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WTO investment facilitation debate throws up several concerns

The investment facilitation debate in the WTO has aroused concern over the prospect of rules conferring far-reaching investor rights, as well as over the role of the WTO secretariat in setting the discussion agenda at the trade body. Questions have also been raised as to whether China's advocacy of investment facilitation talks is linked to its Belt and Road Initiative for infrastructure development and economic integration.

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Investment facilitation and links to China's BRI

Chakravarthi Raghavan **considers whether China's push for WTO talks on investment facilitation (IF) has to do with its much-touted Belt and Road Initiative, and questions the role of the WTO secretariat in appearing to promote the controversial IF agenda.**

GENEVA: The stalemate over the inclusion of investment facilitation (IF) in the agenda of the 10 May WTO General Council (GC) meeting, which was resolved with a compromise of sorts in the form of a statement by the GC chair, has nevertheless brought to the fore many questionable practices of the WTO secretariat and major systemic issues that, if left unresolved, may cause irreparable damage to the multilateral trading system.

While the compromise has enabled the GC to proceed with other items on the agenda, some current and former trade diplomats feel that it may still leave the door open for the proponents of IF to keep bringing up the issue under different formulations at future meetings, and/or attempt to inject it with a new nomenclature into the upcoming WTO Ministerial Conference at "green room" and similar, smaller consultations in an attempt to secure a decision.

Reacting to the GC chair's compromise statement and modified agenda (see *TWE* No. 638), B.K. Zutshi, former Indian ambassador to GATT 1947 (who negotiated the critical final stages of the Uruguay Round trade talks), said that the best option would have been to drop the IF item altogether from the agenda.

However, it now looks like an "information" item and should therefore have been shifted to the agenda item "other business", which under the GC rules calls for no decision or discussion beyond explanations of the proponents.

As agreed now in the GC chair's statement, the IF proponents may have got a toehold, unless it is ensured that it does not appear on the agenda again without a consensus. There is thus a need to be vigilant, not only vis-a-vis China and other proponents but the WTO secretariat too, Zutshi says.

The secretariat's role and performance on this, he says, "is a new low for the systemic health of the organization: the secretariat, the custodians of the institutional memory, put the item on the draft agenda of the GC meeting in the face of a subsisting decision on the subject!"

This entire episode requires India and others to remain ever alert and vigilant, objecting at official and ministerial levels, to ensure that neither proponents nor the secretariat manage to sneak the IF issue in at some restricted consultation meetings, Zutshi adds in an email communication.

Other trade observers said that perhaps it is time for key developing countries like India to devise ways, including through the WTO Budget Committee, to put restraints on the secretariat, making it clear that the WTO Director-General (the head of the secretariat) is just an international civil servant with no powers or authority beyond implementing in letter and spirit consensus decisions of member states.

Chinese stance

The compromise achieved via the GC chair's statement, over the Indian objections to the draft agenda and initial reports of a hardline stance by some proponents like China to keep IF on the agenda, has led some trade diplomats, past negotiators and trade observers to speculate whether the Chinese stance is linked to its Belt and Road Initiative (BRI) and whether at some future point China will make renewed efforts.

In Chinese history, old and more recent, this has been its style – bringing up the same issue again and again in different ways to wear down opposition.

At a time when the postwar world order, in particular the trade and economic order, is in a state of flux and uncertainty – with the US, hitherto its hegemon, functioning under the Trump administration in a chaotic way but seemingly intent on wielding a wrecking ball to that order – the impasse at the WTO on completing the Doha Development Agenda and the hardline Chinese stance on IF raise many troubling questions.

Among these is whether the Chinese initiative and ideas, whether intended or not, may result in a Chinese "Middle

Kingdom" version of the 20th-century US-led "globalization" (which former US Secretary of State Henry Kissinger, in a 1999 lecture, called "just another name for US domination"*), with China emerging as a 21st-century hegemon and colonial power of sorts. [* Cited in Chakravarthi Raghavan (2014), *The Third World in the Third Millennium CE*, Vol. 1 (Penang: Third World Network), pp. 227, 230-232.]

The BRI and its broad contours were unveiled at a 14-15 May forum in Beijing. Some 28 attending heads of state/government, according to Chinese media reports, signed on to the communique. These reports also said that the forum will meet again in two years' time.

On 16 May, Pakistan's leading English daily *Dawn* published in great detail what were purported to be Chinese plans or at least detailed ideas on the Pakistan leg of the BRI, the China-Pakistan Economic Corridor (CPEC) (https://www.dawn.com/news/1333101/exclusive-cpec-master-plan-revealed). While the CPEC and Chinese promises of aid, loans and investment have received wide support and acclaim in Pakistan, the details brought out in the *Dawn* article have also raised some disquiet in the country, with some opposition parties demanding full and open discussion on its benefits and future obligations before Pakistan signs any accords.

Coupled with the BRI and the kind of ideas that China has in terms of investments (and loans) in other countries – in projects expanding China's world trade share by use of Chinese resources (manpower/skills/export capacity etc) in those countries – the IF proposals in the WTO could lead to "pre-establishment" investment market access rights for foreign investors and corresponding obligations for host countries, all subject to the rules of the WTO's dispute settlement process.

The Chinese and other proposals on IF (see *TWE* No. 638) suggest extremely detailed transparency requirements that would entail spelling out all criteria used in licensing requirements and the appraisal of potential investors. If the criteria are not spelt out in full, the highly elaborated procedural mechanisms would make it difficult for a country to prevent investors from entering its market.

[Ironically, while the IF proposals at the WTO envisage some rules and disciplines involving pre-investment rights for investors under the rubric of "transparency", EU member countries at the Beijing forum unanimously declined to endorse the trade statement prepared by the hosts, according to a report in the British daily *The Guardian*, on the ground that "it did not include commitments to social and environmental sustainability and transparency" (https://www.theguardian.com/world/2017/may/15/eu-china-summit-bejing-xi-jinping-belt-and-road?CMP=share_btn_fb).]

Some of the IF proposals (by China, Brazil-Argentina and Russia) at the WTO have an uncanny resemblance to initial ideas that the US unveiled in 1982-86 when it began outlining its proposals for a "services agreement" under the General Agreement on Tariffs and Trade (GATT) via the Uruguay Round. The US had then envisaged "investment" rights for its service providers to establish facilities and supply services in other GATT Contracting Parties, and for such establishments to be able to diversify once "established". Very difficult Uruguay Round negotiations over the period 1986-94 eventually resulted in a less freewheeling "trade in services" accord incorporated in the General Agreement on Trade in Services (GATS).

The current proposals (now mere "communications") in Job documents before the GC effectively mean that markets in any WTO member state would be open to investors without conditions, unless adequate criteria and conditions have already been put in place by potential host countries. They would therefore be "pre-establishment" investment market access rules, subject to the WTO's fundamental Most-Favoured-Nation (MFN) principle and the enforceable rules of the WTO's dispute settlement process.

Role of the secretariat

At a time when the large majority of the developing-country WTO members are still struggling to secure the completion of the Doha Development Agenda – including ensuring food security, a special safeguard mechanism in agriculture, policy space and other basic development requirements – if the membership is faced with a stalemate over IF in the run-up to the Ministerial Conference to be held in Buenos Aires in December, and the law of unforeseen consequences to members and the system prevails, it will be largely due to the failure of the secretariat under its current freewheeling Director-General to follow the Marrakesh Agreement (WTO Agreement) and past GATT practices.

In terms of the WTO Agreement, the rules of the GC provide that:

- Meetings of the GC shall be convened by the Director-General by a notice issued not less than 10 calendar days prior to the date set for the meeting (Rule 2).
- A list of the items proposed for the agenda of the meeting shall be communicated to members together with the convening notice for the meeting. It shall be open to any member to suggest items for inclusion in the proposed agenda up to, and not including, the day on which the notice of the meeting is to be issued (Rule 3).
- Requests for items to be placed on the agenda of a forthcoming meeting shall be communicated to the secretariat in writing, together with the accompanying documentation to be issued in connection with that item. Documentation for consideration at a meeting shall be circulated not later than the day on which the notice of the meeting is to be issued (Rule 4).
- A proposed agenda shall be circulated by the secretariat one or two days before the meeting (Rule 5).
- The first item of business at each meeting shall be the consideration and approval of the agenda. Representatives may suggest amendments to the proposed agenda, or additions to the agenda under "other business". Representatives shall provide the chairperson or the secretariat, and the other members directly concerned, whenever possible, advance notice of items intended to be raised under "other business" (Rule 6).
- The GC may amend the agenda or give priority to certain items at any time in the course of the meeting (Rule 7).

