RECOMMENDATIONS

FINANCE TO CITIZENS

MAKING FINANCE SERVE GENERAL INTEREST

A report from Secours Catholique - Caritas France

HOW TO MAKE FINANCE SERVE SOCIETY? PROPOSED MEASURES

It is possible to regulate finance in a manner that corrects its hypertrophy and its toxicity for society as a whole by reviewing the rules of the game rather than by adjusting the existing ones. Our proposal's keyword is: control. The proposals below involve ambitious changes for the long term and a progressive sequencing of measures. The proposed measures aim at steering a wide societal debate in order to make finance serve society and the general interest again. . It is both necessary to empower civil society within the debate and its arguments, and to be able to initiate a dialogue with stakeholders in the finance sector, and those actors in charge of designing and implementing financial regulation.

DIAGNOSIS: HOW THE PRESENT SET UP OF GLOBAL FINANCE IS DETRIMENTAL TO THE GENERAL INTEREST

The main points of this report's diagnosis are the following:

- Monetary instability has prevailed since the fixed exchange regime was abandoned in 1973
- Since the 1980s, foreign exchange instability, as well as the liberalization of capital flows, gave birth to a new financial asset class: derivative products. Those products and the high-expected returns they generate have attracted investment away from the non-financial economy. Instead of reducing risks, they have contributed to amplify the variability of commodity and currency prices, making those even more unpredictable, which harms consumers, producers and the conduct of public policy.
- Banking regulation focussed mainly on protecting the banking system from those new risks, rather than protecting the economy as a whole. It also triggered the emergence of a vast deregulated « *shadow-banking* », a parallel banking system where speculative hedge funds operate. The regulation failed to predict and avoid the risks of global or « *systemic* » crises, like the one of 2008.
- From the end of the 1960s onwards, credit has been gradually deregulated in advanced economies. This, combined with the liberalization of cross border financial flows, gave birth to giant worldwide banking institutions, which are both undercapitalized and deemed « *too big to fail* ». Moreover, mainly in advanced economies, too much credit went to existing urban real estate assets, and to the shadow banking system, which deepened poverty and inequality.
- Excess credit to the real estate sector triggered the 2008 crisis, which demonstrated the havoc that a global and deregulated financial sector can cause in society and the non-financial economy; ten years after, societies still have not recovered from the economic and social crisis triggered by the financial crisis.

- Come on… let's return power to the citizens now
- My preciouuus…

Weaning the financial system

- The fact that private capital markets became the main source of funding for states, both for advanced and Global South countries, led to excess debt at the State level, which reduced the capacity of states to fund social needs, whilst the crisis was increasing those needs: increased social spending to cover for the economic slow down, investment needs of the climate and ecological transition, development needs in emerging and developing countries.

Proposed measures to regulate finance to make it socially useful

It is possible to regulate finance in a manner that corrects its hypertrophy and its toxicity for society as a whole. Our proposal's keyword is: control. The creation of money and the allocation of credit are general interest activities. The current regulatory framework, which has been developed over the past forty years, is clearly not effective to protect society from the harm caused by the excess deregulation of finance. A sufficient proof is that the economic and social damage caused by the 2008 crisis has still not been remedied, 10 years after. Commodity and currency prices are more volatile than ever, urban real estate bubbles keep growing, and both the public and the private sector are burdened with debt overhang. From within the financial sector itself, worries are emerging about the unsustainability of the system as it is now. The lack of long-term real assets to support investment, in particular, is a problem for long-term structural investors such as insurance companies and pension funds[1].

The proposed measures aim at steering a **wide societal debate in order to make finance serve society and the general interest again**. They involve ambitious changes with considerable impacts on the structure and organization of the banking sector. Not all proposals are consensual, but the stakes are high enough to warrant initiating a frank and open debate on those societal issues, which concern the general interest. It is both necessary to **empower civil society within the debate and its arguments**, and to be able to initiate a **dialogue with stakeholders in the finance sector, and those actors in charge of designing and implementing financial regulation**. The proposals below involve ambitious changes for the long term and a **progressive sequencing of measures** that will make finance serve society again.

Many of the proposed measures can be implemented on a stand-alone national basis, without requiring adoption at an international level. They may then be pushed forward and discussed in the international regulatory bodies, such as the FSB and the BIS. Those international regulatory instances have been made independent from political powers, and they are too often obedient to a financial sector that they are supposed to control. States are sovereign in the making of their legislation: mobilising members of parliaments, local authorities and citizens is a prerequisite to put financial regulation on the political agenda, in order to make finance serve society again.

A different kind of financial regulation: no longer a fine-tuning, but a change of the rules of the game

Four streams of proposals: stabilize, direct, control, and finance the energy transition

The proposals that are put forward for debate here are supported by economists and academics, and, in some instances such as the Financial Transactions Tax, by governments themselves[2].

The proposals revolve around four axes:
- stabilize the financial sector, i.e. shield economy and society from the consequences of excess risk-taking by the financial sector
- ensure that once stabilized, the financial sector will channel funds towards activities that are useful to society as a whole
- reorganize the supervisory architecture so that finance be regulated to the benefit of the common good/general interest
- Make financial resources immediately available to finance the necessary energy, ecological and social transition.

In order to protect general interest, it is necessary, but not sufficient, to stabilize the global financial system in order to avoid the risk of financial crises. Moreover, financial flows should be directed to meet the needs of a sustainable and inclusive economy. Public authorities should therefore be able to use supervision and control mechanisms in order to ascertain that it is the case. Last, we need an immediate stimulus to address two main stands-off of the current economic context (the global debt overhang and the permanent threat to currency values caused by the deregulation of cross-border capital flows), and to put societies on the path of the energy transition.

1 See Paulina Pielichata, « Foreign-exchange risk suddenly haunting European funds », *Pensions & Investments,* October 16, 2017: http://www.pionline.com/article/20171016/PRINT/171019882/foreign-exchange-risk-suddenly-haunting-european-funds
In this article, Philippe Desfossés, Managing Director of the Public Service Additional Pension Plan, explains that the current very low level of interest rates on government bonds poses a major profitability problem for long-term investors such as pension funds.
2 References for academic and/or political support are mentioned for each proposal

ANSWERS TO THE MAIN ARGUMENTS IN FAVOUR OF THE CURRENT STATE OF FINANCIAL REGULATION

No separation of commercial and investment banks

The attempt to separate commercial and investment banks was resisted hard by the financial sector. The EU put forward a directive proposal (see measure A1) which was well designed, even though not sufficient. The banking sector fought back, and the directive project was finally abandoned in 2017. Among of the arguments leading to rejection, the risk of credit contraction, of increased bank tariffs, or the fragility that would ensue (the coexistence of several activities within a single bank being presented as favouring resilience).

The following counter arguments can be brought to the debate on bank separation:

- Universal banks lend relatively less than smaller banks, in proportion to their size. When a crisis occurs, they are faster to restrict lending;
- Separating commercial and investment banks would not increase the cost of banking services, since the financing of commercial banking would become more attractive to investors: this is because the implicit public subsidy, which benefits first and foremost investment banking activities, would disappear;
- there is no evidence of a useful economic and social role for all the activities that banks are currently undertaking, since about 90% of investment banks activities are not related to the non-financial economy;
- Bank size reduces performance and increases risk: the 13 largest European banks (54% in volume) are less profitable than the 200 that follow in the ranking by balance sheet size[3]

Technicality and complexity

The argument that finance is complex is often put forward in the conversation around finance, both to justify the existence of activities that have little social utility (and may eventually be harmful to society) and to prevent civil society, policy makers and to a certain extent regulators from being de facto more involved in the debate.

