

Citizenship and the market economy. Or: what is really systemically important in democracy?¹

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Abstract: "Too big to fail" and "systemically important" are catch phrases in current debates about the relation between democracy and the market economy. It is characteristic of this relation that certain questions do not even enter the political agenda partly because of the size of economic agents. For key actors in the financial sector like big banks or pension funds are what has been referred to as "too big to fail" or "systemically important", meaning that their behavior can pose a long-term threat to the economic system. Contrary to neoliberal theory, these actors are unable to establish a regulatory regime for guaranteeing the collective good of a functioning financial market system. Unlike a democratic state, they are not "systemically important", meaning "being important for the preservation of a system's functions". A democratic state's capacity to rescue financial institutions by levying taxes depends on the loyalty of the citizens. In order to secure this systemically important civic loyalty, it is necessary to limit the role of citizens as economic actors. This limitation is only one kind of establishing boundaries. Boundaries disrupt chains of causality. The reasons for and against boundaries as suitable means to rescuing and enabling democratic politics should be discussed more intensively.

Keywords: Democracy, financial market crisis, "too big to fail" –problem, Knightian risk, self-regulation of markets, neoliberalism, collective goods and evils, power, citizen's roles, citizenship, rationality of citizens, civic loyalty, borders, boundaries, size.

1 This text is a revised and extended version of my article "Bürgerschaft und Marktwirtschaft. Oder was ist eigentlich systemrelevant?", in the German social studies journal *Mittelweg* 36, Vol. 19 (April/Mai 2010), pp. 38 –50. A partir de la página 29 se publica la traducción realizada sobre esta versión en inglés y la versión alemana.

Many democracies in modern times have by now two problems of size. The one is well known. It is related to the mere numeric size of the population in contemporary democratic legislative states. The other problem of size is called "too big to fail". It consists in the consequences for democratic decision making processes which is as big as banks, insurance companies and pension funds.

"Democracy" that is the name for a government that rules over the people, for the people, through the people. "Over the people" states a rule of law: No one is outside the law, neither Putin, nor Berlusconi or Rodrigo Rato, the former head of the Spanish savings bank Bankia, which caused billions of losses for the tax payers. "Government for the people" is supposed to mean this: The laws are good for everyone and not just for the strong or the lobbyist. And "government through the people" means that the people decide on the laws, which are to hold for them. Who falls under the laws must participate in law-giving processes.²

That is why it is intuitive to imagine the democracy as an assembly democracy ("beer hall democracy"): The ones concerned -- at least adults and the healthy ones -- meet to participate in law giving. In the 5th and 4th century BC Athens it was not unusual for 5000 or 6000 of 21.000 eligible citizens to meet.³ In Swiss Glarus, a canton with 26.000 citizens entitled to vote, 5000 citizens have recently met to decide on draft laws of the regional parliament (They have been doing that for 625 years.) But in spite of the technical possibilities of the internet this assembly democracy seems to be not feasible if one thinks of the hundreds of thousand or millions of citizen, who live in regions like Andaluz or Essex and in cities like Sao Paolo or

2 Political laws are decisions in legal form. The decisions are expressed in sentences without proper names. They are binding for a collective that also includes foreigners. "Foreign" refers to the opposite of family member.

3 Nippel, Wilfried *Antike oder moderne Freiheit? Die Begründung der Demokratie in Athen und in der Neuzeit*, Frankfurt/M. 2008. Ober, Joshua, What the ancient Greeks can tell us about democracy, in: *Annual Review of Political Science* (11) 2008, following M. H. Hansen, *The Athenian Assembly in the Age of Demosthenes*, Oxford 1987.

Warsaw and who would have to meet, that is, if they wanted to meet.

"Representative democracy" is the name of one attempt to solve this problem of the size of citizenship. Representation is supposed to make those people and aspects present who are absent, but still important for the legitimacy and the reasonability of the decisions. That way absent citizens are supposed to get a word via their representatives: for example via parliamentary members, mayors, ministers, political parties, heads of trade unions or chambers of commerce, and so on. One of the problematic threats for representative democracy is that the connection between represented citizens and their representatives becomes too loose. How can the order of representation and the representatives alike make the voices of and the perspectives of the absent people present so that the decision is responsive to those concerned? That is *one* problem of democratic representation. It is also related to the size of the circle of the people concerned.

The *second* problem of size of democracy has nothing to do with what happens in the political decision making process of pro and con. It is rather connected to that which precedes such political decisions. Certain questions do not even become the topic of political debates and decisions. That is partly because of the size that certain economic agents have. Why, for example, should tax financed states rescue private banks and save insurance companies or investments funds from severe losses? After the collapse of the US-American Lehman Brothers Bank in September 2008 this question is not asked in Europe and in the USA anymore. It has been answered positively even before it was put up for political discussion.

If one acts naively for a moment this question suggests itself. This is because the employment of social resources for such a bank bailout is clearly very high, that is, the use of tax money and the state garnishment of the incomes, which the work capacity of people will produce in the future. (This garnishment manifest itself in the form of state debts.)

