A  The Evolution of the modern state

Globalisation and the Global Financial Crisis have caused us to reconsider the nature and function of the modern state. The modern state grew from diverse origins. Some were literally nation states which were often kingdoms or principalities. Some were city states. Some resulted from the breakup of empires. Some are multinational states made up of more than one nation. The United Kingdom and the old USSR are examples. Some city states are becoming global states like Singapore which seeks a role of arbitrageur between other states. Some states like the UK and US host international financial centres which operate with a degree of autonomy as de facto off shore islands. Conversely, a number of states have sovereign wealth funds.

The earliest English writers to consider the state were Professor Sheldon Amos and Sir John Salmond. Both were connected with University College London and combined a positivist approach with pragmatism.

Sir John Salmond in the last edition of his ‘Jurisprudence’ which he edited said; ¹

A state or political society is an association of human beings established for the attainment of certain ends by certain means. It is the most important of all the various kinds of society in which men unite, being indeed the necessary basis

¹ John Salmond, Jurisprudence (7th ed, Sweet and Maxwell Ltd, London 1924), 139
and condition of peace, order, and civilisation. What then is the essential difference between this and other forms of association? In what does the state essentially differ from such other societies as a church, a university, a joint-stock company, or a trade union? The difference is clearly one of *function*. The state must be defined by reference to such of its activities and purposes as are essential and characteristic.

But the modern state does many things, and different things at different times and places.

The traditional roles of the modern state are:\(^2\)

- To maintain social order or declare war;
- To define property rights;
- To provide for administration of justice;
- To provide public goods;
- To regulate markets;
- To tax; and
- To redistribute wealth through welfare programs.

The growth of the modern welfare state resulted in an increased role for the state which has led to increased taxation.

The Washington Consensus, a product of US hegemony, and conceptions of globalisation advocated by bodies like the IMF and the OECD before

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2008 fostered the idea of a retreat of the State. This manifested itself in the following ways:

- Privatisation;
- Outsourcing;
- A race to the bottom by cutting taxes and deregulating;
- The impacts of global finance on domestic economies;
- The impact on global systems of production;
- The bypassing of central governments;
- The transfer of policy-making in certain areas to supra-natural bodies; and
- The emphasis on self regulation.

The role of the state shifted to meta-governance of the economy in the sense of steering, resourcing and assuming accountability in state-owned enterprise and matters such as competition.

The Washington Consensus taken up by the IMF, World Bank and OECD led to a commercialisation of the state. New Zealand accepted this more than Australia did. A federal system tends to be more conservative. On the other hand, necessity has forced the New South Wales and Queensland State Governments to consider privatisation in often

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6 Bell and Hindmoor, above n 4, ch 6.
controversial circumstances. It was thought that greater efficiency and reduced cost would result from this commercialisation. At the same time, global systems of production undermined the state’s power to regulate the market.

In the early 1990s writers like Kenichi Ohmae⁷ argued that nation states were becoming the local authorities of the global system. They were increasingly subject to the decisions and movement of international capital. This was a pro-business, anti-politics agenda and represented a temporary triumph of neoliberalism following on from the mixed experiences of monetarism in the 1980s.

In the decade since September 11th 2001, the West has been distracted by the war against terrorism and the costly invasion of Iraq and Afghanistan. Coupled with deregulation and tax reductions for the rich, the result has been an increase in debt, considerable errors of judgment and a dangerous state of affairs.

This has weakened the West, particularly the US and the UK. At the same time Asian countries scarred by their earlier experiences in the Asian financial crisis have become much stronger. So too has Germany which is benefiting from China’s interest in its export products.

B The Impact of the GFC

The GFC has changed much of the wisdom of the last two decades. Deregulation has been seen to be a policy carried too far. Self regulation has been seen to have its limitations in the Enron era and then the GFC. The need has been felt for state capital to fill gaps in liquidity during the GFC. Systems, which espoused state capitalism, have been seen to have prospered at the expense of those which espoused market capitalism.

The GFC continues and we are now left with some important questions so far unanswered. These concern the future of globalisation, regulation and the state.

