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Book Review — Money and Sustainability:
The Missing Link

A Report from the Club of Rome – EU Chapter to Finance Watch and the World Business Academy

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This report by WAAS Fellow Bernard Lietaer and his associates addresses important theoretical and practical issues regarding modern monetary systems. The central thesis of the report is that effective monetary systems must optimize performance on two complementary goals — efficiency of transactions and resilience in the face of destabilizing forces and events. National monetary systems maximize efficiency, but they lack the resilience to prevent catastrophic events such as those that have plagued the global financial markets and global economy over the past four years. The report advocates adoption of a variety of counter-cyclic, complementary currency systems to supplement and compensate for the inadequacies and vulnerabilities of national money systems.

The authors' effort to make explicit the conceptual framework underlying the current financial system is a very meaningful contribution to the subject of money. It is based on a wider perspective that views money and economy as subsets of society and recognizes the enormous potential for more effectively integrating the subset with the whole of which it is a part. It is important to note their emphasis on the enormously positive contribution which money has made historically to social development, a point often overlooked by critics of the current system.

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The discussion on complementary money systems provides insight into the real sources of wealth creation in society. Complementary systems have the capacity to compensate, at least to some extent, for the structural deficiencies of the present system, and to do so in a counter-cyclic manner at precisely the times when national systems are least able to respond constructively. One very important characteristic of these systems is that they are essentially human-centered — based on unutilized human capacities and designed to serve unmet human needs — rather than market, money or technology-centered. A human-centered approach integrating the principles of economic equality constitutes the right foundation for evolving a comprehensive solution to the present crisis.

Alternative systems that release the productive forces of society and increase the velocity of money exchange are unique attributes that can have a stabilizing, counter-cyclic and stimulative effect on the real economy. The report also suggests that complementary currencies may be an effective way to promote investments needed to address climate change. This alone would make them immensely valuable. It is noteworthy that the USA had a multi-currency, decentralized money system throughout most of the 19th century, a period of very rapid economic and social progress.

1. Resilience & Efficiency

Resilience is a very important attribute of any social system. The occurrence of more than 400 financial crises over the past 40 years is sufficient evidence that the prevailing system of national currencies fails the test of resilience. Proponents argue that national currencies perform far better on the score of efficiency. But the current model may be considered efficient only in the narrowest of terms, with regard to the speed and ease of exchange. Viewed in terms of wider social purpose, here too it fails dismally. The report cites data estimating that the total cost of the 2007-2008 crisis in the US alone exceeds $14 trillion, equivalent to about 90% of the country's GDP.

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The real measure of the efficiency of a monetary system should be its contribution to real economic growth and living standards. National money systems tap the organized market, but they fail to convert the enormous social potentials into wealth. Perhaps the most compelling indictment of the present system is that it does such a poor job of efficiently utilizing resources to produce and distribute wealth. Since the onset of financial deregulation in the 1980s, the growth of real incomes shows only marginal progress for the vast majority of citizens in OECD countries. For all the praise of efficient market theory, efficient allocation of money to maximize returns on that money is not the central purpose of either money or economy. Money is intended to support growth and functioning of the real economy to provide for the basic needs of all human beings.

The problem of financial instability raises issues addressed by Orio Giarini in his writings challenging the notion of equilibrium of a closed system. In "Science & Economics: The Case of Uncertainty and Disequilibrium", he argues that economic equivalence between supply and demand is a tautology, not an equilibrium equation.[1] He views the monetarized economy as part of a larger whole which includes unmonetized as well as unmonetarized activities with real economic value. He also argues that the system needs to be understood in its entirety as an open system that encompasses the entire society and environment. The basic ground for economic events is an inherent uncertainty, which represents the undefined source of all social creativity as well as the field from which new economic value is created.

