11. Democratizing Global Financial Regulation: Labour's Perspective

By Damon Silvers

Human civilization has become global in a way that few could have imagined even twenty-five years ago. The internet, and in particular, the extraordinary low cost and high band width of communication of all kinds has utterly transformed the way nations and cultures interact with each other. Globalization is most profound in economic life, and within economic life, in the financial sector—where markets, institutions, and financial products now appear to know no boundaries.

In comparison with the intensity and depth of global life, global governance is strikingly weak. Individual states remain the real units of political and military power, but they struggle to apply that power to circumstances that are beyond their grasp—global movements of ideas, global markets, global flows of people, global environmental problems, and ultimately, global crises.

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There is a paradox of democratization involved in globalization. On the one hand, globalization has given voice to people previously marginalized—if a government opens fire on a street protest almost anywhere in the world, footage of the shooting will be circulating worldwide in minutes. Companies engaging in socially irresponsible business practices can find themselves the target of worldwide anger in a matter of days, if the conduct touches a nerve among the wired classes. But at the same time, the place where democratization happened was in the nation-state. Successful democratic states are where institutions of popular participation have grown and matured. Their inability to govern global society leaves the field to a variety of frankly undemocratic forces—forces of wealth and privilege, small bands of ideologues of various stripes, and on a more benign, but no less undemocratic, level, experts asserting, and perhaps believing, that they stand above mere people and their messy democratic processes.

Labour movements have been central to the development of democracy in countries and times as different as early Victorian England, Bismarck's Germany, Brazil in the 1980's and Zimbabwe today. Though the labour movement from its inception has had an international ethos, the reality of the labour movement's achievements is that they have largely been within national contexts. Thus the labour movement has always looked at proposals for global regulation with a mix of hope and suspicion—hope that a truly democratic global governance system could emerge, much as it ultimately did at the national level, and suspicion that workers will never be heard in any global governance system, and the result of which will be the destruction of democratic institutions at the national level.

Now, in the midst of a persistent and apparently accelerating global economic crisis, there are rising demands for global governance of what is undeniably now a global financial system. The labour movement reacts to this agenda with qualified

support—financial markets and financial institutions have clearly outgrown national governments' ability to regulate them, with seriously destructive consequences. But the question the labour movement globally asks is—what kind of governance and by whom? Will global financial regulation mean a world that is made safe for bankers and financial firms—where all profits are privatized and all losses socialized? Or will global financial regulation really be managed in the interests of a global public—harnessing the vast energy of the financial markets to the vast needs of the real global society beyond the airports and luxury hotels that define the horizons of global elites?

The Case for Global Regulation of Financial Markets

How global has finance become? At one level the answer is extremely global—key firms like Goldman Sachs or Deutsche Bank are managed globally—shifting resources seamlessly among the key financial centers and locating deals wherever constantly shifting market conditions favour their clients. Stock exchanges have become international conglomerates. Trading operations take place in the ether, not in the gilded rooms that actually were the centers of economic activity less than ten years ago. London, New York, and Hong Kong compete to coordinate global flows of capital with each other, not with Chicago or Manchester or Harbin.

But at another level, national regimes still very much matter. It is not possible to do a securities offering without complying with the laws of some national state. Broad access to investors in any given country requires detailed compliance with those countries' securities laws. In banking, national regulation remains preeminent, as does national responsibility for failure. This continued importance of national regulation is critical to understanding the choices and challenges posed by thinking about how to accomplish an effective global governance structure for finance.

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Inability to Effectively Regulate Financial Innovations

In a fully globalized financial world, national regulators refuse to do their jobs for fear they will scare activity off shore. These dynamics have occurred recently at the highest levels of global political life—most tellingly in the case of hedge fund regulation. In early 2007, German Chancellor Angela Merkel approached leaders of the G-8 seeking a common approach to minimal regulation of hedge funds and other forms of shadow capital. Merkel's initiative failed because of determined opposition of the US and Britain defending important financial interests in Wall Street and the city respectively. Treasury Secretary Hank Paulsen publicly rebuffed this appeal, and it was clear that in doing so the United States was shielding the British government from having to object themselves. The result was that not only was no action taken at the G-8 level, but no action was taken within the European Union or within Germany itself in regard to hedge fund regulation. At the European Union, this project went nowhere until the fall of 2008, when an effort led by the leader of the European Socialists, the former Danish Prime Minister Poul Nyrup Rasmussen, gained traction in the context of the broader financial crisis.

