

## THE REVALUATION OF THE STATE

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After the ‘credit crunch’, the collapse of the ‘housing bubble’ and the consequential economic crisis, there is widespread consensus on the fact that – since the worst is over and we can therefore look at the crisis beyond crisis management – measures need to be taken, to prevent this crisis from recurring. How likely is it that these measures will truly be taken, and what measures should these be? In this paper, the author will suggest that there is a reasonable chance that – while the underlying causes remain unseen – some cosmetic changes will be made to our economic systems. These changes are most likely to be improvements, but one can wonder whether these cosmetic adjustments are sufficient to prevent a second economic crisis. The main point of this article will be that they are not. In order to truly prevent a repetition one needs to reevaluate the state as main arranging and supervising principle, also and perhaps more importantly in the economy.

Whether one talks about ‘NINJA’-mortgages or credit rating agencies, everybody seems to be an amateur economist these days. And, more than ever in recent history, a call for change can be heard. World leaders renounce fundamental changes and a world that will never be the same again. Neo-liberal capitalism seems to have taken a heavy blow to the head. But does this necessarily imply the fall of capitalism, neo-liberal capitalism or even our current economic system?

The answer is probably no. History has never been the kind of ballgame well explained by necessities. History is – more than any other science – a man's game, a hybrid and multi-interpretational get-together of many intertwined factors. The isolated analysis of one of these factors might lead to a straight forward and clear view on our current situation. As tempting as this may seem, this would not do justice to our complex and globalised economy. We are challenged to take the whole system into account if we are to draw conclusions from the past and give suggestions for the future.

It is almost impossible – in the middle of a crisis – to decide whether our current situation is unique. While it is undeniably true that the economy has suffered from severe crises before, our globalised economy is fundamentally different from the world economy as it existed in for example the 1930s. This makes it almost impossible to export suggestions and recommendations from the past to our current situation. Now already, experts with a wide variety of backgrounds offer us suggestions on how this crisis was caused and what needs to be done in the near future. Yet, in reality, hardly anyone was able to foresee this crisis, so what is this expertise really worth?

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Allow me – after this degradation of the noble art of prediction – to take a look in the future as well and predict some of the changes that are likely to be made in the near future. Our current economic system was mainly shaped in the 1980s, when neo-liberal economic policy – with Ronald Reagan and Margaret Thatcher as its main representatives – gained ground and economic governance was mostly characterised as obstructing the market in its search for maximising economic growth. First, I will describe several changes that – based on an overview of both the political discussions and suggestions made by experts – have a significant chance of succeeding. Changes for the better, in my opinion, but not changes that challenge the fundamental weakness of our economic order: the notion of the government as part of the problem, not as part of the solution. After describing some of these possible changes, I will mention some more fundamental changes that would truly alter the relationship between market and government.

First, a serious improvement will have to be made to the remuneration of the credit rating agencies. Agencies such as Moody's and Standard & Poor's – both with names more ironic than our common imagination could ever have come up with – have had the ability to 'break' a corporation. Yet the problem is that they hardly ever really broke a corporation, even if they were aware of its woeful financial predicament. It is not hard to understand why this is: the remuneration functioned as an extremely perverted incentive. Thus the higher the rating, the higher the bonus for the rating agency. In the past this led to the bizarre situation that Enron was rated at an 'investment rate' four days before the company went bankrupt. Later it turned out that these agencies had known of Enron's problems for months. Several banks that are currently saved by tax payer's money from all over the world, obtain triple A ratings until this very day.

An important problem in this system is the notion of customer kindness while one's job is to supervise. A rating agency should not be kind to its customer. It should focus on providing potential investors with a neutral and objective report on the state of the company, rather than trying to please the company with high investment rates. One can even wonder whether we should preserve the current system of several rating agencies competing with each other. One national rating agency could take away the incentive of money-driven consumer kindness, at times that it has to be strict.

Second, supervision should be intensified. This notion has become a truism in only a few months. Where the rating agencies are slightly neglected in the public debate, supervision has been grilled and toasted, as it should be. Since the 80's, financial supervision has been cut down to the bone. Supervisory bodies – supposed to act as aggressive watchdogs – were nothing more than retired and toothless chihuahuas. The common denominator in the cases of both rating agencies and supervisory bodies was the ideological neo-liberal belief that the government should not interfere in the playing field of market

parties, competing for the demands of their customers. In recent times, the financial market has invented inexplicable financial products, even too complicated for the supervisory bodies to grasp. And even in the rare case that such bodies did discover problems, they refused to act. The Icelandic bank Icesave serves as an illuminating example. The Dutch Bank was aware of the problems of this cowboy bank – lending more money than it should, while offering higher interest rates than it could – but did not act, apparently afraid to cause a rat race of customers, reclaiming their money. This would have aggravated the downfall of the bank. Yet, in retrospect, one can justify the conclusion that even a small step such as a dismissive advice would have been preferable to the bankruptcy of the bank. Now the Dutch tax payer – thanks to the Netherlands' toothless chihuahua – has lent money to Iceland in order to render Iceland the opportunity to repay duped (Ice)savers.