First, what is the present situation regarding globalisation? The dominance of the West has been challenged and may have ended. The G20 represents a sharing of power with other economies (including developing economies) with differing interests. Whether state capitalism will prevail over market capitalism in the middle to long term is debatable but this requires intelligent planning by market economies. Globalisation is a dynamic process and there is every reason to think that it can adapt to these new realities.

The second question is the future shape of regulation. It was not simply the free market which failed in 2008 – 2009. Our systems of regulation also failed. There was lack of coordination of banking, securities and

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9 Posner, above n 8, 173.
insurance regulation. So far there has been considerable debate but comparatively little action.

The main lessons that we can learn from the GFC are:

1. no two crises are exactly alike;
2. the first step in a crisis is to ensure stability of the system;
3. regulators must be flexible to respond to an emerging crisis while recognising that they cannot manage it;
4. regulators need to develop a global early warning system to identify asset bubbles and excesses in domestic and/or international markets and the systemic risk implications;
5. there needs to be improved cross-border data sharing and cooperation;
6. regulators must take into account the global nature of the present system and its complications;
7. regulatory reform must not overreact or be overambitious;
8. derivatives need special attention in terms of regulation, disclosure and risk management;
9. credit rating agencies need supervision; and
10. the Financial Stability Board as the place where all the regulators and other important role players meet has an important role as an international coordinating body.

These lessons lead to the need for new institutions, or new functions for existing institutions, and a new approach to regulation.

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10 John H Farrar, Louise Parsons and Pieter Joubert, above n 2, 37.
The idea of a new Bretton Woods Agreement has not been pursued. Instead there has been a strengthening of existing institutions, notably the FSF (now the FSB) and IOSCO.

There appears to be no departure from the principles of the system prior to the GFC, and no change to the conceptual framework or philosophy, but only improvements to existing infrastructure and legislative frameworks. The main themes of the new approach to regulation after the GFC appear to be:  

- a greater focus on macro-prudential risks across the financial system which takes account of banks, shadow banks and private capital;
- greater emphasis on shared information on financial markets;
- a campaign to reduce regulatory arbitrage;
- some greater regulation of hedge funds;
- standardisation of credit derivatives markets and central clearing systems;
- agreed action against uncooperative tax havens;
- improved standards for valuation of financial instruments; and
- more effective oversight of credit rating agencies.

The third question is the impact of the GFC on the role of the state. Are we to see a return to the activist state and state capitalism or is this simply a passing phase?

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Are our concepts in any event out of date in an era of global networks and supply chains? Multinationals already rival nation states in size and importance. Transnational manufacturing distorts the value of exports for states. Transfer pricing is a sophisticated game which they play. There is an emerging class of international executives who do not necessarily have firm national allegiances. This is particularly true in the West but less true in China.

All the signs are that China has the capacity in the next 50 years to overtake the US as the dominant state, provided it can manage its internal weaknesses. So far it has done well and recently the West, particularly the US, has done badly. It would be ironic if the ultimate beneficiary of globalisation and international capitalism is a nominally communist state. This itself raises an interesting fundamental question as to whether Western democracy is compatible with globalisation and the latest mutations of international capitalism. As Joseph Stiglitz said, economic globalisation has outpaced political globalisation.

We have a chaotic, uncoordinated system of global governance without global government, an array of institutions and agreements dealing with a series of problems, from global warming to international trade and capital flows. Finance ministers discuss global finance matters at the IMF, paying little heed to how their decisions affect the environment or global health. Environment ministers may call for something to be done about global warming, but they lack the resources to back up those calls.

