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Globalisation of Financial Services

Political Struggles, Experiences and Alternatives

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Globalisation of Financial Services

Political Struggles, Experiences and Alternatives

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Introduction

In recent decades foreign trade has become increasingly important to banks, insurance companies and investment houses. A current study by UNCTAD shows that companies such as Allianz achieved more than two thirds of their turnover abroad, and the proportion is even higher for other insurance companies. According to estimates by Mercer Oliver Wyman[1] , the trade in financial services will continue to grow rapidly over the next years: from currently 2 billion US dollars to 6 billions US dollars in 2020. The highest growth rates are expected in the emerging market countries such as China, India, Brazil, Mexico or Russia. The global financial market sector amounted to 15% in 2005 and will continue its strong growth.

The savings in Asian emerging market countries are especially attractive for the financial sector; although India and China are still relatively poor countries. Even if only a small percentage of the population achieves prosperity in these countries, these represent a great amount of people in absolute numbers. Meanwhile, there are 299,500 millionaires in China - 4.3 percent more than in the year before. About 70,000 millionaires live in India - 14.6 percent more than in the previous year (Handelsblatt, 18.07.05). In addition, the markets in the USA and Europe are saturated to quite a considerable extent. This is different in China and India, because these countries have only recently opened their financial markets.

The trade in financial services must be "liberalised", that are existing rules and regulations must be removed so that big banks, insurance companies and investment companies houses can profit from the growing wealth in other countries. To achieve this and to secure international long-term expansion, the companies have to rely on their respective governments or on international organisations such as the World Trade Organisation (WTO). The US government as well as the EU, Canada, Japan, Switzerland, and Australia are especially active within the framework of the WTO as well as in bilateral trade agreements for the liberalisation of trade in financial services - they have extremely competitive banks, insurance companies and investment houses. The EU alone has issued requests to 85 WTO members to liberalise the financial sector. However, developing countries predominantly disapprove of further financial liberalisation. Nevertheless, the financial sector is among those services - besides tourism – for which developing countries have made most "commitments" - i.e. binding obligations to open the market.

The liberalisation of trade in financial services is a relatively new phenomenon: the Financial Services Agreement was not adopted until December, 1997 - three years after the conclusion of the general services agreement (GATS) at the WTO - coming into effect in March, 1999. The agreement was celebrated as a great success in the financial press because of its "broadness": 25 developed countries and 77 developing countries had made commitments to liberalisation that covered 95 percent of the entire financial services business. Since the General Agreement on Trade in Services (GATS) includes enhanced liberalisation, negotiations on further concessions have taken place.

Until now, negotiations on the liberalisation of financial services have not

[1] see: www. http://www.merceroliverwyman.com/en/default.xml

drawn much attention from the scientific side or from the global social justice movement. This is all the more alarming because the financial sector plays a key role in the financial stability of a country and the well-being of its population. Liberalisation of this especially sensitive sector can have far-reaching consequences. Additionally, dramatic changes have occurred during the last ten years: As a result of serious financial market crises and IMF-controlled structural adjustment programmes, many emerging market countries and developing countries have opened their markets to trans-national financial corporations, have privatised former state banks and often started to "reform" their social security systems. Consequently, the market share of trans-national private banks and insurances has risen rapidly – and not always with positive effects.

To focus attention on the problems caused by the global expansion of financial corporations, WEED organised a conference in December 2005 at the Gustav Stresemann Institute in Bonn. The aim of this conference was, on the one hand, to increase the awareness of the great importance of a topic which only received little attention until now in circles discussing trade and development politics. Furthermore, shortly before the WTO Ministerial in Hong Kong, we wanted to attract the attention of decision makers from the respective ministries (BMWi, German Federal Ministry of Economics and Technology) and international organizations (WTO, Committee on Financial Services) to the great risks involved in the liberalisation of trade in financial services. Finally, we wanted to extend our knowledge (and that of our guests) on these important and difficult interrelations and topics and to inspire various participants to get involved in practical co-operation beyond the conference. In conclusion, we would like to thank all speakers and participants of the conference that enhanced an interesting process of capacity building on the topic of financial services and corporate responsibility with important steps.

I Enforced Market Opening: Players from the North - Experiences from the South and East

1.1 The Global Expansion of Finance Corporations leads to more Poverty and Instability in the South

For some time, the liberalisation of financial services is being negotiated at the WTO. Prior to the WTO Ministerial in Hong Kong, a new momentum has entered the debate. Nearly every week, EU trade representative Peter Mandelsohn and his US colleague Robert Portman are imposing pressure on the countries of the South: Only if they agree to a services deal – only if they open their markets for the services corporations of the global North – could they expect concessions in agriculture which is so important to them.

Up until now, the critical public is hardly taking any notice of the WTO negotiations in financial services. It is not easy to follow them because they usually are carried out behind closed doors in so-called Green Rooms. Requests are made in secret papers that only reach the public through the indiscretion of individuals or leaks.[1] Despite the fact that the liberalisation of financial services is connected to specific risks of instability.

From our perspective, the GATS agreement on services is a one-way street. Its principle is increased liberalisation and not a Trial and Error procedure. Liberalisation steps that have been agreed on can hardly be reversed even if they turn out to be harmful. The EU requests imply a fast and far-reaching liberalisation of the financial services sector in the countries concerned. The majority of liberalisation requests refers to market access and freedom of establishment for the transnational corporations from the North. They are to guarantee that there are no trade barriers or obstacles remaining that impede profit-making for transnational corporations.[2]

The development policy NGOs WEED and SOMO have been observing the current processes in the financial sector and the GATS negotiations on financial services and analysed them in several studies. Their conclusion is that the gap between the poor and the rich would be increased and that financial stability would be threatened, mainly in developing countries, if the EU Commission were to succeed with their requests.

The GATS negotiations increase the gap between the rich and the poor

The advocates of a liberalisation of financial services claim that it increases efficiency in the financial services sector and would lead to a larger variety in products and improved access to capital for consumers. The experiences so far on the liberalisation of financial services in developing countries, however, lead to a more critical assessment:

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[1] The European public was informed about the EU Commission’s extensive liberalisation requests through such a leak. We agree with (…), who commented this fact with the following words: „Democracy that works by leaks is not democracy.“ (…)

[2] The EU requests can be accessed here (2003): http://www.polarisinstitute.org/gats/Main.html

Once the access to the markets of developing countries has been opened, a large part of the domestic financial sector is taken over by transnational financial corporations. The key sector for developing a national economy is then controlled by transnational actors, and their short-term interest in a fast amortisation of their investment is likely to be higher than their long-term interest in the sustainable development of the host country.

Transnational financial corporations show little interest in poor people as customers. They focus on rich customers in the host countries since they achieve high profits with relatively little effort. This cherry-picking makes access to financial services more difficult for the poor.

Even the establishment or expansion of an extensive network of branches does not interest big transnational banks much financially. Their branches focus on the large cities. The supply of financial services in rural areas decreases, especially in the poor areas.

Big transnational banks attract highly qualified personnel from the domestic financial sector because they can pay higher wages and offer seemingly more appealing career perspectives. This brain drain withdraws the national know-how that would be so vital for the development of the domestic financial sector.

More money is flowing from the South to the North. On the one hand because the financial corporations from the North are repatriating their profits. On the other hand, a large variety of investment opportunities in the North is offered to rich customers from the South. Currently, the financial sector is focussing on the savings in emerging markets. These savings will only be available to a limited extent for domestic investors as soon as they are controlled by transnational financial corporations.

Host countries have to raise additional resources to manage the transformation process and absorb the risks linked to the market entry of transnational corporations. The developing countries have to bear nearly all adjustment efforts accompanying the liberalisation of the financial sector.

In some countries, legal measures oblige the financial industry to special offers for the poor population or participation in development and poverty reduction programmes. The GATS negotiations are also used to abolish these non-market regulations.

The GATS agreement increases the risk of financial crises

The liberalisation of financial services as such already threatens the financial stability of host countries and the entire international financial system, since more and more capital is dislocated at shorter intervals. The GATS agreement aggravates this problem. The GATS provisions concerning systemic risks of financial services are subordinated to the liberalisation commitments. If the industrialised countries were to succeed with their numerous and far-reaching liberalisation requests, the monetary autonomy of governments and central banks in the South would be undermined once more. An independent development from the world market as would be desirable for at least some of the developing countries would then no longer be possible.

Even though the GATS supposedly does not aim at liberalising capital transactions, this would in practice be the consequence of its articles and provisions on financial services.

Despite a lack of adequate analysis of the causes of financial crises, the negotiators of the North ignore the concerns of developing countries, scientists and Non-governmental organisations. The GATS does contain some safety mechanisms that developing countries could apply to protect themselves from the effects of liberalisation. However, due to the increasing pressure during the trade negotiation rounds, developing countries are often forced to abandon them.

Additionally, the GATS agreement only contains relatively imprecise indications which measures of financial market supervision are allowed for public authorities. This implies that the regulation of the financial industry is likely to be a constant issue at the WTO dispute settlement bodies. The abolition of stabilisation measures is also included in the intransparent, bilateral liberalisation negotiations, as the leaked EU requests show. The introduction of new measures for the regulation of financial markets, for instance capital transaction controls or currency transaction taxes could be interpreted as a violation of the GATS agreement. This restricts political options when dealing with financial crises.

Lessons from recent financial crises are being ignored

The experiences from previous financial crises show that developing countries should, if at all, liberalise their financial sector slowly and step-by-step (Sequencing). Market access to transnational financial services corporations should not be granted until the financial sector of a country is established and stable. The financial sector should not be exposed to international competition until it has reached an adequate extent of international competitiveness. The supervision authorities in developing countries should be extended and stregnthened by capacity building first. The requests from the North for a fast and far-reaching liberalisation ignore all these experiences.

A far-reaching reform of the international finance, as discussed especially in the years after the Asian crisis, would have partially substituted national regulation. Since this has not been implemented so far, an effective regulation on the national level remains the most important guarantee for financial stability, especially for the crises-prone economies of developing countries.

The GATS agreement serves the interests of the financial industry in the North

The financial industry lobby are extremely active and successful in influencing the GATS negotiations: The leaked EU requests look like a wish list made by European banks and assurance corporations.[3] The GATS and the current liberalisation demands from the North correspond to the interests of large financial conglomerates for expansion, consolidation and profit maximisation. The GATS only provides the weak article XI or the disputed and imprecise "prudential-carve-out"- clause (implies the right to regulation) to deal with potential market misuse due to the

[3] Several times, the EU requests contain the explicit statement: „industry raises the issue“ (…)

sector's increasing concentration.

The GATS negotiations neglect the needs of the population

As much as the GATS and the EU Commission's request represent the interests of the financial industry, they have little concern for the needs of the population – especially in developing countries:

Universal access to financial services in the South: developing countries need less financial innovation for the rich, and instead need basic services for the broad majority of the population. Micro credits can promote the foundation and development of small-scale enterprises, micro assurances can guarantee a minimum of social security.

Universal access to financial services in the North: In the North, not all people have access to essential financial services like a bank account. Since payments are increasingly carried out in electronic monetary transactions, at least a giro account is a necessary requirement to be seen as a full member of society.

Restrictions of financial services for poorer people and small entrepreneurs. "Cherry picking" will reduce the supply of affordable financial services for poorer people and small enterprises even more.

Affordable financial services: Ironically, financial services are more expensive for the poor than for the rich. The interest rates of micro credits are usually much higher than those of big loans. And the free salary account is only available to the people with higher income and correspondingly high monthly incoming payments.

Transparency of the financial industry and its transactions: abrupt capital flight, intransparent and exorbitant borrowing as well as excessive speculation can lead to banking and financial crises, and their costs are burdened on the general public and entire society. Additionally, offshore-banking enables tax evasion and threatens financing of public goods.

Legal obligations on Corporate Social Responsibility and the promotion of sustainable development: The GATS provides a protection from state regulation under international law to the private financial industry but it does not contain a provision for protecting society from irresponsible management by the financial industry. The agreement neither obliges the corporations to guarantee access to essential financial services nor does it provide a possibility to sanction financial corporations that give allots loans to projects that are harmful to the environment or threaten human rights or worker's rights.

The demands of the North and of the financial industry are out of place in the Development Round

The current WTO negotiation round, the Doha Round, was explicitly declared a Development Round. Previous rounds have liberalised trade in industrial goods, this time the agricultural protectionism of the North was supposed to be on the agenda. It is completely inadequate that the negotiators from the North are demanding a liberalisation of the services sector

[4] US Trade Representative Robert Portman demanded that the negotiation round should enforce the opening of sectors in which US economy is most competitive. He specifically mentioned the financial sector. (…)

in the South in exchange for opening their agricultural markets. They know very well that the services companies in the South are by no means competitive and that the markets of the South would be an easy bait for the global player from the North.[4] Considering the current conditions, market entry by financial corporations from the North entails the risk that certain regions and parts of the population are excluded from economic development. A Development Round that deserves its name would have to be designed differently. The demands for liberalisation of financial services are misplaced in the Development Round.

Position paper by WEED and SOMO

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1.2 Pioneer for "Liberalization": Argentina and Chile

Argentina, Chile and Uruguay are among the countries in which radical neo-liberal reforms of the finance markets and the circulation of capital transactions were already carried out in the seventies. An economic scientific discussion about a detailed analysis and evaluation of these reforms has been largely avoided till now. No wonder: The first neo-liberal experiments were achieved by brutal military dictatorships with active support by Western advisers and institutions such as the International Monetary Fund.

It was the so-called "Chicago Boys" in Chile - Chilean supporters of Milton Friedman who were educated at Chicago University - who led the economic policy during the Pinochet dictatorship and carried out a radical privatisation and deregulation programme. Theoretically, "market liberalisation" was the core piece of the neo-liberal programme: The labour market was to be deregulated, price control was to be terminated, and state protection of key industries was to be overcome in the course of integration into the world market. In practice, it was primarily all about the sell-out of productive assets to trans-national companies and the excessive enrichment of a small agricultural and financial oligarchy at the expense of the population. In Chile, for example, the concession for exploiting the mineral ores - originally one of the main sources of income of the Chilean state - was sold cheaply to foreign investors: 70 per cent of the copper reserves went to EXXON and to other buyers, and these refused to pay taxes to the Chilean state from this time on (Estèvez 2003: 44). It was not only productive enterprises in the agricultural and raw material sectors, but also infrastructure and transport companies, pension insurances, as well as the health and education system which were largely privatised under Pinochet (Estèvez 2003 : 43).

What was the result of this neo-liberal experiment? Even if one discounts the thousands of people murdered and disappeared who became victims of Pinochet's brutal reign, the result is anything but a success:

The proportion of Chileans living in poverty has more than doubled from 20 to 41 per cent between 1970 and 1990 (Collins/Lear 1995);

In contrast, the richest 10 per cent of the Chileans could increase their share of the national income from 37 per cent to 47 per cent in the last decade of the Pinochet reign (Collins/Lear 1995); The Chilean foreign debt increased fivefold within a few years so that the country fell into a serious debt crisis at the beginning of the eighties, when the International Monetary Fund took the opportunity to push the neo-liberal restructuring even further.

The development proceeded similarly in Argentina. In 1976, the armed forces staged a coup d'état and had numerous labour unionists as well as critical journalists, students, intellectuals as well as socially committed priests killed. It is estimated that the Argentine armed forces murdered between 15,000 and 30,000 people from 1976 to 1982, an enormously high number even for Latin America (cf. Süddeutsche Zeitung,

August 13th, 2003). The Economic Ministry was entrusted to Martínez de Hoz - a friend of Rockefeller and an Eton old boy - who was President of the second largest Argentinean industrial group ACINDAR (in which U.S. capital had 30 per cent participation) as well as owner of large estates at that time (Boris/Hiedl (1978): 174). Domingo Cavallo became head of the central bank, and a man from the International Monetary Fund with good contacts to U.S. financial circles (Dante Simone) was placed at his side.

The military regime carried out a broad reform of the finance sector from 1977 onwards, free capital movement abroad was permitted and the local financial sector was deregulated. In addition to this, a currency policy was pursued whereby the money supply was to be controlled by the influx or outflow of foreign exchange (the “enfoque monetario del balance de payos”) - shortly afterwards, the currency was tied closely to the U.S. Dollar by the so-called “Tablita” (Becker/Jäger 2002: 32 p.)

Both, the liberalisation of interest controls which led to exorbitantly high interest rates of over 50 per cent and the liberalisation of capital movements, which allowed an unchecked inflow of foreign monetary capital to occur, created ideal conditions for speculative financial transactions. The short-term exchange rate risk was reduced to zero by the guarantee of the Argentine exchange rate which was devalued in a fixed sequence of small steps (“Tablita”), providing foreign currency speculators with an extremely lucrative business opportunity based on the difference between devaluation and the rate of inflation (Krüger 2005: 173). The Tablita was justified as necessary to combat inflation. In reality, the artificial revaluation of the peso contributed to a small minority being able to use undreamed-of possibilities for making money. Whoever was able to obtain large scale loans at a comparatively low interest abroad could deposit this capital at high interest rates in Argentina and gain enormous profits by reconverting to U.S. Dollars before the collapse of the exchange rate regime, which was hardly a problem for most leading financing corporations with their close relations to the government (Becker/Jäger 2002: 33).

The reverse side of the economic strategy was the enormous growth in foreign debt which multiplied within a few years from approximately U.S. $ 9.3 billion (1976) to almost U.S. $ 46 billion (1983). In consequence, Argentina also entered into a severe crisis at the beginning of the eighties, from which the country did not recover for a long time, also thanks to the structural readjustment programmes of the IMF.

If one summarizes the results of the first neo-liberal experiments, then the result is a very inglorious balance: the neo-liberal reforms of the financial markets and capital movement served the financial and agrarian oligarchs in both Chile and in Argentina, who were not interested in the industrial development of the countries but only in enriching themselves by financial speculation or by the corrupt disposal of profitable state enterprises. While this elite managed to transfer their accumulated fortunes from corruption and speculation to secure foreign bank accounts before the collapse of the respective economies, the rest of the

population carried the burden of mastering the debt crisis.

Lydia Krüger

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1.3 Go East: The Expansion of Western Banks into Eastern Europe

In mid June 2005, the supervisory boards of the Italian Uni Credit and the Munich Hypo-Vereinsbank (HVB) agreed on the biggest cross-border European bank merger ever. The Uni Credit based in Milan took over the HVB as well as the Austrian Austria-Creditanstalt bank whose strong presence in East Europe was the main reason for the union. The merger forms the ninth biggest bank in Europe with a stock market value of about 41 billion euros. The now Italian- controlled group is the biggest credit institution in East Europe. It controls the bank sectors in Poland, Croatia and Bulgaria and also has a strong presence in Hungary, the Czech Republic and Slovakia. About one tenth of the 125000 employees working in 2500 branches will loose their jobs in the coming months.

This mega deal is the occasion for the following contribution to deal with the banking sector in East Europe, a booming market which is forecast to have fabulous profit prospects during the coming decade.

Expansion in waves

The second half of the first decade of the 21st century is considered the most intensive period for take-overs and green field investment in the banking sector of East Europe. “Early reforms in the banking sector led to liberal policies which were marked by weak state control and shortcomings in the judicial structure”, a study by the Raiffeisen Central Bank[1] stated. Those on the spot at the time could hardly make a bad investment. The banking sectors of those countries which applied for membership with the Brussels Union between 1994 (Hungary and Poland) and 1996 (the Czech Republic) were taken over by foreign institutes, the only exception being Slovenia. To a great extent, the take-over process was already complete before EU membership started, so that foreign banks control the terrain in the eight East European new member countries since 2000 at the latest. For the end of 2003, the statistics read as follows, according to bank balance sheet totals: In Estonia, foreign banks control 99% of the credit market, in the Czech Republic and Slovakia the control is 95%, in Lithuania it is 88%, in Hungary it is 82%, in Poland it is 72%, and in Latvia it is 53%, with Slovenia being an exception, where only 33% is controlled by foreign institutes[2] . The new conditions are characterised by aggressive market invasion and a cautious lending policy.

Then a second wave occurred in the initial years of the 21st century, the banking sector take-overs by Western European Institutes involved the countries to the East and South of the EU expansion countries from 2003. Romania, Croatia and Bulgaria, as well as Bosnia-Herzegovina and Serbia Montenegro were considered by bankers to be completely open markets that were just waiting for capital that is hungry for acquisitions. Between 2000 and 2001 alone, the influence of foreign banks rose from 38% to 82% in Croatia, for example[3].

1 RZB Group (Hg.), CEE Banking Sector Report. Wien, Oktober 2004, p. 8
2 ibid, p. 9
3 Bank Austria (Ed..), Bankenvergleich Mittel- und Osteuropa 2001. Wien 2001, p. 12

Today, a few western banks control 91% of the Croatian market, 82% of the Bulgarian, 75% of the Bosnian and more than 50% of the Romanian banking sector, and the take-over phase has not yet finished, especially in Serbia, Bulgaria and Romania. Western investors also came with the Western banks. The biggest industrial take-overs or industrial settlements, for instance by Volkswagen in the Czech Republic, Slovakia and Hungary or by US-Steel in Kosice, were mainly carried out with the corporations' own capital. 60% of the Western investments in the East have been in the services industry and 40% in manufacturing industry[4]. At the end of 2004, the ratio of foreign direct investment was at an average 36.5% of the gross domestic product in the eight new EU countries, even much higher in Estonia with 79%, in Hungary at 55%, and in the Czech Republic just below 50%[5]. Therefore, the dependence of these national economies on external influence is extremely high. This control can be exactly classified by region and by sector. 80% of all foreign investments in the eight new EU countries originate in companies of the old EU. Often these are just a few banks, supermarket chains, automobile manufacturers or household appliance producers on whose vines whole national economies depend. The keenest Western capital in the East, by the way, is Dutch. Companies like Unilever or Shell have their company headquarters in the Netherlands and the expatriate Indian steel giant "Mittal Steel" is registered in the Dutch Antilles for tax purposes[6]. Companies from Germany and Austria occupy the second and third place for foreign direct investments in East Europe. Significant participations or acquisitions by Russian companies have only taken place in Belarus, the Ukraine and Lithuania.

Excursion: From the Debt Trap to Hyperinflation

We will not discuss the worldwide economic crisis of the late 1970s which forced peripheral countries in the global South and East to borrow cheap credits (in US dollars) from international capital markets, only to be led directly into the so-called debt trap from the beginning of the 1980s, due to the high-level interest rate policy of the US. Countries like Poland, Hungary, Yugoslavia and Romania certainly fell into this debt trap. High foreign debts contributed to the acceleration of the economic crisis. At the end of the 1980s, this crisis led to political collapse and territorial disintegration in the three multi-ethnical states of Eastern Europe - Yugoslavia, Czechoslovakia and the Soviet Union. In 1990, six countries in Eastern Europe (Czechoslovakia, Hungary, Poland, Romania, Bulgaria, and Yugoslavia) were indebted to international creditor banks by a total of US $98 billion. The Soviet countries owed a further US $60 billion[7]. The international guardians of capital loans, the World Bank

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[4] Press conference by Gabor Hunya, Wiener Institut für Internationale Wirtschaftsvergleiche (WIIW). Vienna, on June 2nd,2005

[5] Wiener Institut für Internationale Wirtschaftsvergleiche (Hg.), Foreign Direct Investment in Central, East and Southeast Europe. Opportunities for Acquisition and Outsourcing. Vienna 2005, p. 28

[6] In recent years, "Mittal" has bought a good proportion of East European steel works, especially in Poland (the four steel works of the old Polski Huty-Kombinats in Upper Silesia), in the Czech Republic (Nova Hut in Ostrava), in Rumania (the steel converters in Galati and Iasi) as well as the combine in Bosnian Zenica

[7] Wiener Institut für Internationale Wirtschaftsvergleiche (ed.), Countries in Transition 1995. Vienna 1995, p. 60-80

and the International Monetary Fund, have a stranglehold on the individual national economies with respect to the repayment of these credits. These restrictive policies have been used differently in the various countries for the modernisation of the industrial structure, for popular or Nomenklatura consumption. This stranglehold is especially visible in the case of Hungary (foreign debts in 1990 amounted to US $21.2 billion), Poland (1990: US $48.5 billion), and Yugoslavia. Romania was the only country to adopt the ultra-monetarist targets of the international finance organisations, it not only repaid the debt service, i.e. the interest, but also the capital between 1982 and 1989, under the leadership of Nicolae Ceausescu. Almost US $12 billion were pumped out of the population during these years to reach a debt-free status in April 1989. This was too late and entailed too much sacrifice for the population to be thankful to its leader.

After 15 years of transformation, the countries of Eastern Europe are even more dependent due to foreign debts. Restructuring measures, stability programmes, and the battle against inflation have established dependent national economies, and two of them (Bulgaria and Bosnia-Herzegovina) are directly administered by so-called Currency Boards. Parliaments and governments are by-passed and decisions on budgets and financial policy are made by the European Central Bank and the World Bank. However, the debt spiral has taken an even tighter grip on other Eastern European countries. At the end of 2004, eleven countries (formed from the previous six countries) had a state debt of US $335 billion[8] , and this sum is 3.5 times as high as it was 15 years ago. The countries of the former Soviet Union also owe US $250 billion to Western banks and credit institutions. In some states like Romania, debt has catapulted from zero to US $21.3 billion, in Croatia, it has increased ten-fold, from US $2.7 billion (1991) to US $27 billion, in Slovakia, six-fold, from US $2.9 billion (1992) to US $19.7 billion, and it quintupled in the Czech Republic (1992) from US $7 billion to US $36.5 billion, and trebled in Hungary from US $21.2 billion to US $64.3 billion, and more than doubled in Poland from US $48.5 billion to US $111 billion. The transition philosophy, whereby markets were to be opened (for Western investors) and debts transferred has been fully accomplished.

By the way, in most East European countries the reform period started with hyperinflation by which the unfulfilled consumer promises made by the communists to the people were simply dismissed. Countries like Poland, Bulgaria, Romania were confronted with triple-digit inflation rates, Croatia, the Ukraine and Russia with four-digit inflation rates at the beginning of the 1990s. Inflation of this magnitude is nothing less than “the dispossession of the have-nots“[9]. In Eastern Europe, governments and consultants brutally eliminated the disproportion between savings and the amount of goods (none or not enough) provided by the economy that emerged in the late stages of communism to make way for IMF-led so-called structural adjustment

8 Wiener Institut für Internationale Wirtschaftsvergleiche (ed.), Research Report no. 314: Ac celerating GDP Growth, Improved Prospects for European Integration. Vienna, 2005, p. 22, 62, 100, 103, 106

9 See Eduard März, Österreichische Bankenpolitik in der Zeit der großen Wende 1913 bis 1923. Am Beispiel der Creditanstalt für Handel und Gewerbe, Vienna 1981

programmes. Indeed, the economist Johann Kernbauer[10], executive board member of Bank Austria's Capital Invest in Vienna, considers that some of these excess savings had to be skimmed, however, not necessarily in such a brutal way, leaving everything primarily to the market: "Hyperinflation was permitted, alternatives such as a capital levy or a partial waiving of savings were not considered". The decision for market forces to regulate currency depreciation and the subsequent shock therapy cleared the market completely, especially in Poland. New - Western - players with new money could appear on a territory where the currency policy is supervised by the IMF and the World Bank.

The methods of acquisition

During the market expansion of Western European bank institutions into the East, all tricks of power were brought into play. The repertoire of the acquisition strategies included economic power, political pressure, and even military intervention. The invasion into the previously closed markets occurred either by means of privatisation of existing businesses, shell companies or so-called "green field investment", i.e. a complete new structure for the institution involved.

Banks in the Western bourgeois sense did not exist before 1989/91. The communist leadership was content with a single central bank whose subsections took over various duties (export / import etc.), which varied according to the country. This was for example the case in Bulgaria and Russia; and other countries - such Hungary and Czechoslovakia - had a two-level bank system. Alongside or under the national bank or central bank there were various sector banks or mercantile banks, who were given various scopes for independent action, which, however, was limited. There was no interest rate, as a regulating tool for banking policy and characteristic of capitalist conditions, a capital market was inexistent. Remnants of state banks exist only in Poland (PKO bank). In Russia, the state-controlled "Sberbank" holds the biggest market share; and in Belarus, state banks compete with foreign private banks for deposits and the loan business.

In the first phase, in order to open up the mono-bank system, Austrian banks often went East with small branches, for example, the Creditanstalt (later: Bank Austria) and the RZB went to Hungary. The appearance of the Raiffeisen central bank (RZB) is considered the very first example of a Western bank appearing in the East, in Hungary, in 1986 with the opening of a branch in Budapest. In 1990 and 1991, strategies were being discussed vividly in banker's circles on how a highly profitable entrance could be guaranteed with very low risk. Two schools evolved: those pleading for "New Entry", a new beginning, and those analysts preferring "rehabilitation", that is, a restructuring of the ex-communist structure. Stijn Claessens, in a World Bank study, described the two concepts as compatible, nevertheless he preferred the "New Entry" model [11]. Johann Kernbauer of Bank Austria agreed in delineating that mainly green field investments occurred in the first round [12].