When the text of the WTO Agreement was being negotiated in October-November 1993 at official level in Geneva, and the negotiations were among some key delegations outside the GATT building, one of the key issues was in respect of powers and authority of the Director-General. This was eventually settled on the explicit understanding that there would be no change in that regard from the position under GATT 1947.

At that time, the then GATT Director-General, Peter Sutherland, had gone before this group and pleaded and argued for some powers akin to those of

heads of other international organizations and UN specialized agencies, including the ability and right to bring issues to the attention of member states for their decision. As Sutherland himself told this writer at that time, this was turned down near-unanimously within the group, on the ground that the WTO Agreement involved a delicate balance of rights and obligations of members, and that no secretariat official should be enabled to suggest something that could upset this delicate balance.

As a result, it was understood that under the WTO the Director-General would carry out such functions and responsibilities as the Ministerial Conference (and in between the Conference sessions, the General Council) may stipulate from time to time and, except as provided in the WTO Agreement or multilateral trade agreements, "the WTO shall be guided by decisions, procedures and customary practices" of GATT 1947. This meant that the Director-General would have no role either in agenda setting or in subsequent negotiations, except as a facilitator.

Also, under GATT 1947, the chair of the GATT Council did not have any independent authority. They had to consult members and obtain a consensus before proposing an agenda item, particularly if the issue was a substantive one like in the present case of IF.

For example, in 1992, when the Uruguay Round negotiations were taking place, according to Zutshi, India's GATT ambassador who was chair of the GATT Council at the time, two rather controversial issues came up for consideration: (i) the demand by some contracting parties to expel the then Yugoslavia from the membership; and (ii) applications for accession by the People's Republic of China (PRC) and Taiwan. Both issues were highly contentious, Zutshi says, and he held consultations and obtained a consensus on both.

[In the case of Yugoslavia, the consensus was for a temporary suspension of its membership, which entailed the Yugoslav delegation being able to attend meetings only as observers but having the right to receive all documents (a compromise approach that was subsequently also adopted by the UN in dealing with Yugoslav membership of that body).

[In the case of the two accession applications, the text of the decision was also negotiated with major participants. One of the elements of the compromise was to give precedence to the PRC's application in the agenda and, after negotiations, not to grant membership to Taiwan (also involving negotiations on the name to be given to the territory for which Taiwan was seeking accession) ahead of the PRC. (Both eventually acceded to the WTO in 2001, with the PRC accession approved first, before that of Taiwan, which was to be known in the WTO by its capital Taipei.)]

In neither instance, Zutshi added, was there any active involvement of the then GATT Director-General, the late Arthur Dunkel, in these negotiations.

Controversial issue

In the present instance, when the draft agenda was issued including the IF item, WTO Director-General Roberto Azevedo was aware of IF's controversial nature and opposition to the idea from key delegations. He had tried to promote it at a meeting of sherpas in the run-up to this year's G20 summit in Germany, and there it had met with clear opposition from the US as well as from India and South Africa. As a result, Germany as host-chair had to remove it from the draft texts being prepared by the sherpas for the G20 summit.

As far as the WTO is concerned, "investment" has been a controversial issue with a long history dating back almost to the WTO's inception. It had met with considerable opposition even at Marrakesh, when the then European Community (EC) raised it as an item for the future agenda and most developing countries were opposed, viewing it rightly as an attempt by the EC to raise issues extraneous to trade in order to avoid or dilute future focus on the EC's farm policies. The item was mentioned, along with various others raised by other GATT members at that meeting, in the final statement of the Uruguayan chair of the meeting, as subjects that GATT and/or the future WTO might consider.

At the WTO, investment proved controversial ab initio and was resisted by India and others at every stage, with a decision at the fourth Ministerial Conference in Doha in 2001 that the subject, after study in a working group, would be taken up for negotiations after the fifth Ministerial Conference "only on the basis of explicit consensus".

After the collapse of the fifth Ministerial Conference at Cancun in 2003, and with it the Doha Work Programme, the negotiations were relaunched at the General Council in July 2004 in Geneva, through what became known as the Framework Agreement. That agreement stated that the issue of investment would not form part of the Doha Work Programme and that "no work towards negotiations on [investment] will take place within the WTO during the Doha Round".

It is not clear whether, before issuing the draft agenda for the GC meeting, Director-General Azevedo had "consulted" the GC chair; if not, it was a violation of past GATT practices. Even if he had consulted, it suggests poor judgement, on the part of all involved, to have included the item in the draft agenda without prior consultations with the membership and finding a consensus.

At the GC meeting on 10 May, apart from India and others which openly objected to the item on the draft agenda, the US (which had opposed it in relation to the G20 sherpas meeting) viewed the inclusion as "inappropriate" but nevertheless was somewhat equivocal in its stand. At the resumed GC meeting on 18 May, however, the US expressed its scepticism over the issue and said that experience has shown that getting a multilateral agreement on something like this may be a daunting task.

As Zutshi notes in a communication to this writer, members can under the rules propose an item for consideration at the GC, but a distinction has to be drawn between purely routine and implementation issues under the covered WTO agreements and substantive issues of interpretation/clarification of the provisions of those agreements and new issues, both within and outside the remit of the WTO.

While the GC procedural rules envisage freedom to propose agenda items, they have to be those pertinent to the implementation of covered agreements; there is no freedom to members to propose items outside the remit of the WTO. And even in respect of covered agreements, the issue has to be first brought before the relevant Council (Council for Trade in Goods, Council for Trade in Services or TRIPS Council) and brought before the GC only with the reports/recommendations of the relevant Council.

When one talks of agenda setting and subsequent negotiations as the "members' business", one is talking about substantive issues as outlined above and not routine and implementation issues pertaining to the covered items.

If a member or members propose

any agenda item outside the scope of the covered agreements, or a controversial one within the WTO remit also, Zutshi adds, it is the responsibility of the secretariat (Director-General) to advise the member(s) suitably and bring the matter to the notice of the chair. It is then for the chair on his/her own or at the behest of the Director-General to drop the issue and inform concerned members accordingly or undertake consultations with a view to exploring further possibilities. In any case, for an issue outside the remit of the WTO, its inclusion in the agenda of a GC meeting is out of the question without a prior consensus.

Under GATT 1947, Zutshi says, the chair of the GATT Council, on the request of interested members or a request from the Director-General, would undertake consultations. It did not necessarily involve the Director-General's approval.

And while the Doha Work Programme did set up a study group on Trade and Investment (as argued by some members at the GC to make the questionable claim that investment is within the WTO remit), in terms of the 2001 Doha Ministerial Declaration itself and the July 2004 Framework Agreement, it is clear that no work on this subject can take place at the WTO before the conclusion of the Doha Work Programme (as modified by the Framework Agreement) as a single undertaking.

And at the Nairobi Ministerial Conference in December 2015, it was China (to safeguard its own interests) that got inserted into the Nairobi Ministerial Declaration (in the context of the Doha Development Agenda) the words "Members have different views on how to address the negotiations. *We acknowledge the strong legal structure of this Organization*" (emphasis added). The insertion alludes to the need to respect the Doha Development Agenda mandates, and for decisions to be based on consensus (Article IX of the WTO Agreement) and not be imposed by some without the agreement of all.

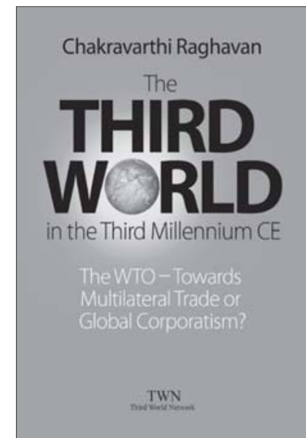
It is clear that those proposing discussion of IF at the GC, and those objecting and refusing to join consensus, do not stand on the same footing. In terms of the Nairobi Ministerial Conference decision, IF is a new issue, and it is for those who propose it to convince others and get their consensus.

And as India said at the resumed GC meeting of 18 May, discussions at the WTO do not occur without a context and that context is setting enforceable multilateral disciplines or rules. *(SUNS8467)*❐

The Third World in the Third Millennium CE

The WTO – Towards Multilateral Trade or Global Corporatism?