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There is a clear need for strong international institutions to deal with the challenges posed by economic globalization; yet today confidence in existing institutions is weak.\textsuperscript{16}

Lastly, to whom are the multinationals, and the global market, accountable? This is the question to which President Nicolas Sarkozy of France alluded at the World Economic Forum in Davos in January 2010 when he said:\textsuperscript{17}

We are not asking ourselves what will replace capitalism, but what kind of capitalism we want...From the moment we accepted the idea that the market was always right and that no other opposing factors need be taken into account globalization skidded out of control...This was not a crisis in globalization. This was a crisis of globalization...What remains to be done is to bring into being a new growth model, invent a new linkage between public action and private initiative...The G20 foreshadows the planetary governance of the twenty-first century. It symbolizes the return of politics whose legitimacy was denied by unregulated globalisation. In just one year, we have seen a genuine revolution in mentalities. For the first time in history, the heads of state and government of the world’s twenty largest economic powers decided together on the measures that must be taken to combat a world crisis. They committed themselves, together, to adopting common rules that will radically change the way the world economy operates.

While one can debate certain parts of his reasoning this is a frank avowal of the role of the state and politics in the scheme of global governance.

\textbf{C Central Banks and the State – Post GFC}

The relationship between states and central banks is interesting for this discussion for a number of reasons.

First, central banks play an essential and prominent role in responding to a financial crisis. They are often the first involved in the resolution of a financial crisis, frequently as lender of last resort to a bank with liquidity

\textsuperscript{16} Stiglitz, above n 15, 21.
\textsuperscript{17} President Nicolas Sarkozy (Speech delivered at the World Economic Forum Annual Meeting, 17 Jan 2010).
problems. Their involvement furthermore extends beyond the most critical part of the crisis through their role in guarding price stability. Central banks are generally independent from government, and do not form part of the executive arm of government, whilst they perform critically important functions in the public interest (leading to a so-called ‘democratic deficit’ where non-elected officials make decisions of a public nature).18

Second, the focus of central banks has for many years been price stability,19 which has sometimes been described as the preservation of the integrity and purchasing power of a nation’s money.20 Price stability is achieved through inflation targeting, and using interest rate policy to keep inflation in check. Whilst central banks have been very successful in the pursuit of price stability, the GFC has indicated that price stability may not be the only, or even the most important function that a central bank has or should have. After the GFC it has become evident that price stability did not provide financial stability. Many central banks consider, at least implicitly, that they also have a responsibility for financial stability.21 This is evidenced through the increasing number of financial

stability reports published by central banks. The real existence and importance of an explicit mandate of central banks for maintaining financial stability should be investigated. Should a responsibility for financial stability be or become an objective of central banks, the legal framework in which they operate, as well as the tools at their disposal, may require changes.

Third, the GFC highlighted the interconnectedness of the financial world, but a ‘dark side’ of globalisation has also been revealed – whilst financial internationalization or globalisation seemed to provide some of the biggest advantages for the globalised world, it also had the potential to destroy those benefits. Central banks are domestic institutions, but their roles in the international financial arena may have to be reconsidered. There is concern that the effect of the growth in national/domestic regulation and legislation may be detrimental to international finance, and the positive aspects of globalisation.

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24 Hieronymi, above n 23, 57. It is emphasised that ‘today, there is an urgent need for a truly international spirit and approach to creating a stable and efficient international subsidiarity (sic) rather than the concepts of centralization and uniformization (sic). Internationalism means that where there is international activity, there is also a need for common legislation and basic rules of behaviour. It is not simply meant for the rule of the biggest and strongest’.
D Work on Systematically Important Financial Institutions

A key issue for central banks and regulators is systematically important financial institutions (SIFIs). The Financial Stability Board has been addressing systemically important financial institutions and the systemic risk posed by them. The recommendations so far are as follows:

- a resolution framework should be created and other measures taken to ensure that problems concerning all financial institutions can be resolved safely, quickly and without destabilising the financial system and exposing the taxpayer to the risks of loss;
- a requirement that SIFIs and initially in particular global SIFIs (G-SIFIs) have higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system;
- more intensive supervisory oversight for financial institutions which may pose systemic risk is needed;
- robust core financial market infrastructures should be created to reduce contagion risk from the failure of individual institutions; and
- other supplementary prudential and other requirements as determined by the national authorities. Some of these recommendations have already been adopted by domestic legislatures whether consequent upon the FSB’s recommendation, or out of their own initiative.

