On the International Monetary System (IMS): A Case of Background Injustice and Parasitic Exploitation

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Abstract

In this thesis I discuss three stylized scenarios of the International Monetary System (IMS): one with floating exchange rates, one with fixed exchange rates and one with closed capital markets. Within the first scenario, I identify two problems of background injustice: the problem of monetary spillovers and the problem of currency speculation. The first problem happens because exchange rates are relative to one another, hence, when the central bank of a country applies monetary policy, it also changes the exchange rate of all other countries vis-à-vis this country. In order to address this problem, I offer a Limited Regressiveness Principle (LRP) and argue for the creation of a global fund. In order to address the second problem, I offer a framework of parasitic exploitation, which includes three conditions of build in mechanisms, vulnerability, and non-proportionality. I argue that the case of currency speculation, is not only a problem of background injustice, but also a case of parasitic exploitation. Then, I discuss the scenario of fixed exchange rates. I consider two stylized but historical cases, the Gold Standard and the Reserve Currency Standard. I also consider a hybrid case, the case of the Eurozone. I argue that the framework of parasitic exploitation can be extended to the stylized fixed scenarios. However, I suggest that both the principles and the responsibilities that arise in the fixed cases are different from those that arise in the general floating case. Finally, I address the case of closed capital markets, or financial autarky, such as the system that existed during Bretton Woods. I argue that a generally open system with embedding institutions - which may include non-extensive capital controls - is better than a completely closed scenario of extensive capital controls, such as the one that existed during Bretton Woods.

Introduction

Section 1) Introduction

In 2019 Argentina suffered speculation on its currency, which led to a decline of the Argentinian peso by 52.4 percent during 2019.[1] This is not the first, nor the worst, case of currency speculation that Argentina has experienced over the last years. In the late 1999, Argentina also faced speculation on its currency.[2] In order to defend the currency against speculation, the Argentinian government took a $ 40 billion support package from international financial institutions and other creditor countries.[3] However, this was not enough. Argentina had to abandon the peso-dollar peg in 2002, which led to a sharp depreciation of the peso. As a result, the GDP dropped, unemployment and inflation soared, and the country faced political and economic chaos.[4]

When thinking about the International Monetary System (IMS) we have two conflicting ideas about it. On the one hand, we may think about the advantages that it brings for individuals, trade, and investment.[5] On the other hand, we may think there is something wrong with a system in which cases of currency speculation, like the case of Argentina presented above, happen. We may also intuit that there is something wrong with a system in which financial crises are global, happen regularly, and have profound effects on people's lives.

This Introduction proceeds as follows. *Section 2* defines and explains the International Monetary System and the Foreign Exchange Market. *Sections 3* and *4* locate this thesis within the debate of global justice and global finance respectively. Finally, *section 5* presents the research question and the structure of this thesis.

Section 2) The International Monetary System (IMS) and the Foreign Exchange market

The International Monetary System (IMS) is a set of institutions, rules and conventions that rule the channels of interdependence that depend on the monetary and exchange rate arrangements that each country implements.[6] The main variable in an International Monetary System is the exchange rate, since on the one hand, it is the one variable that connects one country to others within an interdependent IMS, and on the other hand, it is the variable that influences all other variables within a domestic economy.[7] Today, exchange rates are set mainly by the Foreign Exchange market, but governments may intervene in this market as well.[8]

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[1] https://www.bbc.co.uk/news/business-45451208

[2] Frieden, 2015: 238; Krugman and Obstfeld, 2003: 692-4

[3] Frieden, 2015: 241, 242; Krugman and Obstfeld, 2003: 685, 695.

[4] Idem

[5] Krugman and Obstfeld, 2003: 639-40.

[6] Idem.

[7] See for example, Krugman and Obstfeld, 2003, or Frieden, 2015.

[8] By 2016 more than 93 percent of the world's exchange rate transactions were made by the large financial institutions, and the reminder 7 percent was a combination of transactions made by both corporations and governments (BIS, 2016: 7).

The Foreign Exchange market works in a very different way from other markets, since in this market there is a group of traders representing banks and financial institutions, who trade among each other. The result of their interaction determines the value of currencies.[9] On the other hand, the government – or central bank - may intervene in the Foreign Exchange market. In an economy with open capital markets, the domestic and the Foreign Exchange market are connected by the interest rate (see Annexe 1).[10] The central bank intervenes in the Foreign Exchange market by applying monetary policy – buying or selling assets – which changes the interest rate and, as a result, the exchange rate (see Annexe 2). In an open economy this monetary policy impacts the exchange rate, and it is the latter variable which affects real variables – such as inflation, employment levels and growth, among others.[11]

The exchange rate modifies real variables within an economy because it impacts the direction of trade flows.[12] For example, an appreciated domestic exchange rate makes domestic products relatively more expensive compared to foreign products, which disincentives exports and production, and lowers employment levels. On the other hand, an over depreciated exchange rate makes imports relatively more expensive, limiting the purchasing power of consumers for these products. This has considerable impacts when these consumers are poor people in poor countries who depend on imports to buy basic goods and foodstuff. This profound impact of the exchange rate on a country's economy, and on individuals' well-being, has led the United Nations Development Program to suggest that changes in the exchange rate regime "for equity and poverty can hardly be overestimated" when analysing policies for poverty reduction.[13] Similarly, economist Joseph Stiglitz has argued that "job creation associated with exchange rate policy *is* the anti-poverty policy".[14]

Section 3) Issue of Global Justice: Are principles of justice global?

The issue of fairness in finance and monetary affairs arises in the context of a broader debate on global justice. This debate seeks to answer the following question. Should principles of justice, generally assigned to the domestic realm, be extended to the global arena? In other words, are principles of social justice global? Answers to this question have traditionally taken two positions. The first one is a statist position. Those who take this position argue that principles of social justice should apply to the state because of its institutions, system of cooperation and coercive nature.[15] However, statists accept that there are weaker duties of justice - such as humanitarian assistance - that apply worldwide.

The second traditional position in this debate is a cosmopolitan one. Contrary to statists, relational cosmopolitans have argued that principles of justice that govern a domestic society should be extended to the international context. Those who take this position argue that since there is a global "basic structure of society", domestic principles of justice can be

[9] We will see this in more detail in chapter 4.
[10] Krugman and Obstfeld, 2003: 639-40.
[11] As opposed to an economy with closed financial markets, in which monetary policy implemented by the central bank has a direct impact on real variables. An economy with open financial markets but fixed exchange rates the implementation also works differently, since in this case monetary policy applied by the central bank is powerless (see annexe 4).
[12] Frieden, 2015: 14-5. Also see Krugman and Obstfeld, 2003: 554.
[13] UNDP, 2006: 56. Also UNDP, 2009: 7.
[14] Stiglitz et al, 2006: 244.
[15] Rawls, 1993a; Freeman, 2006; Sangiovanni, 2007; Nagel, 2005; Blake, 2001; Risse, 2006

extended to the global context.[16] Non-relational cosmopolitans argue that an equal respect for all human beings implies that resources should be distributed according to global egalitarian principles. Their arguments are based on the idea that justice should ultimately address human beings and principles of justice are triggered by the fact of being human.[17] As opposed to other arbitrary elements such as nationality, or other elements that are a consequence of brute luck.

The recent literature, or *third wave* of this debate argues for a middle ground between these two positions. On the one hand, those in favour of this intermediate position argue that there are principles of justice beyond the state. On the other, they argue that these principles are not necessarily those of egalitarian social justice that apply within a domestic society. This position is the one taken by Joshua Cohen and Charles Sabel. Cohen and Sabel argue that principles of justice must be sensitive to the circumstances and associative relationships, considering different cases and types of relationships.[18] They argue that these principles are generated depending on the type of human interaction and new principles arise if these relations change. Another author who argues for a middle ground is A.J. Julius. Julius argues that principles of justice are triggered by interactions, and the greater the interaction the stronger the principles.[19] This is because international social interaction must be justifiable to those who participate in, and to those affected by it. Julius argues that in a hypothetical world of closed societies, principles of justice would only arise within these societies.[20] On the other extreme, in a completely globalized world, these principles would be extended to the international arena.[21]

A more comprehensive account of this position is offered by Laura Valentini. According to Valentini the aim of justice is to justify the instances of coercion, or limitations of freedom. Because the global economy with its coercive rule system limits the ability of citizens to pursue their own ends, their sovereignty and autonomy, the system requires justification.[22] This justification can be given by principles of global justice. Valentini stresses that in the current world the state remains the central locus of coercion, so - following Blake's argument - a first set of principles must be focused on justifying state's coercion. However, these principles must be supplemented by broader principles that justify the global system of coercion that states, corporations, individuals and international organizations exercise to one another.[23]

This thesis is situated in this *third wave* of the debate on global justice. More specifically, I endorse Miriam Ronzoni´s idea of background injustice. The idea of background injustice stems from a practice-dependent approach to justice: specific principles of justice arise to govern specific social practices, depend on the nature of these practices, and arise only between those who participate in these activities.[24] Based on this idea Ronzoni argues that certain types of interaction at the global level are social practices that raise problems of background injustice, which in turn trigger obligations to establish something

[16] Beitz, 1979; Pogge, 2002; Moellendorf, 2002
[17] Caney, 2005: 111; Beitz 1983
[18] Cohen and Sabel, 2006: 148, 149
[19] Julius, 2006: 187-189
[20] Julius, 2006, 189-90
[21] For other work that argue for this position see Ronzoni, 2009; Sangiovanni, 2008; Ypi, 2008, 2010; Forst, 2001; Miller, 2010; Stilz, 2009
[22] Valentini, 2011: 192-3
[23] Valentini, 2011: 187.
[24] Ronzoni: 2009: 233

similar to, but not necessarily a, basic structure – or supranational institutions - that regulates these interactions.[25] This thesis assumes that a system – or a social practice - that affects individuals worldwide, should be justified to them. In particular it assumes that the system should be justified to the worse off. However, this justification does not necessarily mean that principles of distributive equality apply at the global level. Justification may instead require other principles.

There is another way – different from the one presented above - in which this thesis takes a third way, which relates to the debate about global finance. On the one hand, throughout this thesis I argue that an IMS with completely open capital markets and no regulation leads to problems of background injustice and parasitic exploitation. In other words, I reject a laissez faire IMS, such as the one we have today. On the other hand, in chapter 6 I argue that having a system of completely closed capital markets, or financial autarky, is also problematic. In that chapter, I argue against Aaron James´ proposal of curbing capital markets and having a system of financial autarky, such as the one that existed during the Bretton Woods period. Instead, I suggest a third way that is different from both scenarios presented above. I propose that a system of free capital should be embedded in regulating institutions that minimizes the problems of background injustice and parasitic exploitation of the current system.

Before I continue with the next section, I will address a common objection to any theory that seeks to work with global principles of justice. This objection derives from the statist view, which argues that because there is no global coercion, principles of justice cannot be enforced at a global level. In response to this objection, it can be argued that the Gold Standard was a system with its own rules and principles. These rules were not enforced by any agent or institution that made states cooperate through coercion. This global fixed currency regime lasted for more than forty years before 1914. Likewise, the monetary system established at Bretton Woods lasted for more than twenty years. Both examples show that it is possible for countries to self-regulate themselves- participating in cooperative systems with particular rules - without the need for a global coercive institution with the monopoly of violence. More recent examples of international monetary cooperation happened after the 2008 Financial Crisis. The G20 countries assumed an important role in mitigating the crisis, cooperating in the application of expansive monetary policies, which allowed the crisis not to become a new great world depression. They also generated changes in financial regulation, avoided competitive protectionism, and implemented an international tax.[26] This case has led to conclusions that powerful countries know that they have a great responsibility in the stability of the system and have acted accordingly, even without being coerced to do so. On the other hand, there have been several current proposals to improve the system such as Tobin Tax and Robin Hood tax. These proposals are being taken seriously in the contemporary debate and by several state leaders. This work is framed as a broader alternative to such proposals.

[25] Ronzoni, 2009: 232
[26] Ocampo, 2017: 229

Section 4) Global Finance

Most of the current debate on global finance relates to the role of the International Monetary Fund (IMF), sovereign and private debt, global taxation, and the consequences of financial crises.[27] In spite of these debates, little attention has been paid to the case of the International Monetary System (IMS). Some work on the normative issues that derive from the IMS has emerged in recent years, but this debate is still in its early stages.

In order to identify the gap in the literature, I will say more about how the current IMS works, which can be used as map to locate the discussions within the broader context. Our general map derives from a basic principle of macroeconomics, also known as the Mundell-Fleming trilemma or the impossible trinity. According to this principle states cannot have at the same time the three of the following elements: freedom of capital movement, exchange rate stability, and autonomy in monetary policy.[28] They can have at most two of the previous elements at the same time. This is not a logical trilemma, but a trade-off between three desirable aims. The issue is not which of the three elements of the trinity we want to sacrifice for the sake of the other two, but rather which equilibrium among the three we should opt for. The proposed view is a balance of the three "horns of the trilemma", rather than a binary choice of two of them.

From the Mundell-Fleming trilemma we can distinguish three main scenarios, in order to leave some variables constant: a closed financial system, and two open ones, one with fixed exchange rate and another with a floating one (See annexe 3). Political theorists have been interested in some of these cases, since the exchange rate is a main variable that shapes macroeconomic conditions in a country, raising issues of justice and distribution of resources. Aaron James has focused on the first of these cases, and has argued for a closed financial system such as the one that existed in Bretton Woods.[29] Juri Viehoff analysed the second scenario, that of countries with a fixed currency under a generally open financial system, such as the case of the European Union.[30] Sanjay Reddy has considered the floating case and has argued for some solutions to mitigate its problems.[31] These three cases are essential for understanding the way in which financial crises arise. In a completely closed financial world it is even possible to have no financial crises at all.[32] In the other two scenarios, other agents apart from states – such as currency traders and banks - play a

[27] The role of the IMF has been questioned because of the constraints it generates on national sovereignty and for acting as a means for domination. See Stiglitz, 2002b: 62, 88; Miller, 2007: 253; Laborde, 2010: 58. The debate on sovereign debt focuses on issues of legitimacy, and intergenerational and social justice. See Wiedenbrüg, 2018; Wollner, 2018; Herman, 2007; Barry and Tomitova, 2007; Reddy, 2007; Dimitriu 2015a, 2015b; Palley 2003; Pogge, 2002, chap 6. The case of private debt is seen as an issue of distributive justice, individual freedom and individual rights. See Persad, 2018; Meyer, 2018; Herzog, 2017; Brownlee and Stemplowska, 2015; Sorrel, 2015; Liarelli, 2015; Douglas, 2015; Hudon and Sandberg, 2013; Hudon and Ashta, 2013; Dobos, 2012; Gourevitch, 2012; Davidson, 2011; Hudon, 2009. The debate of global taxation focuses on issues of reciprocity and in problems of tax evasion and competition, which are detrimental for the state's capacity to achieve self-determination and provide social justice at home. See Brock, 2008; Dietsch and Rixen, 2014; Dietsch, 2015; Gaisbauer et al, 2015; Dietsch and Rixen, 2016; van Apeldoorn, 2016; Ronzoni, 2016; Dietsch, 2016; Wollner, 2016; Rixen, 2016. Finally, the debate on financial crises emphasises the harms of these crises across borders, their effects on the worse off and the coercive element of these crises. See Pogge, 2008: 187-92; Miller, 2010, 122; Valentini, 2011: 196-7.

[28] This trilemma was discovered by Fleming, 1962; Mundell, 1960, 1963. Any book on international economics presents this idea.

[29] James, 2012: chapter 8

[30] Viehoff, 2018

[31] Reddy, 2003

[32] Reinhart et al, 2009

significant role in the mechanism of crises generation and spreading. These agents contribute to financial crisis when they engage in currency speculation and excessive risk taking, respectively. Gabriel Wollner addresses the first case, and defends a Tobin tax – or tax on foreign exchange transactions – which avoids currency speculation and the capital flows that arise as a result.[33] The case of banks is considered also by Wollner and by Viehoff, who argue for a banking reform that would avoid excessive risk taking.[34]

Within this broader context, I will mainly focus on the last scenario, that of a generalized open economy with floating exchange rates, in Part I, and on the other two scenarios in Part II. The former scenario is the general scenario of most of today's world. Apart from Reddy's isolated contribution, normative work focused on the principles that arise in this scenario is completely absent. On the other hand, even if Reddy argues for some solutions to avoid cases of background injustice, he does not offer a normative framework to access this particular case. This thesis intends to contribute by filling this gap.

Section 5) Research Question and Structure of Thesis

The main research question of this thesis is that of the best equilibrium. I will argue that a system where exchange rates can fluctuate and capital can move, but with important limits and remedies is superior to the alternatives. In *Part I* of the thesis I consider the first scenario of the Mundell-Fleming trilemma, that of floating exchange rates and open capital markets, which is the general case of the IMS today.

In *chapter 1*, I argue that in the current IMS there are two problems of background injustice. I start this chapter by introducing and explaining general concepts offered by Miriam Ronzoni that will be used throughout this thesis, such as the distinction between the basic structure and informal rules, background injustice and the practice dependent approach, and procedural and outcome fairness. Then I argue that in the current IMS there are two problems of background injustice: the case of monetary spillovers and the case of currency speculation. The first problem of background injustice, the case of monetary spillovers, generates a tension between states. This problem happens because exchange rates are relative to one another, thus, when a country intervenes in the market to modify its exchange rate, this also changes the exchange rate of all other countries vis-à-vis this country. The second problem of background injustice, the case of currency speculation, happens between the market and the state. This problem happens because the current rules that allow currency speculation, offer traders in the market influence over the exchange rate level of countries. In order to argue that these two cases are problems of background injustice I show that they erode the three conditions of background injustice offered by Ronzoni – the ability to deliver social justice at home, sovereignty, and freedom and equality of agents. I also show that these cases generally lead to outcome unfairness, and that in cases of crisis they also lead to procedural unfairness.

These two problems of background injustice are relevant problems, since, as we saw, the IMS is a social practice that has profound effects on countries' economies, on people's lives, and on poverty and development levels. Because of this impact, I assume that the IMS

[33] Wollner, 2014
[34] Viehoff, 2018; Wollner, 2018

should be justifiable to those that are affected by it, and specially to the worst off – poor people who live in poor countries - since they are the ones who bear the highest burdens of this system.[35] This problem of background injustice leads us to the Research Question. The main Research Question of this thesis is how can these problems of background injustice be solved or reduced?

In *chapter 2*, I address the first problem of background injustice, the case of monetary spillovers. The aim of this chapter is to determine which principle of fairness, if any, is the appropriate one to address this problem and which possible solutions derive from this principle. I start this section by arguing that the principles of fairness that have been proposed for the social practice of trade cannot be extended to the case of the IMS. Then I go back to the problem of background injustice and make a distinction between mere interdependence and background injustice. I argue that domination is the point at which interdependence becomes a problem of background injustice. I also suggest that domination in this case happens during periods of crisis. In order to address this case, I propose a Limited Regressiveness Principle (LRP), according to which regressiveness in a social practice or system, considering background conditions, should be constrained in a way that avoids domination. I also argue that a possible application of this principle is the creation of a global fund, which is a redistributive scheme among participants of this social practice. Finally, I argue that in this case there are two types of responsibility. On the one hand, there is an agential responsibility of states. This responsibility is remedial, since it aims to avoid situations of domination, and holds strong states liable when they contribute to, or have outcome responsibility for, this domination. On the other hand, there is a systemic responsibility, since the problem lies in the absence of an institution that regulates the social practice. This responsibility takes the form of a forward-looking responsibility to create this institution.

In *chapter 3* I take a step back from the case of the IMS, to offer a framework of parasitic exploitation. I start this chapter by drawing on the cases of Universal Basic Income (UBI) and parasitism in nature, in order to offer a framework of parasitic exploitation, which includes three conditions of build in mechanisms, vulnerability and non-proportionality. All of these conditions are necessary, but not sufficient, for exploitation. I also offer three elements that should be present in cases in which exploitation happens as a process, as opposed to in a single transaction. These elements are an exploiter party who obtains additional profit, this profit could not have happened in the absence of the weak party, and the profit comes at the potential expense of the weak party. I also consider that a situation is more or less exploitative depending on background conditions and indirect consequences. I consider different cases in the case of UBI and argue that some cases are not exploitative, others are not exploitative in the moralized sense of exploiting a person, and others are likely to be weak cases of parasitic exploitation. Finally, I conclude that in this case the absence of regulation is preferable even if this allows for parasitic exploitation to happen. Then, I present an inquiry into the nature of the moral wrong caused by speculation in the stock market. I ask whether if this case can be considered a case of parasitic exploitation, and conclude that it can, since it satisfies both the framework of parasitic exploitation and the three elements of exploitation as a process. After considering background conditions and indirect

[35] In this thesis I use Aaron James' and Gabriel Wollner's idea of justification, according to which a system needs to be justified to those affected by it, especially to the worse off (James, 2012: chapter 8; Wollner, 2014). According to James, a system cannot be justified if there are alternative scenarios that leave the worse off better off. According to Wollner, there is justification when a system minimizes erosions of the ability to deliver social justice at home, sovereignty and well-being.

consequences in this case, I conclude that if this case is a case of exploitation, it is likely to be a stronger case than the one of the free-rider in the case of UBI.

Based on this framework, in *chapter 4*, I argue that the second problem of background injustice, the case of currency speculation, sometimes also constitutes a case of parasitic exploitation. In order to argue this, I show how these cases satisfy the three conditions of the framework of exploitation presented in the last chapter, and the three connection criteria. Then, I address the question of responsibility, and I make a distinction between two problems. First, I address cases in which traders profit from exploitation. Second, I focus on the case in which the combination of traders' actions leads to a disaster in the country that has its currency speculated on. For the first problem, I argue that traders that profit from exploitation are morally responsible for their actions. For the second problem I argue that while traders have some responsibility for contributing to the harm, traders as a collective cannot be held responsible for the complete harm generated by their combined actions. I argue that in both cases it is the state – or the international basic structure – as a regulatory agent, which has a forward-looking responsibility to change or implement rules and regulation. From this, I conclude that while currency *trading* is generally justifiable, currency transactions that are *speculative* should be regulated and prohibited globally. Finally, I propose some possible regulatory mechanisms and compliance strategies, such as an extension of the Volcker rule to the Foreign Exchange market.

In *Part II* of the thesis, I address the other two scenarios of the Mundell-Fleming trilemma. *Chapter 5* considers the scenario of open capital markets and fixed exchange rates. I start this chapter by discussing two stylized, but historical, regimes of fixed currencies and open capital markets, the cases of the Gold Standard and the Reserve Currency Standard. I suggest that, because cases of currency speculation were common in these cases, the framework of parasitic exploitation can be extended to the fixed scenario. I also argue that in these cases domination necessarily happens. Therefore, the LRP cannot be extended to this case. Instead, in these cases there is a forward-looking responsibility to change the system to a floating scenario, since this change reduces domination and leaves the majority of – but not all - countries better off. Then I consider the case of monetary unions, and specifically the Eurozone. My initial hypothesis is that when countries join a monetary union they are less likely to be dominated and exploited. I start by asking what the benchmark for domination is in this case. I argue that as opposed to the floating case, in which domination happens when there is a crisis, in the case of monetary unions the benchmark for domination is the absence of mutual advantage. I also argue that, given that the benchmark for domination is different, the principle that applies in this case is also different from the LRP. I suggest that the adequate principle to address the case of monetary unions is Juri Viehoff's equitable risk-sharing principle. I also argue that in this case there is parasitic exploitation. This raises an apparent paradox. Contrary to the initial hypothesis, countries that join a monetary union such as the Eurozone, in which there is capture and no solidarity, are more dominated and equally exploited compared to the floating case. I suggest that this apparent paradox happens both, because in this case countries are objectively worse off compared to the floating case, and because the benchmark of domination is different in the two cases. Finally, I offer policy proposals for the case of the Eurozone, such as a fiscal federalism and banking regulation.

