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Does money rule the world?

On the role of the international financial markets in globalization, public finance and financing development

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Does Money rule the World?
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Summary

The liberalisation and deregulation of the financial markets since 1973 was the economic trigger for the present wave of globalization. The free floating of exchange rates, and the subsequent liberalisation as well as the deregulation of the financial markets played a decisive role for the formation of the present day financial markets.
The original role of the financial markets previously consisted in providing services to the real economy. In the meantime, this subordinate function has been reversed so that the financial sector now dominates the rest of the economy.
This lead to a dramatic growth in financial transfers – up to 3 billion USD per trading day in 2007 - which is increasingly detached from the real economy. However, this separation is relative. If a crisis develops, this hits the real economy and thus also affects jobs and society.
The worldwide speculation business and arbitrage with foreign currencies, interest rates and share prices became an independent source of profit. Extreme short-termism now dominates all portfolio investment strategies.
A basically new process is securitization. Loans are converted into securities and then traded on the market. In this way, the financial market interferes with the traditional relationship between bank and borrower. Large companies no longer seek finance from their bank but obtain it from the financial markets.
At the same time, new financial products, derivatives, became available. Whereas they serve to cushion risks that arise from the increasing instability of the financial sector at the micro level, they accentuate systemic instability at the macro level.
The institutional investor is an innovation which has attained particular importance over the last decade. This represents the institutionalisation and professionalisation of the proprietor function. The sole interest of the institutional investor is the maximisation of profit for the proprietor, the shareholder. This shareholder orientation is being increasingly transferred to the real economy. Other business objectives are neglected.
The emergence of transnational financial markets has developed new and superior sources of high profit. Today, a 25% return on investment is the norm for leading financial market actors. This is the reason why capital holders prefer to invest their money in the new financial market business. The result is a structural weakness for investment in the real economy with negative consequences on economic growth and jobs.
At the same time, the financial sector's instability and vulnerability to crises has increased considerably. Financial crises occur more frequently. The latest proof is the 2007/08 crisis which started as a subprime mortgage crisis in the USA and turned into an international bank and credit crisis with considerable effects on the real economy. It is the most serious financial crisis since the Second World War. Essential characteristics of this instability are exchange rate volatility, short-termism, high risk funds, offshore centres, derivatives, pro-cyclic behaviour ("herd behaviour") and the risk of being infected by the crisis. The vulnerable developing and emerging market economies are particularly affected from the effects of the crisis on real economy.
Altogether, these new developments have in the meantime lead to a new wealth accumulation regime which is extremely focussed on property and capital. Structurally, it affects national economies and the world economy.
The multilateral financial and economic institutions such as the IMF, World Bank, WTO, the Bank for International Settlements, etc., participate with a leading role in establishing this new regime.
We are dealing with a radical change of historic dimensions, a system change comparable to the revolution of Fordism and Taylorism. It is not only an economic process but also affects

everyday life. It amounts to a structural and functional change from the nation-state to the competitive state. The classic welfare state is dismantled. It aggravates the polarisation of society and increases precarity. The cake is growing, but the piece which the financial markets cut out for themselves gets bigger and bigger, and what is left for others becomes smaller.
The capacities for democratic policies within the nation-state are being limited. The transnationalisation of the economy leads to the erosion of democracy.
Public finances are under pressure from two sides: On the one hand, the public spending ratio and public expenditure is reduced, and on the other hand, the public revenue is under pressure because of the erosion of the tax base. The result is a restriction of the political leeway for political institutions. Social disintegration and a growing risk of political destabilization are the consequences.
Civil society must deal with the role of financial markets in globalisation more systematically. A democratic, socially just and ecologically sustainable form of globalisation will not be possible without fundamental reforms of the financial markets.
Numerous suggestions are presented in this text. Taxation of foreign currency transactions, capital transfer controls and – in the medium term - the creation of regional currency unions - are introduced to cushion exchange rate problems.
The short term orientation of the financial markets must be repulsed. Instruments for this are capital controls and taxation with a corresponding governance function.
Institutional investors, especially hedge funds, private equity funds and REITS must be subjected to political regulation. A restriction of leverage is especially necessary to mitigate the risk of taking up highly leveraged credit. Additionally, long-term investors should be given extended voting rights and employee participation must be developed. Important public services, such as social welfare, as well as important infrastructure areas such as transport and energy should be withdrawn from the shareholder dynamic and be publicly controlled. Institutional investors who operate from offshore centres and tax paradises should be banned from operations.
The economic functions of offshore centres and tax havens are to be neutralized through international political pressure and instruments such as taxes on banking secrecy.

Unconditional and complete debt relief is necessary for the Highly Indebted Poor Countries (HIPCs), together with an international insolvency law.

The rating system must be public and organized within the context of financial supervision. Financial supervision in general has to be strengthened and internationalised. The central banks must be subject to democratic control.
Reforms of the multilateral finance institutions to support these measures are suggested in this text. Firstly, these include democratization of the IMF and the World Bank, restricting the IMF to its original mandate as lender of last resort and the abolition of neo-liberal structural adjustment policies. The regionalization of development financing should be promoted, including efforts which are independent of Bretton Woods institutions. The role of the UNCTAD should be reinforced and in the long term, the ECOSOC should increasingly be upgraded as the central institution of economic regulation.
Innovative instruments have to be developed to enable the financing of global public goods such as development and environment. An important role is assigned to international taxation.
The prerequisites for reforms are good at present. The increasing legitimacy crisis of the neo-liberal model strengthens the chances of emancipatory alternatives.

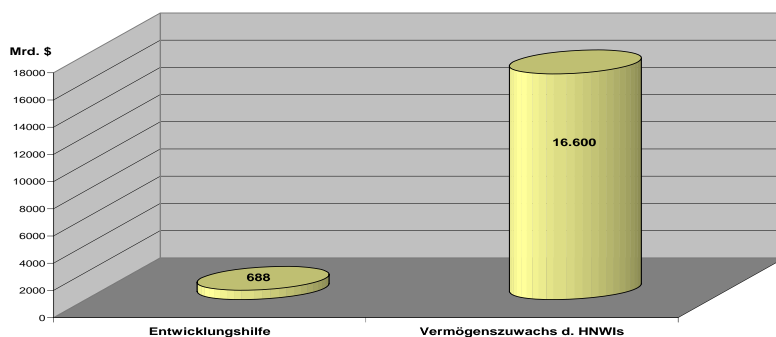
Berlin, April 2008

Introduction

"*The number of people suffering from hunger has not decreased, it has risen from 840 million people in 1996 to 854 million people in 2005.*"
"*The financial capital of the HNWI amounts to $33.3 billion which means an increase of 8.5%.*"

These were two items of information in the media in the spring of 2006. The first results from a ten year assessment after the FAO World Food Summit which took place in Rome in 1996 and planned to halve the number of people suffering from hunger in the world by 2015.
The second news item is from the World Wealth Report (WWR) of 2006, which Merrill Lynch and Capgemini issue annually. The HNWI acronym, an abbreviation that needs getting used to, signifies *High Net Worth Individual*. This does not refer to untiring fighters for an ethically higher cause. Instead, these HNWI are people who have liquid capital (that is, excluding property, production facilities and luxury goods) to the extent of a million U.S. dollars or more at hand.
This wealth increased by 2.6 billion U.S. dollars from 2004 to 2005. Within ten years, the HNWIs doubled their wealth from 16.6 billion U.S. dollars to 33.3 billion. The number of HNWIs also doubled within this time period. In 2005, there were 8.7 million HNWIs worldwide. To help visualise the dimensions, we should know that the accumulated development aid of the OECD states amounted to 688 thousand million U.S. dollars (OECD 2006) during the same time period (1995-2005). That is barely 4% of the wealth increase of the HNWIs (Figure 1).

Figure 1: Development aid from the OECD countries and wealth increase of HNWIs in thousand million USD (1995-2005)



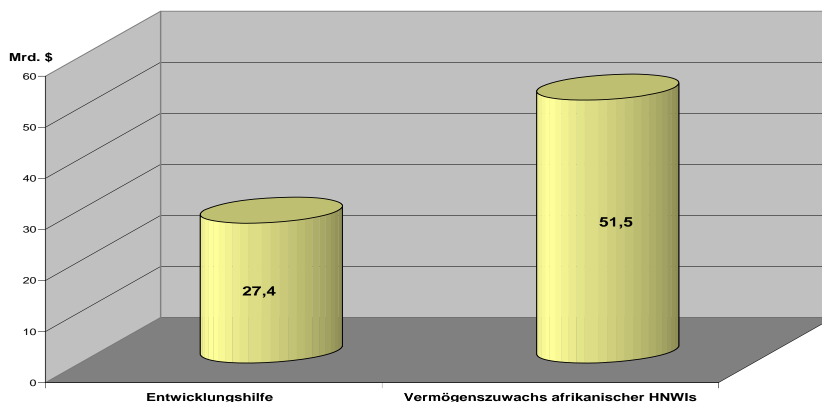
Sources: OECD 2006, Merrill Lynch 2006

Development aid, capital growth of HNWIs

It is also interesting that the strongest increase in HNWIs is occurring in Africa. In Africa, the number of HNWIs increased by 11.5% from 2004 to 2005. The Middle East (9.8%) is in second place. In terms of liquid funds, the African continent was in second place with 14.5%. In absolute numbers, the increase amounted to 51.5 thousand million USD. Approximately 87,000 Africans, a little less than 0.01% of the overall population, are beneficiaries of this kind of growth.
For comparison: African countries received a total sum of 24.7 thousand million USD in development aid which was not quite half of the wealth increase of the HNWIs (Figure 2) in

2005. The WWR estimates that by 2010 capital assets in Africa will increase by another 5.2%. Nevertheless, at the same time, the World Bank forecasts that poverty in Africa will increase and that "by 2030 more than three quarters of the population of Sub-Saharan Africa will be among the poorest in the world."[1]
The enormous growth in capital assets worldwide, also in Africa, is mostly due to the clever use of opportunities provided by international financial markets. For example, the rates of return for internationally traded titles at the Johannesburg stock exchange amounted to 43% in 2005. The private equity funds that have been nicknamed as locusts were particularly lucrative. "*The worldwide profits obtained by private equity funds increased by 314% from 42 thousand million USD in 2004 to 174 thousand million USD in 2005."*[2] New actors such as institutional investors, innovative financial products like derivatives, offshore centres and tax havens, arbitrage and speculative transactions have enabled the accumulation of capital wealth on a scale never seen before in the previous history of mankind. The globalised financial markets have developed into a genuine money making machine for those with access to them and who know how to make use of them.

Figure 2: Development aid to Africa and increase in capital assets of African HNWIs in 2005 (thousand million USD)



Development aid, wealth increase of African HNWIs

Sources: OECD 2006, Merrill Lynch 2006

The main issue now is to regulate the markets in such a way that their potential can not only be productively used for the few winners of globalization, but also by the broad mass of others who to date have been among the losers, especially the poor and the marginalised who live precariously. Whoever speaks of poverty cannot be silent about wealth.
The financial markets have an enormous potential. A small taxation on the foreign currency transactions in the range of one hundredth per cent would produce sums that the development politicians do not even dare dream about in their 0.7% universe. Alternatively, 233 thousand million USD could be raised with a solidarity tax of 0.7% on the capital assets of HNWIs. This is more than double the amount of worldwide development aid.

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1 World Bank (2006): Global Economic Prospects. Managing the Next Wave of Globalization. Washington. p. 79
2 WWR p. 14

In 2007, we celebrated the 37th anniversary of failing to meet the 0.7% target. This should be the incentive to deal more intensively with the systemic questions of our global financial system. There is enough money available out there. It only needs to be distributed properly. We hope that this publication provides some incentives.

1. Basic structures and dynamics of the financial markets

Money lubricates the economy. In its various forms of cash, cheques, credit cards, securities, derivatives or electronic deposits, money is present in practically all economic processes. It fulfils several functions:

a.) money is an instrument of economic measurement as well as a medium of exchange, the means of payment in all economic areas: consumption, production, services, trade, investment.

b.) money functions as a capital accumulator: money has played this role for a long time. However, the importance of this role has grown enormously in comparison with other forms of wealth accumulation (production facilities, real estate, luxury goods). All currencies are not equal in this respect, however. There is a hierarchy, and the U.S. dollar is at the top (see chapter 1.3.).

c.) money is an instrument for increasing the potential of real economic activities since it can reinforce equity capital with borrowed capital in the form of credit, interest, deposits or portfolio investment. Credit and interest also have a steering effect. If the conditions are better than in other areas, capital is attracted.

All these functions are indispensable to a modern society. In this respect, money is more than a medium of exchange, it is a "social institution“(Guttman 1996: 95). In line with the significance of money, the financial market has developed as a separate sector of the economy. Traditionally, this sector was in turn subdivided into three essential partial markets: currency markets, credit markets and securities markets. However, an increasingly stronger integration of these partial markets has taken place in the course of the changes over the last two decades.

Actors on the financial markets are mainly banks, insurance companies, investment funds, stock exchanges, rating agencies and other service providers grouped around these. The financial services industry has exhibited above average growth over the last decades, has undergone strong differentiation and gained greatly in significance.

d.) Whereas the finance sector originally provided a service function to the real economy and was subordinate, it has detached itself or “unleashed” itself from the real economy during recent decades. The service function still remains, but alongside this, it has established an area of activity which operates independently of the real economy and follows a logic of its own and interests of its own. Roughly speaking, the objective in this new sector is to earn money with money, without intermediary real economic processes, production or the trade in goods and services.

This sector has grown enormously over the past two decades (see Figure 3). More importantly, this sector has developed a dynamic that influences other sectors of the economy and society. Tectonic movements of historical consequences are taking place. A new model has started to establish itself with the financial markets as centre and catalyst. It substitutes the politically regulated market economy model which evolved in the USA after the world economic crisis and spread to Western Europe after the Second World War.

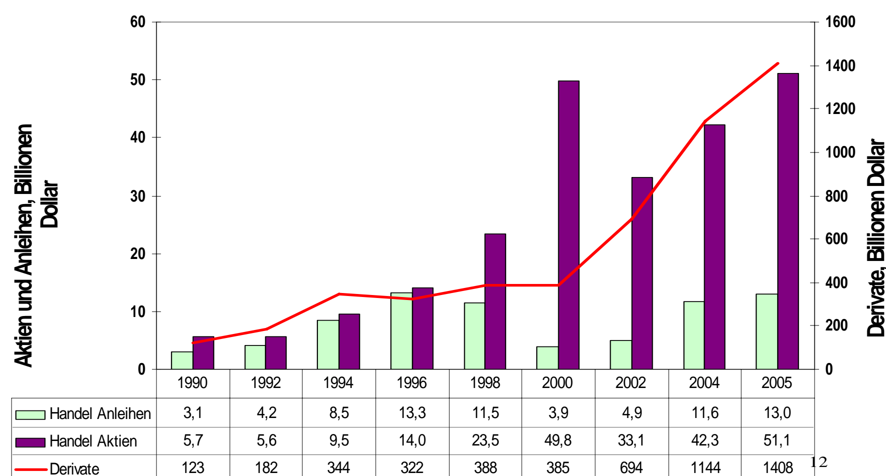
The conceptual prerequisites of this new paradigm are sketched out in neoclassicism and monetarism. It can be considered a socio-political project in combination with the political processes which contributed to establishing the new paradigm: neo-liberalism. Its core elements are:

- the market is the central regulator and superior to all other regulation authorities,
- free competition is the executor of its laws:

- where the market and competition cannot yet develop freely, liberalisation[3], deregulation[4], privatization and commodification[5] are applied to help enforce the market;
- political regulation and its most important medium, the state, must be reduced to its basic functions.

Figure 3

Captions: World-wide trade on the financial markets, 1990-2005
Bonds and shares in billion dollars
Derivatives in billion dollars
Trade in bonds
Trade in shares
Derivatives
Source: Huffschmid 2006



	1990	1992	1994	1996	1998	2000	2002	2004	2005
Handel Anleihen	3,1	4,2	8,5	13,3	11,5	3,9	4,9	11,6	13,0
Handel Aktien	5,7	5,6	9,5	14,0	23,5	49,8	33,1	42,3	51,1
Derivate	123	182	344	322	388	385	694	1144	1408

Source: Huffschmid 2006

1.1. Financial markets - the engines of globalization

Globalization is essentially the transnationalisation of communications, capital transfers, the flow of goods and services and of production. This occurs in interaction with qualitative progress in science and technology. In itself, internationalisation of communications and management is not new. Surges of internationalisation have repeatedly occurred in history, like, for instance, the formation of the world market in the 15th century. A new wave of internationalisation took place in the 19th century, thanks to the invention of the steam engine, electricity, telegraphy and the telephone. Therefore, the current globalization represents both moments of continuity and of rupture. Especially new are the following elements (cf. Enquête Commission 2002):

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3 Liberalisation = removal of interstate barriers to economic transactions.
4 Deregulation = removal of domestic laws and regulations.
5 Commodification = transformation of materials not commercially valued into commodities, e.g. genetic material.

- an abrupt acceleration of exchange processes and innovation as well as an inherent reduction in space, that is, geographical distances become increasingly insignificant. This explains the use of the term global village;
- the inclusion of sectors (e.g. intellectual property, living organisms) in economic valorization processes which previously were barely or not at all accessible,
- the alteration of function and shape of the nation-state, together with a certain loss of control and ability to solve problems.
- the financial markets are the driving and dominating force of this process.

The financial markets being driving and dominating forces of the process does not mean that they are the only determinants. What it does mean is that they cannot be additively assessed as a factor among others. Moreover, they have a direct structuring effect on other economic dimensions (trade, production etc.), but also indirectly structurally affect society, politics, the environment and cultural aspects. François Chesnais, former chief economist of the OECD, described this effect in 1996: *"the financial sphere actually represents the forerunner of economic globalization"* (Chesnais 1996: 10).

