The Financial and Economic Crisis and Developing Countries

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Electronic reference

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THE FINANCIAL AND ECONOMIC CRISIS AND DEVELOPING COUNTRIES

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Abstract
Developing countries were hit hard by the financial and economic crisis, although the impact was somewhat delayed. Every country had different challenges to master. The closer the developing countries are interconnected with the world economy, the crasser the effects. And the incipient recovery that is becoming noticeable is, for the time being, restricted to only a few countries and regions.
The crisis was transmitted primarily by trade and financial flows forcing millions back into poverty. Attainment of the Millennium Development Goals is seriously jeopardised in many countries. Many developing countries did not and do not have the resources to stimulate the economy and protect their socially disadvantaged populations to the same extent as industrialised countries. However, many countries have made considerable efforts to mitigate the effects. Developing countries have also increased their cooperation with one another and are urgently demanding a greater voice in global economic affairs.
Industrialised countries are for the most part more concerned with their own problems. Their readiness to provide more extensive aid is limited. They are under pressure from international institutions to relax their previous dominance in favour of the increasingly strong emerging countries. A shift in power and influence that was already noticeable before the financial crisis is deepening.

Key words
Financial crisis · financial globalisation · G-20 · international cooperation · International Monetary Fund (IMF) · tax evasion · United Nations (UN) · World Bank · Switzerland
1. Introduction

The worldwide measures to deal with the gravest economic crisis since the Great Depression in the 1930s began to show the first signs of recovery in late summer and early autumn 2009. Most predictions are still cautious. Thus, immediately prior to the meeting of the Group of 20 (G-20) ministers of finance in London at the beginning of September the Managing Director of the International Monetary Fund (IMF), Dominique Strauss-Kahn, was concerned that the recovery was both fragile and slow-moving. He warned against growth without employment and against discontinuing the economic stimulation programmes too early, and he also demanded coordinated measures on an international plane (Strauss-Kahn 2009).

The various predictions, particularly for China, India, Brazil, Japan and a few other Asian countries, were optimistic. The United Nations (UN) Economic Commission for Latin America and the Caribbean also predicted a return to positive growth in 2010. But by far not all the countries and regions reported a brightening of the economic prospects in early autumn. The crisis is by no means over for the majority of the developing and transition countries.

As inconsistent as the recovery pattern is now, there was a similar lack of consistence in the impact of the financial and economic crisis on the individual countries and regions worldwide. For a long time it was hoped that the threshold and developing countries would be able to disconnect from the financial crisis in the developed countries of America and Europe due to their improved macro-economic structural conditions. However, the notion of disconnecting from the crisis proved false. The crisis did impact the developing countries, principally via financial flows and through trade. The developing countries and international organisations took a number of steps to mitigate the effects of the crisis, but with varying results. The agenda of international discussions is still set bearing in mind the interests of the rich countries.

2. Effects of the crisis on the developing and transition countries

The crisis originated in the major financial centres in the developed countries. The force of impact on the developing and transition countries became apparent only gradually. The situation is new; previous crises spread from the developing countries. This time developing countries are the victims of the crisis, but they did not cause it. “The causes of the global financial crisis are to be found in the financial and economic policies of the developed countries, primarily the United States (US). Developing countries are not responsible for it, but they are now seriously affected,” wrote Martin Khor, the new Director of the South Centre in Geneva.¹

¹ This South Centre’s “South Bulletin” shows in detail how the developing countries were impacted by the crisis. South Centre. South Bulletin, Issue 34, 16 March 2009. www.southcentre.org/index.php?option=com_content&task=view&id=978&Itemid=1.
The Third World Network (2008) reported that the UN Economic Commission for Asia and the Pacific had in fact registered a “phase of heightened instability”, but at that time they reduced their growth predictions only minimally. In the IMF July 2008 update of the Global Financial Stability Report (IMF GFSR)² the IMF, for its part, registered a weakening of growth in the threshold countries and a heightened risk of inflation. Borrowing abroad became more expensive; investors had become more risk-conscious. But the IMF still characterised the threshold countries as fairly crisis-resistant. The full force of the global financial and economic crisis impacted the developing and threshold countries in the course of 2008. Subsequently the IMF, the World Bank and other institutions continually downgraded their growth predictions for Asia, Latin America and above all Africa.³ High growth rates disappeared and many countries even had to put up with shrinking economic production.

According to the IMF April 2009 World Economic Outlook (IMF WEO), the growth setbacks in the threshold and developing countries were higher than in the industrialised countries. Compared with their growth potential, the developing and threshold countries are therefore harder hit by the global financial and economic crisis than the industrialised countries that caused it.

The regression in economic growth entailed a sinking per capita income, at least in countries with high population growth rates. Macro-economically the crisis manifested itself in mounting deficits in trade and payment balances, dwindling currency reserves, currency devaluations, increasing rates of inflation, higher indebtedness and soaring public budget deficits.

This had a direct impact on the living conditions of the population. The United Nations Educational, Scientific and Cultural Organization (UNESCO) (2009) estimated that the fall in growth cost the 390 million poorest people in Africa, i.e. those who must survive on the equivalent of USD 1 per day, a total of some USD 18 billion or USD 46 per person. This is equivalent to a drop in average per capita income of one-fifth. The International Labour Organization (ILO) (2008) feared the number of unemployed could rise to some 50 million by the end of 2009. The imbalance is mounting. Shortly before the G-20 meeting in Washington in November 2008 the World Bank estimated that a fall in growth of 1% would force 20 million people into absolute poverty (World Bank 2008). Six months later the World Bank predicted that the number of poor would rise further in half the developing countries. Among the low-income countries as many as one-third and in the countries south of the Sahara as many as three-quarters would be affected (World Bank GMR 2009). This means that the Millennium Development Goals faded into the distance for many countries. As a consequence there has already been social unrest in some countries.⁴ In its latest yearbook the international network Social Watch (2009) reports, in numerous contributions by local civil society organisations, on how the crisis has subjectively affected individual countries.

