

# The time has come: Let's shut down the financial casino

## ATTAC's statement on the financial crisis and democratic alternatives

***“Disarm the markets!”*** When Attac was founded in 1998, this slogan was formulated against the background of the financial crash in East Asia. In the meantime, we have witnessed other crises triggered by financial markets: in Russia, Brazil, Turkey, Argentina and the burst of the ***“New Economy”*** bubble in 2001.

At present, the rich world is in the middle of a crisis, which is the heaviest since the Great Depression in 1929. The crash at Wall Street in September 2008 marks the end of a historical period: the system of financial capitalism, a system driven by the only search for maximum profit, has collapsed. It destroyed itself as a result of its own inherent contradictions. The financial shock waves have just reached the real economy. The US has entered into a recession, the EU is following. The entire global economy will be affected.

The contraction of economic activity will increase unemployment and inequality. New pressure will be put on wage-earners to accept more “flexibility on labor markets” implying lower wages and weaker social protection. The decrease in aggregate demand from the rich countries will also hit the vulnerable economies of the developing world and increase poverty. The Millennium Development Goals and the goals of a socially and environmentally friendly sustainable development worldwide will get completely out of reach.

The financial crash and the recession converge with a sharp increase in prices for oil and food which has led to severe social crisis in several developing countries and generated hunger revolts. Both, commodity and food price increases have multiple causes. But again as with the several financial crises, speculation by hedge funds and other institutional investors has considerably contributed to the price peaks and instability.

The trigger of the current crisis was the excessive lending of ***subprime*** mortgages to US households, and the corresponding flawed procedures of securitization through which these risky loans were sold to financial institutions and households, in the United States and worldwide. The ongoing wave of defaults had dramatic consequences on financial institutions such as investment and commercial banks, or hedge funds. Now, also the non-financial sector is affected tremendously. The economic, social and environmental outlook for 2009 is bleak for quite some parts of the world.

One should have known better. The crash unfortunately confirms the forecasts by heterodox experts such as Nobel Prize laureate Joseph Stiglitz, by Attac, by social movements and by other critics. Even supervisors knew that the system was risky, but there was no willingness to act due to the dominant belief in the self-regulation of the market.

Now, under the pressure of the crisis, even the mainstream of the financial community is calling for reforms. However, these proposals do not go far enough since they do not tackle the systemic problems behind the crisis. They are mainly aimed at the financial industry and oriented at issues of stability. This is not enough. Financial capitalism has also disastrous consequences on distribution and democracy. Bankers call for state intervention, what they mean is socialising losses, while keeping profits in private pockets. The rescue actions by the US over 700 billion – the biggest in human history – the rescue packages in the UK, Germany and other countries clearly show this logic. When the financial community talks about reform they, at best, mean a piece-meal (re)regulation and short term crisis management, trying to save the neo-liberal course and to return to business as usual after a while.

What is needed in the interest of the large majority of the people are real changes towards another paradigm, where finance has to contribute to social justice, economic stability and sustainable development. We cannot allow to return to the status quo ante in the years to come.

The crisis is not the result of some unfortunate circumstances, nor can it be reduced to the failure of supervision, rating agencies or misbehaviour of single actors. It has systemic roots, and hence the structure and the mechanisms of the system in general are at stake.

The financial markets constitute the centre and the driving force of neo-liberal globalisation. The finance sector evolved to become dominant over the economy after the introduction of free floating exchange rates between the major currencies in 1973, the abolishment of capital controls and the subsequent liberalisation and deregulation of financial markets and the financial industry, including making supervisors so called independent, but in practice subject to heavy and successful lobbying from the financial industry. Since then, the financial industry and mechanisms have experienced a phase of rapid expansion; the masses of financial assets, debts and world wide search of financial profits grew in tandem. It is also important to remember the sharp acceleration of this process in the aftermath of 2001, when the US economy recovered from the dot.com-crisis in particular the dramatic rise of both the domestic debt of the United States (notably household debt), and the growing external deficit of this country, financed by the rest of the world.