[10] Conversation with Johann Kernbauer on June 1, 2005
[11] See Stijn Claessens, Banking Reform in Transition Countries (Background paper for the World Development Report 1996). O.O. 1996
[12] Conversation with Johann Kernbauer on June 1, 2005

After the first tentative steps at the beginning of the 1990s, a privatisation wave swept over the financial institutions market. In this phase, the acquisition of an East European institute proceeded ideal-typically as follows: the bank to be sold was offered by the state, mostly via the Ministry of Finance or a trust company and previously cleared of debt, i.e. the so-called ”bad debt” – unrecoverable loans given to ailing companies - often had to be taken by the state budget where they tore deep holes in the state finances over the coming years and still do to some extent to the present day.

After a public tender, the various bidders inspected the existing credit portfolios. This mainly entailed the search for loans that were no longer being serviced and had to be eliminated before the purchase. “It was important to separate out bad loans. Then these had to be bought back by the state, this was among the conditions”, Lars Hofer[13] of the RZB recounts, who participated in acquisitions at that time, for a different bank. Special discounts for a high number of actual or supposedly bad loans were given regularly; even when Czech Prime Minister Vaclav Klaus sold off the biggest savings bank in the country, the Ceska sporitelna which managed 70% of the national savings deposits[14], to the Austrian bidder, the “First Bank”. The Czech Republic founded its own bank, by the way, the “Konsolidacni Bank” to take care of the “bad loans”. This state bank managed the budget deficit resulting from the privatisations of banks.

After the losses had been socialized and thus burdened onto future generations or struck off the balance sheet, Western banks initially bought blocking minorities of at least 25% plus a vote in the stocks issued by the state, before becoming majority owners in a second investment wave. The mostly well-developed branch network with – at best – billions of savings deposits in the respective national currencies, was often accompanied by real estate that was owned by the ex-communist banks. Deficit companies which were interwoven into the banks had to be previously closed down or their business links with the financial institution had to be cut. Western European investment groups thus bought an entire bank and credit system relatively risk-free and at a low price, and they had nothing more to do than technically update it.

The Beobanka case

The establishment of a new private banking system in Serbia was probably unique in the East European transition period. The four largest banks - Beobanka, Beogradska bank, Jugobanka, Investbanka – were excluded with one blow when the liberal Djindjic government, under Western European influence, simply withdrew their licenses in January 2002 by state decree and cleared the market for private enterprise. Economists such as Vladimir Gligorov[15] of the WIIW claimed that the great old Yugoslavian banks were no more than “empty shells” which no longer enjoyed the confidence of the population since the freezing of foreign currency accounts in the early1990s. This may be correct, however, it does not explain why the state, which assumed responsibility for the accounts,

13 Conversation with Lars Hofer on May 30, 2005
14 Conversation with Johann Kernbauer on June 1, 2005
15 Conversation with Vladimir Gligorov, Vienna, in December 2004

later set up a lively capital market to trade in these debentures in the form of "bonds". The state mostly stepped in to pick up these open, mostly frozen bank receivables and issued bonds for a total of US $2.8 billion for them. These bonds are traded just like national debt and provided a good proportion of the capital market in Serbia in 2002 and 2003. The banks also thrive on this business. The shells cannot have been that empty! Admittedly, it is difficult to maintain confidence in these "bonds" which feed off the savings deposits from earlier better days and thus hang on the silk thread of the IMF, so long as the IMF permits further debt rescheduling and thus maintains the liquidity of the public budget.

New, globally operating companies from abroad have intervened in the banking system of Serbia since the regime change in 2000. The most successful among them is the Austrian Raiffeisen Central Bank (RZB). The bank was already on the spot, immediately after October 2000, and it was the first foreign bank to receive a state license in March 2001. In the beginning of 2004 it was operating 18 branches with 500 employees in the country. Its growth is essentially based on three pillars: the abundantly available foreign capital, the dissolution of potential competitors by the state and the introduction of the euro.

"We were extremely liquid when we arrived here, because the bank was almost flooded with private customer money. The people stood in queues of up to hundred meters to change DM in Euro and to open an account." When Oliver Rögl of the "Raiffeisen Central Bank" (RZB) remembers the weeks after opening the first branch in Belgrade, his chest still swells with pride, even years later. The deputy manager of the Serbian RZB bank has prepared his own Power Point speech to provide information on the paradise-like conditions in a market that had previously been completely cleared.

The Raiffeisen central bank already planned to set up a branch network in Serbia three weeks after the so-called "bulldozer revolution" of October 2000. In July, 2001, the bank was already on the spot. Soon after, on January 1st, 2002, the licenses of the four biggest Serbian banks in the country were withdrawn by the state. The RZB profited from the closing down of the big banks because thousands of skilled bank employees were thrown on the street at the same time, and the RZB could select the best among them. The euro-changeover was carried out on the same day, driving hundreds of thousands of Serbians into the banks to exchange the DM they had hoarded under the pillow into the new European currency. Within a few months the RZB controlled 20% of the private customer market, and branches were quickly established everywhere in the country. This was not even a gold fever atmosphere, the Raiffeisen central bank did not have to dig for the gold, the people came, stood in queues and brought the money. Ten years of embargo combined with many bad experiences with the state-controlled banks, for which every business activity was forbidden from now on, provided Western banks such as the RZB with a leap of faith unequalled in the history of banking.

Bank Robbery in Mostar

The EU-colonial governor for Bosnia-Herzegovina, Wolfgang Petritsch, resorted to the most extreme measure in the struggle of Western banks for influence in the East. He allowed SFOR units to rob the most important bank of the Croatians in Herzegovina. The "High Commissioner" of Bosnia-Herzegovina sent by the EU and the US had previously dismissed one of the three elected men of the state steering committee, the Croatian Ante Jelavic, from his office and deprived him of his civil rights, as had already occurred with the Serbian state representative in the 3-man state steering committee of Bosnia. Because the "Croatian democratic union" (HDZ), whose leader was Ante Jelavic, had at that time refused to give up its plan to set up a third national entity in Bosnia-Herzegovina, a "Herceg-Bosna", its leader was politically eliminated. Management in this kind of colonial style was provided by the Dayton peace plan in which nobody from Bosnia- Herzegovina had taken part except the Muslim state representatives. Bank robberies, however, were not listed among the intervention possibilities.

In an unprecedented act of megalomania, a unit of SFOR soldiers attacked the "Herzegovacka Banka" central offices on April 6th, 2001 to destroy the financial core of the HDZ. This first attack failed to a considerable extent, and the population of Mostar threw stones at the SFOR soldiers. There was an exchange of fire and twelve warriors of the "community of values" needed medical treatment after storming the bank headquarters. Wolfgang Petritsch called for a second battle against the biggest Bosnian-Croatian bank. Just two weeks later, on April 18th, 500 Nato soldiers clad in SFOR uniforms, started out in 80 armoured vehicles and 20 helicopters to break the financial backbone of the home bank of the HDZ, the "Herzegovacka Banka". During four hours the SFOR troops blew open the safes and took everything that looked like money or securities: Deutschmarks, convertible marks, and one and a half trucks full of coins[16]. "We could not carry out this action with finesse", the head of operations ruefully confessed to "Newsweek". "They broke into the steel room, blew the safes and drove out into the night - all in the name of Nato-peace keeping", "Newsweek" sarcastically subtitled the story on April 30th, 2001.

To prevent an expected response by Croatian units, one of the SFOR helicopters flew over the nearest barracks and released a blanket cover. Contents: approx. 750,000 dollars which poured down over the hungry soldiers. A degrading action, even for colonialists.

The blasting of the bank led to its ruin. "They take our bank, our money from us", complained General Nedjeljko Obradovic, the unrecognised Secretary of Defence of the Croatian self-government, "this is absolutely wrong. They speak with us as if we were mentally backward". And 65-year-old pensioner Stjepan Bakula asked in the "Newsweek" mentioned above, how was he to receive his pension now, after the destruction of the bank. Possibly a German Protestant church somewhere would install a charity fund which would collect a few marks because of the miserable economic situation in Mostar and in memory of the former

[16] Newsweek, 30 April 2001.

mayor in Bremen, Hans Koschnick, one of the first colonial administrators. In 2004, the bank sector of Bosnia was controlled to 75% by foreign credit institutions, the Austrian RZB owns 20% of market share, the Italian Uni Credito owns 17%, the Hypo Alpe- Adria owns 16% and HVB/bank Austria owns 8%.

The Partitioning of the Bank Market

"In Eastern Europe the market is so enormously large, the need for banking services is constantly increasing. Therefore there is no rivalry between the competitors, there is room for everybody", says RZB analyst Lars Hofer, fully believing the dream of never-ending imminent growth.[17] In Romania, according to the RZB representative, only 20% of the population had a bank account at the beginning of 2005. The potential is huge. The strongest presence in the Eastern market is shown by the Belgian KBC (with a balance total of 25 billion Euro), followed by the Austrian institutes: "First Bank" (24 billion Euro in 2003) and "Bank Austria"/HVB (20 billion Euro), the Italian Uni Credito (16 billion Euro), the RZB (15 billion Euro), City-Group, Banca Intensa, Societé Generale, ING Bank, and Commerzbank[18]. Growth rates of 15% per year in the loan business until 2008 and of 11% per year in the deposit business seem realistic[19]. Thus the gold digger's mood of the past ten years continues.

In spite of the often quoted limitlessness, the Western European big players have divided up the markets in the East among themselves. The Belgian KBC controls, for example, the biggest Czech bank, CSOB, and the important Hungarian institute K&H as well as banks in Poland (Kredyt Bank). The "First Bank" has seized the savings bank system in the Czech Republic and Slovakia (Ceska Sporitelna and Slovenska Sporitelna) and has a strong presence in Hungary with the Postabanka. Uni Credito, on the other hand, is in charge of the banking system in Croatia and has a strong market share in Poland and Bulgaria. Bank HVB/Austria is strongly based in Poland and Bulgaria, a merger with the Uni Credito would make them market leaders in the banking system in Poland as well as in Bulgaria. Societé Generale, on the other hand, has invested in the Rumanian and the Slovenian credit market, whereas the RZB operates almost everywhere, and is the largest Western bank in Russia, Belarus and the Ukraine. The small Baltic markets are operated from Scandinavia, there the Swedbank and the SEB share the fattest chunks.

What makes banker's hearts beat faster are the actual balance sheets. The example of Bank Austria-Creditanstalt/HVB shows what the Eastern business is all about: an increase in capital of about 13.6% between the first quarter in 2004 and the first quarter in 2005, with operating profits up by 42.1%, employee numbers down by 4.8%[20]. Opening up the East, as has often been emphasized, saved the balance sheets and profits of the mother companies in the West. The Raiffeisen reports reveal a six-fold increase between 1998

17 Conversation with Lars Hofer, Vienna, May 30, 2005
18 See: Die Bank Austria Creditanstalt Gruppe: Marktführer in Zentral- und Osteuropa. Vienna 2005 (internal paper)
19 ibid.
20 Conversation with Lars Hofer, Vienna, May 30, 2005

and 2004 in the balance sheet total for foreign business (in the East), and the whole company (including business in Austria) slightly more than doubled the balance sheet total for this period. RZB's Lars Hofer says: "Without the opening in the East we would certainly not have reached today's size. This growth is based on the Eastern expansion"[21]. Or, as expressed by RZB boss Herbert Stepic in a newspaper interview: "The opening in the East was a galactic window for Austria and the Raiffeisen central bank" [22].

The historical knowledge with which the Western institutes operate in the East is conspicuous. The banking companies seem to link up with traditions dating back 100 years and more. The historical connection is complemented by a geographic and linguistic proximity. Therefore, there is a comparatively extremely strong presence of Austrian banks in the Czech Republic, Slovakia and Hungary, the Italian leadership position in Croatia and the Scandinavian dominance in the Baltic States. "The Viennese banks invaded Eastern and South- Eastern Europe with Austrian capital", the League of Nations commissioners Walter Layton and Charles Rist wrote in their study of the Austrian national economy after the First World War[23]. Italian and German capital soon followed, and they secured the most profitable investments by acquisition of Austrian companies. Belgian and Dutch corporations arrived in the 21st century to cavort in the bank market.

German banking institutes, with the exception of the Hypovereinsbank HVB, are scarcely present in the East European markets, and this is because of German unification. "They were preoccupied with unification", is the explanation given in banker's circles referring to the absence of Deutsche Bank and Dresdner Bank in Eastern Europe. Indeed, except for the HVB and the Commerzbank, hardly any other German bank is active on the East- European market.

How Business is Done

The entry of Western banks into the East was mainly accompanied by medium-sized Western European companies in the first years, in search of cheap labour and market enlargement. The financial institutions mainly supplied companies from their home countries with credits. The case was different for the "First Bank" and the Raiffeisen central bank (for example in Serbia). Right from the beginning of their presence in the East, these two banks served as savings banks for the ordinary people, and the Ceska Sporitelna and Slovenska Sporsitelna, which were taken over by the "First Bank", had a considerable deposit volume. Only the second step was "wide ranging", the institutes lunged at private customers both for the credit business as well as the deposit business. In contrast to the old EU region, the deposit volume in Eastern banks lies significantly above the credit volume. Whereas deposits on average amount to 44% of gross domestic product in the new EU countries,

21 Conversation with Lars Hofer, Vienna, May 30, 2005
22 Die Presse, May 28, 2005
23 Layton/Rist, The Economic Situation of Austria. Report presented to the Council of the League of Nations, Geneva 1925. See also: Alice Teichova, Banking and Industry in Central-East Europe in the first decades of the 20th century (Festschrift der Creditanstalt). Vienna 2005

and loans amount to 31%. In the Euro zone the ratio is the opposite: deposits amount to 86% of GDP, and loans are 106%. The large difference between the East and the Euro zone can be seen as an indication of growth potential.

Unlike the period before and after the First World War, today's banks rarely deal in industrial joint ventures or take overs of commercial enterprises in the East. At the end of 19th century, for instance, the Creditanstalt-Bankverein was a machine for converting businesses into share companies in which the bank later participated[24] , the banks are mainly linked to the insurance market nowadays.

All kinds of share funds issued by banking corporations are rampant in the Eastern markets, depositing excess Western capital in the East. This speculation business has been highly profitable ever since stock exchanges and a capital market were established. Besides state loans, there are various funds which sometimes promise twice the interest as in Western Europe.

The biggest social problem caused by the de facto takeover of all banking businesses (and industrial as well as service companies) by Western owners is the class structure. A West- European- capitalism, be it the "Rhenish" style or "social partnership" style, needs a strong middle class. The development of such a middle class in the East is not exactly fostered by the dominance of west-European companies. The big companies need to generate profits in the service sector companies as well as in the industry for the shareholders who are based somewhere in London, Amsterdam, Frankfurt, Milan and Vienna. Instead, a kind of deputy bourgeoisie is emerging in some countries who are serving this kind of a peripheral integration into the European Union.

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[24] Teichova, p. 150.

1.4 Enforced Market Opening by War: Foreign Businesses and Banks in Iraq

"Dear Mr De Rato, we have done our best to realize the ambitious political plans we presented in our economic programme of 2004/05 despite the great challenge provided by the specific political and security situation in our country (…). The results were positive: The gross domestic product (GDP) has in fact fallen back by almost 50% in 2004 but this development can be largely explained by the restoration of oil production. Following increasing inflation at the end of 2004 and at the beginning of 2005, which was mainly caused by food scarcity due to the security situation, consumer prices have stabilized in recent months (...)."

The "Letter of Intent" of the Iraqi government of December 6th, 2005 to the International Monetary Fund (IMF)[1] starts with these words. In this letter, the government asks for a loan of 685 million U.S. dollars to be made available in order to complete the economic programme by March 2007. As is well known, the IMF gives nothing without demanding global economic adjustments. The Iraqi case is all about opening up an economy to the international market which was previously run by the state until Saddam Hussein's regime was toppled. In short, the IMF kindly considered the request of the recent Iraqi interim government and granted Baghdad's loan request soon afterwards.

This was not the first time that the IMF gave a helping hand to the new government in Baghdad. In September 2004 already, an "Emergency Post-Conflict Assistance" (EPCA) amounting to 436.3 million U.S. dollars was granted. This was primarily assigned to the reconstruction of the Iraqi administration - which had been partly dissolved by the occupation administration in order to raise the economic reconstruction of the country to a higher level. To make sure nothing went wrong, the IMF also promptly provided the appropriately trained experts to the country who were to train the Iraqi personnel in all aspects of the international financial and banking systems. This part of the task was mainly taken up by the US Agency for International Development, USAID[2]. USAID is taking care of nearly the complete reconstruction of Iraq, i.e. economic development, agriculture, questions of state governance, the judiciary system, reconstruction, and health care.

The target the IMF set was to stabilize the run down of the Iraqi economy, to lay the basis for a reform programme and to enable Iraq to pay its foreign debts. However, certain criteria needed to be met: a wise financial policy must cut state expenditure, the exchange rate (of the new Iraqi dinar) must be stabilized to control inflation and, finally, key reforms have to be implemented in Iraq to transform the country into a market economy.

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1 Information on the IMF and Iraq at www.imf.org
2 Information on the work of USAID in Iraq at www.usaid.gov

Immediately after the Controlling Powers Authority (CPA) took over in April 2003, a central course was laid out. Liberty and democracy could wait, the most important issue was control of the financial system which was to be newly set up for the till then state run economy. Characteristically, the troops marching into Baghdad knew which of the buildings was the oil ministry and they immediately occupied it and hermetically sealed it off. On the other hand, the national museum was not known to them, and this was looted unhindered for two days while US troops were searching for alleged "pockets of resistance" nearby.

Paul Bremer, the new strong man in Iraq, issued one decree after another. On September 19th, 2003, Bremer signed decree no. 39 concerning "foreign investments in Iraq"[3]. This made it possible for all Iraqi resources, with the exception of oil, to be taken over by foreign investors. Kamel Al-Gailani, the interim minister of finance appointed by the US Americans, initiated a comprehensive bank reform soon afterwards. Foreign financial corporations were now allowed to own up to 100% of shares in Iraqi banks. For the first time since the 1950s, foreign banks were allowed to intervene in the Iraqi financial system whose principle assets were the world's second largest oil reserves.

All previous Iraqi laws were thereby cancelled, and the doors were opened widely for foreign corporations and banks. Iraqi businesses and banks, in a state controlled private sector completely weakened by 13 years of UN sanctions, did not stand a chance against the foreign investors invading the country. A comprehensive job was done in securing business through the Iraqi merchant bank and adjusting the Iraqi financial system to the requirements of these corporations.

After the necessary preconditions were created by Bremer's decree no. 39, nothing could stop them. From this time on, Iraqi ministries could borrow tens of millions of dollars to buy all over the world all that was denied during 13 years of UN sanctions. The New York JP Morgan Chase Bank provided the financial security for these transactions[4]. Iraq had to practically mortgage its national oil revenues so that the Iraqi merchant bank could issue the required letters of credit to guarantee solvency and ease the transfer of funds.

Originally, the Iraqi merchant bank was responsible for the trade guarantees which were introduced by the UN "oil for food" aid programme in 1995 to moderate the effects of the UN sanctions on the Iraqi civilian population. This programme enabled comprehensive control of the Iraqi purchases of humanitarian goods from other countries. Payment was by revenue from limited oil sales. The payment was made via an account controlled by the UN Sanction Committee 661 in New York. This control was to prevent Iraq from buying goods which theoretically could also be used for military purposes (dual use). The "oil for food programme" had an overall turnover of

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[3] Extensive information on Paul Bremer's decrees can be read at: www.cpa-iraq.org)

[4] The following details are based on an article by Mitch Jeserich, written for CorpWatch in February 2004. The text, "Banking on Empire", can be read at the highly recommended website: www.corpwatch.org)

460 million US dollars and was terminated in November 2003.

Soon afterwards, the management of the Iraqi merchant bank was taken over by a foreign banking consortium, succeeding against four other international competitors. The tender was awarded to a consortium of thirteen banks from fourteen states led by the JP Morgan Chase Bank in New York. JP Morgan Chase, one of the world's largest commercial banks, was formed by the merger of the J.P. Morgan & Company Investment Bank and Chase Manhattan Co. in December 2000. From then on, Iraqi merchant bank guarantees were no longer managed by UN institutions but by a private banking consortium and the governments linked to these.

The occupation administration and the multinational banks began to manoeuvre the future Iraqi government into a debt trap of an unknown magnitude. Nomi Prins, a former investment banker and book author, criticized the fact that the actual oil export levels and oil prices were kept secret. "The oil, nobody really knows about it, is used to cover various items, although there is no transparency at all about the profits."

It is now possible for Iraq to do international business again even though the purchasing power continues to be low because of the high debt level. The new financial system, however, was installed under an Iraqi government which has not in any way earned this title. The country is to date ruled by various interim governments, the first of which was put in place by the occupying forces (2003-2005) and also governed in their interests rather than in those of the Iraqi people.

Therefore, reconstruction contracts were primarily allocated to US companies with links to the US administration. At first, the Iraqi merchant bank export loans went to companies from those countries involved in the bank consortium that controlled the merchant bank, irrespective of whether the products were good quality or inexpensive.

For example, the US export credit institution supported the Iraqi merchant bank which, at the beginning of 2004, disposed of export guarantees amounting to 2.4 billion US dollars. The US Export-Import Bank approved 500 million US dollars in letters of credit and secured the investment risks of US companies in Iraq. Thus, if Iraqi departments default on their payments to US companies, the US Export- Import Bank would step in to meet the obligation. The US Export- Import Bank, in turn, could reimburse itself from the Iraqi development fund, that is, the real Iraqi budget. 95% of the money in the development fund comes from Iraqi oil revenues - which, despite claims that Iraq has recovered its sovereignty - are under control of the occupying powers.

Iraqis are not the only ones to criticize that the development fund is not transparently managed, and that moneys allocated by the fund cannot be controlled or commented on publicly. The US administration can make its own rules about how it disposes of money from the sale of Iraqi oil.

The other members of the occupation coalition also profit from the new Iraqi

financial system: NEXI, the Japanese export credit institution, has also made 500 million US dollars in guarantees available, the Italian SACE added 300 million US dollars. According to Daniel Zelikow, a leading director of J.P. Morgan Chase, the export credit institutions of thirteen European states have also provided money.

The appearance of JP Morgan in Iraq has created the preconditions for the whole of the Iraqi bank system to be taken over by foreign banks. The Iraqi banks - if they wanted to stop a foreign take-over - had to compete with these foreign banks and their numerous affiliates with almost unlimited capital and credit possibilities. Local banks that were not bankrupt had to come to terms with the foreign banks in order to continue to exist. The newly created "free market" is anything but "free". Rania Masri of the Institute for Southern Studies (Corporation Watch) criticized Bremer's decree no. 39, "are these laws to help the Iraqis rebuild their country for themselves or are they laws to open Iraq up to foreign corporations so that they can profit from Iraqi raw materials?". "This stinks of colonialism and has nothing to do with reconstruction."

JP Morgan Chase is not unknown to the architects of the occupation in Iraq. The bank supported Bush and Cheney in their election campaign with a donation of 158,000 US dollars. In addition, it has close contacts to the corporations which have walked off with billion dollar Iraqi contracts. For example, Riley P. Bechtel, is on the bank's board of directors, president and executive chairman of the Bechtel Corporation which has received contracts of more than 2 billion US dollars. The board of directors of JP Morgan Chase also includes Lee R. Raymond, executive chairman of the Exxon Mobil Corporation. JP Morgan Chase certainly has experience in the Middle East. For 30 years, the bank has handled all transactions concerning oil and natural gas exports from Qatar through the national bank and Qatar was made one of the most prosperous countries of the region which supported the consolidation of the monarchy.

The history of JP Morgan Chase reaches back to the time when slaves were owned in North America. A study of Californian insurance institutions reports that the previous Chase Company which now belongs to JP Morgan Chase offered slave owners life insurances for their slaves. According to the study, when a slave died, Chase paid a certain sum to the slave owner for the loss. The bank has never paid reparations and Charlotte Gilbert Biro, spokeswoman for JP Morgan Chase said: "We do not see that there is a genuine obligation on the part of the bank (for this)."

The Nazis in the 2nd World War were also happily supported by the Chase National Bank as well as JP Morgan helped the Third Reich to confiscate bank accounts of Jewish customers. After the war the deposits were retained. A US Finance Department report of 1945 on USA banking transactions during the war states: "the services performed by the Chase branch office in Paris (....) for the Germans (...) were unjustified" and obviously "arose from a desire to extend its influence".

However, JP Morgan and Chase's disreputable assistance to racist governments was not only confined to the

USA and Europe. The company is still tangled up in a lawsuit because it financed the build up of the police and security apparatus of the apartheid regime of South Africa although the United Nations were already pressing for an embargo against the racist regime (in 1964).

The engagement of JP Morgan Chase in Iraq is anything but a signal for the beneficial new start of the country. Clearly, the money for Iraqi reconstruction is being used to implement an economic policy created by the occupation authority. The radical changes to the financial system were consciously not left to a democratically elected Iraqi government who could decide on future national economic reforms. “If you really want to control an economic system, then you invade the country and put yourself in place before (the country) has a representative government”, says bank expert Nomi Prins. Up to now, almost 200 billion US dollars have been spent in different areas, allegedly to liberate and rebuild Iraq. “However, a functioning democratic Iraqi government was on no account involved.”

The missing information concerning the economic reorganization leaves the population to guess rather than know to what extent their country is being plundered. They notice that something is going tremendously wrong because food prices are increasing nearly every day. Primarily the price increases for petrol and gas has made the people suspicious. “How can it be that not only is petrol difficult to obtain in Iraq when the country is swimming on oil, but prices just keep going up”, car drivers ask who have to repeatedly wait at the petrol stations in the Iraqi capital for hours. The IMF is directly involved in this even though the government has not explained this to the population. To secure the new IMF loan until 2007, even against the opposition of the oil minister in office at that time, the Iraqi government had to implement a “key reform” demanded by the international financial donors: the subsidies on petrol and gas prices had to be drastically reduced. Finally, prices increased fivefold one day after the parliamentary elections on December 15th, 2005.

Karin Leukefeld

1.5 Financial Markets Liberalisation and Bank Privatisation in Korea since the Asian Economic Crisis

Market reforms in the finance sector and the sale of the Korean banks to foreign investors also result from the structural adjustments carried out together with the IMF since the financial crisis of 1997/98. In this brief text we would like to deal with the myths and the consequences of neo-liberal financial market reforms with the example of Korea. In contrast to the widespread notion that neo-liberal reforms are connected to a "retreat of the state", the reforms in Korea involved massive regulatory and financial intervention by the state in the interests of investors, as we will show in the first part of the text. In the second part of this article we will demonstrate that neo-liberal reforms and privatisation do not reduce "crony capitalism". Instead, the take-overs of Korean banks by foreign investors merely internationalise nepotism. In the third part of the text, we show some problems which arise from an extensive take-over of the finance sector by foreign investors and the resulting "market orientation".

1. The First Phase: Liberalisation of the Financial Markets, Nationalization of Debts

The reform of the finance sector in Korea since 1997 is often judged positively because it enabled the stabilisation of the finance sector and opened it up to foreign investors. We will deal with how far this can be seen as positive in parts 2 and 3. At first, the question arises as to how the recovery of the finance sector and the neo-liberal reforms are connected to each other. The IMF and neo-liberal economists claim that it was the neo-liberal reforms which contributed to the recovery in Korea. We, on the other hand, maintain the thesis that the recovery was a result of state intervention.

On the outbreak of the crisis at the end of 1997, the Korean government initially announced a guarantee for all savings deposits to prevent a bank panic. Although the governments of all East Asian countries affected by the crisis announced similar guarantees, it was only in Korea that deposit holders trusted the government. A run on the banks occurred in Indonesia and Thailand despite the guarantees, because savers wanted to exchange their local currency deposits into dollars. In Korea, the deposit holders not only trusted the deposit guarantees, but many Koreans even converted their personal foreign currency and gold reserves into the weak national currency. Thus, many Koreans sacrificed their personal financial security in favour of the national foreign currency reserves. On the one hand, this behaviour can be explained by the strong emotional nationalism in Korea, and also by the confidence in the government's ability to overcome the crisis.

