How IMF and World Bank support for financialisation undermines human rights

At Issue

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Financialisation is a feature of contemporary capitalism that permeates the whole of society. In the case of states, it has meant an increasing drive to develop policies aimed to meet the short-term valuation needs of corporations and the demands of creditors. The emphasis on austerity and structural reforms - promoted by international financial institutions such as the IMF and World Bank - has deepened a pre-existing pro-business bias that ignores States' human rights obligations.

Global capitalism has changed substantially over the last four decades. Technological changes and a shifting geopolitical context have opened the door to new ways of organising production globally, while at the same time modifying the nature of work. The world has been transformed into a single market, subordinated to the rules of capitalism.

A salient feature of this new phase is the process of financialisation, which alludes to the increasing relevance and impact of financial actors and their logic on the economy as a whole. Despite its very country-specific and widely varied manifestations, the process nonetheless has some common features of relevance to a general discussion. The financial sector has increased its weight in national Gross Domestic Production and in labour markets in many countries, but the changes do not end there. We are dealing with a process that permeates all of society, from health, education and housing to food production and responses to the climate crisis. It can therefore be recognised in diverse dimensions. Crucially, it negatively affects states' capacity to meet their legal international Human Rights (HR) obligations. As noted by School of Oriental and African Studies Professor Costas Lapavitsas, the World Bank and IMF played a pivotal role in the financialisation of economies in the Global South

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as, guided and compelled by the World Bank and the IMF, "developing countries [were led] to alter the balance of domestic finance away from bank-based, relational, government-controlled toward market-based, arms length, private institutions and mechanisms." The role of both institutions in furthering financialisation remains evident today in sectors ranging from housing and urban planning to agriculture to climate finance (see *Observer* Spring 2020). It is also seen in the way World Bank and IMF policies and programmes make the State and individuals increasingly reliant on the market to meet their obligations. IMF policies such as demands for austerity and reluctance to recognise capital controls – and particularly control of capital outflows – as an important macroeconomic policy tool (see *Observer* Spring 2022) work in tandem with the World Bank's Maximising Finance for Development approach and drive for 'business friendly reforms' embodied in its *Doing Business Report* (see *Observer* Winter 2021). These create the conditions in which financialisation can expand or take root, as income streams from for-profit provision of essential services are created and traded in financial markets.

The financialisation process supported by the IMF and World Bank has had a significant detrimental impact on democratic governance, as it fundamentally alters the relationships between the state and its citizens. State autonomy is constrained as it prioritises access to capital markets over the needs of its population. The reluctance of states to seek support from the G20's Debt Service Suspension Initiative despite the historic health, social and economic impact of the Covid-19 pandemic for fear of a downgrade by rating agencies and loss of access to capital markets makes the dynamic plain.

Financialisation undermines growth and productivity

Companies take on large amounts of debt to leverage their investments without risking their own capital and use both banks and capital markets for this purpose. Creditors demand debt service payments, which erode the returns available for investment. Since large investment funds are also shareholders in companies, they force them to pursue short-term gains – in their interest. This same subversion of results comes from the short-term logic of distributing profits and linking the income of administrators and managers to these objectives. Overall, corporate profits are diluted into interest payments, management remuneration and profit sharing, which erodes their association with and support for productive investment. These trends have very concrete distributional effects as they favour capital and rents at the expense of labour and thus increase income inequality.

Moreover, in the interest of maximising risk and return management, an increasing number of companies derive part of their profits from financial assets (such as bonds and equities) rather than investing in the business itself. They may even acquire stakes in other firms or real estate for purely speculative purposes, reselling when the asset has appreciated in value. In this way, the profits available are decoupled from productive investment, which has an impact on productivity and economic growth in the medium term. Economies lose dynamism because companies do not allocate all their profits to increasing productivity. Thus, the financialisation of companies not only drives inequality but also undermines economic growth. It also renders the distinction between productive and financial capital futile, as the two merge in similar practices.

