Minding the Gap: Global Finance and Human Rights

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Although there now exists a large and growing body of literature and initiatives on finance and human rights separately, the integration of the two fields has so far been shallow and narrowly focused around a few key areas that are most easily comprehensible to those without specialist financial knowledge. Large swaths of the financial system that have important consequences for human rights realization have barely been touched by human rights analysis. The fact that high-profile initiatives, such as the Equator Principles and the UN Environment Programme Finance Initiative, have so many adherents among leading financial firms, and the fact that most, if not all, such firms now have corporate human rights policies in place, should not mislead one into thinking that a comprehensive embedding of human rights principles into the global financial system has taken place.[1] As a recent report from the Danish Institute for Human Rights eloquently states:

> To an observer with little knowledge of the financial sector, the [existing] initiatives may appear adequate, but they only cover small sections of the sector, and efforts are still nascent in most areas. The asset classes and financial instruments that are least understandable to the layman, such as insurance, derivatives, and bonds, are not visible, while those that are most understandable, such as project finance, are best covered by tools and initiatives. There has been a tendency to focus on large project finance and

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> corporate investment. . . . Making inroads into other types of finance, such as investment banking and structured products, has not been well addressed.[2]

The ongoing financial crisis and the devastation it has wrought, particularly in respect to socioeconomic rights, have served as an urgent call to human rights lawyers to address the lacuna. In light of the crisis it is clear that human rights can be affected at the macro level by complex financial processes and activities that are not readily amenable to existing methodologies in the finance–human rights sphere, and that new thinking is required to address this gap. Moreover, it is clear from the scale of the crisis that financial theory itself does not currently have clear answers to the systemic failings that occurred, and that the assumptions that underlie the financial system itself—namely, that free markets are efficient and contribute most effectively to maximizing human welfare—cannot be taken at face value. As such, there is perhaps scope in financial thinking to broaden the terms of analysis to include greater focus on the real impact that international finance has on the lives of real people—and on their capacity to enjoy their human rights, which are enshrined in international law and national constitutions.

As has been noted in the recent report of the Financial Crisis Inquiry Commission, "the collateral damage of this crisis has been real people and real communities."[3] Perhaps a greater awareness of systemic human rights impacts can contribute to stabilizing the international financial system, or at the very least bolster its social license to operate. It should be made clear that in the present context we consider human rights to be an essential part of the welfare of individuals and, by extension, the communities they live in. They are essentially civil, social, and economic standard setters, and the extent of the efforts to meet them provides some indication of the success or failure of "all organs of society"[4] to cater to the basic needs of its people. Human rights do, of course, have distinctive qualities: they are essential minimum standards, and are backed by purportedly enforceable legal obligations. At their core, however, they are fundamentally matters of welfare.[5] As such, human rights are intimately tied up with the economic health of the state, as well as, of course, much else besides.

Adopting this perspective, we can see how human rights have been hugely affected by the crisis: through the loss of jobs and livelihoods; the knock-on impact this has had on access to other rights, such as food, housing, education, health care, and nondiscrimination; and through the significant deterioration of state finances, which has affected and will continue to affect the state's ability

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to finance human rights realization. Yet none of the areas of finance that are currently well covered by the above-mentioned human rights initiatives and policies had any direct causal bearing on the crisis. Conversely, the complex, interlocking web of systemic failings that led directly to the crisis and its human rights costs has not so far featured in human rights analysis. In the aftermath of the crisis there is little, if any, visibility of human rights principles in the many different regulatory and legislative initiatives on financial reform. Nor has the requisite technical understanding and capacity been built within the human rights sphere for principles of human rights law to have much, if any, relevance to the reform of such issues as capital adequacy, liquidity, risk management, derivatives, financial modeling, ratings, and supervision—issues that were critical to the crisis and that will shape the global financial system and its impact on human rights enjoyment in the years to come.

This article is intended as a first pass at bridging this divide. It highlights four technical aspects of the global financial system that offer an insight into the breadth and depth of global finance and its relationship with human rights, and that have so far been largely off the radar of human rights scholars. First, two financial product groups that have had key roles in the ongoing crisis are examined in light of their human rights impacts: bonds and derivatives. Second, the paper surveys two important financial processes that underpin global financial markets, in order to highlight their human rights implications. These processes are *risk management* and *procyclicality* (that is, the tendency of the financial system to strongly magnify swings in activity in the financial markets and in the world economy). Of necessity the analysis is brief, but it aims to offer a window into the enormous complexity of global finance and the multifaceted ways in which it interacts with human rights.

Surveying the Gap

Over the last twenty or thirty years there has been a "financialization" of the world economic space.[6] The global financial system has expanded so rapidly and become so integrated that it is now the preeminent driving force shaping patterns of world trade and economic growth, which critically underpin human rights realization. A quick review of a few numbers may give a sense of this phenomenon. World gross domestic product (GDP), roughly $60 trillion,[7] is dwarfed by even individual segments of the financial markets. Notional derivatives exposures (discussed in detail below)

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alone are over $1,100 trillion,[8] nearly twenty times world GDP, and daily turnover in foreign exchange markets is in the $4 trillion range,[9] meaning that a value equivalent to world GDP turns over in this one market segment every fifteen days. New financial markets or products can also grow almost exponentially: credit default swaps, a new type of credit derivative invented in the 1990s that played a key role in the credit crisis and the U.S. government's $170 billion bailout of AIG, grew from a value outstanding of $600 billion in 2000 to $62 trillion in just seven years.[10]

Financial markets of such magnitude exert a very powerful influence on the world's economic structures, from the international level right down to the local environment, thanks to global integration and the central role of money in driving economic processes. The amount of money or liquidity available in international markets and the way financial processes shape its usage has a deep impact on patterns of world economic growth—which hinge upon financial and monetary dynamics—and the opportunities for human rights enjoyment that this engenders through job creation and poverty reduction, as well as the capacity of the state to fulfill its more costly obligations under international human rights laws, such as to provide for fair trial, nondiscrimination, an adequate standard of living, basic education, and health care.[11] Conversely, instability in financial markets can very quickly and forcefully derail the world economy and wipe away jobs, livelihoods, and poverty alleviation gains, as well as undermine the fiscal position of the state and its capacity for social spending—all of which are effects that have been amply demonstrated by the current crisis. Thus, for example, the World Bank calculates that the global credit crunch and subsequent economic downturn added 80 million to the number of people living in abject poverty;[12] the International Labour Organization has estimated that over 20 million jobs have been lost worldwide;[13] a recent report of the UN Special Rapporteur on the Right to Food highlights the role that increasing inflows into commodity derivatives have played in the global food crisis and attendant hardships experienced by the poorest of the poor;[14] and in the United States, recent poverty statistics released by the U.S. Census Bureau show a significant annual increase in poverty, which rose from 1.1 percent in 1998 to 14.3 percent in 2009.[15] Fully 43.6 million people now live in poverty in the richest state on Earth—the highest number since recording began in the United States in 1959.[16]

Until now, most of the debate around how the financial and monetary system influences domestic economic and social conditions around the world has been contained in the financial and economic literature. There has been little visibility

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of this context in human rights commentary, despite the highly influential framework that it provides for the global realization of socioeconomic rights. This is partly attributable to the dearth of financial and macroeconomic expertise within the human rights sphere, such that many of the more technical aspects of finance are alien to most human rights analysts. This has resulted in a deficit of scrutiny and accountability for the majority of financial activity. Partly, however, this is also attributable to the way human rights have been conceptualized and utilized in both the state and corporate responsibility spheres. Jurisprudential human rights development has focused very strongly on rights as individual legal entitlements, with all that this implies for the way rights can be claimed and the conditions necessary for acts to be considered as transgressing rights principles (that is, a reasonably direct causal relationship between an act or actor and an individual right holder and a rights violation).[17]

Regrettably, the policy dimensions of human rights (as opposed to their hard legal form) have been largely undervalued or simply overlooked, whether in terms of their political or economic utility. That is, the implications of human rights for policy formulation at the broad macro level have not been extensively investigated. The relationship between human rights and the economy is especially neglected.[18] Even those who rightly seek to stress the wider social (nonlegal) dimensions of human rights too often ignore their interactions with economics, while others make the connection but do so outlandishly, such as by claiming that economics and human rights are categorically incompatible.[19] But even if it is difficult to take seriously such claims, it is certainly the case that there are powerful tendencies in both the economic and human rights fields to oversimplify the complex notions in the other field, while at the same time overcomplicating the interrelations between the two fields. Thus, human rights analysis has failed to engage with complicated, interlocking processes where causality is diffuse and the type of analysis required is more macro and structural, rather than focused on individual acts and direct harm.

