

A failed financial architecture... and how to build a new one



FINANCIAL ARCHITECTURE

Finance is usually explained in water metaphors: money "flows", "benefits from growth", "trickle down" to the poor, capital "leaks" out of countries to tax havens.

From a first glance at this construction, most people will see a waterfall, in the same way that most residents of rich countries think that an enormous flow of their tax contributions is directed to poor countries. In the form of aid, loans, trade benefits and frequently talked about debt cancellations. But the water cascading down doesn't quite reach the poor... Instead it is diverted and -against all logic- it flows up instead of down.

In 2008, Social Watch used this illustration, inspired by the famous "Waterfall" painting by MC Escher, as a metaphor for the global financial architecture. This structure primarily features the Bretton Woods institutions (the World Bank and the International Monetary Fund - IMF), despite the fact that they had clearly failed to achieve the objectives they were created for: to ensure financial stability, full employment and development. We argued then that a mechanism that redistributes capital from where it is scarce (the low and middle income countries) to where it is abundant is "impossible, both in the sense of impacted and in the sense of instable" and that the international financial architecture really needs to be redesigned.

Two years later, the international financial system collapsed, credit sources dried up and recession spread like a pandemic from the richest economies to the poorest.

The need for substantial reform is now widely acknowledged, but a common understanding of what went wrong still needs to be achieved, before a blueprint for a new financial architecture can be agreed upon.

On the other hand, there is a growing consensus on the immediate need to compensate for decreasing private sector activity and falling markets with stimulus "packages". More than USD 10 trillion has been spent worldwide on subsidies or tax cuts benefiting corporations, banks and affluent individuals, but those have largely not resulted in reinvigorating credit or in stimulating countercyclical spending. The banks are reluctant to lend to businesses with uncertain future, and likewise, consumers are preferring to save instead of spend. But people living in poverty, in developing countries or in rich countries, will spend every single penny that they receive. Since the poor do not have the option of postponing consumption, the best stimulus plan to address the global economic crisis is to invest in them. This is not merely a basic principle of justice; it also makes good economic sense.

HEDGE FUNDS AND THE "CASINO ECONOMY"

Common sense and basic math say that you cannot consistently make money betting in a casino. In the same way, in no market can everybody earn above average profits, and no financial instrument can be long term more than the real economy activities on which it is based. Yet, as investors always want to believe they can defy the laws of gravity, huge amounts of money were invested in hedge funds and other "innovative financial instruments", backed by irresponsible high-A credit ratings. The hedge returns achieved by hedge funds in a wide range of the use of higher risk. The higher risk is generated by the use of leverage - the practice by which an investor can borrow money - investors invest more in it, in this regard, the hedge funds invest more than the real economy. As a result, hedge funds began to invest in hedge funds which, in turn, can eventually to leverage themselves. This can go on indefinitely, until the system collapses. The "casino economy" of financial markets led the house of cards in September 2008 and, with it, the global financial architecture and non-wealthy by governments would bring properly.

EXTERNALITIES

The decision by many rich countries to back their banks with government money has a negative impact on other banks in poor countries, people in poor countries are indirectly encouraged to invest in the highly leveraged banks and the highly leveraged banks are not held by powerful states. These externalities were not taken into account by the Bretton Woods institutions. While no country governments spend billions to guarantee the solvency of the private banks, developing countries have to do so in order to compete in the global market, a drop in remittances, scarce credit and are not in a position to spend money.

SHORT OF MONEY... BUT KEEPING BANKS FILLED WITH IT

Due to the instability of financial markets, developing countries have to keep huge amounts of short-term money to fund their countries' foreign operations. To build up those reserves, poor countries are today charged home to the US, buying Treasury bonds that pay only 2%, well below the interest rates that developing countries pay on their own debt.

REMITTANCES

Since 1995, remittances contribute more money than all official development assistance programs combined. In Mexico, remittances are the largest source of income, responsible for 17% of families. Remittances to Mexico were their main source of income in January 2009 as a result of the downturn in the US economy and weak remittance policies.

JUST DROPS OF AID REACH THE POOR

Over the last 40 years, rich countries spent to give 0.7% of their GDP as official aid to poor countries for development assistance. The average aid delivered each year per recipient is USD 16 billion, while total aid delivered that same period reached a mere USD 2.7 trillion. Moreover, official development assistance has declined over the last 10 years, and support for students and refugees in donor countries, by withdrawing the most vital of the aid (general ODA performance, including debt relief and support for students and refugees, has been cut by 27% of ODA in 2008, 2009 and 2010).

