From Finance for Investment to Financial Investment
Background and consequences of the new role of financial markets and investors in developed economies

Paper for the conference
“Finance-led capitalism? Macroeconomic effects of changes in the financial sector”
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Abstract

The paper deals with the changes in financial markets and the strategies of new financial investors. It is argued that the main cause behind the extraordinary growth of financial assets over the last three decades is the continuing upwards redistribution of income and the worldwide spreading of capital funded pension systems. Both have led to a situation of over-saving in which financial investors play an increasingly decisive and leading role for economic development. As a response to the mounting difficulties of traditional institutional investors to find sufficient returns “alternative investors” are opening new areas of financial investment (private equity) and new strategies (hedge funds). The problems which are generated by these financial innovations are proliferated through a competition-led contagion mechanism to the whole economy. They enhance instability, impose shareholder value orientation as new corporate governance pattern and exert considerable pressure on governments. Political counter-measures against the dominant role of financial investors should restrict financial speculation, protect firms and correct income distribution and pension systems as the main roots of financial pressures.

JEL E44, G18, G2

1. Introduction

At the end of October 2007 nobody can convincingly predict the economic and social consequences which the current financial crises will have for the majority of economies and their people. While it is a well documented and undisputable fact that financial turbulence, disruption and crises are regular companions of capitalist developments (see Kindleberger 1989) the effects have been very different even during the last 20 years. The 1987 New York stock market crash of 1987 left investment, production and employment almost entirely unaffected; the currency crisis of the mid-1990s in South-East Asia was the beginning of a severe and partly catastrophic breakdown of production, of mass unemployment and rapidly increasing poverty; the crisis of the European Monetary System broke out in a situation of weak economic development and accentuated this weakness, without triggering a recession. In this paper I will concentrate on the changes in structure of financial markets and behaviour of central actors which are sometimes disregarded in the analysis of the pattern of recurrent financial crises. It

* very preliminary paper, not for quotation
PRESOM = Privatisation and the European Social Model
is argued that the long-term build-up of financial assets in an environment of less rapidly developing opportunities for productive investment the role and driving forces of financial markets and the behaviour of traditional actors on these markets are changing. The strategies of these actors not only perpetuate the traditional instability of financial, markets but exert new and stronger pressure on enterprises and employees on the one hand and on the other hand on governments and parliaments. This impact is also reflected in the liberalisation agenda of the European Union. The resulting instability and enhanced social polarisation call for political action. It should on the one hand try to stabilise financial systems via a stricter supervisory policy. On the other hand it should address the more fundamental problems which have lead to the explosive growth of financial markets and which are located in the increasingly unequal distribution of income and privatisation of social security.

This paper is organised as follows: We start in section 2 with a brief description of the extraordinary growth and internationalisation of financial assets and its main historical background in long-term redistribution and in the enhancement of capital funded pension systems. This is followed by a very brief illustration of what is meant by a “finance-led” pattern of capitalist development as different from an “enterprise-led” pattern (3). The largest part of the paper (4) then deals with the main actors and especially with the emergence and strategies of private equity firms and of hedge funds, as “innovators” with regard to the traditional institutional investors. The resulting problems for financial stability, firms and their employees and for governments are discussed in section 5, followed by the analysis of the European financial markets policy agenda (6) which does not control but rather exacerbate these problems. The final section 7 thematises perspectives for re-embedding financial markets into the framework of a democratic economic policy.

2. Accumulation and internationalisation of private financial assets

We start from the observation that there has been an extraordinary growth of financial assets in the world over the last quarter of a century. As can be seen from figure 1 worldwide nominal GDP in 2005 was 4.5 times higher than 25 years before, $45 trillions after $10 trillions. In contrast world financial stocks (WFS) had increased in 2005 to almost 12 times the amount of 1980, from $12 to $140 trillions. Whereas nominal GDP and WFS were of about the same size in 1980, by 2005 the latter had become more than three times larger than the former.

