

World Finance Report

(or, What is Wrong with the Global Economy – and what to do about it)

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1. INTRODUCTION

We need to separate a consideration of the current financial and economic system from considering the need for establishing a new global financial and economic system.

We have muddled through the LTCM crisis and the South-East Asian crisis, as well as the crisis and impact of 9/11, and emerged relatively unscathed. The third crisis (9/11) was intended by Bin Ladin-type Islamists to bring down the world economy by bringing down the world's largest economy, which has also been the engine of global growth since World War II. While that attack had all sorts of unanticipated effects, including the re-election of President Bush, the LTCM crisis and the South-East Asian crisis did in fact nearly bring down the world economy by engendering the economic and political conditions for the "bust" of Spring 2000, whose effects we still suffer, specially in the high-tech sector.

9/11 has bequeathed to us a stagnating economy and high oil prices - and we need to spend a moment thinking about these before I go on to the more fundamental problems affecting the world economy, which are the main concern of my paper.

I have tried to write this paper in as simple and non-technical a way as possible. That is why I have used the numbering system that I have below, using the minimum possible numbers for purposes of ease of reference balanced with readability. In addition, please note that if a week was "a long time in politics" (as someone much more famous than I once put it half a century ago), a week is a much longer time in politics today than it was then....and is even longer in economics! Many of the facts and figures which I have provided below will soon be superseded by others. However, the points I make onwards seem to me ones that will bear examination over time.

2. The macroeconomic backdrop of the current system

is not bad at present, in spite of poor global sentiment. The key factors that need to be considered are:

- a) the potential impact of sustained high oil prices on growth and inflation
- b) the fortunes of the dollar, and continuing fiscal and external imbalances in several countries

- c) inflation and the potential impact of higher interest rates
- d) ongoing uncertainties about the Chinese economy
- e) the resilience of other emerging market economies in the light of such factors.

2a. Oil Prices. During October 2004 the oil price hit a peak of over \$50 per barrel, more than double in dollar terms what it was since the late 1990s. (NB: All dollar prices of oil here refer to Brent crude. On average, the price of Brent crude is about half a dollar higher than the average OECD import price of crude oil, and \$1 to \$1½ lower than West Texas Intermediate, the other benchmark price).

That is, oil prices are as high in real terms as in 1973-74, and this needs to be seen in the context of the most important countries (the US, the UK, Australia, China, et. al.), withdrawing monetary accommodation and turning fiscal stimulus into fiscal restraint. The US, China and Japan all seem to be weakening their capital spend programmes at the moment. And the US in particular has its own deep-seated financial imbalances to address – in other words the large and bothersome net borrowing positions in the household, fiscal and external accounts. As George Magnus, the UBS Chief Economist, put it in his Chief Economist's Letter, September 2004, "Oil: It's Rather Shocking!" (but written in August 2004):

"Against such a background, the virtual doubling of oil prices since April 2003 constitutes a not inconsequential mini-shock...compare the effect of prices at, say, \$25 a barrel a year ago to \$46 today, against a normalised return to say \$32 a barrel by the end of 2005. Using \$32, we estimate that world GDP growth will drop by about 0.4% in 2005 and by 0.8% in 2006. The biggest losers are Japan and China, with the US and the EU reacting about the same, perhaps slightly worse in the EU".

"All we can say in August 2004 is that nominal and real oil prices, ahead of winter re-stocking, have already transcended levels at which inflationary impulses (headline inflation) have been fired off and at which negative effects on discre-

tionary consumer spending and company costs start to become more significant

"The sooner oil prices come down again and stand down, the less the drag on the world economy from this source. But if they stay around current levels, let alone rise further, then we may find that this will be one of the important reasons for the global slowdown that will probably happen anyway in 2005 – but which it could, itself, aggravate." (emphases mine)

Some observers take this to be the pessimistic view. Yet, consider what has happened in the last few days in terms of oil price trends: OPEC has cut production targets...but no one believes that they will be kept; the result is the opposite of what an OPEC cutback, and therefore a drop in supply, would normally presage - instead of higher prices, we actually have lower prices.

In contrast with Dr. Magnus's view is that of the OECD Economic Outlook, which proclaims "Oil Price Hike Slows Global Growth but Setback is Temporary (30Nov04)":

"Sharp rises in oil prices have slowed the global expansion, but barring further increases, the world's major economies should regain momentum in 2005"

Another OECD paper, published a few days later, has the following view:

"On the assumption that initial market shares (i.e. 38 per cent for OPEC) are maintained ... the baseline scenario generates a trend rise in the oil price to \$35 a barrel by the end of the projection period (2030) from \$27 per barrel in 2003.

(However) *oil price projections depend greatly on the assumptions adopted about economic growth and energy intensity...Higher GDP growth assumptions, or higher income elasticities of demand, especially in China and the rest of the non-OECD, could require either that prices rise significantly more than in the baseline scenario, or that OPEC be prepared to increase its market share significantly, from 38 per cent to around 55 per cent by 2030*" ("Oil Price Developments", OECD Working Paper, 8 Dec04).

So the question is: for how long will the current lower prices be maintained and, if they rise or fall, what the new level will be. No one except God knows. So prudent people prepare for whatever they believe the worst scenario could be, practically speaking.

2b. The fortunes of the dollar, and continuing fiscal and external imbalances in several countries.

