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Global fiscal reform hangs in the balance

GLOBAL INSIGHT

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in Davos

On the map, Washington lies several thousands miles from Davos in Switzerland. Last Friday night, however, the two towns seemed barely a soundbite apart.

As Larry Summers, director of the US National Economic Council, swept into town to represent the Obama administration at Davos, the World Economic Forum arranged the usual high-profile appearance for him in a congress hall.

But instead of delivering a speech – or being interviewed by a local pundit – Mr Summers was grilled by Charlie Rose, the influential American broadcast star, for a US television show.

Unsurprisingly, Mr Summers spent most of the time wailing about the horrors of Wall Street and predatory behaviour of US credit card companies, which "have been preying on the ignorance of their customers". The topic of global co-ordination was barely mentioned, let alone international committees such as the Financial Stability Board.

It was a telling symbol. In January last year, the buzz – or naive hope – in Davos was that the arrival of the new Obama administration would deliver a multilateral US policy approach. However, 12 months on, it was the issue of US unilateralism that haunted the financial reform debates in Davos.

After all, two weeks ago the White House startled the banking world by unveiling the so-called Volcker reform plan, without a token nod towards co-ordination with the rest of the G20.

Thus, the question that regulators and bankers are trying to answer is whether the US is intent on going it alone on the regulatory front – or could it be persuaded to co-operate with other governments via the Financial Stability Board?

At the weekend, non-Americans were trying to put on a brave face. There was profound irritation among some European leaders that they had not been informed of the White House plans.

But after several hours of closed-doors discussions, the global regulatory community appeared to have kissed and made up – at least in diplomatic terms. The mantra emerging from senior financial bureaucrats was that it would not be difficult to incorporate most elements of the Volcker plan into the discussions being held at the FSB.

If America presses ahead with its plans to clamp down on proprietary trading at banks, this might be incorporated – via a few subtle twists – into a wider move by the FSB to tighten the global rules for banks' trading books, regulators observed; similarly, if the US wants to shrink its financial giants, this might become part of the ideas being considered by the FSB to combat the "too big to fail" dilemma.

Indeed, by the end of the meetings, some European officials were even arguing – perhaps over-optimistically – that the launch of the Volcker plan could strengthen attempts to promote a global regulatory overhaul. If nothing else, they pointed out, the plan shows that the Americans are taking the topic of bank reform seriously.

After the meetings in Davos, a consensus was emerging among regulators that it would be sensible to adopt a "twin-track" approach. Most notably, while some aspects of financial regulation needed to be organised on a global basis, there could be scope for national divergence on other issues. After all, America operated with its own Glass-Steagall rules for many years, and it never really adopted Basel II. Thus, as long as there is co-ordination on some key issues (such as capital rules, derivatives trading and resolution regimes) there can be divergence on others (such as tax and bank structure). Or so the mantra now goes.

Perhaps this twin-track approach will work. Nevertheless, the real problem remains the "Charlie Rose" risk – namely that if the political climate becomes more turbulent and the economy worsens, the White House might produce even more populist initiatives. And the US is not alone with this: the UK has also produced a unilateral measure, namely the bankers bonus tax, and more could follow as elections loom.

For the moment, global regulatory co-ordination hangs in the balance. Western investment bankers will be watching beadily, ready to exploit any geographical loopholes; in much the same way they cannily exploited the transatlantic loopholes that existed two decades ago, when America last had its go-it-alone Glass-Steagall regime.

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