Figure 1.
Also the **internationalisation** of capital markets developed much faster than GDP and also than international trade (see figures 2 and 3)

**Figure 2**

**Figure 3**

During the 1970s the amount of internationally invested financial assets corresponded to 50-70% of worldwide GDP, at the beginning of the current decade this ratio had risen to about 320%. This particular dynamic of internationalised financial assets also holds in comparison to international trade: the ratio was about 180% in 1970 and about 700% in 2004.

What were the background and driving forces for this extraordinary expansion and internationalisation of financial assets? Obviously internationalisation could not have happened without the shift of the regime of capital controls prevalent in the Bretton Woods world to a regime of liberalisation of capital movements since the mid-1970s. It is certainly also true that very extensive and generous **loan policies by banks** have plaid an accommodating role, particularly in the second half of the 1970s and during the last ten years. But the exclusiveness with which IMF and BIS have stressed credit policies as the decisive reason of financial expansion and “excess liquidity” seems to be strongly exaggerated. It disregards two other factors – located outside the financial system - which in my view play a large and lastly decisive role for the extraordinary accumulation of financial assets.

**Firstly**, the last 30 years have seen an almost continuous **redistribution of income and wealth** from the bottom to the top, basically reflected in the falling wage share (see figure 4) in the main developed regions of the world. This led on the one hand to a massive concentration of financial assets in the hand of a small group of individuals and firms and, on the other hand, to a lagging behind of private consumption and a long-term slow-down in economic growth as a result of weak final demand.
Secondly, a further accumulation of financial claims took place in pension funds and insurance companies as a consequence of the extension of capital funded pension systems and the reform and privatisation of public PAYG-pension systems which were actively promoted since the 1980s by international financial institutions like OECD and World Bank (see figure 5). So not only profits and incomes of the richest parts of societies are the basis of financial expansion but a considerable part comes from the ordinary people as part of their salaries invested in pension funds and live insurance.

Figure 5
3. The emergence of finance-led capitalism

The extraordinary long-term accumulation of a financial assets which are not channelled back into the productive circuit\(^1\) has started to change the relationship between the driving actors and bottlenecks of capitalist development towards a more finance driven dynamic. This can in a very schematic way be visualised through figures 6 -.8.

**Figure 6**

The changing role of financial market: from finance for investment to financial investment, 1

1. Developing Capitalism

- Households (Savers)
- Entrepreneurs (Investors)

Financial markets are driven by enterprises who need money to finance their investments

**Figure 7**

The changing role of financial market: from finance for investment to financial investment

2. Mature capitalism

- Savers (Rich individuals, Corporations)
- Investors

Financial markets are driven by firms and individuals who have much money and search for profitable investment opportunities – which become increasingly rare.

In developing and traditional industrial capitalism the driving actors were *entrepreneurs* (or manager of firms) and finance was a bottleneck for corporate investment and economic development. (see figure 6) We had a situation of permanent *under-saving* which had to be overcome by money creation via the financial system and central banks. By contrast, in mature capitalist economies we have *over-saving*, i.e. an abundance of financial assets for which profitable investment opportunities are becoming increasingly scarce. (see figure 7) Under these circumstances *financial investors* replace the individual or corporate entrepreneur as the leading actor in development. They emerge as a new service industry, collect the money not only from firms and “High Net Wealth Individuals” but also the pension contributions from ordinary employees and invest them in a number of activities of which production of goods and services is only one option. Others are the organisation of mergers and acquisitions, privatisations, speculation, FDI. Capitalism becomes finance-led capitalism, at least in the developed centres. (see figure 8)

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\(^1\) This has also been observed by large international institutions like IMF and BIS. The fourth chapter of the Spring 2006 WEO is entitled “Awash with cash – Why are corporate savings so high?” and deals with this phenomenon, which puzzles the IMF.
Who, then, are the financial investors?

