

Online consultation on the Commission of the President of the General Assembly on Reforms of the International Financial and Monetary System

Statement submitted by Alliance Sud, Bread for all and Swiss Catholic Lenten Fund (Switzerland).

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Theme 1 Financial regulation:

Under this theme the Commission is examining a broad range of issues to reform financial regulations and regulatory structures. These include: the now indisputable limitations of self-regulation exemplified with "Basle II"; the desirability of a global regulatory authority; changes in incentive structures; transparency; corporate governance; securities markets; restricting excessively risky practices; countercyclical regulations; mortgages; predatory lending and usury; rating agencies; re-regulating liberalized capital and financial markets; sovereign wealth funds; and dealing with offshore banking centres.

The core issue is to make finance serve its original functions to support and enable the real economy to be more productive and managing risks equitably. What changes in regulations and regulatory structures could shift incentives away from risky speculative investments and toward greater stability, fairer tax contributions and productive investments in the real economy, supporting the goals of full decent employment creation and the transition to a green economy?

The current financial and economic crisis, caused by striking regulatory deficits in developed countries, is affecting the entire world. It is imperative that the financial system reform be thorough and democratic. A new regulatory regime must be established **at the international level**, universal in its geographical scope and comprehensive in terms of institutions and instruments regulated. Financial stability is a global public good.

1) The financial system reform must be **led by the United Nations (UN)**. Reform proposals by the opaque and exclusive G20, which relies heavily on inputs from existing standard setting bodies, cannot resolve the current crisis. Nor can they restore citizens' confidence. Standard setting bodies such as the International Accounting Standards Board (IASB) and the Basle Committee are perceived by citizens as intransparent, unaccountable, and dominated by corporate interests. The establishment of a new international regime requires global participation and democratic control.

2) To avoid regulatory arbitrage, the new regulatory regime must be **universal**. Urgent action is needed to **eradicate offshore banking and tax havens**. Ensuring secrecy, offshore banking centres have played a crucial role in the current financial turmoil. Not only have these centres enabled complex financial arrangements and allowed the concealment of excessive risks, but they have also contributed to international capital flight. Assets looted by dictators and officials are often hidden behind banking secrecy, trusts, foundations or other special purpose vehicles allowing for anonymity.

Billions of dollars that could have helped developing countries to mitigate the effects of the current crisis or to finance social development have been transferred to tax havens. Capital flight from poor to rich countries is estimated to range between 500 and 800 billions USD per year.

Measures to tackle illicit financial transfers from developing countries to tax havens were suggested at the Doha conference in December 2008:

i) There is an urgent need for a **UN Code of Conduct** on cooperation in combating international tax evasion and avoidance, as well as for the establishment of an **International Tax Organization** under the auspices of the UN.

ii) Tax havens refusing to cooperate with foreign judicial and tax authorities must be black-listed. This **black list** should include all states unwilling to give tax and judicial information, to abandon strict banking secrecy and to register trusts' beneficial owners.

iii) Both tax evasion and its promotion must be made **legally actionable**. Financial intermediaries such as corporate directors, lawyers and accountants in large financial centres should be held responsible before national courts for promoting or hiding tax evasion. This requires the **generalisation of tax evasion as a criminal offence** in every country.

iv) Tax evasion should also be included under **anti money-laundering legislation**.

v) Transnational corporations (TNCs) need to be effectively taxed. To avoid paying taxes, TNCs have taken advantage of the considerable trade between their multiple affiliates and developed complex mispricing strategies. **Country-by-country reporting** as part of the international accounting standards for TNCs should be required in all sectors, as this would considerably curtail the possibilities for transfer pricing.

vi) **Judicial cooperation** must be significantly enhanced, including among rich countries, and the real ownership of any kind of legal entity must be accessible to judicial and tax authorities.

3) International regulatory norms (i.e., in-capital requirements, accounting standards and transparency norms, limits on leverage, etc.) must be **comprehensive** in terms of the institutions covered. They should be applied not only to banks, but also to private equity funds, hedge funds, etc.

4) To guarantee financial stability, regulatory norms must include new and **improved corporate governance standards** (e.g., stronger representation of risk managers and stakeholders such as employee associations), as well more **balanced incentive structures**. Incentives encouraging managers to focus on short-term results and brokers to engage in risky, high-yield speculation must be limited.

5) All existing financial instruments need to be strictly regulated. **Over-the-counter markets**, in which derivatives and other "toxic" products are exchanged without any public control, should be prohibited. Under a safe regulatory regime, standardised derivatives could be traded at the stock market and would be strictly supervised. New financial instruments must be licensed by public authorities.

