

2010

## The Response to the Financial Meltdown in the U.K.

Bruce J.L. Lowe

*Taft, Stettinius & Hollister*

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### Recommended Citation

Bruce J.L. Lowe, *The Response to the Financial Meltdown in the U.K.*, 1 Global Bus. L. Rev. 83 (2010)  
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# THE RESPONSE TO THE FINANCIAL MELTDOWN IN THE U.K. AND EUROPE

BRUCE J.L. LOWE\*

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## I. INTRODUCTION: APRÈS LA DELUGE C'EST NOUS?

I have always maintained that there was not much wrong with the global economy until the financial industry torpedoed it. I have also posited that because of this, the recovery of the global economy, including in Europe, would be faster and stronger for the very same reason. However, the road to full recovery is not going to be smooth, and things are never going to be quite the same ever again. Indeed, there are going to be significant long-term changes.

It is now over two years since the September 15, 2008 bankruptcy filing by Lehman Brothers sent shockwaves through an already tremulous and jittery financial and political world. In the dark days of the ensuing months, in the United States (U.S.), in Britain and Europe, and in many other parts of the world, markets crashed or severely slumped, commercial and investment banks failed, credit froze, trade and commerce slowed dramatically, profits evaporated, businesses tightened belts, and unemployment figures skyrocketed.<sup>1</sup> In most major economic zones, including the

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\* Bruce Lowe is a partner in the Cleveland, Ohio, office of Taft Stettinius & Hollister LLP. He is a Barrister-at-law of the Middle Temple, London, England, and was educated at St. Edmund Hall, Oxford University, gaining a B.A. and M.A. Degrees in Modern History. He is President of the Henry T. King, Jr. Greater Cleveland International Lawyers Group and a co-founder and Board Chair of the British-American Chamber of Commerce of Ohio. Bruce would also like to thank Jerry J. Torma, Director, International Human Resources, Nordson Corporation, for providing a stream of helpful source information for certain aspects of this article.

U.S. and Europe, governments and central banks, often in consultation with each other over appropriate courses of action, stepped in with packages of bailout measures of various kinds, usually involving substantial loans to shore up credit at major banking institutions, as well as a potpourri of other initiatives aimed at providing public sector relief to private financial and commercial institutions and businesses.<sup>2</sup>

More than two years later, with the benefit of hindsight, the measures appear to have worked in large part. The floodwaters of financial catastrophe have substantially receded, and, while the many scars are evident, and much clean-up work remains to be done, the global financial scene looks a lot brighter, as do the prospects for international business generally.

- Major banks are better capitalized, and some are even doing rather well;
- New credit has not yet really loosened up, but this will happen in time;
- Existing credit has tightened and become more expensive, but this was probably inevitable at some point anyway;
- Interest rates have remained generally under control, stock markets have at least partially recovered, merger and acquisition activity has resumed, and commercial markets, particularly China, (with a predicted 9% GDP growth rate for 2010) are visibly strong and thriving again; and
- Most of the riskier practices that contributed to the mess have been curtailed or stopped - subprime mortgages, high risk hedge funds, credit derivatives, etc.

In sum, both in the U.S. and in Europe, the financial crisis is for the most part over, and the challenge now is to fuel the recovery at the same time as addressing critical vulnerabilities which became apparent as a result of the pressures created by the financial meltdown.

## II. EUROPE: THE CHALLENGES ON THE REBOUND

What I believe has now become apparent is that, with respect to Europe, there are now at least three major challenges for the financial world which were not really there before--or at least not as sharply in focus. How the governments and fiscal advisory groups in Europe (and, for that matter, around the world) address these issues will have much to do not only with the pace and strength of the ongoing global economic recovery, but also with Europe's and the world's collective abilities to control and avert future fiscal crises.

### A. Europe's Three Big Questions

The first of these challenges is how to reform and regulate the financial and banking system going forward in order to minimize the recurrence of another such crisis. So much taxpayer money has been pumped into the financial system, there now has to be a new heightened level of coordination with and accountability on the part of the financial and banking system to governments on fiscal policy matters to a greater extent than existed before September 2008.

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<sup>1</sup> See *Unnatural Selection*, THE ECONOMIST, Sept. 12, 2009 at 15, available at <http://www.economist.com/node/14416804>.

<sup>2</sup> *Id.*

The second challenge, for Europe at least, is "how to marry Europe's cross-border single market for finance with the reality that only national governments can and will step in when things go wrong."<sup>3</sup> As the current Greek crisis has exposed, there is an absence of a defined European Union (EU) framework for addressing a financial crisis in a particular country. While the EU is a financial zone for purposes of fiscal policy governance, national governments have had to act separately when necessary, and there has been a well-publicized divergence among major members of the EU about how to deal with such crises. There is no EU governance protocol for the members to follow as a path to resolving such problems.

The third of these challenges is a broader and more long-term concern which would have had to have been faced by the major EU nations regardless of any economic crisis, but which has become visibly more apparent as an imminent hurdle because of the 2008 financial crisis. This is the problem of maintaining competitiveness as a major industrialized group of nations and economies when their core populations are aging, numbers overall are declining, and emerging powers such as China and Brazil, with growing and more youthful skilled worker populations, are increasingly vying for commercial and cultural dominance.

