

The Impact of Finance on the European Social Models

Paper for the Transform conference in Stockholm, 13./14. June, 2008

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1. Introduction

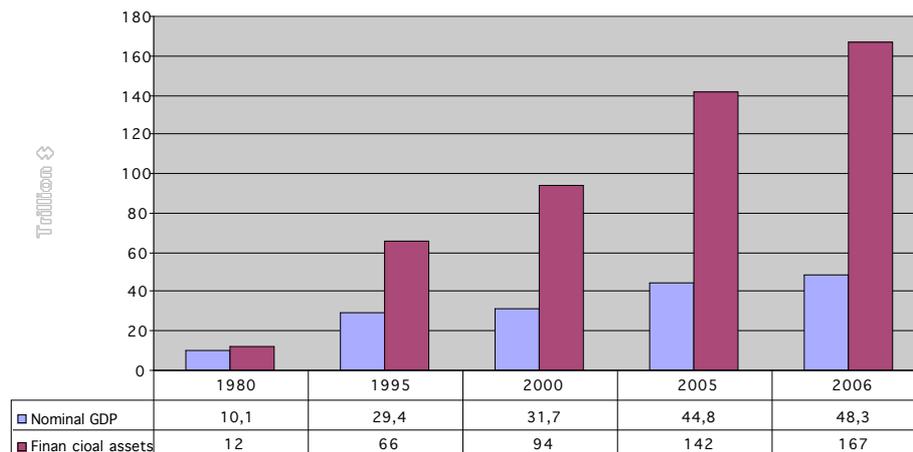
The purpose of this paper is to present some empirical data (section 2) and a conceptual framework (3) for the development of finance during the last three decades, to shed some light upon the main groups of financial investors as the central actors in finance-led capitalism (4) and to show how their strategies affect economic stability, corporate governance and economic policy in Europe (5); finally, to make some brief remarks on the perspectives for resistance against and alternatives to the transformation of the various social models in Europe into one increasingly uniform neo-liberal pattern under the pressure of finance.

2. Private financial accumulation and internationalisation – Mega-trends and their causes

Mega-trends in finance: Accumulation and internationalisation of private financial assets

The increasing role of global financial markets follows from two long-term mega-trends: The first is the extraordinary *growth of private financial stocks (WFS)* – equities, corporate and government debt securities, and bank deposits - over the last quarter of a century. Their amount rose from \$ 12 trn. in 1980 to \$ 167 trn. in 2006, i.e. by the factor 14. In comparison during the same time global Gross Domestic Product (GDP) grew from \$ 10 trn. to \$ 48 trn, the factor is 4,8. In 1980 nominal GDP and WFS were of about the same size, by 2006 the latter had become three and a half times larger than the former.

Figure 1: Development of nominal GDP and financial stocks world-wide, 1980-2006

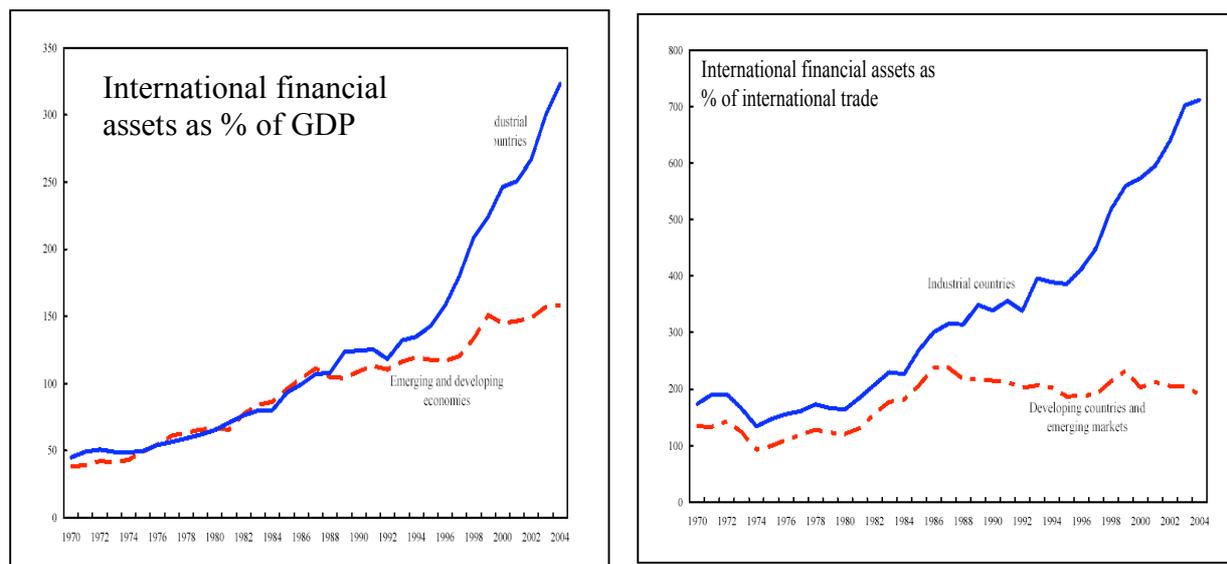


Source, Farrell/Fölsater/Lund 2008, S.3

The second mega-trend is the *internationalisation* of financial assets, which also developed much faster than global GDP. – and than international trade.(See figure 2)

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Figure 2: Internationalisation of Financial Markets



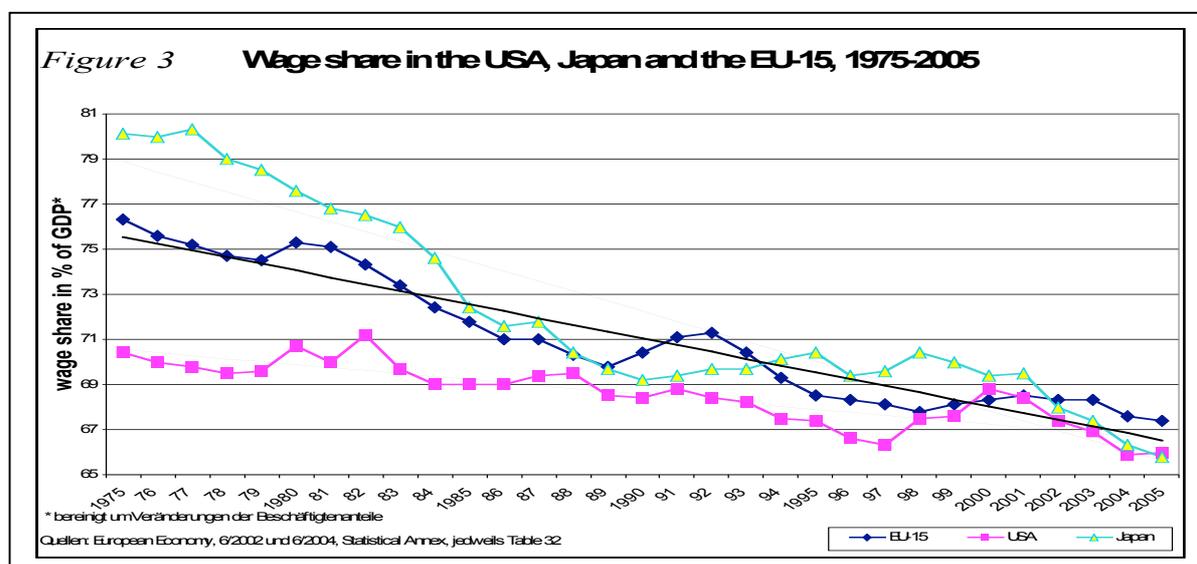
Source: Lane/Milesi-Ferretti 2006: 35

During the 1970s the amount of internationally invested financial stocks corresponded to 50% - 70% of worldwide GDP, at the beginning of the current decade this ratio had risen to about 320% for industrial countries and to about 150% for developing countries and emerging markets. The ratio of internationalised financial assets to international trade was about 180% in 1970 and about 700% in 2004 for the developed world and it rose from ca. 140% to about 180% in the developing countries. (see: Lane et al. 2004: 35)

