ISSUES IN RISK MANAGEMENT
THE INTERNATIONAL ECONOMY POST-CRISIS – HOW MUCH DAMAGE?

The Failures of Risk Management at the Micro (Corporate, Capital Markets) & Macro (Governmental) Levels - Including Assessments of the Basel II & III Accords, The European Systemic Risk Board (ESRB) and Solvency II and the international trading system (WTO).

Karl William VIEHE,
B.A., M.A., J.D., M.L.T.

With all of the focus in academe over the past three decades in the subject of risk management, it should be shocking that the international merchant community has found itself faced with an economic crisis of a magnitude comparable to the great depression of the 1930s. It is inevitable that the intellectual community must scrutinize the inability of domestic and international institutions to fend off the current crisis.

A number of the so-called quote global" issues will be discussed briefly below but, in the end, the great failure arises out of a combination of populism, political arrogance and managerial ineptitude.

The increased globalization over the past two decades and, in particular, more so in the past decade, while not a directly causative factor, nevertheless has been a major indirect factor of the current crisis. The reason is that techniques have been developed-particularly securitization - that shift risk away from its origins. This is certainly most evident in the case of the securitization of manifold financial instruments e.g. mortgages, automobile and credit card loans that were packaged by investment banks and sold all over the world to central banks, commercial banks, pension funds and other institutional investors. The risk is heightened by the fact that there are no effective coordinating institutions to measure the worldwide exposure faced by the industrial, financial and governmental sectors. For three years the United States has been wrestling with legal measures to rectify the economic damage done over the past decade and manifested at the outset of the crisis in September 2008. Even now we are seeing the European Union increasingly faced by the same issues that have faced the U.S. since September 2008. One major question facing the financial community at this time is whether China and India and to a lesser extent Brazil will be faced with the same issues with respect to an effective risk management.

Another factor in the issue of an effective risk management is that both the academic communities and the business communities became far too enamored with the ability of mathematical models to provide precise measurement of the full panoply of market risk. The current risk failure was foreshadowed by the Long Term Capital Management (LTCM) collapse in 1998. And, although mathematical models provide excellent paradigms for analyzing key variables in the marketplace, ultimately consumer behavior has a randomness that does not lend itself to stochastic analysis.

Governments of all genres are far too involved in economic micromanagement. Markets need the broad parameters that provide for a stable business climate and moderate frames of reference for business conduct. The unfortunate reality is that governments today all over the world are in the business of government and, first and foremost, they are in the business of institutional self-preservation. Indeed, the future of the European Union and, in particular, the euro zone sufficiently depends upon the ability of the transnational elites to juggle the interests of their own self-preservation against the instinctual reaction of the citizenry of the member states.

Much of the world has endured an economic malaise which began with the financial crisis and United States in September/October 2008. The magnitude of the US economy relative to that of other countries has created a ripple effect which has slowed the growth throughout the world. Of the so-called BRIC countries, Brazil China and India, have managed to maintain growth remarkably well in view of the catastrophic economic impact on the US and European economies. Of the BRIC countries, only Russia with its proximity to and dependence on the European economies have experienced a continuing economic malaise.

Throughout the world most of the talk and writing of political pundits address the issue of the financial component of the crisis, specifically, the sovereign debt crisis and its impact on the financial institutions in the United States and the European Union.

A neglected aspect of the analyses is the impact of the crisis on the world trading system and, in particular, the WTO. It is arguable that the crisis revealed the fact that, indeed, there is no true international rule of law, that is, all law is national subject only to a particular nation's acceptance of the convenience of rules of law parameter is by treaties and conventions.

In the nine months following the outbreak of the crisis in September/October 2008, at the time of the cram-down bankruptcies of General Motors and Chrysler Corporation many in the legal community question the comportment of federal governmental legal procedures in terms of constitutionality and consistency with historical legal tradition.

Although the WTO continues to function and issues interesting findings such as those with respect to the Boeing/Airbus crises and the most recent ruling with respect to the Chinese restriction of the export of certain rare earth elements, it seems clear that it is important to question whether rules of law matter at all or whether WTO member countries will simply ignore the mandates of WTO rulings.

