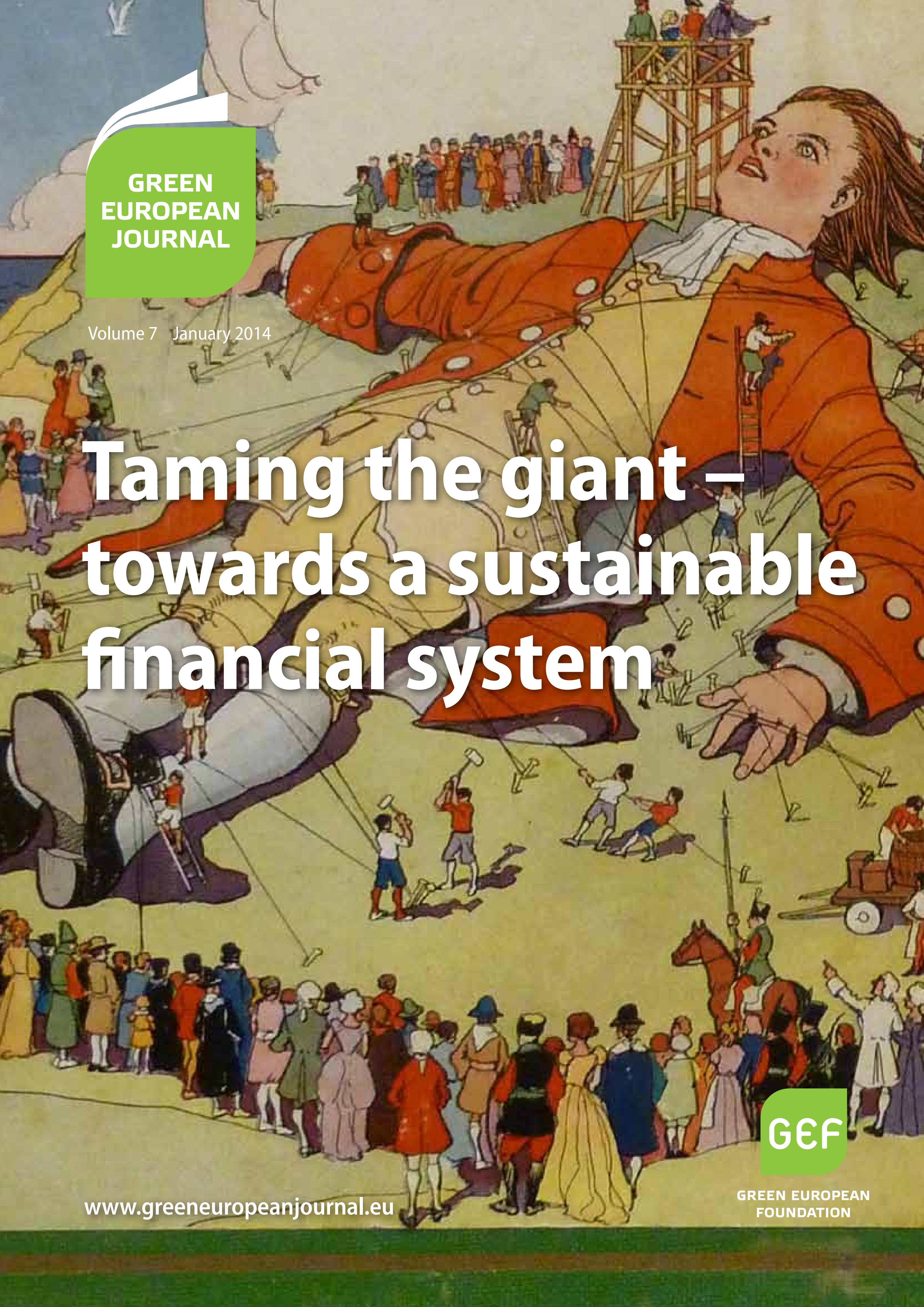

GREEN EUROPEAN JOURNAL

Volume 7 January 2014

Taming the giant – towards a sustainable financial system

www.greeneuropeanjournal.eu

GEF
GREEN EUROPEAN FOUNDATION

Contents

Let’s tame the giant!

The lessons of the last crisis always seem to be forgotten, and the financial world continues to grow and pose a risk to economy and planet. We Greens must marshal all our energy and ideas to reign it in.

Benoît Lechat

In 1726, Jonathan Swift published his famous novel "Gulliver's travel". It has been said that the British writer was inspired by the bursting of the South Sea financial bubble in which he had invested much of his money, as had the physicist Isaac Newton who declared "I can calculate the movement of the stars, but not the madness of men". The arrival of Lemuel Gulliver on the island of Lilliput and his capture by the tiny Lilliputians is probably a metaphor of the sudden and unforeseen change in the fortune of the writer, and the novel is a satire of the dark sides of 18th century English society which were at the base of this early financial crash.

Three hundred years later we are facing the consequences of yet another financial crisis and we cannot be confident that we have succeeded in "taming the giant", i.e. to protect ourselves from a dramatic repeat of the crisis in which the global economy entered in 2007. As described by Finance Watch, during the last five years we have been following the "status quo lifecycle", even if some changes have been brought to the legal framework of the financial system. It seems thus that the time has not yet come to appeal for frenzied optimism.

Nevertheless, the main argument of this seventh edition of the Green European Journal is based on a conviction that regulating the financial system is not only an absolute priority; it is also a goal that is politically within reach and in which the Greens can play a key role.

There are numerous reasons to make financial regulation an absolute priority. Firstly, and it cannot be overstated, the rise of populism throughout Europe can be partly explained by the widespread belief that taxpayers are paying for the reckless actions of the financial world and for the unwillingness or inability of politicians to restore fiscal justice and impose effective regulation. The fight against tax havens is a good example of this situation. If some progress has been achieved (with the help of the Greens in the European Parliament) on this level, more is need as the huge amount of money that is hidden in the tax havens not only deprives the states of important resources but is fostering a growing feeling of injustice throughout Europe.

Secondly, the current economic crisis has had disastrous ecological consequences. It encouraged many governments to delay the ecological transformation of our economies and to fall back on the unsustainable use of fossil resources, like shale gas or coal. Further, it shrank the credit possibilities for the greening of our economies. It is true that the Greens have concrete measures to help the green economy and SMEs to overcome this problem. But these measures can only be implemented if we can convince more people that the financial crisis is rooted in the combination of rising inequalities, unsustainable models of consumption and financial deregulations. We have been underestimating the importance of showing the ecological dimension of the crisis and to connecting the financial and the carbon bubbles.

Thirdly a continuation, or even worse a repetition of the systemic crisis, with its catastrophic social consequences, would make the solutions more difficult to implement because the political majorities to pass them would be narrower and the room for cooperation much smaller. Hoping that things get worse, so that more drastic action is taken, is not part of green politics.

The paradox and probably the tragedy of our current situation is that the political legitimacy of all attempts to tame the giant is inversely proportional to their feasibility. Not for problems of principle, but for political reasons. The current majorities dominating European governments and institutions are completely locked in the economic paradigm that has led us to the crisis. They are also much more susceptible to the banking lobbyists.

Therefore it is also absolutely crucial to support alternative lobbies developed by NGO's like Finance Watch or the Tax Justice Network. It is also urgent that the environmental movement starts to address the financial issue. The Green political foundations are well placed to develop alternative economic models and promoting the debate on provocative proposals like those developed by the jubilee debt campaign or the positive money network.

And, as documented in this edition, it is absolutely crucial to have a strong Green group in the next European parliament.

Benoît Lechat is editor-in-chief of the Green European Journal.

David Kemp

Towards a green economic and financial system

The topic of greening the economic and financial system is broad and daunting. However breaking it down into a few key questions can highlight the steps that we as Greens must urgently take to reign in the financial industry

> Austerity continues to cause real hardship and is damaging social cohesion as well as future productivity; many EU democracies are still subordinated to the wishes of "the market".

What is "the economy" for?

Allocating natural, human and financial resources to the production of goods and services that improve human well-being in a sustainable way.

What is "the financial system" for?

Transporting financial resources through space and time in a way that efficiently and sustainably supports the objectives of the economy.

Hopefully people of all political persuasions will agree (at least in public) that the ultimate aim of the economy is to benefit society.

The main source of disagreement is whether the objective of profit maximisation should be the principle determining the design of the economy (with ex-post redistributive taxation taking care of the social and environmental objectives) or whether social and environmental objectives should actually be built into the design of the economy.

This is where a Green world view can claim the intellectual (as well as moral) high ground: it holds that a poorly designed economy can actually be an obstacle to achieving essential social and environmental objectives as well as create extra economic costs.

What we have now is an economy that is blind to the social utility of what it produces and that, due to the resultant misallocation of environmental, human and financial resources, provokes unrest, creates social hardship and generates huge "externalities" that deplete the very social and environmental capital upon which it depends.

This article sets out some of the most important flaws in the current design and measures that can be taken to correct them.

Why should Greens be as militant about changing the economy and the financial system as they are about the environment and social justice?

Because that system is the main obstacle to implementing Green environmental and social policy.

• **Oh yes! The Crisis continues** – Austerity continues to cause real hardship and is damaging social cohesion as well as future productivity; many EU democracies are still subordinated to the wishes of "the market", EU banks have not been cleaned up (hundreds of billions in subsidies and public bail outs so far [ref ECB], and more on the horizon in wake of the ECB's review of banks next year), corporate and household debt is still huge in the EU (average = 200% of GDP), with productive investment and innovation smothered as SMEs in many countries struggle just to pay the interest ... [ref Economist 24/10/13].

• **This crisis is NOT new or different** – There have been hundreds of monetary, sovereign debt and banking crises in the world over the last four decades [ref. "This Time its Different",Reinhart & Rogoff]. If you had a car that broke down days after you had it repaired, wouldn't you question its design rather than your luck?

• **The "economic Taliban"** are the mainstream politicians who lack the intelligence or courage to question economic ideas that are hundreds of years old (and originated as frameworks to help monarchs finance expansionist wars and colonialism – not to help democratic societies finance innovation and the production of goods and services that promote human well-being [ref "The Cash Nexus", Ferguson]).

• **Greens already have "ownership" of a key concept: sustainability** (Lietaer et al, provide a useful definition: the "optimal balance between (long-term) resilience and efficiency" [ref Money and Sustainability", 2012] – this concept can and should be applied, not just to ecosystems, energy use, social structures etc., but also to the economy.

• **Greens must be vocal on the economy and finance** – not only the current crisis but also the mainstream conception of the economy and finance is one of the major obstacles to implementing a Green policy framework because:
a) Greens are not perceived as having concrete proposals about it; and,
b) the current economy is incompatible with Green environmental and social policy objectives.

What's wrong with the economic and financial system we have?

It is inherently unstable and inefficient at allocating natural, human and financial resources towards production that enhances human quality of life.

• **The role of the public economy is underestimated:** when "the economy" is discussed in the mainstream, the term is virtually synonymous with the "(free) market economy", in which the profits accrue to private producers. The notion that some production should be controlled by Government or civil society or even the consumers of the products (e.g. cooperatives and mutuals) is considered naive, especially since it is often compared to the disastrous Soviet model. The market economy is good for certain kinds of optimisation, but the public economy plays a very important role, particularly with respect to innovation and strategic investment.

• **Market economies are not efficient, even in their own terms:** it is naive to believe that markets are efficient, even if the only efficiency you consider important is measured in terms of profit. Markets are blamed for both "irrational exuberance" and "irrational discounting". When markets will not provide capital to banks, they are deemed totally irrational and governments have to take action to avoid austerity for the banks. When the same markets, at the same time, demand austerity from governments, this, however, is deemed perfectly rational and Governments have to take action. This is all the more ironic when one considers that the two biggest global economic crises in the last 100 years were delivered by the "hidden hand" of the markets, not the public sector.

• **Efficiency is more than profit maximisation:** the mainstream mantra is to "maximise economic efficiency (= profits) first, then to use the wealth generated to fund social (and maybe even environmental) objectives later". A Green response is to "set the social and environmental objectives first, then ensure that the economy is as efficient as possible under those constraints". Anything else is neither efficient nor resilient.

• **Market economies are blind to "social utility":** this leads to an allocation of scarce environmental, human, financial and physical capital resources that is blind to social utility. Indeed, it often leads to forms of resource distribution that generate huge social and environmental costs. Taxing profits to repair the damage caused by the way the profits were achieved is hardly efficient and, furthermore, such attempts to internalise the social and environmental costs are usually met with huge resistance from business, finance and, more importantly, politicians with a vision that does not extend further than the next election.

• **Market economies are poor at radical innovation:** a further market failure is the lack of innovation. Markets are set up to be good at finding innovative ways of lowering the cost of production (including wages) and increasing the price that consumers are willing to pay (marketing) for things that already exist. However, as the usually pro-market Economist pointed out (12/1/2013) in a memorable cover story, the most useful innovation the market has produced in living memory may well have been… the flushing toilet. Radical innovation tends to best fostered most effectively in universities or through government funded programs (including, unfortunately, military ones).

• **Globalisation spreads losses as well as profits:** a major source of the instability of market economies is that all transactions pass through a monolithic medium of exchange: conventional "money". This means that all products can be substituted for each other from an investors point of view. Those with surplus money can, directly or through financial intermediaries, equally invest in all products and will do so on the basis of what generates the most profit. Via the "pockets" of these investors, not only profits but also losses in a market for one kind of product are transmitted to other kinds of product. This means that markets become more interdependent and hence less resilient to shock. The more global the reach of investors, the more global this vulnerability. The consequence is that late payments on mortgages in Los Angeles can lead to a potter losing her job in Lubjanka.

• **"Sovereign debt":** contrary to the popular view, it is private banks that create money (when they make loans). Since they do this for profit, they have an incentive to oversupply, which leads to bubbles. When these burst, markets fail and governments must borrow from the markets, including banks, to save the markets. The latter then tell governments to cut spending, raise taxes and sell off public assets to pay the interest and the principal, which leads to a further transfer of wealth to the markets (i.e. a further transfer of political power), further weakening public control over markets and so on. Debt is definitely sovereign.

• **"Money for nothing":** even worse, when there is nowhere to invest the bank-created money in the real economy, this does not necessarily result in the tap being turned off: banks and other financial intermediaries can create *ex nihil* not just the

money itself but also things to spend it on.
A bet is a classic example: it can be created by mere agreement. Nothing has to be produced at all, other than a contract. This parallel casino economy is not constrained by the physical limits to which the real economy is subject. There is, in principle, no limit to how much money can be passed around in complex circles of bets in the virtual economy which can therefore, in "money" terms, dwarf the real economy. But, of course, losses in the virtual economy, which can also be unlimited, can flow at the speed of light into the real economy to which it is linked through the use of the same medium of exchange, resulting in the kind of disastrous circumstances that we have experienced over the last five years.

• **Markets foster short-termism:** where all products of the economy are treated as investment opportunities, money becomes impatient. This is made worse by the inherent instability of markets leading to boom and bust cycles. Investors are impatient to cash in on profits during booms and unwilling to ride out the busts. While everyone seems to admire Warren Buffet-style investors who analyse an investment target deeply and then invest for 10 years or more, such investors are extremely rare. The speculation mentioned above further encourages the view of markets as a form of lottery where an understanding of the fundamentals of what you are investing in is unimportant and the focus is on "beating the odds" with fancy, but flawed, mathematical models. Similarly, policymakers tend to focus on the next election and are therefore unlikely to provide a counterweight.


© shutterstock

So what kind of an economy do Greens propose, and what route can they suggest to get from here to there?

The key is to "plant" a diversity of economic tools for various tasks alongside the old oak of orthodoxy and to remove the stifling weeds in the overgrown financial sector. These tools should promote long-term resilience and efficiency over short-term profit maximisation, diminishing the role of the outdated economic model without requiring it to be felled overnight.

• **Boost public sector involvement in strategic innovation:** renewable energy, energy efficiency, efficient transport and communications, preventative healthcare are all essential medium- to long-term goals for human well-being. "NASA-style" public programs should be established and funded, combining public, academic and (carefully circumscribed) private resources to achieve set objectives.

Public policy should aim to reduce the overall level of debt. One strategy is to enforce the write down of debt in a "jubilee".

• **Promote a nested economy:** provide incentives for economies that match supply and demand locally first, with any imbalances being met at the next level up until (where necessary) the global level. This leads to a more resilient economy, less subject to the political risks and supply chain issues inherent in a model in which all supply and demand is met at the global level under the sole constraint of profit maximisation.

• **Promote alternative currencies:** over one hundred schemes based on a medium of exchange that can be used to match supply and demand in related goods and services exist. They serve not only to promote the kind of nested economy described above, but can also have features such as a negative interest rate which provide disincentives to the accumulation of such money for its own sake, thus encouraging its circulation and the production of the goods and services to which it relates.

• **Ensure financial services serve the real economy, not the other way round.**

• **Significantly reduce the role of debt:** public, private and financial entities already owe more debt than can possibly be repaid. Public policy should aim to reduce the overall level of debt. One strategy is to enforce the write down of debt in a "jubilee", another strategy proposed by enlightened economists is to use newly created public money to pay off private debt (instead of using it to prop up the price of existing debt in order to assist financial markets, as is currently being implemented on a massive scale under the name of "quantitative easing").