This has also limited the scope for engagement between finance and human rights because the relationship between the two has, of necessity, been constructed in a certain way. The debate on the human rights obligations of corporations, for example, has focused on holding corporations to account for identifiable acts that breach individual (or group) rights. The same framing of rights has been transposed into the financial sphere in the form of initiatives and corporate responsibility codes that focus on areas of finance where defined corporate action impinges

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on human rights in a reasonably direct way—for example, labor policies, equality, and discrimination. As such, the starting point for the endeavor has been an existing template of human rights impacts and values, which is then fed backward into the financial system where it can reasonably be seen to apply, mainly by human rights lawyers who lack broad financial experience. It is, in other words, a "micro" approach to the integration of finance and human rights. Our concern, in contrast, is with a "macro" or "systemic" approach to the relationship between global finance and human rights that looks at the interaction between the structures, processes, and dynamics of international finance and the capacity of states to secure broad-based human rights protection. What this differentiation implies is that analysis should focus not only on the funding of individual deals (for example, mining operations that have problematic impacts on local communities), which human rights scholarship currently addresses quite well. Rather, more attention needs to be paid to the broader impact of the financial system on economic structures and performance, which affects the socioeconomic rights of people on an increasingly global scale.

Similarly, an argument often used to support the inclusion of human rights principles in long-term investment decision-making is the notion of "value"—the idea that companies with good human rights policies in place will represent better long-term investments and hence offer higher returns.[20] In reality, stock market performance is strongly shaped by underlying processes that are not visible in human rights analysis—for example, derivatives, risk management, global liquidity and monetary policy, leverage levels across institutions, and algorithmic trading (which is now estimated to account for about 50 percent of trading volume on the New York Stock Exchange).[21]

Corporate codes of conduct are patently inadequate in addressing the effects of these financial processes and activities because they focus on addressing micro-level impacts—that is, circumstances in which financial activity can be immediately, visibly, and directly tied to the human rights of defined individuals. Many of the major global banks that were at the center of the catastrophic losses and enormous bailouts of 2007–2008 had conspicuous and fully formed human rights policies in place and dedicated corporate social responsibility (CSR) teams to oversee them.[22] Yet the scope of these policies was clearly very limited in terms of their effect on front-office operations and their management of risks to themselves and to the financial system as a whole. Such policies were of little use in shining a light on the effect that financial activity at that time would have on global human rights,

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or in assisting firms in identifying any action to mitigate impending human rights harm (or risks to themselves). Even where such human rights policies were under the responsibility of the board of directors, they were of limited use as they had not been transparently integrated right across bank processes and operations—something that is still a very long way from happening.[23] Similarly, at the state and regulatory level, there was no pressure or incentive coming from human rights commentators to take a closer look at conditions in the finance sector in order to preempt harm, despite warning bells from some senior financiers about the instability of financial dynamics.

Clearly, the securitization and credit derivatives operations of global banks, their risk management and corporate governance failings, and their liquidity risk management all ultimately contributed directly to a global meltdown that entailed very serious human rights consequences, especially for the poor and marginalized in both developed and developing economies. Traditional human rights approaches to the global economy were and are unable to address these features of finance as they cannot be fitted into the typical indicator/checklist-type approach to a human rights assessment of corporate practices. Exploring these deeper, more technical macro-level linkages within and between the financial markets and human rights necessitates moving away from thinking about rights solely in the narrow terms of individual entitlements and direct causality or reasonably proximate complicity to examining the structural conditions that play a role in the ability of responsible agents to fulfill their human rights obligations. Rights need to be conceptualized in the context of interlocking socioeconomic systems at the local, national, and international levels, and such systems need to be examined as part of the task of human rights protection and implementation.

Financial Products

There is a vast range of financial products that currently have little or no visibility in human rights analysis. Such products actually account for the majority of financial activity and they have important implications for human rights. Specialized financial understanding is required to decode the structural impact of many such products on human rights, and the lack of extensive interdisciplinary training among human rights practitioners has so far limited the opportunity for this to develop.[24] In order to move forward, we need to meet the challenge of understanding how they interact with human rights. Here we will present a brief review

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of two types of products with important links to human rights: bonds and derivatives. Bonds—and most particularly sovereign bonds—are perhaps most easily explicable in terms of human rights because of their direct role in funding state expenditure. Derivatives, on the other hand, present a sizeable challenge, not least because under this one product umbrella sits a complex and ever-growing list of mutating product forms and structures that interact with human rights in a multifaceted and nonlinear way.

The Bond Markets

The bond markets interact with human rights in a variety of ways, most notably through the role they play in funding state expenditure on social goods that are intimately associated with the realization of a state's human rights obligations, such as those relating to welfare, health, and education. Due to a long-standing tendency in human rights circles to assess compliance with international legal obligations by reference to absolute levels of government spending on socioeconomic rights–related goods,[25] there has been little recognition of the importance of the sovereign bond markets (let alone the corporate bond markets) for human rights realization. However, as the current sovereign debt problems in the eurozone demonstrate, the relationship between sovereign spending, the enjoyment of human rights, and the bond markets is multifaceted; and there are far-reaching economic consequences of bond market dynamics that have a critical impact on human rights by influencing the capacity of states to deliver on their human rights obligations.

Bonds are instruments through which states, municipalities, or companies can borrow directly from a wide range of investors to fund spending that is not affordable within their current budgets. That is, rather than going to a bank for a loan, states or companies issue bonds that promise to repay the capital (principal) with a specified amount of interest over a set period. This has the advantage of giving access to a global pool of capital; for example, bonds issued by a company in Brazil can easily be bought by a fund manager in London or New York, and there are also large secondary markets for bonds that trade them on a daily basis.

The bond markets are now estimated to be worth over $90 trillion—that is, they are equivalent to world GDP plus 50 percent.[26] Sovereign bonds represent the largest segment of these markets, with a total of $34 trillion in government debt outstanding.[27] This huge stock of debt is now a major cause for concern in both Europe and the United States, with the specter of bond market destabilization

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hanging over these governments. At issue is the willingness of bond investors to keep buying record amounts of debt in order to keep many countries technically solvent and to allow them to continue funding social programs and public services that have relied on bond market funding of fiscal deficits, as well as the intensifying battle between markets and politicians over who should bear any losses on unserviceable debt.[28]

Over the last twenty-five years governments in the advanced economies have become heavily reliant on the bond markets to fund a proportion of their spending; so while the costs of the financial crisis and financial sector bailouts have been considerable, what is really significant is that they have added to an already substantial debt load. Debt levels have more than doubled over the past quarter century—from 50 percent of GDP in 1983 to an estimated 105 percent of GDP in 2012, a level not previously seen in peacetime.[29] States have run persistent fiscal deficits, and the steady expansion in welfare entitlements, social spending, and public sector employment—which are often perceived in human rights circles as indicative of higher compliance with the International Covenant on Economic, Social, and Cultural Rights (ICESCR)—has been funded via a reliance on the bond markets to make up the shortfall.