² All IMF GFSRs can be found at: http://www.imf.org/external/pubs/ft/GFSR/index.htm.
³ The IMF and the World Bank primarily published updated growth forecasts regularly; regional development banks also did so for their regions. In this respect see the issues of the GFSR and the WEO including their IMF regional issues at http://www.imf.org/external/ns/cs.aspx?id=29 and also the World Bank Global Economic Prospects (GEP) and Global Development Finance (GDF).
⁴ The international agencies reported on social unrest in Bulgaria, China and Latvia.
3. Crisis transmission channels

The crisis did not impact all regions, countries and population groups equally or on the same time scale. The patterns developed differently for each country. On the other hand, the transmission channel patterns are clear (Te Velde 2008; IDS 2008; Toporowski 2009). The financial and economic crisis of the industrialised States spread to the developing countries primarily via financial flows and through trade. The closer a developing country is coupled with the global economy, the stronger and more rapid the impact of the crisis.

3.1. Transmission via financial flows

Obviously the collapse of the stock exchanges in the great finance centres in May 2008 was also promptly transmitted to the stock exchanges in the most important emerging countries. The stock exchanges in China, India, Russia, South Africa and Brazil, for example, followed suit immediately. Within a week the Morgan Stanley Capital International Emerging Market Index, which reflects the stock markets in the threshold countries, fell by 23%. It is characteristic of these countries that they already have a highly developed finance sector that is coupled with other countries. The weaker the regulations in the country, the more susceptible it is to risk.

Particularly severely impacted were the countries whose Sovereign Wealth Funds had been invested in toxic, now drastically devalued values such as Singapore and the oil-producing States in the Middle East. Stock market losses also had a sharp impact on countries like Chile, whose pension funds include shares from the industrialised countries.

Net capital flows to the developing countries sank sharply. According to the World Bank, capital flows to the developing countries sank to USD 727 billion in 2008. In the previous year they had still amounted to nearly USD 1,160 billion (see table 1). The World Bank and the IMF expect a slump for the current year. The Institute of International Finance confirmed the pronounced reverse and in June 2009 predicted capital flows in the current year in vigorously emerging markets (28 threshold countries) of USD 141 billion, less than half the figure for 2008 (USD 392 billion) and only one-fifth of the flow in 2007 which amounted to USD 888 billion (IIF 2009). Above all, the countries in Eastern Europe, and particularly Russia and Ukraine, were very hard hit. The withdrawal of foreign capital led to devaluation of currencies in the developing countries.

Consequently, not only were the flows of portfolio and direct investments to the developing countries significantly lower, but commercial bank credits and non-bank financing were also reduced. Regarding foreign direct investment (FDI) in the developing countries, the United Nations Conference on Trade and Development (UNCTAD) posted a weak growth of 7% on a sinking curve for 2008. In 2007 the growth had still been as much as 21% (UNCTAD 2009). For the first quarter of 2009 UNCTAD predicts that the FDI will fall by 25% in the developing countries and by 40% in the transition countries. Investors transferred their funds to supposedly lower-risk countries. Poorer
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economic prospects kept investment plans down. Planned takeovers\(^5\) were postponed or annulled. The credit crunch rendered the financing of such projects increasingly difficult.

### Table 1 – Capital flows to the developing countries, 2005-08 (in USD billions)

<table>
<thead>
<tr>
<th>Total net capital flows, public and private</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private flows (investments and credits)</td>
<td>569.7</td>
<td>739.2</td>
<td>1,157.5</td>
<td>706.9</td>
</tr>
<tr>
<td>Private investment flows</td>
<td>347.2</td>
<td>462.7</td>
<td>658.6</td>
<td>599.0</td>
</tr>
<tr>
<td>FDI</td>
<td>279.1</td>
<td>358.4</td>
<td>520.0</td>
<td>583.0</td>
</tr>
<tr>
<td>Portfolio investments</td>
<td>68.1</td>
<td>104.3</td>
<td>138.6</td>
<td>15.7</td>
</tr>
<tr>
<td>Private credit flows</td>
<td>222.5</td>
<td>276.5</td>
<td>498.9</td>
<td>107.9</td>
</tr>
<tr>
<td>Bonds</td>
<td>56.2</td>
<td>26.6</td>
<td>85.4</td>
<td>10.5</td>
</tr>
<tr>
<td>Bank credits</td>
<td>84.2</td>
<td>144.6</td>
<td>214.5</td>
<td>123.0</td>
</tr>
<tr>
<td>Other credits</td>
<td>−4.5</td>
<td>−4.8</td>
<td>−3.5</td>
<td>−9.3</td>
</tr>
<tr>
<td>Short-term credits</td>
<td>86.6</td>
<td>110.1</td>
<td>202.5</td>
<td>−16.3</td>
</tr>
<tr>
<td>Public credit flows</td>
<td>−71.0</td>
<td>−70.9</td>
<td>0.2</td>
<td>20.4</td>
</tr>
<tr>
<td>World Bank</td>
<td>2.8</td>
<td>−0.4</td>
<td>4.9</td>
<td>7.1</td>
</tr>
<tr>
<td>IMF</td>
<td>−40.1</td>
<td>−26.7</td>
<td>−5.1</td>
<td>10.9</td>
</tr>
<tr>
<td>Other</td>
<td>−33.7</td>
<td>−43.8</td>
<td>0.4</td>
<td>2.4</td>
</tr>
</tbody>
</table>

**Miscellaneous:**

| Net outflows (private investments)         | −59.2 | −125.2 | −138.8 | −164.0 |
| Net outflows (portfolio)                   | −11.6 | −21.5 | −50.6 | −80.0 |
| Remittances by foreign workers             | 191.2 | 229.0 | 265.0 | 305.0 |


The global banks currently experiencing difficulties granted less and less credit to developing and threshold countries. In 2009 there was even a net withdrawal of credits. Towards the end of 2008 taking up loans by governments and private enterprises in developing countries was virtually at a standstill. There was a notable rise in risk premiums and rates of interest.

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\(^5\) One example was the planned takeover of a South African mining conglomerate by Xstrata (Zug). At the 2009 World Economic Forum in Davos the head economist of the World Bank, Justin Yifu Lin, stated that 48 mining projects had already been given up in the Democratic Republic of Congo (quoted in Neue Zürcher Zeitung, 2 February 2009).
for developing countries on the bond markets. During the first nine months of 2008 Brazil experienced a capital drain of USD 13 billion, Argentina USD 20 billion, Mexico and Venezuela USD 19 billion each. Finally, credit business was terminated where funds had been borrowed at low rates, e.g. in Japan or Switzerland, and invested in high-interest countries (“carry trade”).