Finally, *chapter 6* considers the case of closed capital markets. I argue that a system of free finance, or with open capital markets, is better than a closed one, since the latter scenario may generate other costs to developing countries that leave them worse off *overall* compared to the scenarios discussed up to this point. I start this chapter by arguing against a

system of completely closed capital markets, such as the IMS that existed during Bretton Woods. The main defender of financial autarky, or closed capital markets, is Aaron James. I argue against James, and against a system with completely closed capital markets, on four grounds. First, on empirical grounds. I suggest that the costs of having a system with closed capital markets are higher than those considered by James, I suggest that the benefits are lower, and I argue that there is a problem of feasibility of going back to a system of closed capital markets. Second, I suggest that a system with closed capital markets would reduce freedom and equality of agents. Third, a closed system would offer an unfair distribution of benefits and burdens. Finally, I argue that there is no reason for offering priority to creating the institutions necessary for closed capital markets, if there is an alternative possibility of creating embedding institutions within open capital markets, which would lead to similar results with less costs. While the case of closed capital markets raises normative problems, throughout this thesis I have argued that the opposite scenario of open capital markets with no regulation also has normative problems: of background injustice, of domination and of parasitic exploitation. Because both a completely closed scenario and an open scenario without regulations have normative problems, I conclude that the best solution is a third scenario - a case of open capital markets embedded within regulating institutions, such as the institutions and policy proposals offered in the previous chapters of the thesis. This scenario, on the one hand, is not as demanding as financial autarky, and on the other hand, institutions aim to address the problems of domination and exploitation that arise in open capital markets.

Overall, the main contributions of my thesis to the literature are four. First, I address monetary issues in a systematic way, since currently there are only a few papers and book chapters on the topic.[36] Second, I offer a framework of parasitic exploitation that is different from those in the literature. Third, I offer a principle of fairness for the social practice of the IMS. Finally, I argue that different concepts of domination, and different types of responsibility, apply in the general cases of the IMS and in the case of monetary unions.

[36] Wollner, 2014; Viehoff, 2018; Reddy, 2003; James, 2012: chapter 6

PART I

Chapter 1: Two Problems of Background Injustice in the IMS

Section 1) Introduction

In the introduction of this thesis I presented the Mundell-Fleming trilemma of international macroeconomics, according to which countries cannot have at the same time stable exchange rates, autonomy in monetary policy, and open capital markets. States within the IMS can only have two of these three elements at the same time. From this trilemma, I obtain three stylized scenarios: two scenarios with open capital markets: one with floating currencies and another one with fixed currencies, and a scenario with closed capital markets. In the first part of this thesis I address the first of these three cases, the case of open capital markets and floating currencies. In the second part of this thesis, I focus on the other two stylized scenarios.

The case of open capital markets and floating currencies is the general scenario that exists in the IMS today. While there are some exceptions, today most countries allow their currencies float in the Foreign exchange market and their central bank intervenes in this market on occasion. Within this scenario, this chapter identifies two problems of background injustice that exist in the current IMS. The first is the problem of monetary spillovers, which generates a problem of background injustice between states. The second is the problem of currency speculation, which generates a problem of background injustice between the market and the state. This chapter identifies the two cases only, hence, it can be considered an introductory chapter. Later in this first part of the thesis, I address these two problems of background injustice, the cases of monetary spillovers and of currency speculation, in chapters 2 and 4 respectively.

This chapter proceeds as follows. *Section 2* introduces general concepts offered by Miriam Ronzoni that will be used in this thesis, such as basic structure and informal rules, background injustice and practice dependent approach, and procedural and outcome fairness. Background injustice happens when the lack of rules leads to unfairness within a social practice - e.g. when participants are not able to interact as free and equal agents because of the outcomes of the social practice. This concept is relevant when we theorize about the IMS, since this is a social practice that happens in the global realm - in which there is no basic structure such as the one that exists within a state - and it affects those involved globally.[1] *Section 3* suggests that there are two problems of background injustice in the IMS: the case of monetary spillovers and the case of currency speculation. I show that given the current background conditions and informal rules, the absence of regulation and the current rules, lead to regressive outcomes. In other words, the system, as it is today, reinforces pre-existing conditions of dependency and vulnerability of countries. *Section 4* elaborates on the claim that that these two cases are cases of background injustice. I argue that these cases do not only lead to outcome unfairness, but they also lead to procedural unfairness. I suggest that this procedural unfairness occurs when there is a crisis, since in these situations, countries lose their ability to make free choices and interact as equal agents. I also show that the two

[1] Gabriel Wollner and Juri Viehoff have taken a similar approach when discussing aspects of the IMS. See Wollner, 2014; Viehoff, 2018.

cases also violate the three conditions of background injustice offered by Ronzoni: sovereignty, the ability to deliver social justice at home, and freedom and equality of agents. *Section 5* distinguishes the concept of background injustice considered in this thesis from Iris Marion Young's theory of structural injustice. I argue that while there are some similarities between these two approaches, these approaches are ultimately different. *Section 6* addresses the objection that the responsibility for harm is partly a national responsibility of weak states for not having the adequate institutions that protect countries from harm. Finally, *section 7* concludes.

Section 2) Basic Structure, Background Justice, and Procedural and Outcome Fairness

In this section I locate the issue of background injustice within the general literature, and I present concepts offered by Miriam Ronzoni, such as the basic structure and informal rules, background injustice, practice-dependent approach, and procedural and outcome fairness. I introduce these concepts here, since I will use them later in my thesis.

2.1- The basic structure and informal rules

Ronzoni starts by presenting a debate between Gerald Allan Cohen and John Rawls about the basic structure of a domestic society as a locus of justice.[2] On the one hand, Rawls argues that principles of justice should apply to the basic structure, or to the legally coercive mechanisms and institutions of the state because the effects of these institutions are profound and are present from the start.[3] On the other hand, Cohen criticizes Rawls arguing that there are other informal mechanisms that are non-coercive and that also have significant and profound effects on society, such as the family or decisions made by individuals within the system.[4] Cohen's view focuses more on outcomes, and considerable inequalities between actors is a reason to consider a system unfair.[5]

In order to solve this tension, Ronzoni argues that informal rules are a key issue when assessing the fairness of a basic structure. According to Ronzoni, a basic structure and its institutions are created with the goal of ensuring justice and whether they achieve the end of generating fair outcomes or not is a crucial criterion to evaluate if they are just.[6] Because institutions are embedded in a pre-existing context of social norms and informal rules, what institutions do to achieve fair outcomes depends on these informal rules.

Ronzoni's approach is "Rawls-inspired".[7] Rawls makes the distinction between rules, a particular institution and the basic structure of society as a whole – or the narrower and wider context - and argues that it is the latter which should be just, even if specific rules or institutions are unjust.[8] For example, a rule of quotas for women may be, in isolation -or in the narrow view- considered unjust, since it violates a principle of equality of opportunity.[9] However, when addressed in a wider context of the system as a whole, this rule increases

[2] Ronzoni, 2008
[3] Ronzoni, 2008: 207. Also, in Cohen, 1997:7.
[4] Ronzoni, 2008: 207. In Cohen, 1997: 19-20.
[5] Ronzoni, 2007: 78
[6] Ronzoni, 2008: 210
[7] Ronzoni, 2008: 213
[8] Ronzoni, 2008. Rawls, 1999: 60
[9] Ronzoni, 2008: 213-4

equality of opportunity overall. The opposite also applies, a rule that offers no privileges to women in a sexist society may be seen as fair on its own, but unfair when addressed from a wider context.[10]

2.2- Background justice and the Practice-dependent approach

Ronzoni extends her idea of how the basic structure should be assessed at the global level. She observes that most of the issues that arise in the debate of global justice – e.g. unwritten rules, non-coercive international institutions, ideas of differential treatment, and deep inequalities in bargaining power – are similar to the informal rules of a domestic society.[11] In a domestic society, these informal rules are not part of the basic structure but are a crucial element to determine if the basic structure is just. In other words, these informal rules do not tell us what the basic structure is, but what should be regulated by it.[12]

In the domestic context associations can form freely because they are embedded within a basic structure that makes the corrections necessary. To illustrate this idea, Ronzoni offers the case of labour contracts pre-trade unions.[13] In this case the differences in bargaining power between workers and employers could lead to any outcome – e.g. child labour – and unacceptable results. In this case it is the role of the basic structure to determine that there are certain types of contracts that are exploitative, and should therefore be outlawed. Even if labour relationships are not part of the basic structure, this is an area that should be regulated by the basic structure, and a basic structure without labour laws would be unjust. Ronzoni makes an analogy with the global case, in which certain unjust situations may happen – e.g. international agreements that benefit the powerful – and the absence of a basic structure to make the necessary corrections constitutes a problem of justice.[14]

In this context Ronzoni introduces the idea of background justice, which derives from a practice-dependent approach to justice: specific principles of justice arise to govern specific social practices, depend on the nature of these practices, and arise only between those who participate in these activities.[15] This approach is also based on Rawlsian ideas, since Rawls argued that different principles of justice apply to different social practices within a domestic society, and the basic structure should provide background justice for these specific practices.[16] Ronzoni uses the same example of contracts to explain this idea, which is *procedural* because of its focus on the process. Contracts happen in a just background structure when they are free and fair.[17] Contracts are free when individuals are not coerced, and are fair when both parties are able to refuse or renegotiate the conditions of the contract. According to both Rawls and Ronzoni, the basic structure should ensure that these background structure conditions are maintained over time, either by generating redistribution or by other means that allow to maintain the bargaining power and preserve the relation of equals.[18]

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[10] Idem
[11] Ronzoni, 2007: 77-8
[12] Ronzoni, 2007: 80.
[13] Idem.
[14] Ronzoni, 2007: 81
[15] Ronzoni: 2009: 233
[16] Rawls, 1993b: 267
[17] Ronzoni, 2009: 238
[18] Ronzoni, 2009: 240-1; Rawls, 1993b: 267

Based on this idea Ronzoni argues that certain types of interaction at the global level raise problems of background injustice, which in turn trigger obligations to establish something similar to, but not necessarily a, basic structure – or supranational institutions - that regulates these interactions.[19] In the global context different forms of interactions between different actors generate the need for different institutions and regulation to regulate them.[20] According to Ronzoni in this context just background structures should allow states satisfy three conditions of: sovereignty in their territory, social justice at home and the ability to interact as free and equal agents.[21] As an example of the above Ronzoni offers the case of tax competition.[22] Tax competition is a phenomenon in which countries compete against each other by lowering their taxes in order to attract capital and investment.[23] The absence of regulation creates a more regressive system which increases inequality by depriving states of the ability to raise public revenue through taxes, which limits the states' effective sovereignty. This also makes states less free to implement certain public policies because of the lack of revenue and decreases the ability of states to deliver social justice at home. Therefore, Ronzoni concludes that the problem of background injustice in the case of tax competition triggers the need to establish new practices or institutions that regulate this problem.

2.3- Procedural and Outcome Fairness

According to Ronzoni both procedural and outcome fairness are relevant for background justice. Outcome inequality does not necessarily raise problems of background injustice, these inequalities matter when they undermine procedural fairness. She offers the case of contracts to illustrate this case.[24] On the one hand, a contract is procedurally free and fair when participants are not coerced and when both parties are able to refuse or renegotiate the conditions of the contract. The latter condition happens when participants have enough material conditions, have bargaining power, and when accepting the contract is not the only reasonable thing to do. On the other hand, outcomes matter because the outcomes of an agreement, if left unregulated, may undermine procedural fairness conditions, since the increasing inequality may erode the bargaining power of one party, or may leave this party with such few material conditions that accepting the contract is the only reasonable option. In other words, outcomes matter not because they lead to inequality, but because these outcomes may prevent participants of a social practice from interacting as free and equal agents and may also undermine their capacities to deliver social justice at home and to maintain their sovereignty. Ronzoni argues that when these three conditions - of free and equal agents, the ability to deliver social justice at home, and the ability to maintain sovereignty – are violated, this raises problems of background injustice.

In the next section I will introduce two problems of the IMS that can be considered problems of background injustice.

[19] Ronzoni, 2009: 232
[20] Ronzoni, 2009: 245-6
[21] Ronzoni, 2009: 247
[22] Ronzoni, 2009: 250-1
[23] Ronzoni, 2009: 249
[24] Ronzoni, 2009: 238

Section 3) Two Problems of Background Injustice

In this section I introduce and explain two issues that happen in the IMS that can be considered problems of background injustice: the problem of monetary spillovers and the problem of currency speculation. I will show that, as in the case of women in a sexist society, given the background conditions and informal rules, the system - with its current rules and lack of regulation - leads to regressive outcomes.[25] In other words, the system as it exists today, reinforces pre-existing conditions of vulnerability and dependency, leading to regressive outcomes, or increasing inequality.

3.1- First Problem of Background Injustice: Monetary spillovers

The first problem of background injustice has been referred by economists as a problem of externalities, or as monetary spillovers.[26] The IMS is an interdependent system. Because exchange rates of different countries are relative to one another, whenever country A changes the value of its exchange rate – or when the central bank of country A applies monetary policy - this has a similar effect in magnitude but in the opposite direction for the value of the exchange rate of all other countries compared to the one of country A. Therefore, when countries modify their exchange rate, this may have significant impacts abroad. However, instead of considering this as a problem of externalities *only*, in what follows I will suggest that this case can *also* be considered a problem of background injustice.

A system in which every country is free to modify their exchange rate and to generate monetary spillovers leads to outcome inequalities because of informal rules in the IMS. I call these informal rules *channels of dependency*, or the channels through which fluctuations in exchange rates impact countries. To explain why weaker countries are more affected by monetary spillovers and fluctuations in exchange rates, and to show how the channels of dependency operate, I will use the example of Mozambique. This case is a paradigmatic example of how fluctuations in exchange rates harm developing countries. Joseph Stiglitz has presented the main channels through which fluctuations in exchange rates affect developing countries: "(a) the reduction in demand for goods and services produced by domestic firms obviously hurts firm profitability; (b) large devaluations during currency crises affect the balance sheet of foreign denominated debts; (c) increases in interest rates that often accompany crises reduces the values of domestic assets, hurting the balance sheets and profitability of virtually all domestic firms; and (d) uncertainties concerning the state of balance of sheets and future profitability affect the ability and willingness of firms to borrow and invest and banks to lend".[27] In what follows I will explain how these channels of dependency operate through the example of Mozambique.

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[25] Here I refer to regressiveness rather than to unjust, since outcome inequality does not necessarily lead to background injustice. Instead background injustice happens when outcome inequality also leads to procedural unfairness.

[26] Some economists have presented the possibility of cooperating - maintaining a stable rate - to achieve a system in which everyone is better off. The option to cooperate has been presented as a prisoner's dilemma in which cooperation moves the international monetary system from a Nash equilibrium to a Pareto optimum. See Cohen, 2000: 245-256; Frieden et al, 2010: 311; Krugman and Obstfeld, 2003: 601-603.

[27] Stiglitz et al, 2006: 235.

3.1.1- Informal rules or Channels of dependency: the case of Mozambique

There are different ways in which fluctuations in exchange rates impact a country. In the case of Mozambique there are five main channels: impact on prices; change in demand or on trade flows; changes in profitability and well-being; changes in balance of sheets and debt levels; and economic growth and development.[28] Apart from these five channels, there are other channels through which fluctuations affect countries, that do not necessarily happen in the case of Mozambique, such as changes in inflation levels. These channels of dependency are the background conditions or informal rules in which a system of floating exchange rates operate. In what follows I will explain each of these channels.

The first transmission channel of exchange rate fluctuations to the economy is through its impact in prices. To analyse this, it is necessary to consider the *Exchange Rate Pass Through* (ERPT), or the degree to which variations in the exchange rate are reflected in prices. The ERPT affects imports and exports in Mozambique differently. On the one hand, ERPT to imports in Mozambique are high- estimated to be around 71 and 75 per cent. As a result of the high impact of exchange rate fluctuations on import prices, consumers must pay prices that are subject to constant changes. The ERPT to imports is higher in Mozambique than in developed countries due to differences in their market structure. Consumption of imported products in Mozambique is very high, since there are no local substitute products, and the demand for these commodities is inelastic- consumers need to buy these products even if the price increases- the price that consumers pay are those set by foreign firms. Therefore, the degree of pass through to consumers is high. On the other hand, since Mozambican exports do not have a high penetration in the markets of other countries, the ERPT for the prices of export products is low, estimated at around 30 per cent. Also, as Mozambique does not currently possess the capacity to modify market prices, when there is a variation in the exchange rate, exporters decide to absorb this difference to avoid losing competitiveness. This is consistent with results of recent studies, which suggest that since international trade is governed by dominant currency pricing- the exports of non-dominant currency prices (non-USD and non-Euro) are not very sensitive to exchange rate fluctuations.[29]

Nevertheless, total ERPT in Mozambique- like in other developing countries- is relatively high compared to that of developed countries. Unlike the case of Mozambique, developed countries have their economy more diversified, have more substitute products and their exports are based on manufactured products. This makes the prices that consumers pay for their products less sensitive to fluctuations in exchange rates. Also, given that small countries such as Mozambique absorb the ERPT of their exports seeking to maintain their price-to-market, this also means that developed countries are less impacted by fluctuations.[30] Unlike developing countries, developed countries do have the capacity to influence the price of products- especially those of manufactured goods- in the case of fluctuations. Finally, the ERPT impacts less when the prices of the products are in the local currency.[31] In this case,

[28] These five channels are based on those presented in (USAID, 2011).
[29] Gopinath, 2017, Casas et al 2017, Broz et al 2017, and Alessandria, 2013.
[30] Krugman, 1987, and Dornbusch, 1987.
[31] (Reinhart et al 2014) show that economies with high degrees of dollarization have greater exchange rate volatility and higher pass through than those that are not dollarized.

regardless of the exchange rate to other currencies, prices remain the same. This is an advantage for example for the United States because a large part of the products is valued in USD.[32]

A second channel through which the exchange rate impacts the economy in Mozambique is through changes in demand or trade flows. As we saw in the introduction of this thesis, an appreciation of the exchange rate makes domestic products more expensive compared to foreign ones, hindering exports and incentivizing imports, whereas a depreciation makes foreign products relatively more expensive. These fluctuations, and the effect on prices of products, affect trade flows. This point is strongly related to the previous one, since it depends on the degree of ERPT to prices of imports and exports. "It is only when a change in exchange rates turns into a realized change in import and export prices in the buyer's currency that a demand response will occur".[33] Because the ERPT in Mozambique is high, fluctuations in exchange rates generate more changes in trade demand flows compared to other countries with a lower ERPT. However, as we saw, in the case of an appreciation of the currency, the exporters usually decide to absorb a large part of the pass through, otherwise, they would have a considerable reduction in demand.

This brings us to the third channel, profitability and well-being. Both the appreciation and the depreciation of the exchange rate bring changes to profitability and well-being for the people of Mozambique. On the one hand, when there is an appreciation, local products become comparatively more expensive than foreign products. This does not only generate changes in profitability for exporters, who lose profitability due to competition with cheaper imported products, but it also affects the well-being of society as a whole. Local products in fundamental areas, such as agriculture, are substitutes for foreign products in the same area. When an appreciation occurs, the loss of profit for business in this area makes them relocate their resources to other areas. The loss of investments and relocation of resources away from these fundamental areas that protect food security is harmful because it leaves citizens more dependent on foreign products and it also destroys jobs in the local country. The case of agriculture in Mozambique is a good example to illustrate the above. In Mozambique, the main export products are cotton, tobacco and cashew. When there is an appreciation of the local currency this has a detrimental effect on demand and profitability when exporters absorb the ERPT, which leads them to relocate their resources to other areas. This is also harmful for well-being, "since it is these tradable agricultural products that provide the majority of the cash income for rural smallholders, any extended episode of real exchange rate appreciation can have adverse consequences for the livelihoods of a large segment of society, including the poorest segments of the populace who are part of this smallholder cohort ".[34]

On the other hand, depreciations also have detrimental effects on profitability and well-being. Rice and wheat are the highest consumed products in Mozambique, and most of this consumption is imported – e.g. 60 percent of the rice consumption is imported. When there is a depreciation of the currency, these imported products become prohibitively expensive for a considerable section of the population. This is why having local investments in fundamental areas that provide food security is extremely relevant. In the case of depreciations having local substitute products at reasonable prices are an alternative to

[32] Gopinath et al 2010; Gopinath et al, 2008; Bacchetta et al, 2005; Campa et al, 2005; and Devereux et al, 2002.
[33] USAID, 2011: 19.
[34] USAID, 2011: 46.

foreign products for local consumption. This is also why constant fluctuations, or alternations between appreciations and depreciations are considerably harmful to developing countries, such as Mozambique. In Mozambique, there are some domestic investments in rice plantations, which are found in the poorest regions of the country. When an appreciation of the currency occurs, imported rice becomes cheaper than locally produced rice, which leads to these domestic investments to stop being competitive and, if this appreciation is persistent, to close. These closures are not only detrimental for poverty alleviation, since they offer jobs for poor people, but they are also detrimental because, if followed by a depreciation in the exchange rate, they leave consumers vulnerable to not being able to afford foreign basic goods, and to have no affordable local alternative.

The fourth way in which exchange rate fluctuations impact the economy is through changes in the balance sheet of firms and debts in foreign currency. Mozambique, like many developing countries, is an economy characterized by currency and asset substitution. In other words, it has a relatively high degree of dollarization. This means that citizens save, borrow, and pay for business in foreign currencies.[35] This situation happens, among other reasons, because developing countries cannot always acquire debts in their own currency, which is a phenomenon described in the literature as *original sin*.[36] Because developing countries are more prone to inflation and to currency depreciation, there is a lack of credibility from banks in the currency of these countries and reluctance to offer loans in these currencies. Having debts in foreign currencies, makes the balance of sheets of firms of these countries considerably sensitive to exchange rate fluctuations, which has a great impact on the valuation of the firms. For example, if a firm has its assets in local currency but its loans in foreign currency, when a depreciation of the currency occurs, their debts or liabilities increase their real value while keeping the value of their assets constant, which leads to loses of wealth. These variations threaten the country's financial stability. The same happens at the government level with the balance of payments. Mozambique is a country with a considerable deficit,[37] and a large amount of this debts is in foreign currency. This means that fluctuations of the exchange rate lead to changes in the balance of payment position. For example, during the years 2009-10 the currency depreciated leading to an increase in the value of the sovereign debt between 3 and 5.5 percent of their GDP. This is one of the reasons why developing countries have a *fear of floating*, small variations on the exchange rate level have great impacts on the economy.[38]

Finally, the fifth channel through which exchange rate fluctuations impact the economy is through their impact on economic growth and development. This impact is due to the sum of all the previous channels presented. Changes in exchange rates that generate changes in prices, trade flows, profitability and valuations have an impact on investments and resource allocation.[39] In the case of Mozambique, like in other developing countries, changes in the balance sheet of firms discourages investment, and high fluctuations in the exchange rate leads to a sharp exit of international lenders, which in turn amplifies even more

[35] The degree of dollarization of a country is measured in deposits in foreign currency of the total deposits, and in the case of Mozambique this reaches 40 percent. This percentage is among the highest in moderately dollarized countries but it is lower than countries in Asia or Latin America, where this ratio is between 65 and 90 percent.
[36] Eichengreen et al, 2002.
[37] Of around 11 percent of GDP after grants.
[38] Calvo et al, 2002.
[39] Cavallo et al, 2010.

exchange rate fluctuations.[40] Also, the macroeconomic volatility that results from large fluctuations in exchange rates leads to distorted price signals and expected rates of return for investors, decreasing investment and growth, which negatively affects poverty and development.[41] This is why economists have concluded that having exchange rate stability is a key feature to achieving development.[42]

Apart from these five channels of dependency, there are other ways in which fluctuations in exchange rates harm developing countries, which do not necessarily happen in the specific case of Mozambique. For example, another reason why developing countries have a *fear of floating* is that, given their high levels of dollarization and of ERPT, fluctuations in exchange rates generate large changes in inflation and credibility.[43] This happens because given a high ERPT, currency depreciations lead to a relative decrease in the prices of local products compared to foreign products, which increases the demand for these local products and leads to an acceleration of the economy. This acceleration increases wages, in turn, increasing prices for these local products, ultimately generating inflation. In countries that aim to keep inflation at stable levels, these fluctuations make them lose the credibility of being able to maintain this commitment.

