FINANCE TO CITIZENS

MAKING FINANCE SERVE THE GENERAL INTEREST

A report by Secours Catholique – Caritas France

A report from Secours Catholique - Caritas France, in partnership with

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FOREWORD

Combating poverty, inequalities and injustices are part of the core missions of Secours Catholique – Caritas France. For more than 70 years, the association has assisted those in need, rallying support and taking action against the causes of these scourges. It is this commitment which is leading us to question the role of the economy in our societies, as well as the models and economic policies best able to serve the common good.

As Pope Francis reminds us: *"On the one hand, as never before during these years, the economy has enabled billions of people to enjoy well-being, rights, better health and so many other things. Yet, at the same time, the economy and the markets have played a role in the excessive exploitation of common goods, in increasing inequalities and in the deterioration of the planet. Therefore, an ethical and spiritual assessment must be able to navigate its way through this ambivalence emerging into increasingly complex contexts.*"[1]

The current financial system, in our view, plays an essential role in our societies which are too unequal and pay too little heed to the most excluded.

Today, our world is facing numerous striking issues - social, ecological and political - leading us to consider different models of development, in which economic and social organisation is harnessed to serve the citizens, their essential needs, their dignity and their standard of living.

The current financial system, in our view, plays an essential role in our societies which are too unequal and pay too little heed to the most excluded. Pope Francis, in his encyclical *Laudato Si,* highlighted that the reconstruction of a more sustainable common home, of a more just society, of an economy at the service of "*buen vivir*", also required the implementation of economic and financial reforms.

"The 2007-2008 financial crisis was an opportunity for the development of a new economy more attentive to ethical principles, and for a new kind of regulation of speculative financial activity and fictitious wealth. Yet there was no reaction entailing a rethink of the obsolete criteria which continue to govern the world[2]."

We would like to take part in the reconstruction of a "common home" in which each of us can live in a just and sustainable way, and we believe that each citizen has a

1 Pope Francis, April 2018 (Preface to *Power and money. Social justice according to Bergoglio (Potere e denaro. La giustizia sociale secondo Bergoglio*), Città Nuova.
2 Pope Francis, encyclical *Laudato Si,* 24 May 2015, 189.

role to play, and that they must be enlightened about this complex and crucial issue which affects their life and that of the billions of people on this planet: finance.

Finance plays an essential role in the organization of the so-called "real" economy, in both public and private investments, citizens' savings and loans, and payment systems. It has also progressively come to occupy a disproportionate place in the global economy, heavily influencing various sectors of the economy, but also public policies.

It is vital that finance can once again be harnessed to address the issues faced by our societies. What kind of financial system model is desirable to serve the common good, which avenues of reform would enable us to prevent new financial crises, and how could we prevent any speculative drift? How to redirect financial flows toward socially useful investments? All these questions have guided our research, and we attempt to answer them here. Considering finance based on its impact on poverty, inequalities and the general interest, the objective of this document is to offer analyses and recommendations for opening up a discussion between citizens, actors from the financial world and political decision-makers.

The purpose of this document is to offer analyses and recommendations for opening up a discussion between citizens, actors from the financial world and political decision-makers.

Because finance is a societal issue, because it is everyone's business, and because it is important to give (back) "finance to the citizens".

Enjoy the report, and good luck rallying support!

Véronique Fayet,
Chairperson of Secours Catholique –
Caritas Francete du Secours Catholique – Caritas France

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"Today, in view of the common good, there is an urgent need for politics and economics to enter into a frank dialogue in the service of life, especially human life. Saving banks at any cost, making the public pay the price, foregoing a firm commitment to reviewing and reforming the entire system, only reaffirms the absolute power of a financial system, a power which has no future and will only give rise to new crises after a slow, costly and only apparent recovery."

Pope Francis, Laudato Si, § 189

"Finance to citizens: making finance serve the general interest ": is the guiding thread of a research work on the links between finance, poverty, inequalities and the pursuit of the general interest. This research work is underpinned by the quest for political economy frameworks in which all stakeholders contribute to building fair societies. It also encompasses the complexities and tension between the essential role of the economy on the one hand, and the devastating effects of deregulation on society and the planet on the other.

Thus, this six-part document aims to analyse the role and workings of the global financial system, to decrypt its impacts on poverty and inequality, and to propose reforms that would make finance serve the general interest.

It is a fact that banks and finance play a key role in the global economy, far beyond the financial system itself. As they operate today, financial markets generate private profits, but hardly serve the general interest. This adds to poverty and inequality, and diverts financial resources away from issues of general interest.

The first part of this document sets out to explain why the workings of the financial and banking systems is a matter of general interest. The second part sets out the significant changes that have taken place in the global financial system over the past forty years (since the end of the so-called "Bretton Woods" fixed exchange rate system in 1973). The third part shows how the 2008 crisis was partially resolved with the support of the Central Banks, and how this was insufficient to revitalize the economy.

Parts 4 and 5 highlight how the current workings of the financial system are misaligned with the general interest, in developed countries as well as in emerging and developing countries. This misalignment has in particular contributed to slowing down economic development and to widening inequality.

The last part concludes with a proposed set of finance regulating measures, aiming to launch a debate on how to make finance serve the general interest once more.

Key data

- **$100,000 billion,** total global bonds outstanding as at 2014 ($10,000 billion in 1990). This market grew 2.7 times faster than world GDP
- **$75,500 billion,** world GDP
- **$33,300 billion**, the financial market operations of the big European banks, i.e. more than 70% of their operations
- **$15,000 billion,** the gross amount outstanding of derivatives, i.e. the amounts invested in these products (of which less than 10% associated with the non-financial economy)

1. ROLE OF FINANCE AND ISSUES OF GENERAL INTEREST

Finance occupies an essential place in the economy, insofar as it creates and channels financial resources towards the economic actors who require them.

Banks play a role of general interest by managing the payment systems, but also by granting credit. Through these functions they create money and new purchasing power. In the eurozone, coins and banknotes represent approximately 10% of the currency's total amount outstanding: the rest of the money is circulating in the form of cheques, bank transfers or payment cards.

When credit growth outpaces production growth, the price of existing assets will increase, possibly up to the point where speculative bubbles form. When economic agents borrow in excess of their repayment capacities, these bubbles may burst, triggering a recession. This does not affect just the financial sector, but the economy as a whole. For instance, in the US, wages increased by 2.4% over the period 2000-2007; while real estate prices rose by 90% and real estate lending grew by 134%. Such imbalances paved the way for the major crisis of 2008.

In each country, banks are governed by the central bank, which can influence the overall quantity of money in circulation. This amount in turn influences the currency's exchange rate, which affects the cost of imports and the price of exports, and, in the end, each and every citizen's daily life.

Therefore, the banking and financial sector plays an essential role in the working of the economy as a whole. This is directly relevant to the general interest in at least three aspects: management of payment systems, credit management, and currency value.

But, despite its crucial role for the general interest, finance still does not feature in the civic debate or in economic research. Furthermore, policy makers are often very close to the financial elites, and States have become more dependent on the financial actors, due to public debts being put on the market.

2. Global finance: forty years of progressive deregulation

Since the implementation of the floating exchange rate system in 1973, global finance has undergone progressive deregulation. Global finance has undergone a transformation, with the appearance of new products, known as “derivatives”, and new actors. Besides threatening the economy, the “floating” of exchange rates led to the emergence of financial tools initially designed to hedge against exchange rate variations, **derivatives**. They have subsequently extended well beyond that function to hedge against other risks, and have become financial products in their own right. Their initial hedging role has taken a back seat to use as instruments of speculation. Thus today, oil derivatives represent more than ten times the physical oil trade volumes.

The expansion of these derivatives and the volatility in asset prices, notably currencies, has led to profound changes in the banking business. Thus during the 1980s, in order to address mounting risks on banks’ balance sheets, central bankers introduced the so-called **Basel prudential regulation**, which required banks to hold minimum amounts of equity capital to cover for credit risks. The **development of securitisation** was a way for banks to avoid this requirement, since it enabled them to offload credit risks by selling credit portfolios to other structures. This gave birth to a huge so-called “*shadow banking*” system, a parallel credit system outside of the scope of the banking regulations, and comprising both securitisation vehicles and investment funds.

Meanwhile, under the influence of the economic policy of the International Monetary Fund (IMF), **cross-border capital flows have been liberalized. Credit and bank regulation have been loosened all around the world, leading to concentration trends and the emergence of banking multinationals**, deemed “*too big to fail*”. This deregulation was also one of the main factors behind the exponential growth in credit, far beyond the needs of economy, and imbalanced in relation to these needs. Hence, mainly in developed countries, too much credit growth is directed at existing real estate and at speculative activities. This aggravates poverty and inequality, helping to create bubbles and potentially leading to financial and economic crises.

Last, but not least, **the majority of emerging and developing States, and then developed States as well, have become borrowers on international financial markets**, on which they are today highly dependent for their funding needs. This high dependence on private creditors has restricted the margins for manoeuvre of governments to fund public policies: namely social safety expenditure increased by the economic crisis, the need for investment relating to climate change, and development needs in the South.

All in all, these phenomena have led to finance occupying a disproportionate place in the economy, with excessive impact on public policies, while causing growing financial instability.

3. INSUFFICIENT REFORMS AFTER THE 2008 CRISIS

The 2008 crisis shed light on the dysfunctions of finance. The institutional response has been multiform, but unfortunately insufficient. It has been unable in particular to fundamentally address the role of finance and how to make it serve the general interest once more.

The 2008 financial crisis started with a real estate debt overhang: Many US households were struggling to pay off their loans. It then spread like wildfire throughout the global financial system, particularly due to the widespread securitisation of these loans, the massive amount of derivatives in circulation, and the free flow of capital. Financial actors began to panic, unable to assess the risk of their own holdings, or that of their counterparts.

Central banks responded to the crisis by implementing *quantitative easing*, which consists in purchasing assets from banks. This was unable to revitalize the economy. While it safeguarded the workings of the banking system, it also contributed to maintaining speculative bubbles on the financial markets, and to aggravating inequalities between financial actors and other economic agents.

New regulatory measures were adopted both in the USA and in Europe, aimed at stabilising the financial system, so as to avoid further taxpayer bail-outs. Although generally well oriented, they were limited in scope by strong resistance from the financial actors alongside the policy makers, and some of the main issues could not be addressed: the attractiveness of speculative trading remains too high, the non-banking financial is sector is no better regulated, banks are still too large, and credit is insufficiently focused on the needs of the real economy…

Overall, the reforms undertaken have not sufficiently questioned the role of finance with regard to the general interest and the funding of social, economic and environmental issues.

4. TOO MUCH FINANCIALISATION AND WIDENING INEQUALITY IN DEVELOPED COUNTRIES

Beyond the impacts of the 2008 financial crisis on economies and people, **financialisation of the economies since the 1970s has affected the very structure of societies, widening inequality.** When a financial crisis like that of 2008 occurs, economies and people suffer the adverse consequences of the disproportionate level of risks taken by financial market actors. In 18 OECD countries, inequalities rose faster between 2007 and 2010 than during the whole of the 12 preceding years.

Since the 1980s, credit growth **was faster than output and wages, which led to a debt overhang**. Furthermore, the massive accumulation of financial assets slowed down the non-financial economy, keeping a considerable proportion of people unemployed in advanced economies, and further widening wealth and income inequality.

The economic slowdown after the 2008 crisis widened State deficits, as their income decreased alongside their increasing social expenses. State private creditors favour austerity policies, which harm the general interest and are doomed to failure, given the very high level of State debt. Meanwhile**, the level of equity in the banking sector is still too low, with State finances still under threat in case of default**, which would indirectly endanger necessary social services.

5. FINANCIALISATION OF THE ECONOMY IN EMERGING AND DEVELOPING COUNTRIES

The overall development of the financial system over the past forty years has not benefited the developing countries. Poverty may have been reduced since 1990, but it remains too high. The development policies implemented since the 1960s-1970s, i.e. when financialisation of the global economy was in full swing, did not succeed in reducing inequalities between countries, and differences in living standards are still huge.

As a rule, emerging and developing countries lack the hard currencies that they would need to be able to implement ambitious public policies. The financial system as it currently operates favours capital flight from emerging and developing countries to developed countries, hampering local investment. It does not remedy the **lack of local systems able to channel local currency savings toward the infrastructures required to support sustainable development**.

The structural adjustment policies promoted by the IMF and the World Bank in the 1980s favoured excessive currency borrowing by these countries. This swallows up their financial resources and prevents them from acquiring the necessary technologies and fixed capital that would permit them to implement public development policies in line with the current and future issues.

Moreover, the globalisation and financialisation of commodities markets have enabled the establishment of multinationals, combining production and trading activities. They have captured a large part of the value in agribusiness and energy, to the detriment of local people and States.

Thus, **as it currently operates, the financial system creates obstacles instead of providing solutions for developing countries. Moreover, those countries are practically absent from the institutions that design international financial regulations** and guide policies. This situation is particularly unacceptable in light of the investment that emerging and developing countries need to finance their public policies, as well as energy and ecological transitions.

6. HOW TO MAKE FINANCE SERVE THE GENERAL INTEREST ONCE MORE? PROPOSED MEASURES

It is possible to rectify the deregulation of finance, its excessive size and its harmful impacts on the general interest. This involves reviewing the rules of its game, rather than merely adjusting them.

A single keyword to sum up the reform proposals could be: **oversight.**

The proposed measures are based on long-term, in-depth and ambitious reform, and are sequenced in chronological order, revolving around four axes. In order to protect the general interest, it is necessary, but not sufficient, to **stabilise the financial system in order to prevent the risk of crises.** Secondly, **capital flows should be directed toward the needs of a sustainable and egalitarian economy**. Public authorities should therefore be able to employ **control and decision-making mechanisms** in order to attain this. Lastly, **immediate stimuli** must be found to address two major current problems: the global debt overhang and the ongoing threat to currencies posed by the liberalization of cross-border capital flows.

AXIS 1:

Stabilise the financial sector, i.e. protect the economy and societies from the excessive risks taken by finance, in particular by limiting banks to operating in retail services (deposits, loans, payments) and strict oversight of banks and investment funds.

AXIS 2:

Ensure that this stabilised financial system channels savings toward activities useful for society, in particular by using reserve requirements and bank risk weightings, and implementing diversification of the banking sector actors.

AXIS 3:

Reorganize the supervisory architecture to make the financial sector steer a course in the general interest, in particular by expanding the composition of supervisory bodies beyond the financial actors and developed countries.

AXIS 4:

Use monetary and fiscal stimuli, in particular by money creation and taxing capital flows.

The purpose of these proposals is to **initiate a wide-ranging debate on how to make finance serve the general interest once more**. **Empowering civil society** with regard to these issues is a must. It is also necessary to be able to open **dialogue with the financial sector itself**, as well as with those responsible for designing the regulations and monitoring their application.

"*The recent financial crisis might have provided the opportunity to develop a new economy, more attentive to ethical principles, and a new regulation of financial activities that would neutralise predatory and speculative tendencies and acknowledge the value of the actual economy.*" [1]

1 "*Oeconomicae et pecuniariae quaestiones, Considerations for an Ethical Discernment Regarding Some Aspects of the Present Economic-Financial System*", 5, Congregation for the Doctrine of the Faith and Dicastery For Promoting Integral Human Development, 2017, http://www.vatican.va/roman_curia/congregations/cfaith/documents/rc_con_cfaith_doc_20180106_oeconomicae-et-pecuniariae_en.html

INTRODUCTION

Banks and finance play a very important role in the global economy. The financial system does not solely concern bankers or professional investors. Its workings have consequences on the economy as a whole, and so on everyone's economic and social existence.

As they are operating today, financial markets generate private profits, but do not serve the general interest. This adds to poverty and inequality, and diverts financial resources away from issues of general interest.

When citizens meet finance.

This six-part document aims to analyse the workings of the global financial system, to decrypt its impacts on poverty and inequality, and to initiate the debate to suggest reforms that would make finance serve the general interest.

Part One will set out to explain how the workings of the banking and financial system concern the general interest.

The financial world has seen significant changes over the past forty years (since the end of the so-called "Bretton Woods" fixed exchange rate system in 1973). These will be covered in **Part Two**, as they provide a better understanding of how the big 2008 financial crisis came about, but also how it led to a profound and long-lasting economic crisis directly affecting millions of people worldwide, beyond the financial sphere.

Part Three will show that the 2008 crisis was partially resolved with the support of the Central Banks, and how this was insufficient to revitalize the economy. After the crisis, some welcome reforms were introduced in terms of regulation of the global financial sector, yet they were still partial and insufficient.

Part Four will shed light on how the current workings of the financial system are misaligned with the general interest in developed countries[1]: in particular it has contributed to slowing economic activity and widening inequalities.

In so-called emerging and developing countries, globalised finance has contributed to maintaining poverty and has slowed development. This will be illustrated in **Part Five**.

Part Six of this report will recommend a set of worldwide finance regulatory measures, to make finance serve the general interest once more. These measures are designed as themes to which citizens can rally and engage, with a view to constructing more stable and equal economic environments, where the economy is serving human development and dignity.

General interest, our approach

The concept of general interest is the object of several different approaches. Historically, and synthetically, the general interest is regarded in Anglo-Saxon cultures as the sum of private interests and the quest for coherency between them (a utilitarian vision), whereas French political culture takes it further (a voluntaristic vision). In France, the general interest has been at the foundation of public law in the successive Republics, and transcends private interests[a].

To avoid getting into conceptual debates, which are beyond the scope of this document (in particular on the fact that individual interests are essentially contradictory or in tension with each other), the general interest will be regarded here as the need to respect citizens' aspirations, particularly the most deprived, in order to face the structural issues of our societies: combating inequalities and poverty worldwide and transforming our socio-economic models to ensure the essential and urgent ecological transition.

a See the report "Réflexions sur l'intérêt général - Rapport public 1999" [Reflections on the general interest - Public report 1999] by the French Council of State, 1999, http://www.conseil-etat.fr/Decisions-Avis-Publications/Etudes-Publications/Rapports-Etudes/Reflexions-sur-l-interet-general-Rapport-public-1999

1 The appendix sets out a list of the various country categories drawn up for the purposes of this report.

1

ROLE OF FINANCE AND ISSUES OF GENERAL INTEREST

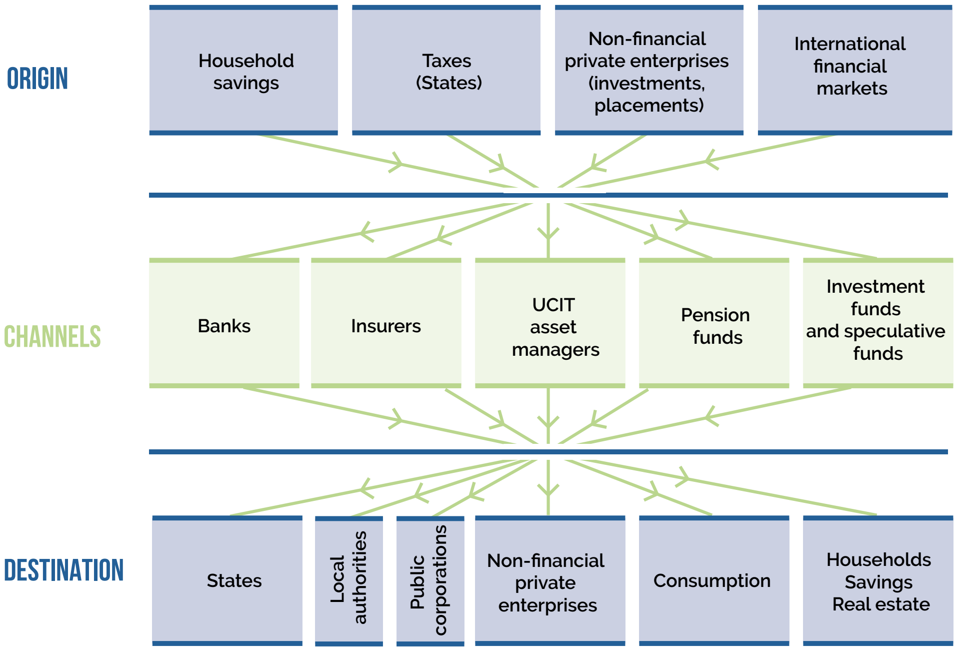
This part sets out to describe the current workings of finance, and its role which has become crucial in relation to the issues of general interest. It will firstly cover the various actors and institutions which make up the financial sector, as well as the mechanisms for money creation and the crucial role of credit. It will then shed light on the impact of the current workings of finance, and any drifts, on the economy and public policies.

1.1. FINANCE, CURRENCY, CREDIT: ACTORS AND MECHANISMS

A. WHAT DO WE MEAN WHEN WE TALK ABOUT FINANCE? THE MAIN ROLES OF FINANCE IN THE ECONOMY

Finance is a set of entities which *create* and *channel* money that they receive from certain economic actors (households, businesses, the State, local authorities and also international financial market players) and *direct* it toward other actors requesting this money. These financial entities may be grouped into five main categories[1]: banks, insurers, pension funds and plans, collective management bodies and investment funds, some of which are speculative in nature (*hedge funds*).

FINANCE: VARIOUS ACTORS CREATING, DIRECTING AND USING MONEY



Hence it is the financial sector that determines the return on the money, as well as the conditions under which the economic actors can borrow it. Borrowing is necessary in order to fund the acquisition of an asset which will either be simply owned, or used for production (in which case we talk about an investment). Therefore money and finance are at the heart of the economy.

1 For detailed explanations, see https://www.lafinancepourtous.com/decryptages/marches-financiers/acteurs-de-la-finance/

The activities of each of these categories of financial actors are summarized below (a blue box indicates retail banking).

FINANCE: A VAST VARIETY OF PROFESSIONS WHICH AFFECT EACH AND EVERY CITIZEN'S DAILY LIFE

Banks

Money creation

Retail bank:
- Deposits
- Payment systems
- Financial placements

Commercial banks: compulsory loans (businesses and States).

Share issues for businesses.

Manufacturing derivative financial products for clients and trading for themselves

UCIT asset managers

E.g. : Amundi

Collect savings and place them on the financial markets.

Purchasing shares, bonds, placement products.

Manufacture and manage Sicavs (open-ended investment companies), FCPs (common investment funds), other UCITs [Undertakings for Collective Investment in Transferable Securities] and other fund types (real estate, etc.).

The banks are shareholders of the fund managers and distribute their funds to individuals and businesses.

Insurers

Eg. : AXA

Sell and manage general insurance and life insurance.

Purchase State loans and other products, which enable them to fund loans paid to policyholders.

Banks are capitalized by insurers, and distribute their policies and placement products to individuals.

Pension funds

E.g. : ERAPF [French public sector pension fund]

Collect pension contributions and place the money on the financial markets so as to be able to provide the pensions.

In France, act for the State, for mandatory retirement; in Anglo-Saxon countries, private funds collect and manage directly.

Investment funds and speculative funds

Eg. : PAI Partners

Collect savings and place the money in all sorts of vehicles according to the savers' choice.

Some investment funds in businesses (this is the case with PAI), others in financial derivatives (hedge funds), others in real estate (Real Estate Investment Trusts). Finally, certain funds manage secured bank loans (securitisation funds).

B. BANKS CREATE MONEY, CREDIT AND PURCHASING POWER

Banks play a vital role in the economy, because they manage deposits and payment systems. If the banks suddenly closed, the economy could shut down, because payments would not be received by economic agents. In this respect, the bank performs a general interest function: managing payment systems. Yet the role of banks in granting credit is just as important for the general interest, and less well known. It is often understood that "*Deposits make loans*": the banks collect money from deposits, and it is this money that they use for lending purposes. This would make banks a mere channel, a neutral player. The quantity of money lent would be equal to the quantity of money collected. Yet this is a misconception that is behind a frequent under-estimation of the role of banks in the economy[2]. In fact, when a bank provides a loan, such as a real estate loan to an individual,

2 Although most economists and specialists recognize that "*loans make deposits*", there may still be some debate. See for example these exchanges between two former actors from the financial world: Roland Verhille, "Les crédits (les dettes financières) font-ils les dépôts, la monnaie ?", [Do loans (financial debts) make deposits, currency?] *Les Échos,* 4 December 2012, http://archives.lesechos.fr/archives/cercle/2012/02/04/cercle_43040.htm and Pascal Ordonneau, "Loans make deposits", *Les Échos,* 22 April 2011, http://archives.lesechos.fr/archives/cercle/2011/04/22/cercle_34684.htm

And finance created money.

it does not take the money from anywhere: it manufactures it, through e-writing. It writes a real estate loan (the debt owed by an individual borrower, owned by the bank) into its accounts, and gives the money to the borrower. The latter then transfers it to the vendor of the purchased asset. The vendor is left with "new" money, new purchasing power, which they can now use for expenditure. Hence in reality, *"loans make deposits"*. As the borrower pays off the loan, the amount outstanding of the bank loan will decrease. Therefore the new money created by this loan will gradually be destroyed. Hence the banking system accommodates the constant creation and destruction of money.

This is a central point, since it highlights how, by deciding whether to grant a loan, banks decide how and to whom purchasing power is directed in the economy, and which projects receive funding and can therefore be executed. Yet distribution of banking loans is not balanced across all sectors of the economy, far from it (see parts 4 and 5).

C. BANKS ARE GOVERNED BY CENTRAL BANKS, WHICH INFLUENCE THE TOTAL QUANTITY OF MONEY IN CIRCULATION

To be able to operate, a bank needs to obtain a licence from the central bank of the country where it is based. A central bank is the "bank of banks". It is the body responsible for monitoring the total quantity of currency in circulation in a country (or a currency zone, such as the European Central Bank – ECB – in the case of the eurozone).

A central bank has four essential functions:

- it manufactures *coins and banknotes*. In the eurozone, coins and banknotes represent approximately 10% of the currency's total amount outstanding: the rest of the money is circulating in the form of cheques, bank transfers or payment cards;
- it monitors the total quantity of money in circulation. Banks send their accounts daily to the country's central bank[3], which can in this way measure how much money has been created or destroyed;
- if the banks create too much money for the liking of their central bank, the latter can take some money off them, via the so-called *reserve requirements* system: banks must place a percentage of savers' deposits in the account of the central bank[4]. In some respects this money is *frozen,* i.e. it cannot circulate in the economy. The sum of the reserve requirements to be deposited is calculated as a percentage of bank deposit amounts outstanding. The amount in the eurozone is currently 1%. A central bank can increase the reserve requirements amount if it wishes to limit credit expansion[5];

A central bank is the "bank of banks".

- it is employed to balance banks' balance sheets (a bank may have too many deposits and not enough loans, or vice versa). To do so, it can lend money to banks. The market of loans made between banks is known as the *interbank market*. They make these loans at a rate which acts as a credit reference, the interest rate of which is calculated from this base rate, adding an additional credit cost according to the risk taken by the bank in approving loans. If a central bank wants to reduce the quantity of money in circulation, it increases its intervention rates; hence lending becomes more expensive, and banks engage in it less.

Therefore central banks *regulate* the total quantity of currency in circulation, the interest rate and the rate of money creation by commercial banks. Independence from the central bank comes down to the national government, and the organization of the monetary policy by the government. There are various degrees of independence of central banks worldwide[6]. Hence, for example, the central banks in the eurozone (the ECB) and the USA make their decisions independently of the governments. The Central Bank of Japan acquired its theoretical independence in 1998, though certain researchers still regard it as closely linked to the government[7]. The Central Bank of China[8] is dependent on its government.

3 Since the implementation of the so-called Target 2 payment system in the eurozone, this is no longer done daily as before, but continuously.
4 Yet in practice, central banks use this credit directing mechanism only very rarely, or not at all (see part 6).
5 The reserve requirements mechanism is different from the bank solvency ratio (see below).
6 See Ed Balls, James Howat and Anna Stansbury, "Central Bank Independence Revisited: After the financial crisis, what should a model central bank look like?", Harvard Kennedy School, November 2016, https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/67_central.bank.v.2.pdf
7 See, for example, Moritz Bälz and Markus Heckel, "The Independence of the Bank of Japan in the Light of Statutory Rules and Central Bank Independence Indices", in Frank Rövekamp, Moritz Bälz and Hanns Günther Hilpert, *Central Banking and Financial Stability in East Asia*, pp.25-41, January 2015, https://www.researchgate.net/publication/300790800_The_Independence_of_the_Bank_of_Japan_in_the_Light_of_Statutory_Rules_and_Central_Bank_Independence_Indices
8 "Why China's Central Bank Is OK Being Dependent on the Government", *The Wall Street Journal*, 16 September 2014, https://blogs.wsj.com/chinarealtime/2014/09/16/why-chinas-central-bank-is-ok-being-dependent-on-the-government/

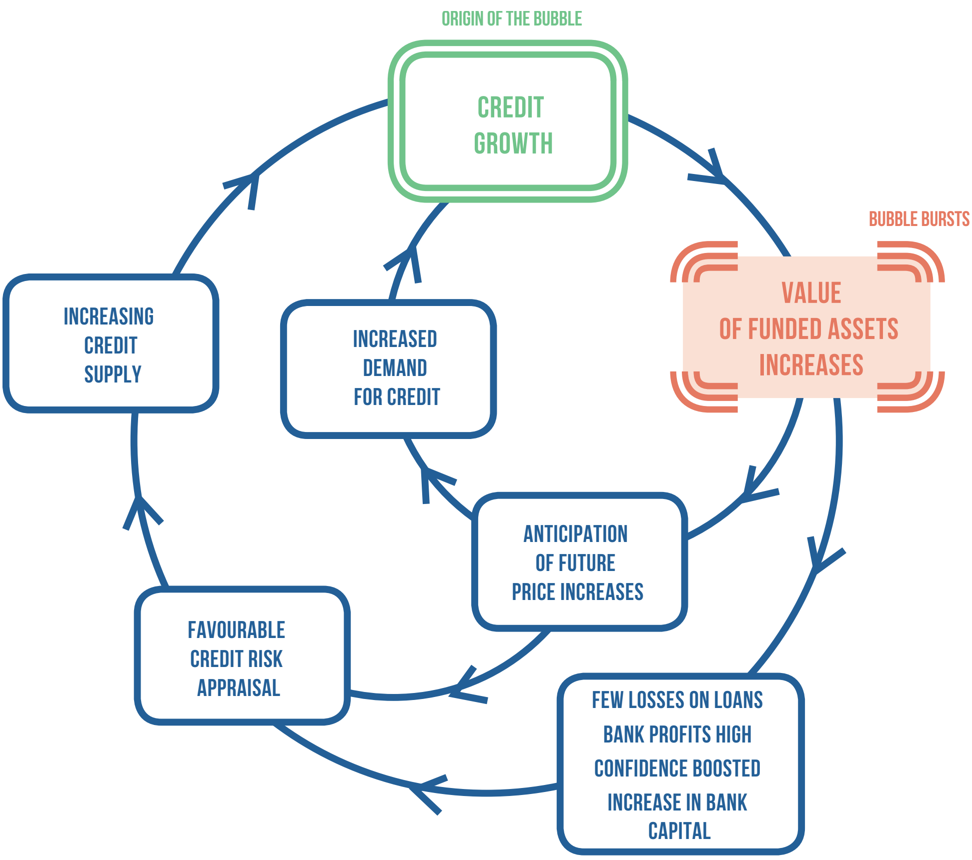
D. THE KEY ROLE OF CREDIT IN THE ECONOMY

The rate at which commercial banks create credit is important, since it influences economic activity, and therefore the citizens' daily life. Indeed, credit supports economic activity: it provides funding for investments or purchases by people who do not have money immediately available (or not enough). The considerable investments of the industrial revolution could not have been funded without credit. But too much credit can also be harmful. If credit is granted too easily, it can lead to debt overhang.

Bubbles form when credit increases faster than production

For three decades leading up to the 2007-2008 financial crisis, credit in the advanced economies increased faster than production[9]. When this is the case, since more

CREDIT GROWTH AND PRICE BUBBLE FORMATION



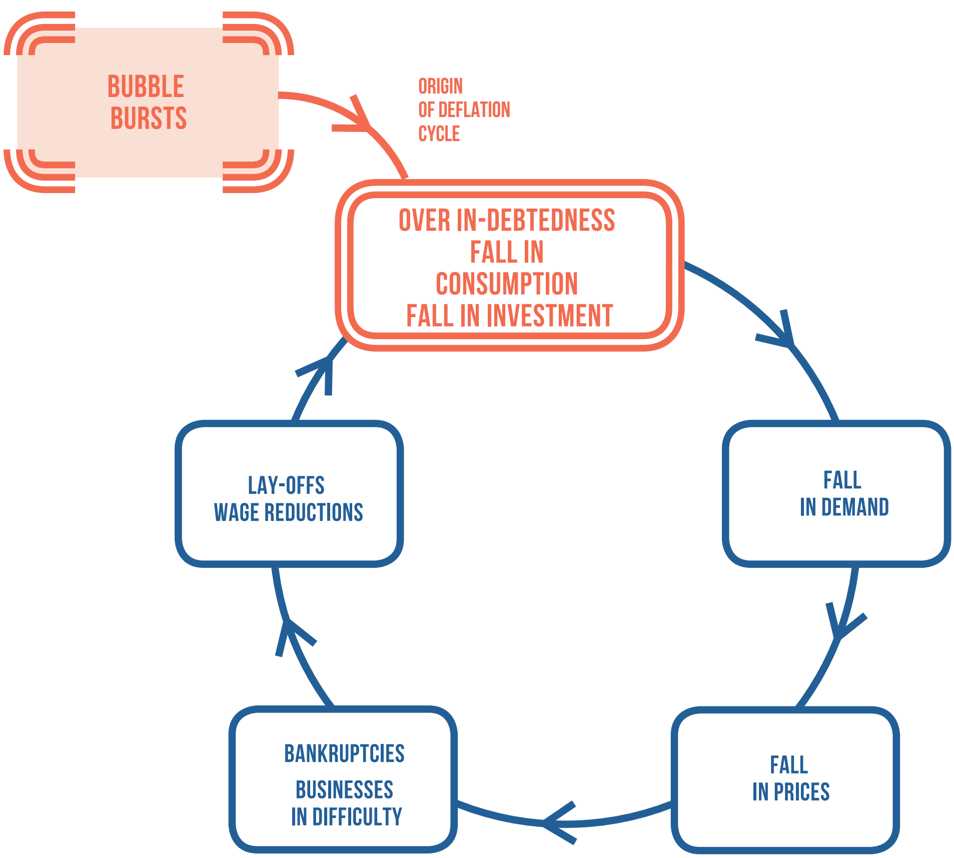
9 The share of credit in the private sector worldwide went from less than 70% of GDP in the late 1970s to nearly 130% in 2007. See the World Bank data, https://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS?end=2007&start=1971

money is earmarked for the same quantity of assets, the price of the funded assets increases. And so a price increase cycle begins; as prices rise, the expectation is that they will rise further; demand for credit increases, and the lending makes prices rise. We talk about a price or rate *bubble*[10] for an asset when there is a big and steep increase, without any objective reason or underpinning factors. It was in this way that the US real estate bubble formed between 2000 and 2007. Over this period, the price of real estate increased by 90%; simultaneously, real estate lending increased by 134%[11]. In Spain, over the same period, real estate prices increased by 120%, and real estate lending by 254%[12].

Debt overhang causes the bubbles to burst, and triggers recessions

The bubbles can end up bursting. The bursting of a bubble consists in a rapid fall in prices which had previously increased. A bubble may form slowly, over

DEFLATION DUE TO SERVICING DEBT



10 From the *Financial Times* glossary:http://lexicon.ft.com/Term?term=asset-bubble
11 Adair Turner, *Between Debt and the Devil*Édition de l'Atelier, April 2017, p. 112.
12 European Central Bank, "*Structural issues report: housing finance in the Euro area*", March 2009, https://www.ecb.europa.eu/pub/pdf/other/housingfinanceeuroarea0309en.pdf

several years, but it bursts all of a sudden: when prices start to fall, investors get nervous and all sell at the same time, which causes an even bigger drop in prices, and generates more fear, therefore leading to more sales. When does the bubble burst? For example, when certain borrowers do not manage to pay off their debt. Since they are then forced to sell the asset they had invested in to pay it off. This sale triggers a fall in prices.

And if wages are not increasing as quickly as credit, borrowers automatically find it increasingly hard to pay off their loans. Their debt level increases until the point that they can no longer pay it off. Under these conditions, the credit bubble is very likely to burst.

In the USA, wages increased by 2.4% between 2000 and 2007, while real estate prices rose by 90% and real estate lending grew by 134%.

Hence in the USA, wages increased by 2.4% over the period 2000-2007; while real estate prices rose by 90% and real estate lending grew by 134%. [13] If an economy's debt overhang becomes substantial, the economy is slowed down, because over-leveraged households reduce their consumption and investments so as to be able to pay off their debts. As demand slows, businesses hesitate to invest. Some lower their prices to sell more. This is what is known as *debt deflation*[14].

This is what happened prior to the 2008 crisis: three decades of credit growth outpacing production caused the formation of a real estate bubble in the USA, which ended up bursting, plunging the US economy into a recession. This recession did not only affect the banking or financial sector, but the whole of the US economy. The banks make secured real estate loans, which means that they take the real estate as collateral: if the borrower does not pay off their loan, the bank becomes the owner of the asset and expropriates the owner-occupier in order to sell it. Some entire districts in the USA had been funded by mortgage lending: when the over-leveraged owner-occupiers had to leave due to seizure by the banks, the shops and businesses in these areas had to close, depressing economic activity. This phenomenon of individual bankruptcies came on top of others (such as the fall in prices in an attempt to sell more, or the absence of sufficient investment due to lack of money), which intensified business bankruptcies, slowed down orders and production, while increasing unemployment and poverty (see part 3). In one year, from 2009 to 2010, the number of poor Americans, i.e. living on less than 10,000 dollars per year, increased by 4 million[15], to reach 44 million individuals, i.e. one American in seven, the highest rate since 1994.

The growth rate in lending, and with it the risk of bubble formation, are therefore issues of general interest, not solely concerning the financial sector: when speculative bubbles burst, the consequences affect a vast number of economic actors, exacerbating poverty and inequality.

13 Heidi Shierholz and Lawrence Mishel, "A Decade of Flat Wages The Key Barrier to Shared Prosperity and a Rising Middle Class", Economic Policy Institute, August 2013, *briefing paper* no. 365, http://www.epi.org/publication/a-decade-of-flat-wages-the-key-barrier-to-shared-prosperity-and-a-rising-middle-class/

14 Concept highlighted by the British economist Irving Fischer after the 1929 crisis, and recently revived. See Steve Keen and Gaël Giraud, *L'imposture économique, [The economic deception]*Éditions de l'Atelier, 2014; and Gaël Giraud *Illusion financière [Financial illusion],* Éditions de l'Atelier, 2014.

15 Erik Eckholm, "Recession Raises Poverty Rate to a 15-Year High", *The New York Times*, September 2106, http://www.nytimes.com/2010/09/17/us/17poverty.html?pagewanted=all&_r=0

Bubbles form when credit increases faster than production.

E. THE QUANTITY OF MONEY IN CIRCULATION INFLUENCES THE CURRENCY EXCHANGE RATE

As we discussed above, the function of a country's central bank is to monitor the amount of currency in circulation nationwide. Excessive money creation may increase inflation[16], which has consequences inside a country: according to whether production is increasing more or less rapidly, the increase in the money supply has a greater or lesser impact on prices. This also has consequences on the country's external trade. If a currency is experiencing high inflation, it tends to depreciate against other currencies.

If there is strong money creation in Brazil, for example, there will be more reals in circulation per existing US dollar. The real will depreciate against the dollar: more reals will be needed to purchase products in dollars, therefore imports of US products will be more expensive. As they become more expensive, imports will slow. Conversely, the price of products exported by Brazil to the USA will decrease, since fewer dollars will be required to obtain the same quantity of reals. Therefore exports are facilitated by currency depreciation.

16 We are presenting this issue in simplified form. For a better understanding of the issues of money creation, read for example, Gabriel Galand and Alain Grandjean, *La monnaie dévoilée [Money unveiled],* L'Harmattan, 1997.

The Brazilian inflation rate was 8.9% in 2016[17], and the real lost a quarter of its value against the dollar.

Therefore the quantity of money in circulation inside a country influences the currency's strength outside the country. This has direct consequences for the price of imported products and the export competitiveness of the country's businesses. Protecting the currency's external value or, to put it more simply, the exchange rate, is one of the reasons why the ECB and the Fed (Federal Reserve Bank, as the US central bank is known) have low inflation targets, set at 2%[18].

The currency exchange rate is also a matter of general interest, which has consequences for a country's entire economic activity. It indirectly influences the products that the consumer can find (or not), their price and the ability of the country's businesses to provide jobs in sectors set up for export sales.

1.2. FINANCE: OVERSIZED AND MONOPOLIZING THE GENERAL INTEREST

As discussed in Part 2 (historical developments), finance has occupied an increasingly prominent place in the economy, and exercises a powerful influence over issues of general interest.

Despite its crucial role for the general interest, finance still does not feature in civic debate.

The general public is unfamiliar with finance. Financial subjects are very often regarded as too complex, and finance has been become much more globalised and complex over the past forty years (see Part 2). This is illustrated by the famous quote by Alan Greenspan, Governor of the Fed (1987-2006): "*If I turn out to be particularly clear, you've probably misunderstood what I've said*."[19] By extension, this quote may be revealing as to financial actors deliberately seeking complexity, so as to remain incomprehensible to non-specialists in monetary and financial matters.

Civic debate and information of civil society on economic matters are very much organized around growth and jobs. It is clear that there are links between level of economic activity, purchasing power and jobs, on the one hand, but also between credit growth and monetary issues, on the other hand: however, these links are only rarely mentioned outside of specialised circles. In the eurozone, civic debate on monetary issues has become further removed from each and every citizen's daily life, since the currency is managed at ECB level, rather than directly by the States.

17 Data from the IMF's International Financial Statistics (IFS), http://data.imf.org/regular.aspx?key=61545849
18 See the speech by Janet Yellen, "Inflation, Uncertainty, and Monetary Policy", September 2017, https://www.federalreserve.gov/newsevents/speech/yellen20170926a.htm; and on the ECB's site, "Monetary Policy", https://www.ecb.europa.eu/mopo/html/index.en.html
19 "If I turn out to be particularly clear, you've probably misunderstood what I've said." A quote by Alan Greenspan in 1988, at the beginning of his Governorship. https://www.nytimes.com/2005/10/28/business/what-if-the-fed-chief-speaks-plainly.html

The culture of complexity.

Finance, the poor relation of economic science

One of the causes of the absence of debate around finance also lies in the fact that finance is often considered by most economists as an economically and socially neutral channel, subject to little critical analysis. Indeed, until recently[20], economic theory was scarcely concerned with finance, credit or banks. It was long considered that finance and credit had to be neutral overall in the economy: what is lent by some is borrowed by others, with these amounts cancelling each other out. Even today, economic research relates to supply, demand, jobs, inflation… but using economic models in which credit, banks and finance are absent. There are also economists working on the financial markets, but using models targeting optimization of the financial markets themselves, without necessarily making a link with the workings of the non-financial economy[21], outside of the financial markets.

It has therefore been on the basis of incomplete economic theories that the banking and financial system has been largely deregulated over the past four decades.

It has therefore been on the basis of incomplete[22] economic theories that the banking and financial system has been largely deregulated over the past four decades. This supposed neutrality of finance is not borne out in practice, since the assumptions on which it is based are never verified. Yet it is this theory which is largely taught in economics; and for the most part, economists have assumed that finance, left to its own devices, will produce good results for the economy as a whole.

Hence the so-called "neoclassical economists" (Robert Lucas, Robert Barro, Thomas Sargent, Neil Wallas, among others) take the view that money is neutral and that the economy always returns to equilibrium after a shock. Neokeynesians, such as Olivier Blanchard or Paul Krugman, regard money as a fixed element outside of the economic systems ("exogenous" money), and neutral in the long term. A small number of economists belonging to the post-keynesian school, such as Hyman Minsky, Steve Keen or Gaël Giraud, or even Lord Adair Turner, are attempting to build models according more importance to money and credit, to get closer to reality, and therefore improve analysis and anticipation[23].

