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# Note from the editor

Dear reader,

It is a pleasure to be involved with the *Newsletter* as its editor this year. I have been a reader and occasional contributor to this publication since its first issue in 1999, and have been impressed by the sustained quality and tremendous variety of the articles that appear here. Last year, we saw some distinctive pieces under the imaginative editorship of Philippe Steiner, and I am sure I speak on behalf of all the *Newsletter*'s 1900 subscribers when I thank him for his tremendous work throughout the year.

This is a packed issue, reflecting the generosity of its contributors, their enthusiasm for publishing here, and their capacity to meet my deadlines. Thanks to them all, and to Christina Glasmacher for her superb work in putting all of this material together and managing the whole editorial process. Predictably, most of the papers reflect my own interests and knowledge of the economic sociology field – the sociology of money and finance. In addition, I tried to pull in papers on topics, or which have a theoretical framework, that have not necessarily been covered here in the past. But my key rationale was simple: I approached authors whose work I had enjoyed reading.

Timothy Sinclair, co-author of an upcoming book *The Problem with Banks* (Zed), kicks the issue off with a provocative piece on the ratings agencies. He takes on the rather commonplace view that these important agencies are undermined by a conflict of interest, and argues that we should be focusing on the dilemmas these agencies face as 'gatekeepers' in a market system. The conflict of interest argument, while throwing up important issues, mainly serves a political purpose, he suggests. There is no 'simple fix' where the ratings agencies are concerned, rather we must get to grips with the complex circumstances under which they have developed and rebuild the relations of trust on which their effective operation depends.

Daniel Mügge, author of the recently published *Widen the Market, Narrow the Competition* (ECPR), invites us to stand back and think about finance, particularly financial regulation, in light of the issues raised by Armatya Sen's important book *The Idea of Justice* which was published last year. Criticisms of finance are commonplace these days. What struck me about Daniel's argument is that he was moving on from this largely negative and increasingly unhelpful debate about finance to consider, in a rather pragmatic way, issues about how financial reform might answer key questions about the nature of justice. The challenge he lays down for scholars in this field is both important and exciting.

Andreas Langenohl sets out a different kind of challenge to scholars in the sociology of finance. He argues that the field lacks a systematic category of 'expectation,' and he seeks to develop such a category through an intriguing interpretation of the sociology of Georg Simmel. His argument that we should reclaim the notion of 'expectations' takes its point of departure from a particular understanding of price as an effacement of the complex motivations behind the actions of others. In financial markets, all that participants have to work with in terms of deciding how to act is therefore a particular model of expectations. Necessarily, they must reduce each other to 'carriers of expectations'. This, he argues, is something sociologists need to understand in more depth.

During the past year we have witnessed a major crisis in the eurozone, and two of the papers in this issue deal with some aspects of its unfolding so far. Looking back, Sonja Juko's paper should be a sobering reminder that the precise nature of the 'crisis' in the eurozone deserves to be debated and contested far more than has hitherto been the case. As she points out, neither the precise timing nor the actual unfolding of the crisis – she focuses on Greece, but one can surmise that similar issues would arise in relation to other 'troubled' states – can be explained by reference to the 'fundamentals' alone. Part of the picture that seems to be missing, she suggests, is the role of the media in framing the crisis, both as a crisis, and as a particular kind of crisis. Juko's detailed analysis of this problem is important and timely.

Looking forward as the crisis continues to unfold, my own paper, co-authored with Johannes Lenhard, deals with the euro crisis and suggests that the increasingly widespread critique of the eurozone as a 'transfer union' misrepresents some important sociological aspects of the union as it has developed so far. The paper's main proposal about the eurobond, together with its attempt to bring Bataille's arguments to bear on our understanding of the moral economy of the eurozone, are intended to stimulate debate about some important issues that are likely to preoccupy us for some time to come as we face up to a future in which the eurozone may be fundamentally changed.

The paper by Aleksander Miłosz Zieliński and Dietmar Wetzel builds on work they have been doing on power relations among banks in contemporary society. This is a wide-ranging project, and in the paper included here the specific focus is on how we might categorize the relationship between banks and other areas of societal life in economy, politics and media. The 'matrix' they come up with for examining these relations throws up some fascinating insights, and we should welcome this attempt to get to grips with banks as a major part of society, not least because there are actually very few systematic treatments of this subject.

The last two papers of the issue explore a similarly neglected side of our monetary and financial systems, namely the circulation of forms of money at the local level. Throughout the time of the current crisis, the local currency movement has continued to develop and offer communities alternative ways of managing their local economies through the medium of money. Josh Ryan-Collins, one of the founders of the *Brixton Pound* launched in London last summer, reflects on the theory behind local currencies, offering some interesting insights into the points of intersection with more conventional theories of money. Meanwhile, the paper by Gill Seyfang, Adrian Smith and Noel Longhurst examines the thinking behind the major research they are undertaking which looks at the role of complementary currencies as 'grassroots' innovations which offer solutions to problems of sustainable development. These are important topics that deserve to generate a lot of sociological discussion.

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# Credit Rating Agencies and the Global Financial Crisis


## By Timothy J. Sinclair

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## Introduction

The often vitriolic public debate about the role of the credit rating agencies in the generation of the subprime crisis has revolved around an idea which now seems deeply entrenched in popular, financial market and academic understandings of the agencies and their incentives. The core element of this thinking is that how the agencies are remunerated generates a significant problem for the quality of the ratings they produce. The issue identified is a conflict of interest between the central purpose of ratings and the remuneration model that funds the ratings of the major, global agencies.

I argue that the concern with conflicts of interest in rating agencies is largely mistaken. Conflicts of interest permeate social and economic life in capitalism. How institutions acknowledge and respond to conflicts of interest is important, but the existence of conflicts of interest in itself was not the major cause of the subprime crisis. I will argue that rating agency involvement in the crisis is not a result of breaking implicit regulative rules about conflict of interest, but is attributable to fundamental dilemmas about the role of rating agencies (and similar gatekeepers) in a market system. Although criticism of conflicts of interest may serve a useful political purpose, too much attention to issues at this level will produce complacency about the inherent volatility of global finance, setting the world up for a repeat of the global financial crisis once the appetite for risk returns (Vestergaard 2009: 9).

I begin this article with a short review of the agencies' history and how they function. The article then considers the claims about conflicts of interest which have dominated the debates about the agencies since the beginnings of the crisis in the summer of 2007. I then develop an argument about the role of the agencies in making structured finance possible. It is this role that is key to understanding the global financial crisis not as a result of rule transgression, but as a crisis at the level of the social relationships which make global finance possible. This is why the crisis is so deep and why it has been so hard to develop a response by policy-makers and market actors. The nature of this crisis transcended the very definition of crisis as understood by these actors.

## Origins and Purpose

Henry Paulson, U.S. Treasury Secretary at the end of President George W. Bush's administration, made it clear when presenting the policy statement of the President's Working Group on Financial markets in March 2008 that in the midst of market turbulence, officials, politicians and their advisers believe credit rating agencies "play a major role in financial markets," and that the work of the agencies must be 'improved' in terms of the specific challenges faced in rating complex financial instruments like structured securities, and by avoiding the reality or appearance of conflicts of interest (Paulson 2008).

These comments, and the energetic reaction of European financial regulators to the perceived culpability of the agencies in the generation of the subprime crisis, point to the increasingly important job done by wholesale credit rating agencies in global markets. In fact, it was not too many years ago that rating agencies were little known outside the United States. Until the mid-1990s most European and Asian companies relied on their market reputations alone to secure financing. But this changed when the pressure of globalization led to the desire to tap the deep American financial markets and to a greater appetite for higher returns and thus risk. In these circumstances, the informality of traditional old boys' networks is no longer defendable to shareholders or relevant to pension funds half way around the world. The result is that an essentially American approach to market organization and judgment has become the global norm in the developed world, and increasingly, in emerging markets as well.

Ratings are increasingly central to the regulatory system of modern capitalism and therefore to governments everywhere. Getting credit ratings 'right' therefore seems vitally important to many observers. But in pursuing improvement in the rating system we need to appreciate the challenges and limits to rating. I argue, after due attention to the origins and work of the agencies, that our expectations of the agencies are founded on a limited rationalist or machine-like understanding of the workings of capital markets. A more appropriately social (and dynamic) view of markets makes the challenge of effective rating even more daunting. The increasingly volatile nature of markets has created a crisis in relations between the agencies and governments, which increasingly seek to monitor their performance and stimulate reform in their procedures, just as they do in other institutions.

Rating agencies emerged after the Civil War in the United States. From this time until the First World War, American financial markets experienced an explosion of information provision. The transition between issuing compendiums of information and actually making judgments about the creditworthiness of debtors occurred after the 1907 financial crisis. By the mid-1920s, nearly 100 percent of the US bond market was rated by Moody's.

Two major American agencies dominate the market in ratings. Both Moody's and S&P are headquartered in the lower Manhattan financial district of New York City. Moody's was sold in 1998 as a separate corporation by Dun and Bradstreet, the information concern, which had owned Moody's since 1962, while S&P remains a subsidiary of McGraw-Hill, which bought S&P in 1966. Both agencies have numerous branches in the US, in other developed countries, and in several emerging markets. S&P is famous for the S&P 500, the benchmark US stock index listing around $1 trillion in assets.

Rating agency outputs comprise an important part of the infrastructure of capital markets. They are key benchmarks, which form the basis for subsequent decision-making by participants.  In this sense, rating agencies are important not so much for any particular rating they produce, but for the fact that they are a part of the internal organization of the market itself.  So, we find that traders may refer to a company as an 'AA company,' or some other rating category, as if this were a fact, an agreed and uncontroversial way of describing and distinguishing companies, municipalities or countries.

A rationalist way to think about what rating agencies do is to see them as serving a 'function' in the economic system. In this view, rating agencies solve a problem in markets that develops when banks no longer sit at the centre of the borrowing process. Rating agencies serve as what Gourevitch calls "'reputational intermediaries'" like accountants, analysts, and lawyers, who are "essential to the functioning of the system," monitoring managers through a "constant flow of short-term snapshots" (Gourevitch 2002: 1 and 11). Another way to think about the function of the agencies is to suggest rating agencies establish psychological "rules of thumb" which make market decisions less costly for participants (Heisler 1994: 78).

But purely functional explanations for the existence of rating agencies are potentially deceptive. Attempts to verify (or refute) the idea that rating agencies must exist because they serve a purpose, have proven inconclusive. Rating agencies have to be considered important actors because people view them as important, and act on the basis of that understanding in markets, even if it proves impossible for analysts to actually isolate the specific benefits the agencies generate for these market actors. Investors often mimic other investors, "ignoring substantive private information" (Scharfstein and Stein 1990: 465). The fact that people may collectively view rating agencies as important – irrespective of what 'function' the agencies are thought to serve in the scholarly literature – means that markets and debt issuers have strong incentives to act as if participants in the markets take the rating agencies seriously. In other words, the significance of rating is not to be estimated like a mountain or national population, as a 'brute' fact which is true (or not) irrespective of shared beliefs about its existence, nor is the meaning of rating determined by the 'subjective' facts of individual perception (Ruggie 1998: 12-13).

What is central to the status and consequentiality of rating agencies is what people believe about them, and they act on collectively – even if those beliefs are clearly false. Indeed, the beliefs may be quite strange to the observer, but if people use them as a guide to action (or inaction) they are significant. Dismissing such collective beliefs misses the fact that actors must take account of the existence of social facts in considering their own action. Reflection about the nature and direction of social facts is characteristic of financial markets on a day-to-day basis.

## Global Financial Crisis

The subprime crisis that began in the summer of 2007 may rank as one of the most traumatic global developments of the last one hundred years. It caused dismay and panic throughout elite circles in developed countries as efforts to reignite confidence in the financial markets were frustrated again and again. Given that the subprime securities market was worth only $0.7 trillion in mid-2007, out of total global capital markets of $175 trillion, the impact of subprime assets is out of all proportion to their actual weight in the financial system (Bank of England 2008: 20). This suggests that an explanation for systemic crisis cannot be deduced in rationalist terms. The 'subprime crisis' is not a direct consequence of subprime mortgage delinquencies. The paralysis that came over global finance is a consequence of the intersubjective nature of markets, rather than the logical result of relatively minor problems with lending to the working poor. But this analysis of the subprime crisis is difficult to incorporate in a rationalist view of markets, in which events have logical causes. In a rationalist world, panics, crises and collapses have to be explained as a result of specific failures. It is necessary, in these circumstances, to find those institutions that did not do their jobs properly and make sure they do in future. This assumes, of course, that a proper job can be done and the problem solved.

It comes as no surprise then that the rating agencies have been subject to unprecedented criticism and investigation in the midst of the subprime meltdown. Congressional committees, the Securities and Exchange Commission, the European Parliament and Commission, and the Committee of European Securities Regulators have conducted investigations, amongst others. A very senior rating official has indicated that the crisis over subprime ratings is the most threatening yet experienced by the agencies in their century of activity. This is a curious development, given that the rating agency business is now open to greater competition since NRSRO designation became subject to the Credit Rating Agency Reform Act of 2006. It suggests that the image of a movement from regulation to self-regulation, or from police patrol to fire alarm has not created a world of autonomous non-state authorities. What we see instead is a serious disciplining of the agencies by states, intent on improving their performance (Moran 2003: 1-11). Or perhaps the identification of the agencies as scapegoats in the context of elite and public dismay over the effects of globalized markets, as US investment banks were in the 1930s (Galbraith 1954). An outcome of this crisis is likely to be a limited reconstruction of the agencies along more 'accountable' lines.

## Reconsidering Conflict of Interest

The major discrete criticism of the agencies that followed the onset of the subprime crisis is that ratings were defective and did not warn of trouble ahead because of the perverse incentives created by a conflict of interest at the heart of the business model adopted by the agencies. The idea is that because rating agencies are funded by fees paid by issuers or sellers of securities they have strong incentives to inflate ratings to please their customers. The financial and popular press alike treated the observation that rating agencies were funded by those they rate as a scandalous revelation (Wighton, 2009; Baker 2009: 100).

Originally, in the first days of Moody's Investors Service, ratings were paid for by the sale of newsletters about credit quality. But this model became less effective in the 1960s when a bull market put a premium on information. Newspapers and other news services treated ratings as news, turning ratings announcements into public goods, obviating the need for payment by investors. Free riding became a major issue. The expansion of the financial markets in the 1960s, after decades of subdued activity following the Great Depression, World War II and the founding of the Bretton Woods regime meant the agencies needed more resources to respond to the greater volume and complexity of securities than could be provided by the vulnerable subscription system. This is what drove the agencies to change their business model at the end of the 1960s.

In principle, there is indeed a conflict of interest in rating. Crockett et al. assert that "Conflicts of interest occur when a financial service provider, or an agent within such a provider, has multiple interests that create incentives to act in such a way as to misuse information" (2003: xix). The idea here is that conflicts of interest mean the market gets less information or lower quality information than otherwise. In concrete terms, the inference is that payment of fees by issuers compromises the principle-agent relationship between the agencies and investors who use ratings as part of their decision-making. The agencies are assumed in these circumstances to issue less critical ratings than they otherwise would.

The problem with this view is the assumption that an inherent conflict must equal an empirical problem. But there is no equivalence in the material world. What we actually find in rating, as in many other spheres, is a conflict of interest certainly, but no more so than exists in universities in which students pay tuition fees that support the salaries of the professors who grade their examinations. Rating agencies, like universities, manage this dilemma, in the case of the agencies through codes of conduct, and by de-linking analysis and remuneration for analytical staff.

The management of this conflict is not just in a negative or legalistic form. The agencies have strong incentives to maintain their reputations. Prior to government utilization of ratings in prudential regulation starting in the 1930s a Moody's rating was already a market-determined necessity in order to sell municipal bonds. Rating cannot therefore be reduced to a 'regulatory license' as some scholars have suggested (Posen and Smick 2008: 8-9). There are strong business reasons for the agencies to avoid rating inflation because reputation underpins their franchise, as it does in eminent universities.

If conflicts of interest were a major material problem in the rating industry we would expect to find a series of empirical cases that could be interpreted as supporting this claim. No doubt there would have been much talk of scandal and corruption in the agencies. But this is not the case, leading other observers to suggest that the agencies do indeed manage their conflicts effectively (Smith and Walter 2002; Crockett et al. 2003; Coffee 2006; Véron 2009). The problem with rating is not a conflict of interest in the conventional sense. The problem is much deeper. I examine this in the next section.

## Conflict of Role

Two impulses seem to dominate responses to major crises. The first is to search for and attach blame to those who are alleged to have brought the crisis about, the culprits. This provides material for the media and incessant chatter in blogs. This impulse gives rise to panels of bankers who are forced to apologize for their alleged errors in front of Congressional and British Parliamentary committees. I have explored the uses of moral panic elsewhere (Sinclair 2010).

If this first impulse is politically useful, embarrassing to a few and somewhat satisfying to many others, the second impulse is, in the circumstances of this crisis, more likely to damage collective welfare. The second impulse is to create – typically in haste – a framework of regulative rules that are "heavier" or "harder" or more somehow more "serious." The impulse to regulate is derived from a failure to understand what it is the rating agencies did that was actually in error and a failure to accept the social nature of finance and the circumstances that brought this crisis into being in the first place. It is this understanding that forms the substance of my reconsideration of conflict of interest.

The prevailing understanding behind the impulse to punish and regulate seems to be that the people involved were doing things wrong. It is as if the mechanic fixing your car has downloaded the wrong software updates to the car's computers. No tip for him then and perhaps a remedial visit to mechanics school or the sack when the next round of layoffs come along. But this mechanical analogy will not do for global finance. Finance is not, contrary to the financial economists and their Efficient Markets Hypothesis, a natural phenomenon. While financial markets may display regularities in normal times, these regularities are not law-like because diachronic change is an ever-present feature of all social mechanisms, including markets.

John Searle made a useful distinction relevant to this problem. He suggested it is possible to distinguish rules that "regulate antecendently or independently existing forms of behavior…" from a much more architectural form of rule (Searle 1969: 33). These other "constitutive rules do not merely regulate, they create or define new forms of behavior." He goes on to suggest that chess and football are only possible with rules. The rules make the game. The basic point here is that the public and elite panic has focused on regulative rules and those who allegedly broke them. But this is not the problem with rating agencies or what has brought about the global financial crisis. Constitutive rules have been damaged, and this is why the crisis is so deep and so obviously challenging to the powers that be.

In the case of the rating agencies, I argue that what I would now term regulative conflicts of interest are insubstantial and no more than a useful rhetorical device to address poor forecasting. What are important and little commented upon are the constitutive conflicts. The major conflict of this order has been going on since the early 1980s and the rise of structured or asset-backed finance. Structured finance is important because it has been the major means through which financial innovation has made illiquid debts like credit card receivables, car loans and mortgages into tradeable, liquid securities. In a context of low interest rates and the hunt for yield, structured finance has grown into around 40 percent of total global debt securities of around $30 trillion.

When people think of financial innovation they inevitably think of computers and highly-educated 'rocket scientists' developing quantitative techniques for managing risk. But that is not the heart of this matter. Lawyers are key to this. The real essence of structured finance is the legal rights to revenues organized in the contracts and trusts which underpin the securities. This documentation can run into thousands of pages. The point is that these legal underpinnings give different rights to different tranches of a security. Some, such as the AAA tranche, have the right to be paid first. While others had to wait in line. This is how a mass of not very creditworthy subprime mortgages could produce some AAA bonds. These investors had first right to revenue and the expectation was that even if some subprime mortgage holders defaulted as expected enough would pay so that those with the highly rated securities would be paid in full. Unfortunately, when expectations are upset and people are uncertain this model does not work and securities of this type look dubious. Add recession to this picture and you can imagine a wholesale right-down of the global market in securities.

But as disastrous as this is, it is not the specific constitutive conflict of interest the rating agencies committed. That failure was to move into the markets themselves. For decades Moody's and Standard & Poor's had played the role of a judge or referee, standing back from the action and making calls as necessary. This role is what they were valued for and it is this role which allowed them to build-up reputational assets. The problem is that structured finance is only possible with the active involvement of the rating agencies. The agencies and their ratings actually make the distinct tranches of structured finance possible. Because of the complexity of the legal documentation and protection necessary for these tranches, the raters did not operate as judges. In structured finance the raters increasingly acted as consultants, helping to construct the securities themselves, indicating how they would rate them if organized in particular ways.

## Conclusions

It is intriguing that despite the worst financial crisis since the 1930s and the identification of a suitable culprit in the rating agencies proposed regulation should be so insubstantial, doing so little to alter the rating system that has been in place in the US since 1909 and Europe since the late 1980s. Part of this can be put down perhaps to a lack of confidence on the part of regulators and politicians in the efficacy of traditional solutions to market failure. It may also recognise the weakness of ostensibly heavily regulated institutions such as commercial banks and an understanding that the financial system is, despite the rating crisis, likely to continue to move in a more market and more rating-dependent direction in future. Indeed, the rating agencies have been major beneficiaries of the bailout program, reporting substantial returns despite the crisis (Ng and Rappaport 2009).

The global financial crisis is a crisis at the constitutive level. It reflects a deep loss of confidence in the basic infrastructure of the capital markets. This loss of confidence is a social rather than a technical process and tinkering with regulative rules, while tempting and politically distracting, will not address the heart of the matter. Like the Great Depression it seems likely that the damage done to the social relationships which underpin global finance, such as the reputational assets of the rating agencies and the trust financiers have in each other, may take many long years to recover. It is tempting in these circumstances to prescribe a simple fix, but institutions, contrary to some, develop over time and like communities, do not heal instantly. Encouraging institutional diversity and restraining hubris about alleged cures is our best way through. For the rating agencies, attending to the relationships and the expectations that built their reputations in the first place is their best course of action. The extent of substantial change is likely to be limited.

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# Amartya Sen's *The Idea of Justice* and Financial Regulation

**By Daniel Mügge**

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## Introduction

Much political economy scholarship, including research showcased in this newsletter, has an implicit normative agenda. It sets out to uncover social structures that shape peoples' lives without their consent. More often than not, these social structures generate or sustain inequalities, whether in material welfare, exposure to risk, access to education or democratic participation, or the ability to lead lives in line with ones own norms and preferences.

Financialization is a hallmark of contemporary capitalism (e.g. Epstein 2005; Krippner 2005). Observers disagree about origins and consequences of the phenomenon and even its proper definition. For now, we simply take it to mean the growing relevance of processes in financial markets for structuring other economic or social domains. Financialization then highlights the reordering of production under ostensible pressure from unleashed capital markets (Froud, Haslam et al. 2000; Lazonick and O'Sullivan 2000; Duménil and Lévy 2004; Glyn 2006) as well as the changes these markets have wrought on peoples' everyday lives (Leyshon and Thrift 2007; Langley 2009; Warren 2010).

This prominence of finance has made it a common target of normative criticism. Analyses of how finance is regulated – even in fairly technical domains such as accounting standards (Perry and Nölke 2006) or capital adequacy rules (Claessens, Underhill et al. 2006) – have tried to uncover unfair or unjust(ified) consequences of the rules in question.

This work is often convincing in the analysis of regulation's consequences. But equally often it is sorely lacking clearly spelt out normative standards. At times, plain material inequality, tied to financial market functioning, is sufficient to elicit disapproval. Alternatively, rules that affect various stakeholders differently trigger claims that surely, financial regulation should be subjected to more democratic scrutiny than is commonly the case (Mügge, Blom et al. 2010; Mügge forthcoming).

Noble as such concerns, their advocates rarely offer concrete suggestions about the criteria financial regulation would have to fulfil to deserve our support. This is the point of departure for this article. Rather than starting from scratch, it climbs on the shoulders of a giant of contemporary political theory – Amartya Sen. His *The Idea of Justice* (Sen 2009) offers not only an accessible yet exhaustive overview of his own ideas; he also situates his arguments in broader debates in ethics, making comparisons with alternative formulations easy. An economist by training, Sen extensively draws on classics in political economy, including Smith, Marx and Mill, augmenting his relevance for debates over financial regulation.

Sen dismisses utopian approaches to justice, which try to sketch the just society. Instead, he favours enhancing justice incrementally. 'Enhancing justice' means identifying aspects of our social environment which can (and should) be changed if thereby people were empowered to live their lives in line with their own wishes. Sen recognizes that given diverging norms and preference orderings, it is impossible to reason through to the just society. Rather, deliberation is indispensible to understand how contrary demands on society can be reconciled in practice. Sen does not start from an objective vision of the good life, which people should (be entitled to) live. Instead, the key lies with people themselves. That said, he concedes that people are often deprived of meaningful control over their lives to such a degree that we can still identify their living situations as instances of grave injustices.

Convincing as the arguments are in their own right, it is not self-evident that they generate practical guidance when applied to financial regulation. While this article seeks to strengthen the foundations of normative debates about finance, it also explores the helpfulness of Sen's arguments for debates in finance in the first place.

Much of Sen's work has concentrated on developing countries (notably Sen 1999), and his approach that sees capabilities as freedom has relatively straightforward implications there. For example, scholarship drawing on Muhammad Yunnus has spelled out how micro-finance might aid farmers and small entrepreneurs and insulate them against economic shocks (e.g. Young 2010). Normative imperatives here are relatively clear as credit is scarce and gross, and therefore easily identifiable, injustices abound.

In contrast, this paper concentrates on the OECD world. It explores to what degree well-established normative arguments are able to provide guidance in contemporary debates about financial reform. Three conclusions emerge from its analysis: first, publicly guided provision of credit has significant potential to advance societal justice. Framing debates around for example student loans or mortgages in terms of justice and empowerment (rather than for example economic investments) provides ammunition to those arguing in favour of heavy state intervention in this domain.

Second, the financial system could be made more just by curtailing the insecurity it inserts into people's lives. Financial innovation has often been hailed as an instrument to redistribute risk towards those actors willing and able to handle it. Arguably, the opposite effect has been at least as strong: by enticing corporations to plan short-term and pushing governments to deregulate labour markets, unleashed finance has increased many people's insecurity. This effect of liberalized finance offers much scope for corrective measures and the promotion of justice.

Finally, however, Sen's *Idea of Justice* is unable to guide reform of the plumbing of global finance – regulation covering wholesale finance including accounting standards, derivatives regulation, rules for credit rating agencies, etc. The effects of such rules are too complex and intertwined to allow an assessment of how their reform might boost people's capabilities. Instead, Sen's arguments suggest serious benefits from downscaling finance such as to allow meaningful political control. Given people's diverse preferences and values, the enhancement of justice as empowerment requires economic frameworks in which people can shape their financial environment through the democratic institutions that they (hopefully) have at their disposal. A return to some form of Bretton Woods-like order seems desirable – an order that combined openness to trade and regulated capital flows with at least the ambition to install democratic control over national financial systems. While the mergence such an order may not be likely in the near future, the apparent difficulty to erect it is a crucial obstacle to the realization of justice.

## Ethics and financial governance

Given the centrality of finance in people's lives there is surprisingly little debate about desirable financial system design that takes ethics serious. When Adair Turner, chairman of the British Financial Services Authority, suggested that we distinguish financial services that are 'socially useful' from those that are not, his statement was seen as ground-breaking.**1** From afar, of course, it is unclear what other than social utility we should consider when debating financial market policy. The furore surrounding Turner's statement was far more noteworthy than his 'insight' itself.

That said, four divergent perspectives reject an explicit consideration of ethics in financial regulation. First, thinkers of various hues deny that financial markets should be engineered with an eye to fairness standards of whichever kind. Libertarians see such tampering with markets as undue interference with individuals' inalienable right to use property as they see fit. This exclusive focus on individuals precludes an engagement with justice and fairness, both of which are relational concepts. Common as this position is, it completely ignores that – rather obvious for readers of this publication – finance is necessarily social. It is difficult to imagine a complex financial system that could function without some collectively binding rules. Hence, the notion that there existed something such as pre-social property or finance is absurd.

