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UNRESOLVED MONETARY ISSUES, IN AN ASYMMETRIC FINANCIAL INTEGRATION

ABSTRACT

The process of the European integration has been evolving trough some very complex roads map. The Treaty of Rome, as signed in 1958[1]*, after some long initial efforts, was compacted into the small Europe following a path of incremental steps convergence and entered into the financial single market promoting a monetary union, the EMU, which was endorsed by the issuance of a single currency in the year 1998, the ECU. This incremental step did not at all consider the protective CRA (Community Reinvestment Act) provision*[2]*.*

Provision that was envisaged in the US when adopting a loose attitude towards the interstate banking asking all the banks doing business over the border to supply evidence of a reallocation of funds within the areas of inception, in order to avoid a financial transfer of funds from weak less developed States toward stronger financial areas. Furthermore, underlying real economy issues, linked to the huge shift of the world financial order from the English speaking world communities to the Asian reemerging Countries, as changed after the monetary disorders following the demission of the gold exchange standard, announced by President Nixon on the 15th August 1971 (Ferguson, 2008).

We are now living trough one of the most astonishing shifts there has ever been in the global balance of financial power, from the English-speakers to the Asian continent, from the monetary or fiscal policies to the supply side economics, the booming China is tracing her final own asymmetric path to prosperity according to the Wealth of Nations principles, as outlined by Adam Smith. The European economic integration process must take in serious consideration such an event. The financial turmoil is just a side effect and financial globalization has aggressive activities like predatory banking and destructive take over by banks in search of new larger critical sizes. As free banking over the border activities have been deregulated in both Europe and North America, the Central Bank functions have been necessarily substituted by larger institutions as the BCE, the FMI and the World Bank, while a global Authority is not yet available or likely to be soon operating.

Key words*: interstate banking, financial imbalances, community predatory banking.*

JEL classification*: G210*

[1] <http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en /ec/ 032a0006.htm>
[2] <http://www.occ.gov/news-issuances/bulletins/2011/bulletin-2011-41.html>

1. INTRODUCTION

Along the implementation of the single currency the euro, three major stock market bubbles burst in the international financial arena: the dot.com bubble in the year 2000, after the market closed at 10.395 on 27 September 1999, on October 2002 it was at 7.286, the related and consequent subprime rate bubble in the year 2007, few months after the Standard & Poor regained its 2000 value and, thirdly the derivative bubble in the year 2008, as a likely final consequence of the monetary policies adopted by the FED in those years. Meanwhile, the sovereign massive debt reached unbearable levels in many Southern Countries, challenging all the convergence criteria and reaching the annual GDP level in several countries:

- price stability, inflation should not to be over 1.5% of the average percentage points of the three best-performing Member States;
- the annual government deficit: it should not have exceeded 3% of national GDP;
- government should have never exceeded the limit of 60% of national GDP.

Since the Keynesian revolution, the economic theories and economic policies, prevailing during these years were:

- a general opinion that the 20th century Great Depression should have been managed with monetary, rather than fiscal policies, (MUNDELL, 199)
- hence any fiscal policy, according to Milton Friedman and the Chicago School, were commonly perceived as doomed to failure,
- thirdly, the trade off between inflation and unemployment was accepted as an unavoidable final effect of a monetary expansion, lately defined quantitative easing, without too much concern for the purchasing power of money. (FISHER, 1997)

"We used to think," James Callaghan told the Labour party conference in 1976, "you could spend your way out of a recession and increase employment by cutting taxes and boosting spending. I tell you in all candour that this option no longer exists.......”[3]

2. CONCURRING EVENTS

During the period in which the European Union, surfacing out of the Rome Treaty, was shaped into the final Maastricht EU frame, the following events changed the global economic perspective:

- on the 15th August 1971 the gold exchange standard and the dollar gold parities, were *temporarily suspended* by President Nixon, with the demise of the Bretton Woods pact when he invited *Secretary Connally to suspend temporarily the convertibility of the American dollar*[4]. As a consequence, a loose monetary policy

[3] <http://www.newstatesman.com/search/google/Callaghan%20%20and %20candour? query= Callaghan%20%20and%20candour&cx=014587529549946006773%3Aq0ke2unon2y&cof=FORID%3A11 &sitesearch=>