By Chakravarthi Raghavan



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THE second volume of *The Third World in the Third Millennium CE* looks at how the countries of the South have fared amidst the evolution of the multilateral trading system over the years. Even at the General Agreement on Tariffs and Trade (GATT) gave way to the World Trade Organization (WTO) as the institution governing international trade, this book reveals, the Third World nations have continued to see their developmental concerns sidelined in favour of the commercial interests of the industrial countries.

From the landmark Uruguay Round of talks which resulted in the WTO's establishment to the ongoing Doha Round and its tortuous progress, the scenario facing the developing countries on the multilateral trade front has been one of broken promises, onerous obligations and manipulative manoeuvrings. In such a context, the need is for the countries of the Third World to push back by working together to bring about a more equitable trade order. All this is painstakingly documented by *Chakravarthi Raghavan* in the articles collected in this volume, which capture the complex and contentious dynamics of the trading system as seen through the eyes of a leading international affairs commentator.

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WHO DG-elect faces herculean task on "health as rights issue"

For the incoming head of the World Health Organization, realizing his stated goal of universal health coverage will be fraught with challenges, not least of which is that posed by the dominance of neoliberal economic policies.

by D. Ravi Kanth

GENEVA: As climate change and neoliberal economic policies wreak havoc by increasing the disease burden in the poorest and developing countries, the newly elected Director-General of the World Health Organization (WHO), Tedros Adhanom Ghebreyesus from Ethiopia, faces a herculean task of working on his declared basis that "health is a rights issue" and "an end in itself."

On 23 May, Tedros, a malaria expert, secured the distinction of being the first African candidate to be elected to WHO's top job. He is also the first Director-General elected democratically through a secret ballot.

Effectively, his election brought about a paradigm shift by discarding the previous non-democratic approach of WHO's Executive Board of 34 countries choosing the Director-General. Until now, candidates from developed countries made it to WHO's top job because of the manner in which the Executive Board was manipulated, according to a health ministry official from a developing country who asked not to be quoted.

(Not all earlier Directors-General from developed countries, however, turned out to be reflective of or hew to the North's agenda. Halfdan Mahler, a Dane who served as WHO head from 1973-88, proved exceptionally to be concerned with pushing for public health solutions to the problems of developing countries, as in his pioneering approach reflected in WHO's 1978 Alma-Ata Declaration which emphasized primary health care as the key to securing "health for all by the year 2000" – a focus and target that his successors abandoned in favour of the traditional approach to medical care. Mahler brought to his post all his earlier experience as a doctor working in a missionary hospital in India, and with great diplomatic and political skill made Western industrialized societies accept and promote his ideas. – *SUNS*)

Universal health coverage

In his press conference after being declared the new Director-General, Tedros made significant remarks on how he intends to take up his new assignment. He declared that "health is a rights issue" and "an end in itself". This is perhaps a landmark pronouncement, rarely heard from his predecessors.

At a time when more than 3 billion people in the world are denied "access to healthcare and universal health coverage," Tedros has boldly admitted that the goals set out in the WHO Constitution (which entered into force in 1948), the Alma-Ata Declaration and the Sustainable Development Goals are relevant and valid today.

"But still, half of our population doesn't have access to healthcare and universal health coverage," he lamented. "I think it's time to walk the talk, and the world is asking for that."

The new Director-General says health ought to be "a means to development". This is an argument advanced by the Nobel economics laureate Amartya Sen in a keynote address to WHO in 1999. In his lecture on "health in development," Sen famously said that "good health is an integral part of good development" and "given other things, good health and economic prosperity tend to support each other."

Sen maintained that "the enhancement of good health can be helped by a variety of actions, including public policies (such as the provision of epidemiological services and medical care)."

"Growth-mediated enhancement of health achievement goes well beyond mere expansion of the rate of economic growth," Sen argued. "Even when an economy is poor, major health improvements can be achieved through using the available resources in a socially productive way," he pointed out.

"Financial conservatism should be the nightmare of the militarist, not of the doctor, or the schoolteacher, or the hospital nurse," Sen maintained.

It is therefore significant that Tedros has driven a strong message that "health is a means to development [and] it's not actually a waste – it's the smartest thing to invest in."

"And wherever I have been travelling, that was very visible, and that's why I said yesterday, all roads should lead to universal health coverage and it should be the centre of gravity of our movement," Tedros emphasized.

He further clarified that what he means by "universal health coverage" is that governments must address the "financial barrier" and challenges facing "access to [affordable] drugs."

Tedros said governments must address "the barriers to equality, access to quality of care and diagnosis."

More important, "universal health coverage should be at the centre to address these barriers," the Director-General-elect pointed out.

He said that universal health coverage will not appear the same across all countries, stating that there would be tremendous "diversity" as "some countries want to use private services to achieve universal health coverage [while] others use public services only [without commercializing basic health care]."

He mentioned that there are countries that use "a mix of private and public"; some countries use "general tax, others use insurance." Therefore, "there is no one way or one means of achieving universal health coverage," he argued.

Tedros suggested that "based on a country's situation, different ways of achieving universal health coverage" are possible.

Without imposing a one-size-fits-all approach, "we need to have a consensus and agree health is a rights issue" regardless of the "means" that are adopted for achieving that goal.

"But we have to agree that health is a rights issue, an end in itself," he repeatedly emphasized, suggesting that "universal health coverage should be at the centre, and it has to be tailored to the needs of the countries."

Given the realities on the ground since the late 1980s when governments in the developing and poorest countries were forced to embrace neoliberal economic policies under pressure from multilateral financial and trade organiza-

tions, investments in the health sector, particularly for primary health care and universal health coverage, have come down dramatically.

Moreover, access to affordable medicines for tackling major diseases such as tuberculosis, cancer, HIV/AIDS and several non-communicable diseases has become a nightmare in both developed and developing countries because of the pharmaceutical patent regime. Even though governments can take recourse to compulsory licensing provisions, they were unable to use them because of coercion and pressure from Washington, according to several studies.

Against this backdrop, the *South-North Development Monitor (SUNS)* asked Tedros whether his emphasis on "health as a rights issue" is achievable when governments are driven by neoliberal economic policies that are contributing to dramatic cuts in investments for the health sector.

He was asked to clarify whether it would be appropriate to leave the policies to be followed for universal health coverage to governments which are increasingly influenced by neoliberal economic priorities – without an intervention from WHO.

Tedros acknowledged that it's "a very important question" and argued, "If we [WHO] are going to ask commitment from countries, the commitment should be to the goals."

"As long as we agree on the goal for achieving universal health coverage, the means could be private, public, or a mix," he maintained. "There are countries who have very robust private, and who have achieved better outcome in terms of universal health coverage."

"So that's why WHO should be advocate for the outcome, rather than the means," Tedros argued, suggesting that "there are many ways of really achieving universal healthcare."

"Then on the public health investment, there are public health issues that the government should actually be responsible for [and] everything cannot be in the private hands," Tedros said.

"If you're talking about those, then of course WHO should really advocate for some of the public health areas or interventions to be entirely done by the government itself, so we have to differentiate the two, so we can do both," he said.

In crux, Tedros faces a gigantic task in the coming months and years to advance policies within WHO as well as influence governments for pursuing universal health coverage initiatives, according to health officials and experts from developing countries. *(SUNS8471)* ❐

Slow growth stalls progress on SDGs

Weak economic growth is impeding efforts to achieve the internationally agreed Sustainable Development Goals, according to a UN progress report.

by Tharanga Yakupitiyage

NEW YORK: The world will not be on track to eradicating poverty by 2030 if current growth trends continue, a UN task force has found.

On 22 May, the Inter-Agency Task Force on Financing for Development, comprising over 50 international institutions, launched a report assessing progress on the Addis Ababa Action Agenda, a global framework on development financing to help implement the internationally agreed Sustainable Development Goals (SDGs).

Though there has been some progress in development financing, slow global economic growth and decreased trade and investment growth since the 2008 financial crisis has hampered progress on the SDGs, including the eradication of poverty by 2030.

"Despite expectations of improved growth in 2017 and 2018, the current global environment bodes poorly for the achievement of the SDGs," said UN Under-Secretary-General for Economic and Social Affairs Wu Hongbo.

In 2016, the world economy grew at its slowest rate since the crisis and the global gross domestic product (GDP) is projected to grow at less than 3% over the next two years.

