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Cash or Crash?

The role of global financial markets – problems and alternatives

Many associate the ‘global financial markets’ with negative developments such as the danger of a crisis, speculation and too much power in the hands of a few. In fact, very often financial markets do no longer support the economy, but dominate it. Companies as well as states are increasingly under pressure. A lot seems to be going wrong.

However, financial markets do actually have a vital function. They fund the production and consumption of goods and services in the so-called real economy. Those who save money can invest it on the financial markets. This money can then be at the disposal of companies, governments and private individuals who need it for investments or consumption. In addition to this, currencies can be exchanged on financial markets, which is important in order to buy foreign goods in international trade or to invest abroad.
These functions, however, have lost relative importance during the past decades. Instead of supporting the real economy, the financial markets are increasingly dominating corporate, economic and political decisions.

1. What are financial markets?

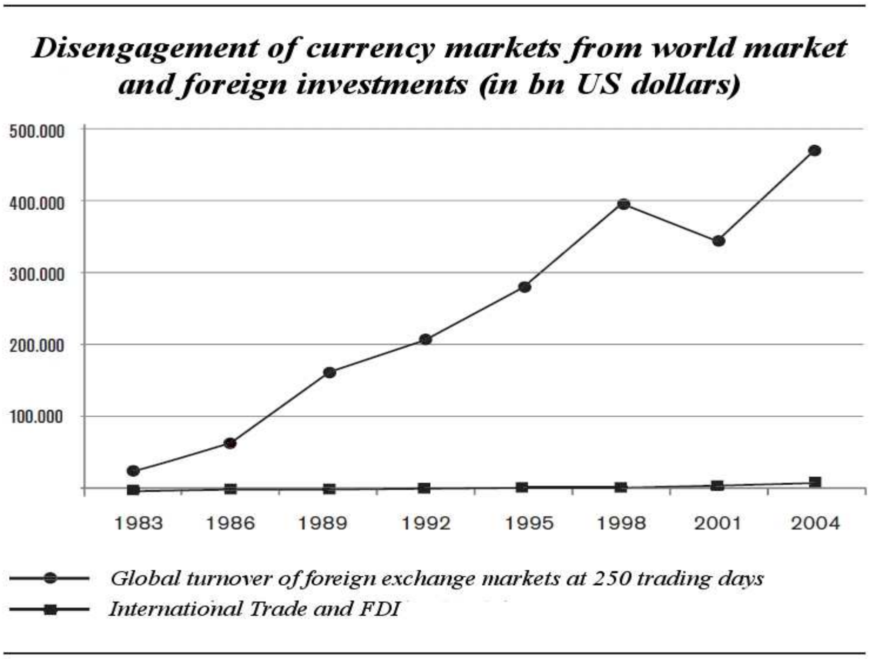
Fundamentally financial markets can be divided into three different types:

Credit market: Banks grant loans to companies, governments or private individuals who use that money to fund investments or consumption. For banks there are safety regulations in place; they are liable to a supervisory authority and have to keep minimum reserves.

Securities market: An important form of financing for large enterprises and governments is the issuing of shares and bonds respectively. For the buyer purchasing a share implies buying a part of the company which makes him or her co-owner. Bonds, however, are debt securities the debtor of which is obliged to pay interest for. On the ‘primary market’ new bonds or shares are issued. On the ‘secondary market’ these securities are dealt in.
The most modern form of securities are derivatives. Initially they were created as a safeguarding body, however today they can be seen as bets bearing high risk and possibly high yield. This sector boomed over the past years; on a daily basis the sixty-fold of the annual economic output of all industrialised countries is dealt in on the derivative markets.
Securities are basically being dealt in on stock exchanges which are liable to a supervisory authority. This is why it is worrying that most of the deals with derivatives are struck outside the stock exchange; ‘over-the-counter’ (OTC), where there is no monitoring body.

Currency market (foreign exchange market): For the process of international trade, currencies

are exchanged on the foreign exchange market. This is where the exchange rate, the price of a currency, is determined.
Due to the liberalisation of capital movements since the 1980s international foreign exchange markets have gained in volume. Only a fraction of the deals struck effectively include the purchasing of foreign goods or the placing of cross-border real investments. The majority are mere



financial operations, hence speculations.

