Preface

by

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If one is to believe the prevailing sentiment in public discussion in continental Europe, economics is not a science, but a sort of religion, a neoliberal sect, which preaches for privatization and deregulation of everything, whose deleterious role is now laid open by the financial crisis. In public discussion, little attention is paid to the fact that good economics and good economists make a clear distinction between public concerns and private concerns, calling for the intervention of public policy where public interests are involved and for non-intervention where no or at least no significant public interests are involved.

The one-sided perception of economics by the public is in part due to the fact that some economists tend to be one-sided, calling *only* for privatization and deregulation and relegating interventionist welfare economics to the realm of nirvana economics, which has eyes only for market failures and never for government failure. In part, the one-sided perception of economics by the public is also due to … a one-sidedness of reception where outrage over an economist's calling for deregulation in one area, e.g. labour markets, makes people overlook the same economist's calling for regulation in another area, e.g., banking.

In his many writings, scholarly and popular, Hans-Werner Sinn has consistently made the distinction between public concerns and private concerns, calling for less government intervention or more government intervention as appropriate. Even so, in public policy discussion, he is often represented as one of those neoliberals who believe in nothing but privatization and deregulation. The papers presented in this collection show how mistaken this view is.

In the area of financial economics, Hans-Werner Sinn has consistently been on the side of those who warned of the dangers of excessive deregulation and has actively called for more, rather than less regulation. His thinking about these issues goes back to his doctoral dissertation *Economic Decisions under Uncertainty*, where he observed that, if people's ability to pay is limited and there is a lower bound to what people can be made to suffer if they fail to pay their debts, then people may have a natural preference to accept certain gambles on the presumption

that, if the gamble succeeds, they win, and if the gamble fails, their creditors lose. This observation is fundamental to the modern theories of credit rationing and of banking regulation. Among economists, it is usually associated with the famous article by Stiglitz and Weiss in the *American Economic Review* of 1981. This article was actually preceded by Hans-Werner Sinn's doctoral dissertation, which was accepted by the University of Mannheim in 1977 and was published in German in 1980 and in English in 1983. The relevant chapters of this dissertation are again made available in this collection of writings.

Re-publication of this collection at the present moment is particularly welcome because the financial crisis contributes to renewed thinking about the need for regulation. In several papers, Hans-Werner Sinn has stressed the importance of the behavioural effect that he had discovered for banking and argued that, to counteract this effect, we need more effective regulation, in particular, regulation of bank equity. He has also warned that such regulation must be harmonized across countries because there is a danger that, otherwise, competition among countries might lead to excessive deregulation. Both points will be important in our thinking about banking regulation in the wake of the crisis, to which the insufficiency of bank equity and the insufficiency of concerns about bank risks have contributed in a major way.

Unfortunately, there is a paradox involved: Equity capital that a bank needs to meet regulatory requirements is not available as a buffer against losses, which would be the usual function of (unregulated) equity capital. Through this paradox, capital regulation itself has also contributed to the crisis: As banks made losses and these losses reduced their equity capital, they had to sell assets in order to stay in line with regulatory requirements. These asset sales increased the pressures on asset prices and imposed additional losses on other institutions that were holding these assets. To avoid getting into this kind of vicious circle, we should need not just more equity capital in banks, but *more equity capital in excess of regulatory requirements* in banks. As yet, we have no idea on how to deal with this paradox. However, I am sure that Hans-Werner Sinn will contribute to this discussion as well as previous ones.

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