Such rates are likely to leave almost 7% of the world's population extremely poor by 2030. Least developed countries (LDCs) will fall the farthest behind, Wu stated.

Though the number of people living on less than $1.25 per day has decreased dramatically in the last few decades, the decline largely relied on strong economic growth in developing countries, the report notes.

Low economic growth is also contributing to rising levels of unemployment. The International Labour Organization estimates that there will be 3.4 million more unemployed people in 2017 than in 2016, and further increases are expected in 2018.

Unsustainable strategies

The Director of the Division on Globalization and Development Strategies at the UN Conference on Trade and Development (UNCTAD), Richard Kozul-Wright, noted that these trends are partly due to the failure to develop sustainable growth strategies.

"A lot of people expected that post-financial crisis there will be a serious reflection on the kinds of growth strategies forged prior to the crisis which were clearly unsustainable and not inclusive, but that hasn't really happened," he said.

Weak investment is another major challenge hindering the achievement of the SDGs and thus growth, he added.

Between $1-5 trillion of additional investment is needed for infrastructure alone, a key element to help sustain growth in developing countries. Transportation infrastructure enables trade and economic development, which is particularly important in landlocked developing countries, while energy-related infrastructure is essential for climate change mitigation and adaptation. However, public and private infrastructure investment has declined globally.

Though official development assistance (ODA) increased by almost 9% in 2016 from 2015, escalating humanitarian needs have led to significant short-term and long-term financial gaps.

Uncertainty in key policies of major countries only heightens risks in the global economy, including the US' proposals to cut foreign aid and climate finance.

Wu noted that the creation of national policies that align with the SDGs as well as international cooperation to boost sustainable and inclusive growth is crucial. "Many of the challenges that countries face, including slow economic growth, climate change and humanitarian crises, have cross-border or global repercussions and it cannot be addressed by any one actor alone," he stated.

The launch of the report coincided with the second annual forum on financing for development which brought to-

gether member states and international organizations to discuss the pressing issues laid out in the report and its potential solutions.

Participants reached an agreement on SDG financing, calling on governments to increase and adhere to their ODA commitments and improve tax policies, including international efforts to fight tax evasion, while urging development banks and private sector actors to help mobilize catalytic resources.

"We will have our voice heard whenever we can, we will speak loudly for the LDCs and the vulnerable countries and its people," Wu concluded. *(IPS)* ❒

Ecuador focuses on new UN tax body to fight illicit financial flows

Ecuadoran Foreign Minister Guillaume Long speaks with Inter Press Service's *Tharanga Yakupitiyage* about the need to curb international tax dodging and about his country's initiatives on this front as chair of the developing-country Group of 77.

NEW YORK: The time is now to work together to fight illicit financial flows, according to Ecuador's Foreign Minister Guillaume Long.

Ecuador, having long advocated for tax justice, has shed light on the issue at the United Nations. With his country being the current chair of the Group of 77, Long highlighted the need to end the financial secrecy of tax havens that often harm developing countries and to create an intergovernmental body to help regulate taxation and financial flows.

In an interview with Inter Press Service (IPS), Long explains the issues, challenges and goals in achieving tax justice.

Q: The President of the UN General Assembly said that financing to meet the Sustainable Development Goals (SDGs) is going to take $6 trillion annually and $30 trillion through 2030. Do you think much-needed finances will be made available if the current rate of illicit financial flows is curbed?

A: I think it's huge what you can get from curbing illicit flows and basically from tax dodging or tax evasion. In the case of Ecuador, we calculated that an approximate amount of $30 billion is held in tax havens.

Just so you get a general idea of what that means, Ecuador's gross domestic product (GDP) is roughly around $100 billion, so $30 billion means almost a third of our GDP. Most countries struggle to grow, but here you've got 30% of GDP literally being robbed from us in tax havens. That means less investment, less dynamism in the economy, less creation of jobs and also less taxes – it's those taxes that are used for public policies to reduce poverty, reduce inequality and create much-needed infrastructure.

There have been estimates that public infrastructure that is needed right now in the developing world is roughly $1.5 trillion. This includes hospitals, schools – the kind of infrastructure that the developing world needs to reduce huge rates of inequality and poverty, and some of the things we are trying to amend through, for example, the SDGs. And that's only probably about 15% of illegal assets held abroad in tax havens and various offshore accounts.

[Curbing illicit financial flows] could revolutionize and dramatically transform the story and history of development. And it would certainly be one of the best sources of financing for development, which is the big thing.

Now that we have come to an agreement on the 2030 [Sustainable Development] Goals and what it is that we want to do, the next question is: how do we do this? And we have to do this with resources. Some resources are available to us, but many others aren't and this is basically through tax dodging.

This is also fundamentally a practice that is carried out by elites and therefore it also means that you get greater rates of inequality. In a continent or a region like Latin America, if you do a per capita average, then it is the middle class, but we know that averages hide huge disparities and Latin America is actually the most unequal region in the world, and a lot of that has to do with elites not being a willing part of the social contract. And a major aspect of the social contract is taxation and not participating in tax dodging.

Q: How much does the developing world, particularly Africa, Asia and Latin America, lose to illicit financial flows?

A: There are huge numbers that are being reported. Oxfam talks of $7.6 trillion in tax dodging – I'm not even talking about illicit financial flows, not even talking about offshore accounts, I'm talking about $7.6 trillion in tax dodging.

This is why Ecuador has taken this issue so seriously. We've been talking about tax havens and tax avoidance for years, particularly in this government in the last 10 years with the presidency of Rafael Correa. But after the Panama Papers scandal last year, President Correa really launched this as his priority and as a major crusade. He even launched what he called an "Ethical Pact" which included a referendum in Ecuador to ban civil servants and elected officials from holding assets in tax havens. If you are found to hold assets in tax havens, you can be removed from office automatically.

I really think Ecuador is one of the countries, if not the country in the world, that's done the most. This referendum, which was successful in terms of its results, is an example to the world. And I think Ecuador has been the most proactive country in the year that's transpired since the revelations of the Panama Papers in taking concrete and bold steps.

Another major thing that we have been doing on the international front is from our [chairmanship] of the G77. We have pushed for the creation of an intergovernmental body on tax justice. We had a workshop this morning which was co-chaired by Ecuador, India and South Africa with huge participation exactly on this issue.

There is an opportunity – now that the issue is back at the forefront of the media, it means that we have to maximize that opportunity to try and create mechanisms, particularly inside the United Nations, that fight tax dodging. [This issue] we can deal with if we have the right tools and institutions to fight that.

Q: What are your thoughts on public disclosures on tax havens like the Panama Papers? Is that something that is needed more in order to increase transparency and action on tax havens?

A: Whistleblowing plays an important role. When information is public and people find out about these things, if their politicians have been hiding money and fog them – most politicians have a very patriotic discourse saying they're going to create jobs and economic activity and bring foreign investment. But surely there is a paradox and a contradiction if you are saying "vote for me because I'll bring loads of foreign investment into the country" and then on the other hand you've got all your personal assets hidden away somewhere without

paying taxes. I think when those contradictions and lies – and I would use the word "robbery" especially if you are dodging taxes – are exposed, then that's a good thing. It creates greater consciousness.

I think this is a time of great opportunity because since the Panama Papers scandal, a lot of countries that could be considered to be tax havens are starting to take measures because they are under increasing pressure by people and by countries like Ecuador and other countries to do something about it.

The fact that we are having this debate today and the fact that I am talking to you is not necessarily in the tax havens' interest because it brings the spotlight onto their activities, so generally speaking, those kinds of public disclosures are a very important part of creating a general awareness that this must stop.

There are a lot of double standards too. On the one hand, developing countries are under pressure for all sorts of things: they've got to grow, they've got to be good economically, they've got to guarantee human rights – all of these things which we absolutely abide by and are very committed to. But surely there is a contradiction with having to do that and then, on the other hand, all of these countries that are kind of sermonizing to the rest of the world from their civilizational pedestal are reaping the benefits of all the crony and corrupt elites of the developing countries depositing their money in these bank accounts without paying taxes.

So there's a hypocrisy there that has to be exposed. And if these public disclosures can help to do that, then so be it.

Q: Has there been any progress since the UN Economic and Social Council (ECOSOC)'s adoption of the UN Code of Conduct on Cooperation in Combating International Tax Evasion?