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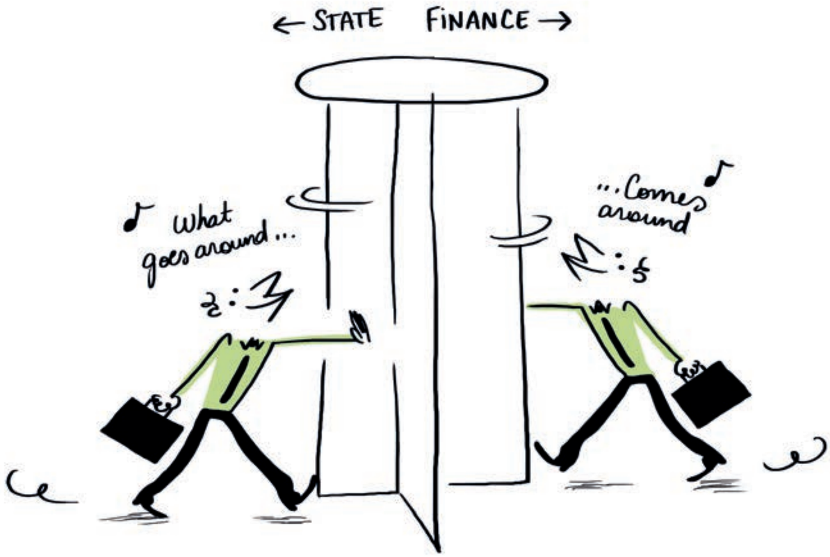
20 The modern economy developed at the same time as the Industrial Revolution: a reference point for its advent is the publication of Adam Smith's famous work, *The Wealth of Nations,* in 1776.

21 The expression "non-financial economy" will be preferred to the commonly used expression "the real economy", since financial operations cannot be regarded as non-real or virtual, and they are based on non-financial operations. Hence the problem is not so much the disconnect of finance from the non-financial economy, as its excessive size.

22 More precisely, these assumptions are the hypothesis of efficiency of markets introduced by Eugene Fama in the 1970s and the hypothesis of rational anticipations, developed in particular by Robert Lucas in 1972. See Adair Turner, *Between Debt and the Devil op. cit.,* chapter 2, pp. 72 et seq.

23 On the diversity of models and their consideration of money, see Alain Grandjean and Gaël Giraud, "Comparaison des modèles météorologiques, climatiques et économiques : quelles capacités, quelles limites, quels usages ?" [Comparison of meteorological, climate and economic models: what are their capacities, limits, uses?], working document, Chair Energy and Prosperity, May 2017, pp. 56 et seq., http://www.chair-energy-prosperity.org/wp-content/uploads/2017/03/publication-2017-comparaison-modeles-grandjean-giraud-1.pdf



Toing-and-froing detrimental to independence.

Borrowing States, closely aligned with the financial markets

In the developed world, States are borrowers from the financial markets[24] (see part 2). This leads to these States being dependent on the financial markets. As the German sociologist Wolfgang Streeck wrote[25], while States have to justify themselves to their citizens, they also have to provide much more specific justification to the private financial market actors funding them, due to being borrowers. This is one of the reasons why citizens must ensure that their interest – the general interest – prevails in matters of State funding.

The very strong links between States and the banking system are reinforced by the often significant intellectual proximity between the political and financial elites (see part 3). The identical training and widespread practice of "revolving doors" between public and private can lead to damaging confusion between the general interest and private interests[26].

The 2008 crisis, a rude awakening

The 2008 crisis highlighted the inability of economists to anticipate a major crisis. In addition, this crisis was only "plugged", rather than resolved (see part 3). Ten years after the crisis, the banking and financial system is still fragile and disproportionate to the needs of our societies, and the economic crisis is ongoing. National revenue and living standards in many countries are 10% lower, or sometimes more, than

24 Within the Finance ministries, there are teams responsible for communicating with the advisory banks to organize loans from the financial markets, several times a month in the case of France, where the function is provided by "Agence France Trésor", attached to the Ministry of Finance (the advisory function of a bank consists in advising a borrower on the best way to organize the loan given the market conditions: rate, term, etc.).

25 Wolfgang Streeck, *Du temps acheté. La crise sans cesse ajournée du capitalisme démocratique [Buying time. The delayed crisis of democratic capitalism]*, Gallimard, 2014, in particular p. 120.

26 See the report "Les conflits d'intérêts, nouvelle frontière de la démocratie" [Conflicts of interest, the new frontier of democracy], Joël Moret-Bailly, Hélène Ruiz Fabri, Laurence Scialom, Terra Nova, February 2017 (pp. 14-16), http://tnova.fr/rapports/les-conflits-d-interets-nouvelle-frontiere-de-la-democratie

they would have been if the crisis had not struck, and they could remain at these levels for a long time more[27].

So we need to ask whether the banking and financial system, which is at the heart of the economy, is working as it should to serve the general interest. Proposing diagnostic-based routes of reform to ensure that this is the case. And rallying wider support from citizens and their political representatives on this theme, since after such a serious crisis and in such a problematic economic context, it is no longer possible to think that finance has no importance in the economy, or that it naturally ensures the optimal placement of capital flows.

27 Adair Turner, *Between Debt and the Devil, op. cit.,* p. 33.

1 OVERVIEW

Finance plays an essential role in the economy, insofar as it creates and channels financial resources towards the economic actors who require them. Banks play a role of general interest by managing the payment systems, but also by granting credit. Through these functions they create money and new purchasing power. When credit grows faster than production, the price of existing assets will increase, possibly up to the point where speculative bubbles form. When economic agents borrow in excess of their repayment capacities, those bubbles may end up bursting, triggering a recession. This recession does not affect just the financial sector, but the economy as a whole. In each country, banks are governed by the central bank, which can influence the overall quantity of money in circulation. This quantity influences the currency's exchange rate, which affects the cost of imports and the value of exports, and therefore each and every citizen's daily life. Therefore, the banking and financial sector plays an essential role in the working of the economy as a whole. This is directly relevant to the general interest in at least three aspects: management of payment systems, credit management, and currency value.

For forty years, the world of finance has undergone progressive deregulation. From a system governed by multiple rules and constraints, we have moved to a much less regulated system, and increasingly less focused on serving the needs of our societies. Finance has also undergone a transformation over the last forty years, with the appearance of new products and new actors.

Part two tracks the main developments, to provide a better understanding of how the financial sector is currently organized, in order to consider how it can be adapted to serve the general interest.

2

GLOBAL FINANCE: FORTY YEARS OF PROGRESSIVE DEREGULATION

The 2007-2008 crisis revealed that finance's place in the economy and in our societies had become excessive and uncontrolled. The excessive size of finance greatly affects poverty and inequality. This financialised system is the result of several phenomena which have occurred since the 1970s.

Global finance as it is today has been built on the basis of progressive deregulation, which can be subdivided into four main stages *(see sub-section 2.1)*:

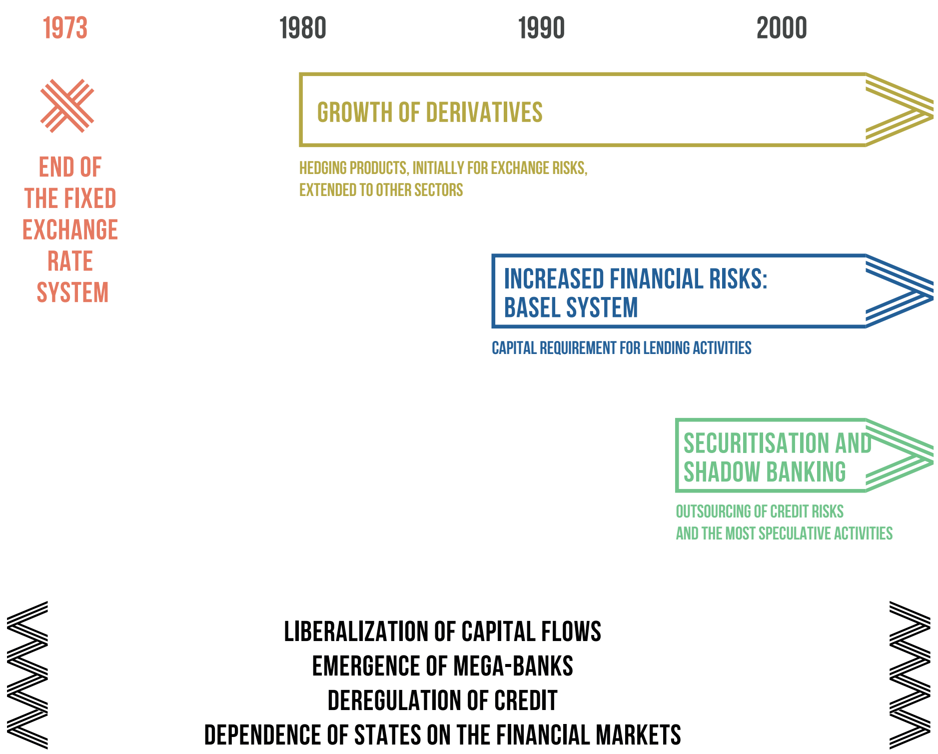
- the end of the fixed exchange rate system;
- the growth of derivatives;
- the Basel banking regulations;
- the development of the shadow banking sector.

These developments to the financial system have occurred against the backdrop of four other phenomena *(see sub-section 2.2):*

- liberalization of capital flows;
- liberalization which has enabled the formation of international banking mega-groups *too big to fail*;
- in the developed world, State debt has been progressively transformed, from an essentially internal debt (citizens lending to the State), to a "market" debt (States obtaining funding on the international markets);
- the rules governing the granting of credit have been progressively loosened.

Each of these stages and phenomena enables a better understanding of the organization of the financial system as it is today, and its interactions with the non-financial economy. Analysis of these factors shows that the financial system is not naturally deregulated and global. It is the elimination of certain operating

THE FOUR MAJOR STAGES AND FOUR PARALLEL PHENOMENA IN THE CONSTRUCTION OF THE CURRENT FINANCIAL SYSTEM



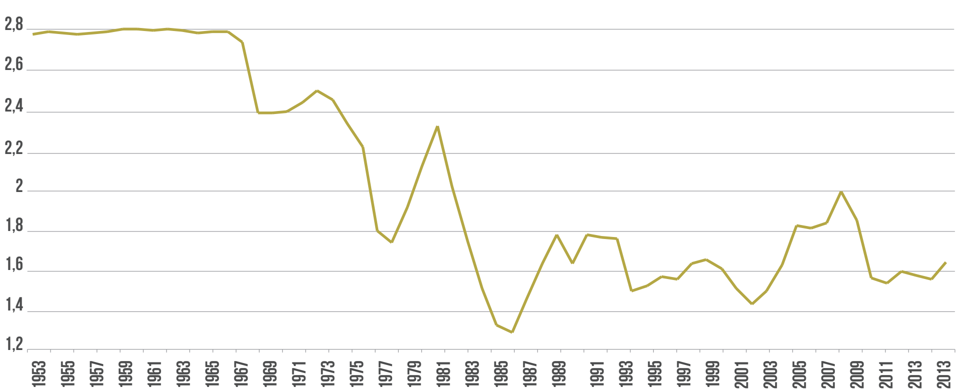
rules which has made it possible to go from a more local, more fragmented and more regulated banking and financial system, to the current system. Below, the report will attempt to analyse how this progressive deregulation of finance has served the general interest, or otherwise, in particular in light of the consequences of the 2008 crisis.

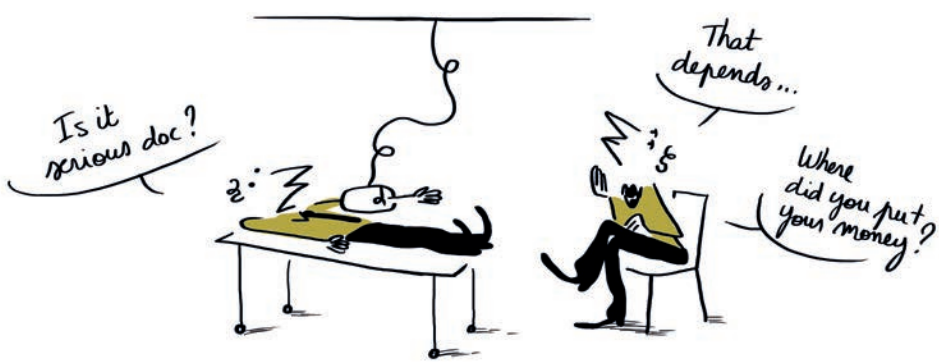
2.1. THE FOUR SUCCESSIVE STAGES OF FINANCIAL DEREGULATION

A. FROM 1973, THE GLOBAL FIXED EXCHANGE RATE SYSTEM WAS ABANDONED IN FAVOUR OF A FLOATING EXCHANGE RATE SYSTEM

After the Second World War, and in particular to learn the lessons from the 1929 crisis and the Great Depression, the Allied countries decided at the Bretton Woods international conference, in 1944, to set up a fixed exchange rate system: all currencies would be measured in dollars, with the value of the dollar fixed against gold[1]. The USA saw rapid economic growth and manufactured dollars in large

EVOLUTION OF THE POUND STERLING EXCHANGE RATE AGAINST THE US DOLLAR FROM 1953 TO 2013





Source: Exchange rate history, taken from http://fxtop.com/fr/historique-taux-change.php?MA=1

Comment: The exchange rate of the pound sterling against the dollar has fluctuated significantly since 1973 (over the previous period, exchange rates were fixed and changed only in rare and exceptional devaluations).

1 One ounce of gold, i.e. approximately 31 grams, was worth 35 dollars.

quantities. The US gold stocks were no longer sufficient to ensure parity of the dollar with gold. In August 1971, the USA therefore "suspended" and, in reality, definitively abandoned convertibility of the dollar into gold. From March 1973, exchange rates between currencies would no longer be *fixed* but *floating*, i.e. they would be determined on the exchange rate market according to supply and demand. Variable rates would open up the possibility of heavy speculation on currency rates. Hence for example, the franc was regularly attacked during the 1970s and 1980s, with operators selling the franc en masse to purchase Deutsche Marks (DM) or Pounds Sterling (£). This gave rise to an exchange crisis: the rate of the franc fell against the other currencies, and if France could not control the speculation using its reserves to purchase Deutsche Marks or Pounds, it would need to devalue its currency[2].

The financial system and economies would become intrinsically unstable because of the international monetary system, or rather because it no longer existed.

"*Currencies were floating freely; it was an illusion that this freedom could be controlled. Currency floating has deleterious consequences for our economies, and more generally for our societ*ies." This was how Jacques de Larosière, the former Director General of the International Monetary Fund (IMF)[3], described this first stage of deregulation. From 1973, there would be successive exchange rate crises worldwide. The financial system and economies would become intrinsically unstable because of the international monetary system, or rather because it no longer existed.

B. DERIVATIVES PROLIFERATED TO COVER NEW RISKS

Besides the threats to the economy, currency floating has also led to the emergence of financial tools designed to hedge against exchange rate variations, but which have proven toxic to the economy and societies (far outweighing the advantages that they supposedly presented).

Currency options: an exchange risk hedging tool

In 1973, the currency exchange rate moved from fixed to floating, and has varied unpredictably ever since. This new situation was very awkward for international trade: if a French operator agreed a sale in dollars to be completed in three months' time, they no longer knew the equivalent amount in francs (or now euros). The banks would therefore create new products for their customers known as "currency options". A currency option is a contract which gives the buyer the right to purchase currency at a later date at a certain rate, set when the contract was signed. Someone holding a currency option is therefore protected against erratic variations in the exchange rate: in financial terms, an option is an exchange rate risk *hedging product*. It must be noted that holding a currency option opens up a possibility, but does not create an obligation. On the set date, the holder of the option may choose not

2 The franc was devalued in 1958, 1969, 1981, 1982, 1983 and 1986.
3 Jacques de Larosière, *Cinquante ans de crises financières [Fifty years of financial crises],* éditions Odile Jacob, 2016, p. 76.

to complete the currency transaction; this choice will be based on whether the currency's market value is better on the date the option is exercised than the rate included in the option contract.

Currency options: an example of a derivative

Currency options are an example of a category of financial products known as derivatives. A derivative is a conditional, optional product: it is an additional possibility added onto a "basic" financial transaction, also known as an underlying transaction which, in this example, is a simple currency purchase. The option has a price: for example, it will cost 2% of the amount it is intended to cover[4]. If, after a while, the market conditions change and the same option costs 2.20%, the holder can sell it on for a profit. The option is therefore both an exchange risk hedging instrument, and a *financial product* in itself. It is also possible to buy and sell options without ever entering into an exchange transaction or being the owner of the underlying product.

In 2008, the gross value of the derivatives market was estimated at more than 35,000 billion dollars or more than 50% of world production of goods and services.

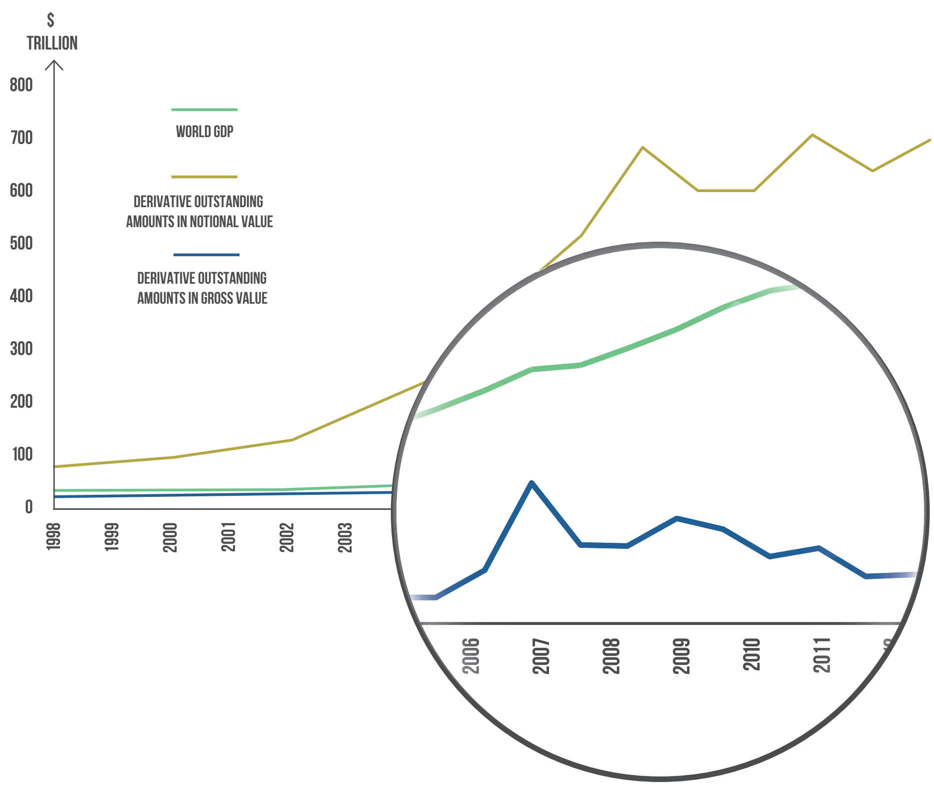
Historically speaking, the creation of currency options was the first step in the derivatives boom[5]. The banks created these to allow their customers to protect themselves against new variations in currency exchange rates caused by the collapse of the fixed exchange rate system in 1973. Subsequently, derivatives were extended from currencies to other types of underlying assets: commodities, interest rates (here, we talk about "*swaps*" which are loan-based interest rate exchange contracts), and the risks of a borrower defaulting on credit (these are known as "*Credit Default Swaps*" or "CDS").

The very rapid growth in derivatives

Derivatives have seen very rapid development since their emergence in the early 1980s. In 2008, the gross value of the derivatives market was estimated at more than 35,000 billion dollars, which equated to more than 50% of world production of goods and services (approximately 63,400 billion dollars)[6]. Oil derivatives, for example, currently total more than ten times the physical volume of oil in circulation, which demonstrates the excessive size of the financial sector compared to the non-financial economy, and the fact that the prices of commodities or products are set based on derivative product transactions more than based on the underlying market conditions (see below).

4 This is just one example; in reality, the price of currency options is highly variable, based on the currency to be covered and the time horizon.
5 There are examples of derivatives being used in Antiquity, then in the United States in the 19th Century.
6 In 2016, the gross value of outstanding derivatives was almost 20% of the global GDP; in 2000, it was less than 10%. If we look at the notional amount, i.e. if we take the value of covered assets (or underlying assets) into account, the comparison with world wealth becomes jaw-dropping: it went from almost 300% in 2000 to 1000% in 2008, and remained at over 600% in 2016 (BIS and World Bank data). See in particular the BIS statistics:http://stats.bis.org/statx/toc/LBS.html

DEVELOPMENT OF DERIVATIVES AND WORLD PRODUCTION



Source: BIS (http://stats.bis.org/statx/srs/table/d5.1?p=20001&c=), World Bank (http://databank.worldbank.org/data/home.aspx)

Comment: The derivatives trade volume increased sevenfold in 10 years, a growth that was out of step with that of global production over the same period.

Hedging instruments which have become largely speculative

Derivatives, taken individually, are hedging instruments: their purpose is to protect, a bit like an insurance policy. Yet since they have themselves become financial products, and volumes have boomed, the hedging role has taken a back seat, in favour of pure speculation (or "gambling"). Metaphorically, it is as if in addition to insuring your own house, it was possible to buy insurance policies on your neighbour's house, because a market for purchasing and reselling insurance policies on any house had developed. Hence the regulators allowed the development of markets where the same house was insured tens of times against fire, and where certain actors had an interest in their neighbour's house burning down[7].

Derivatives, or how to take out insurance (tenfold) on your neighbour's house.

7 This comparison was borrowed from the book by Gaël Giraud, *Illusion financière, [Financial illusion] op. cit.*, p. 26.

Derivatives fever.

Disappearance of price signal in the economy

Derivatives transactions have become so big in terms of volume that they have an impact on the rates of underlying products, i.e. products from the non-financial economy. The rate of a currency or commodity is less and less determined by the adjustment of the physical supply and demand for this product, and more and more by the focus of the options market on the rates. Furthermore, as the derivatives transactions volumes are very large, and in the absence of barriers to cross-border capital flows (see p.47), they can shift very rapidly from one product to another, the rate and price for many products have become hard to predict. This has the consequence of blurring the price signal, i.e. the ability to estimate the future evolution of a price, even on an estimate basis. Yet it is currently very complicated to do so, since the prices of certain commodities are less dependent on traded values than on the speculative behaviour on these markets.

Hence the price of oil, which represents one third of the world's energy sources[8], has become *unforeseeable* and subject to abrupt fluctuations since the 1980s. As the mathematician Nicolas Bouleau wrote, "*The financial markets are massively disturbed. They cause fluctuations in the price of commodities: metals, oil, cereals, wool, cotton, etc. and conceal the trends. This prevents manufacturers from distinguishing within the price signal the evolution of shortages and factoring them into their investments.*" [9]

8 "Key World Energy Statistics", International Energy Agency, 2017, p. 3, https://www.iea.org/publications/freepublications/publication/KeyWorld2017.pdf
9 See articles and videos about speculation on Nicolas Bouleau's blog, http://www.nicolasbouleau.eu/videos/2013-2/

The commodities price has become unpredictable.

Oil is a highly financialised commodity: transactions on oil financial derivatives represent more than ten times the physical volumes. The price of oil is unstable and unpredictable: since 2000, the rate forecasts by the International Energy Agency (IEA), in successive editions of its World Economic Outlook (WEO) data bank, have proven to be far removed from reality. Since the IEA has the best economic information at its disposal, it does not seem possible to attribute the difficulty in making exact forecasts to a lack of information. It would rather tend to show the misalignment between the basic market data (supply, demand, production, etc.) and the reality of prices.

Derivatives have seen massive development with the disappearance of the fixed rate exchange system. Initially designed as hedging products, and boosted by the liberalization of cross-border capital flows, they have become instruments of massive speculation, which has destroyed the price signal in the economy. it is not solely the financial sphere which has become unstable because of speculation, but also the non-financial economy.

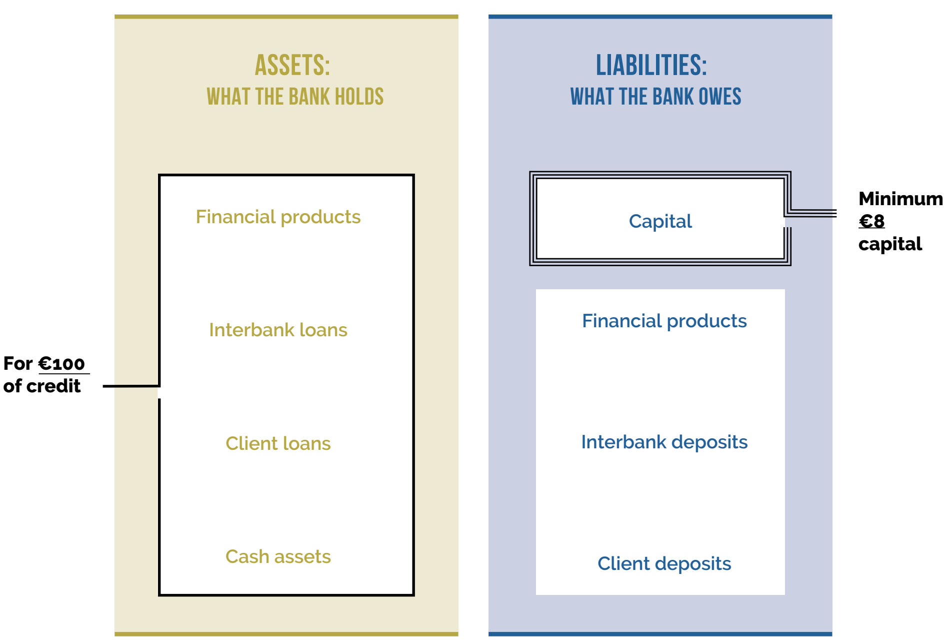
C. PRUDENTIAL BANK REGULATIONS SET UP

In order to be able to honour the hedging contracts (exchange or derivatives operations) that they offer their clients, banks must themselves purchase currencies and commodities. Since the 1980s, they have recruited new profiles known as *traders,* who work in new departments known as *trading rooms.* Bank balance sheets have grown and new risks have appeared, which are very different from traditional credit risks for clients. Hence in 1974, governors of the central banks of the G10 countries[10] met to deliberate on these risks at what would become known as the Basel Committee.

Banks make a lot of loans to each other: it is not uncommon for loans from other banks to represent 20 to 30% of a bank's funding. If a bank loses too much money on an exchange operation and goes into bankruptcy, another bank that has lent to it may never be reimbursed, goes bankrupt in turn and so on. This chain reaction is known as *systemic risk*. To prevent this, the Basel Committee regulators decided to impose on all banks a minimum capital requirement (also known as equity capital). Capital is the money provided by the shareholders, to which losses are allocated in the accounts, plus retained earnings. The greater the capital, the more a bank can withstand a big loss without going bankrupt. The solvency ratio is part of the so-called "*prudential*" bank regulations, since it involves encouraging bank shareholders to be prudent by retaining more capital in them.

A new regulation governing the equity capital requirements for banks, and stemming from the recommendations of the Basel Committee, was gradually implemented from 1988[11] (only credit regulation is covered here). This regulation obliged banks to maintain a constant equity capital holding corresponding to 8% of the total of loans granted, known as the "solvency ratio".

THE CAPITAL REQUIREMENTS IN THE BASEL SYSTEM



10 The eleven biggest industrialized countries: Germany, Belgium, Canada, the USA, France, Italy, Japan, the Netherlands, the United Kingdom, Sweden, Switzerland.

11 The regulations were set nationally but are, in fact, a transcription of the recommendations of the Basel Committee. Read the history here:https://www.bis.org/bcbs/history.htm

However, this ratio is not calculated based on total assets, but from "risk-weighted assets"[12]. In other words, it is based on assets to which a factor has been applied to reflect the risk level.

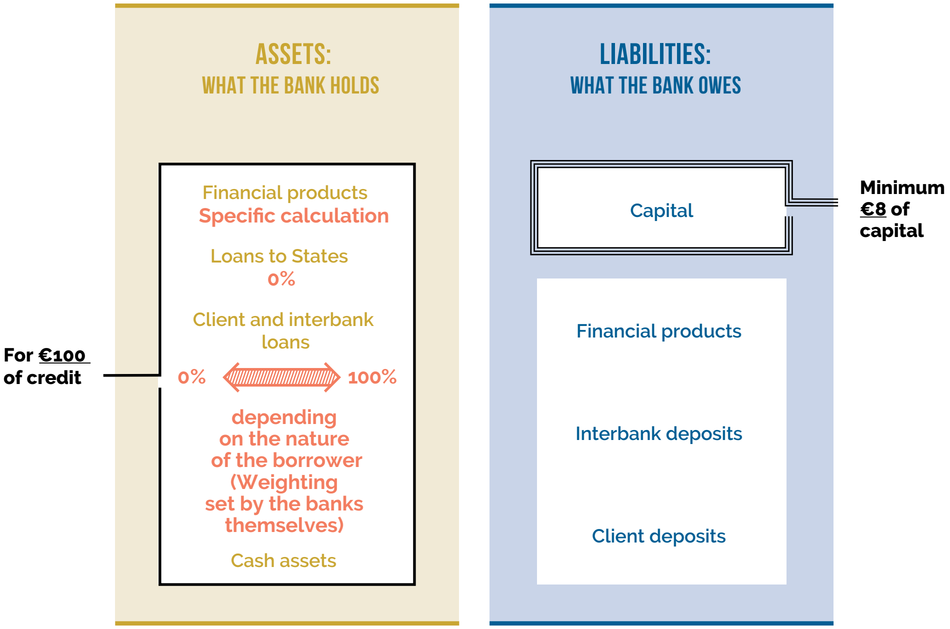
Therefore, the amount counted in the capital ratio, in percentage credit granted, is:

- zero, if the client is a State. In theory, a State will always be capable of paying off a debt in its national currency since the State is able to create money for reimbursement purposes;
- 20% if the client is a bank;
- 50% if the credit is a property loan (mortgage).

This prudential regulation has undergone many evolutions (today, it is the Basel III accord of 2010 which applies), but the basic principle remains the same.

The aim of this regulation was to regulate the banking sector and limit risks. It had fundamental consequences for the organization of banking, the greatest being the development of securitisation and the shadow banking sector.

CREDIT WEIGHTING IN THE BASEL SYSTEM



The percentage that the banks must retain depends on the risk of non-payment of the loans.

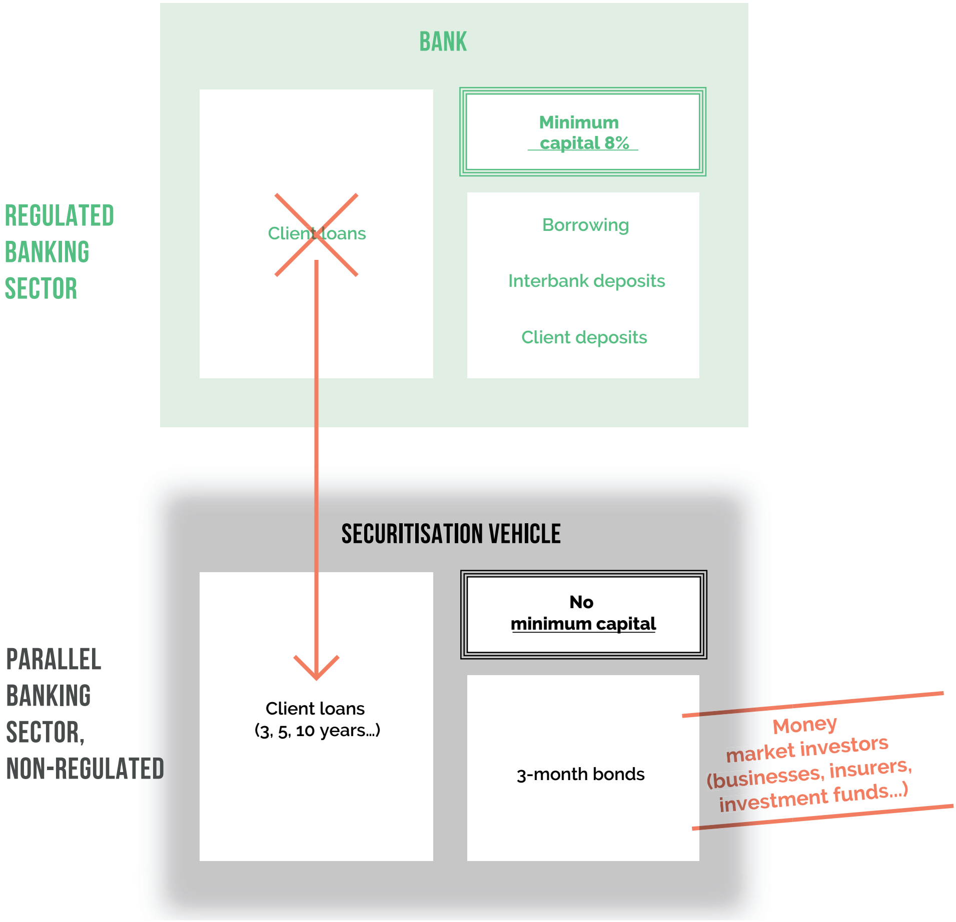
12 This means that it differs from the leverage ratio, which compares absolute amounts of equity capital and liabilities. It is the latter which is the subject of recommendations in this report, to enable a better understanding of the risks taken by the financial actors (see part 6). See also the table on systemically important banks, which compares the two ratios (page 49).

D. OUTSOURCING OF FINANCIAL ACTIVITIES AND DEVELOPMENT OF THE SHADOW BANKING SECTOR

Retaining sufficient capital protects the bank from the risk of bankruptcy, but goes against the short-term financial interests of its shareholders. A bank's shareholders generally want to maximize their return on investment, measured by the profit/invested capital ratio. The lower the invested capital, the higher this ratio. In response to the imposition of capital ratios, banks on the one hand increased the share of zero-weighted assets in their balance sheets, namely State loans, and on the other hand, for assets which did weigh on the capital ratio, they set up a system to "remove" the risk from their balance sheets: *securitisation*.

Securitisation consists in a bank selling a credit portfolio to another structure known as a "securitisation fund". This fund is not a bank, and is therefore not subject to the capital regulation: it may have very low capital. The fund purchases loans from the bank with money that it has raised from financial market investors, in the form of bonds (debt securities, which can be bought and sold). In general, the way this works is for the bank to sell long-term credit portfolios (real estate or to businesses)

DIAGRAM OF SECURITISATION



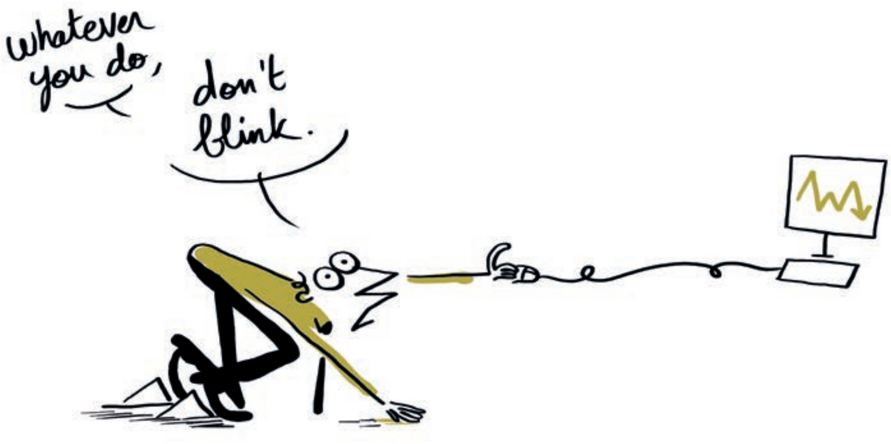
to financial structures which are funded by issuing bonds on the so-called money market (short-term bonds market, with a term of less than one year).

Who invests in these securitisation funds? All the market actors (businesses, savings placement funds for individuals such as Sicavs, etc.) seeking to obtain a slightly better return than from the current interest rates on short-term placements, which is very low, can invest in these funds. In fact, since the 1980s, the low inflation policy adopted by the central banks in developed countries has meant that interest rates have remained very low.

What is the benefit of securitisation for a bank? The bank grants the client a loan; in so doing it receives a commission. It then sells this loan to the securitisation fund, thereby recouping the money which it can lend once more, and then once more collect commissions, and then sell further loans. This is the new banking model: "*originate to distribute*". Banks are transforming into credit designers and placers; the risk is transferred to financial market investors, who invest in the form of securities (shares or bonds).

In this way, a *shadow banking sector* has emerged, which includes in particular securitisation funds. It also encompasses speculative funds. Some are specialised in arbitrage techniques[13], others in various forms of derivatives, depending on the market opportunities. In general, a *hedge fund* has little capital, and belongs to a single person or a small group of shareholders; it is in debt to a bank, at a low rate.

It is impossible to precisely break down the shadow banking sector since, as it is not regulated, we do not have accurate information on it: no authority is responsible for



High-level trading.

13 Operation which involves taking advantage of very short-term discrepancies (e.g. from minute to minute), or rate differences there might be at the same time for the same security on different Stock Exchanges, e.g. Paris and New York), see point C of this definition: http://www.cnrtl.fr/lexicographie/arbitrage

LEVERAGE, A MAJOR TOOL OF SPECULATION

Calculating shareholder gains as a function of a business's debt level

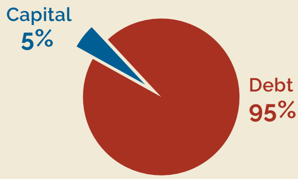
For ease of presentation, the calculation disregards gains tax (and possible borrowing deductions), but the mechanism is similar after tax payment and deductions.

A business funded:

- 5% by its shareholders
- 95% by debt

ASSETS

100 %



SCENARIO No.1

BORROWING RATE 2% < BUSINESS RETURN 10%

Cost of debt	Business gain
95 x 2% = 1,9	100 x 10% = 10

Shareholder gain = 10 - 1,9 = 8,1

They had invested 5 • They gained 8,1

BINGO Effect: 162% gain

SCENARIO No.2

BORROWING RATE 5% > BUSINESS RETURN 4%

Cost of debt	Business gain
95 x 5% = 4,75	100 x 4% = 4

Shareholder gain = 4 - 4,75 = -0,75

They had invested 5 • They lost 0,75

HAMMERBLOW Effect: they lose 15% of their investment

Securitisation thanks to shadow bankers.

registering its operations. Nonetheless, in recent years, the Financial Stability Board (FSB, see part 3) and the European Central Bank (ECB), for example, have started to look into this phenomenon more closely. This sector has taken on considerable importance over the past twenty years. According to the ECB, in the eurozone at the end of 2015, of 67,000 billion euros of total financial assets, 26,000 billion – i.e. approximately 40% – were held by actors in the shadow banking sector[14]. The USA saw has seen a similar development[15].

The shadow banking sector is therefore massive, and lacks the same safeguards as the banking sector in terms of risk: no minimum capital, unlike the banks, no product registration chamber, or regulating body. In addition, in the case of securitisation, lenders and borrowers are separated by a chain of financial products[16]. Lenders do not really know which borrowers they are funding, which was one of the factors triggering the 2008 crisis (see part 3).

Since the abandonment of the fixed exchange rate system in 1973, derivatives have developed, and then the Basel prudential banking regulation was set up, which led to outsourcing of some banking activities to a shadow banking sector.

14 ECB, *2015 Annual Report*, p. 60, https://www.ecb.europa.eu/pub/pdf/annrep/ar2015en.pdf?2e7998c5daf6a2a7e4bfccb41e81b504; see also the low estimates of the FSB, in its "Global Shadow Banking Monitoring Report 2016", May 2017, http://www.fsb.org/2017/05/global-shadow-banking-monitoring-report-2016/

15 See in particular Jun Luo, "*Shadow Banking*", a regularly updated information page, as at late 2016, the FSB estimated that one third of the world's "*shadow banking*" was based in the USA.

16 See Hyun Song Shin, "Financial intermediation and the post-crisis financial system", *BIS Working Papers* no. 304, March 2010, https://www.bis.org/publ/work304.pdf

Simultaneously, several related phenomena have accentuated deregulation and reinforced finance's hold over the economy and societies, which has accentuated the deregulation of finance and the disproportionate place that it has come to occupy in economies and societies.

2.2. A SERIES OF RELATED PHENOMENA REINFORCING FINANCIALISATION

A. LIBERALIZATION OF CROSS-BORDER CAPITAL FLOWS

During the 1960s and 1970s, developed countries[17] would seek to preserve growth and jobs in their countries. To do so, they would export manufactured products to the least developed countries. Europe and the USA accumulated trade surpluses (exporting more than they imported), unlike the other countries which registered trade deficits (importing European or US manufactured products, and exporting mainly commodities). In 1973, the dollar collapsed after uncoupling from the gold standard. Yet oil was sold in dollars by the producer countries. They joined forces within the Organization of the Petroleum Exporting Countries (OPEC), and quadrupled prices, to offset the fall in the dollar: this was the first oil shock. This abrupt economic contraction would slow down demand and economic activity in the advanced economies[18].

The post-war international monetary system[19] set up the International Monetary Fund (IMF), a body encompassing all the countries in the world, and designed to ensure the smooth running of the system. In particular, the IMF is responsible for lending to States which require it and which could not borrow on the private financial markets. Hence a large number of emerging countries in Latin America, Africa and Asia needed to borrow money from the IMF in the 1980s, since they had exhausted their currency reserves due to many years of trade deficits. The developed countries needed to invest abroad to find new avenues of growth, after the oil shock.

From the 1980s, the IMF adopted the so-called Washington consensus doctrine[20]. This made the granting of its loans in currencies to the emerging and developing economies subject to these countries adopting a liberal economic programme. Hence the IMF encouraged these economies to privatize their banks, open up their borders to capital flows, in particular from the USA, and eliminate commercial borders and customs duty. Two other international bodies then recommended similar liberal policies[21]: the Organization for Economic Co-operation and Development (OECD)[22] and the World Trade Organization (WTO)[23]. The Washington consensus played an essential role in enabling the emergence of

17 At this time, the "developed countries" were those in Western Europe (West Germany, Belgium, France, Italy, the Netherlands, the United Kingdom, Sweden, Switzerland), the USA, Canada and Japan – which made up the G10, a group established in 1962 and expanded to 11 countries in 1964.
18 See in particular Joseph Stiglitz, *La grande désillusion [Globalization and its discontents],* Fayard, 2002; or Rawi Abdelal, *Capital Rules, the construction of global finance,* Harvard University Press 2007.
19 Set up at the Bretton Woods Conference in the USA, at which the Allied countries met in 1944.
20 Concept developed by John Williamson between 1989 and 1990. See analysis conducted in the IMF's magazine *Finance and Development* several years afterwards: https://www.imf.org/external/pubs/ft/fandd/fre/2003/09/pdf/clift.pdf
21 Two books deal with these active roles of the OECD and IMF in the liberalization of economies: *Globalization and its discontents* by Joseph Stiglitz, Nobel Prizewinner for economics, and *Capital Rules, the construction of global finance,* by Rawi Abdelal, a lecturer at Harvard Business School.
22 Organization for Economic Co-operation and Development, bringing together 35 developed countries and created in 1960.
23 World Trade Organization, created in Geneva in 1995

very large banks with global networks, such as Citibank or BNP Paribas. They formed their networks in the 1980s, thanks to this economic policy favourable for the creation of multinational groups.

By greatly liberalizing cross-border capital flows, the policy of the Washington consensus has also favoured international speculative flows. Hence in 1997, several speculative investment funds managed to devalue the Thai baht because there were no restrictions on baht purchases by foreign capital[24]. The country's currency and stock market lost three-quarters of their value in a matter of days.

The Washington consensus has had only a slight impact at best on the economies of the emerging and developing countries (see part 5). The countries that saw the most spectacular growth were those which completely (or largely) disregarded it, and protected their countries from foreign investment: in particular South Korea, Taiwan and China[25].

B. The emergence of mega-banks

The process of deregulation, including cross-border capital flows, had the consequence of the banking sector being dominated by very big banking groups. While the US real estate crisis triggered the 2008 financial crisis, the global dimension of this crisis was due to the multiple connections of a huge bank which collapsed, Lehman Brothers.

