Building a new monetary, financial and energetic framework through an international negotiation

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The Financial Crisis, the US Economy, and International Security in the New Administration

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A. Understanding the deep causes of the crisis

1. The current financial crisis is a proof of the lack of global governance. The crisis is about much more than the shortcomings of national banking regulations. It has forced the European Union to act as one. Once again, the EU moves forward thanks to the disequilibria that its very existence creates and which make it progress. The creation of the euro had raised the question of the coordination of economic and fiscal policies. Member states had not wanted it. The necessity of a coordinated answer to the financial crisis has led them to change their minds. Similarly, once the fire is put out by immediate measures which can restore confidence, the quest for a middle and long term answer to the current financial crisis must lead to a progress in global governance – and be understood as such.

2. Global governance has to be established between the main regions of the world. After this financial crisis, nothing will ever be the same. The United States made up half of the world's GDP in 1945. Today, it is only a quarter. In 1944, when the first Bretton Woods conference took place, the United States could make the dollar a world currency and ensure its gold convertibility. Exchange rates between the main currencies were fixed, and regularly renegotiated. This system has eased the reconstruction of Europe. But in 2008, this period came to its end. For the first time since World War II, a major financial crisis has started within the United States. This crisis has hurt the heart of the system in two ways: first, the United States and Wall Street; second, the trust between the major banks. This is why a summit on the monetary and financial system must be organized by four large regions of the world, which are to play a key role in the coming knowledge based economy: Europe (speaking as one); the United States; China; and India. The G8, even enlarged, is not appropriate. Four of its eight members are European countries. When, in 1975, Giscard d'Estaing created the G6, and later the G7, this made sense and it reflected the reality of the world at the time. But this is no longer the world we live in.

3. Building a world governance of money and finance requires tackling the causes and not the consequences of the current problems. Financialization, also called finance-led capitalism, has two characteristics: unified financial markets, which create a continuous flow of transactions, regardless of time and space; and the gradual power shift from non financial firms to international finance. Financialization is due to four main causes, which all have their source in the 1970s:

a) Financialization took off when Richard Nixon decided to suspend the gold convertibility of the dollar. This decision had three major consequences: foreign exchange risks became a top concern for multinationals, hence the creation of derivatives strategies to reduce these risks; currency trading grew very rapidly, up to the point where it now represents 97% of global financial flows; money and finance became the two sides of the same coin. Finance cannot be tamed unless exchange rates between the main currencies are stable again.

b) Oil plays a central role in the monetary and financial regulation of the world, as well as in the financialization of the economy. The TOE (tone of oil equivalent) has become a true currency, i.e. both a medium of exchange and a standard of value, because fossil energy is used at every stage of production in all our daily activities. Owners of oil and gas reserves have thus become de facto central bankers, whose "emission policy" regulates economic activity. Furthermore, the first "oil shock" of 1973 created a large amount of petrodollars, which gave a second impetus to financialization. The consequence of this is that the monetary issue can no longer be separated from the energetic issue. The world summit must also deal with energy.

c) The ageing of rich societies has led to the accumulation of savings. Old age insurance used to be granted by children: either directly, via the solidarity within the family, or indirectly, with pay-as-you-go pension schemes. This balance has been broken. Old age insurance has to be found elsewhere. The function of money as storage of value has acquired a new meaning. Foresight mechanisms have been set up at the international level. Pension funds now amount to $15,000 billion. These funds are a major driving force of financialization. In theory, they should be long term oriented. But financialization leads them to work upside down, i.e. against the interests of the wage earners whose savings they manage; and with a bias towards short-termism when their interest is to make long term investments. Global governance should provide these funds with new rules.

d) The evolution of technical systems has led to the merger of money and finance. The SWIFT (Society for Worldwide Interbank Financial Telecommunication) system was created in 1973. Making transfers between banks automatic and faster, this system has unified the international system and, with the subsequent development of financial products aimed at parceling long term risk, it has contributed to the unification of money and finance. As a result, interpersonal relationships and the sharing of risk between lender and borrower have been replaced by myriads of anonymous transactions, which dissolve time and space. The securitization of subprime loans, as well as the €4,9 billion loss suffered by the Société Générale because of its trader Jérôme Kerviel are the latest examples of this: traders live in a virtual, irresponsible, world. It follows that the global negotiation must deal at the same time with money, finance, and energy.