The second position trusts 'markets' to produce socially optimal outcomes. All that is necessary is to engineer proper market functioning – defined in narrow neoclassical terms – through regulation where necessary. All attempts to improve social welfare beyond this point are ultimately self-defeating.**2** Underlying this vision are several ideas: (1) market efficiency is possible, (2) it generates the highest aggregate material welfare, and (3) the latter is the ideal yardstick for measuring social utility. All three ideas are dubious, at best: the crisis has dampened what remained of the optimism about potential market efficiency, certainly in domains as complex as global finance. Once efficiency becomes elusive, arguments about its effects on aggregate growth ring hollow. As the crisis has hit the poor segments of societies disproportionately and exposed their vulnerability, it is unclear why the growth or decline of lower incomes should be treated similar to that of higher incomes, invalidating plain aggregation of material welfare. Finally, much theoretical and empirical work has demonstrated that material wealth narrowly-conceived is a poor guide to people's happiness and the capacity to live the lives they want, certainly in the higher echelons of the income distribution. In short, a hands-off approach to financial markets in the name of market efficiency is indefensible.

Third, stability as a key goal of financial regulation has at times been elevated to the one overall objective to which financial regulation should contribute. Since the crisis, rules were re-evaluated mainly with an eye to their potentially destabilizing effects. As will be argued below, ceteris paribus such stability is also desirable from a justice as empowerment-perspective. But making stability the centre of reform efforts has setting policymakers setting their sights both too high and too low. On the one hand, financial stability, however difficult to achieve, leaves regulatory regimes underdetermined. Stable finance could take many shapes and colours, with widely divergent distributive effects. Facets of financial systems that have clear bearing on questions of justice would remain ignored. On the other hand, it is unclear whether financial stability can in fact be engineered. As Minsky (2008 [1986]) convincingly argued, stability inevitably creates complacency that sees policy makers and economic actors condone and indeed desire credit expansion lest economic growth is stifled. Booms and busts are the inevitable result. Investing all regulatory energy in ostracizing financial instability may thus be setting the aims too high and detract from other ways to enhance justice in the meantime.

The final argument in favour of ring-fencing markets against attempts to engineer specific outcomes is that market complexity dooms any such endeavours. This claim boils down to a distinction between markets, which can function well only when left to their own devices (with potential props to prevent market failure), and their non-market environment, including politics. Also this idea has been undermined from a variety of angles (Chavagneux 2001; Mitchell 2002; MacKenzie 2006). And the recent crisis has reinforced doubts that a self-contained financial system, which could be optimized according to its own 'inner' logic, could be distinguished. This is not to say that markets are 'trivial machines' in Herbert Simon's sense, which can simply be instructed to produce one or the other outcome (Simon 1962). Caution is clearly required, and our capabilities to bend financial markets to our own liking are seriously limited. This point holds for optimizing efficiency as much as for other political projects, however, so that it is no argument against at least the ambition to tailor financial market functioning to socially agreeable outcomes.

Once these four arguments against taking ethical considerations serious in financial market design are discarded, an explicit definition of what financial market policy is to achieve becomes necessary. Even the quest for financial stability is less straightforward than might be apparent right away. Clearly, stability advocates are not in favour of building a financial system so rigid that it would deprive most people of access to credit, just in the name of preventing crises and instability. Just where the proper mix between dynamism, entailing risks and potential disruption, and stability lies is a question for normative theorists to answer. His prominence in this field makes Sen a promising starting point for a search for answers.

## Sen's *Idea of Justice* in a nutshell

Sen's idea of justice can most easily be sketched by contrasting it with those conceptions he rejects. His most fundamental distinction is between utopian ideas of justice and those that take the status quo as their point of departure. The former start by outlining the perfect society – whether in terms of material equality, opportunities for societal participation, or intellectual, personal and spiritual fulfilment.

Such utopias abound, but their champions rarely specify how they could be approached (indeed, whether that is possible at all) and how individual steps leading towards them should be evaluated on their own, given that we might 'get stuck' half way.**3** Conceptions of justice – whether inspired by religious fundamentalism, radical liberalism or socialist or communitarian thought – often paint societal choices in stark terms: any society that is not just or 'right' is necessarily wrong. It is a question of all or nothing. In political economy, this problem emerges when we try to reconcile the realization that power relations penetrate capitalism to its core with the aim of human emancipation from domination. Does partial emancipation exist? Or are there just different degrees of subtlety? Engrossing as those questions may be, they inspire little guidance for policy-choices here and now.

Compared to the utopians, Sen takes a reformist and pragmatic position, going much further than his teacher John Rawls in *A Theory of Justice* (Rawls 2005 [1971]). Rawls had avoided a detailed sketch of the just society itself. But he did specify the rather demanding conditions under which humans might be able to agree on its contours. Absent these conditions, justice was necessarily out of reach. Sen, in contrast, starts in the here and now. He accepts that people's preferences, norms and values may be incommensurable, whether as the result of socialization in different cultures or simply individual differences. We therefore cannot deduce what it is that people want; we can only go into the world and find out. Grand projects are eschewed in favour of incremental societal improvements.4

The diversity of norms and values makes plain material welfare inadmissible as the primary yardstick of societal improvement. Drawing on his earlier work (e.g. Sen 1999) as well as that of Martha Nussbaum, Sen instead opts for people's capabilities to attain their own goals as the anchor of his conception of justice. Furthering justice means changing society so that humans to gain control over their own lives in line with their preferences. It means creating choices where hitherto, there were none. His aim is thus not to define, let alone to create, *the* just society, but to outline a political ethic that seeks to empower people. Furthering justice means identifying and using our collective potential to make society more just than it is now.

What does all this mean for finance? What kind of financial reforms could empower people without unduly constraining others? Just what an 'undue' constraint on others is, is of course unclear. Extreme examples – a trade-off between one man's access to shelter and another man's third holiday home – may be easy to decide. Many other trade-offs are less clear-cut.

Sen sidesteps this question, which might otherwise dog his whole approach. First, there is nothing wrong with leaving thorny questions for later and dealing with straightforward ones first. Second, he acknowledges – more than most utopian philosophers – that people's perspectives differ, and that debate may change their mind, albeit in unpredictable ways. Justice is inevitably linked with public deliberation and some form of democratic decision making. It may thus be possible to craft sufficient consensus to remove at least some grave injustices – already a big step forward in its own right.

The contentious issues in finance and justice fall into three categories: the availability of credit to individuals, indirect effects of financial system functioning, and the aggregate effects of global financial system design (or the lack thereof). The following three sections will delve into each of these to establish whether Sen's thinking provides any guidance for policy.

## Just credit?

The most immediate link between financial system functioning and justice as empowerment lies in the provision of credit. In developed countries, which are in focus here, credit is particularly relevant to finance the three key investments people commonly make in their life – education, a house to live in, and old age provision. Credit can of course not be supplied indiscriminately. To the degree that it is financed through government debt, well-meant credit provision can turn into an excessive burden for society as a whole. The key condition therefore is that credit schemes have to be sustainable, meaning that the burden they impose on future generations should not grow over time. The question is thus neither whether markets function efficiently, nor whether they boost long-term welfare by enabling profitable investment (a view commonly espoused with respect to education), but whether credit provision gives people relatively more control over their lives. Again, potentially adverse future consequences of present-day profligacy are part and parcel of this consideration.

Many OECD countries operate special credit arrangements for the domains mentioned: student loans and grants of various forms, mortgage regimes that target credit and the terms on which it is available to prospective house owners, and often highly intricate pension regimes. The existence of these regimes is good news from Sen's perspective. Government intervention to target credit signals the realization that credit availability is too important to citizens' lives to be left to the market alone. At least some of these credit-regimes have proven sustainable, meaning that they do not impose undue burdens on others, particularly on future generations through ever-mounting debt or excessive inflation for the assets that credit regimes target.5 Fine-tuning the credit supply to meet societal demands is thus possible and a worthy subject of public debate.

To be sure, in each of the domains mentioned above there is ample room for controversy and, from the perspective of justice as empowerment, room for improvement. For example, given scarce resources, it is unclear why tax breaks or concessional loans should be available to citizens who could follow their study of choice or build the home of their dreams without them.

While far from revolutionary, such a view on finance roots it firmly in the social dimension of the financial system. The perpetuation of societal inequalities in opportunity on the back of a skewed allocation of credit becomes indefensible.

## Financialization and everyday life

The observable influence of financial system functioning on peoples' lives goes far beyond the distribution of credit. Consider three examples: the effects of corporate governance on employment, the impact of financial instability on life planning, and the distribution of micro-risks. All three centre on the same issue – relative stability of the economic context within which people can plan their lives.

In line with a general shift towards neo-liberal economic governance, corporate governance reforms in the industrialized world since the 1980s have emphasized the importance of corporations' flexibility. Maximum economic growth, so the argument, depends on the ability constantly to reconfigure the combination of production factors, crucially including labour – hence the call for the flexibilization of labour markets. The flexibility of the latter is primarily shaped by labour market legislation. But at the same time, a strengthening of corporate owners at the expense of workers has increased the emphasis on short-term profits and the attendant 'need for flexibility', particularly in economic downturns (Lazonick and O'Sullivan 2000, critically Froud, Haslam et al. 2000).

For many workers, the result has been clearly negative (Glyn 2006). Irrespective of ultimately unproven effects of flexibilization on aggregate employment, the insecurity that flexible labour markets introduce in workers' lives is at odds with the empowerment that Sen's theory of justice champions. Insecure work arrangements introduce anxiety in many peoples' lives and prohibit long-term planning. The potential need for periodic relocation can disrupt their social lives and generate an encompassing sense of rootlessness (Sennett 2007). If financial regulation triggers managers to push for internal flexibilization, justice could be advanced by providing employment conditions that give employees at least a modicum of control, the potential for long-term life planning and simply some peace of mind.

A similar argument centres on the deleterious effects of financial instability on such long-term planning. Even if in a liberalized economy the economic losses in downturns were compensated by additional economic growth during upswings, the disruptions such volatility introduces in people's everyday lives argue in favour of stability-promoting financial regulation. Such regulation might require limiting financial innovation and its potentially beneficial economic effects. But moderate losses in trend growth would be balanced by the increased control stable economic conditions would grant people.

Finally, financial regulation at the retail end of the financial services food chain distributes the risks attached to financial transactions. Much customer protection legislation already attempts to insulate citizens from risks that they seem prone to misunderstand or unable to bear. That said, enshrining customer protection in financial regulation, often against resistance of the providers of financial services, has often been an uphill struggle, and frequently simply failed (e.g. Warren 2010).

Sen's approach bypasses legalistic arguments about where the responsibilities of customers begin and those of financial firms end. The real yardstick is much more practical: what works in the real world? Which way of organising finance would boost peoples' grip on their finances and lives most? This includes a curb on predatory lending and the strengthening of financial education so that people understand the products from which they can choose. Where products' complexity exceeds many peoples' ability to understand them, a justice as empowerment-approach suggests their prohibition. Why should citizens be exposed to risks that are designed to be incomprehensible? The freedom of the banker to sell products as he or she chooses weighs less heavily than the potential loss of freedom of people who get entrapped in impenetrable legalese and debt.

## Justice and the nuts and bolts of global finance

Important as financial institutions and regulations that are close to citizens are, cross-border integration of financial markets means that all these unfold and are embedded in the strictures of global finance. To take one recent example, pensions, mortgages and student loans in Greece have probably been more affected by the eurozone turmoil in spring 2010 than by any specific Greek regulation. Global finance sets the boundaries in which national choices can be made. In this way, its regulation –particularly in wholesale capital markets – has a strong influence on peoples' capabilities, and it should therefore be a proper object for Sen's theory of justice. But does the latter have anything to say about how credit rating agencies, derivatives markets, accounting standards and the like should be transformed?

Alas, the link between regulation in any of these domains and humans' capabilities is too indirect to allow any such claims. Do we know how derivatives trading could be reformed to serve the aim of justice? Regulation in any one domain interacts with rules elsewhere, and – as the recent crisis has powerfully demonstrated – it remains difficult, if not impossible, to predict the real-world effects that regulation is likely to have. Also, justice for future generations prohibits opportunistic tampering with financial rules for example to boost consumption in the short term, only to invite an economic squeeze years down the line.6 In short, Sen is of no immediate help in reform efforts.

At the same time, his approach points to two more fundamental conclusions. First, if financial globalization inhibits country-level application of justice-standards to financial system design, the legitimacy of such globalization is seriously dented. Sen's perspective thus supports those who see financial globalization as a critical loss of national sovereignty. Most often, such arguments are advanced in the name of national economic development. The emphasis here is different: national control over financial markets may not only be necessary to boost aggregate economic development, but also to allow micro-level choices about ways in which financial system design can help people live the lives they want.

Second, then, global harmonization of regulatory standards is not necessarily desirable. Such harmonization normally advocated as a boost to market efficiency through the easing of cross-border flows and the emergence of best practices. From a perspective of justice, linked with scepticism about the existence of 'ideal' standards, such considerations do not trump the variegated effects of financial standards on peoples' capabilities. In short, financial regulation is not a case of 'one size fits all'.

Instead, empowerment would require meaningful political control and hence a set-up not unlike what Keynes had in mind at the Bretton Woods conference in 1944. It would require an open debate about financial de-globalization to promote such control. Intriguingly, in late 2009 the International Monetary Fund cautiously started to argue the case in favour of short term restrictions on capital inflows in emerging markets. In and of itself, this policy shift constitutes but a minor crack in the intellectual edifice of neoliberal financial governance. But it does provide an opening that may yet lead to a wholesale reappraisal of the societal benefits of globally integrated finance and the ways in which it promotes or obstructs justice.

## Conclusion

This paper has explored to what degree Amartya Sen's *Idea of Justice* can provide useful guidance for financial system design in general and financial regulation in particular. At the micro-level, his approach has clear potential: it provides a yardstick against which targeted credit provision can be evaluated. The key criterion, following Sen, is whether through custom-tailored credit regimes, we can boost people's ability to shape their lives in line with their preferences without shifting the burden for such gain on others. Similar perspectives can be usefully applied to more indirect aspects of financial system functioning, for example its effect on employment conditions.

Sen's thinking suggest also suggests the key constraint on reforming finance in this vein. The Pareto optimality that most economistic theories of justice put central – welfare gains that do not disadvantage other members of society – appears too restrictive. It effectively locks in existing welfare levels and limits the scope for redistribution, not only of material welfare, but also of risk and opportunities in a more general sense. Once we consider extreme cases, such redistribution would clearly seem justified, for example when we contrast people living in opulence with those facing starvation. But a similar logic can be applied to less stark cases, and it holds for effects that financial systems have on peoples' lives just as much as for straightforward material redistribution. Justice in Sen's sense has to be more than just a progression of steps towards Pareto optimality.

Rather, the main constraint lies in the sustainability of financial arrangements. Any regime aiming to enhancing justice should not do so at the expense of future generations' abilities to operate a similar regime, for example because of excessive debts or credit-fuelled escalating asset prices. Justice has to be upheld also across generations.

Sen's approach is much less helpful as a guide for global regulatory reform in wholesale markets, largely because of the complexity of the financial system, our inability to link rule design directly to individual fortunes and unpredictable market behaviour. It does suggest, however, that global finance might need considerable downscaling and segmentation to bring it back under a kind of political control under which justice-related considerations could function as policy yardsticks. National financial systems would need to be insulated against potentially volatile global capital flows for justice in Sen's sense even to become possible.

Such de-globalization appears unlikely at this point. Indeed, officially the whole thrust of discussion, for example in the G20, centres on strengthening global governance in order to salvage cross-border financial integration. The aim is not to reinstall public choice, however, but to entrench the exigencies of global finance even more deeply (cf. Best 2003; Vestergaard 2009). Given the entrenched interests that stand to loose from a measured reinstatement of for example capital controls, this stance is hardly surprising. And there is little evidence that policymakers in charge of global finance spend much time poring over justice and how it could be enhanced through regulation. Pessimists would undoubtedly attribute this state of affairs to the presumed egotism of economic actors. But maybe we simply have failed to spell out clearly just what it would mean for regulatory reform if justice were taken seriously. In that case, the onus is on scholars of finance who do see room for normative considerations in financial governance to explicate and think through their own standards of ethical judgement.

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## Endnotes

1See the interview with Turner in the August 2009 issue with Prospect Magazine.

2Think, in a different context, about arguments that trying to increase employment through deficit spending will only spur inflation in the long run.

3Consider the building of communist society. All attempts to create such a society have stalled way short of their ultimate goal, often installing authoritarian and repressive political systems along the way. Irrespective of one's support for communist ideals, such effects of their implementation should figure in our normative assessment of these ideals. See von Hayek's arguments against socialism in The Road to Serfdom (von Hayek 2001 [1944]) and related arguments by Popper in The Open Society and Its Enemies (Popper 2003 [1945]).

4Here his arguments again chime with Popper, but also with skepticism of modernist top-down reform as articulated for example by Scott (1998).

5This is a particular worry in real estate markets, in which blanket tax rebates for mortgages, for example, arguably end up in the pockets of current house owners through increased real estate prices – an effect that is largely a consequence of limited short-term supply of housing.

6Think for example of calls on rating agencies to be more lenient towards sovereign governments in the eurozone. The effect would undoubtedly be a further build-up of debt, with dire consequences in the future.

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# Analyzing Expectations Sociologically: Elements of a Formal Sociology of the Financial Markets

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## 1. Introduction

Financial markets are meaning machines. Like no other contemporary social institution they lend themselves to the projection of hopes and fears, of illusion and catharsis, of the promise of absolute wealth and a whispering of ultimate demise. Against this semiotic hyperproductivity which began sparking aesthetic, public, and scholarly discourses already in the 17th century, contemporary categories used to analyze the market for the market participants themselves remain surprisingly dry and uninventive. It is still mainly the category of expectation that is used to interpret market movements, inflicting great boredom on those who regularly watch financial news. Surprisingly as well, the social study of finance has so far not displayed any systematic interest toward the category of expectation, and has instead left the term to neoclassical finance and their psychological critiques.

The aim of this essay is to reclaim the notion of "expectations" for sociology as the one notion that is in elective affinity to the social dynamics of the financial markets. In other words, it will treat the predominance of the category of expectation in financial meaning making as indexing some crucial features of financial markets themselves. Methodologically the essay follows the research program of formal sociology in Georg Simmel's sense, inferring the particular structures of financial sociality, not at the cost of an economic viewpoint on the markets, but rather as taking their economicity as a point of departure for a formal-sociological analysis.

The essay proceeds as follows. First, it will argue for the necessity to sociologically determine the specificity of social meaning in the financial markets through a formal analysis of the social situation in which investment takes place (2). Second, the price mechanism will be pinpointed as point of departure for such endeavor, because it is this mechanism that constellates actors to one another and thus structures the investment situation (3). Then, the essay will reference debates about a sociological notion of "expectation" in the discussion about the ontology of the social norm, with the aim to depict expectations as a form of sociality that is genuine to the financial market (4). Section (5) concludes.

## 2. Formal sociology: the characterization of "interactions" (Wechselwirkungen)

### Simmel's formal sociology: The case of money

*Society is not an absolute entity which must first exist so that all the individual relations of its members – super- und subordination, cohesion, imitation, division of labour, exchange, common attack and defence, religions community, party formations and many others – can develop within its framework or be represented by it: it is only the synthesis or the general term for the totality of these special interactions. (Simmel 1978: 175)*

Obviously delimiting his approach from that of the positivist-functionalist sociology of Émile Durkheim, Simmel does not propose to explore society from the assumption that it is pre-given and "there" but insists that it has to be enacted; hence his question, "how is society possible?" (wie ist Gesellschaft möglich, cf. Simmel 1992 [1908], 42) The clue to answer ing this question resides not in assuming the existence of society apart from and above individuals, but in an analysis of ways of "sociation" (Vergesellschaftung, Simmel 1992 [1908]) which bring individuals into mutual relation and interaction with one another. The reconstruction of these relations is seen by Simmel as fundamental perspectives on sociality; and the notion of "society" is introduced as depicting a novel perspective on the social, not a totality that is given the same way that nature is given (Simmel 1992 [1908]: 17). With respect to his "Philosophy of money," the work that the present essay will refer to predominantly, he even regards this endeavour as "philosophy," a term one would recast, with Giddens (1979), as "social theory" today. At the same time, Simmel's analyses often provide a perspective on structures and tendencies of modern societies, which is why Simmel forms an outlook on society – a contemporary analysis – that operates with the close description of social relations which are deemed exemplary for contemporary societies.

Simmel's program of formal sociology is strictly inductive, which explains the breadth of his empirical interests in all sorts of forms of sociation in contemporary society and in society in general – among those, economic sociation. In his "Philosophy of money," the social-theoretical ("philosophical") and the contemporary-diagnostic perspective are intricately woven together. Simmel's interest is mainly with money as a medium of exchange, the reason being that social relations mediated through money are highly significant both for a general social theory (or "philosophy") and for a social diagnosis of contemporary societies. While on the one hand money and the exchanges between individuals it makes possible are, for Simmel, paradigmatically social processes because money is "entirely a social institution and quite meaningless if restricted to one individual" (Simmel 1978: 162), at the same time they form part and parcel of modernity's most characteristic features, like a high degree of individuality that coexists with an equally high level of interdependence between individuals.

For Simmel, money functions as a means as such, it is the "purest reification of means" (Simmel 1978: 211). This is to say, money has the ability to bridge the gap between any individuals' wants and desires and any objects that could satisfy them. Therefore, on the surface money seems to have value, as it brings into reach those objects a person regards as valuable; yet in actuality money merely encodes and represents the discontinuity between a desire and its fulfilment that is the actual constituent of value.

From this it follows that money also redefines social relationships. On the one hand, it anonymizes and formalizes those relations. In the presence of money as a general medium of exchange, the person desiring an object does not have to create an extra motivation or persuasion for the person who owns that object to sell it since money, being an ultimate means to any end, is equipped with an inherent motivation to be accepted in exchange for any object. On the other hand, money creates tight and virtually all-encompassing interdependences between individuals since it can be accepted from any person regardless of her origin, gender, age, education, and affiliation. Thus, exchanges – relations – between any persons become possible. In Simmel's analysis, money-governed exchange regimes make emerge a form of sociality that privileges anonymous interrelations between individuals and at the same time highly individualized life-styles which can disrespect others' sanctions thanks to the self-motivating function of money exchange; precisely the nonchalant inattentiveness to one another that Simmel observed in contemporary societies and in particular in the "economic jungle of modern urban life" (Simmel 1978: 199).

**The sociality of the price**

The one thing that materializes society between any two individuals who agree upon mutual exchange is money. While the desires for objects which equip those objects with value remain personal and insofar have no sociological resonance, money, represented by the price, bridges the gap between subject and object through a representation that involves other exchanges, and thus society (Simmel 1989: 213). Therefore, the price is for Simmel the ultimate sociological fact. At the same time, the price – and here we start moving beyond Simmel – is that category which distinguishes financial markets from all other markets. While this will be explained in more detail in the next section, I will first interpret Simmel's take on the price a bit more thoroughly.

For Simmel, according to my interpretation, the price has a dual quality. On the one hand, it is a localized manifestation of the property of money as a generalized medium of exchange, making possible an ultimate convertibility of all values, that is, of all individual desires (Simmel 1989: 124). This thought has not only been taken up in economic sociology later (e.g., in Parsons/Smelser 1956) but was already prefigured in Marx's famous analysis of money as the ultimate means which "objectifies" social relations. On the other hand, though, in Simmel the price also figures as a factor in the self-fashioning of individuals and their desires: as the price renders desires convertible across individuals, it does so across life courses as well. In Simmel's terms, the "sequence of purposes" (Zweckreihen, Simmel 1989: 204) between ends and means become prolonged, if not protracted; the desire for a certain object is remediated as a desire for money which, in turn, casts the different desires as comparable to each other with respect to their "price." According to Simmel, this leads to an intellectualization of life, as one's own biography becomes rearticulated and rationalized in terms of convertibility between desires (Simmel 1989, 591-616). Here, however, Simmel risks collapsing his analysis into a cultural criticism of contemporary, i.e. fin-de-siècle society, for which an idiom of individualism, self-objectivization, and intellectualism was all too common. The "philosophical" problems he raised with respect to the money medium, though, may be developed further, embracing the price not only as a medium of exchange but as an object of value itself, that is, as a desire.

This brings us directly to the financial markets. For it is here that the price takes on the quality of money itself, that is, of being desired. Many observers have argued that in the financial markets, money is turned upon itself, not longer remaining a medium but also becoming a commodity itself (Marx 1962; Weber 1988 [1894]; Parsons/Smelser 1956). Simmel himself had argued, as mentioned earlier, that money has the ability to replace the desired objects due to its potential to bring any object into reach. The point to be made with respect to financial markets is that not only money as a general means but the price as a concrete object can become the focus of desire. In this sense, the price replaces money which in turn replaces desires or rather, becomes the ultimate desire. It is through this argument that Simmel's analysis, which ultimately led him to a cultural criticism of society and away from a formal perspective, can be taken to a fresh start: the price as an object of desire is the point of departure for a formal sociology of the financial markets, which has to begin with an analysis of the nature of the price in financial markets as opposed to the rest of the economy.

The argument to be made in the remainder of this essay is thus that the fundamental characteristic of the financial markets – namely, to be markets on which prices are traded – results in a type of sociation not imagined by Simmel but analyzable in the framework of his heuristic, that is, as a formal description of the ways individuals relate to one another in the presence of the financial market price.

## 3. The price mechanism as the core characteristic of financial markets

### Financial market prices as products

Financial markets differ from markets in the production-based economy in several crucial aspects, which have been points of debate among sociologist. In particular, there has been a discussion ongoing about whether an economic-sociological perspective should highlight the social embeddedness of financial markets like, for instance, through bank organization, social networks, and the social and cultural construction of prices (Abolafia 1996, 1998; Sassen 1991, 2005; MacKenzie 2005; Power 2005, 2005a; Clark/Thrift 2005); or whether the emphasis should be put on the detachment of financial markets from the production-based economy and therefore highlight its uniqueness (Baudrillard 1992; Albert et al. 1999; Baecker 1988; Castells 1996; Lee/LiPuma 2002; Knorr Cetina 2007). This debate, however, misses out on a couple of crucial points. First, it does not take into account that financial markets can detach themselves from their production-based contexts by virtue of certain features of their social, political, and technological embeddedness, as for instance in global cities, an argument which subverts the confrontation of embeddedness and detachment (cf. Langenohl 2008). Second, the embeddedness thesis tends to lose sight of the economic dimension of the financial economy, treating the economy a field, system, or part of society to be wrested away from economics, with the consequence that the peculiar economic quality of the markets gets effaced. Third, a similar fallacy characterizes the detachment thesis, as its proponents often point out the genuine social – or "postsocial" – uniqueness of market interactions as avant-garde modes of interaction or signification (Knorr Cetina/Bruegger 2002), thereby also forgetting about – sometimes even openly denying (Baudrillard 1992) – the economic effects of markets.

There is thus some reason to assume that the contradistinction between embedded and detached markets, which is often accompanied by a second opposition between production-basis and the absence of such basis, leads astray. At the very least, it leaves no space for an exploration of the argument that the financial markets are more production-based than any market of the production-based economy. Yet it is obvious that the values of the products traded on the financial markets depend in a much more existential way on their means of production than non-financial products. When a cornfield is devastated, an industrial production plant is closed, a company goes bankrupt, or a famous painter dies, their products still may retain and often even gain in monetary value. In the case of these "material" products, that is, the value development is in principle independent of the means of production. However, this does not at all apply to financial market products. An option, a future, or a swap gain their value from their ability to be traded on the financial markets. When trade into these products stops, they slip into inexistence and their value cannot be fixed. In other words, the production sites of financial products are financial markets.

