

Tackling the global financial crisis: For a new relationship between government and markets | 03 NOVEMBER 2008

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It is today beyond dispute that the current global financial crisis is the worst in the last twenty-five years and may well be the worst since the Great Depression.

At first, response to the crisis was to address the immediate bailing out of financial institutions in the developed economies. Huge sums of tax payer's money were to be handed over to the banking system to compensate their losses.

Very quickly, progressive voices around the world rightly labeled this "cash for trash". We called for transparency and accountability. We called for the democratic monitoring of these moneys. Government supervision in order to guarantee that the average citizen, those in mainstreet, do not pay for the criminal acts of the "Wall Streets". Practices, which were at the heart of the crisis.

From the very beginning of this crisis, at the centre of our concerns have been people's jobs, housing, pensions, access to health and education services, in short the livelihood and social protection of citizens.

The social democratic vision of the economy and financial markets is that they should serve the citizens of our society. Financial markets are a means to an end, not an end in themselves. It is not necessarily the case that what is good for Wall Street or other financial centres is good for the rest of the economy. Moreover, trickle down economics - the notion that helping those at the top will benefit all - has been repeatedly rejected.

Four principles guide the social democratic response: solutions to the crisis must be consistent with basic values of social justice and social solidarity as well as basic notions of fairness. The bonds of social solidarity must go across national boundaries; we cannot take actions which help ourselves at the expense of those in the developing world. They must reflect an understanding of the necessary balance between government and markets. Fourthly, any response must respect basic principles of democratic due process, including full transparency.

These principles take on a greater sense of urgency today, as what started as a financial crisis has become very quickly a crisis of the real economy, with the threat of recession a reality around the world. Now we are entering a new phase where emerging and developing economies are suffering the consequences of this crisis as well. Lack of financial regulation triggered the crisis, while fiscal weakness and large public debts have hindered many governments' ability to formulate policies to tackle it. At the same time, serious deficiencies in the global financial system have also been exposed, such as the limitations of the Bretton Woods institutions to guard against macroeconomic imbalances and provide liquidity to those economies in need; inadequate supervision of financial markets in developed economies and under-representation of emerging economies in the governance of the main multilateral lending institutions.

We will not be able to restore confidence in our financial markets unless we change their behaviour, through regulation. And regulation must be comprehensive. Too often, the regulatory process, and more widely the democratic process, has been captured by those who were supposed to be regulated. While some shareholders profited, the voice of the

stakeholders was marginalised. The voice of those injured as a result of inadequate regulation—pensioners who lose their life savings, homeowners who lose their homes, workers who lose their jobs—has to be paramount. Such regulation could encourage real innovation, not the kind that has marked financial markets in recent years, like the derivatives that were supposed to manage risk but instead created it; but innovations that might allow average citizens to remain in their homes in the face of the economic vicissitudes which they face. Banks were allowed to become too big to fail and that was dangerous for all of us.

Given that the restructuring of global finance will take time, the Commission on Global Financial Issues proposes five immediate programmes to protect people today in countries most directly affected by the crisis:

- The creation of a Social Protection Fund to assist developing countries that have inadequate or underfunded social protection schemes to set up social security systems to provide minimum social protections, including provisions for the unemployed, for health, and for retirees;
- The creation of a Small Enterprises Development Fund to facilitate credit and capital flows to small businesses, as a sector which provides the major source of employment and a large contribution to the GDP, and assisting their technological development and expanding decent work;
- The creation of a Financing Infrastructure Fund to help stimulate the economy. Such a fund would simultaneously stimulate the economy in the short run and help our societies meet the long run challenges they face; some funds might be directed, for instance, towards helping meet the challenges posed by global warming; others might be directed at the informal economy from which so many poor earn their living, for example with local programmes for small power plants, rural roads and markets, and technology parks.
- The Commission equally supports the immediate and urgent establishment by the International Monetary Fund of a short-term liquidity line for emerging and developing economies which face a liquidity crisis caused not by deficient domestic policies but by sources of financing being severed due to the systemic crisis, as internationally active banks hoard liquidity, capital is repatriated to financial centres and rich countries' GDP contract. This liquidity facility must allow access to countries by broadening the eligibility criteria in a fair way, so giving support to hundreds of millions of people who are now unwitting victims of this crisis; and it should be provided without the severe conditionalities often imposed in the past.
- New sources of funding, and new lending facilities, have to be given urgent consideration. There is a growing consensus that there are insufficient financial resources in multilateral institutions and regional development banks to provide adequate support for the many economies that may face difficulties. Since the sources of liquid funds in the world today are in countries that have inadequate representation within the IMF, the World Bank, and other existing multilateral institutions, it will be imperative to create new governance structures for these lending facilities that are more representative. These new governance structures should be thought of as a precursor to the more fundamental reforms in the global economic governance that have long been demanded, and may entail more active involvement of other international institutions with wider and more diverse representation, including the various agencies of the UN family, such as UNDP and the International Labour Organisation.

Transparent and sustainable financial governance requires robust regulation of the world of finances which, as stated by the Presidium of the Socialist International, should include the establishment of a World Financial Organisation. The nature and extent of such regulation should itself emerge from global, democratic processes. Well designed regulation should focus on financial institutions and products whose failure puts the entire economy at risk. Elements will include, but not be limited to, demands for more transparency, restrictions on compensation schemes, especially those that encourage short sighted and excessively risky behaviour, restrictions on conflicts of interest, oversight of credit rating agencies, and control of other aspects of the behaviour of financial institutions that have imposed large social costs, without commensurate social benefits. Deficiencies in corporate governance that have given rise to compensation schemes that have benefited corporate managers at the expense of other stakeholders, including even shareholders, need to be given urgent consideration. Tax havens should be ended; and, a tax on short-term transactions considered.

There are other reforms to the international financial system that must be addressed if we are to have a more stable, prosperous, and equitable global economy. These include a reform of the global reserve system, better macro-economic coordination, with more attention paid to the consequences of policies for unemployment, and better ways of dealing with cross border bankruptcies and defaults, including those of sovereigns. The system in which countercyclical monetary and fiscal policies were pursued in the advanced industrial countries while procyclical policies were imposed on developing countries has contributed to global volatility and imposed huge costs on developing countries. The current crisis has given new urgency to these long delayed reforms.

The reform process itself must be open, transparent, inclusive, and democratic; this means that the reform of the global regulatory framework or the way in which financial markets are regulated and supervised must take into account opinions and views of all. For this reason, we propose that discussion about reforms to the regulatory and financial framework for private markets be broadened to include the emerging economies, while at the same time providing a role for contributions from existing institutions that are less representative, such as the Financial Stability Forum.

Social democrats have always stood for markets with social responsibility. Markets that put our citizens first. And, therefore, for democratic governance, a role for government in the economy and rules and regulation in the market. 75 years ago John Maynard Keynes explained how government action could help the economy recover from the Great Depression. In today's crisis, he has been rediscovered. And his ideas have become part of conventional wisdom. Our values, ideas, social democratic policies and their proposals for preventing another such calamity, as the one we are living through today, will in time also be accepted as conventional wisdom. But time is of the essence: the quicker governments can act, the shorter will be our downturn, and the fewer the number of innocent bystanders whose lives and dreams will be dashed in this tragic episode. We are living in a man-made crisis that should never be allowed to happen again. Our Commission is committed to contributing to that end, by constructing a roadmap, in which democracy, inclusion, fairness and green development will find a place in a new political, social and economic vision required for these times.