There are mainly *four reasons* for these mega-trends

The *first* and probably most important one is the almost continuous redistribution of income and wealth from the bottom to the top, clearly reflected in the falling wage share (see figure 3) in the three centres of capitalism : from 1975 to 2006 it fell by four percentage points (from 70,4 % to 66,3 %) in the USA, by ten percentage points (from 76,3 % to 66,2 %) in the EU-15 and by 15,6 percentage points (from 80,1 % to 64,5 %) in Japan.

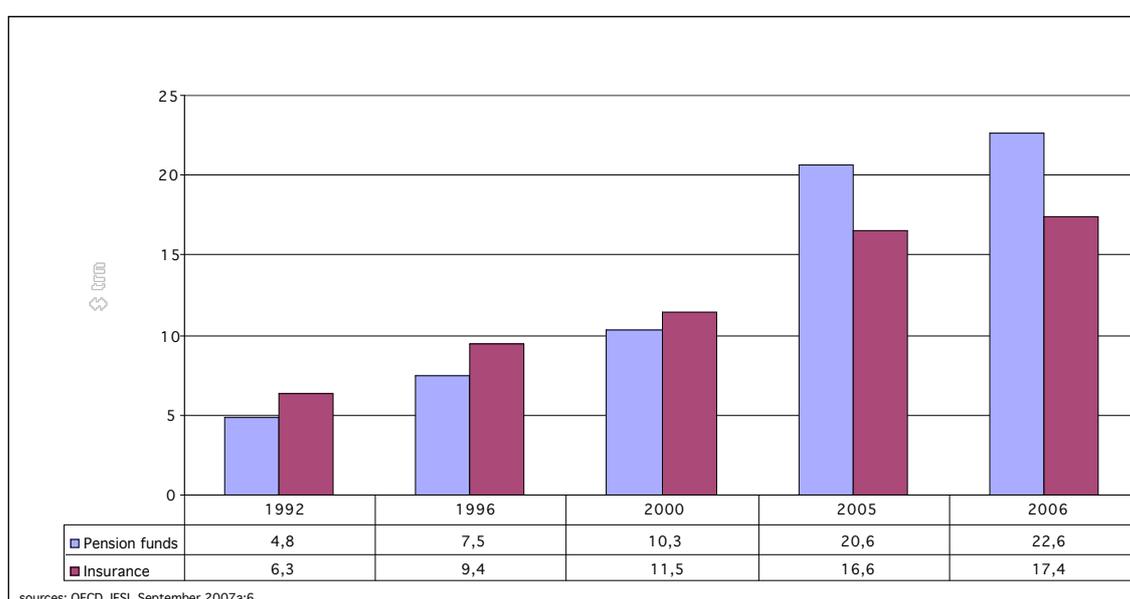
Figure 3: Background 1: Redistribution to the top



This has led, on the one hand, to a massive concentration of financial wealth with a small group of individuals and firms and, on the other hand, to a lagging behind of salaries and wages and private consumption, and, as a consequence, to a slow-down in economic growth as a result of weak final demand.

The *second* background for the growth of financial assets is the trend towards capital funded pension systems. While these have been the dominant systems in the USA and the United Kingdom and in some smaller countries since long time, it was only in the last quarter of the century that the public PAYGO systems, which were prevalent in most other countries came under attack by financial institutions like the World Bank and the OECD. This thrust for “pension reform” channelled a larger part of pension contributions to the capital markets, where they were managed by pension funds and insurance companies. At the end of 2006, assets in pension funds (\$ 22,6 trillions) were almost five times higher than in 1992 (\$ 4,8 trillions) (figure 4)

Figure 4: Background 2: Financial assets in pension funds and insurance, 1992-2006



A *third reason* for the build-up of financial assets was the relatively generous loan policy of banks. Although credit developed in clear waves along the business cycles, its overall extension was stronger than the overall growth of GDP.

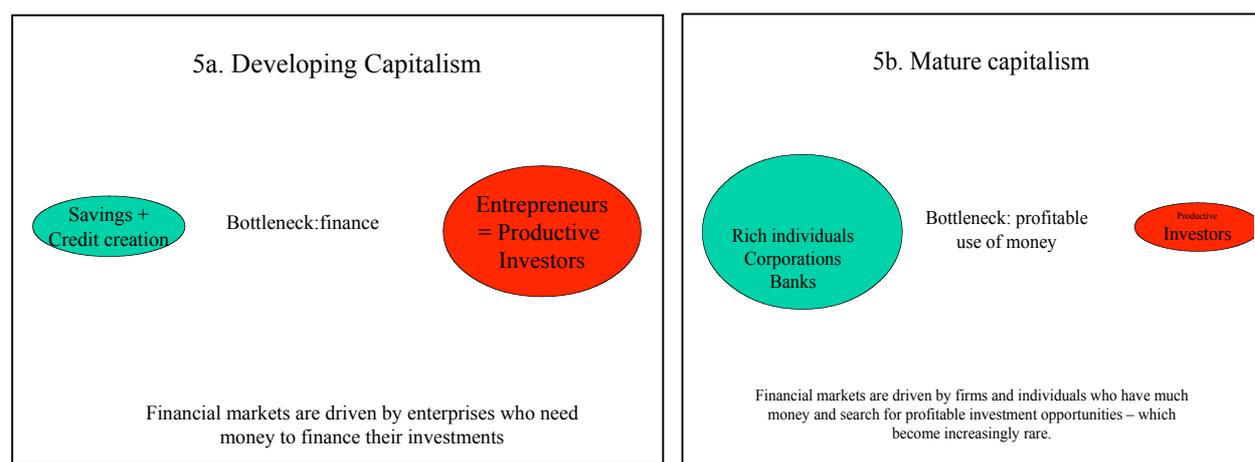
The *fourth factor* relates to the dynamic internationalisation of financial flows and investments. These could obviously not have happened without the shift of the regime of capital controls prevalent in the Bretton Woods world to a regime of *liberalisation of capital movements* since the mid-1970s.