I was one of the first to express public concern about the effects of the falling dollar - and remember being ostracised about 8 years ago at a conference in America for daring to express the view that the fundamentals of the world's emperor economy left it naked. I had asked if it was reasonable to imagine that the world would continue to pour

money into the US if the economy continued expanding consumption, while exporting production?

However, I am now convinced that the world will in fact continue to pour money into the US, mainly because of the lack of good alternatives.

The long-term conundrum is that the world economy is growing, and can only grow, by further consumption in the US economy - and that is driven largely by debt!

This strange kind of "growth" is weakening, and will of course further weaken the dollar.

However, as long as foreign capital continues to flow into the US economy, this should not affect the US economy too much.

The question is whether this is sustainable for the global economy in the long run.

"If the US dollar falls, it can only do so against currencies that are free to move. Much the most important of those is the euro. It follows that to the extent that there is an adjustment of the US current account it will be suffered largely by the eurozone, which will be forced into continuing stagnation, or worse. While that could force needed policy changes, it will do so by first creating disappointment that borders on desperation...."How can imbalances in growth and external accounts across the major regions be resolved while maintaining robust global growth overall?" (as the BIS asks).

The answer is brutally clear: on current trends, they cannot be. If the world is to grow while the US private sector and external imbalances adjust, as they must, the rest of the world must generate a period of demand growth well above that of their own potential GDP.

This essential change is, at present, being doubly thwarted. First, by governments preventing the needed movement in exchange rates, and, second, by policymakers failing to promote domestic demand. If this picture does not change, a disappointing few years could easily become a dismal decade"

- Martin Wolf, Financial Times, 2 July 2003

Though that was written some eighteen months ago (and a week is as long a time in economics nowadays as it ever was in politics), the facts are obdurate. The deficit in the US current account (which includes the trade balance, investment income and unilateral transfers) widened sharply in the second quarter to \$166.2 billion after widening in the first quarter as well. No doubt, the \$50+ billion deficits in the international trade will ensure that the current account widens even further in the third quarter. We now know that foreign capital inflows in November were insufficient to cover financial outflows from the US, leading to a further drop in the value of the dollar. It is worth noting that the trade deficit has been in excess of \$50 billion for six straight months through November. What are the reasons for this? The eurozone and Japan have very weak domestic demand (they represent a third

of global GDP - much the same as the US). For the eurozone, this has been the case for so long that it can be regarded as a condition. Japan combines features of the eurozone and some of its Asian neighbours: there has been weak domestic demand since the bursting of the property bubble some 25 years ago, high savings, and a determination to slow exchange rate appreciation. Developing and Newly Industrialising Asia (the world's fastest-growing economies), like Japan and the eurozone, have high domestic savings, strong debt aversion and a consequent determination to run current account surpluses and recycle capital inflows into foreign exchange reserves. A big divide has emerged between countries that allow their exchange rates to float relatively freely - which includes the big Latin American countries and most of the OECD (except Japan) - and those that do not, including much of Asia. The US and a few other high-income countries (e.g. the UK) are simply adjusting to surpluses generated elsewhere. The result has been massive accumulations of liabilities by their private and public sectors.

So, the optimistic view of dollar weakness is that it is forcing necessary adjustments:

- In the US: it will raise output and exports. The huge financial deficits will therefore decline (slowly?)
- In economies with floating exchange rates, dollar weakness will force other currencies to appreciate, will lower inflation and increase pressure for monetary expansion (whenever China accepts currency appreciation, the rest of Asia is likely to follow)
- In economies with fixed/ heavily managed exchange rates: dollar weakness will create pressure for monetary expansion and therefore inflation.

However, not everyone is an optimist. The first risk in relation to the optimistic view stated immediately above, is that the dollar may fall further if the US is to combine internal balance with a manageable external deficit. An abrupt fall could trigger sharp rises in US long-term interest rates and declines in US asset prices. This could cut household spending, thereby generating a renewed economic slowdown or it could drive the Fed towards debt-monetisation and so towards higher Inflation. I think this unlikely, and my estimate is that the dollar will stabilise at about 1.3 to the euro in January 2005 and improve thereafter.

The second risk is that neither Japan nor the eurozone generates satisfactory growth in domestic demand, so the external adjustment imposed upon them might also create a sharp domestic economic slowdown or even recession.

The third risk arises from non-Japan Asia's resistance to currency adjustment, postponing the external adjustment, but leading in the longer run to higher Inflation and accumulation of bad debts in their financial systems.

The fourth risk is that the external and internal adjustments do not happen: the US ends up with ever growing current account deficits, US protectionism explodes and the role of the dollar as a reserve currency comes into question.

I am an optimist and I don't rate these risks very high. But we need to find a better way of sustaining the global economy than with a growing mountain of US debt. A world in which world economic health can be achieved only at the expense of ever greater private and public debt accumulation in its biggest and "richest" economy as well as elsewhere is in principle unstable.

