Statement

CSO Cluster on Enabling Environment/ Systemic Issues (December 9 2014 Session)

Introduction

Today we have an economy more dominated by finance than ever. Yet, only one fourth of the financial depth gained in the 12 years before the crisis was used to finance the real economy and households. As the dominance of finance has grown, the share of investment into the real economy decreased. After the global financial crisis broke out, the bailing out of banks, stimulus programmes to cushion the effects of the crash and other damages of the crisis imposed a burden to people, state budgets and real economy of more than USD 3 trillion. Millions of people have been pushed into unemployment and poverty, in both developing and developed countries.

The Third FFD Conference, in the lead up to the adoption of the post-2015 development agenda, will offer a ripe moment for governments to demonstrate their commitment to implement reforms of the international monetary and financial system as agreed in Monterrey, and reasserted in Doha and the World Conference on the Financial Crisis. Indeed, attempts to achieve sustainable development goals without a shift in the very model of finance that has led us to the current situation can hardly succeed.

Financial regulation

Finance should serve a real economy that is based on universal human rights, reduces inequality and embraces our responsibility as stewards of creation. That cannot be achieved if finance (markets, institutions, elites) is the main force driving the economy. Financial re-regulation is required to operate that shift. We warn against the increased reliance on financial markets to provide financing for, inter alia, environmental preservation, climate, biodiversity. The involvement of financial firms in natural resources whose negative impacts we have witnessed take hold in food and fuel markets may have unpredictable and dangerous results when brought to bear on other aspects of nature.

Efforts to re-regulate finance should start with countries having the freedom to use capital controls to regulate cross-border capital movements when necessary. The IMF has endorsed the use of such measures in the last several years; however, with too many macroeconomic prerequisites (such as low fiscal deficits, adequate foreign reserves) that, if applied in a draconian way, would diminish the practicality and effectiveness of such measures.

Even though the IMF's Articles of Agreement deny its authority to restrict capital controls,[1] the Fund's programs and surveillance display a bias toward capital account liberalization, as well as a bias toward requiring countries to meet such preconditions before applying measures to manage capital flows. Thus, the IMF should refrain from advising or requiring compliance with preconditions that limit or restrict member countries' choices and ability to regulate capital flows.

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[1] Article VI states "Members may exercise such controls as are necessary to regulate international capital movements."

Financial markets should be regulated at the national level by authorities enjoying adequate policy space and protected from undue influence by financial institutions and the corporate sector they aim to rule upon. The regulation should involve participation of all right holders who are affected by the sector's performance.

No financial institution should be allowed to reach a relative size that would not allow failure to be contained without risk to the economy and vital banking services. Six years of Financial Stability Board's efforts to enable the orderly resolution of Too Big To Fail banks have not managed to clarify what can be done if a new crisis requires it. *Systemically Important financial Institutions* (SIFIs) should be downsized and simplified. A first step would be the separation between investment and commercial banking. Enabling legislation for cross-border resolution of firms operating in more than one country, the requirement to file orderly wind-down plans and capital surcharges to dis-incentivize institutions from becoming too big, are complementary (not substitute) steps.

The Basel Agreement on capital requirements should emphasize the leverage ratio and risk-weighted capital buffers should complement it. Banks should no longer be allowed to establish their own risk weighting.

All derivatives must be traded in public exchanges and centrally cleared, in addition to being reported to trade registers. Particularly risky products such as *Credit Default Swaps,* and dangerous speculative practices like *Naked Short Selling* should be banned. Central clearing houses should have adequate capital buffers and require collateral for each transaction. In order to prevent food and fuel price volatility, regulators should set ex-ante position limits. Banks should not be allowed to use government-insured deposits to engage in trading on their own behalf (proprietary trading).

The regulation of derivatives markets has particular bearing for many developing countries that are dependent on commodities trade revenues. For such countries, instability in those markets leads to unmanageable import costs and unpredictable export revenues. The resulting adverse terms of trade leads to trade deficits and also reduces developing country capacity for diversifying into other sectors. Financial firms should be banned from speculating through physical holdings of commodities, particularly when those firms also trade derivatives contracts in those commodities, and thus are in a position to manipulate the prices of the underlying assets of the derivatives contracts.

Appropriate levels and types of re-regulation should reach all financial markets and financial actors, rather than exempt some actors or instruments. We question the argued rationale behind de-regulation to permit financial entities test higher risk strategies and spur innovation. Far too often such strategies ultimately imposed unacceptable costs on the formal banking sector (and eventually the public budget). Thus, shadow banking vehicles should be subject to strict reporting requirements to ensure proper monitoring and give the basis for more effective regulation. Innovative products must go through a clearance procedure to ascertain that they are consumer friendly and not harmful to the stability of the system.