4. Financial investors: Traditional structures and “alternative” investments

Altogether in 2006 there were almost $80 trillions of financial assets under professional management. A little more than a quarter was privately managed by the owners or their trustees. Most of the remaining wealth was managed by “conventional investment management” or institutional investors. Only a very small part goes to so called “alternative investments”, i.e. Private Equity and Hedge Funds and Real Estate Investment Trusts (Reits). The reason why we will in spite of these proportions in the following mainly deal with two of these alternative investors is that the recent emergence and remarkable activity of Private Equity and Hedge Funds indicates and heralds a new phase of sharper competition between financial investors. These are private firms which compete against each other for the money of the savers and they are under strong pressure from the side of the money-owners to generate profits. At a certain point this becomes ever more difficult and strategies must become more aggressive. PE and HF as “alternative investment” are insofar a reflection of and a response to the crisis of institutional investment “as we know it”. PE is the extension of financial investment into the hitherto not explored area of non-quoted firms. Hedge Funds represent the extension of financial investors into new forms: speculation and shareholder activism.

a. Institutional Investors

Institutional Investors are – besides the investment banking and asset management departments of large banks – the most important traditional form of management of financial assets. Their assets have grown very strongly during the last four years and are now 50% higher than at the peak of the latest financial market boom. (figure 9) Each of the three main groups of institutional investors (investment funds, insurance, pension funds) manages around $20 tril-
Lions. (Figure 10) The largest institutional investors manage assets of more than one trillion dollars. (Figure 10)

Figure 9

The industry is rather concentrated: The four largest firms have each more than $1 trillion under management and the ten largest manage 17% of total funds. (Figure 11)

Figure 11

b. “Alternative” investors 1: Private equity

Private Equity firms are undertakings who collect money from the ultimate owners for closed funds, borrow additional money from banks, use both to buy firms, restructure these firms and sell them after some time (two to seven years) either on the stock exchange, or to strategic investors or to other PE firms.

There are six participants in the whole PE cycle: (Figure 12)
- the money holder or ultimate investor
- the initiating undertaking (PE)

<table>
<thead>
<tr>
<th>Source IFSL, September 2007</th>
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<table>
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<tr>
<th>Table 4 Sources of global assets under management</th>
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<tbody>
<tr>
<td>Sbn, end-2006</td>
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<tr>
<td>----------------</td>
</tr>
<tr>
<td>Pension funds</td>
</tr>
<tr>
<td>US 15,893</td>
</tr>
<tr>
<td>Japan 1,160</td>
</tr>
<tr>
<td>UK 1,686</td>
</tr>
<tr>
<td>France 133</td>
</tr>
<tr>
<td>Germany 1,116</td>
</tr>
<tr>
<td>Netherlands 827</td>
</tr>
<tr>
<td>Switzerland 456</td>
</tr>
<tr>
<td>Other 2,376</td>
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<tr>
<td>Total 22,648</td>
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</tbody>
</table>

* Around one third of private wealth is incorporated in conventional investment management

* Estimate of hedge fund assets and private equity funds

* These figures only show domestically sourced funds for each country without regard where they are managed

* No reliable international comparators are available for total funds under management in each country

Source: IFSL estimates based on Watson Wyatt, Bridgewater, Merrill Lynch, IC, Swasth, Hamster Group and CEA data
- the bank
- the fund
- the firm which is bought, restructured and sold and
- the purchaser of the restructured firm.

As can be seen from figure 13 worldwide PE investment developed in an unsteady way during the last 10 years: it rose steadily until 2000 then dropped sharply and picked up slowly from 2002 to 2005. In 2006 it virtually exploded and reached $365 bns., three times the value of 2005. In the first half of 2007 the strong growth continued before the sharp cut-back as a result of the financial crisis. The extraordinary rise of PE investment in 2006 is partly due to the fact that that year saw a number of mega-deals which have until then been rather the exception. Of the 10 largest transactions since the end of the 1980s seven were carried out in 2006 or 2007 (see figure 14). Although the large majority of PE firms is of US origin (see figure 15) Europe is catching up, rapidly in terms of funds raised (where the European share rose from 21% in 2000 to 44% of funds raised worldwide in 2006), not so rapidly in terms of investment (increase from 21% to 24%).