What US policy-makers want is what economists call "internal balance". If this means a gigantic current account deficit or a tumbling currency, so be it. As issuer of the principal reserve currency, the US is also the world's borrower of first resort. US policy-makers respond to whatever the rest of the world economy throws at them. Income must equal expenditure across the foreign, public and private sectors

During the stock-market bubble, the US private sector moved into an unprecedented deficit. Between the first quarter of 1992 and the third quarter of 2000, its financial balance deteriorated by 11.5 per cent of gross domestic product. Something else happened over that period: an explosive increase in net foreign lending to the US - the inverse of the current account deficit. As a corollary, the fiscal position improved. Then, when the bubble burst, the private deficit shrank, while the public sector's position moved in the opposite direction. In the boom of the 1990s, the driving force was the surge in private spending. In the bust of the early 2000s, when corporations slashed Investment and improved profitability, massive fiscal expansion and monetary easing rescued the economy. The Bush administration's fiscal policy is open to criticism for both its regressive impact and its long-term unsustainability. Domestic spending has not been driving the current account deficit. Instead, the rising external deficit has been driving domestic spending. But, though the external deficit has continued to grow, in combination with the Federal Reserve's aggressive monetary policy, the Bush administration has returned the economy to growth..

2c. Inflation and the potential impact of increasing interest rates. As with the other topics so far touched upon, this is a complicated subject. Clearly, however, inflationary pressures are building up. These are usually countered by increasing interest rates. However, that does also mean that growth will slow! Such are the complexities of the current economic system! In any case, the question is: will Greenspan and others have a good feel for the right balance of veiled signals and threatening noises on the one hand (which influence market expectations about interest rates) and, on the other hand, actual rises in interest rates. The November PPI (producer price index) increased 0.5 percent, significantly less than October's 1.7 percent hike but stronger than most economists predicted. The intermediate goods index is 9.8 percent higher than a year ago, up 8 percent excluding the volatile food and energy components. The crude materials index is up a whopping 25.5 percent from last November; it is up 25.6 percent excluding food and energy. Prices fluctuate more dramatically at earlier stages of processing.

Thus, the 25+ percent gain in the crude materials index and the nearly 10 percent gain in the intermediate goods index don't necessarily point to gains of this magnitude in the PPI for finished goods. However, in a rising rate environment where economic conditions are fairly healthy, more price hikes will pass through than if economic conditions were soggy. This makes it crucial for Fed policymakers to stick to their current policy of increasing the Federal funds rate gradually. Indeed, if inflation rates step up a notch as we begin the new year, the Fed might decide to start raising the fed funds rate target at a slightly quicker pace. Though there is always risk of market volatility and impaired liquidity if the increases are mistimed or of the wrong magnitude, at some point in 2005, 25 basis-point increases could give way to 50 basis-point increases.

2d. Ongoing uncertainties about the Chinese economy.

China is the world's 2nd largest economy in the world by PPP, but it has no information transparency. This is a real and under-regarded issue for the world economy: how do we know whether the Chinese economy is undergoing a boom or a bubble or has a bust ahead? Can and should we have to trust the Chinese government alone on a subject as important as this? We have nothing to go on except for the possibly doctored statistics put out by the Chinese government....What might be the implications of a bust, since China is already the "factory to the world" in such an enormous range of goods? "Managed economies" have a demonstrably bad record - as bad as "managed politics" (as is being tried in Russia at present). In case you think I am exaggerating, consider that prices for residential housing in Beijing are between 7,000 yuan (US\$843.4) and 8,000 yuan (US\$963.9) per square metre. But the average annual income of residents is only about 10,000 yuan (US\$1,204.8). And that's nearly a 100 percent increase from prices just two or three years ago. Yi Xianrong, a senior economist with the Chinese Academy of Social Sciences, has said that the government's macro-control measures have little impact on the real estate sector, and that the sector is the root of the country's overheated economy. Chinese currency policy is another critical wildcard. If China stands alone in resisting rebalancing, it runs a growing risk of being singled out as a scapegoat by the rest of the world. China bashing could intensify in response -- remember the Japan bashing of the late 1980s and early 1990s?. The big difference is that a wealthy and relatively closed Japanese economy was able to cope far better with such pressures than might be the case for an open and still relatively poor Chinese economy.

2e. The resilience of other emerging market economies to these developments.

For India, the consensus forecast of 6% seems reasonable because India has more or less complete information transparency (on the basis of which a higher forecast would be acceptable) needs to be balanced by the challenge of monsoon and other vagaries - though India has often surprised markets positively since liberalisation was gently introduced a couple of decades ago. On the other hand, it could also surprise by liberalising more aggressively. Non-Japan

Asia is not doing badly - indeed, Thailand has recently been specially recommended as an economy in which to invest. Latin America also seems to be doing well at present and its prospects (broadly speaking) seem good. However, Sub-saharan Africa is a challenge: *we* know what needs to be done -*they* know what needs to be done - then why does it not happen? Because it is ruled by thieves, and because the people of these countries (among others) allow themselves to be ruled by thieves. In sum, there is no reason to believe that other emerging market economies will be unsustainably affected by current developments - if something goes wrong in China. If it does, that would change everything for everyone, not only the emerging economies.

3. Additional Factors:

On the positive side of the balance sheet, we have strengthened levels of capital in the financial system, though there are potential sources of greater market volatility and reduced market liquidity. We must also consider that, globally, planning for business continuity has improved remarkably.

Financial reporting and governance: there are widely-acknowledged challenges associated with the implementation of international accounting and auditing standards. Nevertheless, it is clear that there will be increasing convergence in the medium term between the requirements of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board. Audit quality and auditor oversight are also improving, though there is concern about delays to the establishment of the public interest oversight board (PIOB) to oversee IFAC's standard setting activities. The speedy formation of the PIOB is essential, and it is not clear why that is being held up. Financial sector regulation continues to improve, though certain outstanding issues and gaps remain, in the areas of: the preconditions for sound supervision and regulation, consistency of implementation methodology, cross-sector and cross-border regulation, regulatory and corporate governance, and public disclosure. You may be interested to know that some 72% of senior executives who participated in the PwC Survey of Financial Institutions worldwide ("Taming Uncertainty: Risk Management for the Entire Enterprise", 1992) admitted that regulation was either an extremely significant or major driver for changes in the priority of their organisation's management of risk.