Much of the debate of the Boeing/Airbus dispute arises with respect to the legality under trading rules of various types of assistance to the respective companies. But the amount of that assistance pales in comparison to the approximately $80 billion of federal "loans" that had been provided to GM and Chrysler in the pre-and post-bankruptcy period. Throughout the European and Russian auto, truck and machine tool industries similar substantial infusions of capital have been provided. With respect to China, much of the auto industry is derivative of the military-industrial complex and its related large-scale industrial enterprises, so it's clear that China would not come to the table in a WTO dispute resolution on the matter of state subsidization with entirely “clean hands.”

The recent decision by the WTO the China is in violation of trade rules by restricting its export of a variety of rare earth elements raises extraordinarily interesting issues. For example, although oil & gas are not covered by WTO regulations, it certainly not hard to imagine that importing countries would much like to make a demand of oil and gas exporting countries that said exporters are in violation of international fair trade regulated norms by restricting their exports. Indeed, demanding countries could make the same argument against export restrictions on all types of goods and services.

In a sense, this is the flip - side of the argument that the United States is making with respect to its recently passed health care legislation, the so-called Obama Care Health program, which its opponents argue will necessitate all American citizens to purchase healthcare. Clearly citizens of all countries around the globe are "required" to purchase governmental services whether or not they agree with the quality and quantity of those services. Indeed, as we have seen with the dissolution of the Soviet Empire and the recent events in the Middle East, at times the citizenry will reject a socio – political order. The Obama Care opponents are arguing that the federal government in the United

States is moving in a direction which will ultimately require American citizens to purchase not only governmental services all kinds of goods and services which are now provided by the private sector, but under the mandate of public purchase requirements, the private sector suppliers of goods and services would ultimately be driven out of business. It is with the same line of reasoning that Chinese suppliers, for the most part admittedly controlled by the central government, are mandated to supply the market with rare earth elements.

The interesting thing about the WTO is that over the 60 years of its evolution from its precursor, the GATT, there are a number of important sectors of the economy which are not covered by the WTO rules. These include agriculture, maritime businesses, phyto-sanitary issues, oil & gas and, of course, important defense-related industries.

It is too early to assess the damage to the world trading system that might result from USA and EU policies adopted following the 2008 international financial crisis. However, the danger is real and it could parallel the perils faced by the European Monetary Union with respect to the current euro crisis.

It is quite possible that the monetary union could dissolve or that one or more of its members may elect to leave the monetary union. If this does happen, it does not necessarily imply that the trade agreement, which is the nucleus of the European Union, would necessarily dissolve or even been diminished.

Note - Karl William Viehe, B.A., M.A., J.D., M.L.T. - Mr. Viehe has been the U.S. Vice Chairman of the Russian - American Securities Law working group. In this capacity, Mr. Viehe was a principal drafter of the Russian Capital Markets legal structure implemented 28 December 1991 by President Yeltsin. The co-chairman of the working group was Dr. YegorGaidar, named shortly thereafter as Acting Prime Minister, on the Russian side, and, on the American side, Mr. Richard Bernard, Executive Vice President, General Counsel, New York Stock Exchange from 1997 until 2007. Mr. Viehe drafted substantial portions of U.S. AID's Commercial Bank Training Program, also contributing significantly to the commercial bank training program implemented by the World Bank.

Mr. Viehe has been an Adjunct Professor of International Law (and, in 1995, designated as the "Scholar in Residence" at the National Law Center) at the George Washington University, Washington D.C., and Adjunct Professor of International Business at the American University, Washington, D.C. and a member of the faculty at the International Law Institute, Washington D.C. Mr. Viehe has also taught at St Albans School (National Cathedral School for Boys) and Georgetown Visitation School.