• **Restrict the role of financial intermediation:** financial intermediaries should be just that; the "plumbing" of the economy provides a "transport" service in time and space for surplus money, bringing them to the productive long-term investments where they are needed. In particular, the speculative activities encouraged by rampant "financial engineering" by banks, hedge funds, investment firms, insurance companies etc. should be severely curtailed by law. There is a role for speculation: there are situations where risk cannot be spread between actors in the real economy and speculators are able to distribute this risk amongst themselves, but the volume of speculation should be a fraction of the total volume of real economic activity, not a huge multiple as is currently the case in many markets.

• **Shrink the banks:** "too big to fail is too big to exist". Banks have become obese through an oversupply of loans and the over-development of speculative activities. The "plumbing" they provide to the economy is so deeply embedded in all the blubber of excessive risk-taking that governments are forced to step in to support them with the negative consequences described above. It is critical that banks be split into activities critical to the smooth functioning of the real economy (such as providing for the safekeeping of cash, liquidity management and hedging tools for households and businesses) and those that are not (such as capital market activities and proprietary trading). It is also critical that they be made smaller, less complex and less interconnected so that, if they get into trouble through poor business decisions, they can be allowed to go bust without taking the economy hostage.

• **Severely curtail or completely proscribe money creation by banks:** When a bank makes a loan, it simultaneously creates in its accounts: an asset – the promise by the borrower to pay the loan back with interest – and a liability – the promise by the bank to pay the borrower the amount lent. The liability is a deposit and most of the money in circulation is in this form. This is what is meant by saying that banks create money out of nothing. Back in the 1930s, following the Wall Street Crash and the Great Depression it caused, it was proposed to stop this privatised money creation entirely. Banks lobbied hard against the removal of this privilege and eventually won. Instead of halting such private money creation, the Glass-Steagal act was adopted which merely separated deposit and loan activities from speculative activities. The same debate was sparked by the current crisis, but this time policymakers should have the courage to remove money creation from the hands of private banks in the interest of economic stability. This radical but perfectly feasible change would greatly dampen boom and bust cycles, eliminate the risk of bank runs and the consequent interruption of useful banking services, eliminate the threats to democracy inherent in Governments being indebted to banks and greatly reduce the risk of over-indebtedness of the economy [ref Chicago plan revisited, IMF).

• **Provide incentives for "patient money":** long-term equity investment is important not only to ween households and companies off debt but also to promote more stable markets. Currently, interest on loans is tax deductible in many EU Member States whereas dividends on shares are taxed. This gives precisely the opposite incentive. Reversing this incentivisation and lowering taxes on profits as a function of the duration of investment would be a very helpful step. In addition, however, in order to foster long term investment in strategic projects the public sector can attract households and companies to invest in infrastructure for renewable energy, energy efficiency, transport, communications etc. by promoting a wide range of funds with long investment horizons which are structured such that the private investors (directly or indirectly through state and occupational pension funds) take less risk for lower returns and the public sector takes more risk for higher returns.

David Kemp is an advisor an economic and monetary affairs to the Greens/EFA Group in the European Parliament.

References:

- Economist 24/10/13] = The Economist, 26th October 2013, "Europe's other debt crisis".
- "This Time it's Different", Reinhart & Rogoff] = "This Time Is Different: Eight Centuries of Financial Folly", Carmen M. Reinhart,Kenneth Rogoff, Princeton University Press, 2009.
- "The Cash Nexus", Ferguson] = "The Cash Nexus: Money and Power in the Modern World 1700-2000", Niall Ferguson; Penguin Books, 2002.
- Money and Sustainability", 2012] = "Money and Sustainability, The Missing Link", Bernard Lietaer, Christian Arnsperger, Sally Goerner and Stefan Brunnhuber, A report from the Club of Rome – EU Chapter to Finance Watch and the World Business Academy, Triarchy Press, 2012.
- Chicago plan revisited, IMF) = "The Chicago Plan Revisited", Jaromir Benes and Michael Kumhof, IMF Working Paper, Working Paper No. 12/202, 2012.

The carbon bubble: the real threat to the financial system

Carl Schlyter

Over the past decades, markets have invested in damaging industries such as fossil fuels and financial speculation. This has contributed to unsustainable development, and may well be creating an enormous "carbon bubble". However there are steps we can take to stop this bubble turning into another subprime-style crisis.

The threat of great, irreversible and devastating climate change is imminent and illustrates the problem with the misallocation of capital.

Large sums of money, private as well as public, have for a long time been invested in sectors that counteract sustainable development. In the report *Towards a green economy. Pathways to Sustainable Development and Poverty Eradication*, the UNEP describes how a number of crises – for example relating to the climate, biological diversity, fuel, food, water, the financial system and the economy at large – have one basic element in common: the large-scale misallocation of money: *"[d]uring the last two decades, much capital was poured into property, fossil fuels and structured financial assets with embedded derivatives, but relatively little in comparison was invested in renewable energy, energy efficiency, public transportation, sustainable agriculture, ecosystem and biodiversity protection, and land and water conservation".*

Private investors as well as public subsidies and loans have contributed to unsustainable development. For example, the World Bank and the European Investment Bank (EIB), as well as private pension and mutual funds, have, through their investments, counteracted political targets.

The threat of great, irreversible and devastating climate change is imminent and illustrates the problem with the misallocation of capital. Steps taken by the international community, as well as by private actors, to tackle the climate issue are counteracted by steps taken in the opposite direction.

1.1 Uncontrolled climate change or collapse of the stock exchanges – the carbon bubble in the finance sectorr

Two major climate-related risks are connected in a way that is problematic no matter how we tackle the issue: if known coal, oil and gas reserves are burnt, the politically-agreed 2 °C target will not be met. If, on the other hand, these energy reserves are left untouched, it affects the valuation of the companies that own the resources. If the evaluation of the fossil energy companies is a bubble, the effects if the bubble bursts could prove devastating for pension funds and the stock market. If politicians and the international community are serious about their ambitions not to surpass the 2 °C target, it is just a matter of time before the bubble bursts. Politicians and other decision makers must shoulder their responsibility and act to minimize the harm.

1.2 Carbon tied up in known reserves of fossil fuels in listed companies

In order for there to be a reasonable chance of achieving the 2 °C degree target, there is room to emit 565 billion tonnes of CO_2 ($GtCO_2$) into the atmosphere by 2050. This assessment is uncertain, however, and the probability of going beyond a temperature increase of 2°C is 20%, which is essentially playing Russian roulette with the survival of civilisation (Carbon Tracker, 2011).

The 100 major listed carbon companies and the 100 major listed oil and gas companies have between them fossil fuel reserves corresponding to 745$GtCO_2$. That is 180$GtCO_2$ more than the 565$GtCO_2$ there is room for. If we use the known resources of these

If only a fifth of known reserves were to be used, which is the only reasonable approach if the precautionary principle is applied, this will have significant consequences for financial markets and therefore our pension funds.

listed companies, we will emit so much CO_2 that the global temperature increase will surpass 2 °C. The consequences are impossible to ignore.

1.3 Carbon tied up in known reserves of fossil fuels

Apart from reserves in listed companies, there are reserves of carbon, oil and gas in other companies and in public ownership. The largest known reserves can be found, for example, in Saudi public oilfields or gas fields controlled by Russian oligarchs. Even if some observers claim that the reserves in the Gulf region have been exaggerated for political reasons, we have already found more fossil fuels than we can ever use whilst staying within environmental limits.

CO_2 in the fossil fuel reserves known today – taking into account listed as well as unlisted companies – amounts to 2,795Gt, of which 65% comes from carbon, 22% from oil and 13% from gas. This means that, in practice, governments and the global market have available a fossil fuel resource which is five-fold greater than the global carbon budget for the next forty years.

1.4 Unconventional reserves – oil sand and shale gas

Apart from the known supplies of oil etc., there are large so-called "unconventional" energy reserves. The estimates for these, for example oil sand, are – due to the accounting principles in certain countries – conservative. In Canada, for example, the reserves are not accounted for when they are discovered, but only when the oil is taken up from the ground. In other words, the Canadian stock markets could offer a few surprises in terms of hidden CO_2.

Other unconventional resources not stated in the figures above include shale gas, which emits more CO_2 than conventional gas. Shale gas fracking also creates a number of other problems; for example, the great quantities of chemicals used can adversely affect human health. The underestimation of unconventional reserves, and the fact that they are more carbon intensive, affects how much emissions can be reduced by.

1.5 New findings

Large amounts are invested yearly in the search for new fossil fuel reserves or to squeeze out more from the existing ones. In 2010 the investments of listed oil and gas companies only were an estimated 798 billion dollars, of which a dwindling part was invested in renewable energy. To this should be added investments in unlisted companies that together control two-thirds of the world's fossil fuel assets (Initiative Carbon Tracker, 2011). If only a fifth of known reserves were to be used, which is the only reasonable approach if the precautionary principle is applied, this will have significant consequences for financial markets and therefore our pension funds.

The European Union should consider making it mandatory for banks and other credit institutions to account for their exposure to climate risks.

Are we blowing smoke into a new bubble?

1.6 Effects for the fossil fuel companies – the carbon bubble

Using a fifth of the total reserve of fossil fuels means that only 149 out of 745 GtCO_2 from listed companies can be emitted. If decision makers are serious about the 2 °C target, investors risk getting stuck with "unburnable carbon". This constitutes nothing other than a carbon-based asset bubble as lifting away 80% of the declared reserves from the market would have significant consequences for the companies' rating. A strict implementation on the stock market would result in a re-evaluation of the fossil fuel companies' assets, making earlier price adjustments, such as when real estate or IT bubbles have burst, look marginal. This situation has arisen and been allowed to continue as no financial control unit has the responsibility to systematically monitor climate related risks.

The risks involved in, on the one hand, the burning of carbon and the resultant effects of climate change, and, on the other, the regulation of fossil fuel use and the consequent devaluation of companies' fossil fuel assets, are of such magnitude that social stability is threatened. Authorising and regulating authorities in both the financial and environmental domains should, together with investors and creditors, take these risks seriously. The EU is currently discussing the idea of introducing its own credit rating institutes, due to dissatisfaction with the market's inability to foresee and deal with the Euro crisis. In addition, we need to establish an institute for evaluating the financial risks which result from environmental problems. Investments in fossil fuel companies or in the search for new fossil resources would automatically be given junk status. Both the environment and the economy stand to gain from AAA investments which take environmental problems into account, that is, investments with the highest grades, or the lowest risk, according to the rating agencies.

1.7 Time to take on the capital market carbon bubble

The European Union should consider making it mandatory for banks and other credit institutions to account for their exposure to climate risks. This is at least something the authors of the report *Funding the Green New Deal* (Kapoor et al., 2011) suggest. They believe that the climate risk is so significant that is should be understood as systemic. It should be mandatory for banks, other financial institutions and investors to evaluate their CO_2 exposure in lending portfolios as well as investments. This would facilitate a shift of hundreds of billions worth of investments from the "dirty" to the green sector. One example is mandatory stress tests to investigate how an investment would be affected by increased fuel and emission prices. Such a test would increase the investors' awareness of the CO_2 risks they are exposed to. Swedish state-owned company Vattenfall can serve as a warning example: their expansion into Poland and Germany could prove expensive. Had the company accounted for the costs of CO_2 emissions increasing over time, investments in lignite would perhaps have been lower. Stress tests would also illustrate the investment opportunities in the green sector. Green investments would constitute a well-needed diversification and risk reduction, not least for the well-filled coffers in the public funds of oil countries.

1.8 Conclusions and recommendations

The fossil fuel sector seems to be over-capitalised. The capital market has made decisions about financing the future production of fossil fuels based on an incorrect assumption: that was has been financed could actually be used. This constitutes a great and presently unheeded risk for the capital market. Using all fossil fuels presents a risk for the whole of humanity. Stuck as we are between a rock and a hard place, uncontrolled climate change must be regarded as ten times worse than a financial carbon bubble.

1.9 Taking responsibility – regulating authorities and stock markets

The British Department for Environment, Food and Rural Affairs (DEFRA) and the Climate Disclosure Standard Board (CDSB) draw the conclusion that regulating authorities need to act: *"… the scale of environmental investing [will] grow only if the entire market would first swing to environmental investing. (…). Without structural intervention of some sort, an impasse is likely to remain."* (Financial Institutions: Taking Greenhouse Gases into Account). This implies that voluntary action has peaked and those most ready to act have already done so.

Carl Schlyter is a Swedish Green Member of the Greens/EFA Group in the European Parliament. He is Vice-Chair of the European Parliament's Committee on Environment, Public Health and Food Safety.

Sources:

- Bankwatch (2011). Carbon Rising: European Investment Bank energy lending 2007-2010. http://bankwatch.org/publications/carbon-rising-european-investment-bank-energy-lending-2007-2010

- Department for Environment, Food and Rural Affairs and Climate Disclosure Standard Board (2011). Financial Institutions: Taking Greenhouse Gases into Account. http://www.cdsb.net/news/98/financial-institutions-and-climate-change

- Initiative Carbon Tracker (2011). Unburnable Carbon – Are the world's financial markets carrying a carbon bubble? http://www.carbontracker.org

- Kapoor, Sony, Oksnes, Linda, Hogarth, Ryan (2011), Funding the Green New Deal: Building a Green Financial System. A Policy maker Report from Re-Define. Green European Foundation.

- UNEP (2011). Towards a green economy. Pathways to Sustainable Development and Poverty Eradication http://www.unep.org/greeneconomy/Portals/88/documents/ger/GER_synthesis_en.pdf

The financial crisis heralds the need for a deep ecological transition

Theodota Nantsou

In the dismal reality of the deepening financial crisis in the European Union, exploiting the natural environment is seen by troubled member states as a quick-fix solution for rapid economic recovery. Following decades of massive spending on an unsustainable economic and development model, the EU's policy response is essentially a recipe for a much deeper and longer-term environmental crisis.

This article originally appeared in the WWF's Crisis Watch blog.

Since the first bailout package for Greece was approved in May 2010 by the EU/IMF/ECB lending trio, the crisis has spread across large parts of the EU. Although the root causes and the impacts of the economic crisis differ among countries, the prescription is uniform: austerity and budget cuts, environmental deregulation, shrinking of environmental public administration, pressures on wages and living standards. More surprising, however, is the reluctance of the European Commission to uphold its own environmental laws. Why were the structural adjustment programmes imposed on heavily indebted countries not reviewed under the EU's very own strategic environmental impact assessment legislation? Their real impacts on Europe's natural capital still elude the Commission's economic radars.

Despite the fact that certain fiscal indicators have indeed shown improvement on many occasions, critical parameters of social welfare and natural capital conservation have dramatically deteriorated.

The WWF was quick to warn of this blind spot in its January 2012 letters to the EU and the IMF: "[i]t is WWF's strong belief that the crisis unfolding in Greece and the Eurozone countries more widely must be viewed as much more than merely a fiscal crisis. The crisis, in addition to being grounded in mismanagement of national finances, is a reflection of a deficient economic development model built on overconsumption and a steadily increasing ecological deficit and natural resource overexploitation. Until these contradictions in current economic development models are overcome, the measures being imposed on countries like Greece are little more than sticking plasters. Far from healing wounds, they are in fact exacerbating them while storing up longer-term environmental remediation costs."

State responses to the crisis

Through the monthly CrisisWatch e-bulletin, the WWF monitors the major environmental rollbacks and shortfalls that have occurred in the EU since the beginning of the crisis, primarily in the states most affected by the crisis, i.e. Greece, Spain, Italy and Portugal. While these countries are suffering an enforced environmental rollback, other countries like the United Kingdom seem hell-bent on entering their own voluntarily imposed environmental solitude. How else do you explain the current Westminster preoccupation of questioning the utility and benefits of EU policies on environment and fisheries and opening up the possibility of the repatriation of jurisdiction in these fields?

In Greece, the policy domains that have been most heavily impacted relate to environmental impact assessment (EIA) and environmental approval of construction and development projects, as well as forest and coastal protection. Budget cuts and political indifference have caused the collapse of the national system of protected areas. Regulatory uncertainty and constant changes in pricing policies have brought the renewable energy industry to near

A crisis is always a herald to the need for change! The current calamity offers a unique opportunity for an integrated policy roadmap to an ecological transition not only for Greece's economy, but for the entire EU.

extinction. Emphasis now is on "dirty" projects, such as hydrocarbon exploration – widely advertised as Greece's black gold future – coal development and gold mining. Recently, the Environment Ministry released a draft law which declassifies vast areas covered with Mediterranean woodlands, opening the way for controversial and highly damaging development on ecologically valuable lands.

This crisis is not simply fiscal; it is the reflection of an unsustainable development paradigm which is based on overconsumption and results in an ever increasing ecological deficit. The imposed corrective measures implemented in a state of panic and explained to a deeply skeptical public as a solution to the economic downturn are narrowly-conceived economic fixes based on highly questionable assumptions. Often their effect is simply to aggravate a longer term and much deeper crisis, with profound ecological, humanitarian and economic dimensions.

