

THIRD WORLD *Economics*

TRENDS & ANALYSIS

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Fresh financial crisis on the cards?

Warnings have been sounded over the possibility of an imminent global financial crisis. How will developing countries – many of which are vulnerable to large, damaging outflows of capital from their economies – respond to this worrying prospect?

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As US provokes trade turmoil, others embrace WTO-MTS

A recent informal meeting of trade ministers saw participants voice the need to build resilience in the multilateral trading system in the face of challenges posed by resort to unilateral actions.

by D. Ravi Kanth

PARIS: Even as the United States struck turmoil in the global trading system by unilaterally imposing additional import duties on steel and aluminum, several developed and developing countries vowed, at an informal trade ministerial meeting in Paris on 31 May, to embrace the rules-based multilateral trade order.

Participants at the meeting, which was organized and hosted by Australian trade minister Steven Ciobo on the margins of the Organization for Economic Cooperation and Development (OECD) meeting, said the first priority for members of the World Trade Organization (WTO) is to break the impasse at the WTO's Appellate Body.

The US, which has caused the impasse by repeatedly blocking an expeditious selection process for filling the three vacancies at the Appellate Body, was severely criticized by many participants at the meeting.

The participants remained sharply divided on the so-called plurilateral trade initiatives on electronic commerce, disciplines for micro, small and medium enterprises, and domestic regulation.

India, South Africa and a large majority of developing countries unequivocally opposed the joint ministerial statements for launching negotiations on these initiatives on the grounds that they not only eroded the "consensus" principle but severely undermined the multilateral trading system.

India's trade minister Suresh Prabhu said the plurilateral initiatives "weaken the multilateral trading system and undermine the inclusive institutional structure of the WTO."

South Africa's trade envoy Ambassador Xavier Carim, who spoke on behalf of his trade minister Rob Davies, said "many of us are also concerned at the day-to-day erosion of the consensus decision-making in the WTO brought on by the Joint Initiatives."

"The claim that these initiatives are transparent, open-ended and that [benefits of any] accords will be extended to all does not bridge the substantive policy

divergences amongst members that [were] evident throughout 2017 and underscored politically at MC11 [the WTO's eleventh Ministerial Conference, which took place in December 2017]," Carim reminded the participants.

Multilateral system under threat

Although trade ministers did not pointedly cite the additional duties on steel and aluminum, made permanent from 1 June on national security grounds by the Trump administration, almost all participants spoke against unilateral trade measures.

Australia posed two questions for the participants to address: "how to take forward the WTO negotiations" and "how do we build resilience in the system".

On the issue of building resilience, trade ministers overwhelmingly said the multilateral trading system is facing a grave crisis because of the mounting unilateral actions as well as escalating efforts to undermine the WTO Appellate Body.

Without naming the US, Norway's foreign minister Marie Eriksen Soreide cautioned that "might is right is not right" in the face of unilateral trade measures being imposed by some powerful countries. She said "arm twisting" will cause irreparable damage to the global trading system.

Many countries said unilateral trade measures will strike a deadly blow to the multilateral trading system that was built over the past 70 years.

The European Union's trade commissioner Cecilia Malmstrom said that Brussels would renew its efforts to strengthen multilateralism despite the current threats posed by the unilateral trade measures.

New Zealand trade minister David Parker said that members must strive towards building resilience in the multilateral trading system.

His Indian counterpart Prabhu said the WTO "is facing the worst crisis in its

history and unless we act together – and quickly – this system will collapse.”

“For us this means maintaining and strengthening the basic principles of inclusiveness, decision-making based on consensus and the centrality of development in the negotiations and processes,” he said.

China said it is important to address the crisis at the Appellate Body while according primacy to developmental aspects of the trading system.

Without naming the US, South Africa said “the recent trade action that has bypassed the WTO” has undermined the security and stability that the WTO is supposed to provide. Further, the unilateral trade action “has inflicted severe trade damage on some members and has had a detrimental knock-on effect on another cornerstone of the system – the MFN [most favoured nation] principle,” South Africa said.

“Further actions will deepen and extend the damage,” maintained South Africa. “At the top of the list of priorities are the impasse in the Appellate Body and the matter of an impending reappointment [of Shree Baboo Chekitan Servansing, who will complete his first term in the Appellate Body in September].”

“In the absence of a resolution here, the Appellate Body, a cornerstone in the WTO enforcement function, will soon be entirely disabled,” South Africa warned.

A good year

In the face of overwhelming demands for addressing the impasse at the Appellate Body, the US Trade Representative (USTR) Robert Lighthizer said he would disagree with the assessments offered by several participants.

Lighthizer said contrary to the gloom and doom in the global trading system painted by several participants, trade actually grew in 2017. He said last year was a good year for global trade.

Lighthizer also said the crown jewel of the WTO is not the Appellate Body but negotiations and the negotiating pillar. The problem with the WTO, he added, is that it became a “litigation-based organization.” There are too many problems at the WTO’s cost which have not been properly tackled.

Lighthizer mocked the dispute settlement system, including the Appellate Body, saying that there are trade disputes that take more than 14 years to be resolved. He also severely criticized the Appellate Body for not following rules.

Coming to the agriculture negotiations, the USTR said that the talks must result in reducing trade-distorting subsidies and increasing market access. The second big issue in negotiations, particularly in fisheries subsidies, must result in drastically reducing the subsidies provided by the biggest subsidizers.

Without mentioning China, the USTR said the fisheries subsidies negotiations must target the biggest subsidizers, according to a participant present at the meeting.

Lighthizer also said that two-thirds of WTO members are seeking derogations from their commitments on the grounds of special and differential flexibilities.

For its part, China said the special and differential flexibilities are essential for its development, and that it will oppose attempts to dilute the flexibilities.

Trade, according to India’s Prabhu, “must contribute to development.” Given the chequered background to India’s economic development – impressive achievement in some sectors but compelling changes in many others – India has not been able to integrate into the global trading system like many other countries, he said.

“Any endeavour at the WTO for reciprocal trade rules, which ignores the

reality, will further deepen the divide and aggravate the disenchantment with globalization,” warned Prabhu.

“Special and differential treatment provisions for all developing countries without exception, are an integral part of the WTO Agreement and this principle must be protected in all future agreements as well,” he emphasized.

Without naming the US and other developed countries that are calling for “differentiation” to deny special and differential treatment to major developing countries, India said “approaches based on selection, such as the ‘case-by-case’ approach to granting special and differential treatment to developing countries, must be avoided.”

South Africa’s Carim cautioned that special and differential treatment – the fourth cornerstone of the WTO – is under challenge. “Recent proposals to narrow its scope, irrespective of objective differences in levels of economic development between developed and developing countries, will only compound our negotiating difficulties.”

But major industrialized countries – the US, the EU, Japan and several others – said that differentiation among developing countries remains a top priority in providing special and differential flexibilities. (SUNS8693) □

US refuses to discuss trade and investment at OECD

Amid concerns over its protectionist actions, the US showed a lack of engagement during discussions on trade and investment at a recent OECD ministerial meeting.

by D. Ravi Kanth

PARIS: The United States on 31 May struck a body blow to the Organization for Economic Cooperation and Development (OECD) that it had helped create in 1961 by refusing to engage in a discussion on “international trade and investment for strong and inclusive growth”, several participants present at the annual OECD ministerial meeting told the *South-North Development Monitor* (SUNS).

“The US, which had played a central role in creating the OECD from the Marshall Plan, did not even take the floor on a vital issue confronting the global trading system,” said a deputy trade minister from an OECD member country.

The ministerial participants at the

OECD meeting, including the EU trade commissioner and Japan’s trade minister, expressed concern over the conspicuous silence of the US at the meeting’s important thematic session on global trade.

But all the participants at the meeting pressed for global solutions and strengthening the multilateral trade framework, and an immediate resolution to the impasse at the Appellate Body of the WTO’s dispute settlement system.

OECD Secretary-General Jose Angel Gurría admitted that the US did not speak at the meeting on issues concerning trade and investment along with some other countries.

Gurría said the US decision to impose additional duties on steel and alu-

minium was regrettable but the OECD would continue to work on the substantial issues such as the overcapacity in the steel sector and other initiatives, including in the digital economy.

Ministers and senior trade officials said the US did not engage in any substantive discussions at the meeting, including the joint concluding statement.