This is so because financial products are prices. One buys the right or sells the obligation to execute a certain price in a given product (which may be or may not itself be a financial product). Financial products are thus comparable to money in that their use value is identical with their exchange value. However, given the specificity of financial markets that they are essentially future-oriented markets, the use/exchange value of a financial product depends not only on a synchronous comparison with alternative (financial) products but also on a diachronic comparison between bid and put prices of that product (or vice versa). The present price of a financial product thus varies in relation (a) to the price it will have achieved in the future (usually at a given date of expiration) and (b) relative to the price gains of alternative products. For instance, an option about a certain deal which is expected to achieve a higher rise in price than another deal traded through another option at a given point in time in the future will rise in value relative to the second option. Yet the time factor introduces an irreducible risk in this operation, to which portfolio theory has significantly responded by pointing out the necessity to reduce the time span of investments in order to minimize investment risks (cf. Markowitz 1952, 1991; Lee/LiPuma 2004: 142-147).

The futurity of financial markets, if connected to Simmel's arguments that the value of a given object is a function of it being desired, and that this value becomes socially objectivized through a generalized exchange medium generating a price, has two fundamental corollaries. It must first be guaranteed that a price will have been formed in the future, as this is the precondition for it being desirable in a future-oriented investment situation. Second, it must be possible to trade the product at any given time if the relationality between present price, future price and price of an alternative product – that is, in Simmel's terms, the objective value of the price as the articulation of its desirability – changes. The consequence is that price formation for financial products must be operative at any given moment.

To buy or sell a financial product means to buy or sell a price; but neither the price that is traded nor the price for which it is traded have any existence independent from the way they are produced, namely through price formation. Financial markets are exchanges and means of production at the same time and for the same entities: prices. If trade stops, the traded products/prices cease to exist as objectivized desirabilities. Products that can't be traded dematerialize, morph into economic virtuality, and take on a spectral existence, like the "toxic" papers lying in the now proverbial basements of banks for which at present there is no market.

This line of argument displaces the discussion between the embeddedness and the detachment theses in the social study of finance and political economy. The alleged materiality of the "real" economy and the detachment of the financial economy from the former is not the crucial issue here. First, value is not bound to materiality; Simmel, as mentioned, points out that value is nothing but the distance between a subject and a desired object, irrespective of the ontology of that object. Second, not only "material" products and the material production have material consequences. Instead the point of concern and analysis are the ways in which ascribed value is maintained or modified, and how those ways refer to the means of production.

### The mathematicity of price formation as means of production

Due to the requirement that price formation must take place at any given moment that the sociality of financial market products imposes, a type of price formation is needed that calculates on the basis of a supply-demand computation only. Historically as well as systematically it has been argued that financial markets tilt toward giving the circulation of products priority to channelling them from produces to consumer (Sombart 1955, vol. 1, 200-202; Knorr Cetina 2007). In economic-functional terms this has been explained with the double role of speculation to form markets and keep them liquid as well as levelling out contingent differences between prices (Sombart 1919, vol. 2, 663), a point hat has been taken up by arbitrage theory (Beunza/Hardie/MacKenzie 2006). If the priority is thus circulation, this requires a redistribution mechanism that self-organizes. This is exactly what the mathematical price mechanism does.

With respect to the present argumentation, the mathematicity of the price "mechanism" – rightly termed so by economists – guarantees the continuation of trade, and thus the continuity of the financial products' value (desirability). If financial markets were (on a regular basis) subject to contingent non-market intervention comparable to that of the non-financial economy, continuous price formation would not be possible because the interventions would mark defining points without providing a continuous sense of the value of the traded products. Financial products would, as it were, exist as tradable and thus valuable (desirable) entities only at the moment of intervention, because only at these moments there would be a price. Simmel, throughout his work highlighting the mutual definition of money and commodity, remarks that money achieves "actuality" only at the moment it is used for purchase, while a commodity "exists" only as it is sold: "Just as money is real money only at the moment when it buys something, i.e. when it exercises the function of money, so the commodity becomes a commodity only when it is sold; until that time, it is only a possible object for sale, an ideal anticipation." (Simmel 1978: 138) Financial products, however, being money, commodity and price at the same time, have not only no use value apart from their exchange value but also no exchange value apart from their use value to be exchanged, and are thus threatened with complete annihilation as carriers of use and exchange value when trade stops.

In parentheses, this points to an additional differentiation in regard to the materiality or virtuality of financial products. They are not by themselves material or virtual, but oscillate within a continuum between materiality (when price formation is ongoing) and virtuality (when price formation is suspended and prices cannot be fixed). The uniqueness of the mathematical price mechanism is that it produces representations of prices – with prices having no existence outside such representations – on a continuous basis, lending financial products the maximum of materiality they can have. Financial products escape the discussion about their ontology, as the latter depends exclusively on the actuality of the price mechanism.

This astonishing mechanism of mathematical price formation, though, comes at a cost. It was Jürgen Habermas (1995 [1981]) who most systematically pointed to the inability of the market as a "systemic" mechanism to provide explanations and interpretations for what is going on in it. This goes back to his differentiation between two modes of social coordination and orientation: instrumental action, in which actors are interested solely in the effects of others' actions; and communicative action, in which actors seek to achieve agreement about a certain claim or judgment and thus have to take into account the possible motivations that others might have for their actions and judgments. This distinction, Habermas continues, is not only an analytical differentiation but lies at the heart of the societal macro-structure of western modernity. As instrumental action becomes more and more institutionalized in social mechanisms like the administration or the market, the immediate experiential universe of actors, their "lifeworld," becomes liberated from those instrumental obstacles to communicative action, and thus communicatively rationalizable. Although financial markets have not caught the particular attention of Habermas, they can be said to embody systemic mechanisms of instrumental action in an almost ideal-typical way: through the price mechanism, economic actors see only the consequences of others' actions, cumulated in the prices, while the possible motivations behind those cumulated effects are effaced.

It is exactly at this point that a Simmelean approach can be applied. Following my extrapolation of Habermas, the financial investment situation is such that actors have to make decisions on the basis of orientations which reflect only effects, but not motives, of others' actions. This can be said to be a fairly unique type of sociation of individuals, that is, a form of sociality. As such it implies the objectification and institutionalization of subjective value into a generalized mode of meaning whose features shall be analysed in the next section.

## 4. Financial sociation: The category of the "expectation"

### Expectations in financial discourse

Contrary to Habermas, who insists that systemic action can discard the motivations of others, the production of meaning at financial market does involve representations of others' motives all the time, be it in public debate and media reports, in professional circles in which novel analytical models like "sentiment analysis" are imported from behavioural finance, or in other arenas.1 For the purpose of the present essay, which is concerned with a formal sociological modelling of the financial investment situation, the empirical question of how market participants make sense of their actions can be recast as a formal analysis of the ways in which they relate to each other in the financial markets and in the presence of the mathematical price mechanism. Simmel points out that money, which he holds to be a "category of reified social functions" (Simmel 1978: 209), is a structuring moment in sociation in that it connects as well as disconnects individuals. While on the one hand it puts a distance of nonchalant inattentiveness between them, it also interconnects virtually all individuals through networks of economic exchange. As regards the first point, a very similar argument has been circulating at least since the 19th century with respect to the financial markets, especially the stock exchanges. For instance, Werner Sombart (1928, 1077-1079) identified the great European stock exchanges as places where a certain drive toward more abstract, objectified (versachlichte) and rationalized interpersonal relations in modern societies in general originated. With respect to the second point of Simmel's argument, the 19th century has as well witnessed judgments which located the rise of the stock market within a new type of sociality. However, these interpretations of the rising importance of the stock exchange and the financial markets in general do not explain the ways actors refer and relate to each other. In regard to this question, what is more important than the above mentioned social diagnoses of the fin-de-siècle contemporaries are recurring remarks about expectations as a basic mode of interpretation in financial markets as already mentioned in the introduction. It is to this literature that I turn next.

Apart from media representations where the category of the "expectation" is a very ubiquitously used explanatory device, expectations figure in at least two academic contexts.

- First, there is work in neoclassical finance, which has been trying to apply the general theory of rational expectations in macro-economics (cf. Kirchgässner 2008: 84-5) to a modelling of financial markets. Very briefly put, the term "expectation" figures as a key device in these models, as it allows conceiving of financial markets as information-efficient markets, given the presence of actors who conduct their trades according to expectations which have been formed on the basis of information available to all. The market – that is, the prices – can be modelled as reflecting all available information; which is to say, it does not develop any dynamics of its own as long as expectations are rational (cf. Fama 1970; Fama/Miller 1972).

- At this point behavioural finance intervenes, arguing that concrete actors' expectations are everything but rational. Focusing on herd behaviour, the psychology of booms, busts and bubbles, and the "bounded rationality" of human beings in general, this research concludes that financial markets do develop a life of their own, as actors have irrational expectations or interpret others' expectations in an irrational way (cf. most prominently Shleifer 2000, Shiller 2001).

- From this, sociological and political-economic research has concluded that financial markets display a high degree of reflexivity of expectations; which is to say, the markets do not reflect anything outside the expectations and expected expectations that govern actors' tactics and strategies (s. Beunza/Stark 2010).

It is not unfair to say that this sociological syntheses come rather late, given the proximity of the notion of the expectation to sociological endeavors. Also, the sociology and political economy of the financial markets has so far remained within an ultimately psychological notion of expectation, and thus has not that much to add to the findings of behavioural finance. The challenge thus is to re-appropriate the notion of expectation for a sociological analysis.

## A formal-sociological definition of expectation

A brief excursus into a debate in German-speaking sociology of the 1950s and 1960s will serve to move beyond the stage of the debate, introducing a sociological notion of expectation into the social study of finance. In 1958, Ralf Dahrendorf published his influential "Homo sociologicus," a monograph which established the notion of the social role, and with it the notion of the expectation, as a key category of sociology and social theory. According to Dahrendorf, human beings in modern societies are confronted with the "annoying fact of society" (ärgerliche Tatsache der Gesellschaft, Dahrendorf 1965, 21), that is, with norms and underlying expectations which address persons not as persons but as role carriers. While human beings have their very unique characteristics, what makes them social beings is exactly the presence of norms and expectations not addressing persons but action patterns. Against this notion of the norm Heinrich Popitz (1967), who was to become one of the representatives of German-speaking sociology in the 1970s, contended in his habilitation lecture published as "Der Begriff der sozialen Rolle als Element der soziologischen Theorie" that Dahrendorf had conflated sociological with social abstractions, and thus had effectively followed a psychological notion of expectation as opposed to a sociological one. Popitz argued that the existence of expectations and norms cannot be sociologically deduced from the observation of norm-obedient behavior, as such behaviour may have other motivations. Norm- and expectation-obedient behaviour may be the result of an individual's desire to respond to a given expectation, but it may as well be the outcome of traditional or habitual behaviour not subjectively directed toward others' expectations.

For Popitz the most important conclusion was that norms are stabilized not by actual obedience to norms and expectations but by any behavior that may be socially interpreted as being obedient to norms and expectations. For the present essay the most interesting point following from this is that expectations are not mental states but social devices of interpretation and ascription. Popitz's critique of Dahrendorf may be compared to the way Harold Garfinkel (1967) criticized the Parsonsian theoretical model for putting too much emphasis on the socialization function, arguing that social norms have no existence outside of the situations in which they are perceived as functioning. From a sociological perspective radicalized in formal terms, norms and expectations are first of all interpretive frames that structure situations and the ascriptions taking place in them.

**Expectations as meaning devices in financial markets**

This returns us to the financial markets. In the light of the recasting of expectations as ascriptions, the question is not why financial markets are governed by expectations, but instead why market observers prefer to see expectations in these markets and to ascribe them to other market participants. The non-triviality of this question becomes especially evident from the fact that alternatives to the ascriptive mode of expectation exist. For instance, one could ascribe the moving rates at the stock exchange to traditional or habitual or simply irrational behavior. While this sometimes does take place (especially in behavioral finance), the category of the expectation, as a rule, is added to such interpretations in explanations like, "There's a high level of volatility because investors are nervous and do not know what to expect," or, "Fear triggered by xyz reigned the stock exchange today, with people expecting the worst," etc. Why is it that the category of expectation is so often used in the production of meaning in financial markets?

I argue that expectations as a meaning category stand in an elective affinity to certain crucial features of the financial investment situation, and can thus be regarded a sociological-formal quality of the financial markets as a unique site of sociation. This can be demonstrated through confronting expectations as mode of social meaning and ascription with other such modes:

■ First, an index of futurity is characteristic of expectations. Unlike memories, habits and traditions, expectations refer to the future respective to a given point in time. More specifically, they refer to something which will, or will not, have happened. Expectations are thus protentions in the sense of Edmund Husserl and Alfred Schütz, that is, their structure of anticipation is that of the grammatical futurum perfectum. Therefore, the interpretation that something happens according to expectations introduces an accomplished future state as defining reference point of interpretation.

■ Second, expectations are concrete and specific. They anticipate a guess regarding clearly definable events or states in the future. Their specificity distinguishes them from presentiments or suspicions, their concreteness from typifications or interpretative frames. Interpretations that rely on the category of expectation thus screen the (possible) futures for concrete and specific events that might (or not) happen.

■ Third, expectations not only orient action but call for decisions. Contrary to the proverbial "hopes and fears," which like expectations are directed toward the future and may be concrete and specific, the meaning structure of an expectation does not permit inactivity. Expectations necessitate decisions and actions. Framed as an expectation, even inaction refers back to a decision, namely, the decision to expect the actualization of a clearly defined moment, and not just – as with hopes and fears – unspecified waiting. Interpreting situations in terms of expectations, thus, refers to a moment in which a decision to (not) act is interpreted as being or having been taken.

■ Fourth, expectations conceptually presuppose expectations of expectations (Erwartungserwartungen). In social settings governed by the logic of expectations, expectations irrevocably have to refer to other actors' expectations prior to the formation of one's own expectations, as it is the actions of others that have to be taken into account for considering one's own actions. This point is most crucial in regard to financial markets, as in such markets it is only the consequences of others' actions that become visible to actors. Whereas in face-to-face interactions memories, habitualities, hopes, fears, and other modes of meaning can in principle be articulated without necessarily leading to future-oriented decisions and actions, in the financial markets it is only the consequences of such decisions and actions that are in cognitive reach of actors. In other words, whatever takes place in the financial markets can meaningfully be referred back only to the attribution of expectations, because it is only expectations that can be expected to invariably lead to action.

To sum up: the empirical, interpretative heuristic of the expectation fits the problematic of financial markets to anticipate future actions of others while only the consequences of their past actions are visible. The point is not that market actors are psychologically restrained to expectations, but that they have only one conceptual-cognitive frame at their disposal that allows linking the observed consequences of others' actions (prices) with their possible motivations: expectations. The specific infrastructure of financial markets – a purely mathematical economicity in the absence of communicative interaction between the participants – results in a situation in which only the effects of other's actions are unambiguously visible. It is impossible for market actors to reconstruct from these visible effects typifications, presentiments, hopes, fears, etc. of the other participants, because those modes of meaning do not result in an imperative to decide and to act. In other words, they cannot be assumed to be reflected by the trades made. Market actors have no cognitive choice but to reduce the other market participants to carriers of expectations, inferring their (expectations of) expectations, for only (expectations of) expectations can be expected to leave traces in the market.

Thus, the specific form of sociation at the financial market renders itself as a peculiar mode of ascription, as a social abstraction governing the processes of meaningful interaction market participants. Ironically, this mode is none other than that of sociological (wo)man, that is, a modelling of actorhood and social meaning strictly oriented toward the category of expectation. Market participants cannot make sense of one another but as homines sociologici, i.e. as actors whose actions leave traces of their expectations in the market. Like economic value is objectivized and institutionalized through the medium of the money, in future-oriented financial markets meaning is objectivized and institutionalized as expectation. This, I contend, is the formally, and genuinely, financial type of sociation.

## 5. Summary: Expectations and the Social Study of Finance

The social study of finance is gaining ground, pinpointing the social in the markets. The present essay is intended to contribute to this endeavour. Yet it follows a different direction than the greater share of the social study of finance, which circumscribes a sociological approach through playing out the social constituency of markets against their economic effects. The alternative strategy is to depict the sociological meaning of the markets in their specifically and genuinely economic constituency; in the case of the financial markets, in mathematical price formation as means of production for financial products. The social in the markets is thus not theorized as the social construction of the economic, but as the social forms of meaning which are of a specifically financial-economic nature, and which can be subjected to a sociological characterization. To this aim, Simmel's approach of a formal sociology was used in order to demonstrate that the genuinely financial mode of meaning is a sociologization of interactions, that is, the channelling of meaning through the heuristic of expectation. This formal element corresponds to the economic mode of operation of financial markets, which is mathematical price formation. The reduction of the virtual multiplicity of social meaning to the form of expectation, being a correlate to the mode of operation of financial markets as means of productions, turns market participants into empirical sociologists who decipher expectations, and nothing but expectations, in the traces of the effects of others' actions.

## Coda: The crisis

It is doubtful whether the theorization suggested in this essay is of any immediate use in the current, financially triggered, economic crisis. Arguably it will not help advance the discussion about concrete projects of regulation. Still it may be referenced to widen the focus of that discussion.

Some advances in the political and juridical regulation of financial markets seem to aim at forcing more accountability on major financial market actors like investment banks, demanding an increase in capital stocks as counterweight to their financial ventures. Inasmuch, though, as regulation strategies follow the idea of keeping the price mechanism pure and to "price in" all risks, they attribute the crisis to market failure, effectively following a neo-liberal approach that sanctifies the market mechanism and expectations as major mode of financial sociation. This may enhance the productivity of financial markets as means of production for financial products, i.e. prices, as the present recovery at the financial markets seems to indicate. Yet it will fail in times of crisis in which the expectation mode of sociality invariably compounds the crisis.

It seems plausible that any attempt at "regulation" will have to contemplate whether it aims at the prevention of crises or at the improvement of instruments to tackle crises. However, against the background of the theorization proposed in this essay, I do not think that financial markets can be prevented from failing and causing crises, or made capable of developing mechanisms of self-repair, as long as their mode of meaning is predominantly expectations. They will be exposed to "psychological" roller-coaster rides and major breakdowns as long as their sociological infrastructure allows it, that is, as long as ascriptions of expectations dominate the production of meaning in financial markets while the possibility to negotiate those ascriptions between market participants is absent. Actually the importance of expectations, and especially of their reflexive redoubling as expectations of expectations, seems to have increased, as traders report on accelerated market dynamics resulting from the acceleration in which market participants anticipate of others' anticipations (cf. Langenohl 2008: 20-23). As mathematical pricing models increasingly include (expectations of) expectations in markets, like for instance with sentiment analysis, the increasing automatization of financial operations, feeding the category of expectations directly into trading machines, is bound to further compound the situation.

The discussion thus might turn to possibilities of limiting the reach of market participants' attributions of expectations and their absolute convertibility as heuristics in times of crisis, encouraging them to embrace alternative attributions, heuristics, and modes of sociality. What these alternatives would be ("ambiguity" might be a good candidate, yet will be hard to feed into automatic trading systems), and how they might be institutionally fostered (sociology since Max Weber has put some hope in professional ethics, which, though, is hard to maintain these days), remains to be discussed; yet a glimpse into the prehistory of the financial markets as we know them might be worthwhile.

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## Endotes

1A theory that would explain the necessity of representations of others' motivations and their normative context in the financial markets would probably have to go through Talcott Parsons, who attributed some significance to the cognitive functions of norms and expectations of others in social situations (s. Langenohl 2010).

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# Have the Media Made the Greek Crisis Worse? An Inquiry into the Credit Crisis of the State


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**Abstract**

Developments over the course of 2009 and early 2010 have demonstrated that industrialized nations are not immune to credit crises that can threaten their solvency. Dislocations in sovereign credit markets could have triggered a default of countries like Greece, Spain, Italy or Portugal if it had not been for the action by other eurozone members. While it seems obvious that high leverage (that is, the degree to which states rely on credit[2]) to fund their activities has been at the root of the problems, the Greek case suggests that fundamentals alone cannot explain the timing and the dynamic of recent developments. To understand what caused the evaporation of trust vis-à-vis Greek sovereign debt titles, one has to analyze what determined the perception of bond investors. The paper argues that the media contributed to the downward spiral in the level of confidence by investors through its intensified and overly value-laden coverage of the Greek case. To explain what fosters media bias and how it translates into bond markets dynamics the paper looks at institutional features of the media business and the functional relationship between media organizations and financial markets. The role of the media has been subject to much scholarly scrutiny, but has thus far not been in the realm of sovereign credit. This paper aims to fill this gap and, by doing so, tries to shed light on the recent credit crisis of the state.


## 1. Introduction

During the global financial crisis that began after the collapse of Lehman Brothers Holdings Inc. in September 2008 and the economic recession that followed, fiscal positions deteriorated sharply. As a result of cyclical effects and large rescue packages aimed at supporting the banking systems and at stimulating the economies, budget deficits and government debt-to-GDP ratios in most countries in Europe and in the United States soared[3], raising questions about the sustainability of public finances. The financial crisis has, thus, turned into a credit crisis of the state as several sovereigns have been hit by a loss of confidence of investors. From a purely economic perspective, this loss of trust should be a direct function of fundamental factors, in particular those concerning the financial strength of a debtor, such as actual and forecast public debt ratios, public deficit estimates, projected growth rates, and unemployment data. This being said, the case of Greece is somewhat striking and raises questions about other, non-fundamental reasons behind the perception of credit risk. By looking at Greece’s situation over time and in comparison to other countries, it appears as if fundamental indicators do not tell the whole story.

In a notification to the EU Commission on 21 October 2009, the newly-elected Greek government announced a revision of the public deficit ratio for 2008 from 5 percent to 7.7 percent of GDP. At the same time they projected that the deficit for the year 2009 would reach 12.5 instead of 3.7 percent of GDP – the number that had been forecast in spring 2009. The graph below shows that despite the massive revisions of Greece's fundamentals the reaction of bond investors in the immediate period following the announcement was rather subdued. The assessment of Greece's capacity and willingness to repay its debt did not change. The risk premium for Greek debt (measured as the yield spread asked by investors to buy a Greek bond instead of a German bond) stayed flat. This is striking because according to economic theory of market efficiency, new information should be priced in shortly after disclosure. Given the bad nature of the announcement, one would expect the curve to rise reflecting a higher perception of credit risk. However, this was not the case. This leaves room for two possible explanations. Either, the dire state of Greece's public finance was anticipated by investors all along and was already factored in. Or, the news was unexpected but did not alter the perception of risk by bond investors.

See appendix, graph 1

Investors' perception of risk associated with Greek sovereign bonds changed only with a time lag of several weeks and even then only gradually. After 12 November 2009, the risk premium for Greek bonds started to rise as investors began to view the credit risk associated with Greek debt higher than the credit risk of other eurozone countries also facing severe fiscal problems. In December and January 2010, the Greek yield spread continued its steady upward movement. The creeping loss of trust mirrored in the higher yield spread on secondary markets translated into rising funding costs for Greece slowly impairing the refinancing capacity of the sovereign. The perception of credit risk vis-à-vis Greece degraded sharply in the second quarter of 2010. Over the course of April and May 2010 risk premiums for Greek debt exploded to just below 1000 basis points despite the announcement of a rescue package for Greece by the IMF and EU member states and the successful issuance of several billions of money market paper. Only the announcement of the creation of a European Financial Stability Facility amounting to €750 billion could calm down investors fears.

The dynamic of the Greek credit crisis that manifests itself in the development of the yield spread brings up a number of questions. If the parlous state of Greece's finances and the country's weak accounting practices had been a well-known problem ever since the country joined the eurozone, why did the perception of credit risk remain so low over all these years and changed dramatically only over recent quarters?**4** Why did investors start to assess the credit risk associated with a Greek bond increasingly higher than the credit risk of other eurozone countries also facing severe fiscal problems?**5** Why did the trust in Greece's creditworthiness evaporate with a time lag of several weeks after the initial announcement in October and even then only gradually, before fading away sharply, even though no equally significant changes to the fiscal and economic fundamentals were reported afterwards? And above all, why did the risk perception evaporate so sharply after the announcements of details regarding Greece's fiscal austerity regime and the support package by EU member states and the IMF?

While a comparison of the fundamental situation may yield some explanation for the cross-country differences the dynamic over time seems somewhat more puzzling. The deterioration of Greece's funding conditions over time occurred against the background several consecutive credit rating downgrades.**6** Although no significant further changes to Greece's fundamental outlook were reported after the October announcement, all three major rating agencies changed their assessment of Greece's creditworthiness more than once between December 2009 and April 2010.**7** On 27 April 2010, Greece was downgraded to below investment-grade by Standard & Poor's, fueling speculation about the country's default. While the rating downgrades may be seen as triggers for a rise in perceived credit risk, remarks by the rating agencies suggest that the series of consecutive changes were themselves driven by developments in the market for government bonds. This leads back to the question: What drove the downward spiral in the level of confidence vis-à-vis Greece that moved the market and almost led to the country's insolvency?

As neither fundamentals nor rating changes can satisfactorily explain the exceptional dynamic of the loss of trust between October 2009 and June 2010, what other drivers can be made accountable? Jones (2010) argues that the Greek crisis was worsened by the hesitant behavior of European heads of states. This paper offers a different explanation. I argue that it was the way media reported about the events that exacerbated the evaporation of trust in the country's creditworthiness and consequently magnified the financial difficulties of Greece. To understand the potential impact of the media one has to recall the very basic principle of credit: The extension of credit in an economic sense is inseparable from the cognitive credit that a borrower enjoys. A sovereign, who issues public debt to finance expenditures by raising money on the capital market, needs investors who trust that he will be capable and willing to repay the debt at the end of maturity. If this trust is fading, investors will ask a higher risk premium making it more expensive for the sovereign to fund its activities. If trust keeps fading further, eventually investors will stop buying the bonds forcing the sovereign into default. That means if a critical mass of investors starts believing that a government's liquidity is impaired this can become a self-fulfilling prophecy.

Given the uncertainty over the capacity and willingness to repay the debt, the assessment is nothing but a personal opinion of each individual investor. Opinions of individuals, however, do not develop sui generis in a social vacuum, as Ambirajan (2000: 2144) argues, but are instead shaped by the stated and implied views of others. In financial markets, the opinion of market participants with regards to public debt as well as other asset classes is formed by the information transmitted through various news channels. Being a powerful external source of opinion, the media can be a driver of sovereign credit crisis, if its content affects the assessment of investors and consequently their investment decisions.

The political relevance of the Greek crisis is indisputable. The credit crisis that started as a financial-market phenomenon has a deep impact on the lives of Greek citizens. As a result of austerity measures implemented by the Greek government to reassure financial markets, large parts of the Greek population are suffering job losses, salary cuts, tax increases and pension reductions. At the same time, if it had not been for the action by EU members and the IMF, the market movements could have triggered a sovereign default of Greece and, as a potential consequence, also defaults of countries like Spain, Ireland or Portugal. Although the focus of this paper is on the role of the media with respect to the building up of credit crises, it also raises questions about the role of the media in the political process with regards to the fiscal policy of eurozone countries.