Aging populations are exacerbating the situation, because if existing entitlements are continued, the debt burdens on the industrial economies are projected to grow substantially in the years ahead. As the Bank for International Settlements comments: "The aftermath of the financial crisis is . . . bring[ing] a simmering fiscal problem in industrial economies to boiling point. In the face of rapidly ageing populations, for many countries the path of pre-crisis future revenues was insufficient to finance promised expenditure."[30]

This leaves states and human rights in a vulnerable position—as we are now seeing in the eurozone with rising unemployment, reduced welfare spending, and heightened social unrest. The interest costs alone on this huge stock of debt weighs heavily on public finances and can in itself be a factor in social spending cuts. Thus, for example, in 2009 the United States paid $383 billion in interest on its $12 trillion stock of outstanding debt, compared to an education budget of $53 billion.[31] This interest bill is projected to rise to around $700 billion by 2020.[32] Similarly, the United Kingdom owed a sum of £42 billion in interest alone on its outstanding debt of over £900 billion in 2010.[33] Moreover, as states have been relying on issuing new bonds to pay off existing ones that are maturing, and even just to meet interest payments, the 2010 borrowing requirements of the

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member countries of the Organisation for Economic Co-operation and Development (OECD) have been estimated at $17.5 trillion, rising to $19 trillion in 2011.[34] This is a vast amount of bonds to sell, and it effectively leaves countries highly vulnerable to the whims of the bond markets, including "roll-over risk"[35] and sharp spikes in financing costs (when investors demand much higher rewards for taking on more debt) unless budgets are trimmed substantially and made more sustainable. Roll-over risk refers to the risk that bond investors will simply refuse to keep buying new sovereign debt (which would in itself inevitably entail severe cuts to social spending), or will demand much higher rewards for doing so (pushing up the interest rates at which states can sell their bonds), which exacerbates the long-term situation and diverts more of a nation's resources to repaying bondholders, reducing those available for the economy and social spending.[36]

In this situation, the bond markets can effectively hold states to ransom; and human rights principles, such as the presumption of nonretrogression (that, at the very least, human rights protections ought not be diminished), may become largely meaningless in the face of overwhelming fiscal imperatives.[37] Arguments that social spending should be ring-fenced and/or take priority over the repayment of bondholders are negated when states cannot afford to maintain those commitments without the support of the bond markets.[38] Hence, in the context of the current problems in Western Europe, the European Central Bank has been buying enormous amounts of sovereign bonds in an effort to avoid the immediate threat of a rout in the bond markets.[39] This does not resolve the situation; it simply moves the debt around, and leaves the enjoyment of existing levels of human rights realization at the mercy of the unavoidable retrenchment in state spending in order to placate the bond markets.

A key question in relation to the functioning of the bond markets is why risk is so improperly assessed to begin with, such that bond buyers continue to lend to states that are already highly indebted—to the point where there is a reassessment of their "sovereign credit risk" and the market then "malfunctions" because investors will no longer keep playing the game.[40] At that time social programs and other government spending have to be quickly and sharply cut. Surely, efficient, well-functioning markets would avoid problems on the scale we are now seeing, and they would be markets where investors took responsibility for both their gains and their losses. In the context of the eurozone problems, there has been an ongoing battle between politicians and the bond markets over whether bondholders should shoulder any losses or whether—incredibly—ordinary taxpayers

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who are already seeing their social entitlements cut so harshly should actually bail them out.[41] Surely, that is the true "malfunctioning" of the markets, and the point at which human rights arguments should weigh in. Of course, this presents significant challenges because it requires at the very least a review of sovereign credit risk models to incorporate principles of human rights law. Admittedly, this is no easy task, given the current lack of sustained macroeconomic analysis of international human rights law, and because it would entail profound disagreements over how one ascertains what is or is not an optimal level of borrowing for any particular state at any point in time. But given the current lack of effective accountability under human rights law of bond markets or the borrowing decisions of states, this would at least be a good place to start.

Derivatives

In product terms, derivatives arguably represent the other end of the spectrum from bonds insofar as their causal link to human rights is more opaque. Because they are heavily based on mathematics, and are often singularly remote from identifiable human rights harm, mapping their linkages to human rights presents a very formidable challenge. There are now many different types of derivatives, each of which has subtly different causal linkages to human rights that will need to be analyzed separately. Currency futures, for example, are likely to raise different human rights issues than interest rate derivatives. Here, by way of introduction, we will confine ourselves to outlining two points of interaction between derivatives and human rights. First, at the macro level, we will highlight the role that derivatives play in generating and spreading risk throughout the financial system, and the catastrophic implications for global human rights enjoyment that this can entail. Second, we will look at one particular type of derivative that has had an enormous—though largely unacknowledged—impact on human rights over the last six years: commodity futures. Given the harsh impact that the ongoing food and fuel crisis is having on the basic rights of the poorest of the world's people, analysis of the role of commodity derivatives offers a timely and immediate illustration of the interaction between derivatives markets and human rights.

A derivative is a financial instrument that is "derived" from an underlying financial product, such as a stock, a bond, or an equity index (the "underlying"). It allows an investor to track an underlying asset without having to own the asset. The basic forms of derivatives are options, swaps, and futures. An option offers

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the holder the right to buy or sell an asset at a given price during a specified period (up to the expiry date). A swap allows two financial entities (the "counterparties") to swap an aspect of a financial asset—for example, an income payment from a bond or an interest rate on a loan during a specified period. A futures contract allows an investor to buy the right to receive or sell a given asset at a given price on a stated future date. Individually, they sound innocuous enough from a human rights standpoint, and certainly at the level of an individual deal or even a group of deals it may be difficult to attribute defined human rights harm to them. Nonetheless, they are the proverbial "financial weapons of mass destruction,"[42] in that they have enormous consequences for the world economy and socioeconomic rights when they go wrong. The staggering volume of derivatives in existence, coupled with their inherent complexity and opacity, can generate unanticipated and misunderstood risks that are very difficult for both regulators and financiers to manage.[43] As we have already noted, the notional volume of derivatives in existence is equivalent to nearly twenty times the value of world GDP.[44] Moreover, because they are based on mathematics rather than being fixed in any concrete way to underlying goods, the only effective limit on the size of the markets is the inventiveness of financial minds and the demand for the products. They can be created in enormous volumes in a reasonably short space of time: between 2004 and 2007, a value of derivatives equivalent to over $200 trillion (more than three times world GDP) was created, and this figure does not include the mortgage-backed securities that were at the heart of the credit crisis.[45] These derivatives lace unexpected interdependencies throughout the world's financial structures, which means that the risks involved are almost impossible to map in an accurate and systematic way. They can thus behave like a time bomb at the heart of international finance.[46]

Commodity derivatives provide a clear illustration of the impact that obtuse financial products can have on human rights. Whereas commodities markets have traditionally been a niche area limited to those who traded in physical commodities, over the last decade there has been a "financialization" of commodity markets—that is, the increased activity by a broad range of investors in commodity derivatives has had an important impact on price dynamics.[47] There is considerable evidence that financialization has contributed significantly to the sharp rise in commodity prices in recent years, which has heavily affected the right to food and an adequate standard of living of millions of people worldwide. While many explanations have focused on supply and demand factors, such as

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increased demand from rapidly growing emerging economies, biofuels production, and weather events, recent studies have highlighted the role that structural changes in the trading of commodity derivatives have played in the sharp price rises of core commodities.[48] Although historically commodity markets were largely uncorrelated with other financial markets, over the last few years "the increasing presence of index investors precipitated a fundamental process of financialization amongst commodity markets through which commodity prices became more correlated with prices of financial assets and with each other."[49]

After the collapse of the dot-com bubble in 2001, new types of commodity derivatives were launched, which allowed general investors to use commodities for diversification and investment purposes for the first time. New analysis also began to garner attention, highlighting commodities as an investment class that was less correlated to other financial assets—that is, commodities did not move in tandem with other financial markets and so could be used as part of an investment strategy to protect portfolios from volatility in other markets.[50] This was accompanied by rule changes by the Commodities Futures Trading Commission, which effectively "opened a loophole for unlimited speculation," and also by a low-interest-rate environment that sparked a search for higher yields. This combination of factors funneled hundreds of billions of dollars into commodity derivatives inside the space of just a few years.[51]

These developments coincided with rapid, steep rises in the price of commodities. The price of wheat more than tripled in just six years, hitting over $1,000 a ton in 2008, compared to just $300 in 2002. The price of rice rose fivefold over the same period, from $4 per hundred pounds to $20. The price of corn and soybean also doubled, while the price of oil rose from $20 per barrel in 2002 to $145 in 2008.[52] The oil price rise put added pressure on food costs by contributing to sharply rising shipping rates and the costs of agricultural inputs, such as fertilizers. Whereas in the past global food and fuel prices would have been determined largely by issues of weather patterns and supply constraints, today there is mounting evidence that "institutional investors are one of, if not the primary, factors affecting commodities prices" because of the huge positions that have been taken in commodity derivatives.[53]

The human rights costs of this trend have been devastating. In 2009, for the first time, the number of undernourished people surpassed the 1 billion mark, or more than a sixth of humanity, according to figures from the UN Food and Agriculture Organization (FAO). This was a rise of 100 million over the previous year. The

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FAO noted that "the increase in undernourishment is not a result of limited international food supplies. Recent figures of the FAO Food Outlook indicate a strong world cereal production in 2009, which will only modestly fall short of last year's record output." The FAO instead highlighted the "devastating combination" of record high food prices and reduced incomes as a result of the economic crisis, and stressed their impact on the vulnerable.[54] It is only very recently that the role of derivatives in the food and fuel crises has been highlighted by the United Nations, via the Special Rapporteur on the Right to Food.[55] Given the severity of the situation, and the fact that the right to food is a fundamental human right protected under international law,[56] it is all the more remarkable that the role of commodity derivatives in this crisis has not been more forcefully addressed as a human rights issue.