I will return to these questions shortly, but first, a little more about the events of September 2008, the prelude to those events, and the aftermath.

### III. EUROPE BEFORE THE CRISIS

"The most important liberal rules of the international financial system--those of the EU and OECD [Organisation for Economic Co-Operation and Development]--were conceived and authored by Europeans, not by U.S. policy makers."<sup>4</sup>

Europe has had financial crises in the past. Examples of this include the German *Creditanstalt* (Standstill Agreement) of 1931, multiple devaluations (France in 1926, 1958, and 1969; Britain in 1940, 1949, and 1967), gold standard joiners and abandonments (Britain in 1931, 1960, and 1968).<sup>5</sup> However, an increasing general awareness of the desirability of a cross-border monetary system straddled World War II, and from a post-war European perspective was only further inspired by the international agreements reached in the United States in 1944 at Bretton Woods, at which time the International Monetary Fund and the World Bank were first established.<sup>6</sup>

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<sup>3</sup> *Germany's Oddly Vapid Election*, THE ECONOMIST, Sept. 12, 2009, at 54, available at <http://www.economist.com/node/14402188>.

<sup>4</sup> Ann Cullen, *How Europe Wrote the Rules of Global Finance: Q&A with Rawi Abdelal*, HARVARD BUSINESS SCHOOL WORKING KNOWLEDGE, Aug. 21, 2006, available at <http://hbswk.hbs.edu/item/5475.html>.

<sup>5</sup> CHARLES P. KINDLEBERGER, *A FINANCIAL HISTORY OF WESTERN EUROPE 10-11* (Oxford University Press, 2nd ed. 1993).

<sup>6</sup> HORST UNGERER, *A CONCISE HISTORY OF EUROPEAN MONETARY INTERPRETATION: FROM EPU TO EMU*, 15-23 (Quorum Books 1997).

In his comprehensive analysis of European economic banking and evolution,<sup>7</sup> Professor Charles Kindleberger in the introduction lists as the twelfth and perhaps most fundamentally important issue historically affecting monetary evolution:

“(12) The capacity of societies – economies, nations, governments – to adapt to change and to innovate by creating new financial institutions to meet new problems.”<sup>8</sup>

While the concept of European financial unification is an old one, Kindleberger pointed to the United States’ Marshall Plan as providing a post-war boost towards turning the concept into reality.<sup>9</sup> The Marshall Plan was legislated into existence in the 1948 Economic Cooperation Act, and the Congressional preamble to the Act specifically encouraged Europe to follow the Americans in forming a continental-wide economic market.<sup>10</sup> Post-war France also started several initiatives towards various forms of “functional integration,” implementing economic cooperation between countries in areas such as transportation, industrial production, and customs union.<sup>11</sup> These initiatives came together in the landmark Treaty of Rome of 1957, which formed the European Economic Community (“EEC”), including Belgium, France, Germany, Luxembourg, Italy and The Netherlands.<sup>12</sup> The Rome Treaty called for a customs union among the members, freedom of movement of labor and capital, a European Investment Bank, and a fund for assisting economic development in former colonies of the member nations.<sup>13</sup>

The British initially rejected an invitation to join the EEC and formed an organization of the peripheral countries to the EEC, primarily because of Britain’s perceived closer relationship with the United States and its significant trading relationships with its Commonwealth countries.<sup>14</sup> Eventually, however, the attractiveness of the European relationship became clearer, and by 1963 Britain was applying to join the Common Market, but (largely thanks to the famous “Non” of President De Gaulle) did not gain membership until 1973, when it was admitted along with Denmark and Ireland.<sup>15</sup> Thereafter, the EEC continued the process of instilling free trade principles within the Common Market, and effectuating a more complete economic integration. In addition to removal of tariffs and customs, the process involved standardization in areas such as taxation, food and drug laws, interest rates for capital, equalization of wages and salaries, and employment laws.<sup>16</sup>

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<sup>7</sup> KINDLEBERGER, *supra* note 5.

<sup>8</sup> *Id.* at 7.

<sup>9</sup> *Id.* at 447.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 447-48.

<sup>14</sup> *Id.* at 448.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

As economic integration progressed, the development of financial and currency integration inevitably followed suit.<sup>17</sup>

*A. European Monetary Integration*

Nowadays, after virtually a decade of experiencing a common European currency, we can understand its importance, not only to European unity but also in the broader context of world economic globalization. Thirty years ago, thoughtful economists saw common currency as a pivotal aspect of the overall movement towards globalization. An articulated vision in this vein by a fellow economist was included by Professor Kindleberger at the outset of his chapter on European financial integration:

Every person must see that the demand for uniformity in currency is only one case of the growing demand for uniformity in matters between nations really similar. Many subjects, most subjects of legislation, vary between nation and nation; they depend on national association and peculiar idiosyncrasy and other causes. But commerce is everywhere identical; buying and selling, lending and borrowing, are alike all the world over, and all matters concerning them ought universally to be alike too. (Bagehot, *A Universal Money, Collected Works*, 1868 [1978], Vol. 11, p. 65).<sup>18</sup>

Fueled by burgeoning sentiments generally for economic unification, as well as the ongoing weakness of the dollar at that time, from the late 1960s and early 1970s, Europe moved in stages towards the installation of a common currency.<sup>19</sup> First, the EEC Commission in 1969 established a group of experts (the “Werner Group”) to study and recommend a plan for achieving economic and monetary union.<sup>20</sup> This led eventually to the establishment of the European Monetary System (“EMS”) in 1979, the introduction of the initial common currency concept, the ECU (the European Currency Unit), and ultimately, in 1981, the European Monetary Fund (“EMF”) as the repository for the anticipated common currency.<sup>21</sup> Eventually, with the Maastricht Treaty,<sup>22</sup> the formation of the European Union (EU) in 1992,<sup>23</sup> and several rounds of additional accession, culminating in the 2009 Treaty of Lisbon, full European economic and market integration became a permanent reality.<sup>24</sup> As a cornerstone

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<sup>17</sup> *Id.* at 454.

<sup>18</sup> *Id.* at 447 (quoting Walter Bagehot, *A Universal Money, in COLLECTED WORKS VOL. 11 65* (1978)).

<sup>19</sup> Kathleen Burk, *Money and Power: The Shift from Great Britain to the United States, in FINANCE AND FINANCIERS IN EUROPEAN HISTORY 1880-1960 365* (Youssef Cassis ed., 1992).

<sup>20</sup> UNGERER, *supra* note 6, at 97-118.

<sup>21</sup> *See generally* UNGERER, *supra* note 6 (containing a detailed discussion of European integrated monetary development during the '60s, '70s and '80s).

<sup>22</sup> *Id.* at 219-256.

<sup>23</sup> *Id.* at 243-292.

<sup>24</sup> *See European Integration*, EUROPEAN CENTRAL BANK, [http://www.ecb.int/ecb/educational/facts/euint/html/ei\\_001.en.html](http://www.ecb.int/ecb/educational/facts/euint/html/ei_001.en.html) (last visited Nov. 23, 2010).

aspect of the process, European monetary integration kept pace, with the creation of the European Central Bank ("ECB") pursuant to the Maastricht Treaty, and the launch of the Euro as a common currency among eleven member countries in 1999.<sup>25</sup>

Today, the EU (also sometimes referred to, both elsewhere and in this article as the "euro-zone" or "euro group") has twenty-seven member states, of which at least sixteen have adopted the Euro as their national currency. The EU states are well served by a coordinated banking and monetary system. Within that system, the European System of Central Banks ("ESCB") attempts to guide all of the member nations collectively pursuant to principles of monetary policy, arriving at price stability within the EU. At the same time, the ECB watches over the coordinated banking, finance, and monetary policy needs of the Euro member states.<sup>26</sup>

#### IV. SEPTEMBER 2008: MEETING THE CHALLENGE

There is no doubt that the existence of this established framework helped facilitate quick and decisive action in September 2008. Within approximately 24 hours after the Lehman bankruptcy news sent shock waves across the world, the ECB, the Bank of England, and the Bank of Japan had together pumped over 111.7 billion euro (approximately 159.3 billion in U.S. dollars) in quick tenders out to commercial banks, in order to try to prevent liquidity shortfalls, prevent a credit freeze at some of the world's biggest banks, and bolster confidence (the ECB alone contributed 70 billion euro of this).<sup>27</sup>

This process continued for some time, and by the time the dust settled, approximately 2.7 trillion euro (over \$4 trillion in U.S. dollars) had been advanced from central banks worldwide in loans and debt guarantees, mainly to the larger commercial banks in their respective countries or regions.<sup>28</sup> That same day, the British Chancellor of the Exchequer, Alistair Darling, told the BBC, "[g]overnments, central banks and regulators have made it clear that we will do everything we possibly can to maintain stability in the financial system (international cooperation is crucial to ensuring financial stability). This is clearly a very difficult time. We need to take action internationally, and we are."<sup>29</sup>

More than eighteen months later, this strong intervention by governments still "looks like the right call."<sup>30</sup> The crisis wave receded and, with Europe and the world headed into a broad and deep recession, the economic distress and damage could have been much worse otherwise.<sup>31</sup>

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<sup>25</sup> UNGERER, *supra* note 6, at 209-292.

<sup>26</sup> For helpful information on the ESCB and ECB on the European Central Bank's website, see *Organisation*, EUROPEAN CENTRAL BANK, [http://www.ecb.int/ecb/educational/facts/orga/html/or\\_001.en.html](http://www.ecb.int/ecb/educational/facts/orga/html/or_001.en.html) (last visited Nov. 23, 2010).

<sup>27</sup> *European Central Bank Pumps €70 Billion Into Market*, SPIEGEL ONLINE INTERNATIONAL, Sept. 16, 2008, available at <http://www.spiegel.de/international/business/0,1518,578540,00.html>.