A: That was a very important step. It was the first piece of important legislation and regulatory result that came out of the Committee of Experts in a long time. So we are seeing progress, though still not enough, but still progress. And that has to do with [it being] back on the agenda.

Now there is a new step, which I think is very important, that the [UN] Secretary-General from June onwards is going to be naming the members of the Committee of Experts. So that's also a positive development because it obviously raises the stakes and gives it more political clout.

Ecuador's position is that we celebrate that the Committee of Experts was created with largely the fruit of debate that goes back to Monterrey [where the first International Conference on Financing for Development was held] in 2002. But now we think that the Committee of Experts is insufficient and that we need something else. We need something with more clout, with more accountability, with more relation with the United Nations system itself and the governmental nature of this organization.

You have it in other spheres – if you look at trade, the World Trade Organization is a regulatory body at the highest level for trade, while the World Intellectual Property Organization is a regulatory body for intellectual property at the highest level. Those institutions exist because it is in the interest of big capital that they should exist. Big capital is in favour of free trade and if a country stands in the way of free trade, then you get reprimanded. But it's not necessarily in the interest of big capital to have the equivalent in the field of taxation.

This is an important concept that we should bear in mind. A lot of the institutions of global governance that we have inherited respond to specific interests and not always to the interests of the most powerless in society. They respond to the interests of the most powerful in society.

And why should trade be more important than taxation? Probably in terms of redistribution, taxation is more important than trade. Nobody is saying that trade isn't important for the overall accumulation of wealth of different countries, but in terms of redistribution and in terms of capacity of the state to work towards the 2030 Agenda [for Sustainable Development], then surely [taxation] plays a huge role.

It is great that we are getting closer but it is frustrating that we are still talking about a fight in order to create an institution that will then dedicate itself to fighting for a greater outcome which is tax justice. We are not even fighting for tax justice, we are fighting for the right to have the corresponding institutions just like you have them in the fields of trade and intellectual property and others.

Q: Are you proposing a new UN tax body or are you hoping to transform the Committee of Experts into an intergovernmental body?

A: We are looking to transform the Committee of Experts but we are very open to different kinds of formats. We are trying to create consensus [...] – I mean, we preside over the G77 which is 134 nations, so creating consensus between 134 nations is already a tall order – but at the end of the day, we are actually trying to create consensus between 193 nations of the United Nations and that includes tax havens, countries that have been a little pro-status quo particularly in the OECD [the rich-country Organization for Economic Cooperation and Development], and a lot of countries that are not in the G77.

So we are open to all sorts of different outcomes. We just want to raise the hierarchy, the political clout, the visibility, the strength of the body. There are a number of initiatives. Some people have talked about keeping it within the ECOSOC while others want to elevate it to the General Assembly – there's a huge debate within the G77 about it.

But there is consensus between 134 nations of the G77 that it should be an intergovernmental body. And that's something that we are trying to, through our presidency, express the will of the nations that are members of our group.

Q: How feasible is the proposal for an intergovernmental body for approval by the General Assembly?

A: I think multilateralism is a slow process always. I think we are getting closer. And I think that the big conference on financing for development in the next few weeks should make significant progress. I think we will find that there is much more consensus than there was in Addis Ababa [where the third International Conference on Financing for Development was held] in 2015.

Most countries from the Global South have these discussions about tax justice and the right to development. But a number of countries from the G20 [grouping of the world's major economies] or OECD or more industrialized countries have also started to be flexible in their position. We are seeing changes. In the workshop we had today, which would have been unthinkable a few years ago, we had loads of tax havens present. Not just tax havens that are blacklisted in the Global South by the Global North but tax havens from Europe and from other parts of the world.

And they were there because they want to listen in on the debate, which shows that at least they are concerned or interested, and some of them actually spoke out and said they are making changes and showing a greater commitment.

There is another major thing, which is the securitization of the issue. For some countries, [the issue] of terrorism is a big thing. Where do terrorists hide their money? Well, increasingly in constituencies that enjoy banking secrecy and those tend to be tax havens. If we can all at least agree on the outcome, which is greater accountability and greater regulations on that matter, even if it is for different reasons, it's about consensus building and that's what multilateralism is about.

Q: So would this proposed UN tax body help bring such international cooperation in tackling illicit financial flows?

A: That's exactly right. It's not just about naming and shaming tax havens. If suddenly you have two neighbouring countries in a European setting, even if they are developed countries, and they start this kind of taxation war by lowering their taxes in order to try to suck capital and investment out of each other in this kind of race to the bottom, then a [UN tax] body like that should be able to intervene and make at least the right recommendations.

Whether those recommendations become compulsory, then that's another debate, but it should be a body like you have in other fields that has the capacity to make clear recommendations.

Q: Have you faced or expect to face opposition for this proposal, especially from the Global North?

A: For sure. The G77 has been facing – basically [the position] I am presenting to you is not a new position, the position has been going on for decades and there has been clear language on behalf of the G77.

It is interesting because within the G77, you actually have tax havens as well. But even those tax havens have accepted that an intergovernmental body, which doesn't exclude them, is quite a good measure if you want to have a serious debate and discussion between member states on this issue.

This has been the position of the G77 which has been resisted for decades. There [have] been loads of opposition. We saw it in Addis Ababa, particularly [from] members of the G7 [leading industrialized countries] or the G20 and lots of opposition from the OECD countries and opposition from countries that are not always considered to be tax havens in the kind of stereotypical manner.

Countries like the United Kingdom have been opposed to this very much, not only because of its own policies but also because of what are euphemistically called non-autonomous territories. The five biggest tax havens, in relative terms of the offshore assets per GDP index, are non-autonomous territories and four of the five are British while one is [American]. They are not sovereign nations and they are not members of the United Nations. That's an important issue and it's not surprising that there is opposition when we are trying to move away from this.

The Panama Papers singled out Panama and actually Panama is making quite significant efforts to move away from that image. We are very happy to see them move away from such practices but actually, Panama is not necessarily in the top five in terms of the GDP index. The very people who even write up the blacklists are not free of tax malpractice themselves. *(IPS)* ❐

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International financial governance undemocratic

Global governance and coordination on financial matters leaves a lot to be desired, writes *Jomo Kwame Sundaram*.

Why is it so difficult to achieve meaningful coordination when everybody agrees that it is desirable, if not necessary?

President Richard Nixon's withdrawal of the US from and hence termination of the Bretton Woods system in 1971 confirmed the end of the postwar Golden Age. This led to slower growth, greater volatility, more instability and reduced progress in raising economic welfare, among other consequences.

The Bretton Woods institutions (BWIs) – the World Bank and the International Monetary Fund (IMF) – were initially conceived as part of a postwar system of multilateral governance to ensure the conditions for peace, growth, development, employment and prosperity. Today, however, their governance arrangements are very different from those of the rest of the UN system, despite all its variety, and this is part of the problem. In New York, the UN is governed by "one country, one vote", at least at the General Assembly.

The role of the BWIs and their relationship with the rest of the UN system have also changed significantly over time. Europe is over-weighted in the BWIs while developing countries are under-weighted by the formula for determining voting weights.

These governance arrangements have created a sense of exclusion as developing countries feel they have not been fairly represented, especially after decades of dilution of the weight of the "basic vote". For example, in the mid-1940s, there were 44 members, with the weight of their collective "basic votes" totalling 11.4%. Today, there are 189 members, so if the weight of the basic vote remained the same, the total weight of the members would be just under half (189/44 x 11.4%). A few years ago, total basic votes only accounted for 2.2%, or less than 5% of what they should have been!

Governance vacuum

While the IMF is undoubtedly influential in various matters under its jurisdiction, there is no overall governance mechanism for finance comparable to the World Trade Organization (WTO) for trade.

Through the General Agreement on Trade in Services (GATS), it has been the WTO which has been facilitating, without supervising, financial services liberalization. Besides the WTO, the Bank for International Settlements, the Basel Committee on Banking Supervision, the Financial Stability Board and other international organizations have limited jurisdiction in other cross-border financial matters.

Meanwhile, important UN initiatives, e.g., the Financing for Development (FfD) conferences, have been largely stymied and ignored in various discussions on international financial reform as the governments of the rich OECD economies prefer the grossly undemocratic decision-making arrangements in the Bretton Woods institutions to those of the rest of the UN system.