1.2. The problem with exchange rates

International financial relationships were determined by the Bretton Woods system after the Second World War. The supporting pillars of this system were fixed exchange rates for the large currencies, the U.S. dollar as leading currency which was guaranteed by the gold reserves of the USA, as well as controls on capital transfers. The system was controlled and supervised by the International Monetary Fund (IMF), which was specifically created for this purpose. The architects of the system, primarily the USA, together with Great Britain (with the then Minister of Finance, John Maynard Keynes) responded to the consequences of the world economic crisis of 1929 with the Bretton Woods system. Within the context of *political* economy, they knew that the crash of 1929 had produced not only enormous economic disruptions but that it was also an important cause of the advancement of fascism with all its fatal consequences. Such a catastrophe should no longer be possible in the future.
The Bretton Woods era was the longest sustained period of prosperity and stability in the history of capitalism, which is usually crisis-prone (Altvater 2006).

1.2.1 Exchange rates -- not just a variable among others

The Bretton Woods system was terminated in 1973. The exchange rates were released and since then are formed on the market, floating freely. Controls on capital transfers in foreign currencies were gradually reduced in the course of liberalisation and deregulation. Open markets were the objective. Although the U.S. dollar maintained its position as leading currency - 80% of world trade are accounted in dollars, including, almost completely, strategic goods such as mineral oil, and has remained the leading reserve currency. But very recently, this position is increasingly challenged by the euro, among other factors, since the euro has gained territory as a reserve currency and means of payment in world trade.

The introduction of free floating exchange rates did not just change any world economic variable, but an economic regulating parameter of pivotal importance. Alongside interest rates, the exchange rate is the most important strategic determinant of prices in the economy. The existence of different currencies has considerable effect on the relationship between the respective economic areas and their competitiveness. Different currencies increase transaction costs. Even if exchange rates were fixed, as under the Bretton Woods regime, currency conversion involves

costs. Moreover, an exchange rate change risk arises if exchange rates float freely. This volatility then causes uncertainties in foreign trade and investment[6].

The situation is similar in servicing debt. It can suddenly rise - or fall - overnight, if the exchange rate changes. The exchange rate volatility is a permanent uncertainty factor. This occurred on a large scale in connection with the outbreak of the debt crisis in 1982. The drastic increase in the dollar exchange rate was not the only factor, but it was one of the most important factors for the outbreak of the crisis.

The short-term exchange rate changes within one day are less decisive for the exchange rate risk in trade and investment (the rates are fixed every second). More decisive are the medium-term currency rate fluctuations, that is, monthly or quarterly, since these are the ones which influence consumption and investment decisions. However, daily fluctuations represent a problem for debt servicing.

An insurance against exchange rate risk can protect business at micro level against currency uncertainties to a certain degree. This is called hedging (not to be confused with the so-called hedge funds (see chapter 1.6.2.). However, such an insurance is of course an extra cost. And since the currencies of developing countries exhibit greater volatility, their foreign trade is made disproportionately more expensive.

Since exchange rates are a problem for trade, investment and debt servicing, various means of dealing with them at the macro level have been attempted. The creation of a single currency would be an ideal solution. A common currency was an important catalyst for integration in the formation of European nation-states - and had more than just economic importance. Consequently, Keynes already suggested the establishment of a world currency in Bretton Woods. The establishment of the Euro was also motivated by the aim to simplify the economic relations between member countries and to foster the entire process of economic and social integration in the EU. After the crises of the nineties, considerations concerning the formation of regional currency unions following the example of the EU have also been voiced, e.g. in regions of Asia and Latin America (Dieter 1999). The currency integration could become the starting point for a general economic integration. The concept is not only economically interesting but also ecologically sound. Regionalization can reduce transportation requirements, and the "ecological footprint" (index of environmental stress) of production.

1.2.2. Between fixed rates and free floating currencies

A country can be present on the world market with a stable currency by pegging its currency to another currency or being in a basket of different currencies. Of course, this procedure (currency boards) only makes sense if the currency is pegged to a strong currency. The strength of the anchor currency is passed on to the weaker currency, i.e. the currency benefits from a currency bonus because the currency board raises the credit rating, investment is promoted, etc.
There are different sub-variants of currency boards. The most important are:

- a solid link to the anchor currency, whereby every exchange rate variation of the anchor currency has effects. However, this rigid relationship also has disadvantages. The

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6 The following example demonstrates this at the micro level: If a machine in Europe is sold to Argentina on February 1st, to the value of 1 million Euro, and the exchange rate of the Argentine peso falls 5% during the 14 day delivery period, then the buyer has a problem. He must find 5% more pesos to pay the 1 million euros. The whole procedure can of course also occur in the reverse direction.

country's own inflation rate must be synchronized with the inflation rate of the anchor country. Usually, this is made possible through high interest rates, a restrictive monetary policy and a budget austerity policy. However, such measures can damage the domestic economy and aggravate social problems. At the same time, high interest rates attract short-term speculative capital. This represents a stability risk, since an abrupt capital flight can also occur at any time. If the rates of inflation are not synchronized, an overvaluation of the country's own currency can rapidly occur, making exports more expensive (cf. Metzger 2001). In this respect, a currency linkage of this kind is a permanent balancing act. Historical experiences show, for instance in Argentina, which had practised such a model up to the crash of 2001, how risky this system is.

- a more flexible linkage (crawling peg) which allows devaluations up to a certain extent to account for stronger inflation than in the anchor country. Devaluations favour exports, but reduce the currency pegging benefit and increase the risk of inflation by increasing the price of imports. Increasing inflation can ruin the intended competitive improvement and cause renewed pressure to devalue. A downward spiral which then leads to the complete loss of the currency benefit occurs and renders the pegging to the anchor currency meaningless. (cf. Metzger 2001).

1.2.3 Currency reserves for stabilising exchange rates

Another possibility for buffering the volatility of exchange rates is to build up currency reserves to stabilise the exchange rate of a country's currency. This instrument has the advantage that any country can use it for itself, alone. The disadvantage is that the procedure is expensive. There is a permanent drain on means: "*whenever the central bank of a country issues foreign currency that does not correspond to a real economic capital gain in that country, then there is an international transfer of wealth in a quantity that often exceeds the flow of development aid by a large factor.*" (Spahn 2002: 9).

But even this procedure failed to prevent the crash in the Asian economic crisis. There simply were not enough reserves. When they were used up, the exchange rate drops were limitless. The Thai Baath lost 40% of its value, the Indonesian currency even lost 60%.

Table 1: Gross currency reserves of developing countries 1997-2005 (in billion $)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
All developing countries	571.6	588.0	621.2	666.6	748.3	920.1	1,211.8	1,616.6	2,009.5
Eastern Asia & Pacific	212.5	233.2	262.5	272.7	320.4	408.4	545.0	782.0	999.9
China	139.9	145.0	154.7	165.6	212.2	286.4	403.3	609.9	818.9
Indonesia	16.1	22.4	26.2	28.3	27.0	30.8	34.7	34.7	32.8
Malaysia	20.0	24.7	29.7	28.6	29.6	33.3	43.5	65.4	69.7
Philippines	7.2	9.1	13.1	13.0	13.4	13.2	13.5	13.0	15.8
Thailand	25.7	28.4	33.8	31.9	32.3	38.0	41.0	48.5	50.5
Europe and Central Asia	90.8	95.9	102.3	118.9	130.0	173.8	234.6	313.9	408.7
Russia	12.8	7.8	8.5	24.3	32.5	44.1	73.2	120.8	175.7
Turkey	18.6	19.4	23.2	22.3	18.7	26.9	33.8	35.5	50.4
Latin America/Caribbean	166.5	157.3	149.7	152.7	155.5	156.4	189.5	214.4	246.5
Mexico	28.1	31.5	31.0	35.1	44.4	49.9	57.7	62.8	73.0

Venezuela	14.0	11.6	11.7	12.6	8.8	8.0	15.5	17.9	23.5
Middle East and North Africa	43.7	42.0	40.8	45.6	55.1	67.1	89.1	103.3	124.6
Algeria	8.0	6.8	4.4	11.9	18.0	23.1	32.9	43.1	56.2
Lebanon	5.9	6.5	7.7	5.9	5.0	7.2	12.5	11.7	11.8
South Asia	30.0	32.9	37.9	42.6	52.8	79.8	114.8	142.0	148.3
India	24.3	27.0	32.0	37.3	45.3	67.0	97.6	125.2	131.0
Pakistan	1.2	1.0	1.5	1.5	3.6	8.1	10.7	9.6	9.8
Sub-Saharan Africa	28.1	26.6	27.9	34.1	34.4	34.7	38.6	60.9	81.6
Angola	0.4	0.2	0.5	1.2	0.7	0.4	0.6	1.4	3.2
Nigeria	7.6	7.1	5.5	9.9	10.5	7.3	7.1	17.0	28.3
South Africa	4.8	4.2	6.1	5.8	5.8	5.6	6.2	12.8	18.3

Source: World Bank 2006

Therefore, those countries who could afford to do so, have built up enormous reserves in order to be able to not only intervene in normal currency fluctuations but to be prepared to fight off a speculative attack or avoid a crash (see Table 1).

The problem facing those using reserves as an instrument to stabilise their exchange rate and defend it against currency crises is that the procedure absorbs massive amounts of means that are no longer available for development and to combat poverty. The reserves must be financed by public debt: *"the main problem of high reserves for the domestic economy is the accumulation of massive public debt"*. (GDF 2006).

Thus, the Chinese national bank has issued domestic loans to the amount of 805 and 922 thousand million Yuan 2004 and 2005, which increased the sum total of loans to 1033 thousand million Yuan (corresponds to 103 thousand million USD; GDF 2006). There is also the risk that a devaluation of the currencies in which the reserves are kept leads to corresponding losses and high reserves cause increased pressure on interest rates. Thus, this form of protection against exchange rate risk is also highly inefficient and damaging to development in the long term.

1.3. Dollar hegemony and currency competition

Bretton Woods had already established the US-Dollar as leading currency and anchor currency for the world economy. At first, little changed after the end of the Bretton Woods system. The existence of such a leading currency has the advantage that at all international economic activities are calculated in the same currency and prices can easily be compared with each other. International payment transactions are simplified enormously. In this respect, a leading currency has a favourable effect on international trade, foreign investment and international credit relations.

If this leading currency is identical to the currency of a nation-state, however, then this nation-state attains a privileged position. This is because the leading currency is at the same time the domestic means of payment. This state, in this case the USA, is the only country:

- which can undertake foreign trade in its own currency. This means currency exchange transaction costs are not incurred,
- where there is no exchange rate risk. This means that the costs other countries incur to protect against exchange rate risks are also avoided;
- where foreign loans can be raised in its own currency.

The USA enjoy structural competitive advantages, and also enormous influence over the whole world economy due to the status of the Dollar as a reserve currency and leading currency for capital investment. Additionally, the dollar dependence of the world economy means that problems in the U.S. economy are rapidly transferred to the rest of the world. If the Dollar sneezes, the rest of the financial world catches a cold. For example, a dollar devaluation would lower the value of currency reserves of other national economies and dollar asset values would correspondingly fall.

However, the supremacy of the Dollar has been weakened by the establishment of the Euro. An indicator is the proportion of international bonds issued in Euros. The Euro with 45.4% has overtaken the Dollar (38.3%) in 2005, whereas in 1999, half of these securities were still denominated in Dollars and only 28.4% were in Euros. Other indicators, such as the proportion of different currencies used in world trade, as currency reserves or in foreign loans, show the Dollar to be still clearly in the lead, but even here, the significance of the Euro is growing. The proportion of Euros in the currencies of developing countries has increased from 20% at the end of 2000 to 29% in 2005 while the U.S. Dollar proportion has fallen from 68% to 60% (GDF 2006).

The decrease in the dollar monopoly is quite positive from a stability point of view. The one-sided dollar dependence and the associated risks, for example, the interest rate risk and the concentration of capital flows in the leading currency, are both decreasing, and competitive distortions are reduced. This is also beneficial to developing countries. However, the foreign currency transaction costs could increase since two anchor currencies complicate the system. A multi-polar system could even arise with the establishment of further regional currency unions.

More importantly, however, the basic north-south asymmetries between strong and weak currencies are not affected. Over the longer term, a basic reform of the international currency system along the lines of Keynes should be considered, with a global leading currency which is not identical with a national or regional currency.

1.4. Flexible exchange rates, new source of profits

It has been shown that the exchange rate problem under the conditions of free trade presents special difficulties for countries with weak currencies and repeatedly presents them with dilemmas. From a development perspective, urgent work on the exchange rate problem is required. The free market will not solve this problem. Instead, international political cooperation is necessary which addresses the special situation of the developing countries.

Instruments such as the two-tier currency transaction tax, as Spahn, a former advisor to the IMF, proposed in further development of an idea by James Tobin, can contribute to reducing exchange rate volatility and prevent speculative attacks (Spahn 2001; Jetin/Denys 2005).

The question arises as to why a political regulation of exchange rates - which is not the same as a return to the fixed rate system of Bretton Woods - has not long since occurred. The decisive reason is: the present exchange rate system offers new and attractive profit possibilities for financial market players. Of course, freeing the exchange rates and deregulating foreign currency capital transactions opens up the possibilities for arbitrage and speculative business transactions with foreign currency, interest rates and securities on a global scale. Arbitrage uses known

differences in rates[7]. Arbitrage also occurs with interest rates and securities. If this takes place internationally, this always automatically involves a currency transaction.

On the other hand, speculation is, unlike arbitrage, an unsure bet against the future. The speculator expects that the currency exchange rate, a share price, an interest rate or another value will rise or fall within an hour, a day, a week, a month. For example, he buys a currency at a favourable rate today. If the currency rate has increased a week later, he can then sell the currency at a profit.

Even a currency fluctuation of one basis point (= one hundredth of one per cent) can already yield considerable profits for arbitrage and speculative transactions if very large sums are used.

The new source of profit was so attractive that the foreign currency buying and selling has grown explosively since the 1970s. The new profit possibilities are not only limited to exploiting differences in exchange rates. By freeing exchange rates, and with the liberalisation and deregulation of capital markets, there is easier access to corresponding dealings in interest rate differences, as well as price differences in bonds and shares and the market for derivatives (on derivatives, see chapter 1.9.).

Up until the 2001 crash, the rough rule was that a person could obtain twice the profits of real investment through investing in financial businesses (portfolio investment).

However, with the 2001 crash and the end of the New Economy, these profit differences temporarily shrunk. But they increased again with the recovery of the stock exchanges. A return on investment of 25% is standard for the leading institutes trading on the international financial markets. Today, the turnover on foreign exchange markets per stock exchange day is about 3 billion U.S. dollars. Less than 3% of this is spent on international trade and foreign investment. Even if the above mentioned hedging dealings are included - there are seven further hedging deals for each real business transaction - then less than 10% of currency transaction turnover is actually spent on real economic business deals. That is, more than 90% of the transactions are made in arbitrage and in speculative business. In turn, 80% of these are short-term capital flows. The Bank for International Settlements defines short term as a turn-around time of up to seven days. These are the transactions that cause the massive turnovers.

Thus, the new profit possibilities result in a strong interest of those actors who gain from them, primarily the institutional investors and their customers, i.e. institutional investors and rich individuals. Whereas volatility, risk and instability represent a problem for many sectors of the economy, they are new source of exorbitant profits for the institutional investors and their customers. A new phenomenon has arisen and their actors and dynamics are now at the centre of the economy. In American terminology, this is an asset and wealth oriented or shareholder value-oriented economy (Rappaport 1986). Critical discussions speak of financial market capitalism (Windolf 2005, Bischoff 2006). This will be further discussed in section 1.11.

1.5 The stability risk from short-term capital flows

Short term capital flows, especially, have played an outstanding role in the 1990's financial crises. Their proportion has more than tripled, from 176 billion U.S. dollars in 1990 to 454 billion U.S. dollars in the first half of the nineties (World Bank 2000). This increase has several causes. The reduction in foreign currency capital transaction controls and other forms of liberalisation

[7] If, for example, there is a difference in the exchange rate between the euro and the dollar when the stock exchanges in the European time zone close and the Wall Street stock exchange opens, the difference is rapidly equalised by corresponding transactions.

and deregulation are primarily responsible for this increase in financial crises in the developing countries and the emerging market nations.

Additionally, interest rates for short-term loans are more favourable than for long-term loans, since the risk is greater for long-term loan lenders to developing countries. In emerging market countries, short-term borrowing was frequently used by local banks to pass the loans on to domestic borrowers at higher interest rates, and these loans were often used to finance speculative business, including business on the property market.

After the Asian economic crisis, the recognition that the short-term capital acts pro-cyclically gained acceptance even in the mainstream financial community. This pro-cyclic action means that there are disproportionate inflows of capital during economic growth phases, and the capital is rapidly withdrawn when there is a decline in the economy or even a crisis.

The abolition of capital controls has practically removed the means of influencing or controlling capital inflows, outflows or capital flight. Domestic and foreign investors can quickly change into foreign currencies and transfer their capital abroad at the first sign of a crisis. National governments and central banks have hardly any other possibilities for intervening. They can try to act against capital flight by increasing the interest rate, which attracts financial investors. However, this measure has highly problematic side-effects: if the national bank increases the interest rate, it aggravates the recession which triggered the crisis. Business and private debt is increased. This can lead to insolvency on a massive scale, which in turn is very problematic for the national banking sector.