[4] <http://www.wtffinance.com/2011/08/when-did-the-us-get-off-the-gold-standard/ >

started during the seventies and eighties turbulences and after the black Monday's DJ fall in October 1987, when the index slipped 23% to 1.738; credit facilities systematically endorsed by Alan Greenspan were supplied trough all the *roaring nineties,* bringing the D.J. index to an unexpected level up to 10.500 in the year 2000;

- the Berlin wall, the cold war and the Warsaw Pact were eventually dissolved, introducing new instability after the last order established lastly at Yalta. The new landscape emerging from the new era disrupted all the social welfare basic working social relations with the unprecedented competition of low labour Asian costs;
- major Asian economic areas, the South East Asian Nations, China, India Korea, the Philippine, Indonesia and many other previously emerging Countries started to resurface hosting Western Countries firms outsourcing their production to the Eastern world as a consequence of some important economic resource,
- the BCE became an issuing authority receiving some monetary policy powers in year 1998. The EU second banking directive opened a new era of interstate banking in a market opened to credit, financial services and banking merger and acquisition deals all trough European State adhering to the European Union with the free financial market directive Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty[5],
- in United States, the Clinton's *modernization act* and the *monetary easing* policies as a financial remedy, induced an irrational financial euphoria and a huge assets inflation alongside a commodities and goods stable pricing path. The WorldCom and Enron devastating bankruptcies, as the technology dot-com first bubble erupted as unavoidable consequences, and the 9/11 World Trade towers attack, prompted a downward push in interest rates to an unprecedented 1%, which promoted new financial assets bubbles with the sub prime and derivative crisis as interest rates were first lowered, then raised in the year 2005, to offset some CPI inflation tendencies,
- Minsky spent much of his career advancing the idea that financial systems are inherently unqualified to control speculation and irrational euphoria behaviors. At a time when many economists were coming to believe in the efficiency of markets, Mr. Minsky stressed their excess and upheaval, as a predictor of the oncoming markets crisis, which started in the year 2000 and is still a prevailing issue in most general discussions. (MINSKY, 1993)
- The supply side economics as envisaged in an 1978 article by Arthur Laffer, at The University of Chicago, who linked an increasing taxation rates to potential decreasing tax revenues[6], promoted lowering British and North American taxing rates towards a flat rate during the eighties and nineties, consequently enlarging the public debt. The tax issue, has become nowadays the only left path to reduce the internal sovereign growing debts as an unparalleled recession appeared at the opening of the world markets to the lower costing Asian new productions.
- The deregulation of financial and banking markets have allowed a global activity in reallocating capitals, promoting foreign branches and financing activities in the whole global arena.

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[5] <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX: 31988L03 61 :EN:NOT>
[6] <http://www.laffercenter.com/arthur-laffer/the-laffer-curve/ >

Under these actual preconditions and structural framework, the Euro and the European banking sector have undergone a concurrent structural reform, from an operational point of view and within a limited set of possible local alternatives in a very fragmented market.

From a general and global point of view, the world economy has been presenting a huge shift from a prevailing western industrial production to a large scale Asian delocalization process, which has fundamentally changed the financial structure of the world economy.

Such shift has interested all the last twenty years and has started with the Japanese recession and the saving banking sector crisis, up to the European Euro crisis, under strict parameter rules and the huge financial assets inflation, as the world GDP was progressively by and large increasing. It is strange to focus on the fact that generally the present economic recession in Western industrialized countries and in most Mediterranean area are commonly treated as being under specific conjuncture crisis transitory conditions while most of local problems are commonly linked to the vast general structural conditions where scale mass production and low Asian costs are globally affecting all local industrial production facilities. The grounds lie mainly on the two factors, limited market, local or continental and strict labor rules.