This kind of practice can take place inside large conglomerates, which divide themselves into units located in different territories to take advantage of international tax competition. The results of this practice have not been good, and have rather contributed to increasing inequality. Tax havens are an extreme form of this practice, which also add financial secrecy services. This even allows *ad hoc* shell companies to act as lenders to their own core companies, enabling the main company to derive profits as debt repayments to a company that is actually controlled by it, thus avoiding taxes and distributing profits. Tax havens are a huge source of resource leakage globally.

Financialisation drives inequality

This behaviour by large corporations requires higher profits in ever shorter time frames, which are used to distribute or invest in unrelated assets. Meanwhile, the efforts by states and society to benefit from those profits are jeopardised. As a result of the above-mentioned trends, households living on their ability to work see their income share deteriorate. Wages lag behind corporate incomes and profits, while less dynamic economies do not provide enough jobs. The latest *World Inequality Report* stressed that today's income distribution resembles that of a century ago. The global income share captured by the poorest half of the world's population today is about 50 per cent of what it was in 1820. While the richest 10 per cent of the world's population receive 52 per cent of global income and hoard 76 per cent of global wealth, the poorest half earn just 8.5 per cent and own 2 per cent, respectively.

UN human rights experts highlight how the commodification of fundamental human rights such as health, housing, and education further entrenches poverty.

This inequality of income and wealth jeopardises access to basic goods and services. A 19 October 2021 joint statement by 13 UN human rights experts highlights how the commodification of fundamental human rights such as health, housing, and education further entrenches poverty. In the absence of previously state-provided public goods and services, households – whose relative income has deteriorated – must pay for the privatised replacements out of their own pockets.

Women are principally affected by the deterioration of social service provision, as they take on care tasks without commensurate remuneration.

To cope with higher expenditures and meagre incomes, many households are turning to debt. Household debt reached $55 trillion in 2021, up from $15 trillion in 1997. During this period, international financial institutions (IFIs) have been energetically promoting the idea of financial inclusion as a way to support the most vulnerable by supposedly giving them opportunities to invest in themselves and take advantage of their 'human capital' (see *Observer* Autumn 2018). Instead, the deepening of financial reach to the poor – for example, micro-credit – has mainly resulted in a further appropriation of their (low) incomes (see *Observer* Winter 2017-18).

This dynamic accelerated during the Covid-19 pandemic. The growth of debt implies an increase in debt repayment commitments, which restrict already very low incomes, reinforcing the precariousness of household finances. The failure by states to guarantee basic human rights further forces households into debt, the repayments of which threaten those same rights a second time. People move between precarious and poorly paid jobs, but debt remains a constant. The actual or potential need to access credit (that is, debt) requires individuals to self-manage to meet creditors' priorities, a contemporary form of self-discipline that forces increasingly financialised populations to accept unjust jobs and avoid participating in contentious collective actions, such as strikes and calls for higher pay.

Financialised states are unable to comply with their legal human rights obligations

States are also negatively affected by financialisation, but they have not been passive victims. Structural reforms and the veneration of fiscal austerity have been encouraged and, over the last four decades, required in many cases by IFIs such as the World Bank and the IMF. That said, the implementation of these reforms has required government agreement.

As companies invest less and the economy loses dynamism, states collect less taxes, leaving fewer fiscal resources available for their public policies. To encourage foreign direct investment, many states have become involved in a race to the bottom on taxation, losing even more fiscal space. Rich countries in the Global North (such as the US, the UK and Luxemburg) have encouraged the creation of tax havens, or refuse to combat them, thus being complicit in tax avoidance and evasion. An expression of the latter is the Organisation for Economic Co-operation and Development role in the formulation of global tax policies, which has recently been challenged by calls from a group of heads of state from around the world for the establishment of a UN tax convention and tax body. With the estimated $427 billion in revenue lost to tax havens each year, the entire world population could have been vaccinated three times over.

