G-8 Pass Up Opportunity On Hedge Funds, Development

by Rainer Apel and Nancy Spannaus

The "World Economic Summit," which was held in the German town of Heiligendamm on the Baltic Sea coast between June 6 and 8, had the opportunity to act on two major initiatives to deal with the world financial breakdown crisis, in the direction of a New Bretton Woods: one, on the Bering Strait Tunnel proposal, presented from Moscow, and the other, on regulation of the hedge funds, presented by European parliamentarians. Although reports from the private deliberations are not available to this news service, there is little doubt that this opportunity was missed. The participants denied the reality of the bankruptcy of the world system, and thus did nothing to deal with it.

From the German side, there had already been a step in the right direction, with an initiative to force transparency of the hedge funds, but obstruction, particularly from the City of London, carried the day. Although such regulation cannot save the bankrupt system at this point, and nothing but a ban of the hedge funds is appropriate to their criminal behavior, the impulse to fight them is positive. While various sources, including a report in Alaska's *Juneau Express* and a board member of the Interhemispheric Bering Strait Tunnel and Rail Group, just before the Summit, had insisted that Russian President Vladimir Putin would put a proposal for the Bering Strait project on the agenda, it is not known whether he actually did so.

The format of this world economic summit has already been broadened to include developing countries like China, India, Brazil, and South Africa; they challenged the right of the industrialized countries to make decisions about the world economy. One such criticism came in the *Hindu* under the headline, "Forget the G-8!" The developing nations should hold their own summit, the article demanded, rather than sit around in Heiligendamm, waiting to be called into the anteroom, as if they were servants.

Also, former German Chancellor Helmut Schmidt, who originated this form of summit in 1975, criticized the current meeting as a media spectacle that is particularly bad this year because of the hysteria over global warming. In the weekly *Die Zeit,* June 6, Schmidt wrote: "China and India are missing, also the oil-exporting countries aren't there, and the Third World is not even invited.... Saudi Arabia and Nigeria should be there, and eventually also developing countries like South Africa and Brazil.... Therefore, dreams of a trans-Atlantic economic community, such as that our current government wishes possible, are unrealistic."

Schmidt primarily attacked the lack of interest of the summit participants in the really important questions, and their refusal to recognize that "above all, the situation in the globalized financial markets represents a danger for the functioning of the world economy.... We have a superabundance of liquidity in the world. That is life-threatening. Because one can shovel this money back and forth as you like, one can also call in all the short-term financial investments, and therefore cause a recession. To prevent such a fatal development, the great world powers must bring the wild and rampant financial markets under control. They must, at the same time, isolate the tax and customs-free islands. You can dry out the Caribbean tax havens, as well as Luxembourg, Cyprus, and others, through American, German, or British legislation. You could even subject the 10,000 speculative funds to bank oversight. Of course this so far is failing, because especially America and England believe that their short-term advantages are more important than the danger of a systemic collapse."

In reality, German Chancellor Angela Merkel's decision to make climate change, instead of the hedge funds (known in Germany as "financial locusts"), the chief subject at the summit, was a service for the control-shy speculators.

The Hedge Fund Issue

The actual, if also indirect achievement of the summit for the German government, was that at the summit's outset, the trade unions had given strong international support for the German drive to control the locust funds, and that prominent support for this effort, as shown by the letter printed below, by Congressman Barney Frank (D-Mass.).

A meeting was held in Brussels on June 4, including members of the European Parliament, who discussed mobilizing to get the G-8 to act against private-equity takeovers. The European Socialist members of Parliament were led by former Danish Prime Minister Poul Nyrup Rasmussen, who told the meeting that the top 20 private equity and hedge funds now control European corporations employing 4 million workers. This makes the hedge funds the largest employer in Europe, Rasmussen said. "The problem is that they don't regard themselves as employers." They specialize in short-term speculation, and quick-turnover buying, shrinking, and re-selling of corporate assets, and they often have "no respect for jobs, workers, or long-term investment."

While Rasmussen has promoted legislation to stop many "leveraged takeovers" in their tracks in Denmark, legislation which is close to passing, the German government has also indicated its intention to act against the "locust funds." Yet the Social Democrats in the G-8 countries outside Germany were unable to get their governments to take action at the summit. Germany's bid for closer regulations of hedge funds was blocked by U.S. and British opposition. The G-8 statement said, "Given the strong growth of the hedge fund industry and the increasing complexity of the instruments they trade, we reaffirm the need to be vigilant." No "code of conduct," which was Germany's latest proposal, was agreed upon.

No Climate Declaration, and Also No Credit

The good news from the summit is probably that the much-praised Climate Declaration from Heiligendamm remained so insubstantial that it is judged by green politicians and experts as "meaningless." One of the most prominent critics is himself in the German government, namely, Michael Müller, State Secretary in the Environment Ministry. Müller said on June 8: "We had made this determination already back in 1992. . . . We should not forget, that in 1992 at the Earth Summit, the world community had already decided that we must do everything possible to stabilize the greenhouse gases at a level which would not damage the climate. That is already 15 years ago." Müller is not very optimistic about the future for green climate protection.

The greatly anticipated summit declaration on Africa did not do what it had ostensibly promised with its $60 billion in aid. On the one hand, critics found fault with the fact that much of money should have been granted seven years ago, in 2000, when the "millennium goals" for the fight against poverty and disease were set. Nevertheless, many of those dollars, in reality, did not flow to Africa but to Eastern Europe, to fight AIDS there. Thus, it is hocus-pocus to present the funds as "aid for Africa." In general, the demand of the G-8 means that Africa must open itself to free trade, so that conditions can be created to haul out yet more raw materials from the African continent. Germany's annual aid budget for all of Africa will be increased only from 400 million to 500 million euros ($534 million to $669 million).