The globalization of trade and capital flows and currency fluctuations led to the emergence of new so-called « *derivative* » financial products. Most of the exchanged volumes on those products take place between financial companies (less than 10% of derivative products have a non-financial counterpart). Besides, banks create products not when non-bank actors demand those products, but when the products meet the banks' own needs. A case in point is securitization, which enables banks to offload risks away from their balance sheets (see part 2).

Some of the complexity is actually caused by the banking sector itself, notably when it introduces amendments to draft legislation (see for instance the Dodd Frank legislation in the US, the number of pages of which was multiplied ten fold before it was finally adopted, part 3). The complexity then serves to justify recruiting financiers into the supervisory body, as they are deemed capable of understanding a complex legislation.

Moreover, the complexity feature is often put forward by bank executives to clear themselves when they are exposed[4]. In addition to being too complex and too big to fail, banks are too complex to manage well. As the financial sector is not neutral in its impacts on economies and societies, it does matter to avoid the increased complexity of prudential rules, and to be able to simply ban the use of certain financial products[5].

Challenging capital requirements

Both the Bank for International Settlement and this report advocate increasing the capital requirements of banks. However, many in the financial industry disagree, and argue this would slow down the financing of the economy. However, as we recall in part 3, several studies evidence the contrary. Economists, and BIS staff, often compare a bank's equity to the foundations of a building. They show that those banks with higher equity capital finance themselves at lower costs.

The very large financial institution are allowed to carry less capital in the face of their risks, and refuse to adopt a standardized model to measure their risks[6].

Given the impact that the activities of banks have on economies and societies, it is necessary that the same capital requirement methodologies apply to all banks. This is also a necessity for supervisors in order for them to be able to control the implementation of regulation without lengthy contestations, and without having to be aware of the specific features of each weighting system used in each and every bank.

3 Computed from the data (tables A31, A32 and A34 of the annexes) of the final report of the high level expert group on the structural reform of the banking sector in the EU, chaired by Erkki Liikanen, October 2012,
http://www.ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_fr.pdf
See « Factsheet on bank structure reform », Finance Watch, November 2013, p. 2, http://www.finance-watch.org/ifile/Dossiers/Banking %20structure/Facts %20and %20figures %20on %20bank %20structure.pdf

4 See « États-Unis: la Fed met en garde les grandes banques contre leurs pratiques », *L'Express*, October 21 2014 https://www.lexpress.fr/actualites/1/actualite/etats-unis-la-fed-met-en-garde-les-grandes-banques-contre-leurs-pratiques_1613726.html

5 As advocated by Jean-Michel Naulot, a former investment banker and supervisor, in his book *Crise financière, Pourquoi les gouvernements ne font rien*, Seuil, Paris, 2013, p 199

6 In December 2017, the Basel Committee finanlly obtained minimal equity requirements, which goes into the right direction and reduces bank leverage, even though the minimum level should in our opinion have been much higher.

Liquidity on financial markets

The need for capital markets to remain liquid is put forward to justify the short termism in finance, and the existence of speculative products such as High Frequency Trading or derivative products.

As André Orlean, president of the French Association of Political Economy (AFEP), put it in 2008: « *The liquidity in financial markets is usually justified by the fact that were markets not liquid, it would be more difficult to invest, because financial asset owners would need to commit for the long term. However, liquidity on capital markets is also costly, and highly costly, to the economy, through stock market crashes. For that matter, the historical facts are unambiguous: financial crises are indeed integral to capital markets* »[7].

A case in point is the example of High Frequency Trading, whereby transaction are carried out in milliseconds: the very existence of HFT is justified by the additional liquidity it brings to capital markets, as though investors really required to be able to transact at such speed.

We can add that short termism is not aligned with the current and future challenges that confront our societies, such as the financing of the energy transition or the long-term financing of SMEs, for instance. The argument of safeguarding liquidity does not therefore justify avoiding a structural reform of finance.

The independence of supervisory bodies from policy makers

The deregulation and liberalization trend reduces the degree of control that governments have over monetary and financial supervision. Indeed, the financial and monetary spheres have been made independent from political power. This evolution largely stemmed from a mainstream economic theory that considers finance and money as neutral in the economic system. It was also put in place in order to avoid the risk that an inappropriate use of money creation by governments could generate undue inflation. These trends have created two kinds of issues:

If supervisory agencies (central banks and related authorities and agencies) are considered as independent from policy makers, they remain in practice close to the financial sector that they are controlling. This is evidenced by the dominance of individuals coming from the banking and financial sphere in the executive roles at those agencies (see measure C1 and part 3).

With non-conventional monetary policies, central banks have embarked on new roles and responsibilities, and cannot be deemed neutral to the economy any longer. As many economists are claiming[8], among them Thomas Piketty, Laurence Scialom and Michel Aglietta, the ECB has played since 2008 a prominent role in the definition and conduct of policy in the EU and in members' countries.

Because of the prominent role they now play in the economy and in policy, the independence of central banks from policymaking should at least be questioned, considering the interdependency between all actors of policy making (European institutions, governments and parliaments).

Free capital movements

From the 1970s onwards, as mentioned in part 2, the restrictions to cross border capital flows were progressively released. Nevertheless, in many economic areas, such as the EU, or on a global scale, this was not preceded by a convergence of tax, social or environmental norms. The trade liberalization combined with financial liberalization triggered a massive offshoring of industry and services away from advanced economies. It made tax evasion and money laundering much easier, made it possible for hedge funds to take massive speculative positions swiftly and without control, and made emerging country currencies vulnerable to speculative attacks[9].

Even institutions who actively favoured the liberalization of cross-border capital flows, such as the IMF[10], are starting to question its limitations as far as economic development is concerned, and the ability of countries to protect themselves against speculative attacks.