In view of this, the *Financial Stability Forum (FSF),* established after the Asian economic crisis, found that short-term capital flow is one of the main risk factors for stability on the financial markets. However, the countermeasures are limited to safeguards and barriers against the negative effects of global capital flows at the national and micro level. The possibility of controlling the quantity, speed and direction of flows, that would be possible with foreign currency capital transaction controls, for example, was rejected.

1.6. Institutional investors and prioritising shareholders

The enormous dynamics of the financial markets has also encouraged new actors. Some of these actors have actually been present for a long time (hedge funds, for example, exist since the end of the 1940s). However, their present day significance has only grown since the liberalisation and deregulation of financial markets after 1973. Within the new context, they obtain functions and cause effects which were not possible under Bretton Woods conditions.

Insurance companies and pension funds have also existed for a long time. However, today they are actors on the international financial markets. This has consequences both for these institutions and for the operation of the system as a whole. A new type of investor has developed which is described by the generic term "institutional investor".

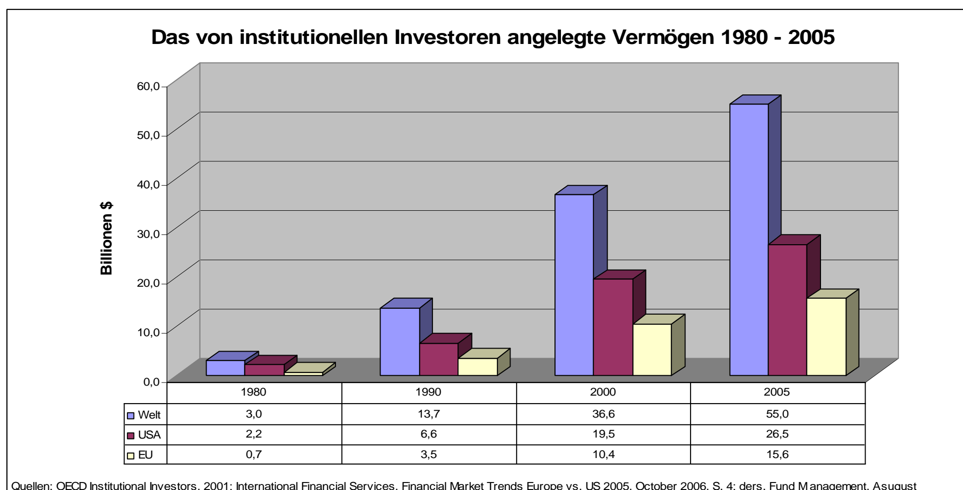
This term includes banks who step into investment banking, if they were not already involved in this area. Also, there are investment funds in differing variants from government funds to private equity and hedge funds (see below), as well as insurance companies and pension funds. In 2005, 55 billion USD, that is 70% of the worldwide 78.7 billion in assets, was managed by institutional investors. Of this amount, 20 billion was administered by pension funds, 17 billion by insurance companies and 18 billion by investment funds (Huffschmid 2006).

Figure 4

Captions: Assets invested by institutional investors 1980-2005

Y-axis: $ billion; x-axis: World, USA, EU

Sources: OECD Institutional Investors, 2001; International Financial Services, Financial Market Trends, Europe versus US 2005, October 2005, p. 4; ibid, Fund Management, August.



The concept of institutional investor signifies that the ownership function has become institutionalised and professionalised. This in turn enables the owner's interest in the greatest possible yield to be more massively realised and manifests itself in a new business behaviour.

Traditionally, the investor's wish was to receive an annual dividend or interest for the shares and bonds they held. Thus, the assets usually remained in their possession over the long-term. That is now in the past. The objective in acquiring shares and securities is not the annual dividend, but the resale at a profit when the market price increases. Based on highly sophisticated methods and mathematical models, the institutional investor is now chasing 24 hours a day behind any opportunity to increase returns. The speed of assets turn-over has increased dramatically. Competition between the institutional investors has continuously increased the profit expectations to an even higher level. Fast and high profits have become the dominant motivation of behaviour. Individual behaviour entails greater risk, the systemic risks increase.

This process is accompanied by a change in business financing. Complementary to the appearance of institutional investors, the traditional credit financing by the company's (house) bank is no longer prevalent and capital market financing through shares, bonds, derivatives, etc., has become the main form of financing. However, this only applies to companies of a certain size. Small and medium-sized businesses hardly have access to capital market financing.

The institutionalised and professionalised owner function has developed a different logic in management behaviour as a result of the competitive pressure on the financial markets. The classic objectives of business growth and competitive improvement through innovation and increased productivity naturally remain of interest. The short-term interest in increasing the share price - or, with take-overs - the short-term increase in profitability ("decorating the bride") now takes precedence. The management is tied to the company by participation in company profits

and provided with "golden handshakes", that is, very large severance compensation, in the case of failure.

1.6.1 Private equity funds

The logic of the new wealth accumulation regime is manifested most clearly with the example of private equity funds (PEFs),[8] which were specially created to optimally exploit shareholder value. This business sector is growing extremely dynamically worldwide. They became spectacularly well-known by the "locusts" metaphor thrown into the debate by Müntefering, the then SPD chairman and later German vice-chancellor. Just as locusts pounce upon the fields and devour everything growing there before moving on, so do PEFs that buy up businesses, squeeze the maximum in profit out of them for a few years and then sell them off. PEFs are mostly closed funds, that is, money collection points, which build up a certain sum. When the intended amount is collected, a business or part of a business is purchased.
An essential feature of this procedure is that they operate with considerable leverage, that is, with a high proportion of borrowed capital (up to 90%). For example, to buy a business at the purchase price of 100 million euros, they use 20 million in equity capital from their investors. The remaining 80 million is borrowed. The debt is then transferred to the business when it is acquired. The profit is not only achieved by the resale but also through "special dividends" distributed before the sell off.

The business undergoes restructuring to achieve the targeted increase in value of the business before resale, whereby costs are reduced and profits increased. A permanent feature of the cost reducing strategies are staff cuts, extended working times, outsourcing of less profitable business areas and investment rationalization - so long as these are compatible with the profit target on resale.
The management is usually tied into achieving the new business goal of greatest possible resale value by being offered participation in the sell-off profit. The legal company location of 80% of the PEFs is in tax havens in order to operate under the most favourable taxation conditions.

1.6.2. Hedge funds

The institutional culmination of the shareholder logic is finally to be found in hedge funds[9].

They are also closed funds. The number of equity holders is limited, i.e. they are not accessible to everyone because depositors must pay a certain minimum amount of capital (e.g. from million U.S. dollars upwards). These conditions ensure they are only accessible to rich individuals and institutional investors.

In contrast to PEFs, which have specialized in business acquisitions, hedge funds are mainly active in speculative financial business. Thus, they also conduct operations which normal investment funds are not permitted to engage in. This includes, for example, short selling[10], stock market transactions on credit, and the extensive use of derivatives. As a rule, derivative activity is carried out to avoid appearing on any bank or stock exchange balance sheet ("over the counter").

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8 In the English speaking world the term leveraged buyouts is used as a synonym.

9 Hedge Funds do indeed exist since the end of the 1940s within the framework of the Bretton Woods System, but they remained of marginal magnitude. However, they could only develop with liberalisation and deregulation after 1973.

10 Futures trading with currencies, securities, goods, etc. that are not even held at the time A, are contracted to be sold at a certain time B, arranged at time A, when the contract is agreed. The speculation is that when the items that are to be sold at time B are actually acquired, they are bought at a lower price than the price agreed at time A. This kind of transaction is still forbidden in Germany.

Hedge funds are not at all or only barely subject to legal supervision. They reside mainly in offshore financial centres (see figure 5). They work with extremely high leverage, that is, they use external financing. In IMF terminology they are therefore called "highly leveraged institutions" (HLI).

The risk potential of hedge funds has been clearly shown by the near collapse of *Long Term Capital Management (LTCM)*, which faced bankruptcy in 1998. For a long time, LTCM funds were regarded as a strong tip among speculators since two Nobel economics prize winners with their mathematical models were mainly involved in designing the concept. The fund was able to finance assets to the amount of 125 billion U.S. dollars with personal resources of only 4.8 billion U.S. dollars. This corresponds to a proportion of external financing of 1:25 (cf. BIZ 1999:111 ff.). The funds were directly involved in speculative business on the scale of 1.25 billion U.S. dollars just before the crisis.

Figure 5: Geographical distribution of hedge fund asset facilities

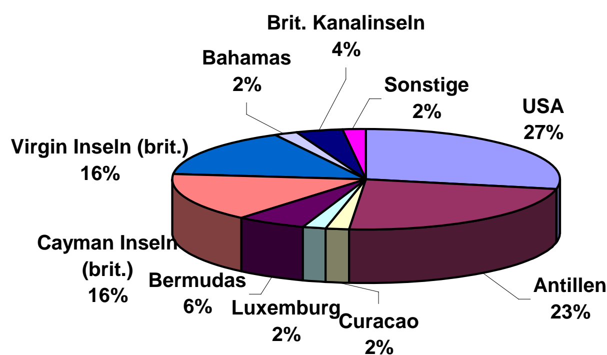
Brit. Kanalinseln: British Channel Islands

Sonstige: Others

Virgin Inseln (brit): British Virgin Islands

Cayman Inseln (brit): British Cayman Islands

Antillen: Antilles



Source: Huffschmid 1999

A very trivial situation then occurred, since some of the creditors demanded their loans back because of problems of their own, and there was a threat of a chain reaction , which could a have triggered a worldwide crash. Consequently, on September 23rd, 1998, the U.S. central bank, together with a number of private sector financial institutions, organized a rescue package to the amount of 3.7 billion U.S. dollars in a spectacular emergency action.

It became obvious that LTCM businesses were completely non-transparent. On the one hand, the total amount of indebtedness and of risk positions were not clear. On the other hand, the scope and extent of the hedge fund business lacked all transparency in that "they comprised a variety of

financial instruments and extended over various markets and the existing contracts ... were also of a high degree of complexity" (BIS 1999:112).

The experiences with LTCM forced the FSF to classify this type of business as especially risky. Nevertheless, practically nothing has changed. On the contrary, the deposits managed by hedge funds in 2006 have increased by almost a third. In all, the hedge fund deposits are estimated at 2.097 billion USD. Altogether, there are several thousands of such funds. However, the business is highly concentrated. The ten largest hedge funds manage 250 billion USD[11].

The German government suggested calling for greater hedge fund transparency at the G8 Summit 2007, in order to recognize stability risks in time. But this proposal was opposed by Great Britain and the US who would only accept an improvement in voluntary self-control. Officially, it was argued the funds were useful in terms of political stability because they accepted risks which other actors did not want to assume. As the 2007/08 crash has shown, in which hedge funds played a fatal role, they were indeed particularly ready to take risks and bought a lot of bad mortgages (see chapter 1.9) because these at first yielded particularly high profits. However, the risks did not disappear, but were distributed all over the world and nobody knows where. Assigning hedge funds the role of guardians of financial stability proved just as logical as giving pyromaniacs the job of fire protection.

1.6.3 Pension funds and insurance companies

Next to banks and investment funds, increasing numbers of insurance companies and pension funds are surging into the international capital markets. Especially in the US and in Great Britain there is no or only rudimentary public pension systems, and private funds are the main supporting columns of old age pension schemes. In the 1990s, pension fund assets in Great Britain amounted to more than 150% of the gross domestic product, 60% in the US and almost 100% in the Netherlands (cf. OECD 1999). Considering the enormous quantity of assets managed by insurance companies and pension funds, it is understandable that these funds have become some of the most important actors on the capital markets. Their share in the capital markets will continue to increase if the pressure towards the privatization of public social welfare systems continues.

Capital market financed pensions are, however, less secure than public systems based on the solidarity principle. They are, of course, dependent on the ups and downs of the capital markets. Thus, tens of thousands of pensioners in the US lost their pensions overnight or saw them being dramatically reduced because of the stock market crash of 2001. For institutional investors, however, there are enormous profit prospects to be expected if the assets in public pension systems can be privately exploited.

A particularity applies to insurance companies, and especially to pension funds: for the sake of their depositors they are subject to quite strong legal supervisory control. They are obliged to avoid risk exposure and to operate rather conservatively. This is an advantage for the funds and their depositors. However, the other side of the coin is, considering political stability, that the pension funds are the first to withdraw their capital for safety reasons when an actual or suspected financial difficulty arises in a country. Due to the very typical pro-cyclic behaviour of the financial markets ("herd instinct"), other investors soon follow and thus cause the very crisis

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[11] Financial Times Deutschland, March 30, 2007, p.23.

that could possibly have been prevented. This is exactly what happened during the Mexico crisis of 1994, when U.S. pension funds were triggers for the great investor exodus.

1.7 Rating agencies

Subsidiary branches have formed around the rapidly growing finance industry, which in turn offer services to the financial service industry. These include consulting, specialist and data providing companies. An exceptionally prominent position among these is occupied by the rating agencies. Although they, themselves, are not directly involved in market dealings, the rating agencies are part of the financial market dynamics. Acquiring capital on the international financial markets by a large agency is hardly possible any more without rating. Alongside the two leading rating agencies, *Moody's Investor Services* and *Standard and Poor*, there is a number of other companies, but these play a very subordinate role when compared to these two. Only the London based *Fitch Ratings* has gained in significance recently. Moody and Standard and Poor have virtual official status and are frequently consulted by governments for political advice, even though they are private companies.

The function of rating agencies consists in recognizing economic developments and estimating the risk of an investment as well as assessing the credit rating of financial market actors for investors. The rating agencies use different classifications from "very good" via "unsafe" to "high risk."

It has repeatedly occurred that the rating agencies did not meet the requirements with their assessments. They did not foresee any of the great crises. It is particularly problematic that the rating agency assessments frequently seem to act pro-cyclically by confirming upward or downward trends, and thus reinforcing them: if rating agencies discover increased net capital is flowing into a country, then they infer a higher credit standing[12] for that country and as a result, improve its credit rating. But the causality should actually work in the reverse way: the agencies judge a country or a private financial market actor on the basis of economic criteria and these then obtain more capital because of an improved credit rating.

However, in reality, it frequently occurs that credit worthiness is downgraded at the first sign of a crisis and this strengthens the trend to withdraw capital from that country. The herd instinct of investors is reinforced. For example, this was the case in the Asian economic crisis: the countries involved were highly rated immediately before the outbreak of the crisis so that investors followed this "guidance" and invested massively. However, the rating agencies rapidly downgraded the Asian debtors when the first crisis symptoms became visible in May 1997. This started a wave of selling shares, bonds and foreign currency (Dieter 1999).

The agencies are paid by those very facilities which they assess. This causes a problematic collision of interests. This collision is reinforced by the fact that the agencies at the same time advise their customers on how to achieve as good a rating as possible. The boundary between advice and assessment becomes blurred. In addition to this, particularly high charges are requested for rating complex derivatives. Therefore, the rating agencies first gained handsomely from subprime mortgages which triggered the financial crisis of 2007/08 (see chapter 1.9.).

Even more important, however, is the fact that the credit worthiness test criteria are themselves based on neo-classical theory and are thus also filled with its ideologically biased content. For

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[12] Credit worthiness, soundness of a company or country.

this reason, Standard & Poor and Fitch downgraded the credit worthiness of Italy in October 2006 because the draft budget of the centre-left Prodi government did not conform to neo-liberal standards. The risk premium on Italian government bonds increased promptly (NZZ, 20.10.2006).

The rating agencies also failed completely during the great Enron and WorldCom scandals. Scepticism about rating agencies had consequently grown in the European financial community even before of the crash of 2007/08. However, this had less to do with the basic problems, than the fear that the two large American agencies would privilege American companies and did not know enough about European markets and European companies.

1.8. Derivatives

It is no coincidence that a certain type of instrument has made an astonishing career in this new system: the derivatives.

Derivatives are considered as the incarnation of innovation on the financial markets. However, the initial idea is old. Basic forms of derivatives were already well-known since the 17th century. The original motive was to protect trade in agricultural products against (future) price risks, e.g. crop failure. Thus derivatives always refer to a future business, so-called financial futures. In this way, derivatives can refer to the price of future goods, interest rates, shares and other securities or even to stock exchange indices, such as the DAX or the Dow Jones or arbitrary combinations of these. Today, derivatives are quantitatively the most important form of securities.

Derivatives can transfer various risks (risks with currency, price, financial markets) to others in a specific way. The belief that some market specialized participants could handle certain market risks better would seem to make it easier to calculate market trends. The rational basis for derivatives lies here: the insurance character.

In principle, there are two basic forms which are repeatedly found in a modified way in every derivative - forwards (standardized futures products, traded on the stock exchange) and options. A forward offers the buyer a certain security for the future, for example, a fixed price when purchasing or selling goods or financial products at the termination date. Each time, only a small proportion of the total value must be paid when purchasing futures. The rest is paid when the future is redeemed.

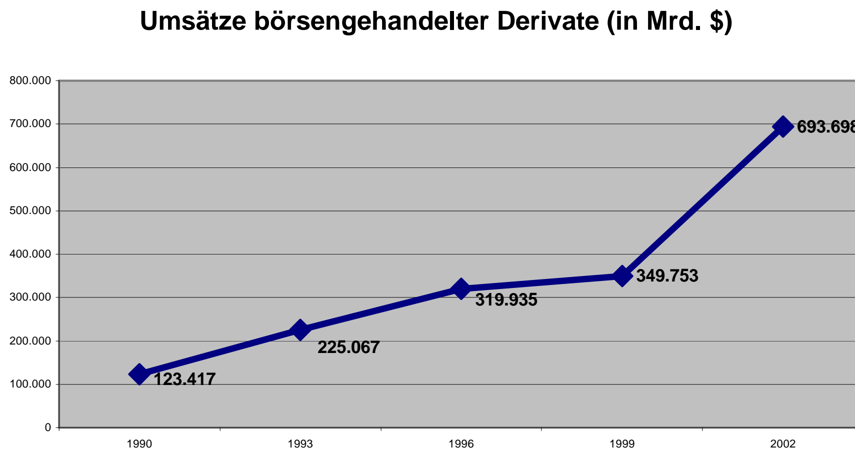
Options are the second basic form of derivatives. It grants the owner the (tradeable) right to obtain a certain benefit at a previously agreed date and time or to decline it. For example, if a person is dealing exclusively in the acquisition of shares, profits are gained if the share price increases, but losses are inevitably incurred if the share price drops. Derivatives offer a contrast to this: they also offer the opportunity of earning money when the stock exchange declines with a warrant for both cases.