To understand the role of the media in credit crisis of the state one has to address two different sets of questions: First, how do the media contribute to the evaporation of trust? This turns the focus to potential media bias that may manifest itself in the intensity of media coverage, the selection of sources, and the choice of words, the limiting of the debate, omissions, or the framing of news. The second set of questions refers to the 'why'. Why is media biased? The rest of the paper is divided into four sections. Section 2 provides an overview of the related literature the analysis draws on. Section 3 sets out what fosters media bias by looking at the institutional features of media organizations and the functional relationship between the media and the financial market. The arguments provided here also help to understand the feedback loop between the media and market movements. Section 4 presents empirical evidence on media bias in the Greek credit crisis. In the last section I re-cap the main points and briefly comment on the policy implications.

## 2. Related Literature

The arguments presented in the paper draw on a broad range of literature. Important analytical aspects concerning the media are derived from existing research within various fields of social sciences, where the power of news organizations is a central issue.

The media has been a central issue of communication scientists for many years. Some studies look at the factors that shape news content. Most studies, however, have been dedicated to establishing a link between news coverage and opinion formation (for an overview see Shoemaker and Reese 1991). One major result of these process-and-effects studies is that media organizations play an important role not only with regards to "what people think" but also with regards to "what people think about" (de Vreese 2001) as the day-to-day selection and display of news by journalists focuses the public's attention and influences its perception (Craig and McCombs 2003). This links to a second finding according to which news coverage tends to be cyclical, peaking during key events but hardly visible before and after (de Vreese 2001). These findings suggest that media coverage may have exacerbated Greece's financial woes by overemphasizing the issue in their reporting that lead to an exaggerated response by investors. If media had turned its focus on other problem countries instead (for example Ireland or Spain), bond investors may have started to question the creditworthiness of these countries (more than they actually did) triggering a similar risk premium dynamic as in the Greek case.

The question of media impact has also been debated by numerous sociologists (for an overview see McQuail 1985). Most authors stress that media organizations are social institutions that exert an influence on the messages they transmit. Media, in their view, is manufacturing a version of reality that may deviate from other possible versions of reality. While some scholars see the vast scale, the anonymity, and the lack of regulation critically, others stress the importance of free expression for educational purposes and for improving democratic participation. Some work sheds light on specific roles that certain media organizations play. Whether a relationship between audience motives and media effect exists, remains a theoretical controversy. The view propagated by the media is likely to reflect the concerns of those who have most power to gain access to media. Following this theory financial news may reflect the views of financial market participants who act as a major source for financial media organizations (see section 3). The relationship between financial markets and public discourses has come under scrutiny by economic sociologists (for an overview see Langenohl 2010). According to authors like

Knorr-Cetina (2007) or Clark, Thrift and Tickel (2004), financial market dynamics are determined by public discourses created by (real-time) communication. Clark, Thrift and Tickel (2004: 291 and 301) observe a "penetration of media into finance" and argue that investors are susceptible to media influence in their decision-making process.

Political scientists have tended to neglect the role of the media. Only in recent years, researchers have turned to study the role of the media for politics (for an overview see Schudson 2002). A general assumption is that the media is an increasingly important and autonomous force in politics. The arguments refer to the patterns of media ownership and the behavior of news institutions, the social organization of networks, and the influence of cultural belief systems, assumptions, and values in news production. Apart from trying to understand and explain media content, many scholars are interested in its effect on policy processes and outcomes. Critics see the media as a crucial factor in the crisis of politics and political leadership. Authors with a somewhat more neutral stance argue that media increasingly shape but do not control politics. This view is supported by research work examining the impact of news content on foreign policy.8 The role of the media for fiscal policy has, so far, been neglected.

The relationship between financial markets, investors and the media has also been subject to research by economists. Several economists provide evidence that a causal link between media reporting and market movements does exist. Engelberg and Parsons (2009) find that the packaging and transmission by the media rather than the information being reported in the news is associated with significant financial market movements. Tetlock (2007) explores whether financial media news induces, amplify, or simply reflect investors' sentiments. He finds that media pessimism (measured as the share of negative words in a widely read news column on stock markets) predicts downward pressure in stock markets. His findings suggest that media content can serve as a proxy for investor sentiment and trading activity that is not based on true information. A more recent paper by Tetlock, Saar-Tsechansky and Macskassy (2008) examines the forecasting power of language used in financial news stories for corporate results. Their research shows that investors factor in the information embedded in words with a negative meaning. Mullainathan and Shleifer (2005) offer an explanation for the use of loaded words in media coverage. They find that media accuracy is limited when people share similar beliefs because news organizations have an incentive to slant9 the news to match the beliefs of their audience.

The review of the literature reveals that the role of the media has been subject to much academic work. Yet while a number of authors look at the relationship between the media and financial markets, so far, analysis has not been applied to sovereign credit crises. This paper aims to fill this gap and, by doing so, tries to shed light on the driving forces behind the recent sovereign debt market turmoil. Although some parts of the discussion below describe general features of media organizations, the hypothesis and the theoretical arguments presented in this paper relate to financial media only. The term "financial media" refers to media organizations such as news agencies, TV channels and print media (as well as their respective internet pages) with a special focus on broadcasting economic and financial news. It should also be noted that when talking about investors the primary focus is large, institutional investors including insurance companies, pension funds and alternative investment funds (eg hedge funds) as well as banks' fixed income departments since they constitute the bulk of bond market trading.

## 3. Theoretical Arguments

To understand the underlying factors that explain media organizations' supremacy to shape the credit perception of the broader community of institutional investors and to influence their willingness to give credit to sovereigns, one has to look at the institutional features of media organizations and their functional relationship with financial markets. Both, the institutional features and the functional relationship, determine the production of news content and set the stage for a causal link between media reporting and financial market movements.

### Institutional features of the media

Financial media organizations are characterized by four major features: freedom of press, global reach, fast diffusion, and profit-orientation. These features interact with and reinforce one another. At the same time, they determine the dissemination of financial news.

Media organizations enjoy a large degree of freedom with regards to what they report (content) and the modes of presentation. In countries with sophisticated financial markets (such as the United States and member states of the European Union), the freedom of the press and public expression are not only formally guaranteed but in most respects also actually the case. Existing content regulation mainly serves to protect minors, health issues and matters of decency (McQuail 2001). Entrepreneurial deliberations may have some constraining effects as media corporations consider credibility issues and potential legal conflicts. The organizational structure of media organizations suggest however, that commercial interests play the predominant role in the selection of newsworthy events and the presentation hereof.

Media organizations act global with regards to the content and the extent to which this content is distributed. The global reach of the financial media has been enlarged by the integration of financial markets through liberalization and even more so through the invention of new technological advances. Thanks to electronic forms of distribution like the Internet, financial information has become globally available. The global distribution of financial news serves the need of global financial markets, where sovereign bonds from most developed countries are traded internationally and therefore nearly around the clock.

Technological progress, apart from spurring the integration of world economies and financial markets, has also increased the speed of news transmission (Sassen 2005). Financial market news, today, is often real-time: news agencies, Internet news feeds from newspapers and financial TV channels provide information to investors at the trading desks the moment they are made public. The speed by which information is transmitted to financial market participants is a major selling argument by news companies like Reuters or Bloomberg. It allows them to charge a premium for the use of their service. The servicing speed of news providers is a result of both competition among media organizations and the need for speed demanded by investors (Knorr-Cetina 2007). Most financial trading nowadays takes place electronically. Relevant news is priced in in a quick fashion and on an ongoing basis as investors adapt their portfolios to new information. The speed by which market activities take place requires that relevant news is transmitted as fast as possible. Market participants who rely on a slower news provider may incur real losses on their asset portfolios.

Finally, media organizations operate as large-scale, commercial enterprises. As such, above ideological purposes, their main goal is to make profits. With rising demand for profit competition for audiences has become fiercer. The resulting market pressure determines the choice and the presentation of stories as well as the selection of sources of news. Commercial interests drive media organizations to adjust financial news content to the informational need of the investor audience (Pfetsch 2002: 15), who are looking for 'guidance for investment decisions'. To attract a large investor audience media organizations seek to solicit (well-known) financial industry experts to produce (additional) news content for them, for example by writing eye-catching opinions or commentaries or by serving as interview partners. Competition among media organizations dealing with financial news is particularly high given that financial news production is a truly global business.

Given the features discussed above, the financial media possess a unique capacity to reach financial market participants worldwide, freely and quickly. Following the commercial logic, media organizations have not only an incentive to respond to the requirements of financial market audiences but also to dramatize and present issues in a spectacular and sensationalistic way (Benett 2009: 85 and Mazzoleni and Schulz 1999: 257). To understand more thoroughly how financial media coverage may affect the perceptions that investors acquire of reality, it is necessary to take a closer look at how the media and financial markets interact.

**Media function and financial markets**

Sovereign bond markets, like any other financial market segment, cannot function efficiently without information sharing. Before financial markets developed, states negotiated the terms of a credit with investors directly. The latter usually consisted of a small group of relatively homogenous people. According to historians, investors in sovereign debt commonly received valuable goods as collateral. This created a strong interdependency between both parties. With the creation of financial markets the relationship between states as debtors and investors as creditors has become impersonal. States no longer negotiate directly with potential investors. Instead, the terms of government debt are set on the bond market where investors set the price by buying and selling public bonds.

Against this background, bond investors rely on publicly available information and external assessments of the quality of a sovereign's credit to make a decision whether to extend credit (purchase a bond) or not and to set the price according to the inherent risk. The need for information transparency goes beyond the daily reporting of market activities and related price movements (Knorr-Cetina 2007). Information (in the form of news content) that goes beyond market activities and related price movements consists of third party opinions transmitted by the media.10 Opinions are provided by financial market experts who themselves are either deeply involved in bond market trading (like fund managers and financial analysts from banks, insurance companies, and investment funds) or benefit by some other means from actively engaging in financial market opinion formation (for example credit ratings companies but also people from academia).

Although publications of most financial market experts are in most cases also disseminated directly, media organizations serve as transmitter of this externally produced information. The importance of financial media organizations for financial markets lies in its function to screen and collect news from a wide range of sources.11 They filter and select external information deemed relevant for specific market segments. Given the vast amount of information available, the financial media have become an important service provider for investors, who would not be able to collect and filter the information as fast and efficiently as news providers do. In this respect, media communication serves an important function for the efficient functioning of financial markets. Vice versa, financial markets have become essential for media organizations, too. Financial markets provide media organizations with a cheap and constant news flow. At the same time, financial market investors provide a large and sound audience group with a strong demand for information. Media organizations are drawn into a symbiotic relationship with the sources of information by economic necessity and reciprocity of interest (Herman and Chomsky 2002 and Sigal 1987) making media organizations and financial markets "complementary institutions" (Langenohl and Schmidt-Beck 2008: 4345).

By distributing existing external information media organizations react to what has happened. In that sense their role for financial markets is rather indirect. However, media organizations are not simply a messenger. Instead, one can find a more direct role of news organizations for financial markets. Driven by competitive pressures, media companies assume an active part through their selection of details and by creating news themselves for example by publishing special issues based on internal economic analysis or by asking industry experts to give an interview or write a comment.

The importance of experts' opinions in the context of financial markets can be explained by the fact that their statements benefit both investors and media organizations. Experts are cast as representatives of special knowledge (Langenohl and Schmidt-Beck 2008). By looking behind the figures and providing interpretations experts give investors insights into particular market perceptions. This is why comments by financial experts receive a lot of attention by market participants. For media organizations, personalities from the financial market industry embody professional and eloquent figureheads, either as authors or as interview partners, who attract audiences by providing special reports that competitors do not have. In-depth interviews, in which the story is the interview (Sigal 1987: 13), have become a current feature of news-making also in the financial press. In contrast to periodical reports by national and international institutions, expert opinions in addition to other more frequent publications12 provide news on an ongoing basis. Against this background financial media organizations, being driven by commercial interests, have strong incentives to give market experts a platform to make their views known to financial market participants.13

The reliance on market experts, however, can jeopardize the objectiveness of media reporting. For example, financial experts are representatives of the financial institutions they work for. As such, they have an interest not only to optimize their institution's image but also to act in favor of their employer's interests (Langenohl and Schmidt-Beck 2008). It is unlikely, that fund managers publicly propagate a view that differs markedly from their investment positioning. If other market participants take up their perspective that has been disseminated through the media this may in turn yield higher returns for them. The prediction of a default of a country being voiced by prominent experts and diffused through the media may trigger a sell-off of the country's bonds making it impossible for the country to refinance itself. In such a scenario, news, as Sigal (1987: 15) puts it, is not what happens, but what someone says has happened or will happen. The reaction to statements by Josef Ackerman illustrates the effects the publication of an opinion by a prominent market expert may have. In a special interview broadcasted on television on 13 May 2010, the CEO of Deutsche Bank said that it was unlikely that Greece would repay its debt adding that this could trigger a "meltdown" on sovereign bond markets. The following day, the yield spread of Greece 10-year bonds soared by 40 basis points and continued rising thereafter, partly destroying the positive effect of the €750 billion rescue package announcement. By selecting certain financial experts as a source of content for their daily coverage, media organizations indirectly determine the information that is being disseminated. Asking the economist Nouriel Roubini ('Mr Doom') for a comment, one can be sure to receive a rather dark picture of a particular issue.

Apart from the selection of content, the power of media organizations to shape the opinion of market participants arises from the fact that they choose between numerous formats to present a topic and to increase its salience in the news (Craig and McCombs 2003). For example, newspapers and magazines can print a lead story, display an issue as a special report, dedicate lengthy articles on it or use large headlines. TV channels can choose the opening story on the newscast or the length of time devoted to a story. These cues repeated day after day effectively communicate the importance of a topic. Headlining and the use of specific language in their reporting enables them to mobilize interest and outrage.

From what has been said so far, it should have become clear that the transmission of information through the media is crucial for the functioning of financial markets. It reduces complexity and acts as a frame that guides the decision-making process of investors (Arnoldi 2006). As such, media coverage both reactive and proactive can be regarded as setting the agenda: By selecting information deemed as relevant and by presenting it in a specific way, media coverage can set the agenda for bond market activities. Market activities, in turn, may set the policy-agenda by forcing governments to react to market movements, as recent events suggest. Having outlined the institutional and functional forces underlying media reporting, the next section looks at the actual content of media reporting as the Greek credit crisis unfolded.

## 4. Media operation during the Greek credit crisis

Studies by researchers like Engelberg and Parsons (2009), Tetlock (2007), or Telock, Saar-Tsechansky and Macskassy (2008) have shown that a causal link between media reporting and financial market movements does exist. According to the work of these scholars, determinants can be both quantitative and qualitative. The quantitative approach assumes that the more frequent a given stimulus is, the more potent its impact will be. The qualitative approach is based on the assumption that the use of words that are loaded with affective rather than informative value or the use of certain "labels" (Shoemaker and Reese 1991: 33) may strongly shape peoples' thoughts. It also contains the idea that the singling out and highlighting of certain elements, referred to as 'slanting' by Mullainathan and Shleifer (2005), can manipulate people's perception. Based on the existing research two hypotheses will be investigated:

*H1: The visibility of Greece's financial situation increased between October 2009 and July 2010 as reporting became more intense. The intensity of media reporting cannot be fully explained by the occurrence of major news events.***14**

*H2: The news coverage of the Greek case was characterized by an intense use of value – laden expressions and labels in their headlines that conveyed a negative sentiment.*

Obviously, searching for content patterns, one cannot look at every message distributed on every medium. Using the database LexisNexis for the empirical analysis, the focus is on messages in news agencies, newspapers, magazines and other written media, including web-based publications. The findings presented below therefore relate to these types of media only. For the quantitative analysis, the study focuses on news content in the German, the British, and the American press. The financial markets of these countries represent an important part of the global network of financial markets and are relevant with regards to financial market activities elsewhere. For the qualitative analysis, the focus was narrowed down to a selection of German newspapers, professional magazines and web-based news publications. The German market is of particular interest because German investors hold large parts of Greek debt. As such, the perception of German investors is highly relevant for the Greek bond market.

**Quantitative Findings**

Despite the fact that the dire state of Greece's fiscal situation was no secret, Greece did not face much scrutiny by media organizations up until autumn 2009. Between January 2009 and August 2009 the German, UK and US press produced an average number of 99 reports per month.15 This compares to a monthly average of 71 reports in 2008. Although one can observe a slight increase, the visibility of Greece's financial situation measured as the average number of monthly reports was still relatively low compared to the news coverage since autumn 2009. Between September 2009 and July 2010 media coverage increased significantly. The average number of monthly press reports dealing with public finance and Greece soared to 1.502 that is, fifteen times as high as in the previous time period. Even if one leaves out reports by news agencies, with 909 the number is still much higher.

The comparison of media coverage in the German, UK and US press reveals some interesting cross-national differences. In the sample period German media organizations (excluding news agencies) devoted most attention to the Greek crisis. Their coverage exceeded significantly the coverage by news organizations in the United Kingdom and the United States. Given the importance of German investors for the Greek bond market, this finding supports the notion that German media organizations responded to the demand of the investor base and provided them with increased information concerning Greece.

A closer look at the development of media reporting during the months of the crisis reveals that the dynamic of media reporting (measured as the sum of total press reports by German, UK und US press using 'Greece' and 'public finance' as key words) matches strongly with the dynamic of the loss in trust in Greece's creditworthiness measured by the credit spreads (see graph 3). The faster rise in the risk premium for Greek bonds that started in December 2009 coincided with a much higher reporting frequency. The same applies to the development in the weeks and months that followed this initial ascent of the Greek yield spread. The surge in the risk premium during April and May 2010 was accompanied by a strong jump in news coverage. During the peak period when the risk premium climbed to its highest level (calendar week 18, 19 and 20) the number of reports stood between 1000 and 1400 per calendar week.

See appendix, graph 2

Of course, the frequency of reports by itself provides little proof for an overly intense reporting by media organizations. Instead the number has to be put into perspective to the key events that took place during the respective time period. Graph 4 shows that the number of events increased over time. Against this background, the higher number of reports can be seen as a reaction to the increased frequency of news events. However, the number of events can only partly explain the increased scrutiny by media organizations during the observation period. A comparison of the number of reports and the number of events in the weeks that preceded the steep rise of the risk premium (between calendar week 6 and calendar week 13) suggests that the reporting during these weeks was much more intense than seems justified by the number of salient events. Although the high frequency of reports mentioning Greece's financial situation did not immediately accelerate the loss of trust by bond investors, it is likely that it attracted a growing audience and, thus, may have set the stage for the rapid loss of trust in Greek bonds that followed by gradually impairing the perception of market participants. The revision of the Greek budget deficit in October 2009, in contrast, was not accompanied by increased media scrutiny and investors stayed remarkably calm.

While the number of key events can be regarded as given, media organizations, driven by incentives described above, choose the intensity of their coverage. As indicated, media organizations can create additional news by publishing written comments by and interviews with financial experts or by making headlines with supplementary analysis. The higher ratio of reports to key events between calendar week 6 and calendar week 13 suggests that the editorial approach changed over time. As uncertainty about Greece gained ground on financial markets and the need for information rose, media organizations started producing extra news, sometimes with a considerable time lag to or even without any particular reference event.

See appendix, graph 3

The analysis of media reporting about the Greek credit crisis reveals that in the first phase of the Greek crisis (last quarter 2009) news reports followed rather than preceded events. At first sight, this supports the notion from studies which show that media attention to certain events or issues is cyclical, peaking during key events but hardly visible before and after (de Vreese 2001). In this sense, the media did not act as an agenda-setter but as an agenda-sender. However, this relationship between events and media reports became somewhat detached during the first half of 2010, as media attention was higher than the number of events would suggest. Against the background of the functional interaction between media as news provider and financial markets one could argue that the media reporting proved rather pro-cyclical in that it reinforced market developments through the feedback loop of its coverage.

**Qualitative Findings**

Report intensity is one possible driver for the changed perception of bond investors and resulting market movements, news content is another. Media organizations are able to shape news content through their selection of information and specific highlights provided in their reports and through their presentation in terms of language and placement. The selection depends on the editorial approach and is reflected in the use of different formats. Media organizations assuming a reactive role may choose to present predominantly official information (for example announcements by public authorities or ratings companies) in factual articles. Or, they may provide additional information in the form of special issues, extra analysis or expert opinions either in written form or provided in an interview context, thus, assuming a more proactive role by artificially increasing the range of available information. The use of value-laden words, expressions, or labels can be regarded as another characteristic of the proactive approach.

The analysis of the headlines of a selection of 450 press reports by German (web-based) newspapers and magazines indicates that starting in December 2009 media organizations followed an increasingly proactive approach.16 As the focus of financial market participants turned to Greece, media organizations reacted to the increased demand for information with the provision of additional news. The number of written opinions and interviews between February 2010 and May 2010 rose not only in absolute terms but also as a share of all the press reports in the sample. Media coverage, thus, increasingly published personal views held by financial experts and market participants who were asked to provide their opinion.

The turn to a more proactive approach becomes evident not only in the choice of additional formats but also in the language used to present the news. In December, the term "Greek crisis" appeared as a leading label in media reports. It was introduced in headlines in different formats such as articles, special features and analysis dealing with Greece's fiscal situation. The term "crisis" defines an abrupt and unexpected situation that creates uncertainty, threatens important goals and calls for change. Although the revision of the Greek budget and debt figures in October 2009 did meet these criteria, media reports not only in Germany but also in the United Kingdom and the United States started using the label "Greek crisis" after the rating downgrade by the rating company Fitch on 8 December 2009. In the months that followed, further labels emerged, among them "Greek drama", "Greek tragedy" and to a lesser extent also "Greek virus". The connotation of these terms is clearly negative or even alarming. By using these labels in headlines and titles news reports purported a notion of doom irrespective of the actual content of the article they referred to.

A closer look at the wording in headlines and introduction texts provides more evidence that media organizations followed a rather proactive approach. Against the operative convention that objective media reporting should guarantee no explicit bias and a minimum of interpretation and values, headlines and introduction texts of press reports in the analyzed sample contained a large amount of value-laden vocabulary or expressions. In nearly half of the press reports, titles were either overly negative or filled with sarcasm and cynicism. Titles like "Time bomb for the euro" (Der Spiegel, 7 December 2009), "Shockwave from Athens" (Die Welt, 16 January 2010), "The next tsunami" (manager magazine, 1 February 2010), "Prayers on the deathbed" (Der Spiegel, 15 March 2010), or "Looming default. Economists give up on Greece" (Spiegel Online, 28 April 2010) are just a few examples for the use of sensational language in press reports during the observation period. The wording used by the media clearly created a psychology of looming collapse. Even if investors did not believe in a Greek default at first, they were much more likely to do so after hearing or reading the news on Greece.

With headlines like "Carry calculators to Athens" (Börsen-Zeitung, 9 December 2009) and "Athens' creative accountants" (Die Welt, 27 February 2010), media reports slanted the news by using images with a clearly discrediting meaning. Press reports by influential media organizations covering the political responses by EU member states were also characterized by sarcasm as titles like "EU sets up for fight show against speculators" (Spiegel Online, 10 March 2010), "Wavering until the system crashes" (Spiegel Online, 29 April 2010), "Greece under total control" (Die Welt, 5 May 2010) reveal. The examples give an idea of the public discourse with regards to the Greek case which was led by German media organizations. Although only tentative, the findings indicate that media reporting was characterized by the use of value-laden words that may have accentuated negative sentiments and the uncertainty felt by market investors. Taken together, the quantitative and qualitative results provide evidence that media coverage contributed to the dynamic of the Greek credit crisis by magnifying investors' risk perception.

## 5. Conclusion

This paper argues that the media worsened the loss of trust in the Greek state by accentuating the looming risk perception of market participants. To be sure, understanding the impact of the media in the Greek credit crisis is not an easy task and leaves room for controversial discussions. The contribution of this paper is that it provides an analytical framework to think about the role of the media in the context of financial markets and to analyze media output against this background.17 The analytical framework encompasses three different levels of arguments: the institutional features of media organizations, the functional relationship between media organizations and financial markets, and the way news content is being presented. From what has been said, it should have become clear that it is not the media by itself but rather the interaction and the mutual reinforcement of institutional and functional features and the tools of the media that are critical with a view to financial market developments.

What does this imply for policy makers? The prevalence of the media, as Strobel (2000) notes, contracts the policy-making process, giving officials less time to respond. This is particularly true with regards to financial markets where new information is processed and acted upon very fast creating a dynamic setting for policy action. Although this does not mean that the media determines policy outcomes it can build up considerable pressure on policy makers. When it comes to activities on sovereign debt markets, this pressure is especially strong, since the funding of the state and, thus, the room for maneuver of policy makers is directly affected.

There is little disagreement that freedom of press is a necessary precondition to provide a common space for communication in which ideas can be exchanged and public opinion can develop. The freedom of press is particularly important in the context of financial markets because information sharing is a prerequisite for an orderly functioning of the pricing mechanism that takes place via the market. Even if press freedom is not sufficient to create a public accountability, regulation is no solution. Instead, policy makers need to be aware of the complex relationship between financial markets, financial news coverage and the potential impact on their own fiscal situation. Otherwise, they might have to take decisions which are forced upon them by the market. Although, in the case of Greece, one may argue that in the long run this may bring about some positive turnaround, the resulting legitimacy deficit is not desirable.

See appendix, table 1

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### Endnotes

1 Paper prepared for the SGIR 7th Pan-European International Relations Conference: September 9-11, 2010. For comments please contact sonja.juko@gmx.net .

2 The meaning of 'credit', in this context, refers to the legal contract where one party receives financial resources from another party and promises to repay him in the future along with interest, thus 'credit' in a purely financial or economic sense.

3When measured as a ratio to gross domestic product, part of this effect is automatic. This is because economic crises affect both the numerator (a government's fiscal deficit) and the denominator (a country's gross domestic product).

4In 1999, the Economist wrote that it was clear that Greek statisticians had learned from its Spanish and Italian colleagues how to fudge accounts to the satisfaction of bureaucrats in Brussels in order to join the monetary union [Economists, 23-01-1999]. See also Jones (2010): 26.

5The countries illustrated here rank lowest in the eurozone with regards to their fiscal and economic performance. For an overview of major fiscal and economic indicators see Appendix 2.

6In the course of the past twenty years, credit ratings have become a key component of publicly traded securities and thus an integral part of today's financial markets. Based on an analysis of the macroeconomic fundamentals of a country, sovereign credit ratings provide an external opinion of the capacity and willingness of governments and other debtors to repay their debt in full and in time. For a detailed discussion of sovereign credit ratings see Bhatia (2002).

7For a chronicle of the rating events see Appendix 1.

8Strobel (2000) investigates a phenomenon called "CNN Effect" according to which the TV News and the print media are pivotal in causing the government to pursue certain foreign policies. He comes to the conclusion that the effect of CNN news coverage on foreign policy is clearly "exaggerated" (Strobel 2000: 172). Yet he states that the media, in particular the prevalence of real-time media, does have an impact for political action.

9'Slanting' describes the process of selecting details that are favorable or unfavorable to the subject being described (Hayakawa 1990). See Mullainathan and Shleifer (2005) for an illustration of slanting financial news.

10Following Habermas (1989), financial media reporting involves to a large extent ideologies and viewpoints, turning media organizations into leaders and dealers of opinions.

11Apart from market experts, governmental institutions, national and international organizations also serve as a news source.

12For example, reports, reviews, and outlooks by credit rating companies as well as credit market analysis by financial institutions.

13Hermann and Chomsky (2002) argue that using experts serves media organizations threefold: First, they provide a steady flow of news. Second, it is cost-efficient. And third, it helps to protect media coverage from criticism of bias.

14The study distinguishes five types of key news events: Rating events, Greek bond emissions, official announcements by the Greek government with regards to economic or fiscal issues, official announcements by international organizations and EU institutions and other relevant news (see chronicle in Appendix 1).

