Democratic governance of international financial institutions in a time of financial crisis

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Introduction

The ideal of a democratic governance of international financial institutions rests on the belief that democracy would lead to the formulation of better policies, standards and norms that would embrace the vast heterogeneity of national contexts and therefore would better respect the national interest of each nation-state (Germain, Randall 2004) (Germain, Randall 2007)[2]. Democracy usually implies a public debate where each participant is constrained to present arguments that justify logically its point of view (King, Loren A. 2003). This contradicts the rule of power where one or a few nation-states impose discretionary decisions without any justification because there is no need to justify them. In a democratic debate, it is also expected that the arguments developed by nation-states do not regard their national self-interest exclusively to the expense of others, but also take collective interest into account. In this respect, democracy is the only way, if any, to reach a compromise.

We assume that it is in this spirit that the letter of invitation calls for participants to think about the way "to increase the effectiveness of democratic participation of all members of society and of as many countries as possible in the formulation of rules and standards for the international financial system".

The exercise is difficult in itself because even in an ideal world, there are no simple universally agreed rules to make democracy works at the global level (Bohman, James 1999). But the additional constraint "that no major institutional political, economic and social changes occur" makes it even more complex. Indeed, most International Financial Institutions (IFI) are organised specifically to exclude developing countries from deliberation or decision. This is especially the case of those which follow the "shareholder principle" of representation (Underhill, Geoffrey 2007) where some nation-state members contribute more resources to the institution than others and do expect in return a higher voting share. Such is the case for the IMF and World Bank or the BIS, and even regional financial institutions like the "Inter-American Bank of Development" or the "Asian Development Bank" which all have a banking status. The problem gets even trickier if beyond nation-states, IFI should include members of the so-called "civil society". Not only the definition of

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[2] On this point, R. Germain (2007, p 5), for instance states: "Deliberative democracy if organised globally or transnationally has the potential to make finance better serve development and social goals".

"civil society" is fuzzy, but there are many inequalities between its members in terms of cultural, human, financial, resources, and competition to get access to IFI. Not to say their representativeness and legitimacy. Which organisation should represent the society in IFI?

Finally, initiating a serious thinking over democratising IFI cannot disregard the present world financial crisis born in the USA in 2006. In short, this crisis is rooted in the shareholders' outrageous demand for a 15% to 20% annual return which has reflected in developed countries in a decrease of the labour income share of GDP, while labour productivity was still increasing even at a slower pace. In Marxist terms, one would say that the rate of exploitation or surplus value reached record levels which is confirmed by the upward trend in profit rate (Ellis, Luci and Kathryn Smith 2007;Husson, Michel 2005). The resulting higher capital income share not only paid fart dividends to shareholders but also nurtured in the nineties the second biggest speculative wave in the US history (Shiller, Robert 2000). After the burst of the dot-com bubble in March 2000, the FED cut the interest rate to avoid a depression but refuelled the speculative engine, this time on real estate. Because households' real wage is not allowed to increase regularly, like previously during the fordist regime of accumulation, the only solution to make people consume is to convince them to get indebted and to make a deal with trade-surplus countries, in particular China and Japan, to finance an historical current account deficit. In the USA, this logic of debt-led demand has been carried to the extreme with a saving rate falling to almost zero. This was less the case in Europe and unknown in Japan. This extremely dangerous way to create demand for goods and services could not last forever. Finance-led capitalism is much more risky and endogenously unstable than previous models of capitalism. This risk is real: households don't earn enough to maintain a sufficient demand. But financial "innovations" did gained time by transferring this risk to many investors throughout the world; enough time to inflate a new speculative bubble. The financial crisis did not burst this time in Asia, but in the US, in the biggest economy and one of the biggest financial centres. At the time, the Asian crisis had sparked a hot debate about the need to build a new "global financial architecture", or a new "global financial governance", and legitimated the Basle II process. What will be the lessons of the present crisis? Neo-liberals will say that the crisis points to the urgent need to implement the Basle II accord with some adjustments (Wellink, Nout 2008), having in mind that the core should be preserved, i.e. banks' self-control (Greenspan, Alan 2008)[3].

For the social movement, not only does this last crisis prove once again that deregulated finance is prone to crisis and drag societies into costly social and human disasters, but financial crises are precisely the moment to rush into the breach and question the whole neo-liberal financial architecture. We should seize advantage before momentum

[3] "The crisis will leave many casualties. Particularly hard hit will be much of today's financial risk-valuation system, significant parts of which failed under stress. Those of us who look to the self-interest of lending institutions to protect shareholder equity have to be in a state of shocked disbelief. But I hope that one of the casualties will not be reliance on counterparty surveillance, and more generally financial self-regulation, as the fundamental balance mechanism for global finance" (Greenspan, Alan, 2008, op cit).

is lost by making claims at the national and international level to go past the present architecture and delineate our own views about global finance and its governance. It is beyond the scope of this paper to present a comprehensive reform programme. One frequent criticism of such programmes is that it needs such a strong social mobilisation to get a chance to be realised that meanwhile the social movement stays disarmed and paralysed. This is why our intention is to make proposals to democratise as much as possible the existing institutions at the national and international levels, to protect society from the destructive consequences of financial crises and to start creating the financial system that society really needs. These three aspects should be considered together. There is no point in asking to have a say in the IFI arena if governments from developing countries have nothing different to say, or even defend the same conception as the Breton Woods institutions or the existing regional development banks. The presence of representatives of the social movement in all IFI is a necessary safeguard to ascertain that people's interests will be defended.