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The authors of the report refer to the international financial system as a Global Casino, a very fitting analogy which lays stress on the inherently non-productive character of the present system that diverts vast resources for speculation. Daily, some $4 trillion is traded in foreign exchange transactions, only 2% of which makes its way into the real economy. At the root of this phenomenon is an increasing surplus of money arising from concentrated accumulation by the richest of the rich. Like every other form of concentration, beyond a point the positive accumulation is converted into a destructive force. The current system is geared and biased toward creation of money for speculation, rather than to support the real economy. The authors' arguments on efficiency and instability in relation to derivatives testify to the dangers inherent in speculative trading of financial instruments. To scientifically make a case against speculation would itself constitute a huge and original contribution to economic theory.

"Economy is a subset of society and environment."

Since national monetary systems are not likely to be replaced in the near future, it would be useful to examine the potential scope for improving resilience within the existing national money systems. This would only enhance the credibility and utility of adopting complementary currencies as a supplementary measure. Given the authors' intimate knowledge, experience and original perspective on money, it is quite possible that they may be able to come up with proposals that those within the system fail to recognize. That would create a powerful entry point and may provide a wider opportunity for presenting their more comprehensive approach.

2. Externalities

The discussion in the report on externalities clearly highlights the tendency of social systems to become compartmentalized and isolated from the wider social purpose they are intended to serve. The authors stress the fact that economy is a subset of society and environment. This places money and economy in a wider context. It highlights the fact that a subsystem both depends on and should serve or at the very least be in harmony with the wider interests of the entire system. By the same logic, the monetary system is merely one subsystem of economy and cannot function effectively unless it is in harmony with that wider entity. Here the observations about speculation and inequality are particularly important. Financial markets, which evolved as an adjunct and support for commerce and industrialization, have become more and more divorced from their original function, depriving the real economy of essential capital and even destabilizing it by their speculative behavior. The same is true of the banking system, since the walls separating commercial from investment banking have been torn down. Money goes for speculation rather than investment in production and jobs. In other words, even economy has become an externality to finance!

This perspective is an excellent complement to that of Orio Giarini, who has emphasized the importance of several other boundary lines between society and economy: He continuously reminds us that the fundamental purpose of economy is to promote human welfare; that the basic notion of value must be related to utility and human welfare; that there is an essential difference between the material-based, resource-limited industrial economy and the human-centered service economy we have today; that the principle of uncertainty must be incorporated into any true measure of economic value; and that the boundaries between monetarized and non-monetarized activities are ever-changing.

3. Governing Banking

The current crisis arose because banks have lost sight of their principal function, which is to serve society. The current crisis is a function both of the nature of the monetary system and the way the monetary system is being operated by the banks. In other words, even within the present system, there is considerable scope for changing the operating rules. Social progress often involves introducing internal controls to compensate for externalities. Are there ways in which the externalities threatening the national money system can be countered by internal rule, system and discipline? For example, when it nationalized the commercial banking system in 1969, the Government of India introduced priority sector banking regulations to ensure that growth of the commercial banks would be utilized to channel funds to agriculture and small industry, not merely servicing the urban corporate sector and the wealthy. What government did by central bank dictate can also be done by law.

Although the report focuses on inherent structural deficiencies in national currencies and the value of promoting complementary money systems, it is important to recognize the scope and need for actions to alter the functioning of the present system in order to make the analysis and recommendations comprehensive and complete. This need is only addressed in a minimalistic way by most of the actions now being taken by governments to reform banking and financial systems. A Tobin Tax or other measures to reduce speculation would have immense impact on the overall monetary and economic system. The Tobin tax is an excellent example of a public policy measure that can be used to curb the excesses of speculative money transfers and improve the resilience of the entire financial system by stabilizing system-wide effects. In recent years many internalized measures have been abandoned on the excuse of globalization. Such measures at the national level need to be introduced at the global level as well.

The discussion in Chapter V forcefully brings out the inherent propensity of the present system to magnify inequalities and the impact of growing inequalities on economic development, social stability, and ecological sustainability. The vast growth inequality of incomes and wealth seen in recent decades is very largely due to the biased manner in which banking seeks to maximize profits by supporting and leveraging speculative investments, rather than leveraging investments in the real economy.