In numerous countries remittances by migrants which had been rising continually in recent years stagnated or even sank. Countries where the proportion of remittances in the capital flow was considerable, such as Central American States and India, were particularly hard hit (World Bank 2009; Awad 2009; Burki and Mordasini 2009). The standstill or reverse in remittances was often coupled with a freeze in engagement of foreign labour or even the repatriation of foreign workers. Finally, there is a threat of regression or at least stagnation in official development assistance (ODA). However, for the year 2008 the Organisation for Economic Co-operation and Development (OECD) reported a rise in ODA contributed by member countries to 0.3% of the gross national income (GNI) (OECD 2009). According to OECD, should the quantitative targets set for 2010 be achieved, the member countries would have to increase their aid even further. During previous crises the donor States always reduced their aid. Donor States with substantial budget deficits and mounting public debt downgrade the priority of development aid. This would exert pressure above all on those developing countries where ODA accounts for a high proportion of incoming capital.

3.2. Transmission via trade
On account of the world economic recession, there was a sharp fall in the demand for goods and services from the developing and emerging countries. The fall in growth in China and India also entailed a drop in their demand for energy and mineral raw materials, particularly from Africa. Sinking prices and export volumes led to a collapse in export income (UNCTAD 2009c). The 49 poorest developing countries saw their export income reduced by 43.8% during the first six months of 2009. The more important the developing country exports to the US, Europe or the larger threshold countries, or the greater income flexibility of the prices of export goods, the stronger the impact on the country’s exports. In view of its proximity to the US, Mexico is a significant example. The Bangladeshi monthly growth rates for textile exports decreased until April 2009; since then they have been negative. In July 2009 Bangladesh exported 10% less than in the same month the previous year. In Kenya the central bank warned of a fall in exports of flowers. In Zambia export earnings for copper crashed by 54% during the first quarter of 2009. The tourist

7 For example, Malaysia decreed a halt to engagement, Spain reduced the quota for Moroccan seasonal workers and Dubai sent foreign workers back.
9 Ireland and Italy have already announced cutbacks in their aid, and so have Lithuania and Estonia (new in the circle of the donor nations).
destinations in the Caribbean and Africa were faced with slumps in income. The higher the proportion of exports in the gross domestic product (GDP) of a country, the harder the impact of dwindling demand during a crisis. A country where a single sector accounts for a high proportion of the economy was particularly susceptible to a clumping risk, as in the case of the Slovak Republic with its automotive industry and Ukraine with its steel industry.

Lower State income may also be coupled with sinking export income, as in the case of Côte d’Ivoire, Lesotho and Swaziland where 40-50% of State income derives from customs duties (IMF 2009e).

4. Responses to the crisis

In the wealthy countries the discussion on how to deal with the global financial and economic crisis marginalised the developing countries and their needs. At all events, the impact of the crisis on the poor countries did not hit the headlines the way bank bailouts and toxic securities did.

In recent years many developing countries have made significant macro-economic progress. Consequently, some of them are better armed against the crisis than they were on previous occasions. These countries are not exposed to the crisis without any protection whatever. Many governments in the developing countries have undertaken measures according to their own powers. They have strengthened their (regional) cooperation with one another. The UN, IMF, World Bank and other international organisations have also endeavoured to support the developing countries. They were urged to act by the non-governmental organisations and numerous academic powers.

4.1. Developing countries’ response at national level

There is a considerable degree of variation in the initial position of the individual developing countries. Some have high international currency reserves, others have a substantial inland market. However, many countries had already been severely depleted by the food and energy crises.

4.1.1. Fiscal stimulation measures

Wealthy countries responded with extensive fiscal interventions.\textsuperscript{11} Numerous developing countries also launched programmes of this kind. Countries with substantial international currency reserves and a low budget deficit, like China, were in a position to do so. China announced a CNY 4 billion programme (some EUR 430 billion) for the years 2009 and 2010 to be invested in domestic infrastructure, social security, technology, environment and education.\textsuperscript{12} I. Ortiz posted an analysis of fiscal stimulation plans in 43 industrialised and developing countries as per March 2009 (Ortiz 2009). However, a procedure based on individual programmes for each country was considered insufficient, and a multilateral, coordinated approach was called for. Most

\begin{itemize}
\item \textsuperscript{11} In the US the stimulation programme amounts to over 7% of the GDP.
\item \textsuperscript{12} Other examples are Korea, Malaysia, the Philippines, Thailand and Vietnam. South Africa also stepped up its investment and social spending.
\end{itemize}
developing countries had and still have a clearly lower financial-political scope for stimulation programmes and social measures to protect the poorest. Using a special fiscal capacity indicator, a UNESCO team ascertained that 43 of the 48 low-income countries examined have no scope for stimulation packages in favour of the poor (UNESCO 2009). Higher bilateral aid and liquidity aid from the international financing institutions could significantly expand the range of options for such countries.

4.1.2. Money policies
Other countries, like India, opted for other paths. India does have considerable international currency reserves to call on, but it also has high fiscal deficits which leave little room for increased expenditure. Consequently, India put the emphasis on monetary measures, in particular facilitating credit access options for producers. For many developing countries, however, these money policy measures are strictly limited because easement in interest policy impacts the exchange rate of their currency and the rate of inflation.

Conversely, the effect of devaluation of currencies as a specific export incentive measure would probably be limited as long as global demand did not rise more strongly. Some countries, in contrast, have introduced selective trade restrictions on non-essential luxury goods.

4.2. Stronger South-South cooperation
There are hardly any reliable figures available as yet on the effects of the crisis on South-South trade and South-South direct investment. The pronounced growth of past years will be somewhat slowed but will continue, according to Khalil Hamdani, Special Adviser of the South Centre in Geneva (Hamdani 2009).

A good example of strengthened South-South cooperation is the expansion of the Association of South-East Asian Nations (ASEAN) multilateral credit agreement. In February 2009 the finance ministers of these countries plus China, Japan and Korea raised the scope of this Chiang Mai Initiative to USD 120 billion (ASEAN 2009).13

In May 2009 seven South American States14 founded the Bank of the South with a capital to be paid in of USD 7 billion to finance development projects. Also under discussion is an expansion on the lines of a monetary union or a monetary stabilisation fund (Ugarteche and Ortiz 2009). In April 2008 the Bolivarian Alliance for the Americas group of Latin American States resolved on a joint monetary council, a reference currency for their inter-State trade, a chamber for payment compensation and a reserve fund for trade transactions (Cassen 2008).