In synthesis, we think that what the social movement does have to say is the following: (1) "Financial capital does not search for opportunities to become productive capital. It looks for chances to enjoy "arbitrage" gains, that is, to profit from differences in interest rates paid in different countries or profit from differences of prices of financial markets. This capital never becomes productive investment", (Carvalho, Fernando Cardim de and Jan Allen Kregel 2007) (p 16). Therefore, each country has the right to restrict capital mobility in order to deny this unproductive "hot money" the access to its economy. (2) The neoliberal assumption that all kind of risks stemming from the financial or the productive spheres can be accommodated by financial "innovation" is false. These risks are not divided into smaller and smaller amounts until they disappear, like molecules that dissipate in the atmosphere. Quite to the contrary these risks are transferred to other hands in some cases in remote countries where they sometimes concentrate again until the crisis bursts. These false "innovations" are part of the problem. They don't reduce risks, they can even create them. Therefore, each country should exercise its right to scrutinise them and decide whether to authorise them under strict conditions if their usefulness for society is proven or simply ban them. (3) The primary objective of a financial system should be to offer to workers a risk-safe savings system for their future needs and to finance public companies, in particular public utilities, popular housing, cooperatives, small producers, ethnic minorities. This domestic financial system should be disconnected from the international financial system to isolate him from global financial crises and help the country to counteract the destabilising effect of global finance. The idea is to establish a dual financial system: A financial system for big private companies, which encompasses domestic investments banks, domestic financial markets or international financial markets under tighter regulations and capital controls. The second financial system would be a "people financial system", where speculation should be banished, guaranteeing a small but safe real interest rate to households' savings to finance investments of collective interest.

On the ground of these three principles, established on a domestic basis, a democratic international dialogue would try to reach agreements between countries. The idea is to extend these principles at the international level but not necessarily to define common standards and norms due to the variety of national contexts. This international dialogue would also include all segments of the society of each country to guarantee a public political debate. Democratic International Institutions either global or regional would be in charge of the application of the agreements.

The next two sections discuss in more details these proposals at the domestic and international levels. Section 3 presents some proposals to address more specifically the present financial crisis.

1. Democratisation at the national level.

Several measures can be adopted to democratise and improve the way present domestic financial systems are working.

Basic measures of democratisation of public institutions

- Ensuring more independence of the public authorities and regulatory agencies from the private sector. As a rule, finance ministers, governors of central banks, financial market supervisors, and all high-rank officials under their command should not come from the financial industry[4] and should not be allowed to return to it when they leave their position, at least not before a certain period, say five years. This in order to avoid single-mindedness and private capture of public policy, norms and standards, and rent seeking strategies.
- Public monitoring mechanisms in order to ensure accountability of public financial institutions should be created. This could be done by including members of parliament and a broader range of social groups in the boards of institutions in charge of supervising the private sector, with full member rights. These boards would publish annual reports giving detail account of the supervision of private financial sector, the difficulties encountered and the proposals to resolve them.
- Hearing of the governor of the central bank at the parliament to explain its policy and justify its decisions. This already exists in some countries, like the USA and the EU, but not everywhere. Members of parliament would be allowed to question him. In the same session or in a separate session, accredited representatives of trade unions and NGO should be able to question the central bank on its policy.
- Development Banks and other similar banks (agriculture banks..,) which use public money for public interest purpose, should include members of

[4] To avoid repetition, in what follows the term “finance industry” also includes the banking industry.

parliament and representatives of the social movement in their boards, with voting rights. Public hearings of the governor of the Bank of development should be organised at the parliament, with mechanisms to allow MP and representatives of the social movement to question him.