Figure 1: World GDP from year 2000

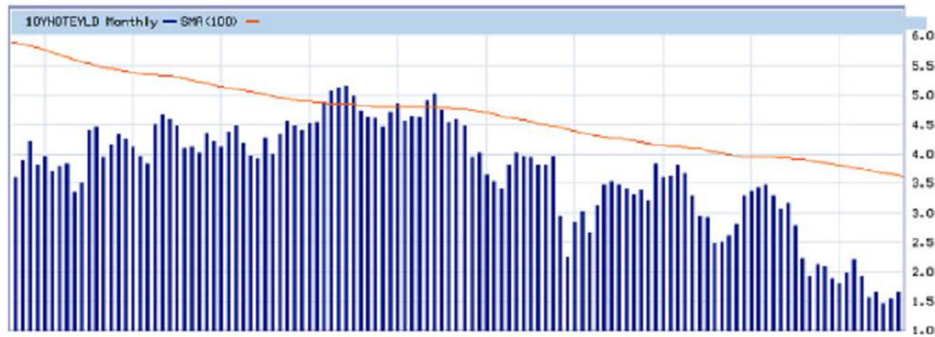
Year	2000	2005	2007	2008	2011
GDP (current US$ bill.)	32,001.93	45,232.14	54,891.06	60,587.02	81,172.27
GDP growth (annual %)	4.1	3.5	3.8	2.0	1.7
Inflation, GDP deflator (annual %)	4.7	4.9	5.4	8.1	4.0

Source: http://www.worldbank.org/

These factors explain and show clearly and definitely the huge shift to the Asian industrial centers. Meanwhile, the world financial markets have actually been unified in a single interest rates market as most major banks are nowadays operating globally. The general monetary perspective universally adopted have progressively reduced the cost of money almost to zero, not considering essential for the business activity the Keynesian marginal efficiency of capital or, better said the profit expectations. The trend in interest rates, according to the prevailing monetary and fiscal policies adopted, have shown a common shift to the lower interest rates values: after the Japanese applied even zero rates, the US 10 years bond, according to the schedule below, looks

decreasing progressively in the following schedule, pulled towards the zero value from over 6% :[7]

Figure 2: US 10 years bond interest rates



Source: http:/online.wsj.com/mdc/public/ npage/2 3050. html?symb= 10Y Note Yld&sid=1224 11/09/2012

Accordingly same has been the European 10 years euro bonds outlook.

Figure 3: European 10 years euro bonds rates

Source: http://sdw.ecb.europa.eu/browseSelection.do?DATASET=0&sf_A&sfl5=4&DATA_TYPE_FM= PY_10Y 1M&node = 3570581

Assuming a common general suggestive definition, the present financial and banking market crisis may look like the final effect of an originating global deregulation of most financial markets, as started in the USA trough the *Depositary Institution Deregulation and Monetary Control Act* passed in 1980, the *Garn-St. Germain Depositary Institution Act*, deregulating the *Savings and Loan* industry in 1982, finally and disruptive, the *Gramm - Leach - Bliley Act 1999*, known also as *Commodity Futures Modernization Act,* a general unleashed control over banks and a widely spread abuse of management

[7] <http:/online.wsj.com/mdc/public/ npage/2 3050. html?symb= 10Y Note Yld&sid=1224 11/09/2012>

compensation trough generous stock options programs and common leveraged buy out and take over and by some management recurring misbehaviours culminating with the eloquent Enron and WorldCom financial disasters.

On the other side, the market bubbles eruptions in the years 2000, 2007 and the last 2008 derivative toxic financial bubble and connected stigma, might be seen as the natural consequence of all worsening monetary scenarios, or the grounds final effect of very deep rooted series of monetary mistakes, like a *tsunami* in an recent phase of severe global monetary bubbles.

The traditional inflation values, as connected to the money supply growth, were since then divided into two separate paths: financial assets inflation on one side and consumer price inflationary index on the other; they split and started to move along separate value paths. The financial assets expansion were strictly linked to the monetary expansion policy, while the CPI was restricted from the progressive substitution of Western productions with cheaper Asian goods and not linked to the productivity growth, as Alan Greenspan was continuously telling the media and the Senate Banking Committee: "….. productivity explained it all. Companies felt good, analysts felt good – all was well because increasing productivity was promoting a new era." (Fleckentein, Sheenan, Greenspan, 2008)

The main deregulation, since the introduction of the Glass and Steagall Act, during the great depression, with the devaluation of the dollar and the establishment of the new $35 gold price parity in the year 1933, has been terminated when the United States took the dollar off the gold convertibility for foreign Central Banks, with the Nixon's announcement stating in *1971: "I have directed Secretary Connally to suspend temporarily the convertibility of the American dollar except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States"*.

