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Take back the palace

In wake of the Paradise Papers, it's time tax-paying citizens recognised their power to create change

The release of the Paradise Papers has deepened public anger about the activities of the 1 per cent in evading taxation. The global investigation has created an opportune moment for wider debate about how the increasingly corrupt and out-of-control global financial system can be tamed.

It is time for the financial sector to serve the real economy, where people live, innovate and work. It is time for the sector to be dislodged from its position as master of the global economy. For if, in future, we want to tax the rich, to dismantle tax havens, to avoid another global financial crisis, to tackle criminality and inequality, it's vital that we start to think differently about the global financial system. If we want a system that makes it possible for us to finance the shift of our economy away from fossil fuels, if we want to thwart the rise of nationalism and authoritarianism… we must begin to think differently about the system.

Above all, we, as taxpaying citizens, must begin to think differently about our own power to bring about change. We must think about how to use – or leverage, to use financial terminology – the powers we have. We must remind ourselves of how the private financial system depends on taxpayer-financed institutions. We need this understanding of our potential power to influence and make demands of the finance sector if we are to begin to manage offshore capitalism, to bring offshore capital back onshore.

In the basement

We operate within and depend upon a financial system over whose construction we – and our elected representatives – had no say. We, the majority of the world's citizens, cower in the basement of a 'financial palace', built and occupied by the 1 per cent. The wealthy, rent-gouging residents of this global palace exploit those in the basement; the 99 per cent, the real economy in which taxes are collected. They devote very little of their enormous wealth to investing in and supporting either the

basement or its occupants. And yet they depend on these same taxpayers for the public institutions that enable them to make massive private gains.

The guarantees provided by governments to banks that are 'too big to fail and too big to jail'; the quantitative easing and low interest rates arranged by central banks; the enforcement of contracts made possible by public judicial systems; the safe streets they choose to live in – all these services are essential to the accumulation of private financial gains. And they are all possible thanks to the largesse of domestic, law-abiding taxpayers.

Without doubt, there are many powerful vested interests that will oppose the need to dismantle and rebuild the current international financial architecture. They will argue, and many of us will agree, that, thanks to modern technology, it's impossible to transform the system. They will argue, and many of us will accept, that nothing can be done. Instead, they will insist, we should all just relax and prepare for the next crisis of a globally interconnected financial system. And the best way to do that, they will argue, is to cut public spending and squirrel away the savings for the next global private bank bailout.

Take heart from history

We should resist such defeatism; we have been here before. Defeatedly is how Europeans and Americans viewed an earlier bankers' creation: the global gold standard of the 1920s and 1930s. Yet in 1931, Britain unilaterally withdrew from the then-dominant gold standard system. Not only was Britain not hurt by this decision, the economy actually prospered. Most bankers and commentators, and almost all economists, were shocked. 'We didn't know you could do that,' they said.

The United States followed Britain's decisive lead in 1933, when President Roosevelt refused to attend an international conference whose purpose was to reinstate the gold standard. His firm rejection of the bankers' plan scuppered the system entirely and laid the ground for the development of a new global financial architecture: the Bretton Woods system. Under the leadership of Roosevelt and economist John Maynard Keynes, the bankers' financial architecture – which had led to the 1929 financial crisis and the Great Depression – was publicly rejected. A more democratic and stable system was devised. We must take heart from that.

There is a second example of international transformation that could act as inspiration. Late one Sunday in August 1971, with Americans tuned in for their favourite cowboy serial on TV, President Nixon took to the airwaves to make a shock announcement: the US was unilaterally

dismantling that international financial architecture so painstakingly constructed by a gathering of economists at Bretton Woods in 1944. He did so without consulting his allies or the financial institutions, and without proposing an alternative. The international community was shocked. They hadn't known Nixon could do that. They hadn't realised the US could so easily default on its obligations to repay its debts in gold.

The International Monetary Fund was tasked with coming up with a new framework. It failed to do so. Instead, US sovereign debt became the global reserve currency, and a ramshackle financial system was surreptitiously cobbled together by private financial interests. And cobbled together is the correct way to describe the secretive, haphazard and piecemeal way in which the sector constructed the global financial architecture after 1971. An architecture and system that, with increased frequency, inflicts crises on hundreds of millions of people.

Fundamental to the operation of the system is the notion that the owners of capital should be able to live beyond the reach of those in 'the palace's basement'. They want to be able to move their (often illicit, fraudulent and speculative) capital gains into tax havens, beyond the reach of regulatory democracy and its taxation systems.