More radical measures of democratisation

- The charter of the central bank should include full employment and sustainable growth[5] as official goals of the central bank besides inflation control. The central bank should be accountable for these three goals and not only for inflation. The hearing of the governor would be the occasion to check how the central bank policy takes them into account.
- The central bank should not be independent from the political power. The role and power of the central bank is too important to be left in the hands of self-proclaimed "independent" governors that are exempt of any kind of democratic control. According to national traditions, the governor should be appointed by the government or by the parliament, or a combination of both. The rest of the board should be appointed by the government, the parliament, trade unions and NGO in proportions to be decided through political debate.
- The same mechanisms should be established for all development banks. Too often, development banks are focused on the financing of big projects (dams, roads, highways, airports, industrial parks), which serves well the interest of big private companies, but do not take into account the interest of the population who lives nearby (deforestation, drought, pollution, industrial hazards, etc.). Big private companies receive more easily cheap loans from development banks because they are more profitable than SMEs and cooperatives which are less profitable in monetary terms and more risky, although it can be very profitable socially and ecologically. The charter of development banks should be revised to include explicitly all aspects of social development: reduction of poverty and income inequality, reduction of gender inequality, of discrimination against disabled people, ethnic inequality, regional inequality and protection of environment. If the president and the board of the bank are appointed according to democratic rules, and their activity is more public and accountable, these banks would better serve the public interest.

[5] Full employment and sustainable growth are not contradictory but complementary objectives. Full employment does not imply producing as much as possible to the cost of the environment. Reducing working hours per individual allow sharing jobs between all members of the labour force without necessarily pushing the GDP growth rate too high and destructing nature, like in China for instance.

2. Democratisation at the international level

Developing countries are usually excluded from the exercise of real power inside IFIs (IMF, World Bank and BIS) and this is the first motive of reform[6]. This is particularly damaging in the case of the IMF and the World Bank because these institutions have the power to force indebted countries to implement the neo-liberal programme due to the conditionality linked to loans. This is not the case of financial standards and norms defined by the BIS which are not legally binding. Powerful countries such as India and China have shown that it is indeed possible to refuse accords partly or totally decided by a small group of rich countries. Of course, not all developing countries have a sufficient bargaining power to do the same. Rich countries may threaten to shut them the access to their financial markets if they don't comply with the Basel Accord and possibly the IOSCO principles. Private investors may be reluctant to invest in a country that has not committed to adopt the Basle II accord for instance. This threat is powerful and explains why the first Basel accord has been widely adopted across the world.

The first way to alleviate the pressure imposed by IFI on financial rules and norms is to interpret and enforce them in a way that fits the country's specificities. Pillar 2 of Basle II gives some leeway to national supervisors in this sense. Way back before Basle II, East countries for instance had already accumulated an experience in "mock compliance" (Walter, Andrew 2007). The second way that can give more bargaining power to developing countries, especially the smaller and poorer ones, is to form alliances, preferably but not exclusively on a regional basis to refuse collectively standards and norms deemed contrary to their interest. To go further, developing countries should improve regional integration to define more appropriate principles that could be translated into different national standards and norms. Eventually, developing countries can create their own regional institutions.

Basic measures of democratisation of IFI

The first measure is to reform the mode of representation in the IFI to correct the grossly and systematic under-representation of developing countries even under the "shareholder principle". The IMF, but not the World Bank, has made a small step in this direction by slightly increasing the quota of China, Mexico, Korea and Turkey. While showing that it is possible, these small voting and capacity increments do not solve the problem which is how to democratise profoundly these institutions, rebuild their multilateral character and restore the confidence of developing countries.

There are four basic measures that could be undertaken to democratise the IMF and the World Bank (Woods, Ngaire 2008). (1) Reform of the voting system; (2) Reform of the

[6] On the governance of the IMF and the World Bank see above. On the governance of the BIS and IOSCO see Jetin, Bruno. 2007. "The Basel II accord and the development of market-based finance in Asia. ." *Who rules the financial system*. IBASE: Rio de Janeiro.

designation process of the general manager, (3) Reform of the formation of the board and decision-making; (4) Moving the location of the institutions.

(1) Reform of the voting system

Many proposals have been made to reform the voting system in the IMF and the World Bank[7]. This system tries to conciliate two principles: The Westphalian conception of sovereign equality of states that translates into the "one country-one vote rule" that formally prevails at the United Nations for instance and the "shareholder principle" where each country receives a quota that equates its financial contribution to the institution and determines its voting weight and its representation to the executive board. To recognise the sovereign equality of states and to avoid the appearance of making decisions exactly like a corporation, each member received 250 "basic votes" plus one additional vote for every 100,000 Special Drawing Rights of its quota. Basic votes in the IMF have not increased proportionally with increases in quota-based votes. From an original 11.3 % in 1944, they increased to an historical high in 1958 to 15.6% and since then fell to an all-time low of between 2 and 3% (Rapkin, David P. and Jonathan R. Strand 2006). This shows that in practice, the "shareholder principle" has largely prevailed because major contributors insisted upon having higher voting power. Among them, the USA was given the higher shares and voting power because it was initially the largest creditor and could lodge higher reserves in the IMF. Now that the USA are by far the largest debtor and Asian countries, among others, the largest holders of international reserves, the formal reason to maintain the previous distribution of shares is no more legitimate. A general redistribution of shares is also necessary to reflect the changes in world economy, the emergence of new economic powers in the South and to democratise these institutions. Several proposals have been made:

The most obvious is to strengthen basic votes in relative terms to give more weight to the "one country-one vote principle". At the Asian Development bank, the proportion is set to 20%. A higher proportion at the IMF and World Bank could be discussed. A radical proposal giving 100% to basic votes to realise full equality between countries is not possible within the system as it works, because developed countries and other important creditors would go away. They would definitely give preference to bilateral relations with the countries they accept to help, according to their own conditionalities and with direct control of the money invested. Another aspect of the question is that the "one-country-one vote" gives the same weight say to Maldives and China. The size of the population affected by a decision is clearly not the same and the fairness of the "one-country-one vote" principle is doubtful. The size of the population, i.e. the "population principle" must be taken into account. But again, the "population principle" cannot be the unique principle because small countries, and in fact the majority of countries, would be excluded once China, India, the

[7] The World Bank's mechanism for determining capital subscriptions (analogous to IMF quotas) derives directly from the IMF's procedures and the results are almost identical. For this reason, in what follows we focus on the IMF, having in mind that much of the proposals apply to equally to the World Bank,

USA or Russia, had voted together. A safeguard to avoid the “tyranny of the majority” must be adopted which could be labelled the “minority principle”. The minority would have a guaranteed minimal voting power and a granted representation in the decision-making process. Once again, this should be fine-tuned to avoid the paralysis of the decision-making process. One can see that the only solution is to employ a mix of different principles (Underhill, Geoffrey 2007): the shareholder principle, the one-country-one vote principle, the population principle and the minority principle. These principles can be embedded in the quota formula, the voting process and the election of the executive board. For instance, the population principle can compound the relative size of the economy which is presently the only criteria for determining quota (Kelkar, Vijay, Vikash Yadav, and Praveen Chaudhry 2004). A double majority voting system can be adopted to conciliate this reformed shareholder principle with the one-country-one vote principle(Rapkin, David P. and Jonathan R. Strand 2006). The passage of a resolution requires support by a majority of both states and weighted votes (O'Neill, B and B. Peleg 2000). The minority principle can be embedded, among other possibilities, in the definition of the majority of states with the provision that this majority should include a pre-determined share of “small countries”. Another possibility is that “country debtors subject to conditionality as users of IMF services would receive more equal representation relative to developed country creditors, recognising that the causes and costs of debt crises are a shared responsibility and that the poor in debtor countries probably bear the brunt of adjustment” (Underhill, Geoffrey and Xiaoke Zhang Forthcoming). This would positively affect the poorest countries notably those of Africa.

2) Reform of the designation process of the general manager

Until now the managing director of the IMF has been appointed from among a small group of European countries with the consent of the USA while the managing director of the World Bank is appointed by the US. These directors can be then reappointed for five more years. This is particularly non-democratic because it means that the managing director will never come from developing countries or even from other developed countries (Japan, Australia or New Zealand). It explicitly assumes that a US managing director of the World Bank will defend the interest of the US prior to the interest of the World community or that a European managing director will defend the interest of European countries before the interest of the world community. There is no such thing as a “multilateral spirit” or a global collective interest that could be represented by a citizen from a developing country for instance. The issue at stake is important because the managing director of the IMF chairs the board and holds all the senior management and staff to account. The hold of developed countries goes beyond the selection of the managing director. “An informal convention has evolved to the effect that “staff representation would roughly match quota share”. Even this standard is not met as 47 percent of department heads at the Fund are from English-speaking industrial countries, while approximately 20 percent are from developing countries.”(Rapkin, David P. and Jonathan R. Strand 2006). The demand is simple: all candidates to the position of managing director should be treated equally, regardless of nationality. Another alternative is to organise a rotation between continents. For instance, the next managing director should be African; an all African candidates should be treated equally. The final choice would be based on competence only.

3) Reform of the formation of the board and decision-making

Up to now, there is a small executive resident board of 24 members in Washington DC chaired by the managing director. The five largest members of the IMF appoint their own Director (USA, Japan, Germany, France and UK) who report directly to them. All other members have gravitated into groupings or `constituencies' of countries which elect a Director to represent them. The constituency director wields the collective vote of all his or her members. Unequal voting power means that some directors, like the African director who wields 1.42% and represents 24 African countries, can be simply ignored. There are no set rules governing how countries group together within the IMF. Constituencies are each run according to their own rules or traditions. There are virtually no mechanisms for holding an elected director to account within the IMF or within its constituency. Elected directors owe a much clearer allegiance to the IMF than to their constituency. Most of them do not maintain close links with their constituency. An exception is the Baltic constituency where the elected director regularly consults and solicits inputs from respective capitals. This shows that a democratic practice is possible. The board makes decision on the basis of consensus underpinned by a majority of voting power (Lombardi, Domenico and Ngaire Woods 2005).