15This is the result of a news search using a combination of "Greece" and "Public Finance" as key words.

16The sample of press reports is the result of a news search using a combination of "Greece", "Public Finance" and "Economy" as key words. The selection of news papers and magazines encompasses Börsen-Zeitung, Die Welt, Der Spiegel, Spiegel-Online, Focus Magazin, Focus Money, Manager Magazin, Capital, Finance, Platow and Euro.

17The explanatory framework developed in the paper is not solely applicable to the credit crises of the state but virtually to any financial market dynamic. The paper is, thus, a contribution to a more general discussion about the relationship between financial markets, the media and policy making.

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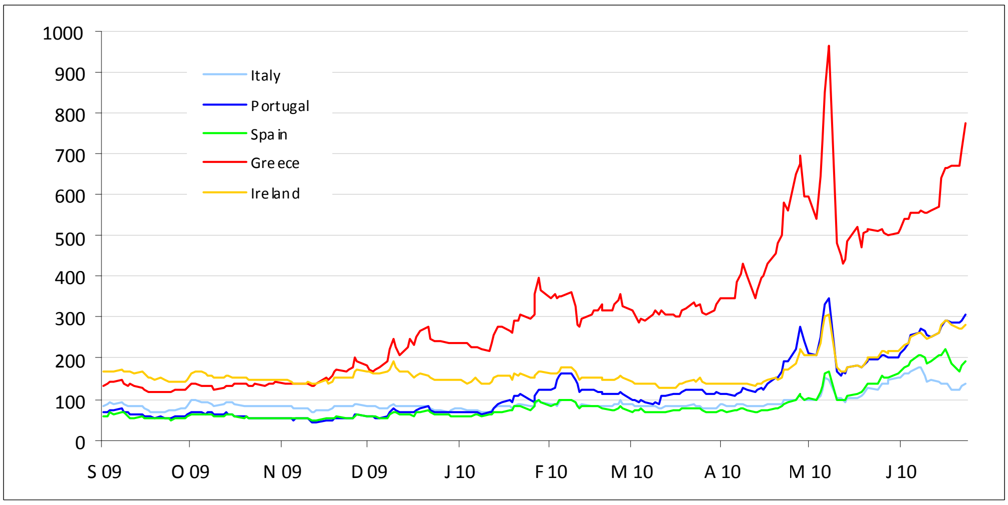
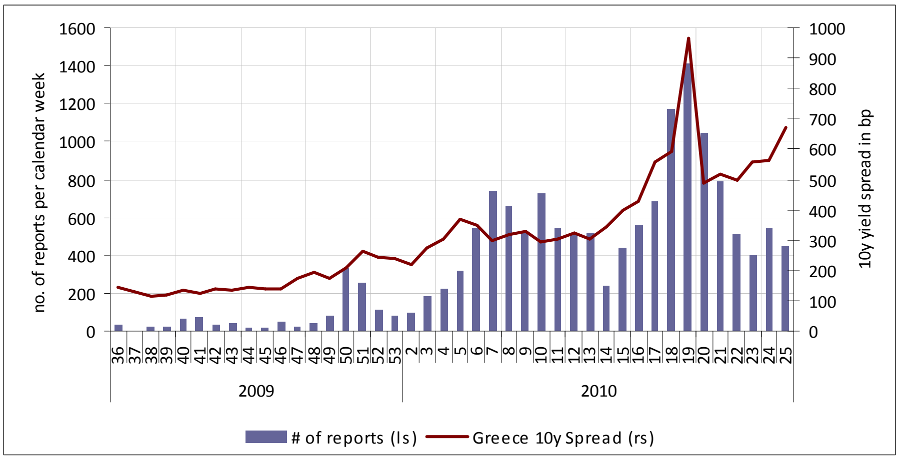
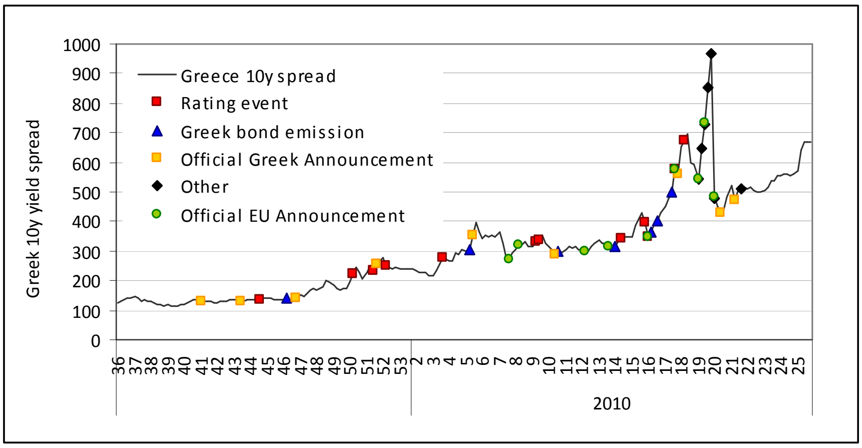
**Appendix**




Graph 1: Yield spread* of selected European countries vis-à-vis Germany since September 2009. Source: Bloomberg. *Differences of 10-year bond yields in basis (bp) taking German bonds as a benchmark




Graph 2: Greek credit spreads and media reporting. Source: Nexis Lexis




Graph 3: Greek credit spread and news events. Source: Bloomberg and various newspapers.

**Table 1**: Chronicle of key news events between October 2009 and May 2010

| Date | Event | Event details |
|---|---|---|
| 05.10.2009 | Official Greek Announcement | Greek socialists win election |
| 21.10.2009 | Official Greek Announcement | New Greek government revises budgetary and fiscal statistics |
| 29.10.2009 | Rating Event | Moody's warned Greek and Portuguese goverments of possible future downgrades of their sovereign debt |
| 10.11.2009 | Greek bond emission | Greece issues 15-year bond amounting to 7 bn Euro at 5,3% |
| 13.11.2009 | Official Greek Announcement | Greece announced that recession continued in Q3 |
| 08.11.2009 | Rating Event | Fitch downgrades Greece to BBB+ |
| 16.12.2009 | Rating Event | S&P downgrades Greece to BBB+ |
| 17.12.2009 | Official Greek Announcement | Greece announces austerity measures |
| 22.12.2009 | Rating Event | Moody's downgrades Greece to A2 |
| 14.01.2010 | Rating Event | S&P downgrades Greece to A" |
| 26.01.2010 | Greek bond emission | Greece issues 5-year bond amounting to 8bn Euros at 6,1 % |
| 27.01.2010 | Official Greek Announcement | Greece disclaims that China will invest in Greek bonds |
| 11.02.2010 | Official EU Announcement | EU leaders declare to be ready for coordinated action to secure financial stability in the euroarea |
| 16.02.2010 | Official EU Announcement | Ecofin urges Greece to reduce public deficit |
| 23.02.2010 | Rating Event | Fitch downgrades Greek banks; the rating company argues that austerity measure will slow down economy, weaking credit quality |
| 24.02.2010 | Rating Event | S§P puts Greek outlook on negative |
| 03.03.2010 | Official Greek Announcement | Greece presents austerity plan |
| 04.03.2010 | Greek bond emission | Greece issues 10-year bond amounting to 5bn Euros; investors demand is strong |
| 16.03.2010 | Official EU Announcement | Ecofin audits implementation of austerity measures; draw positive conclusion |
| 25.03.2010 | Official EU Announcement | EU leaders announce coordinated action to safeguard financial stability in the euroarea declaring that rescue package is "ultima ratio" |
| 29.03.2010 | Greek bond emission | Greece issues 12-year bond amounting to 390 Mio at 5,9 |
| 31.03.2010 | Rating Event | Moody's downgrades Greek banks from A1 to A2 |
| 09.04.2010 | Rating Event | Fitch downgrades Greece from BBB toBBB- |
| 12.04.2010 | Official EU Announcement and Rating Event | EU and IMF announce details of rescue package for Greece; at the same time Fitch downgrades Greek banks |
| 13.04.2010 | Greek bond emission | Greece issues money market paper with 6 and 12 month maturity amounting to 780 mio Euro each (higher than envisaged) |
| 15.04.2010 | Greek bond emission | Greece increases money market issuance by 180 mio Euro |
| 21.04.2010 | Greek bond emission | Greece issues money market paper with 2 month maturity amounting to1,92 bn Euro ant 3,65% |
| 22.04.2010 | Official EU Announcement and Rating Event | Moody's downgrades Greece; Eurostat revises Greek deficit for 2009 from 12,7% to 13,6% |
| 23.04.2010 | Official Greek Announcement | Greece applies for support package; support covers funding needs for 2010 and 1/3 of 2011 |
| 27.04.2010 | Rating Event | S§P downgrades Greece to BB+ (non-investmentgrade) |
| 03.05.2010 | Official EU Announcement and Other | IMF, ECB, EU commission and Greece agree on austerity grogram; The federal cabinet of Germany approves German assistance |
| 04.05.2010 | Other | German banks agree to buy Greek government bonds |
| 05.05.2010 | Official EU Announcement and Other | Three people get killed during protests in Athens against the austerity regime; EU commission reports that deficits have reached all time highs |
| 06.05.2010 | Other | General strike in Greece |
| 07.05.2010 | Other | German parliament and the upper house approve German assistance law |
| 10.05.2010 | Official EU Announcement and Other | EU and IMF announce 750 bn Euro rescue package |
| 12.05.2010 | Official Greek Announcement | Greece receives first tranche of IMF loans (5.5 bn Euro) |
| 18.05.2010 | Official Greek Announcement | Greece receives first tranche of EU support (14.5 bn Euro) |
| 20.05.2010 | Other | Protests in Greece |

# Transfer Union or Common Bond? On the Moral Economy of the Eurozone

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For the past year the eurozone has been facing a crisis that some observers predict will not pass until the basic structure of the monetary union is transformed. One of its member-states could be ejected for 'breaking the rules,' while others face a strict insolvency regime and a set of fiscal controls that further compromise their sovereignty. If this is 'Phase 2' of a global financial crisis, it has a distinctive European flavour as arguments about who (or what) is to blame go to the heart of what the euro was all about in the first place. In this note we want to highlight one aspect of the debate, namely, the claim that the eurozone has become a transfer union. Framing the eurozone in terms of a notion 'moral economy' drawn from Bataille, we argue that this claim is misjudged.

'Transfer union' has become part of the euro lexicon only recently.[1] Examples of its use include Jörg Krämer, chief economist at Commerzbank, claimed that the eurozone 'has moved away from a monetary union and towards a transfer union' (*New York Times*, May 11 2010); and Columbia's Economics Professor, Jagdish Bhagwati, who in an interview with *Frankfurter Allgemeine Zeitung* published on 20 June 2010, said: 'It is possible that the monetary union turns into a transfer union,' he said, 'if the weak countries have problems and everyone gets worried about the Euro, the question rapidly becomes political. It is in the end not good for Europe if countries such as Greece default. There will therefore be a transfer of money in such situations – to a certain extend they will be forced to do so'. The notion of a transfer union is generally used in such instances as a proxy for aid programme, and invoked to describe redistributive functions that – so it is argued by critics – were never intended for the euro. As Ralph Atkins writes in the Financial Times, 'the ECB's critics believe buying government bonds even on a small scale blurs monetary and fiscal policies, favours the fiscally irresponsible and risks turning the eurozone into a "transfer union" in which richer nations support poorer rivals – all of which are against the terms on which Germans thought they had joined the euro in 1999' (7 July 2010).

The idea of a transfer union is expressed, for the most part, in negative terms. In this article, we offer an alternative view and propose a re-framing of the idea of a transfer union in terms of arguments about moral economy – particularly by Mauss and Bataille[2] – that suggest that the notion of a transfer union is not as problematic as it presently appears. Indeed, elements of such a union have arguably been a crucial feature of the eurozone from its very inception. The article is divided into three main sections. The first part will lay down the basic theoretical arguments about the concept of a transfer union, using the work of Bataille as a starting point. In the second part, this concept will be further developed with regard to current (and, we suggest, misconceived) arguments about winners and losers within the eurozone. The last part of the paper will consider one possible development of the eurozone which addresses some of these issues, namely a common eurobond.

## General Economy

Bataille uses the notion of gift exchange to develop a highly distinctive interpretation of 'political economy'. His main contention is that gift exchange conforms to a model of economic life, which he calls *general economy*, which contrasts with our own (neoclassical) model of *restricted economy*. Whereas restricted economy starts with the problem of scarcity and focuses on 'particular operations with limited ends' (1949: 22), general economy starts with the problem of *excess*. For Bataille, gift exchange is never a matter for purely 'economic' calculations, but rather 'political' ones: 'More often than not it is the solemn giving of considerable riches, offered by a chief to his rival for the purpose of humiliating, challenging and obligating him.[3] The recipient has to erase the humiliation and take up the challenge; he must satisfy the obligation that was contracted by accepting' (ibid., 67). Moreover, 'a good many of our behaviours are reducible to the laws of potlatch; they have the same significance as it does' (69). A similar argument is put forward by Mauss in *The Gift*, where he describes the potlatch among the Indians of the American northwest as a contract whose collective nature is crucial to its position within a more general system of 'total services' in society. Material and moral life, and exchange, function here 'in a form that is both disinterested and obligatory' – a sense of obligation which, Mauss says, is 'expressed in a mythical and imaginary way or, one might say, symbolic and collective' (1950: 42).

Bataille does not simply explore gift exchange and sacrifice among the Aztecs, but somewhat surprisingly, addresses the Marshall Plan in the book's final chapter. Formally known the European Recovery Programme (ERP), the Plan (named after George Marshall, the US Secretary of State) was put into operation in 1947-51 to support the postwar reconstruction of the European economy – some US$13 billion worth of economic and technical assistance (as against a US GDP of $258 billion in 1948) were given via the Economic Cooperation Agency (ECA) to those European countries joining the Organization for European Economic Co-operation (OECD). Transfers under the Plan operated as loans: American suppliers were paid in US dollars credited against ERP funds. They were explcitly *not* gifts: the European recipients had to repay the monies in local currency, which was then deposited by the government in a counterpart fund. This money, in turn, could be used by the ERP countries for further investment projects. The Marshall Plan was significant for the development of the international monetary system. It was instrumental in the establishment of the European Payments Union (EPU) in 1950, lifting the majority of capital controls in Europe while encouraging a system of fixed exchange rates and a degree of trade liberalization. Moreover, drawing rights connected to the EPU were supported by ECA funds, and facilitated the process of establishing full convertibility under Bretton Woods.

Describing it as 'an investment in the worlds interest,' Bataille saw the Plan as an answer to general economy's fundamental problem: excess. He charaterized its payments as *condemned wealth* (182) that had been generated by an economy 'so developed that the needs of growth are having a hard time absorbing its excess resources' (179). In making this argument, Bataille drew on François Perroux's 1948 text, *Le Plan Marshall ou l'Europe nécessaire au monde*. Perroux, a Professor at the Collège de France, drew a distinction between 'classical' and 'general' economy which maps onto Bataille's basic framework. According to Perroux, in 'classical' economics we make calculations according to isolated interests, as against a general interest to which the 'national point of view' was 'irrelevant' (cited in Bataille, 1949: 189). How, though, might such discussions about the postwar reconstruction of the European economy be relevant to the present-day plight of the eurozone? The differences are, of course, significant: the Marshall Plan consisted of funds from outside Europe, and for all Perroux's talk of the general interest, the motivation to resist Soviet interests in Europe was an important part of the rational behind the Plan as it was eventually put into operation. Nevertheless, Bataille's framework can be used to place the idea of a 'transfer union' in rather more positive light.

## Winners and Losers

The description of the eurozone as a transfer union has been provoked and sustained by the 'bailout' of Greece: the 'stabilization facility,' worth some €750bn., that was set up in May, drawing on funds from the IMF (up to €250bn.) contributions from euro zone member states (€440bn.) and the EC (€60bn.). A bond supporting this facility has been established, backed by member-state guarantees, and was rated AAA by Standard & Poor's and Fitch in mid-September. One significant function of the eurozone stabilization facility is that it merely renders *visible* economic asymmetries that have existed all along. As the existence of this stabilization fund suggests, the current crisis in the eurozone is being inextricably linked to an underlying problem of imbalances among member states. But the imbalances that necessitate what looks like 'aid' from some member-states to others did not emerge suddenly, their basic contours have been present in the eurozone ever since its inception. They are also part of longstanding debates comparing the eurozone to Mundell's (1961) model of an optimum currency area (OCA). Although Mundell was largely positive about monetary union in Europe – and even about a world currency (1968) – OCA theory has been invoked mainly by the euro's critics.

Now, more than a decade since the euro's inception, discussions of OCA theory have given way to arguments about transfer that focus directly on perceived losses and gains between surplus and deficit countries incurred as a direct result of their membership of the eurozone. According to Sinn, for example, Germany has not only been a net contributor to the EU budgets but has lost out from its inclusion in the eurozone. His argument focuses on finance, and suggests that convergence in interest rates provoked an 'investment' boom elsewhere in the euro zone (e.g. Spain and Greece) which not only starved the German economy of investment but fed rampant consumerism and booming house prices elsewhere. According to this view, German net investment was very low between 1995 and 2008, with the consequence that Germany had the second lowest growth rate (behind Italy) in the eurozone between 1995 and 2009.

Sinn's account has not gone unchallenged. Wolf, author of *Fixing Global Finance* (2010a) and one of the FT's most influential columnists, argues that German investment was kept low by a combination of weak domestic demand, structural rigidities and globalisation – *not* its eurozone membership (2010b). If the outflow of savings from Germany to countries on the periphery of the eurozone fed consumption and growing current account deficits, these can hardly be described as 'gains' but rather present very short-term 'booms' whose damaging consequences are now being experienced by citizens in those very same countries. The contrary argument, that Germany has in fact *gained* from its membership of the eurozone, rests on the fact that a relatively high percentage of its exports – two-fifths – go to other eurozone countries. Moreover, its surplus position has been helped by the euro's stable value, whereas an independent German currency that appreciated in value would have reduced its competitiveness.

As this debate suggests, the euro project has always been driven by a complex interplay of individual and general interests. According to Dumas, for example, those countries in the eurozone that are now in account surplus have been benefitting directly from the deficits that have been accumulating elsewhere: 'In effect, these economies have been taking a free ride, generating income and building up assets by selling into the domestic demand of the deficit economies, fuelled by borrowing that should not have taken place' (2010: 160). Dumas applies this analysis to Italy (where real consumption rose by 3.5% between 2001-9, as against 0.5% in Germany) as well as Greece: 'without those Italians spending away,' he claims, 'German output, jobs, incomes and consumption would have been even worse. The folly of the miser indeed' (ibid., 169-70).

Significantly, any 'Keynesian' solution to the crisis in the eurozone – using expenditute to stimulate aggregate demand – tends to be viewed as contrary to the interest of those states deemed to be strongest because it would mean surplus countries saving less and spending more. Saving may seem 'virtuous' when considered in isolation – as may a balanced budget, which Dumas regards as the key ideology underpinning Germany's economic policy (ibid.,168) – but under the circumstances that prevail in the eurozone, where there are significant current account imbalances between core and peripheral states, there is a classic paradox of thrift:

*In the Keynesian scheme of things, what appears to suit a firm, for example cutting wages, may seem damaging for all (including the firm) if applied generally throughout the economy, if aggregate incomes falls and with it demand and profits. Similarly, what seems prudent for an individual – or even an inidvidual country – may not prove prident if too widely practised. In the modern world economy, an apparently prudent saver may ultimately prove to be imprudent, even assessed from the most narrow, selfish standpoint. And in the process of saving too much, the globalized economy and system have been strained, with reduced willingness to sustain globalized markets, especially free trade, on which savers, especially saving countries, depend. (ibid.,11-12)*

According to Dumas, the eurozone faces precisely this dilemma between the interests of individual member-states and what is in the collective interest, and this relates to the problem of maintaining the integrity of the system as a whole. This mirrors exactly Bataille's perspective of general versus restricted economy. Indeed, Dumas suggests that the euro will fail if 'the countries that are competitive – in Europe, Germany and its immediate surrounds – *refuse to spend their income*' (ibid., 155, italics added).**4** The problem, in other words, is one of *expenditure*.**5** Following, Bataille, what seem like rational economic strategies when viewed in isolation – 'austerity,' or the denial of expenditure – may turn out to be anything but, even when viewed 'from the most narrow, selfish standpoint'. Viewed with the collective interest in mind, such behaviour may cause long-lasting damage.

## The Eurobond

The stabilization facility – which Bataille might characterise as condemned wealth – is a temporary compromise. Driven by a collective interest in avoiding the fall-out from any Greek default as the crisis was in full swing earlier this year, the facility merely delays the crucial decision about how – not whether – the eurozone should be reconstituted. One significant aspect of this decision should be to address the financial architecture of the Euro. This has been flawed from the outset. When the Maastrich Treaty was signed in 1992, the eurozone got a central bank but no central treasury. It was never the aim to establish fiscal integration - politically, this was always a step too far. Less widely discussed at the time was the other side of sovereign financing: not tax, but bonds. When it came to sovereign credit, here, too, eurozone members were apparently on their own: they were to be part of a collective *monetary* arrangement while still needing to make their own independent *financial* arrangements. Until the present crisis, however, things did not quite work out this way. As the chart below indicates, the introduction of the euro coincided with a *de facto* 'unification' of government bond yields. Member-states were borrowing at similar rates, as if they were exposed to the same same underlying degree of risk. Given their collective interest in ensuring that monetary union was a success, and given that there was no provision for any member to exit the euro, perhaps this was a reasonable assumption.

The impact of this 'unification' on Greece is especially striking: starting with a yield of over 11% in the beginning of 1998, it declined constantly to about 6% in mid 2000 and even further to a low at 3.3% in September 2005. Similar examples can be seen with both Slovenia and Slovakia experiencing a rapid lowering of bond rates. All of this implies that one significant benefit of eurozone membership for these states was cheaper government borrowing.

See appendix, graph 1

Writing early on in the eurozone's lifetime, Aglietta and Scialom suggested that rates reflected a common 'benchmarking' of German interest rates:

*Government bonds have been converted into Euros since the first day of EMU ... The process has included outstanding debt as well as new issues. By the second half of 1998, interest rates of the same maturity bonds had already converged, with very low spreads. This was an indication that the market was unconcerned about the sustainability and solvency of government debt in participating countries. German bonds provided the benchmark because their market was deeper and broader ... It is as if a single yield curve has been established. (2003: 52)*

One implication of this is that the eurozone could be seen as an arrangement that has *already* worked as a 'transfer union' as regards sovereign borrowing. That is to say, some member-states benefited from easier credit conditions – through the bond markets and filtering through into private corporate and household debt – specifically because of their membership of the euro. So why have rates diverged? One answer is that debt has been used in a different way since the global crisis. De Grauwe, for example, points to the 'flight to safety' of investors dumping private debt and turning to low-risk sovereign debt. Crucially, this means that those eurozone governments with a stronger reputation have enjoyed a *lowering* of rates, while those countries considered weaker could not draw the same benefit. Spreads have therefore increased. And yet as he points out, some states – Greece and Ireland, particularly – saw their rates actually rise, and he views this as a function of perceived credit risk: 'This has probably to do with the fact that some of these countries (e.g. Greece) have high levels of debt, and others, like Ireland, experienced a fast deterioration of their government debt levels' (2009: 243).

In light of this, the underlying rationale of the eurozone is up for questioning once more. But the current crisis seems particularly intractable not simply because the different member states lack the political will or ability to resolve it. Rather, it is especially difficult for them to do so because the euro's configuration as a *monetary* system is at odds with the financial architecture that supports it. Although member-states' debts are in their own 'domestic' currency (euros) their lack of independent control over that currency severely limits their options when dealing with sovereign debt. This is due to monetary integration. On the other side, some member-states are confronting serious difficulties in raising debt through bonds. This is a form of financial *dis*integration. The result is a confused mixture whereby sovereignty is both pooled and not pooled. One currency, sixteen state debtors.

In the current crisis, the pursuit of self-interest by eurozone member-states will probably lead nowhere. In order go *somewhere*, on the other hand, the logical choice seems to be between a) integrating the euro's financial architecture, b) reducing the eurozone's size, or c) dismantling it altogether. While option b) is favoured by many, there is no guarantee that it will work without attending to a) at least in some form. Indeed, one could argue that a) has been happening anyway, up to a point. As we have noted, member-states were largely borrowing *as if* there was a common rate prior to the present crisis, and the stabilization facility has its own dedicated eurobond. If it is to survive, member states within the eurozone need to pursue objectives that are framed by collective interests. Arguably, a eurobond is the logical extension of this argument in the sense that it would, for the time being at least, be the most tangible and concrete – and, above all, achievable – embodiment of a eurozone not only conceived but operating according to collective interests.

Discussion of the eurobond has been minimal. Prominent interventions on the issue include those by Issing and Soros, who take opposing views, but there has not been much debate. According to Issing, the eurobond looks attractive only as a short-term solution to the crisis, i.e. as a means of deleting the interest rate spread and providing guarantees that the weaker states – the PIIGS – cannot default. But the longer term consequences would be damaging, according to Issing: 'the argument that some countries are in such a terrrible situation that they will be unable to get out without substantial help from their neighbours is ... unconvincing [and] would turn against a common bond,' he says, before concluding: 'It would be hard to find a clearer case of free riding' (2009: 78). Likewise, it would be hard to find a clearer case of a discussion of the eurobond issue that is so tightly framed by the emaciated logic of restricted economy.

Soros, by contrast, argues that the absence of a eurobond is a 'structural defect' of the eurozone. However, he envisages a common bond not as a replacement for bonds issued by individual states but rather as an addition – which, presumably, is a role the stabilization bond now fills. For one thing, it would lend credence to the rescue of the banking system and allow additional support to the newer and more vulnerable members of the EU. For another, it would serve as a financing mechanism for coordinated counter-cyclical fiscal policies. Properly structured, it would relieve Germany's anxiety about other countries picking its pocket.

*The main use of monies acquired by this means would be to fund infrastructural projects such as gas and oil networks that would both increase member-states' independence, while also fulfilling what Soros refers to as a 'counter-cyclical' function – presumably, this means providing stimulus at times of crisis. ('The eurozone needs a government bond market,'* FT, *February 18 2009)*

Soros's eurobond proposal is something of a halfway house, whereby member-state governments borrow collectively without conceding their additional capacity to borrow as independent states. One clear advantage of such an arrangement would be that it avoids what Issing regards as the greatest danger of the eurobond, which is that the strong states face higher borrowing costs. A similar compromise is envisaged by De Grauwe and Moesen, whose proposed a eurobond would be a means of reducing the 'distortions' and 'externalities' created by divergent bond yield spreads. However, in order to placate German fears that a eurobond would generate moral hazard problems - i.e. 'weaker' states would borrow feeely in the expectation of a bailout – they propose a system of differential pricing: 'the interest rate (coupon) on the euro bond would be a weighed average of the yields observed in each government bond market at the moment of the issue' (2009: 134). This would be a transfer of security – there would be an underlying collective guarantee for the bond – but not of resources. So the free-rider problem that Germany fears is circumvented whereas the bankruptcy issue is solved. Greece would benefit nonetheless: the possibility of being shut from the market would not exist any longer – money would always be available.