![Figure 12](image_url)

**Figure 12**

Private Equity: how it works

![Figure 13](image_url)

**Figure 13**

**Chart 1 Global private equity market**

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![Figure 14](image_url)

**Table 3 Largest private equity transactions**

<table>
<thead>
<tr>
<th>Announcement year</th>
<th>$bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Office Prop. Trust (2007)</td>
<td>38.9</td>
</tr>
<tr>
<td>Hospital Corp. of Amer. (2005)</td>
<td>32.7</td>
</tr>
<tr>
<td>RJR Nabisco (1989)</td>
<td>31.1</td>
</tr>
<tr>
<td>Harrah’s Entertainment (2006)</td>
<td>27.4</td>
</tr>
<tr>
<td>Kinder Morgan (2006)</td>
<td>21.6</td>
</tr>
<tr>
<td>Freescale Semicond. (2006)</td>
<td>17.6</td>
</tr>
<tr>
<td>Albertson’s (2006)</td>
<td>17.4</td>
</tr>
<tr>
<td>Hertz (2005)</td>
<td>15.0</td>
</tr>
<tr>
<td>TDC (2005)</td>
<td>13.9</td>
</tr>
</tbody>
</table>

*Source: Fortune*

![Figure 15](image_url)

**Table 4 Largest private equity firms**

<table>
<thead>
<tr>
<th>Firms ranked by amount of capital raised for direct private equity investment between 2001 and 2006</th>
<th>$bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Carlyle Group</td>
<td>Washington DC</td>
</tr>
<tr>
<td>Kohlberg Kravis Roberts</td>
<td>New York</td>
</tr>
<tr>
<td>Goldman Sachs Princ. Investm. Area</td>
<td>New York</td>
</tr>
<tr>
<td>The Blackstone Group</td>
<td>New York</td>
</tr>
<tr>
<td>TPG</td>
<td>Fort Worth</td>
</tr>
<tr>
<td>Permira</td>
<td>London</td>
</tr>
<tr>
<td>Apex Partners</td>
<td>London</td>
</tr>
<tr>
<td>Bain Capital</td>
<td>Boston</td>
</tr>
<tr>
<td>Providence Equity Partners</td>
<td>Providence</td>
</tr>
<tr>
<td>CVC Capital partners</td>
<td>London</td>
</tr>
</tbody>
</table>

*Source: Private Equity International*
Specific features of the PE business model are:
- a limited number of ultimate money holders (closed funds)
- the legal headquarters are usually located offshore to avoid financial supervision. (Management is usually carried out in the financial centres, for Europe in London)
- high leverage: only between 20% and 40% of a purchase are financed through “private equity”, the rest through bank-loans to raise return on equity (as long as return on investment is higher than the cost of credit)
- Active involvement of the PE firm in the management of the purchased firm with the objective to raise the value of the firm.
- The strategic perspective of sale, which is from the beginning the dominant guideline for PE activity.

Problems:
- The perspective of sale in the medium term determines the behaviour of the management which will be focussed on short-term cost cutting instead of developing strategic perspectives and productivity raising investment. Most of these cost cutting measures are taken at the cost of the employees.

- A specific problem is the increasing burden through debt and debt service. The loans which the PE funds have taken to finance the purchase of a firm have to be serviced and repaid by this purchased firm.- which of course deteriorates the financial status of the latter.

- To get the invested money back as quickly as possible and even before the sale of a firm the managers increasingly often pay extra dividends or bonuses to the fund owners, and these payments are financed again through bank loans. Such “recapitalisation” pushes the respective firm even deeper into debt.

