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WHY FINANCE MATTERS FOR THE COMMON GOOD?

Financial techniques and instruments have allowed investment and trading activities to expand in time and space. Without them, neither economic growth nor economic globalisation would ever have taken place. Over the centuries, finance and financial institutions have become increasingly specialised, culminating in the emergence of a veritable financial system. In modern–day economies, this system fulfils three main functions:

- It ensures the flow of payments on which economic activity depends to run smoothly. In doing so, the financial system facilitates the use of money as a means of payment.
- It ensures that the available monetary resources are used effectively across the economy by placing excess liquidity of some agents at the disposal–on a temporary basis and for reward–of other actors who have trading or investment plans but who lack the necessary liquidity. By doing this the financial system enables money to operate as a veritable store of wealth.
- It creates financial assets (ie, transferable contracts embodying rights and obligations), estimates the inherent risks, determines their prices, and facilitates their exchange. By pricing assets, the financial system extends the function of money as a standard of value to a specific category of transactions.

This description of the financial system emphasises its secondary, derivative nature. On the one hand, in each of the above ways it acts as a functional extension of money, whose efficiency and radius of action are increased as a result. As an extension of money, finance is dependent on it and remains subordinate to money which has ultimately a public aspect. On the other hand, it is the vocation of the financial system to serve other economic (ie, commercial and industrial) activities, which it helps, as it were, to keep well–lubricated and flowing smoothly. The traditional lack of autonomy of the financial sector explains the relative lack of interest that economists have shown in it. This is why, to this day, financial assets and transactions involving them are absent from national accounts.

Five centuries after financial activities started to expand in Northern Italy, a new «window of opportunity» to these activities was opened up some thirty years ago, in the form of technological breakthroughs in the processing and transmission of data. The financial sector has taken full advantage of these new opportunities, as its unprecedented vigorous expansion over the past fifteen years shows. During this period, finance has developed three to seven times faster than other economic activities.

Growth of various economic and financial items, between 1980 and 1995, in nominal terms

Item	Growth
Turnover of «Fortune 500» enterprises	140%
Total assets of «Fortune 500» enterprises	230%
Nominal GDP of OECD	300%
Value of world merchandise trade	440%
Capitalisation of world stock markets	970%
Turnover of world stock exchanges	1170%

Observatoire de la Finance, various sources

Today, finance is the spearhead of the so–called «globalisation» process and, as such, enjoys unprecedented visibility and prestige. The scale of the changes now taking place inevitably raises questions about the true nature of finance. Is it a purely quantitative phenomenon, or are we dealing with a totally new technological and political situation in which the relationship between financial activities and other areas of economic, political and social life has been fundamentally altered? Has finance ceased to be dependent on politics and economics and become an autonomous, or even a dominant, force?

The recent explosive growth in the influence and importance of the financial sector implies a profound change in the relationship between finance and the pursuit of the common good. The notion of «common good» embraces two separate concerns: on the one hand the social concern, where the question is what the financial sector brings to the community; and on the other the personal concern, where the question is how finance contributes to the growth and self–realisation of each and every member of society. Accordingly, the relationship between the financial system in its present state and the common good poses new questions, opens new horizons and calls for new inquiries. At least three avenues of research can provide a basic structure for looking at how finance contributes to the common good.

DIRECTION ONE: THE RELATIONSHIP BETWEEN POLITICS AND FINANCE

On August 15th 1971, President Nixon took the US dollar off the gold standard, thereby exposing public policy–through the dollar–to market forces. This decision (which, it need hardly be added, was merely a stage in a much longer process) marked a profound change in the relationship between finance and politics.

Finance rushed in to fill the hole that Nixon's decision had made in the Bretton Woods system. It was aided by a number of factors, including technological progress in data transmission and processing and increasing international harmonisation of laws and regulations. Taking the dollar off the gold standard was the springboard for the large–scale development of national, and above all international, financial activities. Like it or not, the discord or weakness of the governments of the day set in motion the collapse of central–bank control over the creation of money and the value of national currencies. Today this process is culminating in what may be termed the «privatisation of money».

The changing relationship between finance and money is about to result in the amalgamation of two fields which were once legally and institutionally subordinate to one another. While this amalgamation of money and finance implies a certain degree of «privatisation» of money, finance in turn now has more immediate implications for the common good–a dimension that traditionally applied only to money. This new state of affairs requires redefining the powers and means of action that are available to national, international and supranational public bodies, particularly as regards the supervision and regulation of financial activities.

