



The Financial Crisis in Constitutional Perspective

The Dark Side of Functional Differentiation

INTERNATIONAL STUDIES IN THE THEORY OF PRIVATE LAW



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THE FINANCIAL CRISIS IN CONSTITUTIONAL PERSPECTIVE

This volume presents the first thorough sociologically-informed legal analysis of the financial crisis which unfolded in 2008. It combines a multitude of theoretically informed analyses of the causes, dynamics and reactions to the crisis and contextualises these within the general structural transformations characterising contemporary society. It furthermore explores the constitutional implications of the crisis and suggests concrete changes to the constitutional set-up of contemporary society.

Although the question of individual responsibility is of crucial importance, the central idea animating the volume is that the crisis cannot be reduced to a mere failure of risk perception and management for which individual and collective actors within and outside of financial organisations are responsible. The 2008 crisis should rather be understood as a symptom of far deeper structural transformations. For example contemporary society is characterised by massive accelerations in the speed with which societal processes are reproduced as well as radical expansions in the level of globalisation. These transformations have, however, been asymmetrical in nature insofar as the economic system has outpaced its legal and political counterparts. The future capability of legal and political systems to influence economic reproduction processes is therefore conditioned by equally radical transformations of their respective operational forms and self-understanding. Potentially the 2008 crisis, therefore, has far-reaching constitutional implications.

International Studies in the Theory of Private Law: Volume 9

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This series of books edited by a distinguished international team of legal scholars aims to investigate the normative and theoretical foundations of the law governing relations between citizens. The context for such investigations of private law systems is set by important modern tendencies in systems of governance. The advent of the regulatory state marks the withdrawal of the state from direct control and management of social and economic activity, and the adoption instead of procedural regulation and co-regulatory strategies that promote the use of private law techniques of ordering and self-regulation in social and economic interactions between citizens. The tendency known as globalisation and the corresponding increases in cross-border trade produce the responses of transnational regulation of commerce and private governance regimes, and these new systems of governance challenge the hegemony of traditional national private law systems. Furthermore, these tendencies towards transnational governance regimes compel an interaction between different national legal traditions, with their differences in culture and philosophy as well as their differences based upon variations in market systems, which provokes questions not only about competing policy frameworks but also about the nature and adequacy of different kinds of legal reasoning.

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List of abbreviations

CCO	Chief Compliance Officer
CDO	Collateralised Debt Obligation
CDS	Credit Default Swaps
CEO	Chief Executive Officer
CSR	Corporate Social Responsibility
DDR	<i>Deutsche Demokratische Republik</i>
DOJ	US Department of Justice
DPA	Deferred Prosecution Agreement
ECB	European Central Bank
ECJ	European Court of Justice
ETUC	European Trade Union Confederation
EU	The European Union
FAO	Food and Agricultural Organisation of the United Nations
FASB	Financial Accounting Standards Board
FHA	US Federal Housing Administration
FINMA	Swiss Financial Market Supervisory Authority
FLO-CERT	Independent International Certification Agency for Fairtrade Production Processes and Products
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
HUD	US Department of Housing and Urban Development
IASC	International Accounting Standards Board
IKB	<i>IKB Deutsche Industriebank AG</i>
ILO	International Labour Organisation
IMF	International Monetary Fund
INGO	International Non-Governmental Organisation
ISO	International Standards Organisation
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
RMBS	Residential Mortgage Backed Security
SEC	US Securities and Exchange Commission
SIV	Structured Investment Vehicles
SPS Agreement	Agreement on the Application of Sanitary and Phytosanitary Measures
SRSg	Special Representative of the Secretary-General
TBTF	Too big to fail

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TINA	There is no Alternative
TNC	Trans-National Corporation
US	The United States of America
UK	The United Kingdom
UN	United Nations
UNICESCR	United Nations International Covenant on Economic, Social and Cultural Rights
UNSR	The UN Special Representative on Business and Human Rights
US	The United States of America
USA	The United States of America
USD	US Dollars
WHO	World Health Organization
WTO	World Trade Organization