These four factors which determined the thrust for the explosive growth and globalisation of finance were not a reflection of the “iron laws” and an inevitable “logic of capital”. Rather they were the result of changing social power relations (wage share) and political decisions (pension reform and liberalisation of capital accounts) which in turn were responses to economic and political difficulties and pressures

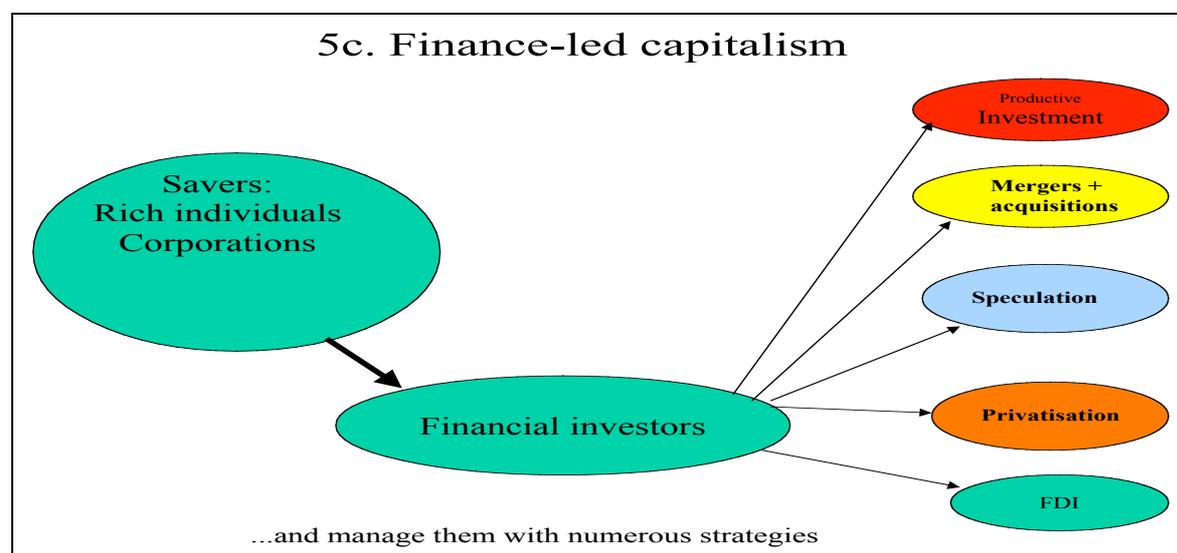
3. Finance-led capitalism – conceptualisation of a new configuration

The extraordinary long-term accumulation and internationalisation of private financial assets has started to change the quantitative proportions between the financial and the productive sectors of the economies, and as a consequence the relationship between the driving actors and bottlenecks of capitalist development towards a more finance-driven pattern. (fig 5a-c).

Figure 5a-5c: The changing role of financial markets: from finance for investment to financial investment



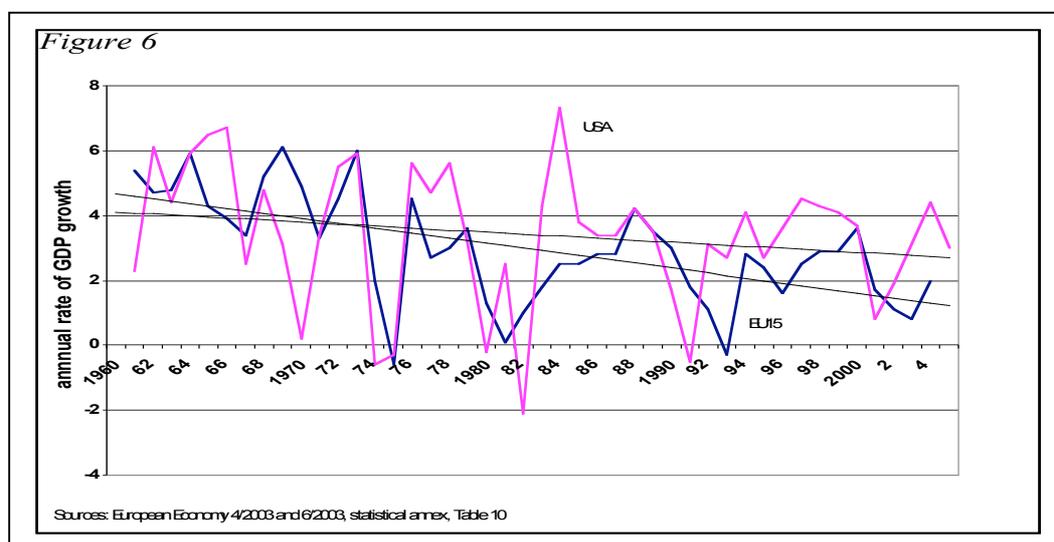
In the traditional pattern of capitalism the driving actors were individual *entrepreneurs* or corporate *managers* whose work was concentrated on the production and sales side of their companies. Finance was a bottleneck for corporate investment and economic development. (see figure 5a). This bottleneck was overcome not only through household saving but also and primarily through credit creation by the banking sector which was politically supported by the central banks. By contrast, in mature capitalist economies we have an abundance of financial assets for which profitable investment opportunities are becoming increasingly scarce (see figure 5b) - while at the same time credit creation continues at large scale as the source of profits for the banking sector. Under these circumstances of financial over-accumulation *financial investors* replace the individual entrepreneur or corporate manager as the leading actor. They collect and centralise large amounts of money from the ultimate asset owners and invest them in a broad range of activities of which production of goods and services is only one option. Capitalism becomes *finance-led capitalism*, at least in the developed centres. Privatisation is one prominent outlet for excessive capital (others are speculation, mergers and acquisitions, FDI et al.). (figure 5c)



The gradual emergence of this new configuration of markets and actors does not change the basic nature of capital, which is the exploitation of labour via the production of surplus value and its appropriation as profits on capital. The new group of capitalists – originally a service industry for the management and enhancement of financial assets – is much further away from the concrete production process than the traditional entrepreneur has been and also much further than the technocratic management of large industrial or service corporations. In this perspective one could say that finance-led capitalism is a further real mystification of the nature of capital: It eliminates all intermediate steps between money and more money ($G - G'$) as the purpose of capital, whereas capitalist manufacturing still follows the visible formula $G - C \leftarrow P \rightarrow C' - G'$

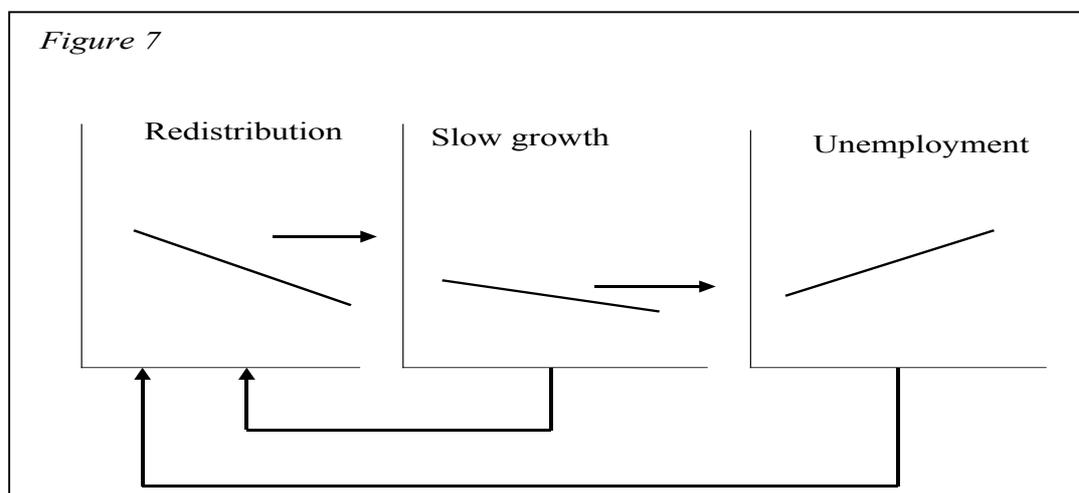
The rise of finance-led capitalism has been accompanied by a long-term slow-down of economic growth, at least compared to the growth rates of the post-war quarter of a century. (see figure 6).