M. Morais de Sa e Silva sees a certain danger for South-South cooperation (Morais de Sa e Silva 2009). South-South projects are being increasingly funded by ODA.15 Such triangular projects could fall victim to reduced ODA.

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13 China also made bilateral monetary swaps in the billions to, among others, Korea, Hong Kong, Indonesia, Belarus and Argentina.
14 Argentina, Bolivia, Brazil, Ecuador, Paraguay, Uruguay and Venezuela. See also Agencia de Prensa del Mercosur, 12 May 2009, reproduced at: http://www.oid-ido.org/article.php3?id_article=933.
15 The author mentions Japan, the United Kingdom and the European Union (EU). But she also calls for bilateral exchange of information, precisely between neighbouring countries.
4.3. International initiatives

The same ever-recurring themes run like a red thread through the international initiatives to deal with financial and economic crises, although they may be weighted differently or even run in the opposing direction. It is always a question of the reform of the international financial system, acquisition of additional liquidity, control and regulation of markets and the specific competences of a wide range of institutions.

The primary actors for development policy debates were the UN and certain of their special organisations, the Bretton Woods institutions, the EU and the regional development banks. The G-20 assumed an incontestable role. Non-governmental organisations throughout the world played an active part in these discussions and published numerous documents. Many in the academic world were concerned with these issues.

4.3.1. The processes in the UN

The UN claimed an important role for itself at a very early juncture. UN Secretary General Ban Ki-Moon had offered to host a global conference on the financial crisis. He received the backing of the Group of 77 (G-77) and many civil society organisations. In vain! The UN and its sub-organisations did put forward analyses, staged conferences and seminars and proposed measures, but the more important role fell to the G-20 and the Bretton Woods institutions.

From Monterrey to Doha

The financing for the development conference held in Doha was staged, independent of the financial and economic crisis, to examine progress since the 2002 Monterrey conference on finance for development. But the food, energy and financial crises played a significant role throughout the preparatory phase and had a marked influence on the conference and the resolutions taken. The timing of the conference proved unfortunate. The G-20 finance summit, held shortly before in Washington, took the wind out of Doha’s sails and only a few heads of State and government attended. The closing document described the dramatic global situation for the most part pertinently but remained vague with a view to concrete action. Nevertheless, after hard negotiations the Doha conference did resolve to hold a highest-level UN conference on the financial crisis and its impact on the poorest countries in 2009. This was important in that the topic could not be monopolised by the G-20; the UN thus kept its role in the process of reforming global financial architecture.

Stiglitz commission

Already before the Doha conference the President of the UN General Assembly, Miguel D’Escoto Brockmann, deployed a commission under Professor Joseph Stiglitz to examine the global finance system and to propose appropriate

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17 This can be found under point 79 of the closing declaration at: http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf.
measures. To this end, the commission conducted a broad consultation procedure in which almost 100 civil society organisations also participated. The commission published its provisional report in mid-March 2009 (UNO 2009). Further to a comprehensive analysis section, in very clear language for a UN document, the report also included numerous proposals for measures. Thus, the commission urgently proposed a globally coordinated stimulation policy and demanded more financial aid for developing countries. A new global credit organisation would be necessary for this purpose. The Stiglitz commission further demanded a new international reserve currency and a comprehensive reform of the international financing institutions. Also necessary is a global council for economic coordination on the lines of an economic security council. This report, together with other analyses submitted, was discussed in-depth at a special UN General Assembly event. In mid-May the commission presented its provisional report, which was at the same time the basis for the UN General Assembly session scheduled for June on the reform of the international monetary and financial system (UNO 2009a).

The UN conference on the global crisis

The UN conference on the global financial crisis, which was decided on at Doha, was planned for the beginning of June 2009. However, the preparatory process proved difficult; just determining the modalities took several weeks. The conference was first postponed and then rescheduled for the end of June.

In the meantime the G-20 had already established facts at the summit in London (see below). With considerable effort, they did manage to produce a closing document (UNO 2009b) with plenty of vague phrasing and no concrete plans of action. That was the result of an embittered struggle between the industrialised countries and the Group of 77, the latter backed up by strong commitment on the part of the non-governmental organisations. The primary concern of the industrialised countries was patent, i.e. the UN’s role in global economy issues should be kept as small as possible. In the end only very few heads of State and government from the industrialised countries attended the conference eventually held from 24 to 26 June. The final document advocated comprehensive reform of the international financing institutions. In contrast, there was nothing substantially new with a view to novel and additional instruments in development financing. The document recognised the necessity of political leeway for the developing countries, though without going into

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22 All the conference documentary matter and the programme are posted at: http://www.un.org/ga/econcrisissummit/.
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the conditionality issue. The paper further proposed that additional special IMF drawing rights should be admitted, primarily for the developing countries. In the combating of international tax evasion and illicit capital flows, the document did not go beyond the principles already established in Doha.

The fact that the conference managed to install a continuation process can be rated as the most positive result from the viewpoint of the developing countries (South Centre 2009). This strengthens the UN claim to a strong voice on global economic and financial issues. Thus, the UN as a “G-192”, as it has already been called, virtually becomes a counterbalance to the G-20. The excellent analyses by UNCTAD (2009a, 2009b, 2009d), in particular, are significant.

4.3.2. From the G-8 to the G-20

The G-20 has clearly assumed the role of coordinating instrument for global economic and financial policy. The major threshold countries definitely have their own place at the Group of Seven/Eight (G-7/G-8) table now. And with this, the industrialised countries have taken the changed global economic power structure into account. The financial crisis further accelerated this development. The G-20 represents 85% of the world GDP, but 2.6 billion (for the most part impoverished) people and 172 countries are excluded. The G-20 put itself on the throne, rendering the legitimacy of decisions with global impact questionable.

Switzerland is not a member either. Like the Netherlands and Spain, it does not even have observer status. After the Pittsburgh summit, Swiss Federal Councillor and Finance Minister Hans-Rudolf Merz commented critically on its legitimacy. Officially, the Federal Department of Finance does, however, welcome the Pittsburgh resolutions (FDF 2009).