Thirty so-called systemically important banking groups worldwide, representing 2/3 of the global economy in size.

Following the crisis, the Financial Stability Board, the global regulation body responsible for improving the stability of the financial system, identified 30 world banking groups of so-called systemic importance[26]. Indeed it believes that one of these groups going bankrupt could trigger a global financial crisis. The cumulative balance sheets of these 30 banking groups as at the end of 2016 represented approximately 50,000 billion dollars, i.e. more than two thirds of global production[27]. Yet ten years after the crisis, these banking groups still have too low an equity level. Their average equity capital ratio is only around 5%, often very different from the prudential ratio calculated by the banks themselves (a discrepancy of 1.71 to more than 4, depending on the banks)[28].

The equity capital of a banking group represents the accounting quantity to which the group's losses are allocated. Saying that a bank has 5% leverage equates to saying that it cannot lose more than 5% of its balance sheet without going into bankruptcy. Yet the economic and financial contexts remain

24 For a description of the 1997 Asian crisis, see https://www.alternatives-economiques.fr/crise-asiatique-de-1997/00064005
25 As the World Bank reluctantly admitted in 1993: "The East Asian miracle: economic growth and public policy", http://documents.worldbank.org/curated/en/975081468244550798/pdf/multi-page.pdf
26 G-SIBs for Global – Systemically Important Banks. See the list drawn up by the FSB, http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf
27 See the banking data from the Global Capital Index of the Federal Deposit Insurance Corporation, one of the US' regulation authorities (see https://www.fdic.gov/about/learn/board/hoenig/global.html). Global GDP was estimated at approximately 75,000 billion dollars. See the World Bank's database http://databank.worldbank.org/data/home.aspx
28 This big variation at the different banks between the equity capital ratio and the prudential ratio point shows how complicated it can be for the regulator to be able to compare banks' risk exposure levels, since the weighting method varies between banks.

SYSTEMIC BANKS AND THEIR CAPITAL AND LEVERAGE RATIOS (2016)

Establishment	Country of origin	Capital ratio (capital divided by risk-weighted assets)	Leverage ratio (capital divided by total assets)	Ratio between the two ratios
UniCredit	ITALY	9.04	3.24	2.79
Deutsche Bank	GERMANY	15.58	3.5	4.45
Mizuho FG	JAPAN	12.59	3.9	3.23
Société Générale	FRANCE	14.8	4.2	3.52
BNP Paribas	FRANCE	12.87	4.4	2.93
Crédit Suisse	SWITZERLAND	18.01	4.4	4.09
UBS	SWITZERLAND	19.94	4.58	4.35
Barclays	UNITED KINGDOM	15.58	4.6	3.39
Sumitomo Mitsui FG	JAPAN	13.53	4.63	2.92
Mitsubishi UFJ FG	JAPAN	12.74	4.69	2.72
ING Bank	NETHERLANDS	16.34	4.8	3.40
BPCE	FRANCE	14.48	4.94	2.93
Banco Santander	SPAIN	12.53	4.98	2.52
Nordea bank	SWEDEN	20.69	5	4.14
Royal Bank of Scotland	UNITED KINGDOM	17.71	5.1	3.47
HSBC	UNITED KINGDOM	16.1	5.4	2.98
Bank of New York Mellon	USA	12.59	5.6	2.25
State Street	USA	14.74	5.6	2.63
Crédit Agricole	FRANCE	16.08	5.7	2.82
Standard Chartered	UNITED KINGDOM	15.7	5.7	2.75
Morgan Stanley	USA	19.01	6.2	3.07
Agricultural Bank of China Limited	CHINA	11.06	6.27	1.76
Goldman Sachs	USA	15	6.4	2.34
JPMorgan Chase	USA	14.09	6.52	2.16
Bank of America	USA	12.44	6.9	1.80
China Construction Bank	CHINA	13.15	7.03	1.87
Bank of China Limited	CHINA	12.28	7.06	1.74
Citigroup	USA	15.29	7.22	2.12
Wells Fargo	USA	12.82	7.5	1.71
Industrial and Commercial Bank of China	CHINA	13.42	7.55	1.79

DISCREPANCY BETWEEN CAPITAL AND LEVERAGE RATIO

MORE THAN 4 — BETWEEN 2 AND 4 — LESS THAN 2

Source: Global Capital Index of the Federal Deposit Insurance Corporation https://www.fdic.gov/about/learn/board/hoenig/capitalizationratio4q16.pdf

Comment: Banks ranked by leverage ratio (increasing order of leverage). The capital ratio of the banks is only around 5%, often very different from the prudential ratio calculated by the banks themselves based on risk-weighted assets (a discrepancy of 1.71 to more than 4, depending on the banks).

highly volatile. We already mentioned the structural instability of the financial sector, due to the floating exchange rate system and the substantial role of derivatives. On top of these risks, since the crisis there is also the risk of bankruptcy of over-leveraged States (referred to as defaulting). Hence for example, in the case of the first Greek public debt crisis of 2010, French banks held tens of billions of euros of Greek State debt; if Greece had declared that this debt would not be paid off ("defaulting"), French banks would have sustained considerable losses.

Hence in the context of high financial instability, it is legitimate to consider that 5% equity capital is too low a level to be sure that a systemic banking group cannot fail. Indeed, this is the OECD's analysis: in 2012, it estimated that banks in OECD countries were 700 billion dollars short to be considered solid[29].

C. PROGRESSIVE DEREGULATION OF CREDIT

Alongside the opening up of capital and the emergence of mega-banks, most developed countries have, little by little, deregulated the credit sector, which has contributed to reinforcing finance's place in the economy and societies.

Before 1973, domestic credit was tightly controlled in most advanced economies. In the USA, for example, banks did not have the right to go beyond State borders[30], and commercial and retail[31] banks remained separated by the Glass-Steagall Act of 1933[32].

The decade 1970-1980 was a period of *banking deregulation* in the advanced economies. In France, the Debré reform of 1966 removed bank specialisations: all banks could now carry out all trades (retail, commercial, short and long-term lending, etc.) and were free to open branches. During this period, banks would be more in competition and become more concentrated. Small local banks and banks specialised in the local public sector (Crédit local de France, Regional Development Societies, etc.) disappeared in favour of big banking networks. The result of these developments was a highly concentrated French banking sector comprising a few global mega-banks (notably BNP Paribas, Société Générale and Crédit Agricole).

Small local banks are disappearing in favour of large banking networks

The same trend could be observed worldwide in all the advanced economies, in the decade 1970-1980:

- the central banks abandoned *credit quantity control* to let the banks themselves determine either the total quantity of credit that they granted, or the breakdown by economic sector of these loans, according to the country. This resulted in a generalized and very rapid growth in real estate's share of the total credit granted (see Part 4);

29 Adrian Blundell-Wignall and Paul E. Atkinson, "Deleveraging, Traditional versus Capital Markets Banking and the Urgent Need to Separate and Recapitalise G-SIFI Banks," *OECD Journal: Financial Market Trends*, Volume 2012 – Issue 1, 2012, http://www.oecd.org/daf/fin/financial-markets/Deleveraging,%20Traditional%20versus%20Capital%20Markets%20Banking.pdf

30 McFadden Act of 1927.

31 "Retail banking" involves management of payment systems, deposit collection and lending. "Commercial banking" involves purchasing financial securities (shares and bonds), manufacturing, managing and selling derivatives, and financial operations such as mergers or stock market listing for clients.

32 Act establishing the separation of deposit and investment banks, watered down from the 1970s, before finally being repealed in 1999.

- they also abandoned *specialisation of financial establishments* by type (retail bank, commercial bank, bank specialised in local credit, etc.), and many governments authorized banks to have ancillary activities, especially insurance. The birth of multinational mega-banks goes back to this period;
- finally, central banks no longer oversaw *credit orientation*. The main objective of central banks was now to maintain low and stable inflation. Regulators tended to consider that while inflation remained low, growth in private sector debt was not a concern. However, this growth in credit played a key role in the 2008 crisis (see Part 3).

From this period, the financial markets have tended to be regarded as markets for any good or service, and credit as an ordinary product which would find its optimal direction in a liberalized market. Yet credit and the financial markets are structural elements of economic activity and society. They come under the general interest, the public good, since they are at the service of economic (non-financial) activity and the needs of societies, and so should not be entrusted without oversight to the private sector. Before the major crisis of 2008, several financial crises occurred, which can be attributed to excessive financial liberalization: hence for example, the US savings banks crisis of 1986, the bursting of the real estate credit bubble in Japan in 1990, which plunged the country into deflation from which it has still not emerged, the fall of the US Long-Term Capital Management (LTCM) speculative fund in 1998… Yet many economists and regulators have attributed these crises not to excessive liberalization, but conversely to the fact that liberalization of the financial markets had not gone far enough.

D. "MARKETING" OF THE DEBT OF ADVANCED STATES

Finally, finance has also come to occupy a prominent place in our economies and our societies since States, previously funded by mobilizing domestic savings, have become progressively more indebted to the financial markets.

Paragraph A above showed that the emerging economies became heavily indebted to the IMF in the decade 1980-1990, in the context of the Washington consensus economic policy. In his book "*Globalization and its discontents*", published in 2002, the Nobel Prizewinner for Economics Joseph Stiglitz[33] explains how developed countries, and particularly European countries, also become steadily more indebted on the financial markets from the 1980s, and how the financial markets applied identical budget control rules to those that the IMF had applied to emerging countries.

The example of France: State debt was "marketed" from the 1970s

Before 1973, the French State had no debt on the financial markets. It was funded "internally" by means of the "Treasury circuit". When the French State needed money, it borrowed directly from its citizens, issuing "Treasury bonds"[34], which

33 Joseph Stiglitz, *Globalization and its discontents, op. cit.,* 2002.
34 A bond is a "financial security" which represents a loan. This security is negotiable, it can be bought and sold (on the "financial markets", which handle bonds, shares and derivatives). The bond holder receives reimbursements (loan amount plus interest) from the borrower.

individuals could purchase from the bank counters. Banks were obliged to buy some of the State loans. The central bank, the Bank of France, lent money to banks for that reason, and also lent money directly to the Treasury. With this funding circuit, the Treasury did not need external resources.

The Debré banking reform of 1966 was a first step in authorizing the State to borrow on private financial markets. From 1973, the oil shock and slowdown in growth led to a widening public deficit. So the State had to find other sources of funding, though out of political choice, it opted not to resort to monetary creation. These reforms had the consequence of "*forcing the State to live as a borrower, i.e. question the cost of borrowing and debt servicing*"[35] . Starting in 1985, the French State set up the primary dealers system, *SVT* (spécialistes en valeurs du Trésor). The debt is auctioned off[36]: the State launches issues on the market, and sells the debt to the lowest-bidding investors for a given borrowing term. The SVTs[37] are a few big banks, both French and foreign, which are entitled to bid, and which purchase State debt. These banks can then keep it for themselves, or sell it on to market investors: "institutional investors", insurers or pension funds, as well as individual placement bodies (Sicavs, etc.). This is an international placement system. Hence 55% of French debt is held by foreign investors, 18% by French insurers and 7% by French banks[38].

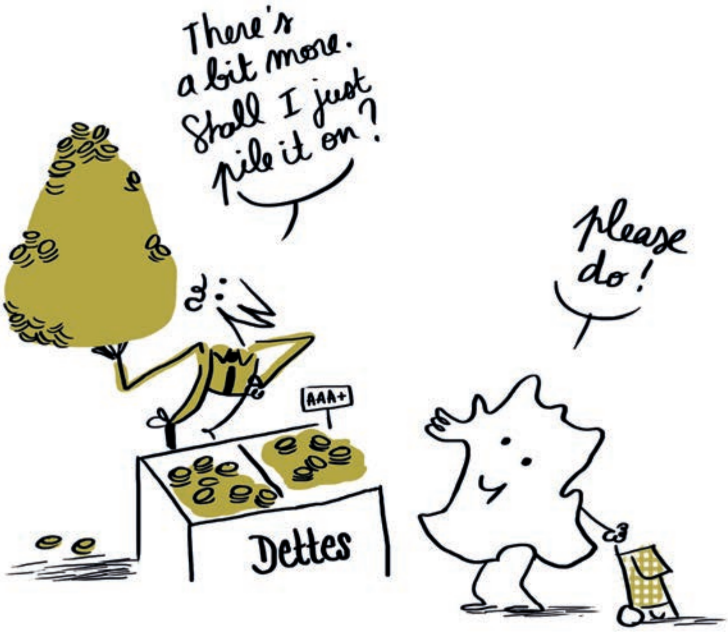
Since the financial market actors favour austerity policies, they impose restricted margins for manoeuvre on States, especially in developed countries, which cannot implement ambitious public policies.

Marketing of French State funding has failed to restrict its debt level (see part 4). Public debt as at the end of 2016 amounted to 2160 billion euros or 98% of annual production (GDP). In 2015 the interest expenses were 43 billion euros, and the cost of paying off the borrowing principal had reached 150 billion euros. New issues launched in 2015 amounted to 221 billion euros[39]. This meant that the State is in a situation where it needs to borrow massively to pay off existing debt, and that weighs heavily on its budget. In comparison with the amounts above, the leading item of State expenditure, schooling, represents an annual budgetary expense of 50 billion euros. The French State launches an issue every two weeks on average on the international financial markets.

A similar trend in the other advanced economies

The other big advanced economies, such as the United States, Japan and eurozone member states, are in a comparable situation to France: leveraging on the international financial markets to fund public deficits and high debt level. The global capital markets have developed from the USA, and then the UK, throughout

35 Quote by Jean-Yves Haberer, Director of the French Treasury from 1978 to 1982, in Benjamin Lemoine, *L'ordre de la dette [The order of debt]*, La Découverte, 2016, p. 99.
36 The so-called adjudication system.
37 As at 1st March 2017, there were 16 establishments making up the SVTs group, selected by Agence France Trésor. For the list, see http://www.aft.gouv.fr/rubriques/primary-dealers_83_lng1.html
38 Figures from Agence France Trésor. See "Détention des titres de la dette négociable de l'État par groupe de porteurs au quatrième trimestre 2017" [Holdings of State negotiable debt securities by bearer group in Q4 2017], http://www.aft.gouv.fr/articles/detention-des-titres-de-la-dette-negociable-de-l-etat-par-groupe-de-porteurs_960.html (viewed in Q1 2018).
39 Figures from the Budget Department. See the documents available on the Performance Forum, https://www.performance-publique.budget.gouv.fr/budget-comptes-etat/comptes-etat#.Wi6FMbggs_U



The gradual sell-off of state debt.

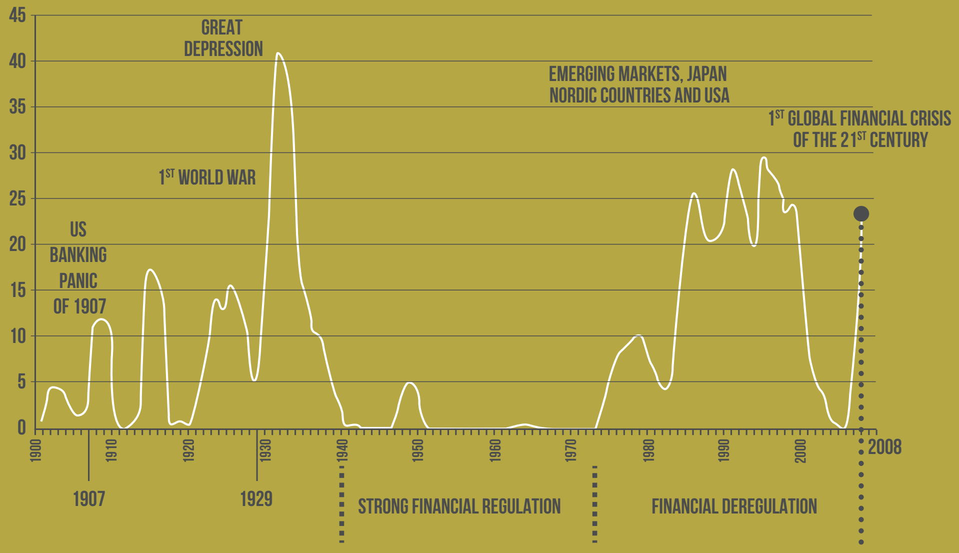
Europe since the 1980s. Hence the current situation is one of high *generalized public debt*, with China and Japan being the exception, as both countries borrow very little on the international capital markets: State deficits are funded by internal monetary creation and domestic savings.

Since the financial market actors favour austerity policies, they impose restricted margins for manoeuvre on States, especially in developed countries, which cannot implement ambitious public policies.

2
OVERVIEW

The current global financial system was built on the new deal brought about by floating exchange rates from 1973. To face the increasing risks in bank balance sheets, central bankers have implemented the prudential system of the Basel Committee. A big shadow banking system has developed outside of the scope of the banking regulations, comprising investment and securitisation funds.

FINANCIAL CRISES HAVE BEEN MUCH MORE FREQUENT SINCE DEREGULATION IN THE 1970S-1980S



Source: Banking crises: an equal opportunity menace, p. 6, Carmen M. Reinhart, Kenneth S. Rogoff, Working Paper 14587, National Bureau Of Economic Research, http://www.nber.org/papers/w14587

Comment: There have been frequent major financial crises since the end of the fixed exchange rate system in 1973, and before the big crisis of 2008. This has resulted in instability due to the floating exchange rate system, but also the fact that the financial regulations implemented after 1973 did not manage to eliminate this instability, or prevent these crises.

Meanwhile, under the influence of the economic policy of the IMF, cross-border capital flows have been liberalized. In addition, credit and bank regulation worldwide has been loosened, enabling in particular the emergence of banking multinationals. This has also been one of the main factors behind the exponential growth in credit, far beyond the needs of the economy. Lastly, the majority of emerging States, then also developed States, have become borrowers on the financial markets, on which they are today highly dependent for their funding needs.

All of these phenomena have enabled finance to occupy a disproportionate place in the economies, but also to weigh very heavily on public policies. Moreover, this has generated growing financial instability, as the diagram above shows.

Since 1973, there have been numerous financial crises. Yet the 2008 crisis was the first global one. It has had a considerable economic impact, directly affecting the lives of millions of people. The third part shows that attempts at post-crisis finance regulation have been unable either to revitalize the economy or exclude the risks of another crisis.

How crises correlate to deregulation.

3

INSUFFICIENT REFORMS AFTER THE 2008 CRISIS

The 2008 crisis shed light on the dysfunctions of finance. The institutional response has been multiform, but unfortunately insufficient. Greatly weakened by the excessive influence of financial actors, the reforms undertaken did not question the role of finance with a view to making it serve the general interest once more. The 2008 financial crisis started with a real estate debt overhang: Many US households were struggling to pay off their loans. It then spread like wildfire throughout the global financial system, particularly due to the widespread securitisation of these loans and the massive amount of derivatives in circulation. What's more, the inability and/or unwillingness of the US government to prevent the bankruptcy of a very large investment bank, Lehman Brothers, had an explosive effect and triggered a real economic disaster[1].

1 See, for example, "De la crise financière à la crise économique" [From financial crisis to economic crisis], *Documents et débats*, no. 3, Banque de France, January 2010, https://www.banque-france.fr/sites/default/files/medias/documents/documents-et-debats-numero-3-integral.pdf; or France's CAE (economic analysis council), *La crise des subprimes* [The subprimes crisis], La Documentation française, 2008, chapter 1, pp. 11-61 http://www.ladocumentationfrancaise.fr/dossiers/d000041-crise-financiere-2007-2008-les-raisons-du-desordre-mondial/les-facteurs-a-l-origine-de-la-crise-des-subprimes; and Marc Roche, *Histoire secrète d'un krach qui dure, [Secret history of an enduring crash]* Albin Michel, 2016, which explains how this global crisis unfolded day by day.

3.1 BEHIND THE CRISIS, THE BURSTING OF A SPECULATIVE REAL ESTATE BUBBLE

Since the 1980s, there has not been any regulatory action to guide bank credit in advanced economies (see Part 2). Banks therefore have the freedom to choose the amount of credit that they grant and whom they grant it to. As such, from this period onwards, banks have chosen to mainly engage in *real estate lending*, as risk analysis for credit requests in other sectors (such as SME funding, for example) is much more complicated and because the mortgage guarantee reassures the lender. Today, the real estate sector represents more than 50% of bank lending (individuals and businesses combined) in 17 advanced economies[1], even though this is not the only solution to address housing issues[2]. These loans are given at the expense of these economies' other needs, such as funding for innovation, SMEs or ecological transition (see Part 4).

The real estate sector now represents more than 50% of bank lending in 17 advanced economies.

Real estate lending, an attractive product for banks and a bubble and crisis factor

Real estate lending is a safe product for banks as they can use the property as collateral and therefore lock in the customer in the long term. Real estate usually has two characteristics: it is easy to sell and its price goes up, if is located in an urban area and in a dynamic economic environment.

Despite its importance for home ownership, the negative impact of real estate lending in developed countries is that, broadly speaking, they only fund purchases of existing real estate, but not the construction of new housing. [3]. It is not just the imbalance between supply and demand that causes prices to rise, but also the availability of credit for different types of real estate. If credit for older property were less freely available, prices could not rise as much. When the growth in the volume of real estate lending is greater than the growth in the construction of new housing, it raises the prices of the older properties and causes bubbles to form (see Part 1). And when this real estate bubble bursts, it leaves serious economic consequences in its wake. This real estate bubble phenomenon affects all developed countries, for example, Japan – which experienced a major housing crisis in the late 1990s[4] – or Malaysia, which was hit by a crisis at the end of the 2000s.

A classic real estate crisis in the United States in 2007, which spread worldwide by the securitisation of credit

From the early 2000s in the USA, American banks were granting a high number of mortgages to households[5] with low credit ratings (the so-called "*subprime*" lender

1 See Oscar Jorda, Moritz Schularick and Alan M. Taylor, "The Great Mortgaging", SF Federal Reserve Bank, 2014, http://www.frbsf.org/economic-research/files/wp2014-23.pdf; and Part 4.
2 Solutions to housing access problems, mainly in overstretched areas, include greater modulation of credit for the most disadvantaged people, but also the development of social housing and rental properties.
3 Between two-thirds and three-quarters, depending on the country, see Adair Turner, *op. cit.*, p. 106.
4 See Christophe Blot, Jérôme Creel, Christine Rifflart, Danielle Schweisguth, "Petit manuel de stratégies de sortie de crise. Comment rebondir pour éviter l'enlisement?" [Little handbook of crisis busting strategies. How to bounce back to prevent stagnation], *Revue de l'OFCE,* no. 110, July 2009, pp. 342-345 and 361-363, https://www.ofce.sciences-po.fr/pdf/revue/13-110.pdf
5 These loans were very often variable rate and rechargeable, i.e. renewable.

category). Many banks had encouraged and paid often unscrupulous brokers to provide low-interest loans for the first two years, with the rate to be reassessed later, speculating that the market would continue to rise[6]. The bankruptcy of the "*subprime*" borrowers triggered a downward spiral in prices which caused property prices to drop and left entire neighbourhoods deserted. Moreover, as mortgages had become largely securitised, they created a ripple effect, causing a crisis for all securitisation vehicles. Furthermore, American *subprime* mortgages were placed in Europe as well as in the USA. Because nobody knew exactly where the defaulting loans were accommodated, it was impossible to pinpoint exactly where the losses were. Therefore, all securitisation fund investors sought to get out at the same time. Securitisation, which was supposed to reduce risk, ultimately spread and intensified it. The US bank Lehman Brothers was one of the most active banks when it came to creating securitisation funds, in which it was a shareholder: it immediately found itself in trouble[7].

The bankruptcy of a single banking giant, Lehman Brothers, required massive central bank intervention

The Lehman Brothers bank was a systemic bank managing 600 billion dollars in outstanding debt, and placed securities in all developed countries. It went bankrupt in early September 2008, and the US authorities did not want, or were unable to implement a bailout plan. It was the fall of Lehman that triggered the worst global financial crisis since 1929. Lorenzo Bini Smaghi, an ECB Board member, analysed this episode: "*Letting Lehman fall was a serious error. The attitude of the USA was unfathomable. They had not gauged the risk of contagion of the real economy due to the interconnectivity of the markets and the domino effect*."[8] Lehman's bankruptcy then brought down the world's leading insurer, the US-based AIG[9]. AIG had purchased *Credit Default Swaps* (CDS) from Lehman for products in its portfolio. When the guarantor collapsed and the market crashed at the same time, AIG suffered the full impact of the losses. Financial actors then began to panic, unable to assess the risk of their own holdings, or that of their counterparts. This led to a deadlock in the interbank market, with actors no longer wanting to lend in view of the risk. Faced with this crisis of confidence between financial actors, the US Treasury and the US and European central banks launched substantial interventions to

The US Government had not gauged the risk of contagion of the real economy due to the interconnectivity of the markets and the domino effect.

6 Michael Lewis, *The Big Short: Inside the Doomsday Machine,* W. W. Norton, 2010; Jean de Maillard, *L'arnaque. La finance au-dessus des lois et des règles [Fraud. Finance above the law and rules]*, Gallimard, 2010; Carl Levin and Tom Coburn, "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse", US Senate Report, April 2011, http://www.nytimes.com/interactive/2011/04/14/business/14crisis-docviewer.html

7 In September 2008, Lehman Brothers employed 25,000 people and was the fourth largest American commercial bank. It had a balance sheet of 700 billion euros, with only 25 billion euros of capital. Risky investments amounted to 275 billion dollars. The bank had made 39 billion dollars' worth of guarantee commitments for default risks with 930,000 counterparties (see Pierre-Yves Collombat, "Une crise en quête de fin. Quand l'Histoire bégaie", [A crisis looking for a way to end. When history stutters.] *French Senate information report* no. 393, February 2017, p. 41, https://www.senat.fr/rap/r16-393/r16-3931.pdf).

8 Cited in Marc Roche, *Histoire secrète d'un krach qui dure [Secret history of an enduring crash]*, *op. cit*., p 222.

9 See this account of the development of the US insurance giant on the derivatives market: Pierre De Gasquet and Virginie Robert, "AIG: le symbole d'une déroute" [AIG: the symbol of a rout], *Les Échos*, 1 April 2009, https://www.lesechos.fr/01/04/2009/LesEchos/20396-039-ECH_aig---le-symbole-d-une-deroute.htm AIG started developing its derivatives operations from 1987. From the early 2000s, these had become considerable. In 2008, AIG had already sold 446 billion dollars' worth of CDS, including 307 billion dollars' worth to foreign banks. In the face of financial panic, AIG was unable to cover the insured defaults, and had to be rescued by the US taxpayers for a final sum of 180 billion dollars. Of this amount, nearly 12 billion was used to help a major French bank, Société Générale.

The 2008 financial crisis.

avoid bankruptcies and calm the markets, amounting to 1000 billion dollars in the space of a few weeks[10].

Because of businesses going bankrupt and a decrease in orders due to the sudden credit crunch, the crisis caused a substantial fall in production in advanced economies, of between 10 and 15% over three years from 2008 to 2010[11]. The situation for disadvantaged people also deteriorated further in developed countries (see Part 4). This crisis also triggered a phenomenon of "debt service deflation" (see Part 1).

3.2. THE CRISIS WAS CURBED THANKS TO A PUBLIC BAILOUT OF THE BANKS AND GENEROUS MONETARY POLICIES FOR THE FINANCIAL SECTOR

Temporary State support for the banks

After the collapse of Lehman Brothers, the governments of developed countries chose to save their banks[12] so that bank failures would not result in losses of household savings or impair the functioning of the economy. These bailouts were inevitable due to the excessive size of banks, which had become systemic, or in other words "*too big to fail*". These bankruptcies would indeed result in an even more serious financial and economic crisis (see Part 2). At the beginning of the crisis, governments injected money into the banks. These government capital injections did not exceed 3% in total of the GDP of advanced States: which represented a

10 European Union Member States committed 1600 billion in aid to the financial sector (or more than 13% of GDP) between the end of 2008 and the end of 2010 (see the final report of the High-level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, October, p. 21, http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf). For details about the various types of aid in the US financial sector, see "Report on the Troubled Asset Relief Program", Congressional Budget Office, May 2013, http://www.cbo.gov/sites/default/files/cbofiles/attachments/44256_TARP.pdf and Moira Herbst, "The bank bailout cost US taxpayers nothing? Think again", *The Guardian,* 2013, https://www.theguardian.com/commentisfree/2013/may/28/bank-bailout-cost-taxpayers.

11 See Adair Turner, *Between Debt and the Devil*, *op. cit.* pp. 33 and 325.

12 These bailouts were not subject to any regulatory compensation although, at a time when banks were in trouble and seeking support, politicians could have demanded and secured far-reaching reforms.

The financial crisis resolved.

large amount in absolute terms, but rather little compared to the 10 to 15% total shortfall in GDP caused by the crisis (see above and Part 4). Furthermore, these injections were made in the form of loans which were then paid off by the banks: altogether, the "bank bailouts" cost the governments of developed countries very little or nothing, directly. What did cost the governments, however, was the decrease in tax revenue and the increased spending on social welfare, due to the contraction of economic activity (see Part 4). This is a good illustration of the link between finance and the general interest and, more specifically, why it would seem essential that the goal of the reforms initiated since 2008 should be not just to ensure the resilience of the financial sector in order to enable it to recover after a crisis or to reimburse temporary State aid. What must be prevented is the formation of bubbles that are likely to generate economic crises when they burst, with consequences not just for citizens and non-financial businesses that are affected, but for States too. Finance must be regulated as part of the overall management of the economy, and not just as an individual sector, since finance occupies a central place in all economic activity[13].

Finance must be regulated as part of the overall management of the economy, and not just as an individual sector, since finance occupies a central place in all economic activity.

Central bank "quantitative easing" policies, one-time support that has become ongoing

Following the start of the crisis, it quickly became clear that state capital injections into banks were not enough to resolve the liquidity problems brought about by the crisis of confidence between financial actors. Banks, fearing that other banks would go bankrupt, no longer lent to each other. First as a matter of urgency, and

13 Several recommendations address this critical issue (see Part 6).

then in a more organized fashion, central banks in the USA, Europe and Japan resorted to printing money on a large scale to lend to banks. However, central banks were also aiming to keep inflation low and stable (see Part 1). If they had lent money directly to the banks, it could have caused inflation[14]. They therefore opted for security buy-back programmes. This involved providing money to banks in exchange for securities that the banks had in their balance sheets. This practice by central banks is known as "quantitative easing"[15]. Initially implemented as a matter of urgency to avoid a shortage of money on the financial markets, these policies been sustained since 2010 in the USA and since 2014 in Europe and Japan, at a repurchase rate of tens of billions of euros per month. They have led to a considerable increase in central bank balance sheets: between 2009 and 2016, the Fed's balance sheet increased from 2000 billion to 4500 billion dollars[16] and the ECB's rose from 2000 billion to 3600 billion dollars[17].

Between 2009 and 2016, the Fed's balance sheet increased from 2000 billion to 4500 billion dollars, and the ECB's rose from 2000 billion to 36,000 billion dollars.

Quantitative easing, a swelling factor in speculative bubbles

Several analysts have pointed out that by purchasing securities held by banks, central banks are supporting prices[18]. Since 2010, the stock markets have risen sharply for shares as well as bonds, particularly supported by massive purchases by central banks. For example, the French stock prices level indicator, the CAC 40, rose by 28%[19] between late 1990 and late 2016. It could be regarded as a speculative bubble: it is not necessarily better economic prospects for businesses that push up prices, but simply that demand for shares is supported by the large purchases made by central banks. Over the same period, inflation was only 6%[20]. This means that people who had invested their portfolios in shares over this period, or who had enough cash to acquire them, were able to grow even richer.

Hence for Jacques de La Rosière, former Managing Director of the IMF (1978-1987) and Governor of the Bank of France (1987-1993): "T*he 2008 crisis, with its unemployment and recession, is an extreme manifestation of what excessive debt can produce. And the "quantitative easing" monetary policies, implemented in order to minimize the effects of the "great recession", born out of abuse of debt, plunge an observer such as myself into an abyss of questions and doubt. Debt continues to grow as a result of the massive creation of zero rate liquidity. Since the same causes produce the same effects, one cannot help but worry about excessive risk-taking and the formation of asset bubbles, the bursting of which is*

14 Prices rise as more money is being put into circulation with the same quantity as goods produced.
15 "*Quantitative easing*".
See the video by "Dessine moi l'éco", February 2015, http://dessinemoileco.com/quantitative-easing/
See also Part 3 of this article: "Comment fonctionne la politique monétaire" [How the monetary policy works], Arnaud Parienty, *Alternatives économiques*, no.354, February 2016 https://www.alternatives-economiques.fr/fonctionne-politique-monetaire/00008972
16 See https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm
17 See: https://www.ecb.europa.eu/pub/annual/balance/html/index.en.html; this is the balance sheet of the entire Eurosystem, in other words, of the ECB and the national central banks.
18 See the Positive Money analysis based on the analysis of the figures provided by the ECB: http://www.qe4people.eu/wealth_inequality_ecb_qe. In his 2016 speech "Whose recovery?", the Bank of England's Chief Economist Andrew Haldane said, "*So far at least, this has been a recovery for the too few rather than the too many, a recovery delivering a little too little rather than far too much.*" See https://www.bis.org/review/r160719e.pdf
19 http://www.boursorama.com/patrimoine/guides/bourse_chiffres.htm, rising from 3805 points on 31 December 1990 to 4862 points on 31 December 2016.
20 France-Inflation.com 2018, http://france-inflation.com/calculateur_inflation.php

Post-crisis regulation.

always problematic. Zero rates offer the possibility of putting off essential reforms, but for how long?"[21]

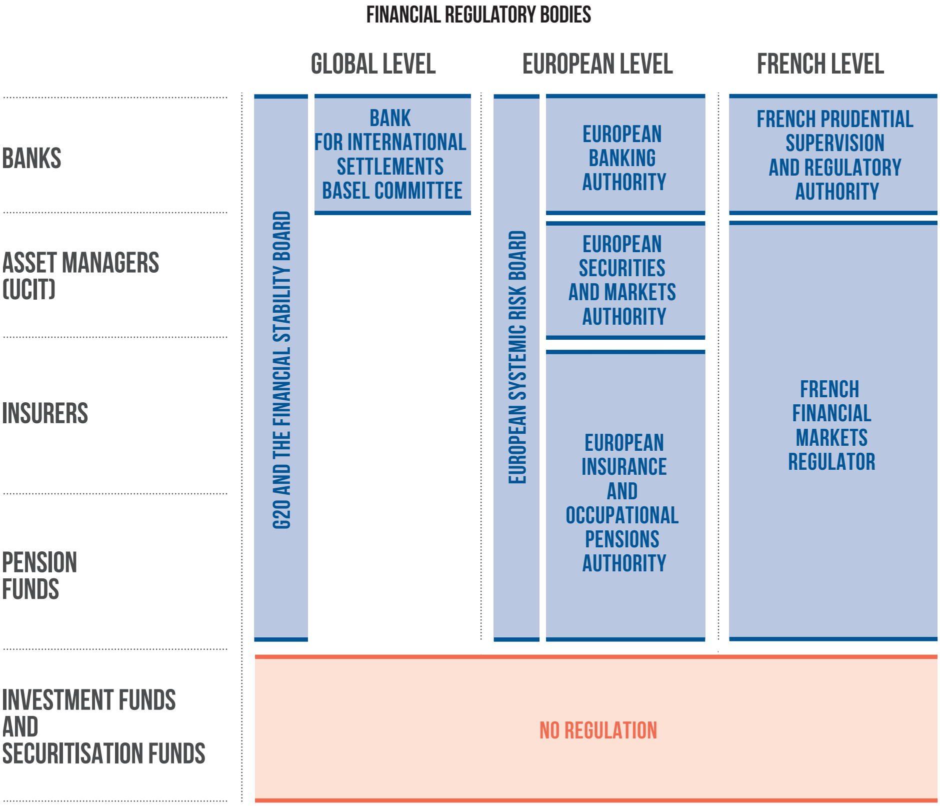
3.3. POST-CRISIS REGULATION HAS ONLY (PARTIALLY) ADDRESSED FINANCIAL STABILITY

The monetary policy of central banks has been just one of the aspects of post-crisis regulation. Financial regulators have attempted to stabilise the financial system, and some reforms have been very helpful[22]; however, financial sector reform has remained incomplete.

The creation of the Financial Stability Board

After the 2008 crisis, the main regulatory response was the creation of the Financial Stability Board (FSB) in 2009. This board, which is under the aegis of the Basel Committee, home to the central bankers of 90 developed countries, also includes international financial bodies (the IMF, the OECD, the IASB which regulates international accounting standards, and IOSCO which supervises the regulation of financial securities, shares and bonds[23]). It has a global scope and supervises all regulated financial markets: banks, collective management, insurers and pension funds… but not the unregulated financial markets, namely securitisation and investment funds. There are other bodies for managing regulation in more detail at the level of the financial products, at both national and European level.

21 Jacques de Larosière, *Cinquante ans de crises financières [Fifty years of financial crises], op. cit.,* 2016, p. 226.
22 Such as the strengthening of the banking capital ratio, the introduction of a leverage ratio and a ban on speculating on the failure of States without state debt (the "naked CDS" ban, in technical terms).
23 IMF: International Monetary Fund, OECD: Organization for Economic Co-operation and Development, IASB: International Accounting Standards Board , IOSCO: International Organization of Securities Commissions.



Comment: The FSB and Bank for International Settlements (BIS), and especially its Basel Committee, are the two global bodies of financial regulation, but a large part of the financial markets remain unregulated.

A slightly stronger capital ratio

Under the leadership of the FSB, prudential constraints on the banking system have been strengthened. The new Basel III prudential system has been implemented gradually since 2010. The minimum risk-based capital ratio has been increased, but only by approximately 2%[24]. Very large banks, known as systemically important financial institutions (SIFIs[25]), are subject to close monitoring and additional equity capital requirements in the event of a crisis, known as the "countercyclical capital buffer"[26]. For banks in the European Union, the new capital charges are only fully compulsory from 2018.

Introduction of the leverage ratio in Europe

These new standards, based on FSB recommendations, were the subject of the new European Directive known as CRD-IV[27]. They required banks to publish a new ratio[28]: the leverage ratio. This is the ratio of equity capital, not risk-weighted,

24 The regulations are complex and provide for different scenarios depending on the bank size.
25 SIFIs (Systemically Important Financial Institutions) are financial institutions whose troubles or uncontrolled bankruptcy could cause significant upheaval in financial systems and economic activities due to their size, complexity and systemic interconnectedness. For the list of SIFIs, see page 49, Part 2.
26 Between 1% and 2.5% equity capital, depending on their systemic importance.
27 Composed of Directive 2013/36/EU and Regulation 575/2013, implemented in France, notably as part of the 2013 Banking Act.
28 Only new for European banks, as it was already mandatory for US banks.

to the balance sheet total. It is a very simple measurement: this ratio can be read directly from an accounts balance sheet, unlike the Basel capital ratio, which requires complex risk-weighted credit calculations. In a way, the leverage ratio is more "objective" than the capital ratio. In order to calculate the latter, banks draw up their own risk calculation system, which may lead them to underestimate. In addition, it is difficult for regulators to closely supervise the risks taken and compare the risks taken by different banks.

Banks draw up their own risk calculation system, which may lead them to underestimate.

Conversely, the leverage ratio is based on accounting figures, without assigning risk weightings to the volume of credit. In the case of large banks, accounting figures are checked by external auditors. The Basel Committee set a minimum of 3% for this ratio from 2018: a minimum of 3 in equity capital for a balance sheet total of 100.[29].

The obligation to channel financial products through clearing houses

Among the European Directives drawn up following the 2008 crisis, The Markets in Financial Instruments Directive and Regulation (Mifid and Mifir), adopted in April 2014, stipulate routing derivatives transactions through clearing houses. A clearing house is a body that registers derivatives and pays the holder what is due upon maturity (or, conversely, collects it). This system helps to avoid a large number of transactions between banks, as banks centralize everything they owe to another bank or a client to the clearing houses, and only pay the net.

The limit of this system is that only 40% of the derivatives will be covered: all foreign exchange operations remain outside of this system, as well as commodity derivatives and so-called over-the-counter derivatives, which are the most complex and therefore potentially the most dangerous. Transparency now exists in theory by recording transactions in central repositories. The main repository is American (Depository Trust and Clearing Corporation). Located in London, it collates 90% of European transactions. This is a positive thing, but, despite being introduced in 2014, the system is still not usable; the interest issues have not been overcome[30].

Furthermore, going through clearing houses could strengthen interconnections between financial actors. In 2017, for the first time, the FSB studied the development of the clearing house system, and hypothesized that the failure of one financial actor (bank, fund) using a clearing house could lead to a systemic crisis for 23 of the 26 clearing houses examined[31].

29 A much higher threshold is suggested in the recommendations of this report (see Part 6): around 20% for this ratio, in order to make bank managers and shareholders more responsible for the risks taken. To give a sense of perspective, the average of 30 global systemically important financial institutions at the time of writing this report is 5.40% (see table on p. 49, Part 2).

30 See Jean-Michel Naulot, *Éviter l'effondrement [Preventing collapse],* Seuil, p. 109.

31 See "Analysis of Central Clearing Interdependencies", BIS, FSB, IOSCO, July 2017, http://www.fsb.org/wp-content/uploads/P050717-2.pdf; and Bruno Biais, "La compensation centralisée crée-t-elle plus de risques qu'elle n'en assure?" [Will centralised compensation create more risks than it covers?], *Revue Banque,* no. 781, February 2015, http://www.revue-banque.fr/risques-reglementations/article/compensation-centralisee-cree-t-elle-plus-risques

The new Dodd-Frank Act in the USA

In 2010, with a view to learning from the 2008 financial crisis, the USA adopted the Dodd-Frank Act. It was initially far-reaching[32]: in addition to the obligation for banks to keep 5% of their securitised loans in their balance sheets, it introduced debt to equity ratio of no more than 15 to 1 for systemic institutions, as well as the supervision of rating agencies by the Securities and Exchange Commission, the stock exchange watchdog in the USA. After consulting with the US financial sector, which bitterly contested the bill, the wording was reviewed and became more complex, with the text reaching nearly 850 pages[33]. In 2016, a quarter of the 400 provisions of the text did not yet apply… And Donald Trump, elected at the end of that year, began to repeal many of the act's provisions, replacing them with legislation that was very much in the interests of the financial sector[34].

While regulatory measures are moving in the right direction, they do not go far enough, and some major problems have not been addressed.

While these regulatory measures, such as the Dodd-Frank Act or the European Directives, are a step in the right direction, namely to stabilisation of the financial system, they do not go far enough and some major problems have not been dealt with:

- *banks are still too big to fail, therefore there is a still a threat to the State budget;*
- *there is still too much recourse to market funding (bonds) as opposed to bank credit: as a result, there is a lack of small and medium-sized banks who are better able to meet the needs of the economy and societies;*
- *separation of banking activities has not been achieved;*
- *speculative activities are still too attractive;*
- *a massive, non-transparent and unregulated shadow banking sector, where a large part of these speculative activities take place.*

3.4 MONETARY AND REGULATORY MEASURES THAT DO NOT CALL INTO QUESTION THE LINKS BETWEEN FINANCE AND THE ECONOMY

"Quantitative easing" has failed to revive the non-financial economy

The quantitative easing policy of the central banks has helped to keep the financial system running, and the crisis most likely would have been much more severe without it. However, even some ECB leaders have expressed doubts about the effectiveness of this strategy for the economy[35]. They have failed to initiate a revival of investment and therefore a potential fall in unemployment. Only existing financial securities can be purchased by central banks under this policy,

32 See "Dodd-Frank Wall Street reform and consumer protection act", Public Law 111–203, July 2010, http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf; and "La réforme de Wall Street vue par la société civile: leçons et perspectives" [The Wall Street reform as seen by civil society: lessons and perspectives], Center of Concern and CCFD-Terre Solidaire, 2011, http://ccfd-terresolidaire.org/IMG/pdf/ccfd-dod-franck-int-fr.pdf

33 Drawing out and complicating regulations is one of the techniques used by *lobbyists* in order to make them inapplicable and... denounce their complexity (see below).