An anti-austerity march in Athens

Opportunities waiting in the wings

A crisis is always a herald to the need for change! The current calamity offers a unique opportunity for an integrated policy roadmap to an ecological transition not only for Greece's economy, but for the entire EU. Its aim needs to be the articulation of a new development paradigm, based on comprehensive ecological reform at all levels, which will boost innovative and competitive entrepreneurship and produce good livelihoods for all.

In the case of Greece, a vital step towards the necessary economic shift to sustainability would be to include specific and measurable sustainable development targets and indicators in the country's economic adjustment programmes. After all, it is the European Union that supports and monitors the progress on these programmes, which are notoriously focused on austerity, rather than putting Greece on the road of full implementation of EU policies. Leaders prove themselves in difficult times and the EU now needs to honour its role as a global sustainability leader.

Greece urgently needs to reorient its restructuring efforts towards the closure of fundamental societal deficits – not simply economic ones. Policy makers need to look at the broader picture: unclear and complex laws and rules, legal uncertainty, social inequality, lack of public participation in policy making, environmental crime, lack of basic environmental knowledge and planning tools, administrative ineffectiveness, non-transparency in the public and the private sector, shortage in vision and new ideas. It is these deficits that are at the heart of the current crisis.

Natural resource security and sustainability, transparency and accountability at all levels, legal certainty, clear rules, and socially equitable and participatory development are principles and values that need to be cultivated and upheld as foundations for a prosperous economy. Economic and development policies need to reflect the environmental costs of consumption and production and support low-carbon entrepreneurial activity. At the sectoral level, Greece's prospects for a thorough green reform are indeed bright and promising in the areas of tourism, primary production, energy and industry.

A simultaneous economic and ecological transformation offers Greece and the rest of Europe the unique promise of truly sustainable ways out of the crisis and a better quality of life and a less stressful future for all.

Theodota Nantsou is Head of Policy at WWF Greece. Her current focus is on the proper mix of ecological, social and economic policies that will lead Europe to a truly sustainable way out of the crisis.

Debt, the whole history


David Graber

Author of the famous slogan "We are the 99%" and linchpin of the "Occupy" movement, David Graeber is currently one of America's most popular critical intellectuals. A self-described anarchist, this anthropologist has been combining political militancy with a prestigious academic career. Graeber was in Brussels last October at the invitation of the Committee for the Cancellation of Third World Debt to present the translation of his latest book: *Debt, the First 5,000 years.*[1]

1 David Graeber, Debt, The first 5000 Years, Melville House, 2011; French translation: *Dette, les 5.000 premières années, Les liens qui libèrent, 2013.*

David Graeber's book traces the history of debt (a lengthy history at that), now a concept that has become eminently political. In passing, he also shakes up preconceived ideas on the origin of money, the genesis of debt, and social organisation in general. Over the course of the past 5,000 years, the storyteller takes the reader from New Zealand to Mesopotamia, from Scandinavian sagas to Iroquois narratives, interweaving the stories of history.

How did you come up with the idea of writing a history of debt?
I realised that while there were histories about almost everything, from underwear to money, none was written about debt. Meanwhile, the topic has obviously gained crucial significance since the crises of 2007/2008. Also, the word "debt" has a particularly strong moral connotation, as verified by its etymology. In many languages, the concept of "debt" is linked to that of "fault" or "sin".

In addition, I describe in the book how an anecdotal event triggered my interest. I was taking part in a charity event organised by a priest at Westminster during which I described to a militant lawyer the ravages that creditors had caused in Madagascar, a country where I spent a lot of time conducting research for my thesis: drastic health care cuts and ensuing infant mortality, hunger, disease, death. Her reply was: "But surely one has to pay one's debts." It intrigued me that the pervasiveness of moral judgement on issues of debt reaching far into circles where one would expected it the least intrigued me and prompted me to explore the subject.

When discussing barter in your book, you are insisting on what you call the "myth of barter". What do you mean by that?
All economics courses and textbooks begin with the following historical fiction: at the beginning there was barter. As barter wasn't very practical, people ran into difficulty finding adequate arrangements to settle exchanges on the spot, so money was invented, and currency as a unit of measurement. Yet, there exists no evidence from economic anthropology that supports this story. On the contrary: many ways of organising economic activities were found, but none of bartering, nowhere, never. The only exceptions are societies like in Argentina during the '90s, with established monetary systems that underwent a severe a crisis that, as a result, resorted to barter in a substantial way. But, contrary to what economists so often maintain, this was not a *return to barter*. Barter is actually a new practice, a specific invention conceived in response to monetary crises in monetised countries.

In other words, at the beginning wasn't barter: there was debt. Primitive exchanges did not involve the immediate exchange of goods in the form of barter. On the contrary, one party would put forth what the second party was interested in and the latter would contract a debt to be fulfilled once the creditor found something of interest to request from the other contracting party. Societies were closely knit such that instant payment wasn't necessary. Quite the opposite, there evolved an intricate and multi-layered

Money was born out of state violence rather than as a result of some benign intent to ensure the smooth exchange of goods or the requirements of benevolent commerce.

network of debts fostering economic production and social bonds.

Debt, therefore, historically preceded money. The latter in fact has various origins, primarily found in criminal justice (very precise tables including the kinds of reparation due for specific types of offences) or the need for war (feeding an army being logistically cumbersome, peasants were issued currencies they had to accept in exchange for food). Thus, money isn't borne out of economic necessity *stricto sensu*, but rather from state or proto-state needs.

Money was born out of state violence rather than as a result of some benign intent to ensure the smooth exchange of goods or the requirements of benevolent commerce. The history of money is military history not economic history.

How important is it to debunk this myth? If economists continue to believe in fables which anthropological evidence belies, what are the consequences? Are they serious?

Once again, the invention of money is deeply connected to the necessities of war and the technologies developed for waging them. The myth of money emerging as a result of the inconvenience of barter allows for the white washing of this embarrassing truth. It also allows for the legitimacy of economics as a scientific discipline, separate from society and context. Believing that money existed before debt and was created to satisfy strictly economic necessities confers a kind of purity to economic "science". Economics is then endowed with laws of its own, de-contextualised, de-historicised, and dissocialised. This is now the prevailing vision of economics in the academic world. The recent crisis should have acted as a kind of call to order and to reality, but has hardly had any impact in this regard.

Trying to break this myth or to show that it is just that, a myth, also demonstrates that the foundations on which economics as a scientific discipline has developed are not only fragile, but also false, and that the entire edifice must be reconsidered.

You also attack the notion of exchange or rather the idea that any human relationship can be reduced to this concept?

Inevitably, when one has it in their mind that everything is exchange, one can always bend reality enough to fit it into preconceived categories. This obsession took on paroxysmal dimensions in the '60s, particularly in the works of Levi-Strauss: he asserts, for example, that all human life can be summarised into three spheres of exchange: language (exchange of words), kinship (exchange of women), and the economy (exchange of goods).

This exaggeration also plays itself out when we hear that there is exchange (and therefore some form of reciprocity) in medieval societies between peasants who feed the lords and priests, lords who protect the clergy and peasants, and finally the clergy who pray for every one. If this is truly an exchange, the basis for it is rather odd: would peasants refuse to feed their lords alleging that they did not wage war satisfactorily the previous year? Concepts can be made to mean

Debt, on the contrary, is a drastic departure from the general laws of exchange and reciprocity.

whatever one wants and this is what happened, in my opinion, with the notion of exchange and reciprocity. This obsession with the idea of exchange, which preoccupied philosophers from the enlightenment to Nietzsche and Levi-Strauss, proved blinding in that it prevented us from seeing the very facts and practices before our eyes. The assumption that everything is governed by the concept of exchange and reciprocity leads one to believe that debt is the real root of morality as debt is the result of balance not being restored. Debt, on the contrary, is a drastic departure from the general laws of exchange and reciprocity.

The concept of exchange needs a good deal of twisting for it to explain a number of social and economic practices. That is why I suggest replacing the idea that exchange and reciprocity are at the heart of human activities by a triad consisting of three principles – communism, exchange, and hierarchy – that seem to me more apt at explaining the diversity of practices and modicums of social organisation.

How would you sum up these three principles and the way they operate?
Communism, which has of course nothing to do with events in history that claimed association with it over the course of the twentieth century, describes the part of human relations founded on the principle of "from each according to their abilities, to each according to their needs." There are many examples of this in history, including in industrialised societies. This is the case, for example, every time one collaborates on some common project. If you are in the process of repairing a broken pipe and you ask your colleague, "pass me the wrench", the latter doesn't ever respond by "and what do I get for it? " – even if you are working for Goldman Sachs or Exxon Mobil. The principle is also manifest when you ask for a light of a cigarette in the street. This baseline form of communism constitutes the raw material of sociality, recognition of our interdependence.

Anthropologist Raymond William Firth reported a Maori story that illustrates my point and the logic behind baseline communism, albeit in a rather extreme fashion. A glutton in the habit of strolling along the seashores came to anger the village fishermen, as he persistently demanded the best part of their catch. To the extent that it was absolutely impossible for these fishermen to refuse his request for food, they agreed and gave him what was requested until the day they decided that enough was enough...and struck the man down. In other words, it was morally easier to assassinate this parasite than to deny him the food he asked for. As long as the person asking is neither an enemy nor making unreasonable requests, the principle of baseline communism will prevail without calculation or expectation of some form of reciprocity.

Contrary to my second principle (exchange), communism does not in fact involve reciprocity or equivalence. One hands out a cigarette to a stranger not assuming that he will give one back, but rather assuming that come the day you need one, someone else will oblige. Exchange, on the other hand, posits that objects of exchange as well as the people exchanging them are of equivalent value. It assumes

This transition from a situation of theoretical equivalence to a situation of hierarchy constitutes the core of debt and explains how the concept acquired its moral significance.

a form of reciprocity that has been improperly been branded on all social relations. Specific instances of exchange erroneously became rules of thumb. Commercial exchange is by definition impersonal, which is relatively new. At least in theory, because, in practice, a minimum level of trust is always necessary. Even in the most impersonal of shopping centres, sales personnel are still expected to show a modicum of friendliness and patience (not to mention bazaars in the Middle East).

As regards the principle of hierarchy, it prevails, for instance, in medieval societies and has too been wrongfully described in terms of exchange. It occurs when the people transacting and the goods they are exchanging are of a different nature (food for protection, for example). This principle lies at the origin of castes, which again has been wrongfully analysed in terms of exchange and reciprocity.

It goes without saying that these mechanisms and principles are not completely rigid and that a continuum can exist among them. According to these principles, debt is something very specific that requires a situation in which neither exchanging party feels fundamentally different from the other. But as long as debt remains unpaid, the logic of hierarchy will prevail between the two parties. This transition from a situation of theoretical equivalence to a situation of hierarchy constitutes the core of debt and explains how the concept acquired its moral significance.

How have economists received and discussed your work?

It depends on which ones (laughs). Clearly, this discipline is dominated by the neo-liberal paradigm, including Adam Smith's founding myths, such as primitive barter. What is strange is that despite mounting anthropological evidence that this vision is totally wrong, the vast majority of economists hold on to the dominant paradigm. Surprisingly, they appear less loyal to other of Smith's positions that are less in phase with capitalism's current developments and are hence viewed as obsolete. Smith's radical criticism of corporations, for example, was entirely overlooked. [2]

That said, and even if the discipline is obviously dominated by people and paradigms that are patently oblivious to empirical research, there are numerous researchers at the margins who are open to transdisciplinary reflection and are trying to integrate the teachings of sociology, anthropology,

2 The following quote from Adam Smith is known more among the anti-globalisation movement than among economists: "The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventurers. They have, accordingly, very seldom succeeded without an exclusive privilege, and frequently have not succeeded with one. Without an exclusive privilege they have commonly mismanaged the trade. With an exclusive privilege they have both mismanaged and confined it" (Wealth of Nations V.i.e.18: 741).

By obstinately envisioning everything solely terms of exchange and reciprocity, it became impossible to understand what was there naked, before our very eyes.

or history into their own research. And so, for example, I am far from being the first to denounce the "myth of barter". If all those who preceded me failed to influence economists, it is probably because they lacked a substitute myth. This is in part what I am trying to accomplish with this new three-pronged paradigm. I also think that this triad has the advantage of bringing to light a series of interactions that have hardly been studied before and therefore remain poorly understood – namely everything pertaining to what I call baseline communism or everyday communism. By obstinately envisioning everything solely terms of exchange and reciprocity, it became impossible to understand what was there naked, before our very eyes.

© shutterstock

Your book ends at the threshold of the current crisis and abstains from making any policy recommendations regarding the issue? If you were asked to make recommendations, what would you suggest?
By taking apart the moral rationale at the heart of the debt construct, I try to show that debt shouldn't be treated any differently from any other kind of promise. Not fulfilling electoral promises has never barred politicians from re-election. In a loan, there is always a measure of risk that the dominant discourse on the necessary repayment of debts conveniently pretends to ignore. For the State, for instance, repayment of its debt cannot occur at the expense of the health and food security of its citizenry: only such unwarranted and exceptional moral status leads to the kind of excesses I witnessed in Madagascar… and to activist lawyers failing to see any problem with it.

It is debt's unwarranted moral status that triggered the writing of this book. It is also what I want to highlight in conclusion: this status is illegitimate and acts of absolute immorality are committed in its name.

How do you reconcile your activism with your academic career? We know for example that some of your former students have accused Yale University where you used to teach of not to have renewed your contract because of your political positions and militant activities.
Yes, I must confess that it was a spontaneous mobilisation on their part. As for me, the combination of academia and activism is not too difficult if you accept the idea that you will never again be hired for an academic position in your own country (laughs).

It is possible that we are at a pivotal moment in the history of our civilisation, the kind that is only experienced every five hundred years. To live through this period without utopian ideals would be a grave mistake.

For the rest, I have always made it a point to strictly separate the two in terms of publications. In academic journals, I publish nothing of what my militant activities inspire in me. When it comes to books or articles related to activism, I always try to avoid outrageous or avant-garde positions or claims of any kind of scientific superiority. On the contrary, I try to contribute to the best of my ability to the discussion of issues that are of interest to the movements I participate in, like any other member of these movements.

You know, one of the "Occupy" movement's less well-known merits, which took a long, very long time to emerge, is that in occupying a place one's sense of urgency and daily imperatives begins to change. This makes it possible to entertain deeper and more sustained discussions than in situations where the need for efficiency calls the day.

What other topics are you currently exploring?
I'm working on issues of inequality. As always, my perspective relies on anthropology and history. This will in all likelihood be the topic of my next book. There exist various myths regarding the so-called equality of certain early societies or the manner in which settlements were formed and cities born out of them have generated inequalities through the specialisation of labour. The first thousand years of urban civilisation in Mesopotamia constitute, from what we know, a period of great equality. Conversely, there are hunter-gatherer societies that are highly hierarchical.

Obviously, the intention is not to romanticise the past, but to show that a great deal of what is presented to us as self-evident has, in fact, no historical basis. To free ourselves from these mental constraints is to set free a new utopian imaginary. It is possible that we are at a pivotal moment in the history of our civilisation, the kind that is only experienced every five hundred years. To live through this period without utopian ideals would be a grave mistake. You know, in recent decades a powerful anti-utopian movement has emerged that posits an artificial connection between utopianism and the gulag. Utopias aren't the problem; the problem is only having one and imposing it on others.

Comments collected and translated by Edgar Szoc, a regular contributor to the Belgian Green foundation Etopia.

Tim Jones

Life and debt

The ongoing crisis, caused by excessive global debt, saw only financial institutions being protected. For life to come before debt we need to build an alternative to this out-of-control financial system.

While the levels of poverty in Europe are different, the current crisis mirrors the events that led to the Third World debt crisis in the global South.

Debt is used by international institutions and local elites to force through economic policies which act against the interests of ordinary people. As the current global financial meltdown fuels a growing debt crisis, millions of people across the world are being forced into poverty.

The Jubilee Debt Campaign was founded to campaign on the Third World debt crisis which created massive hardship and suffering for millions of people in the global South from the late 1970s. During that crisis we uncovered some of the ways debt is created and used to transfer wealth from one part of society (and the world) to another, to make finance more powerful at the expense of the mass of people and to predetermine economic choices and restrict democratic rights.

We campaigned to end such crises, but whilst $130 billion of debt for the most impoverished countries has now been cancelled, debt was actually growing across the world and the financial system – which fuelled the debt – grew ever more powerful. The most recent financial crisis was the culmination of this unsustainable economic situation, where complex financial instruments were used to hide the true extent of global debt.

Ordinary people were not responsible for, and did not benefit from, the debt

The fallout of the current global financial crisis has been felt across the world with shocking rises in unemployment, poverty and human suffering.

But how did we get here? Throughout the 2000s, Western banks went on a lending spree in countries such as Greece, Latvia and Portugal, fuelling economic bubbles, inflating housing costs and creating construction booms.

These loans came to an abrupt end as the financial crisis hit. Now millions of people are suffering increased unemployment, poverty and the devastation of public services, such as healthcare and education as a result of this reckless lending.

In the eye of the storm of the financial crisis, with banks facing bankruptcy as a result of massive over-lending, governments stepped in to bail them out. But the bailouts did not stop there. The EU and IMF lent money to ensure the reckless lenders, such as the banks, continued to be paid. Meanwhile austerity was forced on populations under the pretext of making the debt payable. In reality, economies have crashed or stagnated, while debts have kept increasing.

