

Hamburg, January 2001

New Year Letter 2001

To all friends and colleagues of IFF
Ladies and Gentlemen

We would like to take the opportunity of wishing you a happy and successful New Year and of thanking you for your help and co-operation in the past year, and for the confidence you have shown in us.

1. Whereas the theme of our last New Year's Newsletter was the importance of long-term and consistent reflection on financial services, the year 2000 has highlighted that short-term issues may become even more prevalent. The New Market and the **Internet** information communication system, which became inflated into the **Dream Factory** of a drugged work-free society, helped form a new version of the old gold-digger mentality. Securities with a material value of a mere €20 million went up to over €6 billion on the stock-market for a time. "Expert" economists informed us that mere "expectations" and "exciting ideas" and "access and networking" had replaced the analysis of charts and values. Dubious founders of religions appropriately named "stock-market gurus", whose sole measure of truth was doubtless their own coffers, took money from ordinary people and then went on to wangle even more money out of them in order to minimise the losses of the large investors. Estate agents as always made a good profit and questionnaires submitted to banks in media interviews about the "get-rich-quick society" for a time put serious issues in the shade, even at IFF. In the words of Goethe's Sorcerer's Apprentice, "Lord, we are in dire need! Those spirits that I summoned will not now let me go."

"People who live under democracy (i.e. in the USA) nurse great passions. But these passions are largely exhausted by the love of wealth. That does not mean to say that their spirit is meaner (than that of the French) but results from the fact that money plays a much more important role in their life...Values attributed to old things, to people's origins and to the State, dwindle. People now barely distinguish between themselves according to their profession. It is only money that continues to make differences so visible and remains capable of raising the status of some above that of others. (Alexis de Tocqueville, De la Démocratie en Amérique, 1835/1840) Paris Gallimard 1968 P. 264f)

2. According to Rifkin, the 21st century will be an **Age of Access** or, upon a closer reading, an age of exclusion. People who have no capital cannot exercise demand. People who do not exercise demand will increasingly be excluded from the necessities of life. It is true that a new opportunity appears in modern capitalism: poor people are not those who have no property because loans replace own capital in the credit society. But the point is that creditworthiness takes over from wealth, based on a highly subjective evaluation by financial service providers of the individual's future potential, with fatal

consequences. Alas, if that evaluation is wrong or if the right individual in economic terms is not the right individual socially. The level of responsibility of the banks for general social well-being will increase exponentially in the "Age of Access".

In his book, *The Age of Access, – the New Culture of Hypercapitalism, Where all of Life is a Paid-for Experience*, (New York: Penguin Books 2000) Rifkin describes how the hunger for investment opportunities after the privatisation of land, the means of production, nature and work in the two previous centuries have now also turned information, communications and culture into mere commodities, the distribution of which is to be taken over by the market. What matters, according to Rifkin, is no longer the current marketplace, but the long-term Network (5;10), not property but the application of capital (P.208), not industrial production by labour but cultural capitalism (7). The work ethic has turned into a play ethic (7). It is now not things which have been worked on which are sold, but things which have been experienced. The opportunities of the individual are pre-determined by what potential investors in that person consider to be his or her Life-Time Value, that is to say the sum of their opportunities for earnings and expenditure (7). "Economies of speed replace economies of scale." (22) "Work is replaced by software...feelings of faith, empathy, and solidarity – are replaced by contractual relations in the form of paid memberships, subscriptions, admission charges, retainers, and fees." (9) "In the new network economy what is really being brought and sold are ideas and images." (47) "It is the sharing of economic activity that is the defining feature of network-based economy."

Already 25% of the US economy consists of financial services, entertainment, communications, management consultancy and training. (52) The issue for the future is therefore how, in a society of financial services and credit in which no longer is anything "held, accumulated or inherited", but only "made available" for use (84), and in which everything is subject to the law of exchange, the cultural life of humanity can survive. The right to participation, once bound up with ownership (McPherson), will be incorporated into the distribution capabilities of the large providers, which control patents over science and genes, entry into "gated communities", access to the networks of life and culture. There must therefore be a fresh struggle for the right, "not to be excluded from the totality of human resources and activities" (239)..

