AFTER COVID-19:

CAN WE TAME GLOBAL FINANCE?

WALDEN BELLO

A joint publication of Focus on the Global South and the Transnational Institute

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EXECUTIVE SUMMARY

The Covid 19 pandemic has brought the financial sector to a halt, much as it has the real economy. The volatile dynamics that have produced crisis after crisis are thus temporarily frozen. The question is: Will governments take advantage of the interruption to put their financial houses in order so as to prepare them for the resumption of financial activity once the pandemic is under control?

This report starts by showing how, prior to the pandemic, most of the reforms that were needed to prevent a repetition of the 2008-2009 financial crisis were not in place. For instance, investment instruments such as derivatives that had played such a key role in the 2008-2009 crisis, were still being traded. The "too big to fail" conundrum had, in fact, become worse, with more assets being concentrated in the top tier banks than before the crisis. To complicate things, there were new destabilizing elements that were not present during the Global Financial Crisis, the most important of which was China's overheated financial sector.

The report then proceeds to list the 10 necessary reforms, giving in detail the reasons for each of them. The reforms, it notes, are changes that are non-neoliberal but they can be accommodated within a reformed capitalist system, though progressive alliances will need to be formed to secure them. The proposed reforms are:

1. Tame hedge funds and close tax havens
2. Ban mortgage-backed securities and derivatives
3. Move towards 100 per cent reserve banking
4. Nationalize institutions that are "too big to fail"
5. Reinstate the Glass-Steagall Act separating commercial from investment banking
6. Crack down on executive greed
7. Squeeze out credit ratings agencies
8. Convoke a new Bretton Woods Conference
9. Make Central Banks provide liquidity to the public instead of to private banks and make them accountable to the public
10. Promote public banking and public investment.

The last section raises the question whether the reforms, once secured, can be maintained. It voices the concern that the incessant drive towards profitability constitutes a strong counterforce against a managed Keynesian solution centered on sustaining demand. It also expresses skepticism about the fashionable theory that growth can be delinked from increasing C02 emissions, thus making managed growth compatible with decarbonization. It poses the question: Can the world continue to avoid moving to a post-capitalist economic system if the twin goals of equality and reversing climate change are to be achieved?

GLOSSARY

CDOs - Collateralized debt obligations or synthetic securities created from the pooling of mortgage-backed securities of different "qualities," but the value of which cannot be dissociated from the ability of the original mortgage-holder to service the lowest quality mortgage-backed security.

CDSs - Credit default swaps or contracts that the holders of CDOs take out to insure themselves against losses if their CDOs turn sour in the event of a downturn in the real-estate market. They are termed 'swaps' to avoid the federal regulation to which other forms of insurance are subject. Speculators buy CDSs in the expectation that the growing risk of default will raise the price of the CDSs they purchase, and they can make a profit from the sale.

Derivatives – A financial product that is not in itself an asset but whose value is based on the price movements of an underlying asset. Derivatives are bought or sold depending on expectations, or 'bets' on the likely change in value of the underlying asset.

Dodd-Frank, also known as the 'Wall Street Reform and Consumer Protection Act' - The law enacted in 2010 as the Obama administration's response to the 2008 global financial crisis.

Financialization – A term that refers to a condition or state where the dynamics of speculative finance rather than that of production becomes the main driver of a capitalist economy, so that the prices of many goods, including food, are determined less by actual demand than by the movement of securities or derivatives that are "tied" to them.

100 per cent reserve banking - A banking practice whereby total loans made by the bank must be backed 100 per cent by its equity, so that in case of a crisis, all depositors can be reimbursed.

Glass-Steagall - The Depression-era law in the United States that separated commercial banking from investment banking and that was repealed during the Clinton administration by the Gramm-Leach-Bliley Act.

Hedge funds - Funds formed by groups of investors using borrowed money that engage in potentially high yielding but risky investments which often operate from locations known as tax havens to escape high taxation in their home economies.

MBSs – Mortgage-backed securities, or assets based on mortgages that are made liquid by securitization and sold on the market by the bank serving as mortgage originator, and then traded by other parties, but the value of which depends on the original mortgage holder's ability to service the mortgage.

Neoliberalism - The dominant economic ideology whose the fundamental principle is that markets must be free of regulation by the state to the greatest degree possible so as to bring about the most efficient allocation of resources in the economy, as reflected in the unit prices of goods. Market freedom extends to freedom from tariffs and import quotas, freedom from controls on capital flows, and freedom of market participants from high taxes.

Overproduction - The contradiction between the tremendous productive capacity of capitalism owing to massive investments in capital-intensive technology and the absorptive capacity of the population that is limited by social inequalities that restrain consumption. Also sometimes referred to as overaccumulation or overcapacity, this condition leads to a decline in the rate of profit, according to Marxist economists. Marx famously described this condition as the development of the forces of production being constrained by the social relations of production.

Quantitative easing (QE) - The process of a central bank pumping cash into private banks by buying the latter's debts, with the goal of having the private banks issue low-interest loans to consumers so that consumer spending can revive the economy.

Securitization – Conversion of traditionally immobile assets like home mortgages into mobile, liquid securities that can be bought and sold in financial markets.

Shadow banking - The set of institutions that perform banking and other financial sector activities such as lending, trading, and investment but are not subject to the same regulations as the formal (commercial) banking sector.

Subprime mortgage-backed security – A security or financial product whose value is tied to a mortgage held by a borrower whose ability to service the mortgage is considered low.

"Too big to fail" - The informal practice whereby the state bails out the biggest banks when they are insolvent owing to the belief that allowing them to collapse would bring down the whole economy.

INTRODUCTION

COVID 19: A RARE OPPORTUNITY TO PURSUE FINANCIAL REFORM

The Covid 19 pandemic has frozen the financial sector just as it has brought the real economy to a screeching stop. Financial indices like the Dow Jones, FTSE 100, and the Han Seng Index rise and fall on the latest news, going up with announcements that the "curve has been flattened," then falling a day later when reports that the virus has been contained are found to be premature.

The pandemic, however, may be a blessing in disguise in one way: it might have staved off another global financial crisis temporarily. The question is: Will the world take advantage of the breathing space afforded by Covid 19 to make the changes in the financial sector that are needed to prevent another financial crisis that could be more devastating than the 2008-2009 implosion?

The bear and the bull: symbols of capitalism's boom and bust cycle.
https://commons.wikimedia.org/wiki/File:Bull_and_bear.jpg

THE POLITICS OF NON-REFORM

When Barack Obama became the US president in 2008, one of his stated priorities was to fix the global financial system. He famously told Wall Street, "My administration is the only thing that stands between you and the pitchforks."[1] Over ten years later, it is evident that timidity on the part of government and resistance on the part of finance capital combined to ensure that little reform took place under Obama and his counterparts in the rest of the world, despite the high-sounding commitments to global financial reform made by the Group of 20 Summit in Pittsburgh in 2009. Obama's favored legislation, popularly known as the Dodd-Frank Act, was universally regarded as quite soft when it came to disciplining financial actors.

Reform went into reverse when Donald Trump became president, with his successful campaign to weaken the already weak Dodd-Frank Act.

What are the key indicators of the failure of reform?

First, the 'too big to fail' problem has become worse. The big banks that were rescued by the US government in 2008 because they were seen as too big to fail have become even more too big to fail, with the 'Big Six' US banks—JPMorgan Chase, Citigroup, Wells Fargo, Bank of America, Goldman Sachs, and Morgan Stanley—collectively having 43 per cent more deposits, 84 per cent more assets, and triple the amount of cash they held before the 2008 crisis. Essentially, they have doubled the risk that felled the banking system in 2008.[2]

Second, the products that triggered the 2008 crisis are still being traded. This includes around $6.7 trillion in mortgage-backed securities sloshing around, the value of which has been maintained only because the Federal Reserve bought $1.7 trillion of them.[3]

US banks collectively hold $157 trillion in derivatives, about twice global GDP. This is 12 per cent more than they possessed at the beginning of the 2008 crisis. Citigroup alone accounts for $44 trillion, or 50 per cent more that its pre-crisis holdings, prompting a sarcastic comment from one analyst that the bank seems 'to have forgotten the time when they were a buck a share', alluding to the low point in the bank's derivatives' value in 2009.[4]

Third, the new stars in the financial firmament—the institutional investors' consortium made up of hedge funds, private equity funds, sovereign wealth funds, pension funds, and other investor entities—continue to roam the global network unchecked, operating from virtual bases called tax havens, looking for arbitrage opportunities in currencies or securities, or sizing up the profitability of corporations for possible stock purchases. Ownership of the estimated $100 trillion in the hands of these floating tax shelters for the super-rich is concentrated in 20 funds.

Fourth, financial operators are racking up profits in a sea of liquidity provided by central banks, whose release of cheap money in the name of ending the recession that followed the financial crisis has resulted in the issue of trillions of dollars of debt, pushing the global level of debt to $325 trillion, more than three times the size of global GDP.[5] There is a consensus among economists across the political spectrum that this debt build-up cannot go on indefinitely without inviting catastrophe.

Fifth, instead of more tightly controlling the financial sector, some countries have followed the advanced capitalist economies in liberalizing it. In China, the world's second biggest economy, this has created a dangerous conjunction of factors that could lead to a financial implosion: a volatile stock market, a property bubble, and an unregulated shadow banking sector. The number of vulnerable points in the world economy has increased and all are candidates for the next big crisis.

The casino economy. *https://en.wikipedia.org/wiki/Stock_market_bubble#/media/File:Philippine-stock-market-board.jpg*

THE CHINA PROBLEM

It would be good to devote some time to China's financial vulnerabilities since these are often misunderstood by western analysts.

When experts discuss threats to global finance posed by the Chinese economy, they often focus on the massive indebtedness of its corporations to the country's state banks. This debt clearly poses a threat to the domestic economy. It is, however, not an immediate threat. China is no ordinary capitalist economy. Under normal capitalism, when loans are nonperforming, the banks come calling on the debtor and either collect or force them into bankruptcy. But in China, the fact that the state enterprises and the banks are owned by the government places the day of reckoning far into the future. As Dinny McMahon writes:

> The real advantage of China's system of state ownership isn't that the cleanup is easier than in market economies; it's that the clean-up is easier to put off, something that it can do indefinitely but not forever. State firms may be "backed" by the state, but in practice that doesn't mean that the government covers the companies' debts if they can't repay them. Rather it means that the banks are safe from political fallout if the loans go bad. They will just hold bad loans on their books and, with the government's acquiescence, pretend that they're fine—as they've been doing for some years already. In the short term, there's no real fallout. Sure bank profits erode—after all, a big chunk of their loans aren't paying interest—but otherwise no one has to take responsibility for mounting bad loans. And, most importantly, deadbeat companies are kept alive.[6]

But the financial system has other vulnerabilities apart from the mountain of debt owed by state-owned enterprises (SOEs). These are a real estate bubble, a roller-coaster stock market, and an uncontrolled shadow banking system.

The Real Estate Bubble

There is no doubt that China is already in the midst of a real estate bubble. As in the United States during the subprime-mortgage bubble that culminated in the global financial crisis of 2007–09, the real-estate market has attracted too many wealthy and middle-class speculators, leading to a frenzy that has seen real estate prices climb sharply.