3.1.2- Channels of dependency and regressive outcomes

The example of Mozambique illustrates how, given the current background conditions in the IMS, fluctuations in exchange rates and monetary spillovers, lead to regressive outcomes. Because of their pre-existing vulnerability, developing countries are more affected by fluctuations through these channels, since (i) they have their debts in foreign currency; (ii) they are more dependent on imports; (iii) their exports have a lower penetration in foreign countries; and (iv) products are internationally priced in currencies of strong countries, among other reasons. Developing countries usually have debts in the currency of a strong country – e.g. in US Dollars - and when their currency depreciates against the strong currency, their debts are worth more in real terms. Another example is that people in developing countries have a higher consumption of imported products for food and basic goods. Thus, when their exchange rate depreciates vis-à-vis the currency in which they buy these imported products, the real value of these products increases, leaving these people with less purchasing power to buy these products. Because fluctuations are more harmful for weak countries, as a consequence of these channels, their pre-existing dependency is reinforced, since now they are also dependent on having stability with the exchange rate level that they have with strong states.

As opposed to developing countries, strong countries are less affected by these fluctuations in exchange rates. Hereafter, I will refer to strong countries as those which have strong currencies, mainly the United States and the Eurozone.[44] While the power of a country is reflected on its currency, having a strong currency offers additional benefits to countries

[40] Gopinath 2017: 6.
[41] Nzekwu, 2006: 62.
[42] Rodrik, 2008.
[43] Calvo et al, 2002.
[44] Even if Europe is not a country a monetary union can be considered an agent from an international monetary perspective because it has its own central bank, applies one monetary policy, and has decision-making procedures.

that issue them and puts these countries in a privileged position within the system.[45] This privileged position, makes strong countries less affected by monetary spillovers of weaker states. For example, because international transactions are generally priced in strong currencies, such as US Dollars or Euros, regardless of the exchange rate to other currencies, the prices of products from these countries in the international market remain the same regardless of fluctuations of the exchange rate.[46] Another reason why strong countries are not affected by fluctuations of developing ones is that the latter countries' exports have a lower penetration in the market of the former countries, thus an appreciation of the currency of the weaker countries does not have a considerable impact for consumers from strong countries, who can opt for substitute products.

3.2- Second problem of Background Injustice: Currency Speculation

The second problem of background injustice happens between the Foreign Exchange (Forex) market and states. Traders in the Forex market trade for different motives, some of these motives are: need, arbitrage, hedging, and speculation.[47] I will define and say more about these different types of transactions in Chapter 4. Here I focus on the latter type of transaction only. Speculation happens when traders aim to make profit from a change in prices of assets.[48] For example, if a trader thinks that the value of an asset will increase in the future, she has incentives to buy the asset today and sell it in the future. In what follows, I will suggest that speculation on currencies brings a second problem of background injustice, since systematic speculation on the vulnerability of countries generates considerable harms for these countries, ultimately leading to regressive outcomes.

3.2.1- Speculating on weak currencies: Cases of Currency crises

Currency traders analyse numerous aspects of countries in order to decide whether to buy or sell their currencies. If they believe that the currency of a particular country will be worth less in the future, they sell it, which leads to the depreciation of that currency. The main reason that leads traders to believe that a currency will be worth less in the future is the vulnerability of the country that issue it. Some of the variables that traders analyse in order to determine whether a country is vulnerable or not are: general macroeconomic variables, such as inflation and unemployment; business and consumer confidence; trade; natural disasters and conflict; commodity prices and natural resources; and levels of sovereign debt.[49] An example of how natural disasters play a significant role in determining the value of the currency is the case of Japan. In 2011 Japan faced an earthquake and a tsunami that killed thousands of people. This disaster was seen by traders as a negative signal and started selling the currency, which lead to a depreciation of the Japanese currency, the Yen.[50] However, due

[45] Cohen, 2015. For how the power of a country is reflected on its currency see Cohen, 2015: chapter 5. For the benefits that having a strong currency offers to countries that issue them see Cohen, 2015: chapter 4.
[46] Gopinath et al 2010; Gopinath et al, 2008; Bacchetta et al, 2005; Campa et al, 2005; and Devereux et al, 2002.
[47] Steiner, 2002: 3-4.
[48] Steiner, 2002: 3-4, 317
[49] Fieldhouse, 2015: chapter 6.
[50] Fieldhouse, 2015: 80-81. The Yen depreciated in 688 pips during the 5 days after the tsunami and, after a brief recovery, continued to depreciate for the following two months.

to the overall strength of their economy, Japan recovered from the depreciation of its currency in a relatively fast period of two months.[51]

Corruption and political conflict in a country act in a similar way: currency traders recognize this as negative signals and sell the currency leading to a devaluation of the currency, or to currency speculation. For example, in Turkey during 2001 a case of political corruption led to the devaluation of the currency.[52] Similarly, in 2018, Turkey faced problems in its international relations with the United States regarding the conflict in Syria, and faced a currency crisis after then US president Donald Trump said he would "devastate Turkey economically", and doubled tariffs in Turkish steel and aluminium industries.[53]

Another variable that shows a country's vulnerability is the sovereign debt, and more specifically the debt/reserve ratio.[54] This indicates that the fewer reserves a country has, in relation to their debts, the more vulnerable the country is. This sign of vulnerability has led developing countries not only to currency speculation, but also to more serious currency crises. In particular, when the currency of countries is pegged, currency crisis also lead to *balance of payment* and to *debt crisis*.[55] This process happens as follows, traders speculate on the currency, thinking that it is worth less than the value at which the government is committed to, and sell it, which generates pressure for devaluation.[56] In order to counteract this devaluation pressure, the government has to sell international reserves, to increase the interest rate and generate an opposite appreciation pressure on its currency. On the one hand, this increase of interest rates makes it harder for banks to lend, which could ultimately lead to a banking crisis.[57] On the other hand, this sharp change in a country's level of international reserves is known as balance of payment crisis. When the government is no longer able to maintain the currency level it lets its currency float and deeply devalue; this sharp change in the level of the currency is known as a currency crisis. When these lost reserves were the only means a country had to pay their short-term debts, it also faces a debt crisis.

This is what happened in the cases of Mexico in 1994, and Brazil and Argentina in 1999-2000. In Mexico the government devalued the currency beyond the depreciation limits that they had established, which led traders to speculate against it. The government tried to defend the currency but ultimately ran out of reserves and had a balance of payment crisis.[58] As the Peso was allowed to float, it suffered a deep depreciation, which soared inflation, more than doubled unemployment, led to "sky-high" interest rates and to a generalized *banking crisis*.[59] The government was able to avoid complete disaster only through an emergency loan of $50 billion from the U.S Treasury and the IMF.[60] Similarly, after the Asian crisis in 1997-8 traders speculated on the currency of countries which had similar characteristics as East Asian countries.[61] One of these countries was Argentina. In order to defend the currency against speculation, the government took a $40 billion support package

[51] Idem.
[52] https://www.ft.com/content/9c792596-b1b5-11e8-8d14-6f049d06439c
[53] https://www.bbc.co.uk/news/world-46866661
[54] Ocampo et al, 2008: 10.
[55] Krugman and Obstfeld, 2003: 674.
[56] For a more detailed explanation of this process see Krugman and Obstfeld, 2003: 502-5.
[57] Krugman and Obstfeld, 2003: 691
[58] Krugman and Obstfeld, 2003: 506
[59] Krugman and Obstfeld, 2003: 687.
[60] Idem.
[61] Russia had a massive currency crisis and debt default (Frieden, 2015: 238). For the case of Russia see Krugman and Obstfeld, 2003: 692-4.

from international financial institutions and other creditor countries.[62] However, this was not enough, the situation continued to worsen and in 2001 Argentina defaulted on its debts.[63] Argentina had to abandon the peso-dollar peg in 2002, which led to a sharp depreciation. As a result, the GDP dropped, unemployment and inflation soared, and the country faced political and economic chaos.[64] Brazil also faced speculation and negotiated a support package of more than $40 billion from the IMF, the World Bank and creditor countries, in order to maintain the value currency stable.[65] However, this package was not enough to fulfil its purpose and the depreciation of the currency led to 5 years of recession.[66]

The Asian financial crisis shares similarities with the cases presented above. During the first half of 1997, traders speculated about a possible devaluation of the baht - which was pegged to the US dollar - since Japan, a major trading partner of Thailand, faced an economic slowdown.[67] Like in the previous cases, this led Thailand to lose reserves, and when it attempted a controlled devaluation, the speculation turned to be massive, which generated a sharp drop in the currency's value. This led traders to speculate on the currencies of Thailand's neighbours, such as Malaysia, Indonesia, South Korea. All of these countries, except Malaysia, received loans from the IMF to contain the crisis. However, despite these loans the countries faced currency crises. In the case of Indonesia, the currency lost 85 percent of its original value, there was mass unemployment, people were unable to afford basic foodstuffs, and ethnic violence broke up.[68]

3.2.2- Currency speculation and regressive outcomes

The cases presented above are all cases in which traders speculate on the vulnerability of a country. However, traders can also speculate on a country's strength. For example, in 1971, traders thought that the German economy was doing better than that of the United States, which led them to make massive purchases of Deutschmark (DM) in the Forex market.[69] Speculation on a country's strength also brings harmful consequences to the country that has its currency appreciated. Because of this appreciation, the exports of this country become relatively more expensive to others, which harms export industries and generates a tendency to a misallocation of resources away from industrialized sectors.[70] Because speculation – either on vulnerability or on strength - brings harmful consequences, in chapter 4, I will suggest that citizens have a structural vulnerability, since the rules and regulations leave them vulnerable to traders speculating on their currency in general.

Apart from this systemic vulnerability, a consideration of the background conditions, or the pre-existing vulnerability or strength of countries, is also useful. Given these

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[62] Frieden, 2015: 241.
[63] Krugman and Obstfeld, 2003: 685. The government adopted the *corralito* measure: froze bank deposits and restricted account holders to withdraw no more than $250 a week, and later blocked citizens' access to their bank accounts (Krugman and Obstfeld, 2003: 685, 695)
[64] Frieden, 2015: 242. Krugman and Obstfeld, 2003: 685, 695.
[65] Frieden, 2015: 238; Krugman and Obstfeld, 2003:694.
[66] Idem
[67] Krugman and Obstfeld, 2003: 691.
[68] Idem
[69] Krugman and Obstfeld, 2003: 558-64
[70] Another example of speculation on the strength of a country are cases of what economists have termed *Dutch disease* (Corden and Neary, 1982), which describes a situation in which a new source of natural resources is found in a country. Because traders believe that this will make the country stronger – e.g. will increase trade – they speculate on this country's strength, appreciating their currency and offering it a value that is higher than its fundamental value.

background conditions of countries, a system that allows speculation leads to regressive outcomes for two reasons. First, since the outcomes of speculating on vulnerability are more harmful to countries than the outcomes of speculating on strength. Cases in which traders speculate on a country' vulnerability are especially harmful to these countries, since this has the potential to generate a currency crisis, that triggers other types of crises, such as in the cases presented above. As opposed to these cases, when traders speculate on strength, they rarely (if ever) generate outcomes that are as harmful as crises. Second, speculating on vulnerability is more common than speculating on strength. Most contemporary cases of currency speculation are cases of speculation on a country's vulnerability, whereas cases of speculation on strength are rare. When traders consistently and systematically speculate on the currencies of countries which they think are vulnerable, this leads to considerable harms on these countries, increasing inequality and creating regressive outcomes.

From this section I conclude that both the case of monetary spillovers and the case of currency speculation lead to regressive outcomes in the IMS. In the next section, I will argue that there are other reasons for why these two cases can be considered cases of background injustice.

Section 4) Why are these issues problems of background injustice?

In this section I elaborate on the claim that the cases of monetary spillovers and of currency speculation can be considered problems of background injustice. I argue that, like in the case of contracts, these cases do not only lead to outcome unfairness, but they also lead to procedural unfairness. I suggest that this procedural unfairness happens in when there is a crisis, since in these situations, countries lose their ability to make free choices and interact as equal agents. Finally, I show that the two cases also violate the three conditions of background injustice offered by Ronzoni: sovereignty, the ability to deliver social justice at home, and freedom and equality of agents.

4.1- Procedural and Outcome fairness, and Crises

Earlier in this chapter, we saw that outcome inequality does not necessarily raise problems of background injustice, these inequalities matter when they undermine procedural fairness. In our case, procedural fairness is eroded when countries face a financial crisis. A financial crisis can be defined as a situation in which "asset prices see a steep decline in value, businesses and consumers are unable to pay their debts, and financial institutions experience liquidity shortages".[71] Crises can take at least four forms, a currency crisis, a balance of payment crisis, a banking crisis, and a debt crisis, and different indicators offered by economists allow us to distinguish between a shock and a crisis for each of these cases. First, a currency crisis happens when a country experiences a sharp depreciation of their exchange rate as a consequence of speculation, and the change in nominal exchange rate exceeds a certain threshold.[72] The second type of crisis, the balance of payment crisis, is related to the first. When a country is facing currency speculation, the state may try to keep

[71] https://www.investopedia.com/terms/f/financial-crisis.asp

[72] For some indicators of when a country faces a currency crisis see Eichengreen et al, 1995, 1996; Kaminsky et al 1998; Kaminsky and Reinhart, 1999; Frenkel and Rose, 1996; Esquivel and Larraín, 1998

the currency stable by intervening in the Foreign exchange market and using reserves to counteract the speculative effects. Ultimately, when the state faces a sharp decline of these reserves due to this situation, there is a balance of payment crisis.[73] Third, a banking crisis happens when capital flight – e.g. short-term deposits relocation, portfolio relocation, among others – occurs, causing banks to face liquidity shortages. Indicators for this type of crisis vary, and include situations in which there is a bank failure, massive government intervention and bailouts, large scale bank nationalization, and when the costs of the erosion of capital are high.[74] Finally, a debt crisis happens when states default on their external debts and need to reschedule the agreement, indicators that measure these crisis measure this debt rescheduling and postponement of payment.[75] A financial crisis can be any of the above on their own or a combination of these crisis – e.g. a country may have a currency, balance of payment and banking crisis at the same time.

The presence of a crisis erodes procedural fairness, since countries facing a crisis are in extreme need of funds – to either solve their liquidity problems, to stabilize their macroeconomic situation undermined by a sharp depreciation of their exchange rate, or to meet their debt obligations - hence, these countries agree to conditionalities imposed by the IMF or other creditor countries, such as liberalizing their economy and dismantling capital controls, in order to obtain loans.[76] This is an erosion of procedural fairness, since weak countries accept these conditionalities because this is the only reasonable thing to do considering their situation, and their lack of material resources and their extreme need puts them in a position in which they cannot negotiate and have no bargaining power in negotiations.

There are two ways in which outcomes are connected to this procedural unfairness. The first way is a direct way. This is the case of the Latin American crisis of 1980s, in which the crisis was a direct effect of monetary spillovers applied by the United States, which led to a generalized debt crisis. The second way in which outcomes are connected to procedural unfairness is an indirect way. As we saw, when countries in the IMS are free to modify their exchange rate and generate spillovers, this reinforces pre-existing dependency from weak states to strong ones, since they also depend on having exchange rate stability vis-à-vis the strong country. This reinforced pre-existing dependency, induces these countries to make certain choices. The harmful effects of fluctuations generates a *fear of floating* that motivates developing countries to spend large amounts of international reserves in trying to stabilize their currency or peg it to that of stronger countries.[77] These choices are not only costly – e.g. these reserves could have been used in social spending – but they also undermine certain capabilities of countries such as their ability to use monetary policy to counteract shocks and make them more susceptible to currency speculation and to crises, since the market may doubt the commitment of the government to maintain the promised exchange rate level.[78] When these countries face a crisis, with similar procedural unfairness problems as the ones presented above, this is also an outcome, since these states were induced to peg their

[73] Krugman and Obstfeld, 2003: 504-6
[74] See Caprio and Klingebiel, 1996; Lindgren et al, 1996; Dermigüç-Kunt and Detragiache, 1997; Kaminsky and Reinhart, 1999
[75] See Berg and Sachs, 1988; Lee, 1991; Balkan, 1992, Lanoire and Lemarbre, 1996; McFadden et al, 1985; Hajivassiliou, 1989, 1994
[76] Stiglitz, 2002b: 59-67
[77] Calvo and Reinhart, 2002.
[78] See Obstfeld et al, 1995; Eichengreen, 1994; Svensson, 1994; and Obstfeld, 1985.

currency, making them an easy target for speculators and increasing the probability of a crisis.

4.2- Freedom of agents and freedom of choices

The examples presented above do not only show how fluctuations in exchange rates and monetary spillovers are harmful to developing countries and create more inequality. But they also show how pre-existing dependency and vulnerability of developing countries on developed ones is increased and made more profound by the current social practice of a laissez faire IMS. This relates to Ronzoni's concept of freedom of agents because, like in the case of tax competition, when weaker states are made more vulnerable and dependent on strong ones they are also made less equal and have less bargaining power in international decision making, which raises procedural issues of fairness.

Apart from Ronzoni's concept of free agents which is related to equality of relationships between states and to their ability to pursue effective sovereignty, there is another freedom related issue that arises in the case of the IMS: the freedom of choices. The concept that choices are not free refers to the idea that when individuals are dominated, or are immersed within an environment of dependency, they cannot make free choices.[79] The most famous example of this concept is the case of a slave: the choices a slave makes to try to please his master are not free choices.[80] We may also think about Marx's idea of workers having to work for the capitalist for low wages. It is because of the workers' vulnerability and dependency on the capitalist, that they agree to working for these wages, which is a choice that as a result of their vulnerable position.[81] Similarly, in the case of the IMS a pre-existing dependency from weak countries to strong countries, which is reinforced by a laissez faire system, makes them take certain choices. The harmful effects that fluctuations of the exchange rate of developing countries vis-à-vis that of stronger ones generates a *fear of floating* that motivates developing countries to spend large amounts of international reserves in trying to stabilize their currency or pegging it to that of stronger countries.[82]

Both of these policies – the accumulation of reserves and pegging the exchange rate- bring considerable costs to developing countries. In one sense, these reserves are costly because this is money that could be used in social spending by these countries. The accumulation of reserves also generates global problems. Because they decrease world liquidity and increase the debt of countries, they tend to increase the probability of world financial crises.[83] However, when countries peg their currency to that of another country, they lose autonomy monetary policy.[84] This is harmful for these countries because monetary policy is a mechanism that would have allowed them to counteract shocks, and they lose this ability. Pegging the currency to that of stronger countries also make the countries that peg

[79] According to Pettit, what is important for a choice to be free is not the amount of options a person has, but that they have enough protection to make free choices (Pettit, 2006: 134).
[80] For example, the slave of a kind master can have a wide range of options, but has no social freedom. This situation could lead the slave to seek to keep the master in good mood, accepting options that the master wants him to choose without him having to ask explicitly for it (Pettit, 2006: 137).
[81] Wolff, 2018: 178
[82] Calvo and Reinhart, 2002.
[83] UN, 2009: 111-2; Carvalho, 2010; Greenwald et al, 2010: 135.
[84] As we saw in the trilemma, countries may have at most two of the following elements at the same time: exchange rate stability, freedom of capital movement and autonomy in monetary policy. When countries a free system of capital movement peg their exchange rate, or commit to the stability of it, they lose the third element of independent monetary policy.

more susceptible to currency speculation, since the market may doubt the commitment of the government to maintain the promised exchange rate level.[85] This leads us to the second problem of background injustice in the IMS.

These choices of weaker countries also bring benefits to stronger countries. On the one hand, when countries accumulate reserves they do so in the currency of strong countries, and because their currency as reserves acts as an interest rate free loan for the country that issues this currency, this acts as a transfer of resources from weaker to stronger states.[86] On the other hand, when countries peg their currency to that of stronger countries, this gives the strong country benefits, such as more centrality, trade benefits, while maintaining the ability to implement monetary policy.[87]

4.3- Three conditions of background injustice

As we saw, Ronzoni offers three conditions that when violated raise problems of background injustice: the ability to deliver social justice at home, the ability to maintain sovereignty, and having free and equal agents. These three conditions are eroded in the case of the IMS. Monetary spillovers limit the ability of countries to achieve social justice at home. Because changes in exchange rate modify real variables, when they are a consequence from abroad this limits the capacity of a country to shape its domestic macroeconomic environment necessary to deliver social justice at home, hence, also limits their sovereignty.[88] We also saw that an unregulated IMS increases inequality and reinforces pre-existing patterns of dependency, making participants less free and equal.

Monetary spillovers also limit the ability of countries to achieve social justice at home, and as a consequence the practice of an effective sovereignty. Because changes in exchange rate modify real variables, when they are a consequence from abroad this limits the capacity of a country to shape its domestic macroeconomic environment.[89] This happens because, as we saw earlier in the Introduction of this thesis, in an open economy – as opposed to a closed one – the exchange rate is the variable that determines all other real variables – such as inflation, employment levels, among others – within an economy. On the one hand, these changes generate issue of distributive justice because levels of employment and purchasing power of individuals *are* issues of social and distributive justice. On the other hand, the level of exchange rate – depreciated or appreciated - has distributional impacts for different groups within a society.[90]

The second problem of background injustice happens between the market and different states. Currency traders analyse many aspects of countries to determine the value of their currency. Any sign of vulnerability – e.g. a natural disaster, a political crisis, or a low debt/reserve ratio – is interpreted by the market as a sign that the currency of that country will be worth less in the future and leads to speculation on that currency, as we saw in the case of Argentina.[91] This situation creates a problem of background injustice, since a *laissez*

[85] See Obstfeld et al, 1995; Eichengreen, 1994; Svensson, 1994; and Obstfeld, 1985.
[86] Stiglitz, 2002a: 224, Greenwald, et al 2010: 333; UN, 2009: 113; Cohen, 2015: 21
[87] Cohen, 2015: chapter 4
[88] A similar idea is offered by Wollner, 2014: 467.
[89] Idem
[90] Frieden, 2015: chap 1; Frieden, 1994. An appreciated exchange rate will benefit consumers who will have access to relatively cheaper foreign domestic products and those who have debts in foreign currency, while it harms those related to export industries.
[91] Fieldhouse, 2015: chapter 6.

faire Foreign Exchange market that allows speculation generates a regressive system: countries which are inherently more vulnerable have a higher chance to have their currency speculated on compared to that of strong countries, since the currency of the latter countries reflects the credibility of the country that issue it. Because currency speculation leaves the country that has its currency speculated upon worse off, a system that allows speculation leaves weaker countries systematically worse off. In other words, it accentuates pre-existing vulnerabilities.