4. These primary causes for financialization have been reinforced by two processes:

a) Shareholders wanted to get back at the technostructure of firms. In the name of “economic democracy”, shareholders wanted to remind everybody they were the true bosses. The shareholder value principle has led to demands for short term returns out of line with the efficiency gains of the real economy. Raiders have filled entrepreneurs’ seats. Financial results have become more and more important within profit and loss accounts, even for non financial firms. Stock options have broken down the solidarity between the top management and other employees. The globalization of the economy and the computerization of production processes have put an end to the “fordist agreement”, i.e. the double balance which had been achieved after World War II: firstly between capital and labor, regarding the sharing of productivity gains; secondly within the workforce, between the top management and the rest of the employees. Growing income inequality is not primarily due to an increase in capital gains but to the creation of a caste of very high professional wage incomes closely tied to “the verdict of the markets”. A structural reform requires reversing this trend by linking remunerations to long run responsibility.

b) The financial system has become an end in itself. The financial system has developed techniques and compensation schemes which only benefit itself. This is in particular the case of the American financial system. In the United States, from 1947 to 1983, the profits of the financial sector fluctuated around 15% of the total amount of profits. Since 1983, financial profits have risen rapidly, reaching 30%. One measures the drain on the economy. It is urgent to stop this tendency where financial institutions head the field instead of the true wealth creators.

B. Recasting the monetary, financial and energetic system by providing structural answers

The global governance needed today is a consequence of the analysis above. The crisis will have hardly calmed down that the establishment will want to go back to the previous régime, leaving taxpayers picking up the pieces and political leaders carrying the can, as it will want to consider what has just happened as a mere mishap, a teenage crisis which will teach us self moderation. It is at this moment that political leaders will need courage, lucidity and vision to address the causes, and not only the symptoms. Here is a series of ideas:

1. Yes to a new Bretton Woods. It is desirable to submit a strong initiative to the future US Administration. This negotiation will acknowledge the end of the empire. This is why it is vital that the United States takes the lead, and doesn’t feel it is forced by a coalition. This second Bretton Woods will be very different from the previous one, both in scope and regarding the actors implied. This negotiation will be about the general regulation of money, finance, and energy. It will be the first act of a global governance based on the relationships between the main regions of the world. It is within these regions that key regional currencies can be established, which would be tied to one another by stable exchange rates, regularly revised. Within these regions, regional institutions of regulation will progressively set up equivalents of what once was the European Monetary Snake. The European Union, the United States, China and India are natural pillars of this framework. Contrarily to the G7, the European Union, or at least the Euro zone, must speak as one.

2. The introduction of new regulation mechanisms can limit the scope of future crises. These are the mechanisms everybody is thinking of (see for instance the G20's agenda). They do not address the deep causes of the problems, but they can mitigate their consequences. Are usually mentioned:

• a ban on tax heavens: tax heavens prevent us from seeing the woods for the trees. Large states use them as a means for indirect fiscal dumping. For their suppression to be truly useful, it must come together with a negotiation on a common tax floor and lead to global fiscal rules. The European Union has to show the way.

• new prudential rules for banks' stockholder's equity: this is better than doing nothing, but this will not prevent drifts to take place when the dilution of risk leads banks to ignore the magnitude of the risks they have taken.

• legal limits to the fragmentation of long term risks, because this fragmentation leads to the negation of what banking consists in (this means either a strict regulation of, or a ban on derivatives).

• limits to conflicts of interest: this is a theme that keeps coming back every time there is a crisis, as does the separation of commercial banks from investment banks (this was already the case in the Sarbanes Oxley Act in 2002, but it has not prevented the current crisis from happening).