In 2010 alone the financial support of tax states in the EU, that is, guarantees and liquidity measures, recapitalisation and impaired assets came to the almost unfathomable sum of 1105,2 billion Euro. That amounts

to 9% of the GNP of EU-countries.⁴ In Great Britain official numbers estimate that the previous cost of bank rescue totals 140 Million Pounds.⁵ In the USA the rescue program TARP (Trouble Asset Relief Program) has since October 2008 and until now (=July 2012) caused losses of around 16 billion Dollars for the tax paying community. Open bills of around 124 billion US-Dollars are not even included in this calculation. The insurance company *AIG* alone owes 36 billion Dollars.⁶ According to estimates of the budget office in the US-American Congress *CBO* from March 2012 the rescue measure TARP will cost 32 billion Dollars.⁷ Another US-office estimates around 68 billion Dollar.⁸ For comparison: in 2010 the expenses for medicare, i.e. for government health insurance of pensioners amounted to 245 billion Dollar.⁹ The expenses of food stamps for starving US-citizens, amongst those 1,8 million people in the city of New York were at 68 million Dollars in the financial year 2010.¹⁰ -- A last example from Europe: In Spain the formerly private savings bank *Bankia* will according to estimates from May 2012 cost tax payers 12 billion Euro.¹¹ In order to finance such bank

- 4 Cf. Vgl. European Commission, Commission Staff Working Paper Autumn 2011 Update (1st December 2011), = {COM (2011 848 final)}, Figure 2, p. 8.
- 5 According to Mark Hobart, secretary of the British Treasury, cited in *Süddeutsche Zeitung*, June 19, 2012, p. 25: "Schwer zu bändigen".
- 6 Cf. Office of the Special Inspection General for the Trouble Asset Relief Program (SIGTARP), Quarterly Response to Congress, July 25, 2012: Figure 2.1, p. 37 f. indicating the realized loss of 16 billions US-Dollar. As regards the number about *AIG*: See figure 2.2, pp. 40, 48. On outstanding repayments see Congressional Budget Office (CBO), Report on Trouble Asset Relief Program – March 2012, Figure 2. p. 4, retrieved on July 27, 2012, via <www.cbo.gov/publication/43139>.
- 7 Cf. CBO, Report on Trouble Asset Relief Program – March 2012. (= March 28, 2012), Infographic.
- 8 The agency is called "Office of Management and Budget" (OMB), with data basis from November 30, 2011. See as a source: Office of the Special Inspection General for the Trouble Asset Relief Program (SIGTARP), Quarterly Response to Congress, July 25, 2012, , Table 2.3, p. 42 (= cf. endnote 5).
- 9 Cf. *Financial Times Deutschland*, December 13, 2011, p. 23: "Armes Amerika".
- 10 Cf. *Süddeutsche Zeitung*, April 14, 2010: "Obamacare – das Jahrhundertprojekt".
- 11 Cf. *Financial Times Deutschland*, May 24, 2012, p. 17: "Spanien stützt Bankia mit mindestens 9 Mrd. Euro".

rescues the government also shortens the budget for orphanages and homes for the disabled. In Mataro near Barcelona, for example, caregivers hardly got there monthly wage of 1.300 Euro in the summer of 2012.¹²

One could ask, whether one shouldn't spend more money on orphanages and food aid and less money on bank bailouts. Why is this question so naive? Because -- that is the standard reply -- there is no alternative to bank bailouts and stabilisation of world-wide financial markets. The agents on these markets: investment banks, financial institutes with retail-banking services like insured deposit-taking and payment services, hedge funds, insurance companies, pensions funds etc are often too big for us to let them fail. The damage would be unbearably high.

In the first instance the "size" of those agents refers to something monetary like the total assets of banks, the amount of a pension funds' *portfolio market value*, or a bank's *debt to equity ratio*. That is "size" in the sense of a set of elements according to a unit. In the second instance "size" has to be understood more abstractly: "size" here refers to the cause of a certain type of risks.

Generally speaking a risk is a probability relation between the occurrence of negative causal effects and the occurrence of positive effects of an action or forbearance. A risk for judges and agents consists either in (1) insecurity about which of the known and limited number of possible causal effects will occur, or in (2) insecurity, what possible causal consequences might be.¹³ In a throw of a dice one is insecure which face the dice will show. This is the first type of insecurity, since in that case one knows which possible faces there are. That does not hold for the second type of insecurity.