Chinese real estate prices soared in so-called Tier 1 cities like Beijing and Shanghai from 2015 to 2017, pushing worried authorities there to take measures to pop the bubble. Major cities, including Beijing, imposed various measures. They increased down-payment requirements, tightened mortgage restrictions, banned the resale of property for several years, and limited the number of homes that people could buy.[7]

However, Chinese authorities face a dilemma. On the one hand, workers complain that the bubble has placed owning and renting apartments beyond their reach, thus fueling social instability. On the other hand, a sharp drop in real estate prices could bring down the rest of the Chinese economy and—given China's increasingly central role as a source of international demand—the rest of the global economy along with it. China's real estate sector accounts for an estimated 15 percent of GDP and 20 percent of the national demand for loans. Thus, according to Chinese banking experts Andrew Sheng and Ng Chow Soon, any slowdown would "adversely affect construction-related industries along the entire supply chain, including steel, cement, and other building materials."[8]

The problem is not just a real estate market slowdown having a domino effect on the rest of the economy owing to reduced demand; it is also that so many other industrial sectors are heavily invested in real estate. As the former chief economist of the Agricultural Bank of China writes, "Almost all big manufacturing companies have, to a certain extent, gotten involved in real estate. ... For many companies sales are stagnant, business is difficult, and the ability to earn a profit has sharply declined, so more and more manufacturing companies have started to subsidize their losses by getting involved in real estate or with financial investments."[9]

THERE IS NO DOUBT THAT CHINA IS ALREADY IN THE MIDST OF A REAL ESTATE BUBBLE. AS IN THE UNITED STATES DURING THE SUBPRIME-MORTGAGE BUBBLE THAT CULMINATED IN THE GLOBAL FINANCIAL CRISIS OF 2007–09, THE REAL-ESTATE MARKET HAS ATTRACTED TOO MANY WEALTHY AND MIDDLE-CLASS SPECULATORS, LEADING TO A FRENZY THAT HAS SEEN REAL ESTATE PRICES CLIMB SHARPLY.

The Shanghai Casino

Financial repression—keeping the interest rates on deposits low to subsidize China's powerful alliance of export industries and governments in the coastal provinces—has been central in pushing investors into real-estate speculation. However, growing uncertainties in that sector have caused many middle-class investors to seek higher returns in the country's poorly regulated stock market. The unfortunate result is that a good many Chinese have lost their fortunes as stock prices fluctuate wildly. As early as 2001, Wu Jinglian, widely regarded as one of the country's leading reform economists, characterized the corruption-ridden Shanghai and Shenzhen stock exchanges as "worse than a casino" in which investors would inevitably lose money over the long run.[10]

At the peak of the Shanghai market in June 2015, a *Bloomberg* analyst wrote that "No other stock market has grown as much in dollar terms over a 12-month period," noting that the previous year's gain was greater "than the $5 trillion size of Japan's entire stock market."[11]

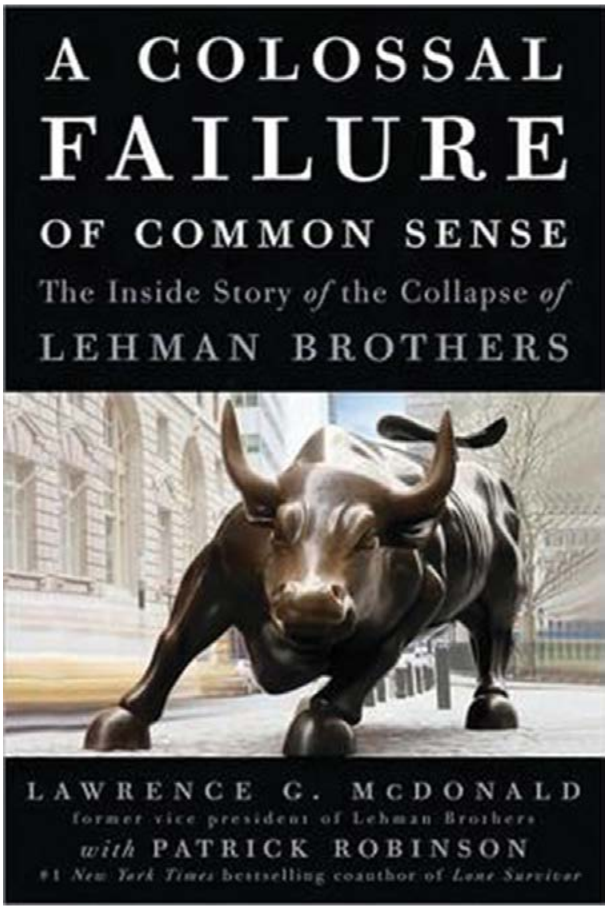
When the Shanghai index plunged 40 percent later that summer, Chinese investors were hit with huge losses—debt they still grapple with today. Many lost all their savings—a significant personal tragedy (and a looming national crisis) in a country with such a poorly developed social-security system.

Chinese stock markets, now the world's second largest according to some accounts, stabilized in 2017, and seemed to have recovered the trust of investors when they were struck by contagion from the global sell-off of stocks in February 2018, posting one of their biggest losses since the 2015 collapse.

Shadow Banking Comes Out of the Shadows

Another source of financial instability is the virtual monopoly on credit access held by export-oriented industries, state-owned enterprises, and the local governments of favored coastal regions. A significant part of the demand for credit from a multitude of private companies is not being met by the official banking sector, and the void has been rapidly filled by so-called shadow banks.[12]

The shadow banking sector is perhaps best defined as a network of financial intermediaries whose activities and products are outside the formal, government-regulated banking system. Many of the



The unravelling of the investment bank Lehman Brothers in 2008 brought Wall Street and global finance to the brink of collapse.
https://en.wikipedia.org/wiki/A_Colossal_Failure_of_Common_Sense#/media/File:Lawrence_G._McDonald_-_A_Colossal_Failure_of_Common_Sense_The_Inside_Story_of_the_Collapse_of_Lehman_Brothers.jpeg

shadow banking system's transactions are not reflected on the regular balance sheets of the country's financial institutions. But when a liquidity crisis takes place, the fiction of an independent investment vehicle is ripped apart by creditors who factor these off-balance-sheet transactions into their financial assessments of the mother institution.

The shadow banking system in China is not yet as sophisticated as its counterparts on Wall Street and in London, but it is getting there. Ballpark estimates of the trades carried out in China's shadow banking sector range from $10 trillion to more than $18 trillion.

In 2013, according to one of the more authoritative studies, the scale of shadow banking risk assets—i.e. assets marked by great volatility, like stocks and real estate—came to 53 percent of China's GDP.[13] That might appear small when compared with the global average of about 120 percent of GDP, but the reality is that many of these shadow banking creditors have raised their capital by borrowing from the formal banking sector. These loans are either registered on the books or "hidden" in special off-balance-sheet vehicles. Should a shadow banking crisis ensue, it is estimated that up to half of the nonperforming loans of the shadow banking sector could be "transferred" to the formal banking sector, thus undermining it as well. In addition, the shadow banking sector is heavily invested in real estate trusts. Thus, a sharp drop in property valuations would immediately have a negative impact on the shadow banking sector—creditors would be left running after bankrupt developers or holding massively depreciated real estate as collateral.

Is China, in fact, still distant from a Lehman Brothers–style crisis? Interestingly, Sheng and Ng point out that while "China's shadow banking problem is still manageable…time is of the essence and a comprehensive policy

The Shanghai stock exchange building at Pudong.
https://en.wikipedia.org/wiki/Shanghai_Stock_Exchange#/media/File:Shanghai_Stock_Exchange_Building_at_Pudong.JPG

package is urgently needed to preempt any escalation of shadow banking NPLs [nonperforming loans], which could have contagion effects."[14] Beijing is now cracking down on the shadow banks, but these are elusive, and unless there is a fundamental reform of its national credit system to end the virtual monopoly by the export-oriented economic complex of the banking system, there will always be a strong demand for these *sub rosa* entities.

Finance is the Achilles' heel of the Chinese economy, and it is likely to reassert its vulnerability in the post-Covid 19 period. The negative synergy between an overheating real estate sector, a volatile stock market, and an uncontrolled shadow banking system could well be the cause of the next big crisis to hit the global economy, rivaling the severity of the Asian financial crisis of 1997–98 and the global financial implosion of 2008–2009.[15]

A MINIMUM PROGRAM FOR REFORM

IV

Textbooks tell us that finance is the system that connects those with surplus funds to those who need funds (but don't have them) to invest in the production process. In this scenario, finance is a productive and constructive force. But in the view of those who would reform the finance system, the essential problem is that finance has become an end in itself—its connection to production severed, leaving the financial economy not only separated from the real economy but also subverting it. Financial reform, say those who want it, could make the financial economy once again the 'servant' of the real economy, of production, and of society. In the words of one of the most passionate liberal reformers:

> The financial catastrophe that occurred in 2007–2008 must not cause us to make mistakes: finance is not the enemy, for the simple reason that, in and of itself, it has no quality of being good or bad. It is only a blind mechanical force that, poorly used or unsupervised, could take a turn for the worse (as we saw with the subprime crisis) or, used well and properly maintained, can offer us something better: prosperity shared by all without harm to our planet (as seen with the development of green bonds). Let us not forget that old saying, 'Money is a poor master, but a good servant.' That same tool, used well or poorly, according to the will of actors, can lead to the creation or destruction of value.[16]

However, most progressive reformers do not labor under this illusion. They believe that finance is not a force derailed from its "true functions"—but rather one that, under capitalism, displays a constant tendency to lose its connection to production and to become an end in itself. Thus, while progressives may support financial reforms that limit the tendency of finance to derail the real economy, that drive, in their view, is fueled by the dynamics of the system of production itself, by its tendency towards overproduction and stagnation, leading money capitalists to prefer to make money out of money.

Liberal reformers and progressives are united, however, around two things: first, that there is an urgent need to rebottle the genie that was released during the liberalization of finance that began during the Reagan–Thatcher years; and second, that ten years after the 2008 crisis, there have been very few, if any, effective reforms put in place to stop such a crisis happening again. On the contrary, there has been aggressive counter-reform, a key manifestation of which was the US Congress successfully passing legislation in early 2018 to dilute the already weak Dodd–Frank Act of 2010.[17]

This section describes proposals for reform in 10 key areas. (They do not include proposals directly related to the Covid 19 pandemic.) There are two caveats:

- They do not comprise a revolutionary program, for two main reasons: first, they cover only the financial system and contain no recommendations for reforming the productive system, trade or other sectors of the global capitalist system; second, they are meant to be pursued within the current dominant system of production and their achievement will not necessarily mean a break with it. Nevertheless, a successful drive to make these reforms real will add to pressures for a comprehensive transformation of the system from a capitalist to a post-capitalist one.
- No matter how attractive and rational reform proposals are, they will not materialize unless reformers are able to construct a winning alliance of governments, civil society organizations, citizen movements and other actors both within and across national borders. What follows does not provide advice on how to construct such coalitions. What we are confident in, though, is that the proposed program offers the substantive basis on which such coalitions can be built.