Introduction

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THIS BOOK IS devoted to a legal and sociological analysis of the financial crisis which came into the open in 2008, and asks how the crisis can be analysed in terms of systems theory. Should the dynamics leading to the crisis be identified as being constituted by the 'blind' and 'self-destructive' evolution of the economic system, or should they, instead, be found in more general tendencies of societal de-differentiation? Or did the crisis serve as a symptom of the inability of both the political and the legal systems to steer and regulate societal developments, an inability that might have been deepened through increased asymmetries in the level of the globalisation of different functional systems leading to an unsustainable 'de-coupling' of the global markets from the wider societal context? Alternatively, the crisis can be understood as a failure of risk perception and management for which individual and collective actors, both within and outside of financial organisations, bear responsibility.

Common to most of the contributions is the presumption that the causes of the crisis cannot merely be understood as a reflection of individual and organisational misbehaviour, or as a consequence of a shifting power balance between territorially organised states. Instead, the crisis reflects far more fundamental transformations of the basic structures of society insofar as the crisis can be understood as a side-effect of increased functional differentiation. This development has, however, been asymmetric in nature, in so far as the economic system has advanced 'further' than other functional systems. Paradoxically, this development has thus triggered the emergence of new forms of de-differentiation through the expansion of economic rationality beyond the borders of the economic system. The evolutionary emergence of such asymmetries has intensified already apparent rationality conflicts, thereby undermining both the impact and the reach of existing regulatory structures.

With regard to both the short-term and the long-term reactions, another strong focal point is that the crisis makes it pertinent to analyse both the role and the capability of states as the 'saviour of last resort' as

well as to seek an increased understanding of the reasons for the obvious failure of the self-regulative efforts of the financial system. In addition, the capability of social movements to act as a vehicle of change as well as the possible role of transnational legal and political structures is explored upon the basis of a constitutional perspective.

In the first contribution, Gunther Teubner asks if there is such a thing as collective addiction. If it exists as non-individual purely communicative compulsions to growth, then, the greed of individual bankers is not the main problem. Instead, we must look for the specific social addiction mechanisms that cause such impersonal addiction phenomena. The concept of systemic addiction provides a novel approach to how social systems approach catastrophes and transform themselves at the moment of the disaster, not through the intervention of political actors, but autonomously and within the bounds of their own systemic logic. A constitutional moment emerges when a catastrophe begins and societal forces for change are mobilised of such intensity that the 'inner constitution' of the economy transforms itself under their pressure. Plain money reform is one of several examples that illustrate a capillary constitutionalisation of the global economy, the effects of which could not be achieved through either the national or transnational interventions of the world of states.

Complementary to Teubner's contribution, Rudolf Stichweh explores the extent to which a general theory of crisis within social systems can be developed. A central point is that the danger of inflationary tendencies, well-known in relation to the money medium within the economic system, can potentially be observed within all systems, since they all rely on constitutive symbols which can be subject to inflationary or deflationary movements. It follows that, in a multi-contextual world in which no single system possesses a structural primacy vis-à-vis other systems, crises not only occur within the economic and political systems, but also within other systems. The kind of spill-over effects which unfold when a crisis within one system triggers negative effects within other systems thus occurs between all functional systems and not just between the economic and the political systems and their respective environments.

The following three contributions focus on the breakdown of expectations as a central cause and characteristics of the 2008 financial crisis. Karl-Heinz Ladeur attributes the causes of the crisis to a fundamental transformation of society into a knowledge-producing network-society characterised by constant change and high levels of uncertainty. The transformation of banks away from mere intermediaries between savers and borrowers and into far more complex risk-managing institutions is a case in point here. In such a world, the attempt to return to a unitary public ordering of the economy upon the basis of a clear-cut normative

framework becomes an illusionary objective. Instead of stabilising normative expectations, the law should, instead, orient itself towards the structuring of cognitive learning processes in order to minimise the possibility of systemic break-downs.