WOMEN AND THE POOR ARE HIT THE HARDEST

The world's poor are being hit by a crisis for which they are not responsible. According to estimates, 1.1 billion people are falling an extreme poverty to 2009 and 200,000 babies are being born in the state of poverty. Women are affected disproportionately. They are the first to lose their jobs and the last to recover them, are required to compensate for the reduction of health and education services provided by governments, and suffer increased domestic violence perpetrated by the men in their households. Low income countries face a financial gap ranging from USD 270 to 760 billion this year. However, while more than 2.3 billion people in lower income countries are unemployed, rich countries committed just one 5% of the additional developer finance required to compensate low income countries. After a decade above all four, a net of 100 billion USD is left between the start of the crisis in 2007 and the end of 2010. Already had led by saving food and energy prices that peaked in 2008, as well as soaring food shortages and widespread hunger, poor countries are seeing how the demand for their exports is dropping and that remittances are low. To family members working in the developed world are declining.

COMMODITIES SPECULATION

The building and explosion of the crisis in the financial system was fuelled by an insatiably growing pressure and subsequent every year of the price of primary commodities. The price boom between 2002 and mid-2008 was the most pronounced in several decades, in a significant measure and health. The price decline since mid-2008 stands out for its steepness and the number of commodity price effects. The price rise for a number of commodities such as energy, metals and food commodities, and contributed to food crisis in a number of countries during 2007-2008. In the same way, the price in commodity prices in the second half of 2008 was one of the most dramatic through which the demand for commodities and financial activity in the major industrialized countries was maintained to the developing world.

The very first sustained increase in primary commodity prices between 2002 and mid-2008 was accompanied by a growing pressure of financial markets to commodity loans restructures. The "restructuring" of commodity markets has related concerns that many of the poorest commodity price developments - and especially the steep increase in 2007-2008 and the subsequent steep increase - was largely driven by the financial investors' use of credit facilities in the second half.

CREDIT RATING AGENCIES

Rich, Moody's and Standard and Poor's, among others, are companies that assign grades (ratings) for loans and other debt obligations issued by companies or governments and based on the market. The loans' creditworthiness (i.e., the ability to pay back) affects the interest rate. Bigly "junkies" (low credit ratings) with obligations from Asia, Africa and Latin America are often sold to hedge funds or other investors. The credit rating agencies trade like, as the financial crisis of the subprime mortgage in the US demonstrated, and many investors' greed as well were actually worthless. With the collapse of the US market in September 2008, an estimated USD 150 billion of wealth was "lost" or "washed" in China, investment banks and their derivatives set were drastically, the Securities and Exchange Commission of the US Government is investigating anti-competitive practices of credit rating agencies and working of interest, as they were grading the credit of a large company that never the source of a large part of their income.

THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK

The London summit of the G20 (an ad hoc group of the 20 most economically important countries) promised to repair the global economy by strengthening financial regulations, leading and reforming the international financial architecture. This requires protection and putting recovery through a global economy.

However, the only apparent financial architectural move was to announce the injection through various ways of USD 1.1 trillion into the IMF, the World Bank and regional development banks. Due to the glaring absence of a political consensus, the G20 members did not contribute to creating a global fund of international financial stability. In the agreement on international aid was to limit the resources of the International Financial Institution, whose decision-making has been controlled by the US and Europe countries since its creation.

However, the benefits of the capital market having increased, particularly for the IMF, which will be followed with a new USD 250 billion, cannot be compared to the potential positive repercussions of a coordinated fiscal stimulus. As economic reports have pointed out, IMF funds only help the world's economies if countries borrow from the fund, whereas fiscal stimulus affects neither global demand overall.

The G20's decision to channel funds predominantly through the IMF rather than through more diverse allocation of funds, is a serious restriction through which the developing countries may be exposed with the same type of potential and conditions policies that contributed to creating the crisis.

The capital reallocation of both the IMF and the World Bank comes without any explicit reform requirements for the institutions. Instead, the only reforms called for are that the G20-19 members on the boards of the Bank and Fund, and government reformers to increase justice and participation by developing countries, which, however, were not to be realized and implemented until 2011 for the IMF and 2013 for the World Bank.

While the IMF and the World Bank are not required to meet the requirements, those very institutions almost always require reforms from their member countries whenever upon obtaining loans.