34 See for example Isabelle Chaperon, Éric Albert and Stéphane Lauer, "Dix ans après la crise financière, la finance mondiale renoue avec les excès" [Ten years after the financial crisis, the financial world is back into excess], *Le Monde*, 8 July 2017, http://abonnes.lemonde.fr/economie/article/2017/07/08/les-germes-de-la-prochaine-crise_5157671_3234.html?xtmc=trump_dodd_frank&xtcr=3. See also "Sous Trump, l'allègement de la règlementation bancaire est en marche" [Under Trump, easing of banking regulations is underway], AFP, 2017, http://www.lepoint.fr/economie/sous-trump-l-allegement-de-la-reglementation-bancaire-est-en-marche-16-11-2017-2172767_28.php

35 "*The transmission of unconventional instruments to financial conditions, and, further down the road, to economic activity and price developments, is surrounded by a high degree of uncertainty*". from a speech by Peter Praet, member of the Governing Council of the ECB, at the ECB and Its Watchers XIX Conference, Frankfurt, 14 March 2018, https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180314_2.en.html

which means that new investments cannot be funded. Investments in energy transition, for example, cannot be funded by this program; in addition, banks do not tend to fund them very much, considering them to be unprofitable and too risky (with a few exceptions, and in the absence of ambitious climate policies that would make them more profitable)[36]. Finally, this program cannot fund State deficits: governments must first borrow on the financial markets and, only once they have done so, the bonds issued are eligible for purchase by the central banks.

Simply stabilising the financial sector is not enough: credit must also be redirected toward the non-financial economy

Even if the regulatory measures taken since 2008 (section 3.3) were applied immediately, with a broad scope and with a higher degree of constraint in terms of the leverage ratio, they would not be enough to reorient the financial and banking sector to serve the general interest. In Europe as well as the United States, the measures taken following the crisis aimed to stabilise the financial system *itself*, to protect it against the possible consequences of a new crisis. However, this may not be an adequate goal from the point of view of the general interest. Indeed, the 2007-2008 crisis primarily affected economic activity and demand in the non-financial economy. It is not just the issue of banks that needs to be addressed, but also that of credit, in terms of its restriction and direction. Because, even if the major banks never went bankrupt again, even if they never needed to be bailed out with public money, their workings can be detrimental to the overall economy if they create too much debt, and if that debt fuels speculative and unequal bubbles rather than harmonious economic development for societies. It must be ensured that the workings of the financial sector do not destabilise the economy, particularly during financial crises, but not only then: by creating bubbles, e.g. real estate, which generate economic tensions long before the bubble bursts.

The reforms undertaken have not changed the financial sector's tendency to prioritize the pursuit of very high profits in the (very) short term. Since these reforms have not made these market activities any less attractive, returns on investments in the non-financial economy and corporate stakes will never be as high as those offered by speculative products such as derivatives that are still in circulation, despite the damage they may have caused in the 2008 crisis.

The strengthening of equity capital requirements (Basel III) sparked a lot of debate about the redirection of bank credit to the non-financial economy. Large banks often report that the equity capital requirements set by the Basel III ratios are too high, and that this prevents them from funding long-term investments or SMEs that are struggling or are in the start-up phase[37]. They favour *trading* activities and "safe" placements such as government bonds or loans to very large

36 See for example Alain Grandjean, "Quelles évolutions réglementaires pour réussir le financement de la transition énergétique" [What regulatory changes to achieve energy transition funding], *Revue Banque & Stratégie*, no. 362, October 2017, http://www.revue-banque.fr/risques-reglementations/article/quelles-evolutions-reglementaires-pour-reussir-fin

37 See for example "Les accords de Bâle et leurs conséquences sur l'économie" [The Basel Accords and their consequences on the economy], French Banking Federation memo, June 2017, www.fbf.fr/fr/files/ANABHE/Memo-04-Bale-avril2018.pdf

businesses. However, as seen in Laurence Scialom's[38] analysis, which is based on BIS[39] studies, the strongest growth in credit being allocated to SMEs can be observed in banks with the most capital and, most often, in the smaller ones.

The Chief Economist of the BIS noted in 2016 that *"a well-capitalized institution will find it easier to borrow*" and that "*the more capital a bank has, the more funds it has to lend, and on much better conditions than an under-capitalized bank." "Therefore*," he added, *"if the monetary policy objective is to unblock bank lending to the real economy, it is crucial to ensure that banks have enough capital."*.[40]

Finally, the banking reforms driven by the FSB and the Basel Committee are based on the workings and practices of large systemic banks, which results in regulatory requirements not necessarily being suitable for small and medium banks, as well as financial actors that are based on cooperative and ethical models[41].

3.5 THE APPLICATION OF THE REGULATIONS IS WEAKENED BY THE SUPERVISORS' LACK OF RESOURCES AND THEIR PROXIMITY TO THE ACTORS OF THE SYSTEM THAT THEY ARE SUPERVISING

How can one explain that regulations have maintained an approach that seems too restrictive on financial regulation and which, ultimately, fails its purpose? Several hypotheses can be made. Part 1 already made reference to the dominance of a liberal economic theory and ideology that takes it for granted that finance left to its own devices obtains the best results for the general interest[42] – going against all the evidence since the 2008 crisis. Other explanations include: lack of human resources and room for manoeuvre of the supervisors, or their close proximity to the world they are regulating.

Regulators lack the human resources to deal with huge banking and financial groups

In France, supervision of finance is divided between two administrative authorities - the Autorité des marchés financiers (AMF) [Financial Markets Regulator] and the Autorité de contrôle prudentiel et de résolution (ACPR) [French Prudential Supervision and Resolution Authority] - and the Haut Conseil de stabilité financière (HCSF) [High Council for Financial Stability], which reports directly to the Ministry of Economy and Finance and is tasked with ensuring the stability of the financial system. The AMF employs four hundred and seventy members of staff to handle the protection of savings invested in financial products, investor information and the smooth running of the markets, while assisting with ensuring the regulation of these

38 "Monsieur Macron, résistez au mantra des banques sur la réglementation" [Mr. Macron, stand up to the banks' mantra on regulation], *Banque & Assurance*, 10 March 2017, http://communautes.agefi.fr/status/12577
39 See in particular Hyun Song Shin, "Bank capital and monetary policy transmission", 7 April 2016, http://www.bis.org/speeches/sp160407.pdf; and Leonardo Gambacorta and Hyun Song Shin, "Why bank capital matters for monetary policy", *BIS Working Papers* 558, April 2016, http://www.bis.org/publ/work558.pdf
40 Hyun Song Shin (economic advisor and head of research at BIS), "Bank capital and monetary policy transmission", at the ECB and Its Watchers XVIII Conference, Frankfurt, April 2016, https://www.bis.org/speeches/sp160407.pdf
41 See Sabine Lautenschlager (member of the ECB Executive Board) "Walled off? Banking regulation after the crisis", speech given at the Institute of International and European Affairs, March 2017, which hints at considering possible proportionality in the regulatory reporting burden for small banks, https://www.bankingsupervision.europa.eu/press/speeches/date/2017/html/se170313.en.html
42 This "certainty" is based on the theories of the rationality of the actors and the efficiency of the markets (see section 1.2), and Adair Turner, *Between Debt and the Devil, op.cit.*, p. 72 et seq.

markets at European and international level. Only the HCSF, which meets three to four times a year, can directly intervene to rectify, or stop, ongoing speculative processes. The methods of effective action therefore appear to be very limited[43].

Too often supervisors have to rely on information provided by the entities they supervise, and they often lack the human resources needed to verify it

In addition, data from banks and financial institutions is not automatically transmitted to the supervisor. The supervisor has to ask the banks that they supervise to provide them with this data, which slows down and weakens the supervisory process. Therefore all too often supervisors have to rely on information provided by the entities they supervise, and they often lack the human resources needed to verify it[44].

Close proximity between the supervisors and supervised entities

Finance, like many other economic sectors, has seen the development of so-called "revolving doors" phenomena, encouraging the "capture"[45] effect that supervisory bodies may experience from the actors that they are supposed to be overseeing. As such, Terra Nova analyses the various phenomena that increase "*conflict of interests hypotheses*"[46] including the "*multi-positioning of actors*"[47] or the development of interconnections, particularly between the private sector and public sector in the case of "*revolving doors*"[48] – which affects the financial sector among others – as well as the sharing of cognitive frameworks between regulators and those being regulated, the demand for increasingly advanced expertise and greater professional mobility, for example[49].

Given their purpose, the ACPR, HCSF and AMF executive committees mainly consist of people from the financial sector. However, these actors' intellectual proximity, education or professional experience raise questions over the way they see things when it comes to regulating; in the absence of political representatives and citizens (such as consumer organizations, for example), how can we ensure that the link is made with the wider economy and the general interest, and that it is not just the internal stability and prosperity of the financial sector that is prioritized? The argument of financial expertise being needed for a supervisory position on a management board could be justified at the level of advisory or implementation duties, but it is questionable when it comes to cases of decision-making and/or arbitrage.

The proximity between supervisors and supervised is also reflected in the way in which supervisory bodies develop their guidelines. In 2014, the Brussels

43 See Jean-Michel Naulot (former member of the AMF Board), in "Une crise en quête de fin. Quand l'Histoire bégaie" [A crisis looking for a way to end. When history stutters], op. cit., p. 241.
44 See "Une crise en quête de fin. Quand l'Histoire bégaie" [A crisis looking for a way to end. When history stutters], *op. cit.,* and in particular the statements made by Gérard Rameix, then President of the AMF (pp. 163-164).
45 See in particular Joël Moret-Bailly, Hélène Ruiz Fabri, Laurence Scialom, "Les conflits d'intérêts, nouvelle frontière de la démocratie" [Conflicts of interest, the new frontier of democracy], Terra Nova, February 2017 (pp. 14-16), http://tnova.fr/rapports/les-conflits-d-interets-nouvelle-frontiere-de-la-democratie
46 Ibid.
47 Ibid., p. 14
48 Ibid., p. 15.
49 Ibid. The report mentions, for example, "*the London Stock Exchange's appointment in September 2014 of the former MEP Sharon Bowles as non-executive director, who chaired the Committee on Economic and Monetary Affairs until May that same year [and who had had] many meetings with representatives of the London Stock Exchange during her term as MEP*" and "*the case of Benoît de La Chapelle Bizot, the current Director General Delegate of the Fédération bancaire française [French Banking Federation]*", who having begun his career at the "*Commission bancaire [Banking Commission] and then [at the] General Directorate of the Treasury, again working on banking issues*", in 2010 became the "*Minister-Counsellor for financial and monetary affairs of the Permanent Representation of France to the European Union and, as such, represented France for financial and banking regulatory matters*", (p. 16, footnote of page 16).

Supervised entities are themselves the supervisors.

organization CEO (Corporate Europe Observatory) studied “the fire power”[50] of the financial industry and showed that it devotes a significant number of human and financial resources to influencing regulations that are under discussion. Its workforce is at least thirty times larger than those of trade unions and civil society organizations involved in these matters. It is also through their strong presence in supervisory body advisory committees that financial sector representatives can promote their interests. More recently, the CEO reported that they constitute the majority within 22 committees set up by the ECB, occupying 508 of the 517 places[51].

Politicians and third countries absent from supervisory bodies

Supervisors’ accountability to citizens is ultimately very limited, particularly as a result of the political commitment to making supervisory bodies independent from political representatives. National or European parliamentarians only have limited access to those in charge of the authorities, and do not have much control or guidance over their actions.

In addition, only developed countries with a significant financial center take part in the major decisions of these authorities. Third countries, and particularly developing countries, cannot voice their concerns and expectations regarding financial oversight. However, they are heavily affected by financial deregulation: volatile prices for agricultural commodities, public funding on the financial markets, speculative attacks on their currencies, etc. (see Part 5).

50 "The fire power of the financial lobby. A survey of the size of the financial lobby at the EU level", Corporate Europe Observatory, ÖGB Europabüro and AK EUROPA, April 2014, https://corporateeurope.org/sites/default/files/attachments/financial_lobby_report.pdf
51 "Open door for forces of finance at the ECB", Corporate Europe Observatory, October 2017, pp. 3-4, https://corporateeurope.org/sites/default/files/attachments/open_door_for_forces_of_finance_report.pdf

3
OVERVIEW

The 2008 financial crisis was due to unregulated elements of the current financial system: the bursting of the housing bubble, magnified by securitisation, across borders that no longer exist for capital flows. The economic and social impact of the crisis has been significant and, ten years later, the economy has not recovered its previous strength. The quantitative easing policy has failed to revive the economy and, although it has helped to preserve the workings of the banking system, it has contributed to maintaining unequal bubbles in the financial markets. Post-crisis regulation was too limited, but most of all it only focused on the financial sector itself and not on its links with the economy. As a result of the strong influence of the financial sector, policy makers and financial supervisors have failed to implement ambitious reforms.

The 2008 crisis has slowed economic activity and increased poverty in developed countries. However, even before the crisis, the financialisation of the economy had detrimental consequences for developed countries. It is important to make a precise diagnosis so that we can suggest reforms which ensure that finance serves the general interest once more.

4

TOO MUCH FINANCIALISATION AND WIDENING INEQUALITY IN DEVELOPED COUNTRIES

Beyond the impacts of the 2008 financial crisis on economies and people, financialisation of the economies since the 1970s has affected the very structure of our societies, widening inequality. This has also been exacerbated by the growing role of real estate lending, and has the effect of hampering the non-financial economy. Furthermore, most developed countries have seen their public debts rise as a result of the crisis and have implemented austerity policies preventing economies or societies from recovering. Finally, the excessive size of banks continues to be a major risk for taxpayers. All of these elements demonstrate the multiple effects that excessive financialisation can have on increased poverty and exacerbation of inequality.

4.1. THE 2008 CRISIS: IMPACT OF THE FINANCIAL CRISES ON SOCIETIES

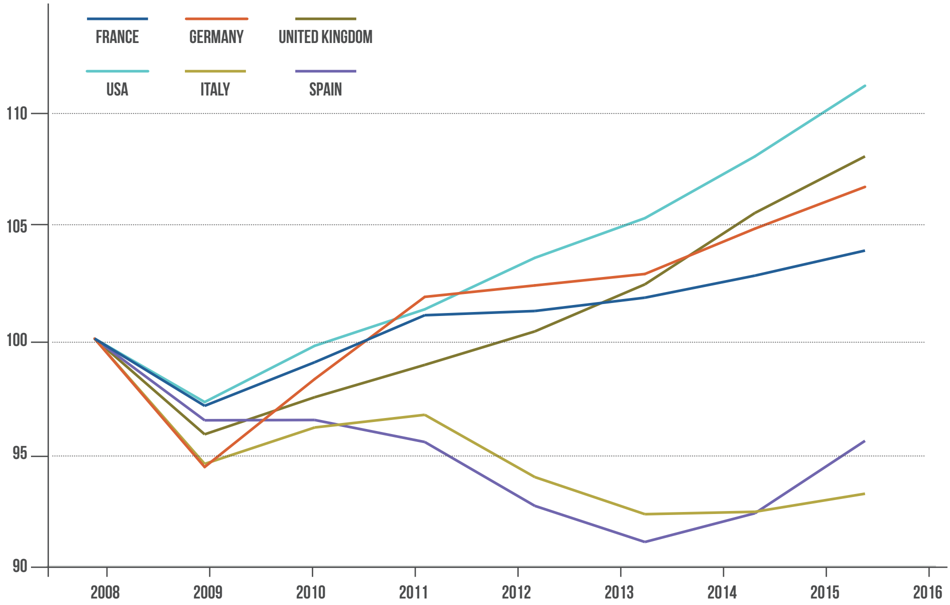
Unfortunately, the 2008 crisis offers a glaring example of the impact of financial crises on economies and societies. This is an example worth analysing in order to highlight the links between financialisation, poverty and inequality. This crisis has led to a significant drop in production in advanced economies, ranging from 10% to 15% depending on the country, between 2008 and 2010[1]. This drop was initially caused by a sudden slowdown in lending. Banks were effectively applying the brakes when it comes to granting new loans. This was not because businesses were failing, but because the securitisation market had stopped working[2]. However, the banks' operating model was oriented towards creating loans which are then securitised (see Part 2). In addition, banks were in serious trouble during this period, with several major banks having to be urgently bailed out by the State.

Contagion sweeps the rest of the world.

The slowdown in lending would cause many cash-strapped businesses to go bankrupt, especially those whose operations were based on bank credit which suddenly became unavailable. Subcontractor bankruptcies break down the production line. Furthermore, the drop in the financial markets led to a fall in prices and shares, and substantial losses for investors: consequently, investment slowed down dramatically, including in large businesses. Many of these reacted by implementing savings programs to try to free up financial resources from their own operations. These "lean" management programs involved in particular scaling back on suppliers and order volumes, in order to have less inventory to finance, as well as staff cuts. In the eurozone, unemployment rose from 7.2% in March 2008

1 Adair Turner, *Between Debt and the Devil, op. cit.,* p. 57
2 This prevented banks from taking credit out of their balance sheets, so as to minimize their commitment in relation to their equity capital and thus issue new loans. See Paul Mizen, "The Credit Crunch of 2007-2008: A Discussion of the Background, Market Reactions, and Policy Responses", *Federal Reserve Bank of St. Louis Review*, September-October 2008, https://files.stlouisfed.org/files/htdocs/publications/review/08/09/Mizen.pdf

EVOLUTION OF GDP IN SEVERAL DEVELOPED COUNTRIES, FROM 2007 TO 2015 (BASE 100: 2007)



Sources: OECD, http://stats.oecd.org/index.aspx?DatasetCode=SNA_TABLE1

Comment: The 2008 financial crisis caused economic output to fall. Germany, the USA and France managed to return to the 2008 level in 2011, the United Kingdom took until 2013, while Italy and Spain have still not done so.

to 9.5% in May 2009[3]. In France, it increased from 7.6% at the start of 2008 to 10.2% in November 2009[4].

The crisis therefore interrupted a growth dynamic in developed countries. The level of economic activity should not only be compared with that of 2008, but also with what would have been achieved had the crisis not occurred. Adair Turner estimates that the production level in developed countries today is 10% to 15% lower than if there had not been a financial crisis in 2008[5].

The crisis has had a major impact on the rise of poverty in France and other developed countries

The 2008 crisis has had a major impact on the rise of poverty in developed countries. An OECD[6] study analysing the effects of the economic crisis on poverty and inequality shows that the inequality level increased by 1.4% in 17 OECD countries between 2007 and 2010, more than in all of the previous 12 years.

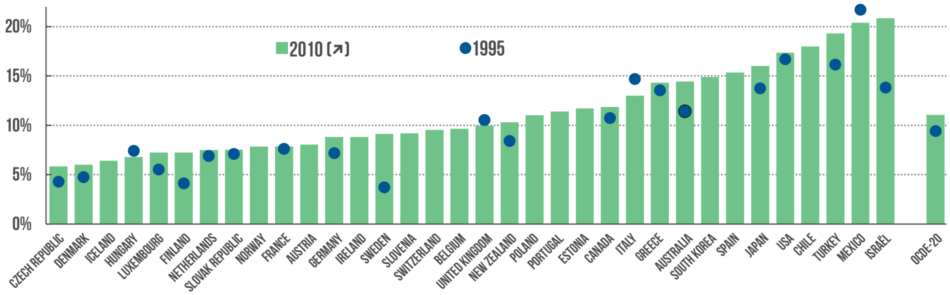
3 See "Impact of the economic crisis on unemployment", Eurostat Statistics Explained, 2009, http://ec.europa.eu/eurostat/statistics-explained/index.php/Archive:Impact_of_the_economic_crisis_on_unemployment

4 "D'une crise à l'autre. Des *subprimes* à la crise mondiale" [From one crisis to another. From subprimes to global crisis], Les politiques économiques à l'épreuve de la crise, *Cahiers français*, no. 359, November-December 2010, http://www.ladocumentationfrancaise.fr/var/storage/libris/3303330403594/3303330403594_EX.pdf

5 Adair Turner, *Between Debt and the Devil, op. cit.,* p. 33.

6 "Crisis squeezes income and puts pressure on inequality and poverty", results from the OECD Income Distribution Database, May 2013, http://www.oecd.org/els/soc/OECD2013-Inequality-and-Poverty-8p.pdf

RELATIVE POVERTY INCREASED IN MOST OECD COUNTRIES BETWEEN 1995 AND 2010



Source: OECD "Crisis squeezes income and puts pressure on inequality and poverty," Results derived from the OECD database on income distribution (May 2013), p. 5, http://www.oecd.org/els/soc/OECD2013-Inequality-and-Poverty-8p.pdf

Comment: At the end of 2010, relative poverty (less than 50% of median income) affected an average of 11% of the population in developed countries (20 as defined by the OECD), i.e. 148 million people. With a few exceptions, this rate has increased considerably since 1995.

In the United States, the increase in poverty linked to the crisis was very sharp: from 2009 to 2010, the number of poor Americans increased by 4 million, reaching 44 million[7], or one in seven Americans.

In France, according to the Observatoire des inégalités [Inequality Monitoring Centre], the number of people living in poverty increased by nearly one million people between 2005 and 2015[8]. With the crisis, the 60% poverty rate[9] increased from 13.2% of the population in 2008 to 14.2% in 2012.

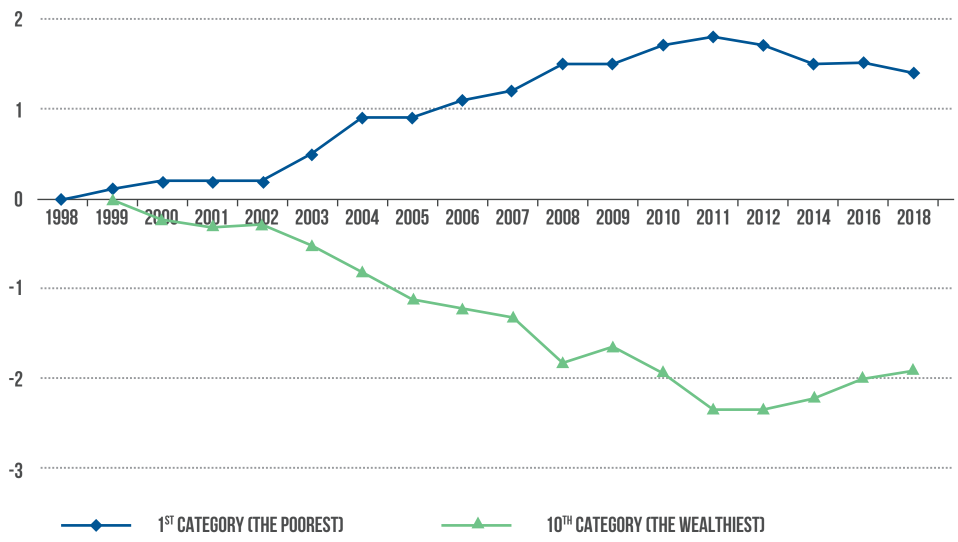
The number of people in France receiving the basic RSA [welfare] (535 euros per month for a single person) grew by almost 50%, i.e. by more than 500,000 people between 2008 and 2015[10], a number which had increased by less than 8% over the previous ten years[11]. Meanwhile, the number of people receiving minimum social benefits (RSA, the elderly, unemployed no longer eligible for unemployment benefit) increased by 24% from 2000 to 2015 and now applies to 4.1 million people. This sharp increase was due in particular to the effect of the crisis on career endings (unemployment, work interruptions) which affected the level of pensions. As a result, State social spending increased in order to meet new compensation needs. In France, the cost of welfare increased by 36 billion euros in 2009 compared to 2008[12].

7 Erik Eckholm, "Recession Raises Poverty Rate to a 15-Year High", *The New York Times*, 16 September 2010, http://www.nytimes.com/2010/09/17/us/17poverty.html?pagewanted=all&_r=0
8 "L'État de la pauvreté en France" [The State of poverty in France], *Notes de l'Observatoire,* no. 4, November 2017, Observatoire des inégalités, https://www.inegalites.fr/IMG/pdf/notes_de_l_observatoire_-_etat_de_la_pauvrete_en_france.pdf
9 Calculated on the basis of the 60% threshold: somebody is poor when their income is lower than a certain percentage (60%) of the threshold which divides the population into two, known as the median income, a threshold used at European level by Eurostat.
10 Bearing in mind that the rate of non-uptake remains high, with 36% of those eligible for basic RSA not applying for it. See Gisèle Biémouret and Jean-Louis Costes, "Évaluation du non-recours aux minima sociaux et aux soins des personnes en situation de précarité sociale" [Evaluation of non-uptake of basic welfare and care for people in a situation of social insecurity], Annex 2 of the "Rapport d'information sur l'évaluation des politiques publiques en faveur de l'accès aux droits sociaux" [Information report on the evaluation of public policies promoting access to social rights], National Assembly, October 2016, http://www.assemblee-nationale.fr/14/pdf/rap-info/i4158.pdf
11 See this summary table published by Insee: https://www.insee.fr/fr/statistiques/fichier/2407796/reve-protec-rmi-rsa-famille.xls
12 Data, France.inflation.com, http://france-inflation.com/dette_publique_france_1950.php

The 2017 report by Secours Catholique - Caritas France[13] on the state of poverty in France highlights several phenomena of worsening poverty in the years following the crisis: for example, the fragility index[14] of families with children increased from 1.39 in 2010 to 1.48 in 2016. More and more of the households that Secours Catholique – Caritas France meets are having to deal with arrears. The proportion of households met which have resources and are facing arrears went from 65.3% in 2010 to 67.3% in 2013 (utility bill and rent arrears are the most common unpaid bills).

Lastly, the cost of living has increased for the poorest who, when their expenses are taken into account, are experiencing higher inflation than the population as a whole. Conversely, those who are better off are experiencing lower inflation than the population as a whole. The gap between these two divergent trends has been growing since the end of the 1990s and intensified at the time of the 2008 crisis (see graph below).

THE GAP BETWEEN PRICE INCREASES FOR THE POOREST AND WEALTHIEST HOUSEHOLDS IN RELATION TO THE PRICE INCREASES FOR THE FRENCH POPULATION AS A WHOLE



Source: Insee, 1998-2015 price index according to the standard of living of households included in the report by Secours Catholique – Caritas France on the state of poverty in France, *op. cit.*

Comment: The poorest experience higher inflation than the general population while the wealthiest experience lower inflation.

13 "État de la pauvreté en France, Préjugés et cohésion sociale" [State of poverty in France, prejudices and social cohesion], Secours Catholique–Caritas France, *Rapport statistique 2017*, https://www.secours-catholique.org/sites/scinternet/files/publications/rs17_0.pdf

14 Ratio between the proportion of a category of people observed at Secours Catholique and the proportion of the same category observed in the population France as a whole. When this index is greater than 1, it means that this category of people is over-represented among those met by the association. These people tend to be more vulnerable to insecurity and extreme poverty.

Oversized real estate lending and inequalities

Credit was deregulated in developed countries in the 1970s and 1980s (see Part 2). Free to choose the type and quantity of credit they dealt with, in a majority of developed countries banks allocated the bulk of the credit to the real estate sector. This means that only 40% of bank credit finances other economic sectors, such as the development of commerce or non-real estate businesses. In addition, in most cases, real estate lending finances already existing assets, which entails a rise in prices[1]. Studies have shown that credit conditions could account for the 45% rise in the price of real estate in the United States between 2000 and 2005[2], and the 50 to 60% rise in France[3].
The rise of real estate prices is not uniform in developed countries. It is centred on assets most in demand: mostly properties in large cities and their suburbs. And since the price of land has also been comprehensively deregulated, there is no limit to price rises[4]. However, the rise in

EVOLUTION OF THE SHARE OF REAL ESTATE LENDING IN RELATION TO THE TOTAL CREDIT GRANTED BY BANKS IN 17 DEVELOPED COUNTRIES (1880-2010)

Source: Graph taken from Jorda, Schularick and Taylor, "The Great Mortgaging", op. cit.

Comment: The share of mortgages in relation to the total credit granted by banks in 17 developed countries has grown continuously, today reaching almost 60% of the total credit granted today.

prices of real estate in "desirable locations", as well as rents, has had major social consequences, accentuating inequality[5]. For example, in France, housing costs amount to 18% of household income overall, but this rises to 31% of income for the poorest quarter of the population, and 41% for those renting in the private sector. In France this figure increased by 2% on average between 2000 and 2013, but by 6% for the poorest.

1 See Adair Turner, *Between Debt and the Devil*, op. cit., p.p. 106-107.
2 Edward L. Glaeser L., Joshua D. Gottlieb and Joseph Gyourko, "Can Cheap Credit Explain the Housing Boom?", *NBER Working Papers*, no.16230, National Bureau of Economic Research, Inc., 2010, http://www.nber.org/papers/w16230.pdf
3 See "L'évolution des prix du logement en France sur 25 ans" [Evolution of housing prices in France over 25 years], analysis note 221, French Strategic Analysis Centre, April 2011, p. 8, http://archives.strategie.gouv.fr/cas/system/files/2011-04-29-prixdulogement-na221_0.pdf
4 For example, in the late 1990s, the value of the entire real estate stock in the Chiyoda district in downtown Tokyo was worth more than the total land value of the whole of Canada. Richard Werner, "Princes of the Yen: Japan's Central Bankers and the Transformation of the Economy", East Gate Books, 2003, quoted by Adair Turner, *Between Debt and the Devil, op.cit.*, p. 118.
5 Data from "Rapport sur les inégalités en France 2017" [Report on inequalities in France 2017], Observatoire des inégalités, p. 122 et seq.

Housing costs for first-time buyers amount to 48% of their income. Given the change in purchase prices (and the absence of a proportional increase in wages), over a period of 40 years, access to property in France has also differed considerably depending on wealth. There were half as many homeowners amongst the poorest 25% of households in 2013 as there were in 1973 (16% compared to 33%). Conversely, the proportion of homeowners amongst the wealthiest 25% stood at 66%, compared to 43% in 1973. Yet, in times of uncertainty, particularly when it comes to the possibility of working until retirement, access to real estate is an important safeguard.

In France, the growing share of real estate loans out of total credit, coupled with the rise in real estate prices, has contributed to exacerbating inequality.

This data therefore supports the hypothesis that, in France, the growing share of real estate loans out of total credit, coupled with the rise in real estate prices, has contributed to exacerbating inequality.

The high level of real estate prices is also a major contributing factor to the exacerbation of poverty. Housing is becoming more and more of a burden on the budgets of the most disadvantaged households. As indicated above (see p. 77), housing arrears (rent and energy bills) are the main unpaid items for households that Secours Catholique-Caritas France meets every year[6]. Over ten years, these people have seen their rent increase by 20%, while their resources have only increased by 12%.

Between 2010 and 2016, the cost of real estate increased by 18% in Germany, 10% in the United States and 14% in the United Kingdom, countries which have also seen inequality widen (see section 4.2).

It would therefore seem that old real estate lending, the main activity of the banks, has had a major impact on the general interest in terms of financial stability and the growth of poverty.

The purpose is obviously not to restrict access to housing, in particular for lower income people, but to take into account the fact that, globally, too much lending for old real estate causes instability and risks of speculative bubbles. The issue of access to housing for all must form part of ambitious and global public policies, particularly in terms of land planning, stimulating real estate, access to mortgages for poorer households, developing rental housing stock by offering affordable rents for those on a low income... The measures proposed in Part 6 take this analysis into account.

6 SCCF, "État de la pauvreté en France" [State of poverty in France], *op. cit.*, pp. 69-70.

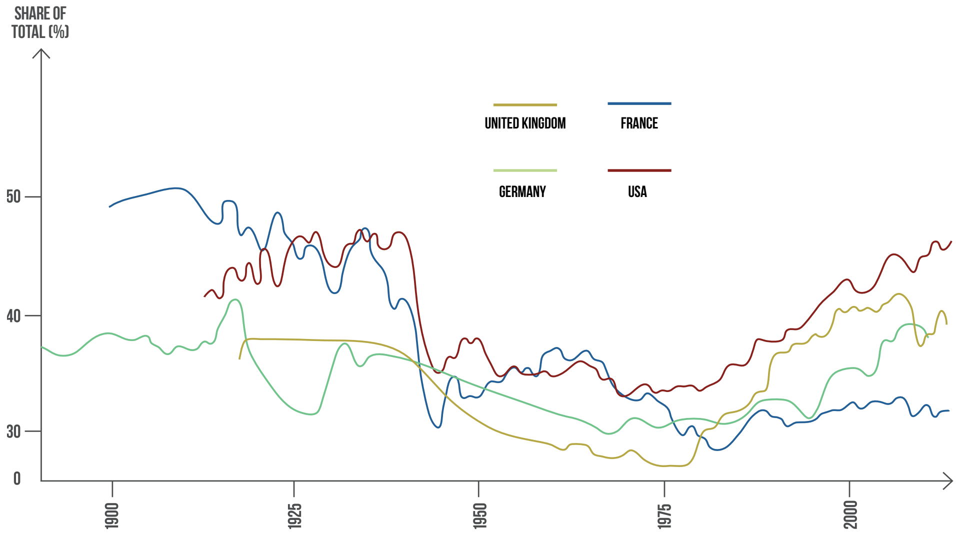
4.2. FINANCIALISATION OF THE ECONOMY HAS BENEFITED THE RICHEST: INEQUALITY HAS WIDENED SINCE THE 1980S

Income and wealth: related inequalities that feed one another

In order to analyse inequality, we need to distinguish between income inequality and wealth inequality. Income includes wages, but also financial income: rents, dividends, interest on bond investments and capital gains. Since 1980, when financialisation of economies gathered pace, it can be seen that the share of income earned by the 10% of households who earn the most has increased considerably in advanced economies, as shown in the graph opposite for Germany, the United States, France and the United Kingdom. These are partly wage inequalities: for example, the Global CEO Pay Index covering wage gaps across the world, compiled by the financial news company Bloomberg and published at the end of 2017, shows that an American boss earns on average 265 times more than the average employee. In Germany, this gap is 136 and in France it is 70[15]. In the United States, 20% of households with the lowest earnings have not seen their wages increase since the 1980s, while the incomes of the top

In the United States, 20% of households with the lowest earnings have not seen their wages increase since the 1980s.

INCOME INEQUALITY TAKE AN UPTURN AFTER 1980

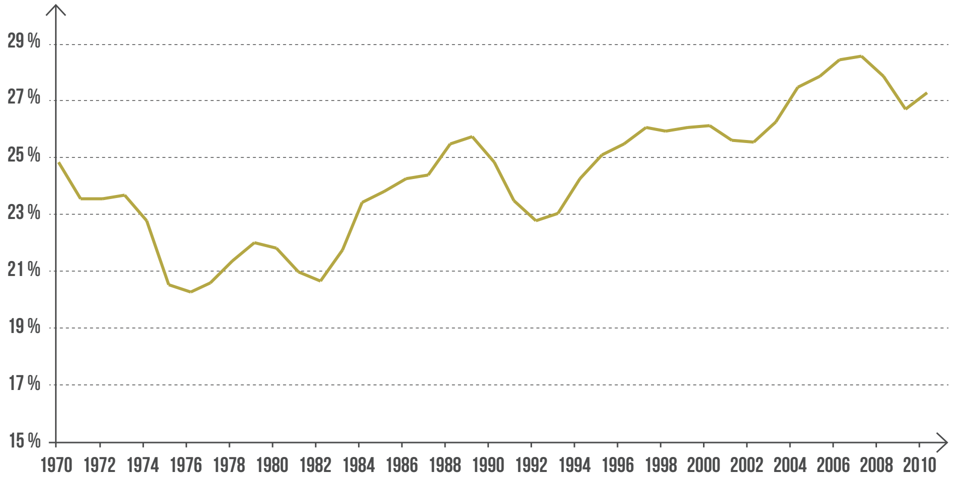


Source: World Inequality Database, www.wid.world/fr

Comment: The wealthiest 10% of Americans earned around 35% of the national income in 1980 and 48% in 2010. The wealth of the top 10% also rose sharply in the United Kingdom and Germany, much less so in France (see below).

15 Anders Melin and Wei Lu, "CEOs in U.S., India Earn the Most Compared With Average Workers", *Bloomberg*, 28 December 2017, https://www.bloomberg.com/news/articles/2017-12-28/ceos-in-u-s-india-earn-the-most-compared-with-average-workers

SHARE OF CAPITAL INCOME IN THE NATIONAL INCOME OF 8 RICH COUNTRIES (1970-2010)



Source: *Le capital au xxi^e siècle [Capital in the 21^st Century]*, *op. cit.* on http://piketty.pse.ens.fr/fr/capital21c

Comment: Capital income in eight developed countries (Germany, Australia, Canada, the United States, France, Italy, Japan and the United Kingdom) increased from approximately 20% of total income (GDP) in the 1970s to nearly 30% in the 2000s.

1% of households have tripled. According to Oxfam[16], in France, the 21 richest people have as much wealth as the poorest 40%.

However, income inequalities are also due to non-salary income, derived from real estate and financial assets. Hence people able to build up significant assets can generate additional income, enabling them to increase their wealth. This is how income and wealth inequalities feed one another[17].

Stagnation of income from employment and (excessive) debts among the less well-off…

The increase in inequality in advanced economies can largely be explained by the fact that since the 1980s – the beginning of the period of financialisation of the economy – income from employment has stagnated. Why has income from employment stagnated[18]?

After the Second World War, prices rose sharply in the advanced economies, particularly in the United States, the United Kingdom, France and Germany. From the 1960s, high unemployment, above 5% of the active population, began to occur, particularly as a result of the transition from a production model based on Fordism to the era of leaders whose earnings were more and more dependent on business share prices[19].

16 "An economy for the 99%", information document, Oxfam International, 2017, https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620170/bp-economy-for-99-percent-160117-en.pdf?sequence=1

17 See in particular Branko Milanovic, "Increasing capital income share and its effect on personal income inequality", *Munich Personal RePEc Archive, Paper* No. 67661, November 2015, https://mpra.ub.uni-muenchen.de/67661/1/MPRA_paper_67661.pdf

18 See the IMF report, "World Economic Outlook 2017", chapter 3, http://www.imf.org/~/media/Files/Publications/WEO/2017/April/pdf/c3.ashx; and Thomas Piketty, *Le capital au xxi^e siècle*, [Capital in the Twenty-First Century], Le Seuil, 2013

19 See in particular Michel Aglietta and Antoine Rebérioux, coll. *Dérives du capitalisme financier* [Deviations of financial capitalism], éd. Albin Michel, coll. "Bibliothèque d'économie", 2004. Other factors, such as technological advances and the mechanization of many tasks, explain this change.

As wages stagnate, credit grows.

In order to combat unemployment and rising prices, governments would pursue anti-wage increase policies. However, when wages stagnate, there can be no economic dynamism, because there is no additional demand. This is why governments have allowed household credit to increase, and it has grown by 10% to 15% per year in advanced economies since 1980, while production has only increased by 5% per year: the aim being to support demand. Hence in the USA, household debt rose by 80% between 1998 and 2007, reaching almost the equivalent of GDP. Economic growth in developed countries has therefore been based on credit, with credit replacing rising wages to support demand. However, this has led to widening inequality.

One of the essential characteristics of debt is that it results in enormous losses for the households who have the least.

More specifically, debt overhang has worsened inequality, in other words, getting into more debt than we are able to pay off. France, the 1989 Neiertz Act limited households debt: still in force, it prevents anybody from getting into a situation where the amount they have to pay off is greater than one third of their income, with the banks being required to check the borrower's status before giving them credit. It is partly[20] thanks to this control of the level of household debt that France is the developed country where household debt has increased the least and inequality widened the least.

In other developed countries, where debt overhang is not restricted as it is in France, many households have gone into debt while trying to maintain or improve their standard of living, while their income from employment has stagnated. Due to securitisation (i.e. selling credit to avoid the risk of non-repayment), banks have

20 France's state welfare system is also a contributing factor.

The impact of real estate lending.

readily granted credit without accurately analysing the risks. However, if somebody has too much debt in relation to what they are able to repay with their income, they will become poorer while trying to pay off the debt. They would have to sell some of their assets to be able to do so. All those who get into more debt than they are able to repay are regressing on the income scale; and those who avoid going into debt regress in relative terms, since their income from employment is growing at a slower rate than financial income.

The American economists Mian and Sufi[21] measured this phenomenon after the crisis in the United States. Between 2007 and 2010, the crisis reduced the average wealth of US households. The average wealth of the richest 20% of Americans went from 3.2 to 2.9 million dollars. But the poorest 20% of Americans saw their average wealth of $30,000 fall to almost zero. The authors determined that "*one of the essential characteristics of debt is that it results in enormous losses for the households who have the least*".

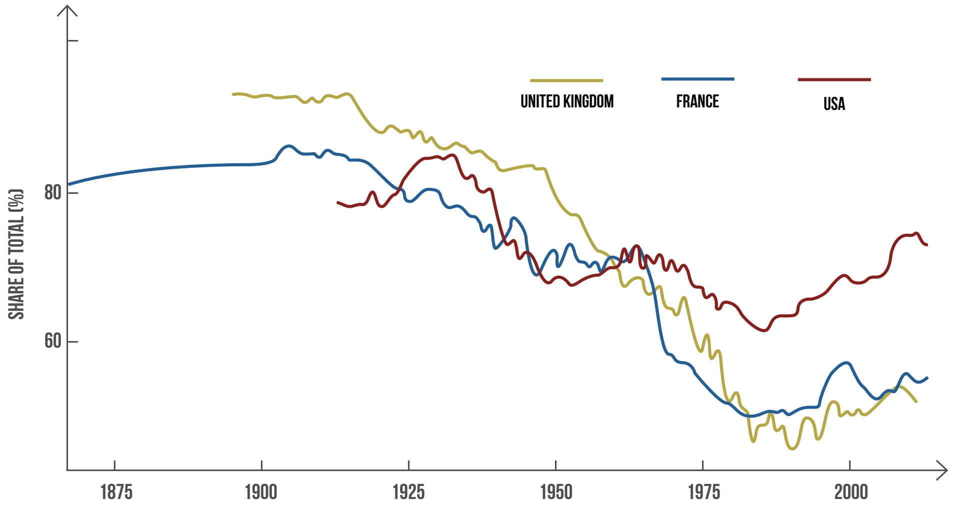
The spiral of income from wealth allowing increases in wealth, which in turn generate income

At the same time, financial and real estate income rose sharply[22]. Households that own or can build up real estate or financial assets go up on the income ladder thanks to rents, dividends, capital gains and interest received.

Hence wealth inequality grew rapidly from the 1980s: those who were able to amass wealth were able to borrow easily in order to acquire a rental property portfolio or invest their savings in the stock market and generate financial income

21 Atif Mian and Amir Sufi, *House of Debt*, Chicago, University of Chicago Press, 2015.
22 See in particular Thomas Piketty, *Le capital au xxi^e^ siècle, [Capital in the Twenty-First Century], op. cit.,* p. 351.

WEALTH INEQUALITY TAKES AN UPTURN FROM THE 1980S



Source: World Inequality Database, www.wid.world/fr

Comment: Wealth inequality has been increasing sharply in the United States since the 1980s. In 2012, the richest 10% held nearly 80% of the total wealth – as much as they did in the 1920s. In France and the United Kingdom, wealth inequality has been increasing since the 1980s, but nowhere near as sharply.

from their growing assets. Meanwhile, tenants and first-time homeowners were having to make payments for their increasingly expensive properties, struggling to eat and save; their only income, from work, had stagnated; so wealth gaps widened.

Note that the wealth of the richest is likely to have been underestimated in these figures, which come from national statistics and therefore exclude the amounts that might be hidden from national tax authorities in tax havens. The most conservative estimates, which combine national data and the "Panama Papers", show that the underestimation of household assets could amount to 8% globally and 11% for the European Union[23].