More important, the US blocked the OECD's final concluding statement because it could not agree on the need to keep the multilateral trading system open and to resist protectionism.

Gurria said the US joined discussions on all other issues barring trade and climate change.

Trilateral meeting

United States Trade Representative Robert Lighthizer also ignored concerns raised by the European Union and Japan at a trilateral meeting on Washington's steel and aluminium tariffs as well as its investigations into autos and automotive parts under Section 232 provisions.

The trilateral meeting, which was held on the margins of the OECD meeting, did however see the US, the EU and Japan issue a strong statement on "the non-market-oriented policies of third countries", with the three countries discussing "actions being taken and possible measures that could be undertaken in the near future."

Without naming China, the three countries "confirmed their shared objective to address non-market-oriented policies and practices that lead to severe overcapacity, create unfair competitive conditions for our workers and businesses, hinder the development and use of innovative technologies, and undermine the proper functioning of international trade, including where existing rules are not effective," according to one of the officials familiar with the trilateral discussions.

The US, the EU and Japan insisted that "market-oriented conditions are fundamental to a fair, mutually advantageous global trading system and discussed various elements or indications that signal that non-market-oriented policies and practices exist for businesses and industries."

The three countries said they "concurred on the need to deepen and accelerate discussions regarding possible new rules on industrial subsidies and SOEs [state-owned enterprises] so as to pro-

mote a more level playing field for our workers and businesses."

Further, they elaborated on their joint scoping paper "defining the basis for the development of stronger rules on industrial subsidies and SOEs."

"On that basis, they agreed to deepen that work, and expressed their intention to begin their respective internal steps before the end of 2018 with the aim of initiating a negotiation soon thereafter. The Ministers emphasized the need to ensure the participation of key trading partners in these future negotiations," the three ministers – Lighthizer, EU trade commissioner Cecilia Malmstrom and Japan's trade minister Hiroshige Seko – said in their joint statement.

On technology transfer, the US, the EU and Japan said that "no country should require or pressure technology transfer from foreign companies to domestic companies, including, for example, through the use of joint venture requirements, foreign equity limitations, administrative review and licensing processes, or other means."

The three countries "agreed to deepen cooperation and exchange of information, including with other like-minded partners, to find effective means to address trade-distorting policies of third countries, including harmful forced technology transfer policies and practices, and where appropriate, to pursue dispute settlement proceedings at the WTO."

They also said "non-compliance by some governments with their WTO transparency obligations is a priority in the work for improving the effectiveness and efficiency of the WTO monitoring function. They agreed to continue cooperation in the WTO to achieve full implementation of existing WTO rules."

Retaliatory move

Despite the trilateral meeting in the morning, tensions between the three came into the open by evening at the OECD ministerial meeting when the EU announced that it will press ahead with a trade dispute against the US at the WTO in a tit-for-tat measure against the latter's decision to impose the steel and aluminium duties on the EU.

Malmstrom described the US move as a "bad day for world trade."

"We did everything to avoid this outcome," she said, suggesting that "the

very last couple of months I have spoken at numerous occasions with the US Secretary of Commerce."

"I have argued for the EU and the US to engage in a positive transatlantic trade agenda, and for the EU to be fully, permanently and unconditionally exempted from these tariffs," she said.

"This is also what EU leaders have asked for," Malmstrom said, suggesting that "throughout these talks, the US has sought to use the threat of trade restrictions as leverage to obtain concessions from the EU."

"This is not the way we do business, and certainly not between longstanding partners, friends and allies. Now that we have clarity, the EU's response will be proportionate and in accordance with WTO rules," she maintained.

"We will now trigger a dispute settlement case at the WTO, since these US measures clearly go against agreed international rules."

The EU will initiate a safeguard dispute and impose immediate retaliatory measures to the tune of several billions of dollars as part of the "rebalancing measures and take any necessary steps to protect the EU market from trade diversion caused by these US restrictions."

The EU has already published a list of tariffs on a range of American goods worth some \$1.6 billion on 18 May. The targeted American products include sweet corn, maize, semi-milled rice of different categories, orange juice, cranberry, Bourbon whiskey, tobacco, T-shirts, flat rolled iron and stainless steel products, which would be levied additional duties of 10%, 25%, 35% and 50%. (SUNS8693) □

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US again blocks consensus over AB appointments

The deadlock in filling long outstanding vacancies in the WTO's Appellate Body persists, with the US continuing to reject efforts to appoint new members to the AB and with an existing member up for reappointment.

by Kanaga Raja

GENEVA: The United States has once again blocked at the World Trade Organization the launch of the selection processes to fill three current vacancies on the seven-member Appellate Body (AB).

With the US repeatedly blocking consensus – for the twelfth time now – to begin the selection processes, it has prolonged the impasse over this issue, which has been before the WTO's Dispute Settlement Body (DSB) for more than 17 months now.

At a meeting of the DSB on 28 May, the US once again informed fellow WTO member states that it was not in a position to agree to a joint proposal sponsored by some 67 members that called for the simultaneous launch of the selection processes to fill the three vacancies on the AB as soon as possible.

Two AB members whose second and final four-year terms have expired are Ricardo Ramirez-Hernandez and Peter Van den Bossche. Ramirez-Hernandez's second term expired on 30 June 2017, while that of Van den Bossche expired on 11 December 2017.

Another vacancy pertains to Hyun Chong Kim from South Korea, who had tendered his resignation with immediate effect on 1 August 2017 prior to taking up his appointment as a minister in the Korean government.

Meanwhile, a farewell ceremony was held for departing AB member Ramirez-Hernandez at the WTO also on 28 May.

In his farewell speech, Ramirez-Hernandez said the crisis being faced by the dispute settlement mechanism and in particular the AB could have been avoided if it had been addressed face-on as it began to escalate.

"You, the Members, need to ask yourselves, what is the contribution of the AB to the international rule of law? What does this paralysis do to the WTO Dispute Settlement System as a whole?" said Ramirez-Hernandez.

"This institution does not deserve to die through asphyxiation. You have an obligation to decide whether you want to kill it or keep it alive," he added.

Expiring term

In a related development, the Chair of the DSB, Ambassador Sunanta Kangvulkulkij of Thailand, informed members at the 28 May DSB meeting that she had received a communication indicating that AB member Shree Baboo Chekitan Servansing was interested in serving a second term. His first four-year term expires on 30 September. The chair said that she would begin consultations with members on the matter and report back at the next meeting of the DSB on 22 June.

(The seven-member AB is thus now functioning with only four members, one of whom is due for reappointment at the end of his current term in September. Two more of the current AB members are due to retire next year, and if the US continues with its consensus-blocking approach, the AB will no longer be able to function, lacking the minimum of three members to hear appeals.

(Dispute settlement can still function, with disputes referred to panels automatically on a second request, and the panels can hear parties and third parties to the disputes and hand down rulings. However, if one of the parties then notifies that it is appealing a panel ruling, the panel report cannot be adopted until the AB is able to hear and give a ruling on the points of law being appealed. Thus from next year, in practical terms, the DSB will not be able to complete its task on disputes, paralyzing the system. – *SUNS*)

According to trade officials, South Africa, on behalf of the African Group, told the DSB meeting that the group was increasingly concerned by the recent developments with respect to the appointment of AB members. It believed that some of the issues raised may be amenable to solutions in the short term while others would require more discussion.

The African Group was of the view that consultations on the reappointment of Servansing should begin immediately so that the DSB is in a position to decide in September.

Joint proposal

On the filling of the three current vacancies in the AB, a joint proposal on AB appointments was tabled at the DSB meeting by Argentina, Australia, Bolivia, Brazil, Canada, Chile, China, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, the European Union, Guatemala, Honduras, Hong Kong-China, Iceland, India, Indonesia, Israel, Kazakhstan, Korea, Mexico, New Zealand, Nicaragua, Norway, Pakistan, Panama, Paraguay, Peru, Russia, Singapore, Switzerland, Chinese Taipei, Turkey, Ukraine, Uruguay, Venezuela and Vietnam.

The proposal called for the DSB to take a decision with regard to the following:

(1) to launch one selection process to replace Ramirez-Hernandez, a second selection process to replace Kim, and a third selection process to replace Van den Bossche;

(2) to establish a Selection Committee composed of the WTO Director-General and the Chairpersons of the General Council, the Goods Council, the Services Council, the TRIPS Council and the DSB, to be chaired by the DSB Chair;

(3) to set a deadline of a 30-day period after the date of its decision, for WTO members to submit nominations of candidates; and

(4) to request the Selection Committee to carry out its work in order to make recommendations to the DSB within 60 days after the deadline for submitting nominations of candidates, so that the DSB can take a decision to appoint three new AB members as soon as possible.