1. Targeting hedge funds and closing tax havens

Two entities emerged with greater power following the global financial crisis. One was the central bank (a topic taken up below) and the other was the private institutional investor. Though weak, the regulatory initiatives that followed the crisis covered the big banks, including investment banks such as Goldman Sachs and Merrill Lynch that converted themselves into fully fledged banks subject to government regulation. Private institutional investors such as private

WHILE PROGRESSIVES MAY SUPPORT FINANCIAL REFORMS THAT LIMIT THE TENDENCY OF FINANCE TO DERAIL THE REAL ECONOMY, THAT DRIVE, IN THEIR VIEW, IS FUELED BY THE DYNAMICS OF THE SYSTEM OF PRODUCTION ITSELF, BY ITS TENDENCY TOWARDS OVERPRODUCTION AND STAGNATION, LEADING MONEY CAPITALISTS TO PREFER TO MAKE MONEY OUT OF MONEY.

equity funds, hedge funds, sovereign wealth funds and pension funds continued, however, to be virtually unregulated. Collectively, these funds now control some $100 trillion, concentrated in some 20 asset management companies. These companies include BlackRock, with close to $5 trillion in assets, and Vanguard and Amundi, each with more than $1 trillion in assets.[18]

The implications of a financial world now dominated by these unregulated giants are well laid out by one who has dealt with them first hand:

> At the risk of exaggerating, I suggest that humanity may end up depending on a close circle of chief investors and chief economists to allocate savings. These investors will say that their management is highly decentralized and fragmented and therefore has little chance of going in the same direction, but who will guarantee for us that all these people are not going to think in the same way at the same time, leading to a widespread financial panic—with the catastrophic consequences that we have all seen?[19]

These funds have grown partly because they function as tax shelters for the global elite, and many of them are headquartered in tax havens such as the Cayman Islands and Liechtenstein. The fact that they are tax shelters, as the Panama Papers expose has shown, is the reason why these entities are so powerful. They have mastered the tax codes of key countries, mined them for possible

The New York Stock Exchange, heart of global finance. *https://commons.wikimedia.org/wiki/File:NYSE127.jpg* loopholes, and, like the pirates of old, sail out of their sheltered coves to exploit these vulnerabilities. To take one example, one hedge fund named Renaissance Technologies was able to avoid paying $6.8 billion in taxes over 13 years, using a maneuver that is illegal but commonly used: the use of derivatives to claim that short-term capital gains are long-term gains not subject to the taxes levied on the former.[20] The United States' Internal Revenue Service (IRS) does not need new legal authority to stop the practice, but it is unwilling to take on the hedge funds. As one tax expert sees it: 'The problem is the IRS is hopelessly outgunned, especially when it comes to complex areas of the law where aggressive entities can marshal armies of lawyers.'

Obviously, then, a key step in taming the hedge funds is to make sure tax agencies are well staffed and that ambiguous provisions in the corporate tax code that can be used for tax avoidance are either legislatively fixed or clarified in the accompanying implementing rules and regulations (which is usually where lobbyists manage to dilute or thwart the will of the legislative power).

There are other measures.

Owing to the secrecy they provide their clients, the hedge fund industry, claims one report, 'seems to operate primarily through offshore jurisdictions'.[21] Their preference for tax havens such as Liechtenstein, Panama or the Cayman Islands—and the impact of these on onshore economies—is captured in one report:

> [A] spokesperson for the UK Financial Services Authority was quoted as saying, 'nobody ever registers hedge funds in the UK. If somebody did, we'd be scratching our heads over how to deal with it. We'd have to devise something.' The issue has become all too obvious to both politicians and the public: what is structured offshore has a significant impact onshore... Hedge funds undoubtedly shorted shares in US, UK, French, and other banks and helped bring at least one, HBOS, to a position of needing state aid and forcing it into a merger. The sector has assumed no accountability and is tainted by the combination of very high earnings subject to very little tax.[22]

Closing down tax havens (or at least forcing them to lift the veil of secrecy they place on 'resident' hedge funds and the clients of these funds) is thus an important tool in reducing the power of these entities. Critical in these battles are transparency agreements such as the Automatic Exchange of Information among countries, which requires tax havens to disclose their corporate and financial clients—an arrangement that will cover some 100 countries by 2018.[23] A potentially tougher measure is the Foreign Account Tax Compliance Act of the United States (FATCA), which requires financial institutions outside the US to determine whether they have any customers who are US citizens and report information on all of those customers' accounts to the IRS. Any institution refusing to comply has an automatic withholding tax assessed on its US-sourced income.[24] Similar legislation can be adopted by other governments.

Such measures need not always be agreements between national governments, or even be bilateral or multilateral in character. For instance, during the 2001 Argentine financial crisis, the city of Buenos Aires unilaterally adopted a policy that all companies 'situated in [a] low [or] no-tax jurisdiction must either prove that they have genuine economic activity there (similar to that which they wish to undertake in Buenos Aires), or they have to transform into a national Argentinean company'.[25]

These measures should be seen as part of a multipronged attack on bank secrecy conventions and laws that have long protected both the mafia and the super-rich. Needless to say, tough penalties in the form of huge fines or jail terms for executives of funds that allow themselves to be used illegally as tax shelters would be critical to the effectiveness of anti-tax evasion agreements.

Another important legal measure would be to update and upgrade anti-trust or anti-monopoly laws to apply specifically to hedge funds, private equity funds and institutional investors. The fear of collusion is not an idle one. While it is intended as a caricature, there is much truth in Bloomberg analyst Matt Levine's articulation of many people's concerns about the power of the private equity and hedge funds:

> There is something a bit weird about so many public companies, which are theoretically locked in the bitter struggle of capitalist competition against each other, all being owned by the same half-dozen mutual fund complexes. It is not entirely crazy to look at those complexes and see the old-timey 'trusts', dressed up in modern financial theory. If BlackRock and Vanguard and Fidelity own shares in every big company in an industry, why should they want those companies to compete hard against each other? And if the shareholders don't want it, why should the managers compete? If you worry that US companies are increasingly being managed on the behalf of a unitary shareholder class, at the expense of workers and consumers, well, you are not alone.[26]

Institutional investor control of an industry might not yet be a major problem, but if there's anything that the recent crisis has taught us, it is that it is better to be proactive than sorry. Proactive measures can include rules against buying shares in competing corporations or in the holding companies of competing oligopolies.

A final measure to counteract the threat posed by hedge funds is an old prescription—one that has never been enacted but is widely endorsed—which is to tax all movements of capital across borders, be they undertaken between independent companies or subsidiaries of the same entity. The purpose of this measure, also known as the Tobin tax, is not simply to slow down the movement of capital and bring about a measure of global financial stability. It is to significantly lower the returns on hedge fund investments, making fund contributors less attracted by sales pitches that promise them large, untaxed dividends. Financial institutions will scream freedom of movement and globalists will inevitably say this measure is an attempt to return to a pre-globalized world that no longer exists. It should be remembered, however, that during the so-called *Trente Glorieuses* ("three glorious decades"), when the post-war international economy was at its height, cross-border movements of speculative capital were severely restricted, and this was a key reason for the dynamism of the productive economy that characterized most of that period.

2. Banning mortgage-backed securities and derivatives

Mortgage-backed securities (MBSs) are securities based on mortgages that are pooled together and converted into instruments that can be traded in the market. It was the huge demand for MBSs and the desire of mortgage originators to offload risk to buyers that served as the fatal formula for the issuance of subprime mortgage securities that flooded the global financial system with securities that became toxic after the mortgage holders could no longer service them, nearly bringing down the system.

Should MBSs be retained but more rigorously controlled? In their heyday, MBSs were promoted as spreading and diluting risk, thus preventing or limiting bankruptcies resulting from mortgages gone sour. What happened is that risk was indeed spread through the system, but since there were hundreds of billions of subprime MBSs issued, risk was not diluted but concentrated and, like a virus that multiplies past a critical point, nearly killed the system. There is also the argument that MBSs allow mortgage originators to sell off mortgages and obtain capital to release for other ventures. This argument must be set against the consequences of the dangerous incentive to lower lending criteria in order to hook in subprime borrowers if one does not have to take responsibility for the consequences of non-repayment. What may be good for each mortgage originator individually is bad for the whole system collectively, a phenomenon similar to Keynes' paradox of thrift: that is, each individual saver may be serving his or her own interest but is contributing to pitching an economy into deeper recession. The potential costs of allowing MBSs to continue to be traded are so much greater than the potential benefits, so it makes good sense to disallow them.

As for derivatives, there is no quarrel with simple derivatives such as forward contracts in commodity markets; these fix financial obligations, with a premium assumed by the buyer, to insure against losses brought about by market movements during the time the contract is in force. Forward contracts or hedging in commodity markets is a form of insurance against transparent movements in the real economy. But while agricultural and other commodity futures may have been the historical predecessor of financial derivatives, the former now make up less than 1 per cent of the total market.[27] Today, the derivatives markets, as Ole Bjerg points out, 'are… dominated by trading in derivatives where the underlier is some form of financial indicator with a highly abstract relation to the actual productive economy'.[28]

The utility of these more complex derivatives is hard to fathom. Take the case of collateralized debt obligations (CDOs). MBSs were securitized mortgages, and CDOs were securitized MBSs. The process involved taking the lower-rated tranches of MBSs, pooling those tranches, and dividing the pool into a new set of tranches for sale to investors. Perhaps the best description of how the end product became detached from its underlying asset is laid out by Kathleen Engel and Patricia McCoy:

> The complexity ran riot with the resuscitation of CDO tranches. CDOs were pooled and tranched into CDOs squared and CDOs squared were re-securitized into CDOs cubed. The astonishing thing about CDOs (whether they were plain, squared, or cubed) was that the underlying bonds could be junk, yet the top tranche of any CDO could carry an AAA rating. Essentially, CDOs purported to make steak out of chicken. Arrangers pooled tranches of mortgage-backed securities with low or no ratings (the chicken) and sliced those pools into tranches, with the top tranche earning an AAA rating.[29]

The fact that buyers did not really understand what they were buying is a good reason for banning finance-based derivatives. The case for banning them increases when the movements of hundreds of billions of these ill-understood instruments can potentially trigger a massive economic catastrophe, like the credit default swaps (CDSs) sold by AIG in 2008. Unleashed on the market, CDSs turned out to be Frankenstein's monster, over which all actors lost control.

A final reason for outlawing finance-based derivatives has to do with the fact that they do not fulfil any useful economic or social function: what purpose do such complex instruments as CDOs and CDSs really serve for buyers and sellers who rarely understand their dynamics? The answer is simple: speculation. Buying CDSs on US debt, for instance, does not require owning US Treasury bonds. It does not mean that the buyer expects the US to default anytime soon. One buys CDSs to speculate on price movements of the underlying asset. If the protection is higher a week after it was bought, the buyer can resell it and make a tidy profit.[30] If one wants to gamble, one can go to a regular casino, instead of betting on derivatives with the potential to inflict massive harm on society.

In sum, in contrast to simple, commodity-based derivatives, financial derivatives should be banned for the following reasons:

- Their dynamics cannot be understood by regular investors or even by professional ones, as Warren Buffett famously admitted. This being the case, many of those who engage in them incur great personal risk because of their ignorance.
- The movements of these instruments, which are ill-understood even by government regulators, pose a serious potential threat to the real economy, since they can materialize into crises in interaction with other factors.
- Their main use is for speculation, not insurance against individually or socially useful purposes such as protection against negative price movements provided to farmers by forward contracts.

