

New Year Newsletter 2002

To all friends and colleagues of IFF, ladies and gentlemen

From our new location close to the river we would like to take the opportunity of wishing both you and ourselves a peaceful year in 2002, in the hope that we will be able to make our own contribution to that peace through our work in the finance sector.

In IFF's last two New Year newsletters, we called first for a long-term approach and then for sustainability in the finance sector. The dramatic fall in high-tech shares, the scaling down of the perspective on the Internet phenomenon, so that it now looks more like the discovery of the fountain pen, has led to prophecies of an "Age of Boredom" (Süddeutsche Zeitung, 28.12.2001, page 24 "Die Party ist vorbei - the Party is over"). But that is not our view. Politics takes its lesson from the economy and the social lesson delivered by the economy is "competition". Whether it be competition between rivals in the marketplace, or the improvement of services for all, we either talk or compete to the death. Integration or suppression, inclusion or "elimination", war or contest, these were alternatives not only for the ancients at the time of the Olympic Games, when war ceased while the games were in session.

1. The motto for the New Year could be **more "Wettbewerb" and less "Konkurrenz"**. It would have to be a European motto, because this distinction is alien to American and English.

In English, both "Wettbewerb" and "Konkurrenz" mean "competition". There is no equivalent for the word "concurrency" in relation to the economy, which expresses the "agreement" and "co-operation" elements of the original meaning of the words "running together" (cf. Herbst/Readett Dictionary of Commercial, Financial and Legal Terms, Thun Schweiz 1989 page 227). In English you would accordingly wish for "less competition and more concurrency"

"Wettbewerb" (fr.: competition translated as "fair competition") and "Konkurrenz" (fr. concurrence translated as cut-throat competition) carry different associations. If you act like Jacob in the Old Testament, who swindled Esau out of his birthright, you act as a cut-throat competitor in the eyes of God. If you act like Microsoft, and make your monopoly system inaccessible to others, American courts have determined that you are engaging in unfair competition in relation to Netscape, Quicken, WordPerfect and Novell. Cut-throat competition's motto is not to be better but to be more successful. On the other hand, if you engage in "concurrency", or fair competition, both competitors strive attain the same goal. Competing for the "wager" (originally a "pledge" still visible in the German word "Wette" inherent in "Wettbewerb" which mean literally translated "compete for a pledge") amounts to striving towards a common good. Whether the goal is an olive branch, the beauty of a dance routine or going "higher, faster, further", is determined by the performers. But performers in the economy

are society. The goals of fair competition must therefore be defined in the interests of society as a whole.

If economic competition today is only understood as cut-throat competition for financial gain, we have lost crucial aspects of the development of social productivity. Profits do offer a universal measure and a rationality, they are difficult to manipulate and have little to do with justice, so they are more attractive than all other measures in terms of their effectiveness. But profit is no more an end in itself than running 100 meters in 9.79 seconds was for Maurice Greene in 1999. Money is only a unit of measurement and a representative of something else; in other words, it is only a means of evaluating our targets.

As a means, it is balanced by disadvantages. You cannot tell where money comes from, whether it is "dirty", or whether it has been obtained through achievement or oppression, or theft. Profit is not the issue, but rather how the money has been made. The process in which profit will be realized is socially determined. Responsibility is what determines peaceful, fair competition, which is directed towards the benefit of all.

2. This is the sense in which Social Finance concentrates on situations where **competition meets social interests** in the financial services sector. Promotion of the existential interests of consumers, small businesses, mortgagees and non-profit institutions should be the objective of fair competition in the provision of financial services. Profit realisation alone only provides the potential. Social responsibility makes this potential accessible to all.

The products of these problem children of the financial services system are, in the long term, a benefit to society, even if they do not contribute to the gross national product. This group, currently forced into cut-throat competition with "private clients", "big business", "commercial property" and the "for-profit" sector, loses out to financial service providers, because the competition fails adequately to take into account the objectives of social finance.

The consequence of heightened competition in the banking sector, where minimum standards limit the extent to which costs can be passed on, is the withdrawal of providers of financial services from the High Street, from mass provision and from provision for low income groups. In the Anglo-Saxon, de-regulated model, the spiral of costs and charges is rising. The liquidity crisis of social investment is thus only another aspect of its debt crisis, recently highlighted by the EU Council of Ministers.

3. **American solutions** are increasingly helpless in the face of this trend; more symmetry of information (Stiglitz), financial literacy, retreat to the local community (Spirit of Community: Etzioni, Rifkin), corporate responsibility, altruism (social sponsoring), ethical investment, transparency (Community Reinvestment), voluntary work through the non-profit sector and community work, or compulsion to self-reliance through welfare cuts.

Adaptation to the "demands" of the finance sector (asceticism, self-employment and ethics) or the development of ghetto economies appear to be the only approaches on offer.