Mexico, speaking on behalf of the 67 co-sponsors of the joint proposal, said that the considerable number of members submitting the proposal reflects a common concern with the current situation in the AB that is seriously affecting its workings and the overall dispute settlement system against the best interest of its members.

Mexico said that the proponents are flexible in the determination of the deadlines for the selection processes but they should take into account the urgency of the situation. It continued to urge all members to support the proposal in the interest of the multilateral trade and dispute settlement systems.

In its statement, the US said that as it had explained in prior meetings, "we

are not in a position to support the proposed decision."

According to the US, for at least the past eight months, it has been raising and explaining the systemic concerns that arise from the AB's decisions that purport to "deem" as an AB member someone whose term of office has expired and thus is no longer an AB member, pursuant to its Working Procedures for Appellate Review (Rule 15).

During that period of time, the DSB has adopted by "positive" consensus four reports signed by someone no longer an AB member, and there currently remain two ongoing appeals where the term of one of the persons appointed to the division has expired, said the US.

[The US claim that the reports have been adopted by "positive consensus", however, appears questionable, since in terms of Article 17.14 of the WTO's Dispute Settlement Understanding (DSU), the question of "positive consensus" arises only for non-adoption. The US attempt at the DSB meeting to have the DSB adopt the AB report on the Airbus compliance panel ruling by "positive consensus", namely unanimous consent of members, failed when the EU and Brazil among others made clear that the adoption was by the normal "negative consensus". – *SUNS*]

The US claimed that the DSB has not yet addressed the problem of persons continuing to hear appeals well after their terms have expired.

Repeating the arguments it made at previous DSB meetings, the US maintained that under the DSU, it is the DSB that has the authority to appoint AB members and to decide when their term in office expires, and so it is up to the DSB to decide whether a person who is no longer an AB member can continue to serve on an appeal.

Last month, the US said, it repeated concerns over the background note circulated by the AB on Rule 15 and asked for WTO members to be provided additional information. The US had pointed out that, unlike with other international tribunals cited in the background note, Rule 15 is not set out in the constitutive text of the WTO dispute settlement system, i.e., the DSU. It has therefore not been agreed to by WTO members, the US argued.

"We therefore asked to be informed by the Appellate Body why this basic

difference between the DSU and 'some international tribunals' was not reflected in what was purported to be a background document," it said.

The US said it also called members' attention again to a misleading, at best, statement that appeared to have been very carefully crafted to avoid mentioning that Rule 15 was in fact "criticized by [a WTO] Member in the DSB" and was "called into question" at the time of its adoption, contrary to assertions in the background note.

The US maintained that the criticism of Rule 15 in the DSB by a WTO member at the time of its adoption is the type of basic information one would expect to be included in a document with the intention to make an objective presentation of the issue.

"We therefore asked to be informed by the Appellate Body why India's intervention was not drawn to the attention of WTO Members in the Background Note and further asked why the Appellate Body's statement was drafted in the manner it was," it said.

"We have yet to receive information in response to either of these inquiries," the US added.

(When Rule 15 was notified to the DSB by the AB as a working procedure, India had voiced its systemic concerns, but the US at that time had remained silent. – *SUNS*)

The US said it appreciated the recognition by members at the last meeting of the fact that addressing this issue is a joint responsibility of all members, and it appreciated the willingness they expressed to engage on this issue.

The US said that it remains resolute in its view that members need to resolve that issue as a priority. A number of ideas have been mentioned in the context of informal discussions in which the US has participated, representing a diversity of views on possible solutions.

"We therefore will continue our efforts and our discussions with Members and with the Chair to seek a solution on this important issue," the US concluded.

Concerns over impasse

Colombia (for the GRULAC group of Latin American and Caribbean countries), Canada, Australia, Chinese Taipei, Thailand, Singapore, India, Norway, Pakistan, Russia, Switzerland, Brazil, Korea, Ukraine, Hong Kong-China, China,

Japan, Mexico, Uruguay, Guatemala, Ecuador, Turkey, Costa Rica and New Zealand all took the floor at the DSB meeting on this issue.

According to trade officials, these members reiterated their concerns over the continued impasse with respect to the appointment of new AB members. They urged all members to show flexibility in order to resolve the deadlock as soon as possible.

Several members pointed to the dangers that the continued impasse poses not only to the dispute settlement system but also to the WTO as a whole, and said that members have an obligation under the WTO rules to initiate the selection process to fill the vacancies on the AB.

Other members underlined that the US concerns and the issue of AB appointments should be treated separately. Several members also called on the US to share its views and develop ideas on how to resolve its problem.

According to trade officials, Russia, Switzerland, Brazil, Korea, China, Guatemala and Turkey criticized the US directly or indirectly for failing to put forward any proposals over the past half-year for resolving the problem and/or failing to engage in any meaningful discussion on its concerns.

Canada expressed deep regret that the DSB has been unable to fulfil its legal obligation under Article 17.2 of the DSU to appoint AB members as vacancies arise. Canada agreed that it is time to start a process or, if necessary, several processes to select new AB members for the three current vacancies.

Like other members, Canada said it is disappointed that the US has linked the start of the AB selection processes to the resolution of certain procedural concerns it has shared with members. Canada invited the US to engage in discussions with interested members with a view to expeditiously developing a solution to the concerns that it has raised.

Japan said that it is the responsibility of the entire WTO membership, acting as the DSB, to ensure the proper functioning of the WTO dispute settlement system in a manner consistent with the DSU. It welcomed the readiness expressed by many members to engage and looked forward to working with other interested members in this common endeavour.

Colombia, on behalf of GRULAC, expressed the group's deep concern

about the present situation, which it said affects the good performance of one of the central bodies of the WTO. If this problem continues without being solved, it will imply, in the short term, practically the paralysis of the AB, putting the entire dispute settlement system at risk.

Colombia noted that the delay in launching the replacement process, having already arisen with three vacancies, means failure to comply with an existing mandate, and involves a flagrant breach of a legal obligation emanating from a covered agreement. This, it said, has systemic consequences and is a bad precedent for the organization. It inflicts damage and affects the image and credibility of the WTO, particularly taking into account the complex international scenario that today adversely affects trade multilateralism.

Colombia said that it has heard of concerns expressed in relation to the functioning of the dispute settlement system and specific issues regarding decision-making which are impeding the launch of the replacement process. "We cannot validate that these concerns pre-

vent a legal obligation from being fulfilled and are linked to the replacement of the vacancies already arisen or to arise."

Colombia pointed out that the operation of the system cannot be stopped while the concerns of some of the members have not been resolved. It called attention to the seriousness of keeping blocked the replacement of vacancies. It also said that the selection process should not be conditioned to a different process, which must be addressed on its own merits.

In this regard, Colombia urged the membership to find a solution that allows members to advance as soon as possible in the fulfilment of the legal obligation it mentioned.

Russia said it is deeply concerned about the continuing US blockage of the selection process and the fact that the US links it with the resolution of the "problem". Russia said that for the past half a year, the US has neither put forward the concrete problem nor the possible ways to resolve it. This leads to the inability of

the WTO members to engage in a meaningful discussion and move towards the resolution of this issue.

According to Russia, such unilateral actions kill the trust in the multilateral process and contribute to the chaos in multilateral rules even though they are taken under the pretence of compliance with the existing rules. There is always room for improvement but such improvement should not be contrary to the well-functioning of the dispute settlement mechanism and of the WTO system as a whole.

Russia called on the US to provide a clear picture of the problem at issue and its potential solutions or stop the blockage.

According to trade officials, the Chair of the DSB said it was regrettable that members were still not in a position to launch the selection process and that the matter required political engagement by members. She asked members to share their views on how to proceed and said she was ready to hear from delegations on their ideas. (SUNS8691) □

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Time for multilateral trust buster, says UNCTAD

Asymmetric market power due to corporate rent-seeking necessitates tightening of anti-trust regulation, including on a multilateral level, suggests a UN development body.

by Kanaga Raja

GENEVA: Rising market concentration and corporate rentierism in core sectors of the global economy are a major driver of growing global income inequality, according to the UN Conference on Trade and Development (UNCTAD).