Together, these trends have led to the establishment of a new economic model, a new form of capitalism, which by some is called **financial globalisation**, some call it **financial capitalism** and others speak of **shareholder capitalism**. However you name it, one thing is clear: whereas in previous times financial markets had a subordinate and instrumental role to the real economy, this relationship has been turned around. The grasp of “financial interests” on the “real” economy increased tremendously by making all economic activities subservient to profits in the financial markets and creating financial instruments to make profits only through the financial markets, while at the same time failing to serve sustainable production and farming, and stable savings by ‘normal’ customers. The logics and dynamics of short-termed profit maximization have penetrated into all pores of economic and social life. The perfect mobility of financial capital, which is the result of neoliberal policies, plays a crucial role in the world economy, today. It creates global competition not only among multinational firms, but also among nation states, their social and fiscal systems and among workers of different parts of the planet. By creating a power relationship in favor of corporations relative to their workers, this domination of capital has led to rising inequalities, to decreasing labor, social and environmental standards as well as to the privatization of public goods and services.

Shortly, the “freedom” of financial actors has been extended at the expense of the huge majority of people and has led to economic activities that degrade the environment. The failure of this model has never been as obvious as today in the food crisis, the climate crisis and energy crisis. This model that was supported by governments worldwide is completely discredited. Therefore clear consequences must be drawn so that political and economic decision-makers fully turn around this unsustainable and un-equitable financial system towards the needs of people, equity and sustainability.

A historic window of opportunity is opening. It will depend on pressure from public opinion whether a real change of course is achieved.

### **Another finance system is possible: Stability and solidarity before profits**

Due to the complexity of the present finance system, it is impossible to resolve the problems with only one instrument. There is no Archimedean point. A whole box of instruments will be necessary. However, in view of the hundreds of single proposals which will come up in the near future and which all will be controversial, we can define some basic requirements which have to be met in order for single proposals to be acceptable as emancipatory reforms:

### **A. Systemic changes instead of piecemeal repair**

The whole finance system in its neo-liberal form has proven to be economically unstable and inefficient as well as harmful to equality, general welfare and democracy. Therefore, systemic changes are necessary. One of our major goals is to break down the pillars of neoliberalism, in particular the worldwide mobility of capital. Some regulatory measures aimed at maintaining asset-driven capital accumulation and pure financial stability, protecting the wealthy, and superficial reforms aiming e. g. at mere “transparency” are unacceptable.

### **B. A new Bretton Woods instead of “self-regulating market forces”**

The crisis shows that markets left alone without political regulation and democratic accountability lead to disastrous results. Therefore, democratic control is required as well as international cooperation instead of destructive competition between national economies. In economic and financial decision-making, priority has to be given to sustainable development and to the human rights of all three generations.

An appropriate institutional setting under the auspices of the UN has to be set up to strictly regulate and re-orient the financial system. Due care will need to be taken to make such a setting accountable and pro-active towards equity and sustainability, and capable of preventing (rather than reacting to) financial crises. For instance, discussions to give the IMF a mandate to monitor the link between financial markets and the real economy should be given to the UN, and should assess the link between the financial markets and poverty and sustainable development. It should support strong international intervention to prevent build up of huge trade surpluses / current account surpluses in some countries and huge trade deficits/ debt / current account deficits in other countries (currently US vs China). Such a UN body would also be the forum for decision-making about the extent to which financial services companies, financial products/services would be liberalized and freedom of capital movements is being limited. This would mean that such decisions would not be taken in the WTO/GATS and free trade agreements (FTA) as is currently the case.

National supervision and international cooperation between regulatory and supervisory bodies, especially at the EU level, have to be strengthened, made democratic and broadened with a mandate to serve societal needs. The participation of trade unions, consumers and other stakeholders in regulation has to be assured. Rating has to become a part of public supervision with a mandate to also assess the impact on society (e.g. avoid financial products, loans and companies that destroy the environment).

For the immediate crisis management, close international cooperation is needed on European level, including Switzerland and Russia and on transatlantic level.

Limits must be placed on unrestricted free trade and free capital mobility worldwide. The dogmatic “openness” of goods, services and financial in- and outflows must be substituted by a more differentiated approach. New international agreements must put other goals – like financial stability, tax justice, or social justice and sustainability- over the free flow of capital, goods and services. Social rights and historical conquests of workers must not be endangered by these treaties; on the contrary, they should foster international solidarity instead of competition.