Figure 6: growth in the EU-15 and in the USA, 1960-2005



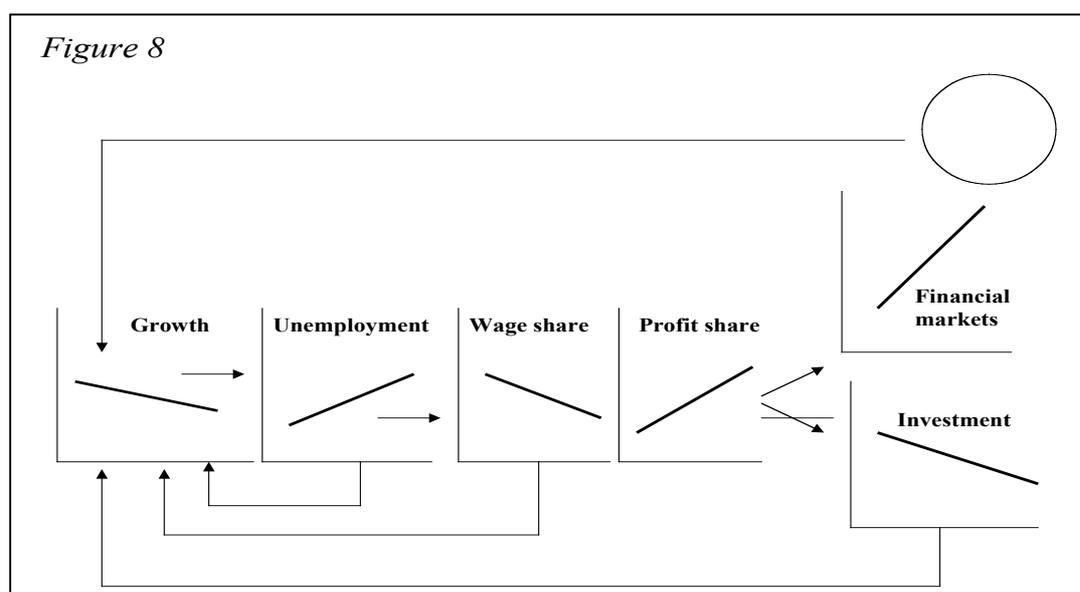
With the continuous rise of profits in spite of slower growth a vicious circle of low growth, rising unemployment or precarious employment and further upwards redistribution developed. (see figure 7).

Figure 7: Vicious circle: redistribution, slow growth, unemployment



This pattern in turn fuels the strong growth of financial markets. Profits and high incomes are not completely used for consumption – at least beyond a certain point of luxury consumption – or for productive investment – because there is no market for additional final goods and services. Instead these resources are invested on the financial markets. Periodically they can temporarily boost economic growth through massive financial speculation. But when the speculative bubbles burst there will be massive negative effects upon growth, employment and the social welfare of the majority of people. (see figure 8)

Figure 8: Consequences of slow growth and redistribution – strong growth of financial markets

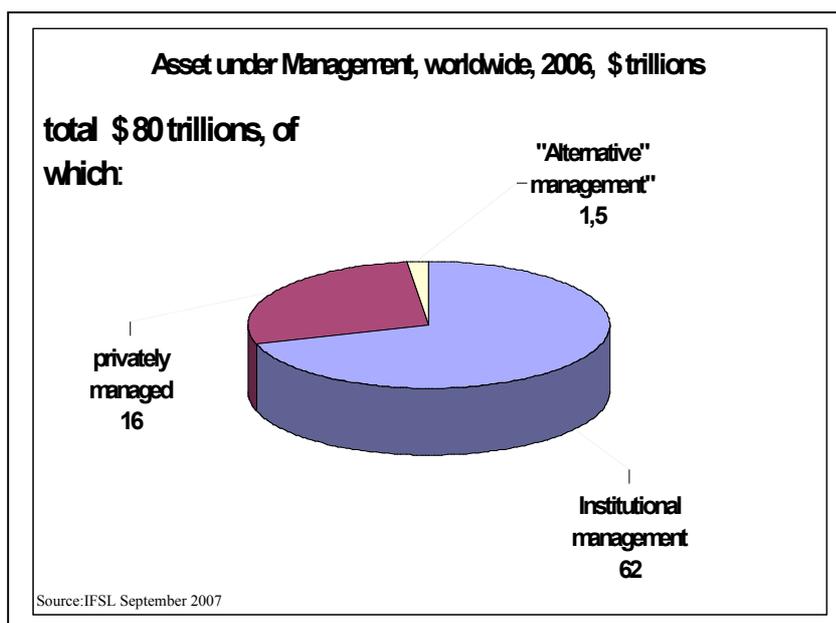


The transition to this pattern of finance-led capitalism is a gradual process which has started 30 years ago and is by no means terminated. It should be regarded on the one hand as a roll-back against the success and achievements of progressive reform-policies in the two decades after World War II, and, on the other hand, as a new form of over-accumulation of capital as an alternative to the traditional form of over-accumulation. Whereas the latter has materialised in manifest overcapacity (or under-utilisation of existing capacities) in the productive sector it is now increasingly reflected in the accumulation of capital which is not invested in the productive sector but in the financial sector.

3. Financial investors – the central actors in contemporary capitalism

More detailed figures than those which McKinsey has provided (see figure 1) are available not for all \$167 trillions financial stock but only for private assets under professional management. The total amount of these assets reached about \$ 80 trillions at the end of 2006. More than three quarters (\$ 62 trillions) were managed by institutional investors, one fifth was privately managed (by banks or endowments, foundations etc.) and 2% by “alternative” investments i.e. hedge funds and private equity. (IFSL 2007a: 6)

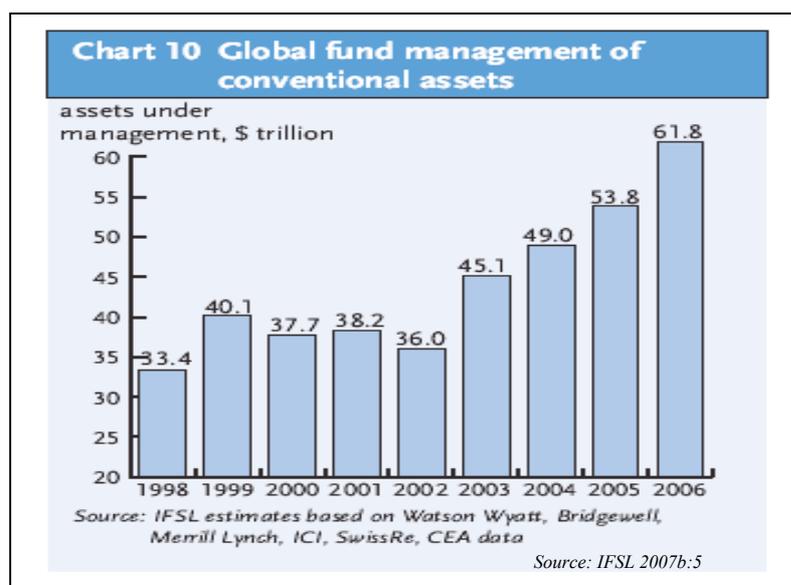
Figure 9: Assets under management worldwide, end 2006



Institutional Investors: Pension funds and privatisation of pension systems

Institutional investors are by far the most important traditional form of financial investors. In the last 26 years the assets under management by institutional investors rose from \$ 2,9 trillions in 1980 to 62 trillions in 2006, i.e. by a factor of 21. In the last four years assets under institutional or “conventional” management increased by \$ 26 trillions. They are now 50% higher than at the peak of the latest financial market boom.(figure 11)

Figure 10: Global fund management of conventional assets



Institutional Investors are subdivided in three large groups: investment (or mutual) funds, insurance and pension funds. The group with most funds is pension funds (\$ 23 trillions.), followed by investment funds (\$ 22 trillions.) and insurance (\$ 17 trillions.). The structure of

institutional investors differs strongly across countries: While in France only 3,5% and in Germany only 5,7 % of all conventionally managed funds are in pension funds, this category covers 60,6% of all institutional assets in the Netherlands, 49,2% in the USA and 34,1% in the UK. In Germany more than three quarters of assets (77,5%) are managed by insurance companies, which in the USA account only for less than one fifth (18,6%). (see table 1).

