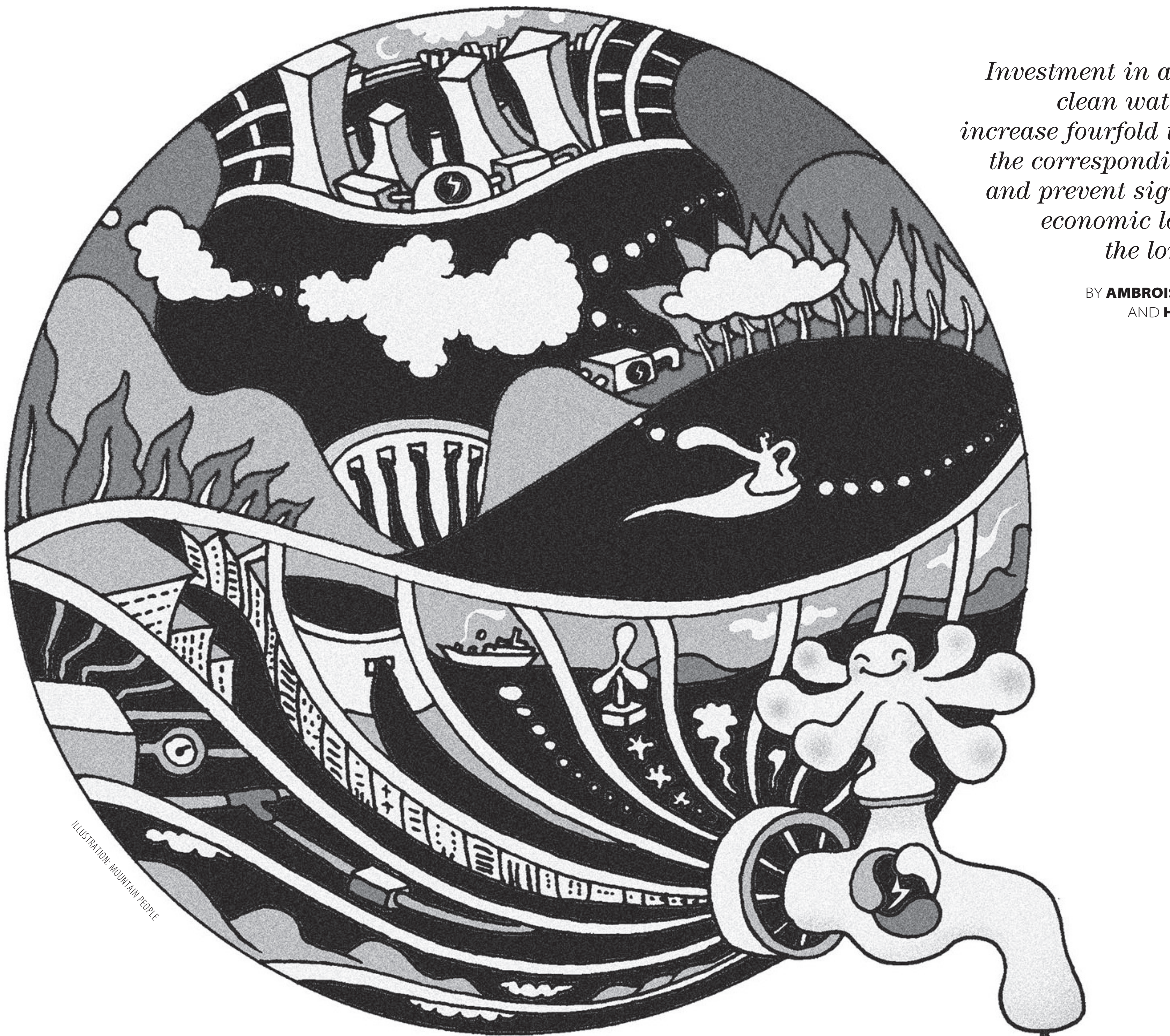


ILLUSTRATION: MOUNTAIN PEOPLE

The water crisis is a vital investment opportunity

Investment in access to clean water must increase fourfold to reach the corresponding SDG and prevent significant economic losses in the long term

BY **AMBROISE FAYOLLE** AND **HENK OVINK**

Together with air, water is arguably the planet's most important natural resource. Functioning water systems are one of the technological pillars of civilization, which often makes a water crisis a matter of life or death.