Thus, the world of derivatives has long since departed from its basic function of protecting against risks involving real economic transactions, interest rates and securities. The growth rates in the derivatives business shows this. While derivatives were a negligible quantity on the financial markets 30 years ago, the turnover of stock exchange listed contracts already amounted to 123.4 thousand million U.S. Dollars (nominal value) in 1990. In 2002 it had increased almost six-fold to 693.7 thousand million U.S. dollars (see Figure 6) - but these sums only include business listed at the stock exchange. This fact is extremely important, since only about a fifth of derivative trade is carried out over the stock exchange (Lipke 2003). The other 80% of trade takes place unofficially and without any legal supervisory control ("over the counter").

Figure 6: **Turnover in stock exchange traded derivatives (in thousand million $)**

Source: BIS**Figure 6**

Gelöscht: ¶



Source: BIZ 2003

Even if every business transaction was protected by derivatives, the real economy-based proportion would still be less than 5%. Therefore, by far the largest portion is used for speculative trading. Buyers and sellers no longer have anything to do with each other. Dealers with not the slightest interest in wheat purchase large quantities of grain forwards in order to sell them profitably when the contract matures. Only a very small proportion of this business actually refers to material objects such as grain, gold or oil - the BIS assumes this proportion to be approximately 1%. The predominant proportion concerns financial products. There is practically no end to fantasy in developing derivatives: meanwhile, the system has achieved such a complexity that there are derivatives dealing with derivatives of derivatives.

This business turns out to be particularly risky when it is financed by loans. This then repeatedly leads to crashes, as in the case of the well-known Barings Bank 1994. Derivatives also played an important role in the collapse of ENRON in 2001. Derivatives were also centrally involved in the latest financial market crisis (see chapter 1.9).

The kind of derivative that is intended to protect real economic transactions, i.e. hedging in the sense of actually securing risks, can, under certain circumstances, be beneficial to developing countries as second best solution, as long as the volatility on deregulated financial markets is not adversely affected by other measures (for example, exchange rate stabilisation, currency controls, international taxation etc.).

However, developing country economies are under threat even if they are not directly involved in any business with speculative derivatives. This is because the speculative type of derivatives (especially options, short selling, etc.) has increased the systemic risk and endangered the stability of the financial markets even beyond the function of the useful derivatives.

Consequently, international regulation of the derivative business is desirable from the development policy point of view.

1.9. The example of the 2007/08 US mortgage crisis

"Innovative" financial products have also played a large role in the latest financial crisis. The initial starting point was the intention of making mortgage loans for the acquisition of residential property available to the poorer sectors of the population (unemployed persons, low wage-earners) in the USA. These sectors are usually not credit worthy because of their precarious income situation. The risk of defaulting is so high that such mortgage loans are not normally granted. This is the reason for the term *sub-prime* for these loans.

Admittedly, the lenders were not at all concerned with the social aspect - residential property for the financially weak. Instead they were responding to the pressure of competition in opening up a new market segment on the financial markets. New investment possibilities were being sought after the crash of the New Economy in 2000/2001, and the sub prime loans sector was considered to be one of these. This business grew from 174 billion to 600 billion USD per annum in the period 2001 to 2007 (Evans 2008: p. 7).

How poorly the creditors were socially minded is shown by the fact that after an interest free period of mostly a year, variable interest rates were agreed which were often above the usual rates. This is in contrast to the European property market, where such mortgages have a fixed rate of interest. Additionally, the speculation was that the property bubble would continue to grow, and consequently, prices would increase. Finally, *"credit allocation standards were lowered to entice more people in, and so to lend more money."*[13] Seduced by what was at first an interest-free loan, and the prospect that their property would increase in value, many grasped the opportunity who would otherwise never have bought residential property.

In the meantime, the banks providing the credit, knowing the risks, sold the loans on. And this was to agencies specially created for this purpose (the ABS companies: Asset Backed Securities). Amortisation payments and interest flowed into these companies. The sub prime loans were purchased with cleverly structured bonds (Residential Mortgage Backed Securities - RMBS). The risk was thereby split up and distributed among various types of loans, so- called tranches. The lowest tranche had to carry the risk up to a certain percentage of the overall credit volume, for example 3%. Therefore, the buyer of this tranche receives a particularly high risk premium.

The next class of tranches must carry a part of the risk not covered by the lowest tranche class. The third tranche then entails part of the risk left over from the second, and so forth. Since the higher categories carry a very low risk under normal circumstances, the rating agencies classified their credit rating with a high credit worthiness (see 1.7.).

The less favourable tranches were in turn either bought (and resold) by hedge funds ready to accept high risks, or by other ABS companies who split them up and sold them off again according to the above mentioned risk splitting procedure. Thus, bad loans climbed up this ladder system step by step to the best credit ratings.

The whole structure then collapsed when the property inflation came to a full stop and interest rates increased. The tidal wave flooded the dams of the lower tranches and so reached those rated as first class. The crisis had arrived. The infection effect came into play immediately because the

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[13] Stiglitz, Joseph: America's Day of Reckoning, August 17, 200

international financial markets were so interwoven and almost all big banks in the industrial countries were affected. The first insolvencies in the USA occurred, including the fifth largest bank in the country, *Bear Stearns*. The Fed provided *J.P. Morgan Chase & Co.* with a spectacular 30 billion USD cash injection to enable it to take over Bear Stearns and so prevent a complete collapse[14].

At that time, the initial liquidity crisis had already grown into a bank and credit crisis. The banks no longer trusted each other and inter-bank trade dried up. The end of the crisis could still not be seen at the time of the writing this current text[15]. Nevertheless, the USA is de facto already in a recession. The consequences for the real economy will gradually be revealed. The repercussions will be felt way beyond 2008 and 2009.

The crisis is not an accident or the result of several unfortunate events coming together. Instead it has structural causes which sooner or later would have lead to a crash. Essential elements of the present financial system are intertwined in accelerating the dynamics of crisis:

- competitive pressure and the greed for ever increasing profits lead to risky transactions which serious institutions would previously never have undertaken,
- bank supervision failed,
- rating agencies have once again shown that they are part of the problem and not part of the solution,
- the complexity of the "innovative" financial instruments makes the system non-transparent and leads to unforeseeable chain reactions,
- the highly speculative institutions, especially hedge funds, are directly involved in the crisis,
- internationalisation rapidly spreads the crisis across the entire globe,
- offshore centres and tax havens serve as relay stations for large-scale speculative transactions (see 1.10),
- the financial crisis spreads to the real economy and leads at least to a "dent in growth". The IMF forecasts 0.4% (October 2007),
- the main sufferers are those at the bottom end of the social ladder. Approximately five million households could lose their homes and the money invested there.
- The drop in global growth will dampen demand from industrial countries and thus have a negative effect on the exports of developing countries. Hedge funds switch to speculating on raw materials and food, contributing to the increase in the prices of oil and food. All developing countries dependent on the import of these goods will face serious problems.

Finally, it is interesting that the crisis started in the USA, the most highly developed financial market in the world. The crises in the emerging market and developing countries have always been attributed to poor financial sectors and supervision, corruption ("crony capitalism"), etc. It was believed that such crises could not occur in industrial countries with highly developed financial markets and functioning supervision.

All in all, the neo-liberal strategy of completely deregulated financial markets has been discredited like never before by this crash. *"What is happening today on the credit markets is a heavy blow for the reliability of the Anglo-Saxon model of transaction oriented capitalism."*[16]

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[14] NZZ Online 17.03.2008.

[15] Beginning of April 2008.

[16] Martin Wolf, Head economic commentator for the Financial Times, Financial Times, 12 December 2007.

1.10 Offshore centres and tax havens

An important element in the international financial system is largely freed from bank supervision and regulation: these are described as offshore financial centres (OFC). OFC are special economic zones, which - in contrast to what the name suggests - are not necessarily overseas. On the contrary, many lie directly in the centre of London City or in Dublin. Sometimes the offshore centre is also an independent international legal entity (e.g. Luxembourg, Liechtenstein or Monaco). Offshore means nothing more than that the territory in question has no or hardly any bank supervision and no or low taxes are levied. Thus, in Liechtenstein, for example, there is a flat-rate tax of 1,000 Swiss francs levied on foreign companies - these are practically all mail-box companies.

Dozens of different tax havens advertise worldwide with political stability, stable exchange rates without foreign exchange controls, unrestricted capital transfers, inviolable banking secrecy, protection against foreign court judgements, minimal official supervision and protection against confiscation. Today, there are approximately 70 tax havens with 2 to 3 million persons or companies with accounts registered there. This number is growing at an average of 10-15 % per annum. (Oetsch/Wahl 2006).

In addition, frequently, the guarantee of maintaining banking secrecy at all costs virtually makes offshore centres ideal places for money-laundering and tax evasion. An investigation of Monaco by the French national assembly legal affairs committee concluded that the miniature state "encouraged money-laundering" (Frankfurter Rundschau: 6.23.2000). The banks in Monaco hold 340,000 accounts for 30,000 formal inhabitants. 6,000 mail box companies are registered in the principality. Setting up such a company costs nothing apart from the registration fees, amounting to 2,500 euros. Once the company is established, any amount of money from drug trafficking or other criminal activities can be washed thanks to Monegasque banking secrecy. Taxation on capital gains, income and inheritance does not exist.

Reliable data on financial flows to, from or between OFCs is not available. Not only the mafia, terrorist networks or other dubious customers make use of OFCs. International companies, banks, and other institutional investors also use the quiet oases.

Another highly problematic dimension of OFCs is their contribution to the erosion of corporate, wealth and capital taxes. Tax dumping is operated through tax privileges and special services (setting up companies, holding company management, mail box companies, etc.). The stronger the competition with this distorting strategy is, the more nation-states are deprived of tax revenue. According to Tax Justice Network estimates, 11.5 billion U.S. dollars in private assets are invested in the OFCs. At least 255 billion have been withheld from the tax authorities of the countries of origin. (TJN 2005).

An essential motive for establishing OFCs was the opportunity for governments to incur large amounts of foreign currency debt without problems. However, governments are no longer dependent on the OFCs since the additional further liberalisation and deregulation of financial markets in the 1980s. As a consequence, the offshore centre function expanded in the private sector, and especially as an operation base for certain types of institutional investors, who used OFCs as a tax paradise and safe haven for large private fortunes and for money-laundering.

OFCs are a serious problem for development policy. The capital flight and tax evasion of prosperous and corrupt elites to the OFCs leads to a permanent drain of financial resources. About 50% of all cash capital and securities from Latin America are invested in OFCs. This proportion amounts to even 70% for the Middle East. The losses caused by OFCs to the developing countries are valued at 500 thousand million U.S. dollars per annum (Christensen/Kapoor 2005). For clarification: this sum is approximately the same as the 510.8 thousand million U.S. dollars which all the developing countries paid in debt service in 2005 (GDF 2006). This is also approx. five times the amount of total ODA.

The first report of the FSF identified OFCs as the third problem for stability of the financial markets alongside the short-term capital flows and high risk funds. The problems should be mitigated with proposals for more transparency.

What the FSF did not dare to say: OFCs are superfluous from a macroeconomic perspective. They are only useful to a small privileged group of actors - very wealthy individuals, institutional investors particularly ready to take risks as well as for criminal and terrorist activities. However, they are a central element in the structure of the new, asset oriented and financial market dominated world economy. In March 2008, the discovery of tax evasion by several thousand rich Germans in Liechtenstein, among these the chairman of the German Post AG, one of the biggest TNCs of the country, active in more than 100 countries, confirmed this one again.

1.11. The new financial market-centred wealth accumulation regimes

The repeatedly used expression of asset or wealth driven capital markets is not only a theoretical concept but also empirically verifiable. Although the wealth theme only plays a marginal role in science and politics, and only small amounts of statistical material are available, the data in the World Wealth Report of Merrill Lynch/Capgemini still shows the direction in which the economy and society is being driven by the financial market dynamics. This is especially visible in the higher regions of wealth.

The financial capital of HNWIs and the number of HNWIs has doubled between 1996 and 2005. *HNWIs = High Net Worth Individuals*, are persons with liquid capital amounts of 1 million U.S. dollars or more, not including real estate and tangible assets. The wealth itself has thus doubled between 1996 and 2005, that is, within a decade (see Table 2). The average growth rate came to 8%. Merrill Lynch forecasts a similarly high growth rate up to end of the decade.

Among the 8.7 million HNWIs, approximately 1% belong to the ultra-HNWIs (with liquid assets of 30 million and more). This group has again grown strongly among the HNWIs, up to 85,400 persons in 2005, an increase of 10.2% compared to 8.9% in 2004 (Merrill Lynch 2005: 4).

In 2004, the gross domestic income of the whole world came to 40.9 billion, 31.6 billion thereof in the industrial countries (UNCTAD 2005). To visualize the scale: 8.2 million HNWIs in 2004 were about 0.12% of the world population (6,400 million). They dispose of financial capital that is three times as high as the annual gross domestic income of all developing countries together with a population of 5,100 million people. The growth rate of the capital assets of HNWIs amounted to 16.7 billion U.S. dollars over the last 10 years. A sheer doubling.

If an annual solidarity tax of only 0.7% were imposed on the assets of HNWIs, this would still amount to approximately 210 thousand million U.S. Dollars, that is approximately triple the development aid officially agreed to by the OECD countries in 2004. This is very far from what politically can be achieved at present, but it still casts an interesting light on the prevailing

discussions regarding development policies, millennium development goals, etc. From this perspective, the sums being played with there are peanuts.

Of course, wealth has several causes and was already there before the neo-liberal model was established. Therefore, the phenomenon cannot be attributed to the financial markets alone. Nevertheless, besides statistical correlations, there are also structural relationships between financial market driven globalization and social polarization. In the 1990s, François Chesnais, former chief economist of the OECD, had already raised the question as to whether the new dynamic was a disadvantage to the real economy, and thus to the source from which the mass of the population can gain prosperity: *"Could there not be a relationship between the globalization of the financial markets and the distinct weakness, if not stagnating of industrial production ... and investment, together with unemployment in the OECD countries, including Japan?"* (Chesnais 1996: 17).

Table 2 Development of HNWI assets and HNWI numbers 1996-2005

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Capital (in billion USD)	**16.6**	**19.1**	**21.6**	**25.5**	**27**	**26.2**	**26.7**	**28.5**	**30.7**	**33.3**
Number of HNWIs (in millions)	**4.5**	**5.2**	**5.9**	**7**	**7.2**	**7.1**	**7.3**	**7.7**	**8.2**	**8.7**

Source: Capgemini / Merrill Lynch , World Wealth Report 2006

In the meantime, this approach has been developed further: *"the shaping of the structures of financial market capitalism by the pivotal role of institutional investors [has] a depressive effect on economic growth which can be particularly attributed to three factors: firstly, the excessive accumulation of financial capital is promoted, secondly, a rather unfavourable environment for real economic innovation is created, and thirdly, the governments and central banks are forced into a restrictive fiscal and monetary policy ."* (Deutschmann: 58)

In other words, the hypertrophic expansion of the financial markets puts pressure on the real economy and therefore on economic growth, the distribution of employment, and consequently on demand. This also explains the long- term trend of growth rates for the developing countries, which were 5.5% on average between 1960 and 1980, and fell to 4.2% between 1980 and 2004, even though the exorbitantly high growth rates for China, 9.6% on average, are included in the calculation (UNCTAD 2006: 46)[17].

In a nutshell, financial market dynamics lead to an increasingly larger portion of the accumulated wealth being acquired by a small sector of monetary asset holders. Altvater calls this an expropriation economy (Altvater: 49ff). In terms of the popular metaphor of an economic cake, the cake grows, and the rich and the super-rich cut out a bigger and bigger slice of the cake for themselves, whereas the majority is told that they must be satisfied with a smaller slice.

This is not a temporary economic development, it expresses a systemic change. A structural change is occurring which encompasses the entire economy and its significance can only be compared with the Taylor/Ford revolution in the first half of the 20th century. The production

[17] At first glance, those that criticise ecologically motivated growth could be under the impression that the new financial market regimes support their interests. In fact, the opposite is the case. This is because the decrease in economic growth rates is not planned, controlled or driven by the dynamics of ecological processes, but instead, is anarchic and crisis prone. The economic, social and political distortions thereby caused reduce the possibilities for an ecological transformation of the prevailing economic growth logic.

regime which was superior then is now being replaced. It has lost its dominant role. Financial capital, which traditionally was subordinate to the real economy, has now become the dominant factor. *"Emanating from the United States, a power shift from top management to the shareholders has taken place over the course of the last two decades".* (von Weizsäcker 1998: 15). In other words, business success is measured solely in terms of one single indicator, the profit for the ownership. The owners rigorously push for an increasing return on equity, since this parameter is the decisive factor for valuing the business on the stock exchange.