A first reform could be to "change the convention that the managing director chairs the board. Instead, as an organ which oversees the managing director, the board should be chaired by one of its members" (Woods, Ngaire 2008). A second reform concerns decision-making and creating an incentive for countries to act more genuinely by consensus. At present the G7 members of the IMF command just over 40% of voting power and need only one further executive director's vote in order to claim consensus for a decision. The change of quota shares and the double-majority voting would induce the G7 or other group of countries to really consult across the membership and to realise a real consensus. A third reform would be to suppress the right of the five largest countries to appoint directly an executive director and to elect all executive directors. A fourth reform would be to involve parliamentarians into the IMF (Eggers, Andrew, Ann Florini, and Ngaire Woods 2005) and the World Bank. Parliaments could play more of a role in holding the Executive board of the IMF into account. They should know what decisions are being made and with whose approval or abstention. They need to know how their government or the executive director representing their country is defending their country's interests on the board. Minutes of the board meeting should be made public quickly; voting should take place on all issues and a voting record should be published rapidly. The IMF and World Bank staff should be held to account during and after negotiations with a country. This requires an increase in transparency and access to information for appropriate Parliamentary representatives throughout negotiations.

4) Moving the location of the institutions

The location of the IMF and the World Bank at Washington DC is more than symbolic. It establishes an organic link with the US Treasury and Congress. One way to break this link would be to move the location of both institutions to developing countries. The World Bank could be located in Africa, for instance South Africa, and the IMF in Asia, for instance India, or in Latin America, for instance Argentina. Of course this would not be sufficient in itself to guarantee the independence of the Bretton Woods institutions from the US, but at least it would make it less easy, because some potential US officers and senior officers would find it less attractive to work for these institutions in developing countries. If combined with the previous proposal, the IFI would look less like US institutions and multilateralism would be strengthened.

More radical measures: Reforming existing institutions or creating new ones?

In the NGO community there is a debate regarding the position to adopt vis-à-vis the IMF, the World Bank and the WTO. Should we close them or reform them? Closing them clears the way for building new ones with real democratic governance and a new mandate. Everybody knows how difficult it is. Reforming the existing institutions from the inside to democratise them, change their objective, their top-down military approach, make them accountable may seem more appealing and doable. But it is in fact as difficult as closing them because these institutions are tightly controlled by developed countries which will not accept to give away their power with enthusiasm. The same is true with the BIS whose statutes require a 60% voting rights for any amendment (Jetin, Bruno 2007). Because these 60% are owned by the G-10 countries, this means that it is virtually impossible to democratise the BIS from within. Of course, this does not mean that demands to include developing countries in all BIS committees are useless, quite to the contrary. But a compromise in which some big developing countries would be included is insufficient and unfair. The G-10 privileges must be abolished and should not be substituted by a G20 which includes some important developing countries but cannot pretend to represent all of them democratically (Heilleiner, Gerry 2001). One point of agreement between all NGO is that the mere disappearance of the Bretton Woods institutions without any substitutes would not be a good thing (ATTAC 2002) (Plihon, Dominique 2007). The example of the WTO shows that the failure of the Doha round led to the multiplication of bilateral free trade agreements, or economic partnership that includes agreement on FDI, with worse conditions than the one included in the Doha round. The trade negotiation between the EU and African countries is a sad illustration of this. Building regional institutions of a new type may be the solution.

Promoting regionalism to build local and better financial governance and institutions

Regional integration may offer an alternative to neo-liberal globalisation in trade, investment, finance, monetary and exchange policy. But regional integration is not progressive in itself. The case of the European Union (EU) shows that regional integration can replicate and even take the lead of neo-liberal policies. The same could happen with developing countries. For instance, Asian countries could have decided to strengthen the regional integration of their banking system and use it as an instrument of development to finance investment projects of regional interest. Instead, governments have decided to dismantle capital controls, to keep on deregulating their financial markets and to promote Asian Bond markets. Bank-based finance is not necessarily geared towards development. It depends on state policies. But market-based finance is for sure geared toward short-term profits and is not concern by development goals.

The new-born “Bank of the South” in Latin America could be a case study of what can be done. It has the potential to circumvent the IMF and the World Bank by creating an institution independent of the G7 countries and their neo-liberal dogmatism, in favour of a progressive Latin American integration giving top priority to social development and ecological concerns. The Bank of the South could also be the opportunity to create a brand new international institution which adopts the “double-majority system” or even the “one country-one vote” principle. It could also include parliamentarians and representatives of the social movements of Latin America.