Additionally, the restructuring of the banking system was not primarily the result of market forces but occurred through state initiative and active state intervention. The government closed and merged financial institutions in a way that the number of the banks was reduced from 33 to 19 and the number of other financial institutions decreased from 142 to 114. Consequently, con-

centration in the banking sector increased. In 1997, the three largest banks controlled 27% of all bank deposits - in the year 2000 it was already 54%. Moreover, the government nationalized insolvent banks which it had classified as viable. The government took care of the debt and, in addition, invested money in the rationalisation of the banks. From 1997 to the present, the government has invested a total of $135 billion of tax money in reconstructing and rationalizing the banks. This corresponds to about 32% of the Korean GDP. If the revenues from privatisations are subtracted, the result is a net cost to the Korean taxpayer of 22% of the GDP. Nevertheless, further cash injections into the financial system will also be necessary in the future, as will be seen in the second section.

Paradoxically, the aim of the nationalisation of the banks was their re-privatisation and the liberalisation of the financial system. Under pressure from the IMF, the government committed itself to opening up the financial system to foreign investors and carried this out more rapidly and more extensively than even the IMF required. The government used all means available to increase the banks' profitability for private investors. The government was even prepared to use force against bank employees who were on strike in order to break the resistance of the labour unions to the rationalisation measures. Thus, some of the largest and most militant labour struggles in Korea since 1997 were in the banking sector.

The results are impressive from the government's point of view. The number of employees in the surviving banks was reduced by 25% from 1997 to 2000, 15% of the branch offices were closed and the profits increased by 183%. Unsurprisingly, after the state carried out the expensive and conflict-ridden stabilisation and restructuring process, foreign investors showed an interest in the take-over of Korean banks. Thus, foreign investors did not contribute to overcoming the crisis, but, in the final result, profitted from the reform measures. On the other hand, the general public, the dismissed employees and the Korean taxpayers, were burdened with the costs of the stabilisation and reform measures.

2. The Second Phase: Bank Privatisation and Casino Capitalism

The first phase of the bank reforms, immediately after the outbreak of the crisis, was characterized by ad hoc rescue measures which led to the nationalisation of the banks. This phase, however, was only a short intermezzo during which new institutional basic conditions were created for the financial market. The finance market reform in Korea was a central component of the more thorough structural reforms, which were directed towards the U.S. model of shareholder capitalism.

A radical liberalisation and deregulation of the finance market was the most drastic measure for this, whereby the banking sector, insulated till now, was to be opened to foreign investors. This triggered a flood of foreign capital into the Korean finance market. As a consequence, foreign investors became central players alongside the Korean government in the Korean banking sector. This was also the desired political effect. The Korean government regarded foreign investors not only as

an emergency solution in a crisis but as long-term reform partners in the belief they would assist Korean banks to become internationally competitive financial institutions by providing advanced know-how and management.

April 1998 which for the first time permitted the take-over of Korean banks by foreign investors. Since then, three of seven remaining commercial banks with nation-wide operations were sold to foreign investors: Newbridge Capi-

Share of foreign capital in commercial banks operating nation-wide (November 2005)

	Foreign investors share	
Kookmin Bank	85,8%	
Shinhan holding	64,0%	Merger with the Chohung Bank
Hana Bank	76,6%	Converted into a finance holding
Woori holding	11,7%	78% of the shares still held by the state. Re-privatisation planned by March 2008 at the latest
SCB First Bank	100%	Shares no longer traded on the stock exchange
Korea Exchange Bank	74,3%	Lone Star (50.53%), Commerzbank (14.61%)
Korea Citibank	100%	Shares no longer traded on the stock exchange

The movement of foreign investors into the Korean banking sector was carried out in two ways: by shareholder participation in the banks or by complete take-over of the banks. Today, foreign investors hold more than 66% of the bank shares in Korea compared with 18% in the year 1998. Worldwide, Korea ranks third behind Hungary (89%) and Mexico (83%) in the foreign ownership of bank shares. The market share of foreign capital in the Korean banking sector, including the regional and specialist banks, rose from 8.5% in the year 1997 to 30% in the year 2004. The sale of Korean banks to foreign investors contributed significantly to this change. A new bank law was passed in tal took over the Korea First Bank, the eighth largest bank in 1999. In 2000, an investment consortium under the leadership of Carlyle and JP Morgan took over the Koram bank, the seventh largest bank. Lone Star took over the Korea Exchange Bank, the fifth largest bank, in 2003. These three banks, now controlled by foreign investors, have a market share of about 15%.

At first, the growing significance of foreign investors in the Korean banking sector was welcomed by all sides - the Korean government, the involved banks, the general public as well as the international financial markets - as a positive and hopeful sign for market-

conform reforms. This was primarily seen as an "impressive" interim balance for the Korean government. Together with the IMF, the government saw "regaining the confidence of the international financial markets" as an important indicator of the government's success. However, faith in foreign investors as a helper and modernizer of the Korean banking system proved to be an illusion.

The first doubts arose when it was disclosed that the foreign investors which bought up Korean banks were all Private Equity Funds (PEF), which realized astronomical profits by the resale of their share holdings without paying any taxes. The fund managers justified the high profits as a well earned reward for making a high risk investment. But this argument lost all credibility when the dubious conditions under which the Korean government sold the banks to the funds came to light. The PEFs practically undertook no financial risks with the take-overs. On the contrary, the negotiated contract conditions promised the PEFs risk-free and secure profits. This was because the PEFs only had to take on healthy loans on purchase. A "put back option" spared the investors from any risks which might occur after the purchase. Thus, the Korean government was liable for any bad loans discovered after the take-over and not the investors. Three examples show that these contracts excessively favoured the investors and granted them gigantic profits, whereas they were extremely expensive for the Korean taxpayer and burdened the general public with almost all the risks. Additionally, in some cases, the contracts were made possible by corruption and crony capitalism.

Third Phase: The Invasion of the Global Player and International Crony Capitalism.

1st case: Korea First Bank, "the goose that lays golden eggs"

In the year 2000, the Korean government sold her shares in the Korea First Bank to Newbridge Capital for 500 billion Won (approx. U.S. $ 500 million). At the beginning of 2005, Newbridge Capital resold her share in the Korea First Bank to the Standard Chartered Bank for 1.650 trillion. Won and thus realized a profit of 1.15 trillion (approx. U.S. $ 1.2 billion). However, a state cash injection of 18 trillion Won (approx. U.S. $ 18 billion) flowed into the Korea First Bank from January 2000 on, that is just before the take-over by Newbridge Capital, up until the resale to the Standard Chartered Bank at the beginning of 2005. The Korea First Bank, now called the Standard Chartered First Bank Korea is to receive a further state financial subsidy totalling 860 billion Won (approx. U.S. $ 860 million) in the period from 2006 to 2008 as a result of the put back option. It is thus not surprising that next to Hong Kong, Korea has become the most important and most profitable location for Standard Chartered Bank.

2nd Case: The take-over of the Korea Exchange Bank by Lone Star: "Project Knight"

Lone Star bought a 51% share in the Korea Exchange Bank for 1.3 trillion Won (approx. U.S. $ 1.3 billion) in September 2003. A bank take-over by an investment fund such as Lone Star is not possible under Korean banking law except in insolvency cases.

To make the deal possible, Lone Star designed the „Project Knight" plan. "Project Knight" describes the concrete procedure for avoiding banking law restrictions. This involves the skilful falsification and manipulation of the Korea Exchange Bank balance books. Here, the bank was suddenly transformed into an insolvency case with a capital reserves quota of 10%. After several meetings between Lone Star and the relevant Korean officials from the Ministry of Finance and the bank supervisory authority, the project was realized according to plan. The deal was completed successfully. Lone Star can count on a profit of at least U.S. $ 2 billion from its share in the Korea Exchange Bank in the forthcoming resale of the bank.

3rd case: Citibank: How a Global Player Expands its Business and Makes a Profit.

Citigroup bought 98% of the shares of the Koram Bank in April 2004. Carlyle, the previous main shareholder with a 37% holding, made a profit of U.S. $ 676 million from this transaction alone. Considering the many dividend payments of the previous years, the investors in Carlyle can enjoy a return of 250% on their investments.

The example of Citibank also shows how business practices can change when Korean banks are tied into multinational bank companies. After the take-over by Citigroup, for example, the credit allocation system was fundamentally changed. Business loans, particularly loans to medium-sized and small enterprises, to which the bank had previously given priority, declined massively. Instead, the money was transferred by Citigroup to Citigroup branch offices abroad or to other Citigroup affiliates. From November 2004 until the end of June 2005, a total of 1.83 trillion Won (approx. U.S. $ 1.8 billion) flowed from Korea into Citigroup branch offices abroad, from which Citigroup had raised the short-term loans to finance the take-over of the Koram Bank for a total amount of 3.1 trillion Won (U.S. $ 2.7 billion). Even the Citi-Financial in Korea, at that time an insolvent Citigroup affiliate, obtained generous loans from the Koram Bank at an extremely favourable interest rate. In view of the Citibank credit allocation practice, the contribution of foreign banks towards financing investment in Korea is extremely questionable.

4. Results and Outlook for the Future

The myth of a neo-liberal liberalisation and privatisation ideology can be refuted on the basis of the Korea case study. In contrast to the assertions of the IMF, the opening up of the Korean financial markets did not lead to a stabilisation of the crisis situation because of a foreign capital influx. It was the state which stabilized the financial system with guarantees and tax money. The foreign investors only returned after this stabilisation, and even then had their investments secured by state guarantees. The virtually risk-free investments ensured gigantic profits for the foreign investment funds, and they were not even taxed. Korean "crony capitalism" was not reduced through the influence of foreign investors; instead the national crony capitalism was simply internationalized. Finally, as a result of the transition to shareholder

capitalism, the banks appear to increasingly strongly orientate themselves towards short-term profit interests for the investors and to neglect their role as credit providers for industry. The banks in Korea which are dominated by foreign investors and multinational companies are only the forerunners and the remaining Korean banks will join them, one after the other.

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and Thomas Kalinowski

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1.6 Global Players Made in China: China's Changing Development Strategy

When the "11th Five-year Plan for National Economic and Social Development" was discussed and adopted at the fifth Plenary Conference of the 16th Central Committee of the Communist Party of China (CPC) in November 2005, there was a novelty: for the first time in fifty years the plan was not called jihua (plan) but changed to guihua (programme). What is to be expected from this programme direction of the PR China over the next five years, since actual developments appear to be permanently overtaking the new plans?

The Chinese economic success story can be well comprehended by growth rates of an average of 9.4 per cent in recent years (1978 - 2004). On announcing the figures for 2005 (GDP growth rate 9.8 per cent), the Gross National Product of the previous year was revised upward by an additional 16.8 per cent to 15.99 billion RMB (1.93 billion US $), since newly raised data for the service sector in 2004 of 2.3 billion was included in the calculation. This Chinese boom, which has now lasted for more than a quarter of a century is generally characterised as being the result of the so-called "reform and openness policy" which has been articulated in various ways: at the end of the 1970s/ beginning of the 1980s it was the interaction of a general economic reactivation of agriculture, businesses and the economic administration system. In addition, the technological modernisation of industry was to profit in the long run from the opening up to foreign capital. The objective was a general increase in the standard of living for all sectors of the population. However, the per capita income averaged over the whole population at U.S. $ 1.090 (real; 2003) is, from a global perspective, still comparable to income levels in many developing countries. Of course such average values have to be analysed more exactly. The significance of such data has to be put into perspective considering the sheer size of the total population. More important is the assessment of regional disparities within the country: not only does China have 22 per cent of the world population; but two thirds of the population live in the coastal and central regions. A change in the social structure of Chinese society has taken place over the last few years with the formation of a mainly urban middle class. This class follows the concept of striving for "a little bit of prosperity" (Xiao Kang), with a definite increase in available private household income, and accompanied by the adoption of Western consumption norms and lifestyles. Not only the gap between city and countryside, but more significantly, the recent report of a growing super-rich class of about 250,000(!) Chinese Dollar millionaires illustrates the growing income differences among the Chinese population. But these millionaires only constitute the smallest fraction of the population as a whole. The majority of the Chinese population lives on a low to lowest income outside the prospering urban areas: although only ten per cent of Chinese land is economically suitable for agriculture, up to 65 per cent of the population still depends directly or indirectly on the agricultural sector. Migration into cities and internal migration are

problems which confront China with great challenges. One of the objectives formulated in the 11th Five-year Plan is to counter such regional disparity urbanisation and the general regional coordination of the Chinese national economy remain on the agenda. Additionally, greater focus is to be placed

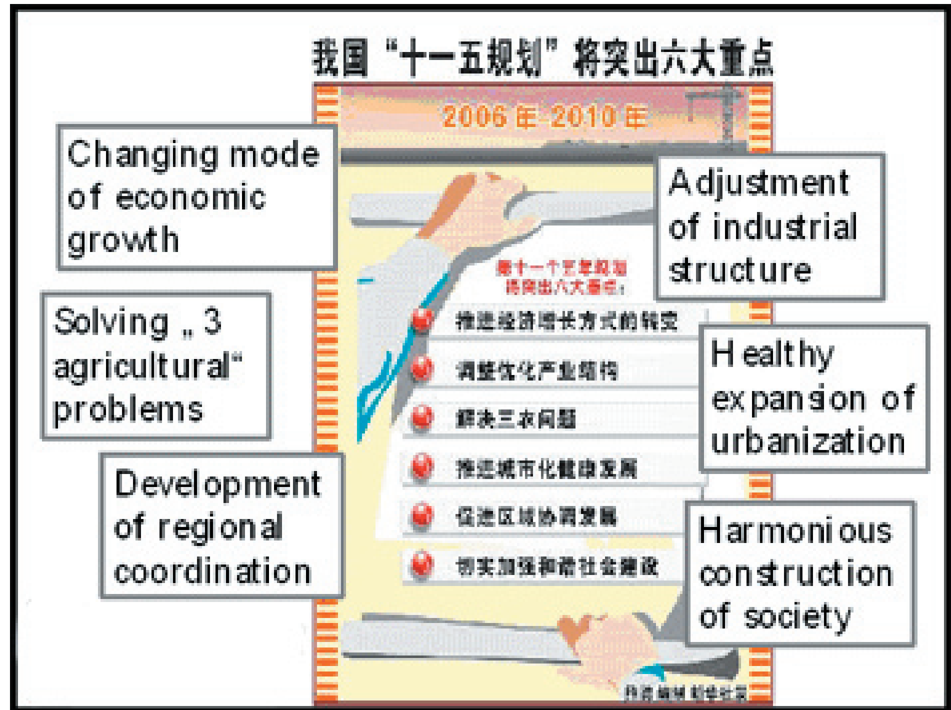

Figure: The 11th Five-Year-Plan: Most important points

Source: Author`s own compilation based on: http://news.xinhuanet.com/misc/2005-10/07/content_3590217.htm> (accessed on november, 18th 2005).

trends within the country. As shown in the figure, six points are judged to be especially relevant to ensuring a "harmonious social structure."

The policy is linked to the ninth and tenth Five Year Plan. In relation to rural urbanisation, the keywords of the "three agricultural problems" are improvement the situation of the farmers, particularly improving living standards in rural areas, as well as farming productivity in the rural small industry. Thus, the complex question of on how further positive developments can be achieved in coordinating the use of resources. The dimensions are also immense in the area of consumption: the global significance is revealed in the relationship to worldwide energy consumption. The west, particularly the US and Europe, are indeed still the main consumers, however there is a growing Chinese demand for the most varied resources due to China's expanding economic growth and the extension of its production capacities, and this, by the way, is carried out with sig-

nificant participation of foreign manufacturing plants in China. For instance, China consumed twelve per cent of primary energy resources, 15 per cent of freshwater, 25 per cent of aluminium oxides, 28 per cent of rolled steel as well as 50 per cent of cement in 2004. The 11th five-year plan is now striving for a so-called "green Gross National Product", and thus turning to a sustainable development concept: alongside the target of doubling the Gross National Product in the period 2000 to 2010, the energy consumption per unit of Gross National Product (measured in terms of the level at the end of the tenth five-year plan) will be reduced by 20 per cent. China's worldwide share of the GDP was four per cent in the year 2004.

For a long time, China's integration into the world economy was seen in the framework of opening up to foreign capital and the control and the utilisation of the resulting profits, whether it is capital or know-how. In retrospect, the initial coordination of foreign engagement, for example by clearly defined joint venture requirements and the assignment of regional locations - at first only a few (five) economic special zones and 14 coastal cities were selected in the 1980s for opening up to foreign investors, is in particularly glaring contrast to today's practice. With China joining the World Trade Organisation (WTO) on December 11th, 2001, China even appears to have supposedly unconditionally agreed to

GDP per capita	Double GDP per capita from 2000-2010 through structural reforms and improvements in efficiency.
Energy use efficiency	Reduce energy consumption per unit GDP by 20% from the level at the end of the 10th Five-Year-Plan by substantially improving energy use efficiency.
Corporate Competitiveness	Nurture excellent companies that are relatively competitive in the global market based on their own brands and intellectual property.
Reform and Opening up	Further promote the ongoing transition to a market economy and opening-up policy. Seek to realize an approximate balance in the balance of payments.
Social Policy	Popularize nine-year compulsory education. Maintain the increase in employment opportunities in urban areas and realize a relatively well-established social security system, thereby continuing to reduce the size of the poor population.
Quality of Life	Raise the income level and improve the quality of life on all fronts for both urban and rural dwellers, and stabilize prices. Substantially improve the situation with respect to housing, transportation, education, culture, hygiene and the environment.
Democracy and the rule of Law	Seek new development in creating democratic laws and regulations as well as in building a moral and spiritual culture. Seek to take new steps toward the construction of a harmonised society by improving public safety and safety at the working place.

Table: Major Goals of The 11th Five Year-plan

Source: Kwan, Chi Hung (2005): The 11th Five-Year Plan as a Steppingstone to Realizing an "All-Round Well-Off Society", in: RIETI, 24 October 2005. Online. Available http://www.rieti.go.jp/en/china/05102401.htm 18 November 2005).

gradually opening up key industries such as the banking sector to foreign capital. The question then arises as to whether the desired global integration was not purchased at the price of loss of independence. But China at present holds all the aces; with the continuing boom, China has been able to stabilise its economic power and to expand into various fields: the People's Republic is the top address for foreign investors for direct investment, and ranks in first place (Luxembourg is excluded in this case) with more than U.S. $ 155 billion for 2004 alone (contracted; more than U.S. $ 60 billion realised). Thus, in terms of the attraction and scale of direct investment, China is very different in comparison to other countries; particularly compared to other developing countries. Considering the general dependence on foreign countries, this is surely an indicator which should not be underestimated.

On the macro level, the People's Republic otherwise extends its global scope: worldwide, China's currency reserves lie in second place behind Japan. It recorded an increase of 34 per cent in 2005 and amounts to U.S. $ 819.9 billion, a record value which would enable China to settle all its foreign debts at one blow and in addition be able to finance its imports for another ten months. It is assumed that China's currency reserves will even overtake those of Japan during 2006. After years of refusing to do so, China devalued the Chinese Yuan (RMB) in relation to the U.S. Dollar in July 2005 by a rather symbolic amount and at the same time the structure of the currencies held by China was changed in favour of greater proportions of Euros and the British Pound Sterling. Estimates assume that China is at the moment holding about three quarters of its foreign currency reserves in Dollars. After their unofficial circulation, possible plans of the State Administration for Foreign Exchange (Safe) to carry out a further shift to the disadvantage of the Dollar in the next months have led to nervous reactions of reassurance, primarily in the American financial press. These reactions imply that although such measures would at best have only marginal consequences for the U.S. economy, the danger would lie in other countries following the example of China, which, they hope, is a purely hypothetical scenario. Interestingly enough, for a long time, Chinese foreign trade experts and scientists in particular have already discussed the problem of the currency reserves in relation to the level of direct investment and the trade balance surplus towards the US. A balanced account of payments is a current objective of the reform and openness policy. In 2005, China's external trade volume increased by 23.2 per cent in total compared to the previous year, and reached the value of U.S. $ 1.400 billion. Exports increased by 28.4 per cent to U.S. $ 762 Billion, and imports are estimated to be U.S. $ 660.12 billion.

At the micro-economic level, the aim is to promote competitive businesses and the creation of "global players of Chinese Origin". These are encouraged to establish brands of their own and especially to play a pioneering role in IT and the consumer goods industry. Lenovo/Legend, Haier or TCL can be named as well-known businesses. These new competitors have already been watched closely by foreign businesses operating in China over the last few years, but this development has incre-

asingly been noticed (in the West) in 2004-2005, for example, when Lenovo bought IBM's PC division or when the Chinese CNOOC made a much discussed takeover bid for Unocal (which failed because of political resistance by U.S. Congress). All these developments can be seen as strategically linked to the policy of the last ten years of structural adjustment of industry. Internally, this meant the restructuring of state-owned businesses; in the industry, the expansion of the service sector, as well as the development of marketable products in the sectors of information and communications technologies or high-tech consumer goods. Additionally, profound changes are likely to occur due to new/changed ownership structures (i.e. ranging from private enterprises to WFOE -Wholly Foreign Owned Enterprises). Even businesses which have been protected until now, such as the banking sector, will be affected, whereby the WTO agreements will gradually allow foreign capital.

At the same time, China tries to control the investment flows regionally in order to counteract the regional imbalance between the coasts/central areas and the industrially less developed border regions. The main regions are the (North-) West and the industrial North-East of China which has been affected by the restructuring of state-owned enterprises. As a part of the so-called "go west initiative", attempts are being made to guide foreign investments towards these regions. Another trend is to promote the growth of research and development centres which will support businesses.

At first, the question arose concerning the programmatic direction of the People's Republic China over the next five years. As the data indicates, the Chinese development strategy has to be principally seen as a re-capitalisation strategy. Apart from the discussion of all the indicators to increasing economic power, the interaction between the structural character of this integration into the world economy and maintaining the long-term economic independence of the local players (e.g. in key national economic sectors such as the banking sector) are of central importance. Notably, planning figures are avoided in the explicit programmatic wording of the text of the 11th five-year plan. A mixture of sustainable development and technological modernisation has emerged, with a strong emphasis on understanding that the large scale problems lead to consequences for the internal development in China as well as globally. The greatest challenge for China is and remains balancing the adjustment process and safeguarding the living conditions of the Chinese population.

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1.7 Resolution Adopted at the 11th Annual Regional Labour Symposium on "More Trade – Less Jobs"

We, the representatives of the trade union fraternity from Southern Africa (from Angola, Botswana, Lesotho, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe) under the auspices of the Southern African Trade Union Coordination Council (SATUCC), joined by representatives of ICFTU-AFRO, ITGLWF-Africa, UNI-Africa, IUF-Africa and SEATINI;

CONCERNED about the levels of poverty, unemployment and social exclusion in Africa; the lack of access to education and training, health, proneness to diseases and mainly HIV/AIDS, tuberculosis, malaria and other related infectious diseases; protracted conflicts in some countries; the risk of not attaining the Millennium Development Goals (MDGs); the lack of social protection which affects particularly women, youth, persons with disabilities, the aged and children, and the exposure to poor occupational health and safety conditions of the majority of workers, particularly in the informal economy;

ALSO CONCERNED that massive unemployment has been effected due to economic liberalization, retrenchments, and company closures in a number of countries has led to high dependency ratios;

AND that the trade union movement is under attack from governments, multinational corporations, and from institutions promoting a neo-liberal agenda, leading to informalization of our economies and falling membership of trade unions;

FURTHER CONCERNED about the unregulated globalization that is leading to increasing inequalities, the erosion of workers' rights, jobless growth, increasing numbers of "working poor" particularly in the informal economy, privatizations, reduced role of the state, devaluations; removal of subsidies, cost sharing in health and education; and deregulation of labour markets;

AWARE that the current phase of globalization is anti-worker and anti-poor, particularly against those in Southern Africa;

ALSO AWARE that the current trade regime works to the disadvantage of the poor developing countries, particularly those in Southern Africa, and economic liberalization has not been accompanied by broadly shared economic growth and social development;

REAFFIRM our commitment to the Philadelphia Declaration, in particular, that: i) Labour is not a commodity; ii) Freedom of expression and of association is essential to sustained progress; iii) Poverty anywhere constitutes a danger to prosperity everywhere; and iv) The war against want requires to be carried on with unrelenting vigour within each nation;

SUPPORT the recommendations of the Report of the World Commission on the Social Dimension of Globalization, A Fair Globalization: Creating Opportunities for All, and the ILO's Decent Work Agenda and its role in poverty

alleviation and the global economy through the four strategic objectives – fundamental principles and rights at work; employment; social protection; and social dialogue;

REKINDLE our commitment in the pursuit of the principles and objectives of the African Charter for Human and Peoples Rights;

COGNISANT of the fact that trade union action must not be exclusively aimed at the workers in companies, institutions and sectors, but also at improving the position of the informal-sector workers, the unemployed, poor migrants, women, youths, the disabled, older people without social protection, the excluded in general;

NOTE with concern that increased trade liberalization including increased exports, a number of countries are experiencing food insecurity, de-industralization, falling employment levels and low export revenues;

ALSO NOTE that preferential trade access by developing African countries is being threatened by the agreement on agriculture and NAMA;

FURTHER NOTE that the deteriorating working conditions, casualization of employment, and pressure on wages in a number of countries as a result of laxity in enforcement of international labour standards and national legislation, among other things;

ALSO NOTE that a number of countries have put in place export processing zones in which poor working conditions – low wages, long working hours, denial of workers' right to freedom of association and collective bargaining, forced overtime – are prevalent; FURTHER NOTE with concern that NAMA negotiations have the potential to i) negatively affect production and employment in a number of non-agricultural sectors; ii) lead to loss of jobs; iii) decrease policy space for governments; iv) lead to loss of government revenues from tariffs; and v) increased preference erosion;

AWARE that a poor person usually has only their physical and intellectual assets to offer and hence employment and decent work are the best way of fighting poverty;

ALSO AWARE that Africa's ability to fight poverty, unemployment and inequalities is being undermined by the unfair and unjust trade patterns;

DISMAYED by certain WTO rules that pose threats to public services posed by the General Agreement on Trade in Services (GATS) and reaffirms that vital public services – notably education, health, water, public transport and other essential public utilities – must be excluded from negotiations on trade liberalization under its auspices, with governments retaining the right to regulate and protect in the public interest;

PARTICULARLY AMAZED by the fact that life saving drugs (for diseases like HIV/AIDS, TB and malaria) cannot be accessed by the poor due to developed countries' insistence the need to safeguard « intellectual property rights » in the implementation of TRIPS;

DO HEREBY RESOLVE as follows:

1) African countries should put the creation of jobs and decent work at the center of their trade policies and development;

2) The Hong Kong Agenda should reaffirm the unfulfilled promises of the Doha Development Round that contains provisions on development and the creation of decent work for all;

3) Call on our governments to avoid a race to the bottom, whereby they are compelled to compete against one another, and in the process lead to lowering of labour standards, in order to attract foreign direct investments;

4) Call on our governments within the SADC framework to consult and involve trade unions in trade negotiations and particularly in the delegations to the forthcoming WTO Ministerial Conference in Hong Kong;

5) Developing countries should not be pressured into binding their tariffs as well as lower their tariffs (under NAMA). In this way our countries would be able to use industrial policies for development given the policy space, and would not lose trade revenues from tariffs;

6) With regard to Mode IV (temporary cross border movement of natural persons), support migration that are orderly, incorporate migrant workers' rights, encourage full integration and prevent all forms of discrimination;

7) On agriculture, we call on developed countries to eliminate all forms of tariff and non-tariff barriers to products from the South, and that the Agreement on Agriculture should ensure the respect of agricultural workers, and enhance food security for all;

8) On services, in order to safeguard vital public services from further liberalization and privatization, public services should be excluded from further negotiations in Hong Kong and beyond;

9) We call on the 6th Ministerial Conference of the WTO to take action to propose a joint Ministries of Labour and Trade Ministers' Meeting, with full participation of the trade unions, employers and the ILO;

10) We call for more transparency and democracy in the international trading agreements, including decision-making processes at the WTO, and accessibility of the WTO to trade unions and representatives of other democratic organizations.

Finally, we would like to thank the FES, SATUCC and LaRRI for the financial and technical support provided to the Symposium.

adopted in Windhoek (Namibia),
December 7th 2005.

