14</sup> MARX K., *Capital. A Critique of Political Economy*, 1890, London.

other irreparable injuries, like those inflicted on the environment in the name of profit and economic growth.

It is in this context that the contemporary nature of the fundamental practical message of the *General Theory* of Keynes<sup>15</sup> can probably be added, according to which the capitalist economy based on the free market can, or rather, needs to be stabilized using appropriate monetary and tax policies to ensure the fair distribution of wealth, thus reducing inequality, without, moreover, renouncing the values on which this type of economic system is based: *freedom of initiative* and the protection of *private property*.

The use of stabilization policies shared at international level is increasingly necessary if one considers the fact that to date there is no real alternative to the neo-liberal economic model and economic globalization. The convergence of states towards a single economic and trade system has inevitably made their respective economies increasingly interdependent upon one another, meaning that the effects of any kind of crisis that hits a certain country or economic area, regardless of size, very quickly spreads to the other countries (spill over), compromising regional, or in the worst case scenario, global economic and financial stability.

It is without doubt that the globalization of the economy and trade exchanges have caused a reduction in the fundamental prerogatives connected and bound inextricably to the international subjectivity of states. Nevertheless, the reconstruction of the changes suffered by the economic and monetary sovereignty of states<sup>16</sup>, with the exception of obvious cases like the adoption of a single Currency, at European level, is by no means an easy feat, not only because the concept of sovereignty, in a broader sense, on the one hand has changed over time, but also because, on the other hand, it suffers from the contrast existing in

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<sup>15</sup> KEYNES J.M., *The General Theory of Employment, Interest and Money*, 1935, London.

<sup>16</sup> CARREAU D., *Souveraineté et co-opération monétaire internationale*, Paris, 1970, pp. 52-54; SHUSTER M. R., *The Public International Law of Money*, Oxford, 1973, p. 9; BURDEAU G., *L'exercice des compétences monétaires par les états*, in *Recueil des Cours*, 1988, p. 236; F. MANN A., *The Legal Aspect of Money*, Oxford, 1992, p. 461)

international doctrine between those that consider that the competence of a state in a certain matter exists only if it is regulated by an international law and those that, on the other hand, consider the competences of a state to come before the international system, which intervenes only to limit them on the basis of the principle of the peaceful co-existence among states within the international community. Nevertheless, beyond the debate on how the economic and monetary sovereignty of states has changed, the comments made by the Permanent Court of Justice in the well-known Wimbledon case<sup>17</sup> of 1923 remain true. In this case, the Court highlighted that the limits to the economic and monetary sovereignty of a State, which today may be those deriving from the participation in the Single Currency, are still an expression of the sovereignty of a State. The Court observed, in fact, that the conclusion of a treaty is not an abandonment of the sovereignty of the State due to the mere fact of regulating the adoption of obligations, but rather one of its typical attributes.

The approach of those that try to link the topic of the construction of a new economic and monetary stability to that of the possible recovery of the sovereignty by a state is therefore wrong. The true focal point is the fact that states have not yet created a multilateral system capable of regulating the financial services sector from which, as it is known, the crisis originated and whose regulation at global level is responsible for a number of supranational bodies (with inevitable potential conflicts of responsibility among them) that operate, mainly, with forms of soft law and, therefore, those without any actual binding force.

Due to the widespread phenomena of social, fiscal and environmental dumping,<sup>18</sup> western countries have witnessed progressive

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<sup>17</sup> Permanent Court of Justice, Case of the S.S. "Wimbledon", Britain *et al.* v. Germany, (1923) PCIJ Series A01.

<sup>18</sup> It is an expression used in International trade law to specify when a country or company exports a product at a price that is lower in the foreign importing market than the price in the exporter's domestic market. This may be due to several factors including a less expensive labor or the possibility of not having to submit to particular obligations or practices for the protection of the environment.

deindustrialization, which has led to the progressive conversion of their economies, with the particular strengthening of the services sector, in which the financial sector seems to have prevailed today.

The more advanced economies, by focusing therefore on the strategic sector of financial services and by relying, at international level, on soft law as a regulatory tool, as well as a number of supranational bodies as guarantors of the efficiency of the sector in question, have left the way open to major banking and insurance players in a legal framework characterized by a major lack in regulatory uniformity in the different economic areas of the world. Otherwise, this would not explain the reason why the sector in question lies outside the GATS-WTO system, bar the laying down of a laconic provision in the Annex dedicated to financial services, which establishes that *«A Member may recognize prudential measures of any other country in determining how the Member's measures relating to financial services shall be applied. Such recognition, which may be achieved through harmonization or otherwise, may be based upon an agreement or arrangement with the country concerned or may be accorded autonomously»*. Such a provision limits itself to recognizing the importance of financial stability, authorizing Wto member states to autonomously undertake the measures that they unilaterally consider more effective to protect consumers.

