Mugur Isărescu: Enhancing the role of governance in international business

Address by Mr Mugur Isărescu, Governor of the National Bank of Romania, at the 37th EIBA Annual Conference, Palace of Parliament, Bucharest, 8 December 2011.

*   *   *

Ladies and gentlemen,

Distinguished audience,

It is an honour and, at the same time, a great pleasure to address the 37th edition of the ***Annual Conference of the European Academy of International Business***. Allow me to join the organisers in addressing all participants a warm welcome. I am delighted that Bucharest is hosting today such a momentous event attended by so many guests from among world-famous professionals.

I am also glad to welcome you this evening to the reception offered by ***the National Bank of Romania***. Throughout its 131 years of existence, the NBR, established in 1880 as the 16th central bank in the world, has constantly supported and developed strong ties with the academic community, hosting numerous conferences, encouraging debates and building partnerships aimed at enhancing financial education. In this context, we are happy to contribute these days to the annual gathering of your organisation.

Today's theme – ***governance*** – is quite a vast topic, and was clearly brought to the spotlight by the recent global economic and financial crisis.

When talking about governance, one cannot ignore the times we live and the major economic and financial uncertainties we all are grappling with. Therefore, it is essential to look at trends and changes in the governance in the light of the lessons to be learned from the global financial crisis. It would be an unpardonable mistake by exiting the crisis without learning all its lessons.

Governance can generally be seen as the manner of exercising power in a country's economic and social resource management to ensure its development. It should also apply to the regional and global context.

We all know that good governance means drafting appropriate policies, programmes and regulations that must thereafter be transposed into legislation. The role of the governments, that is of politicians, is obvious here, and institutions play a major part in a country's governance, as the American Nobel laureate ***Douglas North*** noted. I cannot help emphasising this, the more so as our host today is a citadel of legislative power.

There are many aspects one can approach when talking about governance. I would like to say a few words about three levels: macrogovernance, corporate governance and also one of the key themes of these days – governance in the European Union.

Let me begin with macroeconomic governance which is closer to my area of concern.

I do believe that approaching governance in a broader economic context could prove both relevant and useful. In this context, I cannot stop short of underlying how important ***consistent economic policies are for ensuring a sustainable development***, and to repeat my belief ***that there is no substitute for consistent, sound and stability-oriented economic policies***.

Therefore, I will share with you ***some of the lessons*** from my own experience.

First, I will refer to the importance of having a good fiscal and monetary policy mix. If fiscal policy is relaxing, then the natural reaction is to tighten monetary policy. But one should take into account that monetary policy cannot always be a substitute to a sound fiscal policy. In other words, not always and in any circumstances can monetary policy steps compensate for fiscal policy measures.

Secondly, I will touch upon the risks related to pro-cyclical fiscal policies. We have experimented this in Romania and are fully aware on the risks related to the boom-bust cycles. During booms, as budget revenues pick up there is a strong temptation to spend more and no appetite to publicly debate the issue of structural deficits. On the other hand, when bust emerges one realize how limited your toolkit is and that all measures to address the situation translates in to a prolonged recession and GDP volatility.

Last but not least, I will refer to the monetary policy by underlining how essential financial stability is to help achieve our overriding goal which is price stability. As I said before, it is my belief that the two are not conflicting; they may be compatible if your measures are carefully implemented. Over the past few years the NBR has used all its available instruments to fulfil its tasks in the area of ***achieving price stability***, seeking to ensure a ***low volatility of the exchange rate*** – an exchange rate which is set by the market. In short, ***all our steps have focused on maintaining stability and rebuilding confidence***.

In conclusion, over the past 10–15 years most economists have discovered ***good governance – with its four pillars: transparency, accountability, predictability and participation*** – as a major determinant of economic growth. Thus, economic governance implies the need to ensure stable, transparent and predictable rules that encourage competition and fair access to public services. It is achieved through a country's public and private sector institutions and the civil society.

Moreover, the ***recent crisis***, which today wreaks havoc given the structural interdependencies worldwide, ***has underscored the need for an in-depth reform of economic governance at global levels.*** As Mr. Jean-Claude Trichet, the former ECB President, said, in light of the global crisis, "*International interdependencies are too large for purely national or regional rules to be optimal and there is a clear need to strengthen global governance, in particular in the financial field.*"

I would also like to share with you a few thoughts about ***corporate governance***. I'm sure the debates on this topic will be comprehensive during all these days and you, as specialists, will be able to unveil its very generous facets.