• enhanced criminal responsibility for corporate executives: the series of crises has popularized the idea that there is an economic establishment which is submitted neither to the same justice nor to the same moral rules than the rest of society. If trust in financial societies is to be restored, there will be a need to address the question of the responsibility, including the criminal responsibility, of board members who benefit from their position without being able, in fact, to effectively control complex financial strategies which they do not grasp. The debate that, following the Enron scandal, had led to the adoption of the Sarbanes Oxley Act, already touched on this issue. The scandal created by the subprime crisis gives a renewed and increased importance to this question.

3. Stabilizing currencies requires stabilizing the cost of energy. Which means that negotiations have to take place with countries of the Middle East and Russia. This stabilization strategy implies the creation of regulating stocks. This is the only way to disarm speculation, to limit blackmailing from large fossil energy producing countries, and to absorb the large fluctuations in production caused by natural disasters (e.g. hurricane Katrina) or political crises (e.g. Iraq). The necessity for global regulating stocks is also clear in the case of the main agricultural commodities. Furthermore, these stocks could be the counterpart for a means of payment and create a currency unit for exchanges between the multinational companies, which are the backbone of global trade.

4. Creating negotiable individual quotas in fossil energy as a full-fledged currency. It is absurd to use the same money (i.e. both a standard of value and a medium of exchange) to pay for human labor and for non renewable natural resources, in particular fossil energy. If we want to stimulate growth and well-being, that is if we want to encourage human labor, we need to separate labor from energy. This requires creating a “vectorial money”, which is feasible will e-wallets. The “energy” dimension of money will necessarily take the form of negotiable individual quotas. David Miliband, Gordon Brown’s foreign secretary, had already sketched the idea when he was environment secretary. This is the precondition for a Keynesian stimulus of aggregate demand.

5. The internal logics of the economic and financial systems must be reviewed. Nowadays, the very logic of the system pushes individuals towards short-termism and irresponsibility. All the financial mechanisms move us away from a long term oriented and responsible behavior. The problem cannot be solved only with stricter controls and more virtue. The deep logic of the system must be changed. These changes must address:

• compensation schemes of financial intermediaries: compensation schemes based on the number of transactions must be suppressed, as they create an incentive to maximize the number of transactions, for the sole profit of intermediaries;

• the evaluation of the performance of intermediaries, which should only be done on a 5 year moving average basis;

• the ban on stock options which have disrupted the solidarity between firms’ wage earners;

• shareholders’ voting rights. Voting rights should be granted only after stocks have been owned permanently during several years (e.g. 3 years). After all, nobody would think of giving voting rights to tourists just after they have entered a country. This simple rule would calm down many speculative activities. Is it no accident that family firms, where the long term survival of the enterprise matters more than short term profits, are doing well.

6. **Reorient the savings towards a long-term sustainable investment**. We need to drive a systemic transition towards sustainable investment. In order to do that we have to invent the new storage of value function of money. In principle it would be a share of the conditions for future prosperity of the world. This is the only way to be legitimate in claiming a part of this prosperity for our old age. The real tomorrow “gold” is natural, human, immaterial and material capital of the planet. The practical means to move in that direction is yet to be invented. If we would spend but a small portion of the creativity we spent for so-called innovative finance and accounting we would certainly find solutions. When there is a will there is a way. The reorientation towards long-term concerns in particular pension funds but their present management is driven by short-term performance. These funds have a natural orientation towards long term investments. They could finance the transition towards a sustainable society. After all, the only guarantee for our pensions is a prosperous planet.

7. Allow and promote a plurality of currencies. As the euro demonstrates, money is first and foremost the symbol of exchanges within a community. The growth of the internet and the security of e-exchanges make possible the creation of currencies for different communities, which will facilitate the matching of unemployed arms with unsatisfied needs, whose coexistence is the great scandal of the current world economy.