Today, about 2 billion people lack access to safe drinking water, and about half the world's population experiences severe water scarcity for at least part of the year. Our limited freshwater resources are overburdened by growing populations and water-thirsty economies. By 2030, global water demand is expected to have exceeded the sustainable supply by 40 percent. As demand for water grows and temperatures rise, water scarcity is to threaten more lives and livelihoods — and thus the stability of societies around the world.

How can we turn the tide so that water empowers communities, secures economies and keeps the planet livable? As with global public goods such as a clean environment, there is a tendency to focus on the costs of improvement today, rather than on the greater long-term benefits of investing in the preservation of natural resources. The water sector today is underfinanced and chronically short of capacity to meet demand.

However, if we want to achieve the Sustainable Development Goal (SDG) of ensuring clean water and sanitation for everyone, we must increase global spending on water fourfold, to more than US$1 trillion per year, or about 1.21 percent of global GDP. We also must make up for the US$470 billion we lose every year through flood damage and poor irrigation.

By protecting the environment and the climate, every cent invested in the water sector boosts our economies, now and in the future.

When the European Investment Bank in December last year provided a 200 million euros (US$217 million) loan to Jordan to finance a desalination plant on the Red Sea and a pipeline to the capital, Amman, Jordanian Minister of Planning and International Cooperation Zeina Toukan described these projects as crucial for water security and comprehensive economic development.

We all need to adopt similar thinking about how we value and manage water.

As with many other challenges, the public sector cannot fill this large investment gap alone. Businesses have an important role to play.

Estimates by CDP, a nonprofit organization that collects environmental-impact data, show that more than US$300 billion of business value is at risk globally if no action is taken to address water scarcity. Yet it would cost only one-fifth of that total, or about US$55 billion, to tackle the problem.

If businesses deploy new technologies to reduce their water consumption and to exploit wastewater as a source of energy, heat, nutrients and materials, they can reduce their environmental footprint and free up more water for use by others.

The CDP estimates such "water-related opportunities" at US$711 billion, reflecting not just savings on water use, but also the growth of long-term potential markets in water-smart technology and the benefits of better community relations.

Because water is cheap in most parts of the world, businesses often have little incentive to invest in saving water or in boosting the efficiency of water-intensive production processes. To persuade the private sector to focus on water-system preservation, we first need to start thinking of money spent on water as a real investment, rather than as a cost that can never be recovered.

Second, the right value must be assigned to this water to create the necessary incentives for users and businesses to use it more efficiently, and for preservation to be economically rewarding. In the case of water, this requires a delicate balancing act, because affordable access to drinkable water and sanitation is a recognized human right — which means it is nonnegotiable.

Third, global cooperation and new cross-border programs to mobilize greater investments in water would overcome market failures, and prevent water from being politicized and weaponized.

This week's UN Water Conference in New York, the first such gathering since 1977, is a unique opportunity to discuss water security and tackle the crisis head-on, as well as to acknowledge that water investment is as critical to a sustainable and just economy as is clean-energy investment.

We can establish new guidelines for fixing the water cycle and ensuring a more holistic approach to sustainable development everywhere, from the Netherlands and Luxembourg to Nigeria and Laos. We must also find more ways to incentivize water financing from public and private sources that are willing to wait for their investments to bear fruit.

Water is what is to carry the SDGs across the finish line. We must finally start recognizing it as a fundamental part of our investment portfolios, and put it at the center of our economic policies.

Ambroise Fayolle is vice president of the European Investment Bank. Henk Ovink is the Dutch special envoy for international water affairs.

It's regulations on banks, stupid

The ongoing banking crisis shows that regulating the sector does not work

BY **ANTONIO FOGLIA**

Do more bank "bailouts" amount to more proof that capitalism does not work? Some commentators seem to think so.