THE BANK FOR INTERNATIONAL SETTLEMENTS (BIS)

Based in Basel, Switzerland and with a staff of over 500 people, the BIS is largely ignored by the public, even when it was the last international financial organization established in 1930 and is currently a key pillar in the international financial architecture. As a bank, the BIS only provides services to its members, which are the central banks of 95 developed and middle income countries in an "exclusive" manner. It is the only institution on an international level which is done through the Basel Committee on Banking Supervision. The BIS has been a key player in the G20 Summit approved the 192 into a Financial Stability Board (FSB), reported to membership of G20 countries and mandated with monitoring global financial stability and promoting members' financial systems. For that, the task would be to conduct national supervisory while others argue that the BIS has no real power to accomplish anything. In the recent past, BIS and its Board Committee have been responsible for creating the standards and codes for the financial sector which are not to be realized and implemented in the financial sector which are not to be realized and implemented to ensure financial stability.

WORLD TRADE ORGANIZATION (WTO)

The current Data Based of trade negotiations include financial services. Developed countries and their financial institutions are pushing a group of developing countries to open its financial markets, by allowing the establishment of foreign banks, and by allowing freedom of cooperation financial flows and services. The negotiations conclude along the proposed line, the developing countries would have to adopt the financial architecture that makes them more vulnerable.

It would also mean that countries that wish to be able to adjust policies prepared by the Single Committee to regulate financial flows and countries and instruments that are widely used in the international financial system. The G20 leaders (unintentionally) led to better regulation of global finance and to the "success of the Data Based", which would most exactly the opposite.

THE DEMOCRATIC DEFICIT

Less than one third of the countries of the world are members of the Bretton Woods institutions, but their decisions have de facto international financial rules that apply worldwide. Many countries are members of the Bretton Woods institutions, but they are not represented in the decision-making process. The US, with 16% of the world's population, is the only country that has the votes in the WTO every country has one vote, but has decided on "majority" "consensus" mechanism which gives the US a veto power in the major trading and trade issues world countries' operations.

In the case of the World Bank, the "veto" power of the US is not only a veto, but the majority in the overall balance of institutional arrangements - which protects the US against sharing of the benefits of globalization.

CRIME FIRES

The more banks than of the global proceeds from criminal activities, corruption and tax evasion at USD 1.8 billion per year will have developed financial economies. Arrogant Money Counts head of the global "money" crime and drug trafficking has been evidence that "money institutions, drug money crime the only financial investment capital" and therefore money crime in the global trade has been used to keep banks alive in the global financial crisis.

TAX HAVENS

Due to the instability of global government, it is a fact that the wealth or poverty of nations, but tax havens, which offer money, law, tax incentives, and tax regulations in a combination of all three allowing companies and wealthy individuals to benefit from the extreme benefits of tax. The good of education, education and the rule of law - while using offshore would to escape their responsibilities to pay for them, the more of the world outside the borders. Calculations made by the Tax Justice Network suggest that around USD 1.5 billion of the private wealth of "high net worth individuals" were currently held in tax havens - a "right" offshore - and thereby protected from their countries of residence. The benefits from being just this individual wealth - who are the substantially more than has through tax evasion and avoidance by corporations - would be enough to pay for the entire world's education. The annual worldwide income earned and those individuals are likely to be about USD 200 billion. Some of the income, a minimum 30% can be used to pay for the world's education. At roughly making just the very only pay that has been used to maintain the global financial system.

THE DEBT OF THE RICH

Most of the members of the G7, the politically most powerful countries of the world, have become "highly indebted rich countries" (HIRC). The nominal debt of the United Kingdom is more than four times its annual income. France two times, Germany one and a half and the US 100% of its annual GDP. In addition, the growth prospects in 2009 of all these countries are negative. These leading countries have sustained trade and fiscal deficits for more than a decade and have accumulated huge debts, over increasing consumption, in some cases with the general credit card. These high income and wealthy countries, which are the most powerful, are the most powerful. The US countries supported their economies with energy restrictions from rich, Latin America and Africa. These poor countries have spent resources which, in the case of China or India, have become rich nations, and will be transferred from countries to rich countries to pay for their own consumption. China has become the third largest global creditor. The money is flowing "right" from the poor to the rich.

The rich countries are not to be followed by 100 member countries, who are countries should not reduce the scope of international cooperation and no new lending should go to providing advanced countries, however developed they may be, unless they reorganize their economic and financial structure to the poor.

SMALL TAXPAYERS

Each year developing countries enter into an up to USD 148 billion of tax revenue from offshore source holders in tax havens. An estimated USD 2.2 billion of developing country wealth is held offshore by individuals, corporations, trusts, and other entities. In 2008, the world's total tax revenue was estimated at around USD 120 billion. If money moved offshore by private companies was included, the figure would be much higher. The total of the losses outweighs the USD 120 billion of tax revenue of the developing countries received in 2008. And capital flight is a growing problem, with an additional USD 100-200 billion being moved offshore each year.

CAPITAL FLIGHT

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CARRY THE BURDEN

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