Eurodad – Glopolis International conference 2013

Debt, finance and economic crisis: consequences and solutions

Conference background paper

June 3-5, 2013, Prague

This paper explains in greater detail the conference theme, how the various seminars explore key issues and provides useful background information.

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Background

The global financial and economic crisis of the past half-decade has underlined the failure of economic policy-making and the dominant economic model. The global economy remains in critical condition, and even emerging markets are struggling. According to the *2013 World Economic Situation and Prospects:*

> *"A growing number of developed economies have fallen into a double-dip recession. Those in severe sovereign debt distress moved even deeper into recession [in 2012], caught in the downward spiralling dynamics from high unemployment, weak aggregate demand compounded by fiscal austerity, high public debt burdens, and financial sector fragility.*
>
> *Growth in the major developing countries and economies in transition has also decelerated notably, reflecting both external vulnerabilities and domestic challenges. Most low-income countries have held up relatively well so far, but now face intensified adverse spillover effects from the slowdown in both developed and major middle-income countries."*

At the same time, according to the OECD "Income inequality increased by more in the first three years of the crisis to the end of 2010 than it had in the previous twelve years".

Europe at the epicentre

As has happened throughout history, the financial crisis has caused a sovereign debt crisis, though this time its focus is currently in Europe. Private debt and an under-regulated financial sector have been at the core of the current crisis in most countries, but the public sector is paying the price.

Many European countries have unsustainable debt to GDP ratios, with a variety of causes. Bank bail-outs have massively increased government debt in many countries, and irresponsible lending and borrowing has also been to blame. The recession itself has pushed borrowing up further. Piecemeal and often counter-productive interventions are being promoted by the "troika" of the IMF, European Central Bank and European Commission, backed by other European governments. These interventions are failing to solve the debt problem in a fair and sustainable manner, and are focused on enforcing severe austerity measures that are hurting the most vulnerable people in Europe. The Eurozone debt crisis threatens further regional – and possibly global - recession with obvious consequences for public debt accumulation.

Seminar A "*European debt crisis, making the links*" (4 June, 1400) will explore a range of pressing issues, including what it means for democracy in Europe, the role of the IFIs, and the implications for North-South relations and what solutions can be pursued for the benefit of all countries suffering with illegitimate debt burdens.

Our special event, *"Crisis, what crisis? Different policy responses in Central and Eastern European (CEE) countries"*, (3 June, 1400) will discuss the crisis in CEE, and what can be learned from the experience of this critical region.

However, though Europe is at the epicentre, other countries are also suffering sovereign debt crises, and others are likely to face these problems if their national economy or financial sector suffers a shock, or is affected by the global downturn. The South Centre has been predicting, for some time, that developing countries have been sustained by high commodity prices and an inflow of investment capital owing to low interest rates in the developed world – two conditions that cannot last.

Meanwhile, across the world, the poorest suffer the most from what has now become a near-universal focus on austerity economics. A recent paper from the Institute for Policy Dialogue and the South Centre, co-authored by Isabel Ortiz, one of our keynote speakers (3 June, 1600), finds that in 2013, "…public expenditure consolidation is expected to intensify significantly, impacting
119 countries in terms of GDP, and then steadily increase to reach 132 countries in 2015."
"One of the key findings of this analysis is that fiscal contraction is
most severe in the developing world."

From consequences to solutions

Times of crisis offer opportunities for change – both good and bad. This crisis comes at a time when tectonic plates are shifting – the era of US hegemony is at an end, and the new world order promises to be based on a multipolar world, a situation not seen for almost a century. The economic "rise of the South" is unprecedented in its speed and scale, but political change is happening more slowly, and offers opportunities and dangers, as seminar 1, "*Global power shifts–the implications of changing geopolitics for change",* will explore (4 June, 1045).

At the same time, citizen's voices for change have been strong and loud, from the Arab spring to the indignados. Though old economic ideologies limp on, their failure opens ground for new thinking. Much can be learned from countries that have chosen different paths, such as Iceland and Ecuador, and those with recent experiences of emergence from deep crises, such as Argentina, as one of our key note speakers, Alan Cibils will explore (3 June, 1600).

How to capitalize and turn these powerful public demands into concrete changes will be the subject of our day 2 plenary, *"Creating change-rethinking our strategies"* (4 June, 1545).