However, what capitalism are they talking about? It has been a long time since there was any trace of market discipline or capitalism in banking, one of the most heavily regulated industries of all.

Coming on the heels of the travails of Banco Popular and other banks, the failure of Silicon Valley Bank (SVB) is another case of an institution collapsing overnight without breaching any of the many prudential regulations by which it was governed.

The 2008 global financial crisis exposed the horrendous mistakes that banking regulators had made in the preceding years, but rather than correcting them and developing a robust understanding of why these errors were committed and how they could be avoided in the future, politicians and the public at the time demanded that supervisory authorities simply double down on regulation.

So, that is what they did, and we are now seeing the results.

The main mistake in contemporary banking regulation is the requirement of only a razor-thin capital cushion. This is an artifact of a previous era. It is based on the capital that Japanese zombie banks had in the 1990s, reflecting the desire among those writing the international banking regulation framework, known as "Basel rules," not to embarrass their colleagues at the Bank of Japan.

After the global financial crisis, it was again too embarrassing to recognize the extent of this mistake, so policymakers and regulators settled on a more gradual approach.

As a result, capital as a share of total assets has risen by less than 30 percent in Europe and the US since 2007.

True, Tier 1 ratios (the ratio of equity and reserves to risk-weighted assets) improved by more, but that was largely achieved by tweaking the rules for calculating the numerator and the denominator. Capital would have tripled if banks had been required to carry the same ratio that hedge funds carry voluntarily for the same level of risk.

Look at SVB. It had US$200 billion in assets, US$86 billion of which was in residential mortgage-backed securities that are not due for at least 10 years, and which are carried on a held-to-maturity basis. At fair value, though, this paper was worth only US$71 billion, implying a US$15 billion loss. That amount was more than enough to wipe out the bank's US$12 billion in capital, and it was written clearly in the bank's financial statements last year.

In practice, the prevailing "prudential" regulations allowed SVB to leverage its capital more than 10-fold on that book of risky securities. Given the volatility of the assets, that is insane. Even an aggressive hedge fund would not have leveraged such a book by more than threefold.

However, SVB was allowed to operate and publish a Tier 1 ratio of 12 percent, well within the "prudential" limits.

That brings us to the second major uncorrected mistake of banking regulation: Solvency is assumed to rest on a held-to-maturity basis.

Even "conservative" banking experts such as John Vickers, a former chief economist of the Bank of England, seem to accept this.

However, would Vickers leave a deposit with a bank that is insolvent on a mark-to-market basis? No, he would not, and nor did SVB's depositors. When they finally realized what should have been clear for many months, they tried to withdraw their money as fast as they could.

This problem would seem to apply only to the US.

In Europe, regulators have reined in liabilities (through the net-stable-funding ratio) and assets (through the liquidity-coverage ratio), so this kind of mismatch should not happen, but as comforting as this arrangement might be, it also means that the authorities have regulated the interbank lending market out of existence — and probably the banks as well.

Who would leave a deposit at a bank that can achieve only yields below those of the high-quality liquid assets in which the banks and depositors themselves can invest? Banks would remain confined to the payments business, at least until central bank digital currencies arrive, and transfer that business to the "central bankrupters," too.

Do we want capitalism or not? If we do, we need to get rid of the failed regulations (and regulators), and end the "status quo" in which central bankers preside over monetary policies with long, variable and lagging effects, and hence have an impact on future economic conditions that they cannot predict.

We also need to stop thinking that bank deposits are the only financial asset whose price is fixed at par and guaranteed by the nanny state. If banks financed themselves through traded certificates of deposit (CD), crises like the current one would not happen. SVB's CDs might be priced at 85 percent, owing to the uncertainty surrounding a liquidation or a recapitalization, but there never would have been a run on the bank. The runs happen only because the first 85 percent of people in line would get par, while only the last 15 percent would get zero.

Antonio Foglia, a board member of Banca del Ceresio, is a member of the Global Partners' Council of the Institute for New Economic Thinking.