3. <u>THE CONSEQUENCES</u>

The unavoidable transition from the gold-exchange to the flexible exchange rates system, with the subsequent outbreak of massive inflation and stagnation during the 1970's, the huge interest rates volatility, the hedging derivative innovation and the new supply – side economics in the 1980's, may be considered connected consequences.

Finally, the return to some monetary stability, is mostly based on the oil standard and the EMS plan. Since its suggestion in 1978, the European Monetary System (EMS) as outlined by the Luxembourg Prime Minister Pierre Werner, was designed as a framework for monetary policy coordination to overcome the long lasting unsettled turmoil among European and World currencies with the final project for a single currency. As Fisher wrote in uncertain and fluctuations' similar times, "*Instead of resisting in a monetary fatalism, some economists, bankers, and statesmen have come to recognize that nearly all inflation and deflation are man-made, and why should we not therefore have a man-made stabilization?*" (Fisher, 2009).

Disillusioned by the uncertain attempts to restore a global monetary reform, likely due to cold war grounds, trough the Gold Commission appointed by President Carter and chaired by Donald Reagan in 1982, which minutes were not published, and by the devastating floating exchange rate system, the EMS founding fathers wanted to restore a system of fixed - but - adjustable exchange rates within most of the European Community, which finally brought to the issuance of the Euro at the end of the 1990's.

At Bretton Woods in New Hampshire in the year 1944, the gold reserve problem was eluded by the establishment of the new platform leading to the *gold-exchange standard*, supported by Harry Dexter White, from the U.S. Treasury Department, a necessary compromise between gold supporters and gold contrarians, based on the circulation coverage by both gold and dollars. The IMF with the linked gold parities system, lived up to its dismissal by the President Richard Nixon in August 1971. In that year the *gold standard* was unquestionably and unconditionally definitely abandoned and we entered the present cycle of ever growing financial and monetary turbulences, likely primary precondition to an *oil standard* first and to the more or less deep pretentious fine tuning of most of the monetary policies implemented by the issuing Central Banks up to the wrong presumptions of Mr. Greenspan. (Fleckentein, Sheenan, 2008).

An other set of adverse deregulations is linked to the cross border banking activity, with the abolition of some of the Mc. Fadden Act provisions, the 1994 Riegle Neal Interstate Banking and Branching Act, the 1999 Gramm-Leach-Bliley Act and the EU mutual recognition principle, as expressed in the EU Directive 646/89, furthermore have all brought new problematic issues. The most recent legislation provided a complex new framework of limits, in order to avoid predatory deposit acquisitions and prescribed compulsory reinvestments paths, aimed to restrain excessive capital attraction toward regional overdeveloped areas.

Modern technology, the progress in the telecommunications sector and the end of the cold war, have all promoted the deregulation of most of the banking activity, in order to create a looser framework of rules able to widen the globalization banking process. The economic crisis, traditionally and in previous periods, even if originating in the USA, were generally affecting the peripheral emerging countries and distant areas of the world, like the Asia crisis of 1998-1999, the Russian default of 1998 and similar numerous different cases in those years, nowadays, with a terrific astonishing shift in the normal financial behaviour, the crisis hits the core countries: Europe and most of the English speaking countries, scarcely affecting the BRICS, (Big, Rapid, Industrializing Countries), which have been increasing their GDP along a trend above the level of the previous developed countries "*Capital, by its votaries' accounts, was outpacing outmoded structures, breaking the binds that had tied it, and taking the path of least resistance as it spread across the globe, digging in and taking root wherever it could*."(Brittain-Catlin, 2005)

In the rapid growth of new markets and industrial areas, as well as for the financial disparity existing among different regions, powerful forces drained originally sensitive funds and available resources for the investments from less developed areas to more developed regions, which most of the times took advantage of the offshore or special industrial areas outside the EU, like Turkey or the free industrial' special zones within

the Moscow region, or several other free zones around the world. (Brittain-Catlin, 2005).