While the levels of poverty in Europe are different, the current crisis mirrors the events that led to the Third World debt crisis in the global South. A lending boom to Latin American and African countries in the 1970s turned to bust in the 1980s when the US increased interest rates on the debt, and the global economy entered recession. To protect Western banks, the IMF bailed out the reckless lenders, while enforcing austerity, privatisation and liberalisation.

For example, Jamaica has endured over 30 years of spending more than 20% of government revenue on debt payments. In that time the government has paid more in principal and interest than it was lent, yet still owes an estimated $7.8 billion.

From the Latin American debt crisis in the early 1980s to the East Asian financial crisis of 1997 and today's global financial crisis, unregulated private lending and borrowing has caused devastation for those who have nothing to do with such reckless behaviour.

Crises have been used to further empower finance and create an ever more volatile system

Despite how they are presented in the media, bailouts are not temporary support to an economy suffering economic shocks. Rather they prevent defaults, enabling debts to continue to be paid to the financiers – effectively bailing out the reckless lenders. Today, in Jamaica and Greece even the IMF admits that the debts can never be repaid in full.[1] In Pakistan and Tunisia IMF bailout loans are being used entirely to repay old debts – in Pakistan's case, to pay previous IMF loans. In Latvia, even though there wasn't a *government* debt crisis, IMF bailout loans were given and used to pay off Scandinavian banks, saddling the government with *more* debt.

The austerity and privatisation policies forced on Latin American and African countries in the past did not work any better:

- Between 1980 and 2000, economic "growth" per person, per year was -0.5% in Latin America, and -1.5% in Africa.[2]
- Between 1980 and 1990 the number of people living in poverty in Latin America increased from 144 million to 211 million.[3]
- In Africa, the number of people living in extreme poverty (on less than $1.25 a day) increased from 205 million in 1981 to 330 million by 1993.[4]
- And most telling of all, *the debt was not reduced.* Across Latin America and Africa, government foreign owed debt increased from 17% of GDP in 1980 to 33% in 1990.[5]

The problem of high debt payments is exacerbated by massive tax avoidance and evasion, which reduces further the money available to governments. Both debt payments, and the outflow of untaxed profit and capital, are ways countries continue to be looted and people impoverished while further enriching corporations and elites elsewhere.

1 See IMF. (2013). Jamaica: Request for an extended arrangement under the Extended Fund Facility. IMF Country Report No. 13/126. May 2013. And IMF. (2013). Greece: Ex post evaluation of exceptional access under the 2010 stand-by arrangement. IMF. 20/05/13.
2 Calculated from World Bank. Global Development Finance database.
3 The percentage increase was from 40.5% of the population to 48.3%. Bertola, L. and Ocampo, J.A. (2012). Learning from Latin America: Debt crises, debt rescues and when and why they work. Institute for the study of the Americas. 20/02/12.
4 The percentage increase was from 51.5% of the population to 59.4%. World Bank. Global Development Finance database.
5 Calculated from World Bank. Global Development Finance database.

As well as increasing poverty and inequality, the bailout system sows the seeds for the next crisis by increasing debts and handing ever more "power without responsibility" to the banking sector.

As well as increasing poverty and inequality, the bailout system sows the seeds for the next crisis by increasing debts and handing ever more "power without responsibility" to the banking sector. A working paper for the Bank for International Settlements claims that in the run-up to the current global financial crisis banks lent large amounts to banks in highly-indebted countries, because of "expectations of a bailout" if any country got into trouble.[6] The system actually *encourages* reckless lending.

The highest price is paid by the poorest in society through the austerity

Bailouts come with conditions to introduce austerity measures such as cuts in government spending, increases in taxes and privatisation. Former IMF mission chief to Ireland, Ashoka Mody, says there is *"not one single historical instance"* where austerity policies have led to an exit from a heavy debt burden.[7] But this failure of austerity is only part of the story. It is the impact of unjust debts and austerity on ordinary people which shows the true extent of its failure.

In 2000, as part of Millennium Development Goal 8, 189 countries – including those of the EU, US and Japan – agreed to *"deal comprehensively with the debt problems of developing countries"*. They have failed to do so. This is one of the reasons debt-burdened countries are off track to meet other development goals. Jamaica is off track on at least one of the indicators for *all* the MDGs. In two it has even gone backwards. In 1990, 97% of children completed primary school. By 2010, the figure was just 73%. Maternal mortality has almost doubled, rising from 59 per 100,000 live births in 1990 to 110 by 2010.[8]

High debt payments, and cuts in government spending, make it more difficult to provide decent quality public services such as healthcare and education. Jamaica spends more than twice as much on debt payments as it spends on education and health *combined.* This year and next, in Pakistan, spending on foreign debt payments will be the same as the combined spending on health and education.

Countries in Europe have also taken a huge step backwards. In Greece, new hospital fees have left many people untreated and children go unvaccinated because it is no longer free. Health expenditure has fallen by 40% between 2010 and 2013.[9] Latvia has lost 8% of its healthcare workers and 14% of school staff.

6 Turner, P. (2013). Caveat creditor. BIS Working Papers 419. July 2013.
7 Crosbie, J. (2013). Former IMF official warns austerity could be 'self-defeating' for Ireland. The Irish Times. 21/07/13. http://www.irishtimes.com/business/former-imf-official-warns-austerity-could-be-self-defeating-for-ireland-1.1470669
8 World Bank, World Development Indicators database.
9 Calculated from IMF. (2013). Greece Fourth Review Under The Extended Arrangement Under The Extended Fund Facility, And Request For Waivers Of Applicability And Modification Of Performance Criterion. 16/07/13. http://www.imf.org/external/pubs/ft/scr/2013/cr13241.pdf and IMF, World Economic Outlook database.

Questioning the legitimacy of debt frees our minds to begin thinking about how society could be if it was not controlled by finance – if it was based on different principles from those dictated by the market.

© shutterstock

What kind of world are we building?
The importance of debt as a perspective for building a movement for social change is that it helps get to the root of the myths that underlie the debt-austerity economy.

The imposed narrative "we are in debt?", "then it must be our fault", "how can we make up for it?", seeks to force us to believe *there is no alternative.* Questioning the legitimacy of debt frees our minds to begin thinking about how society could be if it was not controlled by finance – if it was based on different principles from those dictated by the market.

The struggle against debt is a struggle over principles and values. There can be no one policy solution to free people from the scourge of unjust debt and austerity. Some specifics do emerge, however. One of the key routes to justice is for the unjust debts to stop being paid. This could happen through debt audits that lead countries to repudiate debts, or through the creation of a fair and independent arbitration process for reducing government debts.

In 2008, the Ecuadorian government set up a public debt audit commission to investigate where the countries debt came from. After finding that various debt contracts were illegitimate and potentially illegal, President Correa announced they would not be repaid. Whilst this pledge was not fully followed through, it caused the value of Ecuador's debt to fall dramatically on financial markets, so the government was able to buy it back on the cheap, leading to a dramatic debt reduction.

An alternative approach is that being attempted by the government of Grenada. After defaulting on its debt earlier in 2013, the government of the Caribbean island has now publicly stated it wants to negotiate with all its creditors jointly – something which the likes of the IMF and World Bank do not normally allow to happen – and for all lenders to share in writing down the debt.

But the cancelling of unjust and unsustainable debts is not enough if we want to build greater economic democracy and prevent future debt crises. Economies need to become fairer, with governments getting the resources needed to provide decent services through fair tax systems.

The root cause of debt crises across the world is the unregulated financial system, where large quantities of loans move between countries, fuelling trade imbalances and global instability. A wide range of regulations on the financial system are needed to get finance under control and reduce these huge flows of money across the world.

These recurring debt crises are not inevitable, but the result of ideologically driven economic policies and mistakes. In the 1950s and 1960s, the number of governments which defaulted on their debts to foreign private creditors averaged four every twenty years. Since the 1970s this has risen to four *every year*.[10]

The "Bretton Woods System" from the late 1940s to early 1970s was a time of much greater government involvement in the economy, and specifically there were regulations on the movement of money – lending, speculation and investment – between countries. These so called "capital controls" between countries were matched with "credit controls" limiting the amount of lending banks could undertake, and in what sectors. For example, in the UK there were limits both on how much banks could lend, and of this, how much they could lend for mortgages for housing.

For life to come before debt we need to build an alternative to our out of control financial system – including tax justice, controls on lending and the cancellation of unjust debts.

For more information see Jubilee Debt Campaign's report *Life and Debt: Global studies of debt and resistance*
http://jubileedebt.org.uk/reports-briefings/report/life-debt-global-studies-debt-resistance

Tim Jones is a senior policy and campaigns officer for the Jubilee Debt Campaign.

10 Borensztein, E. and Panizza, U. (2008). The costs of sovereign default. IMF Working Paper WP/08/238. http://www.imf.org/external/pubs/ft/wp/2008/wp08238.pdf

Ben Dyson

Positive money: how to fix the creation of money?

In Autumn 2013 the Green Party of England and Wales voted to adopt a motion that would remove the power of banks to create money, and return that power to a democratically accountable part of the state. But what is money? How do banks create it, effectively out of nothing? And why is reforming money and regulating finance so important for dealing with the big social and environmental issues we're facing today?

The current monetary system is the reason we have such a pronounced and destructive cycle of boom and bust, and it is the reason that individuals, businesses and governments are overburdened with debt.

The banking sector and the creation of money

In late 2010, then-Governor of the Bank of England, Sir Mervyn King, stated that "[o]f all the many ways of organising banking, the worst is the one we have today." It's a statement with which most people outside the banking sector – and many within it – would agree. The 2007/08 financial crisis led to massive increases in unemployment and cuts to public services as governments around the world were forced to bail out failing banks. Many of the countries at the centre of the crisis are still suffering from the consequences today.

It seems clear that our banking system is fundamentally dysfunctional, yet for all the millions of words of analysis in the press and financial papers, very little has been written about the real reasons for this. Although there are many problems with banking, the underlying issue is that successive governments have handed the responsibility for creating new money to the private sector corporations that we know as banks.

Today, almost all of the money used by people and businesses across the world is created not by the state or central banks (such as the European Central Bank, Bank of England or Federal Reserve), but by the private banking sector. Banks create new money, in the form of the numbers (deposits) that appear in bank accounts, through the accounting process used when they make loans. In the words of Mervyn King when he was still in charge of the Bank of England, "When banks extend loans to their customers, they create money by crediting their customers' accounts." Conversely, when people use this new money (or deposits) to repay loans, the process is reversed and money effectively disappears from the economy.

When banks feel confident and are willing to lend, new money is created. Banks profit from the interest they charge on loans, and therefore use bonuses, commission and other incentive schemes to encourage their staff to increase their lending, creating money in the process. The loans they make tend to be disproportionately allocated towards the financial and property markets. As a result our economy has become skewed towards property bubbles and speculation, while the general public has become buried under a mountain of debt. Allowing money to be created in this way affects us all. The current monetary system is the reason we have such a pronounced and destructive cycle of boom and bust, and it is the reason that individuals, businesses and governments are overburdened with debt.

Questioning the money creation process

Central banks maintain that they have the process of money creation under control, yet a quick recap of the debt-fuelled crisis of the last few years calls that claim into question. By handing the power to create money to banks, the state has built instability into the economy, since the incentives facing banks guarantee that they will create too much money (and debt) until the financial system becomes unstable. This is a view recently vindicated by the chairman of the UK's Financial Services Authority, Lord Adair Turner, who stated that: "The financial crisis of 2007/08

Without the power to create new money when they make loans, banks would lose a great deal of their power and influence over the state of our economy.

occurred because we failed to constrain the private financial system's creation of private credit and money" (2012).

We have little hope of living in a stable and prosperous economy while the money supply depends entirely on the lending activities of banks chasing short-term profits. Attempts to better regulate the current monetary system are unlikely to be successful: whenever regulation is effective in preventing a certain type of problem in the financial system, it is only a matter of time before lobbyists start to argue that the regulation is no longer needed.

Rather than attempt to regulate the current banking system, it is the fundamental method of creating money and getting it into the economy that needs to change. Positive Money, the organisation I founded in 2010, argues for a reform of the monetary system that would remove the power to create money from banks and return it to a democratic, transparent and accountable body. We want to see new money created in the public interest, rather than in the short-term interest of the banking sector.

Reforming the banking sector

The key element of the reforms is to remove the ability of banks to create new money (in the form of bank deposits) when they issue loans. The simplest way to do this is to require banks to make a clear distinction between bank accounts where they promise to repay the customer "on demand" or with instant access, and other accounts where the customer consciously requests their funds to be placed at risk and invested. Current accounts are then converted into state-issued electronic currency ("sovereign money"), rather than being promises to pay from a bank, and the payments system is functionally separated from the lending side of a bank's business. The act of lending would then involve transferring state-issued electronic currency from savers to borrowers. Banks would become money brokers (i.e middlemen), rather than money creators, and the money supply would be stable regardless of whether banks are currently increasing or decreasing their lending. Without the power to create new money when they make loans, banks would lose a great deal of their power and influence over the state of our economy.

After these changes banks would no longer be able to create money. Instead, new money would be created only by central banks (such as the ECB or the Bank of England) and transferred to the government (or divided between national governments in the case of the Eurozone), who would then be able to spend the money in line with their democratically-mandated priorities. There are three main ways that this newly created money would reach the real economy: either through additional government spending; through tax cuts (for example by lowering regressive taxes), or through providing a citizens' dividend to each citizen of a country.

Whereas money created by the banks makes its way mainly into property and financial market bubbles, money created by the state would be injected directly into the real economy. This would boost employment and benefit ordinary people, rather than simply benefiting the wealthiest. In 2012 two IMF economists released a working paper where they modelled the effects of these changes, and found it would lead to a very significant fall in personal debt and a significant rise in employment. (See Kumhof & Benes, 2012).

Can the financial industry be reformed, or do we need to change the entire concept of how we create money?

Steps towards reform

Of course, any attempt to remove the power to create money from the banking system would be met with furious lobbying, meaning that such a change requires a movement behind it. The organisation I founded in 2010 is aiming to build that movement, but we know it won't happen overnight.

Luckily, there is something that governments could do to address some of these problems immediately. Rather than fuelling the economy by allowing banks to create money as households to go ever further into debt, or by flooding financial markets through Quantitative Easing, the ECB could simply create new money and transfer it to national governments to spend into the economy. This money would reach the real economy far more effectively than money created through Quantitative Easing, and would do so without relying on households to keep increasing their debts. It would make the economy safer and help ordinary people rather than financial markets.

This policy, proposed by Lord Turner, former chairman of the UK's Financial Services Authority, could be used in a wide variety of situations. In the UK, where the economic recovery is fuelled by rising personal debt, this additional spending would offset the rise in debt and prevent excessive household debt leading to another financial crisis. But in Europe, which is in danger of slipping into deflation (a potential downward spiral of falling prices and falling spending), the additional spending could help to keep the economy ticking over.

Whereas money created by the banks has the main effect of pushing up house prices and fuelling speculation, the money created by the state can be spent on things with real social and economic value. A recent paper by colleagues of mine, *Sovereign Money: Paving the Way for a Sustainable Economy*, outlined two ways in which the creation of just £10bn could have a huge social and economic benefit. One way is for the money to be spent on the construction of affordable housing (to cope with the shortage in the UK). Every £10bn spent this way ultimately leads to a £28bn rise in GDP, whilst lowering the cost of living for ordinary people. A second option is to employ people to retrofit the UK's housing stock with adequate insulation. The UK has some of the most energy-inefficient housing in Europe, meaning that while we have some of the lowest energy costs per kilowatt hour, households lose a huge amount of the energy they pay for through the walls of their homes. Investing in making homes more energy efficient could lower the UK's energy demands for housing by 40%, with a subsequent fall in carbon emissions.

Conclusion

Simply attempting to regulate the existing financial system will not be enough – what is really needed is fundamental reform of the way that our money is created. There is huge potential in reclaiming the power to create money for the public benefit. In Autumn 2013 the Green Party of England and Wales voted to adopt a motion that would do exactly this. The challenge now is to provoke a wider public debate around the fundamentally-important questions of a) who should be allowed to create money, and b) how should that money be used?

Further information: www.positivemoney.org

Ben Dyson is founder of Positive Money.

Debt and financialisation: the Portuguese example

Nuno Serra

The idea that the peripheral countries were the authors of their own destruction continues to exist at European level. However a closer examination of the facts shows this is not the case, and an urgent reprioritisation of EU policies is needed.

On the eve of another review and evaluation of the Memorandum of Understanding, signed between Portugal and the Troika (European Commission, European Central Bank and International Monetary Fund) in May 2011, the European commissioner Olli Rehn gave an unexpected statement from Brussels: "Portugal no longer lives beyond its means".

Those words are doubly unexpected because in their wake, the Troika visitors leave new austerity measures (more wage cuts in the salaries of the private sector and more changes in labour legislation), and because that statement could mean that the Portuguese economy is today better than at the beginning of the "structural adjustment" programme put in place by the Memorandum. That is very far from the truth.