Inequalities that impede economic prosperity

It is also possible to assume that income and wealth inequality contribute to the slowdown in economic activity. As John Maynard Keynes pointed out[24], the wealthier households are, the larger the proportion of their income they save. A millionaire does not consume a million times more than an individual with an average income: they do consume more, but only to a certain point. Conversely, an increase in welfare benefits would be directly fed back into the workings of the non-financial economy: it would mean fewer unpaid bills, more consumption, better nutrition, etc. Therefore, the richer the wealthier part of the population gets,

23 Gabriel Zucman, *La richesse cachée des nations,* [The Hidden Wealth of Nations], Seuil, 2017, p. 11. The "Panama Papers" are data files containing the details of fortunes hidden in Panama, which were made public by the International Consortium of Investigative Journalists (ICIJ).
24 John Maynard Keynes, *The General Theory of Employment, Interest and Money* (1936), p. 114, cited by Turner, *op. cit.*, p. 167.

the less demand is supported by consumption. Hence, by increasing inequality, the financialisation of the economy has been detrimental to economic activity. According to an OECD study: "*a 3 point Gini [index] increase in inequality*[25] *– i.e. the average of the OECD countries over the past 25 years – would result in the loss of 0.35 percentage points of growth per year over 25 years, or an eventual cumulative GDP loss of 8.5%*"[26].

4.3 FINANCIALISATION DIVERTS INVESTMENT AWAY FROM THE NON-FINANCE ECONOMY

The financial products available in today's markets, especially derivatives, often yield substantial returns, above or even well above 10% per year[27]. However, investment in the non-financial economy or energy transition cannot offer such returns, particularly when an economy has slowed down due to weak demand. Capital will therefore naturally move towards these financial derivatives rather than the non-financial economy[28]. Prices are thereby driven up, further increasing their returns. By way of reminder, these derivatives are "bets": the money invested does not fuel the non-financial economy. This attractiveness of financial investments at the expense of investments needed for the general interest has been reinforced by the mainly American and European monetary policies of quantitative easing which enable financial actors to go into debt at a lower cost in order to achieve big profits quickly (see Part 3). According to Stephen G. Cecchetti and Enisse Kharroubi, "*the level of financial development is good only up to a point, after which it becomes a drag on growth. When the credit granted by banks to the private sector represents more than 90% of GDP, any further increase in bank lending tends to reduce growth.*"[29] Other more recent studies[30] confirm this analysis.

In 2013, the American economist Larry Summers put forward the theory of a "*secular stagnation*"[31] of advanced economies: a lack of demand from households and businesses which would explain the weakness in economic activity since the crisis. An ECB[32] survey in May 2017 revealed that the main problem for SMEs in the eurozone is finding customers. As a percentage of production, the rate of investment has been steadily declining in advanced economies since the 1970s[33]. This can be explained by the lack of demand but also by the extreme

25 The Gini index measures inequality in a country or geographical area.
26 "Does income inequality hurt economic growth?", *Focus on Inequality and Growth*, OECD, December 2014, https://www.oecd.org/social/Focus-Inequality-and-Growth-2014.pdf
27 See, for example, the returns of so-called "Warrant" options on shares, https://investir.lesechos.fr/traders/conseils-warrants-derives/certificats-une-strategie-de-rendement-attrayante-sur-schneider-1648192.php
28 The sums spent by financial actors on derivatives alone are more than 25% higher than investments recorded in OECD countries in 2016. See the BIS statistics, "Global OTC derivatives market", https://www.bis.org/statistics/d5_1.pdf and OECD statistics https://data.oecd.org/gdp/investment-gfcf.htm.
29 Stephen G. Cecchetti and Enisse Kharroubi, "Reassessing the impact of finance on growth", *BIS Working Papers*, no. 381, 2012, https://www.bis.org/publ/work381.pdf
30 Joshua Aizenman, Yothin Jinjarak and Donghyun Park, "Financial Development and Output Growth in Developing Asia and Latin America: A Comparative Sectoral Analysis", *NBER Working Paper,* 20917, January 2015, http://www.nber.org/papers/w20917; and Claudio Borio, Enisse Kharroubi, Christian Upper and Fabrizio Zampolli, "Labour reallocation and productivity dynamics: financial causes, real consequences", BIS Working Papers, no. 534, https://www.bis.org/publ/work534.pdf
31 See Larry Summer, "The Age of Secular Stagnation: What It Is and What to Do About It", February 2016, http://larrysummers.com/2016/02/17/the-age-of-secular-stagnation/
32 ECB, "Survey of the access to finance of enterprises in the Euro area. October 2016 to March 2017", May 2017, https://www.ecb.europa.eu/pub/pdf/other/ecb.accesstofinancesmallmediumsizedenterprises201705.en.pdf?17da4ff2a730b7ababea4037e4ce8cae
33 See "Farewell to Cheap Capital", a McKinsey Institute study, December 2010, p. 3, https://www.mckinsey.com/~/media/McKinsey/Global%20Themes/Global%20Capital%20Markets/Farewell%20cheap%20capital/MGI_Farewell_to_cheap_capital_full_report.ashx

short-term strategies adopted by financial actors when they invest in non-financial businesses and expect high yields quickly, more often than not in contrast with the company's need for stable and sustainable resources[34]. The lack of demand is mainly caused by persistent low-wage inflation and widespread debt overhang, which leaves little room for consumption and limits household expenditure to the bare necessities.

However, investment needs remain unmet in many sectors in advanced economies: transport infrastructure in the United States is in an alarming state[35]; France has a shortage of hospital beds, childcare places, reception facilities and support for migrants, etc.; all advanced economies have a great need for investment to ensure a proper energy transition.

Growing inequality and a non-financial economy in need of investment: these two consequences of financialisation have also had a direct impact on States' expenditure and revenue. And since much of the financial sector's activity involves lending to States, it is important to question the overall balance of the financialisation of advanced economies for States, and therefore for each citizen as a taxpayer.

4.4 OVER-LEVERAGED STATES WITHDRAW FROM SOCIAL COMMITMENTS, WHICH CONTRIBUTES TO THE INCREASE IN POVERTY AND INEQUALITY

The economic slowdown that followed the 2008 crisis has weighed on State public finances

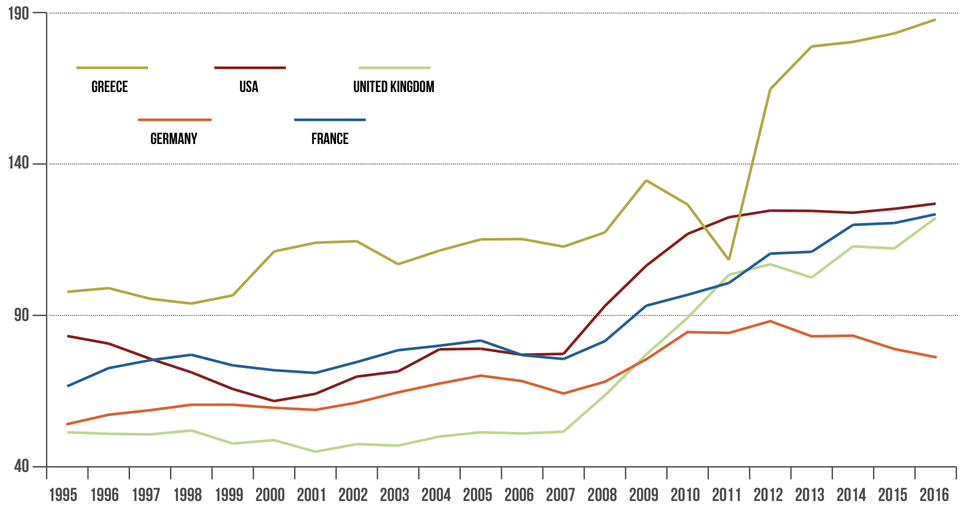
In 2009, France's tax revenue dropped by 37 million euros compared to 2008. Corporate profits fall, meaning that there is less tax revenue; the drop in production also results in a reduction in VAT. In addition to the decline in tax revenues due to the economic crisis, there is also a decline due to State tax reduction policies. Hence in 1990 the average corporate tax rate was 40% in the G20, but in 2015 it was only 28.7%[36]. In France, "*the government plans to lower the corporate tax rate from 33.3% to 25% by 2022*".[37]

France's public deficit, which stood at -2.5% in 2007, plunged to -7% in 2009 and 2010, before returning to -5% in 2011[38].

This trend – declining revenues due to a drop in economic activity and fiscal choices, and higher spending due to the increased cost of welfare payments (see the example of France above) – can be seen on average in all developed countries, as shown in the work by the OECD, which is summarized in the graph below.

34 See Tristan Auvray, Thomas Dallery and Sandra Rigot, *L'entreprise liquidée. La finance contre l'investissement, [The liquidated business. Finance against investment]* Michalon, 2016.
35 See "Infrastructure Report Card 2017, a comprehensive assessment of America's infrastructure", American Society of Civil Engineers (ASCE), https://www.infrastructurereportcard.org/wp-content/uploads/2017/10/Full-2017-Report-Card-FINAL.pdf
36 Esmé. Berkhout, "Tax battles. The dangerous global race to the bottom on Corporate Tax", Oxfam, 2016, https://www.oxfam.org/sites/www.oxfam.org/files/bp-race-to-bottom-corporate-tax-121216-en.pdf
37 Marie Bellan, "Budget 2018: ce qui change pour les entreprises" [Budget 2018: what changes for businesses], *Les Échos,* 27 September 2017, https://www.lesechos.fr/economie-france/budget-fiscalite/030623671729-budget-2018-ce-qui-change-pour-les-entreprises-2117550.php#RF1uvTw1wxCHOBua.99
38 See Eurostat's statistical data: http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00127&plugin=1

EVOLUTION OF PUBLIC DEBT IN RELATION TO THE GDP OF SEVERAL DEVELOPED COUNTRIES, FROM 1995 TO 2016



Source: OECD, http://stats.oecd.org/index.aspx?DatasetCode=GOV_DEBT

Comment: In OECD countries, the crisis raised the average rate of State debt from 73% of GDP in 2007 to more than 110% in 2015.

In order to finance these widening deficits, developed countries are getting even deeper into debt

As explained in Part 2, from the 1980s, the governments of advanced economies began to borrow from private financial markets by putting "*their debt on the market*". When the crisis hit, OECD states were already heavily in debt, with 85% of their GDP on average (OECD data). Because they suddenly had to finance their increased deficits, the crisis increased their debt ratios: in France, for example, debt would grow from 65% to 95% of their GDP between 2008 and 2013.

Even though the interest rates were low, the interest charges on this new debt added to State public deficit. In France, the interest on debt is the government's fourth item of expenditure in the 2017 budget: National education accounts for 50 billion euros, pensions for 48 billion, local governments for 47 billion and debt interest for 42 billion[39]. The growth in debt therefore increases the deficit, due to the increasing burden of interest.

39 Maxime Vaudano, "Où va l'argent de l'État ? Visualisez en un coup d'œil le budget 2017" [Where does State money go? Take a look at the 2017 budget], *Le Monde,* 29 September 2016, http://www.lemonde.fr/les-decodeurs/article/2016/09/29/ou-va-l-argent-de-l-etat-visualisez-en-un-coup-d-il-le-budget-2017_5005405_4355770.html

The 2011 European Stability and Growth Pact imposed austerity by limiting public deficits

In 2011, European economies were slowed down by the effects of the financial crisis and States went even further into debt in order to cope with the decline in revenue and increased expenditure that the crisis had brought about. As several economists[40] have noted since then, this could have been an opportunity to launch a comprehensive plan to revive the economy in Europe, supporting demand and jobs through investment. Hence in 2010 the United States launched an 800 billion euro recovery plan which led to some economic recovery (more than 11% growth in production between 2008 and 2015). However, Europe went the opposite way: European Union states imposed an economic austerity program, setting a public deficit target of no more than 3% of GDP in the 2011 European Stability and Growth Pact. This pact used and confirmed the budget deficit targets set out in the 1992 Maastricht Treaty, which were set in a context when the issue of supporting the economy following a major crisis did not exist.

Austerity programmes have helped to prolong the crisis.

The application of this program is strictly monitored by the European Commission at the level of each Member State. As such, in 2014, 2015 and 2016 the European Council sent the French government economic policy recommendations including a package of austerity measures[41]: a reduction in government spending, structural pension reforms reducing the level of future pensions, savings on unemployment insurance, structural reforms of the labour law making dismissals easier, reductions in employer contributions, corporate taxation cuts and an increase in VAT.

Austerity policies prolong the crisis

Faced with the economic crisis and unemployment which was still a problem five years later, many economists, such as those from the IMF[42] in June 2016, have acknowledged that the austerity program has contributed to prolonging the crisis. In 2012, the International Monetary Fund warned Europe of the social and political risks arising among the people of Europe who were tired of endless reforms and austerity[43]. The ineffectiveness of the austerity policies was also observed by Caritas Europa, particularly in its 2014 *Crisis Monitoring Report* which denounced the fact that "*the priority given to austerity measures*, *to the exclusion of virtually all other approaches, would not solve the crisis and has caused social problems that are likely to have lasting impact.*"[44] After four decades of credit growth exceeding that of production and wages, households in advanced economies are heavily in debt (see section 4.2). Demand therefore remains low. In order to revive it, either

40 In particular James K. Galbraith, Stuart Holland, Steve Keen or Gaël Giraud.

41 See, for example, the Council's recommendations for France's 2016 national reform program and the Council's opinion on France's stability program for 2016, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016H0818(27)&from=EN

42 Jonathan D. Ostry, Prakash Loungani and Davide Furceri, "Neoliberalism: Oversold?", *Finances and Development*, June 2016, https://www.imf.org/external/pubs/ft/fandd/2016/06/pdf/ostry.pdf; Romaric Godin, "Quand le FMI critique le néolibéralisme..." [When the IMF criticizes neoliberalism], *La Tribune*, 27 May 2016, http://www.latribune.fr/economie/international/quand-le-fmi-critique-le-neoliberalisme-574748.html; and Heiner Flassbeck, Thomas Piketty, Jeffrey D. Sachs, Dani Rodrik and Simon Wren-Lewis, "L'austérité a échouée : la lettre ouverte de cinq économistes à Angela Merkel" [Austerity has failed: the open letter by five economists to Angela Merkel], *Alternatives Economiques*, 10 July 2015, https://www.alternatives-economiques.fr/tribune/lausterite-a-echoue-la-lettre-ouverte-de-cinq-economistes-a-angela-merkel-201507101013-00001756.html

43 See, for example, Phillip Inman "IMF warns of fresh global crisis unless eurozone finds a fix", *The Guardian*, 8 October 2012, https://www.theguardian.com/business/2012/oct/08/imf-warns-global-crisis-eurozone

44 "Crisis Monitoring Report", Caritas Europa, 2014, p. 10, http://www.caritas.eu/sites/default/files/caritascrisisreport_2014_en.pdf

purchasing power has to be restored or public investment has to be made, which could reduce unemployment to a certain extent. These two approaches are off-limits due to the strain of the public deficit, which instead causes further unemployment in the public sector and reduces purchasing power by slashing welfare benefits. In the eurozone, and particularly in France, the implementation of "regressive" public policies, such as the decision to sharply reduce subsidized employment in 2017, has had a negative impact on the standard of living, exacerbating inequality and fracturing society at a time when needs are growing.

The financial crisis has therefore reduced State revenue and increased State expenditure. It has increased State deficits, and as such States have had to borrow yet more from private financial markets. In 2011 eurozone leaders decided to follow an economic austerity policy that is in line with the wishes of their private backers. This austerity policy is clearly contrary to the interest of European citizens, since it requires the State to reduce welfare and public services at the exact time that the extended economic crisis meant that they were needed. It also has very significant human costs and contributes to further widening inequalities. "*The risk of poverty or social exclusion rate (the combined indicator of poverty used in the Europe 2020 strategy) increased between 2008 and 2013 in most EU-28 Member States, affecting 122.5 million people, or 24.5% of the entire EU-28 population*."[45] In France today, 1.5 million children are raised in families living in poverty.

Optimism is a must.

45 "Poverty and inequality on the rise. Just social models needed as the solution!", Caritas Europa, p. 10. http://www.caritas.eu/sites/default/files/caritascrisisreport_2015_en_final.pdf

The decision to finance their debt by only borrowing from private financial markets has made States dependent on these markets and the economic policies that suit them.

Finance and austerity policies

The current workings of the financial markets is essentially pushing developed countries into practising austerity policies. They are a condition for State borrowing, yet the advanced States are continuously borrowing from private financial markets. Lenders want to ensure that a borrower does not get into yet more debt so that they can maximize the likelihood that the borrower will pay off the loan. Financial analysts employed by the financial markets regularly publish analysis notes for State debt buyers, assessing compliance with austerity policies[46].

To address the situation of State debt, there are several opposing approaches; while some think it is a question of cutting public services in France, other actors, such as the former chief economist of the IMF, Olivier Blanchard[47], recommend a revival by public order, or a social “Marshall plan” in developed countries, as recommended by Anthony Atkinson[48], a world expert on inequality. However, if borrowing States do not follow the economic policy recommendations of the financial markets, they will see the cost of their debt rise and even run the risk of not being able to borrow.

The example of Greece reminds us that, nowadays, the demands of the financial markets in terms of debt repayment take precedence over public interest considerations in the eurozone. In 2016, the unemployment rate stood at 26% and 35% of Greeks were living below the poverty line. Forced austerity was not working. By the end of 2016, GDP was down by 1.2%, registering its biggest quarterly drop for 18 years. Austerity policies have an immense and unacceptable human, social and political cost.

The example of Greece reminds us that, nowadays, the demands of the financial markets in terms of debt repayment take precedence over public interest considerations in the eurozone.

Austerity policies in the Eurozone are destined to fail because the debt is not repayable

Adair Turner[49] stresses that policies other than austerity must be employed if we are to restore economic growth in the eurozone. Indeed, the fiscal pact aims to reduce deficits to 3% and public debt to 60% of output. However, Turner[50] points out that, in order to achieve this given the current situation, there would have to be very large budget surpluses: 4% to 7% of GDP for more than ten years, depending on the country. Yet such strong and sustained performances have never been witnessed in advanced economies.

46 See, for example, the analysis by Maxime Alimi, Eurozone economist at Axa (one of the main buyers of French debt), from November 2014, http://www.globalix.fr/content/france-le-déficit-la-dette-et-le-spread

47 Thierry Fabre, "La mise en garde de l’ex-chef économiste du FMI contre l’austérité" [Caution by the former Chief Economist of the IMF], Interview with Olivier Blanchard, *Challenges,* 2 March 2017, https://www.challenges.fr/economie/la-mise-en-garde-de-l-ex-chef-economiste-du-fmi-contre-l-austerite_456597

48 Anthony Atkinson, "*Inequality*", Seuil, 2016.

49 *Between Debt and the Devil, op. cit.,* p. 293 et seq.

50 *Ibid.* p. 289.

There are other ways out of the crisis

All the developed countries are stuck with the three-fold issue of "debt overhang – unemployment – low demand", bar Germany, whose debt is low (70% of GDP) thanks to its trade surpluses. To emerge from debt overhang, the debt can be restructured. And to stimulate demand, money creation can be used to serve public investment and the general interest.

However, States are not just dependent on the financial markets that finance their debt; they also depend on banks, as they perform general interest functions such as the management of payment system and granting of credit. Yet, ten years after the crisis, banks in developed countries remain very fragile, which is detrimental to the general interest.

Fragility of the banking sector and risk to citizens

The liberalization of capital flows and financial deregulation have led, among other things, to the emergence of mega banking groups (see Part 2), where losses, even limited ones, for a single group could quite easily lead to a major financial crisis due to their low equity capital[51]. Yet the fragility of the large banking groups is detrimental to the public interest. If a bank is on the verge of bankruptcy, the State in which it is headquartered will inevitably inject capital into it. In June 2017 the Italian government injected 6.6 billion euros into the Monte dei Paschi bank to prevent bankruptcy[52]. The Spanish Court of Auditors estimated that the bank bailouts cost the Spanish taxpayers more than 60 billion euros between 2000 and 2015[53].

The fragility of the large banking groups is detrimental to the public interest

At a time when State deficits are very tight, when there is a lack of public investment in social infrastructure, it could be argued that there is a drain on public resources to the benefit of the financial sector and at the expense of the general interest.

States save their banks to avoid bankruptcy that would have major economic consequences, as the 2008 crisis showed with the payment and credit systems interruption. Banks are therefore too big to fail. True, this bail-out meant that States protected functions of general interest such as payment systems and credit. However, bank shareholders take advantage of this "implicit guarantee" from States to make even more profit as, the lower a bank's or business' capital, the more profitable it is for shareholders: they receive the bank's profits, which belong to them, with a lower outlay and their investment is more profitable. Bank shareholders do not usually capitalize them sufficiently, yet they take significant risks and collect the corresponding profits, safe in the knowledge that, should things go wrong, the State is guaranteed to come to the rescue.

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51 As a reminder, these big banks have on average only a 5% equity capital holding in relation to their total commitments. If a bank incurs losses greater than its own capital, it can go bankrupt unless it is bailed out. Because financial markets are so closely interconnected, this bankruptcy would spread very quickly, as it did in 2008.

52 "Bruxelles approuve le plan de sauvetage de la banque italienne BMPS par Rome" [Brussels approves Rome's bail-out plan for the Italian bank BMPS], *La Croix,* 5 June 2017, http://www.la-croix.com/Economie/Entreprises/Bruxelles-approuve-plan-sauvetage-banque-italienne-BMPS-Rome-2017-06-05-1200852655

53 "Espagne: le sauvetage des banques a coûté 61 milliards d'euros aux contribuables" [Spain: bank bail-outs cost taxpayers 61 billion euros], *La Tribune,* 11 January 2017, http://www.latribune.fr/economie/international/espagne-le-sauvetage-des-banques-a-coute-61-milliards-d-euros-aux-contribuables-629658.html

It is therefore vital that bank shareholders ensure that capital is held that can fund a general interest function, which would guarantee them a certain sustainability and, as such, they themselves would commit enough capital to ensure the stability of the banking system. If the private financial markets judge that investing in banks is no longer an attractive proposition under these circumstances, the State can provide banks with capital.

The low capitalization of banks, which has persisted following the crisis, poses a risk to the taxpayer, while bank shareholders benefit from the remuneration of these risks. Private profits and public losses have become the rule for the banking system, which is against the general interest.

4
OVERVIEW

The various impacts of the current organization of the financial system discussed here are detrimental to the interests of citizens of developed countries. When a financial crisis like that of 2008 occurs, economies and people suffer the adverse impacts of the disproportionate level of risk taken by financial market actors. Since the 1980s, credit growth has been faster than output and wages: which has led to renewed growth in inequality. The excessive willingness of banks to lend to old real estate has also caused prices to rise, with consequences in terms of poverty and inequality through the cost of housing. Moreover, the build-up of significant financial assets has slowed down the non-financial economy and therefore helped to keep too much of the population of advanced economies in unemployment and poverty. In addition, this economic slowdown has served to increase State deficits while their revenues are decreasing and the cost of social welfare is increasing. State private creditors favour austerity policies, which are harmful to the general interest and doomed to failure, given the very high level of State debt. The banking sector still represents a risk to State finances, and therefore indirectly to welfare benefits, which are becoming increasingly necessary.

The analysis of the consequences of the financialisation of the economy cannot be complete without covering the specific aspects of emerging and developing countries.

5

FINANCIALISATION OF THE ECONOMY IN EMERGING AND DEVELOPING COUNTRIES

The financialisation of the global economy has had disastrous consequences for emerging countries, and even more so for developing countries[1]. The development policies that had been encouraged since the 1960s and 1970s, i.e. at a time of rapid financialisation of the global economy, did not succeed in reducing inequalities between countries, and the differences in standards of living remain vast. Having also suffered the socio-economic effects of the 2008 financial crisis, these countries are being structurally affected by many aspects of financial globalisation whilst being poorly represented at the international bodies responsible for setting the banking and financial regulations.

1 See the appendix for the classification used in this report to define advanced, emerging and developing (included least developed) countries. In this section, most of the analyses presented relate to both emerging and developing countries, even though, very often, developing countries, including the least developed countries, have been the most badly affected by the consequences of financialisation.

5.1 LIMITS OF FINANCING AND COOPERATION POLICIES FOR EMERGING AND DEVELOPING COUNTRIES

From the 1980s, international financial institutions and the most developed countries focused their programmes for cooperation with developing countries on the introduction of liberalisation and deregulation reforms (see section 2), in conjunction with measures to drastically reduce public spending and moderate wages. Known as structural adjustment programmes, they were theorised under the term "Washington Consensus"[1]. Intended to foster economic development and reduce inequality, they very often had the opposite effect. For example, in Latin America, while some countries managed to reduce inflation to below 10% per annum, the number of people in poverty increased from 120 to 220 million between 1980 and 2000[2].

In 2000, the international community set eight Millennium Development Goals (MDGs), intended to "*end poverty in all its forms*"[3] in developing countries. These goals were defined for the 2000-2015[4] period and established the main arcs of the development and cooperation policies adopted by developed countries and international bodies. Major progress was made: extreme poverty has decreased considerably around the world, with the number of people living in extreme poverty halved. But this overall decline masks some huge disparities, largely due to the decrease in China and India, two heavily populated countries. As noted by CADTM, based on data from the World Bank's PovcalNet tool, "*extreme poverty has barely decreased in southern Asia, and above all has greatly increased in sub-Saharan Africa*"[5]. In countries in sub-Saharan Africa, an additional 176.1 million people started living in extreme poverty between 1981 and 2005[6].

Based on statistics from the World Bank, Oxfam noted in 2014 that seven out of ten people were living in countries where inequality has increased over the last three decades[7]. Oxfam also highlighted the fact that, between 1988 and 2011, the richest 10% of the population accrued 46% of the overall income growth, whilst the poorest 10% only received 0.6%[8]. Over a longer timeframe, we can see that the average income per capita in countries which are now in the Eurozone was 15 times greater than that in countries in sub-Saharan Africa in 1960. In 2006, the gap had widened to 38[9].

1 Numerous analyses of the political impacts of the Washington Consensus have been conducted. Read the articles by John Williamson, architect of the Washington Consensus, already cited in section 2, for example; Joseph Stiglitz, *Globalization and Its Discontents, op. cit.;* and Dimitri Uzunidis, "Les pays en développement face au consensus de Washington. Histoire et avenir" [Developing countries under the Washington Consensus. History and future], *Annuaire français de relations internationales,* vol. 6, 2005, http://www.diplomatie.gouv.fr/IMG/pdf/62_865-879.pdf

2 World Bank, *World Development Indicators*, 2003, https://openknowledge.worldbank.org/handle/10986/13920?locale-attribute=fr

3 "Millennium Development Goals. 2015 Report", United Nations, http://www.un.org/millenniumgoals/2015_MDG_Report/pdf/MDG%20 2015%20rev%20(July%201).pdf

4 These were followed by the Sustainable Development Goals set under the 2030 Agenda (extending the initiative to the climate and to collective action, i.e. affecting all countries, not just developing countries).

5 CADTM, "World Debt Figures 2015", http://www.cadtm.org/IMG/pdf/DEBT_FIGURES_2015-2.pdf

6 Jimi O. Adesina, "Rethinking the social protection paradigm: Social policy in Africa's development", June 2010, https://ec.europa.eu/europeaid/sites/devco/files/erd-socpro-poverty-adesina-20100628_en.pdf

7 Branko Milanovic, *All the Ginis*, Dataset, cited in "Even it up: Time to end extreme inequality", Oxfam International, 2014, https://www.oxfamamerica.org/static/media/files/even-it-up-inequality-oxfam.pdf

8 "An economy for the 1%. How privilege and power in the economy drive extreme inequality and how this can be stopped", Oxfam International, 2016, https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bp210-economy-one-percent-tax-havens-180116-en_0.pdf

9 "Combating Poverty and Inequality. Structural Change, Social Policy and Politics", UNRISD, Geneva, 2010, http://www.unrisd.org/80256B3C005BCCF9/httpNetITFramePDF?ReadForm&parentunid=92B1D5057F43149CC125779600434441&parentdoctype=documentauxiliarypage&netitpath= 80256B3C005BCCF9/(httpAuxPages)/92B1D5057F43149CC125779600434441/$file/PovRep%20(small).pdf

Despite their clearly stated intention, the MDGs did not question the foundations of the policies spearheaded by the international financial institutions under the Washington Consensus, despite the criticisms these had faced since the early 2000s. Recommendations promoting liberalisation and decreasing public spending, amongst others, continued to play a key role in the conditions governing the support programmes provided by the IMF and World Bank to countries in need of their help[10]. The inequalities both between and within countries remain stark, something which undermines sustainable poverty reduction, the stated goal of the policies introduced by the international community.

Towards financialisation of cooperation policies…

To implement the agendas for development and combating climate change set in 2015 at the international conference on sustainable development (New York, September 2015) and as part of the Paris Agreement (December 2015), the international community needs to mobilise "*several thousands of billions of US dollars*"*. Faced with the challenges of the socio-environmental crisis, and the varying levels of budget difficulties (*see* sections 3 and 4), developed countries which are aid donors are increasingly calling on the private sector to finance these requirements, particularly as concerns infrastructure.
However, there is a clash between the objectives of public decision-makers, the primary goal of which is to develop the social sectors, and those of investors seeking profits, usually with a rapid — and high — rate of return. The growing power of private actors in financing development and the transition between energy sources is leading to a change in how public policies are conducted, increasingly based and judged on purely financial criteria**.
However, rather than set up binding frameworks and regulations which would foster the promotion of economic and social rights, policy makers are more disposed to advocate the introduction of incentives and conditions which create a favourable environment for the private sector: public-private partnerships, public guarantees for private funding, introduction of green bonds, the move towards introducing infrastructure bonds… This leads to the privatisation of development issues, and the risk of an unbalanced allocation of funding to projects set up to provide the private sector with high rates of return, to the detriment of funding designed to improve the essential services used by the public.
Lastly, the development of instruments like green bonds and social impact bonds, or mezzanine financing, as part of the policies adopted by development banks risks reinforcing the demand for exceptionally high financial returns, rather than the often very modest profits made from general interest projects, for which it is neither possible, nor desirable, for the user or taxpayer to be charged a high price.

*The Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF) estimated that to implement the SDGs between 2015 and 2030 would require "*several thousands of billions of US dollars*" (bearing in mind that "*Global savings remain robust, at about $22 trillion a year… The stock of global financial assets… is estimated to be about $218 trillion)*", http://www.un.org/ga/search/view_doc.asp?symbol=A/69/315&Lang=E

** see Mondes en développement, vol. 45, 2017/2, no.178, presentation "Financing or Financialisation of Development?" https://www.cairn.info/revue-mondes-en-developpement-2017-2.htm; particularly the introductory article to this presentation by Jean-Jacques Gabas, Vincent Ribier and Michel Vernières, "Financing or Financialisation of Development? An Issue under Debate", https://www.cairn.info/load_pdf.php?ID_ARTICLE=MED_178_0007

10 See the analyses undertaken by Eurodad, particularly "World Bank and IMF conditionality: a development injustice", June 2006, http://www.eurodad.org/files/pdf/454-world-bank-and-imf-conditionality-a-development-injustice.pdf; and "Progress on IMF conditionality?", November 2012, http://www.eurodad.org/files/pdf/528e3326ba624.pdf

5.2 THE 2008 FINANCIAL CRISIS HAD A HUGE IMPACT ON EMERGING AND DEVELOPING COUNTRIES

The 2008 financial crisis triggered a major recession which also affected emerging and developing countries. It led to a huge increase in unemployment levels across the globe. In 2015, a total of 197.1 million people were estimated to be unemployed, more than 27 million more than before the crisis, and it was emerging and developing countries that saw the greatest increase[11].

For example, when orders stopped arriving from contractors in the North, there was an immediate increase in unemployment and poverty in these countries, whilst the impact on developed countries was slower and less marked. So, following the crisis, emerging and developing countries experienced an overall drop, not just in production and exports, but also in the amount of capital sent home by family members working in the North (6% drop between 2008 and 2009[12]), and in direct foreign investment (24% drop between 2008 and 2009[13]). We can see that the annual growth of GDP per capita in the least developed countries fell from 4.7% over the period 2005-2009 to 2.1% between 2010 and 2014[14]. The Institute for Public Policy Research[15] estimated that the number of people in developing countries living on less than 2 dollars per day increased by 120 million in the months following the crisis and, in 2010, production (gross national product) in these countries was 1300 billion dollars less than it would have been if the financial crisis had not occurred; finally, more than 100 billion dollars of capital which would have been remitted by developed countries to other countries was lost: a significant shortfall hindering the economies of these countries.

The number of people in developing countries living on less than 2 dollars per day increased by 120 million in the months following the crisis.

Furthermore, in most of these countries, the welfare systems are underdeveloped or non-existent. In fact, due to the crisis, figures show that "*Between 2008 and 2012, more than half of developing countries reduced spending on education, while two-thirds decreased spending on health*"[16]. With a downturn lasting almost ten years, intergovernmental organisation South Centre demonstrated, in its analysis of the financial crisis[17], that the austerity measures implemented by many developed countries, coupled with the quantitative easing introduced by the central banks (particularly those in Europe and the United States) did not enable a robust economic recovery and heightened the vulnerability of many of the emerging and developing countries largely dependent on external markets (finance, goods and services) and multinational companies.

11 "World Employment Social Outlook, Trends 2016", p. 2, http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_443472.pdf

12 Dilip Ratha, Sanket Mohapatra and Ani Silwal, "Outlook for Remittance Flows 2010-11. Remittance flows to developing countries remained resilient in 2009, expected to recover during 2010-11", *Migration and Development Briefs,* no. 12, April 2010, World Bank, http://pubdocs.worldbank.org/pubdocs/publicdoc/2015/10/193511444756850985/MigrationAndDevelopmentBrief12.pdf

Savings transferred by migrants rose to 336 billion dollars in 2008, approximately three times the ODA declared for that year by the developed countries (112 billion dollars, see https://data.oecd.org/oda/net-oda.htm).

13 "World investment report 2010", United Nations Conference on Trade and Development, http://unctad.org/en/Docs/wir2010_en.pdf

14 The Sustainable Development Goals Report 2016, United Nations, New York, 2016, p. 9, https://unstats.un.org/sdgs/report/2016/The%20Sustainable%20Development%20Goals%20Report%202016.pdf

15 Tony Dolphin and Laura Chappell, "The Effect of the global financial crisis on emerging and developing economies", Institute for Public Policy Research, September 2010, https://www.ippr.org/files/images/media/files/publication/2011/05/Financial%20crisis%20and%20developing%20economies%20Sep%202010_1798.pdf

16 Oxfam International, "Even it up", *op. cit.*

17 Yılmaz Akyüz and Vicente Paolo B. Yu III, "The Financial Crisis and the Global South: Impact and Prospects", *Research Paper,* no. 76, May 2017, https://www.southcentre.int/wp-content/uploads/2017/05/RP76_The-Financial-Crisis-and-the-Global-South-Impact-and-Prospects_EN-2.pdf

Beyond the socio-economic consequences of financial crises occurring in developed countries, emerging and developing countries are suffering structurally from the financialisation of the global economy.

5.3 SOME ASPECTS OF FINANCIAL GLOBALISATION DAMAGE THE STRUCTURE OF EMERGING AND DEVELOPING COUNTRIES

A. LACK OF ACCESS TO "STRONG" CURRENCIES: CURBING DEVELOPMENT AND VULNERABILITY TO EXTERNAL SHOCKS

Finance within developed countries is global because the currencies used in developed countries are classed as "strong"[18]. This means these currencies can be exchanged without any restrictions: with euros, you can buy dollars, yen or pounds sterling, with no restrictions applied or authorisations required. You can also use euros to buy Russian roubles or Indian rupees, but not the other way around. The rouble and the rupee are currencies classed as "nonconvertible" within the international monetary system, governed by the IMF.

For example, if a French company or individual based in India has some rupees, then they will need to request authorisation from the Central Bank of India to convert them into euros. The Central Bank of India will refuse to grant this authorisation if it does not have any euros at that point in time. This situation often arises, even for many emerging countries[19]. How can the Central Bank of India obtain euros? It is not allowed to produce them. Only the ECB can do that. It can borrow them from the IMF or the World Bank (with interest, and repayment conditions), which will result in it taking on debt in a strong currency. It can also use euros which come from the sale in euros of exported Indian products. But India imports more than it exports; its trade balance is in deficit. And India may be wary of becoming indebted to the IMF, since it would be difficult for it to find the euros required to repay the loan. Indian individuals may procure euros for their holidays, but an Indian company cannot borrow euros in India unless the Central Bank provides authorisation, and it will only do so if the company generates receipts in euros for its exports which will allow it to repay the loan.

There are currently 18 convertible currencies. The other 180 currencies in the world are subject to exchange restrictions.

In real terms, global finance only relates to transactions in convertible currencies. There are currently 18 of these[20]. The other 180 currencies in the world are subject to exchange restrictions, and the countries which issue them only have limited access to the resources of global finance: they can borrow strong currencies if they can repay them, i.e. if they export to countries with a strong currency. In countries with limited convertibility of their currency, finance is essentially local: strong

18 For the sake of accuracy, these currencies should be described as "convertible", as explained in the rest of the text; "strong currencies" is an approximation intended to be informative.
19 For example, the Central Bank of Algeria has suspended convertibility several times in its history.
20 List of currencies currently considered to be convertible: Australian dollar, Bahraini dinar, Canadian dollar, Danish krone, euro, Hong Kong dollar, Kenyan shilling, Kuwaiti dinar , New Zealand dollar, Norwegian krone, pound sterling, Singapore dollar, South African rand, Saudi riyal, Swedish krona, Swiss franc, United Arab Emirates dirham, US dollar. In practice, the decision on convertibility is taken by the IMF, at the request of the central bank in question, which must hold sufficient reserves in other strong currencies. See the explanations of the IMF, which employs the concept of usable currency: "New appendix: frequently asked questions on the characteristics of reserve assets", IMF, July 2011, https://www.imf.org/external/np/sta/ir/IRProcessWeb/pdf/faqapp.pdf

The highly exclusive strong currency club.

currencies, used by the global multinational banks, only have a relative place in the country's economy.

This is reflected in how banking networks are organised. Global banking groups, such as Citigroup or BNP Paribas, have subsidiaries in virtually every country in the world[21]. But, in countries with nonconvertible currencies, they have fewer branches, and only deal with foreign currency transactions[22]. It is the local banks which provide banking services to companies and households. In this case, the global megabanks do not contribute to the development of financial services designed to benefit the local population, as their focus is on providing services to major companies and high-net-worth individuals.

Of course, emerging and developing countries have varying degrees of access to strong currencies. Those that export a lot to developed countries have large reserves of strong currencies, and even though their currency is technically nonconvertible, in practice, loans and borrowing in strong currencies are easy and commonplace. This is the case in Chile, for example, but especially in China, which has the largest reserves of US dollars in the world; it has two currencies, the yuan, which is used internally, and the renminbi, its external currency.

But, for most emerging and developing countries, the restricted access to strong currencies makes it difficult both to secure investments from non-resident companies, but also for local companies to expand due to the additional costs linked to the associated mistrust, whether warranted or not, of partners (suppliers, banks, etc.).

21 See, for example, the registration document issued by the BNP Paribas group for 2016, https://invest.bnpparibas.com/sites/default/files/documents/ddr2016gb.pdf, pp. 222-230. See also the list of countries in which CitiGroup is active at http://www.citigroup.com/citi/about/countries-and-jurisdictions/

22 The exception is when these groups have taken over a local banking network.

Countries which do not have access to strong currencies are vulnerable to monetary speculation, which results in poorer populations.

As stated in the first section, the exchange rate applied to a country's currency has a direct impact on the lives of its citizens. When a currency goes down in value against other currencies, the price of imported products goes up while that of exported products drops, making them easier to sell. A currency can depreciate if too much of it is created within the country[23] but also if it is subject to a speculative "attack" coming from outside the country.

Since the late 1990s, Thailand, Malaysia, Indonesia, Mexico, Brazil, Argentina and Russia have experienced banking and currency crises which caused them to lose almost 15% of their GDP.

Strong currencies are also prone to monetary speculation, although this is made more difficult by the fact that developed countries have free access to the strong currency market: to counter an attack, all they generally need to do is borrow[24]. It is a lot harder for emerging and developing countries to borrow strong currencies, for the reasons already explained, and they are therefore more vulnerable than developed countries to monetary speculation.

There have been frequent, and serious, currency depreciations in emerging and developing countries ever since the floating exchange rate was implemented in 1973. Crises in the most deeply affected countries over the period from 1990 to 2010 include: Thailand, Malaysia, Indonesia, Mexico, Brazil, Argentina and Russia. Since the end of the 1990s, these countries have suffered banking and exchange rate crises which caused them to lose almost 15% of their GDP. This was the case in Indonesia, for example[25]; the global effect of this was much greater than the 1929 crash was for Europe and the United States. In another example, the value of the Mexican peso fell by 50% between 1994 and 1995; the Thai baht, the Malaysian ringgit, the Indonesian rupiah and the South Korean won fell between 50% and 70% in 1997. The Russian rouble lost 60% of its value in 1998[26]. In these circumstances, it is difficult to believe that the floating exchange rate and free movement of capital have been beneficial to these countries.

Globalisation of the financial system has not therefore given everyone access to strong currencies, and the floating exchange rate has resulted in huge monetary instability in emerging countries, with varying degrees of vulnerability affecting the purchasing power and standard of living of their populations.

In these conditions, we need to question the impacts the mechanisms of the global financial system have on emerging and developing countries, and draw an initial conclusion: the benefit to the population of the liberalisation of exchange rates and financial globalisation, the notable proponents of which include the IMF and World Bank, is not necessarily guaranteed.

23 If the central bank manufactures a lot of currency, or if private banks create a lot of currency by giving credit.
24 But this is not always possible: George Soros's Quantum fund caused a devaluation of the pound sterling in 1992 during an attack of this type. See, for example, Jean-Marie Pottier, "Une crise qui rappelle celle de 1992-1993" [A crisis similar to 1992-1993], *Challenges,* 11th February 2010, https://www.challenges.fr/monde/commentaire-une-crise-qui-rappelle-celle-de-1992-1993_359398
25 See "Recovery from the Asian Crisis and the Role of the IMF", IMF, 2000, https://www.imf.org/external/np/exr/ib/2000/062300.htm
26 See "Les krachs boursiers, une vieille histoire" [Stock market crashes, an old story], *Le Monde,* 10th October 2008, http://www.lemonde.fr/la-crise-financiere/article/2008/10/10/les-krachs-boursiers-une-vieille-histoire_1105364_1101386.html

The floating exchange rate.

B. EMERGING AND DEVELOPING COUNTRIES SUFFERING FROM CAPITAL FLIGHT

Since the early 2000s, there has been a slight yet regular rise in the flow of investment from developed countries to emerging and developing countries, as demonstrated by the chart on page 103. According to an analysis from the South Centre[27], these investments helped to gradually improve the situation in these countries and, via a ripple effect, attracted yet more investment, particularly as the price of commodities was more competitive. But, since the start of the 2000s, another phenomenon has been noted: these countries have started to export capital to developed countries. This trend has grown, to the extent that net capital flows (inflow minus outflow) towards emerging and developing countries are now negative.

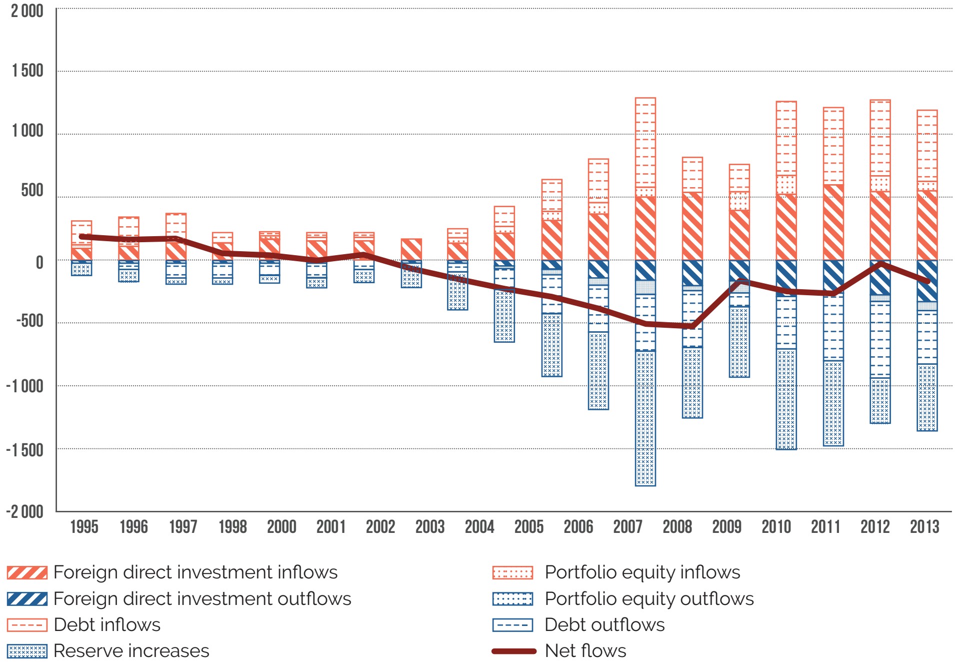
The net flow of capital to emerging and developing countries is now negative.