	Pension funds		Insurance assets		Mutual funds		Total		
	trns.\$	%	trns. \$	%	trns. \$	%	trns.\$	%	% of total
US	15,893	49,2	6,012	18,6	10,414	32,2	32,319	100	52,3
Japan	1,16	27,4	2,49	58,9	0,579	13,7	4,229	100	6,8
UK	1,686	34,1	2,469	50,0	0,787	15,9	4,942	100	8,0
France	0,133	3,5	1,863	49,5	1,769	47,0	3,765	100	6,1
Germany	0,116	5,7	1,571	77,5	0,34	16,8	2,027	100	3,3
Netherlands	0,827	60,6	0,428	31,4	0,109	8,0	1,364	100	2,2
Switzerland	0,456	46,3	0,368	37,4	0,16	16,2	0,985	100	1,6
Other	2,376	19,5	2,19	18,0	7,607	62,5	12,174	100	19,7
Total	22,648	36,6	17,392	28,1	21,765	35,2	61,804	100	100

source: IFSL 2007b: 6

The industry is rather concentrated: The four largest firms have each more than \$ 1 trillion under management and the ten largest manage 17% of total funds. (see table 2)

Table 2: Largest global investment managers, end 2006

Nr.	Name	Country	assets
1	Barclays Global Investors	UK	1 623
2	State Street Global Advisers	US	1 534
3	Fidelity Investments	US	1 300
4	The Vanguard Group	US	1 050
5	JP Morgan Asset Management	US	898
6	Capital Res. And Management	US	850
7	ING Investment Management	NL	694
8	Deutsche Asset Management	DE	662
9	UBS Global Asset Management	CH	658
10	Credit Agricole Asset Management	FR	642
11	PIMCO Allianz Global Investment	DE	642
12	Northern Trust Global Investors	US	640
13	AllianceBernstein L.P.	US	625
14	Axa Investment Managers	FR	579
15	Prudential Investment Management	US	568

Source: IFSL 2007b: 6

The largest group of institutional investors, pension funds, is directly linked to the structure and changes in pension systems. While in a few countries like the US and the UK pension systems have traditionally been based mostly on private capital stocks, most other countries have seen strong efforts for pension reforms with the aim to complement or substitute the traditional public PAYGO pension systems through private capital funded systems. This thrust for the (at least partial) privatisation of public pension systems is a worldwide phenomenon, starting already in the 1970s in Latin America; the first changes took place in Chile immedi-

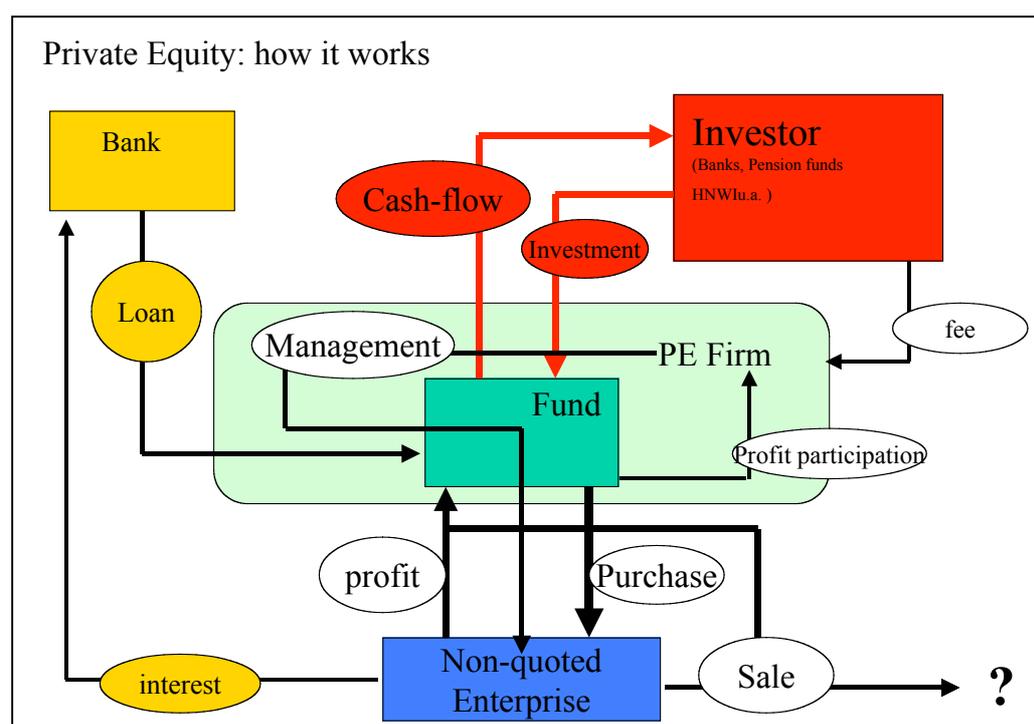
ately after the coup d'état of general Pinochet in 1973. It received a further strong push and support through international financial institutions like World Bank and OECD and reached continental Europe – East and West – in the 1990s. The strong growth of pension funds during the last decade cannot be explained by the development of the traditionally private systems - the comparatively slow macroeconomic growth, even slower wage development and high unemployment had also a moderating effect on the development of individual contributions to pension funds – but they are the result of the privatisation of increasing parts of pension systems. This has been in the interest of pension funds (and of insurance companies), which are – in Europe more than in the US - in many cases managed by off-springs of large financial corporations like Barclays, ING, Allianz, Axa, Deutsche Bank, UBS etc.

Institutional investors have developed rather steadily during the last 25 years. But since the beginning of the current their assets have massively increased. This extraordinary growth has made it more difficult for them to generate the attractive returns which they need to keep their customers (the ultimate money-owners) and maintain or enhance their competitive position in the markets. These difficulties have created space for various financial innovations and innovators, which have started to change the reach and impact of financial investors. Most prominent amongst those financial innovators are *private equity firms* who open up *new areas* for financial investment and *hedge funds* who introduce *new strategies* and benchmarks in corporate governance.

