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A New Start in Economic Policy

Beyond Financial Capitalism

'Germany must get moving', the former German President Herzog demanded in 1997. Ten years later, this move has encompassed not only Germany, but gone through the entire world – but not in the way Roman Herzog imagined. Those who for thirty years preached that we should trust the self-regulating power of the markets and worshipped the lean state as the best of all possible states now suddenly have moved to doubt the markets' power to heal themselves and call for the state to be their saviour. Friedhelm Hengsbach – one of the best known German commentators on ethical issues – not only deals in this article with the search for causes of the current financial and economic crisis but also offers scenarios for the future.

Friedhelm Hengsbach*

Financial Experts search for the Errors

'Certainly the banks have made mistakes', Klaus-Peter Müller, the former boss of Commerzbank, admitted in an interview. But he stated exactly the same thing five years ago. He never said what the mistakes were. However, he sees the real cause of the crisis in a twofold failure by the state. After the speculative bubble of the 1990s, Alan Greenspan should never have operated such an expansionist monetary policy. And the Bush administration should not have let Lehmann Brothers go to the wall. But for the collapse of that bank, Commerzbank, would have posted good results.

'I can hardly bear to hear the word greed anymore.' That sentence is by Hilmar Kopper (former CEO of Deutsche Bank). If by these words he means that to explain away the financial crisis simply as the result of individual mistakes is itself mistaken, then one can agree with him. Because the moral outrage of voters stirred up by politicians with their broadsides of insults, or the pillorying of individual actors, are just as misguided as the fixation of public debate on the bonus payments to financial managers who have driven their banks to the wall.

Financial experts are right to direct attention to

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the miscalculation of risks which had grown exponentially alongside the innovative financial services, shadow banks, bank-free zones and the immeasurable extent of networking among the actors in the monetary sphere. Home owners, it was claimed, had miscalculated their long-term ability to keep up payments; dealers had forced mortgages on them in a wildly over-optimistic manner. Departmental heads in commercial banks allegedly failed to supervise and support their subordinates adequately.

Trading in derivatives, securitising loans and structuring them outside the banking supervisory body, founding off-balance sheet companies as special purpose vehicles, insuring default risks and securitising them, and channelling supposedly innovative, but actually incomprehensible, uncontrollable financial services into the global financial cashflows to the extent they did, are now seen as demonstrating gullibility, naivety and irresponsibility. Nevertheless, public supervisory bodies had also largely tolerated such practices and assessed them in an unduly lax manner.

Systemic Errors

The search of the financial experts for errors does go beyond the normal microeconomic perspective, but it remains within the boundaries of the established financial sector. For that reason, there should instead be a search for the structural deficits of the capitalist financial regime.

The first point to mention is the ‘monetary revolution’. The elastic money supply, along with an unrestrained grab for ‘the earth as a global piggy bank’ is a crucial explanation of the dynamics of capitalism. The natural limits of a barter or metal currency have been overcome since the banking system gained unrestricted power to print and lend money, which in turn no longer imposes any limits on the growth of the real production potential.

And for wealthy sections of the population in economically affluent societies, money is no longer used simply as a means of exchange, but also has assumed the function of a capital asset. As a means of storing and increasing value, it competes against property, consumer durables and stocks.

Secondly, the means for controlling the markets for goods and for capital are now diverging from one another. Controlling the markets for goods, as reflected in price levels, is restricted by real factors of production and real purchasing power. Controlling the capital markets, especially those involving financial assets, is determined on the demand side by subjective future expectations, which are not restricted by any real barriers.

On the supply side, there is an absence of restraints on the potential of the banking system to create credit, especially as the limits imposed by the central bank, which previously also had constituted a barrier within the real economy, are being evaded. The results have become evident in recent years: The interplay between the expansive granting of credits by the banks and the explosive expectations of the owners of financial capital that its value will automatically increase, have pushed one another up higher and higher. Thus the expectations of fictitious, credit-financed increases in assets were able to spiral speculatively upwards and divorced themselves from the economics of the real world.

Thirdly, the limitations on liability which were granted to Public Limited Companies (PLCs) were further undermined by the investment banks and financial investors, leading to systematic under-capitalisation. On the basis of an extremely low proportion of own capital, and the leverage effect of a high proportion of external capital, the yield on own capital could be expanded considerably. International accountancy rules displayed values close to those of the market, but they were based more on fictitious expectations than on real capital gains.

