Manfred Nitsch

School of Business and Economics

Freie Universität Berlin

Manfred.nitsch@t-online.de

Berlin, July 20, 2013

How could a "Positive Vision" of the financial sector and the international currency system look like?

Exploratory reflections on the recent call by FINANCE WATCH, Brussels

1. Two sovereigns – and their respective constituencies

FINANCE WATCH (FW) has called on its members for ideas on the fundamental issues in finance and money in order to present a comprehensive "Positive Vision", as an alternative to the status-quo, when it comes to intervene in the election campaigns for the European Parliament in 2014, and in the selection process for the new commissioners of the European Commission, also due in 2014.

Not only in FW's call, but also in many other statements and critical comments about the present financial crises, it is argued that solutions should be looked for which would make the financial sector "serve" the real economy. In the modern world of monetary (or "capitalist") economies around the globe, this quest is based on a nice, romantic idea, but unfortunately it is leading us nowhere. Ever since the major part of our economies and their employment of labor is guided and driven by capital markets, economic "sovereignty" lies no longer with the consumer, as often suggested in textbooks and popular economics. Consumers might still have control over consumer good markets, but not more than that. It is the wealth owner/investor/financial manager who decides over investment and employment. He/she always has the choice to finance employment-creating and –perpetuating enterprises and sovereign debtors or to sit on cash ("liquidity preference") and real assets, without taking the risks which are always attached to real-economy activities.

The term "economic sovereign" has just been slipped in as a deliberate equivalent to the "political sovereign", namely the voter, who nowadays decides who is to rule and reign in the State with its various organs such as legislative parliaments, executive governments on different levels, and the judiciary. In the political sphere, we find the one-person-one-vote principle, whereas in the economic sphere, the one-dollar/euro/yen/peso/rupee/yuan…-one-vote principle reigns, which makes the financial sector, as the agent of the wealth owner, some kind of antipode to the democratic sovereign. Whether we like it or not, the liquidity preference leverage of the economic sovereign has developed in an evolutionary process over the last few centuries so that it has become inherent to the contemporary capitalist system of society. We should analyze and recognize rather than wish away his/her power over employment and growth, - as long as we are not up to changing the whole system.

Acknowledging the power of the wealth owners, their managers and agents, i.e. the financial sector and its peak and apex institution, the Central Bank, as the guarantor of its "stability", means abandoning the idea of converting this whole complex into a "servant". You better recognize or even exaggerate its power by calling it the "Temple", and its representatives the magicians, priests, temple masters, cardinals, shamans or wizards, who demand obedience, faith, worshiping and tributes. Ever since antiquity, Temple and Palace have governed human societies in a precarious balance.

In a "Positive Vision", the Knight-Templar President of a Central Bank would thus have not to be seen as a *servant* but rather as a *bon patron* residing in the temple, - opposite the palace, where, hopefully, another *bon patron* is being installed by popular vote. Within such a structure, both *patrons* would in a certain sense "serve" society, but more so like the absolute monarch calling himself the "first servant of my country" than in the sense of a master-servant relationship.

What we would have to live with, even in an optimum positive vision, is a precarious balance of power between Governments and Central Banks, which should be regulated by overarching local, national, regional and global constitutional structures, based on democratic principles and the rule of (international) law. States would be inhibited to print their own money ("bonds") for frivolous political adventures, and the Central Banks would be prevented from printing money for the sake of moribund banks and other financial sector *amigos* instead of preventing inflation to eat up the value of the savers' financial assets. After all, the constituencies of the Palace are the voters, and the constituencies of the Temple are the owners and managers of financial wealth.

2. Constitutional issues

In the Westphalian model (since 1648), every nation had a flag and a currency so that the spatial reach of State and Central Bank was rather congruent. With the introduction of the Euro, this model was overcome by an important group of countries. The Maastricht Treaty and some other documents tried to provide a legal framework for a new structure with one temple (ECB) and 17 palaces (national governments) plus one *sui generis* castle (EU Commission, Council and Parliament). Many actors did not obey to some of the most important rules, which eroded discipline on all fronts so that the post-Lehman financial crises made the whole edifice nearly tumble. Everybody tried to defend established interests and to minimize costs when it came to contribute to the stabilization of the European political and economic institutions. Exit options have been discussed as well as the build-up of a transfer union, and in the meantime muddling-through has become the dominant line of action.