The resulting huge process of delocalization has surfaced only as a recent force attracting capitals and skills which have been transferred only in present times and under specific globalization asymmetries, to the high financial risk and less developed areas, from already developed ones, downsizing the spread between the less developed and the industrialized zones. "*When my publisher asked me to write a book on outsourcing, I immediately jumped onto the internet to see whether I could pay a guy in Calcutta to doo it. Too many choices popped up on the screen, so I did it myself.*"(Buchholz, 2004)

This process, for instance, was one of the main reasons of the everlasting underdevelopment of some southern Italian agricultural insulated regions, after the Italian State unification, ratified in year 1860. The South, once industrially developed, became all of a sudden and for mostly Northern a source of investment initiatives attracted Northward despite recurrent announcement of financial and fiscal facilities for all Southern areas were always announced by all Italian governments.

When the US adopted the interstate banking legislative, a remedy was adopted trough a strong review of the Community Reinvestment Act, enacted according to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which repealed restrictions on interstate banking, stressed the *Community Reinvestment Act* ratings, received by the out-of-state banks as a consideration and compulsory operating base, when deciding whether to allow interstate branches mutual financial relations or not.

According to Bernanke, a surge in bank merger and acquisition activities followed the passing of the act, therefore: "*... the CRA affirmed the obligation of federally insured depository institutions to help meet the credit needs of communities in which they are chartered, consistent with safe and sound operations",*[8] and supporting groups increasingly used the public comment process to protest bank applications refusals on *Community Reinvestment Act* grounds. When applications were highly contested, federal agencies held public hearings to allow adverse comment on bank's lending records. In response many institutions established separate business units and subsidiary corporations to facilitate CRA-related lending. Local and regional public-private partnerships and multi-bank loan consortia were formed to expand and manage such CRA-related lending. In 1999 the Congress enacted and President Clinton signed into law the Gramm-Leach-Bliley Act, also known as the *Financial Services Modernization Act*. This law repealed the part of the Glass–Steagall Act that had prohibited a bank from offering a full range of investment, commercial banking, and insurance services since its enactment in 1933. A similar bill was introduced in 1998 by Senator Phil Gramm, but it was unable to complete the legislative process into law. Resistance to enacting the 1998 bill, as well as the subsequent 1999 bill, centered around the legislation's language which would expand the current types of banking institutions into other areas of service but would not be subject to CRA when shifting to the new financial areas. The Senator also demanded full disclosure of any financial "deals"

[8] <http://www.federalreserve.gov/newsevents/speech/Bernanke20070 330a. htm>

which community groups had with banks, accusing such groups of "extortion". The Community Reinvestment Act was intended to encourage depository institutions to meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. It was enacted by the Congress in 1977 (12 U.S.C. 2901) and was implemented by Regulations 12 CFR parts 25, 228, 345, and 563e.[9]

4. THE PRESENT TREND

Apart from the CRA provision and compliance requirements, the second pillar enforcement against the fund transfer from producing to savings and investment areas is represented by all the instruments created in order to avoid some predatory banking products, as the credit securitization.

Credit securitization is a new age structured process whereby loans and other receivables are packaged, underwritten, and reshaped in the form of transferrable securities. Often these instruments, called asset-backed securities, provide capital to companies in financial stress, therefore qualifiedly predatory and this circumstance is one of the central motivations of securitization. (Kravitt, 2002)

Most of the sub prime mortgage collateralizing activity might be placed under this perspective, often with consequence a sophisticated path towards cheap take over of minor or stressed banks, financial companies, industrial concerns and similar local operating entities.

On the other side, banks on an interstate environment are moving from the traditional individual prime rate to the new, more volatile base rate, like LIBOR or EURIBOR which, sometimes, the banks themselves control. They may agree to fix, raise, maintain and stabilize such rate, using it as a *benchmark* for commercial loans to so-called *middle-market* and *smaller* borrowers, and thereby suppress or eliminate competition between themselves. So, they may forecast the onset of worldwide inflation and raise commercial interest rates, which might increase their profits: they raise and standardize the spread points charged above the new base rate for commercial borrowers. So they may move away from fixed-rate loans toward *floating*, variable-rate loans, linked to the new prime, and adjust those rates to fluctuations in short-term interbank basic rates. This reduces bank competition and lead to noncompetitive, higher rates for middle-market borrowers, while set banks free to make prime loans to their preferred, multinational corporate borrowers.

