STRATEGY SESSION 3 - Linking Illegitimate Debt to Other Critical Issues

The 2007 Financial Crisis – lessons and opportunities for the illegitimate debt movement

Discussion Paper and Proposals

In Northern countries the financial crisis and likely economic recession are major topics among citizens, journalists and politicians. Both the causes of the crisis and its consequences are of interest to debt campaigners. They offer insights into the inequity and instability of the world economy and an opportunity to mobilise to create major change. However private banks and others are diverting blame away from themselves and the free market policies they promoted and trying to ensure that nothing is done.

Big bailouts

The financial crisis is caused – in large measure – by the speculative lending of private banks and investment houses. They have invented ever more complex financial arrangements which make it hard even for them to understand where liabilities lie. Because they misunderstood their own balance sheets or took too many risks several U.S. and European banks have gone bust and had to be taken over by rivals or bailed out. In other words they obtained debt relief – paid for and/or orchestrated by the state.

They argue that they these bailouts are necessary to prevent 'systemic risk' which will make everyone suffer further. However the trillions of dollars that have been pumped into the finance system in the form of bailouts and cheap credit lines since August 2007 have not succeeded in refloating the financial system – credit is still very tight and consumers are feeling the pinch. Many more people now realise that there is one law for the rich (in 2006, the world's top-paid 25 hedge fund managers earned more than $14 billion between them) and another for the poor. For example low-income families are having their houses repossessed (up to 2 million US families are at risk and a projected 45,000 homes in the UK will be taken back by the banks this year) at the same time as the banks themselves are getting bailouts. Large financial companies have lost around $500 billion from risky housing loans, but they are mainly surviving intact.

Amount	Bailout operation
£26 billion	Bank of England loan to private bank Northern Rock (UK)
€17 billion	Sachsen LB investments transferred off balance sheet with a regional state guarantee (Germany).

What banks did wrong

Private sector financiers have evolved new investment vehicles such as private equity companies and hedge funds that are designed to maximise profits while minimising risks for the investor. Their roles include commodity price and currency speculation and corporate asset stripping at the expense of workers and the environment. These funds operate in a highly leveraged manner – i.e. they take on debt at a large multiple of their own stake. They retain rights to profits generated but spread risk through new corporate entities called Special Investment Vehicles. These slice up the debt through a process known as securitisation. Some such investments (resulting from mortgage loans to low-income families in the USA) have become impossible to value during the last year, adding to the major uncertainties about the banking system and making banks reluctant to lend to each other, let alone anyone else.

The International Trade Union Confederation commented last year: "private equity funds have developed extreme forms of financialisation beyond the scrutiny of public stock markets, while hedge funds have invented new ways of speculating in everything related to the world of finance". Banks introduced these mechanisms to increase the amount of money they had available to loan.

This apparently easy credit caused asset bubbles (for example in housing) and increased economic concentration (for example more banking mergers). It also enabled many individuals to get into huge personal debts (in 2007, US consumers owed $920 billion in credit card debt). Now the easy credit is no longer there, some of the asset bubbles have burst – i.e. house prices are falling. Some argue indeed that it is the sudden absence of easy credit (and the associated interest rate rises) which are the main cause of the real economy slowing down.

A major reason for introducing these vehicles has been "to devise ways to make money by evading regulations; by extending the process of commodification (derivatives have enabled virtually everything – from weather to bandwidth and risk – to be priced, bought and sold); and by devising elaborate new financial vehicles through which they have been able to dump their 'risks' onto less informed retail clients (for example, pension holders) or onto the State, whilst ring-fencing their own profits from liabilities", according to a forthcoming paper by UK activist Nick Hildyard. He continues that the new corporate structures "have bypassed many of the obstacles that previously stood in the way of the private sector's long-term investment in – and expansion into – the development of hospitals, roads, water distribution and other utilities, with major implications for corporate control of areas that profoundly affect public welfare".

There is a lot of anger among the publics in countries affected by the "credit crunch", some of which could – if alliances are well-made – be channeled into thinking about the legitimacy of international debts and about the international economic order. It is unclear how the credit crunch is going to play out internationally – most Southern countries are not reporting major impacts so far (as they are now considered 'safer' than many Northern ones). But this can change according to market sentiment, and interest rate rises may put major pressure on debt repayments by governments, banks, other companies, and individuals.

Political lessons

Many Northern debt campaigns have (following their Southern colleagues) been shifting their focus in recent years. This shift includes situating their debt work in a broader analysis of South-North financial flows and of problems in the global financial system. Experts estimate that every year $500 - $800 billion leave Southern countries due to criminal activities, tax evasion, and corruption. South-North financial flows are several times larger than annual aid flows ($90 billion), foreign direct investment to the South ($240 billion) and migrant remittances. Researchers Boyce and Ndikumana point out the links between debt and capital flight: "foreign debt can cause capital flight by contributing to an increased likelihood of a debt crisis, worsening macroeconomic conditions and the deterioration of the investment climate". But clearly a large part of the blame for capital flight is with Northern countries which allow the creation of tax havens and of corporate structures which enable tax evasion and rapid capital movement.

The credit crisis – at least in the North – gives an opportunity for debt campaigners to go further in this systemic analysis. This includes pointing out what is wrong with current financial policies, exposing the corporate lobbies who have the major influence, and propose new measures to re-regulate in favour of the majority. The parliamentary measures and other official actions undertaken in the USA, France and Belgium against vulture funds – a particular case of private sector profiteering, shows the potential.

The crisis offers excellent opportunities to make the links between sovereign debt, commercial debt and individual private debt. Through these links new alliances can be formed, for example with trade unions or consumer protection groups. Interesting law cases are likely to emerge – for example about banks mis-selling mortgages to low-income customers while omitting to emphasise the unaffordable interest rate rises after two years. These may set precedents for other challenges on international sovereign loans.

The political and public opinion climates are ripe for broader work by debt activists including to promote more responsible lending frameworks, laws and regulations both nationally and internationally. If we play it right we can be at the centre of the greatest public and political push back against financial liberalisation and speculation that has occurred for two generations. If we and others do not mobilise successfully we will see ever greater speculation and corresponding indebtedness (including in sectors such as land, food and carbon) which will intensify inequalities and lead to ever greater economic, social and political instability).