Exposing national currencies to market forces means submitting public policy to external assessment. There is nothing wrong with such assessment in itself; indeed, it may help to prevent governments from pursuing aberrant policies. It does raise two questions, however. Should policy makers accept the subordinate position to which they have been relegated by the markets? And are financial markets the most appropriate authority to assess public policy? In this connection, one cannot help noting the asymmetry between those who use a national currency on a daily basis as their unique means of payment and those who use it as an asset among others only to maintain or increase their wealth. There is a growing ambiguity about the roles of finance, which is globalised and in private hands, and money, a local means of payment and a symbol of sovereignty, which–in theory at least–is there to serve the overall national interest.

DIRECTION TWO: THE ECONOMIST PARADIGM

Until recently, any attempt to investigate financial issues was tantamount to trespassing on private property. First there were the financial professionals, who were keen to maintain something of a smokescreen around their field of activity. Next came a small circle of academics, who allowed the emergence of a paradigm which has since come to prevail among university economists. Known in short as the Modigliani–Miller–Arrow–Debreu paradigm, it continues to dominate supposedly scientific journals and to determine appointments to teaching positions. The list of «guardians of the temple» is a long and impressive one, from the prestigious cohort of Nobel prizewinners to researchers who are all too often constricted by their own methodology. Despite undeniable theoretical breakthroughs, this concentration of effort by sophisticated academics and professionals has imperceptibly resulted in finance becoming divorced from its economic context, both as a subject for study and as an activity.

This leaves economic science poorly equipped to weigh and analyse the many complex links between the financial sector and the rest of the economy. Consequently, it is not in a position to answer one of the key questions facing today's world. In order to stand up to this challenge, economic science will need to develop a new paradigm for research and analysis. Even though there seems little chance that such a new paradigm will emerge from within the discipline, nevertheless problems cannot be solved by looking the other way.

This is a time of change, and yesterday's cast–iron certainties are giving way under the pressure of indisputable fact. Finance can no longer be treated as a separate activity cut off from other dimensions of social and economic life. Although the financial sector still finds it hard to accept fundamental challenges to its traditional way of thinking, cracks are now starting to appear in the ivory tower. The very growth of the financial sector is forcing those outside it to look more closely at the nature of that growth and the issues that it raises–whether or not the guardians of the temple of mainstream economic thinking like it.

DIRECTION THREE: THE FINANCING OF OTHER ECONOMIC ACTIVITIES

Like other components of the financial system, stock exchanges have been expanding almost continuously for the last 20 years. Yet most of this growth (including that of so–called «emerging» markets), in terms of either capitalisation and volume of transactions, cannot be satisfactorily accounted for by «fundamental» economic data. In fact, the number of listed companies, their contribution to GNP and their industrial profitability have essentially remained unchanged.

The influx of liquidity into stock exchanges–including emerging stock markets–can be explained firstly by the spread of modern savings instruments such as investment funds, and secondly by the banks' abandonment of their traditional role as lenders. This has profoundly affected the way in which the financial system performs its function of converting savings into investment.

Many banks today would sooner sell their clients' shares of investment funds than make them a firm commitment on a savings account and then lend the money–at their own risk–to some little–known small or medium–sized enterprise. While perfectly comprehensible from the banks' point of view, this change in the way in which savings are converted into investment may have an adverse impact on the economy as a whole, and thus on society.

It is reliably estimated that over 90% of the transactions on leading stock markets merely involve changes in the ownership of securities which are already in circulation–in other words, they are largely second–hand markets. This means that transactions involving new securities seldom account for more than 10% of the total. While a certain degree of liquidity is undoubtedly essential if markets are to operate smoothly, only transactions involving new securities can give companies the finance they need and so truly convert savings into investment.

Stock–market listing enables companies to significantly reduce their financing costs (both debts and equity capital). As a result, listed companies can obtain financing much more cheaply than unlisted ones, which are usually small and medium–sized enterprises. Not surprisingly, listed companies find it easier to substitute capital for labour than do unlisted ones. Behind this financially impeccable logic lies the risk of a drift towards a two–tier economy–and a two–tier society.

On the one hand, there are the major companies, which are highly intensive in financial capital and mainly employ highly skilled staff. On the other hand, there are the smaller companies, which have higher financing costs and are relatively labour–intensive. These employ local labour, which is less mobile and often less skilled.

This is a little–explored feature of the operation of the financial system. Yet, as the spectre of a *two–tier society* and economy looms larger, it is an increasingly urgent issue.

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