When it comes to draft a "positive vision", democracy should be on top of the agenda, which means recognition of the principle that all public power emanates from the people. Thus not only the State but also the Central Bank has to be subject to some kind of mandate by the people. The installation of the masters of the temple as well as the modalities for their impeachment should be decided directly or indirectly by parliaments. Decisions about legal tender, capital flows and controls, global, multilateral and bilateral treaties, the licensing, supervision and closing of banks and other financial institutions, the reduction of financial claims in cases of overindebtedness and other modalities of insolvency regimes, - all that, and many more details, including penalties, of course, would have to remain in the domain of the political sovereign.

Money in the form of a certain currency determines the space of any "economy", not only within the geographical limits of the respective currency union, but also within the realm of global finance. Globalization is not to be reverted into national, let alone imperial boundaries, but it has to be managed in an intelligent and productive way. When the line of argument with regard to the quasi-sacredness of money is drawn a bit further, the usual textbook functions of money, namely unit of account, store of value and means of payment in markets and for taxes, are to be somewhat augmented in the direction of means of "redemption" from debt and other obligations as well as "tribute" in the sense of sacrifices for idols and cis-mundane gods.

For instance, persistent current-account imbalances within the Eurozone between surplus countries like Germany and deficit countries in Southern Europe can be interpreted as an expression of the idolatry of export surpluses by the Germans, from politicians to businesspersons, trade unionists, journalists and academics alike. But persistent surpluses imply rising debts on the other side, and when the creditor does not accept deficits, the debtor is unable to honor his or her obligations so that redemption by default becomes the logical consequence. The loss of financial claims built up by persistent current account surpluses should thus be seen as a somewhat disorderly, but nevertheless justifiable tribute to the idolization of being an "export nation". With well functioning insolvency regimes for individuals, firms, financial institutions and sovereign debtors, the age-old problem can thus be tackled, if not solved, of how to let und make creditors and surplus agents participate in the costs of adjustment.

For the Central Bank, the prime instrument of action is the creation of trust in the redemptive power of its money and in the will to print as much of it as deemed necessary by the chief wizard. In addition, the whole financial system's clergy-personnel should inspire trust and it should be kept clean of scandals and misbehavior. Since the management of risk and uncertainty is its core business, that's what it has to stand and answer for! However, it is to be expected that the externalization of risks and costs to other subsystems of society remains an important strategy of this pressure group of society's creditors, which likes to present itself as a humble "intermediary" between savers and investors. Like any important interest group, also this giant is short-sighted, if not blind, when it comes to take his market partners', i.e. here the debtors' interests into consideration; no fair insolvency regime can ever be expected from that side. Powerful checks and balances from outside have to be in place and functioning in order to avoid generalized debt peonage and finally to convert a dangerous monster into a *bon patron*.

Apart from the media, an enlightened public opinion, critical academic research and general transparency, the main check against an overreach of power by the financial sector is the coercive power of the State. The Palace's ultimate means of action has always been the sword. Sanctions and penalties are therefore in the last instance highly important, even though at the forefront, the discourse tends to be rather peaceful, invoking rules, regulations, institutions and order. One of the main lessons learnt from the present crises is that there is a need for strict congruence between the power to act and the responsibility and liability of persons / managers as well as firms. Enterprises, especially banks, rating agencies, law firms, insurance companies, hedge funds etc., as well as sovereign actors have to be subject to judiciary control for their deeds, including the threat with severe fines for legal entities and imprisonment for their managers and other persons responsible for damage to taxpayers, employees, local authorities, etc.

3. Preliminary conclusions

Checks and balances between the Palace and the Temple will always be open for discussion and reform, but master-servant concepts and dreams one way or the other do not provide a "positive" answer. The contemporary world is dominated by the principles of the United Nations as expressed in the Human Rights conventions since 1948 and many other agreements. Democratic and UN politics and capitalist economics, both taken in a broad sense, are therefore the bases for any "positive vision", particularly for Europe and its present currency and finance muddle.

As explained above, such a "positive vision" of the financial system would imply the acceptance of the two existing different logics and sovereignties, - but with a clear preponderance of the democratic principle that all public power emanates from the people and the mandates it gives to its representatives. Both institutions should obey by the rules of a constitutional order which protects their constituencies so that the State does not interfere unduly into the realm of the wealth owners and their agents, nor does the financial system and its Central Bank put unjustified costs on taxpayers and their agents, namely sovereign governments.

One of the important instruments to be sharpened is the insolvency regime and its efficient implementation on every level. And the regulatory implications of the general principle of congruence between the power to act and the responsibility to stand up for the consequences should be high on the agenda, too.