The size of economic agents referred to in the "too big to fail" -

12 Cf. *Frankfurter Allgemeine Zeitung*, August 8, 2012, p. 29: "Tragödie mit halbem Chor".

13 As is generally known the distinction between (1) and (2) was coined by the economist Frank H. Knight. Knight calls insecurity (1) "risk" and insecurity (2) "uncertainty". Cf. F.H. Knight, *Risk, Uncertainty, and Profit* (1921), New York: Harper Torchbooks 1965, p. 233; 223 ff.

context is the cause of effects which belong to insecurity (2). This size is associated with unmanageable causal interconnectedness or complexity of economic agents. The risk here is connected with insecurity about what could happen if banks or insurance companies of a certain monetary size and connectedness collapse. The consequence of this is that political measures against this collapse, just like actions against natural disasters, are excluded from political debates. Yet, things do not stop at non-recurring disaster operations, since the danger of a collapse of big economic agents builds up again and again. It is because of this danger, too, that for several years the political elite in Europe have been extending the elimination of democratic politics. The elimination of the budget sovereignty of elected parliaments in the Euro-zone countries by the European Stability Mechanism (ESM) in June 2012 so far is the clearest example.¹⁴

The magic phrase used to justify this elimination of democratic politics is "systemically important" or "too big to fail". But what actually is "systemically important"? And what can the smoldering global financial crisis tell us about the role of the economy in Western societies with a democratic polity?

I. Functions of financial markets and the inability of financial market players to regulate themselves

One of the functions of financial markets is to move capital from one side that does not currently need it to another side that does. They are also supposed to transfer capital from entrepreneurially inactive hands to entrepreneurially active ones. Those functions are fundamental characteristics of the financial market system. The performance of such

14 Cf. "Treaty Establishing The European Stability Mechanism", Brussels 1st February 2012. The Board of Governors (= the 17 ministers of finance of the Euro-states) is allowed to change the authorised capital stock (cf. article 10 of the "Treaty"). According to article 9 the Board of Directors may call in capital from the national member states by simple majority to restore the level of the authorised capital stock. The directors are so called economic experts, accordingly appointed by the national governments. Cf. European Commission Brussels: <<http://europe.eu>>, keyword "ESM".

tasks by a properly functioning financial market is entirely compatible with a generalizable, publicly defensible interest in efficient operation of the economy. Players in the financial market system are systemically important if their failure results in the non-performance of functions within the system that cannot be performed by anyone else. Clearly, banks and insurance companies have been, and remain, unable to prevent the failure of those functions. They are systemically important in the sense of their potential to pose a fundamental risk, but not to come to the rescue.

Amid the profusion of proposals to limit risks that are either being floated or have been implemented, it is noteworthy that these private sector market participants have been keeping a very low profile:

Only recently the *International Institute for Finance* (IIF) has called for new financial assistance amounting to 20 billion for Greece and its private banks by the EU. The idea of asking its 450 members for such assistance did not even occur to this association of global players. Though this would not have been absurd. After all 48 of 130 Euro-billions of the second rescue package went to Greek banks.¹⁵ Probably the most recent Greek debt cut was too fresh on the Institute's mind. The *IIF* only just managed to secure the participation of private creditors under the faithfully promised condition that this participation would be non-recurrent.

In Germany the Association of German Banks may have voted in favor of a private bad bank,¹⁵ but it insisted that the "toxic" securities transferred to it should be underwritten largely by guarantees from a government-owned institute (*Soffin*) that is sponsored by Germany's taxpayers. And the introduction of genuinely neutral rating agencies within the sector shows no sign of materializing. It is true that the creation of *Eurex* as a European clearing house for credit default swaps (CDSs) is a move by the banks designed to promote transparency and thereby encourage confidence in interbank trading.¹⁶ As with commodity futures

15 Cf. *Financial Times Deutschland*, February 2, 2009, p. 15: "Private wollen eigene Bad Bank".

16 Cf. *Wall Street Online*, December 15.12, 2008: <http://www.wallstreet-online.de/nachricht/264565.html>, retrieved on March 31, 2009; cf. also *Financial Times Deutschland*, March 11, 2009, p.17.

exchanges, when trading CDSs banks deal with others only via an intermediary, funded by fees, that acts as a guarantor – the central counterparty. But this initiative came about only "in the shadow of the hierarchy", in other words in response to governments threatening to impose stricter capital requirements on financial institutions trading in such derivatives. The volume of credit intermediated by shadow banks, e.g. investment funds or securities lenders, was 16 Billion Dollars in 2010, whereas the volume of credit intermediated by traditional banks amounted to 13 Billion Dollars. Until now, no strong efforts have been made to regulate the shadow banking system.

Also, the European Union leaves it open until at least 2013 how high the liquid securities (*the collaterals*) with which traders of derivatives cover possible payment obligations have to be.¹⁷ Why exactly is it that economic agents always want less securities than state lawmakers? Why can't they themselves limit their own risky size?

"We cannot rely on the banks regulating themselves", the economist and market fundamentalist Horst Siebert noted some time ago.¹⁸ If we are to avoid backing the wrong horse again next time round, we need to understand why we cannot rely on (capital) market players regulating themselves.

Markets are price-setting competitions over opportunities for exchange with rival players. The maintenance of a functioning financial market benefits all market participants. For that reason, a bank that contributes to the maintenance of the market does not thereby gain any advantage over other, rival actors. In the market, there is no premium for acting in a way that benefits all alike. Literally, one cannot sell more or buy more as a result. Self-regulation does not pay. The failure of market

17 Cf. Sebastien Dullien, "Anspruch und Wirklichkeit der Finanzmarktreform: Welche G20-Versprechen wurden umgesetzt?", Macroeconomic Policy Institute (IMK) Berlin, March 2012, p. 11 f. See also Marc Roche, *Le capitalisme hors la loi*, Paris 2011.