3. Moving towards 100 per cent reserve banking

Excessive leverage (a high ratio of debt to equity) in the lending operations of banks such as Lehman Brothers was one of the central causes of the 2008 financial crisis—the banks had insufficient funds to reimburse investors when panic took hold. This necessitated the US government's bailout of the big banks and the insurance behemoth AIG to prevent a similar run on them. Raising the portion of equity to total assets thus became one of the demands of reformers. Basel III responded by recommending an equity floor of 3 per cent of total assets. This did not satisfy the reformers, however, who demanded a higher ratio – some recommending 20 to 30 per cent.[31]

Even more radical was the so-called 'Chicago Plan', originally put forward by economist Irving Fisher and a group of economists at the University of Chicago including Frank Knight, Henry Simons and Paul Douglas, in response to the banking crisis during the Great Depression. Later backers of the plan have spanned the spectrum of post-war economists, from Milton Friedman on the right, to James Tobin in the center, to Hyman Minsky on the left. The Chicago Plan proposed 100 per cent reserve banking in place of fractional reserve banking: that is, the bank would hold liquid reserves against 100 per cent of deposits. This meant that, with 100 per cent of deposits to be covered by liquid assets, loans to the private sector would have to be made from equity or long-term debt incurred by the bank, not from short-term debt from its creditors and depositors. This would enable banks to meet creditors' and depositors' demands for their money in the event of an economic crisis.[32]

The merits of the Chicago Plan are well articulated by Mervyn King, former governor of the Bank of England:

> The great advantage of reforms such as the Chicago Plan is that bank runs and the instability they create would disappear as a source of fragility. The Chicago Plan breaks the link between the creation of money and

> the creation of credit. Lending to the real economy would be made by wide banks [as opposed to narrow banks] and financed by equity or long-term debt, not through the creation of money. Money would once again become a true public good with its supply determined by the government or central bank. Governments would not have to fight against the swings in money creation or destruction that automatically occur today when banks decide to expand or contract credit. It was the sharp fall in credit and money after 2008 that led to the massive expansion of money via quantitative easing. As Irving Fisher put it, 'We could leave the banks free... to lend money as they please, provided we no longer allowed them to manufacture the money which they lend... In short, nationalize money but do not nationalize banking ...' Such reforms would indeed eliminate the alchemy in our banking system, which the official reform agenda fails to tackle.[33]

King hesitates, however, to fully support the idea, citing important opposition from the banks who fear losing the 'implicit subsidy' that they now enjoy from the government Federal Deposit Insurance Corporation's (FDIC's) coverage of depositors' accounts, and the 'disruptive' effects of such a move in the form of 'a costly reorganization of the structure and balance sheet of existing institutions'.[34]

These are not, however, sufficient grounds for not making the move. First of all, resistance from the banks to any attempt to limit their room for manoeuvre is a given. Second, the move to 100 per cent reserve banking could be carried out in stages: for instance, from 3 per cent equity to total assets to 30 per cent after four years, then to 60 per cent after eight years, and finally 100 per cent after ten years.

A move towards 100 per cent reserve banking, as noted above, has had support across the political spectrum. Those on the right see it as a step away from uncontrolled debt creation, while some on the left see it as potentially "revolutionary." Bjerg cites three reasons for the latter:

> First, control of the money supply would be shifted from commercial banks and credit markets to the central bank and the government, which would restore the government's capacity to apply measures of monetary policy in order to stabilize the economy or perhaps even steer economic development towards specific societal goals such as equality and sustainability. Second, the profits from issuing new money (seigniorage) would be reclaimed by the central bank and made available to the government for public spending rather than being appropriated by for-profit private banks and distributed to shareholders, managers, speculators or other members of the current monetary aristocracy. Rather than borrowing from private banks and investors at variable interest rates, the state would be able to borrow at zero interest from its own central bank, thus reducing or even eliminating the growing volume of debt that is currently burdening many national economies. And third, the risk of bank runs and monetary collapse would be eliminated as banks would have no other liabilities than what is immediately covered by their reserves of central bank money.[35]

4. Nationalizing financial institutions that are 'too big to fail'

The "too big to fail" problem refers to a situation where the imminent failure of a financial institution threatens to bring the economy down with it and the government is forced to bail it out to save the economy. The "too big to fail" problem was exacerbated rather than resolved by reform efforts following the last financial crisis. US government action to merge weaker with bigger banks resulted in the biggest banks in the United States becoming even bigger. The international Finance Stability Board (FSB) identified 29 banks whose failure would have negative consequences globally, thus signaling to their managements, according to critics, that they would not be allowed to fail. The Dodd–Frank legislation also encouraged moral hazard, they say, when it designated as 'systemically important' all banks with more than $50 billion in assets.

A relatively simple way to turn things around and discourage moral hazard would be to stipulate that because they are 'systemically important', banks with over $50 billion in assets should automatically be nationalized to ensure that they will not be a burden to the public should a financial crisis occur. The prospect of preventive nationalization will constitute the ultimate deterrent to the banks' efforts to grow even bigger at a time when evidence is plentiful that bigger bank size has become dysfunctional in terms of promoting efficiency, financial stability, societal welfare, and even shareholder interest.[36] Stronger deterrence can be achieved if legislation stipulates that, once a bank reaches a certain threshold, say $25 billion, this will automatically trigger an intensive government audit of its condition and performance.

The $50 billion figure is useful as it is already enshrined in the Dodd–Frank legislation—thus short-circuiting debates about what size merits the 'too big to fail' label. As for what happens to nationalized banks, they should be broken up into smaller entities in anti-trust fashion, although there should be no stipulation that these resulting entities should be in private ownership. They may also be state-owned entities, community-owned institutions or cooperative enterprises. In this regard, that state or nationalized banks can be profitable while prioritizing the needs of the community is shown in the case of the highly successful state-owned Bank of North Dakota in the US, which:

> ...had almost $4 billion in assets and a $2.67 billion loan portfolio at the end of last year [2010], according to its most recent quarterly financial report. It made $58.1 million in profits in 2009, setting a record for the sixth straight year. During the last decade, the bank funneled almost $300 million in profits to North Dakota's treasury.[37]

5. Reverting back to Glass–Steagall

One of the most consequential acts of the neoliberal era was the repeal by the Clinton administration of the Depression-era Glass-Steagall Act, which had separated commercial banking from investment banking. This had led banks to gamble recklessly with the federally insured cash of bank depositors, secure in the knowledge that losing on investments would have no detrimental consequences. One of the provisions of the Dodd-Frank Act was the Volcker Rule, which, it was said, restored the separation of commercial banking from investment banking. The Volcker Rule was supposed to do this in two ways: First, it separated proprietary trading (from which the banks were banned) from market-making activities (in which they were allowed to engage). Second, it banned banks from maintaining an in-house hedge fund of which it owned more than three per cent. These two provisions were supposed to ensure that banks would not use federally insured deposits for speculative activity.

Critics felt, however, that this was an illusion since the line between proprietary trading and market-making activities is an exceedingly porous one. Legally permissible moves to ensure that a bank's investments do not deteriorate in value can easily shade off into speculative activity implicitly backed by FDIC-insured (government-insured) deposits. Moreover, allowing an in-house hedge fund would be an open invitation for a mega-bank to plough a large part of its resources into it, since even just three per cent of a hedge fund could run into a few billion dollars' worth of federally insured depositors' money.

In other words, despite the Volcker Rule, the banks are still organically connected to the trading operations of the largely unregulated shadow banking system, with banks being allowed to use government-insured depositors' funds for risky activities such as those that led to the massive bailouts in 2008.

Under the Trump administration, a major effort has been under way to roll back the Dodd–Frank Act, with the already weak Volcker Rule being a special target. Not satisfied with the concessions they obtained allowing them leeway to use depositors' money for risky trading, the banks have proposed changes that (one report notes) "won't go so far as to eliminate the ban on proprietary trading, but...would make it easier for banks to comply and give them more control over defining what constitutes improper trading," meaning that the proposed changes "could expand the types of trading that banks are permitted to engage in."[38]

Defending an already watered-down Volcker Rule is not, however, enough. A reform agenda must include a return to the strict Glass–Steagall separation between commercial and investment banking that was one of the pillars of financial stability in the mid-twentieth century.

6. Cracking down on executive greed

Bankers continue to be very unpopular, with post-crisis scandals, like the discovery in 2016 that Wells Fargo executives had been making up millions of unauthorized accounts for thousands of unsuspecting customers, doing nothing to improve the image of the greedy, devious and overpaid banking executive. In some jurisdictions, reformers have capitalized on public disenchantment with the banks to successfully push through measures to cap or limit executive pay.

In the EU, the European Parliament enacted legislation curbing the bonuses of bank executives that capped cash bonuses at 30 per cent of total bonuses and required that at least 40 per cent of the total bonus be deferred for three to five years.[39] While there is debate on how much bite the EU caps have, their significance must not be understated. As Bertrand Badré notes, bankers are probably the only professionals to have their compensation set by EU directive.[40] Moreover, the present legislation can be a precedent for future, more stringent, bonus and salary curbs.

In Switzerland, nearly 70 per cent of voters in a 2013 referendum agreed to give shareholders a veto over executive compensation and forbade large bonus payments or "golden handshakes" to departing executives, giving the country some of the world's strictest controls on executive pay.[41] However, a referendum later that same year rejected a proposal to limit the pay of top executives to just 12 times the salary of the pay of the lowest-paid worker.

Bonus caps, ratio-based compensation and maximum pay are different ways of skinning a cat, as the Americans say. Advocates can adopt the method best suited to their electorates, a vast section of which continues to be fired by populist anger over bank executives' greed and abuses.

The banking industry, of course, will scream that pay caps will drive the best talent away from the top banks. Even if that claim were true—and it is probably not—it might, in fact, be a good thing for the best talent to be driven out of a non-productive and destabilizing industry and encouraged to go into more productive or useful occupations.

7. Squeezing out the credit ratings agencies

The role of credit ratings agencies (CRAs), like Standard and Poor's and Moody's, in helping precipitate the 2008 financial crisis is well known. They are currently on the defensive owing to the damage to their reputations, yet, as perhaps the most respected academic expert on CRAs claims, they "continue to generate little informational value, and yet be rewarded handsomely for their ratings. They continue to operate as an oligopoly with special regulatory treatment."[42]

CRAs represent a case of regulatory capture. A clear example of this was when the Dodd–Frank Act removed CRA exemption from liability for misstatements in a registration or investment prospectus under section 11 of the US Securities Act of 1933—a move that would have opened the gates to suits against the CRAs for fraud, deception, malice, incompetence, or all of the above. The CRAs responded by refusing to rate a number of new complex instruments. Then the SEC refused to implement the Dodd–Frank Act's elimination of CRA exemption from liability on the grounds that "certain parts of the asset-backed securities markets would not properly function if the SEC implemented the Dodd–Frank mandate."[43] Whatever the reason, the SEC refused to implement the law.

Given such regulatory capture, a first step in a strategy to bring CRAs under control would be a congressional review of the SEC's implementation of the Dodd–Frank provisions relating to CRAs, with the intent of preventing the SEC from flouting the law.

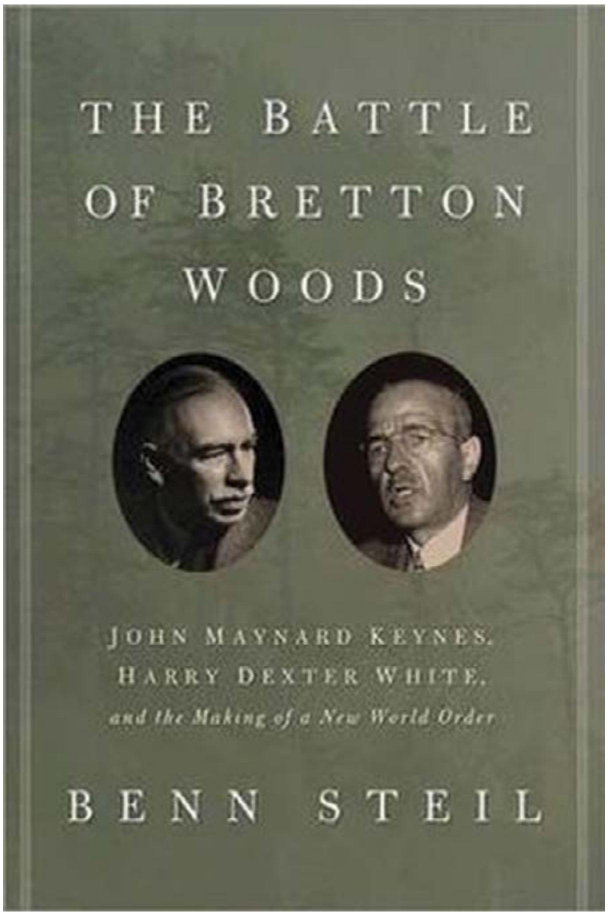
This must be accompanied by legislation to ban the CRAs from rating all derivatives and other complex securities, and by exposés of the questionable ratings methodologies of the top CRAs to encourage investors to reduce their reliance on such ratings. A fourth prong would be to apply anti-trust law to break open the cartel of Standard & Poor's, Moody's, and Fitch.