Clearly, when the financial products in question are both enormously complex and remote in the first instance from human rights harm, the preventive defense of human rights will require a new type of engagement with the financial system. This may well require market-based solutions that are unfamiliar to human rights practitioners, who tend to focus on rights-based remedies and tools. In the case of commodity derivatives, for example, one issue that has been under discussion by the U.S. government has been the reinstatement of position limits on speculative positions in commodity futures—something that may result in the protection of the right to food.[57] Moreover, the risks flowing from derivatives directly challenge the notion that finance and human rights only interact in the zone of complicity[58]—that is, where finance funds the activities of frontline businesses that contravene human rights, such as sweatshop labor in the textile industry. The relationship is in fact much broader.

Financial Processes

The processes that underpin various financial markets and transactions are themselves an important part of the human rights picture because they powerfully shape the way the financial system works and the impact that it has on socioeconomic rights. Such processes as risk management and procyclicality may not have featured so far in human rights literature, but they are important contributors to the type of herding of financial behavior that causes market excesses of the kind that we have witnessed over the last decade. Indeed, both have been identified by regulators as having played key roles in the dynamics of the credit crisis—both by

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fueling the boom phase and exacerbating the bust phase, and by rapidly transmitting problems from one market to another.[59]

Risk Management

Risk management presents a conundrum for human rights, and is something of a red herring: there is a tendency to focus on well-understood "human rights risks" while ignoring the enormous impact that the deficiencies in financial risk management have on human rights. There is a common perception in human rights and CSR circles that everyone knows what risk is, and thus human rights risk management is simply a question of adding a set of human rights criteria to the existing risk management framework. These can then be managed as a stand-alone, specific category of risk. Usually these "human rights risks" are linked to the concept of "reputational risk." For example, the drive to incorporate human rights standards into banking has been sold very strongly on the basis that bank activities that manifestly breach human rights will cost the bank financially by besmirching its reputation. It is even common to hear human rights lawyers talk of human rights in terms of "nonfinancial" risk. This immediately puts human rights matters beyond the mainstream concerns and preoccupations of the finance industry, such that human rights advocates then find themselves having to wage an intellectual, moral, and legal offensive to justify why financiers should take human rights into account at all.[60] But the two are not so easily disaggregated. When financial risk management fails, the financial system is hit by catastrophic losses that rapidly translate into economic contraction and broad-based human rights consequences, as they did during the latest crisis. Jobs, incomes, housing, food, education, health care, social security benefits, and access to the basic goods needed for an adequate standard of living may be understood by lawyers and others as socioeconomic human rights, but they are also fundamentally economic goods that are essential parts of the economic fabric of any country, and they are extremely difficult to isolate from the impact of financial crises.

To limit the concept of "human rights risk" to a narrow range of activities where finance most directly affects individual rights is to ignore the role that faulty risk management systems play in the way the financial system as a whole affects human rights. The management of financial risk can itself be an important threat to human rights enjoyment in respect to many of these issues. Indeed, one of the biggest and most frustrating misconceptions regarding the interaction of human rights and finance is the tendency to separate nonfinancial risks from financial

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risk, with the undesirable consequence of marginalizing human rights risk management.[61]

The way risk is defined, measured, managed, and priced is central to the business of finance. Over the last twenty years strenuous efforts have been made to streamline risk management and turn it into a quantitative science that offers a set of mathematical techniques for gauging the level of risk attached to financial activity. This "science" is now a highly complex set of processes for different types of risk (market, credit, liquidity, and so on), which requires dedicated quantitative specialists and large information technology infrastructures. Core techniques have been packaged into generic models that are sold by specialist providers to financial companies worldwide, and they are embedded in international banking regulations as lynchpins of the capital adequacy regime.[62] At its heart, this risk management science has been constructed around statistics and probability theory on the basis of financial and economic data—that is, the calculation of risk is seen as needing only the right mathematics applied to the right financial data. Broad awareness of more qualitative factors has been largely stripped out of the risk management process—that is, market data will be used in isolation from its social context, as if the financial markets are separate, self-contained systems unconnected to the broader human world in which they operate. Awareness of social factors—of how global financial processes are affecting the lives of people worldwide and, conversely, how the living standards of the world's people will influence financial variables—is not factored into the calculation because it is assumed that market data contains all the information necessary for assessing all relevant risks.

This is a crucial part of understanding how the process of repackaging subprime U.S. mortgages came to imperil the world's financial system and have such devastating worldwide human rights consequences. Because the apparent risk of these mortgages and their securitization was manipulated using complex mathematics, little, if any, attention was paid to the social changes in the U.S. housing market that were the inevitable product of trillions of dollars flooding into the mortgage market. The assessment of risk failed to take into account changes in underlying conditions, including the widespread misselling of mortgages to people who could never afford to pay them back.[63]

Moreover, the way risk management methodology has been constructed has resulted in a bifurcation that has important consequences for human rights. Core processes, which are geared toward "normal" market conditions (that is, a

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likelihood of only small losses), are supplemented by "stress testing," which is meant to test a portfolio against the risk of crisis. The methodology for core processes is defined with far more apparent mathematical precision than stress testing because it is founded on probability theory, which copes well with normal market conditions but fails where the risk of extreme events or crises is concerned. This has resulted in an overreliance on core processes, and a systematic underestimation of the risk of financial crisis.[64]

Even though severe crises occur with regular frequency—on a roughly five-to-seven-year timescale in recent decades—risk management struggles to incorporate them in its probability-based statistical methodology, assuming instead that, incredibly, they occur only once in thousands of years.[65] A calculation run by four risk specialists on the actual size of the probabilities used in normal risk management found that they "worked on truly cosmological scales, and a natural comparison is with the number of particles in the Universe." That is, the assumed probabilities of severe events are so infinitesimally low as to only be comparable with these gigantic numbers. They described their results as "breathtaking," noting that even milder crises than the most recent one had, on this statistical scale, "an expected occurrence of less than just one day in the entire period since the end of the last Ice Age."[66] This mind-boggling anomaly at the heart of the financial system blinds many financiers and quantitative risk managers to the threat of significant financial turmoil as a consequence of collective exuberance, and effectively sanctions the excessive collective risk-taking that inevitably produces such turmoil in the first place. It also results in a collective abdication of responsibility for the devastating human rights consequences that result, because financiers can point to the depersonalized failures of the risk management process rather than take responsibility for poor judgment and a failure to act to prevent harm.

Such underestimation is a huge problem for financial risk management and for human rights generally. A financial system that is at least twenty times the size of the world economy, and that is premised on risk models that assume normal market functioning, is ill-equipped to handle crisis conditions, and is simultaneously ill-equipped to defend human rights enjoyment from the devastating consequences that follow serious risk management failures. Risk management in this sense is a world away from the familiar one of human rights checklists. It is, however, critical to understanding the genesis of financial instability, with its attendant human rights harm, and to devising a strategy to interpolate human rights

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principles into core financial processes. Because of its central role in shaping the behavior of the financial system, risk management is arguably a key battleground for defending human rights from financial excesses. This is a problem that has not yet garnered much attention from a human rights standpoint, but it merits significant scrutiny.

Procyclicality

As noted above, procyclicality denotes the tendency of the financial system to strongly magnify swings in activity in the financial markets and in the world economy—a serious structural problem that is "hard wired" into the heart of the global financial system. Procyclicality played a significant role in the genesis and transmission of the current crisis, and has been a key concern of regulators in framing regulatory reforms, but it is such a technical issue that it is rarely heard of outside financial debate.[67] To our knowledge, procyclicality has never featured on the radar of human rights discussion, yet it is extremely significant for global human rights protection. Procyclically exaggerated cycles in the financial markets can be devastating for human rights in rich as well as poor states, as they can result in all states being rendered exceptionally vulnerable to job losses, financial hardships, discrimination, loss of political and social voice, and barriers to accessing adequate education, health, and housing services. Addressing procyclicality is therefore central not only to financial stability but also to protecting human rights from a malfunctioning financial system.