### **C. Breaking the dominance of financial markets**

The basic orientation for a real change has to aim at breaking the dominance of financial markets over the real economy. Some suitable instruments for that purpose are:

- taxation of all kinds of financial transfers including currency transactions, in order to finish with speculation, to slow down the speed of financial markets and to end short termism while financing fair and sustainable trade, production and consumption should be stimulated. This

includes a multilateral tax on all currency transactions to discourage short-term speculative transactions across borders.

Second, national authorities should unilaterally impose an appropriate taxation on national stock exchange transactions in order to stop speculation and ensure a more progressive taxation.

-Prohibition of the creation of (worldwide) financial industry conglomerates which are too big to fail, or too interconnected to fail, and too complex to manage all potential risks.

- Progressive taxation of capital income. A main factor contributing to the swelling of financial markets is the concentration of wealth. Thus, in order to slow down and stabilize financial markets, substantial redistribution of income and wealth from the rich to the poor is required as well as reducing incentives for excessive profit making and taxation evasion mechanisms used by the rich and even the financial industry itself.

- Before **redistribution**, economic policy has to provide for just **distribution**: Wages must not grow slower than productivity (except working time is reduced) and work has to be shared fairly.

- Privatisation of social systems and of important infrastructure such as energy and railways has to be stopped and reversed where it already happened. The privatization of pension funds has to be revised as they have led to the creation of capital roaming the world for high profits and investing in company shares that are socially and environmentally irresponsible.

#### **D. Mitigating the effect of the crisis on real economy and “speculator pays principle”**

As the current financial system and the crash have affected the real economy and society, emergency programmes to mitigate its effects on the real economy and society are urgently needed..

Given the depth of the crisis, bail out packages might be inevitable in order to prevent the total collapse of the financial system. However, these rescue packages must be linked to strict conditionality, excluding any moral hazard. In cases, where bail outs are successful without nationalization, its costs have to be repaid by the shareholders - including interests. Where this is not possible, the state acquires shares or nationalizes completely the enterprise.

The overall costs of liquidity injections, bail outs and mitigating measures should be paid primarily by those who are responsible for the crisis and have amassed fortunes. Therefore a special crisis fund should be set up in each country. The fund is fed by a one-off extra duty on all capital income above 50.000 Euro and a 1% extra tax on all corporate profits in the financial sector.

A share of this fund should be used internationally for the assistance to those poor countries which suffer from the crash and are hit by the food and commodity price crisis.

In addition, substantial public investment should be undertaken into the social infrastructure, education, culture and environment as these sectors suffer from under-investment and will create employment and support sustainable development.

#### **E. Reforming the EU, democratic control over the European Central Bank**

Special attention has to be given to the EU. The financial dimensions in the Lisbon and other treaties are shaped according to neo-liberal dogma. Article 63 of the Treaty on the Functioning of the European Union (ex art. 56 ECT), which forbids any restrictions on capital flows not only within the EU, but also to all third countries and thus sets the perfect conditions for the overwhelming hold of finance on society, must be changed: There are good reasons to partly restrict the movement of capital: to guarantee financial stability; to avoid tax evasion and tax competition; to exercise an employment-friendly monetary policy without risking capital flight. We also call for restriction of the freedom of establishment (art. 49), leaving capital free to migrate wherever conditions are most favourable and financial institutions free to seek asylum in the City of London or anywhere else they choose.

The decision-making on financial regulations and supervision at the EU level and in EU member states needs to be fully revised and reoriented away from mainly supporting the growth and competitiveness of the financial industry. A common system of regulation and supervision should be set up, which is shaped according to the highest standards and not in the logics of a race to the bottom.

Parliaments need to regularly assess if the right regulations on the financial markets and on the financial industry are in place. The European Parliament needs to have the right to introduce regulation. EU regulations should set all necessary criteria for the financial industry (for lending, risk assessment, investment, issuing of equities/investment banking activities) so that financial means and services are only provided to sustainable activities and poverty eradication.