3a. However, as one senior British banking supervisor put it: "There are two significant financial sectors that are not internationally regulated. These are hedge funds and reinsurance companies."

The reinsurance industry is not particularly transparent, either. The IAIS's first global reinsurance market report, which is supposed to analyse the size and structure of the global insurance market for 2003 is not yet here, though it is scheduled for the end of this year.. There is also a proposed study of reinsurance by the Group of Thirty. There

is currently no harmonised framework for reinsurance supervision even in the EU - though one was proposed on 21 April 2004, this has been fiercely lobbied against by German reinsurers among others.

Rising inflows to hedge funds and derivatives have an as-yet-non-determined effect on market functioning and on the risk profile of financial institutions. The Financial Stability Forum promises to continue reviewing developments in these fields, drawing in part on the results of analyses being done by a number of bodies. We need to regard this as an area to watch. The scale of the markets here is mind-bogglingly huge: for instance, the size of the market in OTC derivatives alone is US\$169.7 Trillion (compare that to the total amount of US currency in circulation around the world is only \$700.5 billion)

Now when I say that hedge funds and derivatives are internationally unregulated, you might draw my attention to the International Organization of Securities Commissions (IOSCO), which published a paper in 1992 on the "Regulation of Derivative Markets, Products and Financial Intermediaries". In response, may I just draw your attention to the definitions used in the report:

"For purposes of this report the term "derivative" (refers) to only those products:

- (i) in which the market itself is the issuer;
- (ii) that are subject to the rules of an exchange; and
- (iii) for which a clearing organization is used to settle profits and losses, make deliveries and guarantee cleared trades.

"While it is recognized that some jurisdictions permit off-exchange trading in futures and option contracts, the issues raised by such trading ... are not within the scope of this report".

This is a wonderful way of appearing to investigate while dodging investigation, by placing the vast bulk of what is supposed to be investigated outside the scope of the investigation.

Similarly, The Joint Forum (Basel Committee, IOSCO, & International Association of Insurance Supervisors) has published a paper in October titled "Credit Risk Transfer", which reads, in part, as following: "it is clear that CRT...has a long history. In recent decades, loan syndication and securitisation activities experienced significant growth. The present report, however, focuses more narrowly on the newest forms of CRT, in particular those associated with credit derivatives...even if outstanding notional amounts are still limited compared with outstanding amounts of other OTC derivatives (CRT involved US\$2.3Trillion and, as pointed out earlier, OTC derivatives involved US\$169.7 Trillion, according to *Risk Magazine's "Credit Derivative Survey"* (February 2003) and the Bank for International Settlements' publication *OTC Derivatives Market Activity in the First Half of 2003*, (November 2003). In other words, the problems associated with the USD169.7 Trillion are sidelined, while focusing on the

problems associated with US\$2.3Trillion. The problem with our world is not only that self-regulation sometimes works poorly, but the take-over of politics by special interests also means that even the regulatory bodies can become too close to "real market movers and real market practices".

3b. Fraud in Capital markets: The Chairman's Task Force established by IOSCO's Technical Committee, has submitted two reports on a description of the events concerning the Parmalat case and on key issues for consideration in light of recent financial scandals. These should help to lessen the probabilities of such frauds in the future, though that is no guarantee against other types of fraud.

3c. Efforts are underway in relation to Offshore Financial Centres (OFCs), led by IOSCO, the Basel Committee on Banking Supervision, the IMF, and the Offshore Group of Banking Supervisors. The FSF agrees that achieving further progress is necessary and is prepared to consider further steps. It will consider periodic reports based on the IMF's assessments and IOSCO's work, though the FSF's view continues to be that the publication by OFCs of their IMF assessments and follow-up reports is of paramount importance. The publication of these reports would make life easier for everyone, except presumably for the OFCs and their government-related elites. Though I doubt whether the mere publication of these reports is enough, it would provide a good basis to continue reform efforts.

3d. Productivity/Unemployment: One influential view is that "during the next decade, private sector productivity growth will continue at a rate of 2.6 percent per year" ("Will the U.S. Productivity Resurgence Continue?", By Dale W. Jorgenson, Mun S. Ho, and Kevin J. Stiroh, *Current Issues in Economics and Finance* 10 (13), December 2004).

"Productivity" is more or less a mathematical observation depending on economic growth and employment growth. If real GDP grows more rapidly than employment, productivity will probably have increased. When employment increases more rapidly than real GDP, then productivity gains are likely to decrease. Robust real GDP growth allows for healthy gains in both employment and productivity.

In fact, we have seen strong productivity growth in the US at least partly because employers have been reluctant to hire workers in the past two years. It is only within the past 11 months that non-farm payroll employment has posted even reasonable (and not yet robust) gains.

Healthy productivity growth allows employers to raise wages without causing inflationary pressures to develop. However, productivity growth can also reduce the demand for labour when economic conditions are soggy or moderate.