Among the consequences of the orientation towards shareholder value are an increase in competition at the micro level as well as at the macro level with nation-states and regions competing against each other to attract businesses. This is also a historical modification: "*whereas the institutions of organized capitalism tend to weaken competition, financial market capitalism is intensifying competition step by step"* (Windolf 2005: 25). Since, for their part, institutional investors compete for individual investors, they must offer them a higher profit than their competitor. In this way, the intensification of increasing competition is transferred to the real economy.

The same applies to the short term logic of financial markets, which now also invades the real economy. "The investor is interested in one single resource - money - and he maximizes this. However, the business objective is directed towards several resources ... as a combination of resources -, and this combination must be balanced as creatively and new as possible and as productively as possible." (Malik 2005; 141).

The new, capital and asset driven regime of accumulation is not only a stability risk to financial markets and the real economy in a narrower sense, but tends to affect the whole development of society.

1.12. Some consequences

The radical changes outlined up until now produce various effects, either alone or in interaction with others. Supporters of the neo-classical position claim that private financial flows, increased market liquidity and international competition especially have a positive effect on development. They believe that growth and prosperity would be created and poverty reduced. The economy would be more efficient, state bureaucracy and corruption would be reduced.

The following chapters shall outline risks and problems in areas that are important from a development friendly viewpoint – problems and risks which are produced by the new financial markets dynamics: financial market stability, distributive justice and democracy.

1.12.1 Stability risks

The new developments on the financial markets increase stability risks for the whole world economy. This is confirmed by the increase in large scale crises and crashes, such as in Mexico in 1994, East Asia in 1997, Russia in 1998, Brazil in 1999, Turkey in 2000, the Argentine crisis with bankruptcy of the state in 2001/02, the bursting of the speculation bubble on Wall Street in 2001, the crash of ENRON and the end of the New Economy, and finally the U.S. subprime mortgage crisis in 2007. Additionally, there is a permanent debt crisis of many developing countries that continues to this day.

The increasing frequency and intensity of crises was the reason why the FSF was founded after the Asian economic crisis, when discussions on the new financial structure emerged and reform

proposals were debated. This is because a crisis can destroy the development efforts of many years within a very short time.

The neo-liberal mainstream analysis claimed that poor economic fundamentals in the affected countries, inadequate banking sector supervision, corruption and nepotism ("crony capitalism") were responsible for the outbreak of the crises. These factors may very well have played a role. But they cannot explain why whole regions were struck by the financial crises even when the economic fundamentals and the conditions varied considerably in the countries concerned. It is also striking that of all countries, the most serious financial crises occurred in fast-developing nations and emerging market countries (e.g. the Asian tiger economies), even though, for example, the IMF had praised their positive economic development just before the outbreak of the same crises (Dieter 1999).

Thus, the systemic factors that result from a highly integrated world financial system must be taken into consideration. The structures and dynamics of the world financial system provide the prerequisites for instability and crises. The amount of credit allocated to developing countries in the 1970s would have been much lower if liberalisation and deregulation of the financial markets had not occurred, and thus, the debt crisis would not have been possible.

Alongside the structures and mechanisms already presented - exchange rate volatility, short termism, high risk funds, offshore financial centres, derivatives, systemic risks also emanate from basic mechanisms and patterns of behaviour such as:

- the enormous acceleration of transactions,
- pro-cyclic behaviour ('herd instinct') of actors,
- the risk of being infected, that is crises can also spread rapidly to other countries through strong international networking
- the completely irrational expectations of market participants - which is in contrast to the claims of theory.

In addition to this, financial supervision and control is generally less well developed in developing countries and emerging market economies than in industrialised countries. But even in industrial countries, this is not enough to prevent high risk transactions, as shown by the subprime mortgage crisis in the USA. Due to the speed of innovation in the financial markets, the supervisory control system is like the race with the hare and the tortoise, and the hare is always beaten to it.

Even when no crisis is looming and the financial markets are functioning normally, the volatility and the hectic on the markets not only signify permanent costs for protecting against risk but also continuous stress, especially for developing countries. If a crisis does occur, then the developing countries have to pay a particularly high price.

Table 3: Unemployment, poverty and income per capita in crisis countries

	Unemployment (% of total work force)		Poverty (% of the population)		GDP per inhabitant (in U.S. dollar)	
	1995	*1998*	*1995*	*1998*	*1995*	*1998*
Indonesia	4.91	14.81	11.3	22.5	3,800	680
South Korea	2.0	6.8	15.3	27.8	9,700	7970
Thailand	1.1	3.4	15.1	26.7	2,740	2200

Source: WEED 2000

Small and medium-sized businesses had to register for bankruptcy on a massive scale as a result of the Asian economic crisis. Consumption demand collapsed and mass unemployment, wage cuts and impoverishment spread (see Table 3). It was not only the countries where the crash occurred which were hit. Other countries were also indirectly affected. Thus, the collapse in Laos following the crisis in Thailand was even greater, because more than 80% of the country's foreign trade was carried out through Thailand.

Regarding the consequences of the crash in Southeast Asia, Stiglitz stated that *"the workers had to bear the costs in the form of higher unemployment and falling wages. The workers were asked to listen to the sermon about "bearing sacrifices" after the same preachers had shortly before told them that globalization and the liberalisation of financial markets would bring them growth they had never seen before"* (Stiglitz 2000).

The main losers from volatility, instability and crises are the socially weaker sectors of the population, since financial market dynamics have enormous distributive effects.

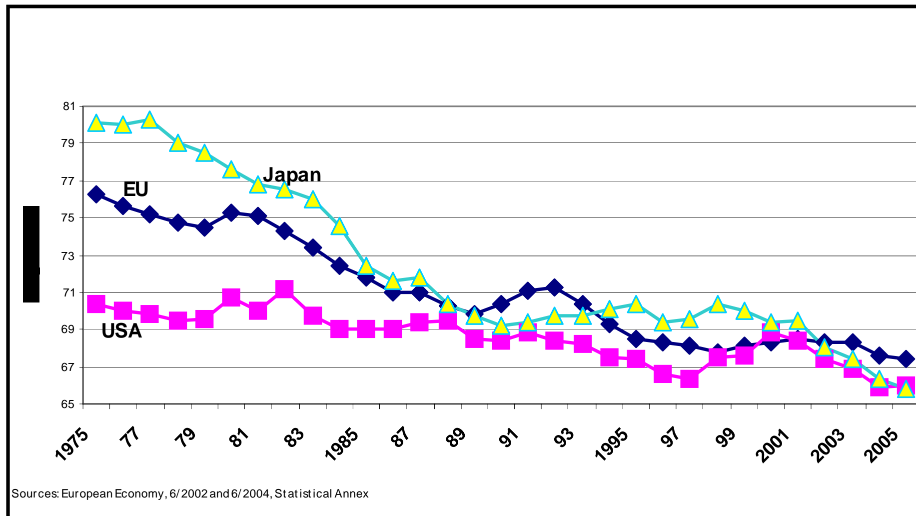
1.12.2 Distribution, social justice

The concept of social justice and equality is ancient and is already found in all world religions. It became a component of democracy theory with the European Age of Enlightenment and the French Revolution, and was finally codified in the General Declaration of Human Rights of 1948 through the efforts of the workers' and Socialist movement and later in the Economic and Social Human Rights.

Social justice finds wide acceptance as a normative reference even if the reality appears different. On the other hand, social justice as a norm is also specifically rejected in social-Darwinist theories and by the intellectual fathers of neo-liberalism. Thus Hayek states: "*inequality is not regrettable but most welcome. It is simply necessary. Social justice can only occur in a command economy ... where the state determines the relative incomes of individual citizens",* (*Hayek* 1981).

For the developing countries, the World Development Report of the World Bank of 2000/2001, focussing on poverty, concluded that in the 1990s, at the zenith of orthodox structural adjustment, poverty increased particularly in those regions which followed the Washington consensus programmes, especially Latin America, Sub Saharan Africa and the emerging market economies (see table 4). The then president of the World Bank, James D. Wolfensohn, wrote: "*increasing inequalities have reinforced many people's feelings of injustice and disrespect".* (World Bank 2000/2001: vi).

Figure 7: Wage ratio in the USA and the EU- 15, 1975-2005



Social polarization is confirmed by empirical results. Thus, the *"inequality in spendable household incomes in most developed countries has again increased (after the increase in inequality in the 19th century and the adjustment in the 20th century). This represents a break in the trend."* (Hradil 2005: p. 478). The same applies to the developing countries (Davies et al. 2006:2). Additionally, larger sections of the population of most industrial countries face greater precariousness and increased poverty (Förster/Pearson 2002: 4).

Table 4: Income poverty 1990-1998 in selected regions (persons with less than $ 1 per day - in millions)

	1990	**1993**	**1996**	**1998**
Europe and Central Asia	7.1	18.3	23.8	24
Latin America and the Caribbean	73.8	70.8	76	78.2
Sub Saharan Africa	242.3	273.3	289	290.9

Source: World Bank 2001

On the other hand, there were successes in reducing poverty in those regions where an independent path was taken, especially in countries like China. Despite millennium development goals, nothing has changed in the progress of this inequality. This is because the gap between rich and poor countries has also grown.

1.12.3 Financial markets and democracy

As mentioned above, a feature of the present wave of globalization is that there is a change in the function and form of the nation-state. Whereas the welfare state function is being increasingly dismantled, the nation-state is progressively mutating into a competitive state in which society and the economy is being reorganized for global investment competition, that is, virtually making it fit for the world market (Hirsch 1995).

This leads to changes in the relationship between politics and the economy, which are often interpreted as the state losing control and the ability to solve problems. The state appears to be powerless in the face of financial markets. In actual fact, it was the governments themselves - initially the USA and Great Britain, but then the other industrial countries as well - which caused this development. Nevertheless, it is true that the influence of the financial markets on decision making has increased dramatically in the course of globalization.

The mentors of neo-liberalism also speak of the question of democracy. They either operate according to an undemocratic, elitist theoretical principle in that the "free market economy" is the only legitimate economic system, which must "also be defended against majorities" (Hayek 1944). Or they demand "depoliticizing of the state" as a prerequisite for increasing efficiency and international competitiveness (Friedman 1962:11). According to Friedman, the central problem was that a democratic state dependent on mass legitimisation must automatically be inefficient.

Apart from these ideological stand points, globalization of financial markets has actually led to a democracy problem. The structural cause for the new power of financial markets beyond the economic sphere lies in the fact that economic structures and processes have been sourced out of the framework of nation-states. A trans-national space has been created to which the single nation-state has no access. The most advanced examples are the financial markets and the internet. However, this "disembedding" of economic activity beyond the framework of the nation-state has no corresponding extension of national state power and thus also of democratically legitimised decision making. This is because no democratically legitimised international or trans-national executive exists, just as there is no such parliament or judiciary. A new basic asymmetry has been formed: structurally, politics and thus also parliamentary democracy have been disadvantaged with respect to the economy.

The identity between voters and the elected, which is fundamental to democratic decision-making, is being increasingly eliminated, since access to basic decision-making is being withdrawn from the elected. "*Since the nation-state must organize its decision-making on a territorial basis, congruence between the involved and the affected in the interdependent international society is increasingly rare*" (Habermas 1998:108). So long as the economy was largely within the nation state, it was subject to nation-state regulation. Workers, women, environmental and other social movements managed to tame the Manchester capitalism of the 19th century by long lasting social struggle and subjected it to democratic control up to a certain extent. However such a framework of order does not exist for the globalised economy.

Attempts to compensate this with a system of global governance are very narrowly defined in terms of competence, and their powers are severely limited, as is shown by the example of the International Court of Justice. Other institutions such as G8, IMF, WTO, World Bank, OECD, NATO and, to a lesser extent, the UN-system are one-sidedly biased due to power structures and are a far cry from a trans-national democracy.

Broader aspects of the relationship between democracy and financial markets are:

- the **alleged inherent constraints** that are repeatedly **claimed** and the alleged non-existence of alternatives. If this were true, one must conclude that: *"the paralyzing perspective is that future national politics is reduced to a more or less intelligent management of forced adjustment to the imperative of safeguarding "competitiveness" and withdraws any remaining substance from political discourse"* (Habermas 1998:95).
- the **social polarization**. Undemocratic political structures are encouraged. Hostility to foreign residents and racism and corresponding political movements are reinforced

everywhere. The rise of religious fundamentalism observed worldwide adds to these problems.

- **cultural diversity is exposed to considerable homogenising pressure by globalisation.** On the one hand, the audio-visual industry is also drawn into financial market dynamics and its production is increasingly concentrated in high profit investment, whereas less lucrative projects hardly have a chance of being produced. On the other hand, the same standards, norms, sense of values, role models and principles are spreading over the whole world. Neo-liberal ideology itself has profited enormously from this global expansion among the functioning elite and into everyday consciousness.

The conclusion from this: the globalised power of the financial markets is in contradiction to parliamentary democracy. Dealing with financial markets and the development of alternatives to their present structure is therefore also a prerequisite for regaining the primacy of politics over financial markets.

2. Public finances and financing public goods

Financial markets are the terrain of private economic actors. On the other hand, public finances are the concern of the state. The essential duties of the state consists in organizing state revenue, managing the national budget, controlling expenditure and setting essential macroeconomic control variables (especially interest rates, exchange rate, money supply). The way in which these functions are organised has far-reaching socio-political consequences.
Thus, public finances have a central control function in the community. Public finances constitute one of the most important fields of political activity.

2.1. The traditional relationship between public finances and financial markets

There always were relationships between public finances and financial markets. Traditionally, they existed at the following levels:

- the financial market actors are brought into the financing of the national budget through taxation and fees,
- public finances use the services of the financial markets for the emission of government bonds and raising loans in the private sector,
- the state controls the behaviour of private financial market actors through control of the money supply, the exchange rate and interest rates,
- the state regulates and supervises the private sector (supervision of banks, stock exchanges insurance companies, etc.). This regulation has been developed into a complex system in North America and Europe following the world economic crisis of 1929.

As long as the financial markets were one sector among many, and politics and the state held the primacy in setting the direction of social development, these relationships were not unimportant but still only one element in the overall economic structure.

2.2. The effect of the neo-liberal anti-state attitude on public finances

The monetarist transformation after the end of the Bretton Woods system profoundly changed this. The future development could already be understood from the theoretical concepts of neo-liberalism. Criticism of the state is of course a firm pillar of neo-liberalism. The state is considered to be the basic cause of lack of freedom, as well as bureaucracy, corruption and economic inefficiency. The anti-state creed is therefore a generally recurring theme in all varieties of neo-liberal thinking. Hayek states that *"the state has the duty of securing internal and external security, especially with regard to protecting private property, which is the basis of our social system"*. (Hayek 1981).

2.2.1 The state and inflation

The neo-classical model plays a particularly prominent role in monetary stability. Here, two main threats have been discerned: public expenditure when it is too high or too great a proportion of GDP (a high public spending ratio) and a high wage ratio[18].

[18] According to this, wage increases which exceed increases in productivity drive up inflation. Thus, "*wage discipline*" must be exercised. On the other hand, no limits are set for increases in profits or wealth.

From a neo-liberal perspective, the state is a permanent source of inflation. According to neo-liberal theory, the state triggers currency devaluation through its expenditure.

Of course, also non-neo-liberals do not look on inflation as desirable. But inflation is not just inflation. Hyperinflation, as occurred in some emerging market nations in the 1970s and 1980s is disastrous in every respect and disproportionately affects socially vulnerable groups and sectors. However, a rate of increase from three or five per cent in prices is not only not a problem, but a normal phenomenon which will occur in any case solely because of technological progress. New technologies are developed, new kinds of products and services are introduced. These require investment. This leads to an increase in average prices in the long-term. Such a low money depreciation is not a problem for the national economy if economic growth occurs, employment is sufficient and wages increase alongside with technological progress and growth. It is necessary to balance the advantages and disadvantages between growth, unemployment and price increases. This trade-off was also consciously carried out in the past when the German chancellor in the 1970s, Helmut Schmidt, stated he would "rather have five per cent inflation than five per cent unemployment"[19].
However, there are also losers if there is a normal rate of increase in prices: the owners of capital. The value of cash assets decreases continuously with inflation. This, of course contradicts the basic dynamics of this system under the conditions of an asset and wealth directed economy. In this respect, state monetary policy at this point comes under pressure to make monetary stability a central objective.
According to the neo-liberal dogma, the central banks must be independent of politics in order to institutionally protect the primacy of monetary stability. With sovereignty over monetary policy, the central bank has at its disposal a controlling factor over economic and social policy. However, being independent of politics also means being independent of democratic influence. With respect to the hegemony of neo-liberal ideology, it has hardly been noticed that this is a return to feudalism[20]. It has been suggested that a body with no direct interest will objectively provide the right monetary policy. Monetary policy should be defined by technocrats who are expected to know what the correct interest rate and the proper money supply should be. In actual fact, this policy is completely dependant on the monetary dogma of neo-liberal theory.

The claim that a high public spending ratio induces inflation has been empirically shown to be inappropriate. The industrial countries with the highest public spending ratios, the Nordic countries, not only have low rates of inflation but also have above average growth rates, low unemployment and leading positions in social security.

Conversely, countries with low inflation rates do not at all achieve better overall economic results. The best example of this is the Federal Republic of Germany with a brilliant stability policy but very weak growth, high unemployment and growing poverty.
Despite all this, the reduction in the rate of inflation continues to be a neo-liberally inspired recurring theme of politics. This is in the interest of institutional investors, since for them, a prospering national economy with a inflation rate of 4% is less attractive than an economy with an inflation rate of 2%.

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[19] Helmut Schmidt, cited by Müller (2006: 90). The target used by the European Central Bank without regard to other indicators is 2%.