As the financial system has grown in size relative to the world economy, the global economy has become extremely sensitive to (or "highly correlated with," in financial parlance) financial cycles. Disruption in the financial markets thus has immediate and devastating consequences for both economic activity and human rights. In an attempt to stabilize rapidly growing financial markets, a plethora of rules and methodologies has been built into the financial system—from accounting rules to capital adequacy standards—over the last twenty years. In practice, as the current crisis has revealed, they have instead proven to exacerbate and magnify systemic instability. As a result, financial markets are caught in a cycle of much more extreme bubbles followed by much more devastating collapses in financial and economic activity, with serious ramifications for human rights. In essence, procyclicality means that the stabilizers that were built into the system have proven to work as accelerators rather than brakes, tipping the financial

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system from euphoric highs to devastating and synchronized collapses across the world's now deeply interlinked financial markets.

The way procyclicality interacts with human rights can be broadly summarized in three categories. First, by helping to drive asset prices to euphoric highs, it can be a double-edged sword for human rights. On the one hand, the wealth it creates can generate economic booms that provide new opportunities for poverty reduction and rights realization. In the years between 2004 and 2007, in the "euphoria" phase of the cycle, when procyclicality helped to turn rising asset prices into self-fulfilling prophecies around the world, there were lauded gains in human rights realization in many developing economies, such as China and India, as economic activity intensified. However, the downside was inflation in the price of goods essential to human rights (housing, food, and fuel), as well as higher vulnerability of the economic situation to a reversal. And while the structural instability that procyclicality laced throughout the system was hidden from the view of human rights activists and lawyers, and indeed from many in the financial system, it was clear to those who understood procyclicality that the situation was extremely vulnerable.

Asset prices will generally "revert to trend" sooner or later—that is, fall back to more realistic levels, and the higher a boom phase is driven, as a general rule, the larger the subsequent collapse will be. Socioeconomic rights are deeply entwined with this dynamic because any collapse in financial markets would undo many of the gains in poverty alleviation that the euphoria phase of the cycle had created. The International Labour Organization's estimate of 20 million jobs lost worldwide when world trade volumes collapsed following Lehman Brothers' bankruptcy illustrates the point.[68] Moreover, people who are economically vulnerable may be tempted during the euphoria stage to make certain decisions, such as taking on a loan or traveling to find work in another country, because the economic situation seems so favorable. Once a financial reversal devastates the economic landscape, however, many of these individuals and families suffer enormous hardship as a result of these decisions, which are part and parcel of a long, complex chain of causation originating in part in complex procyclical processes in the financial system.[69]

Second, procyclicality has helped create a gargantuan financial system that is itself extremely vulnerable to a market crisis, because its key stabilizers (for instance, its capital base, risk metrics, and collateral values on lending/leverage) are all benchmarked to current asset prices. What this means is that a crisis can

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rapidly become a collapse, where bank balance sheets are decimated and the value of asset holdings wiped away. This triggers widespread selling of assets and the creation of "one-way markets" in which everyone is trying to sell and there are few buyers, which drives markets into panic mode. This further leads to contagion, where problems pass quickly from one market and country to another as financial entities try to sell anything they can to meet capital adequacy standards and pay off borrowings. Because of this aspect of procyclicality, financial crises are rarely contained in the individual countries where the problems may have originated. Instead, the financial and economic impacts are passed from one country to another. Critically, procyclicality can transmit financial problems into countries that may have had little to do with the problems at the epicenter of the crisis, and where the state may have been making strong efforts to reduce poverty. The Asian financial crisis of 1997–1998 provided a clear example of this process at work, where a financial collapse centered in Southeast Asia quickly spread to markets in Latin America and Russia, sparking major financial, economic, and human rights problems.

Third, procyclicality can actually prolong and deepen the effects of a financial crisis on the financial sector itself, which can delay economic recovery and intensify negative effects on human rights. Because of the procyclical nature of international capital adequacy rules, banks have to hold more capital in the aftermath of a crisis and can be extremely reluctant to take on more risk. Thus, procyclicality can prolong the economic downturn by reducing the supply of credit to the economy and dampening financial activity when it is most needed to stimulate the economy. Because risk is deemed to have increased, higher-risk borrowers (notably the poor) can find it extremely difficult to access credit. For example, despite the enormous public bailouts of large banks in 2007–2008, there have been ongoing concerns that these cash injections have not translated into greater liquidity and loan activity within the commercial banking sector.[70] While from the perspective of human rights law it may seem grossly inappropriate, given the essentially public nature of the funds and the economic hardships being suffered, the banks are constrained by the capital adequacy rules. They cannot simply lend out more capital when the perceived human rights need is greater.

Procyclicality is thus an issue that clearly demonstrates our contention that the integration of human rights into global finance has so far been shallow because it has only touched on those less technical aspects of financial activity, where the effects on human rights are easiest to map. Because procyclicality is produced

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by the compounding effects of the acts of millions of financial actors responding individually to procyclical dynamics inherent in core governing rules and processes, it cannot be addressed using the existing methodological template of linking identified human rights harm or complicity to individual corporate acts or actors or even individual states. Rather, it is an issue of systemic responsibility for collective failings and malfunctioning governing rules. Addressing the human rights implications of this situation requires a multidisciplinary analysis of how financial regulatory architecture can be designed so as to produce markets that are more stable and more aligned with the protection of economic and social rights as well as civil and political rights, and why they currently fail to do so. That is, procyclicality unites the issue of financial stability and human rights protection under one umbrella and necessitates engagement around the question of how human rights principles can be meaningfully applied to more complex, systemic areas of finance.

Procyclicality challenges human rights lawyers to think differently about the nature of the relationship between global financial markets and international human rights law if progress is to be made in embedding human rights principles into core rules and processes. It is not immediately obvious how, if at all, human rights principles could be applied to the reformulation of financial theories, processes, and rules that underpin such issues as procyclicality and risk management; but given the gravity of the consequences for human rights, it is clear that concerted efforts to undertake thoroughly interdisciplinary work are necessary to understand what could be applied and how.

Conclusion

The principal purpose of this foray into some particular examples of financial services products and processes has been to identify and explain the interconnections between global finance and human rights. Some of these are more obvious than others, but all reveal degrees of complexity in concept and practice that are yet to be appreciated by actors in either field. Certainly, more work needs to be done in this regard across the full width of global financial services and deeper into the details of particular human rights problems and possibilities. What remains also outstanding, however, is the vital question of what is to be done with this information. Specifically, what steps can and should be taken to close the gap—to not only ensure that global finance does not undermine human rights

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protections (the "do no harm principle") but, further, to explore how its considerable power and potential can be used in ways that further enhance human rights ends (the "value added principle").

We believe that this is work that can and will be advanced in future research and writings, hopefully by commentators (including the present authors) from both fields. That said, in concluding this paper we articulate three interrelated features of the gap that we consider to be especially significant and that have some prospects for remedy.

The first of these is the reiteration of a fundamental gap in understanding on both sides of the goals and functions of the other, which results in an inability to grasp the problems as well as the benefits each side has to offer to the betterment of individuals and societies. It is of course precisely this gap that we see this paper making some contribution to bridging. The compartmentalization of the fields has grown steadily since the Second World War. The encapsulation of human rights in international law during that time has brought not only enforceability but also rigidity, and the power of human rights rhetoric has brought not only self-assurance and authority but also unrealistic aspirations and an unwillingness to be self-critical. The expansion of financial services especially in the last thirty years or so has been even more self-interested. Based on the intellectually sophisticated edifice of modern financial theory, and the core assumption that liberalized financial markets are socially optimal, financiers have become increasingly less willing (and, until very recently, less required) to be held responsible for anything more than making money flow as felicitously as possible. The casino culture of finance bemoaned by Keynes in the 1930s has reached epic proportions eighty years later.[71]

Yet, it was not always this way. Modern political and economic freedoms were born of the same intellectual firmament—the Enlightenment—and largely driven by the same philosophical convictions: rationality, individualism, and liberalism.[72] It is true that the two sets of freedoms are neither coterminous nor necessarily easily compatible, but they are complementary. No less a titan of the Enlightenment than Adam Smith saw this complementarity as the basis upon which he mounted his philosophical argument for greater social justice to be achieved through greater economic wealth, which was itself best effected through a free market.[73] The fact that this sequence of reasoning is not always remembered in its entirety is in fact a much more significant failing than the arguments that rage over the merits of its individual components. In terms, then, of addressing

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the problems of the relative modern-day perspectives of human rights and global finance, a franker appraisal of their respective conceptual origins as well as their goals, limitations, and conditionalities would be a significant first step toward meaningful interaction.

