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The Banking Crisis:

What Should *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 to obtain from banks for businesses, and this for many years to come. Indeed, when everything is said and done, governments will not be willing or able to force banks to lend out to the real economy, not 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 unprecedented financial instability that was predicted 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 forward (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.

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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 conceivable 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 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 level, 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 born the cost of bailing out the banks, is going to 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 have now embarked, sixteen businessmen got together to decide what they could do among themselves. They had in common to have 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 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. 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

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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.

of the businesses involved at the time. A cooperative was set up among the users to keep the accounts dealing with that currency. Within 3 months there were 1,700 participants; and within a year some 3,000, linked by a catalog of goods available classified in 850 categories. Soon participants could also borrow from that cooperative in that currency at the remarkably low interest rate of 1.5%. All such loans need 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 made an econometric study proving that the secret for the country legendary stability was that strange little unofficial currency, that was circulating among businesses in parallel with the national money. That 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. The annual volume of business in the WIR currency today is about $2 billion per year, and 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, mistake which was corrected in time, and shouldn't be repeated in today's environment. 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 "small business bank". More information on the current status of that system is available on the web.[7]

Our Proposal

We propose that businesses take the initiative of creating such Business-to-Business (B2B) systems at whatever scale that 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 of what happened in the

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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

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 nation-wide system would be justified. In Europe, ideally, such a system should be conceived to be able to operate at the Euro monetary zone level. Otherwise, we are going to see a lot of the economic gains achieved by European integration go to naught over the next decade.

There is one more thing that the businesses who get involved in such systems should consider doing: lobbying their respective governments to have them accept this currency temporarily, in partial payment of taxes. This could apply only temporarily, i.e. for the period during which the banking system will not be in a position to fulfill its traditional role of financing the real economy to the extent that is necessary. Partial payment of taxes – it could be as little as 10% or 20% - would be the most effective incentive that governments could provide to accelerate the widespread acceptance of this currency. We are not just talking of business taxes, but also personal taxes. In this way, business can pay part of the salary of their workers or employees in this currency, which in turn can either buy goods or services from other businesses, or pay part of their own taxes. That would be a powerfully efficient way to avoid the spread of massive unemployment, which ends up costing governments a lot more…

The lobbyists have a simple but powerful argument: governments have just spent trillions of taxpayers money to save the banking system, in the hope that this would avoid that the rot spreads to other businesses. The strategy proposed here doesn't cost any money to the government, will actually increase tax revenue, and is the best systemic way to avoid that the rot will spread anyway, whatever governments do to help the banks.

Why Governments should agree

When everything is said and done, governments will not be willing or able to force banks to lend out to the real economy, anymore than you can push on a string. Therefore, in addition and parallel to accepting the usual bank-debt conventional money, during the transition period — until the banking system has recovered fully enough to play its traditional role — accepting some complementary currency for payment of taxes makes a lot of sense. Which currencies should be acceptable for payment of what types of taxes is a political question that remains open for each government to decide.

As stated above, by accepting this currency in partial payment in taxes, the government provides a powerful incentive for businesses and people to accept this currency. Governments should probably not get involved in creating or managing such systems. Their role should be to assess and determine the criteria of quality and reliability that makes the currency qualify for acceptance by the government. It also have a built-in interest in receiving payments in a robust currency. It is obvious that the existence of such a currency facilitates exchanges that otherwise wouldn't happen, while conventional money or credit are difficult to obtain. These additional exchanges, in turn, increase the taxable income of the businesses involved, thereby starting a virtuous loop that counteracts the credit reductions by the bank.

There are two approaches for a governmental entity to decide what percentage of taxes could be payable in complementary currency. The first one is to determine how much that governmental entity purchases from the business sector. For instance, if 20% of a government's budget is for purchases from the corporate world, it would make sense to accept up to 15% of payment in the currency from that specific group, and pay those purchases with the same currency. Another approach is to levy taxes from a business in proportion to the volume of business that it realizes in that currency. In other words, all sales in national currency are taxable in national currency, and taxes on sales in complementary currency are payable in the corresponding complementary currency. For example, if a company does 10% of its business in complementary currency, the taxes would be payable in that currency in the same proportion.
Which currencies should be acceptable for payment for what types of taxes is a political question that remains open for each government to decide.

Let us emphasize that this would apply during the transition period, until the banking system has fully recovered to be able to fully play its traditional role.

This strategy will increase taxable income to governments at different levels, particularly during a recession when such taxable income will dwindle. When people and businesses are strangled by lack of money, taxable income is automatically squeezed as well. By accepting some payments in currencies other than bank debt money, by definition more governmental income is possible. This isn't theory. For instance, during the crisis of the Rubble of the late 1990s, the Russian government accepted corporate taxes paid in copper in payment of taxes. What we propose is a lot less extreme: complementary currencies are a standardized medium of exchange which governments can spend to provide services in the locations and communities that accept the complementary currency.

One other important decision for national governments to take would be to allow cities and local governments to choose themselves the complementary currency that they are interested in encouraging by accepting in payment of the city or state taxes. Why this is important is explained next.