Private equity firms

Private equity firms (PEF) are undertakings who collect money from banks, pension funds and “High net worth individuals” (HNWI), borrow additional resources from banks, use the money to buy – usually non-quoted – firms, restructure them and sell them with high profits either on the stock exchange, or to strategic investors or to other PE firms. (see figure 11)

Figure 11: Private equity: How it works



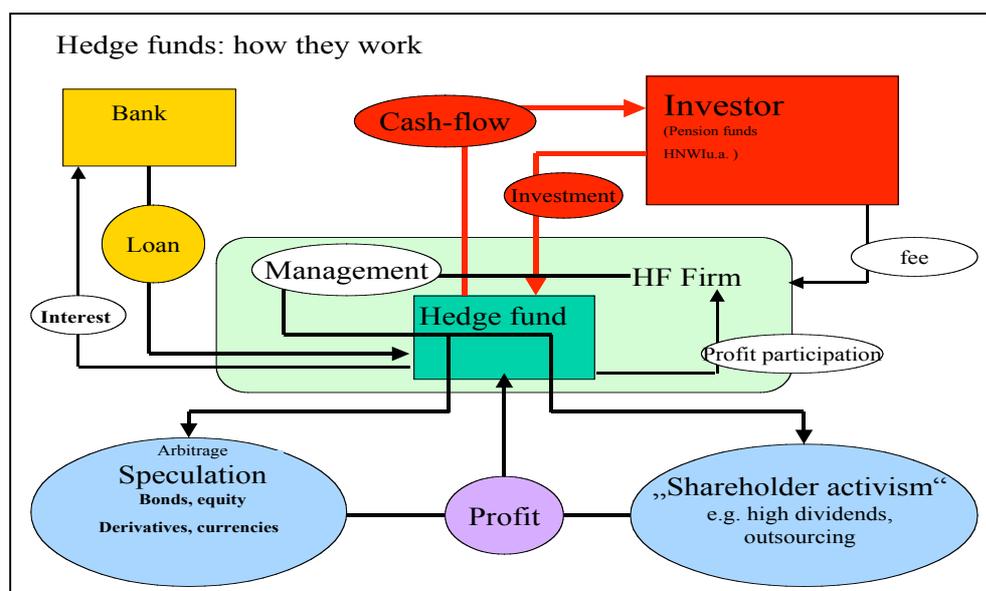
Worldwide private equity investment developed in an unsteady way during the last 10 years: it rose from \$ 60 billions. in 1996 to \$ 200 in 2000, then dropped sharply to less than \$ 100 billions. in 2002, and picked up slowly from 2002 to 2005. In 2006 it virtually exploded and reached \$ 365 billions., this is three times the value of 2005. In the first half of 2007 the strong growth continued before the sharp cut-back as a result of the current financial crisis.

The extraordinary growth of private equity investments in 2006 is partly due to the fact that this year saw a number of mega-deals which have until then been rather the exception. Of the 10 largest transactions since the end of the 1980s seven were carried out in 2006 or 2007 (see IFSL 2007a: 4). Although the large majority of PE firms is of US origin Europe is catching up, rapidly in terms of funds raised (where the European share rose from 21% in 2000 to 44% of funds raised worldwide in 2006), not so rapidly in terms of investment (increase from 21% to 24%). (see IFSL 2007: 2)

Hedge Funds

Hedge funds (HF) are assets which come from HNWI and banks, and increasingly also from institutional investors (particularly pension funds) and which are invested by the hedge fund managers in high profit - high risk securities (*financial speculation*) or in quoted stocks where they develop *shareholder activism* to generate high dividend payments or to enhance market capitalisation or to boost takeover prices.(see figure 13). It is estimated that currently there are about 9000 hedge funds managing about \$ 1,5 trillions of private money. (see IFSL 2007: 1) This figure appears peanuts in comparison to the \$ 62 trillions managed by “traditional” institutional investors. But it should be kept in mind that Hedge funds operate on a highly leveraged basis and with \$ 1,5 trillions private capital can easily invest ten times this amount, i.e. about \$ 15 trillions, which is then much less peanuts and much more coconut.

Figure 12: Hedge Funds: How it works



The majority of hedge fund assets is still of US origin. However the US share declined from more than four fifths (82%) to just under two thirds (65%) between 2002 and 2006. Europe is rapidly catching up, with an increase of its hedge funds asset share from 12% to 24% during

these four years. The role of Asia as a region of origin of hedge fund assets has also risen from 5% to 8%, but remains low. (See *ibid.*: 2) More than half of all hedge funds (55%) worldwide have their legal domicile offshore (mostly on the Cayman Islands) and of those domiciled onshore about half (48%) is registered in the US (mostly in Delaware). (*ibid.*: 7).

4. Strategies of financial investors and their impact on the social models in Europe

In the 1970s and 1980s large European institutional investors in their majority followed a philosophy of passive asset management, i.e. they did not intervene in the strategic orientation or the day-to-day operations of the enterprises in which they invested the capital of their clients. Since the late 1990s this attitude is – under enhanced pressure of US investors, the growing volume of financial assets and enhanced competition, the emergence of new forms of financial investors, particularly hedge funds - increasingly replaced by a more active management to enhance the returns of investments. Basically the strategies followed can be divided into three – mutually compatible and even complementary – groups: financial speculation, shareholder activism and political pressure.

Financial speculation and economic and social instability

Financial speculation – i.e. the purchase/sale of future financial claims for a fixed price in anticipation of a change (or no change!) of the present price of this claim – had originally been developed as an instrument to secure the incomes of buyers or sellers of commodities against oscillations of prices and exchange rates for these commodities. However, in the course of financial deepening financial speculation developed a life of its own, more and more separated from the world of commodities and other goods. This development was facilitated through the termination of the international regime of fixed exchange rates and capital controls and the subsequent liberalisation and deregulation of financial markets in large industrial countries. Therefore the last three decades saw an increasing number of build-ups and bursts of financial bubbles and financial crises, starting with Latin America in the early 1980s until the most recent worldwide financial crisis originating from the US sub-prime mortgages market.

While financial speculation often was and still is carried out mainly by hedge funds in recent years other financial investors like mutual funds and private equity firms and particularly banks are involved in this kind of activity. In the current crisis banks have played a crucial role through their very generous policy of lending – not only to poor homeowners but also to hedge funds and private equity firms who use the leverage effect of cheap loans to enhance the return on capital for their clients. In addition banks circumvented the regulatory capital requirements by transforming their loans into securities which they sold to speculative investors, often to other banks who had no idea about the risks included in these loan packages.