Ironically, Paulsen found himself a year later trying to manage the collapse of Bear

Stearns, the major provider of brokerage services to hedge funds, without sufficient information to understand the implications of Bear Stearns' dealings with those same funds. This experience appears to have contributed to Paulsen's eventual embrace of hedge fund regulation, but has yet to lead to any actual regulation of hedge funds in the US.

Race to the Bottom

Following the Enron and Worldcom scandals, the United States adopted tough rules on the responsibilities, independence and oversight of outside auditors, the independence and authority of boards of directors, and the responsibilities of company officers for the truthfulness of company financial statements. These rules came to be known collectively as Sarbanes-Oxley, after the major piece of legislation enacted by the US Congress at this time.

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These rules were bitterly resented by elements of US business, though they were supported by a number of key business leaders concerned about the credibility of the US business community after Enron. These rules were similarly resented by the directors and officers of non-US companies that listed in the United States.

This tightening of the rules in the United States represented a business opportunity for non-US capital market centers, and particularly for London's AIM market, which was oriented toward smaller, highly speculative issuers. In short order, both the London and Hong Kong exchanges made it a point of telling companies considering public offerings that while the New York Stock Exchange was prestigious, and NASDAQ was the home of Microsoft, they were now hobbled by regulation, while in London and Hong Kong the pre-Enron rules lived on.

There appeared as a result to be some flow of Initial Public Offerings (IPOs) to London, and Hong Kong captured IPOs of a number of major Chinese and other Asian companies. But the data suggested it was unclear at best whether there really was a major drain of business away from US markets, which continued to give investors higher multiples, due in part many argued, to the increased investor confidence generated by the post-Enron reforms.

What was not unclear was the political uses these developments were put to within the United States. The US business community asserted that the US capital markets were facing a "competitiveness crisis" caused by overregulation, a crisis that would lead to the eventual demise of the US financial sector at the hands of zealous regulators and foreign competition. The Bush administration agreed, and continued to push deregulation in the name of competitiveness until it was drowned out by the roar of the financial crisis. In the course of these efforts, the Bush Administration did considerable damage to the Securities and Exchange Commission by hobbling its enforcement efforts, and it blocked domestic efforts to regulate the shadow capital markets until it was too late to avert the coming storm.

Leakage. Tax havens and regulatory havens represent leakage from the global financial system. But they are utterly dependent on regulated, taxed economies. A financial market involving a closed system of Luxembourg, Switzerland, the Channel Islands and the Cayman Islands would be of little interest to anyone. In the absence of global governance of financial markets, capital based in opaque jurisdictions can find its way in and out of regulated jurisdictions, and financial actors that depend upon the developed states of the major economies can avoid paying the taxes to

support those structures. The problem, though, is not what it appears to be. It is not the challenge of persuading one or another tax haven to behave better. It is the challenge of persuading the major markets to collectively close their doors to financial actors based in pseudo-states. That is why it is an issue of global governance.

Contagion. Any investor with a bank account and access to the internet can invest in any publically traded security. This is even more true for institutional investors with resources to enter into global custodial relationships and the like. The result is that regulatory weakness in any meaningful jurisdiction is potentially a worldwide threat. To take only the most prominent example, a bursting housing bubble in the US triggered a crisis not only in the US mortgage market, but also bankrupted Norwegian villages. The combination of mortgage regulators in Eastern Europe that allowed mortgages to be priced in foreign currencies, combined with banks in Western Europe prepared to believe that Eastern Europeans would somehow be able to pay loans in hard currency when their own currencies collapsed has now created a whole new international economic crisis.

The Paradox of Lack of Global Financial Regulation. The problem of contagion gives rise to a paradox. Not everyone has been equally harmed by the global financial crisis. Some countries, most notably India, kept their banks out of global capital markets, and as a result, now have more or less sound banks. The paradox here is that the lesson one could draw from the contrasting experience—say of India on the one hand and Austria, on the other—is that the smartest thing to do at a national level is to wall your financial institutions off from the global market.