Furthermore, it is necessary to alter the monetary policy of the ECB. The bank is at the very centre of neo-liberalism in Europe. It completely rests upon the monetarist ideology by committing itself primarily to price stability at the expense of employment, social justice and economic stability. Consistent with the neo-liberal ideology, it is so-called independent and not at all subject to democratic control. We demand the democratic control over this institution, whose policies influence dramatically the fate of citizens. We disagree with the focus of the ECB on keeping consumer price inflation under 2% - this is a central pillar of neoliberal policy. Instead, we want the ECB to focus on employment and just distribution. Even the annual report of the Bank of International Settlements (BIS, June 2008) advises that the interest rate policy by Central banks should not only look at inflation figures to keep interest rates low but also assess the impact of interest rates on "excessive and imprudent credit growth", the creation of bubbles, and spending and production patterns which are excessive.

The increase of the interest rate by the ECB as reaction to the oil price hike was fully in the line of the neo-liberal dogma. Although the increase of relative prices, as in the case of oil, should not be confused with inflation (which is an increase of all prices), Frankfurt was painting the spectre of inflation on the wall. However, in the present conjuncture inflation is not the problem, but recession and unemployment. The ECB's policy is accelerating and deepening the crisis to which the EU is heading.

Society friendly financial, monetary and economic decision-making will be improved when full control and transparency of lobby and "consultations" by the financial industry and other large corporations will be restricted and made accountable (to start with full transparency).

## **F. Reforms in central parts of the system**

In light of the crisis, some cornerstones of the present system require special attention, such as:

### **a. Capital requirements and prudential practices in the banking sector**

Capital requirements for banks have to be upgraded. In that respect Basle II was a step in the wrong direction. Therefore Basle III is needed, drawing consequences from the crash. Off-balance deals which are at the heart of the current crisis must be banned.

The procedures of securitization must be restricted to institutions under the strict control of governments. Risky procedures of securitization, as in Collateralized Debt Obligations whose purpose was the massive resale of subprime loans, must be prohibited.

Speculative financial products should be prohibited, especially in food and where they have a destabilizing effect. At the very minimum: the bigger the financial conglomerate, the lesser speculative products it can sell or trade in.

All new financial products need to be tested by supervisors for their impact on financial stability and on society before being allowed.

Investment banking has to be shrunk to an extent, where its volume does not constitute any more systemic risk. What remains from investment banking is fully brought under regulation and

supervision, and separated from other financial services. All investment banking activities should include criteria that promote sustainable development of societies e.g. promoting shares of companies that produce environmentally friendly products.

All financial-conglomerates covering retail and investment banking, securities trading and insurance need to be restructured or separated and supervision fully adapted to the remaining conglomerate structures.

The high bonus system should be forbidden as it incites risky behaviour up to the top management, without accountability when high losses are made by the financial company or by (its poor) clients.

#### **b. Strengthening of the public and not-for-profit banking sector**

After World War II, in Europe, the locally orientated, not-for-profit and public banking sector did a good job. Over the last two decades, these banks increasingly merged and transformed into for-profit commercial banks whose shares were traded on the stockmarket, developing towards the Anglo-Saxon market-based financial system. This trend has to be inverted; public and not-for-profit banks must be strengthened and exempted from EU competition law. The public should own at least some of the key banks to provide stable finance for sustainable and just development.

The re-nationalised banks and banks where the state has acquired shares as a consequence of bail outs should be restructured to service the needs of society, including affordable credit for sustainable projects and enterprises, universal access to good basic financial services, etc.

#### **c. Rating agencies under public control**

Rating agencies - which failed badly in the current crisis as well as in almost all crises in the last few decades - should come under public control. They should no longer be paid by the firms they rate - instead they should be financed out of a fund paid for by all users of the ratings and issuers of financial products. They should not only rate the financial aspects but also take into consideration social and environmental risks.

Accountants have failed to expose the weaknesses of the risk control systems of financial institutions. The accountants allowed some activities in the subprime mortgage market, derivatives and other assets to be off balance. Accountant rule settings needs to become again a(n inter)governmental matter.