The three-month moving average shows that US jobless claims have essentially stabilized at roughly 340,000

since April (the consensus forecast is for a range of 325,000 to 350,000 in the next 3 months). A drop in new jobless claims would point to an improvement in the labour market, but it doesn't appear as though conditions have worsened. On the other hand, there is a view that "November 2004's disappointing employment report was hardly an aberration; it marked the 31st month in this now 36-month old recovery, when job growth failed to live up to cyclical standards of the past. So much for the timeworn consensus view that the Great American Job Machine is finally on the mend. Like it or not, the United States remains mired in the mother of all jobless recoveries. ("Morgan Stanley Global Economic Forum", 6 Dec04, quoted from <http://www.morganstanley.com/GEFdata/digests/latest-digest.html>).

3e. Stocks/Shares: We will continue to see daily fluctuations in the stock market - in a wider range than before this week's raising of the federal funds rate to 2.25%. We will also see more bankruptcies and more mergers (the announcement of mergers worth over US\$108billion this week is an indication of what is ahead in this phase of the economic cycle). We are on our way to seeing what I have called the "elimination of the middle-sized company as the backbone of the world economy". Some middle-sized companies may well survive, but the definition of "middle-sized" is itself moving as the global giants grow ever bigger.

3f. Investors in bonds had to contend with 5-year and 10-year note auctions as well as corporate offerings. For the most part, the yield curve flattened. Yields on the long end came down from a week ago, while the 2-year note yield was unchanged and the 3-month yield edged up a few basis points. Bonds are still overpriced and it is not clear in which direction bonds will head.

3g. Gold. As long as the dollar continues to decline while interest rates rise, buy, buy, buy. There is no alternative but for gold to go up. However, there will be short-term fluctuations depending on whether central banks and other holders of gold actually do decide to destock gold, as they have been considering doing for some years now - though that was in rather different circumstances, and they may (should?) be reconsidering now. So buy while you can but watch out for those two time-signals: the dollar stabilising, and central banks releasing vast quantities of gold into the market.

3i. ASSET-PRICE INFLATION: This is routinely ignored in calculations of inflation (which focus generally on retail inflation or inflation for a basket of primary or primary-and-manufactured products). The key development globally, however, has been asset-price inflation, including inflation in the prices of equities, houses and other asset classes. Very little is being done to control or even quantify the effects of asset-price inflation on the global economy. This might be classed as systematic disregard for an increasingly important element of the global economy, and everyone who understands basic economics understands

too why this is not being studied: it is against the interests of the global elites for this to be studied, let alone controlled.

4. WHY DOES THE WORLD ECONOMIC SYSTEM NEED TO BE CHANGED?

President Kennedy in his Inaugural address (1960) had announced America's determination to abolish poverty, with the stirring words:

"If a free society cannot help the many who are poor, it cannot save the few who are rich. ..Our generation should be the first to extend the benefits of civilization to all mankind".

However, while America and the world have enjoyed an unprecedented boom in prosperity since then, with the occasional bout of inflation, deflation or uncertainty on the way, we have not merely failed to abolish poverty, we have not even managed to hold the line. There are more poor people in America (and in the world) today than there were at President Kennedy's Inauguration:

- 3.1 million U.S. households suffer from actual hunger (including something like 2 million children)
- 10 million households (31 million people) *risk* hunger or food insecurity (12 million of these are children)
- In 2003, according to the official measure of poverty, 12.5 percent of the total U.S. population lived in poverty.

Governments, companies and individuals seem therefore to find themselves in a bind, unable to do the good that they would, doing the evil that they don't really want to

WHY? The basic reason is that our individual, corporate and governmental aspirations *clash* with the structures which we have created.

Some key examples:

4.1. The work of everyone, from the most senior executive to the most menial employee, has become increasingly unmanageable in quantity, scope, complexity and uncertainty, with the result that we *talk* of Corporate Social Responsibility and of work/life balance, but are enslaved to the bottom line

4.2. We *talk* of the need to ensure long-term sustainability or at least medium-term shareholder returns, but we have a stock market system which focuses on immediate returns (*this quarter*, at present, but this will soon shrink to *this month* as computerisation enables companies to present their financial statements each month and then *each day* and finally *each moment*).

4.3. "Technology has always *promised* us power and choice, but we are living in what may come to be called the ETC Century (*that of Erosion, Technological Trans-*

formation and Corporate Concentration). Technological power is becoming concentrated in a corporate elite that seems to be struggling for dominance over the rest of the earth.

The RAFI (Rural Advancement Foundation International) Law of Technology Introduction is simple, powerful and easy to recollect:

"Erosion is created by technology introduced in the context of power concentration".

For every Luddite trying to establish social controls over the introduction of untested technologies, there is a much more powerful elite using social manipulation to market new technologies. Any major new technology introduced into a society which is not by its nature just will exacerbate the gap between the rich and poor, and between aspiration and achievement in both environmental care and ethical transparency. (my emphases)

4.4. The purpose of companies, in law, has moved from that of reducing risk to that of maximising returns (raising the question: what kind of company law is appropriate?)

4.5. The *meeting needs* function has become mixed up with the *marketing* function (raising the question: should there be much more stringent moral constraints on advertising and marketing?).