6) **Public rating agencies** must be established to give independent assessments of financial risks.

Theme 2 Multilateral issues:

There will be some overlap between activities of this group and that of others, including the one on financial regulation. It essentially focuses on reforming the global financial institutions in the context of a "Bretton Woods moment" and continuing the "historic role of the United Nations" which established the Bretton Woods institutions in 1944. Questions and proposed changes are discussed in relation to the limitations and failures of existing international financial institutions in terms of their policy frameworks and underlying governance. These include: should new international bodies be created to deal with a vacuum of rules in certain areas? Is it better to create new institutions or reform existing ones? What are specific proposals on reforming or creating new governance structures with better representation; coherence, coordination and accountability around better policy frameworks and adequate policy space at the national level?

1) In the short run, the International Monetary Fund (IMF) and World Bank must help developing countries maintain spending and avoid balance of payments crises. The issuance of **new Special Drawing Rights**, as well as **regional swap systems**, should be used to provide additional resources for low-income countries to address the current crisis. However, support by the IMF and World Bank must **no longer be attached to harmful conditionality**. Poor countries should not have to privatise basic services or cut public spending as a condition for receiving international assistance.

2) In the long run, recurrent lending to low-income countries by the IMF and World Bank should be limited, unless these institutions adopt new economic, social, and environmental principles. **Regional development banks** should become more efficient and gradually replace the infrastructure and similar long-term development financing function of the IMF and World Bank.

3) The **reform of IMF and World Bank governance** must be extensive. The present reform agenda can only be described as piece-meal:

i) The continued use of the existing formula – gross domestic product (GDP), openness, variability and reserves – continues to favour rich countries. At this point, the agenda includes no “demand-based” variables that may favour developing countries as against “supply-based” ones.

ii) Additionally, the measurement of variables continues to systematically underestimate the weight of developing country economies: GDP is not fully measured in Purchasing Power Parity; openness is highly correlated with GDP measured in market prices, and therefore equally biased against developing countries; trade within currency unions is still counted as international trade, which substantially overestimates the share of the Euro-zone members; variability, while potentially a powerful variable to capture developing countries' need for the Fund, it is not measured as a ratio of GDP.

iii) Reforms so far have failed to recognise the erosion of the weight of basic votes. Numerous increases in quotas have affected the quota-related voting power. A four-fold increase in basic votes would be a minimum requirement to undo this erosion of voting power, particularly of low-income countries.

iv) The IMF's potential move away from financing towards surveillance and monitoring requires even-handedness to tackle macroeconomic and regulatory problems in advanced economies as much as, or even more than, those in developing countries. The formula to determine capital contributions should be reformed, basic votes should be increased to the original level and double-majority voting modalities should be introduced.

4) Senior management and directors of the IMF and World Bank must be selected in a **transparent and merit-based process**.

5) Real democratic control over IMF and World Bank activities is crucial. It can be achieved through **parliamentary reviews**. Both institutions should make it mandatory for shareholders to certify that policy positions taken by the Board are regularly reviewed by a committee composed of members of national parliaments or by other representative bodies. Implications of financial commitments to the Bretton Woods Institutions should similarly be reviewed by such bodies. Low-income members' governments must be held accountable by public representatives and civil society for the implications of loans contracted, as must the institutions that give these loans.

6) As part of the UN system, IMF and World Bank should be held **accountable to international human rights law**, including the International Covenant on Economic, Social and Cultural Rights and the interpreting jurisprudence. In order to ensure accountability of the IMF and World Bank to the international human rights framework, the UN's role in global governance should be strengthened and coordination with other UN agencies improved. This Spring's ECOSOC High Level Dialogue with the IMF, World Bank, UNCTAD and WTO should decide on a venue and road-map to achieve this.

7) The Relationship Agreements linking the IMF and World Bank with the UN should be renegotiated with an aim to increase these organizations' **accountability**. The UN must be able to ensure that IMF and World Bank fully respect the jurisdictions of other agencies, funds and bodies, particularly of those with non-economic mandates. A permanent **mechanism for solving jurisdictional disputes** in a transparent way should be established.