Credit Rating Agencies should be subject to strong governance requirements to suppress conflicts of interest and ensure integrity and accountability. Governments should hasten moves towards limiting regulatory reliance on credit rating agencies and reform legal regimes to ensure that the agencies are liable

for negligent behavior. They should implement alternatives to the "issuer-pays" model, including by ensuring that there are competing public agencies and credit rating agencies within the national domain, with independent rating processes.

In order to adequately capture environmental resource constraints and ecological footprints of companies, and consequently countries in which they operate, financial and non-financial reporting will have to be brought under mandatory and comprehensive reporting guidelines. Risks related to exposure to unsustainable assets (for instance, fossil fuels that should not be burned in order to avoid climate-related temperature rises) needs to be factored in companies' financial statements.

The international monetary system

Macroeconomic policy and social policy cannot continue to be addressed as though they are in separate, unrelated categories. Macroeconomic stability built on the back of growing income inequality, under-employment and an erosion of the social fabric is neither sustainable nor just. Thus, the policies to recognize unpaid and non-monetized work, create decent jobs, promote equality and inclusion through the decent work agenda and universal social protection, and establish environmentally sustainable patterns of production and consumption, are integral components of a solid macroeconomic policy framework.

This calls for the reversal of austerity measures, which in most cases have proved self-defeating in achieving fiscal and debt sustainability. Counter-cyclical, rather than pro-cyclical, macroeconomic policies—subject to *ex ante* and *ex post facto* gender, human rights and environmental impact assessments and matched with people's needs—are the best safeguard against disproportionate human rights backsliding and economic and social instability.

Indeed, there is a problematic paradox between the fixation with economic growth, on the one hand, and the global consensus on austerity, particularly in the form of public spending cuts and regressive tax policies, on the other. Excessive levels of austerity will render the post-2015 goals elusive. Developed and developing countries should, where needed, prioritize expansionary macroeconomic policies that could stimulate public investment, create urgently needed decent jobs and re-orient tax policies toward wealth and revenue redistribution, more labor-intensity and less natural–resource utilization for greater socio-economic equality. Quality public services are both essential for economic development and for social wellbeing.

Increased levels of exchange rate volatility have a strong impact on trade performance by constricting levels of domestic investment, destabilizing relative prices of export products (which, in turn, affect competitiveness of the economies), increasing the price of access to finance for production and shifting the value of market access concessions. By affecting the prices of essential imports such as food and energy, they also carry consequences for food security and the balance of trade (in creating or exacerbating current account deficits). Without a reformed international financial and monetary system that can counter these trends, developing countries will continue to be disadvantaged in global trade, even while dealing with a disproportionate share of environmental impacts.

In light of the growing consensus around the shortcomings of the current international monetary system, the Addis Ababa Summit will offer an opportunity to take concerted and coordinated action for reform. The dangers inherent to a continuation of the status quo – based on the domestic currency of one country as the main international trading and reserve currency – should be compelling enough to act. There are four key challenges that a reform of the monetary system must address:

1. Rebalancing and achieving coordination among trade deficit and surplus countries;

2. Ensuring adjustments are non-recessionary;

3. Limiting exchange rate volatility; and,

4. Promoting innovative mechanisms to enable the generation of development and climate finance.

These can be achieved through the following pillars:

1. A credible system for coordination among deficit and surplus countries;

2. A transition path towards a revamped system with a supranational currency as the cornerstone – revamped Special Drawing Rights can serve as a proxy leading towards such currency;

3. Support for countries to use capital flows management measures (as described above).

Additionally, a more resilient monetary system requires greater diversity and regional-sensitivity of approaches. So such efforts at the global level should be complemented and counter-balanced by regional financial and monetary architectures, namely: 1) establishing regional monetary funds that would pool foreign currency reserves to combat speculative attacks and compensate for economic asymmetries within the region; 2) extending intra-regional trade through payments with domestic or regional currencies; 3) establishing or consolidating regional development banks that are oriented to finance the productive and social sectors and are aligned with the realization of human rights, decent work, and sustainable development and, 4) creating democratic regional forums for discussing coordination on stemming financial outflows.

Reform of governance of International Financial Institutions

We call for all IMF members to implement expeditiously the already agreed, though insufficient, reforms to the voting system, including the transfer of two Board chairs from European countries to developing countries. At least one of these chairs should go to the African countries, which at the moment make up the largest-membership constituencies on the IMF Executive Board.