II Financial Markets: Risks and Effects of Liberalization

2.1 The Consolidation of Global Banking Industry

The global banking industry has undergone rapid consolidation and restructuring since the 1990s. Mergers and acquisitions (M&As), privatization of state-owned banks, removal of restrictions on the entry of foreign banks and deregulation of banking industry are part of this process. In order to enhance financial competition, regulatory measures such as interest rate ceilings and credit controls have been removed. Apart from domestic pressures to liberalize the banking industry, several regional and international agreements have also given impetus to market-driven consolidation of the global banking industry. For instance, removal of the restrictions on the entry of foreign banks is an integral component of the WTO and NAFTA as well as a precondition of membership of the OECD and EU. In addition, several banking crises during the 1990s have also hastened the process. In Central and Eastern Europe (CEE) and Latin America, the domestic banking system has been rapidly transformed largely due to privatization of state-owned banks. According to the proponents of financial liberalization, increased consolidation and competition in the banking industry improves the efficiency of domestic banks and results in greater access to credit. The market driven consolidation of the global banking industry raises a number of important policy issues, some of which are discussed here.

As more and more developing countries are easing restrictions on the entry of foreign banks, the cross border M&A mania in the global banking industry has intensified. In the fierce competitive environment created by the mergers and acquisitions, big banks are swallowing each other to dominate global banking industry. Thanks to M&As, Citigroup became the largest bank in the world with assets of $1.09 trillion in 2002. Despite suffering huge losses for the past several years, Japanese banks have again bounced back to top global positions that they enjoyed in the 1980s, largely on account of M&As. Mizuho Group of Japan (a holding company formed by merger of three large banks — Fuji, Dai-Ichi Kangyo and Industrial Bank of Japan) holds the second position in the world with assets of $1.08 trillion in 2002.

The impact of allowing foreign banks to acquire stakes in the domestic banking market has been more dramatic in CEE region where most domestic banks have already become or are likely to become subsidiaries of large foreign banks. In the wake of massive privatization programs in these countries, foreign banks have rapidly taken control over the domestic banking industry. In the nine CEE states, foreign bank holdings have risen from 20 per cent of assets in 1997 to over 60 per cent by the end of 2001. In the Baltic states of Estonia, Latvia and Lithuania, foreign banks (particularly from the Scandinavian countries) captured the domestic banking market within a short span of time. In Estonia, for instance, foreign-owned banks increased their market share from 2.3 per cent in

1997 to over 97 per cent in 2000. The top three banks of Estonia — Hansapank, Uhipank and Optiva — are all foreign-owned. In Latvia, Poland and Slovak Republic, foreign-owned banks accounted for more than 65 per cent of total market shares in 2000 (see Table 1.1). In terms of assets, over 90 per cent of Czech Republic banking sector has come under the control of foreign banks[1]. Out of a total of 41 banks in Romania, 31 were majority or fully foreign-owned in 2001.

In Latin America, similar trends are also visible. For instance, all three top banks of Mexico (Bancomer, Serfin and Banamex) have come under the control of foreign banks through M&A deals. With the takeover of Bital by a transnational bank, HSBC, the total foreign ownership in Mexican banking industry has touched 90 per cent of total banking assets. Since foreign banks had no presence in the domestic markets in the 1990, such a rapid takeover of Mexican banking industry by foreign banks has been accomplished within a few years, particularly after the 1994 currency crisis. In Brazil, foreign banks controlled 70 of country's 181 banking institutions at the end of 2001. In Peru, Venezuela and Chile, foreign banks have also acquired substantial stakes in the domestic banking markets.

In Asia, rapid consolidation of the banking industry has taken place in the aftermath of the Southeast Asian financial crisis. In several crisis-hit Asian economies, bank mergers have been carried out to make them financially viable and large enough to compete with foreign banks in the domestic markets. In Malaysia, for instance, Danamodal, a specialized institution was set up to facilitate consolidation in the banking system. By urging banks to merge voluntarily, 54 financial institutions were merged into 10 'anchor' banks in Malaysia in 1999. In South Korea, Thailand and Indonesia, similar mergers have taken place after injecting large amounts of public funds in the banking system. The other important

Tabel 1.1: Market shares of foreign Banks* in CEE countries (in percentage)

Country	1996	1997	1998	1999	2000
Estonia	2,6	2,3	90,2	89,8	97,4
Latvia	k.A.	k.A.	k.A.	k.A.	69,8
Poland	16,0	18,6	27,9	65,5	65,7
Slowakia	13,6	26,0	25,9	31,1	65,4
Hungary	58,0	55,4	59,4	53,9	61,9
Lithuania	n.s.	n.s.	n.s.	n.s.	59,9

*Banks that are in foreign possession of at least 50 percent
n.s.= not specified
Source: Bank Austria Kreditanstalt, Wirtschaftsabteilung

[1] Colin Jones (2001): „Foreign Banks Move In", The Banker, September 2001, p. 130

consequence of the Southeast Asian financial crisis has been changes in the ownership of banks in the region. In almost every crisis-hit Asian country, a number of banks were nationalized (and subsequently reverted to private ownership) and restrictions were removed on the ownership of foreign banks in the domestic markets. In the case of Indonesia, South Korea and Thailand, the foreign equity participation in local banks has been raised to 100 per cent. With the result, a dramatic increase in the presence of foreign banks in these countries since the mid-1990s has taken place.

Due to rapid consolidation, the total number of banks has significantly declined throughout the world. In the case of US, the M&A activity in the banking sector received a major boost when regulations on interstate banking were lifted. With the result, the total number of banks has decreased drastically from 18000 to less than 8000. In Estonia, the total number of banks has reduced from 42 in 1992 to just 7 in 2002. One of the negative consequences of M&A activity in the banking industry is the massive layoff of workers. On an average, between 10 and 20 per cent of workforce has been laid off in the wake of M&A deals. In Europe alone, M&A deals led to nearly 300000 job losses in the financial sector in the 1990s. The other consequence is the sharp increase in the market share of the top banks. According to The Banker, the assets of top 25 global banks accounted for $14.6 trillion (37 per cent) out of the top 1000 holding $39 trillion in 2001[2]. In the CEE states too, the market share of the top banks has increased. The top five banks in Estonia and Lithuania account for more than 90 per cent of total bank assets. In the Czech and Slovak Republics, the top five banks command more than 60 per cent of total assets, while in Hungary and Poland the ratio is more than 50 per cent. It must be noted here that despite owning bulk of banking assets in the CEE and other regions, transnational banks have not become truly ‘global.’ The geographical spread of top 1000 banks has remained stable over the recent years. The triad — European Union, Japan and the US — accounts for nearly 60 per cent of top 1000 global banks[3]. In terms of assets, 78 per cent of the top 1000 banks belong to the triad[3]. Further, most of the top global banks are rooted in their domestic markets[4]. Even Citigroup, considered to be a truly global bank having presence in over 100 countries, holds bulk of its assets in the US. With only 34 per cent of assets held outside the US, Citigroup is essentially a domestic US bank.

The Market Driven Global Banking versus Imperatives of Development

The rapid market driven consolidation in the global banking industry has important implications for the allocation of credit, which in turn affects economic growth. Rampant competition in the domestic financial sector due to entry of foreign banks could enhance the risks. Fearing erosion of the franchise value because of increased competition, banks and financial institutions have a natural tendency to lend more money to risky projects. Fierce competition in the banking sector has given rise to a situation where banks are increasingly

[2] Stephen Timewell, “Top 1000 World Banks,” The Banker, July 2002, p. 172
[3] Ibid., p. 203
[4] Ibid., p. 200

resorting to speculative and risky activities (e.g., foreign exchange speculation) to reap higher profits. A study by Andrew Sheng of the World Bank found that increased competition was responsible for bank failures in Chile, Argentina, Spain and Kenya[5]. Under a liberalized financial regime, the failure of a large bank can lead to collapse of other banks — which may be otherwise fundamentally sound — that in turn, could trigger a larger systemic risk. This risk in the banking industry is much greater than any other markets precisely due to inter-bank payment and settlement system. International banks are exposed to large amounts of cross border settlement risk because settlement of transactions takes place in different time zones. Since two national payment systems (for instance, of Japan and Switzerland) are never open at the same time, it poses the risk in the sense that if the first counterparty has delivered one side of the transaction, the other counterparty may go bankrupt and fail to honor the contract. This kind of risk is popularly known as 'Herstatt risk.' In June 1974, the Bundesbank closed down Herstatt Bank after business hours when it suffered huge foreign exchange losses. Several banks, which had paid out Deutsche Marks to Herstatt, suffered losses because its closure at this time of the day prevented them from receiving US dollars in return. It has been calculated that losses in the global currency markets due to settlement system amount to $300 million a year. Moreover, the entry of foreign banks in the domestic market does not necessarily lead to better access to credit. Analysts have reported that in several countries the amount of real credit has actually declined in the wake of increased presence of foreign banks. Based on the study of two of the earliest transition economies, Hungary and Poland, Christian Weller established that there is a link between greater international financial competition and less real credit[6]. Christian found that while the number of financial intermediaries, particularly foreign-owned ones, grew in both economies, the amounts of real loans declined[7]. The decrease in total credit was more pronounced in Hungry. While real loans decreased by 5.2 per cent in Poland from 1990 to 1995, and by 47.5 per cent in Hungary between 1989 and 1994, the number of multinational banks increased from 0 to 14 in Poland and from 9 to 20 in Hungary[8]. [7]These economies experienced considerable deterioration in their growth rates during this period.

While the entry of foreign banks is generally considered beneficial as they offer better quality services and sophisticated products and have 'deep pockets' to support losses, they can put domestic banks — whose long-term interests are aligned with the local economy — at a competitive disadvantage. It has been observed in some instances that rapid entry of foreign banks could stall the development of the local banking sector, as witnessed in Australia in the 1980s. By neglecting small and medium-sized enterprises (SMEs), foreign banks can even jeopardize the prospects of economic growth. If re-

5 Andrew Sheng (1996), Bank Restructuring: Lessons from the 1980s, Worldbank, Washington, 1996
6 Christian Weller (1999), The Connection Between More Multinational Banks and Less Real Credit in Transaction Economies
7 Ibid., p. 8
8 Ibid., p. 2

cent experiences are any guide, foreign banks have a tendency to serve the needs of less risky segments such as transnational corporations and 'cherry-picked' host country corporations. Consequently, domestic banks are left with less creditworthy segments of the banking market such as farmers, SMEs and traders. Its consequences for the real economy could be disastrous not only for the developing economies but also developed economies like the US, Germany and Japan where small and medium-sized enterprises constitute the backbone of manufacturing and services. Since bank credit is a vital input for investment and growth, the liberalization of banking sector could also negatively affect the growth prospects, particularly of those countries which have bank-based financial systems. Increased competition could lead to cost cutting measures such as closure of bank branches, particularly in the rural and remote areas. In this context, the experience of India is worth illustrating.

India nationalized the banking sector in 1969 with an objective to transform class banking into mass banking. Banks were given targets for lending in priority sectors (such as agriculture) and were directed to offer banking services to the poor and weaker sections of the society who were neglected by the private banks. Under the nationalization drive, bank branches increased exponentially, from 8200 to over 62000. Most of the new bank branches were opened in the rural areas, which where not provided with banks. This policy regime not only helped in increasing household savings but also provided substantial investments in agriculture, small and medium-sized enterprises and the informal sector. Notwithstanding widespread corruption and red-tapism, the nationalized banks significantly contributed towards the expansion of the country's agricultural and industrial base and regional development. Even the proponents of financial liberalization cannot deny the fact that the financial system was subservient to the needs of the real economy under the nationalized regime.

Since the priorities of the banks in India are now geared towards earning profits, substantial economic and social gains achieved during the nationalization period are fading. Since the 1990s, when the authorities initiated banking sector liberalization in India, a large number of bank branches, particularly in the rural areas, have been closed down. There is ample evidence to show that rural and agricultural credit and lending to small-scale industries and informal sector have suffered negatively under the liberalized regime. The potential costs to the liberalized regime such as reduced saving and investment, particularly in rural areas, cannot be underestimated. Even the new thrust on microfinance programs in the rural areas of the country is unlikely to expand institutional credit if the current policy of large-scale closures of bank branches is not reversed.

The consequences of the domestic banking reforms on growth could also be disastrous for the developed economies. In Germany, for instance, 540 Sparkassen (saving banks) along with 12 Landesbanken (state banks) are the main financiers of the Mittelstand (small and medium-sized enterprises), which constitutes over 95 per cent of German companies and employs nearly

70 per cent of the country's workforce. However, under the directives of EU, the Sparkassen would lose state guarantees in 2005. The removal of state guarantees would not only lead to closure of several Sparkassen but also jeopardize growth and employment prospects, as Mittelstand would encounter serious credit crunch. South Korea and Japan enjoyed rapid economic growth and financial stability under a regime of tight credit and banking controls. In the case of South Korea, the authorities promoted their long-term industrial policy of export oriented industries by targeting financial resources towards industrial projects and providing credits at preferential rates of interest. The policy of 'strategic planning' in Japan was supported by credit controls which ensured that sufficient credit was available for priority areas. However, when South Korea and Japan introduced reforms in the banking sectors, not only their economic performance deteriorated but their financial systems also became much more fragile.

The consolidation in the global banking industry would get a major fillip with the implementation of New Basel Capital Accord (Basel II) in 2006. The Basel II replaces the 1988 Basel Accord which was initially an agreement between the G-10 countries but was later adopted by over 100 countries. The 1988 Accord required banks to maintain 8 per cent of their risk-adjusted assets as capital. The Basel II is ostensibly meant to encourage banks to align their capital more closely with underlying risk. However, the Basel II Accord could also have undesirable macroeconomic consequences and may prove counterproductive under present circumstances. Since risk-based capital requirements would encourage pro-cyclical lending behavior, it can give rise to negative macroeconomic consequences in the form of increased amplitude of business cycles. Besides, the Basel II would strengthen the competitive advantage of big transnational banks with lower levels of regulatory capital requirements. It has been estimated that big transnational banks are likely to save more than 20 per cent of regulatory capital which could provide greater impetus to the M&A activity on a global scale. The local and smaller banks in both the developed and the developing world would be the worst sufferers under Basel II Accord as they would be saddled with more stringent regulatory capital requirements.

China's Banking Sector and the WTO Regime

Historically, China's financial system, essentially a bank-based system, was structured to serve the needs of the planned economy. Even when liberalization program was initiated in 1978, China took special measures to protect the financial sector. The Chinese authorities put severe restrictions on the entry and operations of both domestic and foreign banks. The public sector banks in China have played a central role in mobilizing savings from public and making it available to state-owned enterprises (SOEs) and others. Although recently, the Chinese authorities have granted operational autonomy to the banks, the bulk of China's banking system is still owned by the government. The top four state-owned banks account for nearly 80 per cent of total assets.

Till now, the operations of foreign banks have been very limited with stringent geographical and business restrictions placed on them. Foreign banks in China were confined to foreign currency business, that too with foreign corporations. The earlier strategy of limited financial liberalization has been turned upside down by WTO dictated timetables for rapid liberalization in the banking, securities and insurance sectors. Several major concessions have been granted by China to foreign banks under the WTO deal. Foreign banks have been allowed to conduct all types of foreign exchange transactions with foreign clients immediately upon accession to the WTO in 2001 while there would be no geographical and client restrictions on foreign banks to operate in China by the year 2006. This would give a major boost to the foreign banks as they have been waiting to capture the banking markets of China, which have almost a trillion dollars in personal savings. In particular, foreign banks are going to capture markets in those regions (e.g., coastal regions and cities) where bulk of banking business is concentrated. Given the fact that foreign banks have considerable international exposure and can launch new products (e.g., ATM, credit card, etc) besides providing better services, they are in an advantageous position to capture China's banking businesses. Foreign banks are also going to dominate the highly lucrative trade-related businesses.

The opening up of the banking sector would pose no immediate threat to the big four state-owned banks because they have vast branch networks in both urban and rural areas. But the worst sufferers of opening up would be small and medium-sized commercial banks in China. These banks provide credit to small and medium-sized companies in China who are the engines of economic growth in China. Therefore, it seems likely that less credit would be available to small and medium-sized companies in future which, in turn, would have negative repercussions on the economic growth. Further, by allowing foreign banks to offer banking services to residents, elites may be induced to move their savings from state-owned banks to foreign banks that can offer efficient services and new products. It has been estimated that about 10 to 15 per cent of savings in state banks would move to foreign banks. Given the fact that the survival of many SOEs depends on getting loans from the state banks, such a shift of savings could pose a severe threat to the entire economy. If such a massive shift in banking occurs within a short period, the state banks won't be able to support the SOEs, and as a result many SOEs may go bankrupt.

Undeniably, WTO agreement also offers opportunities for the Chinese banks to compete in the international financial markets. But this is unlikely to happen for two reasons. Firstly, Chinese banks do not have any exposure to international markets. Secondly, the real challenge for the Chinese banks would be to retain hold on their domestic markets, rather than looking for opportunities in international markets. Under liberalized financial system, the Chinese authorities may not be able to sustain economic growth because finance capital makes it difficult for countries to pursue independent policy making. Since the Chinese authorities are determined to go ahead with ban-

king sector liberalization program, it remains to be seen how China would adjust to one-size-fits-all strategy.

Kavaljit Singh

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2.2 GATS negotiations in financial services: The EU requests and their implications for developing countries

In the process of the GATS negotiations, the EU has been making requests to many developing countries to liberalise its financial services sectors. Liberalisation under GATS means more than market opening for services by foreign financial firms (banks, insurance companies, pension fund management, mutual funds, etc.). GATS is mainly about giving foreign service providers, including the financial industry, more freedom to invest so that foreign services can be provided. This means that GATS is more than trade in financial services and that GATS is also an investment agreement!

The EU requests described below do not mean that developing countries will make immediate market opening commitments. Developing countries have the right to ignore any of these requests. The following article however, gives an insight in the kind of requests made by the EU and what the consequences might be for developing countries who positively respond to those requests.

GATS negotiation process is very much geared towards market opening of services through a process of "requests" and "offers". The EU always mentions financial services as one of its (five) key sectors in which it wants to see liberalisation under GATS, for instance in the EU's renewed requests in order to have "improved offers" by May 2005. The additional negotiation methods sought by the EC during 2005 has resulted in new "plurilateral" requests, agreed in December 2005 at the Hong Kong Ministerial Conference, including on financial services which were submitted on on 28th February 2006.

The first GATS requests made by the EU in 2002 included the requests to 94 countries to open up their financial industry. Of these countries, 20 were least developed countries and 30 low income countries. The EU requests to developing countries made a difference between the more developed developing countries and the least developed countries (LLDCs, called 'vulnerable economies'). The revised requests made by the EU in January 2005 remained largely unchanged regarding financial services.

Note that the EC has also been negotiating financial services liberalisation in regional trade agreements such as with Chile and Mexico (10 pages!), and currently in negotiations with Mercosur.

When asking for liberalisation of the financial industry of a country, the EU is doing it in the following ways.

1. Swift liberalisation

The EU requests have aimed at achieving very quick and broad liberalisation in the financial industry of many countries, because the EU financial industry was successfully lobbying the EU negotiators.

* According to the GATS "Understanding on Commitments in Financial Services"

The EU is requesting many "emerging market" countries such as Argentina, Brazil, Chile, China, India, Indonesia, Korea, Malaysia, Mexico, Philippines, South Africa, Uruguay to liberalise in the way as is prescribed in the "Understanding on Commitments in Financial Services" of the GATS agreement.

The Understanding provides a set of full market openings to be applied by WTO members that implement the Understanding[1]. Such broad market opening relates to almost all sectors and all definitions of "trade in financial services" and to many sectors that have not yet been liberalised by many countries e.g. pension fund management, all forms of insurance including social security (e.g. in Chile). Moreover, governments may not introduce new conditions that are more restrictive than those already existing. The Understanding erodes the exemption public financial services have under the rules in the GATS agreement. The most far reaching condition under the Understanding is the requirement that WTO members remove any obstacle to foreign financial services that remains even if all the provisions of the GATS agreement have been respected! Following on, the Understanding provides guarantees that foreign financial service suppliers are permitted to introduce any new financial service.

The wish of the EU for swift liberalisation of financial services by other countries is also reflected in the following leaked EU requests of 2002:

* The EU has made requests to take away measures that limit foreign ownership of banks, insurance companies and certain other sub-sectors in financial services. This request has been made to many countries and means that foreign financial services companies should be able to fully take over the domestic financial industry.

* The EU has made a request to India and the Philippines to eliminate a ceiling of up to 15% (India) or 30% (Philippines) of total assets of the banking system which may be in hands of (totally owned) foreign banks.

* The EU has requested the elimination of the requirement that (Advisory) Boards consist of a percentage of nationals, and not foreigners, e.g. in India and many other countries.

* The EU has requested to remove the limited number of licenses for branches of commercial banks e.g. in Philippines.

* The EU has requested to privatize and liberalize the state monopoly on reinsurance and retrocession services, in Brazil. The EU has also requested access to insurance services in privatisation projects e.g. Philippines.

* Government procurement liberalisation is requested by the EU e.g. to allow foreign financial companies to provide certain financial services to state or municipal agencies, in Brazil and Argentina. However, government procurement liberalisation has been resisted by developing countries in the GATS negotiations because it should only be about "transparency".

[1] See for more explanation chapter 6 of the SOMO Report: M. Vander Stichele, Critical Issues in the Financial Industry, 2005 (update), which can be downloaded at http://www.somo.nl/html/paginas/pdf/Financial_sector_report_05_NL.pdf

The impact of these EU requests can be derived from experience that has shown that as soon as developing country are opening their markets, foreign financial firms often rapidly take over a large part of the domestic financial industry. For instance, the foreign financial industry increased its presence, through acquisitions etc., by 364 % in Latin America in four years (1996-2000). As a consequence, local banks have little chance to survive in poor developing countries although some of them are much better in serving local small companies and poorer clients. The problem is that foreign banks and insurance companies focus on rich clients and rich regions ('cherry picking'): this results in lack of lending to small and medium enterprises, farmers, the poor e.g. Mexico and Argentina. Lack of lending by foreign banks has lead to lack of finances to stimulate the industry and economy of those countries. The focus on the rich clients has stimulated the gap between rich and poor.

Because local banks want to survive the competition from foreign financial services, local banks might take too much risks, which can result in destabilisation of a country's banking system. Also, in order to operate well in new markets, foreign banks attract the best managers from local banks to the foreign banks. The result is that expertise goes from local to foreign banks. Why does the EU argue that more expertise and efficiency will be transferred to local banks by liberalisation of financial services?

2. Trying to get rid of regulatory measures

In the EU requests for market opening in financial services, the EU has been asking many countries to remove a whole list of various governmental measures which are in place in the requested countries because the EU considers them as trade barriers (read: measures that undermine the expansion and profit making of foreign financial firms). The different kind of measures that the EU is requesting to be removed are discussed below.

2.1. Financial stability measures

The following measures which have been put in place by governments to promote the stability of their financial system, and to avoid a financial crisis that has many negative consequences, have been targeted in the EU requests.

Stability measures of Chile:

The EU has requested to eliminate the measure that prior authorisation by the Central Bank is needed before transferring dividends from Chile abroad. The EU sees this as a restriction on payments and financial transfers which is forbidden under Article XI.
The EU requests to eliminate what it sees as a restriction, namely that invested foreign capital can only be remitted abroad after 2 years, in practice 1 year, that is has been invested in Chile. This is called the "Chile tax" because investments that are remitted before 1 or 2 years has to pay a tax.

These requests indicate how the EU is not respecting the policy by a country to avoid a financial crisis. These Chil-

ean measures were effective because Chile was hardly affected by Argentinean crisis and have been praised by the international community of being good examples of measures that are needed for financial stability. The reason why the EU has making these requests to Chile is because the US has been able to more or less negotiate this Chile tax away in its bilateral trade agreement with Chile and the EU wanted the same freedom of capital movement for the European financial industry. In other words, this is not at all negotiating from a development perspective.

<u>* Lessons learned by Asian and other countries in crisis</u>

The EU requests have been targeting the following measures to be removed, even though some of them have been put in place after countries have experienced a financial crisis that was disruptive for their economies and societies. The EU is requesting to:

eliminate a prohibition in Korea for insurance companies to invest more than 15% of their total assets in real estate. Remember, one of causes of the Asian financial crisis was too much and irrational investment in real estate;

“specify” limitations in Korea for lending by credit card members. Note that Korea has been having a major credit card crisis for some time in the beginning of century;

remove the limitation on credits (loans, guarantees) provided by foreign branches to single customers, and take account of capital in the head office of the bank. Remember that during the crisis too high exposure to a few clients was a major problem whereby default in repaying loans by one or a few customers lead to serious problems or bankruptcy of a bank;

eliminate regulations that limit the operations of hedge funds (Investment Trust Management companies), although hedge funds have been identified as one of the investors that can contribute to a financial crisis;

The EU has also requested that foreign banks can get offshore banking licences which is forbidden in India. The EU has requested to Thailand to take away its limitation that foreign banks with an offshore license cannot get access to the Thai market through full branch licence. This contradicts the EU policy against uncontrolled money transfers and money laundering that often happens through offshore banking where there are less stringent monitoring measures and where less taxes need to be paid.

<u>*Capital requirements</u>

The EU wants to take away measures by which governments require money reserves to be located by foreign owned bank branches in the country itself. The EU has been requesting to replace existing measures as follows:

Allow branches to use the parent banks’ capital to meet prudential money reserve requirements, e.g. in India.

Take into account the guarantee extended by the branch’s head office or by another foreign bank for additional lending volume, e.g. in India.

Allow borrower limits to take into account the foreign banks global capital,

e.g. in India.

In other words, the EU made requests that money reserves do not need to sit in countries and that capital of a bank sitting abroad can be used for prudential reserves. However, as the experience of several financial crises in Argentina has shown, there is no guarantee that the parent company/bank will transfer the necessary financial reserves in times of a financial crisis in a country in which it did not hold reserves. The EU is requesting to eliminate these local capital requirements because the international banks, and other financial firms, want to use their capital around the world to make as much profit as possible. This is far from taking concerns of developing countries into account.

* Prudential regulations
The EU has been requesting many countries to remove measures that governments have put in place to ensure the integrity or quality of the financial industry sector and avoid problems of financial instability. Examples of such requests have been made to the following countries: Brazil is requested to eliminate the case by case authorisation for the establishment of all kind of financial institutions.
South Korea is requested to remove restrictions on recruitment and employment of professionals in life insurance, non life insurance and reinsurance.
Mexico is requested to make commitments so that foreign financial companies can trade (for their own account or that of customers) in derivative products; note that derivative products are non-transparent and not so much regulated so that too much wrong assessments made by those buying or selling derivative products can lead to a financial crisis.

The EU wants the elimination of restrictions (on foreign banks) to provide different kind of services ('allfinanz', 'universal banks'). For instance the EU has asked South Korea to remove the rule that financial institutions are prohibited from operating at the same time in different sub-sectors. However, even the US has only since 1999 allowed financial firms to operate in different sub-sectors at the same time, such as banking and insurance. In many Western countries, the supervision of the allfinanz firms is still in evolution because previously, the supervisors of banks, insurance companies and pension funds were separate institutions with too little communication between them. Asking countries to allow allfinanz or universal banks means that these countries first need to put in place costly complex supervisory institutions and the appropriate legislation.

2.2. Economic development undermined

The EU has been asking that countries take away measures that are in place for stimulating economic development and fighting poverty, as follows:

EU has been asking to remove the requirement of mandatory lending to small and medium enterprises (SMEs) e.g in South Korea. However, the experience has shown that foreign banks avoid lending to SMEs, small farmers and the poor in countries like Mexico and Argentina, which has stifled economic development in those countries. The EU considers that special require-

ments by the government for lending to SMEs and agro-business need to be mentioned as exemptions of the commitments made e.g. by the Philippines. This means that such governmental measures are not considered to be exempt of GATS rules nor belonging to the right to regulate.

EU raises questions about the requirement applied to all banks in Malaysia to provide (lending) quotas for low-cost housing. This means that EU considers this as a limitation that should be mentioned in the GATS schedules. Again, these measures to provide poorer families with the financial resources needed for housing are not considered falling under the GATS "right to regulate", but rather as a trade barrier (read: profit making restriction) that must be exempted from the GATS agreement (Art. XVI), and ultimately eliminated.

These EU requests raise a serious problem: Who will decide during the negotiations which regulations are prudential and which ones are not? Will bullying tactics during the negotiations undermine domestic regulation during the negotiations? So far, some developing countries have been reluctant to open up under GATS, or have the Ministry of Finance or Central bank following negotiations e.g. by Chile.

They have also been EU asking for "clarifications" about restrictions and discriminatory measures against foreign banks, e.g. in India and the Philippines. This assumes that local banks have the same behaviour as foreign banks that can move abroad their investments and capital much more easily. The problem is that the GATS rules are designed to take away discrimination between foreign and national banks once a country makes a commitment, mostly through the GATS article XVII obliging a country to give "national treatment" to a foreign supplier of a service sector whose market opening has been committed under the GATS. Consequently, it becomes much harder to support the domestic financial industry, e.g. to allow it to fairly compete against foreign banks.

