

## **The G20 must adopt a just and equitable pathway out of today's crises**

**CIDSE recommendations to the G20 Summit – Cannes, 3-4 November 2011**

### **Introduction**

In 2008 Heads of State of the G20 countries came together for the first time and collectively resolved to tackle the Financial Crisis. Yet three years down the line crises continue to plague the global economy and ordinary people all over the world are feeling this. Poor households suffer the most. The need for coordinated and innovative actions to stimulate the global economy through domestic and collective measures that also address today's reality of climate change, resource constraint and ever increasing inequality is greater than it was then. While the fragile economic recovery in 2010 led to optimistic conclusions that small incremental policy change was having its desired effect, the financial crisis in 2011 tells a different story. Reforms needed for the economies of developed countries to generate decent jobs; fuel demand while making sure that this is not met through unsustainable economic activity; and stimulate credit and service provision focused on maximising well-being in society, have still not been put in place.

A renewed recession in the North would quickly bring negative impacts to developing countries which, in spite of having powered up the recovery, would enter such a new episode with further deteriorated capacities to provide monetary and fiscal stimuli than in 2008.

Problems such as the opacity of the financial system; the lack of fair, transparent and systematic treatment of sovereign debt crises; limited availability of mechanisms to adequately weather the crisis such as tackling tax evasion and avoidance, injections of Special Drawing Rights, and international monetary instability, are directly linked to policies of G20 countries- or the lack thereof. G20 countries have also not yet satisfactorily tackled policy areas that could contribute to economic stability and the well-being of people and the planet, such as by implementing a Financial Transactions Tax.

The nine middle-income developing countries that are members of the G20 account for 58 per cent of the world's poor. Policies of all G20 countries have a significant impact on the lives of poor people worldwide. Yet the main objective of its development agenda appears to be the sustaining of economic recovery in rich countries, boosting international demand. It promotes a development model based on growth and the role of large companies in infrastructure development, a model that has been much criticized, with evidence of its severe shortcomings regarding tax, social and environmental responsibility of multinational companies (MNCs). The development agenda also does not appear to appreciate the significant impact of G20 decisions on men, women and children living in poverty. This could have been reflected, for instance, by prioritising capacity-enhancement of the smallest producers and entrepreneurs - who are often part of the informal economy in developing countries - as the main pillar of their development agenda.

CIDSE, the alliance of 16 Catholic development agencies from Europe and North America is aware of the potential importance of G20 action to poor men, women and children in their own countries and

worldwide. At the same time, we are concerned that indecision or lack of consistency and sufficient development-orientation of G20 decisions could make it more difficult for people to live and work decently or could even lead to further impoverishment. We therefore call attention to areas that the G20 needs to address without further delay and recommend specific actions that need to be taken.

## **1. Global financial regulation**

Measures currently being discussed to regulate finance, discourage speculation, prevent future crises and reorient the financial sector to provide credit for productive and socially-useful activities are either delayed or will be too light to modify business as usual. Furthermore, they fail to offer guarantee that public funding will not have to be on the line, again, to rescue firms that engaged in and profited from excessive risk-taking. To create a climate conducive to development, further action will be needed including:

- }] A framework for cooperation on international banking supervision that replace the current market-based incentives for risk management and which provides greater space for local authorities' intervention in light of, inter alia, their assessments of systemic risks, and the need for countercyclical regulation of capital.
- }] Practical and effective plans to deal with global systemically important financial institutions. The capital surcharges the Basel Committee has announced on systemically important financial institutions intend to compensate for the extra risks they posed, but are within the same flawed logic of the Basel agreement, too small to actually reduce risk-taking incentives, and imposed on too narrow a set of firms. The Financial Stability Board (FSB), in formulating plans to improve the capacity of authorities to resolve systemically important financial institutions has chosen to ignore recommendations to reduce the size and complexity of such financial institutions which oftentimes has not yielded any benefit for society.
- }] Publishing the long awaited list of jurisdictions not complying with regulatory standards and imposing sanctions on territories that do not align with international prudential regulation.
- }] Provide alternatives to the "issuer pays" model, which poses conflicts of interest that compromise the quality of service provided by the agencies. Regulatory measures to remove legal incentives to rely on credit rating agencies from law will not reduce, especially in the short term, the reality of reliance on credit rating agencies.
- }] Adopting policy measures to end the conflict of interest of accounting firms that also provide consultancy services, advising clients how to avoid tax obligations.
- }] Regulating commodity markets to prevent systemic risks and manipulative practices, including margin requirements for traders and position limits; reintroducing rules that distinguish market operators from commercial traders to limit excessive speculation by non-bonafide actors. Participation of publicly insured institutions in commodity derivatives trading should also be strongly regulated- if not completely prohibited, at least in line with the Volcker rule in US law- and requiring higher margin and capital reserve requirements. 'Over The Counter' trading should be carried out in public exchanges and both aggregate speculative position limits (total number and value of contracts for a given commodity) and higher margin requirements should be established and applied equally to all investors.
- }] Following the EU's example banning naked Sovereign Credit Default Swaps to combat speculation on sovereign debt.

## **2. Reforming the international monetary system**

The need to provide for an orderly transition towards an international monetary system that supports stability, trade and an adequate mechanism for adjusting global imbalances without recessionary consequences remains urgent. Reform of the monetary system was announced as a priority by the French Presidency of the G20. Despite all this, the G20 has failed to deliver not only a reform - which could be justified in the light of the timeframe for it to happen - but a consensus on a sensible plan of action. CIDSE has repeatedly promoted the benefits of a revamped system of Special Drawing Rights

as the cornerstone of the international monetary system. If implemented in the right way, such a measure could also generate extra development and climate finance and support full employment worldwide. Such measure should be accompanied by a credible framework for exchange rate management and coordination.

CIDSE also supports greater regional and sub-regional mechanisms for monetary cooperation. In this context it is very disappointing that instead of welcoming the potential contribution of diverse, more flexible and context-driven regional financing and liquidity arrangements to global financial stability, the G20 has opted for a construction that brings them all together with the IMF on the basis of the one-size-fits-all principle.

The G20 has chosen to prioritize discussions on surveillance and lending reforms of the anachronistic IMF structures that have gone unresolved for more than a decade. Current proposals for a Global Financial Safety Net may pave the way for high volumes of lending in crises times. Without binding mechanisms to ensure private sector lenders also share the burden, such a “safety net” may become a safety net for private lenders, fostering their moral hazard. On another item being prioritised, the “framework for managing capital flows”, we are concerned that potential outcomes of this process might be curbs on the right that countries currently enjoy under Art. VI of the Articles of Agreement to implement capital account restrictions. Some preliminary IMF reports recommend subjecting exercise of that right to certain conditions.

### **3. Tackling sovereign debt systematically, fairly and transparently**

The debt crisis facing several European countries once again demonstrates that existing frameworks for debt restructuring lead to systematically suboptimal outcomes and undershoot the required levels of debt reduction. Ordinary citizens of a country and particularly vulnerable groups - in which women are overrepresented - suffer the worst impacts of anti-crisis measures. This has been a reality for developing countries for decades. Now many northern countries find themselves in similar situations.

Relevant agencies with expertise (UNCTAD, International Financial Institutions, civil society, etc.) need to develop a binding, independent and predictable framework for arbitrating on sovereign debt claims alongside standards for responsible lending and borrowing which should be speedily adopted. Such a framework would help to reverse the adverse impacts of a sovereign debt crisis particularly on the social stability of a country and on vulnerable groups. It would also fill the current vacuum in global sovereign debt governance.