- Under such circumstances problems of exit become more severe and the initial perspective to sell he firm to a strategic investor or bring it to the stock exchange becomes increasingly unrealistic. Instead firms are sold to second or third PE investors, who start the same business
again and again. At the end there are the vulture funds who take the firm completely apart and sell the parts separately.

c. “Alternative” investors 2: Hedge Funds (HF)

Hedge funds are assets which come from rich individuals and banks, and in the last years increasingly also from institutional investors (particularly pension funds) and which are invested by HF managers in high profit - high risk securities (financial speculation) or in quoted stocks where they develop shareholder activism to generate high dividend payments or to enhance market capitalisation or to boost takeover prices. (see fig.17) It is estimated that currently there are about 9000 HF managing about $1,5 trillions of private money. (see figure 18) This figure appears peanuts in comparison to the $62 trillions managed by “traditional” institutional investors. But it should be noted that HF operate on a highly leveraged basis and with 1,5 trillion private capital can invest about ten times this amount, i.e. about 15 trillions, which is then much less peanuts and much more coconut.

More than half of all hedge funds worldwide have their legal domicile offshore (mostly on the Cayman Islands) and of those domiciled onshore about half is registered in the US (mostly in Delaware) (see figure 2.20).
The traditional strategy of HF is financial speculation, which can lead to high profits or losses. A good example for the latter case is the Amaranth fund, which lost $6bn within a single week through a failed security speculation. Another and more recent example is the fact that HFAs were prominent amongst the (highly leveraged) buyers of loan packages from the special purpose vehicles or conduits to which the banks had sold these loans. Thus they contributed to the worldwide contagion of the relatively small sub-prime crisis in the US.

The second strategy of shareholder activism is of more recent origin and perhaps reflects the fact that speculation is a very unreliable leg of business activity. The objective of shareholder activism is unambiguous: it aims at rapid and large cash-flows for the shareholders, often at the cost of the long-term strategic position and performance of the firm. The underlying philosophy of this strategy is that a corporation is an undertaking of shareholders for the shareholders and nothing else. All additional interests of different stakeholders must be disregarded.

4. Main problems: Destabilisation, enhanced pressure on firms and governments

The problems which are generated by the new generation of financial investors can be divided into three groups

1. they contribute to enhanced financial instability
2. they push corporate governance in the direction of shareholder value orientation
3. they exert pressure on governments for lower taxes, privatisation etc.

ad 1: instability and crisis: This is not a new phenomenon but it has been exacerbated with the rise of new financial investors. In all big speculative failures at least since the case of LTCM in 1998 hedge funds have been an active driver of the speculation. In the building up of the current crises they have played an important role in buying risky loan packages from banks or their special purpose vehicles

ad 2: corporate governance. The problems of more aggressive shareholder value orientation do not only pertain to the firms immediately affected by HF pressure. At least as important and on the whole much more dangerous is the threat of systemic contagion. This is the proliferation of the aggressive strategies of PE and HF to traditional institutional investors which are the main pillars of financial investment or the management of financial assets. The mechanism is based on the fact that institutional investors are private firms which compete for the money of their investors as ultimate money holders. Their main competition parameter is the promise to generate high returns for their clients. In such an environment hedge funds are benchmark setters, and the channel of proliferation of new corporate governance standards is competition and benchmarks. If one institutional investor places part of its assets in hedge funds and receives higher returns this inevitably push other pension funds into investment in hedge funds or similarly risky investments in order to prevent the exit of clients. This process is just going on in Europe. Particularly worrying is the fact that the share of assets which pension funds have invested in HF has more than doubled during the last decade, from 5 to 11%. (see figure 20), thus, on the one hand, exposing the pensions of employees increasingly to the risks of financial markets and exerting, on the other hand, increasing pressure on these employees to work more for less money and on the state to cut social expenditure.