3. Trade negotiators ignore lessons from financial crises

The EU acknowledges that regulation is necessary but makes little links during the negotiations whether countries to which requests are made to have the necessary regulations in place. The EU mainly argues that opening up financial services increases efficiency but ignores the growing evidence that only the richer segments of society benefit from these improved services.

What is worrying is that Western negotiators brush aside concerns raised by developing countries while the risks of financial instability are not fully analysed or discussed. This undermines the use of GATS exemption clauses by developing countries.

The GATS agreement has three ways by which is increases the risk of financial instability[2]:

risks of financial instability when (developing) countries open up to foreign service providers who have unexpected or risky behaviour

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[2] See for more explanation chapter 6 of the SOMO Report: M. Vander Stichele, Critical Issues in the Financial Industry, 2005 (update)

foreign financial services are often linked to a high level of cross border capital movement which leads to high foreign exchange movements that puts pressure on the exchange rate; this can undermine the value and stability of the national currency
GATS rules can increases the risks of financial instability and financial crisis because they have an impact on government regulation!

Western GATS negotiators ignore the experience of previous financial crisis that liberalization needs to be gradual and well sequenced, underpinned by costly capacity building of financial authorities in developing countries. When the necessary national financial safeguards are not in place, trade negotiations should not push for financial sector liberalisation since the global financial architecture is not reformed and financial firms increase poverty and unsustainable development. EU trade negotiators hardly consult with their Central Banks and those responsible for financial stability in their own countries.

Host countries must spend additional resources for regulatory and supervisory measures to handle changes and risks by new foreign financial firms.

The EU requests should raise a debate about what development perspectives are lacking in the EU negotiation position on financial services. Also, the debate should challenge the EU's position which is fully influenced by the financial sector lobby, and not by civil society. In order to have balanced GATS negotiations that ensure that globalisation becomes more equitable and sustainable, the direction of the negotiations need to be stopped and another approach is needed. So far, EU officials have not been willing to listen to this message.

Myriam Vander Stichele

2.3 Intransparent, Uncontrolled and Crisis Promoting: Trade with Derivatives

Derivatives or financial futures (which are quite similar in their nature) are financial contracts between two parties and concern agreements to be redeemed in the future. Their value depends on the value development of the basic objects underlying them, such as goods, securities, indices or even real events (Latin: derivare = derive). Derivative markets are the fastest growing financial market segment. They serve as infrastructure and function as the driving force for the expansion of worldwide financial means and of financial market deregulation. In other words, they are the products of deregulation, which for their part, drive deregulation (Hafner 2002). Since these derive from other businesses, tradable securities additionally let derivatives blur the boundaries between credits, securities and the foreign exchange market. They therefore contribute to greater interdependence on the financial markets.

By far the largest part of the derivative trade occurs off-market (over-the-counter, OTC), which means that this trade is completely opaque and is not regulated. The most important impulse for this financial innovation (derivatives) was the idea of by-passing state regulations and conditions[1]. But there are additional reasons for the popula rity of derivatives and the permanently new and further development of the basic objects underlying these instruments. Derivatives assist money-laun dering, balance sheet manipulation and tax avoidance, activities described as an "abuse" or "misuse" in the literature. Added to this, the most important motive for dealing in derivatives is seen in the possibility of making enormous profits with relatively low means (leverage effect). This speculative motive can be seen in the exponential growth in trading. More than 95% of the worldwide derivative trade has nothing to do with hedging trading deals (hedging or protecting against risks). Thus the claim that the necessity to hedge is the reason for the rapid increase in the derivative business does not appear to be credible.

Trends in the Derivatives Trade

After a decline in the daily worldwide trade in derivatives and foreign currency in the 1998 to 2001 period, a new increase could again be recorded in the trade from 2001 to 2004 which far exceeded the previous decrease. Meantime, the daily trade in OTC derivatives amounts to more than 2.3 trillion US $ - this mainly covers interest and foreign currency contracts according to a BIS survey - and this corresponds to a 73 per cent increase. In these figures, double counting resulting from buying and selling has already been calculated out and survey gaps (reporting gaps) are not included (BIS, 2005). A definite increase in the worldwide daily foreign currency trading (on and off market) can also be observed. These have also increased from 1.2 US $ billion to almost 1.9 US $ billion after a decline in the 1998 - 2001 period. These numbers

1 The derivative trade has developed from the basic motive for hedging (protection) to an exponential increase in trading (speculation). Originally derivatives were used in the 17th century, primarily in agriculture. For security, farmers and dealers hedged against price collapse and harvest loss risks before harvest time by (tradable) price agreements (the fruits of the field were already sold before the harvest).

which can be found in the previous triennial study of the Bank for International Settlements (BIS, Triennial Central Bank Survey) are based on voluntary reports of the respective countries (if the trading can even be nationally assigned) or of the finance market players involved in the trade. In any case, this is the problem with opaque, off market trading: there aren't any reliable figures, they are always (cautious) estimates. Clear trends can nevertheless be recognized: there is a general and steady growth in derivatives and foreign exchange markets[2] and credit and commodity derivatives especially enjoy increasing popularity. The latter has to do with price fluctuations in the most important commodity markets, and the increase in credit derivatives (among others Credit Default Swaps) has to do with the general trend towards securitization, which has for some years emerged on the financial markets. Only two years ago it was said that the nominal value of credit derivatives for 2004 would rise to more than 5 US $ billion. This forecast was more than exceeded, already in the first six months of 2005 the outstanding amounts for Credit Default Swaps (CDS) stood at more than 10 US $ trillion (BIS, Dec.2005).

Basically, the trade between banks and other financial market players has increased considerably: in turn this can for example be based on the expansion in hedge funds and their dealings, but the activities of asset managers and futures traders have also increased considerably (BIS, March 2005). The highest turnovers are concluded in the interest contracts sector (FRA, Interest Swaps and Options). The outstanding amounts of interest contracts alone amount to 204 US $ trillion of 270 US $ trillion for the whole OTC area (cf. figure 1). The turnovers in interest derivatives themselves have more than doubled in the three year period and have increased to more than 1 US $ trillion (cf. figure 2). The outstanding amounts of foreign currency contracts (Outright Forwards and Currency Swaps, Options) were "only" 31 US $ trillion (BIS: 103). However, the turnovers of foreign currency derivatives at the daily trade are always above the turnovers of interest contracts (only OTC, see Table).

Individual Players

A large part of the global off-market derivative trade is dealt with by financial institutions working in the US market. About two years ago, there were still seven banks responsible for more than 90% of the turnover on this market (cf. Lipke 2003). In the meantime, there are only five banks which dominate more than 95% of this market: these include JPMorgan Chase Bank, Bank of America, Citibank, the Wachovia Bank and HSBC. The remaining almost 5% of the market segment is shared by another 750 banks (OCC 2005). As can be seen with the US example, the off market derivative business is increasingly concentrated in the hands of a few big banks or funds. This inter-bank trade promotes the concentration of finances and opacity. This makes the urgently needed regulation almost impossible.

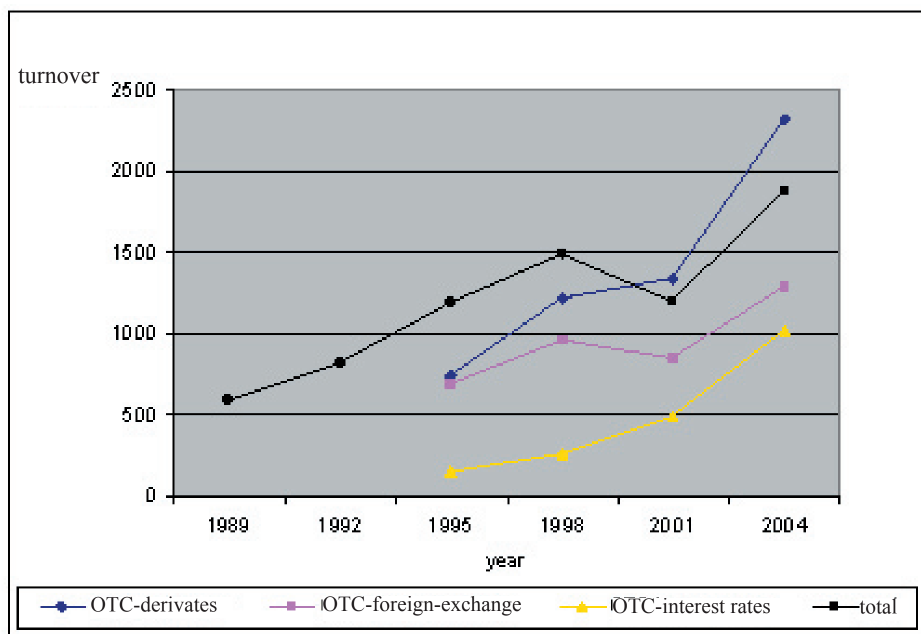
Derivatives as a Stability Risk

Financial derivatives can be used for the purposes of arbitrage, protection against price fluctuation risk, and for

[2] The daily turnover is especially impressive here.

Development in the global, daily foreign currency and OTC derivative trade in billion US $

Year/turnover	1989	1992	1995	1998	2001	2004
OTC-derivatives			739	1224	1342	2317
OTC-foreign-exchange			688	959	853	1292
OTC-interest rates			151	265	489	1025
total	590	820	1190	1490	1200	1880



Source: BIS March 2005, Triennial Central Bank Survey. Foreign exchange and derivative market activity in 2004

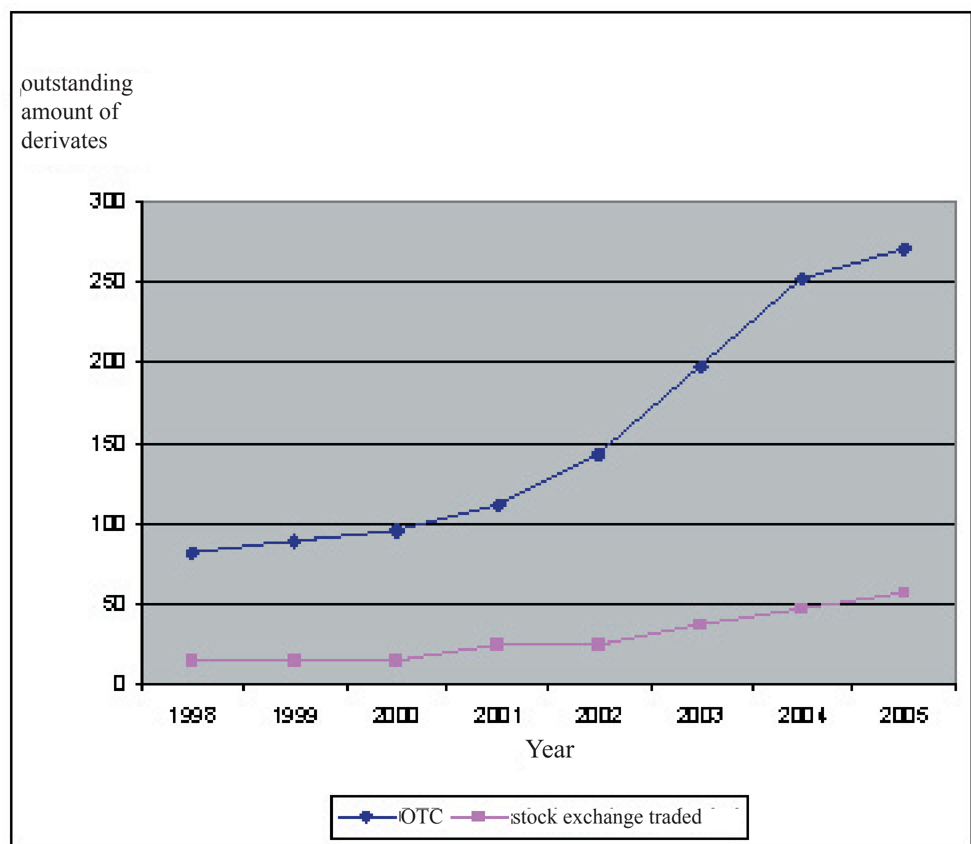
speculation. Speculation is the case if a derivative is purchased when there is no risk to be secured - that is, a risk is bought. Generally, the rapid buying and selling of derivatives has become an end in itself with excessive dynamics, the buyer hopes for short-term profit and the seller for fees and commissions.

On the one hand, leverage provides the possibility of larger profits for laying limited financial resources, but, down on the other hand, derivative transactions result in far larger volumes (of the underlying nominal values!) being moved on the markets than would appear at first sight. The real economic results of these movements are just as difficult to recognize. The stakes in derivatives can lead to interest and foreign currency exchange rate changes, which can have undesirable developments from the viewpoint of the world economy (Filc 1998). Because of the interdependences (de-segmentation) of

Notional outstanding amounts of derivatives 1998-2005 in trillion US-$

Year	1998	1999	2000	2001	2002	2003	2004	2005
OTC	80,3	88,2	99,2	111,2	141,7	197,2	251,8	270,1
stock-exchange-traded	13,9	13,5	14,3	23,8	23,8	36,7	46,6	56,3

Source: BIS, Quarterly Review, Juni 2001-2004, Dec.2005



individual markets (money, credit, foreign exchange markets etc.) there is obviously a multiplier effect from one market to the next. For example, insignificant changes in the futures markets can have far stronger effects on the cash markets (Filc, ibid). Thus, monetary policy control efforts by central banks are undermined by - formally insignificant - interest changes because of possible effects on long-term interest rates.

Since the derivative trade is almost exclusively characterized by speculation, the developments on these markets can also be considered a result of speculation. The increased uncertainty and volatility this creates incites the need for protection with derivative instruments. The derivative trade is a zero-sum game in the sense that risks are indeed shifted, but they are not eliminated and therefore, every gain must be balanced by a loss. Derivatives are products of the so-called developed countries but

due to chain reactions they frequently cause real economic and social damage in developing countries. Frequently, forced overhasty deregulation in the finance market area leaves comparatively fragile financial systems behind, and these are vulnerable to external shocks. Thus economies which are inadequately equipped should not be exposed to this global gambling game. Thus, derivatives contribute considerably to the crisis vulnerability of deregulated financial markets, and evenmore: this trade is a systemic risk.

At the moment, there does not seem to be a trend at the supranational level to proceed with the necessary measures against crises due to unregulated financial markets - the profit prospects for a few market participants are too high. Basically, only one measure will help: states which do not want to be sucked into this system must regulate capital transactions, tax speculative capital flows and close their capital accounts if necessary; this measure could definitely be implemented unilaterally.

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2.4 Out of Control - Hedge Fund Activities

"Hedge funds are the black holes of the international financial system"
Bafin president Jochen Sanio, May 19th, 2005

Hedge funds are among the most notorious players on the financial markets. Their business is speculation, i.e. they bet on the market movements of shares, raw materials, bonds as well as derivatives (finance instruments derived from these). The name is deduced from the English ("to hedge = to protect") and means that their business partly consists in protecting other players on the financial markets against the risk of price collapses in the securities markets or exchange rate fluctuations. But hedge funds are anything but secure, because in contrast to traditional investments in share funds or property funds, they are not covered by investment regulations and their activities are scarcely supervised.

This, at the same time provides the attractiveness of hedge funds: they promise an above average return since they take high risks and engage in deals that are forbidden to other financial market players. The promise may or may not be kept.

It should be clear that the risk with hedge funds increases to the extent where "simple investors" also invest their money in these funds - a phenomenon that is only too well known from the last stock exchange boom and crash. Thus, the stock exchange crisis of 2000 was a bitter lesson for many small investors who were also tempted by advertising to purchase Telekom, Infineon and other shares amounting to a total of 439 billion euro. If these private investors still held these shares at the end of 2002, their value would have shrunk to only 166 billion euro - mainly caused by the enormous decreases in share prices (Die Bank, 8/ 2003).

Ironically, the current boom in hedge funds was partially caused by the dissatisfaction of numerous investors with share price losses - after all, hedge funds promised high yields independent of stock market developments (FAZ, 31.10.05). For example, unlike traditional investment funds, short sales are permitted, whereby high profits can be achieved even when share prices are falling. In short selling, company shares are borrowed from an investor and sold on the stock exchange at the current share price. If the share price then falls, as for example happens when sufficient imitators can be found to follow this procedure with the same shares, then these shares can be bought back at a lower share price. The difference remains as profit.

Hedge Fund Assets: Increased Twenty-fold in Twelve Years

It is estimated that the assets managed by hedge funds has doubled to US $ 1.1 trillion since 2000 (FAZ, Jan. 10, 2006). Over a longer time period, the growth turns out to be even more spectacular: hedge funds exhibited an annual increase of 16% in the nineties, compared with 7.5 per cent from 2000 to 2005 (FAZ, Jan.10, 2006). According to information provided by the Federal Reserve, the assets managed by hedge

funds has increased from around US $ 50 billion by about twenty- fold since 1993. The assets will swell to two trillion dollars by 2009 and to six trillion dollars by 2015 if this continues according to the expectations or wishes of the fund managers (FAZ, 31 Oct. 2005). Here, in the opinion of experts in the business, it is primarily Europe which has some kind of "backlog": according to the ECB, "only" 188 billion euros were invested in European hedge funds at the end of 2005 which corresponds to a share of 27.4 per cent of a total volume of 685 billion euros. (ECB 2005, p.6).

Not only is the asset capital deposited in hedge funds increasing rapidly - as "Manager Magazin" reported - but hedge fund managers could enjoy earnings which the head of the Deutsche Bank can only dream of: the 17 most successful hedge fund managers have each gained more than 100 million dollars in 2003. The average income of the top 25 came to US $ 207 million; the number one, George Soros alone, had earnings of 750 million dollars (Grimm, Harald (2004): Hedgefondsmanager. Finanzmagier mit goldenen Händen, [Hedge Fund Manager. Financial magician with golden hands] in: Manager Magazin, August 24th, 2004). It can be assumed that the taxman will scarcely profit from these ballooning assets. After all, almost all hedge funds are set up in tax havens or offshore financial centres; the setting up of the 10,000th hedge fund was recently celebrated in the Cayman Islands (cf. Hedgeweek 12/2005). Dublin, the British Virgin Islands, the Bahamas, Bermuda and the Channel Islands count among the preferred locations for this branch of business besides the Cayman Islands, which alone houses about 70 per cent of all offshore hedge funds.

The Risk Grows with Size

There are about 8000-10,000 hedge funds in existence worldwide, with an average asset value of only US $ 120 million. But to assume from this that hedge funds present no danger to the stability of the international financial system would be a mistake. After all, the 200 largest hedge funds share about three quarters of the market among themselves. Thus, the196 largest funds together manage about US $ 743 billion - this is already an average of US $ 7.8 billion per fund (CNN, September 8th, 2005). Since the majority of the funds active in this branch of business further expand the assets managed by loans, this does indeed constitute a systemic risk which no one can estimate exactly.

It is known that bad speculation by a single hedge fund can be enough to destabilize the world financial system. Thus, the "Long-Term Capital Management" (LTCM) hedge fund incurred such heavy losses through currency speculations in 1998 that it had to be rescued by an injection of capital to the amount of US $ 3.6 billion. LTCM had capital resources of about US $ 5 billion, but at times entered into contracts with securities to the value of more than a trillion (!) dollars (Verdi 2005, p.7). Meanwhile, the largest hedge funds have assets of 12 to 18 billion US $ at their disposal (cf. table), the danger to the stability of the world financial system emanating from hedge funds has probably grown

[1] Von ca. 50 Mrd. US$ 1993 auf ca. 1 Billion US$ 2005. Vgl. Federal Reserve: Remarks by Vice Chairman Roger W. Ferguson, Jr. to the Banco de Mexico International Conference, Mexico City, Mexico, November 15, 2005. URL: http://www.federalreserve.gov/boarddocs/speeches/2005/200511152/default.htm

The Assets of the Largest US-Hedge Funds in US $ Billions

	August 2005	2004
Bridgewater Associates	17,7	12,4
D.E. Shaw	17,1	11,4
Goldman Saschs Asset Management	15,3	11,2
Farallon Capital Management	13,8	12,5
Caxton Associates	12,3	11,9

Source: Absolute Return Magazine, cited by CNN Money.com, September 8th, 2005.

correspondingly.

However, the LTCM case shows that in the end the big banks were responsible for the crisis since they ignored the risks in awarding the LTCM excessive credit in anticipation of above average profits. And it appears that all banks have not learned from the 1998 crisis. The Swiss big bank UBS recently boasted of investing more than US $100 billion in “alternative investments”, which mainly included hedge funds (Hedgeweek, 12/2005).

Growing Pressure - on Managers, Small and Medium- Sized Businesses (SMBs), Tenants, etc.

Hedge fund activities constitute risks not only to global financial market stability. Since hedge funds are increasingly acquiring shares in businesses and property, they are creating growing pressures on managers, employees and tenants. Since the funds are primarily interested in the short term increase in the value of the business, the shareholder value; they take over the business to have the reserves distributed and enforce higher dividends, whereby they do not hesitate to apply such aggressive measures as dismantling companies and liquidating whole areas of business.

It is estimated that at present about 30 hedge funds have gained influence over the strategy of German companies by purchasing larger blocks of shares (Die Zeit, Nr. 20, May 11, 2005). Different strategies are pursued here. So-called “vulture funds” have concentrated especially on bankrupt businesses, by buying debt and then enforcing a radical reconstruction: an example of this is Rinol, a floor manufacturer in Southern Germany, which in the meantime is controlled by Highbridge/ Zwirn, an American investor (F.A.Z., May 2, 2005). However, hedge funds are increasingly turning their attention to even big DAX-quoted businesses; it is suspected that they have large shareholdings in at least 16 out of 30 DAX businesses (FTD, June 13, 2005).

DAX businesses are desirable objects from the finance investor perspective since their share values are on average lower than their US or British public companies due to the different structures of the financial markets (bank-centred financial markets in continental Europe versus stock exchange centred financial markets in the Anglo-Saxon region). However, from the viewpoint of the hedge funds, lower stock exchange capitalisation can be attributed to poor management which

they correspondingly put under pressure. This pressure is then transferred to the employees for short-term profit maximisation in the form of wage cuts, longer working hours, increased psychological stress, threatened and actual job losses. On the other hand, the management generally are involved as share holders, for example, a part of the management income is linked to developments in the share price, and if it is necessary to sell off segments of the company, the revenue from this is paid out to the share holders and thus increases the share price.

Control is Necessary

At least in Germany, hedge fund regulation is increasingly under discussion ever since hedge funds such as TCI and Atticus managed to foil the take-over of the British stock exchange by the German stock exchange in the spring of 2005. But it is more than doubtful that action will follow words. The government did indeed complain loudly about "financial investors" who "fall upon a business like a swarm of locusts" and "show no consideration for the people whose jobs they destroy" (Franz Müntefering in "Bild am Sonntag", May 17, 2005).

But at the same the government also enacted the Investment Modernisation Law which actually made it possible for private investors in Germany to invest in the highly speculative funds from January 2004. Even if it were desirable: a ban on hedge funds does not appear to be on the agenda at present. However, the supervisors of international finance have requested more transparency in hedge fund dealings at a conference in October 2005, where the following suggestions were discussed:

- A ban on lending shares for only a few days in order to manipulate gene ral meetings or share prices;
- A double voting right for shareholderswho have held their shares for at least two years;
- An obligation to report the loaning of shares;
- A duty to disclose current business;
- Disclosure of ownership structures;
- Introduction of a report threshold for the acquisition of substantial shareholdings
- Stock exchange listed businesses;
- Introduction of an obligatory code of conduct;
- Reinforced supervision obligations with regard to risks for investors.

(Verdi 2005, p.11)

All of this will not be sufficient to correct the numerous undesirable developments which are linked to the imbalances in the financial markets. The main causes of these undesirable developments on the financial markets come from the rapidly expanding private fortunes which face the growing accumulation of debt in private and public budgets. More radical steps are necessary to deal with this fundamental problem: higher taxation of profits and asset income with simultaneous relief for those relying on paid employment, a wage policy that corresponds to productivity gains instead of lagging behind those gains, a reversal of privatisation in the pensions sector as well as democratic control of large financial institutions or their transfer to public ownership.

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2.5 Privatizing Pensions: Experiences from Latin America

Introduction

In many countries, thoughts are being made about reforms of the public contribution-financed pension systems which reach far beyond adapting single variables like contribution rates or retirement age. The transition to an individual capitalization, i.e. saving obligatory pension contributions on individual accounts and investing these funds at the capital market is frequently represented as a simple solution for complex problems. However, every country that believes structural pension reforms would lead to a relief of the national budget, a reduction in ancillary wage costs, perhaps even higher pensions and a revival of the finance sector, should study the effects of pension reforms in Latin America first: this region leads the field worldwide concerning privatisation of state pensions and is once again a "laboratory of modernity", an experimentation field for radical political recipes which would not be possible in most countries of the so-called first world.

Since Chile introduced private pension accounts managed by profit-oriented finance enterprises under dictator Pinochet in 1981, nine other Latin American countries have switched from public to private administration, switched from the inter-generation contract to the individual savings account. The Chilean model - obligatory private pension funds plus the guarantee of an additional state pension increase if the savings are not sufficient to avoid poverty - has been implemented differently in the various countries: In Bolivia, Mexico, El Salvador, the Dominican Republic, and Nicaragua, the old state system was replaced completely, as in Chile, whereas Peru and Colombia have two parallel systems, a pay-as-you-go financed state system and a private fully-funded system. Both elements are mixed in Argentina, Uruguay, Costa Rica, and Ecuador. Only a few countries like Brazil, Venezuela and Paraguay have rejected an obligatory pillar based on individual capitalization coverage and opted for reforms of the existing public systems (cf. Crabbe 2005, Mesa-Lago 2004).

Two questions arise analysing the Latin American experiences: What were the motives for this extremely comprehensive privatisation wave? And: Were the promises of the reformers and their consultants fulfilled?

The background of the reforms

A pension system should provide sufficient benefits for the highest proportion possible of pensioners of a country in a sustainable way. Both targets were not fulfilled in most Latin American countries in the past. The state pension insurance usually only included employees of the formal sector and therefore excluded a considerable share of the population. Nevertheless, the financial situation of the pension programmes was devastating due to increasing dependency rates (the ratio of pensioners to contributors), generous allotments to privileged employee groups, and because of common evasion of contributions and tax evasion. Since pensions reforms were unpopular politically, there were some illegal measures, for instance in Argentina in the eighties,

where the pension payments were not adjusted to the high rates of inflation, leading to savings for the state, however, the majority of pensioners fell towards the poverty line (Hujo 2004).

So there were enough reasons for a reform. Standardised and just rules for all those insured as well as a broader coverage, protection from old-age poverty and stable financing were to be attained. Due to the global changes at the beginning of the nineties, many Latin American politicians were optimistic, capital flowed back to the region again after the very difficult years of the lost decade and many markets were booming. The new decade was also characterised by a huge backlog: after years of stagnation due to stabilisation and structural adjustment programmes, there was an aim for economic growth and second generation reforms were to be undertaken. This included settling the deuda social, the social debt, since the interests of the financial creditors had primarily determined the direction of politics in the past.

A well-timed World Bank policy report appeared, which discussed the reform of the global public pension systems and supposedly had found a model that would both solve the pension problem and also boost economic growth (World Bank 1994). The advocated model of three pillars strongly imitated the Chilean pension system. It combined a public basic income (pillar 1) with a private pension fund (pillar 2) and the possibility of increasing the compulsory contributions with voluntary savings (pillar 3). According to the World Bank, the three pillars would promise a distribution of risks, efficiency gains, relief of the national budget, and reduction of ancillary wage costs as well as positive growth effects by establishing a capital stock and expansion of the financial sector. This positive scenario was even more convincing for many Latin American countries since Chile was considered a model after its transition to democracy and due to its economic successes. Moreover, the influence of the global financial markets on political decisions increased since foreign capital was important for economic dynamics. Additionally, market- orientated reforms of social security promised the support of multilateral lenders and a positive echo from private investors. Internal factors also suggested a privatisation of the state systems: the population's confidence in the state had diminished due to several crises. The prospect of purchasing private property in pension contributions appeared to be attractive, and therefore even cuts, such as a higher retirement age, more contribution payment years or a more unfavourable pension formula were accepted (cf. on the political economy of the pension reforms Müller 2003).