Additionally, a system that allows speculation also reduces the ability of states to deliver social justice at home and to implement effective sovereignty for two reasons. First, the exchange rate is a crucial factor for achieving social justice at home, since it affects all other variables in an economy. Consequently, when the exchange rate is determined by the views of external agents, this limits the ability of the state to control its own macroeconomic environment – necessary to achieve social justice - limiting its effective sovereignty. Second, currency traders have specific views of what makes a country stronger. In particular, they consider that neo-liberal policies - such as privatization - are a sign of a strong economy, whereas social policies are a sign that the economy will stagnate in the future. By speculating based on these policies, the market shapes the policy outcomes of a country, which undermines democracy and self-determination.[92] In chapter 4 we will see that currency speculation may even be considered as a case of exploitation.

In this case, there is also a coordination problem, since if weaker countries unilaterally implement regulation that avoids speculation this does not solve the problem. If for example, Argentina implements regulation that prohibits currency speculation, this does not solve the problem, since traders are distributed worldwide and speculation on the Argentinian peso can still happen from foreign traders. This is why problems of background injustice require global regulation, primarily regulation by strong countries and not unilateral regulation by weaker ones. We will see more about regulation in this case in chapter 4.

From the above we can conclude that in the current system the effects that strong countries generate on weaker countries when they apply monetary policy are much more harmful than the effects of monetary policy applied by weak countries on strong countries. A problem of background injustice also involves a coordination problem, since it is not enough for one country to apply regulation alone, and doing so may leave this country worse off overall given the general absence of rules. For example, if a weak country like Mozambique stops applying monetary policy in order to avoid spillovers abroad, they will still be harmed by monetary spillovers from other countries, and will also be additionally harmed from not being able to apply their own monetary policy. This is why this problem needs global regulation, as opposed to regulation from one country only.

From this section I conclude that the cases of monetary spillovers and of currency speculation can be considered problems of background injustice.

[92] For example, in Brazil during the presidential campaign of 2002, whenever the candidate Lula da Silva proposed something that was against the interests of the market, the financial market players sold the currency generating a depreciation of the Brazilian Real, which generated nervousness in the voters (Stiglitz, 2002a; Stiglitz et al, 2006). The problem with this political manipulation of the market is that, on the one hand, it affects democracy, and on the other hand, the policies that the market seeks to impose are focused on the long term and for the benefit of investors, which undermine the possibility of effecting long-term growth policies focused on the development of countries. Also, in 2018 when candidate Jair Bolsonaro was the strongest candidate for Brazilian elections and he announced privatization measures, the Brazilian currency appreciated in 13%. See https://www.bbc.co.uk/news/world-latin-america-46024533

Section 5) Background Injustice versus Structural Injustice

This section distinguishes the concept of background injustice considered in this thesis with the concept of structural injustice offered by Iris Marion Young. I start by presenting the latter concept. Then I show that, while there are some similarities between the two approaches, these approaches are ultimately different.

Young's theory of Structural Injustice

Iris Marion Young offers a theory of structural injustice that also addresses the concept of background injustice. In order to introduce her concept of structural injustice Young offers the case of affordable housing. She presents the case of Sandy whose salary is not enough to pay her rent, thus leaving her facing the possibility of homelessness.[93] According to Young, Sandy is in a social-structural position, that of vulnerability to homelessness, and it is unfair because she is in this position because of forces that go beyond her choices and actions, and others in a different position could act like Sandy without becoming vulnerable to homelessness. Young argues that this is a case of structural injustice, since none of the agents that Sandy may have encountered has done something wrong, "the causes of being vulnerable to homelessness are multiple, large scale and relatively long term".[94] All these factors put into a mix, lead to some individuals being in the social position of vulnerability to homelessness. Young concludes that "structural injustice exists when social processes put large groups of persons under systematic threat of domination or deprivation of the means to exercise their capabilities, at the same time that these processes enable others to dominate or have a large range of opportunities of exercising the capabilities available to them".[95]

Young argues that structural processes that are unjust have four aspects. First, they generate objective constraints. Structural processes shape, guide and constraint the actions of individuals, not in the form of coercion, but allowing or blocking possibilities and widening or narrowing the range of options that individuals have available to make their choices.[96] Second, they generate positions for individuals within the structure and in relation to other people. In the case of Sandy, her gender and class explain much of her present circumstance. Third, these structures and positions are reinforced by actions of individuals and the informal rules that drive these actions. For example, if people think one neighbourhood is dangerous, they will not bring their businesses there and people will not wish to live there, generating more devaluation of this neighbourhood.[97] Finally, the effects of this actions in the structure are unintended consequences. Individuals who act in order within a system of rules do not intend to create these systemic outcomes. It is the combination of all actions of individuals, which lead to undesirable consequences when looked at it systemically.[98]

[93] Young, 2011: 43-50
[94] Young, 2011: 47. Some of this include the wages people earn, rents that landowners and banks require, forces of demand and supply, different laws of construction, the local housing industry, the Federal Reserve, among others.
[95] Young, 2011: 52
[96] Young, 2011: 55
[97] Young, 2011: 59-60
[98] Young, 2011: 62

The approach of this thesis to the two problems of background injustice share many similarities with Young's theory of structural injustice, but there remain certain differences. One similarity is that like Young I consider the context or the specific position that different states have in the system. This is relevant because there are some pre-existing vulnerability and channels of dependency between countries that should be considered when analysing a policy from the wider context – as opposed to taking a narrow approach that considers particular rules. It is because of this pre-existing context and positions that the same rules for all countries systematically leave stronger countries better off, while eroding the weaker courtiers' position in the system. Another similarity is that in both cases of background injustice there are unintended consequences. In the case of monetary spillovers, when countries apply monetary policy they do not intend to generate harmful effects abroad. On the other hand, the case of currency speculation has been given as an example of unintended consequences by Young herself, who argued that when traders follow their interests within stablished rules they do not intend to generate the harmful effects such as the Asian currency crisis of 1997.[99]

The approach of this thesis also finds certain differences with Young's theory of structural injustice. While Young considers how a plurality of elements - such as laws, informal rules, actions of individuals, among others – generate specific unfair outcomes – e.g. individuals do not earn enough to satisfy a certain standard of living - this thesis considers how a specific social practice and its background rules contribute to generating unfair patterns of distribution among participants given a wider context that considers other variables. The second difference relies on the concept of freedom. According to Young, individuals in certain positions are less free because they have fewer options, since their options are restricted by the structural process. In my view, vulnerable countries in the IMS have their freedom limited not because they have fewer options, but because their position of vulnerability, within a context of *laissez faire* rules that highlights their pre-existing vulnerability, induces them to take certain actions that they otherwise would not need to do.

Section 6) Objection of domestic institutions

In this section, I address the objection that the responsibility of harm is partly a national responsibility of weak states for not having the adequate institutions that protect countries from harm. According to this objection, the impact that exchange rates may have in a domestic economy and to people of the country affected depend on domestic institutions. For example, if there are good working laws, and safety nets, then people would be less affected by these fluctuations. Because these domestic institutions are a national responsibility, then weaker countries also have responsibility for these harmful effects. This objection can be presented as follows,

"In the case of spillovers (a) states' vulnerability to the effects of other states' exchange rate policy depends on how 'flexible' their domestic institutions are in terms of 'adjustment' to economic 'shocks', with wage bargaining institutions being especially important in this respect, and (b) since states nationally control these institutions, it is to some degree under their control as to how harmful spillovers effects will be, in which case (c) the degree of harm is their responsibility not that of the country making the exchange rate change".[100]

[99] Young, 2011: 63

[100] I thank Stuart White and Jonathan Wolff for this objection.

My answer to this objection is that it is precisely because developing countries are poorer, they have less means to apply safety nets and other counteractive policies to mitigate these fluctuations, and this is why they are more affected compared to other stronger countries.[101] Also, there are other factors that do not depend on these institutions, such as a less diversified economic structure and a smaller share in global finance.[102] Also, if developing countries have high consumption of imports and low penetration of their exports in foreign economies, this is not something that the state can control, but that makes them more vulnerable to fluctuations. Therefore, because it is not developing countries' choice, then these countries cannot be held mainly responsible for being affected by these fluctuations.

Section 7) Conclusion

This chapter is the first of four chapters, which constitute the first part of this thesis. This part addresses the case of open capital markets and floating exchange rates. This case is the general one that exists in the IMS today. In this chapter I presented general concepts that will be used throughout the thesis and I argued that within this general scenario there are two problems of background injustice: the case of monetary spillovers and the case of currency speculation. In the next chapter, I will address the former problem, and I will offer a principle of justice that applies to the social practice of the IMS. In chapter 4, I will address the latter problem, and I will suggest that this is not only a problem of background injustice, but also a problem of parasitic exploitation.

[101] Stiglitz, 2002a: 222

[102] Financial crises tend to affect developing countries more deeply, because of their thin financial markets and little possibility of taking derivatives and other risk mitigation instruments. Developing countries have a small share in global finance, and since they are less diversified, modifications in certain assets have great consequences for these countries. This makes developing countries bare the exchange rate risk even if developed countries are more prepared to assume this risk since they have a more diversified portfolio (Ocampo et al, 2008: 14). On the other hand, developing countries are seen as riskier, and do not have safety nets that developed countries have. This makes them more vulnerable to crises, which makes them accumulate more reserves as self-insurance (Ocampo, 2017: 119).

Chapter 2: The Case of Monetary Spillovers

Section 1) Introduction

1.1) Latin American debt crisis of 1980's: an example of monetary spillovers

During the 1980s Latin America suffered a generalized debt crisis, which had profound effects on the population that lasted over a decade, known as "The Lost Decade". It is widely agreed that one of the main reasons for this crisis was the United States' monetary policy applied by the Federal Reserve. In other words, this crisis was an unintended consequence of the US monetary policy.[1] In the late 1970s the United States faced domestic inflation, and in order to counteract it, in 1979 the Federal Reserve applied a contractionary - or tightening - monetary policy. On the one hand, this led to a rise in interest rates for borrowing in dollars, which made it difficult for countries with debts in this currency to maintain or roll over their debts.[2] On the other hand, this tightening in monetary policy also led to an appreciation of the US Dollar with respect to other currencies. Because Latin American countries - like other developing countries - had debts in Dollars, the real value of Latin America's debts increased substantially, making it harder for these countries to meet their debt obligations and leading to generalized defaults in the region, as well as in other developing countries.[3] The example above illustrates the case of monetary spillovers, which is the problem I will address in this chapter. This problem happens because exchange rates are relative to one another; thus, when a country intervenes in the market to modify its exchange rate, this also changes the exchange rate of all other countries vis-à-vis this country.

1.2) Plan of chapter

In the last chapter I introduced two problems of background injustice in the IMS, the problem of monetary spillovers and the problem of currency speculation. In this chapter I address the first of these problems, the problem of monetary spillovers. The aim of this chapter is to determine which principle of fairness, if any, is the appropriate one to address this problem and which possible solutions derive from this principle. Because of the similarities between the social practices of fair trade and the IMS, I start, in *section 2*, by asking if principles that have been proposed for the case of fair trade can also be extended to the case of the IMS. My argument in this section is that different principles of fairness have been proposed to address different instances of trade, and while they may be suitable principles to address those specific instances, the case of monetary spillovers differs from these instances, in such a way that these principles cannot be extended to this case. In *section 3*, I propose a principle that can be used to address this case, the Limited Regressiveness Principle. According to this principle, regressiveness in a social practice or system,

[1] Reddy, 2003: 83-4.
[2] Idem.
[3] Krugman and Obstfeld, 2003: 683.

considering background conditions, should be constrained in a way that avoids domination. I argue that in the general case of the IMS domination happens in cases of crisis. In this section, I also argue that a possible application of this principle is the creation of a global fund, which is a redistributive scheme among participants of this social practice. *Section 4* focuses on responsibility. Here I argue that there are two different types of responsibility. On the one hand, there is an agential responsibility of states. This responsibility is remedial, since it aims to avoid situations of domination, and holds liable strong states when they contribute to, or have outcome responsibility for, this domination. However, this is not a moral responsibility. On the other hand, there is a systemic responsibility, since the problem lies in the absence of an institution that should regulate the social practice. This responsibility can take the form of a forward-looking responsibility to create this institution. I argue that it is also strong states who have this responsibility. *Section 5* addresses an objection. Finally, *section 6* concludes.

Section 2) Features of the IMS and principles of trade

The IMS and global trade share some similarities- e.g. they are both international social practices, they are both markets, among others. Because of these similarities, here I ask if principles of fairness that have been proposed for the case of trade can also be extended to the case of the IMS. I follow the list of principles presented by David Miller.[4] The principles proposed for the case of trade usually address one particular instance of trade. Some of them address the use of forced labour in sweatshops; others address the case of agricultural subsidies; yet others address the division of gains among the chains of production and those who add value to a product such as coffee, among others. Here I do not question that these principles apply to the specific cases of trade that they seek to address. This section aims to show that, while the social practices of the IMS and trade share many similarities, there are particular features of the IMS that are different from the particular instances of trade addressed by principles of fair trade, and therefore they cannot be extended to the IMS. Here I do not intend to argue that these features of the IMS are different to *all* cases of trade, but instead that they differentiate the *specific* instance of trade addressed by each principle from our case, in a way that hinders the extension of each of these principles to the IMS. While in some cases these features are normatively relevant, in other cases I will only use them to show that because the cases and problems are different, some principles cannot be used to address our problem of monetary spillovers.

2.1) Principles of Fair Trade

Principles1and 2) Equal Rules: Reciprocity and Non-Discrimination

One of the principles of fair trade that aims to offer equal rules is reciprocity. According to the reciprocity principle, the rules should be the same among trading partners. For example, if country A trades with country B, and A does not impose tariffs on A, then A shouldn't impose tariffs on B.[5] Another principle that aims for equal rules is non-

[4] See Miller, 2017
[5] Miller, 2017: 255

discrimination. According to this principle, countries should offer the same conditions to all their trading partners, in order to level the playing field among them. For example, if country A trades with countries B and C, and does not impose tariffs on B, then it should not impose tariffs on C either.[6] When thinking about the trading system as a whole these principles combined lead to a uniform set of rules, or a level playing field among all participants.[7]

Principles that aim for equal rules, or a combination of reciprocity and non-discrimination principles, may apply to instances of trade in which parties that participate in the social practice have similar power or level of development. It may be a valid principle to regulate some types of interaction, such as those between developed countries *only* – e.g. in the framework of the GATT agreements. However, while the principle of equal rules may be a suitable principle for some types of interactions, or some instances of trade, this principle cannot address *all* instances of trade. In particular, it fails to address those interactions between agents that have considerable differences of power and development levels.[8] As we have seen, the case of the IMS is one of those cases in which there are not only differences in power and development, but also a whole background structure that reinforces pre-existing positions of dependency and vulnerability, through channels of dependency. Therefore, the principle of equal rules cannot apply to the case of the IMS.

Principle 3) Special Differential Treatment

James Christensen offers a principle of Special Differential Treatment (SDT), arguing that there are certain policies that developing countries should be permitted to put into practice, but which should be impermissible for developed countries. He argues that this differentiation in the rules is necessary for the former countries to achieve development. As examples of this principle, he offers the cases of Part IV of the GATT added in 1965, which only applies the reciprocity principle to developed countries, and the Generalised System of Preferences - which allows developed countries to impose lower tariffs on imports from developing countries.[9] In other words, this principle justifies protectionist measures – such as tariffs - for developing countries but not to developed ones. The idea of having different rules, or having certain policies, that are permissible for developing countries and prohibited for developed ones, can also be applied to the case of monetary spillovers in the IMS. In our case, this differentiation in rules would allow developing countries to apply monetary policy to modify their exchange rate, while prohibiting stronger countries to do so.

The main difference between the IMS and the cases presented by Christensen is that applying the SDT to the former case necessarily erodes the ability to deliver social justice at home, since monetary policy helps to counteract the effects of crises and to control real variables in an economy. The overall level of the economy can be considered as an issue of social justice at home, since the worst-off individuals within a society are more likely to suffer the effects of unemployment or a reduction in purchasing power as a consequence of deviating from internal balance. Also, different exchange rate policies benefit different sectors of society and it is the role of the state to determine a just level, which would distribute wealth fairly among these sectors.[10]

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[6] This principle is different from reciprocity, since it does not demand the other trading party to do the same.
[7] Miller, 2017: 256.
[8] See Christensen, 2015
[9] Christensen, 2015: 506
[10] Frieden, 2015: 7.

In the case of protectionism and tariffs offered by Christensen, the economic structure of developed countries is strong enough for them to be able to avoid using protectionist measures, or at least to restrict their use to a certain level. Developed countries are better prepared to comply with certain rules, such as not implementing tariffs, compared to developing ones. This is because the former countries have a diversified economy, have the capacity to apply safety nets, among other factors. Because developed countries have diversified economies, and the absence of a tariff in steel manufacturing affects mainly people involved in that industry who can move to other areas or rely on safety nets, tariffs only affect a small part of the population. As opposed to the case of tariffs, which in developed countries affect mainly people working in one sector of the economy, the exchange rate touches almost everyone.[11] From the level of debts, levels of prices and general levels of employment within all sectors of the economy, and the ability to counteract shocks, the effects of the exchange rate for the ability of strong countries to achieve social justice at home are much more pervasive than those of a specific tariff.[12]

The ability to deliver social justice at home cannot justify all actions taken by the state. For example, bringing adequate levels of wellbeing for citizens does not justify engaging in wrongs, such as dominating or enslaving other people, in order to achieve these levels of well-being. Similarly, the *status quo* in the IMS cannot be defended on the grounds of securing the ability to deliver social justice at home for some strong countries, since this *status quo* raises problems of background injustice and is unfair for vulnerable ones. However, the claim here is that *always* limiting the ability of strong countries to apply monetary policy does not fairly distribute these opportunities to offer social justice at home and for states to control their own affairs. While the application of this principle solves the problem of background injustice for vulnerable countries, it creates another problem. If strong states can never have the ability to counteract shocks, and control their internal macroeconomic conditions, there would be situations in which this limitation would hinder the ability of these countries to have a minimum of sovereignty. The problem with this policy is that these limitations would always offer the possibility to deliver social justice at home and to conduct their own affairs to vulnerable countries, while always limiting this ability to stronger ones, and this distribution of opportunities is too demanding for strong countries.

[11] Frieden, 2015: 39.

[12] The case of tariffs and protectionism is different for the case of developing countries, which tend to rely on few commodities and have less diversified economies, compared to developed countries. In these cases, tariffs or protectionism in key sectors of the economy may also be seen as public goods, since they also affect the overall conditions of the country and their effects may be as pervasive as the effect of the exchange rate level (UNCTAD, 2007: 120). The argument here is not that the IMS has specific features that cannot be seen in *any* instance of trade, but rather that those particular instances of trade addressed by existing principles of fair trade differ from the case of the IMS. There may be other instances of trade, such as protectionism as a public good for developing countries, that share similarities with the IMS, but that on its own has not been addressed by any principle of fair trade. Let us observe that the instance of trade addressed by principle SDT differs from the IMS not because protectionism is not a public good for developing countries – in both cases tariffs and exchange rates it may be considered a public good -, but while the exchange rates is a public good necessary to achieve social justice at home for strong countries, tariffs are not.

Principle 4) Price in fully competitive market

According to a principle of price in a fully competitive market, fair outcomes in trade happen when trading partners transact with prices that are given by a fully competitive market. Because deviations from this price happens as result of market power of an agent - e.g. a monopoly – this is unfair, since it creates power differentials.[13] To illustrate this principle David Miller offers the case of coffee. In this case, the claim is that fair trade of coffee involves a price that would be obtained if there were many buyers and sellers of coffee and open competition between these parties. In other words, according to this principle, the fair price of a commodity is the price that happens as a result of supply and demand within a context of perfect competition. We can also extend this idea to our case, since the Foreign exchange market of currencies is also a market. In this case, the argument would be that the fair price, or fair value, of the exchange rate is the value given by supply and demand of the market; hence, deviations from this price would be unfair.

The main difference between the exchange rate and other commodities is that the former is an internal (not global) public good, since it satisfies both conditions of non-excludability and non-rivalry, and is necessary to achieve social justice at home. On the one hand, exchange rate policy is non-excludable, because once provided others cannot stop benefiting from it. When the economy is at its full employment level, all citizens benefit with no exception. On the other hand, it is non-rival because when some individuals benefit, this does not reduce the amount of equilibrium in the economy for others. As we saw, this public good provided by the state, through the central bank, is used to achieve social justice at home.

The case of the IMS is in tension with this principle of price in a fully competitive market, since it is the role of the state to deliver public goods and achieve social justice at home, which involves the discretion to intervene in the Forex market and set a price that may be different from the price in a fully competitive market. In other words, when an individual state intervenes in the Foreign exchange market, and generates a deviation of the value of their currency from the value set by the market to their new desired value, we cannot say that the latter value is necessarily an unfair price, since it is the state's role to secure public goods and to bring social justice. This action of the government may bring undesirable consequences abroad, but we cannot say that this new exchange rate value is unfair only because it is different from the price in a fully competitive market. This does not mean that the government should *set* prices for *all* goods, but rather that there are specific prices or variables - such as the interest rate or the exchange rate - that impact the overall macroeconomic conditions of a country, hence, justify government intervention and regulation by an entity such as a central bank, and the value that results from this intervention is not necessarily unfair.

[13] Miller, 2017: 257

Principle 5) Fairness I

Fairness Ia: violation of negative rights as oppression, coerced work and stolen goods

Mathias Risse proposed a principle of Fairness I, according to which instances of trade that involve a violation of negative rights are unfair.[14] Risse argues that trading relations should not violate negative rights of trading partners. In order to illustrate this principle, Risse offers the case of sweatshops. Risse argues that some forms of violations of negative rights that happen in sweatshops - such as coerced work or being forced to work under unsafe conditions - generate products that when traded raise similar ethical concerns than the ones that arise when trading stolen goods.[15]

Principle Fairness I focus on violations of negative rights that occur during the production process of the good that is traded. However, in the IMS there are no products or goods traded. As opposed to the case of trade in which there is an exchange of goods and services – e.g. coffee, agricultural products, and so on – in the case of the IMS there are exchanges of financial assets – such as currencies, bonds, loans, among others.[16] Because in the latter market there is no process of production – beyond the process of producing a contract or of printing money – there is no violation of negative rights of those involved. Also, in this case these is no clear violation of negative rights when trading these assets. Therefore, principle Fairness I does not apply to this case.