18 *Frankfurter Allgemeine Zeitung*, October 25, 2008, p. 11: "»Horst Siebert, Ein Regelwerk für die Finanzmärkte".

participants to coordinate their actions is therefore no accident.¹⁹ This failure of banks to self-regulate for the common good is the worst possible outcome in terms of regulatory policy for advocates of the real existing global market economy. Their credo, "When everyone thinks of himself, everyone's needs are considered", has revealed itself for what it always was: an ideology immune to experience.

Some observers are demanding more virtue on the market. The traders and brokers at Wall Street, Frankfurt, or London's Canary Wharf should become again honest businessmen. These supporters of the revived concept of the honest businessman may object against the argument in the preceding paragraph that the preference for obtaining comparative advantages over rivals need not always prevail. For them, a preference for not suffering a lasting disadvantage compared with others will suffice. The proponent of self-regulation, therefore, is characterized by a more modest preference: not to improve one's position by helping to resolve the crisis, but merely to avoid being worse off over the long term.

However, a few compulsory ethics lessons at business schools explaining how to create character masks are unlikely on their own to ensure that preferences are formed in this way. It may be that there are CEOs belonging to the old school of honest businessmen, indeed. But even they act as an agent on behalf of the principal, that is the shareholder. What form of shareholder responsibility could one appeal to? What kind of legal sanctions could be employed?

The proposal for self-imposed undertakings rather than externally imposed shackles goes no further toward answering these questions. This idea consists in a symbolic contract agreed between the Western world's major financial institutions and the regulators.²⁰ In return for the state

19 The economists Franklin Allen and Elena Carletti talk of a failure of coordination but neglect to ask whether, given the frequency of such defects, that failure of coordination on the part of financial institutions is accidental or unavoidable. Cf. F. Allen/E. Carletti, "Financial System: shock absorber or amplifier?", Working Paper August 2008, published by the Bank for International Settlements (BIS).

20 This proposal comes from two professors of finance at the Stern School of Business of New York University, Roy C. Smith and Ingo Walter: "Wie die

agreeing not to impose measures such as more stringent capital and liquidity requirements, the dominant players undertake not to use equity capital for speculative purposes, hide balance sheet items in off-balance-sheet special purpose companies, and so on.

But the fact is that the leading players are in competition with each other. The proposal cannot work unless they neutralize this relationship in favour of a binding commitment to collective action. Even if such an arrangement were to succeed and the banks genuinely practiced cooperation instead of competition, they would run the risk of their investors deserting them for smaller market players that would continue to play the old game, shielded by the absence of regulation.

There is no doubt that similar things can and do occur, all the time, outside the market sphere and in the earthly lives of normal people such as us. The difference is that in the markets, such happenings cannot even be discussed – let alone, where necessary, denounced. For, in the language of the market duties and rights become risks of costs and chances of benefits. A concomitant of the invisible hand is the (deontic) muteness of the market processes that, supposedly, are guided by it.

II. The systemic importance of the citizens' loyalty

Faced with market participants' proven inability to regulate themselves, economists talk of the state as "lender or buyer of last resort".²¹ So it is hardly surprising that, in this role, the state is "systemically important". Here, though, the systemic importance lies not in the potential

Banken aus der Defensive herauskommen können", cf. *Neue Zürcher Zeitung*, January 25, 2010, p. 10.

21 Cf. e.g. Dennis J. Snower, "Ein Rettungsplan für das international Finanzsystem", Institut für Weltwirtschaft, Working paper IfW-Fokus 48, October 7, 2008, p. 1. Cf on the same statist focus the collection of essays by a group of Swiss economists from the University of St. Gallen (=HSG): Responsible Corporate Competiveness (publ.), *Konsequenzen aus der Finanzmarktkrise. Perspektiven der HSG*, St. Gallen 2009; likewise Stern School of Business, Restoring Financial Stability: How to Repair a Failed System, source: Executive Summaries <http://www.whitepapers.stern.nyu.edu/home.html>, retrieved on September 24, 2009.

to jeopardize a function that defines the system, but rather in the state's essential capacity to rescue that system. "Given that, precisely because of the crisis, the financial system is not in a position to provide the loans to financial institutions that are necessary (to overcome the crisis, L.W.), the only alternative is the state. The state can take on debt in the crisis and reduce it in future because it enjoys tax sovereignty (...)", commented representatives of a German institute for economic research.²² But tax sovereignty is only one side of the coin. The other, habitually neglected side is the loyalty of citizens to the community that is embodied in the state. The tax state is founded on this willingness to offer support. So it is not the case that the state alone, with its immense power of sanction, is systemically important. The loyalty of citizens, too, is systemically important – unless the state is uncoupled from democracy.