A false view of the causes

Since the first impacts of the international financial crisis on the Portuguese economy in 2009, a hegemonic narrative has emerged: the country had been living, in the last decades, beyond its means. With access to cheap credit for families and the state, powered by financial funds coming from abroad, the country had supposedly lost its mind. People and the state would have begun to spend beyond their ability to generate wealth and repay their debts, causing an unsustainable external debt. Related to this particular narrative on the roots of the crisis was the emergence of a discourse describing the "fat" social state and urgently advocating drastic cuts into the public social welfare system (education, health and social insurance). The political and moral electoral ground, necessary for the implementation of the "impoverishment schedule", was then created.

Before presenting some of the devastating impacts of the Memorandum of Understanding on Portuguese society and their economy – and also on Portuguese democracy itself – it's necessary to take a look at the real questions that help us to understand where the crisis of the peripheral countries of European Union came from, through the example of Portugal.

Origins of the crisis in the periphery

When Portugal became a member of the European Union in 1986, several changes took place, placing the country before both enormous challenges and opportunities. Having recently emerged from a dictatorship – one that delayed the development of Portuguese society and the Portuguese economy for more than forty years – Europe was seen as a strategic framework the country's modernisation. The social and economic changes since then, in fact, are extraordinarily impressive: in the early eighties, despite all the progress that the revolution of 1974 allowed, Portugal was still largely a rural nation (with more than a third of its workforce engaged in agriculture and the fishery sector), and with an underdeveloped manufacturing sector. Illiteracy was fixed around 20% and only 12% of the population was enrolled in secondary education.

The National Health Service (SNS) then took its first steps (the child mortality rate was about 24 per thousand). The contribution of Portuguese integration into Europe in the process of economic and infrastructural modernisation is unquestionable. But the Portuguese economy was also affected by some important external shocks in the process of integration, namely after the approval of the

Maastricht Treaty and, even more importantly, after the integration into the Eurozone. In fact, it is not possible to understand the present crisis, marked by the growth of external debt since the mid-nineties, without considering the impact of those shocks. Firstly, the Portuguese economy adopted the neoliberal European approach to the functioning of markets, which defends broad programmes of privatisation and deregulation for national financial systems. Secondly, as part of the process of the creation of the European Single Market, Portugal started to be affected by the free movement of financial capital which allowed the country to gain access to cheap money. The large influx of foreign financial funds, especially the ones coming from the countries of the central Europe, then created the conditions for a significant increase in investment and consumption, which helped to stimulate the national economy and attract further capital. The financialisation of the Portuguese economy was then largely reinforced and the banking system acquired unprecedented importance and centrality in the economy.

Undermining the core economy

At the same time, Portugal has begun to be affected by some of its traditional productive sectors being exposed to wider and more aggressive foreign competition. The difficulties and challenges of competing with other nations in some of those sectors increased: the Portuguese agriculture sector, for example, was not able, in many cases, to compete with the modern agriculture systems of other Member States and, later, when Europe opened its borders to countries such as China, in the manufacturing sector for example, the consequences for Portuguese gross national produce were significant. However, despite the gradual modernisation of the production system, the Portuguese economy was not able, under these conditions, to attract significant levels of capital. Investments were more often put into several non-tradable sectors, such as construction, real estate or the large-scale distribution sector.

Nor did Portugal's entry into the Eurozone improve the competitiveness of the Portuguese economy. Economic growth has basically stagnated since the beginning of the 21st century, reflecting Portugal's inability to compete at the international level. The negotiations for China to enter the World Trade Organisation (WTO), the enlargement of the EU to include Eastern European countries (which led some large companies to invest in, and relocate to, these countries), and the strong appreciation of the Euro against the dollar, failed to help Portuguese producers to improve their exportations. Economic growth became more and more dependent on the internal market.

There is no doubt that the financialisation of the Portuguese economy, stimulated by the foreign surplus funds that the national banking system operated at low interest rates, helped to develop higher internal consumption levels. This is particularly relevant at the housing sector, both on construction and transaction of real estate. Moreover, it is remarkable that 80% of bank loans made to individuals between 1999 and 2009 relate to loans for home ownership, a fact that explains considerably the level of external debt. But even more remarkable is the fact that it was not some kind of irrational pipe dream for Portuguese families to want to have a home of their own. The levels of amortisation of the mortgages were comparable to the average level in the European Union. Furthermore, when compared with families in countries such as Denmark, the Netherlands, Norway or Sweden, the indebtedness of Portuguese families, in 2010, was lower. The problems came, in fact, with the impacts of the Euro crisis and the levels of unemployment generated by the economic crisis. The decision to own a home is not relevant to Olli Rehn's statement about Portuguese families "living beyond" their means.

Mikecogh

Who is to blame? Pigs or politics?

Let us assume, then, that despite all the difficulties, the process of modernisation of the Portuguese economy and Portuguese society was interrupted and hampered by all the unfavourable circumstances that followed the integration of the country into the European Union. We shall also assume that, since the mid-nineties, Portugal followed overly-closely a model of development largely focused on the financialisation of the economy, like other peripheral countries of the EU. Who is to blame for that? Who is to blame, when this process was widely supported by the European institutions themselves, and its politics oriented to benefit the private banking systems? Who is to blame when the economic crisis, that emerged from a financial system crisis due to the deregulation of markets, demonstrated the weaknesses of a dysfunctional Euro governance system unable to ensure the role and capacity of national central banks to deal with the sovereign debt crisis? Who is to blame, when the austerity imposed on the peripheral countries of the European Union is not solving any of its problems and is constantly failing to accomplish the very objectives that it set out to achieve?

The moralistic judgement narrative about the origins of the crisis among the peripheral countries of Europe (like Portugal, Ireland, Greece and Spain) is clearly expressed by the acronym used a few years ago: PIGS. This moralistic judgement is hindering a substantial part of the European Left from seeing what's really going on: the erosion of the European ideal of peace, economic development and social cohesion as a whole, and the gradual destruction of national economies and societies in particular, at the hands of an insane politics of austerity.

In the case of Portugal, the "agenda of impoverishment" is advancing quite well: 450,000 jobs have gone since the beginning of the implementation of the Memorandum of Understanding; companies from several different sectors are falling every day; the external debt is higher than it was two years ago; the public sector is under attack; the fragile Portuguese welfare state is being constantly reduced; investment is falling to the standards of the end of the eighties; and it was expected that by the end of 2013 25% of the population would be below the poverty line. Portugal, a country where inequalities were significant even before the crisis (despite notable progress made since 2005), is today a nation where the middle class is disappearing, giving way to a minority of very rich and a majority of poor citizens, as is happening in the other "PIGS" countries, only the system that has generated the crisis – the financial system – seems to reinforce its position in these economies, making breathtaking political and economic gains.

The urgent need for an alternative

Austerity politics, which seem a fair method of achieving "structural adjustments" and "structural reforms" in order to "promote competitiveness" abroad, are the perfect alibi or "secret code" for the real politics that are being applied in the European periphery: the neoliberal agenda of dismantling the public sector and the public welfare system, promoting a savage new order that expands the rationality of the market to all spheres of life, including access to water or energy. The case of Portugal is, in this sense, particularly clear: the government in charge, since May 2011, has applied twice the amount of austerity measures initially predicted in the Memorandum of Understanding, thereby doubling the resultant devastation during those years.

But it is not only the notion of a decent future for Portugal, or Greece, or Spain or Italy that is at risk. It is also the future of the European Social Model and the possibility of promoting a mode of economic development based on knowledge and environmental respect. To avoid such a regression, all parties of the European Union must unite and recreate a model of European governance that is fairer, more social, more democratic and much less dependent on financial systems that have no constraints on their influence or movements.

Nuno Serra is a geographer and PhD student at the Faculty of Economics and Centre for Social Studies (University of Coimbra). Co-author of the Political Economy blog, "Ladrões de Bicicletas".

Reinhard Bütikofer

Financing a green industrial transformation

If we want to put finance on a leash with smart regulation, Greens must take the wind out of their opponent's sails by having policies that simultaneously unleash finance and restore lending into the real economy and, above all, into a green industrial transformation.

During the crucial challenge of putting speculative finance on a leash, we mustn't neglect to simultaneously unleash finance into the real economy.

In the 1990s and 2000s, protected by the predominance of neoliberal thinking, the financial industry inflated beyond recognition. Mindless deregulation put financial markets on steroids; they ran amok. When the bubble inevitably burst in 2008, the resultant shock plunged the world into a crisis. Europe was hit especially hard. With the Green New Deal, we Greens have been at the forefront of calls for the re-regulation of the financial industry. With our ideas and proposals we have been able to successfully curb bankers' bonuses, tighten regulation on derivatives trading, limit speculation and increase transparency.

Unleashing finance into the real economy

Undoubtedly, much work still lies ahead of us in order to strengthen Europe's financial architecture. The establishment of a robust banking union is one critical example. But during the crucial challenge of putting speculative finance on a leash, we mustn't neglect to simultaneously unleash finance into the real economy. The transformation to a sustainable, efficient, hi-tech economy will cost money and will need investments in our energy system, in mobility, in the building sector, and in many other areas. We need to be able to finance an industrial turnaround.

In the aftershock of the financial crisis, however, credit markets have frozen and lending to the real economy has shrivelled up. According to the European Commission, 2013 saw the lowest bank lending yet to the European economy. This trend shows no sign of abating as European banks continue to deleverage and shed assets. This is particularly hurting SMEs and midcaps.

Southern European economies desperately in search of finance

Simultaneously, European finance is retreating behind national borders. Since 2008, cross-border bank lending has dropped by an astonishing $2.2 trillion. Combined with the excessive austerity policies pursued, this has led to further distortions in financing conditions. This is particularly the case for Europe's South. In 2012 almost 40 per cent of all lending requests were denied in Greece. In Portugal, a quarter of all requests where denied while in Spain the rejection rate was 20 per cent. For the companies fortunate enough to receive loans, their financing conditions were also markedly different from, for example, companies in Germany. While in March 2013, small- and medium-sized companies in Germany paid an interest rate of 3 per cent for their loans; SMEs in Italy, Portugal and Spain had to pay double that. Since then, the situation has arguably improved. In August, the borrowing cost differential between German and Spanish companies was close to 1.5 percentage points. Nevertheless, this is a marked difference when considering that two years ago the gap was only a few basis points. The situation remains volatile and could easily change again.

Last but not least, the banking sector is consolidating with an increasing number of local and small- and medium-sized banks – which provide the majority of the credit to local SMEs – being swallowed up by larger financial corporations which have smaller SME lending portfolios. In 2009, for example, Spain had around 53 banks and *cajas* (savings banks) while by the end of 2012 this number had fallen to 12.

The regulators as hostages of the finance industry

The credit crunch hides a further danger. It allows the finance industry to take European regulators hostage by arguing that more regulation will lead to less lending. This situation will make it harder for us to fight for better regulation. Voices calling for a halt to the Basel 3 banking rules are growing louder. Rules and regulations are being watered down as we speak.

On 12 January 2014, for example, global regulators weakened the new Basel 3 rules by easing the requirements for products such as derivatives. One analyst from BNP Paribas went so far as saying that this was "more of a win for the industry than (he) was expecting". A recent proposal from the European Commission on the structural reform of the EU's banking sector has also been weakened with no mandatory full separation of retail and investment banking activities envisaged.

If we want to put finance on a leash with smart regulation, we must take the wind out of our opponent's sails by having policies that simultaneously unleash finance and restore lending into the real economy.

At its summit in June 2013, the European Council put the issue of financing high on its agenda, announcing an "Investment Plan for Europe". But this plan is a red herring: while the European Heads of State and Government put forth this shiny slogan, they simultaneously cut the EU budget, particularly in those areas that provide financing for innovation, efficiency and competitiveness for SMEs, such as the EU's "COSME" programme.

drinksmachine

The Green response

Few industrialists would think of looking to us Greens when it comes to proposals related to financing. However, precisely because we want to advance an industrial transformation, we have confronted this question and have concrete answers on how to spearhead funding for a green economy.

With public coffers running on empty, and bank lending frozen, the focus has to be particularly on policies that leverage private financing. This can be done via three main routes.

First, taxation policy has an important role to play. Those who contributed to the crisis should also help pay for solving it, for instance. In addition, the Emissions Trading Scheme and carbon taxes are of great importance.

Second, we can create new markets and steer finance into them via regulations and incentives. The renewables feed-in tariff is a prime example. With it, Greens in Germany have not only boosted the uptake of renewable energies; we have created an entire new class of entrepreneurs!

Last, but certainly not least, we need to stimulate private financing via new innovative credit models and partnerships. The stark differences in financing between EU and US companies demonstrates the relevance of this topic: contrary to the US, European firms rely heavily on bank credit. Loans from banks account for roughly 80 per cent of European companies' corporate finance while in the US this represents a meagre 20 per cent with most of the financing coming from private credit markets. As such, European industry is more sensitive to impacts on the banking sector than their counterparts in the US. In this context a number of ideas regarding private financing warrant close attention.

One avenue to allow private financing to flow to small- and medium-sized enterprises would be to establish local bond markets. In Germany, five stock exchanges have carried out over 50 bond issuances for midcaps, with the exchange in Stuttgart leading the way. The individual volumes for these placements have ranged between €30 and €100 million. Local bond markets are also being established now in France and Sweden. One proposal could be to learn from these experiences in setting up local bond markets and allowing successful regions and cities, such as Stuttgart, to team up with their southern counterparts, for example Madrid or Lisbon, to facilitate the establishment of similar exchanges.

Crowdfunding the Energy Transition

Crowdfunding is another, albeit smaller, example holding great promise. Last year, for instance, the crowdfunding website Kickstarter received nearly $500 million, with 19,911 projects reaching their funding targets. In fact, crowdfunding holds such potential, that the United States promoted it in its JOBS Act allowing small companies to access this kind of financing. It is also a great opportunity to advance financing for the *Energiewende*. The crowdfunding platform Mosaic, for example, has financed numerous solar power plants. In Germany, the first steps are also being taken in that direction, with the platform Bettervest allowing individuals to contribute to the financing of energy efficiency improvements whilst at the same time reaping an interesting rate of return for their investments, particularly in the current environment of record-low interest rates. The European Commission has been slow to catch on to this trend but should support these efforts while simultaneously ensuring an adequate regulatory framework in order to provide sufficient protection for investors.

Pension funds for sustainability

Other financing channels could also be investigated, such as the private placement system – well established in the US – which allows the pension fund and insurance industries to supply credit to businesses. One particularly useful business model could be private-private partnerships in which a pension fund teams up with a bank to provide a mixture of long-term and short-term financing.

This would be of interest to both stakeholders since pension funds need long-term assets to match their liabilities while banks are currently extremely loath to provide long-term loans.

There are also a number of other ways that could stimulate European banks to provide greater financing to SMEs. For example, a careful revival of the securitisation market could be undertaken. In this context, collateralised bonds for SMEs could be sold to national investment banks that would link the purchase to further SME lending targets for banks. The European Commission, for example, has calculated that an investment of €10 billion together with limited funds from the Commission could, via a joint securitisation and risk pooling instrument, leverage up to €100 billion in SME lending, benefiting roughly one million SMEs. Such an ambitious policy, however, would undoubtedly need careful scrutiny before receiving the green light.

We need to create a sustainable, long-term financing architecture for Europe and promote policies that will alleviate the credit crunch. With bank lending freezing up, an increasing number of stakeholders are calling for a halt or a "breather" in regulating the financial industry in order to ease financial flows. We must not let them play off the credit crunch against a safe financial architecture, but must go on the offensive ourselves and show them how to finance the real economy.

Reinhard Bütikofer is the Co-Chair of the European Green Party and the Industrial Policy Spokesperson of the Greens/EFA in the European Parliament.

Tax havens jeopardise the stability of the financial markets

Michaela Schmidt

The analysis and publication by journalists of previously confidential data from known tax havens – widely known as "Offshore Leaks" – has excited media interest around the world. However, one important aspect was not addressed by the media: not only do tax havens lead to the loss of tax revenues and enable capital flight and money laundering, but they were also a major contributory factor to the financial crisis of 2007/2008 and continue to jeopardize the stability of the financial market.

This article was originally published in German in "Gegenblende" the online magazine of the German trade union, DGB.

Tax havens laid the groundwork for the rise of unregulated financial institutions (the so-called shadow banks), they facilitate the avoidance of regulatory and prudential supervisory requirements, and they substantially increase competitive pressures in favour of light regulatory systems. Every step towards the re-regulation of tax havens and shadow banks is a positive step in crisis prevention and in the protection of working people against the huge economic costs of financial crises.