Ghetto economies are characterised by the replication for a specific client group of services not available to it in the mainstream. As the reasons for its exclusion lie in the inadequate profitability of such investments within the financial system, any alternatives provided to it are inevitably disproportionately expensive, because of the concentration of this type of investment within the alternative sector. The additional costs may be passed on to the clients (predatory lending, finance companies, cheque cashers, prepaid services, loan sharks, instalment banks, tally men, pawn shops) or they may be taken on by the state or

foundations (micro-lending, community development financial institutions, social lending). "Ghetto currencies" such as "Knochengeld" (according to a greek philosopher money should be made out of "bones" (Knochen) which stink if they are not circulated) in Berlin Prenzlauer Berg, negative interest finance for the unemployed in Wörgl or indeed the new Argentinian currency, exchange networks and the LETS system in the world's poor districts may paper over liquidity crises in the short term, but as a rule they only serve to exacerbate the root problem. These systems are more expensive, more antiquated, less professional and more illusory, even though various significant Social Finance Products have been developed through them (loan circles, step-by-step lending, negative interest finance). Activists within these systems are social politicians rather than financial experts, and they put an ideological gloss on their shortcomings.

Where social policy adapts to the finance world rather than correcting and challenging it, its task is reduced to mitigating the apparently inevitable.

4. **Social Finance** concentrates on the development of **inclusive financial products** within the marketplace, in which society's finance sector takes on the responsibility for universal provision. When everything in the health sector is tied in together, the sick cannot be separated from the hospital, medication from the patient or patient care from the clinic. Risk pooling, asset-backed securities, solidarity pension funds, group products, basic bank accounts, business guarantees for start-ups, rent funds, and reverse mortgages to release equity tied up in real estate to consumers, shared homeownership, social leasing models, use of intermediaries to create concentration of demand, trust funds for social enterprise and futures for social risks - these are some of the products which belong to a "social finance" workshop of the future in which we would like to participate.

5. However, products like this also have to be **pushed into the market**, and thus given the opportunity to compete on a level playing field. The creation of demand is the basis of the latent power of consumers and legislators, of state intervention in the form of subsidies and of the law as agency for imposing liability. Discrimination against asocial conduct creates social content. Alternatives must be put forward to counter the temptation to develop a ghetto economy. In this context, consumer protection and sanctions against unacceptable market mechanisms have their part to play, as does extended and strengthened liability for damages and compensation on the part of providers, as well as incentive mechanisms for social behaviour. Normal profit incentives are insufficient. Volatile prime investments for asset management, share issue and M&A have also set the pace for overdraft rates, because investors increasingly invest on a short-term basis with ever more short-sighted objectives. Society must therefore ensure that collective responsibility still applies at least where it provides a return, even if it is unable to compete with high return investments.

6. Workshops of the future need a distinctly **European component** and European co-operation to achieve these objectives in view of the current focus adopted across the Atlantic. As a contrast to the melting pot, Europe needs a multi-cultural approach and social independence. To that end, for example, IFF has met with French partners with regard both to staffing and to joint ventures in the fields of small business finance, consumer protection and general financial literacy which we hope will prove to be fruitful.

A European debate also means that we will strengthen the multi-lingual element of international communications and demand that the Anglo-American sphere take more account of alternative approaches.

In **commercial English**, which many of us use as Esperanto, we are increasingly moving away from the enhanced philosophical differentiation in, for example, **French**, which would have facilitated the debate about socially beneficial competition. "Solidarité" and "Collectivités locales" denote insurance systems and Communes, "compétition" serves fair competition and not an economy in which cut-throat competition is king. Social provision and ethical investment are defined as services or "Investissements de Proximité" ("community reinvestment"), proximate investments, which call for relational banking, and correspond to the German word "Nächsten" ("your next one").

7. The narrowing down of economic science from the traditional "**social economy**" (Sozialökonomie) approach towards the "economics of competition", from the "Nationalökonomie" to market economics, gives the market a core role also in the interpretation of non market phenomena. Theories of balance, principal agent, transaction costs, asymmetric information, game theory or contract theory are such models for explaining factors which are external to the market. But they render these factors only relevant to the extent that they affect or "influence" the market. In this approach social interest fail to meet the requirements of markets and by definition markets do not fail to meet the requirements of social interest. But processes in which the family, nation and culture currently become ever more individualised can only be analysed through the sociological imagination and analysis of needs outside the present economic discourse. These phenomena are the very processes which will determine financial services, not only in relation to overindebtedness and risk management, but also in terms of retirement provision and credit for the middle classes. We should reflect about the loss of scope present economic science cover to the detriment of the understanding of the economics of non-marketable values.

