The Banking Crisis:

What Can *Businesses* Do Now?

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The travails of the banking crisis have been front page news for months, and the biggest bailout in human history has been completed at the 11th hour and 59 minutes, to everybody's relief. However, the *real* economy, the one where businesses manufacture and sell goods and services, will predictably turn out to be the next victim of the financial crisis, in what we call the "Second Wave".

The "Second Wave" Problem

Whatever governments do for the banks, credit will be a lot harder for businesses to obtain from banks, for many years to come. Indeed, when all is said and done, governments will not be willing or able to force banks to lend out to the real economy, any more than you can push on a string. The trickiest part of the current situation is the simultaneous nature of the banking crisis. When one bank, or even one entire country's banks, gets in serious trouble, healthy companies can find credit from other banks or countries. But when the meltdown is simultaneous across the bulk of the global financial system, another dynamic comes into play. The world economy will predictably veer towards a simultaneous recession, which in turn will worsen the banks' balance sheets, motivating them to further reduce credits, and so on, down a vicious spiral towards either a decade-long recession or a possible depression. Thus, while cutting back on its loan portfolio is a logical reaction for each individual bank, when they all do it simultaneously, it deepens the hole that is being collectively dug for the world economy and ultimately even for the financial system itself.

What all this means in practice is that we have now entered the period of an unprecedented convergence of planetary issues - climate change, financial instability, unemployment and an aging society - that was described in my earlier book, *The Future of Money*[1]. It is most likely that the ensuing crisis will play out in a classic "two or three steps downwards for every step upwards" pattern. Every small step upward (i.e. any temporary improvement) will predictably be hailed as the "end of the crisis." It is quite understandable why governments, banks and regulators will make such statements, simply because saying otherwise would only make the situation worse.

Once a domino effect plays out in the real economy, when a chain of bankruptcies gets going with all its effects on unemployment and other social problems, this will prove even harder to stop than the dominos in the banking system, with its devastating wake of an explosion of social problems.

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[1] Lietaer, Bernard: *The Future of Money: Creating new Wealth, Work and a Wiser World* (London: Century, 2001).

The Choices for Business

There are two strategies that businesses can conceivably take under these circumstances: try to get help from governments individually when their individual problems become unmanageable, or take an initiative to save themselves cooperatively.

The first option is not new. For instance, little noticed in the media in the middle of the turmoil of a banking and stock market panic was the fact that the Bush administration is providing a $25 billion help package for the US automobile industry.[2] Predictably, the European Union is being lobbied by the European car manufacturers for its own 40 billion Euro package.[3] However, it will soon become obvious to everybody that this approach is quickly going to hit a wall. Governments, the world over, have just bled themselves dry to a totally unprecedented extent, just to save the banking system -- to the point that the *Financial Times* even wonders whether the worldwide panic in the stock markets in October 2008 "is not about faith in the banks, but faith in the governments to save them."[4] In short, waiting for when governments will be in a position to save even important businesses, after having borne the unprecedented costs of bailing out the banks, could resemble waiting for Godot.

Therefore, the second option, to have businesses take an initiative to save themselves cooperatively, is clearly the better way. Furthermore, there is actually a very successful precedent – even if it is surprisingly little known – as the following story shows.

A Story

Once upon a time, during a crisis similar to the one in which we are now getting mired, sixteen businessmen got together to decide what they could do among themselves. They and/or their clients had all received a notice from their respective banks that their credit line was going to be reduced or eliminated. Bankruptcy was going to be a question only of time. They realized that business A needed the bank loan to buy goods from

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[2] The US House of Representatives approved the measure by 370 votes to 58. Bernard Simon: "House clears $25bn for carmakers" *Financial Times*. 25th September 2008

[3] ACEA (the European Automobile Manufacturers Association), 6th October 2008. "European auto industry calls on EU to help sustain changeover to low-emission car fleet." http://www.acea.be/index.php/news/news_detail/european_auto_industry_calls_on_eu_to_help_sustain_changeover_to_low_emissions.

[4] Gillian Tett "Leaders at wits' end as markets thrown one tantrum after another" *Financial Times* October 11/12, 2008. pg 1 and 2. For instance, the scale of the commitments made by European countries for the bailout of the banking system is without precedent, representing potentially a multiple of their annual GDP. One idea of this , the assets of the three largest banks that were now guaranteed by their respective governments represent 130% of GDP for Germany; 142% of GDP for Italy; 147% of GDP for Portugal; 218% for Spain; 257% for France; 253% of the GDP for Ireland; 317% for the UK; 409% for the Netherlands (2 largest banks); 528% for Belgium-Luxemburg; 773% for Switzerland (2 largest banks); and 1,079% of the GDP for Iceland. In such a context, we should expect that budget tightening by the public sector will be the rule rather the exception for many years to come, further contributing to the "Second Wave" problem, and making less likely government bailouts for non-financial corporations getting in trouble. All percentages computed from data from the map in the *Financial Times* September 30, 2008 page 3.