A contested term with problematic associations

The term "tax haven" is problematic in itself, notwithstanding that it has now become firmly established in public discourse. For one thing, the term "haven" arouses in people positive associations with harbours, and suggests above all a place of refuge, an enviable shelter from the storm. In addition, the term is also problematic because it foregrounds only the aspect of taxation and fails to address the issue of the continuous avoidance of regulatory regimes by financial institutions, something which is made possible and facilitated in "havens". Whereas tax havens are characterised by very low or even zero tax rates and by strict confidentiality rules regarding banking and tax data – used by non-residents to enable tax avoidance, tax evasion and money-laundering (Palen et al. 2010: 23ff) – as well as the refusal of, or only restricted exchange of, information with other states concerning such non-residents (Rixen 2009: 10), *regulatory havens* are characterised by weak financial regulation. This includes non-disclosure of ownership structures, a lack of interest in foreign companies on the part of regulatory authorities, and the possibility of avoiding capital requirements (Troost/Liebert 2009: 79). Financial institutions which have relocated to regulatory havens are typically owned by non-residents, and the financial sector there is bigger than is required for the financing of the domestic economy (Rixen 2009: 10).

From a geographical perspective, the use of the term regulatory haven as distinct from tax haven may seem irrelevant (and of course it also fails to solve the problem identified with regard to the positive associations of the term "haven" itself), since states or territories are often simultaneously tax and regulatory havens. But distinguishing between the terms is necessary both for analytical reasons and with regard to possible policy initiatives: combating regulatory havens requires measures that explicitly address the problem of the avoidance of regulatory and prudential supervisory requirements – such measures may be different from those required to combat tax evasion and avoidance. Inadequate regulation of financial market participants and tax exile or avoidance are "two sides of the same coin" (Troost/Liebert 2009: 75), and must be recognised as such if they are to be effectively opposed.

The shadow banking system is considered to have been a major cause of the financial crisis and in many cases links to regulatory havens could be demonstrated.

Tax and regulatory havens in Europe

The Tax Justice Network has produced a list of the least transparent financial locations (tax and regulatory havens) (TJN 2011). Top of the list is Switzerland, followed by the Cayman Islands, Luxembourg, Hong Kong and the United States. This demonstrates clearly that tax and regulatory havens are not restricted to palm-fringed exotic islands, nor are they always full nation-states. Two of these locations, it is worth noting, are European states, and the Cayman Islands are a British Overseas Territory. The United States, too, is among the top five, because individual territories within the United States (e.g. Delaware) can be classified as tax and regulatory havens. Some regulatory havens in Europe have also recently – that is, since the onset of the financial crisis – reduced regulatory requirements in order to attract financial institutions or to lure them away from other havens. In *Ireland*, for example, the financial crisis did not bring about a rethink: the Financial Act (2010) makes the transfer of investment funds to Dublin easier. Funds are registered for operation on the next working day in Ireland if the documentation is submitted by 3 pm. Due to their size and complexity, it is virtually impossible for the documents to be thoroughly inspected by the close of business (Stewart 2010: 2). Moreover, the Irish supervisory authorities have made it clear that they consider themselves responsible only for financial institutions headquartered in Ireland. Funds are therefore scrutinised neither by the regulatory authorities before registration nor by the supervisory authorities afterwards (Troost/Liebert 2009: 79). In *Luxembourg*, the largest and most important location for investment funds in Europe, a new law means that approval is granted in advance for new funds as long as the regulatory authority is informed within a month of their establishment (Stewart 2008:2). Since 2006 the Channel Island of *Jersey* has allowed the establishment of new foundations administered via a trust but wholly owned by the founder (Murphy 2008: 38). In September 2007 it was announced in Jersey that hedge funds with over one million dollars in deposits would in future no longer need to worry about permission to register, external auditing or data publication.

Shadow banks: market participants in tax and regulatory havens

The shadow banking system and regulatory havens are distinct closely-related related phenomena. Participants in financial markets use so-called shadow banks to bypass domestic regulation. Although it is true that shadow banks can, in principle, also be set up outside regulatory havens, the majority of them are found in tax and regulatory havens (Rixen 2009: 17). Troost and Liebert (2009: 76) maintain that before the financial crisis the emergence of the shadow banking system and the threat it posed to financial market stability were not noticed in part because this occurred almost entirely in tax and regulatory havens. Put simply, the term shadow banks is understood to mean those financial institutions that carry out bank-like activities without being regulated like banks. Though there is no universal definition of a shadow bank, special purpose vehicles, credit-financed hedge funds and money market funds are in most cases regarded as shadow banks. The shadow banking system is considered to have been a major cause of the financial crisis and in many cases links to regulatory havens could be demonstrated. The collapse of the Northern Rock bank, for example, was triggered by the special purpose vehicle Granite, which was quoted in Jersey and officially belonged to a charitable foundation of Northern Rock. The German regional banks, too, established the majority of their off-balance-sheet special purpose vehicles in regulatory havens, which made effective supervision impossible for the German authorities: Sachsen LB in Dublin, the IKB in Delaware and West LB, too, had subsidiaries in Ireland. In 2006 Sachsen LB's Irish companies employed only 45 people but generated almost all the group's profits (Stewart 2010: 14ff). In the USA, almost the whole of the 700 billion dollar aid package was allocated to the shadow banking sector (Ricks 2010:4).

© shutterstock

A threat to financial market stability

The financial crisis has renewed interest in the effects of tax and regulatory havens on the stability of the financial system. International organisations, regulatory and supervisory authorities and the European Commission have investigated the risks posed by the shadow banking system to the stability of the financial markets, and have identified it as one of the main causes of the financial crisis (EK 2012, FSF 2000). However, the fact that the shadow banks are predominantly based in tax and regulatory havens is not mentioned. Despite this, it is clear that the risks identified as being posed by the shadow banking system for financial market stability are also associated with tax and regulatory havens and are at the least intensified by them. In the first place, the significant growth in assets and liabilities in tax and regulatory havens increases the risk of contagion effects. This is where the tax dimension and the financial market dimension mesh: on the one side, loan capital interest in "high-tax countries" can be set off against taxes, while the profits generated thereby are collected and distributed tax-efficiently in tax havens; at the same time, regulatory havens and shadow banks enable loan capital limits to be bypassed and increase the growth of the debt ratio. Secondly, tax and regulatory havens facilitate the growth – presumed, in the absence of data – of the off-balance-sheet activities of the financial institutions. This means that transactions are shifted to legally independent, non-consolidated firms which nonetheless continue to be closely connected. By this means, risk exposures are concealed and not covered by a sufficient level of equity capital. Thirdly, tax and regulatory havens hinder the global monitoring of financial markets, as national supervisory authorities are dependent for the inspection of legally independent subsidiary companies in regulatory havens on the willingness of the local supervisory authorities to cooperate. Fourthly, regulatory havens

No financial market participant in public ownership or receiving state support should be permitted to continue to operate in tax or regulatory havens.

foster competition over lower supervisory and regulatory standards, a "downwards regulatory spiral". The existence of tax and regulatory havens enables economic interest groups and financial market participants to promote a reduction in regulation on the grounds that it will secure or increase domestic competitiveness (Rixen 2009: 19). Finally, the danger of bank runs is also increased because when crisis conditions develop within the financial system, the consciously fostered lack of transparency, especially concerning ownership structures, further weakens trust in individual shadow banks acting in the market and in the financial system as a whole.

Policy implications and measures

Tax and regulatory havens do not bear sole responsibility for the financial crisis: the deregulation of financial markets was not restricted to the regulatory havens. But they made it easier for interest groups, politicians and financial market participants to call for lighter regulation in the home market and to link this call with the competitiveness argument. Moreover, stronger regulation at the global level as a result of the financial crisis – so long as it does not remain mere lip service – will further increase the incentive for financial market participants to shift into tax and regulatory havens. As tax and regulatory havens are two sides of the same coin, and as tax and financial market aspects interact reciprocally, any measure taken to close tax havens (such as lifting banking confidentiality rules in Austria and Luxembourg) will also improve the stability of the financial system. But beyond that, measures are required which are directly and explicitly designed to counter the threat posed by tax and regulatory havens to the stability of the financial markets. One possibility is to include regulatory havens in a risk map (Issing et al.2009: 10ff). This would make it possible, for example, to set higher equity ratio requirements for financial institutions with connections in regulatory havens so as to take full account of the increased risks. Alternatively, financial institutions could simply be prohibited from doing business in countries with inadequate regulation. At any rate, no financial market participant in public ownership or receiving state support should be permitted to continue to operate in tax or regulatory havens. As regards shadow banks, the European Commission is working on a regulatory proposal currently still in the development phase. It is still too early for a proper evaluation of the proposed regulations – above all, one has to wait and see precisely what regulatory proposals are statutorily prescribed following the consultations with interest groups.

At any rate, the public must be informed of the dangers posed by the existence of tax and regulatory havens to financial market stability, and that every step towards re-regulation in finance policy is a positive step for crisis prevention. Because, sadly, the last few years have demonstrated strikingly that the huge economic costs of financial crises are borne predominantly by working people.

Michaela Schmidt is a researcher for the Council of Workers and Employees (Upper Austria) for their Department of Economic and Social Policy.

References:

- Europäische Kommission (EK) (2012): Grünbuch Schattenbankwesen. Brüssel. Online: http://ec.europa.eu/internal_market/bank/docs/shadow/green-paper_de.pdf [18.07.2012]

- Financial Stability Forum (FSF) (2000): Report of the Working Group on Offshore Centers. Basel. Online: http://www.financialstabilityboard.org/publications/r_0004b.pdf [18.07.2012]

- Issing, O./Asmussen, J./Krahnen, J.P./Regling, K./Weidman,J./White, W./Center for Financial Studies/Goethe-Universität(2009): New Financial Order. Recommendations by the Issing Committee. Preparing G-20, London, April 2, 2009. White Paper No. II. Online: http://www.ifk-cfs.de/fileadmin/downloads/publications/white_paper/White_Paper_No_1_Final.pdf [18.07.2012]

- Murphy, R. (2008): Tax havens creating turmoil. Evidence submitted to the Treasury Commitee o f the Ho use of Commons. London: Tax Justice Network UK.

- Palan, R./Murphy, R./Chavagneux, C. (2010): Tax Havens. How Globalisation Really Works. New York: Cornell University.

- Ricks, M. (2010): Shadow Banking and Financial Regulation. Columbia Law and Economics Working Paper No. 370. Online: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1571290 [18.07.2012]

- Rixen, T. (2009): Paradiese in der Krise. Transparenz und neue Regeln für Steuer- und Regulierungsoasen. Schriften zu Wirtschaft und Soziales, 4, Heinrich Böll Stiftung.

- Stewart, J. (2008): Shadow regulation and the shadow banking system. In: Tax Justice Network (TJN) (Hg.): Tax Justice Focus. 1-4.

- Stewart, J. (2010): Financial Innovation and the Financial Crisis. Paper präsentiert auf der International Schumpeter Society Conference 2010.

- Tax Justice Network (TJN) (2011): Financial Secrecy Index 2011. Online: http://www.financialsecrecyindex.com/2011results.html [18.07.2012]

- Troost, A./Liebert, N. (2009): Das Billionengrab. Von Steueroasen und Schattenbanken. Blätter für deutsche und international Politik, 3, 75-84.

EU financial reforms: an unfinished business

Gaspard Denis

While progress towards a more resilient financial system has undoubtedly been achieved at EU level, it remains nonetheless much too incomplete. The challenge is all the more significant as our system, more than ever, remains dominated by banks that are too big or too interconnected to fail and therefore too dangerous to exist.

Given that these unprecedented rescue programs were entirely funded by the taxpayer, policy makers have been left with no other choice but to adopt measures to deleverage the financial sector.

It was a rather unusual statement that European Commission president, Jose Manuel Barroso, made in October 2008 in the wake of the Lehman Brothers' bankruptcy. Turning his back on the usual "laissez-faire" mantra, he indeed publicly acknowledged the need to "*rethink regulatory and supervision rules for financial markets*".[1] Echoing alter-globalist rhetoric, he also emphasised firmly his wish to ensure that in the future such markets *"function properly for the benefit of citizens and businesses, rather than themselves"*.

Five years later, Mr. Barroso assesses with great satisfaction the work that has been achieved in this field. Speaking in September 2013 at the G20 Summit in Saint Petersburg, he ensured that, on financial regulation, *"Europe has come very far in regulating financial markets"*.[2] It is true that, with more than 30 European Union laws enacted since 2008, the European Commission has been kept very busy with the regulation of the financial sector. Furthermore, there is absolutely no disputing the fact that these new pieces of legislation will contribute to reducing excessive risk-taking activities within the financial system. In that sense, they represent a significant reversal of previous internal market policies, which were systematically geared towards promoting the interests of the industry.

Two main factors have contributed to this change of direction. The most important one is undoubtedly the cost of the financial crisis. Between October 2008 and 31 December 2012, Member States provided €591.9 billion (4.6% of EU 2012 GDP) of capital support (recapitalisation and asset relief measures) to the financial sector. The guarantee measures and other forms of liquidity support reached their peak in 2009 at €906 billion (7.78% of EU 2012 GDP), dropping by almost half to €534.5 billion (4.14% of EU 2012 GDP) in 2012.[3] Given that these unprecedented rescue programs were entirely funded by the taxpayer, policy makers have been left with no other choice but to adopt measures to deleverage the financial sector. Not acting would have simply amounted to political suicide. The second factor – although of lesser importance – lies in the personality of the current Internal Market Commissioner, Michel Barnier. While his predecessor, Charlie McCreevy, was a notorious supporter of market self-regulation, the French Commissioner's political mind-set has proven to be relatively more open to tougher regulation.

Although such regulatory moves have to be welcomed, it would be misleading to view them as the result of a paradigm shift in the way the EU approaches financial reforms. There are two main reasons for this. First of all, as outlined above, this

1 REUTERS, Oct 14, 2008, EU's Barroso urges global rethink of regulation, http://in.reuters.com

2 BARROSO, J.M.D, 5 September 2013, "Statement by President Barroso ahead of the G20 Summit in Saint Petersburg", Joint press conference/Saint Petersburg.

3 Note that less than 0.2% – that is € 2 billion – of the total guarantees provided by Member States has actually been called to date, in State Aid Scoreboard 2013, Aid in the context of the financial and economic crisis, http://ec.europa.eu/competition/state_aid/scoreboard/financial_economic_crisis_aid_en.html

trend is cyclical (not structural): the newly adopted legislative measures are essentially an institutional response to the current public anger at irresponsible bankers. But, as the trauma of the 2008 crisis recedes, the momentum for further financial reforms should progressively slip away. Secondly, although the progress made since 2008 in the field of financial integration is unprecedented, it still falls far short of what is needed to build a resilient financial sector and curb speculation. An explosive combination of intense lobbying from the industry, defensive positions from Member States (always eager to protect their own national "banking champions"), and ideological conservatism from a large majority of the Members of the European Parliament (MEPs) has led to the enactment of financial laws that lack ambition and are full of loopholes.

This is indeed the conclusion that can be drawn from the analysis of some of the key aspects of EU financial reforms that is provided below.

The banking reform jigsaw

The EU banking reform is far from being a uniform process. It comprises many different legislative components, which are progressing at different paces and intertwine in a complex way. Three major steps have been taken in this respect during the 2009-2014 parliamentary term: first, the adoption of the so-called CRDIV package; secondly, the establishment of a single supervisory mechanism (SSM) and, thirdly, the agreement on the EU framework for bank recovery and resolution (BRRD).

In some respects, the adoption of the CRDIV package (April 2013) – which transposes, via a Regulation and a Directive, the new global standards on bank capital – constitutes the most significant breakthrough in terms of regulating Europe's banking sector. Under this new prudential regime, bankers' bonuses will be capped at twice their salary, banks will be subject to a strict transparency regime (under which they will be forced to disclose their activities in tax havens) and, for those which are deemed "too big to fail" (i.e. banks whose bankruptcy would have serious consequences for the financial system and real economy), additional capital requirements will be introduced. However, these positive aspects must not be allowed to conceal the fact that the CRDIV package contains serious shortcomings. In particular, it does not include a binding leverage ratio for banks, which represents a failure to take firm action to limit leverage in the banking system. Furthermore, the CRDIV package introduces new liquidity rules that are much too weak to successfully limit EU banks' excessive reliance on short term and unstable sources of funding. Yet, the 2008 crisis has highlighted how such dependence creates additional vulnerabilities within the financial system.

The agreement on a single supervisory mechanism (SSM) (concluded in March 2013) – the first stage in the establishment of a European Banking Union – was another major political achievement of the parliamentary term. As of November 2014, the European Central Bank (ECB) will be indeed fully entrusted with responsibility for the supervision of all banks in the Eurozone (and of those countries which decide to join the banking union), including the direct supervision of around 130 of Europe's most "significant" banks. While this new supervisory authority is essential to overhaul the current disjointed light-touch national supervision, it lacks nevertheless transparency and accountability. It is indeed unhealthy in a democracy to concentrate so much power in one institution, all the more so as the ECB will find it difficult to depart from its corporate culture of non-accountability. Furthermore, the European Parliament's scrutiny role under the new framework is much too weak. According to the terms of the interinstitutional agreement concluded in September 2009, the ECB will only be required to submit to the European Parliament the information from the minutes of the Board of Supervisors that it regards as most important. Yet, the European Parliament should at least have had full access to the minutes of both the Board of Supervisors and the Governing Council.

The adoption of the EU framework for bank recovery and resolution (BRRD) in December 2013 is the third major step of the ongoing EU banking reforms. Needless to say that this new legislation – which aims at minimising taxpayers' exposure to banks' losses – is of crucial importance. Specifically, it states that shareholders and creditors shall be responsible for any bank losses up to 8% of the total assets before a resolution fund – based on contributions from the banking sector – or the State can intervene.