ad 3: pressures upon governments: Financial investors are one powerful force behind the almost obsessive tax race to the bottom to make a country attractive for financial and other
investors. Such tax race undermines the revenue basis and puts public budgets under mounting pressure, which makes it increasingly difficult to maintain public services at the traditional and necessary level. This budgetary pressure is then a favourable background for the request of financial investors for the privatisation of public assets and public services. In the constellation of growing private financial assets seeking investment opportunities and growing pressures upon public finances privatisation appears as a solution to the problems of both the wealthy and the state: It gives the former a new area for investment and at the same time relaxes the financial burden for the latter. This is visualized in figure 21. Reductions of taxes on corporate profits, capital income and wealth increase the burden on public budgets and at the same time the revenue available to the wealthy. These use the additional money to buy from the government assets and service packages. In a net calculation the whole procedure simply amounts to a gift to the top: Governments give money to rich individuals and then sell them for this money the public assets. From the social substance the whole process is nothing else than the transformation from public to private wealth.

(It remains an open question whether this privatisation of public services under fiscal pressures fulfils its purpose to reduce the fiscal burden for the state. This is obviously the case when together with the privatisation public responsibility for the maintenance of the previously public service is abandoned – with the accepted consequence of a deterioration in the quality, affordability, accessibility etc. of such services. In cases where government privatises services but maintains their provision as a public mission - organised via public regulation or PPPs - the costs of regulation or of buying or leasing facilities and services from the private sector may in a long-term perspective be higher than higher public provision even if this must be financed through public loans.)

6. The European agenda: Open doors for financial investors

The current agenda of the EU for one the one hand, financial markets and, on the other hand, public services does not take account of the new problems which arise with stronger activities
of PE and HF for the provision of efficient, universal and affordable public services, when their provision is outsourced to private investors. Instead of stronger control and enforcement of public services commitments the scene is set for more deregulation, competition and market-opening in both areas.

In the area of financial markets the Commission focuses on stronger market opening and deregulation. Particularly two developments are remarkable:

- On the basis of a report on “Special rights of public authorities in privatised EU companies: the microeconomic impact” (Oxera 2005) the Commission has recently brought to the European Court of Justice an increasing number of cases for infringement of the open market for capital rule and therefore breach of the EC-Treaty.

- In a recent White paper on Enhancing the Single Market Framework for Investment Funds (European Commission 2006d:13) the Commission declares its intention to “examine the types of marketing and sales restrictions that should be removed in the context of the shift to conduct of business rules at the level of the investment firm…” In this respect it seems to follow the recommendations of two reports of expert groups on HF and PE (see European Commission 2006a and 2006b) which were published in July 2006. Remarkably these expert groups who were appointed by the Commission consisted exclusively of representatives of financial institutions as if these were the only ones affected by the organisation of HF and PE. Not surprisingly it recommended a further liberalisation of the markets. Particularly they advocate the removal of the modest national limits for investment of institutional investors in risky asset classes (like HF and PE) “which entail relatively high probability of very adverse investment outcomes” (European Commission 2006d:13.). With this it reinforced the deregulatory approach which was already the core of MiFID, which replaces crude restrictions on the sale of certain instruments to certain categories of investor with a system which places responsibility on the investment firm to ascertain, on a client-by-client basis, whether a particular investment is suitable or appropriate.”(ibid.) . The prohibition of such national barriers could and most probably would trigger a new stream of investment from pension funds in PE and HF.