business B, which in turn needed money to buy stuff from its own suppliers. So they decided to create a *mutual credit system* among themselves, inviting their clients and suppliers to join. When business A buys something from B, A gets a credit and B the corresponding debit. They created their own currency, whose value was identical to the national money, but with the interesting feature that it didn't bear interest. A debit in this currency needs to be reimbursed with sales to a participant in the network in the same currency, or settled in national money. The country's banks mounted a massive press campaign to try to squelch this revolutionary idea. Miraculously, that campaign failed, and this little system saved many of the businesses involved. A cooperative was set up among the users to keep the accounts dealing with that currency. Soon participants could also borrow from that cooperative in that currency at the remarkably low interest rate of 1% to 1.5%. All such loans needed backing by inventory, real estate, or other assets, exactly as in a conventional bank. Over time, the system grew to include one quarter of all the businesses of the entire country.
Sixty-five years later, an American professor carried out an econometric study proving that the secret for the country's legendary stability was that strange little unofficial currency, that circulated among businesses in parallel with the national money. That well-known economic resilience was usually credited to some mysterious and unknown national characteristic. Whenever there was a recession, the volume of business in this unofficial currency would expand significantly, thereby reducing the negative impact on sales and unemployment. Whenever there was a boom, business in national currency boomed, while activity in the unofficial currency proportionally dropped again. The surprising implication of this study was that the spontaneous counter-cyclical behavior of this little system actually helped the central bank of the country in its efforts to stabilize the economy.

This is not a fairy tale, but the true story of the WIR system. The country is Switzerland and the sixteen founders met in Zurich in 1934. Within three months there were 1,700 participants; and within a year some 3,000, linked by a catalog of available goods and services, classified in 850 categories. The system still works today: the annual volume of business in the WIR currency now is about $2 billion per year. The American professor is James Stodder from Rensselaer University. His remarkable quantitative study[5] uses more than 60 years of high quality data to prove the points made in this story. Professor Tobias Studer from the university of Basle, Switzerland, also wrote a little monograph about the history and the economic effects of the WIR on the national economy.[6] The WIR cooperative also made initially some mistakes, such as lending WIR money without proper guarantees, a mistake which was corrected in time. The WIR system is also now accepting deposits and making loans in both Swiss Francs and WIR, and has slowly evolved into a more traditional bank. More information on the current status of that system is available on the web.[7]

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[5] James Stodder, "Reciprocal Exchange Networks: Implications for Macroeconomic Stability". Albuquerque, New Mexico: Paper presented at the International Electronic and Electrical Engineering (IEEE) Engineering Management Society (EMS) August 2000,
[6] Tobias Studer's 1998 monograph is entitled "*WIR in unserer Volkswirtschaft*". English translation by Philip H. Beard, Ph.D. *WIR and the Swiss National Economy* (59 pages) available on http://www.lulu.com/content/268895
[7] www.WIR.ch and http://en.wikipedia.org/wiki/WIR_Bank

Our Proposal

We propose that businesses take the initiative of creating such Business-to-Business (B2B) systems at whatever scale makes sense to them. The big advantage, compared to what happened in Switzerland, is today's availability of very cost-effective information technologies. Setting up such a system and scaling it up so that it makes a real difference can be achieved now in a fraction of the time it took in the 1930s. And timeliness is going to be critical, if one wants to avoid the social and economic ravages that will be unleashed by the unraveling of today's complex business supply chains. In the US, a nationwide system would be justified. In Europe, ideally, such a system should be designed to operate at least at the Euroland level. Otherwise, we are going to see a lot of the economic gains achieved by European integration go to naught over the next decade.

Some Pragmatic Considerations

The speed at which the pragmatic application of this strategy can move is greatly facilitated in our times, thanks to the availability of various softwares to manage complementary currencies, and the Internet as a communication tool. For instance, the WIR cooperative which we talked about above has a proprietary system of large-scale system operational in Switzerland in four languages, which can deal simultaneously with national money and WIR. There are also several other fully operational softwares available for specific complementary currency applications.

It would be a good idea to consider particularly open source software for use in this case, as this would provide the flexibility to add new functions, or new currencies on the same smart card, without having to wait for propriety software developers to catch up with their backlog. For instance, the Strohalm Foundation in the Netherlands has an open source software called *Cyclos* for mutual credit systems used for social purpose applications, which is already in operation in various countries. Similarly, the European Union has funded in cooperation with the French government the development of the SOL system using three different types of complementary currencies on the same smart card.[8] This application is currently in pilot test phase in five different regions in France, and could easily be expanded for additional languages and a fourth currency application for the B2B currency that is described here.