<sup>28</sup> *Unnatural Selection*, *supra* note 1, at 15.

<sup>29</sup> *Id.* (quoting Interview by BBC with Alistair Darling, British Chancellor of the Exchequer, in London, Eng. (Sept. 13, 2008)).

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

As the primary driving force behind these strong, swift initiatives, Gordon Brown, the British Prime Minister, earned widespread kudos at this time, as well as the respect of EU finance ministers and major EU leaders such as German Chancellor Angela Merkel and French President Nicolas Sarkozy. They have since continued to respect his work and understanding of finance and banking systems issues—an area in which he is clearly much more comfortable than most others. It was indeed one of his better moments. His stabilization models -- usually including the installation of tighter lending terms (especially with respect to British banks), the creation of asset protection schemes, and temporary bailouts via government interim acquisition of equity interests (with reversion to private ownership expected as soon as stabilization is achieved) – have been viewed as quite effective.<sup>32</sup> Unfortunately for Mr. Brown, as discussed more fully below, it was not enough to save his job.

Much of Europe has weathered the storm in relatively decent shape. I have had the chance to listen to presentations by several European economists during the last part of 2009 and early 2010, – all *prior to* the Greek crisis, I should add, and they all tended to come down somewhere between guarded optimism and repressed pessimism in their overviews and forecasts.<sup>33</sup> The main reason underlying the relative optimism was, I believe, the feeling that the global economy would generally continue to rebound, and that the financial industry would not drag it down like before. Since then, fresh economic crises have plagued countries such as Greece and Spain in recent months, and undeniably serious fallout effects have resulted, particularly impacting the rest of the EU and dampening general recovery hopes and optimism from time to time. However, the overall impact has been more to temper the optimism somewhat, to spawn intermittent fears of a "double-dip," and perhaps to lengthen the forecasted recovery timeframes, rather than to see any longer term and fundamental impairment of rebound and recovery prospects generally.<sup>34</sup>

#### V. EUROPE: COMING OUT OF THE CRASH

In the aftermath of the crisis, most of the original major EU members have come through reasonably well; Germany especially, where Angela Merkel, in her successful autumn 2009 re-election campaign, was able to point to the economic crisis as having proved the superiority of Germany's post-war "social market economic" model.<sup>35</sup> In France, Holland, and most Scandinavian countries too, governments implemented a variety of stabilization packages helping to restore equilibrium and confidence. In most instances, including in Germany and France, this included restructuring and insolvency measures aimed to provide a greater

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<sup>32</sup> For a compelling account of Gordon Brown's handling of the crisis, see George Parker, *His Finest Moment*, FINANCIAL TIMES, Oct. 14, 2009, at 9.

<sup>33</sup> See, e.g., STEPHAN RAES, HEAD OF ECON. DEP'T, ROYAL NETHERLANDS EMBASSY, PROSPECTS FOR EUROPEAN RECOVERY (2009). See also Roger Bootle, *The Economic and Financial Outlook*, CAPITAL ECONOMICS, Presentation at the Interlex Annual Conference (Sept. 2009).

<sup>34</sup> Chris Giles, *Vulnerable to Vertigo*, FINANCIAL TIMES, July 28, 2010, at 5.

<sup>35</sup> See Daniel Shafer, *On a Roll*, FINANCIAL TIMES, Aug. 16, 2010, at 7. See also Stanley Pignal, *Eurozone Divided as Germany Speeds On*, FINANCIAL TIMES, Aug. 14, 2010, at 2.



flexibility of options to challenged or troubled businesses.<sup>36</sup> In Germany, the insolvency laws now include a procedure which is probably as close to a U.S.-style Chapter 11 as any jurisdiction outside of the United States, i.e., permitting a debtor to remain in possession and operation of its assets and business, under court supervision but without the supervisory control of a court appointed receiver or trustee, while the business is reorganized.<sup>37</sup>

There remain substantial challenges, such as for Greece and Spain, but of the “big dogs” of Europe, it is the United Kingdom – ironically, given Gordon Brown’s crisis leadership – which is the one with ostensibly the most problems. Interestingly, however, perhaps it is the country now perhaps doing the most to redress those problems.

#### A. *The United Kingdom in 2010*

For much of the first decade of the 21<sup>st</sup> century, Tony Blair and Gordon Brown chortled about how Britain’s open trade system and robust economy was outpacing the more tightly regulated and steady continental nations. In September 2008, however, nowhere in Europe (except possibly for Iceland and Ireland) was more sharply affected by the 2008 financial crisis. Britain had already had the Northern Rock Bank failure and rescue as a portent of things to come, and in September 2008, no other financial system came as close to collapsing. I recall flying into Heathrow one morning in mid-December 2008, and watching a TV monitor in the airport announcing that Woolworth’s was closing its door forever. While the Woolworth’s name disappeared from U.S. high street decades ago, in the U.K. Woolworth’s had been a prominent fixture in every British town high street since the early 20<sup>th</sup> century. As a symbol of crisis, it was even more impactful than if, in the U.S., Sears Roebuck were to announce its closing. A venerable old retailer—you wouldn’t be entirely surprised, but it would be significant.

