Ethics in Investment
How can the financial markets become fair and sustainable?

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Who has ethics?

Individual and Society
What is ethics?

- Human rights
- Fairness and Equity: local, national, international
- Responsibility: transparency and accountability
- Sustainability: economic, ecological, inter-generational
- Legality
Ethical investment: society and system
Market, ethics, and the state

Is the market ethical?
- Market in itself is not ethical, mainly because not being a system
- Individual encouraged to follow his/her interest and profit
- Investment: profit is revenue minus cost

Is the market ethically acceptable?
- If market functions (competition, transparency, liability)
- Individual ethical space
- Trade-off between profit and ethics persists

The state has to secure ethical standards
Global GDP and global financial assets

Source: McKinsey, World Bank

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Financial market capitalism

- Liberalization of markets, investors, products
- Short-term speculation and excessive risk taking
- Growth and dominance of financial sector
- Privatization
- Competition between states (tax havens)
- Redistribution of wealth
- Instabilities and financial crises increase
- Global imbalances
U.S. trade balance deficit

Source: U.S. Census Bureau

Ethics in Investment, Markus Henn, 24.04.2010
Tax havens

1. (ALMOST) NO TAXES
2. INTRANSPARENCY
3. NO/LITTLE REGULATION

Seychelles offshore structures can provide you with many investment opportunities and tax advantages. Most common reasons for selecting Seychelles are:

- Political and economic stability
- Tax efficiency
- Limited liability
- Minimum compliance requirements
- Privacy
- Asset protection
- Minimum administrative requirements
- Flexible company legislation
- Many opportunities for international business
- Investment opportunities

Other attractive features include modern and developed trust legislation, efficient aircraft and shipping registries, provisions for the formation and domiciliation of mutual funds and captive insurance companies, and Free Trade Zone for manufacturing and service companies, benefiting from zero taxation, application procedures and availability of work and resident permits.

www.financialsecrecyindex.com:
"Seychelles IBC is just $390.00"

Order NOW!

72 tax havens
(fulfill at least one condition)

1. Delaware (U.S.)
2. Luxembourg
3. Switzerland
4. Cayman Islands
5. City of London

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Tax havens: what's the problem?

- **Revenue losses**: states cannot tax beneficiaries, tax competition
- **Illicit flows** (source: Raymond Baker / Tax Justice Network):
  - 1-1.6 trillion USD per year
  - growth since 1990s approximately 9% annually
  - 350-500 billion USD per year from developing countries
- **Wrong incentives**: investments lead by tax advantages
- **Inequality**: big companies and rich individuals favoured
- **Lack of control / secrecy**: risk-taking
Profit tax rates for stock companies

Irland
Großbritannien
Belgien
Niederlande
Spanien
Frankreich
Italien
Deutschland
USA
Japan

1982
2004

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How do financial markets work?

- **fundamental value**
- **effective price recovery**
- **ineffective price recovery**

Graph showing the relationship between time (0-7) and values (0-1).

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Financial market deficiencies

- Financial markets are no well-functioning markets
- Price mechanism upside down: price increase strengthens demand
- Technical trading, herd behaviour
- Bull and bear markets
- Instability, bubbles, and crises
Financialisation of the food price index

Source: FAO

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The financial crisis: opaque investment

1. U.S. mortgages (suprime)

2. MBS (Mortgage Backed Securities)

3. CDO (Collateralized Debt Obligations)

4. CDO 2 (3,4,...)

5. CDS (Credit Default Swaps)
Limits to speculation

“Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.”

*John Maynard Keynes*
Financial transactions tax

- Small tax (e.g. 0.1%) on all financial transactions
- Discourages short term profit investment
- Sustainable investments almost not affected
- Less liquidity, more stability
- Petition to G20 leaders for summit in June (Toronto)

[www.makefinancework.org](http://www.makefinancework.org)
Tackling tax havens

• **Taxation agreements**
  - Double taxation agreements
  - Information exchange agreements
  - Ideally: multilateral, automatic, obligation for collecting data

• **Country-by-country reporting**

• **International tax coordination: EU, G20/FSB, OECD**
The crisis has highlighted dangers of liberalization

**Recent IMF Working Papers:**

- “Foreign-bank lending funded by domestic deposits and denominated in local currency is likely to be more resistant to external financial shocks and indeed, in Latin America, acted as a firewall against the transmission of global financial shocks.”

- “Foreign banks are not necessarily more efficient than their domestic counterparts” (on Central America)

- „Capital controls on certain types of inflows might usefully complement prudential regulations to limit financial fragility and can be part of the toolkit...“
Further structural reforms

- Regulation of all parties and products
- Strict liabilities, high equity requirements
- Tackling global imbalances
- Implementation of ethical considerations into laws
Ethical investment: individuals and investors
1758: Religious Society of Friends prohibits members from participating in slave trade

Historical example
Negative screening and divestment: examples

- Tobacco
- Human rights violations
- Cluster bombs
- Nuclear power
Positive screening and investment: examples

Good working conditions

Renewable energy

Sustainability
How can a market participant invest ethical?

March 5, 2010
Norway excludes tobacco investments from oil fund

“Norway’s government pension fund can no longer be invested in tobacco companies under new guidelines introduced by the country’s Ministry of Finance. (...) The $450 billion Government Pension Fund-Global, Oslo, which invests Norway’s oil and gas wealth for future generations, follows ethical guidelines set by the government. It already excludes companies that produce nuclear weapons or cluster munitions, damage the environment, or abuse workers’ rights.”

Source: www.financemarkets.co.uk
Engagement and activism

- “Critical Shareholders”
- www.banktrack.org
- www.banksecrets.org

Representatives of Kurdish organisations hand over signatures for stopping Ilisu dam to Austria Creditanstalt (2007)
Ethics, revenues, and profits

- **Invested in ethical funds (2007):**
  - U.S.: 2.71 trillion USD
  - UK: 5.8 billion £

- **Jantzi Social Index (2000-2009):**
  - green and ethical companies average annual return: 5.68%
  - Standard & Poor’s/Toronto Stock Exchange Composite: 5.61%

- **FTSE KLD 400 Social Index (1990-2009):**
  - returns of 9.51%
  - S&P 500: 8.66%

- **But: how far do you follow your ethics at expense of your profit?**
Difficulties

- **Whose ethics**: what makes a particular ethic better than another?
- **Operationalization**: how to measure ethics?
- **Interconnectedness**: what part of economy/state is really ethical?
- **Ability**: enough time and knowledge to act ethically?
- **Dilemmas**: conflicting ethical aims?
April 6, 2010: “Well-known organic companies receive their palm oil by the company Daabon in Colombia [which] takes part in the displacement of indigenous people.” (www.wir-klimaretter.de)
April 18, 2010: “German bank finances giant wind power project in breach of Saami rights.” (www.saamicouncil.net)
Thank you for your attention!

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