The second issue is the simple absence of expertise at key points of interaction between the two spheres. Thus, for example, in policy-making forums addressing such financial matters as capital adequacy, risk management, and (financial) systemic stability, human rights standards (or social welfare concerns more generally) are very seldom voiced by those who are expert in these financial fields. Equally, in human rights and social welfare policy-making forums, sophisticated financial perspectives are rarely provided by human rights experts. We accept, of course, that expertise across both arenas (whichever direction one is coming from) is not easily obtained, precisely because expertise in any one area is hard-won. But that is just the point. If the gap is to be bridged, such cross-fertilization will have to become much more commonplace, and that means actively sought after by players on both sides. The phenomenon of "philanthrocapitalism," the burgeoning of public-private partnerships in development funding and assistance, the rise of innovative financing schemes, the bandwagon of corporate social responsibility debate, some exploratory analyses of the human rights impact of international investment law and arbitration, and even global trade talks that encompass the "how and why" of economic growth and development as well as the "whether and when" are all arenas in which such cross-fertilization can take, and to some extent is taking, place.

Third, as a consequence of the above two factors, there are clearly lacunas in the institutional and regulatory responses to the problem of how better to integrate the objects and practices of global finance and human rights. To address these, the very first step that needs to be taken requires new ways of thinking about how to promote compliance with human rights standards. The historical focus of human rights on regulating the actions of public bodies will need to be adapted and reconfigured in view of the fact that global finance involves a plethora of private actors as well as public ones. And to ensure that any such realignment gains purchase, it will have to be shown how human rights are relevant to the management of the financial system in precise, workable ways, and how human rights can be institutionalized in financial practice.

This last task may prove to be the hardest of all to tackle. Too often and too readily the human rights community is prepared merely to state that "human

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rights . . . provide a clear and universally-recognized framework for guidance in the design, implementation and monitoring of economic policies and programs."[74] As a matter of principle, morality, or even legal obligation, such an assertion may, at a stretch, hold up. In terms of reasoned practicability, however, it offers little of use. This is not to belittle the sentiment and power of the moral assertion; far from it. It is one with which we have abiding sympathy. Rather, it is to focus on the next step—the step beyond rhetoric. It is to demand that thought be turned to what needs to be done to bring the blue-sky aspiration nearer to terrestrial fulfillment. It is to be forced to put ourselves in the shoes of the financiers and consider how they can be persuaded that to understand human rights—their objectives, processes, and limitations—might aid what finance can and ought to achieve.

By speaking human rights to the four financial phenomena featured in this article we have sought to start down that track, knowing full well how long it is. Bridging the gap between the two fields will not be easy, but the task can only properly begin once there is a greater acceptance of its necessity.

NOTES

1 While there is a large body of work in the economic literature on issues of poverty, development, and social welfare, we are focusing here specifically on the interaction between international finance and internationally protected human rights, the relationship between which has so far been conceptualized within narrow parameters

2 Rita Roca and Francesca Manta, "Values Added: The Challenge of Integrating Human Rights into the Financial Sector," Danish Institute for Human Rights, February 2010, p. 14.

3 Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Washington, D.C.: January 2011), p. xvi.

4 The apt term used in the Preamble to the Universal Declaration of Human Rights (1948), that encompasses public and private sectors, individuals, and all manner of organizations.

5 They are "basic rights," in the sense of an individual's entitlement to have life's necessities provided, where otherwise absent, by the state; see Henry Shue, *Basic Rights: Subsistence, Affluence, and U.S. Foreign Policy*, 2nd ed. (Princeton, N.J.: Princeton University Press, 1996), chap. 1.

6 For a consideration of the history and significance of the phenomenon, see Gerald Epstein, ed., *Financialization and the World Economy* (London: Edward Elgar, 2005); and Thomas Palley, "Financialization: What It Is and Why It Matters," Levy Economics Institute Working Paper No. 525, 2007.

7 World Bank, "Quick Reference Table: Gross Domestic Product 2009" (latest figures); available at siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf (accessed October 26, 2010).

8 Bank for International Settlements, "Amounts Outstanding of Over-the-Counter Derivatives: By Risk Category and Instrument"; available at www.bis.org/statistics/otcder/dt1920a.pdf (accessed October 26, 2010); and Bank for International Settlements, *BIS Quarterly Review* (September 2010), p. 22; available at www.bis.org/publ/qtrpdf/r_qt1009.pdf (accessed October 26, 2010).

9 Karsten von Kleist, Carlos Mallo, Serge Grouchko, and Philippe Mesny, "Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2010: Preliminary Results," Bank for International Settlements, September 2010; available at www.bis.org/publ/rpfx10.pdf. This is 20 percent higher than in April 2007, which gives an idea of just how quickly financial markets can grow.

10 International Swaps and Derivatives Association, "ISDA Market Survey: Notional Amounts Outstanding, Semi-annual Data, All Surveyed Contracts, 1987–Present"; available at www.isda.org/statistics/pdf/ISDA-Market-Survey-historical-data.pdf (accessed October 26, 2010).

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[11] These rights are protected under the International Covenant on Civil and Political Rights (arts. 14 and 26) and the International Covenant on Economic, Social and Cultural Rights (arts. 11, 12, and 13).

[12] World Bank Group, "Recovery at the Crossroads: Role and Implications for Developing Countries" (background paper prepared for the G20 Summit, Toronto, June 26–27, 2010), p. 7; available at siteresources.worldbank.org/NEWS/Resources/G20.pdf.

[13] International Institute for Labour Studies, *World of Work Report 2009: The Global Jobs Crisis and Beyond* (Geneva: International Labour Organization, 2009), pp. 3–4; available at www.ilo.org/wcmsp5/groups/public/-dgreports/-dcomm/documents/publication/wcms_118384.pdf.

[14] Olivier De Schutter, UN Special Rapporteur on the Right to Food, "Food Commodities Speculation and Food Price Crises: Regulation to Reduce the Risks of Price Volatility," Briefing Note No. 2, September 2010; available at www.srfood.org/images/stories/pdf/otherdocuments/20102309_briefing_note_02_en_ok.pdf.

[15] Carmen DeNavas-Walt, Bernadette D. Proctor, and Jessica C. Smith, "Income, Poverty, and Health Insurance Coverage in the United States: 2009," United States Census Bureau, September 2010, pp. 14–15; available at www.census.gov/prod/2010pubs/p60-238.pdf.

[16] Ibid., p. 14.

[17] As exemplified by the preeminent concern of human rights law and legal scholarship with individual (or group) dispute settlement and remedial action, rather than preventive policy development.

[18] A theme explored by Mary Dowell-Jones, *Contextualising the International Covenant on Economic, Social and Cultural Rights: Assessing the Economic Deficit* (Leiden, Neth.: Martinus Nijhoff, 2004).

[19] Manuel Couret Branco, *Economics Versus Human Rights* (Oxon, UK: Routledge, 2009), pp. 3–4.

[20] This is also a central part of the argument for integrating environmental, social, and governance (ESG) factors into investment decision-making set out in the Global Compact's 2004 report, "Who Cares Wins: Connecting Financial Markets to a Changing World"; available at www.unglobalcompact.org/docs/issues_doc/Financial_markets/who_cares_who_wins.pdf; see pp. 9–10.

[21] Algorithmic trading is the buying and selling of stocks by computers programmed with mathematical models for selecting opportunities. Many such programs are high-frequency traders, whereby stocks are held for seconds or minutes, and where all holdings are sold at the end of each day. Securities and Exchange Commission (SEC), "Concept Release on Equity Market Structure: Proposed Rule," *Federal Register* 75, no. 13 (January 21, 2010), pp. 3606–12; available at www.sec.gov/rules/concept/2010/34-61358fr.pdf. The SEC comments that "by any measure, HFT [high frequency trading] is a dominant component of the current market structure and is likely to affect nearly all aspects of its performance," p. 3606.