As if this were not enough, tax reforms promoted by the World Bank and IMF and other international bodies have been geared towards reducing direct taxes (on wealth or profits) in favour of indirect taxes (such as value added tax). The central argument has been that these taxes are easier to collect. However, this is only true if tax controls, and oversight, are circumvented. For example, tax on foreign trade operations, which were historically controlled by states, have been dramatically reduced, in order to comply with the commitments to liberalise trade in goods established by the World Trade Organisation. At the same time, the elimination of foreign trade control bodies was promoted.

To compensate for part of this drop in revenue, indirect taxes were promoted by the Bretton Woods Institutions (BWIs), which are regressive – they affect poorer households more – and pro-cyclical – revenues become scarcer when they are most needed (see Briefing, *The IMF, Gender Equality and VAT*). This change in revenue collection was combined with financial and exchange rate deregulation, which has made it easier for large corporations to intensify the evasion-avoidance operations described above. As a result, states have contributed to an increase in inequality through the tax system and deregulation.

IMF and World Bank promote financialisation

With weaker revenue collection and greater volatility in the economy, IFIs have encouraged states to take on debt as a form of financing. Although debt is a valid instrument for public management, its disproportionate growth has promoted a greater creditor power. They have gained such strength that even during the worst health crisis in a century – that linked to the Covid-19 pandemic – private creditors did not provide debt relief nor participate in the G20's Debt Service Suspension Initiative (see *Observer* Winter 2020). In some cases, the power of financial capital is structural and surreptitious, forcing states to adopt certain policies and avoid others for fear of the reaction it will provoke in the mood of the markets. In other cases, as with IFIs such as the World Bank and IMF, the demands are explicit and take the form of conditionalities. Many states adapt their policies to these demands even if they do not take on large amounts of debt, in order to retain market access. Indebtedness, for its part, entails payments that put pressure on public finances.

Undemocratically, many states have adapted themselves to meet the requirements of governance designed by creditors' interests. In fact, it is not unusual that the presence of former staff from financial firms has grown inside ministries and public agencies, bringing their own connections with them and contributing to the revolving door effect where private actors enter the state and influence policy making. A vivid example of this is the case of Argentina during Mauricio Macri's government (2015-2019), which was filled with officers coming from firms – especially banks – and corporate associations that made it easier to change fiscal policies and acquire huge amounts of debt in a very short period. As states are captured by this bias, they fail to prioritise public policies rooted in human rights obligations. Governance is reduced to creating a business-friendly environment, even if that exposes people to higher degrees of uncertainty and vulnerability. Governance is reduced to creating a business-friendly environment, even if that exposes people to higher degrees of uncertainty and vulnerability.

Thus, the change in revenue collection systems and focus has been complemented by a selective reduction in public expenditures. The IMF's systematic emphasis is on the need for fiscal austerity – even during the pandemic. This results in the acceptance of a mechanism and approach which limits the array of policy responses available to states, and thus constrains state sovereignty – leaving states and their populations dependent on the will of financial markets. Thus, austerity has been a major driver of greater inequality in the wake of the pandemic.

Social protection policies encouraged by the IMF and World

NHS workers protest over pay justice, patient safety and an end to privatisation, during the 73rd anniversary of the Health Service in London, July 2021. Credit: John Gomez/ Shutterstock

Bank have opposed universal approaches in many cases, and promoted targeted social protection measures to reduce spending for the sake of a theoretical efficiency that has proved elusive. Although there have been some changes in the IMF's discourse on the importance of social protection, its concrete policy recommendations do not seem to follow the same path, falling behind the rights-based approach of other international organisations. The erosion of social protection risks leaving out vulnerable groups, which has been argued by human rights experts to contravene international human rights law.