Unfortunately, these are not the choices that have been made and there are reasons to fear that the Bank of the South will be just another classical development bank which will promote private interests instead of public interests. The main problems found in the draft charter are (Toussaint, Eric 2007), (Furtado, Fabrina 2007)[8]:

- The lack of transparency and participation of society in the process of negotiation. Only governments’ officials were part of the discussion.
- The diagnosis that under-development of the financial markets is the main cause of Latin America’s problems. As a consequence, the text makes it clear that promoting capital markets at the national and regional level is part of the solution. It is also said that the Bank of the South will borrow on financial markets, which means that the same arguments as in the World Bank will be used to justify that only profitable investments can be financed.
- The draft charter calls for the creation of Latin American multinational firms, without specifying that they could be public, which is an implicit way to say that they should be private. There are no arguments explaining why Latin American multinational firms would behave better than non-Latin American regarding employment, wages, labour conditions and environment.

[8] We rely extensively for this part on these two authors.

- Indeed, environmental protection, health, cultural and educational policies are disregarded.
- Regarding governance, the joint Argentinean and Venezuelan proposal envisages that voting rights should follow the shareholder principle. An opportunity to break away from the World Bank's, IMF's, and IADB's anti-democratic governance is missed.
- These institutions could be shareholders without voting rights of the Bank of the South, which could open the way to a renewed influence and pressure on the management of the Bank of the South.
- This management would enjoy "Immunity, Exemption and Privilege" in exactly the same way as the statutes of the World Bank, IMF, and IADB. This means that whatever happens, the management is not accountable in court.
- Worse, records of the board's meeting are inviolable, which means audits will not be possible.

Against this old-fashioned conception, the Ecuador's proposal contained all the necessary elements to make the "Bank of the South" a democratic and international financial institution[9] .

- Ecuador proposed three instruments: a Regional Monetary Fund, a Bank of the South and the creation of a Latin American common currency which would allow Latin American countries to trade between themselves in their own currencies instead of the US dollar.
- This regional Monetary Fund and the Bank of the South should guarantee in its charter the effective application of Human Rights and international agreements related to economic, social and cultural rights.
- For instance, fulfil the right to decent housing, to good quality education, financing of public policies for food sovereignty and nutritional security and the reconstruction of productive capacities to satisfy these needs.
- The financial resources of the bank should come from four sources: 1) capital contribution from member countries; 2) The Bank's borrowing from member countries with the exception of bond underwriting; 3) Common regional taxes on stock, bond and currency markets, common regional eco-axes and common tax on profit remittances by multinational firms. These regional taxes would be collected by member states with receipts transferred to the development bank.
- A "southern monetary fund" finance by foreign exchange reserves. A country facing a speculative attack could mobilise up to 20% of the pooled foreign exchange reserves of the member countries. In a way, this is what already exists in East Asia with the "Chiang Mai Initiative" which is a web of bilateral and multilateral swap agreements between ASEAN+3 countries.

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[9] We rely again on this part on Eric Toussaint's account (op cit 2007) of the negotiations and on Fabrina Furtado's analysis (op cit, 2007).

Other refinements could be made to improve the "Bank of the South". The real problem is whether it will be created or not and what will be its exact purpose. At the end of the first quarter of 2008, divergences between member states about the principles and structure of the Bank were still unresolved (Strautman, Gabriel 2008). This shows how difficult it is to create a regional and democratic financial institution when domestic financial institutions are not yet democratic.

- **A "World Financial Authority"?**

The idea of a "World Financial Authority" (WFA) is not new and has been revived after the 1997-98 Asian crisis (Desai, Nitin and Jose Antonio Ocampo 1999). The role of the WFA is to create a framework of truly international regulation to minimize systemic risk arising from the operation of financial markets (Eatwell, J. and Taylor, L. 2000). "This means a new international regulatory entity with appropriate powers. An agreed framework should link that entity and national regulatory structures which will play a vital component part". This executive authority would have surveillance power like the WTO, and in fact would be complementary to the WTO (Eatwell J. and Taylor L., op cit). The tasks of the WTA would be to ensure that "the internalization of externalities, and to oversee the development of a credible and effective guarantor and lender of last resort function. It will therefore need to build on the achievements of IOSCO to develop a framework for international financial regulation (including risk management procedures) and to ensure, via the powers ceded to it, that those rules are implemented". "The WFA should also be given the responsibility of ensuring transparency and accountability on the part of international financial institutions such as the IMF and the World Bank".

As we can see, in Eatwell and Taylor's vision, the power of the WTA would be very important and the scope of its responsibility very large. The blind side of their project is that democracy, legitimacy and accountability of the WTA are simply forgotten. Countries delegate part of their regulatory power to the WTA. But because countries are not ready yet to give up their supervisory and regulatory powers, the WTA is far from being created. Instead, some envisage that the WFA could be the mere evolution of the present BIS that has actually achieved the role of a quasi-soft law World Financial Authority (Felsenfeld, Carl and Genci Bilali 2005). One can see that when democracy is not placed at the centre, a good idea can quickly be absorbed by the present neo-liberal financial architecture.

