POVERTY

'MY WORD IS MY BOND': RESPONSIBLE FINANCE AND ECONOMIC JUSTICE

On 15 October 2011, the Occupy LSX movement – having been prevented from occupying a space directly in the City of London among the offices of financial institutions – established a protest outside St Paul's Cathedral under the banner 'We are the 99 per cent'. The protestors have sought to articulate a frustration that resonates widely among both those who choose to protest and those who do not, regarding the inequalities in UK society and globally, and the responsibility of financial institutions to serve society.

The City, the protesters and the role of the church

We live in a world where one per cent of the population controls 40 per cent of the wealth, but two out of every five people – including half of all women under 25 – live on less than US$2 a day.[1] A world where vast sums have been allocated to prop up financial institutions while international aid pledges go unmet and austerity measures threaten livelihoods at home.

Frustrations with this world are exacerbated by the hubris of senior business leaders awarding themselves a 50 per cent pay increase[2] in a year of deep economic struggles for many. Although the media has sometimes overstated the extent of the dispute between Occupy LSX and St Paul's Cathedral, it has sparked a discussion about the role of the church in promoting business and financial ethics, and a fairer distribution of resources.

As Archbishop of Canterbury Rowan Williams noted in the *Financial Times* on 1 November 2011: 'The protest at St Paul's was seen by an unexpectedly large number of people as the expression of a widespread and deep exasperation with the financial establishment that shows no sign of diminishing... The Church of England is a place where the unspoken anxieties of society can often find a voice, for good and ill.'

One of the primary criticisms of the Occupy movement, meanwhile, has been the perceived absence of a specific manifesto for change. But the protesters have been clear that their unity is not centred around a policy platform – although their deliberative democratic approach is moving in this direction. The original priority was to express the widely held view that the current system has failed, but to do this in a way that demanded an actual response.

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Christian Aid does not have all the answers. But neither are we a stranger to the debate about the ethics of the global financial system, in which the City of London plays a central role. In the recent World Council of Churches report *Justice Not Greed*,[3] we drew attention to the way in which the world's poorest suffer most when the global economy hits a crisis.

For more than a decade, we have campaigned on issues where global finance results in grave injustices. In doing so, we have sought to galvanise progressive change. This has ranged from the Jubilee campaign, which began in the 1990s with the aim of freeing countries of the burden of illegitimate debt, to our current campaigning, which seeks to prevent the enormous tax losses suffered by developing countries.

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deregulation, irresponsible behaviour and its impact on people living in poverty. Having presented this analysis, we suggest some proposals for change that deserve serious discussion within and outside the church.

The challenge of increasing inequality

The Occupy London protest marked the 25-year anniversary of the 'Big Bang'; the Rev Dr Giles Fraser describes this as 'the day that the City of London changed forever... from an old boys' club dominated by the values of public school honour – "my word is my bond" – into the boiler room of international capitalism.'[4]

The financial deregulation and associated move to electronic trading that occurred on 27 October 1986, alongside economic policies promoted by the World Bank and International Monetary Fund, have had a profound effect – not only on wealth creation and distribution, but also on the stability of the global economy, with consequences for the poor both on the doorstep of the City and thousands of miles away in developing countries.

Rightly or wrongly, bankers have been blamed for the financial crisis that began in 2008, which directly resulted in the loss of jobs and personal savings, and a complete loss of confidence in our economy. The ensuing bank bailouts perceived as 'socialism for the rich' contributed to a heavy debt burden for the UK and many other rich countries, and to the ensuing austerity measures that have an impact on jobs, schools and hospitals – the basic services that underpin the fabric of our society.

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The decisions made in the City of London and Wall Street have a direct impact on the lives of people in the poorest countries in the world. It is all too easy, however, to demonise individuals and the institutions they represent for irresponsibility and unbridled greed. We are dealing with a much bigger issue – the structural flaws in the global economy that result in the exacerbation of inequalities. These structural flaws excessively reward some, and fail to provide a basic standard of living for others.

Since the mid-1980s inequality has risen in most countries, and in many cases sharply. Yet inequality is not just a problem of unjust allocation of resources, but has broader effects on the social fabric of our society. The higher the level of inequality, the less impact economic growth has in reducing poverty.[5]

Indeed, high levels of inequality can depress the rate of growth[6] and can also have undesirable political and social impacts. The 'Spirit Level' research shows strong long-term associations between inequality and a wide range of negative outcomes, from physical and mental health to criminality.[7] The widespread rioting that took place across England in August 2011 appeared to be a more immediate indicator of the potential social damage.

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Arguably, the church can and should play a role in restoring broken relationships – on an individual level, but also on a structural level – by challenging the economic injustice that maintains such a situation. And there are many examples where the church has done so. For example, the church played a crucial role in the Jubilee Debt Campaign movement, which secured billions of dollars of debt relief for poor countries. Whether through engaging with individual economic actors, companies in which the church invests, or with governments that mediate and regulate economic activity, the church has a contribution to make.

A recent report published by St Paul's Institute highlighted that a majority of city workers think deregulation contributes to declining ethical standards. They think that maintaining high ethical standards is not inconsistent with maximising shareholder value. Yet maximising shareholder value in the short-term seems to require increasing deregulation – or at least to provide a basis for lobbying to this end.[8]

We will explore two particular examples of the effects of financial deregulation on the stability of markets, on inequality and on the ability of poor people to sustain their livelihoods.