In fact, emerging and developing countries have suffered the consequences of a lack of capital controls which facilitates short-termism and increases the volatility of investments (huge, rapid injection and withdrawal of investments within an economy, speculative attacks on currencies as described above, and so on).

Therefore, one of the major factors in this growth in capital outflows from emerging and developing countries is the formation of reserves. To guard against external shocks, following the Asian and South American financial crashes of the late 1990s, many countries have greatly increased their monetary reserves by purchasing bonds issued by developed countries (the proportion of reserves made up of assets held by non-residents more than doubled between 2000 and 2013, totalling almost 45%)[28].

27 "Inequality, Financialisation and Stagnation", *South Centre*, Research Paper, no. 73, February 2017, p. 26, https://www.southcentre.int/wp-content/uploads/2017/02/RP73_Inequality-Financialisation-and-Stagnation_EN.pdf
28 Yılmaz Akyüz, "Internationalization of finance and changing vulnerabilities in emerging and developing economies", South Centre, January 2015, https://www.southcentre.int/wp-content/uploads/2015/01/RP60_Internationalization-of-Finance-and-Changing-Vulnerabilities-in-EDEs-rev_EN.pdf

INCOMING AND OUTGOING CAPITAL FLOWS IN EMERGING AND DEVELOPING COUNTRIES FROM 1995 TO 2013 (IN BILLION DOLLARS)



Source: Internationalization Of Finance And Changing Vulnerabilities In Emerging And Developing Economies, p. 15, Yılmaz Akyüz, South Centre, January 2015.

Comment on the chart: The balance of flows between the North and South was reversed from the early 2000s, mainly due to the increase in foreign-exchange reserves held by emerging and developing countries to guard against speculative attacks.

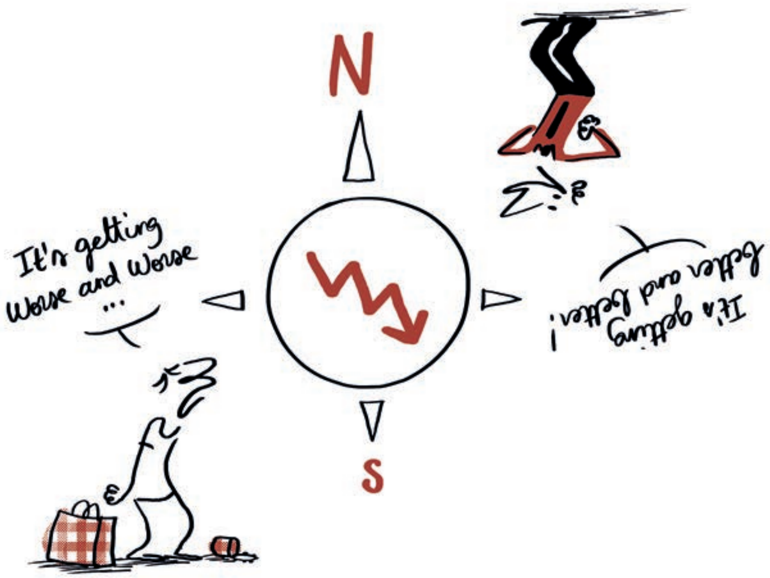
These countries find themselves forced to tie up large quantities of resources to the detriment of investments in their own economies and current expenditure.

Furthermore, after the 2008 crisis, thanks to the quantitative easing policies of the principal central banks, many investors with access to cheap liquidities bought bonds in convertible currencies issued by companies and governments in emerging countries (whereas the receipts for these would be in the local currency). This is a highly risky activity for these economic agents to engage in, all the more so if the governments are implementing austerity policies, as the upward trend in central bank key interest rates in developed countries results in a capital outflow of foreign currency[29].

This balance may become even more fragile if we take the illicit flow of capital into account. According to Global Financial Integrity[30], illicit outflows from emerging and developing countries more than doubled between 2004 and 2013, totalling almost 1100 billion dollars a year. More than 80% of this comes from fraudulent transfer pricing between companies.

29 This is the case in Argentina, for example, where the central bank was forced to drastically hike its key interest rates, despite this move failing to safeguard against the capital outflow of foreign currency. See Kavaljit Singh, "Argentina's Peso Crisis, Capital Flows and Financial Fragility in Emerging Markets", Madhyam, New Delhi, 11th May 2018, http://www.madhyam.org.in/dont-cry-for-me-argentina-peso-collapse-and-global-financial-fragility/

30 "Illicit Financial Flows from Developing Countries: 2004- 2013", Global Financial Integrity, 2015. p. VIII, table X2, http://www.gfintegrity.org/wp-content/uploads/2015/12/IFF-Update_2015-Final-1.pdf



Finance never loses its bearings.

Overindebtedness weakens the ability of developing countries to drive public policies which benefit their inhabitants

The policy upheld by international institutions in the 1980s, known as the Washington Consensus, forced emerging and developing countries into debt, borrowing strong currencies from the World Bank (see above). This policy did not succeed in driving economic growth, particularly in Latin America and Africa. The rates of growth in these countries were low in the period between 1980 and 2000, and the manufacturing industry shrank as investments were directed towards industries extracting and exporting commodities, with no significant emergence of a domestic manufacturing industry within the country[31]. For Asia, the situation was slightly different: by partly refusing to open up to investment completely and adopt the drop in customs duties advocated by the Washington Consensus, many countries (Taiwan, South Korea, Thailand, Singapore…) were able to industrialise[32].

The Washington Consensus policy led to a high level of indebtedness amongst emerging and developing countries: between 1980 and 1990, the average level of external debt held by low-income economies (World Bank classification) rose from 16 to 41% of the GDP, and that of middle-income economies, 32 to 40% of their GDP[33]. For many, this corresponded to the maximum amount of foreign currency they could generate with their exports; the international institutions

31 See Dimitri Uzunidis, *op. cit.*
32 *Ibid.*; and "The East Asian miracle: economic growth and public policy", World bank, 1993, http://documents.worldbank.org/curated/en/975081468244550798/pdf/multi-page.pdf
33 Source: World Bank annual reports, https://openknowledge.worldbank.org/handle/10986/2127

could not lend more. Under these conditions, emerging and developing countries found it increasingly difficult to repay their foreign currency loans and were not able to secure the additional loans which would have enabled them to acquire the technology and equipment to build a domestic manufacturing economy and pursue development policies.

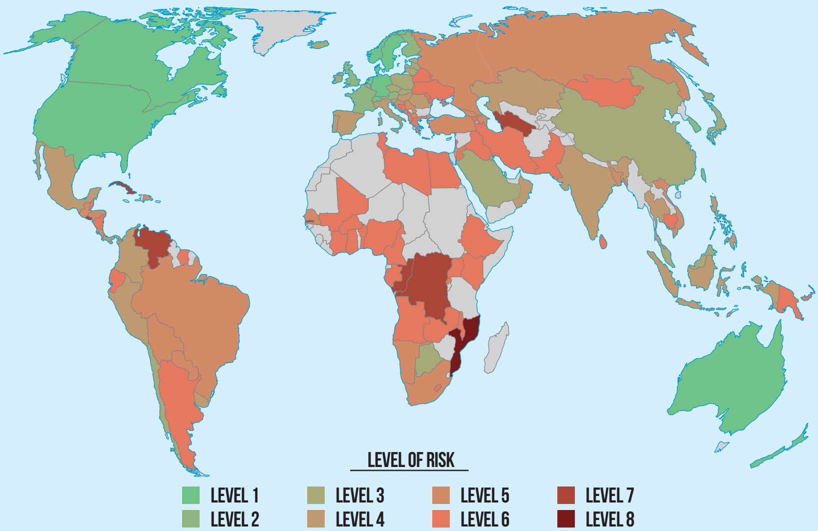
The map on the next page shows the currency credit rating for all the countries in the world, as given by the major rating agencies in 2016. These use a lettering scale to indicate the risk that a country will not be able to repay its debt. The highest rating is AAA, symbolised on the map by the lighter green; the lowest rating is C, which indicates that the country's debt is being restructured (as is the case in Greece, for example). From the rating Ba1 downwards, i.e. from the colour orange, the agencies believe that a loan in the country has risks of not being repaid. Potential lenders are advised that they will be granting this loan at their own risk (the yield on this type of loan is very high, so it attracts investors willing to take on high levels of risk). The map clearly shows that the vast majority of emerging and developing countries are subject to a low level of confidence from investors.

Without the option to borrow on capital markets, and often in debt to the World Bank up to the maximum amount, and with foreign currencies, in some cases, being channelled to developed countries, these emerging and developing countries cannot make the foreign currency investments which would enable them to drive forward ambitious public policies. They are forced to invest endogenously, i.e. with their own currency, since very often they do not have a system for collecting savings which could then be channelled towards the financing of equipment. Most importantly, a large proportion of the technology needed can only be purchased with foreign currency.

This is especially applicable for Africa, as regards issues in investment into sustainable development models to counter the immense challenges of food security and access to energy, for example. The African continent has immense potential renewable energy resources, but these remain largely underexploited, with only 25% to 30% of the installed capacity of this energy being used, according the United Nations Environment Programme (UNEP) and the African Union[34]. The annual investment needed for this is 60 to 90 billion dollars, until 2030. This is four times the amount invested in 2014, despite the existence of support programmes introduced by development organisations, and despite the fact that two thirds of the population of sub-Saharan Africa have no access to electricity. In addition to the political and technological challenges, UNEP and the African Union point to the need for massive investment, particularly in the infrastructure for power transmission and distribution, but also the need to set up innovative local financing systems to enable the inhabitants to acquire solar equipment for their households, for example.

34 "L'énergie comme catalyseur pour atteindre les objectifs de développement durable et mettre en œuvre l'Agenda 2063 en Afrique" [Investing in innovative environmental solutions to accelerate implementation of the Sustainable Development Goals and Agenda 2063 in Africa], UNEP–African Union, May 2017, https://wedocs.unep.org/bitstream/handle/20.500.11822/20921/AMCEN16EGM4Energy_E.pdf?amp%3BisAllowed=&sequence=1

Sovereign ratings list: financial markets' lack of trust in emerging and developing countries



Source: Data compiled from Countryeconomy.com, grouping the ratings set by the major credit rating agencies, see https://countryeconomy.com/ratings

Comment: From the colour (5), emerging and developing countries only attract the most speculative investors, for the most part, as the agencies believe that there is no chance that a loan to these countries will be repaid. Potential lenders are advised that they will be granting this loan at their own risk (the yield on this type of loan is very high, so it attracts investors willing to take on high levels of risk).

Furthermore, these massive investments remain limited, largely by the difficulty in accessing strong foreign currencies, and the ability to both attract external investment and to enable the creation of local financing systems.

Faced with the inability of the financial system to adequately supply emerging and developing countries with foreign currencies, what about their own resources? To what extent can the policies which must be put in place to counter current and future challenges (such as the fight against climate change) also be financed by emerging and developing countries? What is the role of finance within emerging countries?

C. EMERGING AND DEVELOPING COUNTRIES LACKING INTERNAL FINANCIAL SYSTEMS ENABLING THEM TO CHANNEL SAVINGS TOWARD INVESTMENT PROJECTS

Infrastructures for sustainable development

For development, a country needs to have an infrastructure. Production or treatment or distribution facilities need to be built to enable access to electricity or potable water. The British economist, Nicholas Stern[35], amongst others, has demonstrated that socio-economic development is not incompatible with the fight against climate

35 See http://newclimateeconomy.net/ or the collective work "*The New Climate Economy. Better Growth, Better Climate*", https://climate-adapt.eea.europa.eu/metadata/publications/better-growth-better-climate-the-new-climate-economy-report-global-report/11258852

Economic recovery in developing countries.

change, and that it is possible to build an infrastructure in emerging and developing countries which would allow for sustainable economic development, but with a very different economy to that of developed countries, particularly in terms of agricultural practices and patterns of urbanisation.

Based on the current rate of investment, the UNCTAD [36]estimated, in 2014, that emerging and developing countries would have to counter a deficit in investment into their infrastructure (electricity and renewable energy, transport and telecommunications, water and sanitation, health and education) of 2500 billion dollars per annum[37] to reach the sustainable development goals set for the period 2015-2030. Even with strong economic growth in this period (an unlikely hypothesis, based on the current situation), while many countries, particularly emerging economies, would be able to meet the required investment, less developed countries would still face an annual investment deficit of 1600 billion dollars.

The absence of savings vehicles, curbing the introduction of long-term public policies

In emerging and developing countries, there are generally few pension schemes, and social security systems, where these exist, are rudimentary. Even in China, which has already built significant infrastructure, there are no sources of financing dating back more than ten years. Instead, the financing of heavy infrastructure is directly incorporated in the State budget.

However, the creation of ambitious programmes by private investment and cooperation organisations is not sufficient to cover all requirements. This is largely

36 "World investment report 2014. Investing in the SDGs: An Action Plan", http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf
37 The UNCTAD estimated annual requirements at 3.9 billion and the actual investment at 1.4 billion dollars.

Long-term capital investment for infrastructure

In developed countries, infrastructure facilities (rail networks, for example) have, historically, and particularly since the 19th century, been financed by state loans from the affluent ruling class, as they were too costly, but also too risky, to be financed by companies.
The existence of long-term savings vehicles and bonds have enabled capital to be invested over long periods of time in countries with advanced economies: capital collected from employers and employees to be paid out to them upon retirement is invested in the interim, either by the state, or by private pension funds, depending on the country, for the entire length of the working career. Insurance companies also need to provide payment of benefits over the long term, particularly in terms of life insurance.
This long-term capital investment enables infrastructure to be financed over a long period of time. For example, motorways in France have been financed with loans to be repaid over forty, fifty, or even sixty years*. The longer the term of the loan, the lower the annual repayment charges. By having financial resources permanently available, local authorities can stagger the cost of building infrastructure over time. This is essential when you consider the amount of capital to be raised.

* For example, the A28 motorway between Rouen and Alençon, which opened in 2005, was financed by a 60-year loan.

due to the "two-tier" monetary system and the high levels of foreign currency debt incurred by these countries (see above). Further to the question of transferring technology, which is crucial in many domains (and which goes beyond financial matters), emerging and developing countries need to set up long-term financing channels within their economies, both to stagger the cost of investment over time and to provide their citizens with long-terms savings support for their old age. Finally, and most importantly, having their own, well-managed resources will give these countries the power to set their own public policies, without having to depend too heavily on international financial institutions[38].

While there are many reasons for capital to flow from the Global South to the Global North (tax evasion, money laundering, attractive higher returns from the financial markets of the North, etc.), the lack of long-term investment vehicles in developing countries is a major challenge for these countries. If citizens of a developing country want to put capital aside for their retirement, or to pass on to their children, there will often be no savings vehicles available in their country. And the assets (property, businesses, land) in their country may be a less attractive option if there has been little development there. However, if they choose to withdraw this capital from their countries and invest it in the North, they will be helping to slow down growth, as it will delay the point in time when the country is able to invest in the required infrastructure. So, the movement of savings outside of countries in the Global South is both a product of weak growth and a factor in its continuation.

38 This requires strengthening the rule of law, and the accountability of political leaders to their citizens. Secours Catholique – Caritas France participates in many dynamic initiatives designed to meet these challenges. See "From transparency in the extractive industries to fighting for tax justice. suggestions for local use of financial data produced by companies and states", Secours Catholique – Caritas France, January 2017, pp. 47 et seq., http://www.secours-catholique.org/sites/scinternet/files/publications/compendium_transp_multinational_en.pdf. See also the actions undertaken as part of the campaign "Tournons la page, pour l'alternance démocratique en Afrique" [Let's turn the page, campaign for democratic change in Africa], http://tournonslapage.com

It is not just strong currencies that these emerging and developing countries lack, but also financial systems using the local currency which are sufficient and robust, and able to channel the population's savings into long-term investment. It could be said that financial globalisation has led to too much finance in the Global North, and not enough in the Global South.

Finance is not completely absent from emerging and developing countries. However, it is not present in the form of financial systems, but through multinational industrial groups which, by promoting financial globalisation, have prospered here, most often to the detriment of the local populations.

D. THE COMMODITIES INDUSTRIES ARE DOMINATED BY MULTINATIONALS WHICH AMASS A LARGE PROPORTION OF THE VALUE TO THE DETRIMENT OF THE POPULATIONS OF EMERGING AND DEVELOPING COUNTRIES

The emergence of integrated multinationals

As capital markets opened up, large multinational companies began to emerge. In particular, this enabled the industrial groups based in the North to integrate the channels for the supply (fertiliser, energy), production (land and storage facilities) and processing of agricultural and energy commodities on a global basis. In terms of agricultural commodities, the market is dominated by four major agrifoods traders, the so-called ABCD companies (Archer, Bunge, Cargill and Louis Dreyfus)[39]: in 2003, these four companies controlled 73% of the global grain trade[40]. Cargill, for example, is a global group which reported an annual turnover of 110 billion dollars in 2017. We can also include the Glencore group here, which has diversified into agriculture, minerals and energy (more than 200 billion dollars of turnover in 2017[41]), and Trafigura[42], which is more of a petrochemicals specialist (98 billion dollars of turnover in 2016), and Gunvor[43] (47 billion dollars of turnover in 2016).

In 2003, four major agrifoods companies controlled 73% of the global grain trade

Financialisation impacts the setting of prices

The major groups specialising in agricultural and energy commodities often hold dominant positions as market leaders within their corresponding industries. These positions apply to the physical volumes that they process, but also to their level of activity in the derivatives markets based on underlying commodities prices. One of the major consequences of the financialisation of advanced economies is that the price of commodities is no longer determined by the supply and demand of the product itself, but by the supply and demand of derivative financial products — based on the commodities exchange rate — which are around ten times greater in volume (see section 1). Activities within financial markets may make up a significant

39 Sophia Murphy and David Burch, "Cereal Secrets, The world's largest grain traders and global agriculture", Oxfam International, August 2012, https://www.oxfam.org/sites/www.oxfam.org/files/rr-cereal-secrets-grain-traders-agriculture-30082012-en.pdf
40 *Ibid*., p. 9, based on the Australian Wheat Board (no date) Global Wheat Trends, AWB, Melbourne.
41 See the group's annual report from 2017, p. 122, http://www.glencore.com/dam/jcr:d6c11311-5076-44b6-af40-dee29142d663/glen-2017-annual-report.pdf
42 See the group's annual report from 2016: https://www.trafigura.com/media/4136/2016-trafigura-annual-report.pdf
43 See the group website: https://gunvorgroup.com/en/

A few multinationals have ended up controlling everything.

proportion of the activities of some of these groups[44]. This high proportion may have led to the increasing trend for major commodities traders to buy out investment bank trading services[45]. These financial activities enable them to have a much greater impact in terms of price than companies or individuals only involved with production could hope to have.

Furthermore, the industrial arm of groups specialising in agricultural and energy commodities is often integrated into the production and distribution chains[46]. In this case, they are able to control not only the price of commodities, but also the end price to the consumer. These groups, which have integrated the production chain from producer to consumer, and influence the price of commodities on financial markets, are reaping the added value from the agrifood and energy chains that they control. This value comes from activities undertaken in emerging and developing countries, most often to the detriment of these countries' populations, particularly the least developed countries. Olivier de Schutter, United Nations special rapporteur on the right to food[47], has been warning since 2010 that these countries were most highly impacted by the volatility of agricultural commodity prices, a volatility essentially due to speculators.

The consequences of this organisation of the commodities markets, especially agricultural commodities, are legion for small producers, particularly in terms of

44 See, for example, 'Le pétrole, un exemple de matière première dont la volatilité du prix a des conséquences majeures pour les pays du Sud' [Oil: a commodity where price volatility has a major impact on the Global South], Gaël Giraud, Chief Economist for the French Development Agency, video (from 3'45'') posted by the FDA on https://www.youtube.com/watch?v=Jj6Ty6-NHrA. See also Oxfam "Cereal Secrets", *op.cit.,* p 28.

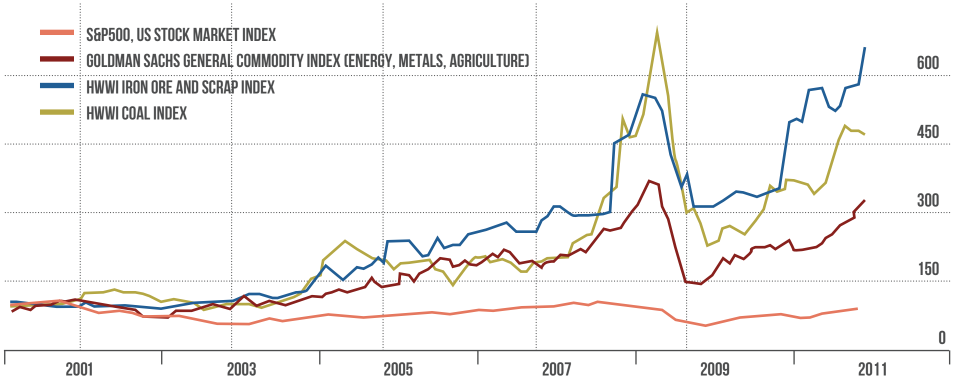
45 See Myriam Vander Stichele, SOMO, "*Will MEPs stand up for financial stability over speculation?*", Euractiv, 13th February 2017, https://www.euractiv.com/section/agriculture-food/opinion/will-meps-stand-up-for-financial-stability-over-speculation/

46 See Oxfam "Cereal Secrets", *op.cit.*, p 8.

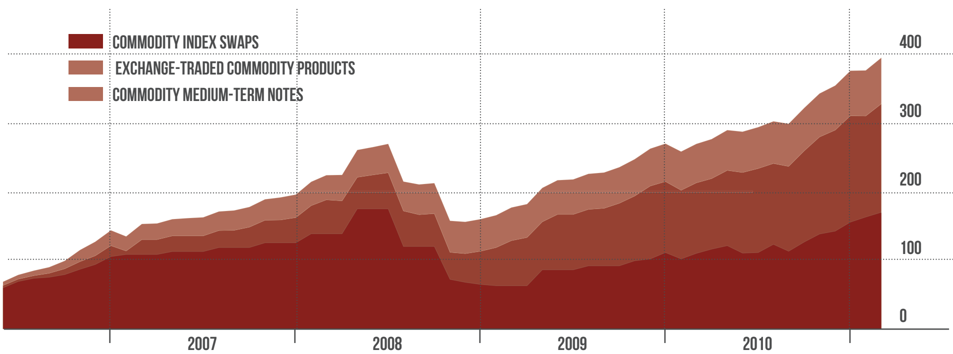
47 See Olivier de Schutter, special rapporteur on the right to food, "Food Commodities Speculation and Food Price Crises. Regulation to reduce the risks of price volatility", briefing note no. 2, September 2010, http://www.srfood.org/images/stories/pdf/otherdocuments/20102309_briefing_note_02_en_ok.pdf

CHANGE IN COMMODITY PRICES COMPARED WITH THE VOLUMES OF COMMODITY DERIVATIVES

COMPARISON OF CHANGES TO COMMODITY PRICES AND THE VALUE OF KEY ENTERPRISES (2000-2011 - BASE 100: 2000)



CHANGES TO COMMODITY-RELATED FINANCIAL PRODUCTS (2006 – 2010, IN BILLION DOLLARS)



Source: BIS Annual Report, 2011, p. 57, http://www.bis.org/publ/arpdf/ar2011e.pdf

Comment on these graphs: Due to quantitative easing policies, the commodity-related financial products market has experienced strong growth since the 2008 crash (bottom graph) and this has affected commodities prices, making them very volatile, much more so than the value of the key enterprises listed in the US (top graph)

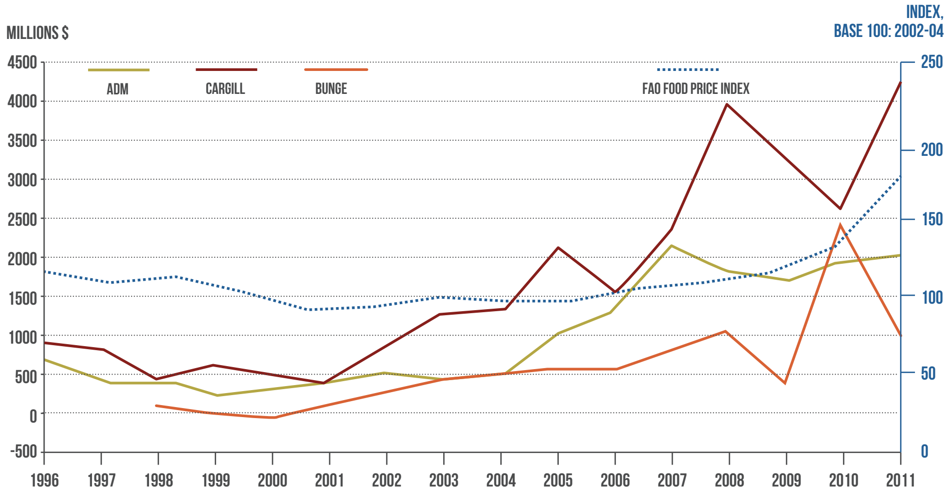
access to land (many groups or investment funds acquire large tracts of land) or the trading opportunities (the concentration, around major groups, of trading and distribution activities means that small producers have no independence when it comes to price requirements, as these are set by the market conditions resulting from the massive volume of activities undertaken by these dominant players)[48].

The unpredictability of prices renders states and populations vulnerable

The huge variations in commodities prices prevents exporters in emerging and developing countries from forecasting prices, and therefore from being able to invest and grow. It also makes them weak propositions as borrowers. The haphazard variations in prices on international markets often trickle down to local producers, leading to instability with adverse effects on economies which only have a small manufacturing base. There are many recent examples of emerging and developing

48 See Oxfam "Cereal Secrets", *op.cit.,* p. 48 et seq.

COMPARISON OF THE PROFIT FLUCTUATIONS OF THE 3 MAJOR AGRIFOODS FIRMS (LEFT-HAND SCALE) AND THE FOOD PRICE INDEX (RIGHT-HAND SCALE) BETWEEN 1996 AND 2011



Source: "Cereal Secrets, The world's largest grain traders and global agriculture" report, Oxfam International, August 2012, p. 23 https://www.oxfam.org/sites/www.oxfam.org/files/rr-cereal-secrets-grain-traders-agriculture-30082012-en.pdf

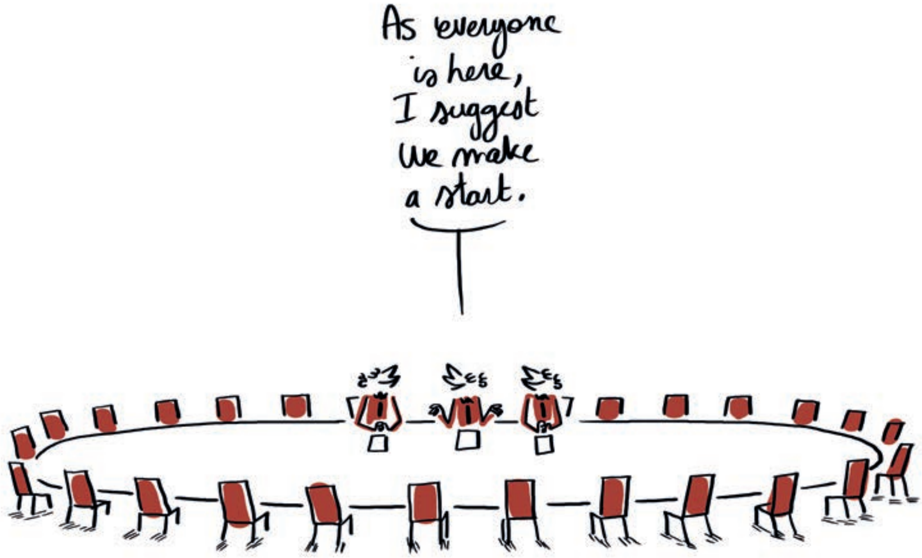
Comment: The profit fluctuations of the agrifoods groups is not linked to the change in food prices.

countries being deeply destabilised by price variations, following the fall in the oil price between 2014 and 2016, but also sugar prices (food riots in Egypt in 2009) and rice (soaring prices in India in 2013)[49]. The price of food commodities has mainly been increasing greatly since the 2000s, but prices have also been highly unstable, which contradicts the assumption that derivative products would be a tool for stabilising prices.

As concerns agricultural commodities, we have seen food prices increase since 2000, in parallel with an increase and volatility in the profits of the major agrifoods groups.

We can therefore state that financialisation (the emergence of derivative products) and globalisation (the opening of borders to capital flows) promoted the formation of large international groups which had their own channels for the production and industrial processing of commodities, particularly agricultural and energy resources, the activities of which offer no benefit to the populations of the developing countries these groups are operating in[50].

49 See "Dix ans après les émeutes de la faim - La faim justifie les moyens !" [Ten years after the food riots - Hunger justifies the means!], CCFD-Terre Solidaire, October 2017, pp. 21 et seq., https://ccfd-terresolidaire.org/IMG/pdf/ccfd-rapport-10ans-emeutes-de-la-faim.pdf
50 See Oxfam "Cereal Secrets", *op.cit*.



No developing countries in the institutions that set the rules.

5.4 EMERGING AND DEVELOPING COUNTRIES ARE POORLY REPRESENTED WITHIN THE REGULATORY BODIES FOR INTERNATIONAL FINANCE

Directly impacted by financialisation and international monetary issues, emerging and developing countries are, however, under-represented in the bodies charged with setting the rules and policies for these issues.

Banking and financial regulations are largely drawn up within institutions based in Basel (Financial Stability Board, Bank for International Settlements, etc.) which bring together the central banks and the governments of the countries which house the major financial hubs. As noted by Eurodad in one of its reports, "*the FSB excludes the vast majority of UN member states, whilst including several smaller jurisdictions at the centre of financial secrecy problems – such as Switzerland, the Netherlands and Singapore*"[51].

Most emerging and developing countries are therefore unable to voice their expectations and demands in terms of global financial regulations; as a result, they are also unable to defend the measures which are key to setting up the national financial systems that they need: the creation of savings systems or an agricultural sector protected against speculation, devices to counter speculative monetary attacks, long-term investment, etc.

51 Jesse Griffiths, "Is the global financial and economic system fit to deliver the Sustainable Development Goals?", Eurodad, October 2017, http://www.eurodad.org/files/pdf/1546835-is-the-global-financial-and-economic-system-fit-to-deliver-the-sustainable-development-goals--1509613918.pdf

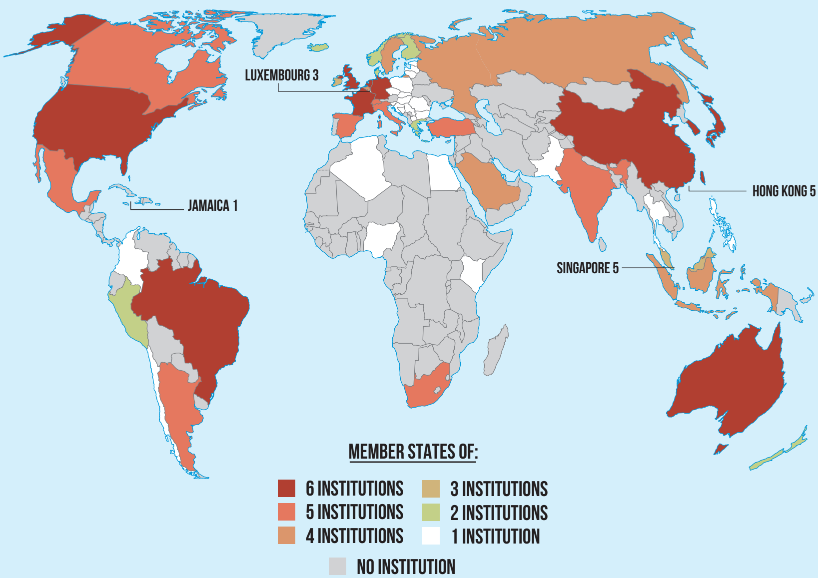
This phenomenon applies to most financial and economic issues

Questions linked to public debt and debt relief mechanisms are dealt with by the IMF, which is made up of representatives from most countries, but which applies a decision-making system using quota-based votes for each country according to its wealth. These questions are also dealt with by the Paris Club, where only creditor countries can make decisions.

When it comes to taxation, it is the OECD, a body which brings the 34 most developed countries together, that sets the international standards, such as the BEPS action plan to counter the tax avoidance practices of multinationals[52].

The Financial Transparency Coalition has studied the composition of six international financial institutions, showing that developed countries make up 61% of their members, whereas the poorest countries have no representation at all[53].

Financial rules set by the richest countries



Source: "Who makes the rules on Illicit Financial Flows?", Financial Transparency Coalition, February 2017, https://financialtransparency.org/reports/who-makes-the-rules/

Comment: Countries ranked according to their membership of six international financial institutions (FATF, BIS, CBCB, FSB, IASB and IOSCO board members). 61% developed countries, only 10% lower middle-income countries and zero low-income countries in these institutions.

52 See Secours Catholique – Caritas France "From transparency…", *op. cit.,* pp. 47 et seq., http://www.secours-catholique.org/sites/scinternet/files/publications/compendium_transp_multinational_en.pdf

53 "Who makes the rules on Illicit Financial Flows?", Financial Transparency Coalition, February 2017, https://financialtransparency.org/reports/who-makes-the-rules/ The six financial institutions are: Financial Action Task Force (FATF), Bank for International Settlements (BIS), Basel Committee on Banking Supervision (BCBS), Financial Stability Board (FSB), International Accounting Standards Board (IASB), International Organization of Securities Commissions (IOSCO).

5 OVERVIEW

The overall development of the financial system over the past forty years has not benefited the developing countries. As a rule, they lack the strong currencies that they would need to be able to implement ambitious public policies. Poverty in emerging and developing countries may have been reduced since 1990, but remains all too present. Inequalities between countries are growing, and EDEs are not catching up with developed countries when it comes to purchasing power; if the current system and economic conditions remain unchanged, they lag at least two generations behind. The financial system as it currently operates favours capital flight from emerging and developing countries to developed countries, hampering local investment. It does not remedy the lack of local institutional systems to channel local currency savings towards the long term infrastructure investment needed to support their sustainable development. It also promotes a debt overhang which swallows up the foreign currency resources of these countries, and prevents them acquiring the technologies and equipment that would enable them to implement public policies capable of meeting current and future challenges. Lastly, the globalisation and financialisation of commodities markets have enabled multinationals to integrate production and trade, and to amass a large part of the value added by agribusiness and energy production chains, diverting it from local people and states.

This situation seems particularly unacceptable when we consider the investment that emerging and developing countries need to finance the required energy and green transition. As it operates now, the financial system creates obstacles instead of providing solutions, and this is heightened by the fact that these countries largely have no representation at the international institutions that design financial regulation and promote policy orientations.

Stabilising the financial systems in developed countries would inevitably have consequences for emerging and developing countries. If financial returns were less appealing in developed countries, then investors in the global South would be more inclined to keep their investments local. There is potential investment in the renewable energies sector in emerging and developing countries, for example, offering the opportunity to create an autonomous energy industry. Stabilising the derivative products markets by reducing the volatility of commodity prices would give developing countries the degree of latitude they need to invest in the future.

6

HOW CAN FINANCE BE MADE TO SERVE SOCIETY? PROPOSED MEASURES

It is possible to rectify the deregulation of finance, its excessive size and its harmful impacts on the general interest. This involves reviewing the rules of its game, rather than merely adjusting them. A single keyword to sum up the reform proposals could be: oversight. The proposals are based around a structural, long term and ambitious reform of global finance, and are sequenced in chronological order. The purpose of these proposals is to initiate a wide-ranging debate on how to make finance serve the general interest once more. Empowering civil society with regard to these issues is a must. It is also necessary to be able to open dialogue with the financial sector itself, as well as with those responsible for designing the regulations and monitoring their application.

DIAGNOSIS: HOW THE PRESENT SET-UP OF GLOBAL FINANCE IS DETRIMENTAL TO THE GENERAL INTEREST

The main points of this report's diagnosis are the following:

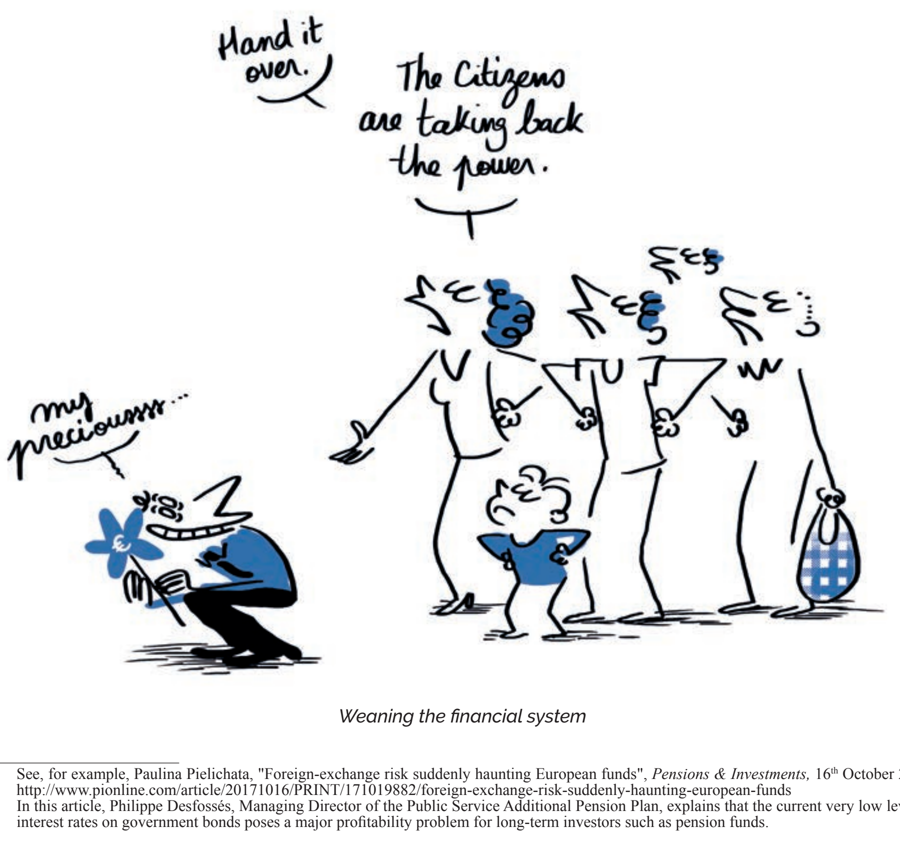
- Monetary instability has prevailed since the fixed exchange regime was abandoned in 1973
- Since the 1980s, the unstable exchange rate, combined with the liberalisation of capital movements, has enabled new financial products to take centre stage: derivative products. Their high returns attract savings away from investments in the non-financial economy, and amplify the variations in commodity prices and foreign currencies, making them even more unpredictable, to the detriment of consumers, producers, and the implementation of public policies.
- Banking regulations were designed to give banks more security against these new risks of instability, rather than to protect the economy as a whole. The regulations also enabled a vast unregulated banking sector to emerge, known as the shadow banking system, where speculative investment funds offer their services. Lastly, these regulations underestimated the risk of global crises, known as systemic banking crises, such as the 2008 crash.
- In the late 1960s, credit activities were deregulated in advanced economies, and this factor, combined with the free circulation of capital, led to the formation of giant world banks, which are both underfunded yet deemed "too big to fail". To add to this, too much of the credit growth, mainly in advanced economies, went to existing urban real estate and to shadow finance, exacerbating poverty and inequality.
- Excess credit to the real estate sector triggered the 2008 crisis, which demonstrated the havoc that a global and deregulated financial sector can cause in society and the non-financial economy; ten years later, societies still have not recovered from the economic and social crisis triggered by the financial crisis.
- The sell-off of public debt, in both developed countries and the Global South, has resulted in a debt overhang which has reduced the ability of states to finance the growing social needs resulting from the crises: namely social safety expenditure

increased by the economic crisis, the need for investment relating to climate change, and development needs in the South.

The proposals: how to regulate finance to ensure it benefits society

It is possible to reverse financial deregulation, and remedy the unchecked expansion and harmful impacts finance has on the public interest. The proposals we put forward could be summed up in a single keyword: control. The creation of money and the allocation of credit are activities that serve the general interest. The current regulatory framework, much of which has been developed over the past forty years, clearly cannot effectively protect society from the harm caused by the excessive deregulation of finance. If proof were needed, a decade on from the crash, we are still experiencing volatile commodity and currency prices, urban real estate bubbles, and overindebtedness of both the public and private sector. From within the financial sector itself, worries are emerging about the unsustainability of the system as it is now. The lack of long-term real assets to support investment, in particular, is a problem for long-term investors[1].

One of the goals of these proposals is to trigger a wide-ranging debate on how finance can be made to serve the public interest. The proposed changes are ambitious and will have a significant impact in terms of how the banking system is structured



Weaning the financial system

1 See, for example, Paulina Pielichata, "Foreign-exchange risk suddenly haunting European funds", *Pensions & Investments,* 16th October 2017: http://www.pionline.com/article/20171016/PRINT/171019882/foreign-exchange-risk-suddenly-haunting-european-funds
In this article, Philippe Desfossés, Managing Director of the Public Service Additional Pension Plan, explains that the current very low level of interest rates on government bonds poses a major profitability problem for long-term investors such as pension funds.

and organised. There is not necessarily a consensus on all these proposals, but the importance of these issues, and the fact that they are focussed on the general interest, means potential solutions need to be debated to open up a frank and ambitious discussion on the subject. It is necessary to both ensure the involvement of the wider society in this issue and to open up this debate with the financial sector, as well as with those bodies in charge of regulating and supervising the banking system. The proposals developed here convey an ambitious and binding long-term vision, and a sequential introduction of measures to change finance to serve society.

Many of the measures being proposed could be introduced independently on a national level, without any need to seek authorisation from international bodies. These measures could then be discussed and defended within the existing international regulatory institutions: the FSB and the BIS, for example. These regulatory bodies have been made independent of political powers, and are too often subject to the will of the financial sector they should be governing. States have sovereign authority to create their own national legislation: it is essential to engage members of parliament, local authorities and the general public to add financial matters to the political agenda and ensure finance is made to serve the public interest.

A new way of regulating finance: changing the rules of the game entirely

The proposals have four axes: stabilising, redirecting, controlling, and freeing up the capital needed to finance the energy transition

The proposals that are put forward for debate here are supported by economists and academics, and, in some instances, such as the Financial Transaction Tax, by governments themselves[2].

The proposals revolve around four axes:
- stabilise the financial sector, i.e. shield economy and society from the consequences of excess risk-taking by the financial sector
- ensure that once stabilised, the financial sector will channel funds towards activities that are useful to society as a whole
- reorganize the supervisory architecture so that finance be regulated to the benefit of the common good/general interest
- Make financial resources immediately available to finance the necessary energy, ecological and social transition.

To protect the general interest, the global financial system must be stabilised to avoid the risk of financial crises. But this step is not sufficient on its own. Capital must be invested according to the needs of a fair, sustainable economy. Furthermore, public authorities must be able to use decision-making and control mechanisms in order to achieve this. Lastly, it is necessary to overcome two major contextual difficulties (generalised overindebtedness, and the permanent threat to currency caused by opening up borders to capital flows) to reinvigorate economies and engage societies to work towards the goal of energy transition.