In a country where the market is everything, altruistic communities have to use the cultural value system to counter the hunger of share indices, financial moguls, analysts and managers of pension funds. "Non-profit organisations preserve history" (254) "Think globally, act locally" (259). Communitarianism, however, is also the slogan of the new "compassionate conservatism" espoused by new US presidential adviser Marvin Olafsky, whose fundamentalist opinions have led him to develop a "brave new world" of the politically correct ordinary citizen.

The biggest German newspaper the *Süddeutsche Zeitung* of 27.12.2000, P. 17, recently reported under the headline "**Schöne Neue Welt der Tagträumer**" ("**Brave New World of the Daydreamer**") on a specific form of community, which apparently now includes 12% of Americans:

"Cynicism, loss of values, power - for many Americans the supposed collapse of society is unstoppable. The State is breaking down, social self-regulation doesn't work, and they themselves have no interest in participation. Instead of going under with the masses, they are taking refuge from the democratic cacaphony in island worlds, in which a lone developer sets the tone. These Master-Planned Communities now form the majority of new residential developments in the USA. They are the latest products of the US dream factory. Summerlin, where 160,000 people will soon be living - more than in Regensburg - is the largest....Where everyone is in agreement, there is no need for hassle." "Summerlin is capitalism cured by capitalism" declared Chuck Kubat, Vice-President of Planning and Design. "Spontaneity is lost, but instead people are safe from the lousy behaviour of others..." (for more on this subject, see Blakely, E. & Snyder, M. *Fortress America: Gated Communities in the United States*, Washington D.C.: Brookings Inst. Press 1997)

Community ideologies (the memory of "defence, home and factory communities" („Volksgemeinschaften“) in Nazi-Germany is still an unhappy one) are won by means of political correctness, whereby those who have the keys keep watch. This phenomena is

not linked to fascism but has always been an unproductive backward looking ally of egoism as Toqueville stated long ago:

"(American) individualism is of democratic origin (ibid P. 266) and threatens to grow as conditions get more equal...Individualism is a calm and considered sentiment, which inclines each citizen to isolate himself from the mass of his fellows and withdraw into his circle of family and friends. Having formed this little society to his taste, he gladly leaves the larger society to look after itself. While egoism springs from blind instinct, individualism is based on misguided judgment rather than depraved feeling. It is due more to inadequate understanding than to perversity of heart...While egoism sterilises the seeds of every virtue, individualism at first only affects public virtues, but in the long run it attacks and destroys all the others too and finally merges with egoism (P.242).

3. Communitarism tends to follow the model of modern insurance industry: exclude those who have the highest risk and gain well-being for the rest. For those who are excluded from general market mechanisms especially in the USA and also in the UK with the highest levels of poverty in the western world (The Guardian, 12.1.2000 and 11.5.2000), new products for the "fourth sector" of the economy - the **Poverty Economy** - are being developed without sufficient social minimum standards imposed by the state. Access or quality has become the main excuse formula for not implementing social consumer protection into financial services law. Consequently the segregation of clients in the credit society creates specific poverty markets.

Pre-paid mobile phone cards are like lead-filled life jackets for those who are excluded from standard contracts because of their lack of creditworthiness. For these you pay long-distance rates for local calls which are otherwise free of charge. The result can be a fifteen-fold increase in charges each month. Very recently, the "Freedom Card" has been introduced by Mastercard for commonly used frequencies, whose effective rate of interest had to be corrected from 21.74% p.a. to 35% p.a. to take the charges into account. American poverty law accordingly does not concern itself with the market, but with access by the citizen to the state in the form of legal and social support, with the result that my research project on "Poverty Prevention and Contract Law – Towards Inclusive Contract Law" at NYU met with incomprehension.

