

Towards a better financial system

Response to the Global Financial Crisis

The current global economic crisis has its origins in the developed countries: the crisis has exposed the inadequate regulations in the financial sector in developed economies, and, perhaps even more seriously, an overly close relationship between the finance sector and the government in the United States in particular. It is no longer a question of whether reform of the international financial system and global economy is needed. The question is which reforms are needed, and how can a genuine process of reform be found.

Developing countries, despite not being responsible, will pay the heaviest price for this downturn, because they start from a more vulnerable position and because they lack the resources that developed countries have to respond sufficiently to the crisis. The G20 is coordinating the global economic response to the crisis. Although the G20 is an improvement from the G7 in terms of representation, to date it has promoted solutions that are inadequate, as explained below.

A truly global response to the crisis, which reflects the seriousness of the situation and proposes the sort of solutions that are truly needed, will be informed by two key considerations:

First, to stimulate their economies developing countries require enough new resources to meet foreign exchange shortfalls and address the debt distress and balance of payments problems they are experiencing. Swift action is needed to provide developing countries with new financing that will not worsen already serious debt burdens.

Second, a number of longer-term steps are needed to move our global economy towards a fairer, open, rule-based, predictable, non-discriminatory trading and financial system, as called for under MDG8. Long-term reform to global governance structures is needed, like steps to cut down on capital flight and tax avoidance and reform of the Bretton Woods Institutions. The UN's role in managing the global economy also needs to be strengthened.

Recommendations to the Australian Government ahead of G20 Meeting, 24-25 September 2009

There are coherent systematic reforms that are feasible for the G20 to pursue, in order to move towards a fairer and more democratic international economy:

1. Emergency finance / preventing a build up of new debt

The G20 proposal for emergency finance to poorer countries in April was completely unsatisfactory, for a number of reasons. While the total figure promised - US\$1.1 trillion – sounds impressive, much of it is not new money, and the rest is either in the form of loans which will lead to new debt for many countries or is using finance mechanisms that are still awaiting approval by the institutions through which they are to operate.

In order to provide urgently needed liquidity to countries that require it, and to avoid a new debt crisis, at the upcoming G20 meeting in September the Australian Government should advocate:

* In place of new IMF loans, that the G20 support the issue of \$250 billion of IMF Special Drawing Rights *for each year the crisis persists*, and initiate a process that enables rich countries to transfer their share of Special Drawing Rights (SDRs) to developing countries.

* That the G20 support an unconditioned moratorium on all debt service payments (principal and interest) for developing countries affected by the crisis, to enable them to make vital import payments rather than service foreign debt.

* That the G20 takes steps towards the establishment of an orderly, fair and transparent debt workout mechanism, as supported by G77 countries, to handle debt rescheduling and resolve debt disputes in a forum that gives equal treatment to both debtors and creditors.

2. Address capital flight through international tax reform

With 60 per cent of world trade now taking place within, rather than between, multinational corporations, the way fees are determined has become increasingly opaque as arm's length pricing is forgotten and the figures are manipulated to reduce tax. Poor countries in particular are deprived of badly needed tax revenues –estimated to the tune of US\$160bn a year. If that money was available to allocate according to current spending patterns, the amount going into health services could save the lives of 350,000 children under the age of five every year.¹

At the upcoming G20 meeting in September, the Australian Government should advocate:

* That the G20 supports Country-by-country reporting, and formally requests that the International Accounting Standards Board adopts this new standard. The G20 should request that the OECD report back by a certain date with the outcomes of its feasibility study of country by country reporting.

* That the G20 initiate a process that moves towards a fully multilateral agreement for the automatic exchange of tax information. A new multilateral agreement on information exchange should lay the groundwork for this, and fulfill the spirit of the London Summit communiqué by including a robust review mechanism to evaluate benefit to developing countries and include provision for change if necessary.

3. Reform of the International Financial Institutions

The track record of the IMF in crisis management at the end of the 1990s had disastrous consequences. Further, analysis of the nine most recent IMF loans to countries affected by the current crisis clearly demonstrates that the Fund is still prescribing pro-cyclical policies of fiscal and monetary policy tightening. The IMF's crisis loans still contain the old policy conditions of reducing public sector expenditure, reducing fiscal deficits and increasing interest rates – which is in stark contrast to the expansionary, stimulus policies being supported in the G20 countries.

The Australian Government should advocate:

* That the G20 demand much stronger reform of governance structures of the IMF and World Bank than are currently being proposed. Plans for the implementation of a double-majority voting system (with a second voting stake on the basis of one-country-one votes to supplement the current quota voting by financial weight) should be begun immediately; the high level board meetings should be made open to the public, in order to make the institutions more transparent.

* That the G20 demand substantial reform of IMF macroeconomic policies in low-income countries.

4. Take steps towards democratic Global Governance

Financial crises of increasing severity have been the defining feature of the past 15 years. This is to be expected, as our current financial system was designed for a non-globalised world of finance that no longer exists. The institutions that are charged to govern it, the IMF and World Bank, are no longer appropriate or equipped to do this. Nor are they democratic and representative of the needs of clients, the developing countries.

* The Australian government should support the United Nations as the principle forum to advise on coherent international responses to the global economy, and support the establishment of a UN Global Economic Council as recommended by the Stiglitz Commission of Experts.

¹ Christian Aid report, False Profits <http://www.christianaid.org.uk/Images/false-profits.pdf>