[20] By the way, this "independence" is much less prominent in the USA. The FED always has been an instrument of the government and, unlike the ECB, also conceives its interest rate policy to be an instrument of economic policy.

2.2.2 National debt

A second dominant topic in the discussion about public finances is national debt. Almost all industrial countries have accumulated a high amount of national debt since the 1970s. The fact that this was at all possible is largely the result of financial market liberalisation and deregulation. Therefore, governments were able to incur foreign debt abroad on a grand scale, and this in foreign currencies.

In principle, debt is not a problem per se. On the contrary, borrowing is an absolutely sensible instrument, without which larger investment would not at all be possible in a complex economy. This applies equally to businesses and households as well as to the state. If investment is successful, the money raised is more than regained. Debt in itself is not the problem, but excessive debt is.

However, there are differences between business management level and the national economic level. Whereas excessive debt leads to insolvency on a micro level, a state cannot go bankrupt. With regard to the economy of a business, the success of an investment can also be directly measured in terms of its profitability. This is again a clear indicator of the ability to service debt. The profitability of investment by the state, e.g. in material infrastructure, cannot be measured as directly. For example, investment in education - from nursery school up to scientific research - has a time horizon of 20 and more years and is embedded in a complex network of other causes and effects. This also applies to other forms of public expenditure. How can the economic, and for that matter, the socio-political effect (citizen satisfaction, political stability) of a well functioning health service be measured appropriately? In this respect, a micro-economic assessment of national debt will always be inadequate, especially when it is used as a decisive criterion to measure the current budgetary situation.

In addition to this, public finance income - taxes, tariffs, customs duties, fees - are continuously the object of political decisions and exposed to the actions of social pressure groups. Thus, the relationship between credit-financed investment and increased (tax) income from economic growth can only be perceived. A fiscal policy that unilaterally favours , for example, corporations and the wealthy, undermines the ability to service debt.

Therefore, there will always be controversy about when debt is too high. The question is, which figure should the amount of debt be related to? The World Bank has developed quantitative criteria for developing countries. However, on the one hand, these refer solely to foreign debt, and on the other hand, there is a certain arbitrariness attached to these criteria, as the controversy about debt servicing ability clearly shows. Whereas the HIPC initiative has set debt service ability to 150% per cent of export revenue, a ratio of 5% was considered manageable in the case of German foreign debt after the Second World War (cf. WEED 2001).

This is not a plea for disregarding national debt as a problem. The tolerable debt limit is exceeded when political capabilities are so restricted that it threatens to confine politics solely to managing the deficit. However, the hegemonic discussion has made national debt the killer argument, under the auspices of which great projects such as, for example, dismantling the welfare system, are pushed through. Such reforms no longer need to be politically legitimized since they appear to be an inherent necessity to which, allegedly, there is no alternative.

Moral support for the ideology of inherent necessity is then provided with the argument "for the well-being of future generations"[21]. This argument is very problematic within this context, however. On the one hand, it conjures up a collective, the future generations, which do not at all exist economically as a collective. Because each Euro debt on the debtor side corresponds to one

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[21] The concept derives from ecological discussions of the 1980s. It encompasses the quite sensible idea that the planet should not be ecologically plundered and ruined today at the cost of future generations.

Euro of a mostly private creditor who profits from interest income from the national debt. And this will also be the case for the next generation. Every generation is divided economically and socially. The formulation - justice for coming generations - conceals the distributive aspect of national debt and excludes those who profit from it. Additionally, austerity policies mean that investment by the state in material and social infrastructure is neglected. Future generations will be seriously affected in a negative way by the absence of the necessary investment in local public transport and ecological regeneration, the decay of intangible wealth, which for example is provided by cultural facilities, and educational and health policies governed by the constraints of a "tight budget".

Even more important, however, than the discussion concerning the ideologization of the problem with debt is that there certainly are other alternative ways to react to national debt than solely with a rigorous austerity policy. At least two options are crucial:

- a restrictive budgetary policy acts pro-cyclically in economic downturn phases, i.e. it aggravates the downturn tendency. Thus, state borrowing must actually be higher in economic downturn phases. Expenditure can also be increased, for example in order to finance state economy-boosting programmes. Debt reduction, however, only makes sense during economic growth phases.
- The magnitude of interest rates is a determining factor in the actual cost of debt service. The debt service is also low when the interest rate is low. National debt is then a manageable problem even when the debt is large.

Table 5: National debt in selected industrial countries

	National debt level in proportion to nominal GDP, 2005 (debt-GDP ratio)
Japan	161.9%
Italy	108.6%
Belgium	94.9%
Germany	68.6%
USA	66.6%
Austria	64.3%
EU 25	64.1%
Switzerland	55.5%
Netherlands	54.0%
Sweden	50.6%
Spain	44.2%
Great Britain	43.1%

Source: German Federal Ministry of Finance, monthly report, January 2006

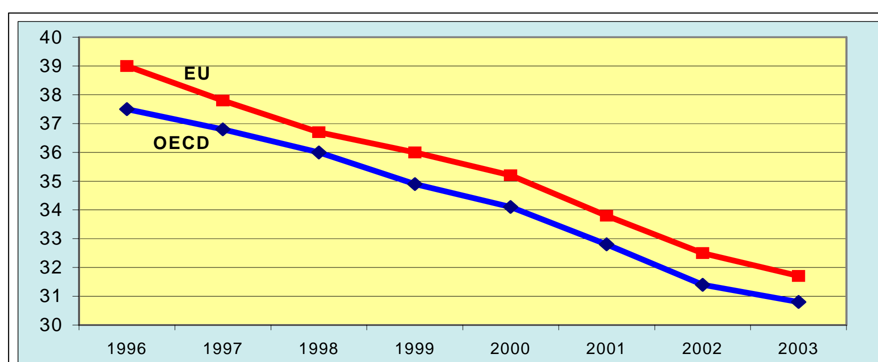
The absolute interpretation of debt consolidation policies has for a number of years lead to many national budgets being cut with a pro-cyclic effect. This counter-productive policy has driven the downward spiral in public expenditure even further. Public investment has declined, with negative effects on employment. However, the subsequent increase in the number of unemployed leads to additional costs for social welfare systems. The pressure for privatisation is increased because welfare systems are now defined as "unaffordable". This is indeed the logic of the self-fulfilling prophecy.

But it is not only the expenditure side which suffers permanent pressure to restrict the financial capabilities. Income, corporate and asset taxation especially should be reduced. As with state expenditure, customs duties and taxation are a thorn in the side of neo-liberalism, since these feed a state which is allegedly “too fat.” On the one hand, this contradicts the ideal of the lean state, and on the other hand taxes are regarded as negative externalities which business sees as hindering global competitiveness. If they are nevertheless accepted as a necessary evil, then they should at least be as low as possible. Income, asset and corporate taxation, especially, should be reduced as much as possible, progression levelled off and be completely abolished over the medium term.

However, liberalisation and deregulation of markets have long since produced far-reaching consequences for taxation systems, and despite the normative concepts:

- financial transfers to serve tax avoidance or evasion have become more possible with liberalisation and deregulation, particularly with the abolition of capital transfer controls;
- at the same time, most nation-states are also actively reducing taxation on corporate profits, capital gains and great wealth. Globalization allows very mobile capital to be transferred at any time to wherever the best investment possibilities are to be found. Governments believe they must cut the taxes for investors to make the country "more competitive" and attract more capital into their national economy. A tax reduction competition ensues which often degenerates into virtual tax dumping;
- Transnational businesses dispose of the possibility of distributing profits and losses to the locations which offer the most favourable tax conditions. Additionally, they can artificially create profits or losses with the aid of processes such as transfer pricing. This works, for example, in the following way: the mother corporation charges the subsidiary for intermediates, services, patents, etc., at prices which are either excessive or too low. Thus, cases were found where 1 kg of paper handkerchiefs were imported from China for 4,121.81 dollars, air pumps from Malaysia for 5,000 dollars each, and also fork trucks for Jamaica at a price of 384.14 dollars, or car seats which were exported to Belgium for a price of 1.66 dollars each (cf. Pak 2004).
- The external financing method which then can be used when the mother company is located in a low tax country and the subsidiary is in a high tax country is also widespread. The subsidiary is knowingly provided with little equity capital so that it must incur debt with the mother company. The interest on the debt then reduces subsidiary profits, and consequently reduces the tax burden, whereas the interest income of the mother company is subject to slight taxation in the low tax country (Liebert 2004).
- Additional incentives for tax avoidance and tax evasion exist with offshore banking centres or tax havens (see chapter 1.10). Here the reduction of capital transfer controls and new technical possibilities (electronic banking) have enabled the strong expansion of these tax loopholes.

Figure 8: Decrease in corporate taxation in the OECD and the EU
(as a percentage of overall taxation revenue)



Source: OECD 2005

As a result, the tax base of the nation-state is being eroded, since income from corporate and wealth taxation is increasingly decreasing. Public finance is being squeezed as if it were in a vice, with respect to both income and expenditure. *"There is a direct link between increasing power of the globalised financial markets on the one hand and on the other hand, the increase in the budget deficits of the industrial countries since the beginning of the 1980s ."* (Plihon 1996: 109).

2.3 Taxation in developing countries

In essence, the trends presented in the previous section are also found in developing countries. However, additional specific problematic situations come into play. Thus, in numerous countries there are only poorly operating or rudimentary tax systems.

The often extremely unequal power relationships between ruling elites and the general population are the reasons why existing tax systems often favour the interests of the privileged. Thus, for example, for the very first time in the history of the country, Uruguay has introduced an income tax after the electoral victory of the Frente Amplio in 2004. This kind of tax, which is taken for granted in the industrial countries, was previously completely unknown in Uruguay. In addition to this, there is often corruption, capital flight and tax evasion. The latter is not only due to conditions within the countries concerned, but is also aided by the existence of tax havens, Swiss bank secrecy and the like.

In addition, in most developing countries, the black economy or informal sector[22] plays an incomparably greater role than in the industrial countries. This sector often accounts for more than half of the GDP. Consequently, since there is no state regulation and control in this sector, no taxes are levied either.

There are also the structural reform programmes requiring market opening which have been enforced by the WTO as well as by regional or bilateral treaties which have caused a decrease in custom duties, fees and taxation and placed heavy pressure on the public finances of the South.

Finally, in many developing countries, there is a greater scepticism and lack of identification with the state than in Europe. The state is strongly experienced as dominating and repressive, often as

[22] The informal sector consists essentially of subsistence economy, black labour and the criminal area, whereby overlapping can also occur.

a residue of colonialism including dictatorship, authoritarian rule and corruption. In many regions, the nation-state is still seen as a distant foreign concept opposed to smaller local, ethnic, religious and cultural communities. On the other hand, positive experiences of state are generally missing, as they were conveyed to underprivileged sectors by the welfare state in the twentieth century in industrial countries.
Because of all these factors, the conditions for public finances in developing countries are even more difficult than in industrial countries. The public finances have fallen from 22% in 1995 to 16% in 2003 in the group of poorest countries. Over the same time period, they dropped from 13% to 7% in the middle income group of countries, which practically amounts to half (World Bank 2005). In contrast to what advocates of the open market policy claimed, the state income losses could not be compensated for by increasing tax revenue through trade expansion, as shown by an IMF study which analysed 125 countries (Baunsgaard/Keen 2005: 18).

2.4. Global public goods and financial markets

The concept of a *public good* as an economic category was systematically defined for the first time after the Second World War (Samuelson 1954). A good is public when it satisfies the following criteria:

- it must be produced, i.e. as opposed to common land, it does not just exist like, for example, freely available grazing land or water,
- it is not provided by a private market participant,
- consumption by one does not limit the consumption by all others, that is, all can benefit to the same extent (no rivalry consumption),
- no one can be excluded from its consumption (not exclusive).

A popular classic example is the lighthouse. It must be built, it is not provided by the private sector, and using it does not reduce its use by others and nobody can be excluded from its use.
In the 1990s, the concept of a public good was newly discovered and extended to global public goods under the impact of globalization. Since problems such as climate change, the decline in biological diversity or international financial crises do not stop at national borders, they must be dealt with globally.
The concept of global public goods is intended as a contribution against the idea that private sector is always superior to the public sector, an ideology which grew massively in the 1990s. At the same time, the ruling neo-liberal discourse perceived global problems from an economic perspective. The necessity of financing environmental protection and development can of course also be democratically, ethically, morally or theologically legitimised by classic fairness arguments or the rights of coming generations.
Nevertheless, apart from the concept, the matter of financing global environmental and development requirements is of eminent significance. The dynamics of globalised financial markets also has tremendous influence. Under the conditions of the globalised financial market regime, several factors have put public goods under pressure:

- the concentration on combating inflation leads to austerity policies which emaciate national budgets, the public spending ratio decreases, leading to a drop in public investment;
- the fall in the expenditure and investment has a negative effect on employment. This in turn reduces the national budget through declining private demand, a shortfall in tax revenue caused by unemployment and greater expense for the social welfare systems. In the long term, this leads to a deterioration in the material and social infrastructure;

- additional debt pressure is generated under these conditions. Pro-cyclic handling of national debt (economies during a recession) leads to cuts in many individual budgets in the economic downturn which have a negative effect on the national economy;
- the erosion of the national tax base leads to a drop on the income side;
- tax relief is granted in order to attract investors, for example exemption from the tax on capital gains;
- democratic policy access to core economy controlling parameters is withdrawn because of the neo-liberal "independence" of the central banks;
- the normative neo-liberalism concepts of the lean state are arching over all these processes. They dominate the deliberations of most politicians.

Public goods are not provided by the market, that is, commercially. Instead, they are provided solely by public services. The central problem now is that the financial requirements for public goods are increasing. At the same time, the money available to public services is decreasing, however. Even modest goals, such as halving absolute poverty[23], which would only require about 0.7% of the BIP of OECD countries, will not be achieved unless a drastic change in policy occurs (Sachs 2005).
A thorough reversal is necessary if the backlog of reforms and social polarization when solving global problems such as the greenhouse effect, the decline in biodiversity, poverty, etc. and if the resulting political destabilization are not to lead to catastrophes. A decisive tool for this is a return to a progressive fiscal policy so that the enormous capital amounts concentrated in relatively few private hands are made available to deal with global problems. As well as this, there is the opening up of new sources of finance such as international taxation.

3. Alternatives

The decreasing acceptance of the neo-liberal model opens a window of opportunity for emancipatory alternatives. The belief that the neo-liberal model has failed is spreading. Concerning developing countries, for example, the World Investment Report of 2006 states: "*the performance of countries, including transitional economies, which carried out orthodox reforms in the 1990s hardly met expectations. They grew less, especially in comparison with those national economies which had pursued alternative strategies, particularly the fast growing newly industrialized economies in East Asia". (*UNCTAD 2006*:* p. 45*).* In its latest World Economic Outlook, even the IMF admits that globalization does not only produce winners: *"based on observed changes in Gini coefficients (the most widely used summary measure of inequality), inequality has risen in all but the low-income country aggregates over the past two decades",* (IMF 2007: p. 139).
The latest financial crisis has finally made the failure of the prevalent model clear in such a way that even its actors realise that the self-healing strength of the market cannot be relied upon. Symptomatic of this is the fact that the boss of Deutsche Bank, Ackerman, called upon the state when he saw that the ghost which he himself had conjured up, could no longer be controlled: *"we need the concerted action of central banks, investors and governments to finally end this melt*

[23] Income poverty is defined as 1 USD per head and day.

down of values"[24]. Admittedly, this only refers to the socialization of the losses. Profits should, as usual, flow into private pockets.

This is the opportunity for reform proposals to start the offensive. Alternatives for various topics already exist, and will be presented below. Altogether, they are building blocks for a new international financial architecture. The common factor is that the financial markets should be subject to democratic control, their dominance over real economy should be ended and their potential should be used for a socially just and ecologically sustainable development.
The range of suggestions varies. Some have a good chance of being implemented, even from a pragmatic perspective. Others may only be realized over the medium or long term. Some can be unilaterally achieved, i.e. within the framework of the national state. These include the two-tier currency transaction tax. Others, such as regional currency unions, are only possible multilaterally.

3.1. An alternative exchange rate regime

The ideal solution for exchange rate difficulties (see chapter 1.2.) would be a uniform world currency. However, this is only achievable in the long-term. Intermediate stages are necessary.

3.1.1. Regional currency unions

The establishment of regional currency unions according to the euro zone model stands out as an obvious possibility. Such regional currency unions would not only have the advantage of reducing the exchange rate risk but also to function as a catalyst for regional economic integration. Therefore, regional currency unions have useful "side effects" for development policy and ecology[25].

Admittedly, regional currencies also raise the problem that convergence of the economic fundamental data of the national economies involved is required. For this, for instance a transition period can be used, where flexible exchange rates, that are controlled, however, by the central banks (managed floating), could exist among the participating countries.

3.1.2 Two-tier currency transaction taxation

On the one hand, the two tier currency transaction tax (CTT) as proposed by the Frankfurt public finance expert and former IMF consultant, Spahn (Spahn 2002), consists of the classic Tobin tax, which in itself has no influence on the exchange rate, as well as a second tier which counteracts undesirably strong exchange rate variations.

