

## The heritage of Adam Smith in times of a global crisis

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Since March 18th, 2008, the birthday of the Business Association, severe changes of global financial and economic conditions have taken place, with effects on liquidity, growth perspectives and the welfare of our countries.

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International stock markets have been suffering an unforeseen meltdown by the end of last year. Banks infected with toxic credit products have been calling for the financial help of governments. Enterprises face bankruptcy.

Governments in most European countries try to soften this hard landing of the financial markets. They have to find individual and complicated compromises between the stability of public finances and the help that is urgently needed by their banks and industries.

Also Cyprus, so favourably situated in the Mediterranean, has not remained unaffected by the economic consequences of the international crisis.

Although the Cypriot economy is still growing with more positive rates than the average of the European Union and even of the Euro zone, some signs of a slowdown in certain sectors cannot be denied, and the perspectives for 2009 and 2010 are less certain than initially predicted.

The Cypriot economy depends to a large extent on foreign investment and on the well-being of foreign economies.

If the Cypriot business partners fall ill economically, Cyprus itself suffers from the virus of weaker investment, weaker demand for services and cuts in the expenditure of foreign tourists.

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The stabilization of international banks is a key to economic recovery, and this problem can only be solved by internationally co-ordinated action plans.

Most governments have taken necessary steps to cure their key domestic problems. But still, we need a new international framework for better surveillance and risk monitoring.

What has been achieved so far on the European level? Several working groups, especially the „Financial stability table“ are co-ordinated by the Economic and Financial Committee which regularly prepares the meetings of our finance ministers in the ECOFIN in Brussels. These committees serve as a valuable „think tank“ to our governments.

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I fully share the ECB's point of view that the stability of the Euro is an asset of highest importance. For that reason, all governments of Eurozone countries have to submit themselves to closer co-ordination concerning their economic policies.

We do not want to give up national responsibility, but we have to make sure that the benefits of the European market and of our common currency will not be destroyed by political desintegration.

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Cyprus has so far strongly supported the efforts of its European partners and will continue to be a watchful member of the EU and Eurozone table. But still a lot of work has to be done. Today nobody can definitely tell us how long it will take Governments in Europe and all over the world to stabilize their budgets again and to return to normal conditions.

What started as a stress test to the global financial system continues to be a stress test to real economies and, as a result, to currencies. Even more, the discussion about measures to tackle these challenges turns out to be a fundamental re-evaluation of economic theories:

The failures of individuals and institutions are easily interpreted as failures of the markets themselves. Even former strong defenders of liberalism now argue in favour of more governmental regulation.

In the course of the 20<sup>th</sup> century, most political systems came to the conclusion that deregulation and free trade are the best sources of prosperity.

Now that we are afraid of mass unemployment and bankruptcies, this idea itself is at stake: The crisis has shown us a misled logic of capitalism, and we have to reconsider the intellectual basis of the free market system:

Did we follow wrong assumptions?

Is the model of government-spending that John Maynard Keynes promoted in the 1930s a benchmark and „best practise“ for today?

Or have we simply misunderstood the basic theory of liberalism?

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In times of a crisis, everybody talks about risks and gloomy perspectives. This is perfectly right and necessary in order to avoid further mistakes. But in business, you cannot only concentrate on risks, you have to identify your chances as well.

The father of modern economic theories was not an economist: The scotsman Adam Smith was neither a banker nor a businessman. He was not even a policy advisor to his government. Adam Smith was a theological moralist.

And here we directly touch a core issue of the current problem.

Human beings have a natural tendency to profit-making.

Adam Smith was the first analyst to find out that the profit of many individuals leads to an optimum when they are allowed to exchange goods and services freely.

He called it the theorem of the „invisible hand“ which – to his point of view – is as good as any legal framework made by men themselves.

On the other hand, human beings are social, ethical „animals“.

Normally, they take into account whether their profit making is likely to do harm to others or not. With a decidedly unsocial behaviour, you will not find a partner to your business.

These are, very briefly, the basic ideas Adam Smith elaborated in his books „The Wealth of Nations“ and „The Theory of Moral Sentiments“.

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These simple facts represented an intellectual revolution in times when economies tried to close their frontiers, to keep their goods and their money under national control.

Today, we are facing an almost global change in government ideology: For decades, the anglo-saxon model of economics and of „good governance“ has promoted liberalism, privatisation and lean administration.

The „invisible hand“ got so invisible that some critics come to the conclusion that Adam Smith was wrong. Others say he was only misunderstood: He never wanted governments to give up intervention at all. He only wanted them to be modest and to restrict themselves to the provision of adequate frameworks.