De Grauwe's fear – shared by Issing – is that without differential pricing there would be a problem of free riding or moral hazard. In Issing's article, one paragraph stands out that both expresses this fear while arguably exposing a flaw in the reasoning behind it:

*Supporters of the European bond idea argue that this would mean that the "strongest" guarantee for the "weakest", and ask whether this isn't exactly what Europeans mean when they talk of solidarity? (2009: 77)*

The question appears to be rhetorical - but arguably, the answer to it is 'no'. 'Solidarity' in the context of the eurozone is not simply a question of strong taking care of weak – doing so is ostensibly in the interests of the latter but against the interest of the former – but rather of a pooling of resources according to the collective interest. Issing's case – and, to a lesser extent, that of De Grauwe and Moesen – takes an isolated, restricted economic view of the eurozone which arguably starts from the wrong place. From a different, general economic perspective, as Dumas has said, the stronger states 'beggar' as well as 'subsidise' the weaker states within the euro zone: a strong exporter such as Germany needed its 'irresponsible' Greeks and Italians. Once the problem is viewed in this way, the free rider argument looks less self-evident, and the moral judgements that are so often attached to the distinction between 'strong'and 'weak' states appear somewhat myopic. In practice, the euro operates as an elaborate system of wealth distribution whose underlying asymmetries have been laid bare during the current crisis. In this sense, the critics are only half-right after all when they say that the euro is a transfer union. It always has been, and must continue to be if the euro is to survive, let alone thrive. In this sense, we would agree with Eichengreen:

*Only when a homogenous debt instrument with a euro wide market comes into existence, when it is backed by the full faith and credit of euro area governments as a group, and only when it is backstopped by the ECB will the euro be in a position to seriously rival the dollar as a reserve currency. (2009: 17)*

## Concluding remarks

'It will be said that only a madman could perceive such things in the Marshall and Truman plans. I am that madman,' Bataille wrote (1949: 197 n. 22). As things turned out, the formula he proposed for the Marshall Plan was very close to that which was adopted six months later (Surya, 2002: 377). Using the same reasoning, the 'madman's' solution to the eurozone – if it is to survive on anything like its present scale – must involve deeper union, and this requires some form of financial (not just fiscal) integration. The alternative is a different kind of madness: the all-too-familiar pattern of serial crisis-and-compromise as we are left speculating about whether specific member-states – Greece now, Ireland next? – will still be part of the eurozone in a year's time.

### Endotes

1The word 'transfer' comes up four times in the original Maastricht Treaty - see Articles 73h and 205 - and never in line with current usage.

2Although Bataille is not widely cited in economic sociology, ideas closely related to his work, focused mainly on gift exchange, are widely used and have featured in recent issues of this newsletter (e.g. November 2009 issue). In relation to money, the notion of gift exchange has been used successfully by Keith Hart, who has been interviewed for this Newsletter (November 2007). Mauss is cautious about applying the gift exchange framework to contemporary society, but does occasionally turn his attention to contemporary phenomena, as in discussions of Friendly Societies and the morality of the 'liberal professions' (1950: 89). 'We touch on fundamentals,' he says.

3Space prevents us from going into the aspect of *rivalry* that is so important to Bataille's approach, but suffice to say it seems to be readily applicable to the political dynamics of the eurozone. As we are seeing at present, only the finest of lines separates co-operation from open rivalry and conflict. However, it is the collective interest underpinning *institutions* in the general economy framework that we wish to bring out: this is fundamental to Bataille's remarks on the Marshall Plan, and to our interpretation of the eurozone's current predicament.

4In any case, budget deficits in the eurozone's periphery undermine the immediate prospects for any Keynesian stimulus, in so far as 'investor confidence requires tightening the budget in small countries with proportionately large deficits, especially those with outstanding debt already' (ibid., 157). The stabilization fund has served merely as a stopgap in this sense, enabling Greece to fund its deficit for the time being but – according to Dumas – undermining the 'spirit' of the euro project sufficiently to cast doubt on Greece's continuing membership and, more generally, on whether the logical next stage – 'fusion into a proto nation-state' (ibid., 158) – will ever be achieved.

5Bataille invokes Keynes just once, referring in the 'Preface' to The Accursed Share to the 'mystery of Keynes's bottles' (1949: 13) – an example from Chapter 10 of *The General Theory* (1936) dealing with the use of expenditure to stimulate demand.

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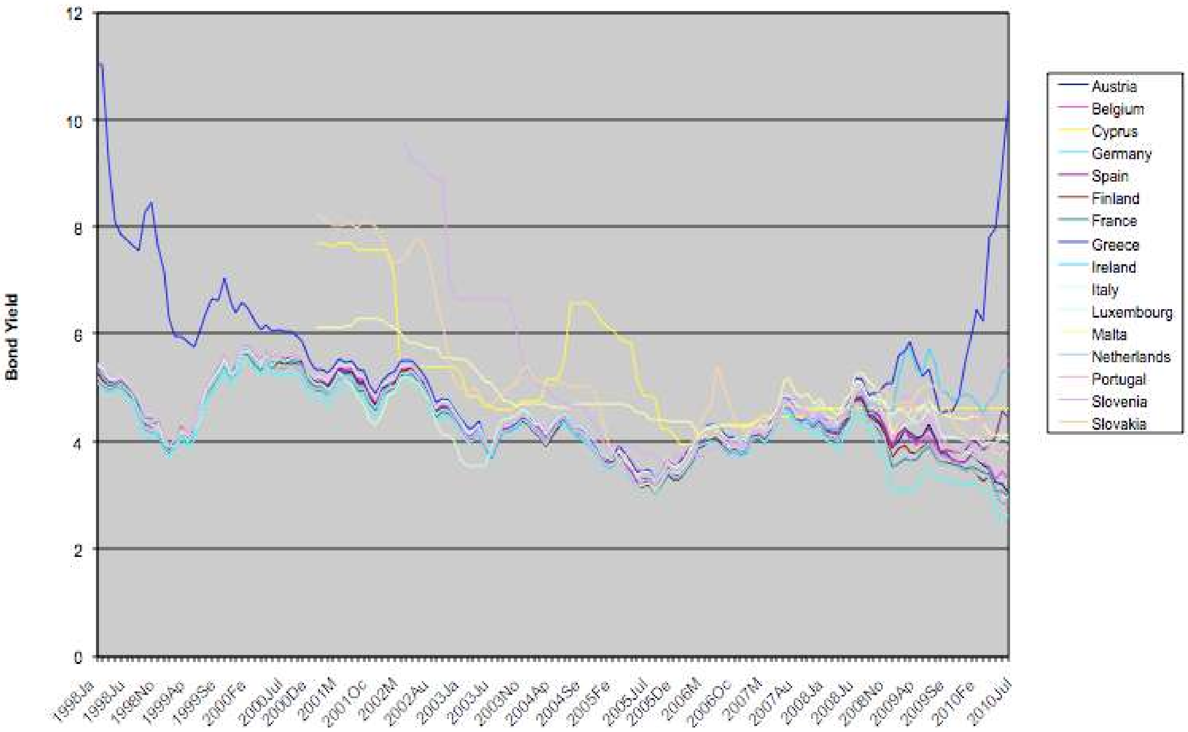
**Appendix:** **graph 1**



# Analysis of Power Relations of Banks in Contemporary Society

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**Please note the change of authorship from the original publication on November 1!**

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The outbreak of the global financial crisis in Autumn 2008 drew the attention of the general public to the financial markets. Over the last two years we have seen a number of popular as well as academic attempts to explain the reasons for the crisis, most of them focusing on the American subprime mortgages on the one hand and the growing market for derivatives on the other. Even before the current financial crisis we could observe a growing interest of social scientists in the financial markets. There has been a number of very detailed analysis concerning the work of financial investors (Knorr Cetina/ Preda2004, Langenohl/ Schmidt-Beck 2007), social sciences of finance (Kalthoff 2009) or ethnographical analyses (MacKenzie 2006) to name just a few. However, so far not many sociological analyses of power relations with a specific focus on financial markets have seen the light of the day.**1** One of the main interests in developing this power-matrix (as well as a series of related analyses, cf. Wetzel/ Zieliński [forthcoming]) was to identify a gap in current research and to provide a first attempt at analysing the power relations between banks and other social fields and institutions.**2** The starting point was the assumption that it must be possible to leave the level of purely functional analysis and to look at causal relations between various institutional actors with a focus on major banks. When looking at the current financial crisis it seems plausible to assume that the concentration of power in the hands of a few actors, among them some of the biggest banks in the world, is one of the main consequences of the ongoing financial crisis. Of course not all major banks can be considered as „winners" of the crisis, but surprisingly many.**3**

In our forthcoming publication we have proceeded in two steps: First we drew a complex picture of the financial market apparatus showing the central position of large transnational private banks in it but also a number of important relations between the important institutional protagonists (eg. rating agencies or the IMF). In a second step we undertook an in-depth analysis of three areas of interest concerning the power of banks: a power-matrix identifying the most important forms of power in the relations between major banks and other institutions, the question of regulative practices as well as an analysis of the ongoing process of concentration in the field of banks. For the purpose of this article we have decided to narrow down the scope and focus on the power-matrix. It is the result of an attempt at identifying different forms of power relations between banks and other areas of societal life. At the base we have the work of Heinrich Popitz who distinguished – from an anthropological perspective – four forms of power. We provided them with a social constructionist twist and analysed various forms of power relations in a highly differentiated society.

While the main focus of our work does not lie on central banks, it is still necessary to include them in an analysis of the power of banks. Through interest rates they have a big influence on the economic cycle and on the realm of possibilities of the major banks. From a critical sociological perspective it seems important to highlight mainly two moments: the dogma of political independence of central banks as well as the possibilities of profit that low interest rates offer to banks. Since the establishment of the Federal Reserve in 1913, the independence of central banks from political institutions has been a central dogma in financial policy. Nowadays practically every country in the world has a more or less independent central bank. Since being independent from the political system is not a given fact, it must be fought for politically. Traditionally, the big private banks have been the major supporter of the independence of central banks (Epstein 2009). From this perspective it is not surprising that the commission which was established in the United States to formulate the bailout in October 2008, had as its members mainly representatives of the major banks (as well as the treasure secretary, Henry Paulson, a former CEO of Goldman Sachs).**4** Concerning the policy of interest rates it is now common – other than e.g. a hundred years ago – that the prime interest rate is not the same as the lowest rates for private and business loans. Instead an interest rate exists for inter-banking loans (in the European Union the Euribor), which is the average of the actual interest rates and forms the base for all other credits which are usually 2% higher than the Euribor.

Obviously big banks are the primary institutions that are interested in low prime interest rates: They are able to access large sums of money more or less for free and assume that the interest rates they have to pay on these loans will be paid for by the loan takers. Over the last decades it has become less and less appealing to invest this money into so called „real economy“, instead the banks use the money for investments into financial markets.

Our working hypothesis is that major banks have managed to profit from the momentum and to use the financial crisis to strengthen their position and to expand their power, also through the use of state aid. Of course we must not forget that the patterns that we will present here are merely a heuristic snap-shot – in reality the power relations are much more dynamic and overlapping. The reasoning behind the analyses of power relations is that for a long time (that is Max Weber's perspective for example) it was rather difficult to study relations of power in society which led social scientists to focus on the analysis of rule. Nowadays, however, especially if we take Giorgio Agamben's thesis of the permanence of the state of emergency (Agamben 2005) seriously, it is rather difficult to identify stable structures of rule in contemporary society (especially in the supranational context). This is why it makes sense to analyse power relations between major players and assume that there might be a connection between these relations and emerging structures of rule. Of course – as the name "relations" implies – it is important to remember that power relations are always two-fold and reciprocal.

## Matrix of power relations

The basis for the following matrix is Heinrich Popitz' power typology (Popitz 1992). Popitz defines power (following Weber) as the ability to prevail against external forces (Popitz 1992: 22). His phenomenological approach identifies power as anthropological constants. We would like to follow Michel Foucault and speak of power relations instead (Wetzel 2004). However, Popitz' typology is a good way to label diverse power relations in different fields of society.

For Popitz the *power of action* is based on the vulnerability of living beings. He adds: „the vulnerability as creature is complemented by economic vulnerability." (Popitz 1992: 24). The *power of mobilisation* is an instrumental form of power. It relies on the possibility to give or take, ie. on a disposition about penalties and rewards that is based on alternatives and credible for the concerned persons or institutions. The *power of data setting* is founded on the fact that by producing artefacts one is able to exercise power over persons who use these artefacts. It is inherent to these artefacts and often latent over a long period of time, but can become manifest at any time. The *power of position* draws the attention to the fact that actors in certain positions possess a special kind of power over other actors which are subordinated to them hierarchically. We add to Popitz' typology another common type of power, the *power of definition*. It stands for the ability to exercise power through the definition of a situation. In this process the complexity of a situation is reduced in a manner which makes certain interpretations plausible while excluding others.

In a second step we add a horizontal axis to our power-matrix. On this axis we locate the social fields. We focus on those areas of social reality which we consider most relevant from the perspective of power sociology, namely: economy, politics and mass media. The result is the following 5 x 3 matrix describing the various forms of power relations between big banks and other institutions.

See appendix, table 1

On the following pages we will describe those forms of power relations that we consider the most important ones. Of course more details could be added to the description of every field. The examples are meant more as an illustration than as a proof for the correctness of the diagnosis.

We begin with the *power of definition* where the creation of highly complex derivatives (SIVs) can be interpreted as an important form of power of the banks. A number of banks, above all Citigroup, had created a number of structured products that were then sold to private and institutional investors from all over the world. The CMDs which played an important role in the subprime crisis are a good example of such SIVs. CMDs are securitisations[5] of American subprime mortgages, i.e. mortgages that have been loaned although it was highly unlikely that the loan takers would be able to pay them back. This power of definition is linked to what we have identified as power of data setting:

The *Revised Framework on International Convergence of Capital Measurement and Capital Standards*, better known as *Basel II*, which was implemented for all European banks on 1 January 2007. This document set new rules for the assessment of investment risk and the according equity ratio while at the same time raising the minimum equity ratio.

Due to the prominent role of banks for loan-giving not only to companies but through mortgage or consumption loans also to private persons this power of data setting can – in a relatively short time span – have big implications for the whole economy. It is easier to assess the range of this power of the Banking Supervision if one remembers that the rules which had been implemented before, the Basel I accord, led to the development of a second accounting (so called 'shadow banking') where banks covered a part of their investments in order to circumvent the regulations of Basel I concerning the equity ratio.**6** It seems likely that for at least some of these institutions these measures were necessary to prevent bankruptcy.**7** One of the consequences of Basel II was that these investments had to be properly accounted for. Since they were linked to the American immobility market through the above mentioned securitizations, they lost a big part of their value when prices for houses started falling which had the consequence that many banks „became heavily undercapitalized" (Fratianni und Marchionne 2009: 3).

It is necessary to link this process to the *power of action* of banks in the field of economy which we have identified as the possibility to enforce a credit crunch. Above all it is the procyclical effect of the Basel II rules that shows its effects: In times of crisis many companies face a decline in orders which makes it harder for them to pay back their loans. Banks are then forced to consider these loans as more risky, which needs more equity and can lead to an additional decline in loans.

After this short overview of some of the most important forms of power of banks in the field of economy, we would like to turn our attention to the field of politics. The first thing we notice concerns the *power of definition* („who is able to define that we face a crisis?"): If we take a close look at the emergence of the financial crisis in 2007/2008 it quickly becomes obvious that the only institutions which are able to diagnose a comprehensive financial crisis are the banks: The decisive event was the breakdown of the inter-banking trade in August 2007**8** as well as in September 2008.**9** Retrospectively this can be regarded as the starting point of the ongoing financial crisis which is directly linked to the self-regulation of the financial institutions: Since nobody else is able to check the validity of the balance sheets of banks, it is only the actors on the financial markets, that can declare a crisis.**10** We would like to illustrate how little overview let alone influence politicians have in this area with a quote from the former German financial minister who declared on 25 September 2008, that is only a few hours before the emergency meeting between the German government and representatives of the major German banks, that „the financial crisis is mainly an American problem" (Schäfer 2009: 203). Leading Swiss politicians made similar statements. It is thus no surprise that journalists like the chief of the economy department of the daily German newspaper *Süddeutsche Zeitung* considered the crisis a blackmail by the financial markets (Schäfer 2009: 205). Critical economists like the American Michael Hudson even went so far as to speak of a coup of the „banksters" (Hudson 2008).

This influence of banks on politics leads us to the *power of action and decision*. There are mainly two reasons why the political system in contemporary democracies can get under heavy pressure from the financial markets: First there is the aforementioned monopoly on the diagnosis of crisis, on the other hand we have the fact, that due the huge amount of public debt and the independence of central banks virtually all nation states have to rely on good relations with the financial markets. Just to cite one example among many for this progressing financialization of society: pension funds invest their assets, i.e. the future pensions of a lot of employees, into financial markets hoping for a maximal return on investment. Thus it seems highly likely that a possible breakdown of institutions which are very important for the functioning of the system would have far-reaching consequences for society as a whole (so called *systemic risk*). Another popular way to formulate this interconnectedness was the "too big to fail" slogan.

The mutual work on the rescue packages from the state – which we interpret as a form of *power of mobilisation* – of politicians and representatives of the major banks appears then as a almost logical consequence of these structural implications. We would like to remind the reader that the bailout had not enough support at all during its first reading in the Congress. The necessary majority was established only a couple of days later – we are left with speculations on the degree of influence and/or pressure exercised on the Congressmen in between to convince them, that and why it was necessary to enact the bailout in such a form (keyword: *lobbying*). In Germany not even the members of parliament belonging to the oppositional fraction voted against the so called *Finanzmarktstabilitätsgesetz* [law on stability of financial markets], although no form of parliamentary, ie. democratic control was implemented regarding the use of these funds.11

During the G-20 summit in London in April 2009, where countermeasures to the crisis were discussed and implemented, the responsible persons were the ministers of finance on one hand and the directors of the central banks on the other hand. This can be regarded as an extreme form of lobbying which we interpret as *power of position*: Lobbying nowadays does not take place indirectly through gratifications for chosen members of parliament but very directly – the person in the government which is most responsible for financial affairs is closely related to the big banks. It is thus hardly surprising that the state aid packages were constructed in such a form that mainly those institutions profited from this process that already belonged to the more powerful actors in the field: „In both cases, before and after the financial crisis, the biggest players on the market had the biggest benefits: before the crisis the highest gains and after the crisis the farthest reaching liquidity guarantees." (Honegger et al. 2010: 311).

In the last part of this section concerning the power-matrix we will focus on different forms of power relations between big banks and mass media. Andreas Langenohl reminds us, that in the last 100 years „the presence of financial markets in mass media has increased a lot" (Langenohl 2009: 253), which can be seen not the least in the way how actors on financial markets try not only to shape but also to anticipate the perception and the image of financial products in the media. Following up on Michel Callon we can observe how „framing"12 plays an important role concerning the perception of financial markets of laymen (Callon 1998). At the same time news become more and more a form of merchandise. Critical media theorists have interpreted this process as the ability to medially create, or even invent reality (Parenti 1993). As a consequence of this we expect far reaching interconnections between financial markets and mass media, as they can be observed for example in the fact that the two biggest wire agencies – Reuter's and AP – now belong to the Canadian financial agglomerate Thomson.13

Regarding the central forms of power relations in this field of society we have to be rather cursory compared to economy and politics since research in this area began only very recently (Reichert 2009). A crucial element of the heavy influence exercised by financial institutions upon average consumers lies in the fact that over the last 20 years we saw a massive increase in the amount of reports regarding the financial markets and written with laypeople in mind which led to a de-mystification of stock markets.14 Until the 1990ies the masses considered investing in stocks as something reserved for the upper classes of society. We put forth the hypothesis that as a result of this PR campaign a rising number of persons from the middle class began investing their savings in stocks. From there it was only a small step to motivate them to invest their money into products which can bring more profit – but which at the same time are also more risky. This is an important form of the *power of mobilization*.

We see a connection to the ability of institutional actors on financial markets to influence the direction of media reports about financial markets in general through advertisement (*power of position*). Over the last 10 years this form of influence-taking has gained importance through the advent of free newspapers. These papers have very small editorial staff and rely heavily on wire services like Reuter's or AP, which leads to a high selectivity of reported news – these papers focus on news that „sell", ie. crime, sex and celebrities. It is more important to provide the latest news fast than to research them in-depth. At the same time free newspapers follow the 'infotainment' paradigm (Postman 1985) and are – due to being available to the readers for free while still having costs of printing etc. – totally dependent on revenue generated through advertisements. At the same time an increasing concentration of the media landscape in the hands of very few huge concerns can be observed concerning which we cannot get into in detail here due to place constraints. It can be assumed, though, that actors with more accumulated wealth are in a stronger position to influence the public opinion.15

Finally we would like to turn our attention to the power of data setting which is especially visible regarding the publication of balance sheet of banks and other financial institutions. As already mentioned, it is very difficult or almost impossible to obtain exact numbers about the actual balance sheet of banks. Concerning companies the situation is slightly different: they are obliged to publish their numbers due to the public character of stock exchange. However, the published numbers are not always reliable: A report of the GAO [General Accountability Office, then: General Accounting Office] showed that between January 1997 and June 2002 around 900 published financial informations had to be corrected due to substantial errors.

This corresponds to around 10% of companies from the NYSE. In the following years these numbers have risen dramatically.16 The scandal around the energy corporation Enron was the case which received most public attention worldwide. Enron broke down in December 2001 as the result of one of the biggest accounting scandals till then.17 It is hard to establish a direct connection between this corporation and the major banks. Fact is though, that not only the Bank of America and Lehman Brothers but also Citigroup and J.P.Morgan reached out of court agreements and paid totally five billion USD to affected investors. However they refused to acknowledge any form of guilt. The prosecutors accused the banks of helping Enron to falsify their financial statements and to cover up their indebtedness. Another charge was that analysts knowingly formulated wrong stock evaluations (FAZnet, 15 June 200518).

Finally it can be argued that regarding the steerage of the perception of the crisis mass media have a huge impact on how the public opinion perceives the events on financial markets. The involved persons consider it to be so huge that at the outbreak of the financial crisis the German chancellor Angela Merkel met the chief editors of the biggest German daily newspapers to suggest to them a cool-headed coverage.

## Conclusion

Analyses of power relations in contemporary society often face the objection that they are overly pessimistic, even fatalistic, and that they do not offer any solutions for improvements of the situation. Obviously this article is not the right place to start a political debate on possible reforms of the financial system (see Mügge in this issue). Instead we would like to draw your attention to the concept of profanations in the sense that Giorgio Agamben (2007 [2005]) gave to this word in his essay *In Praise of Profanation*.

What is a profanation? According to Agamben it means to „return things to the free use of men" (Agamben 2007: 73), things, that had been first sacralized. Distinguishing profanation from secularization, Agamben connects the former to the concept of power in a very specific way: „[profanation] deactivates the apparatuses of power and returns to common use the spaces that power had seized" (Agamben 2007: 77). In his essay Agamben refers to Walter Benjamin's classical fragment *Capitalism as Religion*.19 In his thesis on the religious character of the capitalist system Benjamin identified three principal traits of such a theological conception of Capitalism. First, it is a „purely cultic religion, perhaps the most extreme that ever existed" (Benjamin 2004 [1921]: 288). This means that it does not need specific dogmas or even a theology to function. Second, it is the only religion where the cult is permanent. There is no „weekday" in the capitalist system – the celebration of God through the flow of money never stops.20 Third, it is the first religion ever which is not directed at the absolution or repentance of its followers but at their guilt (*Schuld* in German which at the same time means "debt") – one of the main functions of capitalism being the production of relations of debt. Benjamin identifies a fourth trait as well regarding the representation of God when he wrote that „its God must become concealed" (Benjamin 2004 [1921]: 289).

Agamben concludes his lucid analysis with the thesis that in the meantime capitalism has managed to „generalize in every domain the structure of separation the defines religion" (Agamben 2007: 81) which makes profanation very difficult, albeit not impossible, thus making „the profanation of the unprofanable the political task of the coming generation" (Agamben 2007: 92). We would like to leave it to the imagination of the reader to think of possible connections between financial markets, religious structures and profanations.

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*kus Flück), in: Honegger, Claudia et al. (2010),* Strukturierte Verantwortungslosigkeit. Berichte aus der Bankenwelt*, Berlin: Suhrkamp, S. 335-370.* Tabus in der Welt der Manager. Vom Erfolg und der Kunst der ‚gerechten und angemessenen Vergütung' in deutschen Unternehmen*, in: Ingrid Streble et al. (Hg.) (2009), Verboten, verschwiegen, ungehörig? Ein Blick auf Tabus und Tabubrüche, Berlin: Logos, S. 143-151.*

## Endnotes

**1**Cf. Wixforth 1997 and Pfeiffer 1993. Other than the usual analyses of the power of banks we aren't interested in the interdependences between banks and companies, like the proxy voting power or seats in directories (cf. Brendel 2001), but intend to analyse far reaching forms of power in relation to society as a whole.

**2**The notion of *power relations* as opposed to a quasi-ontological analysis of power stems from Michel Foucault. He defines a "power relation" as an "action that tries to influence the action of others" (Foucault 1982:220).

**3**In Germany the Deutsche Bank can be considered the main winner, in Switzerland this position belongs to Crédit Suisse, while the UBS in Switzerland and the Hypo Real Estate in Germany belong to the losers who needed state rescue, cf. Wetzel/Hofstätter/Flück 2010.

**4**According to the Wall Street Journal „the participation of Ken Lewis, CEO of the Bank of America, Jamie Dimon, CEO of J.P.Morgan Chase; Lloyd Blankfein, CEO of the Goldman Sachs Gruppe; John Mack, CEO of Morgan Stanley; and Robert P. Kelly, CEO of the Bank of New York Mellon" was expected.

**5**The problem with securitizations is that the risk of a loan is being transferred from the bank which gives the loan to the market and can have as a consequence that the bank does not pay that much attention to whom it provides with loans as long as it can make sure that someone else buys the securitization.

**6**"At the end of 2007, J.P.Morgan Chase & Co. and Citigroup each had nearly $1 trillion in assets held *off their books* in special securitization vehicles. For Citigroup this represented about half the bank's overall assets" (Crotty 2009: 570, our accentuation).

**7**Wagster points out that already before the implementation of Basel-I, „banks greatly increased their level of involvement in contingent, as opposed to immediate, claims on the bank (, …) so-called off-balance sheet activities" (Wagster 1996: 1324).

**8**„On 9 August 2007 (...) the interest rate which is taken into account for short-term lending between banks became very volatile. Usually it varies by one or two hundreds of a percent, now it had suddenly risen by 70 hundreds. Banks were making interbanking loans more expensive and hindering the circulation of money " (FAZ, 14 February 2009).

**9**„But the inter-banking trade almost didn't exist. 'The financial markets completely broke down' said Christoph Rieger from Dresdner Kleinwort. 'The central banks are the only ones who put money into the market, nobody else is lending anything.' The important point of reference in the inter-banking trade, the daily libor for the USD, rose as high as never before, by 481 basis points to 6,88 per cent, and ranks much higher than the prime interest rates of the central banks (EU: 4,25 per cent, USA: 2 per cent)." (Frankfurter Rundschau, 01 October 2008).

**10**Cf. the interview with Charles Wyplosz, a professor in economics from Geneva in the Swiss daily newspaper NZZ on 3 January 2010: „NZZ: How healthy is the financial and banking system these days? CW: This is the well protected secret of the regulators like the Finma [the Swiss SEC] (...) The public opinion never knows how good or bad the balance sheet of the banks really are."

**11**Just to remind the casual reader that in many industrial countries the current ministers of finance are former employees of big financial institutes: Henry Paulson (USA) came from Goldman Sachs, Hans-Rudolf Merz (Switzerland) from the UBS. Already Robert Rubin, American treasury secretary in the 1990ies, came from Goldman Sachs (cf. Blomert 2007: 451).

