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Comment

Trust and confidence in the Anglo-Saxon model of regulation have evaporated so much as a result of the financial crisis that Asian policy-makers are now beginning to rethink key issues about regulation from first principles.

As the financial tsunami unleashed by the West has swept across the world over the past two years, it has washed away from many Asian minds the notion that Western financial management was their superior. This will probably be the single biggest effect of the financial crisis and will pave the way for the creation of a new and more stable financial order based on inputs from Asia and other regions.

It is amazing how much can change in a decade. After the Asian financial crisis of 1997/98, *Time* magazine produced a triumphant story titled ‘The Three Market-ers’ explaining how American policy-makers “prevented a global economic meltdown – so far”. It pictured Alan Greenspan, Robert Rubin and Larry Summers on the cover and labelled them “the committee to save the world”.

Over the past 10 years, though, the key ‘marketeer’ has been Mr Greenspan. For most of the decade, Mr Greenspan was treated as god in the American media, which prides itself on being the most open and critical in the world. Yet the US media refused to question the market fundamentalism of Mr Greenspan. And now we know that there were monumental failures of judgement by Mr

Greenspan and other financial regulators in Washington. Why didn’t the US media point this out at the time?

Sadly, the assumptions of the US media were also accepted by most of the rest of the world, since so many global news channels are controlled by US media organisations. As years of continuous economic growth passed by, many accepted the media’s judgement that if left to regulate themselves the markets could do no wrong. Few people saw that Anglo-Saxon market fundamentalism was building up towards the biggest financial storm in 70 years.

This belief of Mr Greenspan’s – that markets would regulate themselves – was his biggest intellectual mistake. Given the American domination of key global institutions, Mr Greenspan’s ideological view filtered into organisations such as the International Monetary Fund (IMF). In April 2006, three years after Mr Greenspan’s comments on market self-regulation, the flagship publication of IMF, the *Global Financial Stability Report*, said the following: “There is growing recognition that the dispersion of credit risk by banks to a broader and more diverse group of investors... has helped make the banking and overall financial system more resilient... Consequently the commercial banks may be less vulnerable today to credit or economic shocks.”

How could the IMF have been so blind? The answer is so astonishingly simple. The IMF followed that market fundamentalist ideology.

TIMID RESPONSE

Many Asians assumed that after this enormous financial debacle, the US Congress and American regulatory agencies would have received a sharp wake-up call and focused all their attention on redesigning the regulation of the financial markets in the public interest and ensuring that they serve the needs of the economy as a whole and not the narrow sectoral interest of the financial industry. Similarly, they need to recognise – as the providers of the international reserve currency – that their decisions have consequences far beyond their shores. This would have been a natural result to expect.

Instead many Asians are shocked to see that the US Congress is struggling to write new laws regulating the financial industry. The lobbyists for the industry are out in full force on Capitol Hill, working to ensure that any new laws are watered down. Yet the failure to regulate the financial markets was one of the leading causes of the financial storm that the world has suffered. AIG, for example, ‘chose’ its own regulator for its riskiest business.

If the US financial industry succeeds once again in ‘capturing’ its regulators, the net effect will be to devalue the US financial regulatory structure and perhaps that of other Western countries.

In 2008, I met an Indian official involved in financial regulation. He told me that a Swiss banker had just come to see him to find out how to get an Indian banking licence. The banker was briefed on the requirements and told that the Indian authorities would also assess his regulator. The European banker smiled and said: “No problem. We have excellent regulation.” The Indian official replied: “After subprime, we are not sure of US regula-

tion; after Northern Rock, British regulation; after Société Générale, French regulation and after UBS, Swiss regulation." In short, the West is no longer the gold standard in the field of financial regulation.

More recently, in November 2009, I spoke with a senior representative of a major European bank. He oversees the bank's operations in east and south-east Asia. He told me that until two years ago, whenever he met his Asian regulators, they would happily accept his explanation if he said that a certain bank practice was mandated by his main European regulators. After the financial tsunami, each of the Asian regulators would now say to him: "We saved your bacon in this crisis. Don't tell us what your European regulator is asking you to do." Given the loss of confidence in Anglo-Saxon regulation, Asian policy-makers have to rethink key issues from first principles.

There is no doubt that most Asian policy-makers feel vindicated by their prudence, pragmatism and caution in dealing with the sophisticated financial investments unleashed by American banks. After the massive errors of judgment in the US financial sector, both in the private and public sectors, the time has come for a new kind of dialogue between the US and its counterparts. American regulators and banks can no longer behave as 'the committee to save the world'. They need to treat their Asian counterparts as equals and recognise that learning is a two-way street.

TACIT UNEASE

Unfortunately, even though this is what most Asians are thinking, in Asian cultures, there is a reluctance to tell one's interlocutor anything that might offend them. One of the few exceptions is a US-trained Chinese lawyer, Gao Xiqing. In a fascinating interview with James Fallows in *The Atlantic* in December 2008, Mr Gao expressed thoughts found in most Asian minds but rarely expressed to their Western interlocutors. Given Mr Greenspan's reluctance to regulate derivatives, Mr Gao's remarks on the same product are worth mentioning. He said: "If you look at every one of these derivative products, they make sense. But in aggregate, they are bullshit. They are crap. They serve to cheat people."

He also spoke for many Asians when he gave the following advice to American policy-makers: "This generation of Americans is so used to your supremacy. You're being treated nicely by everyone. It hurts to think: 'OK, now we have to be on equal footing to other people'. 'On equal footing' would necessarily mean that sometimes you have to stoop to appear to be humble to other people. Americans are not sensitive in that regard. I mean, as a whole. The simple truth today is that your economy is built on the global economy. And it's built on the support, the gratuitous support, of a lot of countries. So why don't you come over and... I won't say kowtow, but at least, be nice to the countries that lend you money. Talk to the Chinese! Talk to the Middle Easterners!"

Mr Gao's remarks are very strong and can be easily misunderstood and misquoted. He was not gloating over the American condition. On the contrary, he wants the US to once again become the strong player it once



Failed thinking: Alan Greenspan's belief that markets would regulate themselves has been his biggest intellectual mistake

used to be. As he says: "I have great admiration of American people... But you have to have someone to tell you the truth. And then, start realising it... then you'll be great again."

Mr Gao's wish is also the wish of many Asians. None relish the downfall of the US or the disappearance of US leadership. Most Asians recognise that the benign international rules-based order created by the US after World War Two is a key reason for the progress that Asians have grown to enjoy over the past few decades. They would all prefer to see the continuation of this rules-based order.

If the US can learn to treat the Asians on the basis of equality and mutual respect, a lot can be accomplished with renewed and strengthened US-Asian co-operation. The centre of world history hovered over the Atlantic over the past two centuries. This is why trans-Atlantic co-operation was vital then. In the 21st century, the centre of world history has shifted to the Pacific Ocean. Hence the US must strive to achieve the same degree of co-operation across the Pacific as it has worked out across the Atlantic, and it must learn to listen. ^{TD}

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