Meanwhile the Poverty Economy is already gobbling up the achievements of **Community Reinvestment** and the fascinating Projects for City Development through credit which we studied and wrote about with enthusiasm four years ago in Chicago, New York, Washington and Los Angeles and which are now propagated all through Europe by governments who feel that the retreat of the social welfare state has not created a solidaritarian private economy by itself. But disclosure does not replace protection. For all those who have followed the consumer movement from the sixties of last century to today this insight is trivial. Only those who have got a minimum level of dignity, economic freedom and access choice and its sister transparency are valuable tools. For the other it is just a sad message telling them what will not be done for them by market forces alone.

4. America nonetheless still remains a land of unlimited possibilities from which we must continue to learn how to overcome the status economy which despite its communitarian promises and paternalistic care inhibits innovation and inflicts social harm. The dream of a private economy based on solidarity can be best dreamed in the most developed market economy of the world, (even if that dream will probably be realised elsewhere.) The core problem of the money economy is that not all people but only investors with their capital voting rights determine what is considered to be productive. As a result, contrary to all reason and democratic principle, vast elements of our labour as carers, raising children, in education, providing assistance and engaged in socially responsible activities is degraded, at least in the marketplace, to pure costs.

The challenge in this respect is to identify models which broaden the horizons of our market economy in such a way as to promote collective provision and sustainability. Where the products of the money economy become weighted towards sustainability, they will also awaken a "sleeping demand" of people who already have more social comprehension than the market is ready to include into its mechanisms.

5. The fifth financial services conference organised by IFF, on this occasion in Göteborg, on the subject of "Access to Financial Services", was very well received in September by over 300 representatives from financial service providers, the social sector, science and politics of over 18 countries. I attempted, in my presentation on "Finanzdienstleistungen und Armut" ("Financial Services and Poverty") (www.iff-hamburg.de), to identify a way forward. Under the banner of "**Solidarity**" and its translation into the language of financial services as "**Risk Instrument**", (insurance, fixed interest, cap, futures, warranty, guarantee etc.), the challenge is to construct these instruments in such a way as to incorporate as many significant but economically unproductive costs as possible and to distribute the instruments as fairly as possible. For example, what state mechanisms achieve in part through social benefits in terms of maternity costs should be available also to some extent privately on the market. However, even directly affected individuals, let alone other members of society, will not wish to purchase such products. Accordingly there would have to be social cartels of demand, in which even those not directly affected would adopt social risks in the collective interest. Belonging to such a cartel would be recognised and rewarded at once as a public declaration of faith in public spiritedness.

This is not a utopian proposition; on the contrary, beginnings are visible everywhere. For example, environmental costs are being taken into consideration in the allocation of investment by churches of their money on ethical criteria; cities or communities are making their relationship with banks conditional upon the banks' agreement to provide services for difficult clients or neighbourhoods. The new law on private pension schemes will ask life insurers to disclose their investment behaviour. When recently a pastor telephoned and explained that €46 million, for which he was responsible on behalf of his parish, had not been professionally, let alone ethically invested, two problems emerged. Where there is a failure to reflect, there is a waste of 1) money, as a result of the absence of professional management and 2) opportunity to demonstrate that ethical conduct should not only govern behaviour in church on a Sunday.

6. Is it possible to run an **Institute for Financial Services** governed by such **ambitions** as a private non-for-profit without state subsidies on the market? Is the objective of developing financial services on a more modern, a better and a more socially responsible basis to be abandoned in favour of poverty research or conversely is a change of direction towards the private financial sector a necessary rejection of the unproductive sector of the economy of the overindebted, the unemployed, lone parents and social aid? I do not believe so.