Fairness Ib: violation of negative rights as non-interference

An alternative way of interpreting principle Fairness I is considering interference that harms others as a case of violation of negative rights, such as Thomas Pogge does.[17] According to Pogge, because of global interdependence, what these countries do within their own territory also affects others abroad, impeding the right of other nations to self-determination.[18] To illustrate his idea, Pogge offers the case of pollution.[19] When countries emit pollutant gases that contaminate the air, this affects all countries, since this contributes to global warming. Hence, polluting activities that are allowed by internal policies of countries that pollute, generate externalities that affect everyone worldwide. Because other countries are harmed by these externalities, there is a violation of negative rights and non-interference, since there is a limitation in the affected countries' political rights. In order to avoid this problem, Pogge proposes that sovereignty of countries – in rules that concern pollution - should be limited and that countries affected by these actions should be involved in the decision-making process of regulation. The case of monetary spillovers and pollution share one main similarity, that both are a problem of externalities.[20] Because of this similarity we find similar proposals to address these two cases. Like Pogge, Sanjay Reddy has proposed

[14] Risse, 2007.
[15] Risse, 2007: 362
[16] Krugman and Obstfeld, 2003: 8.
[17] Pogge, 2007: 29, 30
[18] Pogge, 2008: 192
[19] Idem
[20] In chapter 1 we saw that monetary spillovers are not *only* a problem of externalities, but *also* a problem of background injustice.

that countries affected by monetary spillovers should also participate in the decision making, and approve – or veto - the modification of the exchange rate by other countries.[21]

The main difference between the cases of monetary spillovers and of pollution is that, while both of them are cases of externalities, the case of monetary spillovers is also a problem of background injustice. In the case of monetary spillovers we have seen how the system induces countries to make some choices and interferes in their ability to have sovereignty and to deliver social justice at home. In the case of pollution across borders, for strong countries to limit their pollution levels means a reduction in their industrial production, but because they are already developed they are able to absorb this restriction, or there can be an optimum level which they can agree on. Moreover, the current system offers special benefits to strong countries, while adding additional costs to weaker ones, increasing the vulnerability and dependency of the latter countries to the former ones. In the case of pollution, we do not find these elements of background injustice.

I am also against Reddy's idea that vulnerable countries should have approval or veto over strong countries' application of monetary policy. Because strong countries' monetary policy has a broad impact aboard, it is likely that this monetary policy will negatively affect another country. Moreover, different regions have continuously preferred different levels of exchange rate to achieve development and to improve their citizens' well-being. These levels depend on their internal socioeconomic structure and development strategies. For example, citizens in Latin American countries are mainly consumers and the majority of the products that they consume are imported ones. Therefore, Latin American countries prefer a strong currency, since this makes the relative prices of imports cheaper.[22] Unlike the above, East Asian countries depend on their exports and tend to adopt policies that promote these exports. One of the policies adopted by these countries is trying to keep the exchange rate artificially low, as a strategy to stimulate development and economic growth. In other words, it is likely that other countries will have reasons to veto or to disapprove this monetary policy. Like in the case of SDT, always restricting the opportunity to apply monetary policy to these countries does not offer a fair distribution of opportunities, and it is too demanding for strong countries.

Principle 6) Fairness II

Mathias Risse and Malgorzata Kurjanska propose principle Fairness II, according to which strong countries should consider and refrain from adopting certain policies that generate and intensify global poverty.[23] In order to illustrate this idea, Risse and Kurjanska introduce the case of agricultural subsidies in trade. The tension generated by subsidies arises because governments of strong countries subsidize domestic producers of agricultural products to export these products, which creates winners and losers.[24] On the one hand, these subsidies benefit producers from developed countries, since they make it cheaper for them to produce these goods. On the other hand, because it is cheaper for producers in developed countries to produce these agricultural products, the global price of these goods falls, which ultimately harms foreign exporters of agricultural products who find it harder to compete against lower prices. This tension is intensified by the fact that foreign exporters of

[21] Reddy, 2003
[22] For this example of Latin America compared to East Asian countries see Frieden, 2015: 256-8; Frieden, 1994: 81-103.
[23] Risse and Kurjanska, 2008
[24] Risse and Kurjanska, 2008: 34

agricultural products are usually poor individuals from poor countries. Therefore, a domestic policy of maintaining subsidies in developed countries generates and intensifies global poverty. Risse and Kurjanska conclude that the claims of rich domestic landowners in developed countries have less weight than claims of the global poor. Therefore, subsides cannot be justified, since they are not consistent with positive duties of developed countries with respect to the global poor.

The case of subsidies shares some similarities with our case of monetary spillovers, since domestic policies that benefit individuals within the state's borders modify prices, which ultimately harm foreigners, in particular the global poor. Principle Fairness II offered by Risse and Kurjanska focuses on implementing restrictions either in the application of these policies or in trade, whenever the claims for these policies cannot be justified against the claims of the global poor. An analogy of this principle to our case would justify strong countries' discretion to modify their exchange rate through monetary policy, *only* as long as it does not generate monetary spillovers that harm the global poor, increasing poverty. However, there are substantial differences between the cases of subsidies and the case of monetary spillovers that make this principle unsuitable to the latter case.

The main difference between the case of subsidies and the case of monetary spillovers is that, as opposed to the case of subsidies, which mainly affect countries that are involved in the sector in which the subsidy is applied, in the case of monetary spillovers the same monetary policy affects most countries in heterogeneous ways and degrees. In the case of subsidies in agriculture the countries affected will be those that have high exports of agricultural products, such as many developing countries. Subsidies in other areas, such as manufacturing, will affect countries that have high exports of manufactured products. Because in the case of subsidies, each sector of the economy will have a specific impact in countries that compete in these specific products, there will be subsidies in some areas that will be justifiable according to principle Fairness II, but others that will not.

In the case of monetary spillovers, as opposed to the case of subsidies, a strong country´s modification of the exchange rate affects most countries. In this case, the same monetary policy may affect different countries in heterogeneous ways and degrees, making the probability of affecting development and poverty abroad high. For example, an appreciation of the strong currency may increase poverty abroad, since it makes imports more expensive to foreign poor consumers of these products, especially if these are basic goods. On the other hand, a devaluation of the strong currency may increase poverty, since it makes it harder for people in weaker countries to sell their exports in the international market. Because most applications of monetary policy by strong countries would affect global poverty in one way or another, the application of these policies would never be justified according to this principle, which is very demanding.

Principles 7 and 8) Equative surplus and proportional reward for contribution

The seventh principle states that each party should receive a payment that is proportional to what they have produced, in such a way that they are fairly rewarded for their contribution.[25] According to Miller, this principle is behind complaints that argue that primary producers of coffee receive a very small fraction of the final selling price of the product. Therefore, even if processing companies add value to the final coffee product, the primary producer of coffee should receive a proportional payment for her contribution from the final price at which coffee is sold.[26] Finally, the eighth principle, equative surplus, focuses not on the contribution, but on the benefits that each party receives.[27] The idea is that the benefit of trade, or surplus value – the distance between the minimum price at which each party is willing to transact and the transaction price – is distributed evenly between parties.

The fact that the IMS does not involve goods exchanged makes these two principles unsuitable for this case. As we saw, the principle of proportional reward for contribution states that each party should receive a proportional payment for their contribution in making a product. However, since in the case of the IMS there are no products exchanged to add value to, this principle cannot apply to the case of the IMS. Similarly, the principle of equative surplus depends on the goods exchanged. The surplus value is calculated as the equal distribution of benefits that each party receives from trading a product – compared to the minimum price at which parties are willing to transact. Because the value of the goods exchanged play a crucial role in determining the surplus value, this principle also cannot be extended to the case of the IMS.

2.3) Principles of fair trade cannot be extended to the IMS

In this section we have seen that specific principles of trade apply to specific instances of trade. Because of particular features of the IMS, the case of monetary spillovers differs from the instances of trade addressed by the existing principles of fair trade, and these principles cannot be extended to the case of the IMS for different reasons. Because none of these existing principles of fair trade is a suitable principle to address the case of monetary spillovers, we need a different principle to address our specific case. In the next section I propose a Limited Regressiveness Principle for this case.

[25] Miller, 2017: 261
[26] Miller, 2017: 261
[27] Miller, 2017: 262-3

Section 3) The Limited Regressiveness Principle

In this section, I go back to the problem of monetary spillovers and argue for a principle of fairness that is suitable for addressing this problem. As we saw, the problem of monetary spillovers happens in the interconnected IMS, when a country's central bank intervenes in the Foreign Exchange market, this also has effects abroad. Because of differences in power and channels of dependency, these changes generate more harms to weaker countries when these policies are applied by strong countries than in the opposite case. Because weaker countries are considerably affected by fluctuations, in a system in which all countries are allowed to modify their exchange rate, these countries are induced to make certain choices, such as pegging their currency or spending large number of reserves in counteracting these fluctuations. By contrast, strong countries obtain additional benefits from the system.

I start this section by making a distinction between mere interdependence and background injustice. I argue that the point at which interdependence becomes a problem of background injustice is when there is domination: when the three conditions of domination identified by Frank Lovett – arbitrariness, imbalance of power and dependency- are met in a strong way. This conception of domination is useful because it explains that domination does not happen if only two of these conditions are present. Thus, domination can be reduced by mitigating one of these individual conditions.

I consider that each of the conditions of domination can be either weak or strong. And I offer a comparative assessment between conditions – e.g. a case may have weak dependency but strong imbalance of power – and in relation to other scenarios – e.g. I compare the case of floating currencies with the case of having a common currency with other countries. I work with an intuitive conception of the intensity of these different conditions. When I suggest that one of these conditions is weak, it is because it is present in the case to a certain, but low, degree. In contrast, I consider that a condition is strong when it fails to meet minimal levels of independence, balance of power, and freedom from arbitrariness, for the conditions of dependency, imbalance of power and arbitrariness respectively. In what follows I specify what I mean by weak and strong for each of the three conditions of domination.

In the case of arbitrariness, both procedural and substantive arbitrariness are strong in a system of no rules. On the one hand, in the absence of rules there is strong procedural arbitrariness, since interferences are not under the control of those affected by them. On the other hand, in the absence of rules there is strong substantive arbitrariness, since the unconstrained actions do not consider the interests of those affected by them. In the presence of rules, there is a possibility of having weak or no arbitrariness. However, in a system of rules, arbitrariness can become strong when there are failures in the process and when the interests of those affected by the rules are not considered to the degree that the system or agreement minimally requires.

In the case of dependency, I consider that countries are strongly dependent when they rely on others to maintain stability and balance of their internal macroeconomic environment. While there may be some dependency in normal conditions, as long as countries are able to maintain minimal levels of independence, such as being able to maintain stability and their internal macroeconomic balance without the need of external assistance, dependency is weak. As opposed to this case, when countries are in a desperate situation and need the assistance of others to regain control of their internal conditions, dependency is strong. Similarly, when

countries delegate, or are constrained in using, relevant policy mechanisms – such as monetary and fiscal policy – in a way that prevents them from achieving stability and balance on their own, their dependency is strong.

Finally, in the case of imbalance of power, I consider that imbalance of power is strong when strong countries have the ability to impose their views over those of weaker countries on either a process of collective decision making or in the internal decisions of individual countries. While in normal conditions there are considerable differentials on economic power between different countries in the world, I only consider imbalance of power to be strong when this power is reflected on the decision-making process.

Because at the global level domination is worrisome when it is strong, countries are dominated when these three conditions are strong. I argue that arbitrariness and imbalance of power are necessarily strong in this case. However, the third element of dependency only becomes strong in cases of crisis. I also suggest that when there is domination, the problem of background injustice becomes strong for two reasons. First, in this case the three conditions of background injustice become eroded in a strong way. Second, domination generates a problem of procedural unfairness. I propose a Limited Regressiveness Principle (LRP), according to which the regressiveness in social practices should be limited in a way that avoids domination. Finally, I suggest that the policy application that derives from this principle is the creation of a global fund to which strong states contribute to. The funds collected by this fund should be offered to weak states facing a crisis, up to a level that they overcome the crisis and regain a minimal control of their internal situation.

3.1- Interdependence, Background Injustice and Domination

In the first chapter of this thesis, I showed that in the current IMS there is an erosion of the three conditions of background injustice. However, there is a need to make a distinction between mere interdependence and a problem of background injustice. The erosion of the three conditions of sovereignty, ability to deliver social justice at home, to some degree is pervasive and unavoidable. However, not any erosion of these conditions triggers a problem of background injustice, instead some of these erosions are cases of mere interdependence.

Interdependence in a system of open capital markets is pervasive and unavoidable. For example, as we saw in the introduction of this thesis, countries in the IMS are interdependent and generate monetary spillovers abroad when they implement monetary policy. Because the exchange of countries is relative to one another, when one country modifies its exchange rate, this also modifies the exchange rate of other countries with respect to this county. These monetary spillovers necessarily erode the ability to deliver social justice at home for foreign countries to some degree, since the exchange rate level is a crucial variable that determines the ability of countries to balance their own internal macroeconomic situation. And the ability to control these macroeconomic variables - such as employment levels, price levels, among others – is a crucial ability needed to deliver social justice at home. In other words, in a system in which there are strong arbitrary interferences, or monetary spillovers, the ability to deliver social justice at home is eroded to some degree. Because this ability is an element of sovereignty, countries' sovereignty over their domestic economic policy is also eroded to a certain degree. Also, as we saw in the last chapter, given the channels of dependency between countries, these monetary spillovers lead to regressive outcomes, which have the potential to erode the condition of freedom and equality of agents.

These monetary spillovers and interdependence are unavoidable because they are an intrinsic feature of how a system with open capital markets operates. Therefore, the only way to *completely* avoid the erosion of the background conditions is to move to a system with closed capital markets. I will address this case in chapter 6, and argue that staying in the general floating scenario is better than having a completely closed system. Alternative solutions, such as Gabriel Wollner's proposal of a Tobin tax,[28] mitigates or reduces, but does not eliminate the erosion of the three conditions of background injustice as interdependence. This is because a Tobin tax is a non-extensive type of capital control, that inhibits, but does not eliminate the capital flows of open capital markets. Also, in chapter 4, I will argue that implementing a Tobin tax also has undesirable side effects, such as hindering trade.

The question that arises from the above is when does mere interdependence becomes a problem of background injustice. In other words, we need to determine the point where inequalities are too high for agents to interact in the market fairly; where states are too constrained in their capacity to deliver social justice and more generally to engage in genuinely self-determined policy-making.[29] In what follows I will suggest that interdependence becomes a problem of background injustice when agents become dominated, or when they face a crisis, for two reasons. First, in this case the three conditions of background injustice are eroded in a strong way. Second, domination generates a problem of procedural unfairness. As illustrated in Ronzoni's example of contracts, when a social practice leads to regressive outcomes, it may lead to such inequality that participants in the contract cannot participate as free and equal agents. Similarly, the regressiveness of the IMS may lead to crises, leaving countries in such vulnerable position that they cannot achieve minimal levels of sovereignty, ability to deliver social justice at home and they cannot interact with others as free and equal.

3.2- Domination

Throughout this thesis I will rely on Frank Lovett's concept of domination, according to which domination arises when people or social groups are "dependent on a social relationship in which some other person or group wields arbitrary power over them".[30] Lovett offers a framework of domination, which includes three necessary conditions: dependency, imbalance of power, and arbitrariness. Arbitrariness can be both procedural and substantive. Procedural arbitrariness happens when a power is not effectively constrained by rules and regulations common to all. Substantive arbitrariness happens when institutions fail to consider the welfare, world view and interests of those affected by them.[31] While Lovett acknowledges these two types of arbitrariness, he rejects substantive arbitrariness in favour of procedural arbitrariness.[32] Here I deviate slightly from Lovett and consider that both types of arbitrariness are relevant, in line with the background injustice literature. Dependency happens when one agent is unilaterally dependent on the other, and the degree varies based on whether there is a possibility of exit from the situation.[33] Finally, imbalance of power

[28] Wollner, 2014
[29] I thank Miriam Ronzoni for this point and for the distinction between mere interdependence and background injustice.
[30] Lovett, 2010: 119.
[31] Lovett, 2010: 113; Pettit, 1997, 56.
[32] Lovett, 2010: chapter 4
[33] Lovett, 2010: 43.

happens when a group has the ability to change what another group does, regardless of whether they use this ability or not.[34] This conception of domination is useful because it explains that domination does not happen if only two of these conditions are present, hence, domination can be mitigated by reducing each one of these individual conditions.

Because at the global level there are fewer rules than within a state, or there is more arbitrariness, in this case domination happens when all the three conditions of the definition are strong. In what follows, I will suggest that in this case, the two conditions of arbitrariness and imbalance of power are necessarily strong, whereas the condition of dependency becomes strong in cases of crisis only.

Arbitrariness

Arbitrariness can be either procedural or substantive. Arbitrariness is procedural when a power "is not externally constrained by effective rules, procedures, or goals that are of common knowledge to all persons and groups concerned".[35] This is because, as argued by Philip Pettit, those interferences that are under our control, such as the law, are not arbitrary.[36] In a democratic society, the law considers the views and interests of all citizens, and reflects their will to regulate themselves. Therefore, the law is not an arbitrary interference, since it is under the control of citizens who are affected by these laws. As opposed to the law, when agents are able to interfere with others without any constraint by rules and regulations, the interference is procedurally arbitrary. The current general case of the IMS has strong procedural arbitrariness. In this case there are no common rules that regulate interferences between countries. Because countries are interdependent in this system, arbitrary interferences, such as monetary spillovers necessarily happen.

The second type of arbitrariness offered by Lovett is substantive arbitrariness. As we saw, Lovett defines substantive arbitrariness as situations in which the interests, welfare, and world views of a group are not considered in the decisions that affect them. In the case of the IMS, this type of arbitrariness is related to the previous one. When countries interfere with others arbitrarily, by applying monetary policy that leads to monetary spillovers, they do not consider the interests and welfare of citizens in foreign countries, even if they are affected by these interferences. In the current IMS, the decision to apply monetary policy is a national decision that considers the interests of the country that applies it only. These decisions, when made by strong countries, generate harmful effects on other foreign countries. From this I conclude that arbitrariness in the current IMS is strong.

Someone may object to the idea that arbitrariness in the case of the IMS is necessarily strong, since there are policies that can mitigate this arbitrariness. For example, as we saw earlier in this chapter, Sanjay Reddy suggests that because monetary spillovers of strong countries affect other foreign countries, the affected countries should be included in, or should the ability to veto, these decisions. My answer to this objection is that, as I argued in the last section, because the effects of strong countries' monetary spillovers have effects in most foreign countries, it is likely that their use of monetary policy will be vetoed. Restricting strong countries' ability to use monetary policy, while allowing others to use it, does not offer a fair distribution of opportunities for countries to maintain minimal levels of control over

[34] Lovett, 2010: 55, 82.
[35] Lovett, 2010: 112
[36] For example, taxes are an interference, but because the law that sets taxes is under the control of citizens, it is not an arbitrary interference (Pettit, 1997: 148-9).

their internal macroeconomic environment. Because of the importance of monetary policy, preventing strong countries to use this policy would be too demanding for these countries.

Imbalance of Power

The second condition of domination is imbalance of power, which happens when a group has the ability to change what another group does, regardless of whether they use this ability or not. In the current IMS there is a considerable imbalance of power between countries, e.g. the power of a country like the United States is considerably higher than that of a country like Argentina. As we saw in chapter 1 the power of countries in the IMS is reflected on the value of their currency, and having strong currencies offers these countries a privileged position in the system and additional benefits from the social practice. Moreover, we saw that, in the social practice of the IMS there are background conditions, or channels of dependency, that reinforce these imbalances of power. On the one hand, weak countries are more affected by monetary spillovers compared to strong countries, which leads both to a regressive system, and to exacerbate the differences in power between countries. Also, strong countries have the ability to affect other countries' internal conditions through their monetary spillovers, and in some cases, they affect other countries' decisions – e.g. in the case of the unilateral peg. Ultimately, strong countries have the ability to control what other countries do, as conditionalities for loans in cases of crisis. Because the imbalance of power in the IMS is considerable, I conclude that this condition is necessarily strong.[37]

Dependency

The third condition of domination is dependency, which happens when an agent is unilaterally dependent on another agent. The more independent agents are, the less dominated they are. In the case of the IMS, there is some degree of dependency between countries. As we saw in the last chapter, in the current IMS there are channels of dependency that make weaker countries more affected by monetary spillovers of strong countries. These channels of dependency also make the former countries more dependent on the actions of the latter. This dependency erodes the capacity of countries to control their own affairs without being affected by others, or their self-determination, to some degree. For example, these spillovers may interfere with a country's self-determination by leading to an exchange rate level that incentives imports and hinders exports, which may lead to changes in the internal macroeconomic environment of the country. However, if these changes are not substantial and the country can counteract them by using the policies that are available to them, then in this case dependency is weak.

Even if there is some degree of dependency between countries in the IMS, countries in this case actually enjoy considerably more independence compared to countries that participate in other systems. For example, countries that belong to a monetary union such as the Eurozone, or to a system of fixed currencies, must give away crucial policy mechanisms, which hinders these countries' capacity to control their internal macroeconomic situation and to counteract crises. Because countries in the Eurozone share the same currency, they lose their individual capacity to implement monetary policy. They also lose a natural adjustment mechanism of floating exchange rates, and moreover, their capacity to pursue fiscal policy is

[37] For republicans, imbalance of power is sufficient for domination, there is no need for interference. However, in this case we also have an interference, given by monetary spillovers.

constrained. This situation is common for all countries that belong to a system in which their currency is fixed. Also, in the case of the Eurozone, because countries give away their own currency, these countries also lose the capacity to engage in devaluations (or revaluations) from time to time, which is a mechanism available to countries that retain their own currency while having it fixed. Delegating these policy mechanisms, makes Eurozone countries strongly dependent on the decisions of supranational institutions, such as the European Central Bank (ECB). Therefore, they are less independent. This example gives us a sense of what strong dependency is like. In contrast with Eurozone countries, countries that belong to the current general floating IMS retain these capacities, which offers them considerable independence and self-determination in comparison to countries that belong to a fixed system. Therefore, the degree of dependency that exists in the general IMS today is weak.

While in normal conditions the degree of dependency that exists in the IMS is weak, there are some cases in which this dependency becomes strong, such as cases of crisis. When countries experience a crisis, they are in a desperate and vulnerable situation, and become dependent on the assistance of other countries and international organizations, to regain their normal internal conditions. This position of vulnerability increases dependency, and erodes the capacity of countries to have minimal levels of self-determination and to control their own affairs independently, since it leaves countries vulnerable to accepting any conditionality in exchange for loans. These conditionalities imposed by creditor countries and international organizations erode a minimal capacity of states to control their internal affairs, and to have minimal levels of self-determination.

From the above I conclude that the benchmark for domination in this case is the presence of a crisis. In the general case of the IMS that we have today, there is necessarily strong arbitrariness and strong imbalance of power between countries. Because domination, at the global level, happens when all three conditions are strong, we need to focus on the level of dependency. I have argued that dependency in this case becomes strong in cases of crisis. Because in these cases all the three conditions of domination are strong, I conclude that the benchmark for domination in the general case is the presence of a crisis.