Citizen loyalty is something other than the willingness of more far-sighted economic citizens to offer their support because they appreciate the economic advantages of state rescue packages. Citizens are not merely synonymous with economic citizens.²³ Economic citizens are market participants in the roles of consumers purchasing, investors, and producers selling (including sellers of labor). But not everyone who creates something is a seller, and not every consumer is a buyer. Citizens also inhabit social spheres that do not coincide with the market sphere, and in which other rationalities apply.

This difference in rationalities can be seen in the positive and negative effects that market processes have on those other social spheres. Such externalities are not always experienced simply as financially advantageous or disadvantageous; they may also be viewed as alien or inappropriate. Unlike a clinic manager, a doctor treating a chronically ill patient considers it not only disadvantageous but also inappropriate if he is expected to treat that patient on the basis of a flat fee. Unlike an investor

22 Ulrich Blum/Diemo Dietrich, "Risiko statt Rettung", cf. *Financial Times Deutschland*, January 5, 2010, p. 24.

23 Cf. also Robert Reich, *Supercapitalism. The Transformation of Business, Democracy, and Everyday Life*, New York 2007.

with risk capital or a university bureaucrat, a scientist concerned with pushing back the frontiers of knowledge will not select her potential subjects of research on the basis of the financial benefits from marketing patents: for her, these are an alien point of reference.

Political citizens must combine the perspectives of different social spheres and their rationalities. They face a double requirement: Firstly, they have to examine political decisions in relation to these multifaceted factors; in assessing them their aim has to be multi-dimensional optimizing, rather than one-dimensional maximization. This is simply due to the fact that political citizens are dealing with the concerns of a complex, work-sharing society organized as a *res publica*.

Secondly, political citizens also have to approve the decisions with regard to the following question: What is good or better for all members of the community combined? This requirement is due to the demand for the community to be governed democratically. The civic loyalty consists in the readiness of members of a community to accept these requirements.

Someone who is loyal in this sense certainly asks whose policy accords with her interests. But to a certain degree she also asks: What is good for all together? This community perspective includes the readiness to accept occasional negative side effects of collective goods as burdens that one can be expected to deal with and not just as inescapable, disadvantageous externalities.

It is fashionable to deride this expectation as unworldly and point to political clientelism, cynical lobbying and meaningless, formulaic compromises. The transformation from economic citizens participating in the market to a political electorate does not in itself make us into better people. But if we dismiss and abandon this expectation as unrealistic, in the same breath we also abandon the fundamental principle of a democratic community: that its decisions are in a publicly defensible interest – one that can be generally shared, and mutually justified.

It may be that economic citizens participating in the market are equally keen to adopt this perspective on the public interest and to view things multi-dimensionally. This is what the marketing departments of

companies mean when they speak of "corporate social responsibility". But this orientation is an ornamental extra. Unlike the political role as citizen, it is not essential to the market participant but rather extrinsic. In the market, the contribution to realizing a publicly defensible interest cannot be translated into a position that leaves the contributor better off than rival market participants – unless other participants, such as consumers, act as political citizens and reward this contribution. This advantage is the ultima ratio of the competitors.²⁴

The overbearing approach of Brussel's competition commissars disregards the systemic importance of the citizens' loyalty. For unless a stop mechanism is incorporated, it constantly expands the market mode of social coordination in an imperialistic and dictatorial manner. According to this, people's thoughts and actions should primarily be guided by the economic citizen perspective of the informed investor, purchasing consumer, and vendor-producer. The more thoughts and actions are informed by this approach, the less room there is for adopting and exercising the necessary citizen's perspective on the system as a whole. A full blooded economic citizen will no longer think of paying taxes as something she is obliged to. She will conceive of taxes as often avoidable costs. From such an economic citizen's perspective, it is reasonable to buy a luxury apartment in London instead of paying taxes as an Italian or Greek political citizen in Rome or Athens. After all, what argument could there be against permitting internet exchanges for votes in the name of private property rights and contractual freedom?

We might ask the commissars in the Brussels headquarter of the contemporary European authoritarian regime what kind of destabilizing herd mentality millions of savers would have demonstrated in the period following the collapse of Lehman Brothers Bank on September 15, 2008 if they had finally become fully professionalized economic citizens; if, before

24 Richard Posner freely admits that in the phase before the manifest crisis, "(bankers) and consumers alike seem on the whole to have been acting in conformity with their rational self-interest", cf. R. Posner, *A Failure of Capitalism*, Cambridge, Ma. 2009, p. 235.

drinking their morning coffee, they had gone online to check how Tokyo had closed overnight – after all, the prices for their own healthcare and pensions are listed on the exchange there. We may also wonder what dimensions the market power of institutional investors such as pension funds would reach if the old European pay-as-you-go system for old-age and health insurance were finally brought up to date by switching over entirely to a funded system tapping the capital markets. Unlike the institutions of a democratic community, market participants react only to the signals of purchasing power and defections. Any objection to their business conduct that appealed to fairness or pointed out the social hardship that it caused would fall on deaf ears. Clued-up German clients of Iceland's bankrupted Kaupthing Bank realized that. With sound instincts, they demonstrated not in Frankfurt's banking district but in Berlin's government quarter to get some money back.