Needless to say, this campaign will have to be carried out largely in the US since the CRA giants are US-based and US-regulated entities.

8. Convoke a "New Bretton Woods"

Reforming the multilateral financial institutions is probably the most difficult area for reform since the canopy of global and regional institutions that have passed for a system of global governance are now in a state of great disarray—a situation that is perhaps at its most serious since World War Two, as a result of the erosion of the US-dominated liberal order and the crisis of globalization.

What many had hoped would serve as the lynchpin of the global financial system—the International Monetary Fund (IMF)—has failed to fill the role of banker of last resort and instead become an enforcer of depressive structural adjustment in Europe, along with Germany, the European Commission and the European Central Bank (ECB). Moreover, efforts to reform its system of representation over the last 30 years have yielded few positive results, with the Western powers determined to preserve their hegemonic position. The same failure to accommodate the big emerging economies as well as the less-developed countries has hobbled the ambition of its sister institution, the World Bank, to become the undisputed center of development finance.



The International Monetary Fund and the World Bank, two of the pillars of global finance, were founded at Bretton Woods, New Hampshire, in 1944, with two figures playing key roles, the British economist John Maynard Keynes and the leading US government representative Harry Dexter White. *https://en.wikipedia.org/wiki/The_Battle_of_Bretton_Woods*

The G20, Financial Stability Board (FSB) and Basel Committee on Banking Supervision[44] have failed to follow through on their promise of becoming Keynesian institutions promoting global financial stabilization that they displayed in the immediate aftermath of the financial crisis in 2008–09. Moreover, they are lacking in the formal legal personality that is necessary to give their actions the stamp of full legitimacy, authority and credibility.

In the meantime, alternative multilateral centers have emerged that are essentially challenging the existing system, such as the Asian Infrastructure Investment Bank (AIIB), controlled by China, the New Development Bank, and the Contingent Reserve Arrangement of the so-called BRICS. As Eswar Prasad notes:

> The AIIB stands as a perfect example of China's impatience with marginal changes in the rules of global governance. It is now grabbing the reins and seeking to rewrite the rules but in a way that ostensibly improves on the existing order, which China and other emerging markets see as having been defined by and mainly serving the interests of the major advanced economies. And there is not a dearth of interest in the AIIB, showing that there is little hesitation among both emerging and advanced economies in joining a Chinese-led institution.[45]

Rather than piecemeal reform, what is perhaps needed now at the global level is a new Bretton Woods Conference that would match—if not surpass—in ambition the historic meeting of July 1944 that set up the World Bank and the IMF. This would be a ground-breaking effort to create more representative institutions to govern the global financial system, reform the international monetary system, and organize financing for economic development, social development and environmental restoration.

With trends away from globalization accelerating, the world would probably be better served by a decentralized system of institutions instead of the centralized IMF–World Bank–WTO consortium of global governance that has prevailed during globalization's rise, which has been structurally prone to capture by the world's most powerful nations, and that has served mainly the interests of the global elite. Aside from decentralization, among the principles that should guide the new system would be upholding developmental space for national economies, especially in the global South, the reduction of inequality both within countries and among countries, and achieving a balance between economic development and environmental protection.

In the area of global finance and the monetary system, four key reforms are needed:

1. An effective, global system of capital controls and currency taxes to counter the power of private equity funds and hedge funds to shift capital from one jurisdiction to another to take advantage of differences in investment opportunities or currency exchange values.
2. More stringent taxes on the rich at the national level while preventing them from fleeing to tax havens through coordinated regional or global efforts to shut down the latter.
3. The establishment of institutions to provide financing for development, climate, and public health that will be funded by state funds derived from taxing national and global elites instead of drawing them from private–public partnerships with institutional investors that can easily be subverted by the latter. Along with the first two reforms, this reform is urgently needed to curb the power of institutional investors, who are now the most powerful players in the global economy.
4. The urgent establishment, by international agreement, of a fiat currency to serve as an international means of exchange to end the dollar's monopoly as a reserve currency—a condition that allows not only unfair seigniorial advantages to the United States but is increasingly destabilizing to national economies. The same objective of diluting the strength of the dollar could be achieved by international or regional agreements to substantially increase the use of other strong currencies such as the euro, yen, Swiss franc and renminbi in international or regional settlements.[46]

9. Make the Central Bank provide liquidity to the public instead of private banks and make it accountable to the public

Central banks, it is said, became 'the only game in town' after the outbreak of the 2008 financial crisis.[47] Not unexpectedly, this prominence drew serious criticisms from various quarters. These have to be addressed by any reform program.

One charge is that central bank efforts to provide liquidity to the financial system (QE) by buying banks' assets including

President Barack Obama confers with Federal Reserve Chairman Ben Bernanke at the height of the global financial crisis of 2008-2009. *https://en.wikipedia.org/wiki/Ben_Bernanke#/media/File:President_Barack_Obama_meets_with_Federal_Reserve_Chairman_Ben_Bernanke_4-10-09.jpg*

toxic ones led to them sitting on the money, using it for speculation, or employing it to buy back their own stocks. For instance, liquidity provided by the Federal Reserve was instrumental in JPMorgan Chase's plan to buy back $19.4 billion of its own shares, its most ambitious program since the 2008 crisis, and in Citigroup's effort to buy back $15.6 billion of its stocks.[48]

This criticism is valid. There is no reason why the money created by the central bank should be channeled through the private banks—except as a result of ideological bias. Handing money directly to the people to create demand and ignite the economy was caricatured by Wall Street as former Federal Reserve Board Chairman Ben Bernanke dropping dollar bills from helicopters because they were worried that such a move would underline how superfluous they (the banks) were. But there are other, more constructive and socially useful ways to get money into people's hands in a downturn—for instance, by directing money to public works programs to repair infrastructure, or by investing in the research and development of technologies for the generation and distribution of renewable energy. There is no limit to the possibilities of socially useful investment that would trigger demand and generate employment for which central bank-created liquidity could be used. When fiscal measures are stalled by right-wing opposition, channeling central bank-created liquidity to such demand- and employment-generating projects would do much more to help an economy in recession than giving money to banks to sit on, speculate with, or use to buy back their own stocks.

Another serious criticism of central banks is that, with their larger role, society is putting its future more and more in the hands of 'unelected power', thus subverting democratic accountability. This is much like the charge of democratic deficit levelled at the EU technocracy. It is also related to the concern that the ideal of 'central bank independence' effectively means central bank non-accountability to society.

The idea of central bank independence has recently taken a drubbing. For some, it simply isn't true in practice, and the most egregious example cited is the way in which the ECB became an abject servant of the German Bundesbank and the German government's push to impose harsh austerity policies on Greece.

For some, it is a bad idea. In this view, it is essential that in democratic systems there is no non-accountable institution and that the lines of accountability are spelled out clearly. In representative democracies, the accountability of executive agencies is to both the chief of state and to the legislative power. Even if, as in the case of the Federal Reserve and the ECB, the legislative power does not fund the central bank, for reasons of democratic accountability it is imperative that the latter must be accountable to the former: for example, Congress in the US and the European Parliament in the EU.

Had EU authorities been clear about the subordination of the ECB to a mature European legislative body, there is a good chance that the devastating austerity policies that were imposed on Greece, Portugal, Spain and Ireland could have been avoided. Instead, what we saw was the worst of all possible worlds: a nominally independent central bank implementing the policies of the powerful Bundesbank and German government. As Yanis Varoufakis so aptly put it: '[W]hile Gordon Brown could rely on the Bank of England to pump out the cash to save the City of London, eurozone governments had a central bank whose charter did not allow it to do the same. Instead, the burden of saving the inane bankers fell on the weakest citizens.'[49]

Central bank independence might have seemed of not much consequence in the early twentieth century, but things are different now. The Federal Reserve is now one of the most powerful institutions in Washington, unconstrained by checks and balances, as the former chief economist of the US Department of Labor wrote:

> It would be wrong to infer that the Fed is suited to its heroic role. Our constitution, our history and even our common sense tell us that Congress and the president should sort out the federal budget. They are elected and answerable to the public, and the Fed is not... The Fed and its chairman are unaccountable. Most government agencies complain that another branch or office of government stops them from doing what they would really like to do... Call it gridlock, call it checks and balances, call it what you like—our federal government is well-designed to block extraordinary gyrations and dramatic changes in policy... Not so the Fed. With little more than a wink and a nod, the Fed and its chairman can purchase practically all the paper it wants, currently $85 billion a month, in Treasury and mortgage-backed securities. No small feat... Who within government could block the Fed from making these purchases or pursuing almost any other action? No one, it turns out. The Fed is an agency that has largely escaped oversight... It operates without check, without balance. It appears to work when the other

branches of government fail, but it offends our sense of constitutional democracy.[50]

While it might be an exaggeration to say that the chair of the Federal Reserve is the most powerful official in Washington, it is arguable that he or she is the second most powerful. True, the president nominates the Federal Reserve chair, but once nominated and confirmed by the Senate, there is no check to his or her power. For such power to be legitimate in a democracy, its possessor must be elected.

It is, in short, high time for the position of the central bank chair to be a nationally elected one.

10. Promote Public Banking and Public Investment

Private finance oriented towards profit making brought the much of the world to its knees in 2008-2009 and trapped it in stagnation for most of the succeeding years. Public financing and public spending stepped up briefly after the crisis with monetary and fiscal stimulus programs, but neoliberal ideology and finance capital pushed back and succeeded in driving public money back to its role of supporting private finance. Recently, however, the massive government spending throughout the world to provide financial support for people during the Covid 19 lockdowns without the usual limits prescribed by neoliberal ideology has shown people what government can do to promote the public interest when it has the political will.

Massive public finance for public investment designed to serve the public welfare, like better public health systems, more green spaces, public housing, and low-carbon energy generation and transportation systems, is greatly needed at this point, and the Covid 19 response could be a turning point in terms of institutionalizing it, much like the Depression did for the New Deal of President Franklin Delano Roosevelt.

Existing public financial resources are limited but not inconsiderable. It has been estimated that there are 693 public banks worldwide with assets worth US$37.72 trillion. Public finances are said to amount to over US$73 trillion, once central banks and multilaterals such as the Asian Development Bank, as well as pension and sovereign wealth funds are included. This figure comes to 93 per cent of global gross domestic product.[51] The challenge is to liberate this money from its being used either to support private finance or to be subjected to the limitations of neoliberal ideology, a cardinal principle of which is that public spending must not compete with private spending.

Contrary to a widespread impression, there are successful cases of public banks, like the state-owned Bank of North Dakota mentioned earlier. Aside from state-owned banks, there are other community-oriented financial institutions that are performing admirably. In the Indian state of Kerala, according to Benny Kuruvilla, there are 980 cooperative banks and 1647 agricultural credit societies, with total deposits of some $2 billion. They finance productive activities in the state's much admired "social solidarity economy." The government now plans to bring all these units into the Kerala Cooperative Bank to make the resulting network more effective.[52]

Another example of successful community-oriented finance is Costa Rica's Banco Popular, which is owned by 1.2 million Costa Rican workers. Regarded by some as possibly the world's most democratic bank, it finances cooperatives and groups that are marginalized by private finance, such as workers, peasants, and small and medium-sized enterprises.[53]

Sovereign wealth funds are government-owned investment funds that have a strong potential to be turned into a source of financing public goods. A leader in this regard is Norway's Pension Fund Global, the world's largest sovereign wealth fund, which has divested over $8 billion from coal and eliminated investments in 60 companies associated with deforestation, including 33 companies involved in oil palm production.[54]

Wealth Funds need not be only national in scale. A new model that is emerging from a variety of experiences in Europe and the United States is the "citizens' wealth fund."