Therefore we think that the WTA should rather be a forum where countries could exchange ideas and produce proposals to be debated and voluntarily accepted by countries. The WTA should be established with the following broad principles.

- ✓ It should be a public institution, linked to the United Nations, following the principle of "one country one vote". Parliamentarians and the social movement should be included in the governance system of the WTA along the lines presented above.
- ✓ It should be a non-bank institution to avoid any imbalance of power linked to share ownership. Or, if one thinks that it should be a bank in order to have its own

resources and be financially independent, the shares should be distributed equally between countries.

- ✓ The WFA should cover the whole financial industry and not only banks.
- ✓ The international agreement should be non mandatory unless a consensus exists between all members.
- ✓ It should be responsible for producing international standards for all segments of international finance with the double objective of financial stability and financing economic development. In this respect, one explicit task of the WFA would be to establish a international framework for capital controls so that capital controls decided at the national level could be made compatible and coherent at the international level (Nayyar, Deepak 2000).
- ✓ The "WFA" would be also responsible for the management of an international settlement system that would benefit all countries whatever its stage of development. This international settlement system would be an international public service financed by fees paid by its users. This means that the CLS bank should be owned collectively by the member-states and not by the multinational private banks as presently. This would enable a public control of a good part of capital flows. Other international clearing institutions like Clearstream" and "Euroclear" should also be nationalised.

Conclusion: Dealing with the present crisis, avoiding the next one.

IFI are theoretically responsible for financing development, providing financial support to crisis-stricken countries and establishing financial regulation. All these functions and in particular financial regulation are affected by the present crisis. This is a particularly serious challenge for the Basel II accord which already looks old-fashioned even before its implementation has started. In this context, it is surprising that the only argument that neo-liberals are debating is the following: safety nets imply supervision because of moral hazard. In other terms, it is only because central banks are using public money to bail out bankrupt financial institutions that supervision is justified in exchange. But regulation has to be kept as minimal as possible; it is just a matter of fine tuning.

In fact, regulation needs more than a patch-up (Crook, Clive 2008a). The crux of the matter is securitisation and rating agencies.

Securitisation has at least two big failings. First, it encourages careless lending, because risks can be blended, disguised and supposedly passed on. This allowed banks to cleanse their balance sheet, achieve much higher leverage and evade the requirements to reserve capital. Two, rating agencies failed in part because of conflict of interest. Rating agencies are paid by sellers, not by buyers of the securities concerned. The other reason why rating agencies have failed is simply that financial innovation has been so complex that it is getting impossible to price financial assets correctly (Guttman, Robert 2007). "Regulation ought then to aim at restoring simplicity to financial markets, in other words, to roll back financial engineering (Crook, Clive 2008b). Once again, the point is made that rating agencies cannot carry the burden of supervision. The lessons that can be drawn and the solutions are the following[10]:

- Limits on leverage have to be set in its own right. The use of the leverage ratio in place in the US could be improved and generalised. It should cover all kind of investment funds to limit their risk taking and speculative activities.
- Banking regulation and prudential regulation should be extended to all institutions making loans. The major part of subprime loans have been made by finance companies that are not submitted to these regulations (Castel, Michel and Dominique Plihon 2008).
- Central banks should not refinance banks indiscriminately by auctioning liquidity with the same interest rates to all commercial and now investment banks because it validates ex post their speculative activities and creates moral hazard. In ordinary time, central banks should refinance banks on a case-by-case basis by allocating them a pre-defined amount. When this amount is overspent, central banks would refinance them with a higher interest rate (Castel, Michel and Dominique Plihon 2008). This would help preventing bubbles.
- Lenders have to retain an explicit exposure to the loans they make to assume at least part of the risk.
- Securitisation has to be seriously questioned, and in most cases probably prohibited.
- Public supervision on banks has to be re-established instead of private self-control. Self-control by banks simply cannot work because their internal models, and those of rating agencies, are calibrated on stock market prices. Once a speculative bubble is inflated, these models go blind and are put out of order (Aglietta, Michel 2008). And because capitalism is going from one bubble to another, the simple idea of self-regulating is a pure illusion. To give just one example of how self-control is efficient, Jacques Kerviel, the trader that made Société Générale lose the astonishing amount of 5 billions of euros had been controlled 75 times by his bank during 2007! One solution is for the State authorities to establish their own model of risk, based on simple criteria (for instance the leverage ratio and the capital reserve among others to be discussed) but disconnected with stock prices. This public supervision based on an external model of risk has to be extended to all segments of the financial industry to include all kind of investment funds. Some of them like hedge funds must be simply abolished because they are purely speculative by essence and don't play any useful role.
- Rating agencies must be discharged of their role in the regulatory framework. It should be against the law to ask a rating to a rating agency and then to ask

[10] It is duly recognised that some of these proposals overlap with those proposed elsewhere, notably by ATTAC in Europe.

counselling to the same rating agency on how to "improve" the accounts in order to reach a higher rating. "Ratings shopping" should be discouraged by publishing all ratings, good and bad ones. A state agency must be created to assess at least the main institutional investors and banks and to publish its own ratings according to strict rules. All the ratings, private and public ones should be largely publicised so that potential investors have comprehensive information.