These so-called "bail-in" provisions are however tempered by two major negative aspects of the new legislation. Firstly, EU finance ministers have managed to insert in the text a provision allowing Member States to recapitalise their banks in a "preventive" manner. In other words, if future banking stress tests reveal problems with the credit-worthiness or capitalisation of banks, the BBRD rules will allow for the use of public funds to prop them up. While any request will be subject to *a priori* approval by the European Commission, this is still a major setback.

Secondly, the provisions on the crisis management of cross-border banks are completely inadequate. Originally, the European Parliament wanted to ensure that the European Banking Authority (EBA) could arbitrate on cases where a bank crisis resolution was subject to dispute among national authorities. However, as a result of pressure from the Council, this was not included in the final deal. Instead, national authorities will be able to deviate from the burden sharing plans established in advance of resolutions.

Although three key banking legislations have already been adopted since 2009, the reform process is far from over. While some legislative pieces are entering into the final stage of negotiation between the Parliament and the Council (such as the single resolution mechanism (SRM), second pillar of the banking union), others are still in the pipeline (such as the upcoming rules on shadow banking or on

It can already be safely predicted that the debate on structural reforms – which relates to the mandatory separation of high-risk trading activities of banks – will be one of the hottest issues of the next Parliamentary term.

structural reforms). It can already be safely predicted that the debate on structural reforms – which relates to the mandatory separation of high-risk trading activities of banks – will be one of the hottest issues of the next Parliamentary term.

The OTC derivatives conundrum

Besides new rules on banking regulation, dozens of legislative texts aimed at bringing financial markets under control have also been endorsed since 2009. Their scope encompasses both the players of such markets (such as alternative investment funds (i.e. hedge funds and private equity funds), credit rating agencies, money market funds, etc.) and the financial instruments that are being traded on.

We will focus in this section on two major legislative files tackling the issue of derivatives,[4] which were blamed for exacerbating the financial crisis. Although these financial instruments were originally used as hedges, they are indeed increasingly being used for purely speculative purposes (to bet on future changes in interest and exchange rates, share prices, the price of raw materials, or the risk of a loan not being repaid). Furthermore, 90% of the derivatives market is made up of so-called "over the counter"[5] (OTC – bilateral) transactions, which fall outside direct regulatory supervision.

The political agreement reached in February 2012 on over-the-counter derivative products (the so-called EMIR) was a key step towards tighter financial market rules. A crucial new provision is that the majority of privately traded over-the-counter derivatives will have to be cleared through central counterparties (CCPs). CCPs' prime responsibility is to provide stability by reducing the risk of market participants defaulting on obligations. More specifically, they impose margin requirements and other risk controls in order to mutualise losses among trade participants.[6]

While this new legislation will definitely contribute to bringing over-the-counter derivatives transactions out of the shadows, it is still much too inadequate to reduce risk in the financial system, and may even be counterproductive. As noted by Satyajit Das, expert in finance, CCPs may actually be the ultimate case of "too big to fail": *"the CCP effectively changes the structure of markets from a network that can survive one or more failures to a hub-and-spoke system that is vulnerable to a single failure. This increases risk concentrations within financial markets"*.[7]

Another key file dealing with the issue of derivatives is the newly revised legislation on markets in financial instruments (the so-called MiFID II) that was adopted last January. A key provision is the introduction of

4 Specifically, to buy a derivative grants the right (with options) or the obligation (with futures) to buy or sell the said underlying asset (share, currency, oil, etc.) at a later date, but at a fixed price today. For further information, see: http://www.bankingsins.eu/en/pdf/The_7_deadly_sins_of_banking.pdf

5 "Over-the-counter" (OTC) markets are informal financial markets (primarily derivatives) in which there is no clearing house rules or binding rules governing trade. In other words, the conditions are left to be freely negotiated among investors.

6 In the event of a default by one of the counterparties, the CCP will use the margin posted by the defaulting counterparty to cover the losses incurred.

7 DAS, Satyajit, Nov. 2011, "Derivatives Market: CCP Is Ultimate Case of "Too Big to Fail", http://www.minyanville.com

The EU has clearly failed to deliver a regulatory response in line with the magnitude of the stakes. The adoption of legal provisions capable of effectively curbing unbridled speculation has been insufficient.

a new type of trading venue, called an organised trading facility (OTF), which is designed to trade over-the-counter derivatives. By doing so, the EU intends to comply with its G20 commitments according to which over-the-counter derivatives transactions should not only be processed through central counterparties (see above), but also take place on a regulated trading venue, with the aim of making them more transparent.

One may, however, question the new OTF category's added value as it largely overlaps with existing regulated markets and multilateral trading venues and has weaker regulatory requirements (in particular on pre-trade transparency).[8] There is thus a clear risk that the new OTF category will simply attract volumes away from regulated venues, while not reducing over-the-counter derivatives volumes.[9]

Two other key provisions of MiFID II aim at reducing excessive price volatility in commodity derivatives markets.[10] First of all, a position reporting obligation by category of trader will be introduced in order to help regulators and market participants to better assess the role of speculation in these markets. Secondly, competent authorities will be empowered to limit the size of a net position which a person may hold in commodity derivatives (traded on trading venues and over the counter) if there are concerns about disorderly markets. Provided that the European Securities and Market Authority (ESMA) properly calibrates the methodology for calculating these limits to be applied by national authorities, the measure could help to reduce the scope for gambling on food prices. This being said, given that such limits will be set nationally, rather than at the European level, there is a real risk of a "race to the bottom" as member States could compete to set weaker limits.

Complex regulation: toothless reaction?

Despite some progress towards a more robust and safer financial sector, the EU has clearly failed to deliver a regulatory response in line with the magnitude of the stakes. The adoption of legal provisions capable of effectively curbing unbridled speculation has been insufficient. Instead, up to now, emphasis has been largely put on increasing the transparency of financial operations. This provides evidence that neoclassical economics, and in particular the rational expectations theory, still form the theoretical basis of EU policy-making. From this point of view, the more markets become transparent, the less regulation becomes relevant.[11]

8 FINANCE WATCH, 15 January 2014, "Finance Watch welcomes MiFID II agreement, calls for strong Level 2 to realise the benefits", Press release, http://www.finance-watch.org

9 FINANCE WATCH, 13 January 2012, "Response to MiFID questionnaire", http://www.finance-watch.org

10 In terms of commodities markets, experts consider that there is a level of speculation that is good, or even necessary – typically around 20-30%. But, today, speculation makes up around 70-80% of the activity.

11 LLB,16 avril 2013, "La transparence est-elle la solution à la crise de confiance?", http://www.pauljorion.com

Although transparency undoubtedly facilitates the oversight capacity of competent authorities, it is however insufficient to bring the finance industry back under control. A radical shift – in the way the EU approaches financial regulation – is certainly needed to reach such a goal. This requires in the first place switching from complex to simple rules (i.e. rules that do not rely on assumptions and estimations, are not risk-sensitive, etc.) that are by their very nature less likely to be manipulated. In this respect, the introduction of stringent rules for the separation of banking activities (between those which are essential to society and those which are not), or a tax on the derivative liabilities of large banks would provide a good starting point. Simplifying financial provisions will be the most important challenge of the next legislative term.

Gaspard Denis is a Parliamentary Assistant to Philippe Lamberts, Greens/EFA MEP.

Philippe Lamberts

Green struggles and victories against the mainstream orthodoxy

Thanks to the action of the Greens/EFA Group in the European Parliament some holes have been opened in the mainstream orthodoxy. But we are far from being protected from another systemic crisis. The financial sector continues to blackmail governments and traditional parties. Taxpayers are still paying for the mistakes of the banks. This is an interview with Philippe Lamberts, Green MEP and member of the Committee for Economic and Monetary Affairs, who along with his colleague Sven Giegold is on of the main actors in the struggle against mainstream financial orthodoxy.

Right-wing governments are all in favour of market discipline, except when market discipline can hurt private market players.

GEJ: Five years after the beginning of the financial crisis, has Europe implemented the reforms that would really enable our economy to avoid another systemic crisis?

Philippe Lamberts (PL): It is quite obvious that we are not at the point where we can look the citizen in the eye and tell him or her that from now on, the idea of socialising losses and privatising profits is definitely behind us. We are still faced with financial institutions which are too big to fail, and can blackmail democratically-elected governments on a permanent basis. One could even argue that the institutions that were too big to fail and that survived the crisis have become even bigger today. We have imposed some measures on the financial sector. But, fundamentally, it is still calling the shots. We can witness that in the recent negotiations on the Bank Recovery and Resolution Directive, where EPP people, as well as socialists, were quite reluctant to accept the idea that if private investors are making stupid mistakes, then *they* should pay, and not the taxpayer. In that sense, reforms are not going as far as they should go, if we want to avoid the 2008 scenario.

GEJ: Is it the result of efficient lobbying or of fear of the governments?

PL: Many mainstream parties claim that they want the private sector to pay for its mistakes, but when push comes to shove, they still are very reluctant to do so. They prefer that the taxpayer pays. Recently, SNS Bank, the fourth-biggest Dutch bank, has been in severe difficulties and had to be rescued. After involving shareholders the Dutch government was still €2.7 billion short of being able to rescue the bank. Then they had to choose either to involve bondholder money or to ask the taxpayer. They chose the latter, because they were afraid that involving the junior bondholders would send a signal to the capital markets that if you are a senior bondholder, your money is not 100% guaranteed and that you may lose your money if you don't invest wisely. So they send the signal that if investors invest in poorly-managed banks, then it is the taxpayers who are on the hook. That was the political decision made by the political majority in the Netherlands, by a government which is a predominantly Liberal. Right-wing governments are all in favour of market discipline, except when market discipline can hurt private market players. There is a lot of lobbying going on by the largest financial players and that lobbying is successful. Their main argument is that, if the private sector were to really pay for its mistakes, it might be disruptive for all of society. That is the blackmail argument. It is really just scaremongering, but it is successful.

The last market liberals?

GEJ: Are you sure that if you were the next Green Belgian finance minister, you would have a different attitude in the same situation?

PL: Absolutely. But that means, of course, that we would go against a number of vested interests. The problem is that if one country has that kind of discipline, and all the others do not, and if you have

If Europe does it together, then we have the critical mass to impose our will on market players.

too much interdependency, well, that might be difficult. Iceland imposed very harsh losses on private creditors. As a result, it found itself totally isolated, and did indeed suffer a backlash in terms of reduced economic wealth. But right now the country has got over it, and has started on a stronger footing. In that process, private creditors paid. And that's basically what we as Greens would try to do. But discipline for private financial market players in just one country, especially a small one, does not really work, because they can hit back at you. But if Europe does it together, then we have the critical mass to impose our will on market players.

GEJ: This is another argument, of course, for stronger Green parties, isn't it?

PL: Of course. To some extent, I have often felt that the Greens were the last market liberals in the room. Many mainstream parties remain in a position where they still agree that they are market liberals as long as the market is profitable. When markets become loss-making, then taxpayers have to pay. The Greens do not want to trust every bit of human activity in the market – certainly not. But for the parts of human activity that are entrusted to market logic, then market discipline is the one that makes mistakes, that covers the losses. And I am afraid to say that right now, mainstream political parties are full of discipline when it comes to governments, but conversely they forget the word "discipline" when it comes to market players.

Three dents in the dogma

GEJ: This Green attitude, of being open-minded to markets and so on, was one of the conditions of being successful in the European Parliament. Could you sketch out the main results of Green activity in the European Parliament, not only on banking regulation, but also on the fight against tax havens?

PL: If you want to put it in a wider perspective, all successes have been limited, because we are not the number one party in the European Parliament, but our work is important in the sense that we have opened holes in the orthodoxy.

Firstly, we managed to obtain the first ban on a financial product. In Europe you can no longer do what is called a "naked credit default swap" on sovereign debt. Up until then, it was possible for an investor to bet on the default of the government, just as if, as an individual, you could insure yourself against a fire in your neighbour's house. You cannot take insurance against a risk you are not exposed to, because you would have an interest in the risk materialising. In the market economy this is illegal, but in the financial markets it is legal, except in one domain, which is sovereign debt. This success ran contrary to the logic that financial innovation as such is good. We said no: as governments have the power to ban some food products, some chemical additives, if some financial products prove to be toxic, we should be able to ban them. That goes totally against the dominant logic that "markets know better", that you have to "unleash" the creativity of market players, so that everyone ultimately benefits. That's the first dent.

The second dent that we made was in the field of fighting tax havens. Tax fraud, tax cheating and tax optimisation are the most lethal instruments that undermine democracy, because they deprive elected governments of the means to carry out their policies. This is an area that, in theory, the European Parliament has nothing to do with, since we are not legislators on taxes. Yet we succeeded by including in the Banking Directive the principle that we should at least force the banks to disclose their operations country-by-country. This new legislation will force the banks to disclose each country in which they operate, under which legal structure they operate, how much profit they make, how much tax they pay, how much they receive in subsidies, and with how many people they do all of this. That means that, for instance, major financial institutions such as Deutsche Bank or BNP Paribas will need to disclose that, for instance, in a given Caribbean island, they may have fifteen legal entities which are making billions in revenue – hundreds of millions in profit – on which they pay almost no tax, and they do all this with maybe half a full-time employee. This is the first step in fighting tax havens, as it makes the problem visible. And where there is visibility, it becomes more difficult for elected governments not to act.

The first step towards fighting tax havens in 2015

GEJ: And this is something that we will feel the consequences of within two years?

PL: It becomes applicable on January 1st 2015, so quite soon. So there, we made a dent in the dogma that you cannot force transparency from institutions. This "veil of secrecy" is what helps tax fraud and evasion. There is a total blockade on many other taxation issues because it's entirely in the hands of the Council of the Heads of State and Governments, and, therefore, in the hands of the finance ministries. Since it requires unanimity to get anything passed in the Council, one member state alone can block everything. And that is the elephant in the room.

Thirdly, there is the issue of remuneration. The revenue created by these "too big to fail" institutions, who can blackmail elected governments, is translated into gigantic profits that are first distributed to the managers and second to the shareholders. On this issue, that made a name for me in the City of London, we managed not to put limits on the absolute amount of remuneration, but at least on the leverage of that remuneration. We limited the amount of variable remuneration versus fixed pay.

Europe has no involvement in setting wages; however, one of its competencies is tackling remuneration structures if it is proved that these structures have a systemic effect on the internal market. In this case, the high leverage of variable pay in proportion to fixed pay gives a very strong incentive for bankers to do stupid things. If things go wrong, the taxpayer pays. So there we put in limits, again, breaching the dogma that pay is not for governments to set, claiming instead that governments should have nothing to do with it.

They make so much profit that, for them, breaching the law and then paying the fine is still good business.

By the way: JP Morgan in the US and Deutsche Bank in Europe are currently facing very large fines for breaching the law during and after the financial crisis. But today these banks boast that they can pay these fines and still remain profitable. In other words, they make so much profit that, for them, breaching the law and then paying the fine is still good business. These massive financial institutions are still exporting money from society rather than contributing value to society.

So, we have managed to put a dent in some of the dogma, but the most fundamental, that markets are good and governments are bad, still pretty much remains dominant in economics.

The strategies of EU governments, the European Commission and the Central Bank are still predicated on the idea that the only way to get out of the crisis is (a) to reduce fiscal government debt by reducing your expenditure; (b) to restore competitiveness by reducing the cost of labour and what they call "reducing non-tariff barriers to trade," that is, social and environmental health protection laws. There is no question of increasing competitiveness by decreasing the cost of the remuneration of capital, which in Europe is absurdly high compared to China. This remains the primary logic that drives the mainstream parties: the EPP, the social democrats and the liberals. The Greens are one of the few who are really opposing this logic. However, we are still the fourth group in the Parliament. If we really want to subvert that idea, we will need to be one of the major parties not only in the Parliament but also in national governments. But let's face it, the Greens are part of 4 out of 28 national governments, and we are junior political partners, not major players.

"What do we do to make taxation a real instrument of ecological and social transformation?"

The far left on the balcony

GEJ: And what is the attitude of the far left?

PL: Many of them would share our analysis. But they would rather do it from a balcony. In all the battles I mentioned, even though there was someone appointed by the extreme left to follow each of those legislative files, they were not taking part in trying to improve them. They often voted in the right way, but they didn't put any effort into trying to shift the political balance of power in the European Parliament. Many of them would still expect the system to crumble under the weight of its own problems and then hope that, after the collapse, they would become strong and rebuild society from scratch. The Greens believe that (a) the collapse will hurt society in such a way that reconstruction

You cannot dissociate the social and the environmental angles. Those who will be hurt first will be the weakest in society.

will be much harder than a peaceful transition and (b) who can guarantee that the forces of good – to put it in a black and white manner – will endure after a collapse? If, with the far left, we share the concern about the threat of inequalities, only some of them share our analysis that we are not only facing a social time bomb, but also an environmental time bomb.

GEJ: Yes, the Greens are having some difficulties in showing the ecological dimension of this crisis.

