Elhadj Abdoulaye Séne / Prof. Jens Lowitzsch SS 2015
Kelso Professorship of Comparative Law, East European Business Law and European Legal Policy, Faculty of Business Administration and Economics
Visitor Address: Logenstraße 9-10, PG 202

Financing Productive Property for the Many: Private Investment Credit – Actors, Mechanisms, Instruments

- Forms and mechanisms, overview of the solutions proposed
- Regulatory framework, legal conditions
- Risk assessment and risk management,
- Pooling of risk and the role of intermediary entities

5/6/9 ECTS / MES modules: ZB Wirtschaft, ZB Politik, ZB Recht, WPM 1, WPM 6 // IBA modules: S-Module (old SPO also E-Module); Faculty of Law: Master of German and Polish Law (Module 3); SPB 5 (European Law) (without ECTS)

Dates / Termine: Introduction Tue. 21.4. 2015, 14-15h, Room GD 202; / Wednesday 2 pm. - 3:00 pm / Venue: PG 202 The seminar will be held in English language.

Property ownership – especially that of productive property – is the material foundation of individual political and economic freedom. The economy does not gratuitously provide either capital instruments or confer ownership. Finance performs these functions by allocating capital credit needed for investment. But there is a condition: to qualify for a capital acquisition loan the borrower must put up collateral as insurance that the loan will be repaid. Those without capital assets are excluded from capital credit used to create new capital.

The exception to this rule is consumer credit – today often available at 0% financing cost – which, however, does not serve to acquire the things that produce wealth. And in fact, the vast majority of citizens do not own any kind of property not to mention property generating additional income. Thus they are impeded from access to economic opportunity, as well as from the attainment of economic security and leisure.

Eye of the needle: Access to capital credit

Traditionally the way to asset formation for the poor is savings through forgone consumption. But what can you save when you have barely enough to make ends meet? When financing business activities, i.e., productive property – the bottleneck is access to capital credit. While the majority of the population deprived of assets (and thus collateral) is saving through renouncing consumption, a small wealthy minority profits from access to capital credit.

This is the essence of investment: Costs (also those of credit financing) are covered from the future earnings of the acquired property. Thus, working poor are invisibly but effectively shut out of acquiring the things that produce more and more of industrial wealth, i.e., productive property. The average capitalless employee is limited to owning his labour.

Solutions proposed

Conventional solutions to the dilemma described often propose to redistribute existing capital instead to broaden access to the formation of new capital. However, confiscating capital to redistribute it would violate private property rights. Further, the costs of redistribution are substantial and in the form of elevated taxation may hamper economic development.

The counter model to solve this problem of property distribution was proposed in 1958 by the American lawyer and investment banker Louis O. Kelso based on the financial infrastructure of a free market democracy: Instead of depriving owners of their private property, non-owners should be enabled to become owners through an effective opportunity to participate in the success of their firm not only as wage-earners but also as shareholders.

More recently the idea to provide access to capital credit has been popularised in both developing countries (e.g., M. Yunus' Grameen Bank,) as well as in advanced economies (e.g., Crowd funding).

Of the different solutions that have been put forward the following will be discussed in more detail:

Micro-credit – a means of extending credit, usually in the form of small loans with no collateral, to non-traditional borrowers such as the poor in rural or underdeveloped areas often guaranteed by members of the borrower's community.

Peer-to-peer lending/investing – is on the one hand the practice of *lending* money to unrelated individuals, or "peers", without going through a traditional financial intermediary such as a bank or other traditional financial institution. On the other hand *investing* money in notes takes place online via a peer-to-peer lending/investing company. The notes can be sold as a security and so investors can exit the investment before the borrower repays the debt.

Crowd-Funding – The use of small amounts of capital from a large number of individuals to finance a new business venture, typically via the internet.

Consumer Stock Ownership Plans (CSOPs) – are designed to make consumers the co-owners of utility-producing companies typically on regulated markets with guaranteed prices, regulated market access and long-term relationships between producer and consumer. It can involve government guarantees for loans to CSOP-trusts, whose beneficiaries have insufficient assets to secure loans.

Employee Stock Ownership Plans (ESOPs) – use the borrowing power of a company to acquire shares of that very company for its employees. The cost of credit financing is covered from the future earnings of the shares.

Islamic banking, Musharaka – a type of joint venture or business partnership in which the financing partner is one of the several investors.

The seminar focuses on questions of the normative framework and that of risk management. The aim is to assess the efficiency of different models, discussing the characteristic aspects related to the different types of solutions (i.e., micro vs. macro, regulated vs. unregulated).

Registration until 21 April 2015 at kelso-professorship@europa-uni.de.

Participation requirements and performance test: Proficiency in English; regular attendance; presentation (5-7 min.) of the term paper concept by end-May; first draft of the term paper by mid June; submission of the final term paper by the end of the semester.

Literature:

- Dr. Moritz Renner: "Banking Without Banks"? Rechtliche Rahmenbedingungen des Peer-to-Peer Lending, LSK 2014, 431027.
- Person-to-Person Lending: New Regulatory Challenge Could Emerge as the Inndustry Grows. US Government Accountability Office, GAO-11-613, July 2011.
- Banking without Banks. The Economist: http://www.economist.com/news/finance-and-economics/21597932-offering-both-borrowers-and-lenders-better-deal-websites-put-two
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