Such governance issues inevitably undermine legitimacy and thus constrain more effective global coordination, but of course, there are other problems as well. For many years, there have been some important differences across the Atlantic, arguably since the 1960s.

During the recent crisis, the European approach initially relied on longstanding "automatic stabilizers", arguing that Europe did not need the big fiscal stimuli which the US and the UK – untypically – advocated in 2009.

Later, the European Central Bank warned incessantly of the threat of inflation, while the IMF inconsistently shared the view of the rest of the UN system, that the bigger threat was that of deflation and stagnation.

Instead of providing a desperately needed, coordinated, counter-cyclical fiscal stimulus to the world economy, under the leadership of the then UK Prime Minister Gordon Brown, the G20 major economies grouping committed to a huge capital infusion for the IMF.

It would have been better if the G20 had provided this capital boost on condition that the IMF reforms itself to proactively revive and sustain global economic growth and to better serve developing countries. Without sufficiently reforming itself, the IMF has continued to suffer from legitimacy and credibility problems, undermining its ability to provide more effective leadership.

Although current international coordination leaves a lot to be desired, there have been some modest and generally unsuccessful efforts to improve the situation.

For instance, there were some efforts to improve coordination by the G7 leading industrial nations as well as in Europe at the annual IMF-World Bank meetings in October 2008 and soon afterwards as well, but these efforts did not achieve much.

Meanwhile, then President Sarkozy of France initiated an unprecedented G20 summit to be held at the UN with Secretary-General Ban. US President George W. Bush later insisted on hosting the summit in mid-November 2008 in Washington DC.

(The G20 group of finance ministers had been meeting for a decade after it was created by then US Treasury Secretary Larry Summers and Canadian Finance Minister Paul Martin after the 1997-98 Asian crisis.)

In the following month, the G20 heads of government met for the very first time, and have continued to meet since with limited consequence after 2009. *(IPS)* ❒

Jomo Kwame Sundaram, a former economics professor and United Nations Assistant Secretary-General for Economic Development, received the Wassily Leontief Prize for Advancing the Frontiers of Economic Thought in 2007.

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Land and the right to food in Zambia

A UN rights expert's report on Zambia underlines the link between the right to food and access to land.

by Timothy Wise

Leave it to the UN Special Rapporteur on the right to food, Hilal Elver, to remind the Zambian government – and all of us – that in agricultural countries such as Zambia the right to food depends on the access of the rural poor to land.

"The push to turn commercial large-scale agriculture into a driving engine of the Zambian economy, in a situation where the protection of access to land is weak, can risk pushing smallholder farmers and peasants off their land and out of production with severe impacts on the people's right to food," Elver said in Lusaka on 12 May, at the end of her 10-day official mission to the landlocked southern African country.

In the absence of secure land rights, she warned, small-scale farmers can become "squatters on their own land," as they become labourers or contract farmers to export-oriented commercial farms. "This situation is particularly alarming since small-scale farmers represent 60 percent of Zambians and at the same time produce 85 percent of the food for the population."

With nearly four-fifths of rural Zambians living in poverty and 40% of children – more than one million – suffering stunted growth from malnutrition, Zambia has become one of Africa's most impoverished countries. This, despite strong economic growth and large increases in the production of maize (corn), the country's staple food crop.

Respect, protect and fulfil

The Special Rapporteur's findings were delivered in a short statement at the end of her 10-day mission. Invited by the Zambian government, Elver said she was grateful for her reception in many government offices, but her mission also took her to large-scale agriculture projects, small-scale agroecological farms, refugee camps, schools for former child labourers, and a nutrition project for adolescent mothers.

That is the beauty and power of the right to food, at least in the hands of advocates as committed as Elver and her predecessor, Olivier De Schutter. Zambia has signed the International Covenant on Economic, Social and Cultural Rights – which was adopted in 1966 and has been ratified by 164 member states in the UN – and the government therefore has a duty to "respect, protect and fulfil" the "progressive realization of the right to adequate food".

The right to food is often misunderstood. It commits governments to establish laws and policies to ensure people can produce their own food or purchase adequate food, a right enjoyed by every citizen. School-based feeding programmes, such as those Elver saw in Zambia, are only one example. It also includes an active responsibility for a state to deliver food to people in case of emergency, such as in times of natural disasters or war.

But the right to food goes beyond access, mandating the state also to respect and protect the right to food. "Respect" means the government is obligated to refrain from actions that impede people's access to food, such as removing farmers from their land for mining or agriculture. "Protect" is an even more powerful mandate, obligating the state to prevent actions by non-state actors, such as corporations, that undermine access to food.

The duty to respect, protect and fulfil the right to adequate food at once offers a more expansive and actionable agenda for state measures to guarantee the right to food. Elver made a point of emphasizing several government policies that fail that test, mostly related to land and agricultural development.

Securing land rights

Land rights, like property rights, are a different kind of right than the right to food. There is no human right to land. In agricultural societies, land rights are recognized as crucial to achieving the right to food. Access to food is guaranteed by ensuring either incomes adequate to purchase food or, in the case of many in rural areas, access to the land, water and other resources to produce adequate food.

As Elver noted in her statement, many small farmers in Zambia have neither enough land to feed their families nor secure title to the land they have. I saw the latter problem firsthand, as some traditional leaders on so-called customary lands worked with the Zambia Land Alliance to provide Traditional Landholding Certificates to their subjects while the national government debates a new National Land Policy to address the problem.

As I have previously written, such certificates give tenure security, which enhances everything from women's rights to inherit and own land to their access to credit so they can farm commercially, while avoiding the privatization of land, which could put vulnerable farmers at risk of losing their land to economic pressures.

Elver called on the government to adopt "a gender-sensitive, inclusive National Land Policy" that "protects the rights of those living on customary lands."

"Land-poor farmers in a land-rich country"

The UN envoy was particularly critical of the government's emphasis on large-scale agricultural projects on the country's underutilized land. With so many small-scale farmers lacking land and support, such policies undermine the right to food in a land-rich country such as Zambia.

Zambia is one of many African countries that have large tracts of uncultivated land and the water resources to grow crops. While the government develops 250,000-acre "Farm Blocks" to attract large-scale investors, the majority of small-scale farmers have seen their land access shrink as customary lands are divided among heirs through the generations.

Such farmers have too little land to grow a subsistence, never mind a surplus they can sell to earn cash for non-food needs or, hopefully, to invest in their farms. More than 70% of Zambian farmers have fewer than five acres of land. Researchers have estimated that farmers in Zambia need at least that much to grow a surplus, and with 10 acres they have the chance to become viable commercial farmers. They estimated that giv-

ing such land-constrained farmers 2.5 more acres of land (one hectare) would reduce poverty rates among them from 84% to 48%.

It is hard to find a more powerful step towards fulfilling the right to food among Zambia's smallholder majority. Yet government policies and incentives continue to reserve the country's unused land and water resources for Farm Blocks and other large-scale projects. Not only are such investments slow to materialize, when they do they rarely bring higher incomes for workers or contract farmers, nor food security for host communities, as a recent report from ZLA and South African researchers showed.

More maize does not mean less poverty

The Special Rapporteur concluded with a call on the Zambian government to reconsider policies that favour large-scale investors and overemphasize the production of maize on larger farms. Zambia's production of its staple food crop has more than doubled in the last 10 years, yet rural poverty rates have barely declined and Zambia ranks among the worst on the continent for food insecurity, classified by the Global Hunger Index as "alarming."

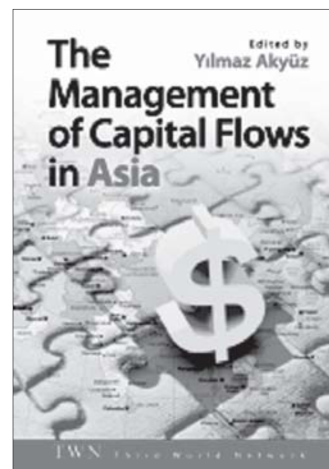
"The agricultural sector has failed to make a dent on poverty levels in the rural areas and as such the model for the strengthening of the agricultural sectors need to be altered," Elver said. "It is imperative that national strategies incorporate human rights principles that include the protection of their access to land and other productive resources in order to protect the country's traditional food system, smallholder farmers and their livelihoods." ❒

Timothy A. Wise directs the Land and Food Rights Program at Small Planet Institute. He is a Research Fellow in the Globalization Program at Tufts University's Global Development and Environment Institute. With a background as an economic journalist and an international development practitioner, Wise's research and writing have covered US farm policies, trade and agricultural development, agricultural biodiversity, food prices and biofuels, and Mexico's maize economy under the threat of genetically modified maize. With a prestigious fellowship from the Open Society Foundations, Wise has researched a book, tentatively titled Feeding Illusions: Agribusiness, Family Farmers, and the Future of Food, *on small- versus large-scale agriculture in the battle to feed the world, drawing on fieldwork in Mexico, Malawi, Tanzania, Mozambique, Zambia and India.*

The above article is reproduced from the website of Food Tank (foodtank.com).

