Briefing financial sector
Amsterdam, 11 June 2004

Dear ATTAC-ers,

The financial industry plays an important role in financial crises and **globalisation** but is difficult to analyse. However, liberalisation of financial services and expansion of the financial industry are major objectives of the **GATS negotiations**.

In the SOMO report "**Critical issues in the financial industry**", chapter 6 explains how developing countries face many risks of financial instability and increasing poverty as a result of the current GATS negotiations. In other parts of the SOMO report, Myriam Vander Stichele critically analyses the products, strategies, corporate social responsibility initiatives and international regulators of the financial industry. This report wants to help social movements to monitor and discuss these crucial but difficult issues.

Some findings of interest for members of ATTAC and other social movements are shortly outlined below. The full report, with full explanations, can be downloaded from **www.somo.nl**. For more information, comments, or a hard copy, contact m.vander.stichele@somo.nl

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1. Financing of corporate globalisation … and marginalisation (see chapter 1 and 3 of the SOMO report)

The financial industry creates an ever-expanding range of products to channel money from large and small investors to big corporations, without checks or restrictions from regulators and supervisors. The collapse of Enron and Parmalat are not isolated incidents. Financial firms are, for instance, involved in:

- Investment banking, i.e. issuing and **selling new shares** or bonds of companies. Investment banking divisions have put pressure on analysts working at the same bank to give positive ratings of their (potential) client companies to investors. This created the stock market bubble which lasted until 2001. More than $ 1.5 billion in fines to US banks (e.g. Citigroup, Goldman Sachs) give an idea of the damage this practice has done: when the bubble burst, shares lost 45% of their value between March 2000 and 2002, a loss equal to half of the GNP of the US in 2000;
- **Many mergers and acquisitions** by multinationals around the world are being promoted, advised and financed by investment banking divisions of large banks

such as Merrill Lynch and UBS; as a consequence, many multinationals expand even when they are heavily indebted;

- Mutual funds management, pension fund management and **capital management** for insurance companies: i.e. buying up and managing shares from multinationals for investors or pensions, or to cover potential claims of insurance clients;
- Speculative financing and protection against financial risks through **derivatives dealing and hedging**;
- advice and servicing **tax evasion** (e.g. through trust services, branches in tax havens or off shore centres), together with accountants.

Marginalisation of the poor is incorporated in the strategies of the financial industry. The strategy of "cherry picking" (or "market segmentation") by the financial industry targets profitable clients, such as big corporations. Small companies and poor customers are left with poor or more expensive services, e.g. through the closing of branches, or the exclusion of poor areas. As a consequence, financing small grocery stores is more difficult than financing international supermarkets like Wallmart. Strategies to target the rich are used especially by foreign banks in developing countries.

2. Unrestrained globalisation of the financial industry (see chapter 2, 5, 6 of the SOMO report)

The current trend in the financial industry is "consolidation", i.e. an **increasing level of concentration** of financial services in the hands of a few, which goes against the intention of the authorities to create a "free market". There is a race among big, especially American and European, financial firms to conquer new "markets" around the world. For instance, in many developing countries, foreign banks take over most of the sector in 5-10 years after liberalisation of financial services. Western banks increased their presence by 364% in Latin America between 1996 and 2000. In Mexico, more than 85% of assets are managed by foreign banks.

This allows financial conglomerates such as Citigroup to make $ 17 billion in profits, an amount equivalent to the average annual loans by the World Bank. These huge profits are not so much used to service clients but rather to expand the company.

Banking, insurance and other financial services are being brought together under the roofs of financial conglomerates without appropriate supervisory and regulatory mechanisms at the national and international level. Moreover, these financial conglomerates **expand their mechanisms of transferring their risks to other sectors** and investors: authorities do not fully know whereto the risks (e.g. of credit derivatives) are being mitigated!

The **lack of control, monitoring and restrictions by the supervising and regulating authorities** has lead to many financial crises, and financial mismanagement continues: the European insurance industry almost collapsed in 2002 and pension fund management has created a gap of $ 2 trillion worldwide to cover all pension claims.

The **very close relationship between the "independent" central bankers and largest financial firms** can be seen from the new "Basel II" regulations on capital reserves that banks need to put aside with each loan, that have just been finalised (published end of June 2004). Basel II will increase the trend of market concentration by the largest banks worldwide, while making it more expensive for developing country governments and companies to borrow. Financial supervisors need to be checked better.

3. GATS negotiations risk increased financial instability and poverty (chapter 6)

Liberalisation of financial services under GATS perfectly fits in the "consolidation" strategies of big banks and insurance companies. GATS rules make liberalisation difficult to reverse and ensure that no single foreign financial conglomerate is favoured over another (MFN). During the current GATS negotiations, the EU and US demands are a **wish list of what the financial industry requires,** e.g. no limitations on full ownership of banks in developing countries. Moreover, the GATS 'Understanding on commitments in financial services' calls for **removal of "any obstacle"** to foreign financial services, even if all GATS provisions have been respected, and for allowing any financial service to be introduced.

GATS liberalisation of financial services **is pushed through without much consideration of having necessary regulatory and supervisory bodies**. China is already indicating it cannot cope with the consequences of its GATS commitments in financial services but the US and the EU keep on pressuring for more market opening. The lessons from the Asian crisis that capital and financial service liberalisation needs to be gradual and with the right regulatory framework are ignored.

New and foreign financial services promote capital in- and outflows (e.g. lending in foreign currencies in China), and increase financial and currency instability. Once liberalised **under GATS, different articles make it much more difficult to manage such capital flows,** and make it conditional on respecting the commitments made to liberalise financial services markets. While GATS is not supposed to liberalise capital flows, GATS articles and commitments in financial services in practice do.

The **prudential measures that allow governments to act against financial crisis and protect consumers are vague, so that they are being attacked** during secret FSI GATS negotiations, or can be attacked through the dispute settlement mechanism. This could also challenge the introduction of new legislation such as a Tobin Tax.

Because of the cherry picking strategies, foreign financial conglomerates in developing countries not only focus on the rich clients but also the rich regions, and pick the best staff from local banks. **Foreign financial services further increase the gap between rich and poor** by introducing products that channel money from the rich in poor countries to the rich countries, and to repatriate profit made off these rich clients to the headquarters in the North.

When the necessary national financial safeguards are not in place, trade negotiations should not push for financial sector liberalisation since the global financial architecture is not reformed and financial firms increase poverty and unsustainable development.