Now, Britain is faced with a spending deficit that approaches 13% of GDP—(projected at 175 billion euro for 2010), far higher than any other G20 country.<sup>38</sup>

- Between early 2008 and the fall of 2009, its GDP shrank 6.2%;
- Its recession lasted for six quarters—longer than any other G7 economy;
- Government borrowing as a share of GDP is forecasted by the International Monetary Fund (IMF) to be the highest of any G20 nation in 2010; and
- Government spending as a share of GDP in 2009 was 52%—higher even than Germany’s 48%—BUT, the statist German financial model is based upon a more extensive framework of governmental support and provides it more efficiently.<sup>39</sup>

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<sup>36</sup> Anouska Sakoui, *Distressed Groups Put New Laws to the Test*, FINANCIAL TIMES, June 22, 2009, at 4.

<sup>37</sup> *Germany’s Oddly Vapid Election*, supra note 3, at 54; see also, Sakoui, supra note 36, at 1.

<sup>38</sup> George Parker, *Choice Cuts*, FINANCIAL TIMES ANALYSIS, September 14, 2009 at 7.

<sup>39</sup> *Out of the Ruins*, THE ECONOMIST, Mar. 27, 2010, at 14; Parker, supra note 38.

There have been murmurings of the notorious 1970's "sick man of Europe" phrase again. In those final pre-Thatcher years of old Labour, Britain was hamstrung by economic stagnation, double digit inflation, and rampant strikes and industrial unrest. A recent *Financial Times* article harkened back to those times and recalled the labor unrest of that era, and a famous quote from the advisor (Bernard Donoghue) to Prime Minister James Callaghan at the time, in his diary:

"Apparently the British, never very keen on hard work, have decided on permanent inactivity. The Anglo-Saxons are normally very sensible, but when they go mad they go completely barmy."<sup>40</sup>

## Flash Gordon

Michael Heath



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Gordon Brown largely had only himself to blame for all of this, and he was always likely to suffer at the polls accordingly. Years of widely-termed "profligate" spending on his watch, coupled with extending a creeping net of indirect taxation in new and creative ways, had much to do with why Britain is in its current predicament. The income-earning taxpayers were the ones squeezed most, and they had their say on May 6<sup>th</sup>, 2010 in the U.K. General Election.

<sup>40</sup> Brian Groom, *A Heap of Difference*, FINANCIAL TIMES, March 19, 2010, at 8.

<sup>41</sup> Reproduced by kind permission of The Spectator, and Michael Heath.



All that being said, the picture for Britain going forward may not be all that bad:

- It is still the world's sixth largest manufacturing economy;<sup>43</sup>
- It still has its fully open trade approach, which gives it optimum ability to take advantage of the global economic rebound;<sup>44</sup>

<sup>42</sup> Reproduced by kind permission of Express Newspapers Ltd. and Paul Thomas. See also <http://www.paulthomascartoons.co.uk>.

<sup>43</sup> *Out of the Ruins*, *supra* note 39, at 14.

<sup>44</sup> The importance of embracing free trade and taking a controlling role in all of its aspects may well overshadow more traditional measures of prosperity, such as where manufacturing occurs. Lord Jones of Birmingham, former chair of the Confederation of British Industries ("CBI") and a non-partisan minister in Gordon Brown's cabinet for trade development purposes, in warning against the temptations of protectionism and espousing the maintenance of free-market ideals, likes to tell a story, particularly for his American audiences, of two people chatting at a club or pub. One has a Dumbledore doll, of Harry Potter fame, with a "Made in China" stamp on the base, which he had purchased at TESCO for £9.99 [euro]. They commiserate that this shows that the West is losing the commercial battle, *but*, Jones says, think about where that £9.99 is going. He then proceeds to enumerate a breakdown: £5 to TESCO, encompassing its shareholders and employees, £2 to logistics and transportation costs, £1 to marketing and advertising costs, £1 to J. K. Rowling and her publishers. Only £1 actually goes to China. The lesson here, according to Jones, is to stay on the cutting edge, be the creators and innovators, the marketers, the supply chain controllers and distributors, and the merchandisers. It does not necessarily matter *where* the manufacturing is done or where the product is sold as long as most of the key stages of this process are controlled by you. This is as relevant for Britain and Europe going forward out of recession as it is for the United States. Similar sentiments have been expressed by other notables, such as Sir James Dyson, the vacuum cleaner inventor/entrepreneur ("The only way we'll compete internationally in the future is by owning ideas. We can't manufacture everything here—certainly not consumer electronics. China and India are too dominant.") Brian Groom, *Balance and Power*, FINANCIAL TIMES, July 22, 2010, at 7.