This is one of the key points highlighted by UNCTAD in its latest Policy Brief (No. 66, May 2018), titled "Corporate rent-seeking, market power and inequality: Time for a multilateral trust buster?".

UNCTAD explains that rent-seeking means "getting an income not as a reward for creating wealth but by grabbing a larger share of the wealth that would have been produced anyway".

According to UNCTAD, the combination of record high corporate profits in lead economies, stagnant or falling investment rates in the real economy and income inequality that is higher than at any point after the Second World War suggests a world in which rent-seeking has become prevalent.

"This is not the kind of enabling environment needed to ensure the inclusive prosperity envisaged in the 2030 Agenda for Sustainable Development, in particular under Goal 10," it said.

Among UNCTAD's findings are that in 2009-15, the surplus profits – due largely to rentierist profit strategies rather than productive investment – of the top 1% of publicly listed firms in a new UNCTAD firm-level database for 56 developed, developing and transition economies represented 55% of recorded operating profits.

Measures to curb abusive business practices should include a review of the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices and of bilateral and mega-regional trade and investment agreements, said UNCTAD.

Extent of rentierism

Highlighting recent trends in the

evolution of non-financial corporate rents and their core policy implications, the policy brief pointed out that gauging the size of corporate rents is challenging for both data-related and conceptual reasons.

Several recent contributions have shed light on increases in rentierism in recent decades, yet their focus has primarily been on financial rentier incomes, variously defined, in a few developed countries. By contrast, said the paper, the UNCTAD estimate of the size of corporate rentier incomes focuses on non-financial sectors and widens the geographical coverage to include both developed and developing countries.

Explaining the methodology, UNCTAD said that for purposes of measurement, rents are approximated as persistent upward deviations from benchmark results that capture typical firm performances in given market conditions. The aim is to measure the gap between actual profits and benchmark or typical profits. A positive gap means that some firms accumulate surplus or excess profits, and if this gap persists over time, the measure provides an indication of forces at work that may facilitate the transformation of temporary surplus profits into redistributive rents.

Balance sheet data is drawn from a new UNCTAD database of the consolidated financial statements of publicly listed non-financial firms in 56 developed countries, developing countries and countries with economies in transition.

The relevant variable is the operating profits of the non-financial firms, and the period covered, 1995-2015, is divided into three sub-periods separated by two major financial crises, namely the dot-com bubble in 2000-01 and the global financial crisis in 2008-09.

According to the policy brief, the share of surplus in total operating profits rose from 7% in 1995-2000 to 20% in 2001-08 and 25% in 2009-15.

"This suggests a substantial increase in the ability of firms to generate and appropriate surplus profits since the early 2000s, with the global financial crisis somewhat curbing the pace towards corporate rentierism," it said.

Market concentration

However, these aggregate figures hide large and widening disparities between firms at the top and bottom of firm distribution.

In 2009-15, surplus profits represented 49% of the recorded operating profits of the top 10% of firms ranked by surplus profits and 55% of those of the top 1% of firms.

Furthermore, the top 1% of firms generate a large part of their surplus profits in two types of sectors.

First, profits are generated in sectors that saw the large-scale privatization of the provision of public goods in the 1990s and 2000s, alongside subsidy schemes for private investors, such as the energy, utilities and telecommunications and healthcare sectors.

Second, said UNCTAD, profits are generated in leading high-technology sectors such as technology equipment, pharmaceuticals and software and information technology services. Some of these sectors, such as pharmaceuticals, have been characterized by high degrees of market concentration for decades, while others have produced superstar firms more recently.

The rise of surplus profits and their concentration at the top end of firm distribution mirrors the trend of growing market concentration in core sectors such as those mentioned above. This has attracted renewed attention in recent years, primarily although not exclusively in studies of changing market structures in the United States, said UNCTAD.

It noted that the top 1% of firms ranked by surplus profits have strengthened their market dominance according to different performance criteria such as revenues, physical assets, other assets and, to a lesser extent and pace, employment. Their share of revenues, for example, has doubled since 1995-2000, and reached 24% in 2009-15.

In addition to organic corporate growth, the high pace of market concentration seems to have also been driven by mergers and acquisitions. In 1995-2000, the top 1% of firms owned 18% of

net assets from mergers and acquisitions; by 2009-15, this figure had risen to 29%.

By contrast, said UNCTAD, while market concentration has also risen with regard to employment, this increase is less pronounced and has flattened considerably since the 2000s.

"The widening gap between indicators of market concentration with regard to, on the one hand, revenues and assets and, on the other hand, employment, lends further support to the view that asymmetric market power is a strong contributory factor to rising income inequality," the UNCTAD paper pointed out.

It noted that some analysts have stated that rising market power and winner-takes-most outcomes are primarily a technological phenomenon. In this view, new high-technology sectors produce superstar firms due to economies of scale, for example, in online services and software platforms, and the network effects of information-intensive goods and services make it difficult for newcomers to compete.

New technologies can undoubtedly play a role in raising barriers to entry, yet this explanation overlooks the interaction between technological and institutional or regulatory avenues to bolstering market power, said the policy brief.

"Superstar firms benefiting from initial technological barriers to entry can use this advantage to further expand their market power in other ways, for example, through the aggressive use of intellectual property rights and pricing strategies or manipulations that make new entries non-viable or by systematically buying high-technology start-ups with new ideas and using their growing lobbying power to prevent regulatory authorities from intervening."

Generally, if growing market concentration, whether or not it originates in technological features, is left unattended, this raises the possibility of a "Medici vicious circle, in which money is used to gain political power and political power is then used to make more money".

The recent proliferation of a range of financial and non-financial corporate rent-seeking strategies – such as the strategic use of intellectual property rights; the raiding of public sectors through ineffective subsidy schemes, dubious privatization schemes and abusive tax-

related practices; and systematic stock market manipulation to inflate chief executive officer remuneration – suggests that such a vicious cycle is well under way, said UNCTAD.

Anti-trust regulation

This situation has triggered a growing policy debate on the need to tighten anti-trust legislation and enforcement, in particular in the United States and the European Union, which host most corporate headquarters, it said.

To be effective, said UNCTAD, anti-trust regulation needs to shift from a narrow focus on consumer welfare to a more comprehensive approach that considers market dominance and corporate abuses.

In the meantime, competition policies and measures aimed at curtailing restrictive business practices may be designed with an explicit distributional objective and greater protection against regulatory capture, it suggested.

Developing countries mostly do not have such regulatory systems and are often the most exposed to the risks of competitive abuse in the absence of effective regulation. In this context, much of the regulatory structure dismantled in the last decades needs to be restored and updated.

Given the global reach of multinational companies, close cooperation between lead economies that host the headquarters of most of these companies is essential for effective and coordinated reforms of anti-trust legislation, regula-

tion and enforcement.

According to the policy brief, there may be considerable political obstacles, yet efforts should ideally focus on a multilateral trust-busting framework.

A starting point could be the United Nations Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices adopted by the UN General Assembly in 1980. These principles consider the interests of developing countries with regard to price fixing, collusion, transfer pricing, predatory behaviour towards competitors and the abuse of a dominant position.

In addition, said UNCTAD, stricter enforcement of existing national disclosure and reporting requirements for large corporations may be useful.

A global competition observatory could facilitate the task of systematic information gathering on the wide variety of existing regulatory frameworks, as a first step towards coordinated international best practice guidelines and policies and the monitoring of global market concentration trends and patterns.

UNCTAD also said that "restrictions on the sharing of knowledge and intellectual property rights, negotiated at the bilateral and regional levels to be more constraining than multilateral agreements, need to be revisited."

Bilateral and regional trade and investment agreements that facilitate abusive business practices should also be considered for reform, it concluded. (SUNS8688) □

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US response to poverty is to imprison the poor, says UN expert

A UN rights expert has denounced high levels of poverty and inequality in the US, describing as “cruel and inhuman” the existence of tens of millions living in poverty in one of the world’s wealthiest countries.

by Kanaga Raja

GENEVA: The United States’ response to poverty in the 21st century is to punish and imprison the poor, a United Nations human rights expert has said.

The UN Special Rapporteur on extreme poverty and human rights, Philip Alston (from Australia), said that it is difficult to imagine a more self-defeating strategy. “In the United States, it is poverty that needs to be arrested, not the poor simply for being poor.”