[22] Bear Stearns, for example, fostered a corporate culture in which senior managing directors were expected to donate 4 percent of their earnings to charity. Lehman Brothers donated $39 million to charity in 2007, and in the previous year had partnered with Spelman College to create the Center for Global Finance and Economic Development. See Peter Shergold, "Global Financial Crisis and Economic Downturn: Implications for Corporate Responsibility," Issue Paper No. 1, Centre for Social Impact, May 2009, pp. 3–12; available at www.csi.edu.au/uploads/31642/ufiles/CSI%20Issues%20Paper%20No%201%20-%20Global%20Financial%20Crisis%20and%20Economic%20Downturn%20Implications%20for%20Corporate%20Responsibility.pdf.

[23] In the context of collateralized debt obligations (CDOs), particularly subprime CDOs, it is worth noting that formal risk management substituted in the vast majority of cases for a basic commonsense look at what was being bought. UBS, in its shareholder report on its credit-related write-downs, conceded that "the CDO desk did not carry out sufficient fundamental analysis as market conditions deteriorated, or conduct 'look-through' analysis to reassess potential issues" in the CDO structures. UBS, "Shareholder Report on UBS's Write-Downs," 2008, p. 30, sec. 6.2.3, and p. 14, sec. 4.2.3.

[24] This is a specific example of a general point about the difficulties in the measurement and evaluation of human rights impacts in all sectors—social, political, and legal, as well as economic. Even as Todd Landman and Edzia Carvalho advance cogent arguments about how human rights can be measured, their work makes clear how difficult it is to provide workable means by which comprehensive and detailed measurements can be made. See Todd Landman and Edzia Carvalho, *Measuring Human Rights* (London: Routledge, 2010).

[25] This is partly due to the precise wording of the obligational clause in the International Covenant on Economic, Social, and Cultural Rights, which talks of an obligation to devote "the maximum available resources" to realizing these rights (art. 2(1)). But it is also partly due to the legal rather than economic background of many commentators on this instrument. See Dowell-Jones, *Contextualising the International Covenant on Economic, Social and Cultural Rights*, pp. 44–51.

[26] TheCityUK, "Bond Markets 2010," June 2010; available at www.thecityuk.com/media/156879/bond%20markets%202010.pdf.

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[27] Figures are for 2009; ibid.

[28] Of course, the critical issue of the U.S. federal deficit and debt, and the use of quantitative easing by the Federal Reserve to purchase treasury bonds, effectively "monetizing the debt," has very important ramifications for the dollar, the world economy, and, ultimately, human rights. The collapse of the U.S. bond market and/or collapse of the dollar would be catastrophic for global human rights enjoyment. Unfortunately, however, within the confines of this paper there is not scope to go into the complexity of how this dynamic would unfold.

[29] IMF, *World Economic Outlook: Sustaining the Recovery* (Washington, D.C., October 2009), fig. 1.7; available at www.imf.org/external/pubs/ft/weo/2009/02/c1/fig1_7.pdf. Despite the concerns in the 1990s that the state was being rolled back from the commanding heights of the economy, in reality there was only a marginal reduction in state spending as a proportion of GDP, and in many cases those reductions have been reversed by subsequent governments.

[30] Stephen Cecchetti, M. S. Mohanty, and Fabrizio Zampolli, "The Future of Public Debt: Prospects and Implications," BIS Working Papers No. 300, March 2010, p. 1; available at www.bis.org/publ/work300.pdf?noframes=1. See the charts on p. 10, which plot the future trajectory of public debt for twelve advanced economies over the next thirty years. In all cases public debt levels at least double, with the UK's public debt jumping from 100 percent to 500 percent of GDP over the next thirty years.

[31] Figures from www.treasurydirect.gov and the Congressional Budget Office, "The Budget and Economic Outlook: An Update, August 2009"; available at www.cbo.gov/ftpdocs/105xx/doc10521/2009BudgetUpdate_Summary.pdf.

[32] Figures from the Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020* (January 2010); available at www.cbo.gov/ftpdocs/108xx/doc10871/BudgetOutlook2010_Jan.cfm.

[33] See www.debtbombshell.com for a breakdown of the UK debt situation.

[34] Hans J. Blommestein, Eylem Vayvada Derya, and Perla Ibarlucea Flores, "OECD Sovereign Borrowing Outlook No. 3," October 2010, p. 2; available at www.oecd.org/dataoecd/11/15/46215216.pdf.

[35] This was effectively what happened to Greece in May 2010 when its eurozone partners, in concert with the IMF, had to step in to activate their offer of emergency financing because Greece needed to sell more than $10 billion in new bonds in order to repay bonds that were maturing, and to keep funding government spending. It was unclear whether there would be sufficient investor demand given the risks. BBC News, "Greek Minister Says IMF Debt Talks Are 'Going Well,'" April 25, 2010; available at news.bbc.co.uk/2/hi/business/8642941.stm.

[36] In Ireland's case, the negotiation of its bailout by its eurozone partners was delayed by concerns over the interest rates it would be charged on the loans, which, it was feared, would just push it further into insolvency and cause even deeper social spending cuts. See EUbusiness, "EU Ministers Divided over Irish Bailout Interest Rate," November 28, 2010; available at www.eubusiness.com/news-eu/finance-economy.7b1.

[37] The principle of nonretrogression was set out in the UN Committee on Economic, Social and Cultural Rights General Comment No. 3: "The Nature of States Parties Obligations," December 14, 1990, 5th Session, UN Doc. E/1991/23, paras. 9 and 10.

[38] See, e.g., Sabine Michalowski, "Sovereign Debt and Social Rights—Legal Reflections on a Difficult Relationship," *Human Rights Law Review* 8, no. 1 (2008), p. 35; and Noel Villaroman, "The Need for Debt Relief: Debt-Servicing Leads to Violations of State Obligations under the ICESCR," *Human Rights Brief* 17, no. 3 (2010), pp. 3–5.

[39] See, e.g., "ECB Steps Up Push to Calm Bond Markets," *Financial Times*, December 3, 2010; and "ECB Bond Buying Triggers Biggest Drop in Corporate Debt Risk in Six Months," December 3, 2010; available at www.bloomberg.com/news/2010-12-03/ecb-bond-buying-triggers-biggest-decline-in-credit-default-risk-since-may.html.

[40] Of course, the credit rating agencies play a central role in this, and have been hugely criticized in light of the credit crisis. But the deeper issue of how risk is perceived, measured, and managed in finance, and the responsibility that financiers take for their own risk decisions, concerns the system as a whole.

[41] Angela Merkel, the German chancellor, has commented: "We cannot keep constantly explaining to our voters and our citizens why the taxpayer should bear the cost of certain risks and not those people who have earned a lot of money from taking those risks" ("Irish Row with Angela Merkel over Debt Bailout," *Inside Ireland*, November 12, 2010; available at www.insideireland.ie/index.cfm/section/News/ext/eudebtbailout001/category/1084). At the G20 meeting in Seoul, the finance ministers of France, Germany, Italy, Spain, and the United Kingdom issued a joint statement assuring investors currently holding eurozone bonds that they would not be expected to take losses from any sovereign bailouts, and that the new rules expecting them to participate in any burden sharing would not take effect until 2013. See "EU Ministers Move to Calm Bond Markets," *Financial Times*, November 12, 2010.

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[42] Warren Buffet, Letter to Berkshire Hathaway Shareholders, February 23, 2003; available at www.berkshirehathaway.com/letters/2002pdf.pdf.

[43] Particularly when coupled with the deficiencies of risk management models and leverage, which we will outline below. All these factors combined in a powerful way to bring down the multibillion-dollar hedge fund Long-Term Capital Management in 1998, despite its Nobel Prize–winning founders. See President's Working Group on Financial Markets, *Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management* (Washington, D.C.: Department of the Treasury, April 1999).

[44] See above text at note 9.

[45] International Swaps and Derivatives Association, "ISDA Market Survey."