- Mortgage loans should be abolished because it leads to households' over-indebtedness. At least, a loan-to-value ratio for mortgage loans should be created to limit indebtedness.
- The prohibition of Special Investment Vehicles (SIV) or its taxation. Like one Deputy General Manager of the BIS now recognise "several years ago, the Bank of Spain imposed an 8% capital charge against SIV assets. This effectively made SIVs unattractive to Spanish Banks" (Hannoun, Hervé 2008). This measure could be easy generalised to all countries, and to start with to the EU.
- "Dynamic provisioning like in Spain. The idea is to set a floor under the fall in provisions during upswing in the credit cycle. This creates a prudential cushion that can be drawn upon as the cycle turns" (Hannoun, Hervé 2008).

To avoid the next crisis, it is necessary to break the dominance of finance over the real economy. Some of the appropriate instruments are:

- Progressive taxation of capital income to remove incentives on excessive financial profit over productive profits (ATTAC 2008b). In particular, shareholders must be taxed appropriately so that they have no more incentives to increase indefinitely workers' exploitation[11].
- "Taxations of all kinds of capital transfers including currency transactions in order to reduce the hypertrophy of the financial sector, to slow down the speed of reduce short-termism"(ATTAC 2008b).
- "A special crisis funds should be set up for buffering the consequences of the crisis on real economy. The fund is replenished through a one off extra duty on all capital income above 50.000 Euro and a 1% extra tax on all corporate profits"(ATTAC 2008b). This would avoid the socialisation of losses of the financial sector, or in other terms, the bail-out of failed banks with taxpayers' money. Instead, the principle polluter-payer would be applied to the all actors of the financial sector.
- Ban stock-options to suppress any incentives for CEO to look for short-term profits.
- Prohibition of fiscal paradise.

[11] Frederic Lordon, a French economist has proposed a special device of shareholder taxation that he calls: "Shareholder Limited Authorised Margin" (SLAM). For more details see: http://www.monde-diplomatique.fr/2007/02/LORDON/14458

Developing countries are for once more fortunate than developed countries because a good part of the false financial "innovations" (Asset-Backed Securities, ABS, or Collateralised Debt Obligations, CDO) do not exist or exist in a limited way. Some of them, in particular in Asia, have maintained different varieties of capitalism which are still far from shareholders capitalism. This has allowed them to preserve some forms of capital control and pre-emptive prudential and monetary policy measures against credit booms (Borio, Claudio E.V. and Ilhyock Shim 2007) (see table above). These measures could be improve and adopted in all countries as a first step. The second step would be to disconnect the productive sphere and what could be labelled a "people domestic financial system" and domestic stock markets which are usually connected to global finance. This people domestic financial system would be base on households and cooperatives and SME savings. The state would guarantee the real value of the savings plus a small real remuneration; say 2% or 3%. This kind of people savings system has been created in France after the Second World War and has been very successful. The savings were collected by the public post office company and other public savings companies and then transferred to a public agency specialised in the financing of housing project and public utilities. This people financial system is now under attack by the EU commission in the name of fair competition. But it could be restored, improved and democratised. The idea is that this people financial system and stock markets would not be governed by the same interest rate (Lordon, Frederic 2008). The main advantage is that the interest rate could be increased to avoid the formation of a speculative bubble for instance, without affecting the productive economy. Although this proposal needs more thought, it has a huge potential for developing and developed countries.

Pre-emptive prudential/monetary policy measures taken against credit booms in Asia

	Prudential instruments					Monetary instruments	
	LTV	Capital	Provision	Exposure limit	Lending criteria	Credit limit	Average reserve requirement
China	01, 05, 06				04		03, 04, 06, 07
Hong Kong SAR	91, 97			94–98		94	
India		05, 07	05, 06, 07				04, 06, 07
Korea	03, 06				06		06
Malaysia	95–98	05		97–98	95		94–98
Thailand	03				04, 05		

"LTV" = loan-to-value ratio; "Capital" = capital requirements; "Provision" = loan provisioning rules; "Exposure limit" = limits on credit exposure to a sector such as the real estate sector; "Lending criteria" = limits on debt repayment-to-income ratio or debt repayment-to-debt ratio or credit line-to-income ratio; "Credit limit" = limit on credit growth. The years indicated refer to the timing of the introduction of the measure. A year coming after a hyphen refers to the timing of the lifting of the measure.

Source: Borio and Shim (2007).

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