4.6. The most basic reason for needing to change the global economy is that it is predicated on ever-growing growth - which is, by definition, unsustainable in a world of limited resources. Some people argue that resources are not limited, and that the market always finds substitutes given time. The challenge is that we may not have much time, as the consensus even among US scientists now indicates. Of course, no one can say for certain. Markets do in fact sort many things out, even if they are not the universal panacea, as some people think. So it is indeed possible that we may have enough time for the market to find corrective mechanisms. Equally we may not. In chess as in business, the winners are generally those who are cautious and conservative and prepare for the negative, if the chances for the positive scenario are equal to the chances for the negative scenario.

4.7. What is worse is much of our so-called "growth" (national, corporate & personal) is driven by debt. Earlier this year, there was anguished debate in the UK when it became known, in October, that UK household debt had reached £1 Trillion. That figure came from a report from the Skipton Building Society titled "Debt in a Decade", whose future debt projections suggest that total UK household debt is set to rise to £1.6 trillion over the next decade (central scenario). Alternative scenarios (with lower probabilities) suggest that total debt might explode to £2 trillion or stabilise around £1.1 trillion. Under the central scenario the household debt-income ratio will increase from 139% to 150% over the next decade. Under the debt explosion scenario the household debt income ratio soars to 193%. Under the debt implosion scenario the ratio falls sharply to 104%.

Interestingly, the UK government had, almost exactly 4 years earlier, in October 2000, established its Task Force on Tackling Over-indebtedness to 'address concerns about consumer debt in the UK by considering ways of achieving more responsible lending and borrowing'!

So why has debt risen instead of declining? Because the culture has changed. The notion that borrowing, and by implication debt, is a bad thing has been the received wisdom for many generations, coming straight out of the Biblical tradition. However, post-War indoctrination into Popular Darwinism changed the culture of the country to the extent that the rules governing official credit allocation were changed in 1971, and hire purchase agreements in 1982, followed by the deregulation of the UK personal financial services marketplace - transforming borrowing into an "acceptable and necessary" part of many people, for whom the only meaning in life consists of consumption.

Professor Kevin Keasey, Director of IIBFS in the UK, writing in this month's issue of Finance Industry Solutions, a newsletter published by BT, noted:

"While the UK economy remains fundamentally strong, consumers are realising that the good times are unlikely to continue. We have been living beyond our means and some belt tightening will be required. It is dawning that:

*Although currently affordable, debt will hang around for longer in real terms because of low interest rates

*Debts have to be repaid but the assets acquired with the money borrowed are often heavily depreciating and illiquid in terms of trying to raise value from them.

"What does this mean for the financial services industry? There is evidence that people are getting fed up with the 'indiscriminate pushing of credit products'.

There is a need and an opportunity for the industry to move to a situation of consent and trust and to prove that it is behaving responsibly by better considering and evaluating individual circumstances. This should involve tools that can be shared by lenders and borrowers, and which consider current exposure levels and the means by which individual circumstances can be managed. If this is achieved, then the current debt overhang may be managed in a smooth manner to the benefit of all concerned.

"The problem the credit industry faces is that it needs debt levels to keep increasing if it is to meet its ongoing profit targets. Consequently, trans-

forming an industry built on pushing credit into one that is responsible in its lending will not be an easy task".

The problem is exacerbated by our culture's systematic denigration of the old, and systematic promotion of what might be called "youth and youth-related values" (for some extremely perceptive remarks on how the overvaluing of youth is driving debt in the UK, see the Henley Centre's consumer research report, [Planning for Consumer Change](#), 2003). Partly as a result of having succumbed to this "youthisation", a huge proportion of the US population has zero net wealth.

Most companies would cease to grow if they were unable to borrow money. Indeed, there is a surprising tendency even for governments to go bankrupt. That takes us to the syndrome known as "too big to fail". If the failure gets big enough, we even change the rules of the game - at least for a time. We have seen totally extra-legal things being done to rescue the world economy as after the South-East Asian crisis and the LTCM debacle.

4.8. There is the further challenge, for the current economic system, that, contrary to its assumptions (revealed in the language that is used) what are called "goods" are not always good. More and more is not necessarily desirable. For example, in agriculture, the Common Agricultural Policy has historically consumed up to two-thirds of the EU's budget (if memory serves) simply to store the overwhelming European over-production of beef, beer, milk, butter and so on purely for the purpose of price-maintenance.

Never before have so many people been so rich, and yet felt so poor. Sixty four per cent of respondents, who had an average wealth of \$38 million felt financially insecure! (The U.S. Private Bank's 2000 Study on "Wealth with Responsibility", from Deutsche Bank's Forum magazine, 6/2000, page 24). One key reason for this is that greater globalisation of business means greater opportunities to make money quickly because of the scale of new opportunities which the traditional multinationals were in the past not properly poised to exploit...but it has become a more volatile world (how much is Bill Gates worth today?)

The equation of "goods" with "the good" is in fact demonstrably invalid, now that it has been scientifically established that there is no correlation between happiness and wealth. People who are very poor do become happier with each additional dollar till a certain threshold is reached, then additional money adds to the sum of happiness with decreasing effect, till another threshold is reached, when the correlation reverses, and the more money you have, the unhappier you get. No wonder Bhutan and Brazil are experimenting with replacing the notions of GNP and GDP with the measurement of a Gross Happiness Index. No wonder King David prayed "Do not give me poverty, or I will be tempted to steal, and do not give me wealth or I will become proud and unhappy. Please give me just enough, O Lord, to enjoy myself in moderation today" (I paraphrase, from the book of Psalms). No wonder the only prayer that

Jesus the Lord ever taught asks: "give us *this day* our daily bread".