2. From Bretton Woods to the casino

International financial markets, as we know them today, first emerged in the 1970s. Before that, the Bretton Woods system accounted for stability. In the aftermath of the devastating Great Depression of the 1930s the victorious powers of the Second World War agreed on a system of fixed exchange rates, making the Dollar the reserve currency. In addition to this, in the respective countries capital in- and outflow were monitored by a capital control body. In order to implement the system the International Monetary Fund (IMF) and the World Bank (WB) were created.
Despite some troublesome aspects – especially the fact that the US Dollar was the reserve currency – the Bretton Woods system constituted a framework for stable development in many countries and played a successful role in avoiding international financial crises.
In 1973 the Bretton Woods system collapsed because the USA decided to withdraw the Dollar as the reserve currency, beyond other reasons in order to print money to fund the Vietnam War. Ever since most currencies have been floating freely, exchange rates are established on the currency markets. Supervisory bodies for capital movements are gradually removed and free capital movement is pushed through. Today capital can move all around the world.
These developments led to the evolution of entirely new actors, the so-called 'institutional investors' such as pension, hedge and investment funds which decreasingly aim at investing for the long term, but more often want to make short-term profits from speculative operations, in particular on the currency market. E.g. if expectations are high that the value of a currency will increase it can be bought at the current rate, hoping that it can be sold later on at a higher rate. Today these speculations have reached a great dimension. Within only four trading days the annual volume of international trade and foreign investments could be processed on the currency market. Everything else is speculation (see chart).

3. Undesirable developments on the global financial markets

The deregulation of the financial markets and the liberalisation of the capital market have far-reaching consequences for democracy and economics. Feminists criticise male-dominated decision-making structures which operate according to the principles of competition and profit maximisation. Financial markets lose their role of supporters for the real economy, but have massive repercussions on it.

Shareholder value governs companies
As from the early 1970s a power shift to the benefit of shareholders has been noticeable. The management is rewarded for running up the stock prices which often happens by means of high-scale lay-offs, wage cuts and location changes. Otherwise shareholders immediately threaten to sell their shares which results in a reduction of stock price. If the prices drop it becomes more difficult to raise capital and there is a risk of being bought up cheaply. Real investments take a long time to become profitable and therefore in comparison become unattractive.

Tax competition and competition for international capital
Companies or rich individuals can relocate production plants or private means abroad. Therefore, threatening to leave the country, they can put entire states under pressure. When threatened, governments give in and lower social and environmental standards as well as taxation of corporate profits and assets. Thus, public revenues drop and states have to start ‘saving’. This leads to the privatisation of public shares, cuts in social security benefits and the lack of funding for services such as child and health care. Especially women suffer from the consequences of these economisations since they (must) carry out the major part of care services without pay.

High interest rates put a strain on state and economy
Free capital movement leads to increased interest rates everywhere since, as a consequence of liberalisation, financial capital is gaining power and manages to pursue its own interests; high interest rates. However, for small enterprises which want to invest, loans become more expensive due to high interest rates. Large businesses prefer investing in financial assets to investing in a business. Thus, fewer jobs are created. Increasing unemployment rates weaken unions which means that wages and salaries drop. Average real incomes have not increased within the past ten years even though parts of the economy have been growing a lot.
High interest rates also put a strain on the state since slow economic growth causes a drop in tax incomes, costs for unemployment rise and state debt repayment becomes more and more expensive. This causes the budget deficit to grow and the state has to cut spending even more.

Privatisation of the pension systems and cuts in social services
Capital markets have fundamentally changed the nature of pensions. Up to now a pay-as-you-go-system made sure that the working part of the population paid for the benefits of retirees. This ‘intergenerational contract’ was based on solidarity and social balance. Allegedly this system is no longer financially feasible. Therefore people are forced into choosing private pension schemes. This does not change the fact that the population ages but bears higher risks, is more expensive and less socially oriented (see Attac position paper on pensions). Despite earning less, women have to pay higher premiums than men because of their longer life expectancy. In countries which have faced (partial) privatisation soaring rates of old-age poverty are noticeable. Still there are tendencies to apply the capital market model also to health care and education.

Danger for developing and newly industrialised countries
Particularly developing and newly industrialised countries suffer from increasing instability on the financial markets. Due to their banking and fiscal systems which are often not very stable they e.g. do not manage to avert great capital in- and outflows in an adequate manner. This can lead to major crises. Also it might cause high devaluation of the country's currency which leads to a dramatic rise

of debts in foreign currencies. Thus indebted countries become increasingly dependent on their creditors.
Nevertheless, the International Monetary Fund (IMF), the World Bank and the World Trade Organisation (WTO) forced emerging markets and newly industrialised countries to open their capital markets. As of the 1970s this fact led to a number of financial crises: Mexico, Asia, Russia, Argentina, Turkey etc. The consequence: Increased levels of poverty, unemployment and debt.