The G-20 summit in Washington in mid-November 2008 was the first held at heads of State and government level. Previously the meetings had involved the individual ministers of finance and the heads of the issuing banks. Although there was talk of “Bretton Woods 2” in the run-up to this summit, the results were far below expectations. In particular, the direct interests of the poor countries were, for the most part, not taken into consideration, although the final declaration did mention the necessity of supporting the threshold and developing countries. They would have to obtain access to sufficient financial resources. The declaration called on the IMF to be flexible in applying its credit instruments. The World Bank and multilateral development banks should use all their resources, and if necessary increase them, to support the poor countries. In the same vein, the heads of State affirmed they were

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23 Ambassador Martin Dahinden, Director of the Swiss Agency for Development and Cooperation (SDC), declared that he was satisfied with the outcome and promised not to reduce Swiss aid. However, Mark Herkenrath, from Alliance Sud, found the discrepancy between the clear analysis and the lack of concrete results offensive. See: Swissinfo, Finanzkrise: Schweiz mit UNO-Konferenz zufrieden, June 2009. www.swissinfo.ch.

24 This implies that all 192 member countries should have a voice at the UN.

25 The following are members of the G-20: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States and European Union. See: http://www.g20.org/.


27 All closing communiqués are posted at: http://www.g20.org/pub_communiques.aspx. This contribution does not consider in-depth all the other aspects of the resolutions, such as restoration of confidence, stimulation programme, stricter regulation and so on.
ready to head the reform of the IMF and the World Bank. There were no concrete courses of action in favour of the developing countries; the phraseology remained vague. The major threshold countries integrated in the G-20 proved to be ineffective pioneers for the poorer developing countries. However, the latter hope to be able to benefit indirectly from the incipient technical reform process, e.g. from the already resolved extended cooperation in the tax sector under the reform of the IMF and the World Bank.

The G-20 summit in London on 2 April 2009, for the first time with new US President Barack Obama, brought more important progress for the developing countries. The summit agreed an expansion of the IMF credit resources available totalling USD 750 billion. The World Bank and multilateral development banks would increase their loans to low-income countries by USD 100 billion. The capital basis would be broadened proportionately. A further USD 250 billion should be made available to finance trade. IMF and World Bank institutional reforms that have already been initiated should be speeded up and extended.28

The international media felt the outcome of this summit was rather disappointing, at least with respect to a new global financial order. In contrast, various comments on the results with respect to the development aspects were cautiously optimistic. Thus, Oxfam (Oxfam 2009) considered it important that the final statement, dated 2 April 2009, acknowledged in article 25 (G-20 2009c): “We recognise that the current crisis has a disproportionate impact on the vulnerable in the poorest countries and recognise our collective responsibility to mitigate the social impact of the crisis to minimise long-lasting damage to global potential.” Oxfam further calculated that a potential USD 240 billion could flow to the developing countries, USD 50 billion of these to the poorest countries. The aid organisation added critically that, however, this would be for the most part in the form of loans and not gifts. Oxfam called for expeditious implementation.

The strengthened position of the IMF was rated more critically by the developing countries and the aid organisations. The voting reform and other governance questions remained mired in generalities. There was no call for a new IMF and World Bank policy; the strict conditionality of loans was only mildly modified (see below).

The third G-20 heads of State summit held on 24-25 September 2009 in Pittsburgh dealt intensively with bank regulation, minimum capital prescriptions, bonuses and debt limits, but also with the continuation and deliberate lapping of growth and occupation strategies as well as global imbalances. After all, the summit agreed that 5% of IMF voting rights should be transferred from the over-represented to the under-represented countries. Moreover, 3% of the World Bank voting rights are to be shifted. At the same time the summit emphasised that reforms of the IMF and World Bank mandate, mission and governance should be continued. The conference also presented two extensive representations in table form of progress made, both with a fundamentally positive appraisal of what had been achieved (G-20 2009).

External institutions were significantly more differentiated and critical in their opinions. N. Woods (2009) did acknowledge IMF efforts for increased inflows of funds. However, he criticised that to date less than 2% of the new IMF credits went to African countries.

Eurodad (2009), the European Network on Debt and Development, acknowledges that more progress has been achieved in comparison to previous G-7 summits. However, it criticised the fact that the G-20 had not yet provided the funds pledged. Aid resources for the developing countries are linked to disadvantageous conditions. Regulation of raw materials speculation and progress with tax havens, *inter alia*, are slow and insufficient.

Jubilee USA Network (2009) takes the same stance. This network of 75 civil society organisations is examining, on the basis of 13 G-20 aims, whether the G-20 is indeed on the right road and whether the needs of the developing countries have been met. Only in the event of a surveillance mechanism, to be created by the UN, monitoring the effects of the crisis on the poorest, does Jubilee come to a positive response on both counts.

### 4.3.3. International financing institution activities

The IMF and the World Bank as well as other multilateral financing institutions addressed the financial and economic crisis early and on their own initiative. At the same time the G-20 resolutions also added impetus. Vice versa, the heads of these organisations were not loath to call urgently on the G-20 heads of State for speedier and more intensive action. They were able to attend the summits as observers.

The principal concerns included on the one hand the policy counselling of the member countries and financial support, which is to be considerably increased. To this end, all the multilateral financing institutions had to significantly expand their own resources. This process had not been completed by autumn 2009. At the same time the financial crisis had entailed increased pressure on the reform of governance. However, the resistance of a few industrialised countries remained high; nevertheless, the reforms should be completed in 2010.

Both the IMF and the World Bank use the spring and autumn meetings to present their measures and activities in the best possible light. The annual meeting in Istanbul in early October 2009 even adopted the optimistic slogan: “Road to global recovery”.

### IMF policies and measures

The IMF has been variously reproached for not having foreseen either the scale of the financial crisis or when the crisis would break and because it did not become more active, at least at the beginning. The more the crisis spread, the more active the IMF became.

Hardly any State had asked for credit aid over a long period and the sum of the outstanding credits had sunk to an all-time low. In October several countries had to apply to the IMF for aid. Iceland, as first West European country since the 1970s, followed by Ukraine, Hungary, then other Eastern European countries, the Baltic States and Pakistan.
whether the IMF would have enough resources if it were confronted with numerous large-scale applications for loans due to the financial crisis. At the same time this about-turn in calls on the IMF challenged it to accelerate and complete the ongoing revision of its credit instruments. This also involved an examination of the frequently criticised economic policy conditions for granting loans. As the IMF recommended massive stimulation programmes to the industrialised countries impacted by the crisis, the developing countries accused the IMF of double standards in view of their previous experience with its stringent conditions. And finally, the developing countries emphatically urged the IMF to at last step up the reforms on voting rights and other governance questions.