Economists attending a meeting in November in Wolfsburg on **private retirement provision** criticised the fact that the Doctrine of the National Economy has contributed very little to the new configuration of private retirement provision in Germany. They regretted that this science had lost its social or political economic competence by thinking in terms of mathematical models. Their forecasts would lead them towards a meaningless analysis unless they could comprehend and reflect the economy from a broader perspective than that of the direct partner in the market.

At the meeting on **Corporate Responsibility** called in Brussels in December by the Belgian Presidency, at which the priority of the 700 leading representatives of the economy was to dissuade the Commission from making any statutory provision for compulsory disclosure, the advantages of ethical investment were supposed to be discussed in the panel on **pension funds**. No doubt the expectation was a marketing presentation of such funds and of the Commission's official policy of the privatisation of retirement provision. These funds overwhelmingly promise standard market returns. They entice clients by the fact that their investments are scrutinised by agents who then assert that they have ensured that the money has not been invested in the tobacco industry. These side effects of pension funds divert attention from their actual social effects, which are not intended to lie in the investment itself, but in the retirement provision they produce. The ethical link of these funds resembles baby seats mounted on armoured tanks and the social consequence of the tank is highlighted in terms of its role as a pushchair. At present, Germany follows the Anglo-American pattern, whereby trade unions and employers work with the major financial service providers to achieve maximum returns for a membership whose strength lies in its numbers. This occurs through the release of funds from national insurance (transfer of contributions). The unemployed, the sick, the disabled, enterprise start-ups and unwaged parents are excluded and thus derive no benefit. Social and collective consumer protection is not taken into account. This does not mean, however, that this is not possible; the Dutch example has demonstrated that it can be done. The large social solidarity organisations have, however, not been concerned with this aspect to date, preferring to market their products as if they had been the ones to discover private banking.

8. Here at **IFF in 2001** we were fortunate to be able to develop and implement projects which lie at the heart of social finance.

In the "**Financial Literacy** for Poverty Prevention" project, we developed further the theme of the lack of knowledge about money on the part of the poor and we went on to devise the outline of a programme of education for all. In 2002, we will be working on a project involving partners in France, Great Britain, Belgium and Italy, funded by the European Commission (DG Social Policy) to gather together international experience and simultaneously to develop an Internet database (open for unrestricted use by all), with categorised materials and models. We will also be participating in the Bertelsmann and Nixdorf Foundation's Oldenburg Internet project on economic education in schools.

Our micro-lending project in five EU countries concluded with a critical report on the **Regulation of Credit Provision by Non-Banks**. It distanced itself from earlier descriptions of micro-lending, which uncritically had incorporated the effects of micro-lending on the US labour market as they had been reported in the US. New research is now available to us, showing that the propaganda effect of micro-lending exceeds its social effect. The report will be published in English in the Nomos series in 2002 and has already been published in French.

We have refined the remit of our "**Small Business Finance**" department in co-operation with the Hamburger Universität für Wirtschaft und Politik (Hamburg University for Economics and Politics) in the areas of insolvency prevention, access to credit, crisis communication and business start-up. The position with regard to this work will be documented in our Financial Services Information (FIS) System. As www.money-advice.net, FIS is offering this Internet platform for social finance anew with more than 25,000 data sets.

In the **small business** field, our work is dominated by our major project on small business crisis prevention, which has been financed by the German Federal Research Ministry until 2003. **FinanzCheck** software has been designed to help small businesses (and ultimately all borrowers and investors) to determine themselves what financial services they should purchase, to evaluate them, to make them transparent and to do their own calculations. FinanzCheck is based on IFF's experiences with financial services checking programmes. It rests on the simple premise about cash-flow that, ultimately, any combination of financial services produces only income or expenditures on the basis of the probability of specific risks at specific times which affect household liquidity. Our objective is to develop a permanent **rating instrument** for small businesses, to be developed in consultation with projects within the French Finance Ministry with a view to facilitating greater rationality, better crisis management as well as greater consumer autonomy in relation to their partners in the transaction. The concept of a telephone hotline involving the local money advice infrastructure for small businesses in financial difficulty is being developed and tested. Finally, we are developing a case-based **Internet advice system** for small businesses, on which Professor Tebroke is also continuing to work with us.

This part of the project is primarily based on the results of the project supported by the Volkswagen Foundation on the **legal mechanisms of small business crisis management**, which has access to comprehensive empirical material on business crises as well as legal precedents. The final report at the end of March 2002 will present this material in the context of work on social conflict and institutional economics, with the participation of Professor Ingrid Größl.

In terms of our Internet presence, we have had the opportunity of developing the ideas and initial steps towards an **Internet Information Co-operative** in the form of our FIS platform, with the support of the European Commission (DG SANCO). We are now applying for the Commission's eContent programme with this Internet information co-operative. Providers from a number of countries are participating, who seek to publish their respective financial expertise at low cost but to a high technical standard. The user target group consists of consumers, providers of financial services, intermediaries, researchers, educators and policy-makers. The providers can construct their own pages to present their contributions. They can use our platform themselves, or have their own appearance within our platform, with selective access options and decentralised maintenance. It is probably the most enduring independent financial information presence on the Internet as well as the most rich in tradition.