Moritz Renner goes in the opposite direction from Ladeur in his contribution. Renner explores the rule of law in the events leading to the 2008 crisis. In doing so he, too, departs from the distinction between cognitive and normative expectations, and argues that the interaction of the legal, the economic and the political system in the era of globalisation is marked by a shift from normative to cognitive expectation structures. This shift, according to Renner, has entailed the simultaneous over-complexity *and* under-complexity of the legal system: an over-complexity of the cognitive expectations which the legal system has to process, and an under-complexity of its internal normative structures. But even more important, the move away from normative expectation structures and the simultaneous proliferation of cognitive expectations have rendered the distinction between normative and cognitive expectations themselves impossible to uphold. The consequence is a breakdown of societal expectation structures, which have been largely replaced by a vague hope for the continuance of the politico-economic *status quo*.

Urs Stäheli introduces a novel approach on the same subject by asking to what extent an ecological and epidemiological, and thus non-causal, approach can contribute to an understanding of financial crises. Through a contrast with classical crisis semantics, Stäheli analyses what is new about recent financial epidemiology and how it is turned into a 'political epidemiology' in order to govern financial crises. Stäheli stresses that financial contagion is made possible by the functional differentiation of the financial economy. It is only through the self-reference of the financial system that new forms of connectivity have become possible.

The analyses of the breakdown of expectations are followed by three contributions that share the view that the financial crisis should be understood as a symptom of a fundamental crisis in society. Hauke Brunkhorst links up with a tradition of theorising going back to Hegel and Marx, which sees modernity and crisis as co-original phenomena. He argues that contemporary social thought—through the move into a paradigm of risk—have neglected the paradigm of crisis. Brunkhorst therefore seeks to re-invent a concept of crisis which is structural in nature, and which combines functional differentiation and social class differentiation in a manner which is capable of providing a diagnosis of the new constellation of a normatively integrated world society.

Dirk Baecker also looks into the relationship between crisis and society. In doing so, he describes crises as events belonging to the immune system of society, and determines the four culture forms of crisis typical of tribal, ancient, modern, and what he describes as next society. The

starting-point is, however, the paradox that a crisis is bound to occur in a society which, in all other respects, works fine. If not, society would be destroyed. This paradox translates into a coding of the events of crisis, which distinguishes the positive side of breakdown from the negative side of design. 'Positive', here, means that there are some events of a crisis which are positively indicated, and 'negative' means that there is reflection about these events, which puts them into the broader picture of the structure and culture of society.

In his contribution, Jean Clam explores the question of whether systems are inherently self-destructive. His thesis is that the *oecumene* of the present is a structural whole with no outside, whose quietude can only be challenged by a new type of securisation or crisis. Traditionally, crises have been those moments of local disorder which are bracketed by the steady ordering of regularly unfolding social processes. In contrast, the radical contingency of contemporary world society, instead, transforms crisis into a permanent feature.

The second half of the book focuses on the already observable, as well as the possible, reactions to the crisis. Marc Amstutz and Alberto Febbrajo do so by looking at regulatory responses. Amstutz understands crises as boundary disorders which occur when the closure mechanisms of one or more social systems deteriorate to such a degree that they become dysfunctional, leading to the emergence of deleterious links and dependencies between the systems involved. Such disorders played a central role in the 2008 crisis in so far as the boundaries between the economic, political and legal systems were effectively undermined. The result is a disruption of the systems' ability to carry out normal operations and thus also to perform their designated functions within the web of society. The radical contingency of social processes, moreover, means that regulatory responses must be evolutionary in nature. Regulation must be designed in a way that makes it possible to react to highly variegated and unpredictable changes. A higher degree of structural diversification in financial institutions is also desirable in so far as more specialised institutions, relying on more precise forms of programming, are likely to be better at ensuring boundary maintenance than institutions characterised by a lower level of internal coherency.