Fourthly, the rivalry between two financial styles, the continental European and the Anglo-American models, has contributed to the crisis through the hegemonial dynamic of the US financial model. Michel Albert has called ‘Rhenish capitalism’ bank-dominated: Private commercial banks control industrial companies through granting loans, their own holdings and personal relationships.

Companies are managed by the interplay of all the groups active within them, which are oriented towards reaching a mutual understanding. The managers work at balancing the interests of staff, customers, shareholders, banks and local authorities. Systems based on solidarity and financed on a pay-as-you-go basis provide assurance against the risks to society posed by old age, poverty and unemployment.

Anglo-American financial capitalism, on the other hand, is driven by capital markets. Markets for stocks and derivatives predominate, and collective actors (big banks, insurance companies, investment firms and financial investors) operate in them. Companies are a capital investment in the hands of the shareholders. Their value is determined using a purely financial indicator: the ‘shareholder value’, the balance of future financial streams, discounted to the present.

The managers work exclusively in the interests of the shareholders and therefore base decisions (and their salary) on the stock market price, which allegedly provides an authentic reflection of the company’s value. The interests of staff, customers, local authority and state institutions are seen as secondary.

The State: Part of the Crisis

The state is neither the saviour from the crisis, nor the solution to it. The social crisis and the financial crisis are two aspects of the same failed economic, financial and social policy.

In Germany, the negligence of the Red-Green Coalition (1998–2005) reduced social security and deregulated the job market. It distorted the pensions, health and unemployment insurance schemes to the extent of destroying the system. Security systems which were supposed to guarantee a standard of living acquired during years of work, was cut back to the level of a socio-cultural minimum for mere existence. At the same time, private, capital-financed provisions were advocated. There was a tendency to put the burden of social risks onto the individual, to privatise security which had been based on solidarity and to commercialise basic rights to work, income, involvement in society and appropriate access to educational and health goods.

Since the Otto Graf Lambsdorff/Hans Tietmeyer Paper of 1982, bourgeois elites have demanded flexible wage agreements, a reduction in job security and the establishment of a low wage sector. The Red-Green Coalition gave in to these demands – through a succession of laws to encourage employment, agency work, part-time and temporary work, and the undermining of job security.

The result has been documented by the 3rd Report on Poverty and Wealth of 2008: An increasing risk of poverty, the dramatic increase in insecure jobs and in poverty even when people are in full-time paid employment. The divergence between income from profits on the one hand, and from wages on the other, and the divergence in amounts of capital owned, have further increased due to an asymmetrically designed fiscal policy.

More or less parallel to the deregulation of employment came the deregulation of the financial sector. During the second legislative term of the Red-Green coalition, the restrictions on stock market trading were loosened, trading in derivatives and special purpose vehicles was permitted, and the banks' profits from sales of their industrial holdings were made tax-free. Hedge funds were permitted in the form of umbrella funds, and the securitisation of loans was fiscally supported.

These moves to relax the rules were justified by EU guidelines and the need to protect investors, but they were also rooted in the desire to make Germany competitive in world financial markets. Then the Grand Coalition (since 2005) did its best to support innovative financial services and sales channels and to give fiscal privileges to venture capital companies.

The German government was also quick to react to the howls of anguish from the financial elites. Did it feel itself a helpless victim to the pressures coming from the Irish, British and French governments? Did it fall for the apocalyptic picture painted by the mega-banks and the public financial supervisory authorities?

The way it reacted was similar to the excited performance of the stock exchange investors, that is, it acted in isolation, in a knee-jerk, exaggerated and spectacular manner. Hardly anyone contradicted Finance Minister Peer Steinbrück, whose first desire was to tidy up the scene of the accident before interviewing any of those responsible for the damage. And Steinbrück pledged that he would put out the fire immediately, even if it had been caused by arsonists.

But there was an alternative to passing round the umbrellas which were unfurled over an accident scene lost in fog. The political elites have become accustomed to using this cliché to cover up their notorious shortage of new ideas. Instead of attempting an across the board rescue operation, the individual sources of the fire should first have been identified and extinguished in the most appropriate ways.

A careful search for evidence would have demonstrated that the 'counterfeiters' included mainly private investment banks, German *Landesbanken* (publicly owned regional banks) and those institutes which had already been hived off and abandoned by the banks which had owned them. The fact that the German government invited the arsonists to drive the fire engine gave them a privileged position in drawing up the state rescue package and thus protected them and the ministerial steering committee against any objections from the German Parliament. This cannot be reconciled with the basic norms of public opinion in a democracy.

The citizens' suspicion of the collaboration between the government and the financial elites is well-founded. For the often quoted phrase 'too big to fail' would have justified the breaking up of the mega-banks and insurance companies, rather than the setting up of new mergers and take overs with public funds to create even larger financial giants.