Whereas revenue should primarily be generated by the first tier of the tax with a very low taxation rate (e.g. 1 base point = 1/100 per cent), the second tier will be due as soon as a certain band width is exceeded. In this case transactions are covered by a high tax rate of up to 100%. In the extreme case, speculation profits will be eaten away, and currency crises and speculative attacks will be prevented. At the same time, the exchange rate can be maintained within a certain band width, whose limits are fixed by the central bank. The limits can vary over the medium term to adjust the economy to economic fundamentals. This does not mean that it is a capped fixed

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24 Handelsblatt, 18 March 2008

25 Regional integration shortens transport routes and so is more ecologically friendly

exchange rate system. The medial line of the band width is extrapolated from previous exchange rate developments and varies over the medium term.
Detailed studies on the technical and legal aspects have shown that the tax is problem-free and technically effortlessly feasible (Denys/Jetin 2005, Spratt 2006). The financial industry itself has created the prerequisites for easy control by the central banks through the creation of very efficient and secure technical platforms for data transfer (Swift - Society for Worldwide Interbank Financial Telecommunications) and payment settlements (Continuous Link Settlement Bank). Additionally, this type of CTT has the advantage that each country can introduce it unilaterally.

3.1.3. Capital transfer controls

Control of capital flows in and out of a national economy also provides an instrument for influencing exchange rates. The restriction, control and taxation of international capital flows was one of the obvious economic policy instruments up to the beginning of the 1970s. These were at first dismantled in the industrial countries during the course of the wave of liberalisation and then also in development countries and emerging markets, mostly because of pressure exerted by the IMF or the World Bank. Through this, these countries were then largely defenceless against the inflow and outflow of capital.

An example of **influx control** is the cash deposit requirement which Chile established in the 1980s. This method requires a part of the transferred capital to be deposited with the central bank. The cash deposit requirement is limited in time, for example, for a year. If the capital which flowed in is withdrawn again after the period expires, the deposited amount is returned to the investor without interest. If the sum is withdrawn before expiry, interest is paid as agreed by a contract. Long-term financial investment is fostered by this. The instrument is exceptionally flexible since the amount of the cash deposit can be restricted to 10, 20 or 30% of the borrowed amount depending on capital requirements of a country.
Malaysia restricted **capital outflow** after the Asian economic crisis broke out: the government forbade payments in Ringgit to foreign countries for goods and services as well as for repayment of foreign loans. Foreign funds exchange was only allowed with the consent of the central bank and foreign currency could only be converted in restricted amounts.
Quantity restrictions are also a typical form of capital transfer control. The import or export of foreign currency above a certain amount has to be notified (this limit lies at USD 10,000 on entry into the USA, for example). The inflow or outflow or both can be completely restricted when a certain amount is exceeded.
Capital transfer controls can considerably expand the political possibilities of national governments and generally contribute to safeguards against financial crises. They can decrease the "risk of infection" considerably. The reason why states such as China, India or Chile which have been unaffected or hardly affected by international financial crises can also essentially be explained by the fact that they have not removed their capital transfer and foreign currency restrictions.

3.2. Regulation of short-term capital flows

The short term nature of international capital flows is one of the most important causes of instability. More than 80% of all capital transactions involve short-term (up to 7 days) capital flows. Thus, this proportion will have to be drastically reduced to a stability driven and

development friendly financial system. Several instruments can be used for this, or, if necessary, also in combination with each other. For example:

- **capital transfer controls** whereby the flows are controlled so that long-term investment is encouraged and short-term capital flows are discouraged or made more expensive, e.g. according to the cash deposit requirement example in the previous section**,**
- the **taxation** of currency transfers (Tobin tax). This sales tax on foreign exchange dealings was suggested by the economic Nobel prize laureate James Tobin with the intention of putting "sand into the wheels" of the financial markets. The basic idea is simple: when large sums are used, often in the range of hundreds of millions, then even tiny exchange rate fluctuations of one hundredth of a per cent still make speculation a lucrative business. Such operations are often carried out over a period of only a few hours - thanks to computers and modern means of communication. Even a low tax can make a large part of this business unprofitable. Then they simply no longer occur.
- a **stock exchange transaction tax on the secondary trade in securities**. The introduction of a stock exchange transaction tax (e.g. to the amount of 1%), imposed solely on the secondary trade in shares and bonds but not on new emissions or first purchases could de-accelerate the securities markets and again produce a stronger tie-in with the financing function. Such a tax would be in conflict with the shareholder-driven logic (see chapter 1.6.). It would remove the incentive to repeatedly buy and sell securities over short time spans. However, the financing of real economic investment would not be affected. In addition to the controlling effect, the stock exchange sales tax would produce considerable income for the state.
- **Interest rate policy.** At present, capital market interest rates on short term loans are lower than for long term loans. This is justified by the argument that, from a micro-economic perspective, the credit risk grows with longer terms. But from a macro-economic view point, short termism in all its forms represents a systemic risk. The central bank should become active and increase interest rates for short-term money and reduce the interest rates for long-term real investment.

3.3. Regulation of institutional investors

The German Federal Government had the intention of pushing for more transparency with hedge funds at the G 8 Heiligendamm summit. However it failed in this respect, primarily because of resistance from the USA and Great Britain. Nevertheless, the topic reached the agenda, even if the call for transparency remains way below the regulation that is necessary.
In principle business transactions in all funds - hedge funds as well as private equity funds - which are located in offshore centres and tax havens, and therefore, subject to no or completely inadequate supervision, should be forbidden. Those who consider this as too much like a planned economy should be reminded of the fact that there are plans to prevent the take-over of strategically important businesses by a certain type of buyer, the so called sovereign funds,[26] or even that this is already the practice in a series of industrial countries. Thus, an Arab fund was prevented from buying harbour facilities in the USA, and current discussions in Europe, which also include Germany, focus on preventing sovereign funds from purchasing energy companies. This is aimed primarily at Russian and Chinese state funds, which now use the enormous foreign currency surpluses of their countries to go on a worldwide shopping spree, buying up businesses.

[26] State owned investment funds.

This approach should be generally extended to all high risk funds that avoid serious supervision. Those which remain should be regulated in the following way:

- **Restriction on raising foreign capital.** Highly leveraged borrowing, whereby borrowing is often a multiple of the equity capital, is one of the greatest stability risks on the financial markets. Transferring the debt to the purchased business should depend on gaining permission from the legal supervisory authority. The supervisory authority can forbid debt transfer when it constitutes a disproportionate strain on the business concerned.
- **Greater voting rights for long-term investors.** Corporate law should be changed so that investors who hold their securities for longer periods should benefit from double, triple or more voting rights depending on the security maturity period. This should make funds give up their locust behaviour.
- **Expansion of employee participation in management.** This is to stop funds dealing ruthlessly with the social interests of the employees.
- **Absorption of additional income of management from company profit participation.** Stock options, and similar compensation, etc., should be highly and progressively taxed to reduce their corrupting effect and make the exclusive focus on the short-term profit interests of shareholders unattractive.
- **Social security systems should be publicly run.** Capital market financed welfare systems such as private health insurance and pension funds are not only less secure for the individual, they also promote social inequality. The socially underprivileged cannot afford adequate protection. Because of the immense sums involved, they increase the systemic risks on the financial markets and foster global redistribution, from the bottom to the top. Consequently, the welfare of every day life should be publicly run and be based on the solidarity principle, which means that it must contain a redistribution component from top to bottom. Private systems should only be accepted as supplementary welfare.

3.4. Regulation of derivatives

As the U.S. mortgage crisis in 2007 has once again shown, derivatives must definitely be regulated so that their destabilizing effect on the financial system is minimized. Thus, only standardized derivatives certified by stock exchange supervisory authorities should be permitted. These may only be traded on the stock exchange. The unofficial market (OTC - Over The Counter) should be dried out. For example, this could be done by withdrawing legal contractual protection, and dealing in them made an offence, just as with illegal drugs. Supervision would have to control that banks and other institutional investors are prevented from trading over the counter. Short selling[27], including products developed for purely speculative purposes, should be banned.

3.5. Neutralizing offshore centres and tax havens

The claim that OFCs are beyond the reach of political regulation because they are autonomous under international law has been refuted by reality. The USA, after September 11th, has shown that sovereignty under international law is no hindrance to taking vigorous action against the financing of terrorism via OFCs, since the Isle of Man, Guernsey, the Dutch Antilles, Puerto

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[27] *In short selling, a fixed term contract on asset values which are not yet in the seller's possession is agreed. Short selling is banned in Germany.*

Rico, etc., come under the jurisdiction of large industrial countries, and are integrated into the normal fiscal and financial laws of the "mother country" by administrative act.
Multilateral action against OFCs would be best. However, this is difficult and only possible over the long term. Nevertheless, individual countries certainly have possibilities for unilaterally protecting themselves from the consequences, provided there is a political will for this exists, since:

- Banks and financial institutions could be barred from entering into transactions with OFCs under the threat of sanctions,
- Transfers to jurisdictions with banking secrecy, anonymous foundations, numbered accounts etc., could be submitted to automatic punitive taxation,
- international cooperation of national supervisory authorities must be promoted and secured in international law,
- an international tax supervisory authority should be created. A dispute settlement body similar to the WTO should be established to decide on sanction-backed measures in case of dispute.
- Transnational corporations should be subject to world-wide uniform basic taxation and/or a minimum tax should be introduced,
- national tax systems and tax evasion investigations should be organized in a way so that tax evasion is only possible with difficulty.

3.6. A new debt regime for developing countries

The massive debt crisis in developing countries which emerged in 1984 and has been exacerbated by further financial crises has at present been overcome by most emerging market nations. However, it is still a serious obstacle to development for many poor developing countries, particularly for the group of about 40 heavily indebted poor countries (HIPCs). The debt relief initiative adopted at the G8 in Cologne in 1999 has brought relief to some countries, but overall, the HIPC initiative proved to be inadequate.

Thus, now is the time to finally and completely eliminate the problem from the world by granting unconditional and complete debt relief.
In addition, an international insolvency law should be established which provides for fair and transparent proceedings if new debt cases occur, so that such crises can be rapidly dealt with. This is because there are no provisions for sovereign state debtors like the insolvency proceedings for businesses and private individuals that exist in most national economies. The details for such proceedings are filed in the drawers of multilateral financial institutions but these proposals could not be put into practice because they were being blocked, mainly by the USA.

3.7 Institutional aspects

The USA rejection of international insolvency proceedings for sovereign state debtors shows that international financial institutions must be fundamentally reformed.

3.7.1. Reform of international financial institutions

- the IMF and the World Bank must be democratized. There is urgent need for a voting rights reform which ends the blocking minority of the USA and the disproportionate

influence of the industrialised countries. A system of double majorities would prevent donors and recipients alternatively gaining majorities.

- the IMF should return to its original mandate of providing liquidity at short notice (the lender of last resort) in the case of problems with payments. The IMF should withdraw from financing development, since it lacks the competence for this,
- neo- liberal restructuring policies must be abandoned,
- the World Bank should be confined to the role of financing development,
- the role of regional development banks should be strengthened,
- the role of the Bretton Woods institutions as neo-liberal propaganda facilities should be abandoned. Instead, the plurality of development models should be recognised.
- at the same time, the UNCTAD role has to be reinforced. Attempts by industrial countries to increasingly marginalise UNCTAD must be stopped. It plays a positive role as think tank and advisory body to developing countries,
- the UN Economic and Social Council (ECOSOC) must be upgraded over the long term as the most important economic regulating institution. It must be equipped with competences similar to those of the Security Council.

3.7.2 The Banco Del Sur, an alternative to the Bretton Woods institutions?

The Banco Del Sur (Bank of the South) is a new regional development bank project for Latin America, announced in February 2007 by the presidents of Argentina (Kirchner) and Venezuela (Chavez). Its head office will be in Caracas. Decisions will be made according to the traditional principle *"one Dollar, one vote",*[28] financial deposits of member countries will be proportional to their economic strength.

In contrast to the existing regional banks which are part of the World Bank family, the Banco Del Sur offers an alternative that will be independent of industrial countries and the Bretton Woods institutions. In this respect, the Banco Del Sur is an innovative approach to multilateral development financing.

Ecuador, Paraguay, Bolivia, Brazil and Uruguay have also joined the project in the meantime. The bank was officially launched in December 2007. The start-up capital amounts to 7 thousand million U.S. dollars. The main financing emphasis is intended to primarily be on infrastructure projects as well as small and medium-sized businesses.

From a development policy perspective, the regionalization and independence from the Bretton Woods institutions and the industrial countries is progress - provided new dependencies do not arise. The future will also have to show, whether the targets for lending are really an alternative to the policies of the Bretton Woods institutions. The bank then could become an alternative to the liberal market monoculture in multilateral development policies and thus aid a plurality of development strategies to achieve a breakthrough. If the bank is successful, it might become a model for other regions.

3.7.3 Rating as a public service - strengthening financial supervision

The commercial rating agencies have proved to be a factor for instability. This service should therefore be taken over by legal institutions under public law which are part of the supervisory system.

[28] Initially Ecuador and Venezuela were in favour of the “one country one vote” principle. Under pressure from Brazil, however, this proposal was dropped.

In general, the supervisory system has to be strengthened. In particular, the transnational cooperation of supervisory authorities has to be improved.

3.7.4 Democratic control of central banks

The neo-liberal taboo concerning the independence of central banks must be broken. It is an alien element in a democracy. In particular, an institution whose decisions substantially affect the fate of whole national economies, and with that, millions and millions of their citizens must be democratically controlled. The duties of the central bank are to be defined by parliament, which should also exercise control over central bank policy.

The participation of socially relevant groups such as labour unions, social associations etc., has to be institutionalised.

3.8. Financing global public goods

The UNO passed the millennium development goals (MDGs) in 2000, and their main concern was to halve absolute poverty by 2015. Against this background, the debate concerning innovative instruments for financing development, which started in the mid 1990s and were made popular in the Monterrey process, has gained in significance. Primarily, the new instruments include international taxes, with the currency transaction tax (CTT or Tobin tax) as the best known example.

In the meantime, the concept of international taxation has been realized in a pilot project. France, as the first country, has introduced an air ticket tax on July 1st, 2006. Others followed, among them, Brazil, Chile, South Korea and Norway. Concerning taxes, an air ticket fee is a very modest project. The revenue is relatively small[29] and the ecological impact is zero. But, politically, this step was a breakthrough (see Landau, 2004). It provides new dynamics to the process. Within only ten years, a new type of regulatory instrument has jumped from utopia into reality. There are many signs indicating that the international taxation concept can gain acceptance over the long term.
The tax on air tickets is imposed by the corresponding national fiscal authority on each ticket purchase. Thus, the immediate impression is of a quite normal national tax. However, it is new, firstly, because it is simultaneously levied with other countries, and secondly, it is raised for an international cause, in this case, the fight against AIDS, malaria and tuberculosis.
The levy is still carried out on a nation state basis, and sovereignty over its use also lies with the respective nation-states. Thus, international taxation does not necessarily require an international institution. However, other, further-reaching scenarios are conceivable. For example, when the tax is raised by a multilateral institution, and if there is a multilateral decision what use should be made of the revenue. This, however, would require a much higher degree of multilateral integration.

3.9. International controls, a new paradigm

The power to impose taxes is one of the supporting pillars of modern states, together with state monopoly on power. Both are historically and structurally bound to the territorial principle of the nation-state. Thus, international taxation is a project which raises all the questions which arise in

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[29] France estimates 200 million euro, Brazil a maximum of 12 and Chile 5 million dollars.

connection with the changing shape and function of the nation-state under conditions of globalization. Therefore, it is historically a completely new paradigm - similar to attempts to internationalise the state's monopoly of power (UN Security Council, International Court of Justice, etc.): the formation of an element of a transnational state.

There is another dimension of international taxation: the steering function of taxes. Taxes set incentives within the framework of a nation in order to pursue economic or social and political objectives. Taxes can eliminate or compensate negative externalities or can provide positive incentives.

Thus, the discussion concerning international taxation is not only about a further source for financing MDGs, but also about (re-)gaining the political means for regulating society. Since the scope of nation state regulation instruments is being eroded under the conditions of globalization, there is tremendous potential for the regulation of globalization through international taxation. International taxes are an important attempt to develop alternatives to neo-liberalism and an indispensable part of a post neo-liberal world order.

In this way, international ecological taxes can make a valuable contribution to the stimulation of climate-friendly behaviour. Thus, conceptually mature proposals exist to tax plane emissions (WGBU 2002) such as those by the Scientific Advisory Council of the German Federal Government on Environmental Changes or proposals to tax CO_2-emissions are available. In the meantime, even the IMF director, Rodrigo Rato, has spoken in favour of a tax on greenhouse gases.

A whole number of other economically focussed proposals besides the CTT have been suggested. These also have an economic steering effect objective and can intervene in international financial markets. They include, for example, international taxation of transnational companies[30], of portfolio investment, of banking secrecy, and of offshore centres.

A decision on a follow-up conference was made in Monterrey in 2008. This conference is scheduled for the second half of 2008 in Doha.

4. Concluding remarks

Civil society has to face the challenge of dealing more intensively with the topic of finances in general and financial markets in particular. A democratic, socially just and ecologically acceptable structuring of globalization will not occur unless the financial markets are correspondingly regulated.

The air of mystery surrounding this topic should not deter anybody. Many seem to find financial questions particularly difficult and complex and only accessible to experts. And some experts like to encourage this impression. Of course, financial market relationships are not simple. But the degree of complexity is in no way different than for other topics, such as world trade, climate change, social and cultural diversity or whatever. Civil society has acquired qualified (counter-) expertise for such complex topics, developed political skills and carried out successful campaigns.

Therefore, the financial market topic is no more complicated than others. Also, a touch of a claim to power is often attached to this complexity talk. The great French sociologist Pierre Bourdieu liked to speak of *"high priests of neo-liberalism"*. Just as the priest pretends to have secret

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[30] Such a tax would have a large tax base. Currently, 860 thousand million US$ are raised in tax from TNCs (Landau 2004, 93). Already, an income of 43 thousand million US$ would be generated by a general levy of only 5%. Technically, this tax could be easily levied, because taxation on TNCs already exists, and they would constitute a high measure of distributive fairness (Cossart 2005). On the other hand, the political difficulties may be considerable.

knowledge, so do some neo-liberalism preachers purport that only they know how the whole system works. This is an ancient power trick and we should not be impressed by it. If bankers and fund managers can understand it, civil society can also understand it.