In the course of the past 15 years, IFF has gathered together a body of knowledge reflected in the form of individual analyses of the failures of financial services in consumer credit (designated "extortionate instalment credit"), in business start-up finance, in failed house building ("risk construction finance"). This takes the form of reports and books, test designs and essays, magazine articles and computer programmes and not least our manner of working. This knowledge is directed at the pathology of financial services and takes all disruptions seriously. Those disruptions are caused on the one hand by technology because of the failure to modernise products adequately and a shortfall in competence on the part of providers and demand. On the other hand they also arise as a result of irresponsible and illegal dealings or structural discrepancies within the system. This knowledge is applied both in its interdisciplinary method and content to the

"final quality test" which the providers would wish to have for their own long-term projections (albeit as far as possible without public involvement).

We were thus able during the year 2000 to identify fundamental points relating to the quality of advice for an increased clientele, to adapt modern retirement models for private housing from the USA to the German market, to advise the legislature in relation to the Investment Funds Directive (UCIT), as well as to advise on consumer credit in Strasbourg and Brussels and on consumer bankruptcy and reform of the German Civil Code in Berlin. We provided the social sector with assistance in the form of the concept of the acquisition of alternative sources of capital (Social-Sponsoring Handbook), we introduced a new sector in between the credit economy and employment offices, we helped build up micro-lending with instruction manuals and handbooks and we were involved in the re-structuring of the subsidiary of a major bank with a view to developing local branches providing new financial services, instead of simply shutting them down.

Our main focus, the lack of profitability of everyday consumers especially those who experience financial problems, has since become a major problem for the financial services sector in general. We have already worked with consumer centres on shortening the length of time needed for financial advice, on efficiency in debt advice through electronic data-processing, reduced individual advice through the use of group advice models and "stacked" advice without any loss of quality. All these are concepts which financial service providers need even for their better-off customers. The fact that the client relationship today is only established through the image of the bank standing by its client even in times of crisis is now of general application. Social responsibility for the middle class and for the essentials of life has been recognised in the recent voluntary code of practice of the Association of German Banks and has been proposed as a European wide guideline for 2002. Hopefully this is not just to prevent a CRA for Europe but the beginning of a new market philosophy when the Commission states:

„At the First European Business convention on CSR (9-10/11/2000) in Brussels, the Commission has welcomed the suggestion of CSR Europe, a group of multinational companies mainstreaming Corporate Social Responsibility (CSR) in global business operations, to propose a Voluntary European Charter on a Minimum Level of Banking Services for All, as an instrument to promote social cohesion. This proposal appears timely and appropriate in view of the growing importance of Banking in Europe as well as the entry into force of the Euro in 2002. The Commission is willing to support and facilitate the preparation and adoption by financial institutions of a Voluntary European Charter on a Minimum Level of Banking Services for All.“(Release of the DG Employment 22 January 2001)

Much criticism that was dismissed a short time ago as fundamentally too radical is now in vogue. With contracts worth over €1.5 million for the next few years it will be easier in one sense to choose, but in another more difficult to distinguish between " **research under a commission** " and "commissioned research". We are only concerned with the former.

Such investigation must remain independent in objectives and methods. The customer decides as to the field and the application of the results. Our interest in applying the best ideas even to the needs of the most vulnerable in society is accordingly an essential part of our projects, even though we do not aspire to impose the application of this aspect on our customers. IFF is in the business of developing possibilities, not practical realities. Their application requires agents within society who are able (including financially able) and willing. For that reason, collaboration with consumer and money advice agencies is of fundamental importance for us and our "service" to this sector far exceeds that for which we are expressly financed.