This assessment by the rights expert came in a full report to be presented to the UN Human Rights Council, which was holding its thirty-eighth regular session here from 18 June to 6 July.

The report was based on a fact-finding visit that the Special Rapporteur undertook to California, Alabama, Georgia, West Virginia and Washington DC from 1-15 December 2017.

“For one of the world’s wealthiest countries to have 40 million people living in poverty and over five million living in ‘Third World’ conditions is cruel and inhuman,” said Alston in a UN news release.

“The Trump Administration has brought in massive tax breaks for corporations and the very wealthy, while orchestrating a systematic assault on the welfare system. The strategy seems to be tailor-made to maximize inequality and to plunge millions of working Americans, and those unable to work, into penury.”

“Locking up the poor precisely because they are poor, greatly exaggerating the amount of fraud in the system, shaming those who need assistance, and devising ever more obstacles to prevent people from getting needed benefits, is not a strategy to reduce or eliminate poverty,” said the Special Rapporteur.

“It seems driven primarily by contempt, and sometimes even by hatred for the poor, along with a ‘winner takes all’ mentality,” he added.

“Contempt for the poor has intensi-

fied under the Trump Administration,” said Alston.

Locked up

According to the Special Rapporteur, punishing and imprisoning the poor is the distinctively American response to poverty in the 21st century. Workers who cannot pay their debts, those who cannot afford private probation services, minorities targeted for traffic infractions, the homeless, the mentally ill, fathers who cannot pay child support and many others are all locked up. “Mass incarceration is used to make social problems temporarily invisible and to create the mirage of something having been done.”

“It is difficult to imagine a more self-defeating strategy,” Alston said, noting that federal, state, county and city governments incur vast costs in running jails and prisons. Sometimes these costs are “recovered” from the prisoners, thus fuelling the latter’s cycle of poverty and desperation.

The criminal records attached to the poor through imprisonment make it even harder for them to find jobs, housing, stability and self-sufficiency. Families are destroyed, children are left parentless and the burden on governments mounts.

“A cheaper and more humane option is to provide proper social protection and facilitate the return to the workforce of those who are able. In the United States, it is poverty that needs to be arrested, not the poor simply for being poor,” said the rights expert.

He noted that only 36% of Republican voters consider that the federal government should do more to help poor people, and 33% believe that it already does too much.

“The paradox is that the proposed slashing of social protection benefits will affect the middle classes every bit as much as the poor.”

According to the report, almost a

quarter of full-time workers, and three-quarters of part-time workers, receive no paid sick leave. Absence from work due to illness thus poses a risk of economic disaster. About 44% of adults either could not cover an emergency expense costing \$400 or would need to sell something or borrow money to do it.

The impacts of automation, artificial intelligence and the increasing fluidity of work arrangements mean that employer-provided social protection will likely disappear for the middle classes in the years ahead.

“If this coincides with dramatic cut-backs in government benefits, the middle classes will suffer an ever more precarious economic existence, with major negative implications for the economy as a whole, for levels of popular discontent and for political stability.”

Extreme inequality

According to the Special Rapporteur, the United States already leads the developed world in income and wealth inequality, and it is now moving full steam ahead to make itself even more unequal. But this is a race that no one else would want to win, since almost all other nations and all the major international institutions such as the OECD, the World Bank and the IMF have recognized that extreme inequalities are economically inefficient and socially damaging.

The trajectory of the United States since 1980 is shocking. In both Europe and the United States, the richest 1% earned around 10% of national income in 1980. By 2017 that had risen slightly in Europe to 12% but massively in the United States to 20%.

Since 1980 annual income earnings for the top 1% in the United States have risen 205%, while for the top 0.001% the figure is 636%. By comparison, the average annual wage of the bottom 50% has stagnated since 1980.

“What extreme inequality actually signifies is the transfer of economic and political power to a handful of elites who inevitably use it to further their own self-interest, as demonstrated by the situation in various countries around the world,” said Alston.

The combined wealth of the United States Cabinet is around \$4.3 billion. As noted by *Forbes*: “America’s first billionaire president has remained devoted to the goal of placing his wealthy friends in his Cabinet, a top campaign promise.”

And many regulatory agencies are now staffed by “political appointees with deep industry ties and potential conflicts”.

“Extreme inequality thus poses a threat not just to economic efficiency but to the well-being of American democracy,” the rights expert warned.

American dream or American illusion?

According to the report by the Special Rapporteur, the United States is a land of stark contrasts. It is one of the world’s wealthiest societies, a global leader in many areas, and a land of unsurpassed technological and other forms of innovation. Its corporations are global trendsetters, its civil society is vibrant and sophisticated and its higher education system leads the world.

But its immense wealth and expertise stand in shocking contrast with the conditions in which vast numbers of its citizens live. About 40 million live in poverty, 18.5 million in extreme poverty, and 5.3 million live in Third World conditions of absolute poverty.

It has the highest youth poverty rate in the Organization for Economic Cooperation and Development (OECD), and the highest infant mortality rates among comparable OECD states. Its citizens live shorter and sicker lives compared with those living in all other rich democracies, eradicable tropical diseases are increasingly prevalent, and it has the world’s highest incarceration rate, one of the lowest levels of voter registrations among OECD countries and the highest obesity levels in the developed world.

The United States has the highest rate of income inequality among Western countries. The \$1.5 trillion in tax cuts in December 2017 overwhelmingly benefited the wealthy and worsened inequality.

The consequences of neglecting poverty and promoting inequality are clear, said Alston. The United States has one of the highest poverty and inequality levels among the OECD countries, and the Stanford Center on Inequality and Poverty ranks it 18th out of 21 wealthy countries in terms of labour markets, poverty rates, safety nets, wealth inequality and economic mobility.

But in 2018 the United States had over 25% of the world’s 2,208 billionaires. There is thus a dramatic contrast between the immense wealth of the few and the

squalor and deprivation in which vast numbers of Americans exist.

“For almost five decades the overall policy response has been neglectful at best, but the policies pursued over the past year seem deliberately designed to remove basic protections from the poorest, punish those who are not in employment and make even basic health care into a privilege to be earned rather than a right of citizenship.”

The Special Rapporteur said his visit coincided with the dramatic change of direction in relevant United States policies. The new policies: (a) provide unprecedentedly high tax breaks and financial windfalls to the very wealthy and the largest corporations; (b) pay for these partly by reducing welfare benefits for the poor; (c) undertake a radical programme of financial, environmental, health and safety deregulation that eliminates protections mainly benefiting the middle classes and the poor; (d) seek to add over 20 million poor and middle-class persons to the ranks of those without health insurance; (e) restrict eligibility for many welfare benefits while increasing the obstacles required to be overcome by those eligible; (f) dramatically increase spending on defence, while rejecting requested improvements in key veterans’ benefits; (g) do not provide adequate additional funding to address an opioid crisis that is decimating parts of the country; and (h) make no effort to tackle the structural racism that keeps a large percentage of non-Whites in poverty and near poverty.

According to the report, the share of the top 1% of the population in the United States has grown steadily in recent years. In 2016 they owned 38.6% of total wealth. In relation to both wealth and income, the share of the bottom 90% has fallen in most of the past 25 years.

“The tax reform will worsen this situation and ensure that the United States remains the most unequal society in the developed world. The planned dramatic cuts in welfare will essentially shred crucial dimensions of a safety net that is already full of holes. Since economic and political power reinforce one another, the political system will be even more vulnerable to capture by wealthy elites.”

The Special Rapporteur said the tax cuts will fuel a global race to the bottom, thus further reducing the revenues needed by governments to ensure basic social protection and meet their human

rights obligations. And the United States remains a model whose policies other countries seek to emulate.

He noted that the United States now has one of the lowest rates of inter-generational social mobility of any of the rich countries. Zip codes, which are usually reliable proxies for race and wealth, are tragically reliable predictors of a child’s future employment and income prospects. High child and youth poverty rates perpetuate the inter-generational transmission of poverty very effectively, and ensure that the American dream is rapidly becoming the American illusion.

The equality of opportunity which is so prized in theory is in practice a myth, especially for minorities and women, but also for many middle-class White workers.

Successive administrations, including the current one, have determinedly rejected the idea that economic and social rights are full-fledged human rights, despite their clear recognition not only in key treaties that the United States has ratified, such as the Convention on the Elimination of All Forms of Racial Discrimination, but also in the Universal Declaration of Human Rights, which the United States has long insisted other countries must respect.