2 References for academic and/or political support are given for each proposal.

Positioning the debate

RESPONSES TO THE MAIN ARGUMENTS OF THOSE DEFENDING THE CURRENT FINANCIAL SYSTEM

No separation of commercial and investment banks

This demand to separate banking activities is ardently fought by stakeholders from the financial and banking worlds. The proposal contained in the European Commission's directive (see measure A1) was well-crafted, although it did not go far enough, but it was fought by the banks, and abandoned in 2017. Amongst the arguments used for dropping it was the risk of a credit crunch, of an increase in banking fees, and even of the fragility that it would cause (the coexistence of numerous activities is seen as a guarantee of strength).

The following counter arguments can be brought to the debate on bank separation:

- universal banks lend relatively less than smaller banks in terms of percentage of their balance sheet. In periods of crisis, they are quicker to restrict credit;
- Separating commercial and investment banks would not increase the cost of banking services, since the financing of commercial banking would become more attractive to investors: this is because the implicit public subsidy, which benefits first and foremost investment banking activities, would disappear;
- there is no evidence of a useful economic and social role for all the activities that banks are currently undertaking, since about 90% of investment banks' activities are not related to the non-financial economy;
- Size is detrimental to performance and increases risk; the 13 largest European banks (54% in volume) are less profitable than the next 200 in the ranking, by balance sheet size[1].

Technicality and complexity

The argument that finance is complex is often put forward in the conversation around finance, both to justify the existence of activities that have little social utility (and may eventually be harmful to society) and to prevent civil society, policy makers and to a certain extent regulators from being de facto more involved in the debate.

The globalisation of trade, capital flow and currency and rate fluctuations have led to the creation of new financial products. In terms of volume, the majority of these products are used between financial establishments (less than 10% of derivatives have a non-financial counterparty). Furthermore, the banks create products which are not necessarily requested by financial stakeholders but which actually serve their own needs, such as securitisation which enables them to transfer risk from their balance sheet (see section 2).

Complexity is introduced by the banks themselves when they influence a law to get it amended (see the example of the Dodd-Frank Act, which saw a tenfold increase in the number of pages it contained before it was adopted, section 3). It allows them to then justify the need to recruit financial experts to the regulatory bodies to understand what it is that needs to be regulated.

Also, the complexity argument is often advanced by bank managers to clear their name during financial scandals[2]. In addition to being too complex and too big to fail, the banks have proven to be too complex to be managed effectively.

1 Calculations based on data (tables A3.1, A3.2 and A3.4 in the appendices) in the final report of the High-Level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen, October 2012, http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf
See the "Factsheet on bank structure reform" issued by Finance Watch, November 2013, p. 2, https://www.finance-watch.org/wp-content/uploads/2014/01/Facts-and-figures-on-bank-structure.pdf

2 See "États-Unis: la Fed met en garde les grandes banques contre leurs pratiques" [US: the Fed warns big banks about their practices], *L'Express*, 21st October 2014, https://www.lexpress.fr/actualites/1/actualite/etats-unis-la-fed-met-en-garde-les-grandes-banques-contre-leurs-pratiques_1613726.html

As finance cannot be neutral with respect to the economy and society, it is important to prevent prudential rules from becoming too complex, or even to have the option to adopt measures to prohibit certain products[3].

Challenging capital requirements

The increase in capital requirements favoured by the Bank for International Settlements (a proposal also defended in this report) is contested by many stakeholders from the financial sector who see it as a way of curtailing the financing of the economy. However, as reiterated in section 3, many studies contradict this point. Economists and decision-makers at the BIS often compare a bank's level of capital with the solidity of a building's foundations. They also show that the better capitalised banks have lower financing costs than the others.

The very large financial institutions are allowed to carry less capital in the face of their risks, and refuse to adopt a standardized model to measure their risks[4].

Given the repercussions that banking activities have on economies and society, it is essential that these rules are the same for all banks. It is also essential that regulators are able to apply them without incessant dispute, and without having to understand every single weighting system applied by every single bank in detail.

Liquidity on financial markets

The need for capital markets to remain liquid is put forward to justify the short termism in finance, and the existence of speculative products such as High Frequency Trading or derivative products.

Or, as summarised by André Orléan, president of the French Association for Political Economy, in 2008: "*We often justify liquidity based on the fact that, without it, investment would be more difficult as it would require a long-term commitment on the part of the owner. But liquidity also has a macroeconomic cost, and a considerable one: stock market crash. In this respect, history is unambiguous: crises are inextricably linked to market finance.*"[5]

The example of high-frequency trading (making transactions in milliseconds) is illuminating: its existence is defended by the argument that it brings liquidity to financial markets, as if investors really have any need for trading to be performed at this speed.

We can also add that the current and future challenges of our societies stand in stark contradiction to this short-termism: the energy transition, or sustainable lending to SMEs, for example.

The argument for liquidity does not therefore justify the lack of structural reform of the finance sector.

The independence of regulatory bodies from policy makers

The liberalisation and deregulation movement has caused governments to lose control of the financial and monetary regulatory authorities and to make these independent of the policy makers. Largely inspired by economic theories on the neutrality of finance and currency, this measure has also been justified by the claim that governments should be stripped of the authority to create money and therefore trigger inflation.

3 As advocated by Jean-Michel Naulot, a former investment banker and regulator, in his book "*Crise financière, Pourquoi les gouvernements ne font rien*" [Financial crisis: why governments do nothing], Seuil, 2013, p. 199.
4 In December 2017, the Basel Committee finally obtained minimal equity requirements, a move in the right direction that reduces bank leverage, even though the minimum level should in our opinion have been much higher.
5 "L'aveuglement au désastre. Le cas des crises financières" [Blind to Disaster: The Case of Financial Crises], interview with André Orléan, *Esprit,* March-April 2008, http://www.esprit.presse.fr/article/orlean-andre/l-aveuglement-au-desastre-le-cas-des-crises-financieres-entretien-14467

These trends have created two kinds of issues:

- while supervisory agencies (central banks and related authorities and agencies) are considered as independent from policy makers, they actually retain close links to the financial sector they are controlling, as evidenced by the dominance of individuals in executive roles at those agencies who have a background in the banking sector (see proposal C1 and section 3);
- the central banks have taken on new roles and responsibilities, meaning they can no longer be deemed neutral in terms of the economy. As underlined by many economists[6], including Thomas Piketty, Laurence Scialom and Michel Aglietta, the ECB has played a prominent role in the definition and introduction of economic policies in the EU and in eurozone countries since the 2008 crisis.

Because of the prominent role they now play in the economy and in policy, the independence of central banks from policymaking should at least be questioned, considering the interdependency between all actors of policy making (European institutions, governments and parliaments).

Free movement of capital

From the 1970s onwards, as mentioned in part 2, the restrictions to cross border capital flows were gradually removed. Unfortunately, in many economic areas, such as the EU, or on a global scale, this was not preceded by a convergence of tax, social or environmental norms, and this triggered massive offshoring in the industry and services sectors. In terms of the financial sector, it created tax havens where tax evasion and money laundering is much easier, and made it possible for hedge funds to speculate without limits and destabilise the global economy through speculative attacks on the currencies of countries[7].

Even institutions that actively favoured the liberalization of cross-border capital flows, such as the IMF[8], are starting to question its limitations as far as economic development is concerned, and the ability of countries to protect themselves against speculative attacks.

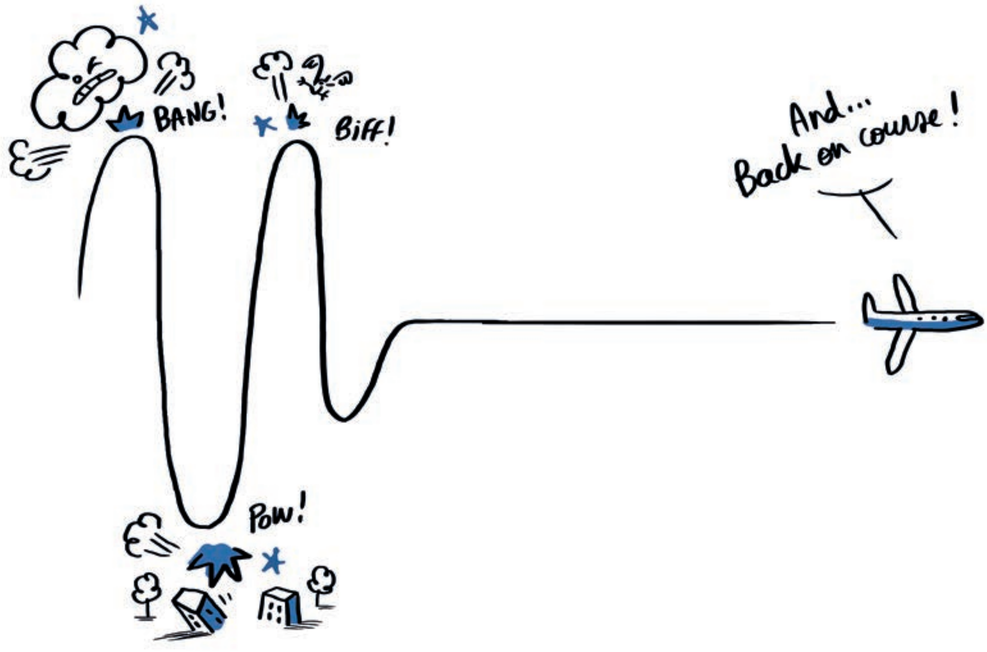
6 "*[The ECB] has acquired executive power via the troika (along with the European Commission and the IMF), which defines and ensures the execution of memoranda in countries being "helped"; it plays a central role in the Eurozone and Eurogroup summits which coordinate national economies; it has become the banking world's regulator, making life or death decisions affecting the largest banks in the Eurozone; it has established itself as a reformer, working with coalitions built on prioritising "structural reforms" (labour markets), "competitiveness" (restrictive salary policies), and so on.*", appeal in *Le Monde*, 22nd January 2018, "Démocratiser l'Europe, cela commence à la Banque centrale européenne" [Nominations for the ECB: There must be public debate on the renewal of the central bank], available at http://piketty.blog.lemonde.fr/2018/01/29/democratiser-leurope-cela-commence-a-la-bce/

7 See "La chasse aux dogmes" [The war on dogma], by Alain Grandjean: https://alaingrandjean.fr/2013/12/02/la-chasse-aux-dogmes/

8 "The Liberalization and Management of Capital Flows. An Institutional View", *IMF Staff paper*, 14th November 2012, https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/np/pp/eng/2012/_111412.ashx
See also http://www.brettonwoodsproject.org/2016/04/imf-reopening-case-for-capital-controls/

A. FIVE MEASURES TO STABILISE THE FINANCIAL SYSTEM

The first challenge posed by the current financial system is its stability, i.e. the need to protect the economy and societies from the excessive risks taken by the finance sector. As mentioned in this report (in particular part 3), even though some of the measures taken since the 2008 crisis are moving in the right direction, they remain insufficient.



Stabilising the financial system

Measure A1

RESTRICT BANKS TO DEPOSIT-TAKING, GRANTING CREDIT AND OPERATING PAYMENT SYSTEMS

This measure is about redefining the business of banks as solely the collection of deposits, the granting of credit, and the operation of payment systems. Banks would therefore no longer be allowed to buy or underwrite[3] financial securities (shares or bonds) or derivative products or commodities. Only banks, redefined in this way, would have access to central bank refinancing; investment banks, the prime movers in speculative trading and shadow banking operations, would be excluded.

SCOPE:

At least the G20 countries, comprising the EU and the 19 most advanced economies. The measure should be gradually adopted by all countries.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Adrian Blundell-Wignall, ex-advisor to the OECD on capital markets[4];
- the report from the High-Level Expert Group on reforming the structure of the EU banking sector, chaired by Erkki Liikanen[5];
- Finance Watch[6].

INTERMEDIATE STEP: RING-FENCE CAPITAL MARKET ACTIVITIES AND DRAW UP SEPARABILITY PLANS

This measure represents a major structural shift for the banking sector. In order to pave the way for this objective, measures ensuring separability and the independence of subsidiaries could be adopted on a temporary basis. This would consist of gradually streamlining investment banking activities and ring-fencing them into dedicated structures, which could not be financed via bank loans or by transfers between subsidiaries (particularly in the event of a crisis). This measure would be accompanied by a group subsidiary separability plan that could be enforced within 48 hours by each bank should a financial crisis occur[7].

This would constitute a first step, following which the status of bank would be granted exclusively to retail establishments. It would enable a move towards a more stable financial system, whilst also forcing banks to better understand and manage the potential risks incurred by their capital market activities. Managers would be better able to supervise all the activities of their subsidiaries and of their traders. In addition, to counter the existence of institutions deemed “too big to fail”, the

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3 Bonds are a way for banks to take on risk without increasing their capital. To protect the general interest from the risk inherent in banking activities, this measure must include not only straightforward financing, but also the risk incurred by the issuing of bonds.

4 See, for instance, Adrian Blundell-Wignall, Gert Wehinger and Patrick Slovik "The elephant in the room. The need to deal with what banks do", *OECD Journal: Financial Market Trends*, vol. 2009, issue 2, http://www.oecd.org/finance/financial-markets/44357464.pdf

5 See the high-level expert group report, *op. cit.*, http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf

6 See Finance Watch, "The importance of being separated", April 2013 https://www.finance-watch.org/wp-content/uploads/2018/08/The-importance-of-separation-8-April-2013.pdf

7 See "Preparing for a European Banking Union. Statement no. 37", European Shadow Financial Regulatory Committee, September 2013, http://www.esfrc.eu/sitebuildercontent/sitebuilderfiles/statement37.pdf
The proposal is also developed by Adrien Béranger and Laurence Scialom, "Banking Union: Mind the Gaps", International Economics, vol. 144, 2015, pp. 95-115.

measure would also effectively reduce the phenomenon known as "too big (and too complex) to manage".

Transferring the most risky activities to subsidiaries was the option adopted in German and French banking laws in 2012-2013, but in a very limited capacity. The European Directive's project to restructure the banks, launched in 2014, was the most ambitious, despite still not going far enough, but this process was abandoned by the European Commission after the 2014 elections.

Measure A2

ALLOW A MAXIMUM LEVERAGE RATIO OF 5 FOR BANKS

Banks' own funds (equity) should be at least 20% of their total balance sheets (today, systemic financial institutions hold on average 5% equity. See part 2).

SCOPE:
At least the G20 countries, comprising the EU and the 19 most advanced economies. The measure should be gradually adopted by all countries.

MEASURE SUPPORTED BY, AMONG OTHERS:
- Anat Admati and Martin Hellwig[8];
- Lord Adair Turner[9].

Measure A3

ALLOW A MAXIMUM LEVERAGE RATIO OF 5 FOR ALL INVESTMENT STRUCTURES, AND PREVENT BANKS FROM LENDING TO THEM

This group of actors includes investment banks, brokerages and financial intermediaries, investment funds (such as UCITS), private equity funds, and hedge funds. All such "investment structures" should retain minimum equity equal to 20% of their total balance sheet. That means they could borrow up to 80% of their balance sheet resources. Lenders could be capital markets, retail investors, corporates, and so on, but not banks. Banks themselves would be limited to lending

8 *The Bankers' New Clothes. What's Wrong with Banking and What to Do about It,* Princeton University Press, 2013; read the review of this work by Jézabel Couppey-Soubeyran, "Comment rhabiller la banque" [How to redress the bank], *La Vie des idées,* 16th September 2013, http://www.laviedesidees.fr/Comment-rhabiller-la-banque.html

9 *Between Debt and the Devil, op. cit.*

to other banks, individuals and corporates. If a non-financial corporate derived a major share of its income from activities on capital markets, it would be considered as an investment structure and could no longer borrow from banks.

SCOPE:

This measure could be initiated by the FSB and the BIS and gradually be implemented worldwide. It would require control and supervision of the currently unregulated so-called shadow banking system. It would also require the activity of corporates to be monitored; this could initially be limited to listed companies, to bring it under the control of the stock market regulators in each country (such as the AMF in France, for example).

MEASURE SUPPORTED BY, AMONG OTHERS:

- Jean-Michel Naulot[10].

Measure A4

REGISTER AND SUPERVISE SHADOW BANKING ACTIVITIES

The supervisory authorities of the banking and insurance businesses (in France, the ACPR and the AMF) should systematically register and supervise all shadow banking activities, and the Central Bank should be aware of the activities and risks incurred by those actors.

If the capital requirements of investment funds are to be controlled (measure A3), then these funds must be properly supervised. Firstly, this would involve mandatory registration, as is the case now for banks: in most countries, to be legally allowed to undertake banking activities, a bank must be registered with the Central Bank and must obtain a banking licence. Secondly, a dedicated regulatory body would have to be charged with overseeing investment fund activity, and ensuring the minimum leverage ratio (20% of the total balance sheet) is being held.

SCOPE:

This measure could be implemented by the FSB on a G20 initial perimeter, and then extended into national and other jurisdictions.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Lord Adair Turner[11]:
- Jean-Michel Naulot[12].

10 *"Éviter l'effondrement" [Preventing collapse], op. cit.*
11 *Between Debt and the Devil, op. cit.*
12 *"Éviter l'effondrement" [Preventing collapse], op. cit.*

Measure A5

TAX FINANCIAL TRANSACTIONS (FTT)

The tax base should be wide and the rate high enough to deter speculative trading.

This would require a tax on financial transactions (FTT) to be introduced. The rates for this tax must be adapted to each product. Studies to simulate these tax rates[13] resulted in the following recommendations: 0.1% for shares, 0.2% for all other products (bonds, currency, derivatives) and on orders cancelled by high-frequency traders (orders placed and then cancelled within a very short period of time in order to determine positions).

The FTT is designed to reduce the volume of speculative trade, and also to raise tax income quickly, which would help mitigate the effects of the losses and costs incurred due to speculative trading. The FTT is bound to be reduced and/or cancelled after a transition period, notably since its tax base will contract rapidly if the other measures envisaged make speculative trading less attractive for investors.

SCOPE:
This measure should be adopted by national parliaments, and could be promoted at supranational level (monetary or economic groups, financial bodies like the FSB)

MEASURE SUPPORTED BY, AMONG OTHERS:

- Several political and religious key figures such as Al Gore, Kofi Annan and Archbishop Desmond Tutu, as well as key corporate leaders, such as Bill Gates and Warren Buffet, and economists, such as Joseph Stiglitz and Lawrence Summers[14];
- this measure is also supported by many NGOs, such as the "Robin Hood tax" campaign (supported by Oxfam, and the French NGO ATTAC).

Impact of those measures on the financial sector

This group of measures is aimed at separating the world of financial speculation from general interest activities. Banks would no longer have the right to hold financial securities: shares, bonds, derivative products. It would signal a return to an earlier time when the banking profession was very strictly defined. Furthermore, it is necessary for bank shareholders to make a significant financial commitment (via the equity threshold) to avoid the temptation to offer bad credit, which has high returns but with a corresponding high level of risk, or to take on too much risk through managing payment methods. In this logic, all activities relating to financial securities and products would be ring-fenced into structures which would not have the status of bank[15].

13 See the Bill Gates report on the 2011 G20 summit, https://gfov2.gatesfoundation.org/What-We-Do/Global-Policy/G20-Report, and Stephen Spratt and Christina Ashford, "Climate Finance. A tool-kit for assessing climate mitigation and adaptation funding mechanisms", 2011, https://unfccc.int/files/cooperation_support/financial_mechanism/long-term_finance/application/pdf/climate_finance_and_the_financial_transaction_tax.pdf

14 The Center for Economic and Policy Research, based in Washington, has created a list of the very varied supporters behind the introduction of the FTT: http://cepr.net/documents/ftt-support.pdf

15 These structures would include three main categories: the "business banks", along the Lazard or Rothschild model, which engage in financial consultancy and mergers-acquisitions; brokerages and other financial intermediaries, such as broker dealers along the lines of Merrill Lynch, Bear Sterns or Lehman Brothers; and, lastly, all investment funds, from collective investment schemes (UCITS) to hedge funds and private equity funds.

This fragmentation of financial activities would enable risks to be segregated and contagion to be avoided. In addition, strict supervision and well-adapted regulation, which differs for each category of products, would allow avoidance of excessive levels of risk, linked in particular to undercapitalisation.

In the US, between 1933 and 1960, the Glass Steagall Act separated banks into two distinct categories, commercial banks and investment banks, but it was gradually repealed from 1960. In France too, banks were separated into three categories in 1945: nationalised deposit banks, investment banks and medium and long-term lending banks.

Following the logic of its first inventor, James Tobin, the financial transactions tax (FTT) would make tax income available for states to compensate for the fiscal cost of excessive or harmful speculation, even though the other proposed measures will significantly reduce the amount of speculative trade.

Impact of those measures for the general interest

This package of measures would achieve the following:

- **protecting deposit and credit activities, and the management of payment methods, all of which are in the public interest**, from the vagaries of financial speculation[16]. The 20% leverage ratio imposed on banks should be sufficient to **prevent bank failures requiring state bail-outs**. This would also serve to stabilise the investment fund sector as, with greater capital holdings, returns would be less variable;
- **drastically reducing the volume of speculation and its level of risk**. There is currently nothing to prevent a bank from lending to a fund to engage in speculative purchases of currency or commodity derivatives. Banks would no longer be authorised to take risks on this type of operation (protection of public interest activities). The volume of funding available for speculative activities (through excessively high debt taken on by investment funds) would therefore be drastically reduced[17]. **As a result, it would be easier to award investment to non-financial economic activities which serve the public interest**. Speculative bubbles financed by a credit boom (such as housing bubbles) would most likely be significantly reduced: shareholders would have a high level of financial commitment, and would therefore be less inclined to risk the loss that would follow the bubble bursting. As a result, risky lending to individuals who do not have the means to repay, such as the US subprime loans, would become less attractive. This type of lending is a major factor in increasing inequality and reversing social mobility (see section 4);
- **making speculative activities less attractive** thanks to the FTT which, in addition to the financial resources that it would give public authorities to invest in the general interest, is also, most importantly, a regulatory instrument: if a downturn

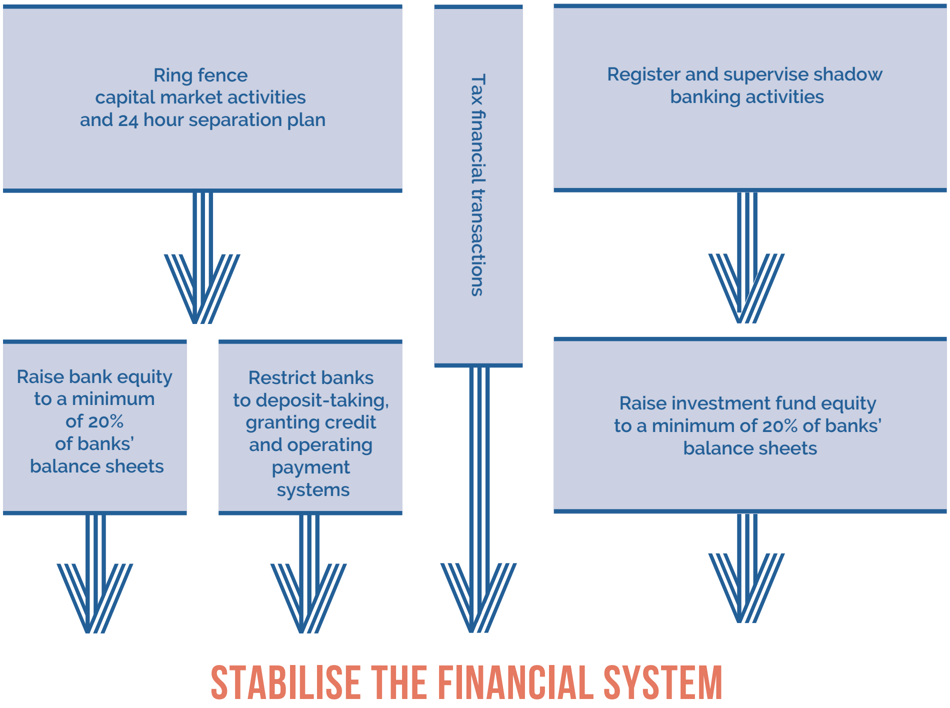
16 The moral hazard and "crime-inducing" bonuses would be dimmed.
17 Estimating precisely by how much is not easy: since hedge funds are not regulated, there are no reliable figures available.

in the financial sector costs the public interest more than forecast, then taxation is a way to compensate for its effects and reduce its impact;

- **decreasing the volatility of currency and commodity prices, which has an adverse effect on developing countries and their inhabitants** (see section 5). An additional level of security would be provided by preventing banks from lending to investment funds. Speculation would remain unfettered, but without recourse to bank finance;
- **bringing the "shadow banking system" into the light**. The central bank would have better control of how money is used, and would be able to better analyse the results of its monetary policy. Supervision would enable the regulator to have a **better understanding of investment practices, which could pave the way for subsequent regulation** if these practices prove detrimental to the public interest (commodities and currency speculation, adopting dominant positions in industrial sectors, etc.).

Those reforms will also entail a reduction in the size of systemic, "too big to fail" banks, which will make the banking sector much more diverse and permit the emergence and survival of local banks, based on cooperative and ethical business models, able to meet the demand of local small scale finance that is necessary for, among other things, the energy transition.

First pack of measures – Proposed sequencing in time



B. FIVE MEASURES TO DIRECT CREDIT TOWARD SOCIALLY USEFUL ACTIVITIES

The first raft of measures is designed to make the financial system more stable and speculative trading less attractive. However, to ensure the financial system is made to serve society, it must enable savings to be channelled towards the projects that this society needs. The history of the past 30 years has taught us that when deregulated, credit does not spontaneously flow towards the public interest, nor does it result in rational economic growth: it flows towards existing urban real estate and speculative financial activities, leaving many of the social needs unfunded. Public policy therefore needs to be able to direct credit towards socially beneficial activities.

Directing credits towards socially useful activities

Measure B1

USE RESERVE REQUIREMENTS TO FINE TUNE CREDIT ALLOCATION

This would consist in the central bank introducing compulsory minimum bank reserves, scaled based on the credit type. This tool is set out in the first section: these are sums which the banks would have to "immobilise", in the form of deposits paid to the central bank, as a percentage of the volume of their operations.

Reserve requirements are still in use in the Europe, at a rate of 1% for short-term deposits (less than two years). Nevertheless, since the eurozone was created, the central bank no longer actively controls the volume or destination of the credit[18]. Yet, controlling credit is a way to prevent prices rising and bubbles being created, which lead to economic crises when they burst, as has been the case in the real estate sector, for example. The proposal is to revive an instrument which already exists, scaled for each credit type (real estate, repairs, consumer credit, etc.).

SCOPE:

The level of reserve requirements is an economic policy decision, which should be made yearly by parliaments (or the economic area), according to the price and demand objectives for each sector. The central bank would be in charge of execution and supervision.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Lord Adair Turner[19];
- Jean-Paul Betbèze, Christian Bordes, Jézabel Couppey-Soubeyran and Dominique Plihon[20].

Measure B2

INCREASE THE RISK WEIGHTING FOR BANKS REAL ESTATE LENDING

The proposal consists in increasing, up to a level to be calibrated with regulators, the risk weightings in the Basel capital framework for real estate lending granted by banks on existing assets. This category of credit must be subject to special regulation because of the structural imbalance between supply and demand of real

18 The reserve rate requirement in the eurozone was lowered from 2% to 1% in 2012.
19 *Between Debt and the Devil, op. cit.*
20 Jean-Paul Betbèze, Christian Bordes, Jézabel Couppey-Soubeyran and Dominique Plihon, "Banques centrales et stabilité financière" "[Central banks and financial stability], Conseil d'analyse économique (economic analysis committee), report no. 96, 2011, http://www.cae-eco.fr/IMG/pdf/096.pdf

estate in large cities, and, as a rule, across the globe. The global impacts on society of the high cost of housing[21], or the risk it poses of creating a housing crisis, are not taken into account when calculating the capital requirements currently used by banks. Only the individual credit risks (asset quality and borrower solvency) are taken into consideration.

The purpose is obviously not to restrict access to housing (see section 4), in particular for lower income people, but to take into account the fact that, globally, too much lending in the real estate sector causes financial instability and a risk of speculative bubbles. Access to housing for all must be a key issue of public policy, and must involve ambitious action, notably in terms of urban planning, land use and credit access for lower income households, as well as the development of affordable rental stock for the poorest households.

SCOPE:

The measure should be promoted by the BIS and then be calibrated by national regulators (Central Banks and governments), depending on the amounts of credit outstanding by category.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Lord Adair Turner[22].

Measure B3

INCLUDE BROWN PENALISING / GREEN SUPPORTING FACTORS IN RISK WEIGHTS FOR BANK LENDING

Without changing the methodology for calculating the Basel capital requirements[23], we propose adding a brown penalising / green supporting factor to the risk weighting, based on the environmental impact of the funded projects or activities. An activity with high emissions would get penalised via its risk weighting: banks would therefore be reluctant to finance it. Conversely, a project based on energy efficiency or renewable energy would receive a reduced weighting. Rather than just greenhouse gas emissions, other environmental and social criteria could be taken into account, such as the contribution to biodiversity for instance, as soon as a methodology could be approved by the regulator to enable this.[24]

SCOPE:

The measure should be promoted by the BIS and the Basel Committee and implemented by all countries:

21 As mentioned in part 4, easy access to real estate credit is a key determinant of the rapid increase in asset prices.
22 *Between Debt and the Devil, op. cit.*
23 But whilst increasing the credit risk weighting (*see* point A.2).
24 This methodology should not weaken banks' overall capital strength (see Measure A2).

MEASURE SUPPORTED BY, AMONG OTHERS: Abdeldjellil Bouzidi, Alain Grandjean and Mireille Martini[25].

INTERMEDIATE STEP: IMPLEMENT A BROWN PENALISING FACTOR TO PROJECTS INVOLVING THE MINING AND USE OF FOSSIL FUELS

To avoid the risks of *greenwashing*, and as we wait for a rigorous and ambitious methodology for appraising and classifying "green" projects, the most urgently required measure could well be to impose a "brown" penalty on projects involving the mining or use of fossil fuels. As it stands, the current mechanism allows projects to be qualified as "green" on a voluntary and declarative basis, as no robust methods governing accountability or classification have been defined. The experience of green bonds is a reminder of the potential pitfalls of such incentives, as the relevance and effectiveness of these on actual green transition projects remains difficult to measure[26].

Measure B4

ENSURE THAT ANY CARBON PRICE SIGNAL IS SET AT A SUFFICIENT LEVEL TO REACH THE OBJECTIVES OF THE PARIS AGREEMENT

In order to keep the global temperature rise below + 2 °C, and to keep the +1,5 °C within reach, greenhouse gas emissions need to be decreased as rapidly as possible to reach zero net emissions by the end of the century. This requires a very quick, very drastic reduction in emissions, first and foremost in the countries which historically bear the highest share of responsibility for climate change. A carbon price signal can provide the right incentive, as it influences both the economic decisions of investors and consumer behaviour. If emitting CO2 is made sufficiently expensive, and if ambitious, long-term climate change policies are implemented, investors will be incentivised to switch to solutions which end reliance on fossil fuels: energy efficiency and economy, switch to renewables.

It is possible to put a price on CO_2 emissions through taxation or by introducing a market to trade emissions quotas[27]; this would also signal an end to policies which conflict with high carbon prices, such as fossil fuel subsidies[28], tax exemptions for high-emissions sectors, free allocations of quotas, or even the practice of carbon

25 "Régulation financière et urgence climatique, Pour des normes prudentielles et comptables plus vertes" [Financial regulation and the climate crisis: towards greener prudential and accounting standards], Terra Nova, June 2017, http://tnova.fr/system/contents/files/000/001/406/original/06062017_-_R_gulation_financi_re_et_urgence_climatique.pdf?1496734990

26 See the note from Secours Catholique – Caritas France, "Mettre la finance au service de la transition énergétique" [Making finance serve the energy transition], November 2017, http://caritasclimat.fr/2017/11/mettre-la-finance-au-service-de-la-transition-energetique/

27 We must highlight the fact that the efficiency and feasibility, and the human and social impacts, of the various carbon pricing tools should not be underestimated. A global approach to climate change policies must be considered when choosing these instruments: an effective reduction of emissions, environmental integrity, respect for human rights and fairness…

28 The G20 countries and the major multilateral development banks have spent, on average, 72 billion dollars of public funding on fossil fuels between 2013 and 2015 (compared to 20 billion dollars on renewable energies). See "Talk is cheap. How G20 governments are financing climate disaster", http://priceofoil.org/content/uploads/2017/07/talk_is_cheap_G20_report_July2017.pdf

offsetting[29]. Only 25% of global greenhouse gas emissions are integrated into carbon pricing measures, and the majority at a price of less than €10 per tonne of CO_2[30]. The High-Level Commission on Carbon Prices, which met in the summer of 2016, recommended **a minimum price of 40 to 80 dollars per tonne of CO_2 until 2020 and 50 to 100 dollars per tonne up to 2030** to ensure the 2 °C goal can be met[31].

It is important to remember that the issue of pricing alone is not sufficient; approaches based on pricing must be accompanied by complementary measures if they are to be effective and fair (for instance, ending the fossil fuel subsidies, channelling tax revenue to fund a fair transition, climate financing, resolving energy insecurity, and so on). Carbon pricing is not intended to be a one-stop solution to fighting climate change; it should be part of a broader set of measures combining ambitious environmental mitigation and adaptation strategies. The diversity of the policy tools used is essential to ensuring the success of the transition, in particular for those sectors and types of emissions where carbon-pricing instruments are not so effective, such as land use.

SCOPE:

National or regional. Countries and regions that have already implemented carbon-pricing tools[32] should review their policies to adopt an ambitious price in line with climate goals, ensuring they safeguard environmental integrity and make a contribution to a fair green transition.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Joseph Stiglitz, Lord Nicholas Stern[33];
- Pascal Canfin, Alain Grandjean and Gérard Mestrallet[34].

Measure B5

PROMOTE DIVERSITY OF BANK BUSINESS MODELS

This is about creating local banking networks, at regional, departmental or city level, and making mid- to long-term credit available to local businesses. These local banks would support the introduction and development of alternative business models around the following dimensions: cooperative/mutualist ownership, ethics and ESG (Environmental, Social and Governance) dimensions, offering retail

29 As concerns carbon pricing measures, see the Carbon Market Watch policy briefing, "Pricing carbon to achieve the Paris goals", September 2017, https://carbonmarketwatch.org/wp/wp-content/uploads/2017/09/CMW-PRICING-CARBON-TO-ACHIEVE-THE-PARIS-GOALS_Web_spread_FINAL.pdf
30 Clément Metivier, Sébastien Postic, Emilie Alberola, "Landscape of carbon prices in 2017", IFCE, 2017, https://www.i4ce.org/download/global-panorama-of-carbon-prices-in-2017/
31 See the executive summary of the High-Level Commission on Carbon Prices, known as the Stern Stiglitz Commission, p. 5, https://static1.squarespace.com/static/54ff9c5ce4b0a53decccfb4c/t/5949402936e5d3af64b94bab/1497972781902/ENGLISH+EX+SUM+CarbonPricing.pdf
32 Carbon market watch, *op. cit*., chart no. 1, "2017 national and regional carbon pricing measures", p. 4.
33 "Report of the High-Level Commission on Carbon Prices", 2017, https://www.carbonpricingleadership.org/s/CarbonPricing_EnglishSummary.pdf
34 Task force report on carbon pricing, "Propositions pour des prix du carbone alignés avec l'Accord de Paris" [Proposal for carbon prices that concord with the Paris Agreement], July 2016, http://www.carbone4.com/wp-content/uploads/2016/08/Rapport_mission_12_juillet_19h10-bis.pdf

customers the option to invest their savings in local projects meeting these criteria. The analysis will be fine-tuned for each country due to their different banking systems.

SCOPE:
The creation of new categories of banks depends on national legislation; Central banks are involved in their supervision, and the way in which they access finance.

MEASURE SUPPORTED BY, AMONG OTHERS:
- the Global Alliance for Banking on Values network promoting ethical banking, Finance Watch and the Mission 2020 initiative launched by Christiana Figueres[35].

Impact of those measures on the financial sector

Those measures would mean that Central Banks in each country regain an active driving role in the economy, by using the existing but dormant reserve requirement policy tool. They would fine tune credit volumes to certain categories of borrowers on policy grounds, making credit more accessible in certain cases and conversely slowing down credit growth when it threatens to create asset price bubbles (see part 1).

Impact of those measures for the general interest

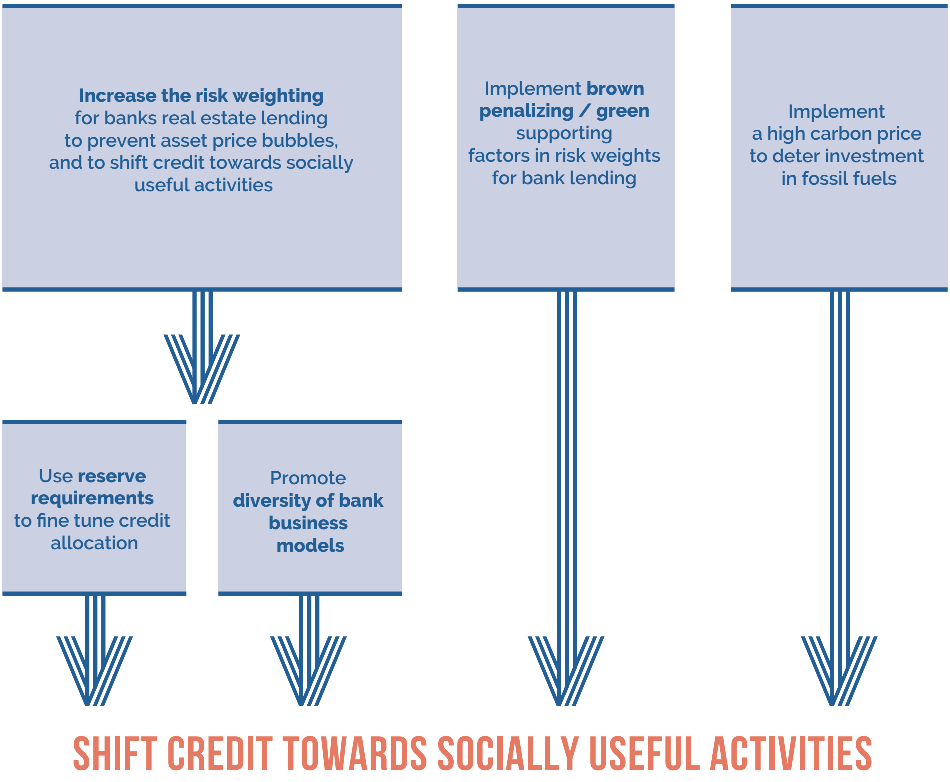
These measures would be used to rebalance lending to benefit the public interest, rather than leaving the private banking sector to award credit based solely on its own interests. As concerns real estate lending, a double-pronged action on reserve requirements and the capital requirements would stimulate a drop in existing asset prices and encourage new constructions, which would promote access to housing in neglected areas. The introduction of green criteria and climate change policies in line with the Paris Agreement would enable the economy to focus on the energy and green transition.

Furthermore, these measures could also be instrumental in creating an economic policy which allows credit to be channelled towards the public interest.

Lastly, the diversification of banking models will promote the emergence of small- and medium-sized mutualist and cooperative banks, and remove the glass ceiling they currently face. These banks would be better able to meet local funding needs, such as investment in the circular economy and energy transition. This would also meet the expectations of socially committed savers, hoping to invest in projects which are managed in a more inclusive way, with more transparency and accountability.

35 "New pathways: Building blocks for a sustainable finance future for Europe", October 2017, http://www.gabv.org/wp-content/uploads/New-Pathways-Building-Blocks-for-a-sustainable-finance-future-for-Europe-GABV-Finance-Watch-M2020.pdf

Second pack of measures – Proposed sequencing in time



C. TWO MEASURES TO MAKE THE GENERAL INTEREST DRIVE THE FINANCIAL SECTOR

Once the financial sector is stabilised (first group of measures) and better geared towards the general interest (second group of measures), it will be necessary to ensure through adequate supervision that the measures are indeed implemented.

Le pilotage de la finance au service des collectivités.

Measure c1

REVIEW THE COMPOSITION AND ACCOUNTABILITY OF THE BOARDS OF FINANCIAL REGULATORS AND SUPERVISORS

Composition

At least half of the members of the executive bodies of financial supervisors should have spent the greater part of their career outside of the financial sector. They must be selected so that they represent the many different stakeholders within a society: representatives of consumers, trade unions and employers' associations, administration, financial specialists from the community who are also committed to public interest issues (climate, inequality and poverty, etc.), academic experts with no links to the financial sector… It should not be possible for any member of these organisations to take up a position within the financial sector within five years of having been employed by a regulator in a management role, nor to be employed by a regulator in a management role less than five years after working in the financial sector.

Accountability

The accountability to national parliaments (and supranational instances, such as the European Parliament) of financial regulators should be reinforced through multi-year presentations by financial regulators, where they would submit their roadmap for the next period for a parliamentary vote. The board composition of such bodies must be proposed and approved by parliament.

SCOPE:

All financial regulatory and supervisory bodies and governments.

THE MEASURE IS INSPIRED BY (NOTABLY FOR THE EUROZONE):

- research commissioned by the European Parliament on the relationship between the ECB and the European Parliament[36];
- Transparency International's recommendations on the ECB's independence and accountability[37];
- Thomas Piketty, Laurence Scialom and Michel Aglietta and several other researchers on the need to democratise the ECB[38].

36 European parliament, "Monetary Dialogue 2009-2014: Looking Backward, Looking Forward", March 2014, http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/518753/IPOL_IDA(2014)518753_EN.pdf

37 Leo Hoffmann-Axthelm, "Two sides of the same coin? Independence and accountability of the European Central Bank", Transparency International EU, March 2017, https://transparency.eu/wp-content/uploads/2017/03/TI-EU_ECB_Report_DIGITAL.pdf

38 "Democratising Europe begins with ECB nominations", *Le Monde,* 22nd January 2018, collective op-ed available on http://piketty.blog.lemonde.fr/2018/01/29/democratising-europe-begins-with-ecb-nominations/

Measure c2

CREATE A WORLDWIDE FINANCE REGULATORY BODY INVOLVING THE WHOLE INTERNATIONAL COMMUNITY

The idea is to put in place a multilateral political body in charge of controlling and supervising financial systems to give every country a say in the making and adoption of finance legislation. This body would be best placed within the UN system, at a sufficiently high level of policy making. Though not faultless, the intragovernmental organisation seems to have the most legitimate claim to host this new body, since it represents all countries in the world.

MEASURE INSPIRED BY:

- Joseph Stiglitz, Youssef Boutros-Ghali and the members of the Commission of Experts on Reforms of the International Monetary and Financial System, set up by the President of the UN General Assembly in 2009 in the wake of the 2007-2008 financial crisis[39]

Impact of those measures

This set of measures would better enable general interest issues to be taken into account. As the financial sector is a sector which serves the economy and society, supervising and guiding its activities must involve stakeholders outside of the world of finance alone. As a rule, the creation, by the banks, of money, credit and purchasing power is one of the core determinants of economic activity. The principal lesson of the last thirty years is that, left to their own devices, banks and financial markets will not favour a fair and equitable distribution of wealth; they will always tend to act in the interest of financial stakeholders. Democratic representation must exert active control on finance and monitor financial regulations, and their economic results, very closely.

Furthermore, international financial regulations are created and imposed by institutions made up of only the most developed countries: the FSB, under the umbrella of G20, and the BIS. And the rules which are discussed here, and then promoted as national and/or regional legislation, very often affect every single country on the planet.

While we can, of course, understand that it is harder to make decisions when a greater number of participants are involved, current mechanisms undermine the legitimacy, in the medium term, of the rules adopted and, for this reason, make their

39 "Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System", United Nations, September 2009, https://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf
See also the brief account of the press conference held by Joseph Stiglitz to coincide with the publication of this report, https://www.un.org/press/en/2009/090910_Finance.doc.htm

adoption by countries which had no say in their creation much more problematic. By opening up participation to countries which do not host major financial institutions but which are affected by the actions of financial stakeholders, the supervisory institutions could adopt the rules accepted and shared by the majority, which would provide a better guarantee of both their effectiveness, and their appropriation in the medium term. The sustainability and legitimacy of common rules could justify a longer period of consultation and decision-making.