Change is possible

The above examples show that transformation of the system is entirely possible. We can build a different edifice – one in which the majority of citizens enjoy the benefits of a new, fairer, more balanced global financial architecture. We do not have to live in the palace built by private interests for the benefit of the 1 per cent.

All that is required to bring about change is wider public understanding and political will. The first task is to abandon the defeatism that informs so much debate about the volatile global financial system. We must abandon the delusion that change is not possible.

The second task is to educate ourselves about money, monetary theory and the deregulated and ramshackle international financial architecture of footloose capital flows. And to have the confidence that none of the economics behind the system is rocket science – even while financiers try to clothe their actions in jargon designed to flummox outsiders.

And the third task is to mandate our elected politicians and central bank officials to introduce controls over cross-border flows, to use what are known as macro-prudential tools to constrain and manage capital flows. There are several reasons it's important to manage mobile capital flows.

The first is relevant to the Paradise Papers revelations, and is best expressed by the economic historian Professor Robert Skidelsky: among other flaws, 'capital mobility has a tolerance for criminality'.

Drug dealers and criminals are particularly fond of capital mobility. Unregulated cross-border flows enable drug cartels to shift their illicit gains secretly across borders, untouched by customs authorities. The global value of heroin trafficking according to the latest (2011) estimate of the UN's Drug agency was $68 billion. The global market for cocaine was $85 billion. These numbers do not of course include the public health costs of this hugely profitable trade. They also do not include the associated costs when profits from drug trafficking are used to finance terrorism and insurgencies.

Oligarchs resident in weak economies are eager to shift their often-fraudulent gains into jurisdictions that enforce contracts and uphold laws. Accounting firms make profits by helping to expedite cross-border flows – including flows into tax havens. Corrupt politicians and public officials, many in some of the world's poorest countries, are particularly fond of the lack of control over their ability to wire funds abroad and away from their own tax authorities.

Transnational corporations use the mobility of capital to engage in what is known as abusive transfer pricing – shifting profits from a higher-tax to a lower-tax jurisdiction, for example. Those gains eclipse the sums exposed by the International Consortium of Investigative Journalists in the Panama and Paradise Papers leaks.

Winners and losers

All these activities occur because governments do nothing to prevent capital flows. And it is the finance sector that has persuaded governments that they don't need to manage cross-border flows, that financiers, billionaires, corrupt politicians and drug dealers alike should be free to move money without hindrance.

The economic argument put forward to defend capital mobility is based on the notion that money is like a commodity – and that like a commodity the market in money should be left entirely to 'the invisible hand', leading those in search of profits to do what's best for society. The flaw in this argument is that money is not in the least like a commodity – it is something created out of thin air overwhelmingly by private commercial banks, and now increasingly by the unregulated shadow banking sector. Financiers argue that money should be free to flow from where it is plentiful to where it is scarce. In fact, against this supposed law

of economics, capital has tended to flow 'uphill' – away from poor and into rich countries.

The consequences? The impoverishment of millions of people in poor countries; tax evasion on the scale revealed in the Panama and Paradise Papers; a massive increase in cross-border drug-dealing and criminality; and the economic, social and political instability associated with these uncontrolled cross-border flows.

Despite these negative consequences, the Western public tends to go along with capital mobility. After all, it makes international travel easier, and enables some to buy second homes abroad, and to use credit and bank cards anywhere in the world. So (with notable exceptions) we have bought into the global financial system. But the truth of who gains from the global financial architecture has been laid bare by the Paradise Papers: tax evaders, fraudsters, corrupt politicians and billionaires. In the meantime, the burden of losses is borne by those who pay taxes and continue to provide the public institutions that make such private capital gains possible. We almost unquestioningly provide these resources to corporations like Amazon, Facebook, Uber and Airbnb, to oligarchs, drug dealers, criminals and corrupt politicians and officials.

We have the power

It's not enough to be shocked and awed by the publication of revelations such as those in the Paradise Papers. We have to learn that we are not powerless. We have to start thinking differently about tax-paying citizens' relationships to these global corporations and incredibly wealthy individuals. We have to start understanding that we have power and political leverage over these tax evaders. That as taxpayers we prop up the systems – including the great public good that is our monetary system – without which these private capital gains would not be made. And that as taxpayers propping up the institutions from which the 1% derive huge wealth, we must insist on terms and conditions, regulations and controls over cross-border flows.

Understanding that power, we need to come together to collectively redesign, rebuild and transform the international palace that is the current global financial architecture – to make it socially just and economically sustainable, for the many, not just the few.



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