The deadline to reform the quota formula should not be missed (again). Such reform must give adequate and fair voice to borrowing countries, especially the poorer ones, by adopting and applying a more balanced approach to variables relating to the “demand for” and “supply of” finance. It should also provide greater weight to Purchasing Power Parity and the size of populations of member countries and should

introduce a "double majority system", i.e. decisions must carry the requisite support according to both the quota distribution and the number of countries supporting the decision. The reform must also introduce democratic accountability for each Executive Director. The process of selecting leaders of all global financial institutions must be open, gender-balanced, transparent, merit-based, and reflective of the composition of membership.

Both the World Bank and the IMF should implement transparent accountability mechanisms beyond the existing ones.

The membership of financial standard-setting bodies should also be broadened to give participation (voice and vote) to all countries which are affected by their policies (e.g., by experiencing positive or negative spill-overs).

International tax cooperation and fighting illicit flows

Progressive, transparent and accountable taxation systems or, more simply stated, tax justice, should be central to any sustainable development strategy.

As stated by the Special Rapporteur on Human Rights and Extreme Poverty, there are also international limits to national-level actions on revenue-raising in the absence of a global tax system: "States are undoubtedly hamstrung in their efforts to enact progressive taxation and combat illicit financial flows that could combat inequality and resource better economic, social and cultural rights realization."

Conservative solid estimates put the annual losses caused by illicit financial flows at USD 6 trillion on average during the past decade, with an average increase of 10% every year bringing capital flight from developing countries to almost USD 1 trillion in 2011,[2] 80% of it coming from to systemic and deliberate minimization of the tax share of multinational companies and wealthy individuals.

If efficient measures are not implemented to stop revenue losses from international tax issues, this will potentially increase the need to consider private finance to be involved in basic public services provisions, with the risk this involved in term of fiscal and development issues.

While the initial BEPS report in 2013 was promising, the current OECD-G20 led corporate tax reform – taking the form of a 2 years Action Plan, suffers from some structural weaknesses particularly linked to the lack of developing countries' involvement and ownership of the process.

While numerous studies and official bodies including UNCTAD now confirm that every year IFFs amount to several times ODA and that poor countries are the first victims of tax evasion and tax avoidance, these latters have not been able to contribute to the initial design of the BEPS Action Plan in 2013.

Unfortunately, the welcome OECD initiatives of consultation process in 2014, has barely mitigated such weaknesses. In particular, three majors demands to include issues related to double tax treaty, harmful tax

[2] Kar, Dev and Brian LeBlanc 2013. Illicit Financial Flows from Developing Countries 2002-2011. Global Financial Integrity, Washington DC. December.

competition and specificities of extractive sector, have not been taken into account. Recent additional measures to include few middle-income countries does not compensate for the fact that most developing countries, in particular LDCs, are not considered as equal partners in this negotiation process.

At mid-term of the BEPS process, the Action Plan is now also showing the limits of its content: it does not update the international legal instruments to transnational strategies, rather its reforms keep running behind cross border economic activities. Despite IMF[3] and civil society clear warnings, the OECD has kept refusing to question the “arm’s length” principle, and insists on treating the national operations of multinational enterprises as if they were independent of each other while they operate as an integrated whole under central direction. Taxing multinational “where economic activity takes places and value is created” is likely to require a transition from a principle of separate entities to a unitary principle. This should be more carefully considered in processes around tax corporate reforms, otherwise the international tax frame will remain at risk of staying far behind multinational huge tax planning capacities.

Another crucial issue of the BEPS process so far has been to deny the country by country reporting of multinational companies - now adopted in large financial and extractive sectors in Europe and the US - from being publicly accessible, while this was a critical element for tax administrations and local civil society from developing countries to have chance to be able to identify mispricing and tax avoidance activities.

Neither is the tax transparency reform toward a New Standard of Automatic Exchange of Information, pushed by G20 and OECD countries together with the Global Forum designed in a way that developing countries can benefit of.

In particular, the requirement for an immediate reciprocity in information exchange, with the massive human and financial resources that it implies, will keep away for a while low-income countries from accessing information on their citizens’ offshore bank account. And the excessive confidentiality’ requirements also imposed by the New Standard eliminates any lasting chance of making a multilateral automatic exchange of information a really global standard. Leaving poor countries away from international transparency reform can constitute an incentive for them to develop their own bank secrecy and compete with other low tax jurisdictions.

After decades of giving in their tax rights to rich countries through OECD model of double tax treaties, most of developing countries are now excluded from the fight against capital flight that further undermines domestic resource mobilization and development challenges.

Recently, the milestone IMF report on the spillover effects[4] of tax policies in the north on developing countries, offers another solid diagnostic of current ineffective international tax cooperation.

The UN Committee of Expert on Tax Matters has provided a critical work for developing countries on tax rights issues, and more recently on tax transparency, BEPS issues and extractive sector. However, the absence of political mandate and financial means keeps preventing developing countries tax officials from being able to significantly influence international tax standards.