Third, the reward for bankers, CEO's, CFO's and other executives of the Board will be drastically altered. Now that citizens feel the pain of having to bail out large, multinational corporations, they no longer react detached when they hear about multimillion bonuses. If the aggressive public opinion towards bonuses for bailed out executives gains momentum and generates results, it is very well possible that perverted incentives – as captured in these bonuses – will be tackled in a broader style. The political motivation to act upon the remuneration structure is both clear and fully justified. Because of the apparent link between short term success and the high level of the remuneration, managers are drawn towards risky investments and an aggressive policy. The stakes are high, just as the possible reward. Yet if one fails, one still leaves with a nice departure bonus, if one leaves at all. Because of this win-win situation, the management has no obvious reason – apart from an apparently extremely rare innate sense of responsibility – to pursue the long-term interest of a company, especially if this might interfere with short-term gains. Now already, suggestions to tackle this problem are widespread. One of the more creative solutions is the suggestion to freeze a bonus for a period of five years. After this period, the company will decide whether the former manager did a good job – and deserved his bonus. Apart from the complicated procedure, this solution does not solve the underlying problem. It might be a more fruitful suggestion to tackle the undermining influence of activist shareholders, who turned out to be more than willing to grant a manager millions a year in exchange for a nice dividend. But this might be a bridge too far, which brings us to the main point of this article, namely the conclusion that changes will be made, but that the fundamentals might well be kept out of harm's way. This is not to say, that the possible changes described above are merely cosmetic. Until very recently, these are improvements that a heartfelt socialist believed to be impossible in the short term. But the solutions discussed above do not improve the corroded piles of our current economic order and therefore do not prevent a commensurable crisis from reoccurring. As mentioned above, only a broad approach is able to capture the underlying causes of the crisis.

Thus, what changes could fundamentally alter the current system and achieve a stabilisation in the economic system? First, staff participation is vital to a more stable future of a company. Where shareholders come and go, the average time of an employee at a company exceeds shareholders by far. Therefore, instead of focussing on the discussions in the annual shareholders meeting, the Board of Directors needs to focus on the employees council's opinion thereby decreasing the influence that shareholders have take the employees council's opinion into account. Note that this measure should not be optional and should not be contemplated in isolation. In the Netherlands, the employees council is consulted on major policy changes, the appointment of Boards of Directors, and the remuneration of the upper layer of the company, but if a conflict between the company and its employees council arises, the employees don't have the power to block or overrule a decision. Furthermore, the employees council should have the power to overrule decisions of the shareholders meeting. The company belongs to the shop floor primarily, and only secondarily to the shareholders. But these two interests do not necessarily have to conflict. We have discussed the undermining influence of activist shareholders such as hedge funds grasshopper investors, but we should not forget the potential importance of careful and competent long term investors. Yet, it seems likely that this category of investors will agree with the employees council on a more regular basis than the grasshopper like behaviour of activist shareholders. Just like farmers protect their crop from real grasshoppers, it can be expected that by protecting the possible prey, hedge funds and private equity investors will be less eager to plunder, strip, demolish and leave a corporation. Also, by creating the legal possibility of rewarding long term investors with a higher dividend, the combination of shareholders interest and company interest becomes more likely, and possibly more frequent.

Also, the powers that be will have to solve the dilemma of financial institutions and corporations, considered to be 'too big to fail'. This has been the underlying argument for providing the hundreds of billions of dollars to prevent imminent bankruptcy of large parts of the financial sector. Bankruptcy would cost millions of savers' money, corporations would go bankrupt and people would lose their jobs, even more than they do now. This is a fairly reasonable argument, but it begs the question of justice. How can one justify bailing out banks that have generated mass revenues for the benefit of their shareholders, but now that reality strikes, the government has to come to the rescue? And more importantly, what are the lessons to be learnt?

My suggestion would be to give corporations a clear choice, starting with the corporations asking for the most support: banks. Either the bank splits its financial institution in separate parts – for instance a regular bank with savers and a more risky investment bank – in order to ensure that the bank can no longer be considered too big to fail or the bank accepts that the government will be an important shareholder with the power to block or force certain

decisions. What is saved by the tax payer, obviously belongs to the tax payer. Another important advantage is that public ownership also gives the government the possibility to take action on the current corporate credit running dry.

Corporate greed is a good thing. Fierce competition between companies can lead to innovation and economic growth. But companies are like nagging children, they need a fostering parent to show them their boundaries, since they will not agree on these borders themselves. And that parent is the state. The 80's have left us with Reagan's inheritance; the notion that a government is part of the problem, not part of the solution. What we have seen in the last months is the fall of Reaganism and the rise of the revaluation of the state. We saw American car directors driving thousands of miles in a Toyota Prius – instead of taking their private jet – in order to convince the American Congress of their goodwill. The difference with the arrogant Board of Directors that threatened the governments to leave if that government did not comply with their demands, could hardly be bigger.

Our economy in crisis needs more than cosmetic changes and adjustments in the margin of our economic system. We should allow employees to have a say in their corporation's policy and their directors' remuneration. Banks and large corporations that are 'too big to fail' can decide to split up or agree on a long term policy influenced by the same government that has to bail them out when they make mistakes. Investment should be directed at the future. If any legal boundaries prevent the reward for loyal, long term ownership of shares, these boundaries should be raised. At the same time, companies should be protected against the grasshopper-like activities of hedge funds and private equity. Rating agencies and supervision bodies need to be as independent and hostile towards their 'customers' as they can be. Incomprehensible financial products should not be allowed on the market.

In conclusion, the state needs to reinstate itself as the main arranging and supervising body in the economy. Private benefits can no longer be accepted to be public burdens in times of crisis. The tax payer, the jobless engineer and the former home-owner will all feel the bitter consequences of corporate greed for years to come, but we have the solemn duty to utilise the current momentum for change and reallocate the power to the people, and their main representative: the state.