THE NEW WORLD ECONOMY

BY **JEFFREY D. SACHS**

The global banking crisis and the world economy

After stabilizing the banking sector, governments should work to ease geopolitical tensions that weigh on the economy

The banking crisis that hit Silicon Valley Bank (SVB) last week has spread. We recall with a shudder two recent financial contagions: the 1997 Asian financial crisis, which led to a deep Asian recession, and the 2008 financial crisis, which led to a global downturn.

The new banking crisis hits a world economy already disrupted by the COVID-19 pandemic, war, sanctions, geopolitical tensions and climate shocks.

At the root of the current banking crisis is the tightening of monetary conditions by the US Federal Reserve and the European Central Bank (ECB) after years of expansionary monetary policy.

In the past few years, the Fed and the ECB held interest rates near zero and flooded the economy with liquidity, especially in response to the pandemic. Easy money resulted in inflation last year, and the two central banks began tightening monetary policy and raising interest rates to staunch inflation.

Banks like SVB take in short-term deposits and use them to make long-term investments.

The banks pay interest on the deposits and aim for higher returns on the long-term investments. When central banks raise short-term interest rates, rates paid on deposits might exceed the earnings on long-term investments. In that case, the banks' earnings and capital fall. Banks might need to raise more capital to stay safe and in operation. In extreme cases, some banks fail.

Even a solvent bank might fail if depositors panic and suddenly try to withdraw their deposits, an event known as a bank run. Each depositor dashes to withdraw deposits ahead of the others. As the bank's assets are tied up in long-term investments, it lacks the liquidity to provide ready cash to the panicked depositors.

SVB succumbed to such a bank run and was quickly taken over by the US government.

Bank runs are a standard risk, but can be avoided in three ways. First, banks should keep enough capital to absorb losses. Second, in the event of a bank run, central banks should provide banks with emergency liquidity, thereby ending the panic. Third, government deposit insurance should calm depositors.

All three mechanisms might have failed in the case of SVB. First, SVB apparently allowed its balance sheet to become seriously impaired, and regulators did not react in time. Second, for unclear reasons, US regulators closed SVB rather than provide emergency central bank liquidity. Third, US deposit insurance guaranteed deposits only up to US$250,000, and so did not stop a run by large depositors.

After the run, US regulators announced they would guarantee all deposits.

The immediate question is whether SVB's failure is the start of a more general bank crisis. The rise of market interest rates caused by Fed and ECB tightening has impaired other banks as well. Now that a banking crisis has occurred, panics by depositors are more likely.

Future bank runs can be avoided if the world's central banks provide ample liquidity to banks facing runs. The Swiss central bank provided a loan to Credit Suisse for exactly this reason, and the Fed has provided US$152 billion in new lending to US banks in the past few days.

However, emergency lending partly offsets the central banks' efforts to control inflation. Central banks are in a quandary. By pushing up interest rates, they make bank runs more likely, but if they keep interest rates too low, inflationary pressures are likely to persist.

The central banks are likely to try to have it both ways: higher interest rates plus emergency liquidity, if needed. This is the right approach, but comes with costs. The US and European economies were already experiencing stagflation: high inflation and slowing growth.

The crisis is likely to worsen the stagflation, and possibly tip the US and Europe into recession.

Some of the stagflation was the consequence of the pandemic, which induced the central banks to pump in massive liquidity in 2020, causing inflation that materialized last year.

Some of the stagflation is the result of shocks caused by long-term climate change. Climate shocks could become worse this year if a new El Nino develops in the Pacific, as scientists say is increasingly likely.

Yet stagflation has also been intensified by economic disruptions caused by Moscow's invasion of Ukraine, US and EU sanctions against Russia, and rising tensions between the US and China. These geopolitical factors have disrupted the world economy by hitting supply chains, pushing up costs and prices while hindering output.

We should regard diplomacy as a key macroeconomic tool. If diplomacy is used to end the Ukraine war, phase out the costly sanctions on Russia and reduce tensions between the US and China, not only would the world be much safer, but stagflation would also be eased.

Peace and cooperation are the best remedies to rising economic risks.

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