Febbrajo's pre-supposition is that the management of a more-or-less profound crisis of legal regulation pre-supposes both the adequate cultural orientations of individuals *and* the ability of the legal system to redefine the structural and functional borders of law menaced by the absence, or the reduced presence, of an essential social factor of inter-systemic integration, such as the state. But the traditional state-centred reconstruction of social life has not yet been replaced by adequate alternatives. Consequently, transnational networks without central authorities try, through an intense dialogue particularly at constitutional

level, to balance cultural specificities, in order to legitimise the emerging material constitutions, especially at the level of fundamental rights, and to support implicit references towards a still unclear vision of a pluralistic 'society of societies'.

In his contribution, Kolja Möller explores the kind of reactions emerging within the sphere of social movements. The striving for global social rights does not lead to the development of economic macro alternatives to the economic and financial crisis; instead, the advocates of social rights appropriate the existing inscriptions of equality in world law in order to highlight the threats posed by global capitalism. The challenge is thus to re-contextualise the agenda of global social rights under the conditions of the global economic and financial crisis in order to establish a true alternative to the market-liberal order of the world economy.

Aldo Mascareño also emphasises the distinction between normative and cognitive expectations. He argues that normative political expectations de-differentiate the cognitively-driven operations of the financial system and over-impose a long-lasting normative conditioning upon autonomously organised cognitive procedures. For example, the 'right to an affordable home' creates a pressure to provide credit to non-creditworthy clients. Against this background, he seeks to develop an ethic of contingency which is capable of confronting the normativisation of cognitive expectations.

In the final section, Chris Thornhill and Poul Kjaer contextualise the financial crisis within larger constitutional transformations. Thornhill provides a long-term historical perspective on the evolution of statehood and the ability of states to intervene in the economic system. The modern vocabulary of statehood can be observed as revolving around a paradox, in so far as it describes, projects and pre-emptively constructs a condition of statehood as an inclusive public order which, despite its reflexive utility, remains impossible to sustain in the long-term. It follows that a societal crisis unfolding outside the state, for example, in the form of an economic crisis, might lead to inter-systemic coalescence and thus to a distortion of the state if the state in question is obliged to lend an improbable or unmanageable quantum of political power to regulate or sustain exchanges in other parts of society. An obvious example is an acute banking crisis, in which political actors internalise the responsibility for social exchanges in the monetary sub-system, and are then forced to deepen their intersection with the economy via changes to the fiscal regime. However, such interventions can only be undertaken for a very limited period of time if the internal coherency and stability of states are to be maintained.

Poul Kjaer sets forth in a similar vein by introducing an understanding of crises as a reduction in the meaning production of social systems, which can either be internally or externally provoked. The emergence of

constitutions and, more generally, constitutional structures can be understood as evolutionary responses to both forms of crisis. This is the case because they are double-edged structures which are simultaneously oriented towards the maintenance of internal order and stability within a given social entity at the same time as they frame the transfer of the meaning components between the social entities and their environments. Thus, the 2008 financial crisis indicates a failure of constitutional bonding. When observed from an overall structural perspective, the reasons for this failure can be traced back to an increased discrepancy between the structural composition of world society and the constitutional structures in place. The crisis reflects a failure to respond to two simultaneous, inter-related and mutually reinforcing structural transformations. First, there is the increased globalisation of functional systems, which has led to massive dislocations in the relative centrality of the different national configurations for the reproductive processes of functional systems. Second, there is a structural transformation of the transnational layer of world society through a reduced reliance on the centre/periphery differentiation and an increased reliance on functional differentiation. One of the many consequences of this development is the emergence of new forms of transnational law and politics. A new constitutional architecture which reflects these transformations is needed in order to ensure an adequate constitutional bonding of economic processes, as well as of other social processes.

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