Obviously, implementing a strategy of this nature should be done in careful steps, starting with pilot application on a limited scale. A European-wide project, for instance, should be started as a cooperative pilot venture on a small scale.

Answering Some Objections

There will predictably be a theoretical economic objection to the proposal made here: a multiple currency approach is less efficient in terms of price formation and

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exchanges. This objection is valid. However, we have shown elsewhere[9], including in a peer-reviewed paper,[10] over-emphasis on efficiency is in fact the systemic cause of the brittleness of any complex system, including the financial system. Such brittleness has been demonstrated spectacularly during the global banking crisis, but the World Bank had identified, before this one, no less than 96 banking crashes and 176 monetary crises affecting 130 countries over a 25-year period. Therefore, our proposal provides a *systemic* solution to the instability of the monetary system, something which the current approaches are not trying to achieve. Systemic solutions are the only ones that will avoid having to face the same type of problem repeatedly in the future.

Finally, for the banking system itself, our proposal involves only temporarily giving up the monopoly of creating money, a much less drastic compromise than losing, for instance, the right for issuing legal tender altogether, or of a nationalization. Furthermore, as stated above, the example of the WIR complementary currency systems has proven to be a key factor in fostering the proverbial stability of the Swiss economy, which is helpful also to a banking system's portfolios.

Some Advantages of the Proposed Approach

This strategy has a number of advantages for the different parties involved, particularly during the transition period that we now have entered.

- This approach will avoid or reduce the strangulation of the real economy by the banking credit contraction that unquestionably is going to occur.
- Complementary currencies have proven a useful tool for enabling the design of incentive schemes in a wide variety of domains, regardless of whether a crisis is at hand. The evidence for this can be found in a number of publications.[11]
- Perhaps most importantly: this strategy will avoid repeating the worst part of the 1930s scenario where a Second Wave strangulation did occur, which resulted in massive bankruptcies in the productive economy, intolerably high unemployment and untold suffering, and a toxic political fallout that has proven a dangerous mess to disentangle once started. (Hjalmar Schacht, Hitler's central banker,

[9] Bernard Lietaer, with Robert Ulanowicz and Sally Goerner: *"Options for Managing Systemic Banking Crises*" Working Paper October 2008.
[10] See Robert Ulanowicz, Sally Goerner, Bernard Lietaer and Rocio Gomez "Quantifying Sustainability: Efficiency, Resilience and the Return of Information Theory" *Journal of Ecological Complexity* forthcoming 2008.
[11] See for instance: Edgar Cahn *No more Throwaway People* (Washington: Time Banks USA, 2004); Deirdre Kent *healthy Money, Healthy Planet: Developing Sustainability through new money systems* (New Zealand: Craig Potton Publishing, 2005); Ellen Hodgson Brown *The Web of Debt* (Baton Rouge, Louisiana, 2007); Lietaer, Bernard *The Future of Money* (London, Random House, 2001); and Lietaer, Bernard & Belgin, Stephen *Of Human Wealth: New Currencies for a New World* (Citerra Press, forthcoming 2008); Greco, T. *Money: Understanding & Creating Alternatives to Legal Tender* Vermont: 2003; Cahn, E. *No More Throwaway People*; Cahn. E. & Rowe J. *Time Dollars*.

pointed out correctly that the electoral popularity of Nazism was directly due to mass "despair and unemployment"…)

Conclusions

Time is of the essence to reap the most benefits of the proposed strategy. As the rot has spread from the banking system to the non-financial businesses, a lot of the damage will be done very quickly. Ideally, the B2B mutual credit system could be replacing bank loans as soon as a bank loan has been called or reduced. Even if your own business isn't affected yet by credit restrictions, don't wait to act until your suppliers or clients are in trouble. In this domain, the proverbial stitch in time saving nine can become painfully obvious.

A proven means is available for businesses to soften the blow of a "Second Wave" that is as predictable as there will be night following day. Why wait to spot a candle until it is getting hard to find it? Why would business people in our age be less entrepreneurial than the Swiss in 1934?

Abridged Bio of the Author

Bernard Lietaer has been active in the domain of money systems for a period of 30 years in an unusual variety of functions. While at the Central Bank in Belgium he co-designed and implemented the convergence mechanism (ECU) to the single European currency system. During that period, he also served as President of Belgium's Electronic Payment System. His consultant experience in monetary aspects on four continents ranges from multinational corporations to developing countries. He was General Manager, Co-Founder and Chief Currency Trader for the Gaia Hedge Funds, one of the world's largest off-shore trading funds during which time *Business Week* identified him as "the world's top currency trader" in 1992. He is the author of fourteen books, written in five languages, including *The Future of Money* translated in 18 languages. More information about the other, as well as some technical papers which provide support for this proposal, is available on www.lietaer.com/crisis2008.html

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