[46] The current crisis is just one in a list of crises that have been caused by derivatives. See Kevin Dowd and Martin Hutchinson, *Alchemists of Loss: How Modern Finance* and *Government Intervention Crashed the Financial System* (London: John Wiley, 2010), pp. 225–44.

[47] See Gerald Epstein, *Financialization and the World Economy*, and Thomas Palley, "Financialization: What It Is and Why It Matters."

[48] See, e.g., Christopher Gilbert, "Speculative Influences on Commodity Futures Prices 2006–08," United Nations Conference on Trade and Development, Discussion Paper No. 197, March 2010; Miguel Robles, Maximo Torero, and Joachim von Braun, "When Speculation Matters," International Food Policy Research Institute, Issue Brief No. 57, February 2009; and Bryan Cooke and Miguel Robles, "Recent Food Prices Movements: A Time Series Analysis," International Food and Policy Research Institute, Discussion Paper No. 00942, December 2009.

[49] Ke Tang and Wei Xiong, "Index Investment and Financialization of Commodities," NBER Working Paper Series No. W16385, 2010, p. 2; available at www.princeton.edu/~xwiong/papers/commodity.pdf. See also John Baffes and Tassos Haniotis, "Placing the 2006/8 Commodity Price Boom into Perspective," World Bank Policy Research Working Paper No. 5371, 2010; available at ssrn.com/abstract=1646794; Parantap Basu and William Gavin, "What Explains the Growth in Commodity Derivatives?" *Federal Reserve Bank of St. Louis Review* 93, no. 1 (2011), p. 37; and Commodity Futures Trading Commission, "Staff Report on Commodity Swaps Dealers & Index Traders with Commission Recommendations," 2008; available at www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf.

[50] Georgi Georgiev, "Benefits of Commodity Investment," *Journal of Alternative Investments* 4, no. 1 (2001), p. 40.

[51] Testimony of Michael W. Masters, Masters Capital Management LLC, before the Committee on Homeland Security and Governmental Affairs, United States Senate, May 20, 2008, pp. 6–7 and 2; available at hsgac.senate.gov/public/_files/052008Masters.pdf.

[52] Data available from futures.tradingcharts.com.

[53] Testimony of Michael W. Masters, p. 1.

[54] FAO, "More People Than Ever Are Victims of Hunger," Press Release, June 2009, p. 1; available at www.fao.org/fileadmin/usesr_upload/newsroom/docs/Press%20release%20june-en.pdf.

[55] De Schutter, "Food Commodities Speculation and Food Price Crises."

[56] Namely, "the right of everyone to an adequate standard of living . . . including adequate food," under Article 11 of the International Covenant on Economic, Social and Cultural Rights.

[57] See Institute for Agriculture and Trade Policy, "Commodities Market Speculation: The Risk to Food Security and Agriculture," 2008, for a discussion of the regulatory debate in the United States; available at www.iatp.org/iatp/publications.cfm?accountID=451&refID=104414.

[58] See above section on derivatives.

[59] The credit crisis "was not an across-the-board deterioration of all credit markets, but—at least in its early stages—an acute crisis that affected certain markets while leaving others virtually unscathed." Risk management and procyclical processes helped transmit problems from one market to another, and across financial institutions. David Greenlaw et al., "Leveraged Losses: Lessons from the Mortgage Market Meltdown" (paper presented at the U.S. Monetary Policy Forum, New York, February 29, 2008), p. 11; available at www.chicagobooth.edu/usmpf/docs/usmpf2008confdraft.pdf.

[60] Usually the arguments made for inclusion are—of necessity because of their starting point—limited to reputational risk, the influence of environmental, social, and governance (ESG) factors on the long-term "value" of an equity, or increasingly, arguments around the corporate responsibility to respect human rights. None of these approaches mainstreams concern for human rights into financial processes proper.

[61] Not only has it limited the way in which the integration of human rights into bank processes has been approached, it has also limited the type of people who are engaged in this process: the vast majority are either pure human rights lawyers or CSR managers who do not themselves have a background in frontline financial operations. The technical know-how of frontline financial operations is therefore not

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present in the discussion from the outset, immediately excluding the more complex areas of bank operations—which account for the majority of financial activity—from the dialogue. Situating the CSR unit technically within the risk management function does not address this gap.

[62] The risk weighting of assets for regulatory capital purposes was at the heart of the second Basel Accord on international capital adequacy. Bank for International Settlements, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (generally known as Basel II), June 2004; available at www.bis.org/publ/bcbs107.htm.

[63] As one observer has commented, the objective was "to use the alchemy of financial modeling to create the appearance of mathematical safety out of dangerous toxic ingredients." Statement by Christopher Whalen, cofounder of Institutional Risk Analytics, to the U.S. House Committee on Science & Technology Subcommittee on Investigations and Oversight hearing on "The Risks of Financial Modeling: VaR and the Economic Meltdown," September 10, 2009, p. 5; available at gop.science.house.gov/Media/hearings/oversight09/sept10/whalen.pdf.

[64] Just a few months before problems in the financial markets began, the UK Financial Services Authority (FSA) had noted that firms were significantly underestimating the likelihood of severe events and were using only very mild stress scenarios to test their portfolios' resilience to problems. UK FSA, "Stress Testing Thematic Review," October 9, 2006; available at www.fsa.gov.uk/pubs/ceo/stress_testing.pdf.

[65] David Viniar, Chief Financial Officer at Goldman Sachs, is quoted as having said in a conference call to investors in August 2007, before the worst of the crisis: "We are seeing things that were 25-standard deviation (i.e. once in every 100,000 years) events, several days in a row." Anuj Gangahar and Gillian Tett, "System Error: Why Computer Models Proved Unequal to Market Turmoil," *Financial Times*, August 15, 2007, p. 9. See also J. Danielsson, "Blame the Models," *Journal of Financial Stability* 4, no. 4 (2008), pp. 321–28; Ricardo Rebonato, *Plight of the Fortune Tellers: Why We Need to Manage Financial Risk Differently* (Princeton, N.J.: Princeton University Press, 2007); and Nassim Nicholas Taleb, *Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets* (London: Penguin, 2007).

[66] Kevin Dowd, John Cotter, Chris Humphrey, and Margaret Woods, "How Unlucky is 25-Sigma?" Centre for Risk & Insurance Studies Discussion Paper Series, 2008.III, p. 4; available at www.nottingham.ac.uk/business/cris/papers/2008-3.pdf.

[67] Lord Turner identified procyclicality as one of the five key issues that underpinned the crisis (UK Financial Services Authority, "The Turner Review: A regulatory response to the global banking crisis," p. 16). In a similar vein, the Bank for International Settlements has commented: "One of the most destabilizing elements of the crisis has been the procyclical amplification of financial shocks throughout the banking system, financial markets and the broader economy" (Basel Committee on Banking Supervision, "Strengthening the Resilience of the Banking Sector," Consultative Document, Bank for International Settlements, December 2009, para. 28; available at www.bis.org/publ/bcbs164.pdf?noframes=1).

[68] International Institute for Labour Studies, *World of Work Report 2009*.

[69] There has been considerable concern in light of the crisis over the rights of migrant workers, who are often the first to lose jobs but who receive little help in returning to their home country. See Ibrahim Awad, "The Global Economic Crisis and Migrant Workers: Impact and Response," International Labour Organization, 2009. Although there is an international convention on migrant workers—the Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families—this convention has only forty-three States Parties (as of September 2010). Critically, it has not been ratified by any of those states that are major recipients of migrant workers.

[70] Aldo Caliari et al., "Bringing Human Rights to Bear in Times of Crisis: A Human Rights Analysis of Government Responses to the Economic Crisis" (Submission to the High-Level Segment of the United Nations Human Rights Council on the Global Economic and Financial Crisis, Geneva, March 2010), pp. 11–12.

[71] "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, *General Theory of Employment, Interest and Money* (London: Macmillan & Co, 1936), p. 142.

[72] David Kinley, *Civilising Globalisation: Human Rights and the Global Economy* (Cambridge: Cambridge University Press, 2009), pp. 6–18.

[73] This is the line of reasoning that links Smith's great work on social justice (*The Theory of Moral Sentiments* [1759]) with his treatise on political economy (*An Inquiry into the Nature and Causes of the Wealth of Nations* [1776]).

[74] Caliari et al., "Bringing Human Rights to Bear in Times of Crisis," p. 18.

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