Mr. Viehe has twice been Co-chairman, with the General Counsel of the Department of Commerce, of the U.S. Department of Commerce annual conference on "Current Issues in International Trade" and three times co-chairman, with the Internal Revenue Service Assistant Commissioner(International), of the United States Internal Revenue Service's annual conference on "Current Issues in International Taxation." These events have been co-sponsored by The George Washington University.

Mr. Viehe has provided legal consultation, guidance and advice on Eurasian market projects to CONOCO, Chrysler Corporation, Marriott, General Motors and a number of other U.S. companies.

In 1995, as a member of the Pugwash Society, Dr. Viehe shared in the Nobel Peace Prize awarded to that society for its more than half a century working towards world peace.

Mr. Viehe has spoken at international conferences and/or meetings in the United States, China, Japan, Mexico, Russia, Ukraine, Turkey, Kazakhstan, Poland, Hungary, Bulgaria, Belorussia, Armenia and Georgia and authored more than twenty publications.

BUSINESS CONSULTATIONS

1990 to 1996: - Consultation to the World Bank, the United States Information Agency and the Central Bank of Russia on the development of training curricula for the training of commercial bankers throughout Russia. A substantial part of the training program was based on the curriculum I provided.

1991 to 1995:

CONOCO Oil - Consultation on "Polar Lights" oil project in Russia, a $440 million dollar investment. Included liaison with the Department of the Treasury, Department of Commerce, the United States Federal Reserve, The U.S. Export-Import Bank, the Overseas Private Investment Corporation (OPIC) and various agencies of the World Bank.

1991 to 1994: - Consultation with a U. S. auto dealership group and Chrysler Corporation on various projects in Russia, including a project to establish dealerships in eleven cities, mostly in capitals of republics of the constituent states of the former Soviet Union. This project was terminated shortly after the events of October, 1993 at the Russian White House, due to the perception of excessive political risk.

1996 - 1997: - U.S. General Counsel for PromstroiBank of Russia (Industrial Bank of Russia). Consultation on successful strategy to have PromstroiBank registered as the only Russian bank to be accredited in the United States, both by the State of New York and the United States Federal Reserve Bank. PromstroiBank became insolvent in the 1998 Russian financial collapse and was subsequently liquidated..

1996 - 1999: - Conceived of and initiated application for the first financial instrument guarantee issued by the World Bank's Multilateral Investment Guarantee Agency; successfully developed strategy and guided the recipient to issue of the guarantee to an investment fund for Ukraine, listed on the Irish stock exchange, in the amount of $100 million.

1992 to 2002: - Consultation to General Motors in Russia on various projects, most recently personal consultation with the President of General Motors, Russia in the Chevrolet - Niva Project, which commenced production of a sport - utility vehicle in September 2002, with a capitalization of $330 million.

2005 to 2010: - Consultation to Sojitz Company (www.sojitz.com) in Russia on various projects in the oil & gas and automotive industries. Sojitz is a large Japanese trading company with annual revenues in excess of $ 40 billion. Current projects include liquefaction of natural gas and retooling of Russian automotive industrial enterprises, with project values in excess of $ 10 billion.

2007 to 2009: - Consultation to Gaz Group (www.gaz.ru) in Russia on various projects involving the economic and financial structuring of deals for the installation of automobile productions lines. Gaz is the largest Russian producers of buses, trucks and cars with annual revenues in excess of $ 6 billion. Current projects include retooling of Russian automotive industrial enterprises, with project values in excess of $ 1 billion.

2009 to Present: - Editorial Consultation – John Wiley & Sons Publishers. New York, New York. Consultation on various advanced technical mathematics publications, including Technical Mathematics with Calculus (Calter&Calter, 6th Edition 2011).

2010 to Present: - Editorial Consultation – McGraw Hill Publishers. Boston, Massachusetts. Consultation on various advanced university technical mathematics publications, including Miller, O'Neill & Hyde Introductory Algebra, 3rd Edition. 2011

2010 to Present: - Strategic Planning, Investment – Alemar Investment Bank. Moscow, Russia. Advising on Structuring Sophisticated Financial Instruments & Investments in the Post- crisis Environment.