**12**Cf. Thompson 2009 for an overview of two academic and four popular frames of the ongoing financial crisis.

**13**Cf. Hack 2007 for a reconstruction of the role this transnational company played in the concentration processes in European economy in the last 30 years.

**14**Which is not equal to more transparency on the financial markets.

**15**Just one example from Switzerland: The widely read left-liberal magazine *Weltwoche* was bought in 2002 by Tito Tettamanti, a wealthy investor. Before the purchase the magazine featured a wide range of political opinions. After a very short time span many journalists left the magazine and it became an important propaganda tool for neoliberal thinking, sometimes with latently racist tendencies.

**16**Source:http://www.rwp.bwl.uni-muenchen.de/files/download/bilanzskandale.pdf

**17**Only half a year later the revision of the financial statements of Worldcom, a transnational company in the field of telecommunication, found out grave discrepancies. Expenses had been accounted for as investments, which increased the revenues by 3,8 billion USD. The responsible managers were sentenced to high jail sentences, cf. Bryce 2002.

**18**http://www.faz.net/s/RubC9401175958F4DE28E143E68888825F6/Doc~ED389CD5E2C0C48B19C3E61
CCFF69275D~ATpl~Ecommon~Scontent.html

**19**Of course, Benjamin was not the first one to make this comparison. Another well-known author who dedicated a whole book to the subject was Paul Lafargue. In 1886 he published *La réligion du capital* where he describes the limitless power of capital consisting in four interrelated traits: a) ubiquity of capital, b) capital as "prime substance" and "world soul", c) the ability of capital to transform and destroy all that exists and d) capital as real and thus true God (Lafargue 2009: 94). Recently quite a large number of publications on the analogy between capitalism and religion has been published. To name just a few: Baecker 2003, Deutschmann 2001, Fleischmann 2010, Goodchild 2002, 2009, Grau 2004, Knitter/Muzaffar 2002.

20Benjamin Barber (2007) identifies five forms of the rule of the market: ubiquity, omnipresence, addictive character, self-replication and omnilegitimacy.

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**Appendix**

| Table 1: Matrix of power relations for major banks | | | |
|---|---|---|---|
| | **Economy** | **Politics** | **Media** |
| **Power of Definition** | To configure structured products | To diagnose the crisis | Information management |
| **Power of Acting and Deciding** | To communicate a 'credit crunch' | Pressure through (systemic) threats | To produce in-transparency |
| **Power of Action and Mobilization** | Capital accumulation, Mergers | To prepare the rescue packages | Motivate to investments |
| **Power of Data Setting** | Setting up rules for capital quota (Basel I and II) | Interest rates | Publication of Balance Sheet |
| **Power of Position** | Stabilizing or destabilizing effect | Lobbying | Advertising |

# Not So 'Mickey Mouse': Lessons in the Nature of Modern Money from Complementary Monetary Innovations


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The financial crisis shattered many of the shibboleths of orthodox economics and monetary policy. These included the "efficient markets hypothesis" so often used to justify the deregulation of the financial sector and the monetarist belief that inflation targeting through interest rate adjustments was the most effective and only necessary tool for stabilizing the economy (Galbraith 2009). Rather less, however, has been heard about what the crisis means for our understanding of the production and allocation of money. In a similar vein, discussions of financial reform and regulation have mainly focused upon institutions – banks, credit rating agencies, regulators – rather than more fundamental questions about the existing modes and rules around monetary production and allocation. For example, few within the mainstream are questioning the fact that, through a gradual process of centralization, deregulation and advances in ICT, today 97% of money in circulation is issued by profit-making commercial organizations (banks) as interest-bearing debt, while only 60 years ago, this was closer to 50% with the remainder issued as coins and notes by the state (Morrison 2006: 51-53). This despite the 'unorthodox' ventures in to quantitative easing by Central Banks which have revealed that, under a fiat credit-based monetary system, there is nothing to stop sovereign states directly creating money whenever they really need to.**1** Neither has policy focused much upon how reforms of the monetary system might meet the global challenges of inequality and ecological sustainability.**2**

Two 'mainstream' schools of thought can be identified in modern monetary theory**3** (Goodhart 1998; Ingham 2006). The dominant 'Mengerien' (Menger 1892) theory (also Metallist or commodity-theory theory) in orthodox economics – and also in modern monetary policy, at least pre-crisis – views modern money as arising naturally out of market exchange as a unique kind of commodity against which all goods could be traded and priced. Money is the 'universal equivalent' that enables multilateral exchange and enables users to circumvent the 'coincidence of wants' required for barter (Jevons 1875; Menger 1892). The emphasis here is upon money's key's function being as a means of exchange. When this concept of money is fed in to neo-classical general equilibrium models of the economy, it becomes a 'neutral veil' enabling production and consumption (supply and demand) to meet more efficiently than barter. Such a model is based upon widely discredited assumptions of perfect information and competition (Stiglitz and Weiss 1981). Leon Walrus based his model of general equilibrium upon an omnipotent 'auctioneer' who knew the value of everything immediately all the time. The paradox is that if we really did have perfect or symmetric information about the value of every good and service we wouldn't need money at all, nor financial intermediaries of any kind, as the problem of requiring a double coincidence of wants would never appear (Werner 2005: 193; Lapavitsas 2005).

In contrast, the 'Chartalist school' of monetary theory regards modern money as a creation of the state as the only actor capable of guaranteeing confidence in a currency through its ability to act as the guarantor of an abstract 'money of account' (Knapp 1905; Keynes 1930; Wray 1998; Ingham 2004). The unit of account function of money is held to be logically anterior to its role as means of exchange or store of value and held to be vital in the establishment of stable pricing system, large-scale market exchange, settlement of debts and modern capitalism itself (Ingham 2008: 65-92). Money is a social relation of abstract value defined by a sovereign money of account.

The Mengerian school relies mainly upon deductive abstract theoretical models (see Kyotaki and Wright 1989 for a modern micro-economic model of the Mengerien position). The Chartalists draw upon a richer range of research, including wide-ranging historical analysis (Ingham 2004) but very little original research. Economic sociologists have adopted a more inductive approach, emphasizing more the social construction of money in everyday use and the way institutions and people actually produce and use money today (Zelizer 1997; Dodd 2005; Thrift and Leyshon 1997). These scholars suggest modern fiat credit-money, based as it is upon a social relation of credit and debt, requires empirical study of the social and political construction of 'monetary networks' that enable the modern monetary system to function. For Dodd (1994: xxiii):

*Each function of money (medium of exchange, store of value) relies on an extended network of social relationships… the analysis of monetary networks provides a basis for detailed empirical study of specific monetary forms without ruling out comparison between them or presupposing which types of social action monetary transaction principally involves.*

Recognising the dominance of the financial sector in the production and distribution of modern fiat credit-money, a few scholars have taken up Dodd's challenge in relation to the monetary networks that maintain modern finance (Thrift 1994; Leyshon and Thrift 1997; Mackenzie 2006). A fourth 'function' of money – as a tool for speculation – has gradually become accepted as part of the challenge facing a globalised largely electronic debt-based money system where credit is largely issued by commercial banks**4** [Lietaer 2000: p332]. Monetary innovation driven by speculative profit was already a popular topic even before the financial crisis with numerous articles on derivatives and securitization and more broadly the process of 'financialisation' (Pryke and Allen 2000; Mügge 2009; Barret et al 2010).

Much less attention, however, has been paid by scholars to monetary innovations that lie outside the world of high finance. This includes both recent state innovations such as quantitative easing and monetary innovations emerging from civil society and the non-bank sector, in particular the small and medium sized enterprise sector which appears increasingly disadvantaged by financialisation and banking consolidation (Dymski 1999). These latter examples are often referred to as 'complementary currencies', an unsatisfactory term that doesn't capture their diversity or function, since often they involve alternative or complementary payment or banking systems as well as actual currencies. I shall instead use the term complementary monetary innovations (CMIs). CMIs are perhaps paid less attention because of their smaller scale and impact. Some in the Chartalist school have used examples of the emergence of complementary currencies to reinforce the argument that money is essentially sovereign in nature, citing examples of 'weak states' giving rise to bartering such as those that emerged in Argentina in 2000 (North 2008; Ingham 2004) and in Russia after the break up of the Soviet Union (Woodruff 1999).

Against the Chartalist position, it has been suggested that financialisation and globalization are undermining the monetary authority of individual states, including its guaranteeing of the 'money of account' function. 'Dollarisation', the emergence of the Euro and the exponential growth in privately created monetary instruments, such as derivatives, are used as examples to illustrate this phenomenon (Strange 1988; Leyshon and Thrift 1997; Cohen 2000; Dodd 2005). Mengeriens might argue that these phenomenon represent moves towards greater efficiencies of scale (Mundell 1961). But there are also interesting monetary developments along an opposite trajectory, involving the decentralizing, some would say 'democratizing' of monetary forms. In particular attention has focused upon the internet as enabling new forms of commercial, social or private online clearing houses that could supersede central bank's roles as guarantors of the unit of account function (King 1999; Hart 2000; Greco 2009). In terms of sheer economic scale, commercial monetary instruments such as loyalty cards, bi-lateral countertrade (incompletely monetized international trade), which is estimated to account for 10% of world trade (Marin and Schnitzer 1995) and, on a smaller scale, regional commercial barter networks also appear to challenge the Chartalist position. These latter examples also extend back to well before the emergence of the internet.**5**

But rather than debating complementary currency's relevance based on economic or geographical scale, we can also turn the argument on its head consider whether interesting lessons about the nature of modern money might emanate from examining CMI's successes and failures, past and present. CMIs can perhaps be thought of as types of large-scale 'breaching experiments' that test the strength of adherence of citizens and institutional actors to assumed social and institutional norms and values around money (Garfinkel 1966; Goffman

1985; North 2010: 203). What both the Mengerien and Chartalist schools have in common is an overly deductivist approach to conceptualising money which neglects the socially constructed and embedded nature of their subject, despite, in the Chartalist case, a recognition that modern money is an inherently social phenomenon.

In this article, two examples of complementary monetary innovation are examined with a more inductive methodological perspective, both of which can be thought of, to some extent, as being stimulated by financial crises: the Brixton Pound (B£) local currency* and the long-standing Swiss WIR credit clearing system**. Both of these monetary innovations are aimed at supporting small and medium sized enterprises, a sector which historically is most endangered by credit crises given their lack of reserves and rapid turnover (Nilsen 2002).
*www.brixtonpound.org and **www.wir.ch

The B£ was launched in September 2009, almost a year to the day after the collapse of Lehman Brothers and with the local Council (the London Borough of Lambeth) having launched a 'Credit-Crunch taskforce' to support SMEs and poorer residents. As a founder-member and now Director of the scheme, I have been conducting 'action research' on the project over the past 18 months with privileged access to its founding, growth and challenges. The Swiss WIR, in contrast, was founded in 1930 following the Great Depression and is perhaps the most successful complementary monetary innovation of modern times in terms of scale and longevity. I review the WIR through secondary sources, particularly the work of the confusingly named Tobias Studer and James Stodder.

The success and failures of these models – which despite both being aimed at supporting the SME sector – are quite different in design, are reviewed and lessons drawn out about what this tells us about the nature of modern money and the social construction of monetary networks. Particular attention is paid to the way in which these two models have attempted to complement or circumvent the dominance of orthodox state credit-money in determining the 'money of account' function.

## The Brixton Pound (B£)

One of the most remarkable developments in the UK complementary currency 'movement' in recent times has been the emergence of local, sterling-backed paper currency schemes in 'Transition towns'.**6** Following Totnes in 2007, the towns of Lewes, Stroud and Brixton in South London have all launched local 'pounds', the usage of which is restricted to independent businesses in their respective areas. There are also a number of 'nascent' Transition currencies in the planning stages.

The aim of these currency systems is to keep a greater proportion of local spend circulating within a 'local area', support the diversity of the high street and ultimately to help re-localise production and consumption patterns. The ideas is that this will create more resilient local or regional economies, less dependent on oil-intensive global supply chains and less carbon-intensive forms of production; both key elements of the wider 'Transition movement' (Hopkins 2008; 2010). Ecological economists have argued for local and regional currencies as important tools for encouraging more effective economic development and greater resilience to external economic shocks (Douthwaite 1996; Jacobs 1985; Lietaer 2001). The currencies can also be viewed as a reaction against the 'Clone Town' phenomenon, whereby the dominance of chain stores and decline of small shops leaves the UK's high streets looking identical (nef 2002). Initial research suggests the Transition currencies schemes also strengthen community networks**7** and they have undoubtedly raised the profile of the areas where they are situated through widespread local, national and international media coverage. Lambeth council, where Brixton is based, estimated the scheme realized £100,000 of value in terms of positive media coverage for the area. Here I focus upon the Brixton Pound (B£) drawing upon findings from qualitative research.**8**

The B£ can seen as a monetary innovation that favours the means of exchange function over the store of value function. In fact, the B£ cannot be 'stored' as there is no B£ 'bank'. The aim was that the currency would circulate more rapidly than sterling among Brixton's small businesses, increasing demand through a 'local multiplier' effect, rather than 'leaking out' of the local economy (nef 2002). By backing the B£ against sterling and making it freely interchangeable with, the currency does not challenge the sovereign 'money of account'. Members of the scheme debated alternative 'backings' for some time prior to the launch of the currency but eventually decided, impressed by the launch of the Lewes £ in September 2008, that a sterling-backing currency would be the best way of creating initial confidence and encouraging a critical mass of traders to adopt it.**9** The group also opted for a range of security features on each note, again conscious of creating initial confidence in the money.10

From an orthodox Mengerien perspective, the B£ makes little sense. The B£ fails at least three of Stanley Jevons' (1875) characteristics of successful money (in comparison with sterling). B£s last only a limited period of time (two years), they are not easily exchangeable (there are only two places in Brixton where it is possible to change back B£s to sterling) and not easily divisible (B£s are issued in £1, £5, £10 and £20 notes only with no coins). Perhaps most significantly, the B£ is simply not widely accepted – they can, by definition, only be used in selected businesses. In addition, the transaction costs associated with B£s are also high relative to sterling since the currency is paper only. As one user reports, the B£ is a 'bit of a pain':

*"So since it launched anyway, I've used them on and off, but they're a little bit difficult to get your hands on sometimes… If you work nine-to-five, um… So I use them when I can and when I remember, but I don't always, like, they're a little bit of a pain. Like, evern when you want to use them, like I do… they're a little bit difficult. And also, it becomes an extra chore… Because you have to go to the cash point and then you have to go to some place where you can do it again. So it makes going to the cashpoint a two point experience."*

Only a few of the businesses involved in the scheme believe the B£ is actually boosting their turnover or footfall, most suggesting that the main users were already regular customers.11 In addition, the scheme's organizers have struggled to persuade businesses to offer discounts to customers paying in B£s – currently around one third of such businesses do so – so the economic advantage to the user also appears marginal.

Despite this there are currently around B£30,000 in 'circulation' (that is, issued and not exchanged back in to sterling), 180 businesses accepting the currency (from 60 at the launch in September 2009), ranging across all sectors12, with only 3-4 businesses dropping out and over 1000 'users' who have agreed to receive emails about the scheme. Users of the scheme, both businesses and customers, appear mainly to be motivated by non-economic, political or ethical considerations. Although an inner city area with high levels of crime and ethnic diversity might seem the last place where a local currency might successfully be introduced, Brixton has a vibrant alternative subculture, with a history of political resistance, squatting and more recently environmental activism. Hundreds of Brixton residents turned out for the launch of the B£ in September last year. Some of the businesses supporting the scheme related to this history and a shared, identifiable sense of the Brixton 'local economy' as a reason for their participation:

*[owner of Brixton cycles] "Its about marketing and its not just about business, its about long term business. So we've obviously been here about what nearly 30 years and we hope to be here for another 30 years… without sort of banging your own drum, we are sort of like a stalwart Brixton business who have been here since the riots, so it adds consistency to people's lives. So its like, "Oh thingy might be in trouble, but there is always Brixton Cycles". Brixton cycles is there, some things are always constant and I think being involved in the Brixton £ just reiterates our commitment to the community…"*13 *(Owner of cycling shop)*

*Well I mean the Brixton Pound does create a lot of commonality… remember what Brixton is, its kind of a kaleidoscope of different, you understand, coming together… and I think that having that as a common denominator does bring some kind of… you know it does something for the community, it does, it, it acts as a common denominator right, in as much as it is money or in err err and also as to the 'our thing' you know, you understand, the mafia aspect of it, 'cosa nostra', our thing, you understand, everybody loves that.*14 *(Sole trader selling ginger beer)*

These kind of sentiments support Viviana Zelizer's (1989) concept of money as being structured by cultural and social meaning. Zelizer focused on the way in which orthodox money ($US) were 'earmarked' for different purposes in the domestic context – for instance pin money for housewives to spend, money for gifts – and how this changed over a 60 year period, from 1870-1930, reflecting changing social norms. When purchasing B£s at least some users might be thought of as 'earmarking' a percentage of their spend for the 'local economy', recognizing the value of small businesses over and above corporate chains:

*"Well I think the B£ is really good. Money that actually revolves in the local economy and builds the local economy, and supports local people trying to build their own businesses is a really good idea. I don't like the idea of ohhh money going to a lot of conglomerates, to pay shareholders.*

*Ummm… who are not doing any work… (User, interviewed 25th June 2010)*

Interestingly, the scheme's organizers have struggled to engage many of Brixton's market traders with the scheme. This is a source of some concern given that many businesses that do accept the currency source goods from the market. Many of these traders, although having worked in Brixton for many years, do not live there and were not born there or in the UK (many are have Afghani or Pakistani origins). A typical response that I received many times when talking to them about he currency was 'you can't put it in the bank' and 'its not real money' or 'you can't pay car parking fees or petrol with it'.

These traders clearly saw that the B£ only partially fulfilled one of money's key functions as a store of value – because it could not be 'put in the bank' at least without changing it back in to sterling. Interviews with B£-accepting businesses who sourced from traders and users who had tried to use the currency with them were also revealing, with a number of them intimating that these traders 'background' meant that they were unable to conceptualize the notion of a Brixton currency as having real value:

*[restaurant owner] P: "Well the obvious thing is the view that its 'Mickey Mouse' money, and there's a very deeply held view amongst, particularly amongst, ummm, ummm… you know, particularly amongst immigrant and ummm…. Now, you know, and I am actually talking about the shops here, not consumers, and it may well be true of consumers. And quite often, the people who own businesses and operate businesses, don't actually live in the area…*

*MT: And on the first issue, the Mickey Mouse money, what do you think we can do about that?*

*P: I think… I don't know how long it took for other areas to establish their money, but I think its about quantity of the money, you build it up and you build it up until its in regular use, and people are seeing it on a daily basis and you can get over that prejudice…" [Restaurant owner]*

*[Café owner] SH: Well, to be quite honest with you, I just use various in the market, I couldn't really name one particular one And a lot of them, ummm, a lot of them are sort of like, they're not, sort of they're not of… how can I say this? They're not of local background, so basically you know all they know is the pound, real pound, you know, they look at your money and they think 'what's that?' Monopoly money, or something like that, do you know what I mean? [Café owner]*

*[user] Um. I mean I know that some of the, um, traders in the market think its not real money. Like I've heard some of the Afro-Caribbean guys say, oh that's not real money, I'm not taking it. So I guess that's an awareness issue.*

We can see clearly from the above comments how the social construction of the B£'s value is an ongoing process, determined by complex and collectively defined conceptions of what counts as the 'the local economy' which determines the trade off with universally recognized additional transaction costs.

The B£ organiser's ambitious aim of genuinely supporting small businesses and re-localising the Brixton economy appears some considerable distance away. Most businesses see a turnover of little more than £30-60 a week at the present time. Very few of the businesses involved purchase supplies from other local businesses using the B£ and many complain of 'just pilling it up in the till' and then having to change it back in to sterling. This involves additional transaction costs for the businesses, although it is free of charge, and somewhat undermines the purpose of the scheme. Hence the B£ organizers are attempting to persuade the local council, the London Borough of Lambeth, to accept B£s as a form of tax, as was suggested by the Chief Executive of the Council at the launch of the scheme in September 2011 when he announced he would like 'B£s to be accepted as council tax'.**15** The Council could then act as a clearing house for the local currency, mimicking the state's role at the national level in creating demand through accepting sterling for tax (Wray 2009). To help in this process, the B£ organisers are currently examining the potential for creating an electronic version of the currency that could be traded with mobile phones, allowing for the creation of bank accounts and avoiding many of the transactions costs.

Whatever the outcome of the B£ project, the fact that such a broad range of businesses agreed to become and continue to be involved in the scheme, despite a lack of tangible economic benefit, does suggest the latent potential for complementary monetary innovations based upon values other than profit, even in inner-city London. The B£ monetary network may well be fragile but, at

180 businesses, it may have reached a critical mass in terms of people's confidence in the value of the money. The sheer empirical fact of the scheme appears to fly in the face of many of the assumptions of the Megerian and Chartalist schools of though on money. Let us turn now to a much larger-scale complementary monetary innovation which may shed further light upon these tentative findings.

## The Swiss WIR

The Swiss WIR (formerly WIR Economic Circle Cooperative or Wirtschaftsring) is perhaps the most 'successful' complementary monetary innovation – in terms of scale and longevity - in modern times. It is a centralized credit clearing system for multilateral exchange with no physical currency but rather debits and credits held at the WIR Cooperative bank. Compared to the B£, the WIR is massive in scale with 68,000 members trading 1.6bn Swiss Francs equivalent in 2009.**16**

The WIR was founded in October 1934, in the midst of the Great Depression, as a self-help organization to promote solidarity amongst the Swiss entrepreneurial middle classes. Revenues in Switzerland from exports and tourism had plummeted by 65 percent in the five years between 1929 and 1934 and the domestic economy was suffering from high rates of unemployment and increasing bankruptcies (Studer 1998: 10). The objective of the WIR Cooperative Bank was to enable its members to buy from and sell to one another despite the shortage of official Swiss Francs. The article of intent of the original statutes of 1934 envisioned "to jointly procure and develop possibilities for work through a ring exchange system and mutual help (...) promotion of local industries and trades, and mutual support in all business ventures." (Defila 1994)

Initially members acquired WIR credit by depositing an equivalent amount in Swiss francs, much in the way B£s are currently obtained. Shortly after, however, WIR deposits were created by making "loans" against collateral, just as in the same way as modern credit-money is created by commercial banks. The key differences being that WIR credit could only be traded amongst fellow members of the WIR cooperative and that WIR credits were loaned at zero interest and accrue zero interest whilst being held in the bank. The function of granting WIR credit loans to members "allows for the creation of an economically significant volume of means of payment, and thus of the needed liquidity for an intense level of barter business, one that can make a significant difference in the economic activity of the individual participant." (Studer 1998: 32). Like the B£, the WIR is primarily designed to favour the 'means of exchange' function of money over its store of value function.

All types of goods and services are exchanged – house painting, hotel stays, used cars, legal services – with offerings posted online and in publications like WIR-Plus. Prices are quoted in units of WIRcredit (or CHW), which for ease of comparison are denominated in – but not redeemable for – Swiss Francs (SFr). The WIR-Bank keeps accounts for each household or firm in terms of its WIR-credits or debits. From the individual's point of view, an account in WIR is much like an ordinary checking account with clearing balances and limits on how large a negative balance can be run.

By the end of 1934 WIR had three thousand participants and its first year of operation, turnover surpassed one million francs, ten times the volume of WIR account balances (Greco 2009: 153). As recorded by Professor Tobias Studer (1998) in his major study of the WIR, it continued to grow steadily with occasional crises and reorganizations and in 1994 turnover peaked at 2.5 billion (equivalent to about US$1.6bn and 80,000 members) – (Stodder 2009: 81). This was still a small fraction of the total Swiss economy, but a significant amount of the members' combined business volume. In 1996, the WIR bank made the decisions to also accept deposits of Swiss francs and began making loans in Swiss Francs. Since then there has been a large and steady increase in its Swiss franc deposits and the volume of its Swiss franc loans, so they now make up a larger portion of its total turnover that WIR trade. Many trades involve part-payment in WIR.

The WIR's success poses a challenge for the Chartalist position that sovereign-backed abstract money of account is required for modern successful modern money. The WIR has no state-like authority other the WIR-bank itself and its members, all 68,000 of which agree to accept the WIR at least in part-payment. Why then has it proved so popular? Research by American economist James Stodder (2009), who carried out regression analysis WIR turnover and credit-issue over 56 years, suggests that the WIR is highly counter-cyclical. Its use increases when the Swiss franc (M2 money supply) becomes more scarce. Stodder argues this may go someway to explaining its longevity and popularity with small and medium-sized enterprises, which make up the majority of its membership and historically tend to be most squeezed during credit crises, a dynamic that can also be seen in the use of trade credits (or corporate barter schemes) (Nilsen 2002).

Interestingly, Stodder suggests the WIR's success is due to it being even less restricted than orthodox fiat credit-money its ability to create liquidity for its members. Whilst the money supply created by a system of demand deposits is fixed by its reserve requirements, the total volume of WIR-credits can grow – or shrink – without limit (Stodder 2009: 85). As Studer (1998: 32) suggests, "every [extra] franc of WIR-credit automatically and immediately becomes a franc of WIR payment medium to be used anywhere in the system". The WIR Bank is able to act in a similar way to a Central Bank for its members as it can, at any time, increase the WIR money supply by creating new or larger overdrafts or loans. This is a clear economic advantage of the WIR over the Brixton £ model which at the moment can only be bought in to circulation with £sterling so does not create any additional liquidity. In fact, in reaction to the 2009 financial crises, the WIR bank even conducted its own program of 'quantitative easing' – called 'Impetus SME' – making available CHW 100 million to 'encourage investment projects' with a maximum loan of 250,000 CHW per applicant.17

Stodder pays less attention in his analysis to the WIR Bank's adherence to strict cooperative lending principles and refusal to engage in speculative financial activity. Both are factors which may be equally important its in longevity and survival of the financial crisis relatively unscathed. It is also interesting to note the WIR's geographical scale. Unlike many cooperatives in Switzerland and other European countries, such as Germany and Italy, it is national rather than regional in scale, operating across all the Swiss cantons and used by clients speaking Italian, French and German. As Stodder suggests, its capacity to be of benefit to SMEs across such a cultural and physical geography suggests it has the potential to be replicated in other countries. Such a concept, on an EU-wide scale, has been proposed by ecological economists as a solution to future European credit crises (Lietaer et al. 2008) and more generally as the most effective model for 'democratizing' the monetary system (Greco 2009).

Stodder's research is backed up by other studies on the counter-cyclical nature of trade credit and commercial barter systems (Nilsen 2002). However, whilst Stodder make an eloquent abstract economic case for the adoption and persistence of the WIR, his research says very little about the social and political dynamics – the construction of the monetary network – that have enabled the WIR to succeed.

The WIR bank is recognized as a normal Swiss Bank under Swiss law despite clearly issuing a currency that is not convertible in to Swiss Francs. This is in contrast to the variety of other complementary currencies – 'scrips' - that circulated in the United States in the early 19th century and that emerged during the Great Depression both in the US and Europe, but which were either outlawed or taxed out of existence by Governments and Central Banks who became concerned about losing centralized monetary control (Fisher 1933; Zelizer 1997: 17) Why did the Swiss Government and Central Bank allowed the WIR to grow to such a large scale? What are the key properties of the monetary network (Dodd 1994: xxiv) that holds the Swiss WIR together? To what extent are WIR members purely driven by perceived economic gains from joining the scheme as opposed to the ethical or political motives that appear to drive membership of the B£? Given that WIR is not convertible in to the sovereign currency of the state, how do we conceptualise its function as a 'unit of account' and its wide acceptance across 'space-time'? Answers to above questions will require empirical, sociological study – they certainly cannot be gleaned from economists' ideal-type models of the economy.