One of the worst omissions of the summit in Heiligendamm can be credited totally to Merkel. She has not intensively followed up the longstanding policy of economic cooperation with Russia by the Schröder government, and this summit did not take up the Russian offer made the previous year at the St. Petersberg Summit, for intensification of energy cooperation. Russia's nuclear industry has made a very interesting offer for technological collaboration with Germany, but nuclear energy is not Merkel's "thing," much less the construction of new nuclear plants.

Meanwhile, Merkel has gone beyond her anti-Russian position during the 2005 election campaign, making herself the leading spokesman for Polish complaints against Putin, and participating in ongoing Western propaganda against Russia—as she did at the EU-Russia summit in Samara recently. And while she does nothing to assert the majority control of the German government at Deutsche Telekom against hedge funds like Blackstone, she is utilizing the same majority control to prevent participation of the Russian firm Sistema at Telekom. That latter action offended the trade unionists at ver.di, who went on strike against the outsourcing strategy of Blackstone at Telekom.

In view of all this, what Merkel still calls the "strategic partnership with Russia," is nothing more than lip-service. Fortunately, German industry is not participating in this neoconservative polemic against Putin and the Russians, but instead is expressing its readiness for building collaboration with Russia.

Putin Saved the Day

In spite of all these problems, Putin was the real star at the Heiligendamm summit, surprising Bush with the proposal that he give up America's plans for missile defense in Eastern Europe, and instead, use the large radar center in Azerbaijan, which is managed by Russia. (See article in *International*.)

Shortly before Putin's arrival in Heiligendamm, he had warned that the American obsession with the question of missile defense would not only launch a new arms race, but would raise the danger of a nuclear conflict. Putin will visit the United States in early July, so President Bush has until then to reflect on the offer. It is really in America's interest to take up Russia's proposal, because it could improve the relationship between Russia and the United States.

And thus, the Europeans could benefit, above all the Germans, who have a basic strategic interest in the development of Eurasia, in close collaboration with Russia. An intelligent summit strategy by Merkel would have prepared the way for such a basic improvement, and thus would have been a constructive contrast to the EU-Russian summit in Samara. If it had not been for Putin's proposal, nothing would have come out of this Heiligendamm spectacle.

Documentation

Rep. Frank to Bush: Time To Act on Hedge Funds

The following letter was sent by U.S. Rep. Barney Frank (D-Mass.) on May 23. Frank is chairman of the House Financial Services Committee.

Dear Mr. President,

I am writing to urge that when you meet with your G-8 colleagues in Heiligendamm next month, that you will ask them to embark on an examination of the issues raised by the rapid increase in the number of and size of private pools of capital operating as hedge and private equity funds. In a few short years these institutions have transformed capital markets in all of the G-8 countries, as well as in many other OECD members. We all need a more sophisticated understanding of how these institutions operate and the consequences of their operations on our economies and financial markets. There are, as you are well aware, a number of concerns that have been raised by market participants, academics, labor unions and parliamentarians throughout the G-8; and two of those strike me as especially important. First, what are the consequences of going private on the firms that are acquired, and on the workers, does the financial and operational restructuring that is central to the process materially alter the new firms' ability to make the investments in people and products that are needed for long term success? Second, does the introduction of substantial amounts of additional leverage raise systemic risk concerns in our capital markets?

The enormous growth of hedge funds and private equity funds poses a new challenge to our societies. Private equity and hedge funds have, in a short period, become owners and movers of vast pools of financial capital, with significant influence on the real economy, employment and long-term competitiveness for our companies. Private equity transactions accounted for over a quarter of all mergers and acquisitions in the U.S. and the EU in 2005. Private equity buy-outs have expanded their reach to very large companies, industries and even companies linked to public services. Hedge fund transactions account for a third to a half of daily trading volumes on main stock exchanges. These alternative funds, particularly PEs, are highly leveraged and are exempt from many of the regulations that apply to traditional collective investment schemes, to banks and to insurance-companies, notably in the areas of prudential oversight and reporting requirements.

An important question to explore is whether the high rates of return required to finance private equity debt-driven buy-outs can jeopardize the long-term interests of target companies and the provision of decent employment conditions and employee security. We are troubled by those cases in which rather than corporate restructuring for the purpose of shared productivity gains and increased competitiveness, numerous private equity funds now appear to be looking at extracting maximum value over a short period before re-selling the company. This poses the risk that employees will be disadvantaged in a fashion that would not have happened without the acquisition.

The picture is the same in Europe, the U.S. and in many OECD countries. In order to ensure a transparent, efficient financial market and effective long-term financing, including hedge funds and private equity funds, we call on heads of state and government, to take the following first measures:

1. To take all appropriate steps to establish full transparency, disclosure and accountability in the international financial markets. There needs to be a level playing field between the alternative funds and other collective investment schemes with regard to transparency and reporting on performance, risk-management and fee structure.

2. To take all appropriate steps to uphold workers' rights to collective bargaining, the education and training of workers and related social issues. Worker information, consultation and representation are essential to ensuring positive outcomes in these areas. This is also an important mechanism to promote the long-term interests of private equity-backed companies.

3. To take all necessary steps to establish an international task force, charged with presenting recommendations on further appropriate regulatory action in relation to the international financial markets. The ILO should be represented in such a task force.