The same Bible of course enshrines the principle "he who does not work, let him not eat". By contrast, since the late nineteenth century a class of people has begun to emerge, which has now grown global (generally called "the global elite") which has enough assets to live off them simply on the basis of interest.

4.9. The whole international financial system is now based on usury (or the taking of interest for the use of money) - which is specifically forbidden in the Bible, in the Koran, in the Indian Scriptures, in Chinese tradition, among the Greeks, Romans, Native Americans, et. al.

Usury inevitably creates a system which grows faster and faster and eventually grows cancerously fast...creating, eventually, a financial and economic system in which economic efficiency comes to be pitted against what is morally right, socially advantageous and psychologically beneficial.

That is, an interest-based economy is programmed to grow faster and faster till it crashes. We need to understand the relationship between usury and the domination of our economies by the notion of growth. A case in point was indicated by a headline in Financial Times on the 10th of this month: "Limiting carbon emissions damages growth, says US". The story read, in part: "The White House was yesterday mulling its response to a bipartisan report from the National Commission on Energy Policy, recommending a mandatory system of tradeable permits to limit greenhouse emissions and tightening of fuel efficiency standards for vehicles". Paul Bledsoe, Director of Strategy, (US bipartisan) National Commission on Energy Policy is reported to have said: "The US is the lone major emitter among developed nations that has not pledged to reduce greenhouse gases. The result is that Europe believes the US is willing to risk the health of the world". (Though we must remember that the US also finances the UN, as well as the Earth Observation Summit, and spends \$5bn each year on related science and technology, including "clean coal" and alternative fuels, e.g. hydrogen)

We need to understand that if we want to have a sustainable (i.e. low-growth) future, the ***re-abolition of usury*** is essential. As has been pointed out by researchers based at the Jubilee Foundation in Cambridge, England, the Jewish Bible outlines in effective detail the sort of economic system which enshrines low growth, and we must remember that, according to the Jewish understanding of their own history, God pulled them out of high-growth economies such as Egypt and Mesopotamia, so that He could give them His message about "shalom", peace and health and prosperity in the whole of life - economics, politics, and the rest. "Shalom" in fact described what we refer to when we talk about "holistic". Such a holistic or shalom economy has, in our own time, been famously

described as the "R" economy "or the "relationships economy" by Dr Michael Schluter, the ex-World Bank economist now based at Cambridge, UK: it is not the value of our shares, bonds and gold and whatever else we may have in our vaults or pockets that has the primary power to make us happy, it is our relationships (with God, with others, and with nature) that have the primary power to make us happy.

If the abolition of usury seems a step too far to you, you might want to take on the reform of stock markets with their focus on short-term returns. Or an examination of the specific reasons that pension funds, whose job it is to provide relatively sustainable long-term returns for pensioners, end up investing on such a short-term basis.

If that too seems too challenging, you might like to consider a campaign to examine the relationship of the WTO to the IMF/World Bank, and the governance structures of these bodies.

Though this may seem a somewhat complicated area to you, it is clearly established that fiat currencies expand growth faster, though at the cost of greater inflation. By contrast, asset-based currencies (provided that the asset base is not being manipulated as at present) are better at providing slower but more solid growth. Bernard Litaer's proposal for a properly asset-based currency therefore would be a good one to adopt at this stage of the world economic cycle, provided a representative group of assets was included (including household value, for instance). It is also clearly established that the abolition of fiat currencies combined with the abolition of usury (see above) would more or less eliminate the boom-bust cycle, which is one of the key difficulties of modern capitalism. In addition, this would eliminate the dependence of the world on ever-faster growth and the consequently increasing threats to the environment that we have had since WWII.

The perversity of so-called "rational" economics is clearly seen from the fact that, when the world has surplus capital, more of it goes to the world's richest country, when accumulated capital should go instead to far poorer ones! "That this is not happening is a grievous failure" ("Balances, Imbalances and Fiscal Targets: a New Cambridge View" February 2004 www.cerf.cam.ac.uk/home/index.php).

Lastly, if nothing of the preceding discussion has convinced you, there is a fundamental issue for you to consider: the transfer of risk from government and from financial institutions to households like yours and mine. Think of what has happened in the area of pensions or of health provision. Think of areas such as hedge funds and derivatives, where the classic Sharpe ratio should be abandoned, since it ignores the asymmetric risk component of fund positions. The problem is that there is no good substitute. Though some theoretical solutions have been proposed, as yet they lack computational constraints and robustness. Think of Credit Risk Transfer, where big questions are being ducked, as I pointed out earlier. I quote again from The Joint Forum paper on "Credit Risk Transfer", October 2004:

"The Working Group spent considerable time discussing with market participants the related questions of how much risk is actually being transferred via credit derivatives transactions, as well as the ultimate sources of the risk protection...."

"In general, the Working Group believes that it would be impractical to develop a precise answer to these questions, because it would require a comprehensive survey of a very large number of market participants, including many private fund managers, and a detailed analysis of many different structured products."

I don't know how you read those statements, but I read them as an admission that no one knows how much credit risk is actually being transferred to whom; nor does anyone know the implications of this lack of knowledge. Further, these statements are an admission that the task is too big to perform. We really are living in a house of cards, in terms of the economics of our world. If that does not persuade you that we need a better financial and economic system than we have, then nothing will do so.