7 « L'aveuglement au désastre. Le cas des crises financières », conversation with André Orléan, *Esprit,* March-April 2008, http://www.esprit.presse.fr/article/orlean-andre/l-aveuglement-au-desastre-le-cas-des-crises-financieres-entretien-14467

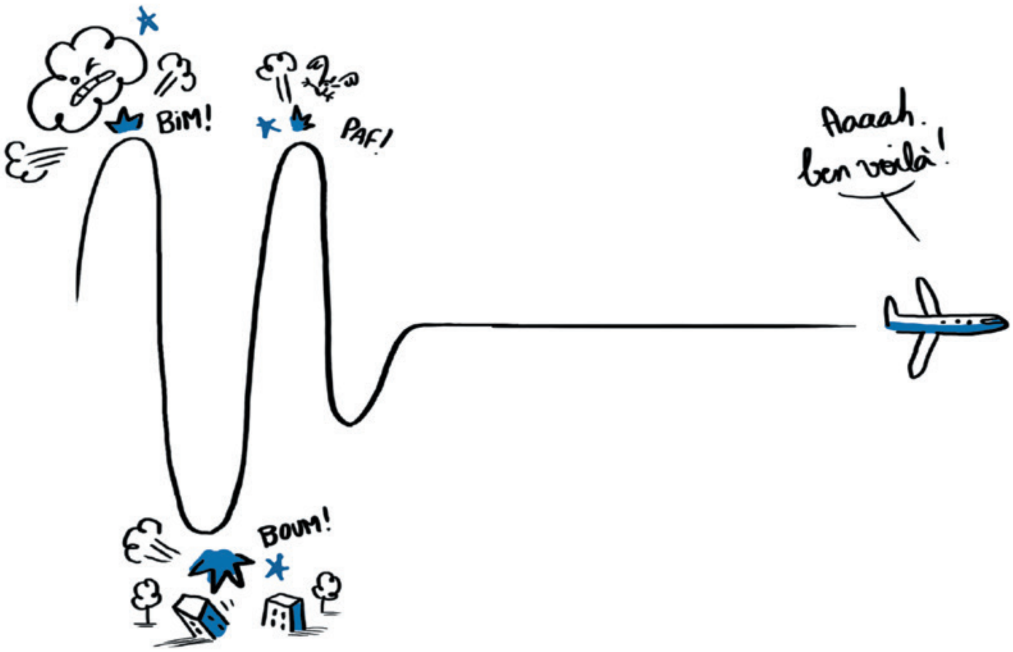
8 « *[the ECB] has acquired executive power via the troika (with the European Commission and the IMF), which defines and ensures the execution of memoranda in countries being "helped"; it plays a central role in Eurozone and Eurogroup summits which coordinate national economies; it has become a regulator of the banking world, deciding on the life and death of the largest banks in the Eurozone; it has established itself as a reformer, working with coalitions built on prioritising "structural reforms" (labour markets), "competitiveness" (restrictive salary policies), etc.* », Appeal, *VoxEurop*, January 22, 2018, « Nominations for the ECB: There must be public debate on the renewal of the central bank », https://voxeurop.eu/en/2018/nominations-ecb-5121773

9 See « La chasse aux dogmes », by Alain Grandjean: https://alaingrandjean.fr/2013/12/02/la-chasse-aux-dogmes/

10 See « The liberalization and management of capital flows-An institutional view », *IMF Staff paper,* November, 14 2012, https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/np/pp/eng/2012/_111412.ashx and http://www.brettonwoodsproject.org/2016/04/imf-reopening-case-for-capital-controls/

A. FIVE MEASURES TO STABILIZE THE FINANCIAL SYSTEM

The first challenge posed by the current financial system is its stability, i.e. the need to protect the economy and societies from excessive risks taken by finance. As mentioned in this report (in particular part 3), the measures taken since the 2008 crisis are not sufficient, even if some of them are moving in the right direction.



- Ah, wel', there it is !

Stabilizing the financial system

Measure A1

RESTRICT BANKS BUSINESS TO COMMERCIAL BANKING: COLLECTING DEPOSITS, GRANTING CREDIT AND OPERATING PAYMENT SYSTEMS

This measure is about redefining the business of banks as solely the collection of deposits, the granting of credits and the operation of payments systems, i.e. what is sometimes referred to as « *commercial banking* ». Banks would therefore no longer be allowed to buy or underwrite[11] financial securities (shares or bonds) or derivative products or commodities. Only banks, redefined as such, could access Central Bank refinancing, versus investment « *banks* » (in the pre –reform sense of the term), which are the key actors of speculative trading and shadow banking operations.

SCOPE:

At least the G20 countries, comprising the EU and the 19 most advanced economies. The measure should be gradually adopted by all countries.

11 Underwriting and granting guarantees are a ways for banks to take the risk without disbursing capital. In order to shield the public interest from the risk of the investment banking business, the exclusion from banking business should include not only financing per se but also underwriting and the granting of guarantees.

THIS MEASURE IS SUPPORTED BY, AMONG OTHERS:

- Adrian Blundell-Wignall, ex-advisor to the OECD on capital markets[12]
- The high-level expert group report on the structural reform of the banking sector in the EU, chaired by Erkki Liikanen[13];
- The Brussels-based NGO Finance Watch[14]

INTERMEDIATE STEP: RING-FENCE CAPITAL MARKETS ACTIVITIES AND DRAW UP SEPARABILITY PLANS

This measure represents a major structural shift for the banking sector. In order to minimize disruption in reaching the objective, it could be envisaged to temporarily adopt ring fencing measures and the transfer of activities into subsidiaries. Investment banking activities would be gradually streamlined and ring fenced into dedicated structures, which could be financed only via intra-group or bank loans. This should come with a separation plan that should be enforceable in 48 hours by each bank should a financial crisis occur[15].

This would constitute a first step before restricting the status of a bank to commercial banking only. This would start the transition towards a more stable financial system, while getting banks to better measure and control the potential risks of their investment banking and capital markets activities. The measure would not only resolve the « *Too big to fail* » issue, but also the « *Too big and too complex to manage* » issue as well.

The transfer to subsidiaries of the riskiest activities was adopted in the German and French banking laws of 2012-2013, but with a narrow interpretation. The EU proposal on bank structure reform, published in early 2014, was more ambitious, although still not fully up to the task. The Commission appointed after the 2014 elections withdrew the proposal in 2017.

Measure A2

ALLOW A MAXIMUM LEVERAGE RATIO OF 5 FOR BANKS

Banks' own funds (equity) should be at least 20% of their total balance sheets (in accounting, not prudential terms: today, systemic financial institutions hold on average 5% equity. See part 2).

SCOPE :

At least the G20 countries, comprising the EU and the 19 most advanced economies. The measure should be gradually adopted by all countries.

THIS MEASURE IS SUPPORTED BY, AMONG OTHERS :

- Anat Admati and Martin Hellwig[16]
- Lord Adair Turner[17]

Measure A3

SET FOR ALL INVESTMENT STRUCTURES A MAXIMUM LEVERAGE OF 5, AND FORBID BANKS TO LEND TO INVESTMENT STRUCTURES

By « investment structures », we mean investment banks, brokerages and financial intermediaries, retail and savings investment funds, private equity funds, and hedge funds. All such « *investment* » structures should retain a minimum 20% equity at any point in time. That means they could borrow up to 80% of their balance sheet resources. Lenders could be capital markets, retail investors, corporates, and so on, but not banks. Banks themselves would be limited to lending to other banks, individuals and corporates. If a non-financial corporate derived a major share of its income from activities on capital markets, it would be considered as an investment structure and could no longer borrow from banks.

SCOPE:

This measure could be initiated by the FSB and the BIS and gradually be implemented worldwide. It requires control and supervision by the relevant authorities of the so-called and currently unregulated shadow banking system.

THIS MEASURE IS PROPOSED BY:

- Jean-Michel Naulot[18].