Pension privatisation, balance sheets after 25 years

The evaluation of the new pension fund systems in Latin America has been analysed extensively during the last few years. This may be caused by increased interest from industrialised and transition countries in private social security systems (Müller 2003, Holzmann et al. 2004). On the other hand, reform opponents and supporters tried to consult the Argentinean case to prove their arguments. The country was declared the model student of the Washington Consensus in the nineties

and fell into the deepest economic crisis of its history in 2001 when the state announced its insolvency. The private pension system which had been implemented on recommendation of the World Bank in 1994 had in no way contributed to growth or as a consolidation instrument and had not led to a diversification of risks in the pension system. On the contrary, the costs of the reform intensified the Argentinean fiscal crisis and increased public debt. As a result of the national bankruptcy, both welfare benefits were cut and the pension fund assets, which had mainly been invested in public securities, were devalued, (though this was only visible in the market valuation that is not implemented for the majority of assets). Additionally, 80 percent of the pension savings were denominated in US dollar and they lost two thirds of their hard currency value due to a forced conversion to the local currency, the peso (Hujo 2004, Rofmann 2005).

The Argentinean example has clearly shown the problems which arise in the transition of a public pay-as-you-go model to a private fully-funded model. The disadvantages of such a structural reform, however, are not only limited to cases of extreme crises. The costs for the national budget arise for all countries which channel the pension contributions to the financial sector but still remain responsible for the regular pension payments. In most cases, these fiscal transition need to be financed via public bonds that are bought by pension fund societies. In view of the Argentinean disaster, even the World Bank stated that this kind of pseudo funding contained risks (Holzmann et al. 2004, p. 89). Their recommendation, however, to finance the reform costs through the tax system, like in Chile, seems to be illusory for most developing countries.

Pension privatisation, however, is not only expensive for the state, the insured also must pay between 30 and 50 percent of their contribution for administration and insurance costs. These costs are primarily caused by expensive advertising. Additionally, tendencies toward market concentration and the mostly insufficient diversification of the investment portfolio are important points of criticism referring to the private insurance model in Latin America. However, the failure of the new pension systems concerning their social impact is even more drastic: in all countries, the proportion of the population which can expect pension payments is decreasing steadily; there still is no definite solution for the integration of self-employed people from the growing informal sector, and frequently low income-earners and women or families are disadvantaged in a private model if there is no social compensation and redistribution (cf. Mesa-Lago 2004).

The World Bank published a subsequent report entitled “Keeping Promises” (Gill et al. 2004), a decade after its influential Policy Report and still described the path as correct if a few corrections were applied (concerning efficiency, regulation, poverty avoidance, coverage), an incomprehensible conclusion considering the previous developments and future challenges in Latin America. The reforms were indeed successful in overcoming reform barriers and have contributed to a simplification of the social security systems as well as a more appropriate equivalence

of contribution vs. benefits. In the long run, the latter is supposed to reduce the pension deficit and improve fairness in the system since some unjustified privileges were abolished. Whether a transition to a private system was necessary to achieve this goal, however, is doubtful. Except for the argument of overcoming political reform barriers, these results could have also been achieved within the public systems.

Although the argument is slightly weakened, the so-called secondary reform aims, i.e. increase in national saving, promotion of the financial sector and the capital market as well as the positive reaction of the international lenders, were pivotal to the decision to implement a multi-pillar model. Indeed, the private pension fund corporations (e.g. in Argentina 70% of these funds are owned by transnational financial corporations) have earned substantial profits from the secure contributions, whereas risks and costs were primarily financed by the state (Cf. for the Argentinean example Golbert/Lo Vuolo 2005, Hujo 2004).

Katja Hujo

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Chart: The new pension systems in Latin America

	Chile	Peru	Colombia	Argentina	Uruguay	Mexico	Bolivia	El Salvador	Costa Rica	Nicaragua	Ecuador	Dominican Republic
Reform year	1981	1993	1994	1994	1996	1997	1997	1998	2001	2004	2004	2003
Reform type	substitute	parallel	parallel	mixed	mixed	substitute	substitute	substitute	mixed	substitute	mixed	substitute
Degree of privatisation: Share (% of total) of insured private system	98	96	45	80	51	100	100	91	100	no data	no data	no data
Coverage degree:% active contributors private system (2003)	49,1	39,2	47,7	33,5	52,7	40,5	44,5	45,0	74,2	no data	no data	no data
Social security pensions available?	yes	no	no	yes	yes	no	no	no	yes	yes	yes	yes
Membership rate fixed-interest fund (% wage)	10	8	10	7,72	12,27	12,07	10	10	4,25	7,5	8,33	8
Administration and insurance costs (% wage)	2,31	3,73	3,49	3,28	2,68	4,48	2,50	3	(a)	2,5	4,0	2,0

Source: Mesa-Lago 2004, Holzmann et al. 2004
n.d.: no data
(a) administration charges as % of investment yield with upper limit

2.6 The Transformation of the European Pension Systems

Introduction

The European welfare states are in a crisis. Low economic growth and mass unemployment has allowed the costs of social security to rise. At the same time, mobile trans-national capital makes tax evasion easier. Far reaching restructuring and reduction of welfare state payments are the order of the day under the dominating conditions of neo-liberal political concepts. Public pension systems are also strongly affected by the market liberalisation restructuring of the welfare state, and in the end, they carry a large part of the costs of social security. On average the pension payments in the EU of 15 countries corresponded to 12.6% of the GDP in 2002, or was about 47.1% of the total social expenditure (Eurostat 2005: 2 ff)
The different restructuring and reducing measures can be classified according to the extent of the changes. An important form of the reduction in public pension payments is in parametric reforms whereby the claim criteria for obtaining a full pension are made stricter or the level of pension payments are simply reduced, without the structure of the pension system itself being changed. Here, there are various possible measures by which the time for receiving a pension is shifted to a later date, a higher number of contributing years is required to qualify for a full pension or early retirement programmes for those leaving working life earlier are dismantled or the penalties are increased. Additionally the annual adjustment of pensions for cost of living increases has been restructured in most EU countries. Inflation rates have fallen since the eighties because of the price stability oriented monetary and fiscal policies and lower wage settlements, and this has consequently led to losses in pensions. In Great Britain, for example, the basic pension has fallen from 20% to 14% of the average salary in the seventeen years since the transition towards linkage to inflation by the Thatcher government in 1980 (Blackburn in 2002).

The second class of reforms which were carried out in Sweden, Italy and some East European countries such as Poland were directed at structural reforms in which so-called notional defined contribution plans (public pensions with a fictive contribution point of reference) were introduced. Here the level of the future pension to be received depended on the individual contribution payments and their fictive interest payments depends on an adjustment for annual wage increases, inflation, or another criterion. To calculate the pension, the total amount of contributions paid is divided by the life expectancy of the appropriate age group. The central aim of these reforms was to produce a strong financial incentive to remaining longer in paid employment.

Finally, the pension systems were partially privatised in most countries. Here, the central point of the argumentation was for a well-balanced relationship between the three columns of old age security. A report of the World Bank (1994) was used to popularize this viewpoint worldwide. The public, contribution-financed pension provides the first column, and should merely prevent old age poverty. The second

and third column should be covered by capital resources and be the responsibility of the private individual or the employer, whereby the second column is obligatory and the third column is voluntary. The proposals were immediately effective where the international financial institutions such as the World Bank or the IMF acted as consultant, as for example in several Latin American and East European states. But the EU commission and the governments of west European states also took advantage of this three columns rhetoric to legitimize (part-) privatisations of the pension systems.

Privatisation in Europe: The examples Great Britain and Germany

Great Britain is the country with the longest tradition of capital-covered private pensions within Western Europe. This is because the national basic state pension only provides a very low income. During the fifties and sixties, capital covered pensions were particularly provided by collective company-based pension schemes which supplemented the low state pensions for many employees. But the real privatisation and individualisation of the pension system began in the eighties under the Thatcher government. Her central objective was individualizing social risks. Here, the trade unions and the welfare state were to be weakened, since these were, in the eyes of the neoconservatives, the representatives of collectivism and the most important opponents of the Thatcher government. Firstly, the remuneration from the basic state pension was strongly reduced in line with the GDP, as also was especially the second state pension based on income (State Earnings Related pension Scheme (SERPS)) which was only introduced during the late seventies by the Labour government. To compensate for these pension cuts, the government increased state subsidies for private pensions and expanded the principle of contracting out. Contracting out meant that the SERPS system could be left and the social security contributions paid into it would instead be transferred into an employer-operated scheme or into a private pension savings plan. The Thatcher government did not introduced this system, but has extended it alongside company-based pension schemes, as well as private pension systems and contribution-based pension systems where the employee carries the risk. The government incentives and advertising campaigns, as well as those of financial institutions, led to the fact that more than 70% of 20 to 59 year-olds were no longer in the SERPS system in 1997 (Devetzi in 2003: 393).

This privatisation logic was not questioned by the Blair government. The Blair government limited itself to improving the situation of the poorest pensioners with the Minimum Income Guarantee and tried to introduce a private pension scheme with contributions covered by the state, so that people of low to middle income could privately secure their old age. In the green paper “Partnership in Pensions” (Department of Social Security in 1998), the new Labour government formulated the objective of changing the ratio of state to private components of the pension income from 60% to 40% then to a new ration of 40% to 60% by 2050. Germany is among those countries in which a large pension reform during the last years has shifted the emphasis

in favour of the private old age pension. The German conservative corporatist welfare state linked the income entitlement predominantly toward the employment status. The income from the pension system is financed mainly by means of parity social security contributions. The state pension has been income-based and adapted annually to overall wage changes since the state pension reform of 1957, and this has lead to a significantly higher state pension level than in Great Britain. Nevertheless, a policy of social cuts began in the 1980s against the background of lower economic growth rates and higher unemployment. Even though this policy continued for a long time along the path of the old system, nevertheless, a pension reform followed with the red-and-green Federal Government in 2000/2001 that initiated a paradigm change. The central objective of the pension reform was the long-term stabilization of the contribution level to the pension system and was linked to a long-term lowering of the legal pension level coupled with an extended private old age security component. To compensate for the lowering of the net pension level, the private old age pension system was to be assisted by the state. In 2008, when this assistance reaches its highest level, the old age pension system supplement will be subsidised to the extent of Euro12.7 billion (the German Bundestag in 2002: 4).

The European Dimension

Although the pension reforms of the recent years are indeed essentially national political decisions, they must also be placed within the context of European integration, or to be more concrete, within centrally directed, particularly economically motivated integration projects of recent decades. Here, the restrictive fiscal policy which underpins the growth and stability pact and which the euro-zone states in the economic union and monetary union are obliged to follow is important.

The state pension systems are a central cost factor in the public households and thereby a potential danger for the EU policy directed towards monetary stability, as was first emphasised for the first time in 1999 by a study of the EU commission (European Commission in 1999). At the EU summit in Stockholm in 2001 it was decided that the so-called open method of coordination (OMK) which was already applied in European employment policy should be extended to pension policy to prevent budget deficits and to achieve cost reductions for businesses. The objective consists in particular in supervising the reform of national systems for the provision for old age, especially with regard “financial sustainability”.

Those states which lag behind in the reduction and privatisation of their social security systems should be exposed and be put publicly under pressure by means of this new supervision mechanism with the aid of the “soft” instruments consisting of guidelines, best practice and the formulation of benchmarks which have also been applied in the European employment policy. In the end, a connection exists between the EU pension policy and the efforts to create an integrated European financial market, a central objective of the EU Lisbon strategy. Here, a pivotal target of financial market integration is the development of a domestic market for the old age pension system for

the employed. The EU sees the significance of setting up old age pension systems for the employed whereby in pension funds and employee mutual benefit pension funds are especially important, in the fact that "these systems involve large financial institutions which have to play a key role in the integration, efficiency and liquidity of the financial markets." (The European Union in 2003: 10)

The Privatisation Discussion and its Proponents

The public discussion about the supposed necessity to reduce state pension systems and to partially privatize them is dominated by two interlinked arguments. The first argument refers to the demographic changes. In view of a growing number of pensioners and less people of working age, the costs of the "demographic time bomb" would rise exorbitantly. The second argument refers to the question of the financial competitiveness of the economy. Then the contributions for old age security would increase strongly if the state pension expenditure is not reduced, and this would weaken European company competitiveness and finally prevent investment, economic growth and the reduction of unemployment.

Beside this continual questioning of state pensions with respect to financial sustainability, the advocates of privatisation speak of the advantages that private pensions would bring for the individual as well as on a macroeconomic level. The individual pension savers would be better off financially because the income return for a capital-covered pension system which depends on interest payments from the capital markets is higher than the state transfer of current contributions which are dependent on wage developments, as for example the General Association of German Insurance Economists argues (GDV 2003: 13 ff). In addition, aging societies could profit from capital exports from the dynamic development of other economies. The whole economy should also profit from the fact that more capital in the form of savings flows into the financial markets, raising the liquidity of the markets and making capital available on more favourable terms for financing external businesses and for venture capital investments. Then this would finally also lead to more growth and employment, which is for example the concept of the EU Lisbon strategy. In other words: The partial privatisation of the European pension systems is a central foundation stone in the establishment of financial market capitalism. This reorganization of European capitalism is politically borne by a coalition of political and economic activists and in particular was supported by the big trans-national financial and industrial companies. The banks, insurance and investment companies hope for huge influxes of resources from the privatisation of the pensions and lobby for this at national and European levels. But big industrial companies also support the trend because, among other reasons, their financial burden is eased by the privatisation and also because they are themselves active in various ways on the financial markets.

Conclusions

Overall, the European pension systems have gone through an extensive transformation process in which private old age security has been upwardly reva-

lued. But the dismantling of the state pension systems and the privatisation create more problems than they solve. As a component of a general neo-liberal cost reduction strategy which also includes low wage increases, social cuts in other areas such as the health system and a restrictive fiscal policy, it also contributes to a fall in consumer demand and thus, in the end, damages the whole of economic development.

Also, demographic change does not necessitate extended privatisation and capital cover. Firstly, higher employment levels and increases in productivity can compensate for the shifts towards an older population. Secondly capital cover and the export of capital do not provide a demography resistant solution. Many of the fast growing economies of the south, as for example China, are also confronted with demographic problems and the massive influx of financial capital into these relatively weakly developed markets could rapidly lead to instabilities as were observed in the Asia crisis of the late nineties. The alleged "natural" advantages of income return from capital-covered pension systems compared with the reallocation of current contributions procedure - if they are actually achieved and are not consumed, as in many countries, by the horrendous fees charged by the financial companies offering them - are a consequence of a transfer of relative social strengths towards capital which has led in recent decades to a continual decline in wage rates (DIW 1998: 838). Hence, higher wage settlements would also increase the level of state pensions.

Also it is more than questionable whether financial market driven capitalism would achieve positive overall economic effects. Deception scandals as a result of reorientation towards shareholder value, as for example at the US Enron enterprise, the short term interests and extremely high yield demands of many financial investors with respect to businesses, or the financial problems of companies such as General Motors whose pension funds are massively under-covered because of low capital market yields resulting from the end of the stock market boom, make the advantages of this model seem very questionable. And, finally, the social gap and the risk of age poverty grow with privatisation of the pension systems. In Great Britain, about 25% of the 11 million pensioners live in poverty, i.e., after paying their housing costs, they have less than 112 pounds per week at their disposal (The Guardian, 13th September, 2004). Therefore, social opposition is necessary against further privatisation of the pension system and we need to present alternatives for a solidarity pension system.

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III Let your money work for development - but how?

3.1. Codes of Conduct for Financial Service Providers

Banks have repeatedly been attacked by non-governmental organisations (NGOs) in the past years because they financed projects that led to reckless environmental degradation and violation of human rights. A prominent example is the campaign against the financing of the OCP pipeline in Ecuador by West LB (Landesbank).

NGOs in Germany and other countries have realised that campaigns on banks attack the centres of economic activity. Projects that are not financed by banks cannot be implemented and what banks consider profitable receives sufficient capital. If banks were forced to include social and ecological criteria in their allocation of loans, many projects would not be able to proceed. An extensive study of banks reveals, however, that they, as centres of economic power, have many possibilities to influence the economy that can have positive or negative effects.

NGOs criticise different areas, such as the following offences:

- Financing environmentally detrimental projects
- Financing projects that violate human rights, e.g. by forced resettlement
- Financing corrupt regimes
- Speculation against currencies
- Money laundering
- Assistance for tax evasion
- Speculating on the state “bailing out” the economy in case of bad speculation
- Inflating the volume of government bonds from developing countries and emerging market countries
- Ignoring necessity for debt relief, preferably without complications, for insolvent developing countries
- Dealing in shares of companies that exploit bonded labour

At the same time, banks should:

1. Invest in environmentally sound technology
2. Invest in forms of renewable energy
3. Allocate loans mainly to small and medium- sized companies
4. Allocate investment and loans particularly to companies with good working conditions

If banks react to these extensive demands they usually reply that they are obliged to achieve profits. Inquiries on the banks’ business quickly face restrictions. Banking secrecy makes it more difficult than in other industries to obtain information on customers, partners and business deals of banks. Codes of conduct have to consider this specific situation in the banking sector.

- Codes of Conduct have to be very comprehensive considering the power that banks have in the economy

- They also need to be monitored in ternally by a powerful body, for instance by a sustainability department that is directly subordinated to the management.

Of course, internal monitoring does not substitute the internal independent supervision.

In future, the following issues should be discussed:

1. How detailed and how comprehensive should codes of conduct for banks be?
2. Is it possible and desirable to build selective alliances between NGOs and progressive banks?

Antje Schneeweiss

3.2 Are Codes of Conduct the Solution?

According to the declared intentions of transnational corporations, a bright future lies before us. In any case, there have been numerous codes of conduct for various business branches since the 1990s, whereby transnational corporations have committed themselves to meet minimum social and ecological standards. Codes of conduct for financial service providers have been in existence since 2003 with the "Equator Principles", and many big banks and insurance companies have also signed up to these. Can codes of conduct contribute to a clear realignment of these businesses towards sustainability?

Equator Principles

High flying hopes have partly been attached to the demand for guidelines for banks. By controlling the allocation of credit, banks can have a far-reaching influence on which economic initiatives can be implemented. If it were possible to have influence on the guidelines for credit allocation, then this would constitute indirect control of investment activity.

Demands for codes of conduct, however, were also a reaction to the disastrous environmental and development policy consequences of many projects which were sponsored with the help of big financial institutes. The WestLB signed the Equator Principles in reaction to civilian social pressure after various NGOs had scandalised the WestLB loans for a pipeline project in Ecuador that caused massive environmental damage and harm to the indigenous population[1]. To escape from public criticism, the bank set up a sustainability division and signed the Equator Principles[2].

The Equator Principles formulate claims to carry out exact studies regarding possible harmful effects on the environment and the indigenous population and, where necessary, to refuse to finance questionable projects. The signatories of the Equator Principles meanwhile include 41 banks, among these the Dresdner Bank, the Hypo Vereinsbank Group and the WestLB[3].

Basic Problems with the Codes of Conduct and the Equator Principles

The Equator Principles show many of the basic problems that NGOs have criticized for years concerning initiatives for voluntary commitments.

The most conspicuous is that individual case investigations of projects are under the sole control of the corporation itself. Consultation with inhabitants of the region where the financed project is to be placed is not provided. Cooperation with civilian social activists is also left to the discretion of the banks[4].

But most serious are the deliberate rejection of any external control of the

[1] Cf. Graf, Thomas, Die West-Öl-B-Pipeline, Menschenrechtsverletzungen und Regenwaldzerstörung in Ecuador [The West-Oil-B Pipeline, Human Rights Abuse and Rain Forest Destruction in Ecuador], Münster (2004)
[2] WestLB, New Thinking. Sustainability Report 2005, p. 2
[3] See : http://www.equator-principles.com
[4] Shaping the Future for Sustainable Finance. Moving from Paper Promises to Performance, ed. by WWF and Banktrack (2006), p. 79

codices as well as the lack of punitive measures for the case of non-compliance. The Equator Principles therefore are none other than an uncontrollable declaration of intent by the corporation[5].

Thus, unsurprisingly there are many cases where the corporations have not kept to their own codes of conduct. The example of Shell is probably the best known. After years of negotiations, NGOs managed to get Shell to introduce a company code of conduct. This, however, has not prevented the corporation from carrying out oil production at the expense of the environment and human rights in Nigeria[6].

The control possibilities that have been deficiently set up represents a problem especially since those affected or civilian social groups can seldom find the means to check the behaviour of corporations. Environmental damage, for example, is often difficult to measure and since corporations are scarcely obliged to disclose their project plans, individual case investigations can only be carried out with considerable effort. It is often even more difficult to provide evidence of environmental damage done or violation of human rights in the case of corporations from the financial community. On the one hand, it is generally considerably more difficult to establish the consequences of speculation and securities trading than, for example, definite violations of labour laws in the production of material goods. On the other hand, the results of growing deregulation, (reducing controls on cross-border capital movements) as well as bank secrecy make the financial community a very opaque field. Meticulous enquiries would be necessary, for example, to get an idea of the engagement of banks in developing countries. Critical activists from civil society seldom have the resources at their disposal that these enquiries would require.

The Equator Principles vehemently insist on the voluntary nature of the guidelines and self-control by the corporations. Every outside interference is declined. This restriction is no accident, but deliberately intended. This is because the voluntary self commitment by corporations is also to preempt and replace demands for more extensive demands for legal regulation of the corporations and external code of conduct control. Thus, at the UN summit in Johannesburg in 2002, a comprehensive programme was presented by civilian social organisations which called for a far-reaching corporate accountability for their economic activities and state control of codes of conduct. On the other hand, there was a publicity offensive on the part of the corporations for voluntary self commitment as an alternative to "command and control" initiatives[7]. The economic lobbying associations, such as the German BDI, pursued the tactics of praising initiatives for voluntary self commitment and at the same time preventing the introduction of outside control by all possib-

5 See: Unproven Equator Principles. A BankTrack Statement, Utrecht (2005)

6 Kerkow, Uwe; Martens, Jens und Schmitt, Tobias. Die Grenzen der Freiwilligkeit. Handlungsmöglichkeiten und Erfahrungen von NGOs und Gewerkschaften bei der Anwendung freiwilliger Selbstverpflichtungen der Wirtschaft (WEED Arbeitspapier), [The Limits of Voluntary Principles. The Possibilities for Action and the Experiences of NGOs and Labour Unions in the Application of Voluntary Commitments by Business (WEED working paper)] Bonn und Berlin 2003, p. 11

7 Kerkow et al. (2003), p. 5

le means[8]. The Equator Principles are derived from this spirit and are a defensive reaction to the criticism of corporations who nevertheless want to maintain complete freedom to pursue their business activities.

But why is there such big resistance to measures that are obligatory instead of based on trust if the intentions of the corporations are supposed to be in such harmony with the demands of civil society, as the Equator Principles suggest? Why is there an enormous resistance to public control if financial service providers, as their representatives claim, are on the brink of carrying out their business in a sustainable way and even appear to be finally convinced that sustainability would also serve their turnover?

The fine sounding words mostly used to wrap up the respective codes of conduct conceal a conflict of interest between short-term economic and long-term social objectives. The globalized, competitive pressure and the growing power of institutional investors make it imperative for corporations to keep the costs for sustainability low. Additionally, it is necessary not to thoughtlessly abandon potential areas of business to competitors and to eliminate possible liability and accountability risks to corporations. Thus, unaccountability is the credo for all corporate code of conduct initiatives, including the Equator Principles. The maximum image gain, whereby the corporation seeks to win the confidence of customers and consensus with civil society, should cost as little as possible in terms of money and accountability.

In consequence the unaccountability logic corresponds to the efforts of the International Finance Corporation, which is the World Bank's private credit agency, to weaken the minimum standards of the Equator Principles[9]. What never was a binding regulation can also be retracted again without too much difficulty. Civil society should consider this effort to soften already insufficient codes of conduct as a scandal and use it as an opportunity to demand more binding regulations to control the business activities of banks and insurance corporations.

Equator Principles and the Deregulation of Financial Services

For the above mentioned reasons, it is advisable to look very critically into the new preference of corporations for sustainability. Codes of conduct scarcely signify a change in the direction of corporate policies but are good for public relations and are an attempt to ward off criticism. Attention should especially be paid to the fact that codes of conduct contain norms which concern the complete corporate business activity in a given line of business, and not just a single sector. Otherwise there is a great risk that a corporation establishes a green or social image through very praiseworthy promises in one line of business

[8] Thus, the BDI declared "The environmental organizations caused the failure to make an environmental declaration by attempting to include an additional clause into the agreed text . Thus the principles can only be considered to be an intermediate step towards the necessary more comprehensive inter-state regulations for transnationally active corporations. The environmental associations have unilaterally violated the spirit of voluntaryness of the agreement […]".: quoted in Kerkow et al, p. 9

[9] See: http://urgewald.de/index.php?page=3-64-156&artid=212&stwauswahl=

whereas the activities of other lines of businesses with potentially damaging consequences are completely ignored. This is particularly relevant with respect to the consequences of financial services deregulation.

Expansion in developing countries is a lucrative growth market for banks and insurance companies; the savings of the upper and middle classes has primarily aroused the greed of the financial community. This is linked to structural consequences for the financial sector in the respective countries since foreign banks and insurance companies hardly acknowledge social imperatives, for example, easy access to financial services such as loans for the poorer sections of the population. Additionally, deregulation is linked to far-reaching reduction in capital movements control and state regulation in general. This will more strongly expose the whole financial sector in developing countries to finance market fluctuations, and the risk of financial crises will increase considerably. Political control of the economy is to a great extent made more difficult by liberalisation, developing country economies will be increasingly dependent on the decisions of international investors[10].

Possible consequences of the deregulation of financial services continue to be ignored by codes of conduct such as the Equator Principles, since they only relate to credit allocation guidelines of financial services providers for large-scale projects. Their potential damage to environment and people in the developing countries are none the less serious. Therefore, there is an inconsistency between the image gain for the financial service providers who commit themselves to observing the new codices and the daily damage arising from the foreign business activities of the banks. It is thus questionable as to what extent the codes of conduct can assess the consequences of liberalisation of the financial services sector. Therefore, the discussion concerning the far-reaching effects of the globalisation of the financial service sector also shows the limits of this approach. Conduct guidelines and voluntary self commitments certainly cannot replace political regulation of the financial markets.

A Step in the Right Direction?

Codes of conduct could at least pave the way for more comprehensive initiatives, which is a hope often formulated by civil society. Starting-points could at least be standards for criticism and demands concerning corporate activities. The absence of accountability in codes of conduct should be compensated by civil society engagement.

The voluntary self-commitment actually offers starting points “to pin down” certain corporations and to demonstrate the inconsistency between words and deeds. Damage to public reputation can sometimes constitute a risk and force the corporation to abandon obviously ecologically and socially damaging projects. But this possible advantage is accompanied by many questions and disadvantages.

• The most publicly effective criticism often depends more on concrete proof of the consequences of corporate activity rather than on whether it followed

[10] Krüger, Lydia und Reiners, Suleika, Expansion ohne Grenzen? Der Handel mit Finanzdienstleistungen, Bonn 2005, S. 44-50

certain codes of conduct. The sinking of the Brent Spar oil rig, for example, became a scandal because the disastrous effects on the environment were publicized. Possible Shell codes of conduct played a subordinate role in this.

• Codes of conduct and sustainability campaigns pursue the objective of improving the public reputation of a corporation. There is the danger of "Greenwashing" if individual fields of business are excluded as, for example, was the case in the financial sector. NGOs should try to prevent this, as seen in the example of Hypovereinsbank, which is held up as a good example and described as Germany's most sustainability-conscious bank in a current rating[11], since this shows spectacular ignorance of the overall consequences of the business activities of this big bank. NGOs must insist on a more extended concept of sustainability and should not contribute to confirming the impression that financial service providers are making definite progress in conduct.

• This is because qualitative changes with respect to sustainability are altogether absent. 60% of the 500 largest corporations in Great Britain have already signed codes of conduct[12]. But it is questionable whether the British economy has made a clear step in the direction of sustainability and that there has been any substantial progress towards the Millenium Development Goals.

• Seen from the perspective of corporations, voluntary self commitment is not complementary to or a step towards binding conditions or state regulation but is a substitute for these. A positive reference to non-binding codes of conduct can steal the thunder from those calling for more comprehensive regulations.

• The danger for civil society is to set extravagant hopes for a dialogue with corporations. Taking part in discussions on the composition of codes of conduct soon turn into a participation trap if public criticism and more comprehensive demands are forfeited for tactical reasons.

Thus, it remains a matter of doubt whether the present voluntary self commitment of financial service providers can lead to fundamental changes in their conduct or that they are productive starting-points for civil society initiatives. In any case, they should not conceal that far-reaching consequences of neo-liberal globalisation of financial markets can only be controlled by binding regulations.