The Management of Capital Flows in Asia

Edited by *Yilmaz Akyüz*



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THE 1997 Asian financial crisis brought home to the region's economies the importance of managing capital flows in order to avert financial shocks. This book looks into whether and how this lesson was taken on board by policy makers in Asia, and, accordingly, how capital account regimes in the region evolved in the post-crisis period.

The early years of the new millennium saw a strong surge of capital flows into Asian emerging markets amid conditions of ample global liquidity. In response to the influx of funds, these countries generally chose to keep their capital accounts open to inflows, dealing with the attendant impacts by liberalizing resident outflows and accumulating foreign exchange reserves. While this approach enabled them to avoid unsustainable currency appreciations and external deficits, it did not prevent the emergence of asset, credit and investment bubbles and domestic market vulnerability to external financial shocks – as the events following the 2007 subprime crisis would prove.

This book – a compilation of papers written in 2008 for the first phase of a Third World Network research project on financial policies in Asia – examines the above developments in relation to the region in general and to four major Asian developing economies: China, India, Malaysia and Thailand.

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Analysis

"Break up the banks to stop the next global financial meltdown"

In his latest book, financial writer David Shirreff lays out an alternative agenda for financial sector restructuring in response to perceived flaws in official reform efforts.

by Andrew Cornford

David Shirreff, *Break Up the Banks!: A Practical Guide to Stopping the Next Global Financial Meltdown*, Brooklyn and London: Melville House Publishing, 2016.

Progress on national and international agendas for reform in the aftermath of the financial crisis has slowed. As David Shirreff puts it, "In the years since the initial, post-crisis burst of enthusiasm financial sector and banking reform has lost its way", with only "stumbling, half-blind" progress towards the solutions he considers necessary.

Continuing disquiet focuses on various shortcomings of results so far. Accountability amongst bankers perceived as responsible for the financial crisis is widely viewed as having been too limited – with only a few legal cases and formal disqualifications from working in the financial sector for high-level decision makers. Although fewer people are now employed in some of the financial sector's activities, the remuneration of senior staff still in place remains elevated, especially in relation to that of their non-financial counterparts.

Consolidation in response to institutional fragilities revealed by the crisis has actually led to increases in bank size and, with it, greater lobbying power. New controls over complex financial instruments do not go very far. Revelations of fraud and malpractice continue to surface.

This is not to deny that useful reforms have been introduced. Banks' balance sheets are stronger than they were pre-crisis as a result of more capital and better liquidity cushions. Risks of insolvency are correspondingly less.

There have been steps in the European Union (including the United Kingdom) towards structural reform involving the separation of banking entities according to their involvement in the traditional activities of commercial banking, on the one hand, and in the riskier activities of investment banking, on the other.

So long as it survives whittling-down by the new United States administration, the mammoth Dodd-Frank Act will reduce or eliminate some of the worst features of banking practice in the United States. Nevertheless, the Act has serious critics amongst those who share its overall objective of a safer financial sector better serving the real economy. Moreover, the complexity and length of the Act is posing formidable problems for translation into applicable regulatory rules.

Measures so far adopted or proposed have not relieved concerns that regulators are still vulnerable to being outmanoeuvred by the bankers they regulate. Not least, finalization of negotiations on the Basel III framework for banks' capital and risk management, linchpin of the global reform agenda, seems to recede forever into the future. A final point especially important for emerging markets and other developing countries: it has been argued persuasively that the new global regulatory framework is not appropriate for banks with less sophisticated operations, and that a version better adapted to the needs of such institutions is needed.

Shirreff describes his book as "a call for revolution – a revolution to reduce complexity in global banks, to split them into manageable chunks, and to change the self-serving nature of the culture that dominates them".

On the face of it, Shirreff is an unlikely revolutionary. Cousin of General Sir Richard Shirreff, NATO's Deputy Supreme Allied Commander Europe 2011-14, he was a long-time financial journalist with *Euromoney* and *The Economist*. In his more entrepreneurial roles he was a co-founder of the semi-technical *Risk* magazine and author of an accessible and skeptical guide to financial risk management published in 2004 (*Dealing With Financial Risk*, London: Profile Books).

The great strength of Shirreff's proposals is their range and his critical attitude towards the shibboleths which still dog policy discussion. What will probably be considered the most radical of his proposals concerns the relationship between the reform of banks' structures – leading to legal separation into three groupings of activities – and of their corporate governance.

Proprietary trading would be limited to investment banks. Caps on bankers' remuneration would be introduced. More generally, the new international regime for bank regulation would be considerably simplified: complex regulatory requirements currently in place or envisaged would be replaced by much simpler standards for capital and liquidity.

Structural reform

What would the steps advocated by Shirreff look like in a little more detail?

The structural changes would introduce legal separation among banking functions which, combined, have been conducive to client abuse and conflicts of interest.

Shirreff's underlying vision of the financial system is as a utility – non-financial analogues which he cites being the sewage system and electricity distribution.

The key functions of banks for ordinary people, in his view, are to facilitate payments and to safeguard and keep track of cash balances. These functions are performed primarily by retail banks, which should thus be in separate institutions with capital levels and deposit insurance rendering failure almost impossible. The returns to investors on investments in such banks would be lower than recent levels but safe.

Shirreff notes that such a regime for retail banking would not exclude the possibility of public ownership, though care would be necessary to avoid control by politicians which, like bad management in the case of private banks, is always a po-

tential problem for publicly owned banks.

The second of the three major institutional groupings in Shirreff's scheme is corporate/wholesale banking. The core activities of such banking would be lending, cash management, and standard foreign-exchange and interest-rate hedging services. These could be accompanied by limited and carefully defined support to investment banks with restrictions designed to ensure avoidance of the interconnectedness which made the collapses of Bear Stearns and Lehman Brothers so potentially dangerous.

The aim would be to prevent corporate/wholesale banks making their balance sheets available to investment banks, private-equity firms and other minimally regulated financial institutions as places where these institutions can "park" underwriting positions and trading exposures. Corporate/wholesale banks would be subject to capital and liquidity rules but not necessarily the same ones as retail banks.

The third of Shirreff's groupings is "pure" merchant and investment banks which would provide advice and transaction services, underwriting the placement of shares and bonds, and taking equity and lending stakes in new and existing ventures. This would obviously include trading in financial instruments.

Of special importance is the proposal that the corporate form for institutions in this grouping should be partnerships, long a common form amongst investment banks. The partnership, in his view, achieves a better alignment of interests between a bank and its top management. Guidelines for employees are less likely to accommodate or encourage risky trading since losses will be met by banks' owners, i.e., the partners.

There would be no capital requirements for this group – as there would not be either for the hedge funds, private equity and other sophisticated financial institutions with which the banks might trade. Regulation would be light, consisting principally of conduct-of-business and stock-exchange rules. But this would not exclude ad hoc regulatory measures considered necessary, for example, to restrain overheated property markets which are frequently harbingers of crisis situations.

Shirreff believes that much of the structural change required by banks would be achieved by the proposal for separation of the three groupings – retail, corporate/wholesale, and investment banks. But he acknowledges that sheer size, which he does not believe can be justified by economies of scale for banks with assets in excess of $100 billion, makes effective management difficult, as exemplified in several instances both before and since the outbreak of the financial crisis, and complicates relations with regulators, politicians and the general public. Thus ceilings on bank size would probably have to be a part of Shirreff's agenda. If this means breaking up the largest banks, so be it.

Another major reform proposed about which Shirreff clearly feels very strongly is capping bankers' total remuneration – now for investment bankers approximately four times that for skilled workers in other sectors such as retailing, healthcare and construction – which its recipients have come to regard with an unjustified sense of entitlement. This has so far been dealt with in reform agendas by provisions for postponement and clawback of bonuses.