What are the implications? An unregulated global market is likely not to be stable in the long run, as national authorities realize the best thing to do to protect their own economies and financial systems is to decouple. This is not protectionism in the sense of shielding domestic institutions from more efficient competition, it is the instinct to shield domestic institutions from toxic practices. In practice of course, the impulses blur, but the result remains the same—an unsustainable global system—with a tendency to re-fragment.

What Form Should Global Financial Regulation Take?

Currently, there is debate about whether there should be a concerted effort to found some sort of global financial regulator. This approach, which appears to be favoured at least publicly by the major continental European governments, is competing with the approach of international coordination, through bodies like the G-20 and the Financial Stability Forum.

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The labour movement has participated in the G-20 process, and has consistently urged at a minimum the creation of a global regulatory floor, particularly to address the challenges posed by the rise of shadow capital markets—hedge funds and private equity funds on the institutional side, derivatives and securitizations on the product side. But the more profound challenge is the question of how financial regulation should be governed on a global scale. Unfortunately, we have many examples of exclusivity in the governance of global institutions. In some cases, like the G-8, that exclusivity became so clearly dysfunctional it had to be abandoned in favour of the inclusion of the major economies of the developing world, which led to the creation of the G-20.

But the paradigm of exclusion remains the norm, whether in older institutions like the International Monetary Fund (IMF) and the World Bank, or in newly minted institutions like the Financial Stability Forum. Exclusion operates on two levels. At the most obvious level, exclusion is about what countries get seats at the table. As a general matter, the labour movement has always supported the inclusion of the global South in key international financial institutions. If anything, the current financial crisis heightens our concern in this regard. Financial rules cannot be written as though the only actors that mattered were developed-world banks and brokerages.

However, there are complex issues embedded in questions of exclusion, issues which raise thorny problems for the labour movement. For example, the global labour movement has been uncomfortable with Chinese participation in many key global institutions because of China's refusal to allow workers to form independent trade unions or to exercise the right to strike. On the other hand, China's is the world's most populous and fastest growing country, whose large trade surpluses and foreign currency reserves are key facts of international economic life. It is hard to imagine how to address issues like global market regulation without having China (and Hong Kong) in the room, and indeed the Chinese are in the room in the G-20.

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But exclusion has another face—which is the exclusion of workers and the larger global public from real participation in international bodies. Here the landscape is somewhat more complex. On the one hand, there is the OECD, which despite being an exclusive club in relation to the developing world, has formal consultative structures—The Trade Union Advisory Committee and the Business and Industry Advisory Committee—representing labour and business on equal terms. Then there are the practices at the IMF and the World Bank, which over the years have developed more informal structures for consulting—not just with the global labour movement—but with a wide range of non-governmental organizations. Unfortunately, there is a world of difference between consultation and democratic governance, a difference that is fully reflected in the continuing worldwide debate about the role played in the world economy by both the IMF and the World Bank.

When one looks at the embryonic global financial regulatory institutions, one sees the kind of structures that would appear to predate the sort of sensitizing that has occurred even at the World Bank and the IMF. The Financial Stability Forum has no consultative processes with parties broadly representative of the public. IOSCO, the international organization of securities regulators, has no interaction with investors, let alone broader public constituencies. The Basel process appears to be even more closed to influences outside the community of banks and central bankers—despite the apparently ruinous consequences of leaving this matter to banking insiders in terms not just of insolvent banks but of the banking system's withdrawal of financing from productive activity in sectors like the German *mittelstand*.

The call by the G-20 for the global governance of capital markets to be delegated to the central bankers in a re-named Financial Stability Board is particularly objectionable even if the number of bankers has been expanded to include representatives from every G-20 government. A body of central bankers, the community that sees itself as "politically independent" and that signally failed to anticipate the crisis, cannot be relied on, with little or no democratic accountability, to reform the regulatory structure of the global capital markets.