In its publication *World Economic Outlook* the IMF showed increasingly clearly how severely the developing countries had been impacted by the crisis. In March 2009 the IMF published an important and comprehensive survey of how the poorest countries have been hit by the crisis and the measures that had to be taken (IMF 2009a). The IMF report submitted to the UN conference in New York in June can also be described as fundamental (IMF 2009b).

In the meantime the IMF had expanded both its instruments for the grant of credit and its financial resources. The IMF created the flexible credit line as a precautionary measure for countries whose policies are considered good and which post sound macro-economic data. The credit conditions were simplified and the credit lines raised. The instruments for the poorest countries were also reformed.

The IMF has also built up its own resources. In August 2009 it created USD 283 billion new special drawing rights, including USD 110 billion for the developing countries (and USD 20 billion of these for the poorest countries). In September the Executive Council permitted the IMF to sell 400 tonnes of gold. Further, there were also bilateral contributions by the individual member countries, as called for by the G-20. This financing procedure was still in progress in October 2009. Switzerland also pledged to provide the IMF with an exceptional, set-period contribution to the stocking up in the amount of CHF 12.5 billion (PFD 2009b).

The Swiss Council of States approved the credit at its 2009 summer session (*Official Bulletin* 2009). On the other hand, the consultative commission adjourned the decision-making until it could examine the report announced by the Federal Council regarding the increase of official development assistance (ODA) to 0.5% (CPE-N 2009).

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30 The *WEO* is usually published twice a year. When necessary there are interim updates. The IMF also publishes regional “Outlooks”. These are posted at: http://www.imf.org/external/ns/cs.aspx?id=29.
31 This document also includes a longer and more comprehensive list of other IMF documents on the subject.
With a view to the annual meeting in Istanbul in early October 2009, the IMF awarded itself good marks for the work achieved so far. IMF aid granted to the 15 countries which applied for credit in the past few months was successful (IMF 2009c).\footnote{Cf. IMF-Supported Programs Help Countries Weather the Worst of the Global Crisis, Says Internal Review. Press Release No. 09/319, 27 September 2009. http://www.imf.org/external/np/sec/pr/2009/pr09319.htm.} In the poorest countries the IMF commitment had helped to make way for effective programmes. The conditionalities have been simplified and limited (IMF 2009d).

The non-governmental organisations do not see the IMF in such a favourable light. Some three international networks reproach the IMF for changing its policy only insignificantly. Rather, fiscally restrictive IMF conditions in three countries examined\footnote{El Salvador, Ethiopia and Latvia.} would impair the essential social protection (Solidar, Global Network, and Eurodad 2009). P. Chowla (2009) also sees a restricted development potential in IMF resources.

The developing countries and non-governmental organisations are by no means satisfied with the extent and pace of IMF institutional reforms. It is a fact that the IMF is now bound to implement quota reform and with it the revision of voting rights by January 2011.\footnote{That will hardly alter the power structure. See: Etwereaa, Ram, Le FMI incapable de se démocratiser. Le Temps, 29 September 2009. www.letemps.ch.} The developing countries would like a shift in voting rights of at least 7\% to give them a majority. The blocking minority of the US should also be done away with. At all events, in 2009 the IMF did undertake an extensive dialogue with civil society that led to the publication of a civil society report (New Rules 2009) and to a joint event in Istanbul before the annual meeting.\footnote{Cf. On the Road of IMF Governance. 2 October 2009. http://blog-imfdirect.imf.org/.}

At the annual meeting in Istanbul the IMF monetary and finance commission confirmed the G-20 agreement and called on it to continue with the reforms already initiated.\footnote{Cf. Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund. Press Release No. 09/347, 4 October 2009. http://www.imf.org/external/np/sec/pr/2009/pr09347.htm.} For the most part, Hans-Rudolf Merz would like to follow suit. However, whenever there was a potential conflict of interests between the cautious financial gestures of the IMF and increased transfer of resources to the developing countries, Merz always upheld the former, e.g. in the question of utilisation of special drawing rights, in the event of possible financial risks for the IMF with watered down conditionalities and in the deployment of gold reserves and interest costs for loans to the poorest countries (FDF 2009b).

**World Bank policies and measures**

The World Bank rapidly became an important advocate for the developing countries in overcoming the financial crisis. It was soon patent that the poorest countries, already depleted by the food and energy crisis, had few possibilities of providing the necessary responses from their own resources.

The World Bank submitted two papers\footnote{All Development Committee papers are posted at: http://web.worldbank.org/WEBSITE/EXTERNAL/DEVCOMMEXT/0,,menuPK:64060743--pagePK:60000303--piPK:64000842--theSitePK:277473,00.html.} setting out the fundamentals of its response to the crisis (Development Committee 2009, 2009a) to the development
committee at the Istanbul annual meeting. Subsequently the World Bank Group raised its total lending activities in the 2009 financial year by 54% compared to the previous year, to some USD 60 billion. One-third of this went to infrastructure projects in the hope of rapidly increasing employment and generally stimulating the economy.

Some USD 33 billion of the total package of USD 60 billion passed through the International Bank for Reconstruction and Development (IBRD) via trade credits to middle-income countries. The World Bank expects a further rise in the coming years. Financing can no longer be covered by the present World Bank capital basis. On one hand, it raised the interest on loans; on the other, it took up significantly more funds on the international capital markets.

The International Development Association (IDA) raised its approvals for interest-free loans or gifts to a record USD 14 billion, an increase of one-quarter above the previous year’s figure. IDA accelerated its processes for the poorest countries to receive their funds more rapidly.

