Wolfgang Hetzer

# Money Laundering and Financial Markets (Excerpt)

## 6. DERIVATIVES

Basically, derivatives are futures transactions. They are usually contracts between two parties concerning an agreement that can or must be fulfilled in the future. Effectively, a bet has been made. Futures transactions are based on a zero-sum game. What one person wins, another loses. Profits and losses derive from the difference between the price of the goods as stipulated in the contract or the synthetic or real security and its market price when the contract falls due. The key factor is therefore always the difference between the future value of an article or security and the basic price stipulated in the contract, i.e. the price at which the contract will be performed. In the case of financial contracts the basic value can be a share, a bond, a share index, foreign currency or anything of the kind.[39]

The imagination knows no limits. The contract does not necessarily need to relate directly to any intrinsic value. Today only 2% of the daily foreign exchange futures transactions (worth USD 1,500 billion) involve trading in goods and services or fixed investment. The rest is simply speculation and cannot be explained in terms of trade or any other ‘real’ economic activity. This speculation game is effectively reserved for the global players: the major banks, investment banks, financially strong companies and hedge funds. Speculation arrived with the collapse of fixed exchange rates and has been fuelled by the globalization of trade and the myriad possibilities offered by modern communications technology.[40] The key catalyst for successful financial innovation stems, of course, from the desire to avoid or evade State regulations and taxes. Ultimately, the reduction of tax burdens is in part due to the derivative-related instruments developed to avoid paying tax.[41]

One of the most common forms of contract traded outside the stock exchange is the swap. Swaps account for about three quarters of derivative contracts. Swapping is a well-known technique for hedging or speculating on future currency exchange rates. We can distinguish between various kinds of swap, such as cross-currency swaps, forex swaps and interest rate swaps. They all basically involve exchanging cash flows on the basis of previously concluded financial transactions.[42] The current boom in derivatives and speculation is of Anglo-Saxon origin. Many view it as the victory of American capitalism over Soviet Communism. They also argue that it entails American business interests enjoying a hegemonic position in American foreign policy, as can be seen from the words of a former American Foreign Secretary: The best course for our nation is not to curse globalization, but to shape it, to make it work for America.[43]

39. Hafner, *loc. cit.* (cf. footnote 2), 45. On the new development of click options *see* Hus in *Die Zeit*, edition 44, 24 October 2002, p. 39.
40. Hafner, *loc. cit.*, (cf. footnote 2), p. 46.
41. *Ibid.*, p. 47.
42. Cf. the examples provided by Hafner, *loc. cit.* (cf. footnote 2), p. 78 *et seq.*
43. Quoted by Hafner, *loc. cit.* (cf. footnote 2), p. 72.