In addition to this, as soon as we touch the axiomatic basics of the system, for example, *"the invisible hand of the market"*, conspicuous parallels to the supernatural and the irrational surface. In this respect, the comparison with high priests is not only polemical. In every other science, stories of an *"invisible hand"* would be laughed at.

Above all, the basic driving force of the system is anything but complex. The prime motive and engine is the well-known principle of profit maximization which also drives the financial markets. Sometimes more aggressively and more excessively than in other markets. However, profit maximization as the sole basis for the economy is a hopeless over-simplification, given the immense complexity of 21st century problems.

Instead of the ominous "*invisible hand*", humanity must consciously decide on its own destiny. Democracy must not stop at the financial markets. The destructive dynamics of unleashed markets must be channelled by reason, and the potential of financial markets should be used for the prosperity of nations, that is, for everybody, and not only to provide wealth for the rich and the super rich.

Does money rule the world? Certainly, and to a considerable extent up till now. It is imperative that the people rule the world. Consequently, we need democratic regulation of the financial markets.

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Appendix

Survey of actors in the political field of "international financial systems"

1. Multilateral State Organizations

1.1. The IMF and the World Bank

The IMF and the World Bank are central actors in the global system of financial governance.

The IMF supervised the system of fixed exchange rates and controlled capital transfers up until the end of the Bretton Woods system. Afterwards, it also retained the function of providing liquidity to countries with a liquidity crisis. However, these are loans which must be repaid after the crisis. Thus, the IMF has become an important creditor. Additionally, it is a preferred creditor, that is, its loans must be serviced first. Conversely, the credit rating of a country increases if it is regarded as creditworthy by the IMF.
The creditor status of the IMF provided the stepping stone for using debtor dependence to force restructuring according to the neo-liberal model on to the debtor and adapt its economy in a neo-liberal manner. Additionally, the IMF was actively involved in the worldwide establishment of the hegemonic discourse of neo-liberalism.
However, the situation has changed over the past years. Large debtors such as Argentina, Brazil and the emerging markets of Asia have repaid their debts to the IMF and are no longer dependent on this creditor.
The IMF also has a leading role with respect to the World Bank. Besides its portfolio funds (25 thousand million U.S. dollars, on average), and its influence on policy discourse, it is the most important institution for financing development and directs mainstream development policy. Since the World Bank is closer than the IMF to the realities of developing countries because of its mandate and expertise, it takes a more differentiated position. Nevertheless, the bank is an integral element of the ruling powers which implemented the dominant interests of the G7 and, in particular, their leadership. Finally, the perception of the elder statesman of American political science, Zbigniew Brzezinski, of the Bretton Woods twins still remains valid: "*officially the International Monetary Fund (IMF) and the World Bank represent global interests and carry worldwide responsibility. In reality, however, they are dominated by the USA which founded them at the Bretton Woods Conference in 1944."* (Brzezinski 1999: P. 49).
www.worldbank.org

1.2. The WTO

The WTO is mainly concerned with trade, and therefore not directly involved in the financial system. It nevertheless plays a role. It has considerable influence over the financial system through the GATS-Annex on financial services.

Financial services became an object for multilateral negotiations for the first time at the beginning of the Uruguay round in 1986. An agreement was reached in 1997 - the fifth GATS protocol, which was ratified in1999.
The general principles and regulations of the GATS also apply to financial services, including the most favoured treatment clause, the reciprocity principle and the non-discriminatory principle. A market-friendly analyst assesses the effects of the agreement on the finance sector as follows: "*from the historical perspective, it has been possible to multilaterally consolidate a uniquely high*

liberalisation standard by means of the multilateral financial services agreement" (Werner, 1999, p. 102).
The EU alone has addressed requests for opening markets to 109 countries in the Doha round. Among these were requests in the financial services area addressed to 84 countries. These included 30 of the poorest developing countries.
Thus, capital transfer controls can virtually be bypassed by means of financial services, as, for example, through profit transfers between the subsidiary and the parent company, or through allowing derivatives.
www.wto.org

1.3. The Bank for International Settlements

The Bank for International Settlements (BIS) in Basel is hardly known and is mostly underestimated with respect to its influence. The BIS is an association of the central banks of the industrial countries. It is formally a limited company, whose shareholders are the central banks of the OECD countries.

The central bank presidents of Belgium, Germany, France, Great Britain, Italy and the USA are full members of the board of directors together with six representatives of private industry from these countries. Stake holders from other social areas, such as labour unions or NGOs, have no access. Another nine central bank presidents from the remaining member states are elected to the board of directors.

The BIS is authorized to support gold and exchange rate transactions as well as short-term credit, bank rates and secured loans[31] for refinancing the member banks. For this reason, it is regarded as the central bank of the central banks. Basically, the BIS exists to facilitate central bank cooperation through the flow of information and multilateral consultation.

Additionally, the BIS serves as a forum for international monetary and financial cooperation. The Committee on Banking Supervision (CBSRP) was set up in 1971 to supervise the global financial system - after an international bank crisis. The Basel Accord (Basel I) was passed in 1988 to set standards for the minimum capital of banks.
Since the G7 summit in 1995, BIS works intensively on the question of international financial stability. It houses the International Association of Insurance Supervisors (IAIS) which seeks to oversee the insurance industry activities and risks since 1998.
All these secretariats and committees are organizationally independent but nevertheless closely linked to the BIS and have at times taken opposing positions to the IMF.
The BIS is not subject to democratic control. It does not have any directive authority, though. It can only express recommendations. However, these recommendations develop a powerful effect on the private sector, which, on the one hand, is also formally represented in the committees of the bank, and therefore contribute to a considerable extent to their formulation. On the other hand, it can rapidly become competitively disadvantageous if the recommendations are not followed. The BIS is of great value as an information source and as an indicator of discussion trends in the financial community.
www.bis.org

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[31] Interbank transfers

1.4. The Financial Stability Forum (FSF)

The Financial Stability Forum was founded in 1999 as a reaction to the Asian economic crisis. It is intended to contribute to strengthening the stability of the international financial system, the ability of the markets to function, and to reducing systemic risks. High profile representatives from finance ministries, central banks and financial supervisory authorities of the G7 countries and other important international financial centres (Singapore, Hong Kong, Netherlands, Australia) as well as representatives of important multilateral institutions and committees belong to the forum (IMF, World Bank, BIS, ECB etc.,)

The forum regularly analyses the situation on the international financial markets to anticipate weak points and to elaborate remedies to eliminate them and supervise their implementation, as well as coordinates the exchange of information between the various authorities, institutions and committees responsible for financial stability.

The FSF does not have any direct intervening political power. The FSF is a component of the global system of economic governance in the form of a think tank, an instrument of political advice and for networking on discussions within the financial community. The political profile is largely determined by neo-liberal thinking, even if the presence of supervisory authorities sometimes cause the contradictions and problems of the financial markets to surface in the forum's statements.

www.fsforum.org

1.5. The Financial Action Task Force for combating tax havens

The Financial Action Task Force (FATF) was established in Paris in 1989 on recommendation of the G7 Summit. Meanwhile, there are 33 member countries, most industrial countries as well as some emerging market countries. Additionally, regional task forces were created (the Caribbean, Asia/Pacific, West Africa, East and Southern Africa, the Middle East and North Africa).

The FATF head office is at the OECD in Paris.

The FATF mandate is very limited. It restricts itself to monitoring, information exchange, accumulating expertise and developing standards and recommendations. In addition, FATF is also narrowly confined to the topics of money-laundering and terror financing. The sums involved are considerable: 590 thousand million to 1.5 billion U.S. dollars annually (FATF 2006).

The committee does not have any practical powers to intervene. It can only issue recommendations. The main result of FATF work is a set of standards - 40 recommendations to counter money-laundering, which were published for the first time in 1990. The recommendations were extended after September 11th ("40+9")[32].

Even if the Task Force cannot directly develop any immediate practical effect, the reports shed an interesting light on the conditions in the offshore centres. For example, it states in recommendation 5 that financial institutions should not enable anonymous accounts or accounts with obviously false names, and should maintain a file with the names and addresses of customers!

www.fatf-gafi.org

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32 The recommendations are to be found at: www.fatf-gafi.org/dataoecd/7/40/34849567.PDF

1.6. The Leading Group for innovative development financing

The *Leading Group on Solidarity Levies to Fund Development* was established prior to the UN plenary session in 2005, following the initiative of the French president Chirac and his Brazilian colleague for innovative development financing (the so-called Lula Group). The immediate introduction of an airplane ticket tax by France to finance development has supplied some dynamics.

This is an informal group. The last meeting of the group in Seoul (September 3-4th, 2007) listed 40 countries as members. The group permits very extensive participation of non-government organizations. NGOs have the right to be heard and are listened to as experts.

In addition to the ticket tax, the *Leading Group* also maintains other instruments on the agenda, particularly the currency transaction tax, for example. At the same time, a variety of other proposals have also been presented to the group, such as an international lottery, cash transfers of working migrants to their home country (worker's remittances) or so-called *Advanced Market Commitments*[33].

Critics complain that such proposals divert concentration on significant measures such as the currency and air traffic taxation and only serve the image of individual countries. What is decisive to the future of the group is whether it is able to play a role in the *Monterrey-Follow up*[34].

www.diplomatie.gouv.fr/en/France-priorities_1/development_2108/innovative-ways-to-fund development_2109/international-conference-on solidarity-and-globalization-innovative-financing-for development-and-against-pandemics-february 28-March 1-2006_3964. HTML

1.7. The OECD

The OECD was founded in 1948 with headquarters in Paris and joined by 30 industrial countries with the objective of promoting reconstruction in Europe.

In theory, the OECD does not intervene in politics[35], but considers itself to be primarily a think tank and advisor on politics. It nevertheless exerts considerable influence. It often provides the conceptual basis for important plans in the member countries through regular country reports on individual topics - from employment to education, from technology, pension systems up to economic development in the member countries, extensive statistics and much more. Thus, the conceptual basis for the wave of privatization of social security systems was prepared by the OECD. The OECD is also active in developing standards such as, for example, the code of conduct for transnational businesses which was already compiled in the 1970s, and has been revised many times, especially with regard to adaptation to the neo-liberal Zeitgeist.

The *Development Assistance Committee* (DAC) of the OECD is the authoritative institution for questions on statistics and definitions on development aid.

The social and political orientation of the OECD has generally turned strongly neo-liberal. Nevertheless, many of its publications are valuable sources of information.

www.oecd.org

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33 An Italian proposal formulated during the Berlusconi government. The point was to subsidise the private production of pharmaceuticals which were indeed important to developing countries, but for which there was no commercial demand because the sick had no money. This is a typical example of how market failure was to be compensated by public services.

34 It was decided at Monterrey that there would be a follow-up conference in 2008. This is scheduled to be in Doha in November 2008.

35 An exception was the attempt to change the scope for an ultraliberal investment agreement (*Multilateral Agreement on Investment* – MAI). However, this case failed in 1998.

1.8. UNCTAD

The UNCTAD was originally founded as a UN conference in 1964 with a negotiation mandate, and was the platform of the developing countries up to the 1980s in the north-south dialogue. It is active for a *new international economic order.*

The UNCTAD became a thorn in the side of the neo-liberals after the monetarist transformation, because it maintained a critical distance. Its negotiation mandate was already withdrawn during the Uruguay Round of the GATT negotiations. Since then, the UNCTAD has been reduced to an advisory body for developing countries. The G7 did not want to tolerate a further multilateral organization alongside the WTO.
The influence of the UNCTAD has again increased in proportion to the obvious failure of the neo-liberal development policy projects; and also as the WTO entered into crisis. It was one of the few multilateral institutions to have theoretical economic pluralism in its statistics, analyses, and reports, and additionally, (neo)-Keynesian and other heterodox approaches were not eliminated.
Among others, UNCTAD topics include trade, foreign investment - and thus also occasionally casts a critical eye on transnational business practices - as well as the debt crisis and the international financial system. Referring to the latter, it stated in the World Investment Report 2006 : "*the market based reforms which were carried out in the majority of the developing countries from the early eighties have not fulfilled the promises of their protagonists. This failure can probably be partially explained by an extremely deflationary macroeconomic concept."* (UNCTAD 2006: P. 61).
Much work by UNCTAD is an important resource for alternatives to neo-liberal orthodoxy.
www.unctad.org

2. Civil society actors[36]

2.1. Europe and international networks with main emphasis on Europe

- **Attac** is an international network of national member organizations in Austria, Belgium, Denmark, Finland, France, Germany, Italy, Switzerland, Sweden and Spain**.** Themes: Globalization, Tobin tax, international taxation, tax justice, tax evasion, regulation of the financial markets. Activities: expertise, publications, work in the field of education, public work, actions. Campaign capability is good in some countries. There is a scientific advisory council with well-known economic scientists in France, Germany and Switzerland. http://www.attac.org
- **Bank Track**, Utrecht**.** An international network of 16 NGOs from Argentina, Australia, Belgium, Brazil, France, Germany, Italy, Netherlands, USA. Themes: Monitoring of banks, insurance companies and pension funds with a strong environmental component. Activities: Research, education, publication, networking, dialogue with the financing economy. http://www.banktrack.org
- **Bretton Woods Project**, London. British NGO with national members (among others Amnesty, Christian Aid, Action Aid). Themes: Critical monitoring on IMF and World

[36] This list is certainly incomplete. The editors would be thankful for any additional information.

Bank. Activities: Research, monitoring, publication.
http://www.brettonwoodsproject.org/index.shtml

- **Campagna per la riforma Della Banca Mondiale**, Rome. Italian network, closely linked to the large aid organization *Mani Tese*. Critical monitoring on IMF and World Bank. Development financing, international taxation, the Tobin Tax. Activities: Campaigns, monitoring, publication.
- **CEE Bankwatch**, Prague**.** Network of NGOs in Central and Eastern Europe. Social and ecological consequences of the activities of financial institutions. Activities: Monitoring information, education, lobbying, campaigns. Strong environment and regional orientation. http://www.bankwatch.org
- **Corporate Europe Observer (CEO)**, Amsterdam**.** NGO. Research, monitoring of private sector lobbying activities. Partial monitoring of the financial services industry. http://www.corporateeurope.org
- **EURODAD**, Brussels**.** European network. Members in almost all Western European countries. Includes Action Aid, Christian Aid, Erlassjahr/Jubilee, HIVOS, NOVIB, Misereor, Oxfam, Save The Children. Themes: Developing country debt, restructuring. Activities: Expertise, publications, lobbying, networking. http://www.eurodad.org
- **European Network on the CTT** (ENCTT). Loosely organised European network of national organizations and networks in Belgium, Germany, Finland, France, Great Britain, Italy, Netherlands, Sweden. Themes: Tobin Tax, international taxation. lobbying, networking. Members use the internet in a decentralized way. In Germany: http://www.weed-online.org
- **Jubilee Campaign/Erlassjahrkampagne.** Decentralized network of national networks in 50 countries. Themes: Debt of developing countries. Research, information, publications, campaigns. Strong proportion of church groups. http://www.jubileedebtcampaign.org.uk German Erlassjahrkampagne: http://www.erlassjahr.de
- **Tax Justice Network**, London**.** Global network of NGOs, labour unions, religious, political and social movements. Tax havens, offshore centres. Research, publications, networking, campaigns. http://www.taxjustice.net
- **Transparency International**, Berlin**.** Transnational NGO with 90 local and national members. Combating corruption. Tax havens, offshore centres. Research, publications, lobbying. http://www.transparency.org
- **WEED**, Berlin**.** NGO. Main emphasis on financial markets, debt, CTT, international regulation. Research, publications, lobbying, networking. http://www.weed-online.org

2.2. North America

- **Bank Information Center**, Washington**.** NGO. Critical monitoring on the World Bank, regional development banks and IMF. Research, monitoring, publications, lobbying. Service orientation for partners in development organizations. http://www.bicusa.org/en/Index.aspx
- **Fair Finance Watch**, New York**.** NGO. Monitoring of the financial service industry in the USA. Activities: Research, publications, campaigns. http://www.fairfinancewatch.org
- **Financial Policy Forum**, Washington**.** NGO. Derivatives, pension funds, development financing. Activities: Research, publications. http://www.financialpolicy.org

- **Halifax Initiative**, Ottawa**.** NGO with corporate members among Canadian labour unions, churches and NGOs. International financial system, multilateral financial institutions, debt. http://www.halifaxinitiative.org

2.3. Developing countries

African Forum and Network on Debt and Development, Afrodad, Harare**.** NGO. Debt. Research, information, education, networking. http://www.afrodad.org

- **Focus on The Global South**, Bangkok**.** NGO with branch offices in Thailand, the Philippines and India. Globalization, world economy, international financial institutions, development financing. http://www.focusweb.org
- **Instituto Brasileiro de Análises Sociais e Econômicas -- ibase**, Rio de Janeiro. http://www.ibase.br
- **PUBLIC Interest Research Centre**, Delhi**.** NGO. World economy. Financial markets financial services. Research, publications. kaval@nde.vsnl.net.in
- **Third World Network**, Penang**.** International NGO with offices in Malaysia, India, Uruguay and Accra. Member organizations in India, the Philippines, Thailand, Brazil, Bangladesh, Malaysia, Peru, Ethiopia, Uruguay, Mexico, Ghana, South Africa, Senegal. World economy, development financing, financial services. Research, information, education, lobbying, networking. http://www.twnside.org.sg