III. On the systemic importance of boundaries

The question: "What exactly is systemically important?" has now already been partly answered. There are two meanings of "systemically important": Firstly, systemically important means something like "a threat to the system =so dangerous that the functions of a system are not fulfilled anymore". That is also what "too big to fail" means. The word "system" here stands for the system of the financial market. Secondly "systemically important" means something like "important for the preservation of a system or its functions". Civic loyalty is "systemically important" in this second sense also for the system of the financial market, since without it the tax state could not save e.g. banks and insurance companies from collapsing. In a nutshell: What is systemically important? -- Civic loyalty of citizens of a state.

A second answer is this: Boundaries are systemically important. This answer is suggested by the first answer. Since civic loyalty is systemically important, whatever sustains this loyalty is systemically important, too. Civic loyalty includes a perspective or an attitude that might wither because the

roles of economic citizens dominate. That is why these roles related to markets have to be restricted. A delineation in the sense of a separation of spheres²⁵ therefore is systemically important.

This separation of spheres also consists in role limitations. The role of the professionalised economic citizen has to be one among other civic roles. She is wrongfully turned into a cross-boundary social ideal if one conceives of human beings as contractors who sell themselves as products; and if the members of the globalized class with their golden Credit Cards and executive positions in international organisations and corporate groups are chosen as role models and idols.

However, restricting the roles of the economic citizen to preserve the scope for citizen loyalty is only one instance of establishing systemically important boundaries. Boundaries disrupt chains of causality.²⁶ Examples include firewalls, the blood-brain barrier, and the right to privacy. Firewalls prevent flames spreading to neighboring properties. The blood-brain barrier blocks the destabilizing migration of certain substances from the blood vessels into the central nervous system. The right to privacy prevents statements and information being picked up and used by strangers. Functional boundaries are designed to promote a specific configuration of states, procedures or activities. Such boundaries are systemically

25 Unlike Jürgen Habermas, Michael Walzer neglects the question of how the sphere of economic citizens and political citizens could be separated. Cf. his *Spheres of Justice. A Defence of Pluralism and Equality*, Oxford 1983, ch. 4: "Money and Commodities". But this question is also important for a theory of justice which Walzer is interested in. Without separation powerful economic citizens could erode the principle of justice of the equal value of political citizenship. This principle means that every citizen can demand from the political institutions in a democracy that these institutions equally influence the social living conditions in her interests. -- John Rawls talks of the fair value of the same political liberties: *Justice as Fairness. A Restatement*, ed. Erin Kelly, Cambridge, Ma. 2001, § 345, pp. 148 ff. -- I do not claim that the principle of the equal value of political citizenships is identical with that which Rawls means.

26 Prompted by Charles Perrow, *Normal Accidents. With a New Afterword*, Princeton 1999. Cf. also Stephen J. Mezias, "Financial Meltdown as Normal Accident: The Case of the American Savings and Loan Industry", in: *Accounting, Organizations and Society* 19 (1994), pp. 181–192.

important; for a system is an interactive phenomenon ordered mainly by the functions that its elements carry out. (An organism, an ecological niche, a school, a firm, or a legal order are all instances of a system.)

Whether boundaries are good or bad is an open question. A firewall may protect against a wildfire, but it also cuts off lines of escape. The issue of the importance of boundaries to a macroeconomy or social economy is likewise unanswered. Boundaries should however not be thought of in terms of self-limitations. In view of the dramatic incapacity for self-regulation it is unrealistic to think in terms of establishing them in that way. This incapacity is also due to the market system's competition itself. Statutory prohibitions and prescriptions as well as incentives channelled through an intelligent design of options are more promising modes of establishing borders.

This concerns the How, not the Why or the goals of the demarcation. There are at least two goals: (1) Boundaries are meant to inhibit the potential of threatening system functions. And (2) they are meant to increase rescue potential by making market participants respect collective evil. The latter cannot be achieved by appeals to the virtues of investors, bankers, and analysts, and even less by oaths that graduates of business schools take, since due to the prospect of profit the level of customary criminality in the financial sector is simply too high.

(1) Some varieties of a demarcation that is meant to reduce the threats are discussed under the keywords "narrow banking" or "ring fencing".²⁷ This refers, inter alia, to the separation of investment banking from other deposit-taking business in order to delimit the possible

27 Cf. e.g. the proposal of the British Treasury: HM Treasury, "Banking reform: delivering stability and supporting a sustainable economy", London (June) 2012, ch. 2: Ring-Fencing, pp. 19 ff.. Cf. Edmund S. Phelps (Columbia University, *Center on Capitalism and Society*), Letter (March 17, 2009) to the British prime minister Gordon Brown. The letter is the summary of a conference "Emerging from the Financial Crisis" that took place at New York in February 20, 2009. Cf. <http://capitalism.columbia.edu/files/ccs/CCSletterG20-2009_March%2024Final.pdf> retrieved on March 2, 2011. Cf. e.g. Randall S. Kroszner/Robert J. Shiller, *Reforming U.S. Financial Markets. Reflections Before and Beyond Dodd-Frank*, Cambridge, Ma. 2011.

consequences of risky investment strategies. The causal chain is disrupted by state prohibitions. The demarcation here concerns roles or fields of activity.