In practice, said Alston, the United States is alone among developed countries in insisting that, while human rights are of fundamental importance, they do not include rights that guard against dying of hunger, dying from a lack of access to affordable healthcare or growing up in a context of total deprivation.

Stereotypes

Alston noted that in thinking about poverty, it is striking how much weight is given to caricatured narratives about the purported innate differences between rich and poor that are consistently peddled by some politicians and media. The rich are industrious, entrepreneurial, patriotic and the drivers of economic success. The poor are wasteful, losers and scammers. As a result, money spent on welfare is money down the drain.

However, he pointed out that many of the wealthiest citizens do not pay taxes at the rates that others do, hoard much of their wealth offshore and often make their profits purely from speculation rather than contributing to the overall wealth of the American community.

In imagining the poor, racist stereo-

types are usually not far beneath the surface. The poor are overwhelmingly assumed to be people of colour, whether African Americans or Hispanic “immigrants”. The reality is that there are 8 million more poor Whites than there are poor Blacks. The face of poverty in America is not only Black or Hispanic, but also White, Asian and many other backgrounds.

Similarly, large numbers of welfare recipients are assumed to be living high on “the dole”. Some politicians and political appointees with whom the Special Rapporteur spoke were completely sold on the narrative of such scammers sitting on comfortable sofas watching cable television or spending their days on their smartphones, all paid for by welfare. He wondered how many of those politicians have ever visited poor areas, let alone spoken to those who dwell there. There are anecdotes aplenty, but little evidence.

Falling short

The report said that according to the official poverty measures, in 2016, 12.7% of Americans were living in poverty; according to the supplemental poverty measure, the figure was 14%.

“There is no magic recipe for eliminating extreme poverty, and each level of government must make its own good-faith decisions. At the end of the day, however, particularly in a rich country like the United States, the persistence of extreme poverty is a political choice made by those in power. With political will, it could readily be eliminated,” it added.

What is known, from long experience and in the light of the government’s human rights obligations, is that there are indispensable ingredients for a set of policies designed to eliminate poverty. They include: democratic decision-making, full employment policies, social protection for the vulnerable, a fair and effective justice system, gender and racial equality, respect for human dignity, responsible fiscal policies and environmental justice.

According to Alston, the United States falls well short on each of these measures.

The Special Rapporteur said that the cornerstone of American society is democracy, but it is being steadily undermined and, with it, the human right to political participation protected in Article

25 of the International Covenant on Civil and Political Rights. The principle of one person, one vote applies in theory, but is increasingly far from the reality.

In the United States there is overt disenfranchisement of more than 6 million felons and ex-felons, which predominantly affects Black citizens since they are the ones whose conduct is often specifically targeted for criminalization. In addition, nine states currently condition the restoration of the right to vote after prison on the payment of outstanding fines and fees. A typical outcome is that seen in Alabama, where a majority of all ex-felons cannot vote.

Then there is covert disenfranchisement, which includes the dramatic gerrymandering of electoral districts to privilege particular groups of voters, the imposition of artificial and unnecessary voter identification requirements, the blatant manipulation of polling station locations, the relocation of Department of Motor Vehicles offices to make it more difficult for certain groups to obtain identification, and the general ramping up of obstacles to voting, especially for those without resources.

“The net result is that people living in poverty, minorities and other disfavoured groups are being systematically deprived of their right to vote.”

It is thus unsurprising that the United States has one of the lowest turnout rates in elections among developed countries, with only 55.7% of the voting-age population casting ballots in the 2016 presidential election.

Registered voters represent a much smaller share of potential voters in the United States than in just about any other OECD country. Only about 64% of the United States voting-age population were registered in 2016, compared with 91% in Canada and the United Kingdom, 96% in Sweden and nearly 99% in Japan.

Proposed welfare cuts

Proposals to slash the meagre welfare arrangements that currently exist are now sought to be justified primarily on the basis that the poor need to leave welfare and go to work.

The report noted that up to \$6 billion annually goes from the Supplemental Nutrition Assistance Program and other public assistance programmes to support workers in firms like Walmart, providing a huge indirect subsidy to the

relevant corporations.

Walmart lobbied heavily for tax reform, from which it will save billions, and then announced it would spend an additional \$700 million in increasing employee wages and benefits for its workers. But the resulting rise in the debt of the United States, due in part to the tax reform, has then been used to justify a proposed 30% cut in Supplemental Nutrition Assistance Program funding over a decade.

The Special Rapporteur also pointed out that the shockingly high number of children living in poverty in the United States demands urgent attention. In 2016, 18% of children (13.3 million) were living in poverty, and children comprised 32.6% of all people in poverty.

About 20% of children live in relative income poverty, compared with the OECD average of 13%. Contrary to stereotypical assumptions, 31% of poor children are White, 24% are Black, 36% are Hispanic and 1% are indigenous. This is consistent with the fact that the United States ranks 25th out of 29 industrialized nations in investing in early childhood education. Furthermore, the infant mortality rate, at 5.8 deaths per 1,000 live births, is almost 50% higher than the OECD average of 3.9.

According to the Special Rapporteur, the official point-in-time estimates of homelessness in 2017 show a nationwide figure of 553,742, including 76,501 in New York, 55,188 in Los Angeles and 6,858 in San Francisco.

The criminalization of homeless individuals in cities that provide almost zero public toilets seems particularly callous, said Alston. In June 2017, it was reported that the approximately 1,800 homeless individuals on Skid Row in Los Angeles had access to only nine public toilets. Los Angeles failed to meet even the minimum standards the United Nations High Commissioner for Refugees sets for refugee camps in Syria and other emergency situations.

In many cities and counties, the criminal justice system is effectively a system for keeping the poor in poverty while generating revenue to fund not only the justice system but many other programmes. So-called fines and fees are piled up so that low-level infractions become immensely burdensome, a process

(continued on page 16)

Warnings of a new global financial crisis

A major international financial crisis could be on the horizon, and developing economies should stand well prepared, suggests *Martin Khor*.

There are increasing warnings of an imminent new financial crisis, not only from the billionaire investor George Soros but also from eminent economists associated with the Bank for International Settlements, the bank for central banks.

The warnings come at a moment when there are signs of international capital flowing out of some emerging economies, including Turkey, Argentina and Indonesia.

Some economists have been warning that the boom-bust cycle in capital flows to developing countries will cause disruption when there is a turn from boom to bust. All it needs is a trigger, which may then snowball as investors head for the exit door in herd-like manner. Their behaviour is akin to a self-fulfilling prophecy: if enough speculative investors think this is the time to move back to the global financial capitals, then the exodus will happen, as it did in previous "bust" phases of the cycle.

Soros recently told a seminar in Paris: "The strength of the dollar is already precipitating a flight from emerging-market currencies. We may be heading for another major financial crisis. The economic stimulus of a Marshall Plan for Africa and other parts of the developing world should kick in just at the right time."

If Soros is right about an imminent crisis, its trigger could come from another European crisis. Or it could be outflow of funds from several developing countries. Some had received huge inflows when returns were low or even zero in the rich countries. With US interest rates and bond prices going up, the reverse flow is now occurring and it is only the start, with more expected to take place.

Soros's prediction may not be widely shared, however. "Honestly I think that's ridiculous," said James Gorman, the head of investment bank Morgan Stanley, commenting on Soros.

"Ticking time bombs"

The Soros warning reminded me of a South Centre debate held in Geneva in April, when we hosted two eminent main speakers to launch their book, *Revolution Required: The Ticking Time Bombs of the G7*

Model.

The authors were Peter Dittus, former Secretary-General of the Bank for International Settlements (BIS), and Herve Hannoun, former Deputy General Manager of the BIS.

A club of 60 central banks, the BIS is known as the bank for central banks and also famous for the quality of its research. You can't get a more respected conservative establishment.

Yet the two recently retired top BIS leaders wrote a book in simple direct language warning of "ticking time bombs" in the global financial system waiting to explode because of the reckless and wrong policies of the major developed countries. Nothing short of a revolution in policy is required to minimize the damage of a crisis that is about to come, they say.

At the Geneva meeting, Dittus and Hannoun pointed to several problems or "time bombs" that had developed in the developed countries, with potential to harm the world.

The main problem is what they call the G7 debt-driven growth model. The G7 major developed economies, except Germany, have lax fiscal policies with high government liabilities as a percentage of gross domestic product (GDP).