For public services the discussion about the Green paper (European Commission 2003) and White paper (European Commission 2004) of services of general interest, about art. 16 of the ECT and about the Services directive have resulted in the formation of an – in spite of all rhetorical concessions - alarmingly neo-liberal position on the side of the Commission.. It is developed via, on the one hand, the overarching importance of the competition rules in the Treaty, and, on the other hand, the definition of an economic activity. The clearest example of this position can be seen in the case of social services. After these had been taken out of the Services Directives in spring 2006 the Commission announced and recently published a communication on social services, the thrust of which is identical with that of the Services Directive.(Commission 2006c) The decisive point is, that if a service is provided for money – regardless of the appropriateness of the price and of the ultimate source of finance – it is regarded as an economic activity and must be subordinated to the competition rules. In other words: An entity providing a public service (health, education) against money has to behave as if it were a private firm in a private market. With remarkable frankness the Commission concludes “It therefore follows that almost all services offered in the social field can be considered “economic activities” within the meaning of articles 43 and 49 of the EC treaty.”(ibid: 9) It seems logical that if social services have to be provided under conditions of open markets and competition there is no reason why they should not be privatised.
If these points of the EU agenda were carried out the likely result would be, on the one hand, more pressure for privatisation in hitherto largely publicly provided social services (e.g. in healthcare and education), and, on the other hand more shareholder oriented pressures on institutional investors in privatised firms as a result of enhanced PE and HF activity.

7. Alternatives

Following the presentation of the problems generated by the strategies of financial market actors the proposals for political control and countermeasures can be divided into three groups: restrict speculation, protect firms and reduce the pressure of investors.

The restriction of financial speculation could be attempted through direct rules for financial investors, for instance through transparency requirements or limitation of their leverage. The problem is that many of the new financial investors are domiciled offshore and cannot be reached. On the other hand, traditional institutional investors are usually located onshore. It should in any case be the rule that pension funds and live insurance should be strictly prohibited to invest in speculative financial instruments. This is still the case in some countries but such rules are under heavy attack from the financial industry. Such attacks must be resisted to avoid delivering pensions to the incalculable risks of financial markets.

The limitation of leverage is also possible via the lending banks, either by setting quantitative limits or by imposing higher capital requirements – 300 or 500% - for loans to Hedge funds or private equity. Also the securitisation and sale of loans to special purpose vehicles should be prohibited or only be allowed under special circumstances; after all such trading is nothing else than the circumvention of credit restrictions which are set by capital requirements. Further tools are taxation of capital gains, currency or other financial market transactions – and of course the set-up of a more cooperative international (regional or global) exchange rate system.

To protect firms from harmful financial investor activities it is essential to prevent in the case of private equity the transfer of servicing obligations for loans which were taken to finance an acquisition upon the acquired firm or to withdraw money from this firm in the form of extra-dividends or bonuses. To make quick hit-and-run strategies by hedge funds in large quoted firms more difficult, the voting rights of shareholders in such companies could be linked to the duration of their holdings, it could for instance only start one year after the acquisition of the shares.

The provisions in the existing European take-over directive to oppose a hostile take-over should be strengthened and not – as is envisaged by the European Commission – weakened. They should give employees of a target firm not only the right to full information but also the right to veto a take-over if employees interests are not sufficiently met.

Reduction of investor pressure. Limitation of financial speculation and protection of firms against exploitation by financial investors are reasonable and – if carried out with sufficient political energy – efficient measures to stabilise financial systems and economic development temporarily. But they will not take the steam and pressure out of the system and will not prevent that financial investors which are under enormous pressure from high returns seeking money-owners will search and develop new outlets and new methods of profit generation which will induce instability and polarisation in new and unexpected places and forms. A more comprehensive strategy to reduce the influence of financial investors in the economy and society must therefore address the roots for the financial pressure. The most important of
these are located outside financial markets, namely in an increasingly one-sided distribution of income and an increasingly capital funded social security system. A long-term strategy to tame financial markets and to re-embed finance in a framework of reasonable and socially sustainable economic development must therefore reverse these trends: It must, firstly, initiate a redistribution of income from top to bottom through higher wages and social expenditure and at the same time higher taxation of wealth, profits and high incomes. Secondly, it should base pension systems on public schemes which are de-linked from the dynamics and risks of financial markets. Both strategies would considerably slow-down the accumulation of profit-seeking financial assets and therefore take much of the pressure from financial markets. Such strategies reach of course far beyond financial market policies.

References (to be completed)
European Commission (2006c), Implementing the Community Lisbon Programme. Social services of general interest in the European Union