By keeping these issues corralled within non-inclusive bodies, the wealthiest countries are also running the risk of seeing other countries set up financial organisations to create their own financial, commercial and tax rules, whereas the major challenges that our planet faces require that we work together to achieve a consensus and strive for universal goals. This creates disparities between different areas of the planet, where the economic and financial stakeholders may suffer (or profit, as is already the case with tax havens), to the detriment of the inhabitants.

Third pack of measures – Proposed sequencing in time

Create a space for worldwide supervision of financial activities including all countries

Review the composition and accountability of the boards of financial regulators and supervisors

REGULATE FINANCE TO MAKE IT SERVE THE PUBLIC INTEREST

D. TWO MEASURES TO USE MONETARY AND FISCAL STIMULUS FOR ECONOMIC RECOVERY

The roadmap would not be complete if we did not tackle two of the main problems with the current situation: generalised overindebtedness, and the permanent threat to currency caused by the generalised opening of borders to capital flows. The solutions proposed here will require monetary and fiscal tools. It is important to mention these in this report, to show that solutions exist. In fact, all the above measures will be more effective if they are preceded by initiatives designed to promote recovery.

Although the option of making full use of monetary instruments would require major structural changes to institutions, particularly within the eurozone, it is, however, possible to envisage solutions within the framework of current laws (as has been the case in recent years for quantitative easing policies). Such measures must be the subject of calm, open discussions. This is all the more necessary given the deadlock, perhaps impasse, in which the European monetary authorities currently find themselves.

Measure D1

ALLOWING CENTRAL BANKS TO FUND A FISCAL STIMULUS

Authorise central banks, ideally including the ECB, to finance states. This measure could take many forms. Central banks could lend money to states. They could also purchase some of the existing state debt, as the Bank of Japan is doing. They could also lend to government funding agencies, or give money to impoverished or overindebted households.

SCOPE:
Eurozone

MEASURE SUPPORTED BY, AMONG OTHERS:
- Lord Adair Turner[40];
- Alain Grandjean and Mireille Martini[41];
- Positive Money[42].

Measure D2

TAX INCOMING AND OUTGOING CAPITAL FLOWS

It consists of studying the feasibility of taxing capital movements, to reduce the negative effects these uncontrolled capital flows have on economies: on the one hand, the loss of tax income resulting from tax avoidance; on the other, the instability linked to speculation, particularly currency trading; lastly, the threat posed to economies by the risk of outflow of certain types of capital. In addition to the financial transaction tax (FTT) explained above, additional efforts are required to give governments a higher degree of sovereignty on capital flows. This issue is already up for debate in several international bodies such as the BIS, the OECD and the IMF[43]. It remains quite difficult to accurately calibrate this measure, as the borders, both within the EU and between the EU and other countries, are largely open, and any such measure could have immediate adverse effects. We are raising the issue as a reminder of the general principle of a return to tax sovereignty, and as a call to back, in principle, any actions undertaken by civil society organisations designed to promote it.

40 *Between Debt and the Devil, op. cit.* This work highlights the potential risks of these measures, but argues that these could be managed.
41 *"Financer la transition énergétique" [Financing the energy transition],* Éditions de l'Atelier, 2016.
42 Frank van Lerven "Recovery in the Eurozone - Using Money Creation to Stimulate the Real Economy", Positive Money, 2015, http://positivemoney.org/wp-content/uploads/2015/12/Recovery-in-the-Eurozone-FINAL-WEB-READY-2015-12-11.pdf
43 See, for instance, Jonathan D. Ostry, Prakash Loungani and Davide Furceri, "Neoliberalism: Oversold?", *Finance & Development*, June 2016, https://www.imf.org/external/pubs/ft/fandd/2016/06/pdf/ostry.pdf

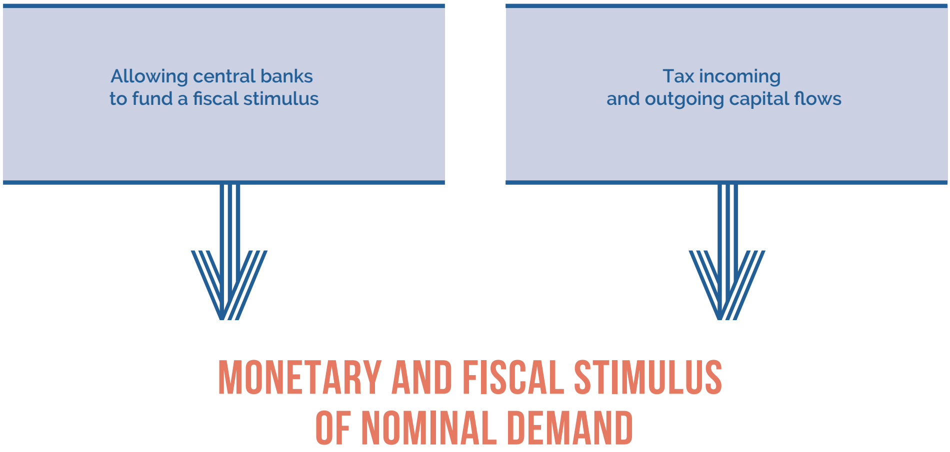
SCOPE:

Each government. An international or regional initiative could facilitate implementation of the measure.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Joseph Stiglitz, Youssef Boutros-Ghali and the members of the Commission of Experts on Reforms of the International Monetary and Financial System, set up by the President of the UN General Assembly in 2009 in the wake of the 2007-2008 financial crisis[44];
- Rawi Abdelal, professor at Harvard Business School[45].

Fourth pack of measures – Proposed sequencing in time



44 Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, *op. cit.*

45 "*Capital Rules: The Construction of Global Finance*", Cambridge, Harvard University Press, 2007.

AFTERWORD

FINANCIAL REGULATION: OUTLINING A REALISTIC PATH

For a longer version of this afterword (in frenh), go to lafinanceauxcitoyens.org

For many, the world has become too complicated, the uncertainty too great, and the changes affecting it too quick for decisions taken about it to remain sound. Any proactive political approach would lean towards barriers, the scope of our understanding of humanity being reduced to managing an ongoing crisis.

Complexity is not inevitable

In fact, the complexity, acceleration and uncertainty that plague our human relations are essentially a social construct. Yet, this climate we have constructed, which is today feeding a confusion which benefits the very few to the detriment of whole societies, *can* be deconstructed and rebuilt anew.

The complexity of our economies is nothing compared with that of, say, weather systems. These are chaotic, and impervious to our will. When it comes to our economies, however, it is largely the machinations of financial markets that have made them impossible to read. So, it is up to us to reform the institutional sources of "noise" that render them indecipherable.

But where to start? Bank separation

As recently stated by the French President, Emmanuel Macron: "*Together, we have redefined global governance of financial regulation, in large part after the crisis that occurred a decade ago. Yet, we have not managed to get to the* heart of the problems that *led us to this crisis. Many of the excesses of capitalism responsible for the 2008-2010 crisis are still there, whilst we have become increasingly complacent about regulation. […] We need to resume the fight for financial regulation*"[1]. This is what our report attempts to tackle, giving an ordered list of realistic reforms.

1 Keynote speech at the High Level Conference on Sustainable Finance in Brussels, 22nd March 2018. http://www.elysee.fr/declarations/article/transcription-discours-du-president-de-la-republique-a-la-conference-sur-la-finance-durable-bruxelles/, consulted on 5th June 2018.

The report proposes starting with the separation of investment banking activities from those relating to deposits and credit[2]. This measure is crucial as it protects citizens' savings and significantly limits the possibility of regulatory capture currently benefiting the systemically important mixed banking groups deemed "too big to fail"[3]. Without it, no other large-scale reform could possibly take place[4].

Who has the right to create money?

The Central European Bank is not the only body with authority to create money; all private banks generate money out of thin air every time they grant a loan. As already expressed with great impact by Pope Pius XI in his 1931 encyclical *Quadragesimo Anno*, this power is analogous to controlling the heart that beats and pumps the life-blood, without which none of us can live.

The report proposes that the recommendations of the 2012 Liikanen report[5] are applied, barring access to central bank refinancing for those financial institutions that continue to undertake investment activities. As a result, they would no longer have bank status. Withdrawing this status from establishments that undertake investment activities would strip them of their power to inject money into financial markets for the purpose of operations which have not been proven to benefit society.

This report is devoted to resuming the fight for financial regulation.

Investment activities would be carried out by the shadow banking sector. But, naturally, reform would only make sense were it to be accompanied by stricter regulation of the non-banking financial sector (proposal A.4).

This does not preclude speculative activities per se: savers are free to gamble their money on the stock exchange. But they would no longer have the right to indulge in this type of gamble whilst inflating the stock of money in circulation to dangerous levels.

While the banks could be separated tomorrow, at national level, removing bank status from investment activities is a longer term affair, and would have to involve European institutions since this is currently the level at which the allocation of banking licenses is decided.

Leverage ratios

Proposal A.2 in the report consists of a requirement for a ratio between the bank's equity capital and its total balance sheet of at least 20%. This ratio currently stands at around 3% for most banks, which renders them dangerously undercapitalised. This proposal is not new[6] and it must be accompanied by the introduction of an equivalent leverage ratio for the shadow banking sector (Proposal A.3).

2 Gaël Giraud, "Le projet de loi de séparation bancaire français est-il suffisant ?" [Does the proposed French banking separation law go far enough?], 2013, *Revue Banque* no. 758.
3 Why? Because most European states would be incapable of honouring the public guarantee of deposit accounts were a systemically important bank to fail.
4 In particular, no substantial steps could be taken to govern derivative financial assets, Gaël Giraud and Cécile Renouard, *"Vingt Propositions pour réformer le capitalisme"* [Twenty proposals for reforming capitalism], Flammarion, 2009 (3rd edition, 2012), Proposal 9.
5 Gaël Giraud and Laurence Scialom "Pour une réforme bancaire plus ambitieuse: Vous avez dit Liikanen? Chiche!" [Towards a more ambitious banking reform: Did someone say Liikanen? We dare you!], 28th February 2013, Terra Nova.
6 Gaël Giraud and Cécile Renouard, *op. cit.,* Proposal 10.

To slow down the rate at which financial bubbles inflate, the report recommends introducing a financial transaction tax (A.5). This may come as a surprise. Is it really the role of Secours Catholique to simply reiterate a recommendation such as the Tobin tax? This measure was also recommended by the Pontifical Council for Justice and Peace[7] and the Vatican document *Oeconomicae et pecuniariae quaestiones*[8].

Increase the cost of carbon

Revising the risk-based capital requirements also provides a lever for meeting the most important challenge that humanity as a whole must face: climate disruption and the collapse of biodiversity. On this issue, the report rightly suggests (B3) the use of weightings applied to the capital requirements associated with loans, based on the latter's "colour": if it is "green", the capital requirement will be relaxed to make it less penalising for the bank to offer credit. Conversely, if it is "brown", the capital cost will be increased. The *green supporting factor* must be accompanied by a *brown penalising factor*, since the only way to ensure a reduction in greenhouse gas emissions is to drastically *reduce* our current emissions.

Addressing the challenges of climate disruption and the collapse of biodiversity which affect all aspects of life.

The introduction of *green supporting / brown penalising factors* is part of a set of proposals currently being debated which also includes the implementation of a global carbon tax (B.4)[9]. The latter must be more ambitious than the levels currently being discussed, and achieved through laws and standards.

Direct the flow of credit

Other ways of modulating capital requirements could be introduced. The report proposes a modulation of the reserve requirements (B.1) that the banks must meet. In the eurozone, this type of measure would be much more effective if we put an end to the myth that the Central Bank is an independent entity. The independence of monetary policy from budgetary policies would only make sense if currency was neutral – something that the facts contradict. This is why it is perfectly legitimate to ask the Central Bank to finance budgetary policies itself, in conjunction with the responsible governments (D.1).

Taken together, proposals B.1, B.2 and B.3 urge a move towards "directed credit", as this expression used to be understood until the end of the 1960s. To this proposal, critics often reply that directing credit would violate the sacrosanct principle of free competition. Yet, there are not three mutually exclusive sets of needs: social issues, industry, and the environment. The climate and biodiversity are all-encompassing challenges that affect *every* aspect of our lives and our societies. Furthermore,

7 "*Towards reforming the international financial and monetary systems in the context of global public authority*" (24th October 2011) http://www.vatican.va/roman_curia/pontifical_councils/justpeace/documents/rc_pc_justpeace_doc_20111024_nota_en.html. See also the Social Justice and Ecology Secretariat of the General Curia of the Society of Jesus (Rome), "*Justice in the Global Economy - Building Sustainable and Inclusive Communities*", Promotio Iustitiae, no. 121, 2016/1, http://www.sjweb.info/documents/sjs/pj/docs_pdf/PJ_121_ENG.pdf and Gaël Giraud, "La Finance est-elle éthique?" [Is Finance ethical?], in *Conférences de Carême à Notre-Dame de Paris*, Ed. Parole et Silence, 2012, "The Church against the excesses of capitalism" *Revista de Fomento Social,* 339, 2014, no. 275 (69).

8 Jointly published on 6th January 2018 by the Congregation for the Doctrine of the Faith and the Dicastery For Promoting Integral Human Development, http://www.vatican.va/roman_curia/congregations/cfaith/documents/rc_con_cfaith_doc_20180106_oeconomicae-et-pecuniariae_en.html

9 Gaël Giraud "Taxe carbone, un impératif pour éviter le désastre" [Carbon tax: the key to avoiding disaster] *Revue Banque,* 27th September 2017.

refusing to direct bank credit towards the public interest in the name of respecting an illusory "perfect competition" is actually analogous to refusing to operate to save a patient suffering a heart attack on the grounds that, according to the theory of perpetual motion, the perfect heart would never stop beating.

Finally, the last proposal (D.2) in the report consists of taxing capital flows. Here, we are entering a taboo area of public debate, deafened by the denunciations of protectionism which are made on a regular basis[10]. Yet, even David Ricardo recognised that, with free movement of capital, the virtues of comparative advantages collapse: quite simply, opening up borders benefits those countries that enjoy absolute industrial advantages as capital will flow towards them (until a better investment opportunity presents itself, of course). Southeast Asian countries understand this well. Ever since the terrible financial crisis of 1997-1998, they have been accumulating foreign exchange reserves, to the detriment of the rest of the planet. Their attitude is nothing if not prudent: experience has taught them that the free movement of capital can be fatal to a whole country.

Rawi Abdelal has written the utopian history of an international law that is entirely subordinate to the free movement of capital[11]. This utopia would be short-lived; experience has shown that capital movement provides no guarantee against war, or the most serious reversal of social mobility and policies. Stopping short of throwing out the Enlightened ideal of an international law capable of intelligently governing relations between Nation States[12], the spirit of Philadelphia[13] has reformulated the best of the legacy of the Age of Reason, this distant offspring of the biblical experience of Wisdom[14].

It is up to us to show we are worthy of such a legacy. This report outlines the path to follow.

Gaël Giraud, Jesuit, senior researcher at CNRS (French national centre for scientific research), Chief Economist at Agence Française de Développement (French Development Agency), director of the Chair Energy and Prosperity, Professor at the Ecole Nationale des Ponts Paris Tech', member of the Scientific Committee at the financial regulation centre of excellence (Labex REFI).

10 Gaël Giraud, "L'épouvantail du protectionnisme" [The spectre of protectionism], *Projet* 1/2011 (n° 320), p. 80-89; "Plaidoyer pour un protectionnisme européen" [A plea for European protectionism], *Projet* 2/2011 (n° 321), pp.79-87. See also Gaël Giraud and Cécile Renouard, *op. cit.,* Proposal 18.

11 Rawi Abdelal, "*Capital Rules, The Construction of Global Finance*" Harvard University Press, 2009.

12 Gaël Giraud, "Régulation mondiale, un rôle pour le FMI" [Global regulation - a job for the IMF], *Projet* 1/2009 (n° 308), p. 74-80.

13 Alain Supiot, *The Spirit of Philadelphia: Social Justice Vs. the Total Market*" Verso, 2012.

14 The key challenge is to put an end to the global trend towards privatisation, something that contemporary post-liberalism is trying to lock our societies into, see Gaël Giraud, "Le capitalisme financiarisé et la transition écologique. De la société de propriétaires' vers une société des communs' ?" [Financialised capitalism and the green transition: from an ownership society to a community-based society?] *Gregorianum*, Pontificia Universitas Gregoriana, 2013 - 94/4.

APPENDICES

LIST OF DEVELOPED, EMERGING, DEVELOPING AND LEAST DEVELOPED COUNTRIES

There is currently no shared set of criteria that all stakeholders use to govern the scale that differentiates developed countries, emerging countries, developing countries and the least developed countries, with the exception of basic income level (GDP per capita), which many agree is an insufficient marker. The classification criteria change according to the stakeholder and the focus of the analysis. The main difficulty lies in identifying emerging countries.

This is why several established lists have been used to draw up the classification table given here, oriented towards the subject matter of this report, namely the place of finance in the global economy and its links to matters of public interest. The selected criteria are mainly economic: income level per capita (GDP per capita) as calculated by the World Bank[1], human development index (HDI) developed by the United Nations Development Programme (UNDP)[2], level of market maturity established by the FTSE index[3], economic growth (change in GDP between 2010 and 2016).

This classification does not include sparsely populated countries (less than 300,000 inhabitants) which do not have a significant impact on the global economy.

OUR PROPOSAL

First group: developed countries

The members of the **OECD and the EU are systematically included. Singapore and Hong Kong are also included in this category** as they are developed in terms of the FTSE index, demonstrating strong growth and, like the others, high levels of income and HDI. Some countries which have a GDP per capita classed as "Upper-middle income" by the World Bank (GDP per capita of between $3956 and $12,235) or which are not considered to be developed (D) by the FTSE index, are still included in this group if they are part of the European Union or the OECD.

1 "New country classifications by income level: 2017-2018", World Bank, https://blogs.worldbank.org/opendata/new-country-classifications-income-level-2017-2018

2 *Human Development Report 2016*, UNDP, 2017, http://www.undp.org/content/undp/en/home/librarypage/hdr/2016-human-development-report.html

3 The FTSE (Financial Times Stock Exchange) is a company that specialises in calculating and publishing financial indexes, maintained jointly by the London Stock Exchange and the *Financial Times*. It provides a classification of countries into four categories, based on criteria useful to companies: *developed* (D), advanced emerging (AE), *secondary emerging* (SE) and *frontier* (F). See http://www.ftse.com/products/downloads/FTSE_Country_Classification_Paper.pdf

Second group: emerging countries

This group contains countries which have a high level of wealth (upper-middle income) and countries with a lower level of income (lower-middle, between $1000 and $3956) but which are recognised by the FTSE index concerning the size and development of financial markets (AE, SE or F), and which have registered high economic growth in recent years.

It also includes Brunei, Bahrain, Kuwait and Oman, Qatar and Saudi Arabia, countries with economies largely dependent on oil, and which are also characterised by a high HDI, and Belize, the Bahamas, Mauritius, Panama and the Maldives, countries where activity is largely dependent on international finance (tax havens). Their level of income per capita is high, even though growth is not always a factor.

Third group: developing countries

This group includes countries with a level of income per capita identified by the World Bank as middle or low (less than $3955 but greater than $1000), and which, for the most part, do not meet the other wealth criteria (notably, a small share of the global GDP, not recognised by the FTSE index).

Sub-group of developing countries: least developed countries

within developing countries, there is a group of countries classified as least developed (LDCs). The UN regularly updates the list of LDCs[4] and uses three main criteria to define them:

- the *income per capita* (average estimation of the GDP per inhabitant over three years; if it is less than $992 US, the country is included for qualification as an LDC);
- the *human capital index*, founded on the criteria of nutrition, health, schooling and literacy;
- the *economic vulnerability index*, a composition of a number of indicators, including natural shocks, trade shocks, physical exposure to shocks, economic exposure to shocks, economic smallness and economic remoteness.

4 See the website of the United Nations Department of Economic and Social Affairs, https://www.un.org/development/desa/dpad/least-developed-country-category.html

LISTE DES PAYS DÉVELOPPÉS

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
ICELAND		High	0.921	23%		44,250	48,614	NC	330
MALTA	F	High	0.856	33%		23,251	26,577	C	428
CYPRUS	F	High	0.856	-6%		28,527	28,325	NC	1161
LITHUANIA	F	High	0.848	23%		14,160	15,873	NC	2932
BULGARIA	F	Upper-middle	0.794	12%		7276	7929	NC	7177
ROMANIA	F	Upper-middle	0.802	18%		8985	10,081	NC	19,877
CROATIA	F	High	0.827	0%	0.07%	13,759	14,372	NC	4236
LUXEMBOURG	D	High	0.898	22%		106,299	111,001	C	567
ESTONIA	F	High	0.865	21%		16,658	17,853	NC	1315
LATVIA	F	High	0.83	21%		13,252	14,715	NC	1993
SLOVENIA	F	High	0.89	5%		23,402	24,357	NC	2075
NEW ZEALAND	D	High	0.915	18%	0.24%	35,292	36,842	C	4615
IRELAND	D	High	0.923	24%		53,747	66,787	C	4700
NORWAY	D	High	0.949	10%		88,643	89,818	C	5200
SLOVAKIA	F	High	0.845	17%		17,763	19,238	NC	5439
FINLAND	D	High	0.895	1%		45,932	45,709	C	5482
DENMARK	D	High	0.925	7%		59,090	60,268	C	5689
ISRAEL	D	High	0.899	-2%	0.42%	32,356	33,783	NC	8065
SWITZERLAND	D	High	0.939	9%	0.87%	75,164	75,726	C	8320
AUSTRIA	D	High	0.893	7%		47,592	47,704	C	8679
SWEDEN	D	High	0.913	14%		53,632	56,319	C	9764
HUNGARY	AE	High	0.836	12%		13,760	14,840	NC	9784
PORTUGAL	D	High	0.843	-3%		21,875	22,347	C	10,418
CZECH REPUBLIC	AE	High	0.878	11%		20,416	21,707	NC	10,604
GREECE	AE	High	0.866	-18%		23,470	22,736	C	11,218
BELGIUM	D	High	0.896	6%		44,618	45,308	C	11,288
NETHERLANDS	D	High	0.924	6%		50,760	52,111	C	16,938
CHILE	SE	High	0.847	23%		14,238	15,020	NC	17,763

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
AUSTRALIA	D	High	0.939	18%	1.59%	53,771	55,671	C	23,800
CANADA	D	High	0.92	13%	2.03%	49,199	50,232	C	35,950
POLAND	AE	High	0.855	19%		13,811	15,049	NC	38,265
SPAIN	D	High	0.884			30,126	31,450	C	46,398
SOUTH KOREA	D	High	0.901			23,753	25,459	NC	50,594
ITALY	D	High	0.887	5%		34,633	34,284	C	59,504
FRANCE	D	High	0.897	6%		41,380	42,013	C	64,457
UNITED KINGDOM	D	High	0.909			40,006	41,603	C	65,397
TURKEY	AE	Upper-middle	0.767	45%	1.10%	12,650	14,071	NC	78,271
GERMANY	D	High	0.926	10%		44,315	45,552	C	81,708
MEXICO	AE	Upper-middle	0.762	18%	1.40%	9397	9707	NC	125,891
JAPAN	D	High	0.903	17%	6.54%	45,961	47,608	C	127,975
USA	D	High	0.92	13%	24.58%	50,190	52,195	C	319,929
SINGAPORE	D	High	0.925	25%	0.39%	50,223	52,601	C	5535
HONG KONG	D	High	0.917	18%	0.42%	34,863	36,726	C	7246

PAYS ÉMERGENTS

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
TAIWAN	AE	High	0.868	-	-		-	NC	23,486
BRUNEI DARUSSALAM		High	0.865	-3%	0.30%	34,184	31,431	C	418
QATAR	SE	High	0.856	36%	0.20%	69,124	66,415	NC	2482
SAUDI ARABIA		High	0.847	31%	0.86%	20,855	21,395	C	31,557
UNITED ARAB EMIRATES	SE	High	0.84	17%	0.46%	37,876	40,864	C	9154
ARGENTINA	F	Upper-middle	0.827	5%	0.72%	10,468	10,149	NC	43,418
BAHRAIN	F	High	0.824	8%	0.04%	21,464	22,436	C	1372
MONTENEGRO		Upper-middle	0.807	1%	0.01%	6997	7455	NC	628
RUSSIA	SE	Upper-middle	0.804	7%	1.70%	11,235	11,099	NC	143,888
KUWAIT	SE	High	0.8	-1%	0.00%	37,926	35,490	C	3936
BELARUS		Upper-middle	0.796	3%	0.06%	6392	6219	NC	9486
OMAN	F	High	0.796	0%	0.09%	17,921	17,071	NC	4200
URUGUAY		High	0.795	20%	0.40%	13,223	14,010	NC	3432
KAZAKHSTAN	F	Upper-middle	0.794	38%	0.18%	10,114	10,570	NC	17,750
BAHAMAS		High	0.792	2%	0.40%	21,443	20,568	NC	387
MALAYSIA	AE	Upper-middle	0.789	35%	0.39%	10,044	11,028	NC	30,723
PANAMA		Upper-middle	0.788	53%	0.07%	9669	10,982	NC	3969
MAURITIUS	F	Upper-middle	0.781	24%	0.02%	8884	9813	NC	1259
COSTA RICA		Upper-middle	0.776	27%	0.08%	8922	9714	NC	4808
SERBIA	F	Upper-middle	0.776	5%	0.05%	5603	5852	NC	8851
CUBA		Upper-middle	0.775	35%	0.00%	6041	6445	NC	11,461
IRAN		Upper-middle	0.774	53%		6008	5758	NC	79,360
GEORGIA		Upper-middle	0.769	30%	0.02%	3599	4080	NC	3952
VENEZUELA		Upper-middle	0.767		0.00%	14,096	14,462	NC	31,155
SRI LANKA	F	Lower-middle	0.766	42%	0.11%	3345	3759	NC	20,714
ALBANIA		Upper-middle	0.764	14%	0.02%	4370	4712	NC	2923
LEBANON		Upper-middle	0.763	10%	0.06%	7734	6984	NC	5851
AZERBAIJAN		Upper-middle	0.759	8%	0.05%	5944	5859	NC	9617

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
BRAZIL	AE	Upper-middle	0.754	2%	2.38%	11,483	10,826	NC	205,962
BOSNIA-HERZEGOVINA		Upper-middle	0.75	9%	0.02%	4906	5306	NC	3536
MACEDONIA	F	Upper-middle	0.748	16%	0.01%	4830	5223	NC	2079
ALGERIA		Upper-middle	0.745	22%	0.21%	4630	4846	NC	39,872
JORDAN	F	Upper-middle	0.741	27%	0.05%	3435	3258	NC	9159
THAILAND	AE	Upper-middle	0.74	19%	0.54%	5485	5901	NC	68,658
PERU	SE	Upper-middle	0.74	31%	0.25%	5633	6089	NC	31,377
ECUADOR		Upper-middle	0.739	23%	0.13%	5153	5210	NC	16,144
CHINA	SE	Upper-middle	0.738	56%	14.82%	5727	6894	NC	1,397,029
FIJI		Upper-middle	0.736	26%	0.01%	4000	4402	NC	892
JAMAICA		Upper-middle	0.73	6%	0.02%	4726	4796	NC	2872
COLOMBIA	SE	Upper-middle	0.727	28%	0.37%	6992	7526	NC	48,229
SURINAME		Upper-middle	0.725	-2%	0.00%	8585	7662	NC	553
TUNISIA	F	Lower-middle	0.725	10%	0.06%	4182	4265	NC	11,274
DOMINICAN REPUBLIC		Upper-middle	0.722	36%	0.09%	6016	6909	NC	10,528
LIBYA		Upper-middle	0.716		0.00%	8350	-	NC	6235
BELIZE		Upper-middle	0.706	13%	0.00%	4378	4320	NC	359
MALDIVES		Upper-middle	0.701	32%	0.00%	6915	7367	NC	418
BOTSWANA	F	Upper-middle	0.698	30%	0.02%	7059	7383	NC	2209
GABON		Upper-middle	0.697	32%	-	9302	9569	NC	1930
PARAGUAY		Upper-middle	0.693	32%	0.04%	3562	3928		6639
TURKMENISTAN		Upper-middle	0.691	60%	0.05%	5843	6987	NC	5565
EGYPT	SE	Lower-middle	0.691	19%	0.45%	2625	2724	NC	93,778
INDONESIA	SE	Lower-middle	0.689	37%	1.23%	3549	3974	NC	258,162
PALESTINE	F	Lower-middle	0.684		-	1705	-	NC	4663
VIETNAM	F	Lower-middle	0.683	42%	0.27%	1538	1770	NC	93,572
PHILIPPINES	SE	Lower-middle	0.682	43%	0.40%	2408	2753	NC	101,716
SOUTH AFRICA	AE	Upper-middle	0.666	12%	0.39%	7537	7504	C	55,291
IRAQ		Upper-middle	0.649	44%	0.23%	5129	5696	NC	36,116

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
MOROCCO	F	Lower-middle	0.647	23%	0.13%	3050	3196	NC	34,803
NAMIBIA		Upper-middle	0.64	32%	0.01%	5677	6021	NC	2426
GUYANA		Upper-middle	0.638	29%	0.00%	3426	3759	NC	769
INDIA	SE	Lower-middle	0.624	49%	3.00%	1579	1861	NC	1,309,054
EQUATORIAL GUINEA		Upper-middle	0.592	-10%	0.01%	15,866	12,029	NC	1175
GHANA	F	Lower-middle	0.579	50%	0.06%	1574	1708	NC	27,583
BANGLADESH	F	Lower-middle	0.579	46%	0.29%	885	1030	NC	161,201
KENYA	F	Lower-middle	0.555	22%	0.09%	1051	1143	C	47,236
PAKISTAN	SE	Lower-middle	0.55	29%	0.38%	1095	1182	NC	189,381
ANGOLA		Upper-middle	0.533	26%	0.12%	3635	3607	NC	27,859
NIGERIA	F	Lower-middle	0.527	24%	0.54%	2454	2458	NC	181,182
CÔTE D'IVOIRE	F	Lower-middle	0.474	49%	0.05%	1331	1563	NC	23,108

PAYS EN DÉVELOPPEMENT DONT PAYS LES MOINS AVANCÉS

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
UKRAINE		Lower-middle	0.743	-9%	0.12%	3039	2906	NC	44,658
ARMENIA		Lower-middle	0.743	24%	0.01%	3655	3925	NC	2917
MONGOLIA		Lower-middle	0.735	64%	0.01%	3496	3895	NC	2977
KOSOVO		Lower-middle	0.734	18%	0.01%	3572	3890	NC	
UZBEKISTAN		Lower-middle	0.701	59%	0.09%	1654	1961	NC	30,976
MOLDOVA		Lower-middle	0.699	26%	0.01%	1862	2063	NC	4066
SALVADOR		Lower-middle	0.68	9%	0.04%	3633	3803	NC	6312
BOLIVIA		Lower-middle	0.674	36%	0.04%	2222	2458	NC	10,725
KYRGYZSTAN		Lower-middle	0.664	32%	0.01%	965	1038	NC	5865
CAPE VERDE		Lower-middle	0.648	12%	0.00%	3385	3453	NC	533
NICARAGUA		Lower-middle	0.645	37%	0.02%	1744	1946	NC	6082
GUATEMALA		Lower-middle	0.64	24%	0.09%	2962	3100	NC	16,252

COUNTRY	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
HONDURAS		Lower-middle	0.625	23%	0.03%	2035	2138	NC	8961
BHUTAN		Lower-middle	0.607	26%	0.00%	2450	2751	NC	787
CONGO		Lower-middle	0.592	19%	0.05%	2818	2798	NC	4996
LAOS		Lower-middle	0.586	56%	0.02%	1387	1643	NC	6664
ZAMBIA		Lower-middle	0.579	33%	0.03%	1569	1622	NC	16,101
CAMBODIA		Lower-middle	0.563	51%	0.03%	927	1078	NC	15,518
MYANMAR		Lower-middle	0.556	52%	0.09%	1191	1420	NC	52,404
SWAZILAND		Lower-middle	0.541	18%	0.00%	3896	3911	NC	1319
CAMEROON		Lower-middle	0.518	35%	0.03%	1263	1357	NC	22,835
PAPUA NEW GUINEA		Lower-middle	0.516		-	1548	1716	NC	7920
SALOMON ISLANDS		Lower-middle	0.515	16%	0.00%	1422	1479	NC	587
MAURITANIA		Lower-middle	0.513	28%	0.01%	1272	1296	NC	4182
LESOTHO		Lower-middle	0.497	-8%	0.00%	1298	1387	NC	2175
SENEGAL		Lower-middle	0.494	30%	0.02%	1024	1093	NC	14,977
SUDAN		Lower-middle	0.49	46%	0.13%	1763	1923	NC	38,648
DJIBOUTI		Lower-middle	0.473	19%	-	1438	1580	NC	927

PAYS EN DÉVELOPPEMENT LES MOINS AVANCÉS

Country	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
EAST TIMOR		Lower-middle	0.605		0.00%	929	987	NC	1241
TAJIKISTAN		Lower-middle	0.627	50%	-	853	968	NC	8549
SYRIA		Lower-middle	0.536		0.00%		-	NC	18,735
YEMEN		Lower-middle	0.482	-39%	0.04%	1031	680	NC	26,916
COMOROS		Low	0.497	15%	0.00%	773	768	NC	777
GUINEA BISSAU		Low	0.424	23%	0.00%	557	572	NC	1771
GAMBIA		Low	0.452	14%	0.00%	538	532	NC	1978
LIBERIA		Low	0.427	26%	0.00%	359	353	NC	4500

Country	FTSE	Income level	HDI	Growth in GDP 2010 - 2016	Share of global GDP	GDP per cap. USD (av. 2010-2016)	GDP / cap. 2016	Convertible currency (C/NC)	Population (thousand)
CENTRAL AFRICAN REPUBLIC		Low	0.352	-25%	0.00%	375	326	NC	4546
ERITREA		Low	0.42		0.00%	498		NC	4847
SIERRA LEONE		Low	0.42	28%	0.00%	470	455	NC	7237
TOGO		Low	0.487	34%	0.01%	521	558	NC	7417
BURUNDI		Low	0.404	13%	0.00%	233	218	NC	10,199
BENIN		Low	0.485	31%	0.01%	799	837	NC	10,576
HAITI		Low	0.493	19%	0.01%	708	729	NC	10,711
RWANDA		Low	0.498	52%	0.01%	650	739	NC	11,630
SOUTH SUDAN		Low	0.418		0.00%	1021	745	NC	11,882
GUINEA		Low	0.414	17%		445	446	NC	12,092
SOMALIA		Low	0.26		0.01%		-	NC	13,908
CHAD		Low	0.396	17%	0.01%	913	860	NC	14,009
ZIMBABWE		Low	0.516	46%	0.02%	875	909	NC	15,777
MALI		Low	0.442	25%	0.02%	708	743	NC	17,468
MALAWI		Low	0.476	25%	0.01%	473	482	NC	17,574
BURKINA FASO		Low	0.402	34%	0.02%	613	644	NC	18,111
NIGER		Low	0.353	40%	0.01%	370	388	NC	19,897
MADAGASCAR		Low	0.512	19%	0.01%	410	416	NC	24,234
MOZAMBIQUE		Low	0.418	46%	0.01%	472	515	NC	28,011
NEPAL		Low	0.558	24%	0.03%	645	682	NC	28,656
AFGHANISTAN		Low	0.479	30%	0.03%	597	596	NC	33,736
UGANDA		Low	0.493	36%	0.03%	635	662	NC	40,145
TANZANIA		Low	0.531	49%	0.06%	781	867	NC	53,880
DEM. REPUBLIC OF CONGO		Low	0.435	49%	0.01%	358	387	NC	76,197
ETHIOPIA		Low	0.448	75%	0.10%	425	511	NC	99,873
NORTH KOREA		Low					980-1800	NC	25,244

GLOSSARY

The definitions given below largely take inspiration from the following sites, which also contain a great deal of further information:

- www.lafinancepourtous.com
- the Central European Bank website. https://www.ecb.europa.eu/explainers/tell-me/html/index.en.htmll
- the glossary of the Bank for International Settlements, https://www.bis.org/statistics/glossary.htm
- the lexicon created by *Alternatives Economiques* in 2012, https://www.alternatives-economiques.fr/mots-de-crise/00066512

Share (financial term): For a company to be registered as limited, its capital must be issued as shares, held by shareholders. For these shareholders, the share is a title of ownership, which lends them certain rights: participation in the management of the company via a right to vote at general meetings, and access to a percentage of the profits — dividends — when the company is doing well. A share has an unlimited lifespan; it can be exchanged directly with another party, or on the Stock Exchange, where it is listed. For the company, the share is a way to raise finance.

Moral hazard: This notion, introduced by Adam Smith in the 17th century, defines a situation where a person or a company might be willing to take excessive risks because they are insured by another party.

Quantitative easing (QE): When the conventional tools of monetary policy fail to combat a recession, a central bank may decide to employ the so-call "unconventional" monetary tool of quantitative easing. In concrete terms, the central bank purchases financial assets from banks (government and corporate bonds) and injects the liquidity into the financial circuits. The banks can then grant new loans, which increases the amount of money in circulation.

Bank for International Settlements: Created in 1930 to manage the settlement of war payments between France and Germany, the Bank for International Settlements (BIS), based in the Swiss city of Basel, is the "central bank" for 60 central banks (which together represent 95% of the global GDP), and is tasked with promoting monetary and financial cooperation. The Basel Committee is one of its most well-known arms. It also hosts the Financial Stability Board (FSB), which emerged from the G20 summits.

Merchant bank (or investment bank): This is primarily a strategic and financial consultancy firm, designed to help companies and investors with operations such as flotation on the stock market, increase in capital, or a merger-acquisition. It can acquire holdings in companies to help them develop and create profit by reselling its holdings. It can also manage a portfolio of holdings on behalf of third parties. As it does not issue credit, its capital requirements are lower than those of commercial banks.

Commercial banks (also called retail banks): This is a financial establishment aimed at private individuals, the liberal professions, associations, small and medium-sized enterprises or local authorities, to whom it offers credit and investment products.

Private banking: Wealth and asset management services for high-net-worth individuals.

Bank balance sheet: As for any company, the **liabilities** provide information on the origin of the bank's resources (the funds collected), while the **assets** show how these funds are used.

Paris Club: Created in 1956, this is an informal group which now includes 22 creditor countries, the role of which is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. Debt relief is offered by postponement of the debt or by a reduction in debt service obligations.

Basel Committee: Created under the umbrella of the BIS in 1974, the main goal of the Committee is to **ensure stability of the financial system on a global scale**, by strengthening bank regulation. It has led to three Basel Accords, aimed at guaranteeing a minimum bank reserve level to ensure banks are financially sound and sustainable. In 2019, banks will have to comply with Basel III, an accord signed in 2010.

Financial Stability Board (FSB): This body emerged from the G20; it was created in 2009 and is hosted by the BIS. It promotes cooperation in the sector responsible for regulating and monitoring financial institutions.

Washington Consensus: This refers to a tacit agreement between the **International Monetary Fund** and the **World Bank**, support by the US Treasury, to only grant financial aid to developing countries in difficulty if they adopt certain Neoliberal economic "good practices" (inspired by an article published by John Williamson in 1989). These recommendations include:
- strict budgetary discipline;
- the reorientation of public spending towards sectors with high economic returns on investment and promoting the reduction in income inequality and the privatisation of public companies;
- fiscal relaxation (enlargement of the tax base, drop in marginal rates);
- monetary stability;
- the adoption of a single, competitive exchange rate, the liberalisation of external trade and the deregulation of markets (removal of barriers to entry and exit);
- the removal of barriers to foreign direct investment;
- the inclusion of property rights (including intellectual property).

These measures have been strongly criticised for the dramatic consequences (destruction of local economies, increase in poverty and inequality) that they may have had in certain countries. It was only with the advent of the 2007-2008 crisis that the IMF and the World Bank modified their requirements.

Deflation: A general drop in prices noted over several quarters. It occurs when global demand is not sufficient to absorb the quantity of goods and services produced by the economy, and is accompanied by a drop in production and salaries, and a rise in unemployment. This is often referred to as a deflationary spiral. Deflation is particularly damaging to indebted economic agents (especially companies, governments and local authorities) who see the real value of their debt increase in comparison to their activity.

Investment funds (private equity): These funds invest in selected companies according to specific criteria (sector of activity, type of business project), but also according to the company's level of development. Therefore, venture capital is aimed at start-ups, development capital at growing companies or those with major development potential, LBOs (leveraged buyouts) to companies in the process of being sold, and distressed funds to the purchase of companies in difficulty. There are also speculative funds, better known as "hedge funds", which focus on risky investments in poorly regulated environments. Investment funds are held as shares by savers.

OTC (over the counter) market: In this market, transactions are made directly between the vendor and purchaser, outside of the regulated markets. The largest OTC market is the foreign currency market.

Bond: Bonds are debt securities, issued by companies and governments to raise funds using the markets. Purchasing a bond is the same as granting a loan to the organisation issuing it, in return for the payment of interest, often on an annual basis (the coupon), before it is reimbursed at the end of the loan period.

Derivative product: A derivative product is a **contract between two parties. It is a financial instrument, the value of which depends on ("derives" from) that of another financial product (the "underlying"), and for which payment will be made at a future date.** The underlying may be an exchange rate, a commodity, a share, a bond, or an index, but it is not traded at the time of the transaction. The derivative product is based on safeguarding against the risk of variation in the value of the underlying. The derivative product is not recorded in the bank's balance sheet, but "off-balance sheet"; however, the profits or losses resulting from the variation of the contract and the cash flows generated by the contract when it is consolidated are recorded in the bank's balance sheet.

Bank solvency ratio: The Bank for International Settlements (BIS), in the process of three successive "Basel" accords, has set **solvency ratios** that all banks must comply with:

- in 1988, Basel I proposed the Cooke ratio, which set the percentage of a bank's credit risk (assets and off-balance sheet) it must hold as capital at 8%;

- with Basel II, the regulatory institutions decided to refine this bank solvency indicator with the McDonaugh ratio, which takes credit risks, market risks, and operational risks into account. This new ratio was maintained at 8%;
- lastly, Basel III (2010), which will definitively come into force in 2019, redefined and reassessed the bank solvency ratio, setting it at 10.5%.

Reserve requirements: These are deposits with little or no interest that every bank in a country or within an economic area must pay into the central bank that governs it. Since 2012, the reserve requirement for the eurozone has been 1% of deposits. As monetary policy instruments, their variation is used by the central banks to limit or expand the extension of credit.

Shadow banking: This refers to all of the activities and actors (investment banks, hedge funds, money market funds (MMFs), pension funds, mutual funds, life insurance, investment funds, securitisation vehicles, consumer credit organisations, digital currency platforms, and so on) which help to finance the economy outside of the banking system (off-balance sheet operations). Shadow banking is a major source of risk as it is not subject to the regulatory measures governing banks. According to the FSB, its global value was approximately **92,000 billion dollars** in 2015, **equivalent to half that of the traditional banking system.**

Underlying: See “derivative product”.

Secular stagnation: This term was originally put forth by Alvin Hansen, an American economist, in 1938, when the country’s economy was suffering a relapse despite the New Deal. The term was picked up by Larry Summers in 2013 to refer to the period following the 2007-2008 crisis. It corresponds to a protracted drop in growth potential (insufficient or inappropriate supply) or a protracted divergence of growth from its potential (insufficient demand). The current period would be classed as secular stagnation as investments linked to new technologies are not leading to either an increase in production, or to increased demand. The result is a drop in investments and high unemployment.

Securitisation: Securitisation is a financial technique enabling financial establishments to convert the debts owed to them by companies or individuals into marketable securities. The debts are transferred by the bank to a securitisation vehicle which issues financial securities which are then placed with investors. The risk of these debts not being repaid is thus transferred to whoever purchases the securities, with the latter receiving a rate of interest in return linked to the level of risk. In 2007, the so-called “*subprime*” crisis (debts which had been securitised) was caused by the inability of creditors to repay their debt.

A report from Secours Catholique - Caritas France, in partnership with

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Finance Watch
Pour une finance au service de la société

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