Pointing to the successful Bank of North Dakota, a protester supports public ownership of the banks during Occupy Wall Street in October 2011.
https://en.wikipedia.org/wiki/Bank_of_North_Dakota#/media/File:Day_21_Occupy_Wall_Street_October_6_2011_Shankbone_3.JPG

Managed independently of the state, these funds could be owned by citizens' groups organized at a sectoral level or at a regional or municipal level. They could be funded by wealth taxes on corporations levied on a percentage of their profits or through dividends via an allocation of corporate shares. The merits of this mechanism are spelled out by Stewart Langley and Duncan McCann:

> For the first time ever, all citizens would hold a direct and equal stake in economic success, with the fund automatically capturing a growing part of the gains from economic activity and distributing it equally. A fund would act as a counterforce to growing inter-generational inequities by slowly transferring a small portion of private wealth, which is disproportionately owned by older generations, into the permanent fund to be shared across future generations. A further strength is that this new economic instrument would help ensure that public assets would be better managed than they have been in the past.[55]

Much thinking and policy advocacy on public finance has recently been associated with the Green New Deal, whereby the key concern is how to raise the funds to combat global climate change. Some estimate that the total cost to contain or reverse climate change will come to $90 trillion, with $6 trillion needed to be raised annually.[56]

In a recent publication by the Transnational Institute and the Institute for Policy Studies, Oscar Reyes lays out six key principles to guide climate financing that are worth laying out in some detail.[57]

First, Central Banks should move from Quantitative Easing (QE), whereby they buy the assets of private banks to enable the bank to create money to lend to corporate clients, to buying bonds from green investment banks.

Second, governments should enact "green credit policies" that "set minimum requirements for the proportion of bank loans targeting green projects and upper limits on lending to carbon-intensive sectors."

Third, green development banks should be created to finance public and community investments in renewable energy and fossil-fuel free energy efficiency projects at concessional rates.

Fourth, there should be a concerted citizens' effort to get the insurance industry to divest from coal.

Fifth, governments should legislate the creation of corporate charters, including financial corporate charters, requiring corporations to desist from harmful economic activities and promote positive ones in communities where they are based.

Finally, there should be a concerted citizens' effort to push the greening of pension funds which manage the retirement funds of a very large number of workers and other people. These funds "should reclaim their 'public' dimension through a revised investment mandate that factors in environmental and social as well as economic considerations. This process should start with divesting from fossil fuels and assessing the climate-related financial risk of their whole investment portfolios to ensure that they are fully compatible with a 1.5°C climate target."

Representative Alexandria Ocasio-Cortez (center) speaks on the Green New Deal with Senator Ed Markey (right) in front of the Capitol Building in Washigotn, DC, in February 2019. *https://commons.wikimedia.org/wiki/File:GreenNewDeal_Presser_020719_(26_of_85)_(46105848855).jpg*

THE BIGGER CONTEXT

V

The last section proposed solutions to address the key problems created by global finance, starting with what has emerged as the main threat after the 2008 financial crisis. The measures proposed constitute a "minimum program": that is, a set of moves that strengthen the world's defenses against another financial crash while not eliminating the possibility of such an event. Capitalism as a system is structurally prone to generate financial crises, and the program outlined here assumes a global economic system that continues to function under the rules of capitalism. State intervention triggered by the Covid 19 pandemic has shown people throughout the world that governments can act decisively.

While these reforms, if enacted, will constitute a giant step in a longer process of transformative change, their durability cannot be guaranteed. A lesson worth pointing out here is the demise of the first round of Keynesianism, which in its heyday—the period from the late forties to the late seventies—was thought to have smoothed out and mastered the contradictions of capitalism. Perhaps we can gauge the long-term viability of the proposed reforms designed to discipline finance capital if we take a close look at the sources and dynamics of financial crises, in particular the 2008-2009 crisis.

The fundamental problem: inequality and falling demand

This investigation, we think, would yield the realization that ultimately it was the dynamics of the real economy that was the real determinant of developments in the financial economy. This was not a novel insight. From the perspective of Marxist economists, the gyrations of the financial economy were a result of the deep-seated contradictions of the real economy, in particular the tendency towards overproduction, or supply outstripping demand.

One cannot understand the 2008 crisis and its aftermath without taking into account the crisis of overproduction that had put an end to the long boom known as the *Trentes Glorieuses*, from the late 1940s to the late 1970s. The escape route from the 'stagflation' crisis (a combination of stagnation and inflation) that gripped the industrial world was a combination of neoliberal restructuring, globalization of production, and financialization.

Neoliberal restructuring essentially involved a redistribution of wealth towards the rich "investor class," which in theory would create incentives for them to invest in production. Meanwhile, production was globalized—through the transfer of productive facilities to take advantage of the cheap labor in developing countries—in the hope that this would make production more profitable. But these two neoliberal measures were wracked by a contradiction. By cutting into or restraining the income of workers and the middle class in favor of the so-called investor class, they ended up restraining the demand for products. This left the system resorting to financialization as the main way to escape the conundrum of overproduction.

Financialization involved channeling surplus capital to speculation as the key source of profits, along with the creation of vast debt to increase aggregate demand—and thus profitability—in the real economy to compensate for stagnant or declining wages. Financialization depended on the creation of speculative bubbles to drive investment, the results being the dot.com bubble in the late 1990s, followed by the subprime mortgage bubble in the mid-2000s. Not surprisingly, over-investment in these areas followed, and this resulted in the deflation of these bubbles followed by recession and stagnation. With little natural demand in the economy, fabricated demand through the injection of trillions of dollars in cheap money into the banks became the instrument to trigger demand and thus bring the economy back to life. That solution seems to have run its course and we are back to the underlying problem that now seems so intractable: inadequate demand.

The role of depressed wages and sharply rising inequality in reducing the dynamism of the real economy has been even more sharply emphasized recently by progressive researchers. To Josh Bivens of the Economic Policy Institute, “The failure of wages of the vast majority of Americans to benefit from economy-wide growth in productivity (or income generated in an average hour of work) has been the root

> ONE CANNOT UNDERSTAND THE 2008 CRISIS AND ITS AFTERMATH WITHOUT TAKING INTO ACCOUNT THE CRISIS OF OVERPRODUCTION THAT HAD PUT AN END TO THE LONG BOOM KNOWN AS THE TRENTES GLORIEUSES, FROM THE LATE 1940S TO THE LATE 1970S. THE ESCAPE ROUTE FROM THE ‘STAGFLATION’ CRISIS (A COMBINATION OF STAGNATION AND INFLATION) THAT GRIPPED THE INDUSTRIAL WORLD WAS A COMBINATION OF NEOLIBERAL RESTRUCTURING, GLOBALIZATION OF PRODUCTION, AND FINANCIALIZATION.

cause of the stratospheric rise in inequality and the concentration of economic growth at the very top of the income distribution."[58] Not only was this producing a social crisis, but the lack of aggregate demand became the central factor responsible for weak growth, with data showing that even before the Great Recession that followed the 2008 crisis, growth had already been constrained "more by slow growth in aggregate demand than by slow growth in the economy's productive capacity".[59]

Not surprisingly, the crisis of demand was degrading productive capacity, resulting in a negative feedback termed 'hysteresis' by economists:

> There is ample evidence that the degraded growth in potential output is itself another casualty of too-slack demand. It is now well-known that changes in productive capacity (i.e., the supply side of the economy) are likely affected by changes in the demand-side of the economy. The most obvious example concerns capital investment. When demand is weak, customers disappear and workers' wages don't grow as fast, or grow at all, as rising unemployment crushes workers' bargaining power. A shortage of customers and weak wage growth blunts the incentive of firms to invest in plants or equipment to expand capacity or save on labor costs. This in turn slows the growth of the economy's capital stock, a key input in its productive capacity. Short recessions will leave only a small scar on an economy's productive capacity, but there is now ample evidence that longer and steeper recessions can do serious damage to even the economy's *potential*, let alone *actual*, growth. We have clearly seen this dynamic over the past decade.[60]

Orthodox economists and "secular stagnation"

An interesting development is that a number of influential orthodox economists have now swung around to the progressive position of attributing what they have called 'secular stagnation' to a crisis of profitability in the real economy. For instance, David Lipton, the First Deputy Managing Director at the IMF, revealed in an important 2016 lecture at the Peterson Institute that one school at the International Monetary Fund, to which he apparently belongs, feels that "low growth is a symptom of an increasing scarcity of profitable investments that began well before the 2008 crisis. Real interest rates have been falling for 15 years and, looking at very low interest rates on long-term bonds, markets appear to expect a long-lasting secular stagnation".[61]

Perhaps the establishment economist most associated with the theory of secular stagnation is Larry Summers, former Secretary of the Treasury under Bill Clinton and one of Barack Obama's key economic advisers. To Summers, the central problem of the economy was the weak demand in the real economy over the last two decades, and extraordinary measures have not been able to surmount it. As he expressed it in one interview, "One of the arguments that I've made is that we had the mother of all housing bubbles, we had a vast erosion of credit standards, we had really easy money, we had the Bush tax cuts plus the Iraq war, and all that got us in the pre-crisis period was adequate growth. Doesn't that show that there's some kind of secular stagnation that you needed all that extraordinary stuff to get to adequate plus growth?"[62] Like the EPI's Bevins, Summers says that hysteresis, or an amplifying of negative feedback, is the result, as "lack of demand creates its own lack of supply down the road in terms of productivity growth".[63]

The American economist Larry Summers is the academic most associated with the theory of secular stagnation, which holds that the world economy faces a future of stagnation of very low economic growth for the foreseeable future. The Covid 19 pandemic threatens to turn stagnation into a deep recession, if not a depression.
https://commons.wikimedia.org/wiki/File:Lawrence_H._Summers_World_Economic_Forum_2013_(2).jpg

To Summers and other secular stagnation theorists, the loss of dynamism is something that affects not only the industrial world, where maturity is accompanied by lower growth rates, but the developing world as well. For Lipton, the convergence with the advanced economies that had been touted as one of the benefits of globalization by its neoliberal proponents was slowing down in the case of developing economies. But perhaps more alarming, he noted, "IMF projections suggest that many major emerging economies are not headed for convergence at all. For many countries, even abstracting from currency movements, per capita income is either flat or falling as a share of U.S. per capita income… Productivity gains and capital deepening look set to fall short, contributing to political strains as expectations of better jobs and higher living standards are not realized. Sadly, this now appears to be true of Brazil, Russia, Mexico, South Africa, and others."[64]

The limits of financial reform

If weak demand in the real economy brought about by inequality is the problem, then it is obvious that quantitative easing and negative interest rates can only bring very limited and temporary relief to an economy in crisis, and creating debt may in fact deepen the crisis in the medium term.

