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RE-REGULATE global finance

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The COVID-19 pandemic led to a combined triple crisis: the response to the health crisis quickly triggered an economic and financial crisis, as governments locked down the economy and financial market actors panicked in the early weeks of the crisis. Contrary to the transatlantic financial crisis of 2008-2009, the unregulated global banking system is not at the centre of the triple crisis. Nevertheless, insufficient financial regulation and inadequate international financial architecture aggravated its impact and made a swift and effective response more difficult.

Financially more vulnerable countries were especially affected. In March 2020, a record volume of private capital left developing countries in record time. Capital flight was more severe than during the 2008-2009 financial crisis. Valuations of sovereign bonds issued by heavily indebted countries plummeted on secondary markets, as investors got scared that emerging economies would no longer be able to service their debts and a series of defaults is at the doorstep.[1]

Financial markets only calmed down when private investors got reason to believe that they will once again be bailed out by the public hand. A new wave of interventions by the world´s major central banks – primarily massive asset purchase programmes – boosted demand for bonds and thus their prices and injected new liquidity into the markets. The IMF declared quickly that it would deploy its US$ 1 trillion lending capacity to ensure that governments do not run out of cash, including the cash they need to pay their creditors. The G20 declared in April its intention to suspend bilateral debt payments owed by Low Income Countries and Least Developed Countries until the end of 2020.[2]

In so doing, major central banks and the IMF managed to stabilize financial markets and avoid a massive series of sovereign defaults, for now. This however came at the price that the bubbles in the international economy grew even bigger. Even market-friendly analysts are increasingly astonished by the mismatch between asset price valuations and the underlying economic fundamentals. While stock markets had returned to their pre-crisis evaluations by summer 2020, the global real economy was in recession, governments faced record fiscal deficits, and several hundred million workers had lost their jobs and income.

This mismatch has made the global economy even more vulnerable to a massive financial crash. Already before the COVID-19 shock hit, global debt levels, public and private debt combined, had reached all-time highs, and this simultaneously in all

1 UNCTAD (2019), The Covid-19 Shock to Developing Countries: Towards a "whatever it takes" programme for the two-thirds of the world's population being left behind. Geneva, p. 3-4. https://unctad.org/en/PublicationsLibrary/gds_tdr2019_covid2_en.pdf

2 IMF (2020), Communiqué of the Forty First Meeting of the IMFC. Washington, D.C. https://www.imf.org/en/News/Articles/2020/04/16/communique-of-the-forty-first-meeting-of-the-imfc

country income groups: high, middle and low.[3] The coronavirus crisis has made clear that fundamental steps in financial regulation and reform of the international financial architecture need to be taken. At least to some extent, it also created new political impetus for it.

Towards capital controls and a sovereign debt workout mechanism

A key challenge is how to get rid of high and unsustainable debt levels when it becomes necessary. While sovereign debt owed to bilateral and multilateral creditors can be cancelled through these creditors' political decision, this is not easily possible for sovereign debt owed to private creditors. Sovereign debt is the only category of debt for which there is no insolvency law that would establish binding rules for its treatment in case of the debtor´s insolvency, and for which there is no insolvency court to treat it – to make binding decisions on debt restructuring and enforce them in a fair and timely manner.[4]

Some private creditors exploit this situation with free-rider strategies. They speculate that when public creditors´ grant debt relief, it frees up money that enables the debtor to continue paying them. Currently, the savings that poor countries realize from the G20´s Debt Service Suspension Initiative (DSSI) are partly cashed in by private creditors instead of creating fiscal space to respond to the health crisis, as private creditors refuse to participate voluntarily, and there is no effective mechanism to enforce participation and guarantee fair burden-sharing. On a more general level, because restructuring debts owed to private creditors is so difficult, the policy choice of bailout is often preferred over debt restructuring. Richer countries use primarily central bank money for financing such private creditor bailouts; poorer countries use IMF resources for doing so.

To address this issue, it would be necessary to fill the gaping hole in the international financial architecture– namely, a sovereign debt workout mechanism. This requires an institution that fulfils the roles that insolvency laws and courts fulfil for other debt categories, that is, one that makes independent and binding decisions on sovereign debt restructurings based on objective criteria and is able to enforce it in an impartial manner. The idea is not new. It has been promoted by the IMF for some time since the early 2000s, by academics and civil society organizations, and by developing countries organized in the G77, but has been repeatedly shelved due political resistance by countries which either host major political centres, or are in a solid net creditor position.[5] The need for such a mechanism became a central item in the multilateral response to the coronavirus crisis, as UN Secretary-General António Guterres also endorsed it prominently at the 2020 UN Financing for Development Forum.[6]

In addition, countries can and should make more use of capital controls in times of crisis. Controls on capital outflows aim to mitigate large-scale capital flight through investor panics, as the one we have witnessed in spring 2020. They also help to reduce severe exchange rate depreciations, which make it difficult for private or public debtors to sustain debt service when loans are denominated in foreign currency. Such controls can come in the form of restrictions that limit the amount of capital that can be transferred out of the country, or in the form of price mechanisms that tax such transfers.