Role of Cities and Local Governments

There are two reasons why we recommend to allow cities and local governments choose their own complementary currencies to implement this strategy. First, cities and local governments will be the first governmental entities to get into still deeper trouble than they are today; and second, given that this approach is radically new, it is simply safer to test out a new system as a pilot at a city or local level, rather than directly on a large scale at the national level.

Indeed, cities and other local government entities will find themselves in the first line to bear the brunt of the social effects of the looming recession, while at the same time they will see their tax revenue shrink, and conventional financing through debt become much harder to obtain. This kind of problem is not going to be limited only to the US. The London-based *Observer* asks "What could possibly come along in the middle of this series of economic nightmares to make things even worse? How about a total depletion of local government finances that pay for the things that make up the very fabric of American society. Imagine that rippling across the rest of the world, reducing public services to skeleton operations… 'What is most disconcerting about the way this turmoil is panning out,' says Sujit Canagaretna, senior fiscal analyst at the Council of State Governments (CSG), 'is that most state governments were already in a terrible state. But now things have worsened considerably and the credit markets have a real choke hold on almost all state treasuries. It is so bad that economic activity in most states has all but ground to a halt.' … As the spectre of a long and painful recession looms ever larger across the globe, it is troubling to note that these dual problems facing governments across America - falling tax revenue and reduced access to debt - are universal. Brace yourselves for another great American export."[8]

The second argument is that some diversity in experimenting with a strategy that is new can only be beneficial to all concerned. If specific issues are considered a political priority, other types of complementary currencies than the B2B one we described above could be considered as well. For instance, if carbon reduction is considered an important priority, a carbon reduction currency program could be launched and accepted in partial payment in taxes. Some applications of the eco-money programs in Japan are precedents that are relevant in this domain. Similarly, local or regional taxes could be paid partially in conventional money, and partially in regional currencies.[9] Or international businesses could pay some of their taxes in Terras, a proposal for a global commercial currency which is fully backed by a basket of commodities.[10] In short, a whole new set of tools to create incentives for specific behavior patterns, either corporate or individual, is now available, and in most cases have already been tested somewhere in the world.[11]

Some Pragmatic Considerations

The speed at which the pragmatic application of this strategy is greatly facilitated in our times, thanks to the availability of various softwares to manage complementary currency, and the Internet as a communication tool. For instance, the WIR cooperative which we talked about above has a large scale system operational in 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 the 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

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[8] James Doran: "America's Latest Export: Empty Municipal Coffers" *The Observer* October 12, 2008 pg 8.
[9] This strategy is explained in Bernard Lietaer *Pour une Europe des Régions: les Regios, compléments nécessaires a l'Euro* (Paris: Fondation Mayer, 2008).
[10] See www.terratrc.org for technical details.
[11] See Bernard Lietaer *The Future of Money: Creating New Wealth, Work and a Wiser World* (London: Century, 2001) and *Of Human Wealth: New Currencies for a New World* (Boulder, CO: Citerra Press, forthcoming 2008).

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.[12] 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 with a cooperative venture on a smaller 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 the price formation and exchanges. This objection is valid. However, we have shown elsewhere[13], including in a peer-reviewed paper[14] that 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 crisis 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 even trying to achieve. Systemic solutions are the only ones that will avoid having to go through 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 issuing legal tender, 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.

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13 Bernard Lietaer, with Robert Ulanowicz and Sally Goerner: *"Options for Managing Systemic Banking Crises*" Working Paper October 2008.

14 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.

- The decision that governments should take – accepting partial payment of taxes in money other than exclusively bank debt money – rests completely within their own political decision power. This strategy is also very flexible: a government can decide to accept payment of certain taxes only, only for a given percentage, for specific types of complementary currencies chosen to be robust and have other positive effects, and/or only for specific periods.
- Complementary currencies have proven a useful tool for enabling the design of incentive schemes in a wide variety of domains, regardless whether there is a crisis or not. The evidence for this can be found in a number of publications.[15]
- Until now, taxes are payable only in "legal tender" which means conventional bank-debt money. Any currency is an incentive scheme, and our current way of dealing with taxes and subsidies is limited to the single instrument of national money. With complementary currencies, a whole additional array of options become available, which can focus on - and fine tune precisely - the objectives that one wants to reach. We can, therefore, tailor the complementary currencies accepted for payments of taxes to the massive challenges faced around the world currently.
- 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 when started. Hjamar Schacht, Hitler's central banker, pointed out correctly that the electoral popularity of Nazism was directly due to mass "despair and unemployment"…

Conclusions

Time is of the essence in order to reap the benefits of the proposed strategy. Once the rot has spread from the banking system to the non-financial businesses, a lot of the damage will be done. 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 until your suppliers or clients are in trouble to act. In this domain, the proverbial stitch in time saving nine can become painfully obvious. Specifically, businesses shouldn't wait for governmental approval of the payment of taxes as proposed here. Get the system going, and then lobby the government. In Switzerland, the WIR system has delivered its benefits for more than seventy years, without ever having enjoyed the tax payment privilege.

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[15] 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*.

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 is available on www.lietaer.com

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