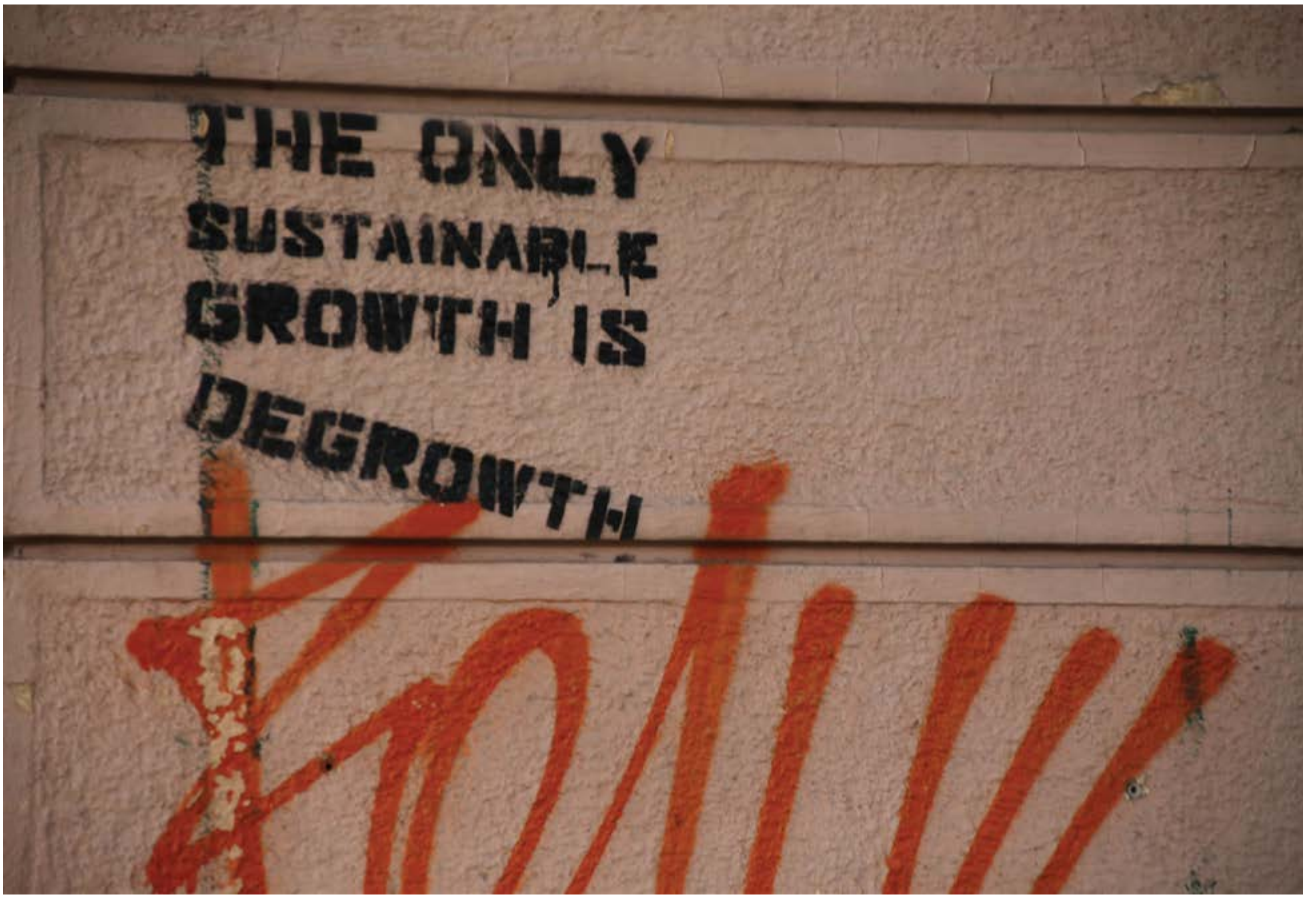
Moreover, a program of reform for the financial sector, such as that we outlined in the previous section, would likewise be insufficient to bring longer term stability to the financial sector. Indeed, without addressing the crisis of demand in the real economy, a reformed financial sector would find it difficult to resist for long the intense pressures for capital to seek profitability in finance rather than in a stagnant productive sector.

In sum, a program of financial reform would have to be integrated into a more comprehensive program of reform of the real economy. This enterprise would have to seriously address the lack of demand rooted in increasing inequality. It would have to bravely acknowledge its roots in the unequal power relations between capital and labor, how this unequal power translates into increasing inequality, and how inequality translates into anemic demand that acts a brake on the expansion of production. So are we back to Keynesianism as the solution?

Reformed capitalism or post-capitalism?

The problem with a Keynesian solution is twofold:

First, the fundamental dynamic of capitalism is the search for profits, and while this might be momentarily quenched by rising demand, leading to a temporary "virtuous



An increasing number of economists and activists see degrowth as the key solution to the climate crisis and that global finance must be tamed and repurposed to bring it about.
https://commons.wikimedia.org/wiki/File:The_Only_Sustainable_Growth_is_Degrowth.jpg

relationship" between rising living standards and rising profits—as happened during *trentes glorieuses*—over the long term the two run into conflict, leading again to neoliberal solutions like financialization so long as the economic system is capitalist. For capitalists and their state agents, restoring and increasing profitability is key, even if it means sacrificing the dynamism of a system of production that can only function if there is rising demand. This tendency was expressed thus by Marx in this inimitable fashion: "'[To the possessor of money capital] the process of production appears merely as an unavoidable intermediate link, as a necessary evil for the sake of money-making. All nations with a capitalist mode of production are therefore seized periodically by a feverish attempt to make money without the intervention of the process of production."[65]

Second, the engine of Keynesian capitalism is increasing demand, which means economic growth. This means larger and larger volumes of carbon emissions. Keynesians would say, not necessarily, since "dematerialization" or the decreasing amount of materials that go into a product owing to advances in information technology combined with greater energy efficiency throughout the economy could "decouple" growth from energy emissions.

The problem with the decoupling argument is twofold.

First, there is no evidence of absolute decoupling of growth and carbon emissions either at a global level or among low, medium, and high income country groupings between 1965 and 2015, although this may have occurred in some countries. Also, there is no evidence for absolute decoupling of growth and resource consumption. Indeed, "Global resource intensities (the ratios of resource use to GDP), far from declining, have increased significantly across a range of non-fuel minerals. Resource efficiency is going in the wrong direction. Even relative decoupling isn't happening."[66]

Second, what appears be happening is the rebound effect or "Jevons effect," after the British economist William Jevons, who formulated the observation that by raising the productivity of coal, that is, making its use more efficient in the production of iron, the price of iron would drop, creating more demand for iron and consequently increasing the use of coal. Efficiency gains in one area translate into savings that increase energy consumption in other areas, thus raising fossil fuel use overall and raising carbon emissions. Thus Tim Jackson says that "simplistic assumptions that capitalism's propensity for efficiency will allow us to stabilize the climate and protect against resource scarcity are nothing short of delusional."[67]

It appears then that another round of Keynesian capitalism will merely postpone the capitalist class's demand for higher profitability and exacerbate the climate crisis. What appears to be clear is that capitalism, whether of the Keynesian or the neoliberal variety, cannot reconcile the two critical needs of our time, greater equality and radically bringing down carbon emissions. Coming to grips with the financial crisis inevitably leads to a solution outside capitalism, whether we call that system post-capitalism, social democracy, or socialism.

CONCLUSION

VI

The Covid 19 pandemic may have postponed another debacle: another global financial crisis. And the halt to production and speculation it has occasioned may provide the breathing space to undertake the much-needed reform to prevent such a crisis from transpiring.

Over ten years since the 2008-2009, few of the needed reforms have been enacted and implemented, and the few that have, like the Dodd-Frank legislation, have been quite weak.

10 key reforms remain to be done:

1. controlling hedge funds and other institutional investors;
2. banning toxic investment instruments like derivatives;
3. moving towards 100 per cent reserve banking;
4. nationalizing institutions that are too big to fail;
5. reverting back to the strict separation of commercial banking from investment banking;
6. cracking down on executive greed;
7. squeezing out credit ratings agencies;
8. convoking a new Bretton Woods Conference;
9. making central banks provide liquidity to the public instead of private banks and making them accountable to the public; and
10. promoting public finance and public investment.

These reforms can be accommodated within the capitalist system, but it is a big question how lasting they can be owing to the dynamics of an economic system inexorably driven by the search for profitability. A new Keynesian capitalism may simply give in over the medium and long term to a new neoliberalism that again liberates finance capital in the name of restoring profitability. Moreover, reform Keynesianism assumes continuously rising demand and economic growth, making it ecologically unsustainable. These concerns raise the question of whether the goals of achieving equity and ecological stability might not, in fact, necessitate the movement towards a new system of production.

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APPENDIX: EAST ASIAN FINANCE AFTER THE ASIAN FINANCIAL CRISIS OF 1997-98

Though the economies of East Asia were negatively impacted by the Great Recession that followed the Global Financial Crisis of 2008 due to the downturn of their exports to Europe and the United States, their financial sectors were relatively unscathed. There were three reasons for this.

First, in the aftermath of the Asian Financial Crisis of 1997-98, Asian banks were, by and large, able to resist the efforts to liberalize them and pave the way for greater participation by western financial interests.

Second, vowing never to fall victim again to western speculators, the Asian countries engaged in major export drives, proceeds from which were converted into massive dollar reserves.

Third, Asian governments and banks were extremely cautious in dealing with Wall Street after they had been burned by the destabilization caused by the volatile entry and exit of western speculators in pursuit of profits from the real estate boom and bust cycle and their efforts to derive profits by speculating on the collapse of their currencies. In fact, one can say that Asian finance turned the tables on Wall Street by providing the massive inflow of funds that contributed to the debt-financed bubble that burst in 2008.

Resisting Liberalization

The IMF and western political and economic interests took advantage of the Asian financial crisis of 1997-1998 to impose what they described as 'international best practices' in the governance of banks and corporations in crisis-hit countries. The aim was to break up what were branded as 'crony capitalist coalitions' and open up the economy to greater foreign investor presence. This push appears at first glance to have achieved notable success, but as Andrew Walter points out, government and business interests evolved a strategy of 'mock compliance'. Mock compliance was formal compliance with the demands of external forces through the passing of new laws reforming the banking system and establishing the independence of regulators, coupled with informal resistance to or noncompliance with these formal strictures by entrenched private sector interests. Explaining why Indonesia registered full compliance with only two out of 25 of the Basle Core Principles forged by the neoliberal global banking establishment, Walter writes:

> It is clear that ratification failure has not been the main obstacle to substantive compliance in Indonesia. Although there were delays in legislation and implementation…

> most of the formal regulatory framework was in place by the end of 1999. Given this, private sector opposition to compliance shifted to less visible forms. It is difficult to judge the relative importance of regulatory forbearance, administrative failure, and private sector compliance avoidance in substantive compliance failures, because all three are often interrelated in the Indonesian case.[1]

The Asian Financial Crisis of 1997-98, whose main victims were South Korea, Thailand, Malaysia, the Philippines, and Indonesia, brought the "Asian Miracle" to an end. To climb out of the crisis, these economies engaged in massive export drives to gain the foreign exchange that would protect their currencies from future attacks by speculators who had brought them to their knees during the crisis. *https://en.wikipedia.org/wiki/1997_Asian_financial_crisis*

In Thailand, the post-crisis hegemony of neoliberalism was even more short-lived. In 2001, the pro-IMF governing coalition was ousted by the election of a parliamentary contingent dominated by the Thai Rak Thai Party (TRT) led by Thaksin Shinawatra. Thaksin promptly paid off Thailand's debt to the Fund and declared Thailand's 'independence' from the institution. After three stagnant years under governments faithfully complying with the IMF's neoliberal prescriptions, the Thaksin administration propelled countercyclical, demand-stimulating neo-Keynesian policies to get the economy back on track. The Thai government provided low-interest loans, instituted government-financed universal health care, and gave each village 1 million baht ($40,000) to spend on special projects. Despite dire predictions from neoliberal economists, these measures contributed to propelling the economy onto a moderate growth path.[2]