## Conclusion: a research agenda on complementary monetary innovations

Much of the debate about the nature of the money and indeed the 'future of money' is conducted within the confines of incommensurable epistemological paradigms – this includes the Mengerian 'orthodox economics' and Chartalist debate but also Marxist, ecological and feminist economists and more utopian thinkers who point to the internet as enabling the re-democratization of money (Hart 2000; Greco 2009). What these schools appear to have in common is a lack of engagement with how people and institutions actually construct the monetary networks that maintain or fail to maintain their monetary systems that surround us.

A more inductive approach to understanding modern money is required with its theory based upon an understanding of what is actually happening rather than what should happen (Werner 2005: 17). Economic sociology, with its emphasis on the social embeddness of economic action ((Polanyi 1957; Granovetter 1985) and its embrace of ethnographic research methodologies, is well placed to do this. The initial research described above on the B£ and the Swiss WIR raises a number of interesting questions about the social construction of modern money and challenges the dominant Mengerian and Chartalist theory. Further empirical studies of Complementary Monetary Innovations could serve as a particular useful research arena given their unique positioning in challenging the legal, institutional and cultural boundaries of orthodox 'state money' and the capacity of non-state and non-financial actors to challenge a monetary system with fundamental flaws.

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### Endotes

**1**Martin Wolf, Economics editor of the Financial Times, is one of the few commentators who does seem to realize there are alternatives: see for example is his article on June 22nd, 'Why its right for central banks to keep on printing money', where he quotes Milton Friedman's work.

**2**For critiques of debt-based money based upon ecological and social arguments, see Daly 1999: 133-168; Douthwaite 2000; Lletaer 2000; and Mellor 2010).

**3**There are range of other 'schools' in monetary theory which we do not have space to discuss here but include Post-Keynesian, 'Circuitist', Marxist, Austrian or 'Free-banking' and Ecological and feminist economists as well as more utopian thinkers. For theoretical overviews see Smithin (2000) and Ingham (2006).

**4**The vast majority of the word's foreign exchange transactions and held to be speculative in nature (need ref).

**5**The International Reciprocal Trade Assocation (IRTA) – a US based association for regional commercial barter networks estimates that $8.25 billion was traded within its regional ecchanges worldwide in 2004 (www.irta.com ).

**6**For in depth reviews of Transition currencies, see Ryan-Collins (forthcoming) and North (2010).

**7**25% of respondents in a survey of users conducted in February 2010 felt the B£ had enhanced their relationships with local businesses.

**8**The quotes below are taken from qualitative interviews conducted by the author, Annie Quick, Himi Hall and Myfanwy Taylor as part of a paid project to understand the potential for Brixton businesses to source more of their goods locally and as part of an MSc dissertation by Ms. Taylor (Taylor 2010). The quotes should be interpreted as representative illustrations of my interpretation of 'what is happening' with the Brixton £, based also upon my own experiences of initiating the scheme and having regular contact with Brixton businesses and users over the past 2 years.

**9**Brixton £ group meeting minutes, Wednesday 27th August 2008 and Monday 15th September 2008.

**10**Brixton £ note design brief, 23rd July 2009.

**11**Based upon qualitative interviews with 20 businesses, June-August 2010.

**12**see http://brixtonpound.org/where/spend

**13**Interview with Brixton Cycles by Annie Quick

**14**Interview with Ossies' Fresh Ginger by Myfanwy Taylor

15Derrick Anderson, Chief Executive of Lambeth Council, September 16th 2009

**16**WIR Annual reports available from www.wir.ch

**17**Banque WIR, Rapport de gestion (WIR Annual Report) 2009, 22.

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# Grassroots Innovations for Sustainable Development: a New Research Agenda

By Gill Seyfang, Adrian Smith and Noel Longhurst

Community action for sustainable development is an important element of most countries' policies for sustainable development. Appeals to 'big society' from the new UK coalition government imply an enlarged role and responsibility for civil society in achieving policy objectives around climate change and sustainability, among other things.

We welcome this growing recognition of the role of civil society in achieving sustainability objectives, but tempered with a few words of caution: First, there is very little empirical evidence to support claims that such objectives are realistic or achievable; second there is a lack of understanding about how to best harness and support the activities that are taking place; and third, existing evidence points to the need for policy support and public investment, and that effective communities may require effective states. In short, the 'big society' rhetoric promises a growing role for civil society, but must not be a smokescreen for community development budget cuts.

Spurred on by these issues, we have developed a research agenda to deepen our understanding of these civil society processes, and their potential. Our recent research into this field, which we term 'grassroots innovations' examines the processes by which community-led initiatives might develop new solutions for sustainable development, and how those ideas and practices might grow and diffuse into wider society.

Two ongoing projects are underpinned by the recognition that much social innovation for sustainable development takes place in civil society, outside of the institutions that are normally associated with the term 'innovation'. In conceptualizing complementary currencies and community projects in sustainable energy as 'green niches' we are seeking to understand the contexts within which such innovation takes place, and how it might be translated to more 'mainstream' contexts. We aim to inform policymakers about how they can support and harness the creative energies and innovative potential of grassroots communities, to help meet sustainable development policy goals.

This short paper sets out our recent research findings, and reports on two new projects, in this field. First, we summarise our arguments about grassroots innovations, distinguishing them from other forms of civil society action, or environmental initiatives. Then we discuss two projects in turn which aim to empirically develop these ideas with new evidence and theory-testing, through detailed investigation of case studies in sustainable energy, and sustainable currencies, in turn.

## Introducing Grassroots Innovations

Grassroots innovations for sustainable development take many different forms. Examples include furniture recycling schemes, organic food co-operatives, low impact self-housing developments, farmers' markets, cycle networks, local car clubs, and community composting schemes. Since 1992, local authorities in the UK have produced over 400 sustainability strategies that promote these kinds of activities. Shell Better Britain's network of groups grew from 10,000 in 1992 to 26,000 in 2002.

We understand them to involve networks of activists and community groups generating novel, bottom-up solutions for sustainable development, and that typically respond to the local situation and the interests and values of the communities involved. In contrast to mainstream business greening, grassroots innovations operate in civil society and social enterprise arenas. Important points about grassroots innovators are provided below.

- Conventionally, government policy and support for sustainable development has considered 'innovation' separately from 'community involvement'. Sustainable innovations are led by firms and market settings; community involvement encourages participation and behaviour change.

- This division misses an opportunity for considering local communities as sites of innovative activity for sustainable development. Social enterprise and community involvement can be considered as sources of innovative potential.

■ Policy to promote sustainable innovation should extend its view and consider how it can support grassroots innovation in and between communities.

■ Communities can provide niche settings, out of which grassroots innovations can spread, scale-up and be adopted into more commercial and market settings (though this process is far from automatic). Grassroots innovators provide green ideas, not sustainable blueprints.

■ The kinds of innovation that take place in communities are not limited to greener technologies. More usually, it involves novel organisational arrangements, new values and lifestyle practices that facilitate the use of greener technologies.

■ Small initiatives, repeated many times over, can add up to significant environmental improvements. Local knowledge and capabilities help develop tailor-made sustainable solutions where top-down sometimes measures fail.

■ Certain communities can champion unpopular and difficult issues because it matters to them. This provides a vital source of innovative diversity when similar issues become salient more widely.

■ Grassroots innovations mobilise collective solutions to sustainability, which helps overcome a sense of powerlessness or futility when sustainability is considered merely a matter of individual consumer choices.

■ However, many grassroots innovators struggle to obtain resources for their projects. Raising grants to survive can eclipse investment in long-term development of an initiative.

■ Many grassroots initiatives are technology takers – the production of modern technologies makes it difficult to adopt and develop locally appropriate forms.

■ The local roots of grassroots initiatives can make scaling-up and diffusion difficult. Amongst socially excluded groups, the initiative is a means to another end, such as the skills to enter employment, or wealth to purchase goods and services.

■ Many grassroots initiatives fail. Risk aversion amongst policy-makers means they are reluctant to support these ventures. But failure and, more importantly, learning from failure is a positive part of the innovation experience. Policy-makers need to take risks, but to do so with effective mechanisms for learning in place.

■ Significant change relies on forces that operate way above the local level. Grassroots innovators alone are unable to drive sustainable development, but they are able to provide diverse seeds for change when conditions in the wider society and economy are right.

■ Finally, our understanding and policies for innovation, developed in commercial and market settings, may be inadequate for grassroots community initiatives. Research is needed to develop our understanding of local communities as sources of sustainable innovations.

Having set out our key understandings of grassroots innovations, we now turn to each of two new research projects which seeks to deepen, test, revise and extend some of the claims made for grassroots innovation above.

## Community Innovation for Sustainable Energy

*“Decentralising energy and embracing the potential of small-scale generation is a crucial component of the green switch in energy... A decentralised approach saves energy and puts generation under the control of local people.”*

*Chris Huhne, MP*

*UK Secretary of State for Energy and Climate Change (REF)*

Recent years have seen a surge in interest and activity in small-scale, sustainable energy projects led by local communities. Examples include solar water heating clubs and insulation clubs, which provide mutual support for system installation; energy awareness and behaviour networks, which provide guidance and reassurance to neighbours on energy matters relevant to them; and co-operatively-owned small-scale renewable energy systems, such as micro-hydro and wind energy.

Our research project will study the diffusion of community energy projects in the UK. It explores the extent of networking between projects, and whether this is assisting in the innovation of community energy. We do this with a view to providing independent advice to policy-makers, community groups and energy businesses about the merits and processes for supporting community energy.

The project is being carried out by a team of researchers from SPRU at the University of Sussex and CSERGE at the University of East Anglia who have experience in the analysis of grassroots innovation for sustainable development. We will draw upon the findings of our research to develop with practitioners a number of Foresight scenarios for community energy in the UK.

There have been a number of initiatives to promote and support community energy projects in recent years. Most recently, in late 2009, the Government's Low Carbon Community Challenge attracted over 500 expressions of interest. It joins a dynamic portfolio of policies helping innovative community projects. It is argued these projects nurture local support for other forms of low carbon energy. Intermediary organisations, such as local and national energy agencies, span local groups through their advice and support, and help new groups access resources and networks.

Are these networks of community-based approaches a promising component for low carbon energy transitions? Existing research on these 'grassroots innovations' finds that individual projects bring small but significant sustainability benefits, but face challenges in meeting their objectives. First, participants have diverse objectives and expectations: boosting their local economy; enhancing local energy security; cutting carbon emissions; contributing to sustainable communities; catalysing wider environmental behaviours; and democratising energy. Second, social entrepreneurs and intermediaries can help develop the social networks involved in the development and diffusion of community energy initiatives. Third, community project activity promotes social learning amongst participants about wider energy issues. However, realising these objectives requires committed individuals, resources, skills, and access to technologies and supportive infrastructures that are not often readily available. Trying to replicate an exemplary community energy project elsewhere appears to be far from straightforward. Scaling-up projects or translating aspects of them to different circumstances can be just as challenging. Each time, innovative adaptations to the process and content of community energy projects can be important.

We aim to examine a previously under-researched area of how these expectations, networks and social learning develop across and between projects, and so aid diffusion into wider society. Furthermore, might these constitute an influential community energy 'niche' within the UK energy system with its own identity and interests? How do projects replicate, scale-up and translate sustainable energy innovations between communities?

Our project runs from October 2010 until September 2013. We will be surveying community energy projects and evaluating their energy and carbon performance. This will be complemented by twelve in-depth case studies into community energy projects, both exemplars and failures. These will offer insights into the way innovations in technologies, organisational structures, market and business models, and strategies for securing support, diffuse across projects. We will also be interviewing advice organisations and policy-makers that provide support to community groups. A series of events, reports and a website will inform policy towards community energy projects, assess the potential of community energy in wider low carbon transition processes, and help improve the success of community energy practitioners at growing and spreading their initiatives.

## Complementary Currencies for Sustainability

The second of our empirical studies concerns complementary currencies, which are new systems of finance and exchange – new forms of money. The research will gather empirical data on complementary currencies to test the applicability of existing theory of niche sustainable innovations in this new setting, and develop new theory where necessary. The two-year project runs until May 2012, and we will convene an international expert practitioners workshop, and an international academic workshop, to inform the project and share our findings.

These ideas will be applied through the first international study of 'complementary currencies', a wealth of local community-led exchange systems that exist alongside mainstream money. They arise for a variety of reasons, in different forms and contexts, worldwide: the German 'Regio' regional money aims to boost local economic development; in the UK and US, Time Banks strengthen social networks and community cohesion by promoting reciprocal volunteering; a new wave of 'Transition Currencies' is launching local money to promote local resilience, and the

Dutch NU-Spaarpas incentivises sustainable consumption patterns through a green 'loyalty card'.

However, despite their intrinsic benefits and potential, complementary currencies have remained small and marginal. Little is known about the processes and contexts necessary for mainstreaming them. For the first time, complementary currencies will be investigated as specifically innovative activities, in order to:

- Examine the diversity and characteristics of 'complementary currencies' in contemporary practice.

- Conceptualise these 'grassroots innovations' as 'niches' where new social infrastructure may be tested, and investigate the range of contextual factors which contribute to the emergence, success or failure of these innovations, and their diffusion into wider society.

- Relate these findings to wider debates on sustainable innovations and transition management, sustainable development and the social economy.

We will map out the range of complementary currencies in existence; assess how they have tried to grow and diffuse; and identify the factors which have helped or hindered this process complementary currency diffusion. We will then investigate how this experience relates to theories of sustainable innovation and green niches, to highlight what is distinctive about grassroots innovations, and how innovation theory can adapt to better explain community-led initiatives. We will recommend policy changes to nurture and grow grassroots innovations for sustainability.

First, a scoping review of existing complementary currencies research and practitioner literature will produce a new dataset cataloguing the breadth and diversity of global complementary currencies, drawing on the applicant's extensive international contacts.

Second, approximately 12 exemplar currencies will be selected from the dataset, and further qualitative research with these exemplars will investigate their innovation-diffusion strategies (how they approach replication, scaling up, and translating ideas to mainstream settings). It will assess success, barriers, and factors which best support widespread diffusion, such as linking with local institutions, or using familiar technologies. A model of currency diffusion will be developed, linking contextual factors with innovativeness.

Third, theoretical work will review the literature on diffusing niche socio-technical innovations and identify what is new about grassroots innovations, and the implications for theory, policy and practice.

Contributions will be made to debates on complementary currency research, innovation/transition management, and sustainable consumption . The research will deliver timely evidence for policymakers to help them harness the potential of grassroots innovations, and policy recommendations will be suggested, forming the basis of a framework with action points for international, national, regional and local action.

## Conclusions

The programme of research we're embarking upon promises to open up exciting new areas for investigation, and offer new understandings about some of the critical areas of action for sustainable development. How do these innovative projects come about, how do they grow and spread, and what are the critical factors for them to 'catch on'? We have launched the research agenda with a new website (www.grassrootsinnovations.org) where we will post project news, research briefings, papers and other information, and which links in to our other work in the field. We invite your contributions, through commenting on our research blog, to feedback on our papers, and participation at our events. We look forward to developing an ongoing conversation among academics, practitioners and policymakers, with the aim of better supporting and harnessing the energy of community-led innovative action for sustainability.

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# Announcement

## Michael Lounsbury and Paul M. Hirsch (eds.), *Markets on Trial: The Economic Sociology of the U.S. Financial Crisis.* 2010, Volumes 30a and b of Research in the Sociology of Organizations, Emerald Publishing

The current global financial crisis, visibly catalyzed by the rapid drop in securitized mortgage valuations in the summer 2007, has entailed a dramatic decrease in the availability of credit, wealth destruction linked to stock market valuations, the failure of banks and insurance companies, numerous other bankruptcies, the growth of governmental intervention, a deep and protracted recession, and a general rise in the uncertainty of Capitalist institutions. It is in unsettled times such as these that hegemonic and taken-for-granted ideas and institutions may be challenged, and new alternatives cultivated. In the context of the early 21st century, it is the neoliberal ideal of free markets and market-based solutions that are on trial.

While the conceptual apparatus of micro-economics has been a dominant force in the structuring of financial market policy and design, the recent crisis has led many economists to question the intellectual underpinnings of their policy prescriptions. To wit, in October of 2008, Alan Greenspan admitted that he was in a state of "shocked disbelief" because "the whole intellectual edifice" supporting his hands-off deregulatory approach to financial markets had "collapsed." In contrast to the deregulatory emphasis of neoliberalism and contemporary micro-economics that was embraced and purported by Greenspan and his contemporaries, economic sociologists have alternatively emphasized that markets are not naturally self-regulating, but are complex institutions that require rules, regulatory frameworks and related infrastructures that enable markets to function.

Economic sociology offers a robust alternative to the current psychologizing fashion in behavioral economics that emphasizes the role of "animal spirits" or "overconfidence" in explaining the crisis (e.g., Akerlof, Thaler etc.). Focusing more on how economic activity is fundamentally interpenetrated with social, political and cultural dynamics, the lens of economic sociology offers a conceptual approach that is better able to shed light on how crises are socially produced and managed. In addition, this intellectual canon has policy implications that can usefully expand current discussions of how to develop more efficacious regulatory structures and policies that may facilitate economic growth and development in a way that is more equitable and less volatile.

*Markets on Trial* gathered some of the most prominent economic sociologists in North America to provide fresh analyses of the recent financial crisis and to develop policy implications and insights based on their work. To support the development of this enterprise, a workshop was held in October, 2009 at the *Kellogg Graduate School of Management*, and papers were developed into this special 2 volume set. Papers range from more historical approaches that examined the sources of the crisis to more detailed archaeologies of how the crisis has unfolded and been managed.

Below is the table of contents for the 2 volume set:

### Volume 1

# Book Reviews

**Books:** Schrage, Dominik, 2009: *Die Verfügbarkeit der Dinge. Eine historische Soziologie des Konsums.* Frankfurt/New York: Campus./Nepomuk Gasteiger, 2010: *Der Konsument. Verbraucherbilder in Werbung, Konsumkritik und Verbraucherschutz 1948-1989.* Frankfurt: Campus.

**Reviewer:** Kai-Uwe Hellmann, Technische Universität Berlin, kai-uwe.hellmann@gmx.de

I am starting with a preliminary remark: the books by Dominik Schrage and Nepomuk Gasteiger both are mainly historical studies about modern consumption and consumers. This is important to know because in this light questions of sociological theories and methods appear secondary. Of course, there is a theoretical background, especially within the book of Schrage, who is a sociologist concernd with discursive analysis and systems theory, but theory remain implicit. Concerning its methods Schrage's study resembles a sociologically told history of ideas discussing influential authors and books in a chronological way while Gasteiger, who is a historian, is typically concentrated on texts of different provenience from classical historical sources.

Schrage is most of all interested in the role consumption is playing within modern society. It is obvious that consumption became a quite ubiquitous and powerful factor in (post)modern life. So the question comes up how to assess the status of consumption. Against this background, Schrage differentiates between consumption as an anthropological triviality which happens constantly all over the history of mankind on the one hand, and commodity consumption, which is historically singular and structurally specific since the establishment of modern society some centuries ago on the other hand. The link between consumption and commodities available only by money exchange gives modern consumption its uniqueness.

Schrage's study is divided into two parts. The first part begins with the conceptual history of the term "consumption" and its two meanings "cōnsūmere" and "cōnsummare" and leads on to the evolution of society and the establishment of modern consumption patterns from the 18th to the 19th century in Europe. It is important to be familiar with the conceptual history of the term "consumption" because, unlike today, at the beginning of the history of this term there were still two meanings in use: "cōnsūmere" in the sense of destruction/wastage and "cōnsummare" in the sense of accomplishment/perfection. Over the decades, the first meaning advanced and received more attention, especially by political economists, while the second meaning vanished step by step. Today the public discourse considers consumption often as wastage. Subsequently, Schrage reconstructs the highly controversial debates on luxury and consumption during these two centuries and then turns to the monetarization of social relationships and the emergence of the role of the consumer. Here, Schrage argues, by implicitly referring to Georg Simmel and Michel Foucault, that the relevance of consumption for daily life has grown since the 19th century to an extent that we can speak of an increasing subjectivation by consumption. This establishes a genuine perspective to observe society and the world in general.

After a short resume and forecast of the second part, Schrage discusses briefly the relationship between fashion and consumption, sketches the amazing appearance of the new department stores and then concentrates on the North American way of consumption. Here we can observe the very beginnings of what consumption has become today almost everywhere. He first outlines the overwhelming influence of Henry Ford, then describes the dissemination and acceleration of mass consumption as a model of private life conduct. Here, Schrage mainly refers to Thorstein Veblen and David Riesman and emphasizes that the actual perception of consumption as a global, quite contested, perspective could develop especially in the environment of the North American society with its specific requirements of differentiation and integration.

In his last chapter, Schrage summarizes his concept of the findings and insights of the genealogy of modern consumption. Most important is the emancipation of consumption from traditional constraints so that we can say that commodity consumption became autonomous, a sphere by its own, on the one hand closely linked to the system of economy with money as its medium and on the other hand, to everybody's need of orientation and definition of a specific social position in contemporary society. Because consumption helps individuals to integrate into modern society and to behave in a way controlled by society, (referring to a classic argument by David Riesman and Howard Roseborough), consumption can be acknowledged for its forceful drive. One could almost call it an institution of modern society.

Schrage's study is a sociologically well informed, highly elaborated historization of modern consumption starting in the 18th century and ending with the Second World War when the core conditions of modern consumption were all fully developed and unfolded. The basic assumption of this study is that from observing semantics we can get an idea of what happens on the structural, societal level. Here he borrows from the sociology of knowledge. For this reason, Schrage repeatedly leaves the level of semantics and "descends down" to the structural level of present day corresponding effects and shifts. For this purpose, he refers, while always relating to concrete problems, to theories and concepts from Baudrillard, Foucault, Luhmann, Riesman, Simmel, Veblen, just to mention some of them. The empirical evidence stems mainly from canonical texts and books which were selected and combined to reconstruct the history of modern consumption.

When Schrage's study ends shortly after the Second World War, Gasteiger's study begins exactly there. His scientific intention is to describe how the consumer was seen in Germany between 1945 and 1989. For this purpose he analyzes the images of the consumer in academic discussions among consumer researchers and consumption critics based on a broad selection of monographs and journal articles. As a result four different images of the consumer in Germany emerge within these more than four decades: the *rational consumer*, the *psycho-social consumer*, the *controlled consumer* and the *postmodern consumer*.

The *rational consumer* came up first and was mainly a phenomenon of the 1950ies when consumerism and consumer protection gained plenty of attention in Germany. Because of this public power, professionals doing marketing, advertising and consumer research felt forced to react to this public pressure and to treat the individual consumer as a highly rational, calculating person. They focused on putting information and truth in the foreground in order to give the consumers the best of advice. Naturally, this was mainly a strategy for legitimating their work.

During the 1960ies, a paradigm shift can be observed. Consumers reached a certain degree of saturation and didn't behave any longer in an easily predictable way. On the contrary, the complexity of consumer behaviour grew so fast that totally new methods of consumer research were needed. The most spectacular method during these years has been *motivational research* referring to psychoanalysis and similar concepts. Suddenly the psychological and sociological conditions and processes of daily life were studied in order to gain from them a better understanding of the new psycho-social consumer. This was a very dynamic and vital episode in Germany concerning this specific business and academic field.

At the end of the 1960ies, the mood shifted again. Intellectuals like Herbert Marcuse, the students' movement and other changes of society, triggered a new critical approach towards consumer culture. Now the consumer became a subject of politics because critics accused professionals very successfully of *manipulating consumers*. Business felt a permanent legitimatory crisis over those years. Institutions like "Stiftung Warentest" gained political attention and influence and established themselves firmly.

The last type in this development is the *postmodern consumer*. His biography started in the 1970ies and stabilized over the 1980ies. This new image emancipated itself from all precursors. The pluralization of society, the silent revolution, the oil crisis and increasing unemployment, just to mention some aspects, pushed consumers into a new era of consumption. Freedom of choice was never greater. The accusation of manipulating consumers became old-fashioned. In consequence, consumerism and consumer protection movement lost influence and financial power. Here ends the study of Nepomuk Gasteiger.

His work presupposes und uses a broad and accepted scheme of interpreting the decades since the Second World War as far as the consumer is concerned. From this point of view Gasteiger confirms many well known facets of these years and changes. On the other hand, there are almost no surprises, which means that the state of the art concerning the academic consumer research obviously is of high quality. The main strength of this study is the volume of the collected materials, especially how they were selected and how they were used. Under theoretical aspects, Gasteiger's study also is focused in the first place on semantics which raises the question what really happens within the lives of the consumers. This question can't be answered within this study. But it may be guessed that these four images of the consumer between 1945 and 1989 were not totally uninfluential, that all four images are still simultaneously in use and that since 1989 some new models entered center stage. Probably this will inspire further research concentrated on the years between 1989 until today, a period that was extremely eventful in the field of consumption and consumer developments (Gabriel/Lang 2006).

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# PhD Projects Projects in Economic Sociology

## The Economization of the Sacred: The Transformation of the Death Care Industry in Germany

**Institution:** MPIfG Köln
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One distinctive feature of our current period of economic transformation is a strong trend towards the expansion of market relations. Yet the question concerning which goods can properly be bought and sold is subject to controversy and debate. There are certain things that cause personal and social conflict in individuals when, in the process of their commodification, these things begin to be actually perceived as commodities. This holds true for services that are traded on funeral markets and thereby causes economic activity in this area to be denied legitimacy. Nevertheless, the German death care industry has recently shifted towards market-oriented reforms, while exchange relations among market actors have became more 'economic'. Focusing on these transformations, I study how market structures, regulation, sacred values, and legitimacy interact during processes of marketization.

### The marketization of the death care industry

The expansion of market relations in the funeral business included the privatization of previously state-run funeral homes, crematories, and cemeteries. In addition, the industry experienced profound changes in the dynamics of competition. While the number of deaths has decreased steadily in recent decades, a large number of new firms have entered the market since the 1990s. Entrepreneurs have been especially attracted by the impending demise of the baby boom generation, which will mean a large number of deaths in the near future. Furthermore, an international trade of funeral supplies – in particular with Eastern Europe – started to emerge after the fall of the Iron Curtain. As a result, the market became more dynamic and highly competitive. Companies tried to compensate for decreasing profits by inventing new products and applying new business strategies.

### The detraditionalization of the funeral

For many centuries, the purchase decisions made at the end of life were strongly influenced by religious beliefs and political ideas. In recent years, however, the authority of collective orientations has eroded and thereby widened the scope for more individualistic funeral choices. At the same time, decreasing numbers of funeral attendees and cemetery visitors also indicate a fading significance of the funeral as such. In addition, the abolishment of the death grants in 2003 – a payment that was granted by the compulsory health insurance funds on the occasion of death – made it increasingly difficult for people to raise the large amount of money necessary for a burial. While funerals costs and cemetery fees increased, individuals had fewer resources to spend. These developments opened the door for cheaper and less elaborate forms of burial. As a result, individuals adopted decision-making strategies that would have previously been considered inappropriate in the funeral market.

### Towards a legitimate market

The funeral industry of today operates much more on a market-oriented basis than it did 20 years ago. Apparent economic activities such as advertising, price competition, and price comparison have become more legitimate in recent years. Furthermore, representations of the sacred – coffins, grave markers, and other memorial products – have become commodified to a larger extent. The case of the funeral market can help us understand how social and historical transformations set the stage for processes of marketization that promote the shift of certain areas of exchange from illegitimacy towards legitimacy.

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**Keywords:** Death, Funeral, Market, Moral, Legitimacy, Commodification, Detraditionalization

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