### **4. Ending the opacity of the financial system**

The G20 has long recognised that the opacity of the financial system contributes to instability and undermines regulatory and revenue collection efforts of governments. Yet the pace of reform is far too slow to match the serious proportions of the problem. Southern countries have not benefited from the small progress in tax cooperation and recent agreements signed by Switzerland with Germany and UK dangerously jeopardise all international efforts towards transparency. For instance, G20 Development Ministers after their meeting in Washington called for the adoption of the Convention of Mutual Administrative Assistance in Tax Matters. In Cannes, all G20 countries may announce ratification of the Convention but nothing has been done in order to ensure tax havens' participation. The Global Tax and Development Forum under the auspices of the OECD and the peer review process have attempted to tackle some issues relating to information exchange. Over 700 Tax Information Exchange Agreements (TIEAs) and Double Exchange Agreements have been concluded as a result. However, only a third of these agreements are actually in force. 93 of these agreements even do not even meet OECD standards. Yet no new list of non cooperative jurisdictions has been published and the threat of sanctions still remain unfulfilled demonstrating a clear lack of political will to follow commitments with action. Worst of all, G20 countries still refuse to address the widespread use of tax-havens by Trans-National Companies (TNCs). TNCs' transparency and tax compliance conduct has been on the agenda

of the development working group in 2011 but concrete proposals in this regard have been removed at the last minute. In order to concretise the minimal progress booked by G20 agreements so far, concrete action is needed. These include:

- } Conducting public consultations within the peer review process with adequate scope for participation by all stakeholders, as part of the reviews.
- } Enforcing official registers of the beneficial ownership of all companies, trusts, foundations, charities in all jurisdictions through the Financial Action Task Force (FATF) and the Peer Review Process with strong and coordinated counter-measures against non-compliant jurisdictions.
- } Adopting strong and unified legal definitions of tax evasion and sanctioning tax evaders, including TNCs, and those designing elaborate tax evasion schemes.
- } Concrete indications of signing up to the Convention on Mutual Administration Assistance in Tax Matters, and using their leverage to get their dependencies and secrecy jurisdictions to join. Unwillingness to ratify this multilateral instrument should be included as one criterion within the definition of a tax haven.
- } Setting a timetable for the establishment of technical standards to facilitate comprehensive automatic exchange of information by competent bodies such as the OECD and the UN Committee of Tax Experts with a view to their incorporation in the above-mentioned Convention.
- } Complying with the commitment made at the Doha Financing for Development Follow-up Conference in 2008 to strengthen the UN Tax Committee.

## **5. Prioritising just and development-friendly strategies to move economies out of the crisis**

Along with addressing the direct causes of the crisis, since the Seoul Summit, the G20 has added on policy-areas to its agenda to revive economic growth. Making economic growth the focus of the recovery is short-sighted and is bound to reproduce the problems currently sought to be tackled. Rather, this focus should be balanced with efforts to tackle systemic weakness, ensure decent jobs, secure human well-being and take into consideration the current challenges posed by climate change and the limitations of natural resources. The G20 must prioritise strategies that will contribute to shoring up economies along with reinforcing the social fabric of their societies and the well being of the planet and people universally.

### **1. Prioritise the small scale sector**

Investing in small-scale sectors can help diversify and strengthen economies, not only by broadening the basket of goods and services that contribute to the country's economic wealth, but also by boosting local and regional markets. With poor women and men being predominantly engaged in these sectors, investing in them will also reduce poverty more efficiently. A recent study of six developing countries (Brazil, Bolivia, Cambodia, Indonesia, Tanzania and Zambia) reveals that the GDP-contribution of the informal economy is significant, ranging from 18.3% in Brazil to 62 % in Cambodia. Moreover, the informal sector's scale of employment in Tanzania and Zambia goes up to 90%.<sup>1</sup>

The needs of small-scale actors in the economy require different strategies than those that currently dominate economic policy planning. The G20 would for instance need to move away from such models as the World Bank's investment climate template, the 'Doing Business' indicators towards models that uphold investing in poor men and women, including their labour as the main asset in the production process.

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1. Just Economics. Estimating the Size of Small-Scale Enterprise in Developing Countries. Unpublished.

Investing in people and small-scale economic activities is an important complementary strategy to boosting foreign investment, trade and even industrial policy work for development. For example, the main ways local businesses benefit from the presence of foreign investors is through linkages usually as suppliers and through learning by interaction with them. In order for this to happen, local businesses need to be given the space and means to sufficiently develop to act as suppliers and not be too far away in their own capacities to be able to adopt new practices and learning. Without these effects, boosting exports or promoting foreign investment can bring limited benefits, even enclave development.