Financial secrecy and illicit capital flight

With the global economy reeling from the collapse of Lehman Brothers in 2008, Christian Aid published *The Morning After the Night Before*,[9] a report that explains how the failures of international financial regulation led directly to the crisis. The report focuses on the combination of financial secrecy and regulatory arbitrage that allowed banks and other financial institutions to attain levels of leverage that were an accident waiting to happen.

The banks and others exploited competition among jurisdictions to have the most lax regulation, seeking out those places that allowed them most freedom to borrow against their assets. In combination with a lack of international regulatory coordination, and of transparency, this meant that these unsafe levels of leverage were achieved in sight of regulators who were impotent, or were hidden from regulators who might have objected. As long as asset prices kept rising, the problem was largely unseen; once prices fell, problems of repaying the underlying borrowing were felt (and continue to be felt) across the global financial system. The report notes an example of a structured investment vehicle in Ireland that had assets of nearly US$112 for each US$1 of capital, compared to a standard regulatory maximum of perhaps US$8 of assets. The owner, the US bank Bear Stearns, was an early casualty of the crisis. Fast forward to November 2011, when the collapse of leading broker-dealer MF Global has revealed its ratio of assets to equity capital was in excess of 80:1.[10]

Our analyses in the reports *Death and Taxes* (2008)[11] and *False Profits* (2009)[12] support estimates of lost tax revenues for developing countries of around US$160bn a year, much more than they received in aid. Here, too, we show that a lack of financial transparency – in company accounts but also between jurisdictions – is at the heart of the problem.

Financial secrecy undermines the Millennium Development Goals, agreed by policy-makers around the world to drive human progress until 2015, in numerous ways. Most tangibly, the diversion of revenues means less spending on health and education, less investment in infrastructure, and less protection of the poorest. More insidiously, secrecy erodes the social contract that underpins government accountability to deliver for citizens.

The Morning After the Night Before makes the argument that addressing the financial secrecy that underpinned the crisis in this way would also deliver great benefits for developing countries. Indeed, countries at all income levels have long been suffering from the tax revenue-stripping impact of financial secrecy. By addressing the fundamental cause, a more transparent system would be created, with widespread benefits through effective taxation as well as greater economic stability.

Financial markets and access to food

In 2011 Christian Aid published *Hungry for Justice*,[13] which includes detailed analysis of the role of commodity index funds in distorting food prices – with huge human costs, above all in developing countries. The responsibility for this is laid firmly at the feet of the Commodity Futures Modernisation Act, passed in the US in 2000. The report quotes the Sunlight Foundation, saying that as this '262-page deregulatory bill' was 'tucked into a bloated 11,000-page conference report as a rider, with little consideration and no time for review, this bill would be viewed only eight years later as part of the failure of our political system abetting a financial storm that brought the world to its knees'.

Commodity index funds are used by pension funds and other institutional investors who were previously barred from taking positions in these markets, and marketed by major investment banks such as Goldman Sachs. Of financial institutions, only these investment banks can take direct positions on the commodity markets, so the Act in effect guaranteed them a profitable opportunity to be the intermediary to commodity markets for pension funds and others.

This piece of financial liberalisation had powerful and unhealthy consequences. As the report shows, the extent of index fund investment in commodity futures and the price of food on a given day became intimately linked. The fundamentals of supply and demand had ceased to drive food prices, sending appropriate signals to producers, and instead prices have come to be dominated by broader financial market dynamics.

From a development perspective, there were two main effects. The most obvious was that as more and more institutional money entered commodity markets (indirectly), prices went in one direction only: up. Figure 1 (overleaf) shows the extent of the distortion: a 50-year pattern of broadly stable commodity prices (broken only by a step up during the 1970s oil crisis) is thrown over as prices explode upwards. The onset of the financial crisis saw a sharp fall, but this was quickly reversed as governments flooded markets with money in an attempt to stave off recession. The second effect, more insidious, is that because food producers can no longer rely on the signals from

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Figure 1 Value of a commodity index since the 1950s[14]

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commodity markets to take investment decisions, this distortion is likely (if left unchecked) to contribute to unnecessarily expensive food and, eventually, to insufficient production.

A starting point for discussion

A discussion regarding the promotion of responsible capitalism and ethics in finance could start by proposing:

- corporate and tax haven transparency, which would challenge excessive risk-taking and challenge the tax abuse that harms the ability of countries, rich and poor alike, to provide for their citizens
- a commitment to carry out a full assessment of the potential human impact of any significant regulatory changes – including outside the country in which a given decision is being considered, and with particular priority for people living in poverty – and to continue with research to understand the full human impact of liberalisation over the past three decades, including the creation of commodity index funds, with a view to responding effectively where human costs are established.

Above all, it is crucial that in any debate about how the financial system might be reorganised in response to the current financial problems, the voices of people living in poverty in the developing world are heard loud and clear. Their concerns, as well as our own, must be addressed. The church and its agencies can and should have a voice in this conversation, and make it heard.

For more information, please contact:
Dr David McNair,
Principal Economic Justice Adviser,
dmcnair@christian-aid.org
020 7523 2034

Endnotes

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Poverty is an outrage against humanity. It robs people of dignity, freedom and hope, of power over their own lives.

Christian Aid has a vision – an end to poverty – and we believe that vision can become a reality. We urge you to join us.

Christian Aid, 35 Lower Marsh, London SE1 7RL
020 7620 4444 christianaid.org.uk