

Ethics Is the Cornerstone of Recovery

Alumni enjoyed master classes on getting through the downturn given by members of IESE's International Advisory Board (IAB) at a special Continuous Education Session held at IESE's Barcelona campus on April 17. Michel Camdessus, honorary governor of Banque de France and member of the IAB, participated in a panel discussion on the financial crisis. In this issue of *IESE Alumni Magazine*, he assesses the current U.S. and European rescue plans.

With respect to the rescue plans, as a former central banker, I am beginning to ask myself if central banks aren't starting to do a bit too much. I agree with other members of the IAB on the need for fiscal coordination and the fact that, in an uncoordinated way, we aren't doing that bad. I also feel that governments are making poor progress in restructuring the banks they decided to nationalize without knowing very well what they would do afterward.

The problem is that for the banks' restructuring, as in many things, you need two to tango. Governments are anxious to get things done but, on the other hand, the bankers have different prerogatives and that is understandable. This is the critical element today. Either we are able to make a difference in this arena or not, and there are reasons to be optimistic.

At the same time, though, we have a very serious problem if the restructuring is delayed too long. We must remember that all the elements of the rescue plans are systemically related: if one is missing, the others are endangered or at risk of becoming less effective.

That said, I would like to focus on what was really behind this tremendous economic and financial catastrophe, what was lacking for such an absurd situation to occur, and then what should be done to avoid a recurrence.

I believe that behind this crisis there were three major basic interlinking deficiencies or failings.

A three-pronged problem

One is regulation. We believed that markets would resolve all of finance's problems, i.e., that self-regulation was enough. That was a mistake. This has been corrected, and the G20 is doing a remarkable job. I have observed or participated in G5, G6, G7 and G8 cooperation for over 20 years, along with my IAB colleague and friend, Toyoo Gyohten of the Institute for International Monetary Affairs. In my opinion, no summit during the last 30 years has been prepared in such a serious and comprehensive way as the London event.



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The summit opened debates on previously taboo issues such as hedge funds, offshore centers and regulating entities. All of these topics were seriously and rigorously addressed. So, concerning regulation, they are doing something now. But this was the first failing.

The second was the international architecture. Six months ago, we were still in 1945. The institutions controlling the monetary and financial sphere concentrated exclusively on monetary developments. They had no right to speak with authority to financiers. Even now, their mandate, mission and instruments have barely been touched.

The resource part of the problem has been tackled. But the mandate of the governing institutions has not been tackled and this, of course, will be difficult. I have been a member of a working group on that topic that is making pretty revolutionary suggestions, but we see a kind of reluctance to make progress in this field.

And the third element, the third missing link, and in my opinion the most important one, which makes me a little concerned about the possibility of really achieving a convincing new start soon, was the ethical part of the problem. Behind this crisis you have problems in the regulatory and institutional fields, and you have major ethical problems.

It is as though we had forgotten half the lessons Adam Smith taught us, that the market economy is probably the best instrument and that profit can be a way of optimizing the economy, provided one is able and committed to moderating one's own greed and to keep in mind the interest of others and society.

Over the last 30 years, we have dismissed Adam Smith as a moral philosopher rather than as the father of modern economics. We convinced ourselves that his theses were possibly relevant in the primitive time of the 18th century, but that we don't need them now. Every ethical rule reduces the efficiency of the market so we should forget them. Well, this kind of thinking has led us to the present catastrophe.

My view is that if we don't address the three systemic interlinked deficiencies in ethics, institutions and regulatory bodies, we will have a questionable temporary end of the crisis.



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The next one could be just round the corner, unless we introduce profound changes in the three domains I have touched on, and in particular in ethics. This is a question for business schools: what kind of business ethics are we conveying to the next generation of leaders?

The clean-up operation

Looking specifically at Secretary of the Treasury Tim Geithner's plan for the United States, I believe there is an essential precondition for the issue of toxic assets to be solved and for the public to believe that it is really being handled.

That is to get all the banks involved to abandon their present attitude of denial. We need to have, as soon as possible, a clear assessment of their situations. The regulatory authorities have to put strong pressure on the banks, and I believe that pressure will be robust. This is the foundation for any rebuilding of confidence.

After that, of course, the correct measures will have to be taken. Recognition of losses means reducing the banks' capital and then putting all the other elements in place. Here you have different approaches. I don't like the "bad bank" approach of nationalization due to my experience of it in France.

Even if it is a temporary measure, the nationalization solution can work in certain cases, depending on the country's culture. But, of course, the temporary nature of the move must be established. And governments must act decisively and rapidly once they decide on nationalization. Then governments must implement measures in line with that country's needs.

The requirements of capital requirements

Another of the questions we are facing is whether Basel II is adequate or whether we should be doing more as with regards capital requirements. There is the underlying fact that precisely as we are trying to do everything to speed up the recovery, we will have a clash between two issues: achieving the appropriate level of capital requirements and the low cost of money. It's a tricky issue.

Here I would like to insist on two other things. Firstly, there is plenty of work being done to correct some elements of the capital requirement, all the issues of pro-cyclicality of the rules and so on. All of these must be corrected.

But I must stress that the very origins of this crisis are still a mystery: the fact is that my friends and former colleagues, supervisors and regulators allowed themselves to be outsmarted for so long. It is amazing that they allowed so many operations to escape their control by being put through securitization or off balance sheet and so on. For me, it's something I am not reconciled with and something that must be addressed right away.

Ethics: education not regulation

In terms of improving business ethics in both the private and public sector, I couldn't agree more with my fellow IAB member Rolf-E. Breuer of **Deutsche Bank**. We need to educate people on ethics rather than prescribe it by regulation. And customers need to react. They can demand that companies behave ethically or take their business elsewhere.

Another issue is corporate social responsibility (CSR). During the last 30 years we had an extraordinary clash between two cultures. On the one hand was CSR, a great innovation of the last 30 years that had an enormous impact on many companies, academia, business schools and management.

Simultaneously, we saw the prevalence of another ethos, the culture of greed, short-termism and the pursuit of the highest profits by any means. The two were totally un-reconciled. Well, here we are. This second culture has destroyed the system and it must be rebuilt from scratch. Confidence will not be reestablished just because the economic outlook improves. Deeper changes must take place.

Perhaps we need to revisit what CSR means. I had the impression recently, at least in France, that CSR increasingly meant including a flattering paragraph in the company's annual report on its funding of two schools in Zimbabwe, for example, accompanied by pictures of disadvantaged young women sitting neatly dressed before their computers.

This was prostituting the concept of CSR. I believe we must revisit it from scratch. We really must instill this culture in younger generations. Confidence in companies will only be reestablished when they are perceived to be working toward something more than just quarterly profit maximization. Only then will the health of the world market economy recover. ■