The same applies to the proposal to impose strict limits on the role of rating agencies. Rating agencies must not simultaneously be arbiters valuing the financial products of a company they are rating, and actors profiting from the ratings of these products. As with a neutral consumer organization, limits on the role of agencies would do away with the profitable, corrupting link between their dual functions of advising and valuing the issuing institutions. It would prevent situations such as occurred in July 2009, when Goldman Sachs, Credit Suisse et al. overruled the judgment of Standard & Poor's and insisted on a more favorable assessment.²⁸

Establishing borders includes time constraints, too. According to a proposal by the economist Edmund Phelps a tax-linked, tensed border should be set up with respect to credit periods: A credit tax²⁹ would force companies to pay a tax for taking on a very short-term rather than a longer-term loan. The aim of this would be not only to encourage more far-sighted investment but also to block the impact of temporarily poor business results on liquidity for a certain period.

These are examples for establishing boundaries before a crisis to come. Boundary-setting is also crucial in a manifest crisis, indeed. A bank's living will, or emergency plans to combat concentrations of risk, which envisage predetermined breaking points for major banks, are instances of boundary-setting during a crisis.³⁰ Operating within a controllable chain of causality, these predetermined breaking points would enable the selective

28 Cf. *Financial Times Deutschland*, July 23, 2009: "S & P knickt vor Banken ein".

29 Phelps, "Emerging from the Financial Crises", , p. 4 (cf. endnote 26). In a similar vein is the proposal by the Governor of the Bank of England, Mervyn King. King advocates compulsory "catastrophe insurance" for banks, to finance government rescue measures. Cf. *The Economist*, October 24, 2009: "Too big to bail out", p. 41.

30 Schweizer Nationalbank, Financial Stability Report, Zurich June 2009, S. 10 for Switzerland. As regards the USA cf. *Neue Zürcher Zeitung*, July 6, 2012: "US-Grossbanken legen ihren letzten Willen vor".

rescuing of units of a big bank, with those that are bankrupt being separated off and wound down.

These examples of systemically important boundaries do not limit any specific variables. It is clear, however, that systemically important boundaries also have to do with variables, such as the often mooted restriction on the leverage ratio – the ratio between common equity and assets.³¹ The total assets of the ailing insurance speculator *AIG* were many times the gross national product of Hungary.³² That is just as unacceptable as it would be for the economy of a country such as Hungary to be controlled by two or three people with private-law connections.

As already indicated, the variable that is to be limited here means the cause of a risk that is linked to uncertainty as to what the potential causal consequences may be.

Some economists favour rendering owners liable as a way of limiting such variables.³³ In so doing, they rely on the deterrent effect of financial loss. But for this deterrent to be effective, a longer duration of liability -- among other requirements -- would be needed, so as to close off the avenues of escape long before damage occurred. This conflicts with the freedom of contract that is held up as an inviolable principle by the neoliberal adherents of real-world capitalism. That freedom would have to be limited if, in the public interest, stricter owner liability is to be used to prevent the entire system – the financial market and its functions – from getting dangerously out of kilter.

(2) Restrictions via deposit liability are just one example of a general strategy: that of translating a collective evil into individualized costs. The subject of this kind of ceiling are opportunities for free-riding and

31 Cf. e.g. Adrian Blundell-Wignall/Gert Wehinger/Patrick Slovik, "The Elephant in the Room: The Need to Deal With What Banks Do", in: OECD Journal. Financial Market Trends, Vol. 2009/2.

32 Cf. the German weekly *Die Zeit*, February 12, 2009, p. 19f.: "Das schwarze Loch". According to this, the GNP of Hungary in 2008 was approximately 152 billion dollars (152 thousand million dollars). *AIG's* total assets were 1 trillion dollars.

33 E.g. Hans-Werner Sinn, *Casino Capitalism. How the Financial Crises Came About and What Needs to be Done Now*, Oxford 2012.

externalising costs. Translating into the language of costs serves to prevent or minimize that evil.

A collective (= public) evil – such as corrupt officials – is one whose effects the members of a community cannot escape. Here, the collective evil is the collapse of the financial market together with those functions whose performance is a public or collective good. In this example, the individualized costs are the financial losses incurred by the individuals jointly responsible for the evil – in this case, return-hungry investors from the affluent and middle classes and their professional agents.