7. Holding this line is not always easy. The example of **micro-lending**, which makes very small loans to business start-ups, demonstrates this. New providers appear, with a social agenda of meeting the shortfall in provision by the banks, but they are still providers, who have to be examined critically. We were among the first to develop such micro-

lending concepts for the banks in Germany. The work was a success in terms of IFF's reputation but not in terms of the subject-matter. Had the results been different, it would have gone better for us with international organisations and with politicians who are seeking inexpensive solutions to a stagnating labour market through self-help. Informal banks are very appealing, but have to be measured by the yardsticks applicable to existing banks. Credit at extortionate rates of interest is not legitimate even if it arises from the unprofessionally high transaction costs of a New York micro-lender. Third World models, where the issue is the actual development of a banking system, may be a source of ideas but cannot serve as a model. 500 years of banking transactions cannot simply be over-hauled socially.

Muhammad Yunus, the famous and respected leader of the Granmeen Bank movement originating in Bangladesh, made a perhaps thoughtless remarks when he drew something positive even from the poverty in his country at the conference in Paris hosted by the French Ministry of Finance (<http://www.finances.gouv.fr/DICOM/manifestations/microcredit>) with the strong political participation of the EU Commission. He explained that, whereas in western Europe the poor receive state benefits, their circumstances in Bangla Desh compel them to treat credit productively. If microlending only works if there is no choice left for a decent living and if we need to go the way of Reaganomics before such brilliant ideas get the necessary response not from governments but from those who are concerned then there is a problem at least for those countries which do not want to worsen but to better the fate of the poor in respect to previous achievements. In so far as Bangladesh and France are different countries and it was strange that nobody intervened. The risk that micro-lending will be over-estimated as a means "pour la croissance et l'emploi" (to quote the title "For Growth and Employment") can lead to a legitimization of an economy based on poverty, in which the unemployed are taken as having primary responsibility for their situation. That is not to minimise the services rendered by the authors of such models but it puts them back in to the context of a very small contribution to national welfare economics. Credit is good for those who have enough to eat and who are thus able to invest the loaned money for productive purposes. It is no alternative to the welfare state. At a similar conference opened by former US Minister of Finance Mr Summers in March in Washington D.C., the state's evaluation of the Community Development Financial Institutions was even less differentiated. However important micro-lending is as a laboratory for the financial services market, the banks cannot be relieved of their responsibility for the provision of credit and the State should not endorse a different level of quality in financial services for the poor from that applicable to the development of the wider community.

8 Our Team has changed and we enter the New Year with 13 academics and a total staff of 22. The areas of competence we have now acquired such as internet supported Information Management, Urban Development, the Economy of International Finance and Education mean that the team is more versatile. If the on-going inter-disciplinary exchange continues to be as successful as previously, this will sustain IFF's claim to be a trailblazer in the financial services sector. The projects already established for 2001 confirm that assessment.

In 2001 we want to focus on and develop projects on "financial literacy", the development of new local branches of the banks in vulnerable city districts, the prevention of consumer and small business insolvency, money advice software, legal developments in credit and in consumer bankruptcy, financial products for shared home-ownership, forms of retirement products based on solidarity and accompany the introduction of a private pension scheme in Germany with empirical research and economic evaluation of its effects on the lower strata of society. We aim also to form a **Study Group on Social Finance** in which we would attract students in subjects such as economics, law, urban development, sociology and politics in aspects of *social finance* as well as *financing social needs*. To that end we will be making further contacts in institutions of higher education in Germany and abroad. We will be helping students in the Social Finance Study Group (SoFIS) with their choice of subjects, international contacts, work place-

ments, specialist diplomas and doctorates and the search for sponsors. The objective is that there should be a supply of highly qualified and motivated students with the necessary commitment to meeting the increasing need for experts in the characteristics and the technical aspects of the relationship between social issues and financial services. We hope that the project, which will run in parallel with partner-projects in different countries on both sides of the Atlantic, will be ready for launch in autumn 2001. Enough for now. If it seems that this newsletter was short on euphoria, it will not have escaped your notice that the year 2000 was somewhat strenuous. So let's hope that work in 2001 will be a little easier on us all.

With kind regards

Prof. Dr. Udo Reifner

INSTITUT FÜR FINANZDIENSTLEISTUNGEN e.V. (IFF)