# A failed financial architecture…
## and how to build a new one

### COMMODITIES SPECULATION

### CREDIT RATING AGENCIES

### THE INTERNATIONAL MONETARY FUND AND THE WORLD BANK

### 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 first 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 55 developed and middle income countries. As an informal "forum" it is a key place to agree on banking rules, which is done through the Basel Committee on Banking Supervision and the Financial Stability Forum (FSF). The G20 Summit upgraded the FSF into a Financial Stability Board (FSB), expanded its membership to all G20 countries and mandated it with monitoring global financial stability and promoting medium-term reform. Some critics fear that this task would unduly violate national sovereignty, while others argue that the FSB has no real power to accomplish anything. In the recent past, BIS and its Basel Committees have been responsible for drafting the standards and codes for the financial and monetary spheres that dramatically failed to ensure financial stability.

### HEDGE FUNDS AND THE "CASINO ECONOMY"

### EXTERNALITIES

### SHORT OF MONEY… BUT KEEPING TANKS FILLED WHIT IT

### REMITTANCES

… result of the downturn in the US economy and anti-immigrant policies.

### WORLD TRADE ORGANIZATION (WTO)

The current Doha Round of trade negotiations includes financial services. Developed countries and their financial institutions are pressing a group of developing countries to open up their financial markets, i.e. by allowing the establishment of foreign banks, and by allowing freedom of cross-border financial flows and services. If the negotiations conclude along the proposed lines, the developing countries would have to adopt the type of financial liberalisation that makes them more vulnerable.

It would also mean that countries that may wish to abide by policies proposed by the Stiglitz Commission to regulate financial flows and institutions and instruments may be violating their new WTO commitments. It is a paradox that G20 leaders simultaneously call for better regulation of global finances and for the "success of the Doha Round", which would entail exactly the opposite.

(Extracted from an analysis by the Third World Network)

### THE DEMOCRATIC DEFICIT

Less than one third of the countries of the world are members of the Basel institutions, but their decisions become de facto international financial rules that apply everywhere. Most countries are members of the Bretton Woods institutions, but the votes are assigned by quotas largely based on the relative economic power they enjoyed decades ago. The US, with 16% of the votes, has veto power, as decisions require 85% of the votes. In the WTO every country has one vote, but key decisions are taken by a "consensus" mechanism which gives real bargaining power to the major traders and leaves small countries powerless.

In the wise words of Amartya Sen: the "central issue of contention is not globalization itself, nor is it the market as an institution, but the inequity in the overall balance of institutional arrangements – which produces very unequal sharing of the benefits of globalization."

### CRIME PAYS

The cross-border flow of the global proceeds from criminal activities, corruption, and tax evasion at USD 1-1.6 trillion per year, half from developing and transitional economies. Antonio Maria Costa, head of the United Nations' crime and drug watchdog has found evidence that "in many instances, drug money is currently the only liquid investment capital" and therefore money made in illicit drug trade has been used to keep banks afloat in the global financial crisis.

### JUST DROPS OF AID REACH THE POOR

Almost 40 years ago, rich countries agreed to give 0.7% of their GNI as official aid to poor countries for development assistance. The average aid delivered each year never surpassed 0.4% and the shortfall has accumulated to over USD 3.6 trillion, while total aid delivered in that same period reached a mere USD 2.7 trillion. Moreover, official Overseas Development Assistance (ODA) figures tend to include debt relief and support for students and refugees in donor countries, thus distorting the real value of the aid claimed: ODA performance, excluding debt relief and support for students and refugees, has been unchanged at 0.22% of GNI in 2005, 2006 and 2007.

Sources: OECD (April 2009) and *The reality of aid 2008*

### TAX HAVENS

Tax, the foundation of good government, is a key to the wealth or poverty of nations. But tax havens, which offer secrecy, low or zero taxation, and lax regulation (or a combination of all three) allow big companies and wealthy individuals to benefit from the onshore benefits of tax – like good infrastructure, education and the rule of law – while using the offshore world to escape their responsibilities to pay for then, the rest of the world shoulders the burden. Calculations made by the Tax Justice Network suggest that around USD 11.5 trillion of the private wealth of "High Net Worth Individuals" alone is currently held in tax havens, largely undeclared – and therefore probably untaxed – in their countries of residence. The benefits from taxing just this individual wealth – let alone the undoubtedly larger sums lost through tax evasion and avoidance by corporations – would far outweigh any realistic increase in aid budgets. The annual worldwide income earned on these undeclared assets is likely to be about USD 860 billion. Taxing this income at a moderate 30% rate would produce around USD 255 billion annually, enough to finance the MDGs in their entirety. Put simply, making just the very rich pay their due taxes could immediately fund measures to halve world poverty.

### WOMEN AND THE POOR ARE HIT THE HARDEST

The world's poor are being hard-hit by a crisis for which they are not responsible. According to estimates, 53 million people are falling into extreme poverty in 2009 and 200,000 to 400,000 babies are dying, because of the drop in growth. Women are affected disproportionally. 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 proportional to the rise in unemployment.

Low income countries face a financial gap ranging from USD 270 to 700 billion this year. However, while more than USD 2 trillion were found to boost Northern economies and emerging markets, richer countries committed just over 5% of the additional development finance required to compensate low-income countries. African countries alone will face a real drop in income of USD 49 billion between the start of the crisis in 2007 and the end of 2009. Already hard-hit by soaring food and energy prices that pushed up inflation, as well as caused food shortages and widespread hunger, poor countries are seeing how the demand for their exports is dropping and vital remittances sent back by family members working in the developed world are declining.

### SMALL TAXPAYERS IN POOR COUNTRIES CARRY THE BURDEN

If low-income countries were to revise their taxes, strengthen their financial administrations and abolish tax exemptions for transnational investors so that the proportion of public revenues within gross domestic product (which was 12% in 2003) was brought to the average level of the rich countries (26% in 2003), their governments' income would increase by approximately USD 140 billion per year.

### CAPITAL FLIGHT

Each year developing countries miss out on up to USD 124 billion in lost income from offshore assets held in tax havens. At least USD 6.2 trillion of developing country wealth is held offshore by individuals, depriving developing countries of annual tax receipts of between USD 64-124 billion.

If money moved offshore by private companies was included, this figure would be much higher. The scale of the losses outweighs the USD 120 billion in overseas aid that developing countries received in 2008. And capital flight is a growing problem, with an additional USD 200-300 billion being moved offshore each year.

(Extracted from Oxfam International, "Tax haven crackdown could deliver USD 120 billion a year to fight poverty")

### 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 external 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 for all these countries are negative.

These leading countries have sustained trade and fiscal deficits for more than a decade and have accumulated large debts, over-consuming systematically, in some cases with lax domestic credit policies. Now, bank rescues and stimulus packages will deepen their debt problem. The rich countries appeased their consumers with cheaply manufactured goods from Asia, Latin America and Africa. These poor countries have export economies which, as in the case of China or Brazil have become surplus economies, and have transferred their surpluses to the deficit economies so that they can over-consume. China has become the United States' principal creditor. The money is flowing "uphill" from the poor to the rich.

This must come to an end and be addressed by all UN member countries, since no country should be outside the scope of international supervision and no new lending should go to shrinking over-borrowed countries, however developed they may be, unless they reorganize their economies and bring financial order to their nations.

(Extracted from Oscar Ugarteche, "The G20 and the HIRCs")

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