- Ignore the Spring 2009 British Airways strike—labor relations are relatively good, nothing like in the 70’s;
- The separateness from the Euro has its advantages—especially now;
- The currency has fallen, making it more competitive;
- Deficit reduction measures will have an impact;
- And not insignificantly, London remains the bustling financial and commercial center of Europe, some would say of the world—something which will not change anytime soon.<sup>45</sup>

Longer term, therefore, under a broader-based and thus more flexible, less party-driven, government than old “New Labour” could provide, the future for the United Kingdom may not be all that grim, even though, particularly in the short-term, there will inevitably be some challenging economic hurdles to overcome. Indeed, a very recent *Economist* article has focused upon how David Cameron and his coalition government have now become the closely-watched “guinea-pig” of the industrialized nations by virtue of their implementation of a group of radical initiatives.<sup>46</sup> The measures include reducing the budget for all major government departments, except the National Health Service, by twenty-five percent (so that the budget deficit, previously running at the inherited rate of 14% of GDP, is projected to drop to 2.1% by 2014-2015).<sup>47</sup> At the same time, the Cameron government will initiate a progressive decentralization of big government and loosening of State controls, with more citizen volunteers taking on leadership roles in areas such as schools, the health service, police, and crime.<sup>48</sup> These ambitious programs are being pushed through on a priority basis, and world leaders will be watching closely to gauge the impact and success of such initiatives, including the crucial question of their impact in either stimulating or curbing overall economic recovery.<sup>49</sup>

## VI. EUROPE LOOKING FORWARD

One thing that I believe history teaches us is that a crisis or disaster of some kind often leads, in its aftermath, to the birth of something more positive and creative than existed before, usually with the objective of reducing the likelihood of a recurrence of the disaster. So it was with the Magna Carta, the United Nations, and a myriad of other examples.

In the wake of the economic crisis, with respect to Europe, it is to be hoped that something similar will occur with regard to the three major questions and challenges that I have previously identified:

1. Financial and banking system reform (and its interplay with government);
2. An EU mechanism for handling member troubles.

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<sup>45</sup> See generally *Out of the Ruins*, *supra* note 39, at 14.

<sup>46</sup> *The Unlikely Revolutionary*, THE ECONOMIST, Aug. 14, 2010, at 19.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* at 20-21.

<sup>49</sup> *Radical Britain*, THE ECONOMIST, Aug. 14, 2010, at 9.

3. A longer term recipe for preventing the aging powers of Europe from declining in commercial and industrial competitiveness on the world stage

#### A. Regarding Banking System Reform

Not surprisingly, the financial crisis spawned widespread criticism and antipathy toward the banking industry. A few days before that same mid-December 2008 morning that I arrived at Heathrow, *Newsweek* writer Daniel Gross, in an article in *Slate Magazine*, had dubbed Royal Bank of Scotland head Sir Fred Goodwin as "The World's Worst Banker."<sup>50</sup> Not surprisingly, by the time I landed and for some time thereafter, even the quality British newspapers were having a field day with this epithet.<sup>51</sup> Of course, the British press does not usually mince words, but ever since that time, governments have been working towards some form of coordinated international framework of banking industry controls designed:

1. To avoid a repeat of the same conditions which led to the crisis;
2. To provide some sort of payback for the losses caused.

Notably, as it has regained its nerve over time, the financial industry has become less submissive and more emboldened in its resistance to reform (this is true on both sides of the Atlantic), and financial reform packages are still being finalized. However, it is probably safe to say that such reforms will include:

- Minimum capital requirements;
- Limitations on the length of debt guaranties;
- (Will likely include) curbs on the sizes of bank executive bonuses;
- (May include) some form of payback mechanism.

These reforms became (and still are) a major focus among European leaders and finance ministers. As an indication, on April 7, 2009, the *Financial Times* reported that Gordon Brown "made numerous calls over Easter trying to build international support for a tax that would reflect the debt banks owed to society."<sup>52</sup>

#### B. Regarding EU Reform Needs

What has been exposed, particularly in relation to the current Greek crisis, is the need for a more definitive framework of mechanisms or procedures to handle problems arising in individual member countries. For this to occur, the EU will be charting new ground. The lack of definition is not without precedent, however. The new positions of EU President and Foreign Minister, which came into being with the ratification of the Lisbon Treaty in 2009, are not well-defined. For example, how does the new EU President interface with the sitting EEC President in Brussels? If

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<sup>50</sup> Daniel Gross, *Who's the World's Worst Banker?* SLATE MAGAZINE, Dec. 1, 2008, available at <http://www.slate.com/id/2205753/>.

<sup>51</sup> See, e.g., Patrick Hosking, *Hubris to Nemesis: How Sir Fred Goodwin Became the 'World's Worst Banker'*. THE TIMES, Jan. 20, 2009, available at <http://business.timesonline.co.uk/tol/business/economics/article5549510.ece>.

<sup>52</sup> George Parker, *Still Standing*, FINANCIAL TIMES, Apr. 7, 2010, at 7.

the position is intended to be mainly as a figurehead or ceremonial, then why did Merkel and Sarkozy make absolutely sure that Tony Blair did *not* get the job? The answer is likely that they did so because they feared he would turn it into a position that outshone and effectively outranked them on the world stage.