Were there really no alternatives to the government's rescue packages? Should the state have guaranteed not the banks, but only the savings held in the accounts of citizens who will never have the chance to live just from the interest on their capital? Should it have permitted rich households to suffer financial losses, and indeed reintroduced progressive taxation of their income and capital?

The state could have put its trust in liquidity assistance to be provided by the central banks, and pressed the powers-that-be among the financial institutions to make their own advance payments as a sign of mutual confidence, and as a measure of subsidiarity, to organise support among themselves and show solidarity. Obviously when Finance Minister Steinbrück quoted the phrase: 'When the heavens cave in, all the sparrows are dead', he was simply parroting the rhetorical clichés of the financial elites.

Scenario for the Future

The state's decision-makers should as a first step be prevented from mobilising public financial resources which do not belong to them, and from stuffing them down the throats of those financial companies which provide them with the label of 'systemic relevance'.

Distributing state stimulants to private banks so that they can restart those credit dealings which serve principally to increase the capital assets of an exclusive club of rich elites, subjecting successful companies to the dictates of instant profits from financial investors and at the same time forcing through a reduction in wage levels, cuts in social service provision and the undermining of public finances – that just cannot be justified. Giving the kiss of life to financial capitalism will trigger justified unrest among sections of the population.

Secondly, large sections of the population are living in poverty. Elementary material needs are in short supply on a worldwide scale, and vital needs are not even being satisfied in affluent countries. Public goods to satisfy basic needs and rights are not available to an adequate extent. Financial capitalism serves mainly a private minority among the capital-owning class.

Increasing economic value-added and providing decent jobs should therefore be the primary objective of state policy. To achieve a fair distribution of the value-added, collective bargaining and social security financed on a pay-as-you-go basis of solidarity should be strengthened. In mature economies, the extreme dependence on exports and industry should be reduced, and ambitious ecological reconstruction alongside (public) work to help people should be expanded considerably.

Thirdly, a fair distribution of the economic value-added to those actors who worked together to create it is not possible without tackling the imbalance of economic power in capitalist companies. Those who own the means of production of course cannot make profitable use of them without employing the labour power of others. As a result, the labour force has the right to codetermination in economic and social matters. The elementary right to take decisions should belong to an equal extent to employees, shareholders and local authority or social bodies.

Social control of companies is the alternative to control by shareholder value and financial investors. A capitalism capable of being democratic in a society of equals beyond financial capitalism is the motto for a global new start, for the good of each and every one of us.

There are important grounds and respectable models on which to base such a new start. In 1947, the CDU in the British occupation zone formulated its Ahlen Programme, following economic collapse and in the midst of social turbulence. Its preamble states: 'The capitalist economic system has not done justice to the vital state and social interests of the German people. The content and objective of the new social and economic order can no longer be the capitalist striving for profit and power, but only the wellbeing of the people.'

After the peaceful revolution, the fall of the Berlin Wall and German unification, Pope John Paul II. asked in 1991: 'Is capitalism the only victorious economic and social system which is worthy of the efforts of the transformation countries, and which can be recommended to the developing countries?' His answer is: 'A human alternative would be: To order the market through social forces and organs of the state and to order companies so that they become places of free work and participation. The western countries run the risk of seeing the failure of socialism as the unilateral triumph of their own economic system, and therefore of not bothering to undertake the necessary corrections to that system.'

Fourthly, financial markets should be deglobalised. Thus the hegemony of the US dollar must be replaced by a multilateral currency regime. Nationally, successful economic development depends on the existence of microbanks, which network agricultural companies, manufacturing industries and companies providing service together – in a financial and cooperative way.

Fifthly, the G20 nations should regulate the financial markets more strictly, so that the money supply, the stability of the monetary sphere and the function of financial companies once again becomes a quasi-public good. The international financial structures thus serve the objective of improving the wellbeing and quality of life of the world's population, and especially of the world's poor.

In a global financial architecture, it follows that all financial services, all financial companies and all the locations where financial services are demanded and supplied, must be subject to public supervision and control. The possibilities for banks to create credit must be tied to strict conditions. To avoid speculative attacks on currencies, the exchange rates of the reserve currencies should be stabilised and short-term cash flows should be taxed in a similar way to the movement of goods.

Angela Merkel, the German Chancellor, declares that the crisis is an opportunity. But this opportunity cannot amount to restoring financial capitalism. Economic democracy is the appropriate name for a new political start.

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