IMF fiscal consolidation deepens financialisation

Austerity measures have also affected other key areas of social services expenditures, such as health, education, and housing. Limits on public spending, including freezes or reductions to the public wage bill, or hiring ceilings in the public sector, are particularly sensitive in areas such as health and education, which tend to make up a significant part of public spending and are particularly important for women (see *Observer* Autumn 2021).

As well as reinforcing inequality, the trend towards austerity is intrinsically linked to the financialisation process, as it enables the creation of profitable businesses to meet the demands of higher-income sectors at the expense of the poor and most vulnerable groups in society. Fund-supported austerity creates a need for investment that states cannot meet. That is where the World Bank acts as a complementary source of resources, supporting the same macroeconomic framework that privileges private sector actors. World Bank projects are commonly designed to 'crowd-in' private investors: as IFIs guarantee that structural reforms take place, market-based solutions can create investment opportunities, in accordance with the World Bank's Maximising Finance for Development approach (see *Dispatch* Springs 2021; *Observer* Summer 2017). But this privatisation has led to the commodification of basic human rights. This has allowed big business, under the logic of speculative valorisation, to gain quasi-monopolistic control of key sectors which are managed in the interest of the market and shareholders. For the majority of the population, the commodification of essential services, such as health and water has meant a rise in the cost of living, eroding their already meagre incomes.

The response promoted by the IMF has not been to guarantee human rights by promoting universal access to basic goods and services. Even in times of fiscal slack – such as that produced by good international prices – the recommendation for countries in the periphery of the global economic structures has been to accumulate reserves to protect themselves against possible sudden capital outflows. This implies that available resources are not used to improve people's lives but are instead used to guard against the possible threats from financial capital. The idea of powerful independent central banks that defend this policy is in fact clear proof of its subordination to financial interests, against a democratic control of monetary policies, as independent central banks are designed precisely to ensure policies are not subject to government (democratic) intervention (see *Observer* Summer 2021). An example of this priority reversal was the case of some countries – such as Argentina – that used their share of the 2021 Special Drawing Rights allocation to accumulate reserves or to pay debt services, instead of using them to improve peoples' life (see *Dispatch* Annuals 2021).

This preventive accumulation is a particular mark of the subordinate financialisation in states in the periphery. Unfortunately, IFIs have discouraged capital controls for decades, putting peripheral economies in a weak position to address external crises, with the main tool being the selling of reserves; i.e., in times of crisis, to guarantee creditors' interests (see *Observer* Spring 2022, Winter 2021). The IMF has played an active role in preserving the interest of creditors, as it did, for example, during the 2018-2019 Stand By Agreement signed with Argentina (see *Observer* Autumn 2019), through which the IMF provided a $44.5 billion disbursement without supportive capital control measures, thus supporting massive capital flight from a country in dire financial and social circumstances (see *Observer* Spring 2022). It was only after massive capital outflows that the Argentine government decided to reintroduce capital controls, and the IMF stopped disbursing the loan.

Unfortunately, there is not a trend toward trying to control volatile capital. On the contrary, states find themselves compelled to encourage financialisation, whereby they compete for new investments – even if these require higher returns that are not reinvested at home. As well as taxing less, losing sovereignty and reducing their role as producers, countries have been encouraged to make labour laws more flexible to lower labour costs. These reforms, supported by the IMF and World Bank, have tended to undermine the human right to decent work, with fair pay.

Despite the detrimental social and economic consequences of fnancialisation, the World Bank and IMF continue to enable, expand and strengthen the process. The push by the BWIs for the creation of a 'business enabling environment,' construed as the primary objective for states, leaves improvements to people's lives and the fulfilment of international human rights obligations hostage to an increasingly crisis-prone economic expansion. But GDP growth cannot be achieved by the violation of basic rights and the promise of its reversal in the future. The exacerbation of global crises as a consequence of the Covid-19 pandemic has demonstrated that it is essential to step away from the increased financialisation of the economy and to develop alternative human rights-based economic models.

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