In particular, the United States has an irresponsible fiscal policy which it has exported to other G7 countries apart from Germany.

The US administration has expanded new expenditure and tax cuts, with no funding other than more debt. This "reckless behaviour", leading to a US fiscal deficit projected to be around \$1 trillion in 2019, was made possible by the permissive monetary policy conducted by the US Federal Reserve since 2009, the silence or complacency of the big three US-based ratings agencies, and the blessing of the International Monetary Fund (IMF).

The G7 central banks have also become the facilitators of unfettered debt accumulation, according to the authors. The near-zero or negative nominal interest rates are a huge incentive to borrow, and extreme monetary policies have de-

stroyed any incentive to fiscal rectitude.

G7 total debt in the third quarter of 2017 was around \$100 trillion. Together, the US, the UK, Canada, Japan and the eurozone account for 64% of the world total debt.

The authors assert that the G7 extreme monetary policies since 2012 have undermined the foundations of the market economy. There are now centrally planned financial markets and the break-up of key elements of the market economy model. Long-term interest rates are manipulated, valuations of all asset classes are deeply distorted, sovereign risk in advanced economies is deliberately mispriced, and all these do not reflect fundamentals.

Dittus and Hannoun warn that the unprecedented asset price bubble engineered by G7 central banks is a ticking time bomb that is ready to burst, after seven years of near-zero interest rates and speculative excesses in bonds, stocks and real estate. The Federal Reserve has dealt with the bursting of every asset bubble of the last 20 years by creating another, larger bubble.

They also warn that the quantitative easing policy of recent years may shift to a worse policy of government debt monetization.

Although central banks have made it very clear that large-scale government bond purchases are a temporary measure taken for monetary policy reasons, they are slipping into a different concept – that of a permanent intervention of central banks in government bond markets.

This is seen as a way to solve the sovereign debt crisis in major advanced economies, by transferring a growing part of government debt to the central bank: 43% of G7 government bonds in major reserve currencies are now held by central banks and other public entities. G7 central banks are at risk of heading towards the slippery slope which ultimately leads to government debt monetization.

G7 central banks at the crossroads

The G7 central banks are facing a dilemma, Dittus and Hannoun point out. They have to choose between highly risky scenarios: policy normalization or government debt monetization?

For the time being, the Federal Reserve and the Bank of Canada are leaning towards normalization, albeit at a slow pace, while the European Central

Bank and the Bank of Japan are dangerously heading towards a continuation in one way or another of the debt monetization experiment.

Here is the dilemma: policy normalization is the only option consistent with the central banks' mandate and with a return to the rules of a market economy. But when the G7 central banks eventually exit from their unconventional policies, they will contribute to the bursting of the asset price bubbles engendered by their monetary experiment. This could well be the worst financial crisis ever experienced, as the level of debt and the artificial level of asset prices have no precedent.

But an even worse systemic crisis would result from the continuation of current unconventional policies leading central banks to cross the rubicon of government debt monetization. The perpetuation of these policies, with their zero or negative interest rates and large-scale purchases of government debt, would encourage fiscal deficits and the continued expansion of public debt.

Public debt monetization, through the transfer of ever more government bonds on G7 central banks' balance sheets, would destroy the market economy as it would pave the way for an unlimited expansion of the public sector, say the authors.

The above shows why the former BIS officials believe a new financial crisis is brewing. Changing the recent policy will lead to an explosion, but continuing with the same policy while buying time will lead to an even bigger crisis.

Impact on developing countries

Their analysis of the crisis in the G7 countries matches that of Yilmaz Akyuz, the South Centre's chief economist and author of the book *Playing with Fire*.

Akyuz goes further, in analyzing the impact a global crisis will have on developing countries. Since the 2009 global crisis, the developing countries have built up new and increased vulnerabilities to global financial shocks. Their financial sector has established even more and deeper links to international financial markets, as shown, for example, by the high percentage of ownership by foreign funds and investors in the domestic stock markets and in government bonds of developing countries.

Therefore, if there is a significant or

big outflow of these foreign funds, the same economies may suffer from loss of foreign reserves, currency depreciation, higher external debt servicing, higher import prices, falling prices of houses and equities and, in worse cases, an external debt crisis.

A few developing countries are already facing crisis and seeking IMF bailouts.

Many developing countries still have strong economic fundamentals. But in many cases, their economies are weakening in one way or another, and the worsening global economic prospects (including the real possibility of a trade war) do not augur well. The conditions for an external debt problem have increased.

It would thus be wise for them to

monitor and analyze what is happening globally, as this will significantly affect the economy. Scenarios should be established on what may happen externally, including the onset of a new global crisis, and how this may affect the economy in various ways, so as to prepare for various measures that can be taken.

Crisis prevention and crisis aversion should now be a priority. Dealing with the domestic economic issues should go together with preparations to cope with changing external situations.

Though we may not be able to control what happens abroad, we can take measures to respond appropriately. □

Martin Khor is adviser to the Third World Network and former Executive Director of the South Centre.

IMF to muddle through crisis again?

By failing to establish an orderly and equitable system of crisis resolution, the IMF may very well find its role significantly diminished in managing the next bout of financial crises in emerging economies.

by Yilmaz Akyuz

It is now more than a decade and a half since the last severe currency crisis in a major emerging economy – that was in Argentina in 2001–02 following a series of crises in Russia, Turkey and Brazil.

It is now common knowledge that such crises generally occur when countries fail to manage surges in capital inflows so as to prevent build-up of fragility including currency appreciations, large and persistent current account deficits, increased leverage and currency and maturity mismatches in balance sheets.

The absence of a major crisis in the Global South since the early years of the new millennium owes not so much to judicious management of the surge in capital inflows that had begun in the early 2000s and continued with full force after the global financial crisis, as to persistently benign global financial conditions resulting from exceptional monetary policies in the US, Europe and elsewhere in advanced economies and favourable global risk appetite.

Even though there has been no fundamental reversal of these policies, the arrival of a Minsky moment appears to be imminent, with markets, in expectation of normalization of monetary policy in the US, getting nervous about the risks

they have taken by investing heavily in emerging economies with poor economic fundamentals in search of yield in conditions of low global interest rates and ample supply of liquidity.

The first serious signs have appeared in Argentina with the recently elected government of President Mauricio Macri knocking on the doors of the International Monetary Fund (IMF). But Argentina is perhaps only the tip of an iceberg. Several other emerging economies are equally or even more susceptible to sudden stops and reversals of capital flows and currency and balance-of-payments crises.

IMF approach to crisis management

In typical IMF interventions in previous crises, liquidity support was provided mainly to keep debtor countries current on their payments to international creditors and to maintain an open capital account. As a result, obligations to private creditors were translated into debt to the IMF. Simultaneously, austerity was imposed on debtors by means of hikes in domestic interest rates, fiscal retrenchment, and cuts in employment, wages and pensions in order to achieve

a sharp turnaround in the current account, primarily through import compression, and to restore confidence among international creditors and investors.

This approach to crisis management was widely criticized on several grounds. A strong case was made that the combination of debtor austerity and creditor bailout would lead to inequality between debtors and creditors in the incidence of the burden of the crisis, create moral hazard by allowing creditors to avoid the full consequences of the risks they have taken and are paid for, and endanger the financial integrity of the Fund.

Inequalities could also be created among creditors; in the event of a default and restructuring, those who exit first could escape without haircut, leaving the others to take the full brunt of debt write-offs. Profit opportunities are also created for vulture funds at the expense of genuine creditors as well as the debtor, as seen in the case of Argentina.

Considerable scepticism was also expressed within the Fund about the wisdom of using public money to bail out private creditors and investors. During the earlier episodes of crisis, the IMF Board recognized the need for involving the private sector in forestalling and resolving financial crises, but insisted on voluntary mechanisms, notably collective action clauses (CACs) and automatic rollover clauses in debt contracts and informal negotiations between debtors and creditors.

However, as these proved ineffective and some advanced economies started to oppose bailouts, the IMF Board agreed that in extreme circumstances, if it is not possible to reach agreement on a voluntary standstill, members may find it necessary, as a last resort, to impose one unilaterally, and that since there could be a risk that this action would trigger capital outflows, a member would need to consider whether it might be necessary to resort to the introduction of more comprehensive exchange or capital controls.