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What is called a failure of the markets by some analysts may also be called an uncontrolled development of the wrong dreams, accompanied by a loss of moral sensibility.

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Governments of all political colours start giving subsidies and guarantees. There is a tendency to protectionism, to a nationalization of risks: First, we only talked about the risks of banks. Now, we are already talking about protecting entire economic sectors.

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As we remember, Adam Smith's theory of the „Wealth of Nations“ showed that mercantilism was not the best model to stimulate growth and prosperity. In his days, he had to persuade people that the benefits of open markets and of free trade are more important than their risks. Today, risks again have become more present to people's minds. We need new efforts to re-establish confidence in the principle of free trade.

The International Monetary Fund and the World Bank have expressed their concern about a potential contraction of the worldwide trade due to a new tendency of protectionism.

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Germany as one of the G7 has expressed its strong willingness not to establish any trade barriers and has welcomed the announcement of the US administration to refrain from restrictive „buy American“ campaigns. Both Cyprus and Germany strongly support the Czech EU presidency in its efforts to avoid protectionism.

Almost simultaneously, the World Bank has asked industrialized countries not to forget their common responsibility for the less developed economies in the world.

Taking into account this responsibility, the Government of the Federal Republic of Germany will spend 100 Million Euro of its recent growth package – in spite of all domestic problems – for projects of the World Bank devoted to developing Third World infrastructure.

The German development bank KfW will provide almost 400 Million Euro in additional loans.

Germany's total contribution to the World Bank will be about one per cent of the national growth package. I mention these numbers in order to underline Germany's awareness to the importance of the worldwide economic development.

Even in times of domestic problems, we will not forget that free international trade is the main source of growth and prosperity to all economies in the world.

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Cyprus' integration into the Euro zone has been a fast track movement – and, I dare say, a tremendous success. The adoption of the Euro, its acceptance throughout the business and private sector and its importance for the Cypriot financial market have served to a certain extent as a protective shield against adverse effects in 2008.

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This is why I feel Adam Smith was right to say that the interaction and the common architecture of international trade are an invisible but intelligent method of combining individual and public welfare.

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Let me stress here that the German Government has always acted as an advocate in favour of clear-cut and transparent common rules to the financial markets.

I am very happy that the Cypriot Government shares our position and helps us to build a more adequate and more risk-averse financial architecture on the European as well as on the international level.

But, let us be grateful for that, Cypriot banks have never had much to do with intransparent or even „toxic“ assets.

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Germany is an economy that highly depends on open trade and on export. With a relatively high density of its population, Germany felt the necessity to switch from agriculture to industrial production at an early stage.

It was the production of iron and steel that helped to build a solid German economy. The high skill of its workers, their precision and their punctuality established „Made in Germany“ as an internationally well known trade mark.

With partners all over the world suffering from economic and financial problems, German companies nowadays face some difficulties in selling their products abroad. On the other hand, traditional bilateral relations, especially to countries that are doing relatively well, become even more interesting to German companies.

I am happy to find that „Made in Germany“ has a traditionally good reputation in Cyprus.

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To my personal experience, most German visitors are of the opinion that Cyprus has much more to offer than beautiful beaches. They are not only looking for five-star-hotels according to international standards, but also for a more individual and unique type of exploring the landscape, the history and the culture of Cyprus.

Agro-tourism and ecological tourism, botanical trips and trekking in the mountains are most attractive to the eyes of German holiday-makers.

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In every crisis, there is an underlying chance.

As the Austrian economist Joseph Schumpeter said, it is a creative impulse in times when former plans are destroyed by unforeseen circumstances.

The bad news is that a shortage of money for investment leads to more competition of projects.

The good news is that you can step forward to new and smarter solutions in such moments.

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Preserving the unique identity of your island in a cultural and an ecological way with environmentally friendly architecture and ecological systems of energy production, water clearance, desalination plants and waste deposit systems are key issues of the Cypriot National Reform Program.

Looking at the limited area of the island, ecology is not only an important economic factor regarding the attractivity to tourism. In the long run, it will also be a service to the Cypriot people themselves, especially to their children and grand-children.

In pursuing this aim, Cypriots will find that German companies are highly qualified partners with international experience, ready to invest in solar thermal energy as well as in a variety of further environmentally friendly techniques.

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If we have a look at our bilateral relations we are already good business partners and honest, reliable friends. But we can still do more, and the international crisis is a chance for all of us to accelerate our common efforts and to become a „winning team“.

Ladies and gentlemen, thank you for your kind attention.