The main objective of the conference is to move from discussion of root causes to focus on solutions. Important questions include:

- How do we need to change our thinking and economic structures to prevent future crises?
- What needs to be done to overcome the current crisis and create a system where finance helps to oil the wheels of the economy instead of bringing it to a halt?
- What should be the roles of the state and the private sector in overcoming crises and creating alternatives?
- What kind of institutions do we need to make finance work for economic justice and sustainable development?
- What can be learned from countries that have weathered the current crisis well?
- Which proposals for change should civil society groups be emphasising now? At which level?

Our morning plenary on day two, "*Solutions and suggestions for the way ahead" (June 4, 0930)* will open up the debate, preparing us for a day of forward looking discussion. This debate also comes a time of unprecedented reflection and discussion on what global anti-poverty, environmental and sustainable development targets should look like, as UN consultations continue on the 'post-2015' development agenda, and the shape of the sustainable development goals. Putting finance at the centre of this will be a theme throughout discussions.

Below, we have grouped discussion of solutions in three broad areas for ease of understanding:

- Major changes to the institutions and structures of the global economy
- Finance flows and domestic resources
- Promoting responsible finance

Major changes to the institutions and structures of the global economy

As one of our keynote speakers, former banker turned South Centre advisor Mah Hui Lim (3 June, 1600), will argue, the global crisis is a result of fundamental failings of the international economic and financial system. Faulty economic theory and lack of effective regulation of finance are both cause and effect of a deeper malaise – an unbalanced global economic system increasingly designed to favour footloose international capital, with a small super-elite benefitting the most. The crisis has not slowed the 'financialisation' of the economy – with the financial markets expanding their reach into new areas including the natural environment and global public goods. Unfathomable levels of inequality are a reflection – and a cause – of the global elite's increasing isolation from democratic decision-making, while the dominance of the finance sector over the real economy continues in many countries.

Changing this picture will require major shifts in policies, institutions and structures, several proposals for which we will explore in more detail.

Resolving sovereign debt problems fairly and rapidly

European countries are experiencing the tortuous, painful adjustment programmes - imposed by creditors in order to avoid writing off their loans - that other parts of the world became familiar with in previous decades. As a result, calls for a fair, transparent, and orderly way of dealing with unsustainable and unjust sovereign debt have grown. Civil society groups' longstanding campaigns for a fair and transparent debt work-out procedure are gaining traction in public debate, and UNCTAD has begun a process on this issue. There are a number of different opportunities for change that will be discussed in seminar C *"Sustainable solutions to debt crises: fair and transparent debt workout mechanism"* (4 June, 1400) including the new UNCTAD process, recent developments at the IMF, the 'defuse the debt crisis' campaign on the G20, and working towards debt work-out for individual debtor countries. This will also be an opportunity to develop the civil society position on this subject.

Who will be the lender of last resort?

One of the principle functions of the IMF, when it was established in the 1940s, was to lend to governments who could no longer borrow from anyone else. However, the IMF has not proved effective at performing this 'lender of last resort' function, and its programmes have become synonymous with harsh and counter-productive austerity conditions. The governance of international financial institutions continues to be dominated by wealthy countries, who hold more than half the voting shares at the IMF and World Bank, due to their one-dollar–one-vote decision-making processes.

This has led to a search for alternatives. The BRICS countries have announced plans for a bank and a mutual financial assistance mechanism. Asian countries are developing their own alternatives, most notably the Chiang Mai Initiative, and similar moves are afoot in Latin America. In Europe, however, regional bodies have proved just as problematic, if not more so, than the IMF.

Seminar 2, *"Managing the global economy: the IMF and alternatives",* will stimulate discussion on this critical issue and present findings from two analyses, one of the proposed Latin

American regional monetary fund (FLAR) and the second of the problematic role being played by the European Central Bank (ECB) in the Eurozone area, in particular considering how the interaction between the ECB and IMF has made crisis resolution in the EU more problematic. Other major issues will also be raised through our discussions, such as the need to regulate capital flows to prevent destabilization and economic damage – a concept the IMF has performed a remarkable, if limited, u-turn on in recent years.

Exposing the dark corners of global finances: tax havens and transparency

The global financial system is dominated by huge black holes where public regulation, taxation and control are minimal, epitomised by the central position of tax havens. Recent research by the Tax Justice Network estimates that there is $7.3–$9.3 trillion in "unrecorded offshore wealth" originating from 139 countries – most of them developing nations. At the same time, global companies and financial institutions use this opaque, unregulated system to evade their responsibilities, particularly by dodging taxes. They are abetted by the weak demands for transparency that governments make of them. According to TJN, unrecorded wealth might have generated tax revenues of $189 billion per year.