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12 See for instance Adrian Blundell-Wignall, Gert Wehinger and Patrick Slovik, « The elephant in the room. The need to deal with what banks do », *OECD Journal: Financial Market Trends*, vol. 2009, issue 2, http://www.oecd.org/finance/financial-markets/44357464.pdf
13 See for instance High Level Expert Group, op. cit., http://www.ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_fr.pdf
14 See Finance Watch, « The importance of being separated » http://www.finance-watch.org/our-work/publications/580-importance-of-being-separated
15 See « Preparing for a European Banking Union. Statement N°37 », European Shadow Financial Regulatory Committee, September 2013, http://www.esfrc.eu/sitebuildercontent/sitebuilderfiles/statement37.pdf
The proposal is also developed by Adrien Béranger and Laurence Scialom, « Banking Union: Mind the Gaps », International Economics, vol. 144, 2015, p. 95-115.
16 *The Bankers' New Clothes. What's Wrong with Banking and What to Do about It ?,* Princeton University Press, 2013
17 *Between Debt and the Devil,Money, credit and fixing global finance 2015, Princeton University Oxford Press.*
18 *Éviter l'effondrement, op. cit.*

Measure A4

REGISTER AND SUPERVISE SHADOW-BANKING ACTIVITIES

The supervisory authorities of the banking and insurance businesses (in France, the ACPR and the AMF) should systematically register and supervise all shadow banking activities, and the Central Bank should be aware of the activities and risks incurred by those actors.

If as proposed the leverage of investment funds is to be controlled (as per our measure A3), then they must be properly supervised. This would involve first mandatory registration, as is the case now for banks; in most countries, the carrying on of banking activities requires registration with the Central Bank and obtaining a banking licence. Moreover, a dedicated regulatory body should be in charge f the oversight of investment funds and the respect of the leverage ratio of minimum 20%.

SCOPE:
This measure could be implemented by the FSB on a G20 initial perimeter, and then extended into national and other jurisdictions.

THIS MEASURE IS SUPPORTED BY:

- Lord Adair Turner[19];
- Jean-Michel Naulot[20].

Measure A5

A.5 TAXING FINANCIAL TRANSACTIONS (FTT)

The tax base should be wide and the rate high enough to deter speculative trading.

Both buy and sell transactions should be taxed, at varying rates depending on the specificities of the financial products. The simulations to date envisaged the following rates[21]: 0,1% for shares and 0,2% for all other products (bonds, forex, derivative products), as well as on the cancelled orders which are rife in High Frequency Trading (orders that are given and quasi-immediately cancelled, in effect becoming short term positions).

The FTT aims at reducing the volume of speculative trade, and also to quickly raising tax income, which would contribute to governments' budgets for the losses and costs incurred due to speculative trading. The FTT is bound to be reduced and/or cancelled after a transition period, notably since its tax base will contract rapidly if the other measures envisaged make speculative trading less attractive for investors.

SCOPE:
This measure should be adopted by national parliaments, and could be promoted at supranational level (monetary or economic groups, financial bodies like the FSB)

THIS MEASURE IS SUPPORTED, AMONG OTHERS, BY:

- Several political and religious key figures such as Al Gore, Kofi Annan and Archbishop Desmond Mpilo Tutu, as well as key corporate leaders, such as Bill Gates or Warren Buffet, and economists , such as Joseph Stiglitz and Lawrence Summers[22]
- This measure is also supported by many NGOs, such as the « *Robin Hood tax* » campaign (in France, supported by NGOs ATTAC and Oxfam).

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19 *Between Debt and the Devil,Money, credit and fixing global finance, op. cit.*
20 *Éviter l'effondrement, op. cit.*
21 See the Bill Gates report to the 2011 G20 summit: http://www.gatesfoundation.org/fr/What-We-Do/Global-Policy/G20-Report, and Stephen Spratt andChristina Ashford, « Climate Finance. A tool-kit for assessing climate mitigation and adaptation funding mechanisms », 2011, https://unfccc.int/files/cooperation_support/financial_mechanism/long-term_finance/application/pdf/climate_finance_and_the_financial_transaction_tax.pdf
22 The Washington based Center for Economic and Policy Research listed the many and diverse supports to the FTT: http://cepr.net/documents/ftt-support.pdf

Impact of those measures on the financial sector

This group of measures aims at insulating the speculative trading universe from the financial activities that concern the common good and the public interest. Banks would no longer be allowed to hold securities: shares, bonds or derivative products. As a matter of fact, this means coming back to a previous state of things, before the global financial deregulation, where the banking business was strictly defined and regulated. Compared to the present situation, it means a much higher financial investment in banks by their shareholders. This much higher level of shareholder money at stake is likely to make shareholders more prudent, be it in terms of bad lending, which pays well before going bust, or in terms of risks in the payment systems sphere. Following this logic, all transactions on securities and financial products, except credit, would be located in non-bank structures[23].

Such a fragmenting of the financial business would allow risk to be contained and help to avoid contagion in a crisis. Strict supervision and adequate regulation of each type of product and actor would avoid excessive risk taking, notably from under capitalisation.

In the US, from 1933 to the 1960s, when it started to be disbanded, the Glass Steagall Act kept commercial and investment banking separate. In France too, in 1945, banks were separated into three distinct categories: retail and deposit banks, which were nationalised, investment banks, and mid and long term credit institutions.

Following the logic of its first inventor, James Tobin, the financial transactions tax (FTT) would make tax income available for states to compensate for the fiscal cost of excessive or harmful speculation, even though the other proposed measures will significantly reduce the amount of speculative trade.

Impact of those measures for the general interest

This package of measures would achieve the following:

The deposits, credit and payment systems, which concern the general interest, would be shielded from the ups and downs of speculative trade[24]. The 20% maximum leverage ratio imposed on banks would avoid bank failure and the subsequent state bail outs. The investment funds sector would also be stabilized by increased leverage requirements, which would reduce the volatility of returns.

The amount of speculative trading and its level of risk would be drastically reduced. As of today, it is quite possible for a bank to lend to a hedge fund for the purpose of speculative commodity or currency trading. With the measures we propose, this would no longer be the case: the general interest banking activity would be protected. The amount of money available for speculative trading, which today stems largely from the excess leverage of hedge funds, would also be drastically reduced[25]. **More finance would then flow to the real, non-financial and general interest economy.** The asset price bubbles financed by excess credit, such as the real estate bubble, would be greatly reduced: shareholders, with lots of their own money at stake, would be much more reluctant to run the risks involved with the bursting of bubbles. Thus, bad lending, such as subprime credits in the US, which were granted to people who could not afford to service the debt, would be far less attractive. Such bad lending is a major factor contributing to deepen inequalities and make people go down the social ladder (see part 4).

Reduce the attractiveness of speculative trading with the FTT: the FTT would provide tax income for public investment in the general interest, but also be a tool available to regulate finance. Should excess risk taking by the financial sector involve unexpected costs to the public finances, taxing the relevant transactions is one way to balance their impact and quantity.