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25 See Financial Stability Board, Guidance to Assess the Systemic Importance of Financial Instruments, Markets and Investments: Initial Considerations – A Background Paper, October 2009 for the survey of views on this concept.

The Basel Committee on Banking Supervision, an international standard-setting body for the prudential requirements for financial institutions, is developing a methodology for the identification of banks that are systemically important from a global perspective. The International Association of Insurance Supervisors is involved in a similar exercise for the insurance sector. Work is also going on at the IMF. One cannot have rule based regulation without this concept being defined but the very act of defining gives rise to arbitrage opportunities.

The regulatory system in the US has been based around industry specific federal supervisors with additional supervisors at state level. One of the lessons learnt in the GFC was that there was poor coordination between these different regulators. There is ongoing debate about an improved system with particular emphasis on ‘systemically important financial institutions’. These are identified by the following characteristics:\(^{27}\)

- the financial system’s interdependence with the firm;
- the firm’s size;
- its level of leverage;
- its reliance on short term funding; and
- its importance as a source of credit and liquidity to other market participants.

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A recent article by Professor Lawrence J White of New York University, "US Financial Regulation: A Hopeless Tangle, or Complexity for a Purpose" described the US system as follows:

- There are five federal regulators of depository institutions as well as one or more regulator in each of the 50 states. The states also regulate lenders and mortgage originators that are not depositories;
- There is a separate federal agency that has the responsibility for regulating Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System;
- There are two federal regulators of the securities markets and financial instruments, as well as 50 state regulators (and 50 state attorneys general, who are prepared to bring lawsuits against securities firms on behalf of their respective states’ citizens);
- The regulation of insurance companies is exclusively the domain of the 50 states;
- Pension funds are regulated by two federal agencies, and, again, the 50 states also have a say;
- Consumer fraud in financial products can be the responsibility of yet another federal agency, as well as the 50 states.

There are overlapping responsibilities and jurisdictional disputes throughout this framework. The Dodd-Frank Act, which seeks to limit the damage caused by the failure of large financial institutions, enables the removal of the administration of an SIFI from court supervised

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29 White, above n 28, 2.
administration under the Bankruptcy Code to administration by the ‘orderly liquidation authority’ under the Federal Deposit Insurance Corporation.\footnote{The Dodd-Frank Wall Sheet Reforms and Consumer Protection Act 2010 (Pub. L. 111-203, HR 4173), Title II. See David Skeel, \textit{The New Financial Deal} (John Wiley & Sons Inc Hoboken 2011) ch 7 and 8.}

The United Kingdom also suffered financial market turmoil which necessitated prompt action for regulation of banks and the creation of special insolvency regimes for banks. This led to the Banking (Special Provisions) Act 2008 which was later replaced by the Banking Act 2009 whose key provisions came into force on 21 February 2009. This was part of a larger regulatory reform package. Key elements of the 2009 act are stabilisation options: transfers to a private sector purchaser, a bridge bank and temporary public ownership. The supervisory system is much simpler than the US model with just one supervisor. There is a new regime for bank insolvency as well as a requirement of ‘living wills’. The purpose of the latter is threefold:

- Pre resolution to allow banks to restructure their operations before they get into difficulty;
- In resolution to provide blue prints for break up
- Post resolution to smooth out problems in the aftermath of failure.

In essence it involves disclosure and a plan.

The two insolvency procedures - bank administration and bank insolvency are new but not drastically different from existing insolvency procedures.
The objectives of the Financial Services Authority were redefined by the Financial Services Act 2010 but the coalition government intends to replace it by a Prudential Regulation Authority under the aegis of the Bank of England.\(^{31}\)

Work on complex financial conglomerates is difficult because of their nature at domestic level. The problem is compounded at international level, and in a globalised world the work must be carried out with a greater degree of urgency than seems to be currently happening. As Dr Hu has written: ‘If we fail to understand the systemic implications of large complex financial firms, the global financial system will likely continue to be haunted by the “too big and too interconnected to fail” syndrome for years to come.’\(^{32}\) There is doubt as to the efficacy of the Dodd-Frank reforms\(^ {33}\) and the UK reforms\(^ {34}\) and whether any governance agency has the sophistication to deal with a complex financial conglomerate in a crisis situation. There is an urgent need for a framework for international cooperation or coordination.\(^ {35}\) If we cannot have complete universalism


\(^{32}\) Oliver Chittenden (ed), The Future of Money (Virgin Books, 2010) 32.