Table 1: Conditions of domination in General Floating IMS

	Arbitrariness	**Imbalance of Power**	**Dependency**
General Floating IMS	Strong	Strong	It becomes strong in cases of crisis

Source: Own Elaboration

Domination is the point at which interference becomes a problem of background injustice, since the presence of domination, or of a crisis, has the effect of eroding the three conditions of background injustice – the ability to deliver social justice at home, sovereignty and freedom and equality of agents - in a strong way. First, countries facing a crisis lose a minimum condition of sovereignty or control over their internal situation. Crises are situations in which countries lose control of their macroeconomic environment because of distorted macroeconomic variables. These could include high unemployment or inflation, a failed banking system, no liquidity in this system, and/or insufficient public funds. Because of the pervasive and harmful effects of a crisis in a country, the government fails to have a minimum ability to deliver social justice at home and to maintain normal conditions without

external assistance. Second, because of this situation, countries become dependent on external funding to regain their internal control, but this desperate situation also allows stronger agents to impose their views on these states in exchange for this assistance. Because the internal policies of countries become shaped by the views of these external agents, instead of on the views of citizens, these countries' minimum sovereignty is eroded. Vulnerable countries facing a crisis become dependent on creditor countries, on the IMF, the World Bank or other creditor countries to accept loans, with conditionalities that they cannot negotiate as free and equal agents, due to their vulnerable condition. Finally, as we saw in chapter 1, cases of crisis are those in which outcome unfairness turns into procedural unfairness, and in which agents are in such a desperate situation that they lose a minimal capacity to interact with others as free and equal agents.

3.3- Regressiveness and LRP

Earlier, I suggested that domination is the point at which interference becomes a problem of background injustice, since the presence of domination – or of a crisis – makes these three conditions strong. A second reason why domination is the point at which interdependence becomes a problem of background injustice is that in the presence of domination there is not only a problem of outcome unfairness, but also a problem of procedural unfairness. And both outcome and procedural unfairness are necessary conditions for background injustice. As illustrated by Ronzoni's case of contracts, large inequalities may offer such differences in bargaining power that some agents are not able to negotiate with others as equals, and to make free decisions.[38] Outcome inequality, or regressiveness, can make weaker countries vulnerable to being controlled by the rich, hindering the capacity of the former states to have a minimum level of control over their own affairs and to make free decisions; hence, they are dominated.[39] Because of this relationship between inequality and domination, the Limited Regressiveness Principle (LRP) aims to limit this gap generated by social practices, in order to avoid domination. In Cécile Laborde and Miriam Ronzoni's words, "No state should be so destitute as to be entirely dependent on other agents. More generally, the global market should not entrench positions of structural and continued dominance of the poor by the rich".[40]

The LRP aims to limit the regressiveness of systems or the inequality between countries, rather than within them. In the current world we have considerable power differentials between countries, which allow some of these countries to obtain more benefits than others from different social practices. As long as these differences do not generate or contribute to maintaining relationships of domination, they do not fall under the cases that this principle aims to address. For example, if countries that have strong currencies obtain certain additional benefits because of their condition of power, but this does not increase their ability to impose their views on agreements or in procedural fairness, and does not generate or contribute to maintaining relationships of domination, this case does not fall under the ones addressed by the LRP. Moreover, the costs on weaker countries should also be regulated when they raise conditions that generate problems of domination. Therefore, according to this principle there is a limit to regressive systems that is needed in order to avoid problems

[38] Ronzoni, 2009: 238
[39] Laborde, 2010: 52
[40] Idem

of domination. In other words, this principle does not aim at formal equality nor for everyone to benefit in the same way from social practices, the *currency* of equality that this principle aims for is that of *equality of relations* among the participants of the social practice.[41]

This principle may be presented as follows:

Limited Regressiveness Principle (LRP): When addressing one specific social practice, its effects and its background conditions – such as power differentials and channels of dependency - the regressiveness of the social practice, or system, should be constrained in a way that avoids domination.

The LRP comes into play when there is domination between countries. Domination, and background injustice, happens when the social practice of the IMS, or more specifically monetary spillovers, generate inequalities or regressiveness between countries that leave weaker countries vulnerable to being under the will of another agent. I have suggested that in the case of the IMS this situation happens when the regressiveness of the system leads to a crisis. In the previous section, I argued that regressiveness should not be constrained by limiting states' capacity to apply monetary spillovers. Instead, regressiveness and avoiding domination should be addressed by either mitigation or compensation policies. I will delve into mitigation policies, such as the possible application of non-extensive capital controls, in chapter 6. In that chapter I will suggest that because non-extensive capital controls are not always effective in preventing crises, there is a need for compensation policies such as the Global Fund. The Global Fund is a redistributive system, to which strong countries - which obtain additional benefits from a system that allows monetary spillovers – contribute. Weaker countries that are harmed by a crisis triggered by the system receive these funds, up to a level that allows them to get out of the crisis and regain control of their internal affairs. Not all crises count for the LRP and the Global Fund, only those that are a result of systemic features of the social practice of the IMS count for compensation. In what follows I will specify the Global Fund.

3.4- LRP and the Global Fund

According to the LRP, regressiveness of a social practice should be constrained up to a level that avoids domination. The Global Fund proposed here is a redistributive system, to which strong countries - which obtain additional benefits from a system that allows monetary spillovers – contribute. Weaker countries that are harmed by the system receive these funds. This Global Fund does not aim for formal equality or equal benefit from contribution in the social practice, but aim to avoid domination.

I have already suggested that domination in the case of the IMS happens in cases of crisis. However, we also need to make a distinction between the reasons of the crisis. Not all crises will count for the global fund, those that count are the ones generated as an effect of monetary spillovers and from dependency created by these spillovers, as opposed to a crisis that may happen for purely internal reasons. These effects can be either direct or indirect. On

[41] Ronzoni, 2009: 238- 40. For others who follow this idea in the context of global finance see Wollner, 2014 and Viehoff, 2018

the one hand, these effects are direct when the main cause of the crisis is a monetary spillover. An example of a crisis that has direct effect from monetary spillovers is the case we saw of the crisis of Latin America in 1980, since in this case the main cause of the crisis were the monetary spillovers of monetary policy applied by the Federal Reserve. On the other hand, the effects of monetary spillovers can be indirect when these effects and patterns of dependency force states to take choices that make them more vulnerable to crises. As we have seen, in the current case of monetary spillovers, weaker countries are sometimes so affected by fluctuations that they need to make certain choices such as pegging their exchange rate or spending large amounts of reserves in order to buffer the effects of fluctuations. In these cases, countries cannot choose freely if they want to peg and they are pressed by the conditions of the system. Because in this cases, monetary spillovers and systemic reasons lead countries to take unfree choices, such as pegging their exchange rate, which leave them more vulnerable to currency crisis and currency speculation, and more dependent on views of the market on whether countries can keep the commitment to the value, these cases also count as crises considered by the Fund. As an example, think of the Asian financial crisis, Argentina and Brazil 1999-2000, Mexico 1994, among others.[42]

In these cases, the funds collected by the global fund should be offered to the countries affected by the crisis without conditionality in order to apply monetary policy to counteract the crisis and to provide safety nets for those most affected by it. These measures make countries less prone to domination by external agents, and freer and more equal, since they reduce the need for these countries to take loans with conditionalities that they cannot negotiate and that ultimately hinder their ability to conduct their internal affairs. Also, by having funds to apply monetary policy to counteract the effects of the crisis allows the country to achieve stability. This would thus allow them to regain control and sovereignty of their overall macroeconomic internal conditions, which includes their ability to deliver social justice at home. This ability is also enhanced by the possibility of offering safety nets to those individuals most affected by the crisis.

The contribution made to the Global Fund should come from strong countries for two reasons. First, these countries are the ones that contribute with their actions to dominating others through the social practice by making weak states more vulnerable. Because of channels of dependency, it is strong countries only who generate considerable effects on vulnerable ones when they apply monetary policy. This is in contrast to weak countries applying monetary policy, because this does not have a significant effect on stronger ones. This additional vulnerability makes weaker states more prone to be dominated by stronger states. Second, the contribution should come from strong countries because they are the ones who benefit more by the system. They benefit in a way that offers them more power to control decision-making processes and to dominate others directly – e.g. when countries act as creditors to other countries they impose their conditions – or through institutions and the overall system. Therefore, strong countries should contribute to the fund up to a level that allows vulnerable countries facing a crisis to stabilize their situation and regain a minimum level of control over their internal situation.

This global fund aims to minimize domination. Therefore, the currency used by the fund should not offer a specific country additional benefits or more power by holding its currency. As we saw in chapter 1, by holding the currency of a country either in reserves or in this fund, offers the country which issues these reserves additional benefits, since it acts

[42] We will see these cases in more detail in chapter 4

as having an interest rate free loan for this country. In order to avoid offering additional power to one individual country, the fund should not be in one currency only but in a basket of currencies. A possible basket currency is the Special Drawing Rights (SDR), the currency used by the IMF and other international organizations, which is a combination of the main currencies used as reserves and in the financial system.[43] Because this basket already considers the percentage of currencies used as reserves, it does not add more debts to the country that issues it in relative terms to other reserve currencies, and therefore additional benefits.[44] Also, having a basket of currencies allows the distribution of power between different states. Because the currencies included in the basket – and their percentages – are actualized every five years, this also offers the possibility of new emerging economies to be part of the currencies in the basket, reflecting a distribution of power between states. Finally, the currencies included are those of strong countries because, on the one hand, they are more stable, and on the other hand, these are the countries that should contribute to the fund.

The idea of this fund can also help to justify a system of open capital markets, or free finance, to the worse off or to poor people living in poor countries. While it is in the best interest of everyone to participate in the IMS and to have free finance to some extent, this situation may create harmful effects for some actors.[45] In this case, a redistributive system such as the global fund, which allows us to mitigate these harmful effects, can help to justify the system to the worse off, who are affected by spillovers. We can make an analogy between this case and the case of competition.[46] In the case of competition, we justify competition because of its benefits to society, since it allows prices to stay at a competitive level and by offering quality services and products to people. However, while this competition will benefit some people it will also harm others, such as those who are made redundant or left out of business because of competition. In this case, the argument to justify competition to those affected by it at an internal level is that competition is justified to those harmed by competition when safety nets are provided to them. This same idea can be extended to the case of the global fund.

Someone may argue that the global fund does not necessarily allow strong countries to maintain social justice at home. For example, if these countries have to pay millions to the fund, this may discourage them to use monetary policy and, as a consequence, undermine their ability to deliver social justice at home and their sovereignty. My answer to this objection is that because domination at the global level does not always happen, the LRP and the responsibility to contribute to the Global Fund are not always triggered. Thus, contribution to the fund should not be too demanding as to limit strong countries' ability to deliver social justice at home. As opposed to Reddy's proposal that foreign counties should have a voice in the decisions of, and the ability to veto, the monetary policy of strong countries since they are affected by spillovers, the LRP is not concerned about countries simply being affected. Instead, the LRP, and contributions to the fund, only happens in *cases of domination,* or in *cases of crisis*. If crises generated by spillovers were so pervasive and common as to discourage the use of monetary policy by strong countries, then the opportunities to apply this monetary policy and to enjoy freedom as non-domination should be distributed between countries.

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[43] https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

[44] Williamson, 2009: 4-5

[45] We will see this case in more detail in chapter 5

[46] I thank Jonathan Wolff for this point and analogy between the justification of the Global Fund to the worse off and competition.

3.5- The Global Fund and Preventing Domination

I have argued that the LRP should limit the regressiveness of social practices up to a point that it avoids domination. In the context of monetary spillovers, I have suggested that domination happens when there is a crisis, especially in a vulnerable country, where the country must thus be assisted via the Global Fund. Someone may question why is this sufficient to prevent domination: if a country plunges into a financial crisis, is it not ipso facto already exposed to domination? Should our aim not be to create a system of rules that prevents, or at least tends to minimise, financial crises to begin with? This objection points out that the mere state of dependency leaves the dependent party ipso facto exposed to domination, and hence, in order to avoid domination, we should aim to prevent dependency. Therefore, there should be a presumption towards preventive policy measures that aim to avoid dependency, or financial crises, from happening in the first place. As opposed to these preventive policies, the Global Fund is a system of compensation that aims to reduce dependency once it has already happened.

While I agree that there is a presumption towards preventive policy mechanisms, in the specific case of the IMS there are reasons why having preventive measures *only* is neither sufficient nor desirable, and hence, throughout this thesis I argue for a combination of both preventive policies and policies that aim to offer compensation to reduce dependency one a crisis has already happened. In this chapter I have introduced the compensation policy of the Global Fund, and in chapter 6 I will delve into preventive policies that aim to reduce the occurrence of crises. In the latter chapter I argue that having a system that completely eliminates dependency, or crises, is not desirable, since it would likely have undesirable consequences, such as hindering trade and reducing liberties – e.g. freedom of movement. Also, preventive measures that aim to minimise - but not completely eliminate - crises, such as non-extensive capital controls, have limited effectiveness, and hence, they do not to prevent nor sufficiently minimise crises. Therefore, I conclude from that chapter that other compensation policies, such as the Global Fund, are necessary in combination with preventive policies.

Section 4) Responsibility and the Global Fund

As we have seen in this chapter, an unregulated IMS leaves weak states vulnerable to domination by other agents. In this section I discuss who is responsible for this situation. I will argue that there is both an agential and a systemic responsibility. On the one hand, I will argue that there is agential responsibility. I will present David Miller's distinction between outcome and remedial responsibility, and argue, first, that there is a remedial responsibility to avoid domination, and second, that this remedial responsibility falls on strong states because of their outcome responsibility. However, even if these states have outcome responsibility, this is not a moral responsibility. On the other hand, I will argue that there is systemic responsibility, since in the current IMS there is an absence of rules and institutions that regulate the interactions between states in the social practice. Because this institution does not exist yet, there seems to be a void of responsibility. As argued by Miriam Ronzoni and Iris Young, this problem can be solved by assigning agents a forward-looking responsibility to create new rules or institutions or change the ones that already exist. As

opposed to Iris Young, who argues that all those who contribute to the process in cases of structural injustice have forward-looking responsibilities to change the structure, I will argue that it is mainly strong states who have a forward-looking responsibility to create the global fund. Finally, I will conclude that the global fund is a mechanism through which states can discharge their responsibilities.

4.1) Agential responsibility

I start this sub-section by presenting Miller's two concepts of responsibility, outcome and remedial responsibility. I will argue that what triggers remedial responsibility in the case of the IMS is the need to avoid domination. Because strong states have outcome responsibility, they are the ones who can be held remedially liable, but not morally responsible. Even if responsibility is not moral, strong states still have remedial responsibilities.

4.1.1) Miller's two concepts of responsibility

David Miller offers two concepts of responsibility: outcome and remedial responsibility.[47] The former type of responsibility refers to responsibility agents bear as a consequence of their actions, and the latter type refers to who should be assigned responsibility to assist someone or address a situation. Outcome responsibility focuses on agents, and asks how we should be credited or debited for our actions and decisions.[48] This type of responsibility is different from both causal and moral responsibility. On the one hand, it is different from causal responsibility, since outcome responsibility requires agency. As opposed to causal responsibility, which asks why something happened, outcome responsibility asks if a person can be credited or debited for her actions. On the other hand, outcome responsibility differs from moral responsibility – e.g. an athlete may win a competition because of her natural talents but because the outcome depends on this talent the person is not praiseworthy. According to Miller, this distinction between outcome and moral responsibility is relevant because it allows us to distribute benefits and burdens without the need to also address moral considerations of blame or praise.

Remedial responsibility focuses on patients, or people who are in need or suffering and asks who should bear the burdens of helping them.[49] In order to assign remedial responsibility, Miller offers a connection theory, and argues that the person or agent remedially responsible is the one who has either moral, outcome, or causal responsibility, or another agent who benefits from P's deprivation, an agent who has the capacity to assist, or other people who belong to the same community as P. Here our focus is the connection between outcome and remedial responsibility. For this case, Miller argues that even when there is no moral responsibility - say the consequence is an unintended side-effect of A's action - those who have outcome responsibility also have a remedial responsibility for remedy. The reason for this connection is that if we want to enjoy the benefits of the results of our free actions, then we should also have to bear the costs of them. Also, Miller argues

[47] Miller, 2007: chapter 4
[48] For Miller's presentation of outcome responsibility, see Miller, 2007: 86-100
[49] For Miller's on remedial responsibility, see Miller, 2007: 100-7

that these conditions are sometimes in tension with each other – e.g. agent A who pushed P into a river may be very weak, whereas B may be a very good swimmer.

4.1.2) Outcome and remedial responsibility in the case of the IMS

These two concepts of responsibility also apply to the case of the IMS. First, for the case of remedial responsibility, Miller argues that it is extreme deprivation which generates humanitarian duties that require us to assign remedial responsibility to fulfil these duties. However, we can extend this idea of remedial responsibility and argue for a different benchmark, that of domination. Because domination is a wrong that we want to avoid (or at least minimize), the threat of this domination *triggers* remedial responsibilities to avoid these situations. In other words, remedial responsibility arises whenever we want to avoid certain wrongs - one of these wrongs could be extreme deprivation - but there could also be other wrongs that we want to avoid, including domination.

Secondly, like Miller we can also assign remedial responsibility to those with outcome responsibility. In this case, because strong states contribute to making weak states more vulnerable, and hence more susceptible to domination, the former states also have remedial responsibilities of compensation when the latter states face the threat of domination. As we saw earlier, strong states, whose currencies have a central role in the system, may contribute to generating a crisis in weaker states, which leaves them vulnerable to domination when they need funds to counteract the crisis and regain minimum levels of control. From this we can also conclude that not all states will have this type of responsibility. Because the international effects of monetary spillovers generated by weak countries are negligible, they do not contribute to domination. It is only strong states which, given the background conditions or channels of dependency, contribute to domination. Because it is the need to avoid this type of domination that triggers remedial responsibility, only strong states are responsible - they are the only states who contribute to this outcome. This responsibility could be discharged through the Global Fund, since this should deliver the funds to avoid the domination of recipient states, and it would demand these funds from states who bear this remedial responsibility.

However, unlike Miller, it is not any outcome that triggers remedial responsibility in this case. Because states act in a system in which they are interdependent with other states, they necessarily generate externalities, but externalities are not necessarily a wrong, even if they generate a loss to other parties. Because externalities are not necessarily a wrong, they do not necessarily trigger the need for compensation – e.g. in cases of competition someone may be harmed by her competitor's actions but this does not necessarily mean that her competitor owes her compensation. Instead, focus on outcome responsibility in this case becomes relevant when there is remedial responsibility that asks who is responsible for remedying a wrong. In other words, strong states do not have outcome responsibilities because they cause monetary spillovers, but because they contribute to generating the conditions for domination.

4.1.3) Responsibility is not a moral responsibility

In our case strong states have remedial and outcome responsibility, but this responsibility is not a moral responsibility for three reasons.[50] The first reason is an absence of intention. States in the IMS may claim that they did not *intend* to generate or maintain relationships of domination through their spillovers; instead they were focusing on their internal issues, and responsibilities with their citizens, when taking these actions. The fact that they do not even act with the system in mind lessens their moral responsibility. The second reason, which is related to the first one, is that states have a justified reason for taking these actions, since it is the responsibility of the state to bring about social justice at home, avoid internal poverty and deliver internal distributive justice through monetary policy.

The third reason why responsibility in our case is a forward-looking responsibility, rather than a moral one, is the absence of knowledge. Strong states in the IMS know that, because their actions have broad effects overseas, their monetary spillovers will likely generate some harmful effects in foreign countries. However, they do not know in advance when these spillovers will bring about domination that will trigger responsibilities. This raises a problem of moral luck: because factors that trigger responsibility are out of the agent's control, it seems arbitrary to assign responsibility in some cases and not in others.[51] Consider the case of two drivers who drive drunk. In one case a person crosses the first driver's path, and the driver kills the person; in the other case the second driver does not kill anyone because no one crosses her path. In this case it seems arbitrary to assign the first driver more responsibility than the second one. A way of solving the tension in this case is to argue that while both drivers share the same moral responsibility, the driver who kills also has remedial responsibility to compensate for the wrong she has committed.[52] As in the case of drunk drivers, strong countries have remedial responsibility for their spillovers only when they commit the wrong of dominating others. However, unlike in the case of drunk driving, there is no moral responsibility. Drunk drivers are morally responsible for engaging in a selfish and unnecessary act that exposes others to harm. However, in the case of spillovers, countries do have justified reasons for taking these actions, which mitigates their moral responsibility.

4.1.4) Even if there is no moral responsibility there is still remedial responsibility

Earlier, we saw that the responsibility which the state has to bring about social justice at home cannot justify everything. For example, a system of slavery used to deliver social justice at home would always be wrong. Similarly, in the case of monetary spillovers, this internal responsibility of the state cannot justify everything, since the state also has global responsibilities for participating in social practices, such as the responsibility of not using these practices to dominate others. In other words, in this case there is an apparent tension between the different responsibilities of the state. On the one hand, the state has the responsibility to realize social justice at home; on the other hand, the state has global

[50] Iris Young also argues, for cases of structural injustice, that agents do not have moral responsibility but a forward-looking responsibility to change the structure because individual actions are not wrong, outcomes are caused by a combination of actions rather than the actions of a single agent, and individuals' actions are constrained and shaped by the structure (Young, 2011: 125-31). However, the reasons in our case are different from Young's reasons.
[51] See Nagel, 1979; Williams, 1981. We will come back to this debate in chapter 4.
[52] Andre, 1983: 206

responsibilities when engaging in social practices. In some cases, the Global Fund will allow states to satisfy both of these responsibilities. Firstly, it offers states the discretion of applying monetary policy when they consider it necessary. Secondly, it offers states a way to discharge their global forward-looking responsibilities with other states. However, when these two responsibilities are incompatible with each other, it is the state's global responsibility which should have priority over the internal one for two reasons. First, as in the case of slavery, subjecting others to domination is wrong. Second, the global fund should offer a fair distribution of opportunities for agents to enjoy self-determination. Consequently, individual states should act according to this distribution. Therefore, even if there are justified reasons for action which lessen moral responsibility, they do not eliminate remedial responsibilities.

4.2) Systemic responsibility

In the case of monetary spillovers there is a systemic responsibility, since one of the main problems is that in this social practice there is an absence of regulation, and the rules that do exist are inadequate and unfair. Therefore, even if states interact with each other following the rules, this situation leads to an unfairness. The apparent problem with this type of responsibility is that the responsibility falls upon an agent that has not been created yet. Earlier in this chapter I proposed a global fund that should coordinate a redistributive scheme between participant states in the social practice, but this agency does not exist: it is rather an institution that needs to be created. Consequently, there seems to be a void of responsibility. This problem can be solved by turning the responsibility of an institution that does not exist into a forward-looking responsibility of agents to create such institution.[53]

Faced with a similar problem, Iris Young has proposed a political responsibility for cases of structural injustice, and has argued that individuals who contribute with their actions to unjust outcomes have a forward-looking responsibility to change the rules or structure, since they benefit and realise their projects through contributing to the process.[54] This responsibility is a forward-looking, as opposed to a backward-looking, moral responsibility, because it does not aim to identify who is to blame - instead it aims to identify who is responsible for changing the structure.[55] Also, this responsibility is political because it involves joining with others in order to take collective action to change the unjust background structure or rules. As an example of a case of structural injustice, Young offers the example of housing.[56] In this case it is the combination of different actions - such as the wages people earn, rents that landowners and banks require, forces of demand and supply, different laws of construction, actions of the Federal Reserve, among others – that combined lead to the injustice of leaving some individuals vulnerable to homelessness. Therefore, all involved in this process are politically responsible for changing the structure.