After nationalization of the banks in India, a major proportion of lending was earmarked for agriculture, small industry and weaker sections of the population. This policy had immense benefits for development. Now that banking is becoming more commercialized, the stress on sectorial targeting is being lost. No wonder income and wealth inequalities are rising rapidly.

4. Plutocracy

The defects in the present system are not limited to the fact that banks control money creation. The problem extends far deeper, into the incestuous relationship between money and politics. The nexus between banks and government creates an effective plutocracy in which both money creation and law heavily favor the wealthy at the expense of the common man. A monetary system explicitly designed to support optimal growth and economic equality would operate very differently. Its impact would be much more like that of complementary money systems.

The concentration of economic and political power resulting from the present system is a subset of the broader issue of how power is distributed in society. Money is a form of social power which is interchangeable with other forms of power, a theme examined in a separate article on "The Power of Money".[2] The principles governing the distribution of that power have immense impact on the results of the money system. Emerging during a period of intensive nationalism and concentration of power in centralized institutions, this means that the monopolistic approach to money creation can easily become a means to monopolize political and social power.

Power belongs to society and is intended for the benefit of society. So, systems need to be evaluated in terms of how they distribute power. In retrospect, that is how we evaluate monarchy, military dictatorship, fascism and state communism. All these systems concentrate power (whether military, political, religious, administrative or industrial) in the hands of an elite. The current system concentrates money power in a similar manner. The impact of excessive concentration of power in any form is well-documented. It inevitably leads to crises and revolutions. When power is truly directed for the benefit of the entire society, it loses its destructive edge.

5. Human Capital

The World Academy's program framework emphasizes the central importance of human capital. This too is powerfully influenced by the monetary and banking system. The present system, which has led to high levels of government indebtedness, fails to take into account or monetarize the enormous value of social capital being created. In a paper for *Cadmus,* we argued that rising levels of education constitute an investment in future welfare and well-being.[3] Therefore, investment in education should be treated as an acquired asset rather than an expenditure, even before it begins to reflect as growth of national income. This would offset the tendency to reduce expenditure on education as a first resort to balancing budgets. The same would apply to public health.

> *"The enormous waste of human resources – human capital – as a result of massive unemployment and underemployment is clear proof of a failed system."*

The enormous waste of human resources — human capital — as a result of massive unemployment and underemployment is clear proof of a failed system. Economist Randall Wray estimated that the real economic and social costs to society of high levels of unemployment and underemployment in the USA equal or exceed the cost of directly employing them. These costs are the result of a system that focuses on and rewards the efficiency of money, rather than the efficiency of all social resources. Of course, the same argument applies with equal force to the wasteful and destructive impact on the environment.

In sum, the report successfully highlights the potential of complementary currencies, which are one of a dozen ways in which the untapped social potential can be monetized and converted into wealth. The report would have even greater value had it fully applied the principles on which it is based to offer a solution to the present financial crisis. Full exploitation of this single mechanism can certainly release great wealth and extend the viability of capitalism, but it does not address the root issue of economic inequality which underpins the present system and thus cannot constitute a permanent solution. For this, the conscience of the world must awaken to embrace higher human values.

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Notes

1. Orio Giarini, "Science & Economics: The Case of Uncertainty and Disequilibrium," *Cadmus* 1, no.2 (2010): 25-34 http://cadmusjournal.org/article/issue-2/science-and-economics-case-uncertainty-disequilibrium
2. Garry Jacobs and Ivo Šlaus, "The Power of Money," *Cadmus* 1, no. 5 (2012): 68-73 http://www.cadmusjournal.org/article/issue-5/power-money.
3. Garry Jacobs and Ivo Šlaus, "Indicators of Economic Progress: The Power of Measurement and Human Welfare," *Cadmus* 1, no.1 (2010): 53-113 http://www.cadmusjournal.org/article/issue-1/indicators-economic-progress-power-measurement-and-human-welfare