PL: It is much easier to make that case in India or China where the ecological time bomb is much more perceptible than it is here. In Europe, by and large, you might think that we are pretty much insulated from the ecological crisis. Europe is still exploiting – and we are not alone in this – many finite resources and taking a share from them. But when we hit the limits of our planets hard – such as climatic or resource-related limits – European societies will be hit as badly as others. So you cannot dissociate the social and the environmental angles. Those who will be hurt first will be the weakest in society. You can't solve the ecological challenges without meeting the social challenges. The two go hand in hand. We haven't so far been successful enough in convincing people that our vision is solving the two at once.

Priorities for the next legislature

GEJ: What are your priorities for the next European legislature and what kind of social and political alliances do we need in order to achieve them?

PL: Basically, our priorities are reducing the level of material inequality and our ecological footprint. But even if the Greens become the third force in the European Parliament, which is not really on the cards right now, that would still not be enough. So we need to build alliances, first and foremost within society and then in the political arena. In the trade union world, in the NGO world, but also in the business world, there are more and more people who have understood the breadth of the challenges we are facing, and people who are already implementing solutions. The Greens must appear as the primary political expression of those actors of change and then leverage that in order to build political alliances with people who share our diagnosis.

Governments have two basic instruments at their disposal. One is regulatory: rules, laws, things you are permitted to do. But just talking about regulation is a complete illusion, if you forget the "M" word: money. The key priority is to focus on the income side of the equation. What do we do to make taxation a real instrument of ecological and social transformation? What level of taxation for capital versus labour income? What kind of taxation for the corporate sector? Right now we are in a situation where small enterprises pay 35% or more, and large corporations pay 5% or less. What do we do to fix that? What do we need to put into place for environmental taxation? And whatever you do in terms in taxation, you have to make sure that taxes are paid where they have to be paid, and that's the fight against tax erosion and tax evasion. That's the number one priority, and it is an instrument that, by and large, escapes the reach of any state or government. And, of course, there is absolutely no way that increased European integration can be accepted and be acceptable, if you do not significantly establish or re-establish European democracy.

Sovereignty has now escaped the people and come under the ownership of the financial sector. When the capital markets – or the people who run the capital markets – have greater sovereignty than democracies, then you really have a democratic issue. Until you solve that issue, further integration will not be acceptable to European citizens. And that will be a chicken and egg problem.

You need further European integration to change the balance of power between democracy and the financial sector, but you cannot do that unless you re-establish democratic accountability on decisions taken at the European level. And quite obviously what has been done in the course of the Eurocrisis by the troika has actually been damaging democracy. We need to give credibility to Europe as stable, not to weaken democracy, but to reinforce it. And that of course is a difficult proposition.

The risk of the "grand coalitions"

GEJ: Yes, but what is the political feasibility of all this?

PL: One major political development that we have witnessed over the last months and years in Europe – especially after the German election – is the rule of the "grand coalition". That is, the coalition of the mainstream political parties, which are supposed to be on the right and on the left. In Germany, you have an EPP and S&D majority. In Austria, Belgium and Netherlands, we have pretty much the same thing with the liberals. My real concern is that the next European Parliament will be dominated by the logic of the two main political parties. The main aim of resisting the extremes, particularly the extreme right, will continue, carrying on mainstream policies, while saying that, "well, we all have to unite in order to avoid the extremes taking over". This would mean that the political breathing space for Greens will be more limited. That would be chilling for European debate. And if that becomes the case, the role of the Greens will be to demonstrate that there is a real political alternative, but that – compared with the extreme ones – has a realistic proposition to get from A (where we are) to B (where we need to be), that there is a group of people who have a viable alternative to mainstream policies, but also a credible one, in the sense that we propose concrete steps to go from where we are today to where we need to be, rather than to hope for a collapse of the current mainstream policies.

Philippe Lamberts is a Greens/EFA MEP and a member of the European Parliament's Committee on Economic and Monetary Affairs.

The wrong phoenix rising

Jasper Blom

It is no secret that the lobbying might of financial institutions has shaped regulatory rules at national, European and global level. But did the disaster of the 2007 financial crisis change this? The honest answer is that the old institutions are still up to their old tricks, and a change in how we make policy is needed if we are to avoid a repeat of the crisis.

The following article is a shortened adaptation of the author's forthcoming chapter in Mügge, D.K. (ed.) (2014) Europe and the Governance of Global Finance, Oxford University Press.

European companies rely heavily on bank financing, making the European banking market the world's largest. The crisis in the banking sector and the resulting regulatory reforms therefore have direct implications for the prospects of European economies to implement a Green New Deal and recover from the crisis, even more so than in other advanced economies. Elsewhere in this edition of the Green European Journal, Green MEP Philippe Lamberts points to the "blackmail" by the largest financial players, holding society ransom to secure their profits. That begs the question whether the crisis has led to a change in the way European policymakers confront the banking lobby, and whether this results in strengthened regulation that ensures stability. This article will try to answer these questions by looking at one crucially important regulatory domain: bank capital adequacy standards. These standards aim to ensure banks hold a sufficient buffer to weather adverse conditions.

At the global level, the Basel capital accords of the Basel Committee on Banking Supervision (BCBS) set the standards for bank capital adequacy. Supervisors from the main European financial markets are members of the BCBS, and the European Central Bank (ECB) and Commission are observers. The Basel accords have been transposed into the EU context through several directives, most recently through the fourth Capital Requirements Directive (CRD IV). That's the official side of the policymaking process. On the other side, the article will show the rampant and heavily biased lobbying taking place in the making of banking regulation, and how that is reflected in the final regulations. The article will conclude with some concrete suggestions on how to improve the democratic legitimacy of regulations through addressing the influence of lobbying. But let's start with the policymaking process.

Financial policymaking in the EU

A major problem with global financial policymaking is the exclusionary policy-making forums in which it takes place, leading to limited and skewed discussions (see Underhill, Blom and Mügge 2010; and particularly the chapter by Baker in that volume). As a result, public policy-makers have developed shared assumptions including the superiority of market mechanisms and the desirability of levelling the playing field ("increased competition leads to more efficient financial services provision"). Bank capital adequacy was also addressed through this market-oriented lense, by allowing the major banks to use their own models to determine necessary capital under the Basel II capital accord.

European policymakers encouraged this global goal of levelling the playing field with an eye to using the Basel capital accords to further European financial market integration (Bieling and Jäger 2009). This is reflected in the application of the Basel capital accords to *all* European banks, even though the accords were originally envisaged to apply only to large internationalised banks (and are implemented as such by, for example, the US). In addition, CRD

It became clear for everyone to see that the global banks successfully privatised their gains and socialised their losses.

IV has strengthened provisions on consolidated supervision for EU banks (Christopoulos and Quaglia 2009: 18). This makes cross-border operations in Europe easier for banks.

The market-oriented lenses of financial policymakers did not emerge out of thin air. Throughout the regulatory process, there was fierce lobbying by the banking industry. An industry representative confided to me that when the BCBS was working on particular issues in the Basel II accord, his association would be called on to organise a high-level meeting with BCBS officials. This lobbying is shown in the responses to the consultative papers which the BCBS issued (see Blom 2011: 133, table 4.5 for more details). The vast majority of comments came from private financial actors (about 70 per cent) and supervisors (another 15 per cent, these were regularly drafted in explicit consultation with the domestic financial sector). Only a handful of Civil Society Organisations provided input, out of a total of 443 comment letters in two rounds.

Brussels under the lobbyist's influence

The European implementation of Basel II simply provided another chance for lobbying. The banking sector was closely involved in the negotiations at the European level, leading the European Banking Federation to commend the Commission for the unprecedented level of consultation (*Financial Times*, 15 July 2004). The EP proved a magnet for lobbying, with a package of almost 600 amendments tabled during discussions between the Commission, Council, and Parliament. Many amendments aimed to address national idiosyncrasies, while the internationally active private sector lobbied to reduce national discretions – and thus to defeat such amendments. Despite all the amendments tabled, the main philosophy and thrust of Basel II remained intact (Dierick et al. 2005).

The global financial storm gathering pace in 2007 revealed the inadequacy of extant bank capital adequacy levels. The internal models of banks as well as external rating agencies spectacularly failed to assess the risks associated with complex securitised products. Many banks experienced liquidity or even solvency problems and required state support. It became clear for everyone to see that the global banks successfully privatised their gains and socialised their losses. The collapse of Lehman Brothers and the narrowly avoided global financial meltdown in September 2008 was the final straw. As the newly appointed FSA chair Lord Turner put it: a clean slate for capital adequacy standards was needed (*Financial Times*, 17 October 2008). But did the intensifying political fights around financial regulation – now that taxpayer's money was visibly involved – also weaken the banking lobby?

In the wake of the crisis: the private sector on the ropes?

The crisis seemed to offer a wake-up call to strengthen financial regulations. The BCBS duly proposed "enhancements" to Basel II in January 2009. These included liquidity risk provisions, the better modelling of securitisations, a stricter definition of capital, cyclically adjusted capital buffers, higher capital requirements for systemically relevant banks, and a gearing ratio (see the overview in Goldbach and Kerwer 2012). This latter proposal (also called a leverage ratio) sets a capital requirement against the balance sheet total of a bank (without risk-weighting) and is a clear departure from Basel II practice. This measure, long in place in the USA, proved quite contentious in Europe, where banks are unfamiliar with the practice. BNP Paribas, for example, stated: "except for its extreme (excessive…) simplicity, this indicator has no clear objective and justification; furthermore, it has proven failures or flawed definitions wherever it has been applied, in particular in the USA" (16 April 2010).

The central line of defence against strengthened regulation of the private sector lobby was the supposed negative economic impact of stringent capital requirements. This was repeated in almost all private sector responses to the various consultative papers on Basel III (these can be found on the BIS website). The banking lobby used the weak economic environment to plead for a delayed phase-in of stringent Basel III requirements. They pointed to politicians' demands that banks contribute to funding the economic recovery, and claimed they would be unable to do so with the "excessive" Basel III requirements (F*inancial Times*, 12 April 2010). This argument resonated with Eurozone supervisors, where the financial crisis had transformed into a sovereign debt crisis hampering economic recovery.

Another lobbying success

The banking lobby was successful in paring down the most controversial aspects of Basel III. Given the uncertain economic conditions, supervisors were hesitant to push stringent regulations (even some who traditionally favoured stringent standards – notably Germany). Although the new accord includes a more stringent definition of capital and an increase in the buffer, its phase-in is planned to last until 2018. In response to the criticisms from especially the European financial sector, the leverage ratio will only be "tested" until 2017. In other words, the precarious economic situation in Europe led public supervisors to give in to the demands of their private sector. This was certainly also related to the weak balance sheet of German and French banks, which would simply not be able to meet stringent capital requirements (Howarth and Quaglia 2013).

But even in the face of financial crisis, European public policymakers did not forget the goal of market integration. An important part of Basel III will be transposed through a "regulation"– meaning it will apply directly in member states. This will limit the scope for the national idiosyncrasies that emerged under CRD III. Another Commission proposal hinted at setting Basel III norms as an absolute rather than a minimum standard (as the BCBS sees it). Such "maximum harmonisation" would mean that countries with large banking sectors can no longer set additional capital requirements (e.g. the traditional "gold plating" of the UK). It would also make it impossible for frontrunners – which will hopefully soon emerge – to include additional capital requirements for environmentally risky investments. Thankfully, maximum harmonisation was defeated in the European Parliament.

Balanced decision-making requires that not only banks are heard in the discussion, but also the users of financial services, from innovative green SMEs, to pension funds, to ordinary citizens.

Conclusion

The discussion above demonstrated the significant impact of the financial sector lobby on financial regulation. This has led to a bias in the rules favouring market practices of large internationally active banks. Moreover, as the discussion of Basel III showed, the private sector lobby quickly re-asserted itself after the crisis and delayed more stringent regulations. This allows more time for the lobby to grind down the support for stringent regulation. The effects are already becoming visible: Financial Times, 13 January 2014 headline "Banks Win Basel Concession on Debt Rules". Like a phoenix from the ashes, the lobby of bailed-out banks has risen to beat down stringent implementation of regulation.

So what is to be done? First, the range of stakeholders involved in the financial policymaking process should be increased. Balanced decision-making requires that not only banks are heard in the discussion, but also the users of financial services, from innovative green SMEs, to pension funds, to ordinary citizens (e.g. represented through Finance Watch). Elsewhere, I have proposed an institutionalised system of "corporatist" representation of stakeholders to achieve this (Underhill and Blom 2013). More importantly, the democratic accountability of the policymaking process should be enhanced. It is the phoenix of democratic citizenship which I hope to see rise out of the ashes, holding those who contributed to the crisis (e.g. by advocating financial liberalisation) to account. This requires transparency on what is going on in the regulatory process from both the official and the other side. A strong and clear "legislative footprint" should be included when financial regulations are put forward to the European Parliament: a discussion on the on the inputs received from lobbyists and stakeholders and how these have been included in the final outcomes. This allows parliamentarians to judge whether an adequate balancing of stakeholder interests has taken place, and determine whether they should actively seek additional views from neglected parties. Secondly, there should be more transparency from those doing the lobbying. Not only a beefed-up lobbyist register, but also transparency on the side of banks and other stakeholders on lobby activities such as discussions with policymakers and the funding of studies (See Van Tilburg and Römgens 2013 for more detailed recommendations).

Notwithstanding the aforementioned proposals, it should also not be underestimated to what extent this bias in favour of large, internationally active banks operating on the basis of the old model of expansion and growth is supported by politicians currently in office. The discussion showed how European policymakers use global regulations to promote the growth and integration of European financial markets. Although bank capital adequacy standards at the global and European levels are not a one-on-one reflection of "capture" of regulators, it is a matter of serious doubt whether public interests have received sufficient consideration. As the world has once again experienced the devastating effects financial instability can bring, this is a worrying conclusion. Fortunately, the elections for European Parliament of May 2014 offer one of those opportunities to hold the official side to account.

Jasper Blom is Director of the Dutch Green foundation Bureau de Helling. In 2011 he dedicated his PhD to the governance of the global financial system.

References

- Bieling, H.-J. and J. Jäger (2009) "Global finance and the European economy: the struggle over banking regulation" in: Van Apeldoorn, B. Drahokoupil, J. and L. Horn (eds) Contradictions and limits of neoliberal European governance, from Lisbon to Lisbon, Palgrave, pp. 87-105

- Blom, J.G.W. (2011) Banking on the Public: market competition and shifting patterns of governance, PhD thesis University of Amsterdam http://dare.uva.nl/en/record/398055

- BNP Paribas, [no title, response to BCBS December 2009 consultative documents], 16 April 2010

- Christopoulos, D.C. and L. Quaglia (2009) "Network constraints in EU banking regulation: the Capital Requirements Directive," Journal of Public Policy, vol 29:2, pp. 179-200

- Dierick, F. et al. (2005) "The new Basel Capital Framework and its Implementation in the European Union", ECB Occasional Paper no. 42, December

- FT, "Bolkestein hails Basel II move" 15 July 2004

- FT "Banking regulator calls for clean slate" 17 October 2008

- FT, "Financials seek to soften Basel stance" 12 April 2010

- FT, "Banks Win Basel Concession on Debt Rules" 13 January 2014

- Goldbach, R. and D. Kerwer (2012) "New capital rules? Reforming Basel banking standards after the financial crisis" in: Maintz, R. (ed.), Crisis and control: institutional change in financial market regulation, Campus Verlag, pp. 247-262

- Howarth, D. and L. Quaglia (2013) "Banking on stability: the political economy of new capital requirements in the European Union" Journal of European Integration, vol 35:3, pp. 333-346

- Underhill, G.R.D. & J. Blom, *Global financial integration, twin crises, and the enduring search for financial stability*, CEPR policy report, 2013

- Underhill, G.R.D., Blom, J. and D. Mügge (2010) *Global financial integration thirty years on, from reform to crisis*, Cambridge University Press

- Van Tilburg, R. & I. D.J. Römgens (2013) Taking *Lobbying Public: The Transparency of Dutch Banks" Lobbying Activities*, SOMO

The Green European Journal is a production of the Green European Foundation. The Green European Foundation is a European-level political foundation whose mission is to contribute to a lively European sphere of debate and to foster greater involvement by citizens in European politics. GEF strives to mainstream discussions on European policies and politics both within and beyond the Green political family.
The foundation acts as a laboratory for new ideas, offers cross-border political education and a platform for cooperation and exchange at the European level.

Published in English by the Green European Foundation, January 2014

Project coordination: Benoit Lechat (Editor-in-Chief) and Andrew Murphy (Editorial Assistant)

Production: Micheline Gutman
Design by DoGood advertising

Cover picture: Burns Library, Boston College

EUROPEAN PARLIAMENT

This publication has been realised with the financial support of the European Parliament.
The European Parliament is not responsible for the content of this project.

This publication can be downloaded at www.greeneuropeanjournal.eu

Green European Foundation asbl: 1 Rue du Fort Elisabeth – L-1463 Luxembourg

GREEN
EUROPEAN
JOURNAL

1 Rue du Fort Elisabeth, 1463 Luxembourg
Brussels office:
T +32 (2) 234 65 70 F +32 (2) 234 65 79
info@gef.eu www.gef.eu

www.greeneuroepeanjournal.eu