"*The hypothesis that acquisitions serve to transfer resources from less efficient to more efficient uses receives substantial support from our results, as do a number of other relevant hypotheses*" (Timothy, Hannan, Steven, Pilloff, 2006). In specific researches made within the FED research department, the predatory banking addressed to the funds reallocations from less efficient areas to developed segments and regions, appear to be substantiate by many factors surfacing as a result of such studies.

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[9] <http://www.ffiec.gov/cra/history.htm>

From an other point if view, the predatory activity reflects the desire to assume a global configuration with local crossed worldwide activities, "*We also find a robust relationship between the proportion of local deposits (sometimes called "core deposits") that a bank has and the hazard of being acquired. Banks with higher ratios of local deposits to assets are more likely to be acquired, no matter the type of acquirer examined. This may reflect a preference for local customers as a result of some synergy associated with acquisitions of banks with substantial local deposits, such as the ability to cross sell to local depositors*" (Timothy, Hannan, Steven, Pilloff, 2006, 29). Actually, the simple evidence of present rapid globalization has become obvious and undisputable as the volume of Eastern handled containers has dramatically growing in a depressed Western progressive recession.

Figure 4: Overall TEU Traffic: First 20 ports year 2002

Geographic Area	TEU	%
Asia	84.951.148	65,89%
North Europe	22.448.422	17,41%
Nord America	14.381.242	11,15%
Middle East	4.194.264	3,25%
Mediterranean	2.954.571	2,29%
Total	128.929.647	100,00%

Figure 5: Overall TEU Traffic: First 20 ports year 2011

Geographic Area	TEU	%
Asia	214.130.458	79,10%
North Europe	29.586.043	10,93%
Nord America	14.001.610	5,17%
Middle East	13.000.000	4,80%
Mediterranean	-	-%
Total	270.718.111	100,00%

http://www.ci-online.co.uk

The globalization process has taken advantage of low Asian work direct and indirect costs, low taxation and transportation improvements, associated to the near technological era in telecommunications, production innovation and fall of any barrier to the world trade as empathized by Adam Smith.

5. CONCLUSIONS

This new perspective has mixed up recession, depression and growth angles on a global scope, too new to be faced trough classical 19 century monetary and fiscal policy models, "… *for the first time in two generations, failures on the demand side of the economy – insufficient private spending to make use of the available productivity*

capacity – have become the clear and present limitation on prosperity for a large part of the world." (Krugman, 2008) Furthermore "*As I noted in chapter one, globalization has also brought huge benefits – East Asia's success was based on globalization, especially on the opportunity for trade, and increased access to markets and technology.*"(Stigliz, 2002)

So was commenting Stiglitz, just after the first dot.com bubble outbreak shocked most of the Western markets, already at the beginning of the new century, forecasting the potential huge impact of the technology mobility and the falling out of World's asymmetric social frameworks. In this general picture, the EU decided to issue a single currency unit, the Euro, and opened the banking markets to the uniform mutual recognition all over Europe, on a mostly universal bank operating model. The consequent large scale merger ad acquisitions and change in operating models, products, technology and critical bank size, has boost amalgamations and over the border operations, that most of the times violate the community protection principles, as already stated in the US model of the CRA, and has become in Europe predatory banking when the final result is the reallocation of funds, fiduciary deposits and capitals to the most developed areas, generally in northern Europe.

As the mutual operating agreements, the widening of the local EU market are now unavoidable, there must be a concern in ruling the local activities and consider the potential drainage of funds and consequent damage of the peripheral regions. At same time, only remedies against the general economic depression seem to be a restructuring of the unbearable conditions of the welfare state, when supported by widening income taxation or growing sovereign debt, which have not been of help in any similar previous social condition and promote a general open attitude to the unavoidable global market, which is promoting and requiring competition, quality and a wide range of new cheap productions.

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