The labour movement has been involved in most of these processes, and is all too aware of the potential for "reform" to actually work to further entrench the power of wealth and weaken democratic structures. We also have seen how sometimes even consultative rights can have a significant effect. An interesting example of these dynamics from the recent past was the process by which the OECD Principles of Corporate Governance were developed in the aftermath of the Asian financial crisis in 1999. While in theory these principles were for OECD countries and were only principles, it was apparent that the real agenda in enacting them was to provide a template for the IMF and World Bank to insist on reforms to corporate governance in Asia. Of course, given the makeup of the OECD, the apparent audience for the document—countries like Indonesia and Thailand were not present. But as the deliberations got underway, it became apparent that a number of countries that had embraced the Anglo-American style of capitalism were hoping to use the OECD process to delegitimize European structures for worker involvement in corporate governance. The combination of a handful of sympathetic governments and an aggressive trade union presence was sufficient to thwart that particular anti-worker agenda, and the result was a document which, in the first rounds at least, was minimally acceptable to the labour movement.

But the more troubling lesson is the great difficulty in getting international institutions to respond to public needs. Here the exclusion of the global South adds to the weakness of workers' voices in advanced countries on many issues.

At one level, the lesson of the OECD experience is the importance of workers having a voice, even an advisory voice, in international institutions. But the more troubling lesson is the great difficulty in getting international institutions to respond to public needs. Here the exclusion of the global South adds to the weakness of workers' voices in advanced countries on many issues. In international institutions dominated by rich countries, globally integrated business interests, particularly in the financial sector, are better positioned to have a continuing organic influence on both the delegations of individual countries and on the staffs of the international institutions than on workers' organizations, NGOs or even the grassroots of developed countries' political parties.

Consequences of Undemocratic Approaches To Financial Regulation

This imbalance of power in international institutions becomes particularly costly at a moment of crisis such as we are now experiencing. Behind the current financial and economic crises are larger, global structural problems—the profound threat of climate change and energy shortages, critical educational and infrastructure deficits in the developing world, most of all problems involving water, and the problems developed countries are having maintaining broad affluence in a globalizing world economy.

It is not enough to imagine global financial regulation as a solution to the threat that more Norwegian villages will be victimized by American mortgage bankers. Policymakers need to consider how to better connect capital—both financial and human—with needs. That is an extremely complicated discussion, involving potentially revisiting the current balance in global capital markets between markets and institutions, considering creating global safe zones for investment similar to the roles played by insured bank deposits in national financial systems, and most of all, mechanisms for financing changes that must happen if our global civilization is to survive over time.

But this type of policy thinking is truly unthinkable in the context of global regulatory

institutions, old and new, that are closed off to the views and interests of the majority of the world's population. For while it is true that on matters like global warming we are all in the same boat, that is of little relevance if we are not all in the same room when it comes to addressing these problems.

Some Final Thoughts On How To Achieve Democratic Global Regulatory Structures

To the extent that relatively open financial regulatory structures have been achieved at the national level, it has been in the context of a larger democratic politics. The labour movement's historic mission has been to create the context for that kind of politics. It is hard to see how, at the global level, open, democratic institutions will be built without pressure from some sort of global public, much as occurred at the national level. Historically, the labour movement has participated in global institutions at one remove from workers themselves. Our institutions send emissaries to global institutions—we do not generally view global institutions themselves as places to mobilize our members. That may need to change.

In terms of immediate demands, the global labour movement is now seeking inclusion of the global South in international financial institutions, and the increased inclusion of workers' voices in the governance of these institutions. We need to think more creatively not just about how to ensure that institutions like the IMF and the OECD do no harm, but about how they can be reimagined as key actors in an effort to mobilize underused global resources to meet desperate global needs.

Renewal in the face of crisis is not charity—it is necessity.

In the past, this sort of talk, imagining a global New Deal, has been seen in the developed world as a Utopian conversation about charity on a grandiose scale. Today, it should be seen differently. If the US housing bubble tells us anything, it is that developed countries need to make better use of their temporary abundance of human and financial capital. At the same time, if developed countries continue their levels of carbon emissions and general resource usage, and developing countries aspire to achieve the same levels and to do so on the cheap, we will all suffer the ruinous consequences. Renewal in the face of crisis is not charity—it is necessity.

The challenge then of regulating finance is part of a larger project of effective global economic governance to deal with a truly globalized economy of the future. This is a necessity for the global labour movement, and it simply will not happen as long as global financial regulatory structures are private clubs where only rich country bankers and finance ministers can gain entrance.

Damon A. Silvers
Associate General Counsel, AFL-CIO, and Deputy Chair, Congressional Oversight Panel for Toxic Asset Relief Program (TARP).

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