Therefore, the EU is without a firm mechanism to address situations like the Greek financial crisis. As a *Financial Times* editorial recently stated—it is basically "a body of fractious finance ministers."<sup>53</sup> When the Greek crisis erupted, for weeks the EU leaders went back and forth on how to deal with Greece. Most envisaged some sort of collective EU bail-out or rescue package, but, Merkel and Germany, in particular, were adamant that Greece should seek assistance first from the free markets and the IMF.<sup>54</sup> The subsequent decision and actions taken by the European leaders reflected that the Merkel view appears to have prevailed. The 110 billion euro loan rescue package from the IMF (primarily) and the euro-zone combined with the major reforms demanded in return for the loan, appear to have stabilized the Greek economy, at least for the time being. The impact has been fundamental. One executive of a major Greek banking group was recently quoted as saying, "[w]hat is happening here is a revolution. Things are happening now that should have happened 30 years ago."<sup>55</sup> Nonetheless, the ultimate results remain in doubt. According to another Greek official, "[i]t's a bit like bungee-jumping. It's very exhilarating but you're in that moment when you don't quite know whether you'll hit the bottom or come up again."<sup>56</sup>

This is probably what should have happened. After all, the IMF is in the business of bailing out nations financially. However, all the while there has been uncertainty because there is no set mechanism or process for dealing with a situation like this, as the result of which the European financial community has lost confidence, and the value of the Euro has declined. There is no question that serious structural reforms are needed to deal with market laggards, such as Greece and Spain, and development of an established framework and set of protocols to deal with crises such as the recent emergencies is necessary. To date, initiatives have met with little success. As one leader, the Prime Minister of Luxembourg, said in 2007, "[w]e all know what to do, but we don't know how to get re-elected once we have done it."<sup>57</sup>

That being said, however, forward-looking thinkers in Europe are already focused upon examining innovative ways to address Greek-like sovereign credit problem situations. Companies and individuals can have bankruptcy restructuring procedures, so why not countries too? Thus, Germany has recently initiated talks within the euro-zone on creating a sovereign debt restructuring mechanism. While these discussions are preliminary, they may very well lead somewhere. The *Financial Times* on August 2, 2010, pointed out that Anne Kruger, former second-in-command at the IMF, and economics professor at Johns Hopkins School of International Studies, had proposed such a mechanism for Argentina a decade or so

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<sup>53</sup> *Time to Send the IMF to Athens*, FINANCIAL TIMES, March 22, 2010, at 10.

<sup>54</sup> *Id.*

<sup>55</sup> David Gardner & Kerin Hope, *A Marathon to Sprint*, FINANCIAL TIMES, July 30, 2010, at 5.

<sup>56</sup> *Id.*

<sup>57</sup> *Staring into the Abyss*, THE ECONOMIST, July 10, 2010, at 23.

ago, and emphasized her opinion that “[i]n the case of Greece, a restructuring mechanism might have avoided the damaging period between January and May this year when the markets were heavily marking down Greece’s debt but euro-zone authorities were in denial that anything was seriously wrong.”<sup>58</sup>

There is still a long way to go before a codified, chapter 11-style sovereign debt restructuring procedure is likely to emerge, but at least in the EU there is ongoing thought development along the right lines.

Structural reforms will have to address some challenging circumstances: A Spain in which forty percent of youth are unemployed;<sup>59</sup> a Britain in which only fifteen percent of households have a discernable breadwinner; a Belgium in which just thirty-five percent of citizens between fifty-five and sixty-four still work;<sup>60</sup> a culture, especially in the southern European countries, in which income reporting for tax purposes bears little relation to actual work (such as the Greek municipality where the average home value is \$2.5 million and the average declared taxable income is \$12,000); and an overall EU population in which the working-age labor force will shrink by 20 million by 2030 while the number aged over sixty-five will increase by 40 million.<sup>61</sup> As a recent *Economist* article stated: “Some of Europe’s most stubborn structural problems involve the misallocation of public spending. Governments have spent years padding civil-service payrolls, unveiling benefits like baby bonuses or early-retirement payments just before elections, and shoveling subsidies to politically powerful interest groups.”<sup>62</sup>

Following the unkind spring of 2010, however, there were signs that European leaders see the need to reform in order to survive. The EU Commission recently announced plans to push through an EU-wide patent, valid in all twenty-seven countries. Most countries, including Spain, have initiated austerity measures. Governments such as Britain and the Netherlands have increased the retirement age for state pension eligibility.<sup>63</sup> As will be emphasized again in the section which follows, strong leadership is required, with vision and imagination.<sup>64</sup> That EU leaders have made reform an absolute priority, is without question. Nonetheless, the path to achieving consensual change will not be easy.<sup>65</sup>

### C. Regarding Europe’s Long-Term Relationship on the World Stage

Europe, as most would agree, is at a critical point in its evolution. One set of structural reforms are undoubtedly needed to address the EU’s ability to handle specific member doldrums. Another wave of more fundamental, longer term

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<sup>58</sup> Alan Beattie, *State of Bankruptcy*, FINANCIAL TIMES, Aug. 2, 2010, at 5.