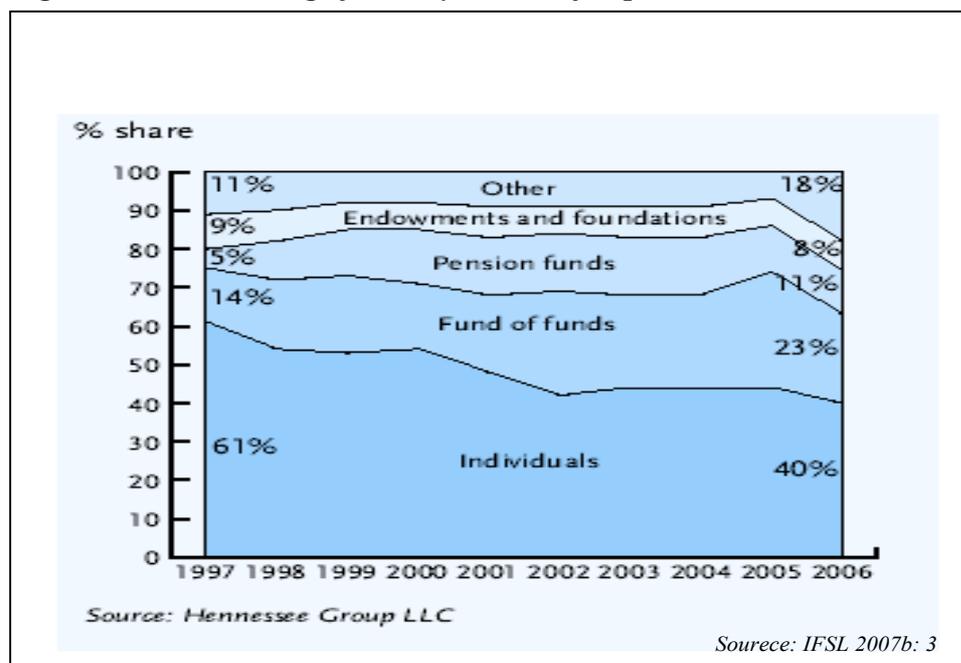
When financial bubbles burst the effect is usually not limited to the financial sphere but triggers economic crises with severe consequences for growth, employment and income for the large majority of people. This has been very obvious in all financial crises in the developing countries, in the dot.com crisis of the late 1990s in the financial centres. The current crisis, too, seriously affects the growth and employment perspectives of the USA. Its proliferation to the non-financial sector in Europe has until today remained rather weak. One reason for this could be that in Europe most countries still maintain substantial barriers against speculative activities of their institutional investors, particularly pension funds. Therefore it is rather alarming that the European Commission regards such barriers as obstacles to one of the fun-

damental principles of the Treaty, the free movement of capital and is determined to start action against these national regulations:

In a recent *White paper on Enhancing the Single Market Framework for Investment Funds* (European Commission 2006d:13) the Commission declares its intention to “examine the types of marketing and sales restrictions that should be removed in the context of the shift to conduct of business rules at the level of the investment firm...” In this respect it seems to follow the recommendations of two reports of expert groups on HF and PE (see European Commission 2006a and 2006b) which were published in July 2006. Remarkably these expert groups who were appointed by the Commission consisted exclusively of representatives of financial institutions as if these were the only ones affected by the activities of HF and PE. Not surprisingly they recommended a further liberalisation of the markets. Particularly they advocate the removal of the modest national limits for investment of institutional investors in risky asset classes (like HF and PE) “which entail relatively high probability of very adverse investment outcomes” (European Commission 2006d:13.). With this it reinforced the deregulatory approach in the Market in Financial Instruments Directive (MiFID) of 2004,(in force since November 2007) which “replaces crude restrictions on the sale of certain instruments to certain categories of investors with a system which places responsibility on the investment firm to ascertain, on a client-by-client basis, whether a particular investment is suitable or appropriate.”(ibid.).

The removal of national protective barriers could and most probably would trigger a new stream of investment from pension funds into speculative hedge funds and thus destabilise the increasingly privatised pension systems in the EU. The fact must be alarming that the share of assets which pension funds have invested in HF to raise their returns has already more than doubled during the last decade, from 5% to 11%. (see figure 13), exposing the pensions of employees increasingly to the risks of financial markets.

Figure 13: Global hedge funds by source of capital



Active management and corporate governance – shareholder value orientation

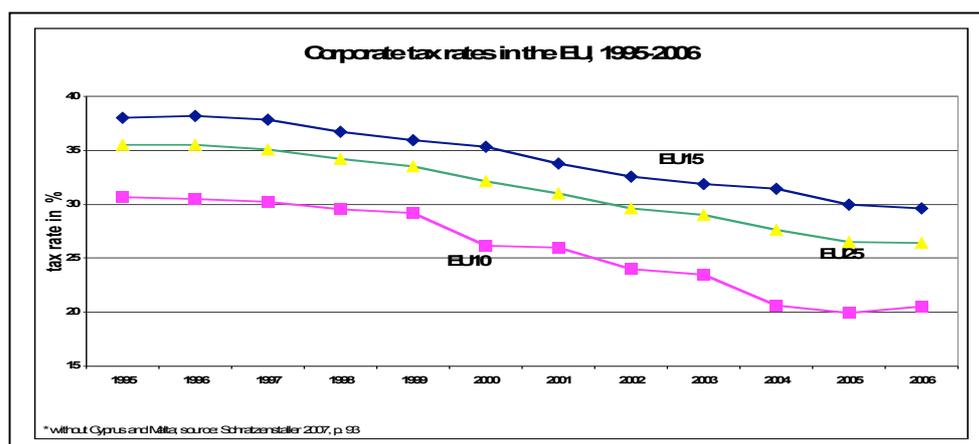
The *second* recently more emphasised strategy of financial investors is more “shareholder activism”. The objective of this strategy is unambiguous: it aims at rapid and large cash-flows for the shareholders, often at the cost of the long-term strategic position and performance of the firm. The underlying philosophy of this is that a corporation is an undertaking of shareholders for shareholders and nothing else. All additional interests of different stakeholders must be disregarded. This strategic orientation differs substantially from that towards financial speculation: It is more realistic in the sense that it acknowledges that profits are generated not in the domain of circulation through speculative trading but in the realm of production through restructuring, cost cutting and enhanced production of surplus value, in Marxist terms through enhanced exploitation of labour. This includes strong attacks on basic elements of corporate governance and employees rights which had been established during the first decades after world war 2

The problems of this more aggressive re-structuring and shareholder value orientation do not only pertain to the firms immediately affected by financial investor activity and pressure. At least as important and on the whole much more dangerous is the threat of *systemic contagion*. This is the proliferation of the aggressive strategies of PE and HF to traditional institutional investors which are the largest pillars of financial investment and the management of financial assets, and from there to corporate governance in the economy at whole. The proliferation mechanism is based on the fact that institutional investors are - mostly - private firms which compete for the money of their investors or ultimate asset-owners. Their main competition parameter is the promise to generate high returns for their clients. In such an environment hedge funds are *benchmark setters* for new profit and corporate governance standards. If one institutional investor places a part of its assets in PE or HF and receives higher returns this almost inevitably pushes other investors, including pension funds into similar financial instruments in order to prevent the exit of clients.

Pressure on governments for tax cuts and privatisation

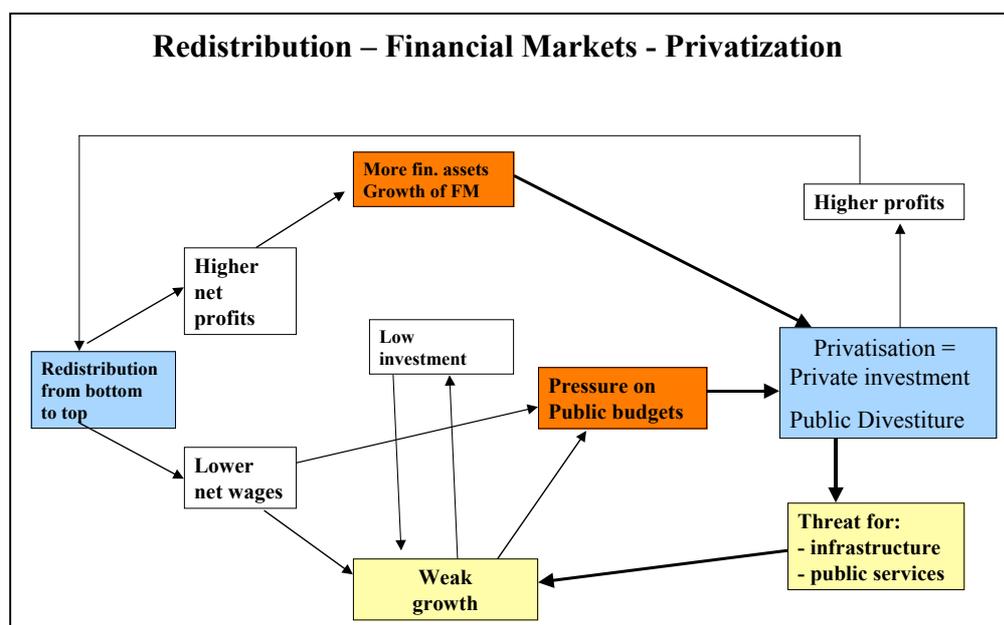
A *third* strategy of financial investors is the exertion of pressure on governments and parliaments to make the respective country and attractive place for financial investment. This pressure is underpinned by the treat to invest in other places if conditions were not shaped according to the interests of financial investors. One of the effects of this pressure is the almost obsessive *race* to the bottom for taxes on profits, interest and capital gains. It has led to a substantial lowering of rates for corporate taxes (see figure 14) and to the exemption of interest income of foreign investors from income tax in many countries of the EU.

