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CREATING A PROGRESSIVE INTERNATIONAL FINANCIAL AGENDA

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FPIF Commentary

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The international financial crisis has shaken the self-confidence of the managers of the international financial system. Their frantic efforts to prop up the global financial system and stimulate national economies are noteworthy, not only for the magnitude of the funds they are throwing at the problem but also for demonstrating they don't seem to fully understand the system that they created. Their confusion is producing the best opportunity in 60 years to create a more socially and environmentally responsible international financial order.

The unfolding of the crisis so far demonstrates the balance of power has shifted enough that the richest countries have recognized they can't solve the current global problems on their own and need to involve the G-20 in efforts to deal with the crisis. However, it hasn't shifted so much that they have surrendered their control over the global economic and financial agenda, or that they can be forced to accept deals that they oppose.

This means that in the short term, global financial institutions will focus on financial regulation as the primary arena for global financial negotiations, rather than broader issues of global governance or justice. It also means that the opportunity for progressive change, while significant, is limited. This can be seen in the declaration from the November 15 G-20's summit, which contained few firm commitments outside the regulatory area and in the meager outcomes of the recently concluded Financing for Development conference in Doha, which leaders of rich countries essentially ignored — although they did make sure its final statement didn't impose any significant new obligations on them.

Exploiting the current opportunity requires governments in developing countries and progressive civil society groups, in the Global North and South alike, to be realistic in their assessment of the situation. If progressive forces want to take advantage of this opportunity, they must develop a program of regulatory reforms that promote more environmentally and socially responsible financial institutions, broader access for poor people and communities to financial services, and more creative funding for poverty alleviation and development. Successful implementation of this program will change some of the incentives for financial institutions, set a precedent for more participatory and transparent international regulatory efforts in other areas, and create new chances to democratize global financial governance.

In fact, progressive forces have begun to take advantage of this opportunity. Last month, hundreds of organizations and thousands of individuals signed a declaration calling for a more people-focused, equitable, and socially and environmentally responsible strategy for dealing with the crisis. The declaration also called for more responsible and comprehensive regulation of the global financial system.

The challenge, of course, is that subjects like fair value accounting, capital adequacy, tax policy, and counterparty risk are not the sexiest of topics, and it's not immediately obvious how they affect poverty, financing sustainable and equitable development, energy, climate change, and food. But if negotiations over international financial regulation take place without governments in developing countries and progressive organizations, we're likely to end up with international financial regulations that are no more responsive to the interests of the poor than

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the current regulatory regime and whose incentives continue to prioritize profit over people, sustainability and equity. In addition, the process that produces the regulatory changes, while it may involve more governments than before, won't be transparent and will be closed to most stakeholders in the financial system.

A Progressive Regulatory Reform Agenda

As the declaration issued last month indicates, a progressive international financial regulatory regime is concerned with solving social and environmental problems while being prudent, efficient, and profitable. It can do this by inserting enough friction in the international financial system to encourage all actors to think about the consequences of their actions before they act. This means that while the regulatory framework should encourage profitable transactions, it should also reward financial transactions that deal directly with poverty, environmental degradation, and the creation of jobs and opportunities for poor people. In addition, it should promote financial innovation that meets two sets of criteria, both of which have equal weight: First, the transaction's sponsors must demonstrate how it facilitates financing for environmentally and socially sustainable activities. Second, they must show how it will enhance market efficiencies, create new financing opportunities or mitigate risk.

Progressive regulations should promote responsible financial institutions. This means that they should not only encourage financial actors to submit to market discipline, but they should also should push them to use "triple bottom line" reporting, and adhere to industry best practices as embodied in such documents as the Equator Principles, the IFC Performance Standards, and the UN Global Compact.

The mechanisms for global financial governance must also enable all stakeholders to raise concerns and hold financial institutions accountable for their actions. This means that they should encourage corporate governance reforms. In addition, all forums in which financial regulations are considered should be transparent and participatory. Consequently, the procedures used by bodies like the Financial Stability Forum and the G-20 should include meaningful opportunities for all interested parties to submit information, and to have that information considered by decisionmakers.

While all items on the international financial regulatory agenda merit progressive attention, there are five items that belong at the top of the progressive agenda for international financial regulatory reform.

First, there should be an international community reinvestment process. This means that all financial institutions — banks, private equity funds, mutual funds — that receive funds from investors in poor countries and emerging market economies should invest a portion of these assets back into projects and instruments from these countries. Consequently, the regulatory regime should require the financial institutions to demonstrate that they reinvested a stipulated portion of these assets in projects in poor countries and emerging markets that target poverty alleviation and meet certain social and environmental indicators. They should show that they aren't only investing in the largest and most profitable projects in the developing world — which also often generate the most intense environmental and social concerns. If they aren't willing to invest in smaller, more targeted poverty alleviating projects, they should invest the funds in intermediaries that specialize in these sorts of projects.

Second, the international regulatory regime should encourage financial institutions, particularly commercial banks and insurance companies, to undertake measures that promote the access of poor people to financial services. This can take the form of accounts with easy admission requirements and no fees or insurance products with low premiums. It should also include establishing easier and cheaper channels for transmission of remittances from richer to poorer countries. If financial institutions find it difficult to provide these services directly, they can invest in institutions that specialize in providing financial services to the poor.

Third, the international regulatory regime should encourage governments around the world to establish licensing requirements for all hedge funds, private equity funds and sovereign wealth funds. These licenses would allow them to operate in that countries' capital markets in return for either investing a stipulated annual portion of their total resources in investments in that country that are targeted at environmentally responsible poverty alleviation. Alternatively they can contribute the stipulated portion to an institution that specializes in these qualifying investments.

Fourth, international financial regulators should learn a lesson from environmental regulators. They should require sponsors of all new financial products to conduct impact assessments that show how they will be used, their risk profiles, the financial costs and benefits that are expected

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to be derived from these instruments, and their likely social and environmental impacts.

Fifth, progressive forces should insist that all efforts at international financial coordination meet certain procedural requirements. This means, at a minimum, that the decision-making processes used in these efforts should be easily understandable to all stakeholders, should include predictable opportunities for participation by these stakeholders and should include opportunities for holding decision-makers accountable for their decisions.

The current crisis has made it possible to begin changing the dynamic of a system which has clearly demonstrated its enormous destructive potential and bending it in a more equitable and sustainable direction. For this to happen, progressive forces need to prepare and adopt an international financial reform agenda that can be presented in all regional and international meetings on the financial crisis, including the next G-20 summit, which is slated to occur on April 2, 2009 in London. Effective advocacy for this agenda will help create a more socially and environmentally responsible international financial system, with additional opportunities for reform.

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