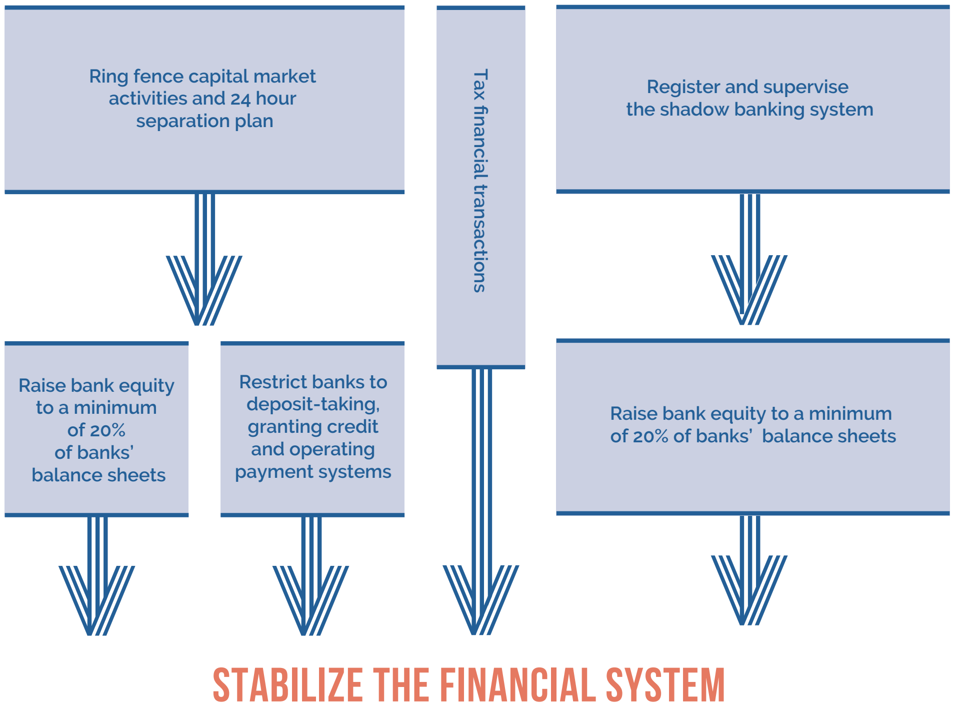
Reduce the volatility of currency and commodity prices, which harms emerging economies and their people (see part 5). Further security would be provided by the prevention of bank lending to speculative funds. Investors would remain free to trade as they desire, but without access to the financial firepower of the banking system.

Shed a full light on the shadow banking system. Central banks would therefore better control the impact of monetary policy. The registration and supervision of the shadow banking system is the only way for the regulator to be able to take the necessary measures if and when the financial practices harm the common good and are detrimental to the general interest (currency and commodity speculation, market dominant positions in the corporate sectors, etc…)

23 Three broad types of activities would be concerned: investment banks, such as Lazard or Rothschild, with their advisory and merger and acquisitions business; brokers and other financial intermediaries, such as broker/dealers, such as Merrill Lynch, Bear Sterns or Lehmann Brothers; and investments funds, be they mutual funds, hedge funds and private equity funds.
24 The moral hazard and « *crime inducing* » bonuses would be dimmed.
25 Estimating precisely by how much is not easy: since hedge funds are not regulated, there are no reliable figures available.

Those reforms will also entail a reduction in the size of systemic, « *too big to fail* » banks, which will make the banking sector much more diverse, and permit the emergence and survival of local banks, based on cooperative and ethical business models, able to meet the demand of local small scale finance that is necessary for, among other things, the energy transition.

Possible time sequencing for the first group of measures



B. FIVE MEASURES TO DIRECT CREDIT TOWARDS SOCIALLY USEFUL ACTIVITIES

The first pack of measures will make the financial system more stable and speculative trading less attractive. However, that will not suffice to make the financial system useful to society as a whole; what is also required is the redirection of financial flows towards the investments and projects that society needs. The lesson learnt from the past 30 years is that when deregulated, credit does not spontaneously flow towards an optimal economic development for society as a whole; in particular, too much credit was allocated to the refinancing of existing urban real estate assets, with detrimental social impacts, at a time when significant social needs remained unfinanced. Therefore, public policy should be able to direct credit towards socially beneficial activities.

- It was about time.
Directing credits towards socially useful activities

Measure B1

USE BANK RESERVE REQUIREMENTS TO GUIDE CREDIT ALLOCATION

The idea is to use banks' reserve requirements at the Central Bank: the requirement level can be modulated according to the various types and destination of credits. This tool is presented in part 1: it refers to the sums that banks are required to deposit at the Central Bank, calculated as a percentage of the deposits and/or the assets they hold.

Reserve requirements are still in use in the Eurozone; in the form of a 1% requirement on short-term (less than 2 years) deposits. Nevertheless, since the euro was put in place, the Central Bank no longer actively controls the volume or destination of credit[26]. This should be questioned, since controlling credit is a way to avoid the making of asset price bubbles, such as real estate bubbles, which subsequently burst and provoke economic slumps. The proposed measure consists of reviving an already existing instrument, which could be modulated by credit type (real estate, repairs, consumer credit, etc…)

SCOPE:

The level of reserve requirements is a public policy decision, which should be made yearly by parliaments, according to the price and demand objectives for each type of credit. The Central Bank would be in charge of execution and supervision.

26 The reserve rate requirement in the eurozone was lowered from 2% to 1% in 2012

THE PROPOSAL IS SUPPORTED BY, AMONG OTHERS

- Lord Adair Turner[27]
- Jean-Paul Betbèze, Christian Bordes, Jézabel Couppey-Soubeyran and Dominique Plihon[28]

Measure B2

INCREASE BANK PRUDENTIAL CAPITAL REQUIREMENTS FOR REAL ESTATE CREDIT

The proposal consists in increasing, up to a level to be calibrated with regulators, the Basel bank prudential capital requirements on real estate lending to existing assets. This category of credit deserves specific attention given its importance on banks' balance sheets, and because of the structural imbalance between supply and demand of real estate in large cities, in many countries. In the current prudential requirement calibration for real estate loans, the global impacts on society of the high asset prices of urban real estate or the risk they pose to a financial crisis are not taken into account[29]. Only the individual credit risks (asset quality and borrower solvency) are taken into account.

The purpose is obviously not to restrict access to housing (see 4), in particular for lower income people, but to take into account the fact that, globally, too much credit to desirable urban real estate has caused financial instability and a real estate asset price bubble. Access to a roof for all must be a key issue of public policy, and must involve ambitious action notably in terms of urban planning, land use and credit access for lower income households, as well as affordable rental development for the poorest households.

SCOPE:

The measure should be promoted by the BIS and then be calibrated by national regulators (Central Banks and governments), depending on the amounts of credit outstanding by category.

THIS MEASURE IS SUPPORTED BY:

- Lord Adair Turner[30]

Measure B3

SET UP A PENALIZING/SUPPORTING FACTOR ACCORDING TO ECOLOGICAL CRITERIA IN BANKS' PRUDENTIAL CAPITAL REQUIREMENTS

Without changing the methodology of the Basel solvency ratio[31], we proposed to add a brown penalizing / green supporting factor to the risk weights in banks prudential solvency ratio, according to the contribution of financed projects or objects to climate change adaptation and mitigation. A business with high emissions would get a penalizing prudential factor; therefore, banks would be reluctant to finance it. Conversely, a business saving emissions would receive a prudential benefit. Other ESG criteria than solely GHG emissions may be taken into account, such as the contribution to biodiversity for instance, as soon as a regulator-approved methodology would permit to do so.

SCOPE:

The measure should be promoted by the BIS and the Basel Committee and implemented by all countries:

MEASURE SUPPORTED BY, AMONG OTHERS,

- Abdeldjellil Bouzidi, Alain Grandjean and Mireille Martini[32].