Theme 3 Macro-economic issues and addressing the crisis:

This group deals with macroeconomic issues, including strategies for maintaining the global economy at full employment. Questions relate to: the mandates of central banks (e.g. are they mandated only to fight inflation or also to ensure growth and full employment?); whether and how they should be more transparent and accountable to the public; is there scope for better coordination among them? How to avoid macroeconomic actions in one country having negative effects in others? How can large countries be more accountable to multilateral surveillance of macroeconomic performance? Should the objectives of multilateral surveillance be broadened to include other concerns such as employment and stability of the financial system, as well as inflation? Should surveillance involve other bodies than the IMF?

Other issues considered under this theme include assessing existing recovery programmes, including bailouts and bankruptcy laws.

The group is also asked what reforms in global trade agreements are necessary to enable countries to respond effectively and consistently with their own economic and social objectives.

Another fundamental issue is how to introduce or strengthen social protection measures to try and limit the damage the economic crisis is already having on people who have lost their job or source of livelihood (compounded by higher food prices and climate change impacts)?

1) Public bail-out programmes for private financial institutions must imply **public control** over these institutions. Particular emphasis should be put on avoiding new mergers and preventing banks from (again) becoming too big. At the same time, state participation in financial institutions and other companies should be seized as an opportunity to make these firms work according to principles of social and environmental sustainability. Finally, financial institutions that profit from taxpayer-financed bail-outs should end their operations in and with tax havens.

2) Stimulus programmes and public assistance for financial institutions in high-income countries must be **attached to additional Official Development Assistance (ODA)**. As these programmes make high-income countries comparatively more attractive to investors, they add to the outflow of capital from low-income countries. The latter are suffering from severe fiscal constraints. World Bank Chief Economist Justin Lin's call for the establishment of a 2 trillion US-dollar Global Recovery Fund to finance stimulus packages in low-income countries is a step in the right direction.

3) At the same time, low-income countries affected by the financial and economic crisis need urgent **cancellation of their debts, without additional conditionality**. Reducing foreign exchange outflows is the best way of easing their balance of payments difficulties. It is more effective than IMF and World Bank assistance or bilateral aid of dubious quality. While in the past it was feared that countries applying for such a debt cancellation scheme would lose access to the international credit markets, these markets have imploded.

i) Unsustainable and **illegitimate debt** of impoverished countries must be cancelled first. Debt audits are required so that citizens can scrutinise lending and borrowing practices and outcomes, and judge which loans were illegitimate.

ii) All debt cancellation must be **additional to funds received through ODA**.

3) While **capital controls** could help low-income countries ease balance of payments difficulties, several bilateral free trade agreements prohibit such controls. The respective clauses must be revoked.

4) Since the fall of the par value Bretton Woods system in the 1970s, instability and misalignments of currency exchange rates have become the norm. **Exchange rate volatility** has a strong impact on trade performance. It affects trade-related factors such as the level of domestic investment, relative prices of export products (which, in turn, affect international competitiveness), and the price of credits. The value of market access concessions and price-based trade liberalization measures that so much attention receive in trade negotiations has been at times dramatically reduced or become uncertain due to exchange rate changes.

i) The dominance of the USD as currency for international exchanges is the root cause of many problems. It creates a strong bias in global competition and greatly supports the over-indebtedness of the United States to the detriment of all other countries. Steps must be taken to move towards a **multilateral currency** for trading and reserve purposes.

ii) Strengthened **regional and sub-regional schemes for monetary cooperation** are key to diminishing widespread dependence on the currencies of a few dominant countries. Ultimately, a more balanced and development-friendly system for multilateral management of exchange rates will build on, and seek to gradually coordinate, South-South regional currencies and currency units. Indeed, multilateral exchange rate coordination is more feasible, as a first step, at the regional or sub-regional level. It would lead, by supporting intra-regional trade, to diversifying trade products and markets, thereby strengthening the resilience of developing country economies to external shocks like the current one.

iii) All these reforms, however, are likely to take a long time. Some degree of currency exchange rate instability will presumably continue to exist, leaving non-reserve currency countries to disproportionately bear its impacts. Thus, a regular and predictable mechanism to ensure that developing countries can **opt-out of their trade obligations** to the extent required to compensate for such impacts on their economies should be set in place.

4) As **speculative movements of capital** generate or exacerbate the fluctuations of export-related incomes in developing countries, they **need to be curbed**. These movements magnify Dutch-disease dynamics and entrench an international division of labour that condemns a large number of countries to specialize on a decreasing number of low value-added exports.