Capital controls can be an effective tool to curb speculative movements of capital, promote long-term investments and stability, and secure policy space. They had been part of essentially every country´s

3 World Bank (2019), Global Waves of Debt. Causes and Consequences. Washington, D.C. https://www.worldbank.org/en/research/publication/waves-of-debt

4 Bodo Ellmers (2016), The Evolving Nature of Developing Country Debt and Solutions for Change. Eurodad, p. 28-35.

5 Bodo Ellmers (2015), The UN´s work towards faster and better resolution of sovereign debt crisis. A tale of legal frameworks and basic principles for sovereign debt restructurings. Eurodad. https://www.eurodad.org/unanddebtcrises

6 UN (2020), Secretary-General addresses the virtual meeting of the 2020 ECOSOC Forum on Financing for Development (UN Web TV), https://www.un.org/development/desa/financing/voice/secretary-general-addresses-virtual-meeting-2020-ecosoc-forum-financing-development

anti-crisis policy toolkit until the 1970s, after which they have been gradually removed as part of the neoliberal agenda, often under pressure by international organizations such as the OECD and IMF. More recently, the pendulum has swung back in favour of capital controls, but in practice their application is often ´too little – too late´.[7]

Towards new taxes and an international tax body

The coronavirus pandemic has also exposed how important a high level of steady fiscal revenue is. Countries which are poor or have suffered from austerity policies in recent years were more heavily affected. Their underfunded health systems lacked capacity to cope with the health emergency. Limited fiscal space also meant they were unable to finance economic stimulus to counter the effects of the economic crisis. Harmful tax competition, tax evasion and tax avoidance are the central reasons why governments all over the world are cash-starved. In particular financial secrecy jurisdictions, or tax havens, facilitate tax dodging. Developing countries especially suffer from an unfair global tax system that allocates taxing rights to their disadvantage.

To address this issue, an intergovernmental tax commission – with universal membership and a strong mandate – should be created at the level of the United Nations. This has been a central global governance demand of developing countries for quite some time, very prominently in the run-up to, and at the Fourth International Conference on Financing for Development in Addis Ababa in 2015. Most work on international tax policy and regulation has been done by the OECD in the past decades, and OECD agreements could be made to create more transparency through, for example, the automatic provision of tax information, or disallowing transnational corporations to evade taxes by artificially relocating profits to tax havens through dodgy accounting tricks. These however have turned out to have limited effect in practice and in any case are not tailored to the needs of developing countries.[8] An intergovernmental tax body at the United Nations could manage international cooperation to address tax dodging as well as harmful tax competition.

It could also pursue steps towards global taxation. A globally coordinated introduction of financial transaction taxes (FTT), for example, has enormous potential to raise revenue and thus create fiscal space.[9] At the same time, it would make speculative activities that can destabilize financial markets and cause crises costlier and hopefully less numerous in volume. At a UN high level event on “Financing for Development in the Era of COVID-19 and Beyond” in May 2020,[10] the idea was proposed of using revenue from a global financial transaction tax to finance a Global Fund for Social Protection. Such an innovation, if realized, could become a key element of the better recovery that the international community is currently seeking.

7 Kavaljit Singh (2019), “Capital Controls. The Policy Pendulum Just Keeps Swinging,” Madhyam, Policy Brief # 3, 5 April 2019, https://www.madhyam.org.in/capital-controls-the-policy-pendulum-just-keeps-swinging/

8 Tove Ryding (2019), An intergovernmental UN tax commission – why we need it and how we can get it. Eurodad/Financial Transparency Coalition, https://d3n8a8pro7vhmx.cloudfront.net/eurodad/pages/529/attachments/original/1590691263/An_intergovernmental_UN_tax_commission_%E2%80%93_why_we_need_it_and_how_we_can_get_it.pdf?1590691263

9 Only in the USA, a 0.1% tax could raise US$ 777 billion over 10 years, and it would be a highly progressive tax predominantly paid by the rich, see Aaron Klein (2020): What is a financial transaction tax? Brookings, https://www.brookings.edu/policy2020/votervital/what-is-a-financial-transaction-tax-2/

10 https://www.un.org/en/coronavirus/financing-development