These principles on corporate governance are largely part of those adopted in 1999 and subsequently revised by the OECD in 2004. They include equal rights and a level-playing field for shareholders, the role of stakeholders, disclosure and transparency, and board accountability. Corporate governance has direct implications on the behaviour of the organisation towards its employees, shareholders, customers, partners, banks included. Poor governance reduces the potential and, worse though, can lead to financial distress and even fraud, while well-governed companies will usually be more competitive than their rivals and will be able to bring in investors who will invest their money in the companies' future growth.

I will also add that no matter how relevant formal rules are to the proper functioning of an economy, it is essential to trust in business partners' word given and their honesty. Whenever this is missing, not only dealings in goods and services, but also financial transactions are hit hard. Given that integrity, confidence and reputation weigh heavily on the economy, everyone pins his hopes on the business sector. Future wealth depends now more than ever on how this issue is dealt with.

This is why we can assert that, *in extenso*, ***good corporate governance underpins the integrity and efficiency of financial markets***. Moreover, for the banking field, in light of recent developments, I truly believe that ***increased ethics is to be welcomed***. Thus, good practices in corporate governance are an essential ingredient of wealth and sustainable growth.

In this context, ***the need for principles of the above-mentioned international organisations to be supported and adhered to by both private and public sectors becomes increasingly clear***. This should be done by adopting and implementing codes of conduct at corporate level and industry-wide, as well as by improving the legal, institutional and regulatory framework pertaining to corporate governance.

Let me now turn to Europe.

In the case of the European Union, the crisis has exposed fundamental weaknesses of the European economy, revealing growing internal imbalances. The functioning of the European Monetary Union has been under particular stress as the existing surveillance procedures proved to be not comprehensive enough. One point that has been neglected was the relevance of current account deficits. I believe that within the EU, the external deficits of Member States are relevant as they reveal discrepancies related to competitiveness, and therefore inconsistent and weak coherence of the economic policies.

The accumulation of imbalances has triggered a slow pace of recovery in Europe. The crisis took its toll on productivity, and prices and competitiveness remain key issues. Also, the functioning of the European Monetary Union caused headaches because of insufficient comprehensive preventive and supervisory procedures.

Moreover, sovereign debt crisis has brought in the limelight not the crisis of the euro per se but of the institutions that governs the eurozone. ***In this context, I will repeat what Douglas North said: Institutions play a pivotal role in governance. And also*** recall the words of ***ECB chief economist, Mr Otmar Issing***. When he departed the institution, in front of 400 strong audience Mr. Issing reminding us that "***Euro is an unfinished project***", stressing that it relied on the monetary pillar, while enhanced fiscal policies and economic cooperation were still needed.

Therefore, as the recent developments also show, ***a more effective economic governance in the EU and the euro area is within reach*** through fiscal discipline, broader economic oversight, closer coordination, a more robust framework for crisis management, stronger institutions and a decision-making based on clear and strict rules.

In the particular case of the interdependent economies across the EU, enhanced governance will boost economic growth and job creation. At the same time, developing a culture of values and professional conduct and ethics can make a very important contribution to the smooth functioning of markets and this is a prerogative of the corporate sector, the private sector in general.

I'm confident Europe will find the right way to move forward, given the common cultural values, with measures and policies that should avoid both asymmetric and side effects. We all know how harmful sudden and large capital swings are.

Europe's governance raises also the issue at a more global level. In fact, international affairs and corporate governance are an integral part of this picture.

High-profile international financial institutions such as the IMF are concerned and involved particularly in economic governance issues, as they provide assistance in two key areas: *improving public resource management and supporting the development and maintenance of a stable and transparent economic and regulatory environment so as to foster private sector activities*.

Other institutions such as the OECD and the World Bank are involved in corporate governance, with the latter formulating a set of principles such as ethics and transparency, as well as accountability.

To sum up, I should emphasise that corporate governance at present is a matter of greatest concern to the business environment, just the same as we, those involved in formulating macroeconomics, are concerned more broadly with economic governance.

I believe that emphasis now should be placed primarily on discipline, fiscal discipline in particular, but also on a shift in culture. I also like to add two words that I see essential when speaking about economic governance: ***stability and confidence***. ***In my view, all efforts these days should be targeted to maintaining stability and restore confidence.***

Thank you all!