<sup>59</sup> *Staring into the Abyss*, *supra* note 57, at 24.

<sup>60</sup> *Id.* at 25.

<sup>61</sup> *Id.* at 24.

<sup>62</sup> *Id.* at 25.

<sup>63</sup> *Id.* at 24.

<sup>64</sup> *Id.*

<sup>65</sup> Guy Dinmore, *Italy Slams Paris and Berlin for 'Pre-Cooked' Deals*, FINANCIAL TIMES, November 4, 2010, available at <http://www.ft.com/cms/s/0/03a068f2-e80f-11df-b158-00144feab49a.html#axzz16DLTwb9q>.

changes, at both individual EU member and market levels, is needed if Europe and its member nations are to maintain and enhance their position among the world's great societies and trading blocs.

It almost goes without saying that strong leadership, individually and collectively, by those at the helms of the major members, will be vital to steer a course that will fundamentally affect the lives of Europe's 260 million inhabitants for decades and generations to come. There are many current bright spots in European commercial achievement – some of Britain's enumerated above, Dutch globalization,<sup>66</sup> German industrial output, and the use of lower-cost manufacturing in Eastern European countries by some of the large manufacturers in the Western European powers.<sup>67</sup> This latter development is rightly regarded as particularly significant if Europe is to remain globally competitive:

The EU was once a cosy club of western European countries. Now 27-strong, stretching from the Baltic to Cyprus and taking in ten ex-communist countries, the union's best justification may be as a means of managing globalisation. For free-market liberals, the enlarged union's size and diversity is itself an advantage. By taking in eastern countries with lower labour costs and workers who are far more mobile than their western cousins, the EU in effect brought globalization within its own borders. For economic liberals, that flexibility and dynamism offers Europe's best chance of survival.<sup>68</sup>

Flexible use of labor resources between and among member countries can help, but it cannot paper over fundamental long-term problems and challenges. In the U.S., the aging baby-boomer workforce will be replaced by utilizing in part a mostly successfully-integrated immigrant population with equivalent skills, education, and abilities. Most importantly, in sharp contrast to the major European countries, the vast majority of these first or second generation workforce immigrants regard themselves, first of all, as "Americans," and only secondarily as members of their country of origin. This ability to absorb relatively seamlessly endless streams of immigrants as its own is one of the U.S.'s great and enduring, yet mostly unsung, strengths. Of course, as a nation of immigrants, it has a distinct advantage. It is not so easy for an immigrant from Senegal or Vietnam to feel French, or one from Suriname or Indonesia to feel Dutch, just as it is difficult for most French or Dutch nationals to look upon their former colonials truly as fellow countrymen. But, if, and it is a big if, Europe is to remain fully competitive on the world stage, that is what needs to happen. The major European nations have the ability to create younger, well-motivated, and sufficiently skilled work forces to compete in the globalized marketplace for many decades to come, as well as to find creative approaches to ease through the problems by making sure that ageing skilled workforces are productive and efficient in the meantime. Indeed, a very recent "CBS on Sunday Morning" feature focused on that very issue at Germany's BMW manufacturing plants and how imaginative efforts were being implemented to "improve productivity" and longevity

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<sup>66</sup> See generally RAES, PROSPECTS FOR EUROPEAN RECOVERY, *supra* note 33.

<sup>67</sup> *Staring into the Abyss*, *supra* note 57 at 25.

<sup>68</sup> *Id.*



in its more senior workforce segments.<sup>69</sup> However, it will take vision and imaginative leadership to attain the requisite goals, including the achievement of fundamental changes in social thinking in those respective countries. This will not be easy. The forward-thinking open market leaders of Europe already face a substantial opposition camp comprised mainly of Europe's still powerful left wing, the public sector workers and their representatives, and much of the French political class. Each of these groups sees global competitiveness as a danger to the maintenance of high cost social welfare systems. They prefer a protected form of intimate capitalism, often called "corporate-ism," preserved among the EU members and within its borders, like a protective shell. This is a recipe which can only spell enormous trouble for Europe down the road.<sup>70</sup>

#### VII. CONCLUSION: EUROPE'S WATERSHED

So there it is. Europe is at a crossroads. The path ahead will come excitingly, yet scarily. This would have been the case even if the economic crash of 2008 had not occurred. However, those events have more sharply underscored both Europe's frailties and vulnerabilities as well as its strengths. The strengths can provide the foundation for future greatness and prosperity. The vulnerabilities must be dealt with; otherwise real progress cannot be made. As I hope the foregoing comments and observations have made clear, these are epic times, and the writing of the current, massively important chapter in European evolution is far from being completed.

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<sup>69</sup> *How BMW Deals With an Aging Workforce*, CBS NEWS (Sept. 5, 2010), <http://www.cbsnews.com/stories/2010/09/05/sunday/main6837469.shtml?tag=contentMain;contentAux>.

<sup>70</sup> *Staring into the Abyss*, *supra* note 57, at 25.