The World Bank subsidiaries Multilateral Investment Guarantee Agency (MIGA) and International Finance Corporation (IFC), responsible for the direct support of the private sector, also stepped up their activities. They granted loans, participated in enterprises and put up guarantees. The latter is significant because local enterprises in developing countries had encountered
increasing difficulties in obtaining trade credits or bank guarantees from the major international banks.\footnote{Thus, local banks in Guatemala no longer wanted to grant credits to local producers as they could no longer trust the previously customary guarantee pledges of the major international commercial banks in view of the financial crisis, as explained by the Fonds International de Garantie, Geneva, in discussion with the author.}

The World Bank channelled its activities through a specially created “Crisis Response Facility”.\footnote{For a compact overview with plenty of links see Financial Crisis. What the World Bank Is Doing. Factsheet (updated 22 September 2009). http://www.worldbank.org/financialcrisis/bankinitiatives.htm.} Before the World Economic Forum in Davos in January 2009 World Bank President Robert B. Zoellick had already called for a “vulnerability fund” to which all countries would contribute 0.7% of their economic programme for development policy purposes. At the time this would have raised some USD 15 billion. However, the World Bank estimated the financing shortfall of the developing countries much higher. According to this scenario, the World Bank considered the financial needs for 2009 to be between USD 350 and 635 billion (Development Committee 2009\textsuperscript{a}). Zoellick repeated the appeal in a call to the leaders of the G-20 summit in Pittsburgh (World Bank 2009\textsuperscript{b}). The World Bank also published numerous studies and reviews.\footnote{The list is available at: http://www.worldbank.org/financialcrisis/.}

Non-governmental organisations recognised the distinct advocate’s role of the World Bank and its will to help as rapidly as possible. However, effective payments tended to lag behind the approvals. Further, there are doubts whether the massive investments in infrastructure would really help protect the socially weakest. They further demanded that the aid measures should not be coupled with economic policy provisos. The services should be rendered as concessionally as possible or even in the form of gifts. The slow and not far-reaching progress in the democratisation of the World Bank was deemed completely insufficient.\footnote{An extensive compendium of such opinions is posted under Eurodad, International Financial Institutions. http://www.eurodad.org/aid/?id=132&item=0&ArticleShowall=true#articles.}

The World Bank was called to heel at the 2009 annual meeting in Istanbul. In the development committee, the industrialised countries bridled at an immediate raise in capital, which the World Bank considered necessary, supported by the developing countries. The World Bank is to make further clarifications before the next spring meeting.

5. Outlook and conclusions

There is no doubt that one of the consequences of the financial and economic crisis was a shift in power and influence. The ascendance of the G-20 at the cost of the G-8 is irreversible. The larger threshold countries are demanding more influence. Brazil, China, India and South Africa do not want to put up with a modest further shift of only 5% of voting rights. A renewed conflict is imminent.

The IMF is back and has again grown in importance. This also explains the adamant attitude of the larger threshold countries. Obviously they also see the IMF rather than the UN as the decisive power centre and forum for
disputes on global economic issues. And they take advantage of their access to the newly significant G-20. They want to exercise their influence there for a new global financial order. Smaller and weaker States are rather committed to the UN, though without far-reaching success.

The industrialised countries have not become impotent. The agenda of the global discussions still bears the stamp of the interests of the rich countries. This can be demonstrated by three examples: the debate on debt, the issue of global taxes and the question of international tax evasion and capital flight.

5.1. The debt problem

In view of the enormous government and issuing banks refinancing programmes, together with the comprehensive economic stimulation measures, there is a long-term threat of enormous budget deficits and mounting public debt, primarily in the industrialised countries. How to cope with this issue is a primary element of public economy and political debate.

Only in narrow interested circles is the problem of the foreign debt of developing countries still the subject of debate and review whereby the burden of debt for many of the poorer countries does seem to be accentuated. In 2008, according to the IMF, the total burden of debt of all the developing countries mounted by a further USD 220 billion to USD 4,529 billion and will, according to predictions, continue to rise in the coming years.

In their latest progress report on the initiative in favour of Heavily Indebted Poor Countries (HIPCIs) (IMF and World Bank 2009) the IMF and the World Bank did post further progress. But they simultaneously warned that in a number of countries the debt vulnerability has risen sharply, namely in high-risk countries like Afghanistan, but also in Ethiopia, Malawi, Mali, Mauritania, Nicaragua and Sierra Leone.

Within the frame of their debt sustainability programme, the IMF voted for a “flexibilisation” of the debt limits for poorer countries so that they could incur higher debts. The Friedrich Ebert Foundation feels that this is on a par with disbanding the fire brigade when a fire is imminent (Kaiser, Knoke, and Kowsky 2009). All HIPCIs would be exposed to at least a moderate risk of being involved in any future debt crisis. Half of the countries are still so severely burdened by old debts that their risk is very high or high. This menacing time bomb is allowed only an insignificant place in the ongoing discussion.

5.2. An international financial transaction tax

The finance sector caused the crisis and should bear the costs! In August 2009 the President of the British Financial Services Authority, Adair Turner, therefore proposed the introduction of a financial transaction tax, and French and German government circles supported the idea. Before the Pittsburgh summit, non-governmental organisations wrote to the G-20 that a tax of this

49 This is more comprehensive than the so-called Tobin Tax which aims to tax only foreign currency transactions.
kind should be introduced and the income used for development purposes. The motion was not discussed seriously either in Pittsburgh or in Istanbul.

**5.3. International tax evasion and illicit capital flows**

The high money requirements to finance the economy stimulation measures and the bank bailouts were certainly one reason for stepping up the campaign against international tax evasion. However, the measures introduced to date largely bypass the needs of the developing countries.

Most talked about were the black and grey lists drawn up by the G-20 in conjunction with OECD. Any country which did not have at least 12 double taxation agreements (DTAs) or tax information exchange agreements (TIEAs) with other countries was blacklisted. These agreements must, at least, meet the OECD minimum standards for mutual exchange of tax information on request. The lists were updated continually (OECD 2009a). OECD presents a review of its efforts in the struggle against tax evasion in an informative brochure published in October 2009. In the meantime, according to OECD, the offshore centres monitored have signed 90 new agreements for improved exchange of information since April and over 60 are currently being negotiated. New ones are being added continually. OECD argued that the developing countries would also benefit from them.

The fact is, however, that these agreements on the exchange of information on tax affairs exclusively concern transactions between the tax havens and OECD States and not the developing countries. Many of them have not yet been brought into operation. Developing countries have also contracted far fewer bilateral DTAs than the industrialised countries. DTAs and TIEAs are bilateral agreements between two States without multilateral power of legal implementation. The OECD standard for the exchange of information is not enforceable under international law.