[3] See limits of arm’s length principles raised by the IMF in its report on spillover effect in international tax matters. May 2014. IMF. Link: http://www.imf.org/external/np/pp/eng/2014/050914.pdf

[4] See IMF report cited in previous footnote.

Thus, an international forum allowing a truly global negotiation process with a broader mandate for reforms is crucially needed, which will ensure that all countries in the world have an equal say on adopting fairer tax rules to fight non double taxation as well as double no taxation and tax transparency.

As indispensable measures for such purpose, we recommend the third Ffd Conference to adopt in priority the following:

- **Strengthen the role of the UN in promoting international cooperation on tax matters, including setting up an intergovernmental tax body,** as demanded several times by many developing countries;
- **Promote a truly multilateral automatic exchange of information that provide a temporary non-reciprocal mechanism for low-income countries**, and promote publicly-available registries of disclosure of beneficial ownership of companies;
- **Promote country-by-country reporting for transnational corporation, that is made public** and accessible to developing countries' tax administrations and local civil society;
- **Promote, in addition to inclusive reforms of international tax governance, a cooperation that supports building national capacities** for tax policy, collection and enforcement, in particular that what relates to international tax issues;
- **Promote alternatives to the arm's length principle** and develop analyses and norms around alternative methods (like formulary apportionment, six methods, fix margin) and unitary principles;
- **Implement financial transactions taxes** (FTTs) which, in addition to their potential to keep sustainable resource flows towards human and environmental development initiatives, a) limit the incentives for damaging short-term speculation in financial markets helping connect finance to the real economy and b) reduce systemic risks.

Debt crisis prevention and resolution

In spite of successive debt cancellation initiatives and the implementation of the IMF/World Bank Debt Sustainability Framework since 2005, the burden of repaying debt continues to take precedence over human rights commitments in an unacceptable number of countries. Moreover, 6 countries that reached "Completion Point" under HIPC (therefore, they received all the stock and flow cancellation available through this program) are at high risk of debt distress while 15 are at moderate risk.

This raises questions about the effectiveness of the Initiative's ability to make debt "sustainable in the long term," even for the limited sphere of its beneficiary countries. Several countries in the Caribbean and Pacific regions are either at high risk or in debt distress. The ongoing phasing out of quantitative easing in the US is adding pressure on the global economy and the debt situation of developing countries, particularly through the impacts on depreciation of their currencies and capital flight. At the same time, the bailouts of European countries such as Greece are evidence that debt distress is no longer confined to the developing world.

The now universal problem of unsustainable debt should be addressed by: reviewing onerous debts and cancelling illegitimate debts, especially in least developed countries; and revising Debt Sustainability parameters to make them more objective and accountable to the prioritization of financial needs for meeting economic and social rights above debt repayments.

An independent and fair public debt workout mechanism should be established as a way to avoid the phenomenon of "too little, too late" that prevails in the current ad hoc, case-by-case patchwork of mechanisms to address debt crises. Ex –ante rules for fair burden-sharing would be the best way to promote responsible lending and prevent buildup of unsustainable debt. The UN should lead in design, implementation and political accountability of an international mechanism that:

1) Is independent of creditors in analysis and decision making, and is situated in a neutral forum;
2) Is comprehensive: Includes bilateral, multilateral and private creditors treating all foreign creditors on an equal basis, and is available to all sovereign states who are at risk of debt distress or claim that their debts are illegitimate;
3) Provides a human needs based approach to debt sustainability: When assessing a government's capacity to service its debt, takes into account the financial resources needed by a government to fulfil its obligations to provide essential services for its population;
4) Holds lenders and borrowers to account for irresponsible behaviour by auditing the legitimacy of claims and demanding the cancellation of unjust debts based on corrupt, irresponsible or undemocratically contracted loans which did not benefit the people of the borrowing country; and
5) Gives all stakeholders, including civil society, the right to be heard and give evidence.

We call for these parameters to be upheld in the negotiations in pursuit of the General Assembly resolution on a multilateral legal framework on sovereign debt restructuring adopted by an overwhelming majority of member states on 9 September 2014.

We also remind member states of Human Rights Council 27/30 which reminded states such a multilateral legal framework should be compatible with existing international human rights obligations and standards. From an economic and social rights perspective, reduced debt burdens and increased fiscal capacity contribute to the creation of the conditions necessary for the realization of all human rights, particularly economic, social and cultural rights. The *UN Guiding Principles on Foreign Debt and Human Rights*, endorsed by the UN's Human Rights Council in June 2012, underscores that States, international financial institutions and private companies have the duty to refrain from formulating, adopting, funding and implementing policies and programmes that directly or indirectly contravene the enjoyment of human rights.