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[11] See: http://www.umweltdialog.de/umweltdialog/finanzen/2006-03-23_HVB_Deutschlands_nachhaltigste_Bank.php

[12] Kerkow et al, p.7

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3.3 Big Brother is watching you. Rating Agencies as Agents of Solvency

"The ability people value most is the ability to pay."
Oskar Blumenthal (1852-1917)

"There are two superpowers in the world today in my opinion. There's the United States and there's Moody's Bond Rating Service. The United States can destroy you by dropping bombs, and Moody's can destroy you by downgrading your bonds. And believe me, it's not clear sometimes who's more powerful."
Thomas Friedman (1996)

Rating agencies judge the creditworthiness (credit standing) of businesses and states: They judge the extent to which a complete and punctual servicing of interest and repayment obligations of credit-related securities such as loans (bonds) is to be expected through their rating codes which stretch from AAA (the highest quality) to D (insolvency)[1].

Through their assessments, rating agencies exert a tremendous influence on whether investors are prepared to hold the securities and if so, then which price the businesses and states have to pay creditors: the lower the rating - the higher the risk assessment - the higher the interest. The rating of a new emission is followed by continuous updates in which downgradings or upgradings can accompany sudden capital withdrawals (notice of credit withdrawal) or capital influxes or credit condition changes. Following Brazil and Mexico, Venezuela has now also announced it will buy back some of its government bonds (FTD, 2-27-6) - especially those in foreign currency, since the debt burden to be repaid would massively increase if the national currency were to be devalued and this can bring a state to the brink of insolvency, as for example happened in Brazil during the run-up to the presidential elections in 2002.

The threshold between the two main categories Investment Grade (AAA to BBB-) and Speculative Grade[2] (BB+ to D) is an explosive issue; this is because legal supervisory regulations require institutional investors such as pension funds and insurance companies or even banks to invest large parts of their funds in securities that have an investment-grade-rating[3]. If the rating falls below the threshold of speculative grade, this inevitably means the loss of immense amounts of capital for the debtor. Rating agencies started up by rating bonds to finance the railway network in the USA and to date have continuously grown in influence, parallel to the expansion in finance markets.

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1 Unlike a bank credit where a banking institute carries out an internal solvency examination and uses the data solely for its own business purposes, the results of the rating of credit-related securities are broadly published for private and institutional investors

2 Also known as "junk bonds" or "higher yield bonds"

3 Additionally, bonds in investment-grade-securities enjoy a lower requirement for capital stock as a guarantee

On the Way to Power by Train

When the US railroads started to stretch across the whole continent in the mid 19th century, the capital requirements exceeded the ability and readiness of banks to provide the credit. Therefore, the railroad industry - as well as other business enterprises - began issuing business bonds. The growing variety of bonds led to an increasing demand for information among investors, and Henry Varnum Poor published the "Manual of The Railroads of The United States" in 1868, a publication containing statistics on the various railroad corporations. John Moody went a step further and founded the first rating agency called Moody's in 1909 (Setty 2003: 1). John Fitch entered the rating business in 1924, which followed the "Fitch Publishing Company" of 1913. Standard & Poor's was founded in 1941 after the merger of "Standard Statistics Company" and "Poor's Publishing Company"(Reder 2004: 178). To this day, these three agencies - with Fitch slightly behind - dominate the global rating market with their international reputation[4]. Their fields of business and their influence have increased continuously.

At first the agencies were self-financing with the ratings they sold to investors. In the 1970's they started levying charges to the bond issuers (Reder 2004: 171f.) - a significant step in transferring power to investors: Whoever wants to raise capital via bonds must have a credit rating and pay for it[5].

Deregulated finance markets are accompanied by increasing intransparency, and this also leads to an increase in the power of the rating agencies which virtually take over the supervisory role from democratic states. Additionally, financial supervisory institutes increasingly rely on the results of the agencies. Recently, the European Central Bank (ECB) announced it would only accept those government bonds as securities for banking business refinancing that were rated at least once with the note A. This could signify increased pressure on budgetary policy for Italy, Portugal and Greece to maintain the existing government bond rating (Die Zeit, 17.11.05): rating agencies gain power over parliaments.

Developing countries are also dependent on rating agencies - since the nineties, international loans have become an essential component of their external financing. The proportion of international loans in foreign debt is considerable, particularly for emerging market countries (cf. Fig. 1): in South America almost 40%, in Eastern Europe almost 20%, and in Asia and Africa almost 10% of the complete stock of foreign debt is in international bonds.

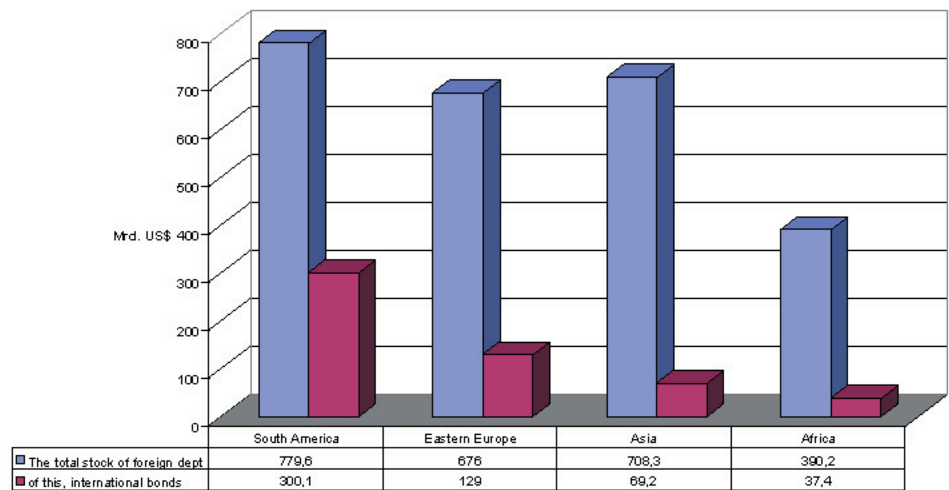
[4] All three agencies are operating as subsidiaries: Moody's is owned by Moody's Corporation, partially a consultancy firm; Fitch is part of the consultancy firm Fimalac and Standard & Poor's is part of the media corporation McGraw-Hill

[5] In addition to solicited analyses, the agencies occasionally carry out unsolicited ratings. They need to be identified as unsolicited and can only be based on public data. Their purpose could be an overall comparison – for instance of all enterprises that issue Euro Bonds with a certain validity. However, these ratings that are carried out without internal information often lead to inferior results; recently, Fitch was discredited because they tried to force enterprises into a contract for paid solvency assessments

New emissions of international bonds in developing countries are approaching the volume of the bank loans allocated each year (cf. Fig. 2). Additionally, the bond ratings have a considerable effect on the conditions applied to bank loans, share prices or even cooperation with business partners.

With public development financing declining, the United Nations Development Programme (UNDP) started

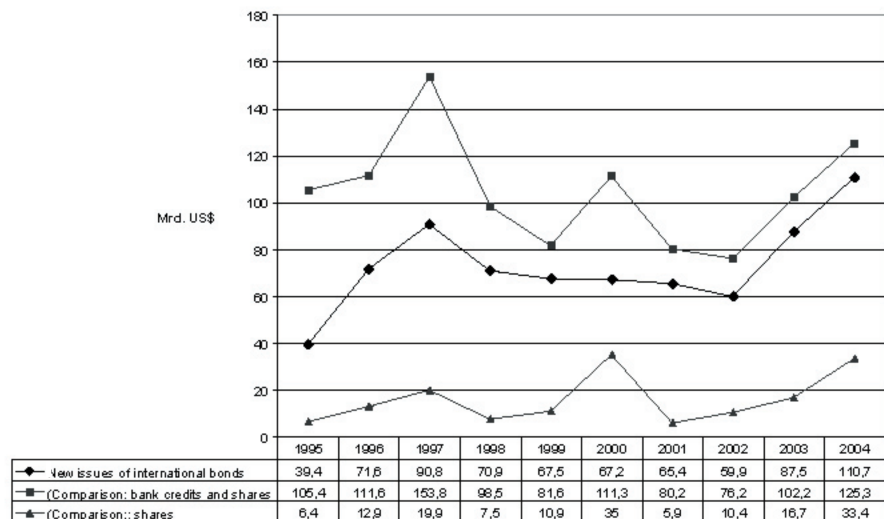
Proposition of international bonds in the total foreign debt stock of developing countries 2003



	South America	Eastern Europe	Asia	Africa
The total stock of foreign dept	779,6	676	708,3	390,2
of this, international bonds	300,1	129	69,2	37,4

Source: World Bank, Global Development Finance 2005.

New emissions of international bonds in developing countries 1995-2001



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
New issues of international bonds	39,4	71,6	90,8	70,9	67,5	67,2	65,4	59,9	87,5	110,7
(Comparison: bank credits and shares	105,4	111,6	153,8	98,5	81,6	111,3	80,2	76,2	102,2	125,3
(Comparison;: shares	6,4	12,9	19,9	7,5	10,9	35	5,9	10,4	16,7	33,4

Source: World Bank, Global Development Finance 2005, 2004.

a rating initiative for African states with Standard & Poor (UNDP News Bulletin 26.2.04) (www.undp.org/dpa/pressrelease/releases/2004/february/pr26Feb04.html). Even Least Developed Countries (LDCs) such as Benin, Burkina Faso and Mali were subjugated to the private economic reign of investors and rating agencies.

Additionally, the rating agencies have extended their lines of business. Besides the rating of corporate and government bonds, and the rating of banks and insurance companies, so-called structured financing has also advanced to important business sections. Due to their huge balances, banks and insurance companies are the biggest sector world-wide, considering the amount of securities emissions, and the banks' daily refinancing business on the money market. The rating of very complex structured financing - such as the booming licensing of various debts to asset backed securities or the inclusion of derivatives - earn the agencies three times the fees as the assessment of normal bonds (FTD, 6.2.06).

The growing power of rating agencies means that besides businesses, whole states are also subordinated to the rule of financial solvency; since this is all that rating criteria assess. For example, this is the reason why externalisation of costs is rewarded with better credit rating. Large banks such as Citibank, Union Bank of Switzerland (UBS) and Deutsche Bank, for instance, receive a rating bonus because it is expected that the state will intervene in case of impending insolvency and the cost burden is then shifted to the taxpayers (Rime 2005). The rating assessment of sovereign states includes the flexibility of the labour market, the pension obligations as well as the rate of public expenditure and state debt, besides economic growth (Standard & Poor 2004 : 3 ff)[6]. An "inflexible labour market" including protection against arbitrary dismissal, a minimum wage, collective wage agreements, strong labour unions, and high pension entitlements, can have a negative effect on country ratings. And Standard & Poor have just reduced the credit standing estimate of Hungary because of doubts about the reduction of the national debt which not only negatively affected bonds, but also had a deflating effect on the Hungarian currency, the Forint (FTD, Jan. 27, 2006).

On principle, developing countries pay higher interest than industrial countries because the country rating risks are set so high. Due to the privatisation of capital flow, rating agencies are often more important to these countries than the World Bank and the International Monetary Fund (Hillebrand 2001: 159). The economic consequences of this principle that solvency alone counts in terms of creditor protection were particularly drastic in the Asian crisis in 1997: To obtain a better rating and consequently lower interest rates, Korea, Indonesia and other countries consented to have their bonds tied e.g. to puts to provide creditors with a lower investment risk due to premature cancellation possibilities. When the creditors actually did call in the money the money earlier, the countries were thrust even deeper into crisis - liquidity was reduced when it was most needed (Dodd 2003). Additionally, the subordination of development interests to the interests of private creditors or Bondholder Values is visible in the

[6] The country rating is also an important criterion for the rating of businesses in the same country since this is a practically insurmountable maximum limit

high volatility of private capital flows (cf. Fig. 2). Strengthening controls on capital transfers as an effective protection against financial crises, on the other hand, would have a negative effect on the rating. Yet another incident actually led to calls for regulation of the rating agencies: the scandals surrounding the Enron energy corporation (2001), the WorldCom telephone corporation (2001) and the Parmalat dairy product corporation (2003) - all three corporations received an investment degree rating shortly before going bankrupt.

From the Call for Regulating to the Decision in Favour of a Code of Conduct
In the year 2004, the International Organisation of Securities Commissions (IOSCO) presented a framework for a code of conduct for rating agencies - the Code of Conduct Fundamentals for Credit Rating Agencies. The codex refers to:

1. the quality and integrity of the rating process
2. the independence and avoidance of conflicts of interest
3. the responsibilities towards the investors and issuers
(transparency and confidentiality).

The framework is meant to be a globally applicable proposal - as a possible basis for implementation in national law or for voluntary adoption by rating agencies in their own code of conduct. While the latter largely occurred, there is a problem with legal liability. Based on a report by its Committee on Economic and Monetary Affairs (ECON), the European Parliament requested the European Commission in 2004 to examine the necessity for legislative measures to regulate rating agencies. In its communication on rating agencies on December 23rd 2005, the commission concludes that no further legislation is required. On the one hand, the commission referred to three guidelines of the Financial Services Action Plan (FSAP), that are just as relevant to rating agencies: the market abuse directive; the capital requirements directive (Basel II) which also includes recognition requirements to the responsible rating agencies; and the directive on markets for financial instruments which is supposed to prevent conflicts of interest. On the other hand, the combination of these directives with the voluntary principles of the IOSCO codex is considered to be sufficient.

The codex is not likely to lead to any change in behaviour since the agencies consider all requirements fulfilled (Everling 2005: 20). And whoever wishes to complain about a violation of principles must contact the agency itself[7]. The principles of the codex, however, do not restrict the power of the agencies as agents of solvency and their pressure on the economic decisions of democratic states. Only measures to control and stabilize capital flows such as capital transfer controls or the taxation of international capital flows could prevent this instead of replacing the deregulation of financial markets with the self-regulation of rating agencies. The discussion about regulation which has started could be a point of reference. Besides the dominant rating agencies of Moody, Standard & Poor, and Fitch, other agencies have been founded that include social and eco-

7 A further voluntary PR measure was agreed by Moody's and Standard & Poor's together with the Committee of European Securities Regulators (CESR): The publication of an annual letter describing compliance with the IOCSO codex (FTD, Dec. 15, 2005)

logical sustainability criteria in their ratings.

Sustainability Rating, a Shooting Star or a Wallflower?

Sustainability rating agencies such as Oekom research, founded in 1993, and Vigeo (since 2002), in Europe, or Innovest (since 1995) in the USA, assess corporations and countries according to social and ecological criteria, such as human rights and employment standards and climate policy or ecological issues such as pollution emissions, consumption of resources and business flights[8]. Unlike Moody, Standard & Poor and Fitch with their solvency ratings from AAA to D, the assessment results of the sustainability rating agencies are far less standardized. Because of the lack of interest among bond issuers, the assessments are mostly not paid by them. Instead, the ratings are ordered by banks setting up sustainability funds or by institutional investors such as foundations and churches. Of the total U.S. $ 44 billion invested in the USA in 2003, U.S. $ 2.2 trillion went to what are called sustainable funds. In Europe, the amount was U.S. $ 0.4 trillion out of a total of U.S. $ 37 trillion. This corresponds to about 5% of the financial stock in the USA and about 1% in Europe (source: McKinsey 2005, $118 Trillion and Counting; Social Investment Forum 2005, Report on Socially Responsible Investment Trends in the United States, (see socialinvest.org); Corporate Social Responsibility Europe 2005, Investing in Responsible Business, (see csreurope.org). These investments can be a pragmatic guiding star for those who would like to invest their money in the socially and ecologically most sustainable way possible or who feel compelled to rely on private retirement provisions because of cuts in state pensions. They are not a substitute for a democratic regulation of the global financial economy, nor has such a claim been made.

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3.4 International Taxation, an Instrument for Regulating Globalization

The French government organised an international meeting from February 28th to March 1st on International Taxation in Paris. The government seeks support from other governments for a tax on air tickets that France has already adopted and wants to introduce on July 1st, 2006. On the agenda were the prospects for other forms of international taxation, for instance a foreign currency transaction tax (Tobin Tax). Some governments, such as Norway and Chile have already signalled their support. A few months before its end, the Schröder government also announced it would participate in the introduction of an airline ticket tax. It cannot yet be seen if the succeeding government will pursue this project. The coalition contract only refers to the tax vaguely: "Internationally, we will actively collaborate further and in a results-oriented manner in the introduction of innovative financing instruments for the promotion of globally sustainable development, especially within the EU, the G8 and in the context of the so-called Lula group (Action against Hunger and Poverty)"[1].

The Rise of an Innovative Paradigm

The seemingly rather inconspicuous event in Paris is the preliminary highlight of a ten- year- process for enforcing international taxation. Historically, international taxation is a new paradigm since taxation has only existed within the context of a nation state until now. As with national ta xation, international taxation can be used, depending on how it is set up, for economic, environmental and control purposes. Therefore, politics would obtain an instrument which can contribute to the regulation of globalisation processes. Additionally, a considerable structuring potential is acquired with the second fundamental function of taxation, i.e. the generation of financial resources[2].

The decision of the French government is a breakthrough even though the ticket tax, as it is conceived so far, will yield only modest returns and its control effect will be at zero. The chances that the process will continue are quite high, since the topic has appeared on the agenda of other governments and powerful players. The Belgian parliament, for example, has passed a law concerning a foreign currency transaction tax, which however will only become effective when other EU countries have followed suit. The Canadian parliament has also advocated such a tax. The UN General Assembly passed a resolution in 2004 with the votes of 115 countries to examine international taxation as an instrument for financing development. In particular, the problems with the financing of the Millennium Development Goals (MDGs) are a strong argument in the search for new and innovative financial sources. An interim assessment of the implementation of MDGs shows that the goals

1 Gemeinsam für Deutschland – mit Mut und Menschlichkeit. Koalitionsvertrag zwischen CDU, CSU und SPD p. 140. www.cdu.de/doc/pdf/05_11_11/Koalitionsvertrag.pdf

2 Cf. Wahl, Peter (2005). International Taxation: Regulating Globalisation, Financing Develop ment. Berlin.

3 Sachs, Jeffrey (2005): Investing in Development. A Practical Plan to Achieve the Millennium Development Goals, Report to the UN Secretary General, Washington.

will not be achieved with conventional development financing instruments[3]. Therefore, the ticket tax could be used to combat AIDS and for a WHO vaccination programme in developing countries. The extent of scientific studies concerning international taxes has also grown in recent years. Two reports were of special significance, the Spahn report on behalf of the Federal Ministry for Economic Cooperation which examined the feasibility of the Tobin tax, and the Landau report ordered by the French President Chirac which analyzed the whole variety of different concepts for international taxation strategies[4]. Both studies came to the conclusion that international taxes are not only technically feasible and economically reasonable but are also politically desirable. The IMF and World Bank also discussed the topic at their Spring meeting in 2005. The only significant objection was that international taxation would encounter problems of political acceptance. The US, especially, strongly defy the strategy. Washington successfully demanded that the term international taxation should disappear from the General Assembly Declaration in 2005. The UN development programme, UNDP, which uncovered the Tobin tax in 1996, was threatened with withdrawal of finances if international taxation was propagated in its name. Nevertheless, the Landau report concludes: "It is true that the success of campaigns for opinion leadership often depends on far-reaching and new visions. Remembering this is simultaneously a call not to give up great fiscal ambitions for the sake of short-term political realism. This would be counterproductive if it were to control every long-term vision of the future. In the long term, the political framework can change, and take on a new shape. The best strategy is therefore not to exclude the great designs but to approach them gradually“[5].

What are International Taxes?

When we speak of international taxes, we are referring to the internationally agreed or internationally organised taxation of cross- border exchange or transaction of goods, services and persons, in the broadest sense as well as the use of such taxation for international purposes, e.g. global public goods. International taxes need not necessarily be introduced globally. Initially a "coalition of the willing" could assume the leadership just as with the Kyoto protocol, and hesitant countries can join in later. Therefore, we do not refer to the frequently used concept of "global taxes". According to this definition international taxation does not necessarily need an international institution for its collection, although this far-reaching option is not excluded. Rather, it is all about international cooperation, as already practiced in many other fields of politics, for example, climate politics. In this respect, international taxation is also a means to influence and control international processes by political cooperation and not by market forces.

International Taxation and Globalization

The emergence of the concept of international taxation is a logical conse-

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4 Spahn, Paul Bernd (2002): Zur Durchführbarkeit einer Devisentransaktionssteuer, Gutachten im Auftrag des Bundesministeriums für Wirtschaftliche Zusammenarbeit und Entwicklung, Frankfurt/M. http://www.wiwi.uni-frankfurt.de/professoren/spahn/tobintax

5 Landau, Jean Pierre (2004): Les nouvelles contributions financières internationales, Rapport au Président de la République, Paris

quence of globalisation. Several factors are intertwined.

Firstly: internationalisation that is accelerated by neo-liberal policies in the interest of trans-national businesses and institutional investors has drastically changed the conditions of nation state politics. In addition to the monopoly on power, the ability to raise taxes is the second foundation on which modern statehood is based. The tax systems which emerged in the 19th and 20th centuries were conceived for the nation state and its relatively closed national economy. Capital and labour were similarly confined within the territory of the nation state. The national tax legislation had a relatively unproblematic access to its tax base and could tax businesses and the prosperous.
Today, a fiscal policy confined to the nation state faces increasing limitations due to capital mobility and trans-national businesses. This leads to an increasing erosion of the national tax base lacking corporate, capital and property taxes, and there is a much higher tax burden on wage incomes. International taxes provide an opportunity to counter the impoverishment of the public budget and the resulting trend towards denationalisation and privatisation.

Secondly: besides the new possibilities for avoiding taxes, globalisation opens up new opportunities for global players to make profits. Today, for example, digitalisation and satellite communications, along with the liberalisation of financial goods and services markets, allow U.S. $ 1.9 billion in foreign exchange dealings per stock exchange day to chase around the globe from one large financial centre to the next within 24 hours. Financial transfers can be carried out in real time and at any instant merely by the click of a mouse. A transnational area has been set up, and returns can be made in a new way in a cyber-economy to which the nation state hardly has any access. To skim off a part of the profits from these and other activities resulting from globalisation and to redistribute this to the losers of globalisation is only logical.
Thirdly, the new technological possibilities also provide the means to very efficiently control and tax financial flows with little effort. For instance, a small electronic tag could be attached to each transaction, like the bar code on every product in the supermarket, and this could ensure complete registering by the central banks.

The Use of the Tax Revenue

The introduction of international taxes achieves a high legitimacy if the revenues are used to finance global public goods and especially for development for the poorest countries in the world. The politically most influential project is the objective of reducing absolute poverty[6] by half by 2015, as stated in the Millennium Development Goals (MDG) of the United Nations in 2000. 2.8 billion people, which is almost half of the world population, must live on less than 2 dollars per day. At the same time, the GDP of the industrialised OECD countries has increased by 63% to $ 29 trillion since 1991. In Germany, the GDP increased by 40% to $ 2.1 trillion in the same period[7]. The 697 billionaires in the world own a fortune of $ 2.2 trillion. The previous struggle of

6 defined as income poverty with a poverty level of one dollar per day
7 nominal GDP according to purchasing power parities. Data from 2002 in the OECD Fact book 2005, http://hermia.sourceoecd.org/vl=4864117/cl=23/nw=1/rpsv/factbook/

development politics against poverty is a history of complete failure. More than 30 years ago, the industrial countries committed themselves to spend 0.7% of their GDP on the development of the poor regions of this world. After reaching its highest level of 0.33% in 1992, this proportion decreased in the following years to 0.23% today (2004).

Which Kinds of Tax Are Being Discussed?

There have been a considerable number of suggestions for international taxation. However, we will restrict ourselves to the best known concepts in this text. In principle, the usefulness and effectiveness of international taxes can be determined applying four parameters. Firstly, through the controlling effect of the taxes, by influencing certain types of behaviour which cannot easily be regulated at the nation state level, such as the excessive consumption of natural resources or speculation on the financial markets. Secondly, the question is whether the revenues are large enough that they can make a substantial contribution to financing global public goods or to the alleviation of poverty. Thirdly, there is the administrative effort to levy and collect the tax, and fourthly, the political feasibility.

The airline ticket charge of one euro for the economy class and ten euros for business flights within Europe and four euros or 40 euros for intercontinental flights decided in France will be introduced on July 1st, 2006. A controlling effect is hardly to be expected for such a low tax rate. The revenues are expected to be 210 million euros per year for France. If the scheme was introduced in the entire EU, revenues could totally amount to 2 billion euros[8]. Airline ticket charges require no additional administrative effort since charges are already levied on each ticket (e.g. airport taxes). The ticket tax has comparatively large political support. As an introduction to international taxation, it is interesting. However, it is only a beginning. Therefore, it should not be used to suppress suggestions which are more far-reaching[9].

The CO2 tax to control the consumption of resources is such a more far-reaching proposal. An advantage of the CO2 tax is the possibility of high revenues. The Landau report estimates that a tax of $100 per ton of coal equivalent would raise $ 100 billion U.S. dollars worldwide. The CO2 was discussed for a long time in connection with the Kyoto Protocol for the reduction of greenhouse gases. However, preference was finally given to a new mechanism of “tradable pollution certificates”. The reason was of mainly political and ideological nature since tradable certificates are market regulated after being issued by the state, whereas taxes require a more active role from the state. Since the certificates are simply donated to CO2 producers at present, they do not create any additional income for the state but represent a re-distribution from excessive energy consumers to energy savers that are in line with the market. It remains to be seen how far such a means of internalising energy costs into market prices is an improve-

[8] EU Commission (2005). A possible contribution based on airline tickets as a new source of financing development: technical reflections in the run up to the UN High Level Event. SEC (2005) 1065. Brussels. http://europa.eu.int/comm/taxation_customs/index_en.htm

[9] When Chancellor Schröder mentioned the Tobin Tax as a possibility at the World Economic Forum in Davos 2005, his Finance Minister hurried to approve the airline ticket tax so that the Tobin Tax would appear superfluous

ment on regulation by taxation which has been implemented for centuries. If this strategy for reducing energy consumption fails, the discussion concerning a CO2 tax will probably grow in significance again.

The Scientific Council for Global Environmental Change of the German Federal Government (WGBU), established when Töpfer was the CDU Minister for the Environment, recommends an emissions tax for air traffic. The Council expected this to encourage the construction of low-emission jet engines. Other suggestions on taxation with an ecological controlling effect are toll charges[10] for passing through internationally used straits, e.g. the Straits of Singapore or the English Channel between Dover and Calais or the taxation of air corridors, and the taxation on the transports of dangerous goods.

The Currency Transaction Tax (Tobin tax – CTT) or its Spahn version (see below) is the most well-known suggestion and meanwhile most mature proposal in all technical details among the taxes with an economic controlling effect. The CTT provides for a very low tax rate of one or several base points (one base point = 0.01%) on all foreign currency transactions. Speculative foreign currency transactions which already make use of small exchange rate fluctuations for profit would become more expensive by this measure. The estimates for revenue from a transaction tax vary widely; however, they are likely to be substantial despite the low tax rate because of the large tax base. A tax of 0.01% on all foreign currency transactions would raise up to $ 38 billion in the euro zone. Introduced worldwide, it could even raise up to 125 billion U.S. dollars[11].

In the meantime, the classic Tobin tax has been advanced by the concept of Paul Bernd Spahn, financial economist and former IMF consultant. The Spahn tax is a two-stage tax which, besides the low tax rate of the classic Tobin tax, provides for a second, very high tax rate of up to 100% if the exchange rates move above or below a fixed band. The central bank fixes the band by extrapolating the recent currency movements. In this way, not only daily speculation is reduced but also large scale speculative attacks such as during the Asian financial crisis of 1997/98 could be prevented. Speculation profits are taxed away by the Spahn tax, which therefore renders speculative attacks senseless. This variant of the Tobin tax has meantime gained widespread agreement among the supporters of foreign currency taxation.

The CTT would be ideal in terms of its controlling and distribution effect, since it collects the money where it is available in abundance. In contrast to a widely held belief, there is also no problem in levying the tax. Technological progress in the electronic processing of financial transactions is so far advanced that an integrated computer program can identify foreign currency transactions and ensures that the tax

10 The distinction between taxes and charges is not always easy. Normally, charges are to be earmarked to a clearly defined purpose. An airport tax directly contributes to financing an airport. However, taxes are increasingly being attributed to specific purposes. The German ecology tax is a well-known example; it is used to co-finance social needs

11 Denys, Lieven/Jetin, Bruno (2005): Ready for implementation . Technical and Legal Aspects of a Currency Transaction Tax and its Implementation in the EU. WEED Working Paper. Berlin, p. 137 and p. 140

12 Denys/Jetin (2005), p. 61 ff.

is levied[12]. Although it is theoretically possible to bypass or evade the tax, these evasive measures will nevertheless cost money so that currency traders or their customers will have to decide whether or not it is cheaper to pay the low tax rate.