INTERMEDIARY STEP: IMPLEMENT A BROWN PENALIZING FACTOR ON PROJECTS INVOLVING EXPLORATION AND PRODUCTION OF FOSSIL FUELS

In order to avoid the risks of greenwashing, and awaiting a rigorous and ambitious methodology on the appraisal and identification of « *ecological projects* », the most urgently required measure could well be to impose a « *brown* » penalty to projects involving exploration or production of fossil fuels. Indeed, the current state of things is that projects are qualified as « *green* » on a voluntary and declarative basis whilst there are still no strong accountability or taxonomy mechanisms in force. Lessons learnt from the experiment with green bonds, the effective contribution of which is still

27 *Between Deb and the devil, op.cit.*
28 Jean-Paul Betbèze, Christian Bordes, Jézabel Couppey-Soubeyran and Dominique Plihon, « Banques centrales et stabilité financière », Conseil d'analyse économique, rapport n° 96, 2011, http://www.cae-eco.fr/IMG/pdf/096.pdf
29 As mentioned in part 4, easy access to real estate credit is a key determinant of the rapid increase in asset prices.
30 *Between Deb and the devil*, op.cit.
31 Increasing the risk weight of credits, though, cf measure B2
32 « Régulation financière et urgence climatique, Pour des normes prudentielles et comptables plus vertes », Terra Nova, June 2017, http://tnova.fr/system/contents/files/000/001/406/original/06062017_-_R_gulation_financi_re_et_urgence_climatique.pdf?1496734990

difficult to assess on the ecological transition, even their effective use therefor, is a reminder of the potential dangers of incentives: they always carry the risk of misuse[33].

In order to keep climate change below +2°C, and to keep the +1,5°C within reach, GHG emissions need to be rapidly decreased to reach zero net emissions by the end of the century. This represents a drastically fast decrease, first and foremost in the countries which bear the highest share of responsibility of climate change. A carbon price signal can provide the right incentive, as it influences both the economic decisions of investors, and consumers' behaviour. If emitting CO2 is sufficiently expensive and if adequate, long-term transition support policies are implemented, investors will be incentivized to switch to exit solutions to fossil fuels: energy efficiency, change in the energy mix.

Measure B4

ENSURE THAT CARBON EMISSIONS ARE PRICED AT A SUFFICIENT LEVEL TO REACH THE OBJECTIVES OF THE PARIS AGREEMENT

There are several ways to price carbon emissions: they can be taxed, or a market for emission allowances[34]can be organized; it will imply ending fossil fuel subsidies[35]that suppress the cost of emitting CO2, as well as tax exemptions for emitting industries, free emission allowance allocations or offset mechanisms[36]. Only 25% of worldwide GHG emissions are currently included into carbon price mechanisms, and most of those are effectively priced at less than 10 € per ton of CO2[37]. The High Level Commission on Carbon Pricing, which issued its report in the summer of 2017, recommended a **carbon price level of at least 40 to 80 dollars per ton of CO2 by 2020 and 50 to 100 dollars per ton by 2030** in order to respect the objective of keeping the temperature increase below 2°C[38].

It is important to keep in mind that those prices cannot be insulated from adequate accompanying transition measures in order to be both fair and efficient: for instance regarding the ending of fossil fuel subsidies, the allocation of tax income to a just transition, to climate finance, to resolving energy precarity… Besides, carbon pricing is not meant to be the sole instrument of climate policy; it should be part of a broader set of measures combining ambitious mitigation and adaptation strategies. The diversity of climate change adaptation and mitigation policy tools is essential to the success of the transition, in particular for those sectors where carbon-pricing instruments are not so effective, such as land use.

SCOPE:

National or regional. Countries and regions that have already implemented carbon-pricing policies[39] should review their goals to adjust them to relevant climate ambitions, warranting environmental integrity and fair contribution to a just transition.

MEASURE SUPPORTED BY, AMONG OTHERS:

- Joseph Stiglitz, Lord Nicholas Stern[40]
- Pascal Canfin, Alain Grandjean and Gérard Mestrallet[41]

Measure B5

PROMOTING THE DIVERSITY OF BANKING BUSINESS MODELS

This is about creating local banking networks, at the regional, departmental or city levels, and making mid to long-term credit available to local businesses, including SMEs. Those local banks could support the development of alternative business models around the following dimensions: cooperative/mutualist ownership, ethics and ESG (Environmental, Social and Governance) dimensions, offering retail customers the possibility to direct their savings to local projects meeting those criteria. There will be specifics for each country because of different banking systems.

SCOPE:

The creation of new categories of banks depends on national legislation; Central banks are involved in their supervision, as well as access to finance.

33 See the note by Secours Catholique-Caritas France, « Making finance serve the energy transition », november 2017, http://caritasclimat.fr/2017/12/making-finance-serve-the-energy-transition/

34 Due consideration should be granted to the global issues around the feasibility, efficiency and social impacts of the various policy tools linked to carbon pricing. A global view of climate policies should be kept in mind when designing policy tools: global effective reduction of emissions, environmental integrity, respect of human rights and social equity….

35 G20 countries and the main multilateral development banks have been allocating some 72 billion dollars equivalent to fossil fuel industries between 2013 and 2015 (versus less than 20 billion to renewable energies). See « Talk is cheap. How G20 governments are financing climate disaster », http://priceofoil.org/content/uploads/2017/07/talk_is_cheap_G20_report_July2017.pdf

36 On carbon pricing measures, see the Carbon Market Watch note « Pricing carbon to achieve the Paris goals », September 2017: https://carbonmarketwatch.org/wp/wp-content/uploads/2017/09/CMW-PRICING-CARBON-TO-ACHIEVE-THE-PARIS-GOALS_Web_spread_FINAL.pdf

37 Clément Metivier, Sébastien Postic, Emilie Alberola, « Landscape of carbon prices in 2017 » IFCE, 2017, https://www.i4ce.org/download/global-panorama-of-carbon-prices-in-2017/

38 See the report of the High Level Commission on Carbon pricing, so called « Stern-Stiglitz commission », https://www.carbonpricingleadership.org/s/CarbonPricing_FullReport.pdf

39 Carbon market watch, *op. cit.,* chart n° 1 « 2017 national and regional carbon pricing measures », p. 4.

40 «High Level Commission on Carbon Pricing », 2017, https://www.carbonpricingleadership.org/s/CarbonPricing_FullReport.pdf

41 See French mission on carbon-pricing, « Propositions pour des prix du carbone alignés avec l'Accord de Paris », July 2016, http://www.carbone4.com/wp-content/uploads/2016/08/Rapport_mission_12_juillet_19h10-bis.pdf

THE MEASURE IS SUPPORTED BY, AMONG OTHERS

The « *Global Alliance for Banking on Values* » network promoting ethical banking, Finance Watch and the « *Mission 2020* » initiative launched by Christiana Figueres[42].