Theme 4 Reforming the global financial architecture:

This group deals with longer term reforms to enhance the stability and equity of the global financial system. This includes dealing with the risk of disorderly unwinding of global imbalances (such as the accumulation of very large current account deficits and surpluses) and how to prevent such imbalances from arising in the future. Another major issue (which had not been not adequately addressed in the 1944 Bretton Woods arrangements) is the need for a global reserve system (a kind of artificial global reserve currency) that would not be dependent on the fluctuations of the US dollar. This dependence on the US dollar as the de facto global reserve currency has led to greater instability, the diversion of financial resources into the accumulation of large contingency reserves and global inequity. What are the best ways to reform the global reserve system? Can the existing IMF system of Special Drawing Rights (SDRs) be reformed for this purpose? Is an entirely different system needed? Can it play additional functions such as providing liquidity to finance global public goods? Can there be gradual steps taken (such as regional initiatives) in a way where not all countries have agree to the new system?

Other questions addressed include: how to establish a fair and orderly system to deal with cross-border bankruptcy (an international sovereign debt restructuring mechanism) in a way where creditors bear their share of the risk (a "super-Chapter 11"); and how to deal with exchange rate volatility and currency speculation.

1) A major reason why the IMF has proved to be incapable of controlling **imbalances** in rich countries' economies is the veto power of the U.S. While the first response to this is a meaningful reform of the multilateral financial framework, an equally plausible alternative is the development of strong regional monetary and financial institutional arrangements, provided that they are founded on principles of equity and the promotion of development of the weakest.

2) Another lesson from the current crisis is the great need to examine innovative mechanisms to regulate global finance. A two-tier **Currency Transaction Tax (CTT)** would moderate the effects of speculative runs on currencies while generating revenue for development. It would so contribute to the prevention of major currency crises. The CTT's feasibility has been corroborated by many studies.

3) A more general **Financial Transaction Tax (FTT)** should tackle the financial instability that has been significantly exacerbated by the recent evolution of new financial instruments. The FTT could be levied on a whole range of financial transactions. It could be introduced step-by-step, first covering all transactions with financial assets, spots and derivatives in key financial centres, then expanding to broader geographical coverage. Proposed tax rates range between 0.01 per cent and 0.1 per cent.

A FTT would stabilise excessively dynamic financial markets. As the tax base is the notional value of the respective transaction, the tax burden relative to the cash invested grows as the leverage effect rises. Such a FTT will specifically hamper those transactions that involve high leverage and therefore a high risk. A general FTT would make transactions more costly the shorter their time horizon is, hence it would tend to dampen technical trading. It can be expected to reduce excessive liquidity stemming from short-term oriented and destabilising transactions.

4) As a result of the current economic downturn, there is a great probability that many developing countries will be forced to **default on their debt repayments**. Despite the various multilateral and bilateral debt relief operations, developing country external debt increased to USD 3.35 trillion in 2008. The Debt Sustainability Framework (DSF) of the IMF and World Bank has been ineffective. It sanctions only the debtor for breaches in the debt ceiling it establishes per country. At the same time new borrowing is in many instances the result of insufficient access to grants. Debtors are first left without alternative but borrowing and then punished for taking credits. The DSF does not address endogenous and exogenous shocks which many post-HIPC countries were hit by recently. The situation of several countries where external debt levels have apparently improved at the expense of generating new domestic debt is not considered.

A different approach to comprehensively address the process of borrowing and lending is needed. **Responsible lending** must be the cornerstone and can only be achieved by the adoption of a binding legal framework that deters creditors from engaging in irresponsible lending. The international community has repeatedly issued calls for more responsible lending for several years, including at G8 Summits, in the G20, in the OECD and in the UN General Assembly. Such a framework would take account of both the origin and impact of the debts and offer equal treatment to both debtors and creditors, ultimately affecting the incentives not only for debtors, but also for lenders, and preventing renewed indebtedness on a sustained basis. The framework could be in the form of an impartial and transparent process for resolving debt crises and disputes. The EURODAD Charter of Responsible Financing (2008), which outlines the essential components of a responsible loan, is an important step towards this goal.

5) A significant development after the Monterrey Consensus has been the growing legal and political interest in the concepts of **odious and illegitimate debts**. The Norwegian Government decided in October 2006 to unilaterally cancel specific debt claims on the ground that the credit in question was an example of “failed development policy,” a key element of conceptions of illegitimacy of debt. In 2007 Ecuador became the first government to convene an official debt audit commission to determine the legitimacy or illegitimacy of historical lending to Ecuador. The debate has been further developed with the publication of papers on the topic by UNCTAD and the World Bank. In order to enable the swift cancellation of such debt, the recognition of illegitimate debt must be noted and affirmed.