As we see, the liberalisation of financial markets has activated a mechanism which makes the global public at large a loser. Only a few financial enterprises and wealthy individuals are winners.

4. Crises

Since the end of Bretton Woods, according to the IMF, more than 160 financial crises came about. Even though every financial crisis is unique there is a basic pattern to the process:

1st stage: Due to an external event expectations regarding economic development change and new prospects for profit are revealed. The object in question can be anything: tulip bulbs, real estate, securities or foreign currencies.
2nd stage: Purchases cause a rise in prices; expectations are fulfilled which leads to herd behaviour. A rush on the object in question starts; at this stage assets are also purchased on credit. The prospect of high profits yields to more and more risky ways of funding.
3rd stage: Real economic data does not react according to the boom. First speculators sell and receive their profits. Prices do not rise any longer which forces a part of the investors to sell their assets in order to pay back their loans.
4th stage: Now prices start to fall. A panic-fuelled selling wave kicks in which leads to investments fleeing to other assets. Quotations hit rock bottom. Many enterprises do not manage to pay back loans which they were granted during the boom. Banks which do not receive any payments call in loans – also the ones granted to productive companies which then means that the crisis has hit the real economy.

In the worst case the banking system collapses because enterprises are not successful in paying back their loans and savers withdraw their money on a large scale. The financial crisis plunges the real economy into a recession.
In the case of foreign loans states often assume liability which then turns private debt into public debt. The servicing of the foreign debt becomes more expensive since the value of the domestic currency plummets due to devaluation. The state has to save money; very often the consequences are social expenditure cuts which aggravate the crisis. Unemployment and poverty rates increase. The public bears the consequences of the crisis while financial investors abdicate from their responsibility and more often than not emerge from the crisis as winners.

5. Claims

Democratic policies have to shape the rules for the financial markets so that the economic interests of the public at large benefit. The aims have to be stability and long term investment instead of short term speculation. To achieve that we need the following:

Capital controls and credit restrictions
In order to avoid severe financial crises China, Chile and Malaysia have successfully introduced surveillance mechanisms for the import and export of foreign capital. In addition to this loans which exclusively serve speculation should be declared illegal.

Tobin tax and stock exchange turnover tax

By means of the tax on financial transactions called after Nobel laureate James Tobin international financial markets could be stabilised (also see Attac position paper on the Tobin tax). A stock exchange tax limits speculation with shares and bonds.

Closing of offshore centres
Institutional investors and the superrich place their money in tax havens (offshore centres) where they are subject to minimal taxes or none at all. These zones of legal vacuum could be easily abolished since they are mostly under the control of Western countries and depend on an access to global financial markets.

Regulations on derivative trading and ban of high-yield funds
Particularly the risky derivative trading, which mainly follows speculative intentions, should be extensively limited. This applies especially to unregulated trading outside the stock exchanges (OTC). Hedge funds (which speculate at high risk) should be banned, private equity funds (which participate in enterprises demanding extremely high yield) limited.

Investor liability in the case of financial crises
At the moment it is safe for international investors to run great risks. In the case of a financial crisis they are refunded by the debtor countries as these are bailed out by the IMF by means of emergency loans funded by tax money. If they had to bear the cost of the crisis they would rather abstain from high-risk speculations.

Global monetary cooperation according to Keynes
Keynes already identified the main error in the Bretton Woods system in 1944: It is not a national but an artificial currency which should serve as a global reserve currency; the “Bancor”. If the banks of issue jointly determine the individual exchange rates with the Bancor everyone benefits from high stability. Regional currency unions can serve as an intermediary step to this global solution.

World Bank and Monetary Fund reform
World Bank and Monetary Fund have to be under the control of the UN and voting rights must be democratised. The creation of a World Central Bank as the lender of last resort should be considered. Loans have to be approved by the population concerned. Structural adjustment policies have to be abolished.

Fair distribution and sustainable development
After fifty years of constant economic growth there is an abundance of money. It is not fair, and detrimental to an economy, that this wealth is in the hands of a few (in Austria 10 percent of the population own two thirds of the total wealth). It is not spent on investments or consumption which would raise the employment rate. It is rather channelled in the financial markets where it tries to achieve high yields and tends to lead to instabilities, fewer investments and less employment. Economically reasonable and socially just financial, monetary and fiscal policies should therefore ensure redistribution from the top to bottom, widely available low-priced loans, high real yield and real incomes and low financial yields.

Globalisation needs to be actively structured – Attac needs your support:
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