#### **d. Regulating funds, especially hedge funds and private equity funds**

Who needs hedge funds and what is their benefit for the economy? When at the 2007 G8 the Germans asked for more transparency for Hedge Funds, it was argued that these funds have a useful function because they take risks that others are not ready to take. In reality, these risks are the risks of speculation only at the service of maximum profit. There is no benefit for the economy stemming from these operations, on the contrary they destabilise the system. Due to the practices of leverage the risk is transferred to the banks. This is why they should not take place at all, and the current prohibition of short selling is insufficient. Declaring hedge funds as an instrument of risk prevention is the same as giving a pyromaniac the task of fire protection. Hedge Funds have to be banned. Regulators and supervisors have to prevent banks from doing business with hedge funds who are located in fiscal paradises. Nobody needs hedge funds except rich individuals and institutional investors in search of high-risk maximum profit.

Private Equity Funds, too, have proven to be a stability risk and have served as a conveyor belt of shareholder capitalism to real economy. This untransparent business model has to be stopped. As an alternative, incentives have to be created to involve banks much more into company

financing and venture capital, in particular for small and medium sized enterprises. The public banks have to play a lead role in company financing.

More generally, the EU should regulate all kind of funds with a directive: All funds must publish their investment strategies and management fees. Certain investment strategies shall be forbidden (e. g. naked sales), the credit borrowing (leverage effect) must be limited and a ceiling of assets under control must be set. Profits made by funds must be taxed more than labour income. Funds that have no legal seat in the EU (e. g. in offshore centres) or that do not comply with EU standards should not get access to the EU market.

#### **e. Limiting strongly derivatives.**

Financial derivatives should only be traded at the stock exchange, standardized and authorized by a supervisory body like pharmaceutical products are being assessed for their (long term) negative impacts. When of pure speculative nature, derivatives should be banned. Trade **over the counter (OTC)** should be banned.

#### **f. Offshore Centres**

Who needs offshore banking centres (OFCs) and fiscal paradises? Only rich individuals and institutional investors who want to hide their assets from tax authorities, the mafia, terrorists, arms traders and other criminal forces who want to launder money. There is no reasonable economic argument in favour of maintaining the economic status of such territories. Therefore their economic function should be completely closed down.

As long as this is not possible, because some big rich countries maintain themselves as OFCs and protect others, a set of unilateral measures can be used, ranging from lifting the bank secrecy of the banks under their sovereignty, via obliging banks which maintain branches in tax heavens to close them, to putting a high levy on transactions with OFCs.

The "Savings Directive" of the EU has to be extended to all capital incomes (at present only interest payments), to legal persons (at present only natural persons) and the automatic exchange of information mechanism to Austria, Belgium and Luxembourg (at present 24 countries). The closure of these loopholes is a condition to exercise credible pressure on other tax heavens like Switzerland or Liechtenstein to give up their bank secrecy and cooperate in an international information exchange.

#### **g. Measures against short term shareholder value policies**

John Maynard Keynes recommended to "marry investors to their assets" in order to encourage long term investment and impede harmful short term speculation. The power of short term oriented shareholders could be limited by coupling the share voting rights to a minimum period of share holding (5 – 10 years) and by the prohibition of stock options (which incite managers to only care for the share price).

Instead the management fees should be ceiled and partly coupled to an indicator of general welfare. Furthermore, trade unions, consumers and other stakeholders must be given effective participation rights in corporate decision making.

#### **h. Regulating indebtedness of households**

Regulatory limits must be placed on indebtedness, first concerning households, by the imposition of ceilings on the ratio of repayments and interests to income in every country. The housing of social strata with lower purchasing power is one component of social programs on the part of Governments. It must not become the privilege of the worst segments of private financial institutions. We strongly support proposals to set up a new procedure of foreclosure which

would allow over-debted home owners to become tenants. However, access to individual home ownership should not remain the main objective of social programs. We demand a real public social housing development, with high social diversity and ecological standards.

Attac Austria, Attac Denmark, Attac Finland, Attac Flanders, Attac France, Attac Germany, Attac Hungary, Attac Italy, Attac Morocco, Attac Norway, Attac Poland, Attac Spain, Attac Sweden, Attac Switzerland