Impact of those measures on the financial sector

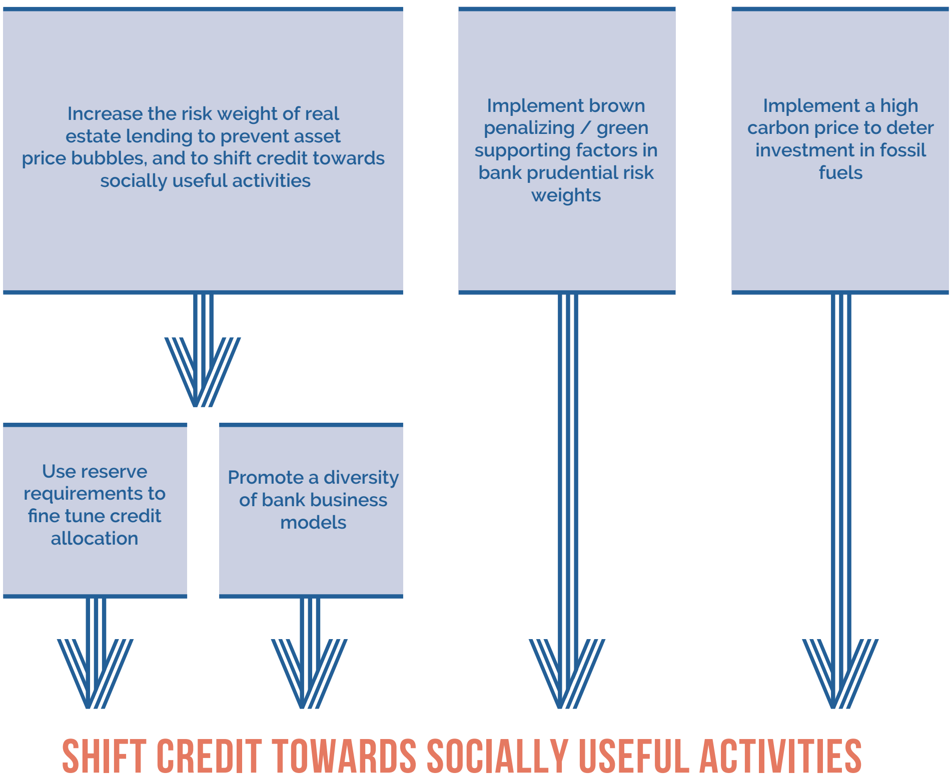
Those measures would mean that Central Banks in each country regaining an active driving role in the economy, by using the existing but dormant reserve requirement policy tool. They would fine tune credit volumes to certain categories of borrowers on policy grounds, making credit more accessible in certain cases and conversely slowing down credit growth when it threatens to create asset price bubbles (see part 1).

Impact of those measures for the general interest

Those measures aim at directing credit towards socially useful purposes, rather than letting the private banking sector allocate credit based on its sole interests. As far as real estate credit is concerned, action on both bank reserve and capital requirements could help lower the price of certain assets and favour the building of new housing capacity, which could increase the availability of housing in forsaken areas. The inclusion of sustainable finance criteria and of climate policies consistent with the Paris Agreement objective would shift the economy towards the required energy and ecology transition. Beyond, those measures are also the way to ensure that credit is directed towards public interest and common good objectives.

Finally, more diversity in the banking sector should make it easier for alternative cooperative and mutualist banks to ramp up and expand, and to be able to meet the presently unfunded needs of local circular economy or smaller projects for the energy transition. This would also meet the demand of retail investors who are often eager to channel their savings towards projects that will be more stakeholder driven and accountable.

Possible sequencing in time of the second group of measures



42 « New pathways: Building blocks for a sustainable finance future for Europe », October 2017, http://www.gabv.org/wp-content/uploads/New-Pathways-Building-Blocks-for-a-sustainable-finance-future-for-Europe-GABV-Finance-Watch-M2020.pdf

C. TWO MEASURES TO MAKE THE GENERAL INTEREST DRIVE THE FINANCIAL SECTOR

Once the financial sector is stabilized (first group of measures) and better geared towards the general interest (second group of measures), it will be necessary to ensure through adequate supervision that the measures are indeed implemented.

- Ah, 'cause I need a license to fly now?
- YES!
Managing finance in the service of communities

Measure C1

REVIEW THE BOARD COMPOSITION AND ACCOUNTABILITY OF FINANCIAL REGULATORY BODIES.

Composition

At least half the directors of financial supervisors and regulators should have spent most of their careers away from the financial sector. They should be picked up so as to represent the various components of civil society: consumers, employees' and managers' trade unions, the government administration, civil society organisations specialising in financial matters but also those involved in broader advocacy (such as climate change adaptation and mitigation, inequalities, poverty…), academics with no connection to the financial sector…. For all directors of financial supervisors and regulators, moving to a position in the private financial sector should be forbidden for at least five years after leaving supervision: similarly, it should not be possible to take up a role as a director of a finance supervisory body for at least 5 years after employment in the private financial sector.

Accountability

The accountability to national parliaments of directors of financial regulators and supervisors (and supranational, such as the European Parliament) should be reinforced. This could be implemented through plurennial presentations before parliaments by financial regulators and supervisors, where they would submit their roadmap for the next period for vote. The board composition of such bodies must be proposed and approved by Parliaments.

SCOPE:

All financial regulatory and supervisory bodies and governments.

THE MEASURE IS INSPIRED FROM (NOTABLY FOR THE EUROZONE):

- Research commissioned by the European Parliament on the relationship between the ECB and the European Parliament[43]
- Transparency International's recommendations on the ECB's independence and accountability[44]
- Thomas Piketty, Laurence Scialom, Michel Aglietta and several other researchers on the necessity to democratize the ECB's governance[45].

Measure C2

CREATE A WORLDWIDE FINANCE REGULATORY BODY INVOLVING THE WHOLE INTERNATIONAL COMMUNITY

The idea is to put in place a multilateral body in charge of the control and supervision of financial systems worldwide. This would make it possible for each country to have a say in the making and adoption of finance legislation. This body would be best placed within the UN system, at a politically high enough level. Though not faultless, the UN intragovernmental organisation seems to be the most legitimate to host this new body, since it represents all countries in the world.

MEASURE INSPIRED BY

Joseph Stiglitz, Youssef Boutros-Ghali and the members of the Expert Commission on the reforms of the monetary and international financial system, which was set up by the President of the UN General Assembly in 2009 in the wake of the 2008 financial crisis[46]

Impact of those measures for the general interest

This group of measures would permit a better representation of the general interest. The financial sector is supposed to serve society and the economy as a whole; therefore, its regulation and supervision must involve relevant stakeholders beyond the sole financial sphere. Overall, the creation of money, credit and purchasing power by banks is one of the main drivers of economic activity. One of the lessons of the past 30 years is that when left to themselves, banks and financial markets do not produce fair and equal prosperity, but tend to act in the best interests of the financial sector itself. National democratic representations should exercise effective and active control over finance, and keep a close eye on financial regulation and its economic impacts.

Moreover, cross border financial regulations are devised and decided upon in instances where advanced economies dominate: the FSB, under the helm of G20, and the BIS. However, it is in all countries that the rules that are debated and subsequently promoted by national and/or regional legislation will most often be implemented.