The offshore economy is interwoven with 'regular' financial systems, with banks facilitating the management of this offshore wealth and related tax avoidance. A former head of a German tax investigation unit concluded that big banks are responsible for "aiding and abetting tax fraud, money laundering and similar crimes." For example, the recent "offshore leaks" revealed that Germany's largest financial institution, Deutsche Bank, helped its customers maintain more than 300 secretive offshore companies and trusts through its Singapore branch. A
handful of major private banking institutions now accounts for 62 to 74 per cent of all offshore private wealth.

Seminar 4, *Reversing offshore economics and improving financial regulation* (4 June, 1045), will discuss the relationship between the offshore industry and the role of banks and other transnational companies, and the link between financial transparency in global tax dodging and reforms in the financial sector. Key questions will include: could financial regulation and disclosure of real owners behind companies, trusts and foundations force an end to the offshore system?

Finance flows and domestic resources

Recent Eurodad research has produced the most comprehensive picture available of the various financial resources available to developing countries. As the summary table below shows, domestic resources dominate, and suffer from fewer of the problems of external resources. Maximising the value of domestic resources, while effectively managing external finance should be the central theme of development finance discussions in the coming years.

Table: Summary of resource flows compared to domestic resources

Resource (year)	*% GDP*[1]	*%GDP LICs*	*Trends, volatility and other features*
DOMESTIC RESOURCES			
Public revenues (2008)	30*	17	Rising over past decade. Predictable, not highly volatile.
Private investment (2010)	28	23	Increased over past decade, particularly in LICs. Not highly volatile.
RESOURCES WHICH ARE NET INFLOWS			
Private borrowing (2010)	1.8		Volatile and pro-cyclical. Loans have to be repaid – costs vary.
Remittances (2009)	1.5	4.9	Steadily rising. In 22 developing countries equivalent to over 10% GDP. Concentrated in certain countries.
FDI (2011)	1.3	1.6	Rising until sharp drop in 2008-9; now rising again. Less volatile than other private flows, but pro-cyclical. Overestimate due to double counting with other flows.
Government borrowing (2010)	0.7		Until 2007 an outflow as governments paid off the IMF. Now a rising inflow as governments borrow, mainly from IFIs, but also from domestic markets.
ODA (2011)	0.6	10	Steadily rising until 2011. Not pro-cyclical overall, but unpredictable at country level. In 37 countries equivalent to over 10% of GDP. Aidwatch analysis suggests this figure is inflated
Portfolio equity (2010)	0.6	-11	Highly volatile and pro-cyclical.
Philanthropy (2010)	0.2		Increasing rapidly.
RESOURCES WHICH ARE NET OUTFLOWS			
Illicit flows (2009)	-4.3	-3	Increasing rapidly but dipped after 2008. Significant underestimate as hard to measure.
Government lending (2010)	-4.7		Mostly from middle-income countries. Sharp increase in recent years due to reserves increasing to protect against heightened risks.

*Figure for upper-middle income countries only: combined figure for all developing countries not available.

[1] All developing countries

Plugging the leaks – stemming illicit financial flows

The above table also shows how important the issue of illicit financial outflows are. This is the topic of Seminar D, *The tax wars trilogy (or introduction to illicit financial flows and global tax dodging).* Crime, corruption, and tax evasion led to $858.8 billion leaving the developing world illicitly in 2010, according to Global Financial Integrity.

Tax justice has risen to the top of the political agenda in Europe and elsewhere, and the upcoming G8 summit promises to make tax a central issue. Meanwhile, some progress has already been made. For example, at European level, banks will be required to report on profits made, taxes paid, subsidies received, turnover and number of employees for each country where they operate – a first victory in the campaign for country by country reporting for all companies. However, there is still a long way to go, and civil society campaigns are rising to this challenge – how to build a global alliance for political change while also focusing on winning concrete implementation will be a key issue.

Economic democracy and illegitimate debt

Reasserting democratic control over finance will be a central theme throughout discussions. Public finance should work for citizens' benefit. Ultimately citizens are paying the prize when their tax payments are used for paying off illegitimate debts rather than financing public services. The Arab Spring once again unveiled that rich countries' lending to developing countries is often motivated by geostrategic and economic interests - while autocratic elites borrow the money for their private benefit rather than acting as accountable agents of their people.