The OECD and G-20 initiative therefore remains insufficient for the developing countries. The Tax Justice Network (2009) has set out in detail why the exchange of information on request is not sufficient, why an automatic exchange of information is necessary and why multilateral rules are essential, precisely for developing countries.

But an enhanced exchange of information in tax matters would not be enough either. Various studies in recent years have shown how the offshore centres foster corruption, capital and tax flight. According to the latest estimates, between USD 800 and 1,000 billion of illicit flows are leaving the developing countries (Global Financial Integrity 2009). Contrary to expectations, criminal dealings or bribery and corruption payments do not account for the greater part of these illicit flows. Two-thirds derive from commercial transactions. Particularly targeted is internal transfer pricing by multinational group concerns. Approximately 60% of world trade is effected within multinational enterprises. By under-invoicing or over-invoicing, book profits and losses can be shunted around virtually at will. This is linked with tax evasion on a grand scale. The English charity Christian Aid (2008) estimates this at over USD 160 billion annually. Four specialised non-governmental organisations demanded six immediate and trenchant measures by letter to the G-20 (Global Witness et al. 2009). The G-20 should prepare for the transition to the...
automatic exchange of information. The rules on the identification of bank clients must be tightened up. Tax evasion should be declared a preliminary to money laundering. The G-20 should show ways of combating abusive transfer pricing. The ownership structure, control and invoicing of offshore enterprises, trusts and foundations should be disclosed. In particular, the multinational enterprises should be bound to detailed, public, country-by-country reporting on their subsidiaries and the associated turnovers, investments, profits, taxes paid and so on. The Task Force on Financial Integrity and Economic Development (2009) and the Tax Justice Network have also vigorously upheld this country-by-country reporting.

It is striking that the Norwegian government has also come out in favour. It set up a special commission whose report on capital flight from the poor countries was published in June 2009 (Commission on Capital Flight from Developing Countries 2009). The study proposes a more demanding development policy that will assure the developing countries sufficient tax income and root out corrupt practices that lead to flight of capital and taxes.

Finally, at end-October the Tax Justice Network published an extensive electronic database listing over 60 tax havens and secrecy jurisdictions, which is being expanded and updated continually (Tax Justice Network 2009a). Each of these havens was examined according to 12 indicators, selected to provide information on the degree of transparency and the spheres of secrecy. Based on this, the Tax Justice Network will shortly also publish a new “Financial Secrecy Index”. This should mark a significant step towards improved financial transparency.

**Digression: the Swiss financial centre under pressure**

In the wake of the financial crisis, the Swiss financial centre has come under heavy pressure from two sides and has had to make significant concessions. On one hand, the behaviour of UBS in the US was harmful. In February 2009 Switzerland had to disclose the data for some 300 UBS clients to the US. At end-July Switzerland and the US agreed to settle the US civil proceedings against UBS out of court.

On the other hand, Switzerland was also put on the OECD and G-20 grey list in April 2009. The Federal Council had in fact resolved on 13 March 2009 that Switzerland adopt the OECD standard for administrative aid in tax matters pursuant to article 26 of the OECD model agreement (FDF 2009c). It announced that it would rapidly initiate negotiations for the revision of DTAs with States that wished this.

In the meantime Switzerland has concluded and signed 12 DTAs entailing extended administrative aid (FDF 2009d). Three more have been negotiated but not yet been signed. These agreements must now be ratified by parliament before they can come into force. It is striking that, with the exception of Mexico (itself a member of OECD) and Qatar, there are no developing countries on this list. Switzerland has contracted DTAs with only 42 developing countries. Some of these do not provide for any administrative aid in the event of tax fraud. Another group of the agreements assures administrative aid only in the event of tax fraud. There are no treaties at all for over 100 developing countries. In these cases there are no contractual commitments with respect to tax evasion and tax evasion.

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fraud (Alliance Sud 2009). Switzerland had already negotiated agreements with Bangladesh, Chile and Ghana before it switched to the OECD standard for exchange of information. The federal councillors ratified these old-model agreements. Those with France and Turkey, also originally negotiated on the old model without exchange of information even for tax evasion, were, in contrast, referred back for reworking. An economic commission motion has been submitted instructing the Federal Council to draw up a concept for the equal treatment of OECD and developing countries.

At a media conference in the run-up to a conference of OECD ministers of finance in Berlin in June 2009 Alliance Sud (2009a), together with partner organisations from Austria and Luxembourg, presented proposals for a new tax foreign policy that would benefit not only industrialised States but also developing countries. The three countries should contribute vigorously to drying out the tax havens. The OECD standard should also apply for developing countries. And finally, taxation of interest should be expanded, analogous to the agreement with the EU, to cover the developing countries.

The latter demand was not new; the aid and development policy organisations had already called for it in vain in previous years. The Federal Council had rejected such motions out of hand several times. So it was all the more surprising that Federal Councillor Micheline Calmy-Rey took up the aid organisations’ idea at the UN conference on financing development at Doha at the end of 2008 and declared Switzerland’s readiness, along with other interested countries, to tax the assets from developing countries deposited with Swiss banks, analogous to the interest taxation agreement with the EU, and to direct the income back to the developing countries. The idea was left on the shelf and was not followed up.

In contrast, various bank representatives launched the idea of a capital gains tax on foreign assets (Swiss Banking 2009). Switzerland should levy a tax for interested countries on income from foreign assets held in Swiss banks. This would equate to a further expansion of EU interest taxation as dividends and fund income would also be taxed. This is aimed primarily at OECD member countries, not at developing countries. To date neither the EU nor OECD has shown any readiness to take up the proposals. There were also initial defensive reactions from the capitals of individual European countries and in international press commentaries. Apparently the idea seems to be rated as an all too transparent manoeuvre by the Swiss banks in an attempt to save what can still be saved. Foreign States would profit from increased tax income from Switzerland but would not have any information on the names of the holders of the assets. Such a capital gains tax contradicts the tendency to improved exchange of information. The EU wants data, not money. The banks’ newly built-up defence for banking secrecy does not appear to be appropriate for a prolonged defensive battle.

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a This was the position at end-September 2009.
b There is a list of DTAs at: www.estv.admin.ch/intsteuerrecht/themen/00170/00784/index.html?lang=de.
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