Our research project supported by the Bertelsmann Foundation on **poverty prevention in private retirement provision** has got off to a good start with its needs-based orientation underpinned by a comprehensive survey of households which has confronted providers of new products the precarious nature of demand for them. At the beginning of January, the Bertelsmann Foundation publicised the first results and our criticism of the disregard for the consequences of premature termination. This area will also be developed as a forum, database and research tab in FIS Money Advice.

The pilot for our project on planning **small, local branches** in co-operation with Vereins- and Westbank is due to begin in 2002. The project intends to test the prospects of linking modern communications technology with the idea of a presence based in a local community. Our objective is to identify alternatives to branch closure.

Consumer indebtedness continues to play a central role. We are publishing the 6.0 version of our **CAWIN debt advice software** programme. Because we were directly involved in the reform of German insolvency legislation through the preparation of a report commissioned by the German Ministry of Justice, we were able to prepare the programme quickly and integrate a considerable number of network elements. Our report made a considerable contribution to shortening the trustee stage of insolvency and the priority assignment of wages each by one year. We will publish our work on overindebtedness for the Arbeitsgemeinschaft der Verbraucherverbände (the German association of consumers organisations – AgV, now incorporated into the Bundesverband der Verbraucherzentralen e.V., the German association of consumer advice centres) and the German Ministry of Justice in **Schuldenreport (Debt Report) 2002**, together with other material, and it will again appear in the Nomos series. We hope that consumer and welfare organisations will again fund its publication.

In the field of **mortgage finance** for first time buyers, Bauvision e.V. wrote to us in the following terms for New Year 2002: "I was greatly impressed by your financial advice handbook in paperback format on a real estate fund for tenants". We will continue to make our data processing programmes, reports and expert opinions available until the ideological dispute around renting and home ownership has abated politically so that the model of an ownership fund for tenants can be established in Germany. In this regard, in the course of 2002 we will be publishing the dissertation by Juliane Pfau on options for housing finance for first-time buyers through asset-backed securities.

In the field of **Social Finance Study** (Sofis), we intend, through the Internet, to build a stronger network of specialists in a number of disciplines who are already working together, and in due course to establish a formal network. The new Masters degree in entrepreneurship at the Hamburg Universität für Wirtschaft und Politik, which we helped to develop, will offer an option from about 2004 concentrating specifically on Social Finance. In order for the course to serve as a model for others it must be well-prepared in terms of content, staffing and indeed finance.

9. At present, IFF has a total staff of **26 with 11 permanent researchers**. Separation from financial and from partisan interests is a fundamental principle for IFF, for its "research by commission" (as opposed to commissioned research (results)) and for its social orientation. The Institute has a sound financial basis, with ample research contracts, and it is increasingly seeking a voice in scientific disciplines. It must remain a research institute.

In 2002, the core group of specialist research staff consists of 11 (4 economists, 4 lawyers and 4 from other disciplines). Helga Springeneer continues to be responsible for work in insolvency and indebtedness, including the CAWIN software and contacts with relevant professional groups. Achim Tiffe works in the field of consumer law and lending, as well as service links with consumer advice centres and specialist agencies. We are looking for an economist to cover research in the field of retirement provision and small businesses from April 1, 2002 on. Economists Andreas Mahlke (member of staff of the HWP) and Christine Zöllner also work in this area. Both have long professional experience in the field of banking and have been studying and working in the UK and France. Michael Motylewski is responsible for our extensive internet and data-processing projects and Michael Feigl looks after the archive and its contents. From January, Isabel Herwig a lawyer with good English and French knowledge will be working in the international section as a researcher. Ulf Groth, who is known to all money advisers in Germany, will have responsibility for attempts to develop models for "General financial literacy in schools and money advice" if we get the envisaged grant from the ministry of family affairs. Ilona Kotek has returned from maternity leave on a part-time basis to replace her former substitute Michaela Krause, who in turn is going on maternity leave. Our new office manager is Andrea Villbrandt who comes with experience in marketing. In the public relations department, Lara Louwien is going on maternity leave and she has been replaced at IFF by Kerstin Domscheit, an experienced press officer from the local government. Dorina Rechter of the North German TV station will be helping us publish our experiences with the publication of 13 special paperbacks in a single "Bank Book" for use by the general public. In October we also took over editing the journal "Verbraucher und Recht" ("Consumer and the Law" – "VuR"), which Tanja Suleck is looking after for us from Bremen.

We hope that we can count on your co-operation and your critical comments for the future. Many thanks for giving us that support over the past year.

With very best wishes from all members of staff of the Institute.

Yours sincerely

Udo Reifner