No protection against litigation was offered, but it was suggested that the Fund could signal its acceptance of a standstill imposed by a member by lending into arrears to private creditors.

The Fund staff went further and proposed a formal Sovereign Debt Restructuring Mechanism (SDRM) to facilitate sovereign bond workouts. However, this did not elicit adequate support and had

to be abandoned. The issue was soon forgotten with a rapid recovery of capital inflows to emerging economies and bounce-back of economic activity in crisis-hit countries.

However, private sector involvement in crisis resolution was back on the agenda again with the onset of the eurozone crisis. The Fund turned its attention to sovereign debt restructuring after misjudging the sustainability of the Greek debt, very much in the same way as it had done with Argentina about a decade earlier, pouring in money to bail out private creditors.

It restarted seeking ways and means for involving the private sector in crisis resolution so as to "limit the risk that Fund resources will simply be used to bail out private creditors" and to ensure that private creditors made some concessions and took some losses on their holdings as a condition for Fund lending.

Subsequently it was suggested that the sovereign approaching the Fund for assistance be asked to find ways of rolling over all bonds and commercial loans falling due within the life of the Fund programme. This would be necessary whether external payments difficulties are perceived to be of liquidity or solvency, which is often difficult to identify with a reasonable degree of precision *ex ante*.

This so-called "re-profiling" was again to be market-based and voluntary. However, no statutory mechanism was proposed for bailing in the private creditors in the event of failure of a voluntary agreement. In such an event, as long as the IMF stood firm in refusing lending without private sector involvement, the debtor would have had no option but to impose unilateral standstills on its obligations to private creditors, but without any statutory protection against litigation. Although various proposals were made outside the Fund to address the holdout problem and protect debtors against litigation, the matter was once again put aside without being resolved.

Potential for crisis

The stakes are now getting higher because of massive amounts of external liabilities that emerging economies built up in the past 10 years. These are not only in debt contracted in reserve currencies, notably by private corporations, but also unprecedented amounts of foreign hold-

ings in local deposit, bond and equity markets.

Furthermore, most emerging economies have eliminated or significantly reduced restrictions over capital outflows by residents.

Consequently, exit of non-residents from local markets and capital flight by residents now constitute bigger sources of potential drain on reserves of emerging economies than external debt contracted in reserve currencies.

Emerging economies are widely commended for the large amounts of international reserves they have accumulated in the new millennium. However, in the large majority of cases these came from capital inflows rather than current account surpluses.

Cumulatively, all G20 emerging economies except China and Russia have registered current account deficits since the beginning of the millennium, at a total amount of some \$2 trillion, while their external liabilities have increased by over \$4 trillion.

Reserves accumulated are less than a quarter of the increase in total liabilities while the rest of capital inflows (new liabilities) has been used for financing current account deficits or private acquisition of assets abroad – assets that would not necessarily return at times of interruption and reversal of non-resident capital inflows.

As of end 2016, on average, the reserves of deficit G20 emerging economies were less than one-third of their total non-FDI external liabilities including debt issued internationally and non-resident holdings in local deposits, bonds and equities.

In many cases these holdings plus short-term forex debt reach or exceed international reserves. In most cases reserves would be totally inadequate to provide a reliable buffer against a generalized exit of non-residents and widespread capital flight by residents.

Limited options

Given the dismal record of the IMF in crisis intervention and management, many emerging economies are loath to go back to the Fund in the event of a severe currency and liquidity crisis, except those such as Argentina whose neoliberal policies are strongly supported by the IMF.

In any case, at some \$800 billion, the

lending capacity of the IMF would be too small to take on the task. The level of liquidity that may be needed by many emerging economies in the event of capital reversals exceeds by a large margin what the IMF could provide under exceptional financing.

Most emerging economies would also be highly reluctant to resort to unilateral debt standstills and exchange controls in view of their exposure to creditor litigation and chronic dependence on international lenders and investors.

On the other hand, not much relief could be expected from South-South multilateral arrangements for liquidity provision, notably the Chiang Mai Initiative Multilateralization (CMIM) of East Asian countries and the Contingent Reserve Arrangement (CRA) of the BRICS grouping.

These are not only small in size but also have design problems. The CMIM has never been called upon, even during the global crisis. It does not include a common fund but a series of promises to provide liquidity, with each country reserving the right not to contribute to the specific request by a member. Its size is \$240 billion and access beyond 30% of quotas is tied to an IMF programme.

The CRA is also designed to complement rather than substitute the existing IMF facilities. Its size is even smaller, \$100 billion, and access beyond 30% is also tied to the conclusion of an IMF programme. Thus, these regional arrangements do not provide escape from IMF conditionality and surveillance.

That leaves bilateral swaps among central banks and bilateral lending by governments of reserve-currency countries, notably the US, and surplus emerging economies with ample international reserves such as China.

A very large part of bilateral swaps established by the US Federal Reserve is with other advanced economies. Those with emerging economies (Brazil and Mexico) are too small to provide much relief. In the words of former chair of the US Federal Reserve Janet Yellen, expanding the swap lines to serve as a safety net for countries encountering balance-of-payments pressures is not within the Fed's mandate and therefore is a complete non-starter.

China has swaps with over 30 countries. But these are mostly with advanced economies and designed to support trade and investment and to promote the in-

ternational use of the renminbi rather than boost reserves.

To sum up, as recognized by the IMF, the global financial safety net including international reserves, Fund resources, bilateral swap arrangements and regional financing arrangements is "fragmented with uneven coverage" and "too costly, unreliable and conducive to moral hazard".

Given the aversion of emerging economies to the IMF and unilateral debt standstills and exchange controls, the next crisis is likely to be even messier than the previous ones. Some countries may seek and succeed in getting bilateral support from China or some reserve-currency countries according to their political stance and affiliation. For instance, one of the most vulnerable emerging economies, Turkey, is likely to ap-

proach China, Russia or some Gulf states with strong reserve positions rather than the IMF if its currency goes into a freefall. In such cases, crisis intervention would become even more politicized than in the past and a lot less reliant on multilateral arrangements.

By failing to establish an orderly and equitable system of crisis resolution, the IMF may very well find its role significantly diminished in the management of the next bout of crises in emerging economies. In other words, multilateralism, however imperfect, could face another blow in the sphere of finance after trade. (IPS) □

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that affects only the poorest members of society, who pay the vast majority of such penalties. Driving licences are also commonly suspended for a wide range of non-driving-related offences, such as a failure to pay fines. "This is a perfect way to ensure that the poor, living in communities that have steadfastly refused to invest in serious public transport systems, are unable to earn a living that might have helped to pay the outstanding debt," said the rights expert.

Another practice that affects the poor almost exclusively is that of setting large bail bonds for a defendant who seeks to go free pending trial. Some 11 million people are admitted to local jails annually, and on any given day more than 730,000 people are being held, of whom almost two-thirds are awaiting trial and thus presumed to be innocent. Yet judges have increasingly set large bail amounts, which means that wealthy defendants can secure their freedom while poor defendants are likely to stay in jail, with severe consequences such as loss of jobs, disruption of childcare, inability to pay rent and deeper destitution.

The Special Rapporteur also found that the United States remains a chronically segregated society. Blacks are 2.5 times more likely than Whites to be living in poverty, their infant mortality rate is 2.3 times that of Whites, their unem-

ployment rate is more than double that for Whites, they typically earn only 82.5 cents for every dollar earned by a White counterpart, their household earnings are on average well under two-thirds of those of their White equivalents, and their incarceration rates are 6.4 times higher than those of Whites.

"These shameful statistics can only be explained by long-standing structural discrimination on the basis of race, reflecting the enduring legacy of slavery," he said.

"Ironically, politicians and mainstream media portrayals distort this situation in order to suggest that poverty in America is overwhelmingly Black, thereby triggering a range of racist responses and encouraging Whites to see poverty as a question of race." Too often the loaded and inaccurate message that parts of the media want to convey is "lazy Blacks sponge off hardworking Whites".

The report also noted that indigenous peoples, as a group, suffer disproportionately from multi-dimensional poverty and social exclusion. The 2016 poverty rate among American Indian and Alaska Native peoples was 26.2%, the highest among all ethnic groups.

Indigenous peoples also have the highest unemployment rate of any ethnic group: 12% in 2016, compared with the national average of 5.8%. One in four indigenous young people aged 16 to 24 are neither enrolled in school nor working, it said. (SUNS8696) □