All over the world, governments are bailing-out failed banks and taking private debts on their balance sheet. According to the IMF, this practice had cost the public sector more than $10 trillion by 2009. And it is not over: Eurodad members in Spain and Ireland calculate the costs for recent financial sector bail-outs at €275 billion and €64 billion respectively, not counting government-guaranteed ECB loans which would add € 357 billion extra just in the case of Spain. Spain has also changed its constitution, ensuring that debt service is prioritised over all other public spending, tying elected parliamentarians' hands when budgets are made.

Independent debt audits have been carried out in several countries, such as Ireland, and are being debated elsewhere, including Greece and Spain, and in Tunisia and other North African countries. In 2012, the Norwegian government announced it would carry out the first ever creditor debt audit.

Seminar 3, *Auditing illegitimate debts as a step towards economic democracy* (4 June, 1045) will outline the damage caused by illegitimate debt and the positive role debt audits can play in righting past wrongs and achieving greater economic democracy.

Promoting responsible finance

Radically improving transparency, regulation and democratic influence over the financial system is extremely important, but we also have to raise the standards required of all financing. Eurodad has, over many years, developed a rigorous *Responsible Finance Charter*, which goes beyond a 'do no harm' approach to one that ensures that lending and investments actively deliver positive development outcomes. The UN has picked up this agenda, and UNCTAD has set out its own principles for sovereign lending and borrowing, a step in the right direction.

Publicly-backed private finance

As the table above shows, private financial resources are extremely important to developing countries, though again, domestic resources far outweigh inflows. Private inflows suffer from problems of volatility and pro-cyclicality, and can have widely varying impacts. For example, as UNCTAD have noted, foreign direct investment has increased dramatically in recent years both to and from developing countries, but its effects have varied enormously.

Donor governments and multilateral institutions have provided grants and loans to private companies operating in developing countries for decades. However, the scale of this support has increased dramatically in recent years and new forms of private sector support have been developed. This was the focus of the 2011 Eurodad–CRBM international conference, and this 'private sector turn' has come to dominate development discourse in many donor agencies and international institutions, which are increasingly supporting public-private partnerships, "blending" facilities and other mechanisms designed to leverage private investment. Declining Official Development Assistance (ODA, or 'aid') budgets are often used as an excuse for focusing on private sources of finance, even though there remains a huge need for public finance for basic services. At the same time, the majority of aid passes through the private sector through the procurement of goods and services, mostly using OECD firms.

This public support to the private sector has become increasingly focused on the financial sector. The International Finance Corporation (IFC, the World Bank's private-sector lending arm) had a total portfolio of $ 45 billion at the end of its last financial year (June 2012) with over 40 per cent being financial sector investments, a proportion that is growing steadily. A recent internal audit showed that the IFC knows very little about the social and environmental impacts of these investments. Seminar 5 (4 June, 1045) *Can public support to the financial sector be an appropriate mechanism for development?* aims to deepen our understanding of the quantity, the instruments used and the development impact of public development finance channelled through the private financial sector. Eurodad has also researched the extent to which this is being replicated for climate finance.

Public versus private – reemergence of deeper discussions

In the aftermath of the financial crisis civil society groups have paid some attention to regulation of financial markets, in terms of reintroducing limitations to movements of capital and financial engineering (such as securitisation and derivatives) which were at the heart of the mechanics of the financial crisis. Campaigns have also been run on the new impacts of speculative funds and investments in commodities and the commons, primarily food and land, and related serious development impacts.

However, relatively little attention has been paid to the relationship between public finance and private financial markets, not just as regards private banks' public bailouts, but also how to reclaim public finance institutions and mechanisms to promote long-term investment, though not necessarily in the manner envisaged by the G20 and IFIs.

Seminar B (4 June, 1400) *Public finance vs. private capital and financial markets: reimagining sustainable public finance* will discuss to what extent public finance can or should have a key role not just to finance the welfare state and all societal needs beyond a profit-making logic, but most important to definancialise the economy and society by shrinking private capital markets and reclaim private wealth for the common good.

Conclusions

Half a decade into the global financial crisis, the causes and consequences are more and more evident, but action to change thinking, structures and policies is sorely lacking. The poorest continue to pay the price. Civil society organisations are pressing for change, and the the Eurodad/Glopolis International Conference provides a unique opportunity for active organisations from around the world to debate how to drive forward political change towards economic justice during turbulent times.

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