The idea that all actors who contribute to the process of an outcome have political responsibility may sometimes be too demanding. In the case offered by Young we may think that while the monetary policies implemented by the Federal Reserve contribute to the

[53] Here I follow Ronzoni's idea that duties of justice arise from interacting with other in a social practice, and that these duties do not require a basic structure, instead when there is a problem of justice due to the absence of this background structure, this situation triggers an obligation to create something like a background structure or institutions that regulate the social practice (Ronzoni, 2009: 323).
[54] Young, 2006: 119
[55] Young, 2006: 123
[56] Young, 2011: 47

problem of housing, they are overall fair. In this case, it seems too demanding for the Federal Reserve to have political responsibilities to change the structure, considering that this entails a considerable and real effort to try to change this. This is especially problematic in the case of the Federal Reserve since monetary policy has effects in almost all areas of an economy, influencing not only housing, but many other issues. This model would necessarily bound the Fed with political responsibility for many issues, to a point in which we may question if the role of the Fed is to implement overall fair monetary policy – which necessarily generates winners and losers – or to act as an entity that supervises the work of other institutions.

Similarly, in our case of monetary spillovers, it would be too demanding to assign responsibility to all actors whose actions are involved in domination that could arise from spillovers. In this case there are many actors who may be indirectly involved in generating the unfair outcome. For example, we may think that banks play a role because they offer loans in strong currencies only; we can also think that the global trade system that prices assets in strong currencies also plays a role, and so on. However, as in the case of the Fed, it is not the role of banks or of the trade system to ensure justice of other social practices. We also need to make a distinction between general actions and background conditions. In this case the channels of dependency are background conditions, rather than general actions, since they are pervasive, long-lasting, established, difficult to change and are not necessarily related to the social practice that we are considering here. Because these are background conditions, rather than additional actions, we can limit this forward-looking responsibility to create the fund to actors in the social practice, or states, for two reasons. First, given these background conditions, actions of states can be foreseen – e.g. we know that given the channels of dependency actions of strong states will have a broad impact abroad. Second, background conditions are constant features, and it is mainly the behaviour of actors who play a role within these background conditions that contributes to an outcome.

While it is states who participate in a social practice, with given background rules, who have a forward-looking responsibility to create the global fund, not all states have this responsibility. This responsibility should mainly fall on strong states for the following reasons. First, the global fund is merely a facilitator which allows states to fulfil their responsibilities. Because it is strong states who have these responsibilities, it is these states who should create the fund that will allow them to satisfy these responsibilities. The global fund should act as a facilitator, which allows participant states to satisfy their responsibilities. The fund should, for example, analyse when the conditions of domination have been violated, and should coordinate the transfer of funds between issuing and recipient states. Because the global fund is merely a facilitator, the responsibility to create the fund falls on those states who have these responsibilities. It clearly cannot fall on those who should be the beneficiaries of these responsibilities. As we saw, what triggers remedial responsibility is the need to avoid domination through the system. Because it is strong states who contribute to domination, they have remedial responsibilities to contribute to the fund. As opposed to these states, weak states suffer this domination, and are the recipients of this remedial responsibility and of the funds. Therefore, it is strong states who also have responsibilities to create a fund that will facilitate the fulfilment of their responsibilities.

The second reason why it is strong states, rather than all states, who have a forward-looking responsibility to create the global fund is a practical or a feasibility reason. Weak states may fulfil their forward-looking responsibility of creating the fund, but because it is strong states who should contribute to the fund, the former states may not be able to enforce this contribution. Because at the global level weak states cannot enforce regulations on strong

ones, what is needed is a self-imposing compromise of strong states to both create and to contribute to this fund. This situation is different from the case of redistribution within a state. This is because, within a state, weak individuals may join with each other and generate laws that are enforced by the state, which has a monopoly of legitimate power, over stronger and more powerful individuals. As opposed to this case, in the global realm there is no global state with a monopoly of power that can enforce the regulations which say that strong countries are the ones that should contribute. Therefore, contribution and the facilitation of this contribution by creating the fund should be self-imposed by strong states. At most we can say that after the fund has been created, weaker states should contribute by having representation and decision-making in this fund, but ultimately the responsibility to create the fund rests on strong states.

Finally, I conclude that strong states have two different types of responsibilities. First, they have an agential remedial responsibility to contribute to the fund. This type of responsibility is not a moral one. Second, these states have a forward-looking responsibility to create the global fund. The global fund acts as an entity that facilitates and coordinates the fulfilment of this remedial responsibility. Because it is strong states who have this remedial responsibility to contribute to the fund, they are also the ones who have a second forward-looking responsibility to create this fund, which facilitates the fulfilment of their first remedial responsibility. It is also these states, as opposed to weaker ones, who are responsible for creating this fund for feasibility reasons.

Section 5) Objection

Miller offers objections to all the principles of fair trade presented in section 2. One of these objections, the one he offers for principle Fairness II, can also be extended to our case and to the LRP. Miller argues that while we may have positive duties towards foreign people, we do not need to discharge these obligations through trade, but through other means such as development aid.[57] According to Miller the aim of trade is to leave both partners better off, but how better off they are after trade depends on their starting positions, and it cannot be guaranteed that both partners will be above a threshold beyond the benefits of trade itself. He argues that while this idea seems more convincing when considering particular instances of trade – such as the exchange of one particular commodity – it is less convincing for trade as a general social practice, since this means that everyone involved in the practice should receive sufficient resources to fulfil their human rights. The problem Miller identifies with this idea is that it burdens trade with a general responsibility to meet human rights that may take many policy measures to achieve.[58] Therefore, he concludes that principle Fairness II is too demanding.

This objection may also apply for the case of the LRP, since countries are already better off by participating in the IMS than not participating in this social practice. Therefore, this objection could be extended to argue that there are no additional responsibilities beyond the benefits that participation in the IMS brings by itself. While I agree with Miller that participating in the social practice of the IMS does not *a priori* raise general responsibilities to fulfil positive duties, additional responsibilities in the case of the LRP are not derived as a

[57] Miller, 2017: 260
[58] Miller, 2017: 260

means to reach a benefit threshold, but as a means to correct a problem of background justice. Specifically, the system should not allow or facilitate domination of some participants in the social practice over others, and this problem raises additional responsibilities. These additional responsibilities are connected to the social practice of the IMS itself and not to general positive duties that could be discharged by other means, and the threshold is not one of sufficiency, but one that allows us to avoid domination through this practice.

Section 6) Conclusion

This chapter addressed the first problem of background justice, that of monetary spillovers. Here I aim to determine which principle of fairness is a suitable one to address this case. After analysing principles that have been proposed for fair trade, I concluded that because of particular features of the IMS, these principles cannot be extended to this case. As an alternative to the above, I introduced the Limited Regressiveness principle. According to this principle, regressiveness in a social practice or system, considering background conditions, should be constrained in a way that avoids domination. I argued that in the case of monetary spillovers, a possible policy application of this principle is a redistributive scheme among those who participate in this social practice, such as the Global Fund. I also argued that in the case of monetary spillovers there are two different types of responsibility that fall on strong states. First, there is a systemic responsibility, which can take the form of a forward-looking responsibility for creating an institution that regulates the social practice. Second, there is an agential responsibility, not for causing monetary spillovers, but for contributing to the domination of other states through the system. The Global Fund can also be construed as a means for states to discharge this responsibility.

Chapter 3: Parasitic Exploitation and the Case of the Stock Market

Section 1) Introduction

In recent years, exploitation has emerged as one of the main normative principles in the ethics of global trade.[1] The notion of exploitation is already intuitively relevant when thinking about global exchange. One of the paradigmatic cases of exploitation in global trade is the case of sweatshops.[2] My D.Phil. will apply this normative principle of exploitation to the case of the International Monetary System (IMS) and will try to detect morally problematic forms of exploitation. This thesis takes an ecumenical approach to exploitation, considering that different conceptions of exploitation may apply to different cases.[3]

More specifically, in this chapter, I will focus on the case of speculation in the Stock market. In this chapter I take a step back from the case of the IMS. I will offer a framework of parasitic exploitation for the case of speculation in the stock market, and I will apply this framework to the case of the Foreign Exchange market in the next chapter. Speculation can be defined as "the purchase (or sale) of goods with a view to re-sale (re-purchase) at a later date, where the motive behind such action is the expectation of change in the relevant prices relative to the ruling price and not a gain accruing through their use, or any kind of transformation effected in them or their transformation between different markets".[4] Here I consider the term speculation as a non-moralized concept – e.g. I assume that there is nothing morally wrong with speculating in a casino. Speculation becomes problematic in markets, when agents engage in this activity and in combination lead to, and benefit from, changes in prices, which are harmful to others. For example, we think that there is something wrong when traders reduce the value of currencies leading to currency crises and harming citizens or when they reduce the value of shares which could ultimately lead to bankruptcy harming the workers of a firm. We can intuitively think that these are cases of exploitation, since there is an element of taking additional advantage of vulnerability.

If we think that cases of speculation in the stock market are exploitative, we should notice that this case differs from classic cases of exploitation. Consider the following examples. A person who is lost in the desert and needs water to survive and is offered a bottle of water at an exorbitant price by a seller, a gouger aims to sell basic goods at high prices in an area affected by a natural disaster, an employer in an area with few employers offers someone a job for a very low wage. Hereafter, I will call these classic cases of exploitation, in which one party with market power takes additional advantage of the vulnerability of the other by offering her an unfair price, cases of *transactional exploitation*. All of these cases have considerable differences with our case of the stock market. First, in our case exploitation does not happen within a single transaction, since traders in the stock market do not transact

[1] See Mayer, 2007a, 2007b; Miller, 2010; Miller 2017; Risse, 2007; Risse and Wollner, 2014; Snyder, 2008; Viehoff, 2018; Reiff, 2013.
[2] Sweatshops are fabrics, in which workers work very long hours, are underpaid, and work under dangerous conditions (Wertheimer and Zwolinski, 2016).
[3] As in Risse and Wollner, 2014: 214
[4] Kaldor, 1939.

directly with workers in firms. Second, the idea of market power as a monopoly is not fully applicable to this case given the large number of participants in the stock market. Third, and more importantly, in cases of transactional exploitation the exploited party is usually better off with the exploitative transaction, e.g. the person in the desert and people in the disaster area are better off paying a high price than not having these goods and workers better off receiving low wages than with no income at all. This creates a paradox of exploitation, or a non-worsening claim (NWC), according to which exploitation in some cases may be justifiable since it leaves both parties better off. A reply to this claim involves a need for a benchmark of justice, since one may argue that the exploited party is better off compared to the absence of the transaction, but worse off compared to a fair, or non-exploitative transaction. By contrast, in the case of the stock market there is no paradox, since workers and people are not necessarily worse off without speculation, since what makes them better off are other types of transactions such as investment.

Given these differences between the case of the stock market and classic cases of exploitation, we may think that this case constitutes a different type of exploitation. Another possibility is that this is a case of parasitic exploitation. Consider the following cases. A parasite infects a host and lives from sucking her blood while causing her disease, a person (free-rider) decides to quit her job and stay at home watching Netflix thanks to the implementation of Universal Basic Income (UBI), a capitalist who owns the means of production of a firm and lives from the surplus value generated by workers' labour. These are some examples of parasitic exploitation that have been presented in the literature. It intuitively makes sense to turn to this literature to address the case of the stock market, since these cases share similar features with our case. First, they do not necessarily happen within a single transaction, e.g. the free-rider does not interact with people who contribute to UBI in a direct way, instead there is a process that connects these people. Second, in these cases there is also an absence of market power, e.g. the free-rider and the capitalist do not have market power over other people, instead build in mechanisms, such as rules or laws, offer them advantage. Finally, these cases also do not present a paradox of exploitation, or NWC, since the parasites or free-riders, simply make the hosts or contributors worse off than they would have been in the absence of these actions. As opposed to transactional cases, in these parasitic cases agents do not enter these situations in a voluntary way, but instead they have no choice than being affected by these activities. Therefore, in these cases there is no need for a benchmark of justice, as the parasite simply makes the host worse off than she would have been in the absence of the infection. Because of these similarities between our case and these cases of parasitic exploitation, I will look at these cases when offering a framework of exploitation.

1.1- Structure of the chapter

This chapter proceeds as follows. *Section 2*, draws on the cases of UBI and parasitism in nature, and offers a framework of parasitic exploitation, which includes three conditions of build in mechanisms, vulnerability and non-proportionality. All of these conditions are necessary, but not sufficient on their own for exploitation. In this section I also offer three elements that should be present in cases in which exploitation happens as a process, as opposed to in a single transaction. These elements are an exploiter party who obtains additional profit, this profit could not have happened in the absence of the weak party, and the profit comes at the potential expense of the weak party. I also consider that a situation is

more or less exploitative depending on background conditions and indirect consequences. Finally, I conclude that in the case of UBI absence of regulation is preferable even if this allows for parasitic exploitation to happen. In the next two sections I present an inquiry into the nature of the moral wrong caused by speculation in the stock market. In *section 3*, I ask whether if this case can be considered a case of parasitic exploitation, and conclude that it can, since it satisfies both the framework of parasitic exploitation and the three elements of exploitation as a process. After considering background conditions and indirect consequences in this case, I conclude that if this case is a case of exploitation, it is likely to be a stronger case than the one of the free-rider in the case of UBI. *Section 4* argues that, as opposed to the case of UBI, regulation of speculation in the case of the stock market is necessary. *Section 5* presents and answers an objection. Finally, *section 6* concludes.

Section 2) Framework of parasitic exploitation: the cases of UBI

This section starts by presenting the case of parasitism in the debate of UBI, which is a case used as an example to offer a framework of parasitic exploitation. The framework proposed here includes three conditions of build in mechanisms, vulnerability and non-proportionality. For non-proportionality I argue for a counterfactual scenario, in which there is no systemic vulnerability that comes from the absence of rules. All of these conditions are necessary, but not sufficient on their own for parasitic exploitation. I also offer three elements that need to be present in cases in which exploitation happens as a process, or cases in which the exploiter party does not interact directly with the exploited party. First, there should be an exploiter party who makes additional profit. Second, the additional profit could not have happened in the absence of the weak party. Third, the additional profit comes at the potential expense of the weak party. I also consider that a situation can be more or less exploitative depending on background conditions and indirect consequences. For the case of UBI, I conclude that it is not clear that the implementation of this system would lead to relevant cases of exploiting a person, and if it does, I argue that it is likely to take a weak form. Finally, I argue that absence of regulation in the case of UBI is preferable to regulation, even if this would allow the possibility of parasitic exploitation to arise.

2.1- Universal Basic Income (UBI)

Before offering a framework of parasitic exploitation, I will start by offering a general definition for the case of Universal Basic Income (UBI). A Universal Basic Income (UBI) is a "policy proposal of a monthly cash grant given to all members of a community, without means test, regardless of personal desert, with no strings attached and, under most proposals, at a sufficiently high level to enable a life free from economic insecurity".[5] In other words, UBI is a constant cash grant given to individuals, and this cash is raised by contributors who pay taxes. According to Philippe Van Parijs' original proposal this tax could come from employment rents.[6] The idea is that the advantaged have access to privileged jobs, which are undeserved gifts, hence these jobs should be taxed to yield-maximizing taxation.

[5] Bidadanure, 2019: 481
[6] Van Parijs, 1995.

Gijs van Donselaar, has argued against Philippe Van Parijs' proposal of a Universal Basic Income (UBI) on the grounds that it would allow parasitic exploitation.[7] According to van Donselaar, the implementation of a UBI violates a principle of non-parasitism in social relationships. He argues that a parasitic relationship happens when "A is worse off than she would have been has B not existed or if she had nothing to do with him, while B is better off than he would have been without A, or had nothing to do with her".[8] In order to illustrate his point, he offers the example of two people, Lazy and Crazy, who are survivors in an island and decide to divide the property of the island into two equal parts.[9] Lazy, who has no interest in working her part of the island, rents her part to Crazy in exchange for rent, which offers her a labour-free income for living. Because Crazy would be better off if Lazy did not exist, while the opposite is not true, van Donselaar concludes that this case violates a principle of parasitism. Similarly, he concludes that a lazy surfer or "non-needy bohemian" who does not want to work, exploits contributors to UBI in a parasitic way.[10]

In what follows, I will offer a framework and definition of parasitic exploitation that is different from that of van Donselaar's one.

2.2- Framework of exploitation

2.2.1- Build in mechanisms

Cases of parasitic exploitation and classic cases of transactional exploitation differ on the overall position of the exploited party with the presence of the exploiter party and the exploitative activity. Consider the following cases. A person lost in the desert who desperately needs water to survive encounters a seller who sells her a bottle of water at a very high price. In an area that has been affected by a natural disaster, which destroyed the supplies of basic goods, a seller (gouger) sells these goods at an exorbitant price. In a place with few jobs and many employees, an employer (sweatshop) offers workers jobs with very low wages, in which they need to work for long hours in dangerous conditions. All of these cases are *transactional* cases of exploitation, in which two parties interact with each other. In these cases, exploitation happens due to the vulnerability of one party who is in desperate need for something – water, basic goods or jobs – which the exploiter party happens to have, and she is offered a disproportionate price by the other party for the transaction. In these transactional cases of exploitation, we have a paradox of exploitation, or a non-worsening claim, since the exploited party is better off by being exploited by her exploiter than in the absence of this transaction. The person in the desert is better off buying an expensive bottle of water than dying, people in the disaster area are better off paying an expensive price for basic goods than without these goods, and people are better off with low paying jobs than with no jobs at all. As opposed to transactional cases of exploitation, this paradox does not happen in cases of parasitic exploitation. By definition, parasitic exploitation leaves the exploited party worse

[7] According to Van Parijs, one cannot truly be free without access to resources to survive and to follow our life plans (Van Parijs, 1995). He defines real freedom as the freedom to do what one might want to do, which also includes the capacity do so (Idem). Van Parijs concludes that the implementation of a UBI would increase real freedom for everyone, since it would allow the resources for everyone to pursue their desired live plans.
[8] Van Donselaar, 1997: 4.
[9] Van Donselaar, 1997: 149.
[10] Van Donselaar, 1997: 153.

off than she would have been in the absence of the parasite or in the absence of the parasitic action. If we consider the case of nature, on the one hand, the parasite benefits from living in the body of the host or by feeding from her blood, and on the other hand, the host is worse off by having a relevant loss of blood or by being infected by disease.

This distinction between presence and absence of a paradox of exploitation is relevant, since in the absence of incentives to enter a transaction or situation, there is an additional form of force or coercion needed for this situation to happen. In transactional cases of exploitation, such as the cases of the desert and gouging, because individuals are better off when these transactions happen they do not need to be additionally, or externally, coerced into the transaction. This coercion is internal, vulnerable individuals are forced by their desperate situation to agree to the transaction – or to make unfree choices –[11] but no additional source of force or coercion is needed for them to enter the transaction. Cases of parasitic exploitation are different, individuals would rather not enter the transaction, but are either forced into it, or they lack the power to prevent these situations from happening.[12] In the case of nature, the host would rather not have parasites, but she lacks the power to prevent being infected by the parasite. This does not necessarily mean that the parasite is overall more powerful than the host, parasites are actually much smaller than the host, but instead the parasite has a specific or limited type of coercive strategy that allows it to obtain benefits despite resistance from the host.[13]

Build in mechanisms in cases of cooperative (or competitive) systems involve an element of coercion from the rules, as suggested above, but also involves an element of lack of rules. In the case of an unconditional UBI, taxpayers contribute to a collective fund that is then distributed among all citizens as a basic income. This system is coercive, since on the one hand, paying taxes in such as scheme is mandatory for contributors, and on the other hand, because an unconditional UBI does not discriminate between justifiable and non-justifiable forms of interaction, individuals can use this system to free-ride. As in the case of nature, those who contribute cannot prevent free-riders obtaining unjustified profit from their taxes. Therefore, in this case of UBI the build in mechanisms that benefit free-riders come both from the coercive rules, that force payment of taxes, and from the lack of rules, which do not discriminate forms of interaction.

Some form of build in mechanism, which is coercive, is necessary for a situation to be parasitically exploitative, since in the absence of this condition, we would have a situation which is voluntary, hence, that the potentially exploited party could prevent if she wanted to. For example, consider the case of people who live in the same house who decide to take turns to cook for everyone else, and there is one person who always eats the food others prepare but never cooks. In this case people who cook could either ask the person who free-rides to contribute, or could stop cooking if they think the system is unfair. Because they have the power to avoid this situation, and stop cooking for others if they want to, this situation is not an exploitative one.

[11] Shelby, 2002: 393
[12] I thank Jonathan Wolff for this point and for the idea of systemic vulnerability.
[13] Shelby, 2002: 401

2.2.2- Structural vulnerability

The second condition is vulnerability. Because those affected by parasitic exploitation cannot defend themselves from the parasite, they are vulnerable to this type of exploitation. In the case of nature, the host is vulnerable, since she cannot avoid being infected by the parasite who has the power to obtain benefits from her. This type of vulnerability is relational, the host may not be vulnerable in general terms, she may be overall healthy and strong, but because she lacks the capacity to avoid parasites, she is vulnerable to their infection. Similarly, in the case UBI, those who are affected by having to pay more taxes than they should due to the presence of free-riders, cannot avoid having to pay additional taxes, and are vulnerable to this increase due to the rules and regulations.

In the absence of this type of vulnerability we would not have a case of exploitation, since the parasite would not have power over this specific agent. For example, consider cases in which parasites have the power or coercive force to infect a certain species, but a particular host is immune to these parasites, e.g. she has a very strong immune system or she has had a vaccination against parasites. In this case, even if the parasite has force over the species, it cannot exploit this particular host. Similarly, in the case of UBI not all will be vulnerable. Consider the case of two people who free-ride on UBI. In this case, one of the free-riders does not exploit the other, since the other is not vulnerable because of the rules, but instead uses these rules to obtain additional profit. Those who are vulnerable because of the rules are taxpayers, who cannot avoid having to pay additional taxes due to free-riders, but not free-riders who obtain unjustified profit from the situation.

In some cases of parasitic exploitation, we can find another type of vulnerability that is not a necessary condition for parasitic exploitation, but that may make a situation more or less exploitative. This is a pre-existing vulnerability. For example, a host that is weak and ill previously to any contact with parasites, is more likely to be infected by parasites, than one that is strong and healthy. Both the weak and the strong are vulnerable to parasites, since they both lack the means to avoid them, but in the former case the parasite exploits an additional type of vulnerability, which makes the host more likely to be infected and more affected by the infection, therefore this case would be more exploitative than the latter one.

2.2.3- Non-proportionality

If we only consider the two previous conditions, of build in mechanisms and vulnerability– in which one party benefits while the other is harmed - we face a powerful objection raised by Richard Arneson to van Donselaar's idea of parasitic exploitation. This is the idea that if we only focus on the outcomes of a coercive system, there may be cases which satisfy the criteria but that are procedurally – and overall – fair. These are cases in which one agent A is bound by coercive justice to assist others, such disabled and old people, which makes this agent A worse off, while benefiting the disabled and the old, but these are not cases of exploitation. In Arneson's words, "one man's parasitism is another man's distributive justice".[14] In other words, even if the affected parties are worse off in the presence of those who benefit from them, because these interactions are fair, or consistent with

[14] Arneson, 2013: 400

distributive justice, the former parties are not exploited, since they are not worse off compared to a fair or non-exploitative scenario.

As opposed to cases of transactional exploitation, in cases of parasitic exploitation we do not require a benchmark of justice, since the parasite simply makes the host worse off than she would have been without the parasite.[15] In other words, because in the latter case there is no NWC, what we need is a counterfactual scenario that is factual hypothetical, we need to know that the parasite is harmful to the host, but we do not need to know exactly how the host would have been in the counterfactual scenario of not having a parasite. Thus, in these cases we only need a causal connection between the parasite and the host and to show that the former is harmful to the latter.