On the contrary, by relying on the efficient jurisdictional system of the Dispute Settlement Body<sup>19</sup>, which manages to ensure that treaty restrictions and the customary practices underlying international business law are respected today, a shared legislative framework could be created, or at least the essential points thereof.

Reaching a regulation at the very least harmonized at supranational level could avoid scandals, such as that of the subprime loans, as well as the default of banks and insurance companies that led to the financial crisis still ongoing today. In other terms, the time has come for the law to

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<sup>19</sup> PETERSMANN E.U., *The GATT/WTO Dispute Settlement System: International Law, International Organizations and Dispute Settlement*, London, 1997.

take back the areas that the excesses of liberalism have occupied in the years prior to and following the crisis, in the name of solid liberalization, privatization and deregulation policies, used as a basis of the well-known *Washington consensus* model<sup>20</sup>.

Therefore, in the opinion of the author of this paper it does not appear to be sufficient to use mere external economic restraints, fixed in agreements to which member states voluntarily commit themselves through internal adjustment procedures, to guarantee economic stability. Also because if it is internationally agreed<sup>21</sup> that this stability is a global public good<sup>22</sup> that the entire international community must strive for, as we are taught in economic literature, there is no common vision on what is meant by this good and how it is to be achieved.<sup>23</sup>

This is the opposite of what happens in the case of price stability that, with the fixing of a 2% rate of inflation, bears witness to a numerical target shared by the major world central banks (European Central Bank, Federal Reserve, Bank of England, Bank of Japan)<sup>24</sup>. Being able to define

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<sup>20</sup> The expression *Washington Consensus*, coined in 1989 by the English economist John Williamson, is usually indicated by a set of 10 economic policy prescriptions that constitute the "standard" reform package promoted by the International Monetary Fund (IMF), World Bank (WB), and the US Treasury Department, all based in Washington D.C., for solving the economic crisis of developing countries. On this topic and its influence on the construction of the European Monetary Union see PERONI G., *The Constitutionalization of the Washington consensus in the European Union: like giving up the Social Market Economy*, in E. SCISO (ed. by) *Transparency and Democracy in the Bretton Woods Institutions*, Springer, Giappichelli Torino, 2017, pp. 91-106.

<sup>21</sup> COTTIER T., *The Rule of Law in Monetary Affairs*, Cambridge University Press, Cambridge, 2014.

<sup>22</sup> SAMEULSON P., *The Pure Theory of Public Expenditure*, in *The Review of Economics and Statistics*, vol. 36 n. 4, 1954, pp. 387-389; DIETER H., *The Stability of International Financial Markets: A Global Public Good?*, in *New Rules for Global Markets. Public and Private Governance in the World Economy*, (ed. by) S. A. SCHIRM, New York, 2004, pp. 23-40.

<sup>23</sup> On the difficulties to define stability in the economic and financial perspective see SCHINASI G.J., *Defining Financing Stability*, IMF Report, 2004. According to Schinasi, *Financial stability* must be defined in terms of its ability to facilitate and enhance economic processes, manage risks, and absorb shocks. Moreover, financial stability must be considered *a continuum*: changeable over time and consistent with multiple combinations of the constituent elements of finance.

<sup>24</sup> The stability to which we refer is the internal one of the currency, while the external one, or exchange rate stability, is not considered. It has been defined by the Governing Council of the ECB as 'an increase in the twelve months of the Harmonised Index of Consumer Prices - HICP - for the euro area of below 2%', to be maintained in the medium term. On this point, see ECB Monthly Bulletin June 2003, p. 85 ss.

economic stability from a tax and financial point of view more clearly and with generally shared parameters, including quantitative parameters, would contribute to restricting the discretion of national and supranational players in the choosing of economic policies to be adopted in order to achieve this stability, in more coordinated and shared terms.

In other terms, the widespread recourse, which most of the time is illegitimate, to the justification of the “state of economic necessity”<sup>25</sup> made by some Governments, especially, during the Crisis years to justify the adoption of economic measures that restrict individuals’ access to essential goods, like the protection of health and access to education<sup>26</sup>, could be reduced.

Not only the human rights movement would benefit from this, especially with regard to social and economic rights, but also international business and economics law as a whole, which could be more efficient in creating stability through the action of its international economic organizations, and in particular the International Monetary Fund and the Bank for International Settlements for monetary stability, the World Bank and OECD for fiscal stability, and the World Trade Organization for trade stability.

This is the real task faced by economists, jurists and supranational institutions in order to achieve an orderly and balanced development of economic, social and monetary relations.

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<sup>25</sup> When exigent economic circumstances might create conditions of necessity that justify deviation from international law obligations.

<sup>26</sup> PERONI G., *The European Central Bank and the European Democracy: A Technocratic Institution To Rule All European States?* in L. DANIELE (ed. by) *The Democratic Principle and The Economic Monetary Union*, Springer, Giappichelli Torino, 2017, pp. 249-264.