Another proposal incorporates the same strategy of translating collective evils in individualized costs. The proposal is to regulate the assumption of new debt by systemically important players in the financial sector. Debts taken on in order to ensure solvency should be tied to a deterrent, legally binding condition that the bonds concerned be compulsorily converted into stocks, thereby forcing risk-taking investors to accept losses of value and increased (borrowing) costs. Debts of individual financial institutions that endanger the system would then manifest themselves in individual cost accounts.³⁴

A version of this is the debt-equity-swap, i.e. the transformation of demands of an endangered bank by the creditors in property-rights of the creditors with respect to the bank. This debt-equity-swap would in the current European financial crisis contain the socialisation of losses, which are actually the losses of private investors and shareholders. In this way the boundary between private and public interests would be secured, since the private interest of investors and the bank's shareholders in a rescue of their bank with tax money could not be secretly passed off as public interest.

The overall aim here is to translate collective evils into the language of the market, i.e. prices for the external effects on society as a whole of the actions of market participants.³⁵ This would, for the first time, oblige the

34 This proposal comes from Dennis Snower, President of the Kiel Institute for the World Economy, "Gläubiger zu Aktionären", cf. *Financial Times Deutschland*, March 11, 2010, p. 24.

35 For the German social scientist Claus Offe, the difficulties of this translation are among the fundamental problems of real existing capitalism. Cf. C. Offe,

market to take note of these evils. It would be an attempt to build into the motivations of market participants a substitute for the political citizen's perspective of collective goods and evils. After all, the adoption of such a perspective has no place in the rationality of players as market participants. For, as we have already noted, the contribution made by a market participant to supplying or securing a collective good cannot be converted into an advantage over market rivals unless there are other market players concerned with the good of the community. Rationally, however, for the market participant that advantage is key.

IV. Conclusion

Political practitioners and academic theoreticians of democracy so far have mainly examined boundaries under one aspect only: Who must be included into decision making processes and who may be excluded? The question of inclusion and exclusion is certainly significant. It is also important as regards the first problem of size of democracy which was discussed in the beginning, that is, as regards the problem that the circle of people concerned often is so broad that their participation in political decisions is severely hindered. Part of the solution of this problem of size lies in answering the question who "really" has to be included and who does not.

But the examination of what the properties and the use of borders in a democratically built society are must not be restricted to this aspect. Boundaries in a democracy should be examined just as carefully as boundaries in ecology currently are.³⁶ A functional property of boundaries is

"Kapitalismus und seine sozialen Schäden. Überlegungen zu Möglichkeiten, den Gesellschaftsvertrag zu komplettieren", Ms. January 2010.

36 Cf. Johan Rockström et al., Planetary Boundaries: Exploring the Safe Operating Space for Humanity, in: *Ecology and Society* 14 (2009). J. Rockström, A safe operating space for humanity, in: *Nature* 461 (September 24, 2009), pp. 472-475. Paul R. Ehrlich/Peter M. Kareiva/Gretchen C. Daily, Securing natural capital and expanding equity to rescale civilization, in: *Nature* 486 (June 7, 2012), pp. 68 - 73. Ted Nordhaus/Michael Shellenberger/Linus Blomqvist, "The Planetary Boundaries Hypotheses. A Review of the Evidence" (Breakthrough

their role of disrupting causal chains. The demarcations described in the examples are employed to extend the political space for decisions through such disruptions. They are supposed to help free modern Western democracies from hostage-taking by capitalist financial markets. "Too big to fail" is but a harmless sounding expression for this hostage-taking, which reveals the second problem of size for today's democracies.

The demarcations are undertaken in laws or legal regulations, that is, in sanction-enforced prohibitions, commands, permissions, and in incentives that combine prohibitions, commands and permissions. But it would be naive to suppose that political legislation is immune to the power of economic agents. For example, British pension funds hold shares in BP.³⁷ That certainly did not encourage the British government to push BP for tightened security standards after the oil disaster in the Gulf of Mexico in 2010. Big US-financial institutes in 2010 invested 1,4 million dollars per day for three months into lobby-work in US-American congress in order to influence consultations about the regulation law by the senators Dodd and Frank.³⁸ In Brussels alone 2000 full-time lobbyist of the financial industry beleaguer the present legislators.³⁹

In order to allow for a policy of intelligent demarcation and thereby support democracy this influence of economic agents simply has to be pushed back. With their influence big banks, monopolist rating-agencies or multinational corporate groups are able to dictate legal norms. Not rarely do political scientists play down this ability to dictate and call it "private governance". One should follow Karl W. Deutsch and call it "power", that is, the possibility to be exempt from having to learn, because one is in a position to impose one's own will on others.⁴⁰ This power is systemically

Institute), Oakland June 2012.

37 Cf. *Frankfurter Allgemeine Zeitung*, July 7, 2010, p. 19: "Erste Fragen zur Systemrelevanz von BP".

38 Cf. the German newspaper *Die Zeit*, October 13, 2011, p. 24: "Chronik des Scheiterns".

39 Cf. *Financial Times Deutschland*, April 3, 2012: "Der Hase und der Igel".

40 "In a sense, it (power, L.W.) is the ability to afford not to learn", Karl W. Deutsch, *The Nerves of Government*, enlarged edition New York: Free Press 1966, p. 111; see also p. 247.

important, but only as a danger that accrues from coldly calculating self-interest, stupidity and contempt for the weak.