Further kinds of tax with economic effects are the taxation of bank secrecy, of financial transfers to tax havens, foreign investments, portfolio investments, e-commerce or the secondary trade in shares. The latter would be an intervention in the functioning of shareholder capitalism. A shareholder's objective is no longer the possession of shares to receive dividends, but to speculate on an increase in the share price and then reselling shares at a profit. This has far-reaching consequences for corporate culture, employment, and even the functioning of the entire national economy, etc.[13] The function of financing businesses by issuing shares would not be affected by a taxation of secondary trade. At the same time, this would create an instrument to start regulating the shareholder system.

Suggestions for taxing the use of space around the Earth's orbit or the electric magnetic spectrum might appear exotic at first. However, it is the well-known idea of managing the public sphere like every parking meter does. Even today, geostationary satellites must register with the International Telecommunication Union (ITU), an UN sub-organization, for a small fee. The details of all these suggestions have been elaborated to various extents. This still remains a challenge for the future.

Ambivalences and Risks

Even if international taxes are a strategy with a promising future, they nevertheless entail some risks and ambivalences. On the one hand, there is the danger that the political mainstream may also agree to them but then promote the strategy especially for taxes that have a problematic distribution policy. For instance, the proposal to consider a European or internationally co-ordinated increase of the value added tax has recently appeared more often. On the other hand, there is the risk of not exhausting the scope for a more socially just fiscal policy which still would definitely exist at the nation- state level. Additionally, new financing sources for development will increase the temptation for further cuts in development aid. Furthermore, by the time international taxes start to gain approval, institutions such as the World Bank will try to influence them or control them completely. During the debate concerning the Tobin tax, World Bank functionaries have already brought the bank into play. Thus, efforts concerning international taxation should also always be linked to the democratisation of international relations and institutions. This also applies to the UN, since most supporters of the concept assign an outstanding role to the UN concerning the use and distribution of tax revenues.

Of course, all these considerations do not argue against the concept itself. They merely emphasise the fact that instruments to regulate globalisation are politically disputed and that

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[13] See the excellent overview by Windolf, Paul (2005): Was ist Finanzmarktkapitalismus?. In: Windolf, Paul (ed. 2005). Finanzmarktkapitalismus. Analysen zum Wandel von Produktionsregimen. Kölner Zeitschrift für Soziologie und Sozialpsychologie. Sonderheft 45/2005 (Wiesbaden)

emancipatory approaches cannot be enforced without political pressure. Schopenhauer once said that a good idea always passes through three phases. In the first it is declared to be nonsense, in the second it is most intensely fought against, and in the third it is realised. With the international taxation concept, we are between phases two and three.

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3.5 Structural Policy and Regional Development, the Significance of the Savings Bank Sector

Germany, a highly developed national economy, has a system of savings banks (Sparkassen) with a market share of about 40%, although there is a focus on liberalisation, deregulation and privatisation within the context of international financial policy (cf. other contributions in this documentation). In Germany, savings banks are mainly owned and/or guaranteed by a local authority and governed by the Savings Bank Law). They work for profit, although this is not their main purpose. The profits are for public benefit and are paid directly or in the form of dividends to the local authority. Every savings bank operates as an independent unit and is legally bound to its region. Savings banks are seen by private banks as the cause of the profit misery on the German banking market, neo-classicists perceive them as trouble makers in a liberal market and for some time now they are under constant fire by the EU Competition Commission. The question is: what benefits do savings banks provide for the general public and is their existence justified. The present article deals with this question in terms of the science of financial markets and structural policy aspects.

The Structure of Savings Banks

Savings banks are legal public institutes with a long tradition and have developed from the philanthropic necessity to promote the concept of saving within the poorer population into regionally oriented general banks. As legal public institutes they are bound to their promoters, which are generally local or municipal authorities or specific purpose boards. They fulfil a variety of tasks which can be included under the concept: “public duty”. The regional principle is a fundamental principle intended to ensure the public duty is met. Loans may be allocated only to institutions, businesses and private persons in the region and also, branch offices may only be opened in the region. The objective is money saved in the region should primarily be invested to promote the local economy and local population. The specific characteristics are summarised in the following box.

Although savings banks are indeed locally independent, however, at the same time they are linked together as a kind of local system supplier in a complex financial trust based on the voluntary principle, interconnected assets, economic calculation and idealism. The savings bank financial group enables the savings banks to act in a flexible and individual way as locally independent institutes and at the same time to offer cost-effective general banking services. The savings bank financial group efficiently provides specialized skills in the back office areas on the economy of scale principle (Gärtner 2003: 19 ff). The savings bank financial group consists of savings banks, regional and federal associations, regional banks, public insurance groups etc., and amounts to about 670 businesses and approximately 390,000 employees with a turnover of 3.3 billion Euro and, in its own estimation, is the largest financial group in the world.

A Summary of the German Savings Bank System

Beginnings: At the start of the 19th century, they began to provide the poorer population with the possibility to save and earn interest and they supplied traders with capital means.

Structure: Savings banks are linked to the communities, local or municipal authorities (responsible bodies) with almost 480 independent savings banks in a decentralized system.

Legal form: Public corporation (Anstalt des öffentlichen Rechts).

Public duty: Savings banks have a public duty which is regulated at the provincial level by the savings bank laws and their statutes, therefore they cannot focus exclusively on making a profit.

EU Competition Control proceedings: In the year 2005, the legal provisions of institutional burden (local authority liability of the municipality in an internal relationship, that is to the savings bank management) and guarantor liability (external liability to third party contractors) were to be terminated.

Regional principle: Conduct of business is concentrated in the guarantor region. In principle, this prevents financial means flowing exclusively to growth regions which can offer better prospects for the savings.

Vertical division of labour: The division of labour between savings banks, regional and federal associations, regional banks, public insurances, etc., makes it possible for the savings banks, although small institutions, to act flexibly and independently at the local level, and at the same time to offer a cost-effective general banking service.

Three column system: Banking system based on three columns (private commercial banks, and the co-operative and savings bank sector).

Area of conflict: Public duty and the orientation towards benefiting the community prevent a profit maximization strategy and enable the business policy to be directed towards the region, and at the same time the savings banks must operate in a very competitive banking market. In addition, those critical of a public banking sector keep calling for the privatisation of savings banks.

(Gärtner 2003: 24 ff)

The Significance of the Savings Banks

Liberalisation, which is understood as freedom of establishment, does not threaten savings banks. Savings banks do not represent a monopoly but are in competition with private commercial banks, as well as with private direct banks, internet banks, co-operative banks, and niche banks. On the contrary, savings banks have to fear the attacks of private banks, the EU Competition Commission and also, sometimes, provincial and communal politicians. The essence of the criticism is that savings banks are not for sale and so prevent consolidation in the German banking market, the name "Savings Bank" is incorrectly protected and that the regional principle represents a regional cartel (e.g. Federal Association of German Banks 2004: 20).

The benefits provided by savings banks are diverse and can be roughly divided up into the following four groups. Firstly, savings banks generate high local tax revenue. Secondly, they have considerable significance in providing employment and training. Thirdly, they provide important service by supporting cultural and social activities in the region through sponsorships, donations and payment of foundation dividends. The distribution of profits to local authorities and councils should not be ignored. Fourthly, and this is really their purpose: they perform an important function as financial intermediaries. They provide access to financial services for all sectors of the population and all businesses in all regions. Being nearby and knowing the customer and the market are especially important for the commercial allocation of smaller loans.

This article focuses on the application of the last mentioned service of savings banks, since their specific legal form can be justified with respect to allocation in the cases of the market failure and with respect to the precautionary principle of public goods. The other three benefits previously mentioned are positive side-effects which alone, however, would not justify public authority activity in the banking sector. A privatisation and a deregulation of the savings bank law in whatever form would eliminate or limit these benefits. The advantages of savings banks as financial intermediaries in terms of banking market and structural policy will now be more extensively elaborated.

Savings Banks and the Banking Market

The German banking market is characterised by a strict separation into three columns (private banks, public authority institutes and co-operative banks). The legal reorganization and (partial) privatisation of the banking market that was extensively carried out in other European countries has not occurred in Germany (Engerer/Schrooten 2004: 74). The German financial system is strongly bank-based, that is, businesses are predominantly financed by bank loans and not - as is usual in Anglo-Saxon countries - by equity or share capital.

In theory, banking and financial systems can be divided into regionally neutral and non-neutral systems (e.g. Klagge/Martin 2005: 392). Neutral banking and financing systems can be derived from neo-classical theory. According to this, and considered from a model perspective, high competition ensures that every profitable invest-

ment receives financing independent of its location. Thus, all market participants know whether an investment will be profitable. Capital moves to the location offering the best possible interest return. Banking systems are efficient if the business sector concentration is low, that is, many banks compete with each other and competition intensity is high. “This is exactly why indices of market concentration (…) play such an important role in almost all recent assessments of US and European banking markets. They are widely used in empirical work” (Fischer/Pfeil 2004: 308).

But weaknesses in the classical financial market theories can be seen in relation to allocation efficiency, availability of credit means and the stability of financial systems. The international developments in recent years and their significant number of financial market crises (cf. other contributions in this book) have shown that privatisation, liberalisation and high competition intensity did not necessarily contribute to high stability in the banking and financial markets. Studies also show that “perfect competition does not inevitably provide the best results for the economy as a whole. At least in parts of their business, banks appear to operate in less than ideal-typical markets” (German Federal Bank 2005: 107). According to newer financial theories, banking markets should, in principle, be distinguished from other markets because, firstly, information is asynchronously distributed between depositors and investors and is only incompletely available. Secondly, it is a loan business, the amount of credit, interest payments and repayments take place inter-temporally and, thirdly, it is based on confidence (for example, German Federal Bank 2005, Klagge/Martin 2005, Fischer/Pfeil 2004, Engerer/Schrooten 2004.)

In connection with this, more recent theoretical approaches assume that markets with lower competition intensity and stable customer-bank relationships (typical house bank relationships) can lead to improved credit means availability at lower prices. This particularly applies to smaller credit engagements because usually the checking effort and costs do not correlate with the size of the loan. The allocation of credit to SMBs (small and medium- sized businesses) is on average not profitable because of the lower credit volumes, as long as long-term customer relationships and local knowledge do not reduce the checking effort costs and risks. Loans to start-up companies bearing more risk are usually only worthwhile if a long-term customer relationship can be anticipated (German Federal Bank 2005: 106). Starting out from a banking system which is not regionally neutral, the key to credit allocation to small and medium- sized businesses consequently lies in the proximity. Therefore, regional development is important to an efficient banking environment. However, proximity to borrowers is also of central importance to banks engaged in credit dealings with SMBs to enable them to operate successfully.

If these theoretical model-based approaches and findings are now related to the specific German banking market structure, the following scenario results: Germany exhibits a high competition intensity at the national level which can primarily be explained by the non-saleability of co-operative

banks and savings banks. Probably, the concentration in the German bank market will increase if savings banks are privatised. However, the competition intensity and the distribution of banks can differ regionally within a nation state, as is also the case for Germany. All private commercial banks, co-operative banks and savings banks have branches in some regions, whereas only the latter two have any significant representation in other regions. Overall, a higher concentration and lower competition intensity can also be seen at the regional level, since co-operative banks and savings banks as a rule do not compete with each other.

If one confronts reality with the new and traditional financial theories, the picture is even more complex: on the one hand, there is the thesis that higher competition leads to higher allocation efficiency. If the concentration indices at the national level and the reasonable bank service prices in comparison to international charges, then this relationship is comprehensible for Germany. At the same time, derivations from the more recent financial and banking market science lead to the thesis that the disadvantages resulting from lower competition in the supply of credit to smaller and medium- sized businesses and particularly to founders of new businesses can be (more than) compensated by the advantages of proximity and stable customer-bank relationships. This is also comprehensible considering the favourable conditions with respect to lower competition intensity at the regional level. From the viewpoint of the savings banks, it can be claimed that they ensure high competition intensity at the national level and stable bank relationships at the regional level. Further research in this area is needed, however.

Savings Banks as Structure-Political Institutions

Without state intervention, a regionally dissimilar development with poorer economic credit supply, i.e. an allocative market failure, can be anticipated in some regions, as is shown by the reality in many regions and can also be shown theoretically. Thus, positive external effects occur in agglomerations that produce self-reinforcing growth at the expense of weaker peripheral regions. This can lead to a regional imbalance if there is no state steering mechanism. This can be established in the context of polarisation theory, for instance (Myrdal 1969), or New Economic Geography (Krugmann 1991), and, particularly in regard to savings banks, Wengler 2002: 109 ff.). Numerous empirical and theoretical studies also recognise that innovations primarily occur in conurbations, especially in regions where the spread of knowledge encounters favourable conditions (Frey/ Zimmermann 2005: 7 ff).

As already mentioned in the introduction, the regional principle is an essential characteristic of savings banks which curtails capital mobility, promotes an interest in the economic development of the region and thereby contributes to a balanced regional development. Savings banks can therefore be justified in the political order.

However, neo-classical economists assume that more effective free market forces and unrestricted production factor mobility will finally produce a distribution optimum. According to this, a

balance between the regions will then occur in the mid to long-term if the state does not intervene. The existence of local authority banks - which limit capital mobility - is difficult to justify according to this concept. Thus, for example, Nürk, author of a study of the Deutsche Bank, states that "(savings) means will always be brought to its most productive use and not artificially kept in a given region by the neglect of efficiency considerations, so to speak" (Nürk 1995, p. 22).

Therefore, the justification of savings banks is a question of the theoretical economic viewpoint: "if the aim is a policy of balance in the context of regional development, a nationwide complete coverage of the distribution of means definitely makes sense (...). If, however, certain growth centres or poles are to be promoted, the means should be (supra-regionally) concentrated" (Wengler 2001, p. 299). In the context of a structural policy traditionally directed towards balancing, newer structure-political strategies such as the cluster approach (see box) also aim for the concentration of economic activities in a region and thus accept local imbalances.

Does this then mean that savings banks are counterproductive against the background of newer skill-based approaches? Not at all, from a theoretical point of view. This is because

Skill Based Approaches in Structural Policy: Growth versus Balance

More recent structure-political approaches, namely the cluster approach, are directed towards locally available skills: everyone knows about the local concentration of businesses or small workshops in the old town parts of European or Middle Eastern cities. The spice markets in Istanbul, the textile markets in Montmartre or the skilled crafts shops in the old town of Bucharest can be mentioned here, for example. Thus, these represent local concentrations of economic activities, which is a "geographical cluster" in the area. The essential advantage is that customers find a comprehensive, geographically concentrated choice, a place frequented by specific suppliers, where a corresponding infrastructure exists, where the businesses are bound by a certain knowledge network and so possess specific information. The basic principles of such so-called clusters (e.g. Rehfeld 1999) are of course founded on these advantages and the system has been further developed. Such an approach can most sensibly be implemented in terms of structural policy where internationally competitive potential has reached a critical mass and components of a corresponding value-creating chain are located. Inevitably, this is accompanied by a withdrawal from the legally based fundamental equivalence principle of regional development.
A new orientation towards a structural policy directed more strongly towards growth is taking place both in the EU and in Germany at the federal and regional levels. Since, politically, the concentration of promoting subsidies in growth regions can only be sustained with difficulty, "cluster

instruments" are in reality also partly implemented in a widespread fashion, and are still distributed according to the "everyone gets a slice of the cake" principle. Thus in the future, on the one hand, growth potentials will be promoted where they exist and, on the other hand, education and culture will be developed or maintained with specific instruments in weaker regions, towns and city districts in order to enable the participation in and the fostering of economic development.

the new approaches can only be successful when they develop growth potential and at the same time are oriented towards balance, as local players require. Thus, savings banks are also acceptable from the regulatory viewpoint, if a growth- oriented structural policy is stipulation since on the one hand they can recognize local growth potential and play a part in its development, on the other hand, they are able to contribute to a regional policy that is directed towards balance. Thus, in the context of the savings banks, it is not a question of "either or", but "both".

Conclusion

By international comparison, the return on investment of German credit institutions is indeed rather low. But this is not necessarily because the bank market is too fragmented and the credit institutions are inefficient because of the high proportion of local authority public law banks and the rigid three column system, as many critics repeatedly claim. Low returns on capital can also result from a high level of competition, which leads to low cost bank services or they can also be the consequence of bad business decisions and depreciation adjustments. A current study of the KFW Bank Group (Kreditanstalt für Wiederaufbau, Reconstruction Loan Corporation) demonstrates the high efficiency and low price structure of the German bank market (KfW Bank Group of 2005).

If private banks had access to savings banks and could get rid of this competition, their return on capital would surely be higher, which probably would have a positive effect on the stock market quotation. Thus, finally, the existence of savings banks is a political question. I believe this article has provided sufficient arguments for the reader to form his own opinion.

The fact that there is a potential for improvement of savings banks should under no circumstances be ignored. Thus, for example, they could more strongly adapt new financing instruments common in other countries, such as participation and venture capital, and also high risk small loan instruments (Micro Lending) to the German market with widespread supply. In this way, they would play the pioneering role they have so often assumed in the past.

Perhaps the listing of the advantages of the German savings bank system provides inspiration for bank systems in other countries, just as German savings banks and other banks in turn have learned from experiences from abroad. It would actually be a platitude to note that a one-to-one transfer would not

make sense because of different conditions and cultures. But this occurs repeatedly in the reverse direction: the development in Germany is frequently discussed in relation to the deregulation of banks and privatisation of national banks world-wide, and that other countries have done their "homework" unlike Germany. Here, the fact that savings banks are not national banks and do not enjoy a monopoly in any line of business is overlooked. A bank under public law also means something completely different in other nation states, therefore, no internationally valid procedure can be created and certainly not be applied to the very specific German bank market.

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3.6 Savings Banks - Indispensable for Regional Economic Development

If savings banks did not exist - they would have to be invented. This became especially obvious during recent years when the major private banks in Germany led themselves into economic crisis. However, instead of learning from their mistakes, the private banks look for the cause of their bad results in the German banking system, in particular in the savings banks (public banks). The Federation of German Banks (BDB) has done some very successful lobbying in order to achieve its goal, the privatisation of the public banks. However, privatisation of the public banks would be a great political mistake with expensive costs for many local authorities and communities.

The German Financial System - One of the Most Stable in the World

No serious crisis has occurred in the financial system in Germany since the foundation of the Federal Republic, which is in contrast to many industrial countries of the western world.
There are various reasons for this, for example a very effective supervision and control system. However, a significant reason is also the structure of the Federal German credit system. The banking environment in this country is characterised by the so-called 3 column system. In addition to the private banks, today there are about 1300 loan banks and just fewer than 500 savings banks and provincial banks in Germany. Savings banks and cooperative banks are regional banks. They are involved in the region and earn their bread from local businesses and customers in the region. The most important private banks, especially the four major banks (Commerzbank, Deutsche Bank, Dresdner Bank, HypoVereinsbank), are globally operating institutions. They have no interest in certain customers or regions, but are purely profit-oriented.

The "banking crisis" of recent years was not a crisis of the financial system, but basically a crisis of the major banks. The profits of loan banks and savings banks did indeed also fall back slightly in comparison to the 1990s, because of the weak economic development. Nevertheless, balance sheets in the red and billions in losses were to be found especially with the major banks. Luckily for the German national economy, the four major banks have "only" a market share of about 16% in Germany! If these banks had a market share comparable to that of the four market-leading credit institutes in Great Britain or Sweden, where four to five banking institutes dominate the market – their problems would have led the entire national economy into considerable difficulties. The result: the state would have had to intervene with financial support for the private banks. The trigger for the crisis was the desire of executive boards and shareholders for short-term maximization of returns. The major banks changed their business policy. They neglected the traditional banking transactions with private customers and medium-sized companies. They closed down many branches throughout the country and considerably reduced staff. The "best bet" included investment banking and the bond business.

The consequences of the wrong business policy have to be carried by the employees with job reductions and wage losses and public finances have lower tax revenues. However, instead of acknowledging their mistakes, some major bank managers who belong, by the way, to the top earners of the branch, even by international comparison, seek the blame in politics. The savings banks and provincial banks are the reason why German bank profits lie far below the average. It is necessary to privatise the savings banks and thus provide the private banks with the possibility to take over the savings banks to consolidate the market. It is quite interesting that the private banks, the advocates of the free market, deplore the intensive competition in the German bank market, and at the same time insist on extending oligopolies on the market, as has occurred in Great Britain. Besides, the example of Great Britain clarifies the negative social results of the returns mania of British banks. The British government and the British consumer's organizations now regret the power of the British banks. This power leads to high prices and to extremely high profits for the British banking groups. The consequences: 3 to 4 million people have no bank account and many business people cannot obtain credit from the banks. Some self-help organizations have already been formed.

Savings Banks Protect the Credit Supply and Provide Competition

British conditions are not possible today in Germany. This is due to the public-law savings banks. They belong to the local authorities or the provincial administrations and are governed by the regional principle. This means that the money the savings bank receives from the customers and businesses of the region is also made available to the people and businesses in the region. The money remains in the region. Whereas the private banks have withdrawn from many regions, the savings banks are represented all over the country. They have more than around 17,000 branches in Germany. The Deutsche Bank has closed 34% and the Dresdner Bank 29% of their branches in the 1999 to 2003 period. The Deutsche Bank still had more than 1576 branches in 2003, the Dresdner Bank more than 1035 branches. While the private banks often refuse to provide an account to those on social security, the savings bank here fulfils its public duty (80% of the social security receivers have an account with a savings bank).

Whereas the major banks have also withdrawn from the company loan business for manufacturers and broad sections of the middle class, this is a business nucleus for the savings banks – since they can only do business with local customers. The credit market share of the savings banks with small and medium-sized companies, as well as independents, has risen steadily over recent years because of the business policy of the major banks. Meantime, it is more than 42% compared with just 34% 10 years ago. With manufacturers, the market share is even 66%. Several medium-sized companies only exist today because a savings bank was prepared to take over the financing from another bank. In the new federal states without a savings bank, there is no bank at all in some regions.

Savings Banks Create Employment and Pay Taxes

The regional savings bank is often one of the biggest employers in a local community. All together about 335,000 people were employed by savings banks and provincial banks in 2003. Of these 23,700 were trainees – a teaching rate which lies significantly above the rate of private banks. Savings banks are frequently also the largest tax payer in the municipality. Because of their regional structure savings banks also pay tax on their profits locally, (the tax burden of the savings banks lies considerably above the level of private banks), private banks use their possibilities to evade tax payments. The Frankfurt city treasurer has especially little to smile about concerning the present situation with the major banks. In addition to direct tax payments the municipal owners of the savings banks profit from the social and cultural commitment of the savings banks to their region. Today there are 570 savings bank foundations. These have paid out about 46 million Euro for projects benefiting the community in 2003. What are often forgotten in political discussions, are the positive indirect effects of a regional savings bank. Savings banks not only secure qualified banking jobs in the region. They secure a large number of other local jobs by ensuring that credit is available to the local middle business class - and thereby secure additional tax revenue from companies and private individuals.

Privatisation of Savings Banks is Damaging to the Public

Private bank lobbyists use the difficult economic position of many municipalities to benefit themselves and demand a change in the savings bank laws which would allow the possibility of converting savings banks into public companies and, finally, privatisation. The present legal position prevents the sale of municipal savings banks. This regulation is reasonable since important savings banks could no longer participate in the savings bank group as a whole if they were privatised to alleviate the financial difficulties of municipal budgets. It is only the sharing of the work load between large and small savings banks, provincial banks, building-society savings banks, IT-services, and fund societies that allows a comprehensive country-wide cover for financial services. Only the present legal structure protects the regional principle and the public obligations of the savings bank. Instead of allowing for the conversion of savings banks into public companies by privatisation discussions, it would certainly be more helpful for politicians to be thinking about how savings banks could fulfil their public obligations even better. A savings bank in the form of a public share company is subject to company law – its commitment is to the shareholder. Even if the local authority remains the majority shareholder of the savings bank, the savings bank must also commit itself to the profit interests of the minority shareholders. Sooner or later, the obligation to the public will suffer. Often the conversion to a public company is only the first step - the privatisation experience with public assets over recent years shows this to be the case.

And if the regional savings bank is finally owned by another bank, then this decision cannot be reversed, with the corresponding consequences:

- for jobs in the savings bank
- for jobs in local medium-sized companies
- for the supply of financial services
- for the tax revenues of the municipality

Indeed, up to now, the policy being followed has prevented a possible privatisation of savings banks. However, the advocates of privatisation have already achieved their first successes.

Discontinuation of the Municipal Liability Guarantee Increases the Pressure to Produce Profits Private Banks claim public law banks have a competitive advantage, because the local district authority or the provincial government provides an unlimited guarantee to the bank, thereby permitting a better credit rating. However, this ostensible advantage quickly turns into a disadvantage. Public banks must generate their own capital resources from their annual surpluses, whereas private banks can easily acquire additional capital by the issue of new shares (combined with high issue surcharges). Increasing capital resources is the necessary condition for additional banking business. The second disadvantage can be the restriction in the line of business, since this of course limits the profit possibilities.

Nevertheless, the savings banks are financially among the most successful credit institutes in Germany. The displeasure concerning better competitiveness led to complaints by the BDB to the EU in Brussels. The BDB has already been successful twice (BDB representatives have declared that they will continue to proceed against the public law banks until they have achieved their purpose, which is privatisation). Although the coexistence of private and public property is expressly regulated for in the EU treaties, the EU competition commission has decided that a public owner may no longer unrestrictedly guarantee companies from July, 2005 (which of course a private owner may undoubtedly do), and that the house-building promotion funds provided by the provincial governments to the regional banks are to return an interest of almost 7%. Thus, the EU has prescribed the lowest level of interest payment the owner of the regional bank has to receive for invested capital, - even if it is not required! Both Brussels decisions raise the pressure on savings banks and provincial banks towards profit return and restrict them when fulfilling their public obligations. The pressure towards a close co-operation between savings banks, provincial banks and the other savings bank group institutes has clearly increased. The distribution of labour within the savings bank group must be organised more efficiently.

Ver.di: Maintain Regional Focus and Public Obligations

The strength of the savings banks lies in their being rooted in the region and being bound into the savings banks group organization. The German services trade union, Ver.di, is strongly committed to these two aspects as a means of protecting interests of the public bank employees and those of many citizens in the local authority community. Privatising the savings banks damages economic development in the regions concerned.

However, the creation of a savings bank group would also be detrimental. Some executive boards and organization representatives try to use the com-

pulsion to closer cooperation within the group to form a savings bank corporation. According to this concept, the savings banks would then be reduced to distributing the products which are created centrally for the whole organization. A locally autonomous customer policy, product policy, price policy or marketing policy would no longer be possible. Many local jobs would be centralized, and therefore disappear from the region. The public obligation to support the local economy would become more difficult. The direction of this policy is clearly shown by the Austrian development which previously had a savings bank system very similar to the German system.

Today most savings banks in Austria are bound by contract and often also by capital to the First Bank. The First Bank is the leading institution of the Austrian savings banks. The individual savings banks are obliged to sell certain products according to certain conditions. Important tasks are dealt with by the First Bank. The savings banks are indeed formally independent, but they hardly have any commercial freedom. Additionally, the First Bank is quoted on the stock exchange and is obliged to be primarily concerned with earning income for the shareholders. Here, as well, the very first step was the conversion of the public law bank into a public corporation.

Thus, Ver.di supports a clearer and more binding division of work between savings banks and provincial banks. Masses of mergers between savings banks or provincial banks however are not necessary. The present regional bank structure does not need any further mergers for economic reasons. Besides, additional mergers would destroy the local identity and cut the links to the provincial and regional savings bank organizations. The borders of the savings banks areas of activity should as a rule mirror those of the local political borders. Also smaller savings banks can also survive in the savings bank group. Often the small institutions even generate the highest income returns. Of course there may be situations in which mergers are necessary to provide the region with an effective savings bank. It may also be sensible to combine certain tasks of several savings banks. Unfortunately, the executive boards of public banks often forget their public obligations when considering this step. As a public company it should be natural to ensure that a new savings bank subsidiary is not abused for wage dumping. The new companies often do not want to be still bound by pay agreements and intend to significantly change the terms of employment for the employees in a negative way. In such cases Ver.di requests more active support from politics, especially by representatives on the boards of governors of the savings banks. If public companies do not make an effort for a socially fair development of the social climate and terms of employment of their citizens, who will?

Jörg Reinbrecht

Weltwirtschaft, Ökologie & Entwicklung
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WEED is an independent Non-Governmental Organisation that was founded in 1990 to raise awareness in Germany for the roots of global poverty and international environmental problems. weed campaigns for a change in international economic and development policies that would put social justice and environmental sustainability in the centre of international policy-making. Our aim is to create more awareness in this respect and develop and implement concrete political alternatives. weed systematically analyses global economic, environmental and socio-political issues, linking the vision of a socially equitable and environmentally sustainable society to action and policy reform.

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