As for financial and corporate reforms that had been initiated in the aftermath of the crisis, these fell by the wayside, with the government spending little energy in support of them. Indeed, upon taking power, says Allan Hicken:

> Thaksin immediately put the brakes on privatization and liberalization. When the privatization effort was finally revived in 2003, shares were generally offered only to domestic stockholders, and where foreign investors were involved, their shares did not carry voting rights. In the area of telecommunications, the setting up of an independent regulatory agency, mandated by law, slowed to a crawl. At the same time, the government worked to keep the sector closed to foreign participation—all to the benefit of Thaksin's companies.[3]

Defensive Measures

Governments throughout Southeast Asia, for the most part, saw IMF reforms as a means by which western interests were prying open their economies under the guise of ending 'crony capitalism'. While they felt compelled to make some concessions because they had accepted IMF rescue funds, they wanted to yield as little ground as possible, substituting mock compliance for substantive compliance. What they focused on instead were measures to protect their economies from the western financial speculators that had targeted their currencies and brought on the crisis. Never again would they allow this to happen. It is therefore not surprising that all countries geared up their export sectors to earn dollars that could then be stowed away as foreign reserves to be deployed for future battles against speculators. Reserve accumulation was a form of 'self-insurance' from future crises by countries that had been taught the bitter lesson of relying on the IMF when facing capital account and current account crises. From less than one trillion dollars before the Asian Financial Crisis, East Asian countries had accumulated over four trillion dollars by 2008.[4]

The 2018 Korean film "Default" depicted the IMF's assumption of the management of Korea's financial sector. *https://en.wikipedia.org/wiki/Default_(2018_film)*

Countries in the region also sought to create regional arrangements that would substitute for reliance on the IMF. In September 1997, at the height of the crisis, Eisuke Sakikabara, then Vice Minister of Japan's Ministry of Finance, proposed the creation of an Asian Monetary Fund (AMF), the bulk of whose funding would come from Japan. This was vetoed by the US and China, the former because it feared the emergence of a rival to the International Monetary Fund, which it dominated, and the latter because it might lead to the creation of a 'Yen Bloc' that would enhance Tokyo's geopolitical and geo-economic position. Indeed, the AMF initiative did seem to be one that sought to advance Tokyo's desire to accelerate the region's recovery as well as speed up its integration under Japanese auspices in order to pull Japan out of its stagnation.

More successful was the strategy of forging of a network of bilateral agreements that would promote sharing of reserves among countries if any of them came under attack by currency speculators. This was the ASEAN+3 Network, better known as the 'Chiang Mai Initiative'. Though the bilateral swap amounts agreed were not that substantial, the Chiang Mai Initiative was nevertheless of great significance for the different regional actors, according to Asia specialist Jennifer Amyx:

For a few actors in the region, such as Indonesia and the Philippines, this project represents, foremost, a borrowing facility, allowing these countries to potentially draw on more foreign exchange reserves than each alone possesses. For the ‘plus three’, which have abundant foreign exchange reserves, it, foremost, provides an opportunity to build political capital with Southeast Asia, as well as some leverage for pressuring international financial institutions such as the IMF to address more seriously their underrepresentation of Asia. For other ASEAN economies, such as Singapore, Thailand, and Malaysia, this project is most useful for the opportunities that its accompanying policy dialogue process provides to exert peer pressure on China. It also offers insights into developments in China at a time when changes in the Chinese financial system and foreign exchange regime could have huge effects on the operations of its neighbors.[5]

The Korean Exception

Among all the East Asian economies, Korea was probably the most transformed by the neoliberal push from external powers. While the chaebol and the banks did put up strong resistance and were able to slow down some reforms, for the most part the neoliberal push was successful. Perhaps the most salient indicators are in the financial system. About a decade after the crisis, foreign investors now have majority stakes in six out of seven nationwide commercial banks, gaining control of three. Some 33 to 50 per cent of bank assets in the country are accounted for by the foreign-controlled banks. Liberalization of the capital market has led to the share of equity-market capitalization by foreigners reaching 43.3 per cent.[6] Foreign institutional investors have also built up considerable stakes in the bulk of listed Korean blue-chip companies, though they do not yet control them.[7]

Perhaps the most reliable assessment of the state of liberalization of the Korean economy is provided by Jungryn Mo, who argues that foreign capital has made inroads into Korean financial markets and even dominates the banking sector, although ‘Korean banks and companies have failed to reach transparency and accountability standards comparable to those of their competitors in advanced economies’ and ‘the movement of the financial system toward a market-based system has been progressing… at an uneven pace.’[8]

Indeed, one can even say that in some instances the government has been more lenient with foreign-owned institutions than with domestic ones. In one notorious instance this almost led to another financial disaster: while the government pressured domestic banks to offset their debts with foreign currency denominated assets so as to square their foreign exchange positions, it did not require foreign banks to do the same. As a consequence, the short-term debts of foreign banks piled up very rapidly, exceeding those of domestic banks by 2006. When the 2008 financial crisis hit, the Korean won depreciated by almost 30 per cent, leading to a situation where the ratio of international reserves to short-term debt fell rapidly from 200 per cent in 2006 to 126.4 per cent in the third quarter of 2008. What saved Korea from plunging into its second financial crisis in 10 years was a $30 billion currency swap approved by the US Federal Reserve Board in October 2008.[9] The roots of the near disaster, according to Yasonobu Okabe, lay in the post-Asian financial crisis policy of the Korean government, which was 'highly permissive to the entry of foreign capital,' leading to 'highly optimistic' government expectations that 'were disappointed by the large capital flight by foreign banks.'[10]

Why was post-Asian financial crisis liberalization so successful in Korea but so limited in its impact elsewhere in East Asia? Part of the answer lies in the strong popular support from the population enjoyed by the crisis-era reform government of Kim Dae Jung as a result the widespread perception that the reckless borrowing from international lenders by the chaebol or conglomerates created the crisis. But another part of the answer lies in geopolitics. The Korean economy could not be allowed to go under by the US, which saw Korea as its front-line military protectorate. Thus, the US government was directly involved in the rescue program, not leaving this to the IMF to manage alone. As noted earlier, it was pressure from the US Treasury Department that got international banks to roll over their loans to Korea at a crucial juncture in the crisis. The quid pro quo was firm government action to carry out the neoliberal reorganization of labor, the disciplining of the *chaebol,* and the opening up of the financial sector to US and other foreign firms. Despite labor protests and resistance from the *chaebol* and the banks, the Kim Dae Jung government and its successors fulfilled their part of the deal. At the end of one decade of reform, the vaunted Korean developmental state had been replaced by a neoliberal state. No longer was Korea the most difficult place to do business in, as US firms were wont to complain before the Asian financial crisis.

'Asia's revenge'

The success of the US in gaining the upper hand in its effort to open up Korea and Asia was not the end of the story. As noted earlier, to protect themselves from further attacks from western speculators, the economies of the region engaged in an export drive that netted them billions of dollars—a great part of which was cornered by the region's central banks. East Asian reserves—excluding Japan's—went from less than $100 billion in 2000 to more than $4 trillion in 2007. The central banks did not, however, keep all of these reserves in a state of hibernation—after all, banks must use money to make money. A large part was recycled back to developed economies through the purchase of assets such US Treasury bills. Much of this was then re-lent to private financial institutions that used it to create credit that financed US consumer spending, particularly in housing. This credit helped create the housing and consumer-spending bubble that collapsed in 2007-200. While Asian money did not create the global financial crisis, it was, unwittingly, a contributing factor. While the US and European financial systems were savaged by the crisis, Asia's financial institutions escaped, virtually unscathed. Such was 'Asia's revenge'.

Avoiding Toxic Securities

Successfully resisting liberalization pushed by the IMF and the United States was one reason Asian banks were able to avoid being drawn into the maelstrom of the 2008 global financial crisis. A second reason was the massive export drive that netted billions of dollars that made these economies less reliant on western finance.

The third reason was that Asian banks for the most part had very little exposure to toxic securities like the subprime mortgage securities that key US and European banks carried on their balance sheets and which brought many to the brink of collapse. The Asian financial crisis had taught Asian banks to be very cautious about adopting the products of financial engineering from Wall Street that claimed to eliminate risk. As one former high official of the Central Bank of Thailand revealed, 'As soon as the crisis broke out on Wall Street, I had my people inspect the liabilities of our banks, and they found very little exposure to subprime securities.'[11] It is also likely that banks in Malaysia, Indonesia, and the Philippines had little exposure since there were no reports of any major banks in these areas that were destabilized in a major way by Wall Street's crisis.

Indeed, this caution was related to the successful resistance to liberalization since foreign stockholders in a liberalized banking sector would probably have promoted purchases of Wall Street's toxic securities.

As noted above, liberalization in Korea nearly led to the country's being dragged into another crisis, but in the case of Japan, the banks and financial authorities were, like their Southeast Asian counterparts, very timid about experimenting with Wall Street's financially engineered products, enabling them to escape the global financial fallout. Recently, however, Japanese banks have begun trading in derivatives and other questionable products—something that formerly cautious banking experts now support in the name of 'financial upgrading.'[12] Moreover, banks have plunged into fintech, or the innovative consolidation of financial services for corporate and individual consumers that were formerly handled by diverse financial intermediaries. As one noted economist asserted, the fintech craze may lead Japanese banking into new uncharted waters.[13]

Public banking

In terms of financial initiatives that benefit the public, as opposed to the one per cent who own the deposits In the private banking system which are deployed by the banks in profitable projects,[14] there are some examples in East Asia that are similar to the financial innovations in Kerala mentioned in the main text. Cooperatives in China, for instance, have been hailed as one of the elements in China's development. The cooperatives financed the rise of the famous government-owned township and village enterprises. As one recent study notes, 'Indeed, contrary to the traditional narrative attributing China's spectacular economic growth to foreign direct investment, it was in fact the initial success of the township and village enterprises that was the decisive factor.'[15]

Vietnam is another country where cooperatives have played an important role in meeting social and developmental needs. The government did not take the path of the mainstream microcredit craze being promoted by the World Bank and other development institutions in the 1980's, preferring instead the Chinese example of creating financial vehicles that combined community–cooperative and national–local government ownership and control.[16] The all-important People's Credit Funds, 'of which more than 1,000 were active by 2017, involved two million members and eight million households across 56 of the 63 Vietnamese cities and provinces. These funds have played a key role in developing Vietnam's rural agricultural base and helped support a rural industrialization and small and medium-size enterprise development trajectory.'[17]

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4 F. Allen and J. Yun Hong (2011) 'Why are there large foreign exchange reserves? The case of South Korea', *Korea Social Science Journal,* Vol 38, No 2 (Dec), p.13.

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7 Ibid., p.264

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9 Y. Okabe (2015) '"Institutional path dependence in Korea and Thailand," in T.J. Pempel and K. Tsunekawa (eds.) *Two crises, different outcomes: East Asia and global finance.* Ithaca: Cornell University Press, pp. 104-105.

10 Ibid., p.106

11 N. Bandid (2020) Personal communication, Bangkok, July 5.

12 N. Yoshino (2017) Interview, Tokyo, June 9.

13 N. Hama (2017) Interview, Tokyo, June 19.

14 In Thailand, now the world's most unequal country, 0.1% of bank depositors own close to 50% of total bank savings. N. Bandid (2020), "Time for the 1 per cent to Step Forward," *Bangkok Post,* April 3.

15 L. Steinfort and S. Kishimoto (2019) "Public Money for Economies of Well-Being," in Steinfort and Kishimoto, *Public Finance for a Better Future.* Amsterdam: Transnational Institute, 2019, p. 24.

16 Ibid.

17 Ibid.

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