While it may be the case that the more countries are involved, the harder it will be to agree a given outcome, the current decision mechanism is detrimental to the long-term legitimacy of adopted measures, and makes them harder to approve by those countries which have not been involved in the design process. The proposed measures would make it possible for countries with no significant financial centre to be part of the process, as finance may nevertheless be highly relevant to them. Thus, regulatory bodies could agree upon rules supported and shared by the majority of countries, which would warrant more efficiency and long-term application of the said rules. Reaching longer term and more legitimate agreements may warrant a longer process in their making.

By restricting control among themselves, the richest countries are also running the risk that other countries adopt their own approaches to financial regulation, as well as tax and trade regulation, whilst the most pressing global challenges of our times require convergence and universal ambition. This separation triggers worldwide disparities that may harm economic and finance stakeholders themselves, as well as the people. The finance sector may also take advantage of such disparities, as with tax havens.

43 European Parliament, « Monetary Dialogue 2009-2014: Looking Backward, Looking Forward », March 2014, http://www.europarl.europa.eu/RegData/etudes/IDAN/2014/518753/IPOL_IDA(2014)518753_EN.pdf

44 Leo Hoffmann-Axthelm, « Two sides of the same coin? Independence and accountability of the European Central Bank », Transparency International EU, March 2017, https://transparency.eu/wp-content/uploads/2017/03/TI-EU_ECB_Report_DIGITAL.pdf

45 « Nominations for the ECB: There must be public debate on the renewal of the central bank », Appeal, *VoxEurop*, January 22, 2018, https://voxeurop.eu/en/2018/nominations-ecb-5121773

46 « Report of the Commission of experts of the president of the United Nations General Assembly on reforms of the international monetary and financial system », Nations unies, September 2009, https://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf

See also the Executive summary of Stiglitz's press conference at the launch of this report https://www.un.org/press/fr/2009/Conf090910-AG.doc.htm

Third group of measures - Possible sequencing in time

Create a space for worldwide supervision of financial activities including all countries

Review the composition and accountability of the boards of financial regulators and supervisors

REGULATING FINANCE TO MAKE IT SERVE SOCIETY

D. THE MONETARY AND FISCAL STIMULUS AVENUES

The roadmap to fixing the financial system would however not be complete if we did not tackle two of the main pitfalls of the current context: the general debt overhang and the permanent threat of currency valuations posed by the near-absolute freedom of cross border capital flows. Although not strictly financial, it is important to mention the existence of possibilities to fix these economic threats; which would also make it easier to fix the financial system.

Using the full range and capacity of monetary policy tools would imply significant institutional reform, particularly in the Eurozone. However, the extended use of unconventional monetary policies for the past 10 years shows that that it is possible to act on those topics within the current regulatory framework. The use of those tools must be widely and dispassionately debated. This is all the more necessary as Eurozone monetary policy is facing a deadlock.

Measure D1

ALLOWING CENTRAL BANKS TO FUND A FISCAL STIMULUS

Central banks should be allowed to finance states (ideally including the ECB). This can be done in many ways. Central banks could lend money to sovereign entities. They could also purchase existing state debt, as the Bank of Japan is doing. They could also lend to state banks or sovereign funds, or give money to the poorest and overindebted households.

SCOPE:
Eurozone

MEASURE SUPPORTED BY, AMONG OTHERS:
- Lord Adair Turner[47];
- Alain Grandjean and Mireille Martini[48]
- Positive Money[49]

Measure D2

TAXING CERTAIN INCOMING AND OUTGOING CAPITAL FLOWS

The proposal is to study the feasibility of imposing taxes on cross border capital flows, in order to reduce the loss of tax income resulting from tax avoidance; instability provoked by speculation, notably in currency trading and the carry trade; and finally the « moral hazard » linked to the threat of capital fleeing a given country. This would come on top of the previously mentioned Financial Transactions Tax, and the main purpose of the measure would be to give governments a higher degree of sovereignty on capital flows. This issue is already up for debate in several international bodies such as the BIS, the OECD and the IMF[50]

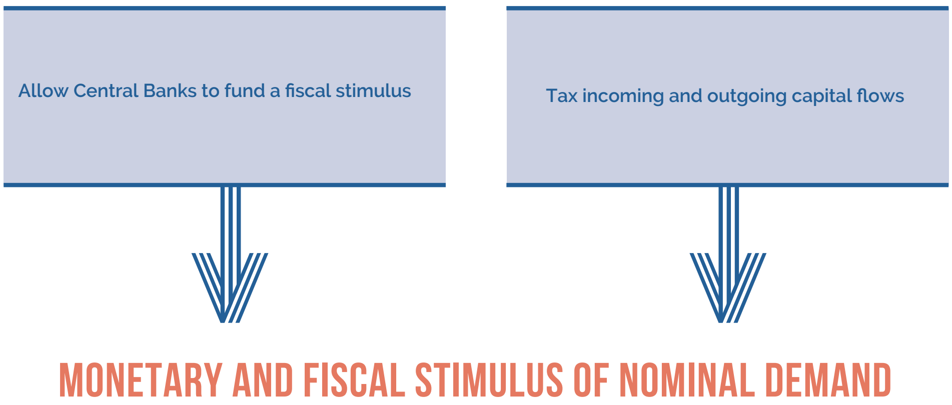
Given the relative ease with which capital can cross borders today, both within the EU and between the EU and other countries, it would be quite difficult to calibrate this measure with precision. It must also be mentioned that any such measure is likely to have immediate negative impacts. We are raising the issue as a reminder of the good principle of tax sovereignty, and a call to back in principle any action, notably from civil society organizations, to promote it.

47 *Between Debt and the Devil, op. cit.* The book does highlight how dangerous such measures could be, but also argues that, and how, the dangers can be overcome
48 *Financer la transition énergétique,* Éditions de l'Atelier, 2016.
49 Frank van Lerven "Recovery in the Eurozone - Using Money Creation to Stimulate the Real Economy", Positive Money, 2015, http://positivemoney.org/wp-content/uploads/2015/12/Recovery-in-the-Eurozone-FINAL-WEB-READY-2015-12-11.pdf
50 See for instance *Jonathan D. Ostry, Prakash Loungani et Davide Furceri,* « Neoliberalism: Oversold? *», Finances and Development*, *June 2016,* http://www.imf.org/external/pubs/ft/fandd/2016/06/pdf/ostry.pdf

SCOPE:
Each government. An international or regional proposal could help with local implementation of the measure.

MEASURE SUPPORTED BY, AMONG OTHERS:
- Joseph Stiglitz, Youssef Boutros-Ghali and the members of the Expert Commission on the reforms of the monetary and international financial system, which was set up by the UN General Assembly President in 2009 in the wake of the 2008 financial crisis[51]
- Rawi Abdelal, professeur à la Harvard Business School[52]

Fourth pack of measures – Proposed sequencing in time



51 Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, *op. cit.*
52 *Capital Rules: The Construction of Global Finance, Cambridge, Harvard University Press, 2007.*

A report from Secours Catholique - Caritas France
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Finance Watch
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And Michel Crinetz, Alain Grandjean, Kako Nobukpo, Cécile Renouard, Laurence Scialom

Authors: Grégoire Niaudet, in collaboration with Mireille Martini

In partnership with: Finance Watch - Institut Veblen pour les réformes économiques
Michel Crinetz, Alain Grandjean, Kako Nobukpo, Cécile Renouard, Laurence Scialom

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