Different approaches to investment spending will also be needed. For example, the G20 focus on infrastructure should not only focus on large-scale and export infrastructure. Building rural roads to enable farmers to reach local markets is equally part of a pro-poor economic development agenda.

## **2. Regulate foreign direct investment and transnational companies**

Transnational corporations (TNCs) have long been seen as an important part of the picture for economic development in poor countries. They can boost growth, create jobs, provide tax revenue, bring in new capital and new ideas. However, in the absence of regulation, the contribution of foreign investment and the private sector to development is not always or automatically positive. TNCs often shop around for the most lucrative investment climate with little consideration of the tax-competition between tax jurisdictions that this causes. Many develop complex transfer pricing strategies, transferring profits to subsidiaries in more favourable tax jurisdictions to evade taxes. In the extractive sector in particular, many lucrative contracts are sealed by buying up local elites. Most trans-national companies do not disclose details of their operations on a country basis, leaving local communities and tax authorities with little information to assess the impact of the companies on their economies.

As the home states of the majority of the world's TNCs, the G20 has a key role to play to regulate foreign investment and transnational companies. A recent study by CIDSE member organization, CCFD-Terre Solidaire revealed that 21 per cent of the subsidiaries of the 50 biggest European companies are located in tax havens. The G20 has recognised the considerable revenue losses countries incur as a result of tax avoidance practices of TNCs and now must address this issue by requiring country-by-country financial reporting. This would address some problems related to tax avoidance and help tax administrations to detect discrepancies and effectively determine the tax dues of commercial operations in their countries

The G20 has expressed the need to tackle regulation as a response to the financial crisis. The September 2011 G20 Development Minister's communiqué urging multinational firms to increase their transparency and compliance with tax laws is notable in this regard and should be built upon with concrete next steps:

- 1 Instruct the International Accounting Standards Board (IASB) to revise the International Financial Reporting Standard 8, for segment reporting, to mandate country-by-country reporting by all multinational companies.
- 2 Urge the IASB to include mandatory country-by-country reporting within International Financial Reporting Standard (IFRS) 6 for extractive industries, as part of its current review.

## **3. Agree to implement a Financial Transaction Tax (FTT)**

CIDSE welcomes the European Union's efforts to promote the implementation of a FTT in the G20. The European Commission's proposal for a European FTT is a first step in the right direction. A global FTT would go a long way in tackling highly frequent and leveraged speculative trading and thus help mitigate fluctuations of asset prices in stock markets, of exchange rates and commodity prices. The substantial revenues that a global FTT could generate would provide urgently needed finance for financing global public goods such as poverty eradication and combating climate change.

We are discouraged by the refusal of some members of the G20 to acknowledge the potential and urgency of implementing a global FTT. In the face of continued animosity of these countries, countries in favour should come together in a coalition of FTT implementing countries in order to pave the way towards a global FTT.

## **6. Reforming the IMF**

The 2010 agreement by G20 to give greater representation to emerging market/ developing countries at the Executive Board has not been honoured, yet, and neither have the limited changes in voting power agreed previously in 2008. It is good that the G20 is calling for a long overdue review of the quota formula that should happen before 2013. But this does not guarantee real equity in the vote allocations unless accompanied by a commitment to include consideration of ‘demand-oriented’ variables that may favour developing countries as against the ‘supply-oriented’ ones that prevail in the formula today. Implementation of the agreements to increase representation of developing countries at the Executive Board through two fewer European chairs should be honoured, and benefit the most crowded constituencies. It should be noted that if one of these chairs went to African countries, the then-three African chairs would still be the ones with the largest workload.



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**CIDSE** is an international alliance of Catholic development agencies. Its members share a common strategy in their efforts to eradicate poverty and establish global justice. CIDSE's advocacy work covers global governance; resources for development; climate justice; food, agriculture & sustainable trade; and business & human rights. [www.cidse.org](http://www.cidse.org).

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