Figure 14: Corporate tax rates in the EU, 1995-2006



Such tax race undermines the revenue basis and puts public budgets under mounting pressure, which makes it increasingly difficult to maintain public services at the traditional and necessary level. This budgetary pressure is then a favourable background for the request by financial investors for the privatisation of public assets and public services. In the constellation of growing private financial assets seeking investment opportunities and growing pressures upon public finances privatisation appears as a solution to the problems of both the wealthy and the state: It gives the former a new area for investment and at the same time relaxes the financial burden for the latter. This is visualized in figure 15. Reductions of taxes on corporate profits, capital income and wealth increase the burden on public budgets and at the same time the revenue available to the wealthy. These use the additional money to buy from the government assets and service packages. In a net calculation the whole procedure simply amounts to a gift to the top: Governments give money to rich individuals and firms and then sell to them for this money the public assets. From the social substance the whole process is nothing else than the transformation from public to private wealth – with negative repercussions in the first place for social cohesion but also for economic growth.

Figure 15: Redistribution – financial markets – privatisation



(However, it remains an open question whether this privatisation of public services under fiscal pressures fulfils its purpose to reduce the fiscal burden for the state. This is obviously the case when together with the privatisation public responsibility for the maintenance of the previously public service is abandoned – with the accepted consequence of a deterioration in the quality, affordability, accessibility etc. of such services. In cases where government privatises services but maintains their provision as a public mission - organised via public regulation or PPPs - the costs of regulation or of buying or leasing facilities and services from the private sector may in a long-term perspective be higher than public provision even if this must be financed through public loans.)

To summarise and broaden the perspective: From the viewpoint of political economy the main problematic accompanying the growing importance of financial investors and their strategies is the enormous shift of economic and political power in favour of capital. Financial investors are not only claiming ever higher economic returns for their assets; they are changing the social framework and environment for all economic and increasing parts of social activity, put-

ting them under enhanced competitive pressure and forcing them to subordinate every tradition, social relationship and activity under the imperative of rapid returns to investment. The – relative – balance of power between labour and capital which had been achieved in the post-war period and was the basis for the continental welfare states in all their diversities is increasingly undermined by the dominating role and strategies of the new generation of financial investors. Social security as an unconditional right of every member of society is increasingly replaced with insecurity and precarious perspectives, the wealth of the upper classes increases and so does the number of poor people, even amongst those who have a job; social solidarity is replaced through individual competition – sometimes complemented by individual charity.

Against this summarising assessment it could be objected that one should not put the blame for all evils in the world upon a limited number of financial investors, whose power would be strongly exaggerated. There is certainly some truth in this objection. In a broader sense one could argue that the general trend of development during the last three decades is the increasingly powerful neo-liberal counter-reform against the social and political achievements during the first two and a half decades after world war 2. But then I would still insist that financial markets are the main medium of this counter-reform and financial investors, and recently particularly HF and PE are the main and very efficient executors of the general social and democratic roll-back which we are currently experiencing.

5 Perspectives for resistance, interventions and alternatives

Following the structure of the problems generated by the strategies of financial market actors the proposals for political resistance and countermeasures can be divided into three groups: restriction of speculation, protection of employees and firms, and reduction of financial over-accumulation.

The *restriction of financial speculation* could be approached through direct rules for financial investors, for instance through transparency requirements or limitation of their leverage. The problem is that many of the new financial investors are domiciled offshore and cannot be reached. On the other hand, traditional institutional investors are usually located onshore. It should in any case be the rule that pension funds and live insurance should be strictly prohibited to invest in speculative financial instruments. This is still the case in some countries but such rules are under heavy attack from the financial industry. Such attacks must be resisted to avoid delivering pensions to the incalculable risks of financial markets.

The limitation of leverage is also possible via rules for lending banks, either by setting quantitative limits or by imposing higher capital requirements – 300 or 500% - for loans to hedge funds and private equity. Also the securitisation and sale of loans to special purpose vehicles should be prohibited or only be allowed under special circumstances; after all such trading is nothing else than the circumvention of credit restrictions which are set by the capital requirement rules. Further tools are taxation of capital gains, currency or other financial market transactions – and of course the set-up of a more cooperative international (regional or global) exchange rate system.

To *protect employees and firms* against harmful financial investor activities it is essential to prevent in the case of PE the transfer of servicing obligations for loans which were taken to finance an acquisition upon the acquired firm or to withdraw money from this firm in the form of extra-dividends or bonuses. To make quick hit-and-run strategies by hedge funds in

large quoted firms more difficult, the voting rights of shareholders in such companies could be linked to the duration of their holdings, it could for instance only start one year after the acquisition of the shares.

The provisions in the existing European take-over directive to oppose a hostile take-over should be strengthened and not – as is envisaged by the European Commission – weakened. They should give employees of a target firm not only the right to full information but also the right to veto a take-over if employees interests are not sufficiently met.

Reduction of financial over-accumulation. Limitation of financial speculation and protection of firms against exploitation by financial investors are reasonable and – if carried out with sufficient political energy – efficient measures to stabilise financial systems and economic development temporarily. But they will not take the steam and pressure out of the system and will not prevent that financial investors which are under enormous pressure from asset-owners seeking high returns will search and develop new outlets and new methods of profit generation which will induce instability and polarisation in new and unexpected places and forms. A more comprehensive strategy to reduce the influence of financial investors in the economy and society must therefore address the roots for this financial pressure. The most important of these are located outside financial markets, namely in an increasingly one-sided distribution of income and wealth, and in increasingly capital funded social security systems. A long-term strategy to tame financial markets and to re-embed finance in a framework of reasonable and socially sustainable economic development must therefore reverse these trends: It must, firstly, initiate a redistribution of income and wealth from top to bottom through higher (minimum) wages and social expenditure and at the same time higher taxation of wealth, profits and high incomes. Secondly, it should base pension systems on public schemes which are de-linked from the dynamics and risks of financial markets. Both strategies would considerably slow-down the accumulation of profit-seeking financial assets and therefore take much of the pressure from financial markets. Such strategies reach of course far beyond financial market policies. They are an element of a strategy for the comprehensive democratisation of the economy.

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