\(^{33}\) See Jeffery N Gordon and Christopher Muller, ‘Confronting Financial Crisis: Dodd-Frank’s Dangers and the Case for a Systemic Emergency Fund’ (2011) 28 The Yale Journal on Regulation 151.


\(^{35}\) See John L Douglas of Davis Polk, ‘Too Big to Fail – Do We Need Special Rules for Bank Resolution?’ Institute for Law and Finance, Goethe University, November 2010, powerpoints; Skeel above n 30, 177, 186. Bank for International Settlements, Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border...
let us at least have some system of modified universalism dealing with cross border cases on a case by case basis and using ‘living wills’ for those cases where universalism cannot be applied. As it is, we seem to have ‘wasted the crisis’.

**E Privatisation**

Privatisation as we have seen was part of the Washington Consensus. Privatisation policies have major economic effects. Have they been positive? The answer to this is complex and seldom provided. The main arguments in favour of privatisation are:

- Reduction of transaction costs of state involvement
- Management and efficiency gains
- Reduction of state debt.

The main arguments against are concerned with loss of accountability and failure to deal with competition aspects.

The IMF and World Bank are committed to privatisation and tend to apply rules and criteria which ensure that almost every outcome is positive proof of the benefits of privatisation. Even failure of a privatised

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enterprise is said to demonstrate lack of viability in the absence of subsidy.\textsuperscript{39}

The labour implications of privatisation tend to be manipulated.\textsuperscript{40}

The public private distinction is increasingly artificial.\textsuperscript{41}

The literature tends to treat all types as homogenous and on an aggregate basis. This is misleading.\textsuperscript{42}

New Zealand seems about to opt for further partial privatisation at an inappropriate time. The Global Financial Crisis has led to more state involvement in the financial and manufacturing sectors elsewhere. Partial privatisations are criticised by even the advocates of privatisation. Stock markets are currently very depressed. All in all this seems a bad time to be continuing the experiment when New Zealand’s earlier experience was mixed. The financial advisers stand to capture the benefits as the did before with large fees and the inside running.

Privatisation should be considered as part of a larger parcel of reforms. The Financial Markets Bill has just been introduced. Privatisation should at least wait until the new Authority has found its feet. Timing is important. There is a need to address the changing role of the state in the post GFC world which is simply not happening.

\footnote{39 Cramer, Ibid p 12} \footnote{40 Ibid} \footnote{41 Ibid p 13} \footnote{42 Ibid}
F. Conclusion

The impacts of globalisation and the GFC on the state have been complex. We need to see globalisation as a loose concept which embraces many different conceptions and think of it in a flexible, dynamic and indeterminist way. We need to see US dominated globalisation as one of many globalisations. Insofar as we have a world capitalist system of a sort we must accept the likelihood of recurrent crises but should plan to protect ourselves against their worst aspects. This requires action at both national and international level. So far we have had panic stricken reaction at national level and slow progress in terms of international regulation. At the same time faith in the Washington Consensus has been shattered and we must adjust to a very different world. At the moment faith in the efficient market hypothesis and the private sector has been questioned. This includes scepticism about privatisation which has not necessarily led to the gains forecasted\textsuperscript{43} but involved another example of financial sector direct and indirect gain at the expense of the public. In this new world we must reinvent the state and recognise that the Third World demands a greater voice in international forums. We are moving from an interstate system to a complex multi-actor system \textsuperscript{44} which includes states, multinationals and international institutions and the


\textsuperscript{44} Robert J. Holton, Globalisation and the Nation State, 2nd ed, (Palgrave Macmillan, New York, 2011), pp. 126.
question is, who are the main actors in this changing world, what are their perceptions and interpretations of this change and to whom are they accountable.