5. What needs to be changed in the Current Economic System?

The foregoing discussion may have caused you to become curious about an interesting question: how come we have created such structures? Specially when the traditional wisdom of all our societies sought to steer us away from the creation of the most important of such structures?

The reasons are our:

- fear,
- greed, and
- lust for power.

In other words, our self-orientation (which is often wrapped up in religious language and imagery), rather than true God-orientation or (as we might put it in practical terms) love-towards God, love towards other human beings and love towards nature.

Interestingly enough, the force of the traditional wisdom waned only with the rise of what I call Popular Darwinism or Evolutionism ("evolution as religion or doctrine or dogma"), particularly following the end of World War II, which was a principal contributor not only to the rise of Fascism and Nazism but also to the enormous decline of faith which has taken place in the post-War period. Most legislative restrictions on the charging of interest, for example, were removed only between the 1950s and the 1970s. The deregulation of the financial services industry in the UK (the first major country to do so) was in the 1980s. In most societies today, as in the case of my caste in India historically, you can legally charge any amount of interest that some foolish or desperate customer is

prepared to bear. In India's case, this resulting in the serfdom (virtual slavery) of tens of millions of people to my caste, before the Evangelical Revival and the work of the Clapham Group turned the East India Company from a "gang of looters" to at least a partial blessing to India.

All this would seem to indicate that there is room for a renewal of the understanding of what is "enough". In The Trinity Forum, a movement with which I am involved, we have a favourite reading, which is the fascinating and famous story by Leo Tolstoy, "How Much Land Does a Man Need?". A recovered and renewed understanding of the importance of truth and of spirituality can play a role in enabling us to overcome the spiritual, psychological and emotional roots of our global financial and economic challenges.

The difficulty is that most of today's spiritualities are merely individual, but it is not enough for spirituality today merely to help individuals with negative emotions. it is necessary also for spirituality to address the concrete question of how to deconstruct the structures to which I have drawn attention. Someone who is trying to explore that is Dr. Peter Heslam FRSA, with his Research Project on Capitalism at the University of Cambridge in England.

I would merely suggest that there may be at least four varieties of spirituality, when it comes to considering their economic or financial impact. First, there are spiritualities that we might describe as aspirin-like (into this I would put Eastern spiritualities and techniques such as yoga, tai-chi, various forms of meditation, and so on). Second, there are spiritualities that we might describe as jujube-like. American Fundamentalism and Indian bhakti-worship are good examples of this kind of spirituality: sweet, but perhaps too sweet. Unfortunately, most contemporary spirituality, Eastern and Western, remains stuck at this level, or even at the level of "spectator sport" (come to the temple or mosque, and don't bother with whether and how this relates to work or to the world). In this respect, much Evangelicalism is as poor as Roman Catholicism: the view seems to be: "Come to church on Sunday, try to be a good person, and don't ask if all that has anything to do with the struggles and efforts of your organisation every day". Much of contemporary Christianity betrays its own spiritual roots by being incense-like - its world-view is that the primary purpose of life lies in "worship" (as in the song: "the reason I live/ Is to worship You"). Actually, as far as I can understand the teaching of Jesus the Lord, a relationship with Him is meant to be dynamite-like or (to use his own imagery), like yeast or like a tree growing, breaking up everything around and making something new and greater instead: we are here to be revolutionised and to revolutionise work and the workplace and the world, while of course doing our assigned job well. This is very different from the view of some other gurus who would have us perform only our own jobs as well as possible, without asking wider questions (as in "bhakti-yoga" and "karma-yoga").

In this context, we might also think about the various different levels of spirituality in relation to the worlds of business, finance and economics.

There is of course, as we have just indicated, the individual level (focused on personal peace, growth, prosperity and health) and these kinds of spiritualities could be described as being purely "selfish". Then there are spiritual techniques which are intended to affect groups at work. Some companies are welcoming such techniques. Other spiritual approaches seek to impact whole corporations or organisations (see e.g. William Pollard's book The Soul of a Firm, Harper & Row, USA, 1996 (ISBN: 0-310-20103-9) which describes the spiritual orientation of The Service Master company). Finally, there are a few spiritualities which are concerned about the whole of the globe and every aspect of society - e.g. Christianity and Islam.

To conclude: You no doubt get a lot of spam. So do I. Among much of this, I receive a Newsletter that nevertheless had a thought-provoking paragraph which provides a fitting conclusion to this short paper while also relating it to this time of year:

"The economic revolution of Christmas is described in two ways by Mary in her famous Song that is recorded in the Bible.. God is working, she says, to fill the hungry with good things, and to send the rich away empty-handed. The challenge to all our personal and professional economic policies this Christmas, is to ask to what extent they fill the hungry with good things (not scraps). How much does your personal and professional lifestyle create justice and prosperity for those who need? Or, rather, do your policies send the hungry away and fill the rich with good things? The more influence you have over the finances in your organisation, the more responsibility you have to work for economic justice. Interestingly, Mary makes those statements about God working to fill the hungry with good things and to send the rich away empty-handed, in relation to the same Jesus who later clearly enjoyed parties, drank wine and celebrated living. He was no ascetic kill-joy, though He was a revolutionary. Sending rich shareholders away full and employees away hungry may increase the competitive edge of a company but this is not the spirit of Christmas. It was only 30 years later that this Child of Bethlehem overturned the tables in the Temple. The spirit of Christmas is a challenge to economic revolution."

Some revolutions are happy ones.



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