Shirreff favours going much further, not only abolishing the bonus pool but also capping total remuneration at all banks with access to the central bank's discount window. The cap would not apply to investment banks set up as partnerships, where, in Shirreff's view, the partnership form itself can be relied on to prevent the most egregious excesses of remuneration.

It should be noted here that Shirreff is skeptical that initiatives targeting banking standards (such as the independent banking standards body proposed by United Kingdom banks) will achieve major reform of the sector's conduct and ethics. However, he does not have an analogous proposal of his own for this purpose. He clearly believes that the most effective steps here would be the legal separation of banking into three groupings, the return to unlimited liability for partners in investment banks, and caps on total remuneration.

New banks

Shirreff also proposes more competition for the sector through the encouragement of new banks, scrapping of the Basel capital framework in its present form, restrictions on the issuance of credit derivatives, and introduction of a financial transactions tax.

The creation of new banks in all three of Shirreff's groupings would be encouraged. This would mean, he hopes, a more diversified banking sector populated by more mutual banks, cooperative banks, communal savings banks, credit unions, and lending operations taking advantage of innovations made possible by information technology, as well as by standard high-street and small-town banks.

He sees value for the corporate/wholesale sector in banks with a business model which would be a reformed version of the German Landesbank. And he makes the case for a state-owned bank providing partial guarantees and other support to corporate/wholesale institutions.

Here he is probably influenced by witnessing the operations of the Kredit Anstalt fur Wideraufbau (KW) when he worked for *The Economist* in Frankfurt and Berlin. (During the initial period of the West German economic recovery after 1945, the KW complemented private banks as a supplementary source of funds for bottleneck investment. Subsequently its role has been more that of a long-term development bank financed partly by public funds and partly through its own resources and borrowings, much of its investment supporting regional policies and small and medium-sized business.)

Basel II and Basel III would be scrapped. Like Sheila Bair, the outspoken former chairman of the United States Federal Deposit Insurance Corporation, Shirreff is opposed to the use of risk-weighted assets as supervisory indicators. As Bair puts it, these over-complicated rules "were subject to rampant gaming and arbitrage prior to the crisis and still are" [Bair S (2014), "Everything the IMF wanted to know about financial regulation and wasn't afraid to ask", in Akerlof et al. (eds.), *What Have We Learned?: Macroeconomic Policy after the Crisis*, Cambridge, Mass.: The MIT Press, p. 131]. In place of risk-weighted assets, Shirreff supports reliance on cruder measures like the leverage ratio. Banks' internal models can be used for their own trading advantage but not for supervision.

Shirreff would like to ban the writing and trading of credit derivatives by regulated banks and insurance companies. These instruments enable counterparties, often financial institutions, to buy protection against the default of assets such as loans or bonds. In return for supplying such protection for a periodic fee, the seller undertakes either to acquire credit-impaired assets at a specified price or to pay the difference between that price and current value of the impaired assets after "a credit event".

Shirreff sees such products as a lazy way of incurring credit exposure without studying or researching the underlying credit risk – an instrument which "takes us away from a world in which banks have firsthand experience of the companies and other borrowers they do business with". Owing to their pro-

liferation in the new millennium, credit derivatives were a major concern to authorities during the credit crisis regarding, for example, the systemic risks which might have to be faced if a major counterparty to credit-derivative contracts failed. Shirreff does not include any proposal other than that for credit derivatives which would involve control over financial innovation through the creation of new financial instruments.

This is perhaps a surprising omission in view of historical experience. Under the Act of 1974, the US Commodity Futures Trading Commission promulgated a guideline for economic and public-interest requirements for new contracts in commodity markets. This was eventually watered down in practice to according the market the decisive judgement as to contracts' viability [Markham JW (1987), *The History of Commodity Futures Trading and Its Regulation*, New York: Praeger, pp. 74, 78 and 144]. The same approach, i.e., without the public-interest requirement, has been retained in recent overhauls of US commodities regulation [Parker E and Perzanowski M (2010), *Commodity Derivatives*, London: Globe Law and Business, p. 551].

Nonetheless, there is the precedent just mentioned for incorporating the public interest in the vetting of proposed new contracts. Shirreff might take the view that, apart from his proposed restrictions on credit derivatives, the reformed framework for investment banking would provide sufficient oversight of complex new financial products without any additional requirement.

Shirreff supports the introduction of a financial transactions tax. He sees such a tax as discouraging what he calls "empty" trading between financial intermediaries often with no end user in sight and with little connection to the production of economic value. He has little time for the argument of opponents that such a tax would adversely affect short-term financing within the financial sector in forms such as repurchasing agreements and securities lending.

On balance, he views such financing as potentially destabilizing through its effects on interconnectedness within financial markets and as providing opportunities to institutions for window-dressing their assets in financial reports. Unsurprisingly in view of his skepticism concerning the social benefits of financial trading without economic value, he is not concerned by the likelihood that such a tax might reduce the amount of high frequency financial trading.

Proposals assessed

So how does Shirreff's blueprint hold up on its own terms? And which parts might be influential or at least be in approximate accord with current reform efforts? The two questions are related.

On some of his proposals, more detail would have been helpful. Shirreff would replace Basel II and Basel III with cruder but simpler, standardized rules on leverage and liquidity. Even though the replacement of capital requirements by leverage rules accords with proposals of some other regulators and commentators, one would have liked something a bit more specific as to the level of the leverage ratio – presumably higher than that which is already included in Basel III. And would Shirreff be more or less satisfied with the rules on liquidity management already part of Basel III?

Shirreff's proposals are clearly a response to what he perceives as the defects of the current reform agendas for the banking sectors of major advanced countries such as the US and those of the European Union. An important question concerning these agendas concerns their global applicability. A corresponding question concerning Shirreff's blueprint is how far it is successful in meeting the shortcomings on this front of these agendas.

One example here might be the Basel capital framework. During the early stages of the negotiation of Basel II, the text contained passages which acknowledged – explicitly or implicitly – the problems of applying such a framework to banking systems at different levels of development. For example, the text of June 2006 contained an annex on the simplified standardized approach which collected in one place the simplest options for calculating risk-weighted assets for the estimation of capital requirements for credit risk.

However, since the initial publication of Basel II.5 in July 2009, revisions of the framework, with the exception of the overdue rules on liquidity risk, seem largely directed at sophisticated banks, with little allowance for problems of applicability at smaller, simpler banks, which are to be found not only in the banking sectors of developing countries but also in those of advanced countries.

Shirreff would short-circuit the problem of the increasing complexity of the Basel framework by scrapping Basel II and Basel III and replacing them with something simpler. Thus a proposal undoubtedly inspired by problems of the reform agenda in advanced countries would probably be much appreciated by regulators in many developing countries.

Other similar examples might be cited. Here too simplification facilitating global application can often be achieved by simply extracting from a regulatory blueprint such as that of Shirreff features of limited or non-existent relevance to the banking sectors of many countries.

But there are also important problems which a truly global reform agenda would need to address but which are missing from Shirreff's blueprint. Examples might be the lesser regulatory capacity in many developing countries and the lower degrees of transparency as reflected in accounting standards and reporting to regulators which greatly complicate the tasks of regulators, supervisors and investors.

No attempt will be made here to assess the potential influence of Shirreff's ideas in the advanced countries – their principal target. But remarks on two subjects indicate the distance separating an alternative blueprint like Shirreff's from official initiatives which have been accepted or are actually being or likely to be negotiated.

Firstly, take Shirreff's structural proposals concerning legal groupings which separate activities currently or until recently carried out in integrated institutions together with reforms in corporate governance. As Shirreff acknowledges, some separation of banks' activities has been legislated or is under consideration in the UK and other countries of the European Union. But there are indications that such reforms have been or will be introduced only in watered-down form. And there are no signs of the separation of pure investment banking activities into separate institutions to which the partnership form would apply. There are rumblings in the US about restoring the separation of commercial and investment banking along the lines of the celebrated Glass-Steagall Act of 1933, but they remain just rumblings.

Secondly, burdened by ever greater attention to the drafting and revision of detailed rules, the effort to finalize Basel III (sometimes now referred to as Basel IV) continues. In view of the huge intellectual and political capital now sunk in this framework, it is hard to envisage radical simplification, let alone something more like the scrapping supported by Shirreff. *(SUNS8468)* ❐

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