Someone may argue that the counterfactual scenario is trivial: a situation in which we remove the parasite. I do not think that this is necessarily the most useful counterfactual scenario, since we need to make two additional distinctions. The first one, is between activities that are parasitic and those that are not. As argued by Arneson we could say that taxpayers are better off in the absence of disabled or old people, but because their activities are not parasitic, taxpayers are not really worse off, since they are only meeting their distributive justice responsibilities. The second distinction is between parasitic agents and parasitic activities. Because agents may participate in multiple activities, both parasitic and non-parasitic, the other parties may be better off in the presence of these agents but worse off compared to the absence of parasitic activities. Later in this chapter, I will present the case of traders, who engage in different types of activities, some of them necessary and beneficial, but others parasitic. In this case, parties affected by traders' actions may be overall better off in the presence of traders, but worse off compared to a scenario in which parasitic activities were identified and regulated. Also, there may be cases in which a non-exploitative scenario may require one party to actively engage in certain activity, rather than disappear, since the presence of the agent is a given consideration. In the case of UBI contributors are worse off compared to a scenario in which the free-rider was also a contributor, rather than compared to the scenario in which the free-rider was absent, say went abroad, since the presence of citizens is a given consideration in this case. In what follows I will suggest a possible counterfactual scenario.

Tommie Shelby offers an implicit counterfactual scenario for cases of parasitic exploitation, which consists in a democratic process. According to Shelby, if a process is democratically defined, this creates an obligation to contribute, and because of the legitimacy of the decision-making process, then the interaction is not exploitative. While this is a plausible benchmark, here I will offer an alternative counterfactual scenario that is not necessarily dependent on specific democratic decisions, but that instead requires that actions taken by participants can be justified to others.[16]

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[15] I thank Jonathan Wolff for this comment.

[16] Here, and in the next chapter, I slightly deviate from the idea of justification generally used throughout this thesis. In this thesis I use Aaron James' and Gabriel Wollner's idea of justification, according to which a system needs to be justified to those affected by it, especially to the worse off (James, 2012: chapter 8; Wollner, 2014). According to James, a system cannot be justified if there are alternative scenarios that leave the worse off better off. According to Wollner, there is justification when a system minimizes erosions of the ability to deliver social justice at home, sovereignty and well-being. Here I consider justification as acting accordingly to the aims of a system. This will depend on which type of system we are analysing, its purpose and what we consider as justified and unjustified forms of interactions within this system. For example, a system which aims to offer distributive justice will have different considerations from a system of market competition, hence, what is justified or not will be different in both cases.

The case of Universal Basic Income (UBI)

In order to offer a counterfactual scenario for parasitic exploitation, I will consider the case of UBI. This case is considered as an example only, and I will not offer a comprehensive view of the UBI issue here. I will argue that some cases in the debate of UBI are not exploitative, others are not exploitative in the relevant way of exploiting a person, others are not clearly exploitative, and others are only mildly exploitative in a parasitic way. Finally, I will argue that the absence of regulation is preferable to regulation, even if this allows for cases of parasitic exploitation to arise. However, the fact that exploitation as parasitism takes a weak form in the UBI case, does not mean that this type of exploitation as parasitism is always weak. Later in this chapter I will argue that stronger forms of this type of exploitation could happen in other cases, such as the case of the stock market, and an even stronger case in the case of the foreign exchange market, in the next chapter.

UBI and justification

When implementing a system such as UBI, the first questions we need to raise are what is UBI for, why should we implement UBI, and what should it achieve? While there are different answers to these questions, let us assume one justification and purpose for the sake of the argument: UBI is a system of distributive justice which aims to decrease inequality of relations among citizens. In other words, the aim of UBI is to increase the capacity of individuals to make free choices and avoid domination,[17] and transactional cases of exploitation. The idea is that no one should be so destitute as to be bought or enslaved by others.[18]

Given this definition, we can distinguish cases that will not be parasitically exploitative. Consider the following cases.[19] A low-paid worker in hard times, or conditions with few employment options and many employees, is vulnerable to her employers' abuse and power to arbitrarily dismiss her, and is offered a low wage that is not enough for her to function in society. In this case, having an unconditional UBI, allows this person to fall back on UBI and exit the situation, increasing her freedom as non-domination. A second case is the case of a wife who is financially dependent on her husband, who controls her by imposing certain limits on her, and she cannot leave because of this dependency.[20] In this case, UBI offers this woman a way out of the dominating situation, and also offers her more bargaining power in this situation.

In these cases, people who do not work and receive benefits do not exploit others, since they interact in ways that can be justified to others – to prevent exploitation and domination – and they use the system for the purpose it was created for, to prevent these types of scenarios. Thus, these are all legitimate interventions. Even if people who receive benefits never contribute back, they do not exploit under the assumption that what they are given is what they deserve in terms of justice, and society as a whole owes them that. In these

[17] See Pettit, 2007; also, Casassas and De Wilespeare, 2016; Widerquist, 2013.
[18] Rousseau, 1998 (1762): 52.
[19] I borrow these cases from Pettit, 2007: 5.
[20] Also, in this case the implementation of basic income leads to more justice in the household, since it would recognize women's labour at home that is currently not being paid, which men free-ride on, and would offer women's self-government and standing as citizens (Pateman, 2004).

cases, even if these people do not contribute back, we can say that this system is a reciprocal one, since if any of the contributors today falls under these situations in the future, she will also be able to avoid domination and exploitation by using UBI.

Counterfactual Scenario

More controversial cases happen when individuals misuse a system that is created for one purpose for a different purpose, in ways that cannot be justified to others. Consider the case of a young adult who does not have dependents, and is not under any threat of exploitation or domination, and because of UBI, she decides to quit her job and stay at home watching Netflix. Let us call this the case of the free-rider.[21] As opposed to the previous examples, of the wife and the workers who uses UBI as an exit option to avoid domination, in this case the person who decides to watch Netflix misuses the system in a way that is not consistent with the purpose and goal that the system aims to achieve. These actions, or interactions cannot be justified to others, since we cannot say that there is a reason of justice to allow people to quit their job because they would prefer to stay at home watching Netflix, as opposed to the previous cases, in which there is a reason of justice to avoid exploitation and domination.

Cases of free-riders are candidates for exploitation as a process because they have the ability to move prices. Unlike transactional cases of exploitation, which usually happen in a single transaction, the case of UBI happens as a process. In this case, there is no single transaction between contributors and recipients, instead there is a system to which working people contribute to, through taxes, this contribution goes to a common fund, which is then distributed to every citizen. The connection between contributors and recipients happens through prices, or taxes. Because UBI is a fixed price, a price that will enable citizens to live a life free from economic insecurity, a connection through changes in prices happens through taxes. The more people are in the paid workforce, the more contributors to the fund, the less amount of contribution each one has to pay through taxes in order to achieve the same fixed UBI. Therefore, the more people free-ride, the more taxes contributors have to pay. Because the free-rider profits from misusing this system, which leads to this increase in prices for others, she is a candidate for exploitation.

These are mainly candidates for exploitation, since they profit from vulnerability when benefiting from this increase in prices. Previously, I argued that the vulnerability of the potential exploited party in the case of UBI relies on the rules and regulations, or in the absence of these rules. Because UBI does not discriminate between the forms in which individuals make use of this system, some individuals may misuse the system and interact in ways that cannot be justified to others, which has the potential to increases prices of taxes to other. This situation allows the potential exploiter, the free-rider, to take advantage of this vulnerability of others, which relies on the rules. On the one hand, coercive rules demand that contributors pay taxes, and on the other hand an absence of regulation that distinguishes between different forms and reasons for interaction, allows the free-rider to benefit at the expense of others.

This idea of systemic vulnerability, has an implicit counterfactual scenario of non-proportionality: a scenario in which this systemic vulnerability was not present. In other

[21] I borrow this example from Bidadanure, 2019: 483.

words, if exploitation is taking additional advantage of vulnerability,[22] then this idea implicitly involves a counterfactual scenario in which this vulnerability was not present. Making an analogy with the case of nature, we can say that there are two counterfactual scenarios for the host. One is in the absence of the parasite, or to say that the host would have been better off if the parasite did not exist. The other one, is the case of immunity, in which the parasite exists but the host was immune to the parasite, or a case in which the coercive force of the parasite was absent. In the case of UBI, I take the second idea of counterfactual scenario for two reasons. First, because the presence of citizens is a given consideration, and second because in this case the counterfactual scenario may require these citizens to actively do something. In this case, contributors are worse off compared to a scenario in which the systemic vulnerability was not present. In other words, compared to a case in which rules and regulations identified unjustified forms of interaction and regulated them. In this case, because the vulnerability relies on unfair, or the absence of, rules then an alternative scenario is to compare a situation in which we had rules that prohibited unjustified forms of interactions. Or a system which discriminates between justified and unjustified forms of transactions or interactions and avoids the latter.

In this case the counterfactual scenario happens when all the interactions are justified according to the aim of the system. If we had a system of rules that allowed us to discriminate between justified and non-justified forms of interaction we would have an equilibrium at a level of taxes that first, offers everyone a UBI; second, allows for people who are under a threat of domination and transactional exploitation to live from this UBI without being forced to work; third, ruled out unjustified forms of interaction, such as free-riding. In other words, this is a system in which UBI fulfils its purpose without allowing free-riding forms of interaction. This equilibrium is likely to be a dynamic one, since the number of people at risk may vary over time. For example, someone who decides to leave her job because of exploitative conditions may at some point find a suitable job. Similarly, conditions may change for someone who at some point had a good job, and she may need to exit to avoid domination or exploitation. We can define this counterfactual scenario as follows,

Counterfactual Scenario: Prices in the scenario in which the systemic vulnerability was not present. In other words, prices in a scenario, in which the rules and regulations prohibited unjustified forms of interaction.

2.3- Exploitation as a process

In cases in which exploitation happens as a process, as opposed to in a single transaction, we need three conditions for exploitation to happen. First, the exploiter party makes additional profit from the vulnerability of the other party, or more profit compared to a non-exploitative scenario. Second, this additional profit could not have happened in the absence of the weak party. Third, the additional profit is made at the potential expense of the weak party. These conditions for exploitation allow us to differentiate cases of parasitic exploitation from other cases, such as externalities.

[22] Goodin, 1987: 198.

Three conditions for exploitation as a process.

The first condition for exploitation as a process is that the exploiter party makes additional profit or takes additional advantage from the vulnerability of the other party. In cases where this vulnerability relies on the rules, or on the absence of rules, the exploiter makes additional advantage compared to a situation in which this vulnerability from the rules did not exist. In other words, the exploiter party makes more profit compared to a scenario of a non-exploitative transaction, in which rules prohibit this agent to interact in the system in non-justifiable ways. In the case of UBI, the lazy person, who is not under any threat of exploitation, domination, nor has any justification to stop working, acts in an unjustifiable way, since she uses the system in a way that cannot be justified to others, and in a way that is not consistent with the aim of the UBI system. Ultimately, this person obtains additional profit compared to a situation in which the system discriminated justifiable from non-justifiable forms of intervention. In the absence of this condition, there could be a situation of exploitation but the agent who is exploiting is someone else.

The second condition is that the exploiter party could not have obtained this additional profit in the absence of the weak party. In cases in which exploitation happens as a process the exploiter and exploited parties are usually connected by a process that involves changes in prices, which leaves one party better off and has the potential of leaving the other party worse off compared to a non-exploitative scenario. However, the main connecting feature in cases of parasitic exploitation is that the additional benefit of the exploiter, could not have happened in the absence of the exploited party nor in the absence of her vulnerability. In the case of parasitism in nature, the parasite takes blood from the host, and hence, exploitation could not have happened in the absence of the host. Similarly, in the case of UBI, the lazy person benefits from the contributions of taxpayers, and she would not have been better off in the absence of these taxpayers. In the absence of this condition, we have cases of externalities. In these cases, one party may be better off and the other worse off through changes in prices, but this may not necessarily be a case of exploitation – e.g. it could be a result of competition in which participants can still operate in the absence of their competitors.

The third condition is that the additional profit made by the exploiter party comes at the potential expense of the weak party. The idea is that while the exploiter party is better off, compared to the scenario of a non-exploitative transaction, this increase in profit has the potential to come at the expense of the exploited party. In other words, this involves the possibility that the vulnerable party gets a worse deal than the one she would have had in the absence of vulnerability and exploitation. In the specific case of UBI, it involves the possibility that tax-payers may need to pay higher taxes than the ones they would have had to pay in the absence of free-riders. While the actual harm hay not necessarily happen, recklessness or negligence about whether harm is caused is enough to justify a charge of exploitation, since the exploiter party knows in advance that her additional profit can lead to harm.

2.4- Degrees of exploitation in the case of UBI

While actual harm is not a necessary condition for exploitation, whether there is actual harm or not may change the degree of exploitation. Consider the following case. A large

country, with very responsible citizens, decides to implement UBI. However, in this country there is one lazy person. In this case the interaction happens as a process, as opposed to a single transaction, hence, when one person obtains additional profit the increase of taxes needed to cover for this profit is distributed among all the contributors. Because in this case there is a large number of contributors and one single free-rider, the additional profit from which the free-rider profits gets diluted among all the contributors, who instead of paying a non-exploitative price of taxes X now have to pay a very small increase of 0,000001. Consider now the case of a lazy country, in which a considerably large number of individuals – say the majority – free-ride in non-justifiable ways. In this case, because there is a considerably large number of free-riders, they are able to modify the price of taxes in a relevant way for contributors. In these cases, the degree of exploitation will vary depending on the degree of non-proportionality of the price of taxes: the more taxes deviate from the equilibrium offered by the counterfactual scenario the more exploited contributors are. In other words, the degree of exploitation depends whether agents act in combination with others or not.

While there have been few experiences of UBI, there is no evidence to suggest that the implementation of UBI would lead to a sufficiently large number of unjustified free-riders, as to modify prices of taxes in a considerable that affects contributors in a strong way. In the cases of Alaska and Mexico the experiment of basic income did not have significant effects in long-term labour participation and supply.[23] In cases such as Namibia and Iran, the implementation of basic income led to an increase of employment overall, in the former case, and in the service sector, in the latter case, since it increased the possibility of entrepreneurships, small businesses and self-employment, or expansion of current businesses.[24]

We should be careful when considering cases of studies that do show a considerable reduction in labour after the implementation of UBI, since what we need to distinguish according to the counterfactual scenario are justified from non-justified forms of interaction, as opposed to a general reduction of labour force before and after the implementation of some form of UBI. For example, in the case of the United States and Canada, an overall analysis of the data suggests a decrease of labour force in these countries, but when disaggregated between groups, the data showed that these reductions came from two groups: the youth and women, especially single mothers.[25] These reductions were offset in the case of the youth by higher school attendance, and for women by an increase in household production, reduced domestic abuse and higher divorce rates, which suggests that UBI offered women relief from financial dependence on husbands.[26] In other words, these were justifiable reasons for interaction, since school attendance and education are necessary conditions for individuals to interact as free and equal citizens in a democratic, and reduced dependence on husbands is also a necessary condition to avoid domination. This study concluded that few, if any workers, dropped out from the labour force for unjustified reasons, or as "knee-jerk reactions" to the implementation of UBI.[27]

[23] For the case of Alaska and Mexico respectively, see Berman, 2018; and Skoufias and di Maro, 2006.
[24] For the case of Namibia and Iran respectively see Haarmann and Haarmann, 2019: 8; and Salehi-Isfahani and Dehzooei, 2017.
[25] Widerquist, 2005 and Widerquist 2018, chapter 6.
[26] Widerquist 2018, chapter 6. Also in DFID, 2011.
[27] Widerquist 2018: 49.

While the empirical evidence is inconclusive about the number of people who are likely to free-ride, we can at least say that it is not clear that people would free-ride in sufficiently large number as to bring significant changes in the tax levels paid by contributors. From this we can conclude that parasitic exploitation in the case of UBI is likely to be weak.

2.5- Background conditions and indirect consequences

I have already suggested that a situation will be more or less exploitative depending on the degree of non-proportionality. Another element that can make a situation more or less exploitative are background conditions, since an exploitative situation will affect people differently depending on these background conditions.[28] For example, a situation in which a poor person exploits a rich one will be less exploitative than the opposite scenario, since the poor is likely to be more affected by exploitation than the rich.[29]

In the case of UBI, even if we have a sufficiently large number of free-riders, there are reasons to think that most of these cases will be weak cases of exploitation in which poor exploits rich. The main reason is that the opportunity cost for not working is higher for rich than for poor. Because rich people earn higher wages, they lose more than poor people by opting out of the labour force. In this case, since low income workers are the ones who are more likely to benefit from UBI, this weak case of exploitation in which poor could exploit rich is preferable to stronger cases of transactional exploitation, which happen in the absence of UBI, in which those who have power are in a position to exploit low income workers.[30]

Earlier, I made a distinction between cases of exploitation and cases of externalities. I think that in cases of parasitic exploitation it is relevant to consider the effects of externalities on the exploited party, since how this party is affected overall by the parasitic action will also be relevant when considering the degree of exploitation. Remember that as opposed to transactional cases of exploitation, in which the exploited party is usually better off in the presence and interacting with the exploiter party, in cases of parasitic exploitation, exploitation happens by harming the exploited party, hence, the more harmed this party is the more exploitative the situation is. We may have cases of parasitic exploitation, in which the exploited party obtains a worse off deal compared to the counterfactual scenario, but because of positive externalities generated by the interaction, this party is better off *overall* compared to this scenario. If this happens, then the situation would be less exploitative than one in which the exploited party obtains a worse deal with no, or with negative, externalities.

In the case of UBI, there are several mechanisms through which the exploited party could be made better off overall compared to the baseline scenario. One possible mechanism is through wages. When people opt out of the workforce, a reduction in labour supply would lead to an increase in wages to those willing to work.[31] Other mechanisms include a reduction in crime and delinquent behaviours, reduction in drug problems, and an increase in social cohesion and self-determination that have resulted from experiments of UBI.[32] Similarly, experiments of UBI suggest a possible savings in hospital costs and public services, since UBI led to a reduction in hospitalization rates for accidents and mental health issues and also

[28] Arneson, 2016: 17-8
[29] Idem
[30] Widerquist, 1999: 399
[31] Widerquist, 1999: 395.
[32] See Haarmann and Haarmann, 2019; Costello et al, 2010.

has effects in reducing some types of psychiatric disorders.[33] All these mechanisms mitigate the degree of exploitation. In the case that these benefits exceed the additional costs for the exploited party, we could also question whether if these cases are exploitative at all.

2.6- UBI and regulation

I have previously defined the idea of non-proportionality of exploitation as one that compares the current scenario with a scenario in which regulation prohibits unjustified forms of interaction. One possible regulatory strategy in the case of UBI is to make it conditional, and offer it only to those who have legitimate reasons for receiving it, hence, detecting and deterring free-riders. However, in the case of UBI I think there is a stronger case against this regulation, even if the absence of this regulation would open the opportunity for free-riders to engage in parasitic exploitation, for three main reasons.

First, because regulating UBI would undermine the capacity of the system to achieve its main purpose. UBI can achieve its purpose, precisely because it is unconditional and because it is an option that is always there. For example, if I am dominated or exploited at my current job, it will take me a long time to find another job and because I depend on this income I cannot leave my current job. If UBI discriminated between different forms of interactions, we would need an application process for this income. Because it would take a long time to obtain the income, then it would not fulfil its purpose, since in this case I could not just exit my job. Instead, I would need to apply for UBI which takes time and effort. This would mean the people concerned would live under conditions of domination and exploitation for as long as the application process takes.

Second, since there are feasibility difficulties in discriminating between legitimate and non-legitimate reasons for interacting, regulation could lead to stronger cases of exploitation or to overall more injustice than a UBI without regulation. It is not clear how we could distinguish between someone who quits her job because she wants to free-ride, as opposed to someone who quits her job for justified reasons, or someone who would have been out of the workforce even in the absence of UBI. This feasibility problem could lead to situations in which someone who is entitled to UBI is not offered this income, which would lead to stronger cases of exploitation and would raise additional problems of justice.

Because cases of parasitic exploitation in the case of UBI are likely to take a weak form, they can be overweighed by other considerations. UBI prevents stronger types of transactional exploitation and oppressive behaviour, in which people are drawn to these situations due to their desperate situation. Because UBI allows people to have an exit option, they are less vulnerable to exploitation and abuse by more powerful employers. As argued by Stuart White, the idea that UBI helps to prevent greater injustices than the ones it creates is a powerful objection to the exploitation argument.[34] Similarly, White observes that UBI can lead to increased overall reciprocity.[35] Even if those who free-ride violate reciprocity, since they fail to contribute to society with their fair share of work, the implementation of UBI would lead to an overall more reciprocal society, since it would offer work incentives

[33] See Forget, 2011; and Costello et al 2003.
[34] White, 2006.
[35] Idem

to low-paid, would recognize nonmarket work, would lead to increased domestic reciprocity and would increase employment opportunities for more meaningful jobs.

Third, a conditional basic income could lead to other problems such as an erosion of social cohesion and could create an undemocratic and disrespectful rhetoric against the least advantaged. Having an unconditional UBI would avoid problems such as the "demonization of the poor", or the idea that those who live from social welfare are undeserving and live at the expense of others, which ultimately undermines equal standing of the vulnerable and social cohesion.[36] Having an unconditional basic income would allow us to move away from these ideas, and would protect self-respect, since it is not only the disadvantaged who would receive this income, but all citizens.

2.7- Bottom line for the case of UBI

Cases of implementation of UBI are still rare for us to offer a definitive answer to the question of whether UBI would generate parasitic exploitation or not. I have offered cases of interaction in this system that would not be exploitative, since the reasons for interaction are justified; cases that are not exploitative in the relevant sense of exploiting a person, such as cases in which the exploited party is not affected in a noticeable or relevant way; cases in which we can question the claim of exploitation, since the exploited party obtains a worse deal compared to the counterfactual scenario but is overall better off when considering her overall situation. I also suggested that morally wrong cases of exploiting a person would likely take a weak form of poor exploiting rich in this case. Finally, I argued that having an unconditional UBI, or absence of regulation, is better than implementing regulation in this case, even if this would allow the possibility of parasitic cases of exploitation to arise. The idea that parasitic exploitation takes a weak form in the case of UBI, does not mean that parasitic cases of exploitation are always weak. In what follows I will suggest that the case of speculation in the stock market is a stronger case of parasitic exploitation than the case of the free-rider and UBI.

Section 3) Parasitic exploitation and the case of the Stock market

In this section, and in the next one, I will inquire into the nature of the moral wrong caused by speculation. In this section, I explore the possibility that speculation in the stock market is a case of parasitic exploitation. I will argue that speculation in this market can be considered a case of parasitic exploitation, since it satisfies the three conditions of the previous framework: build in mechanisms, vulnerability and non-proportionality. I suggest that a possible proxy for the counterfactual scenario for non-proportionality is the Fundamental Value of shares, as opposed to the market price. The case of speculation in the stock market also satisfies the three elements necessary for exploitation as a process: the exploiter party obtains additional profit; this profit could not have happened in the absence of the weak party; and the profit comes at the potential expense of the weak party. Based on how speculation in this case satisfies the previous conditions, background conditions and

[36] Bidadanure, 2019: 491. Also, McKinnon 2003; Pateman, 2004, Birnbaum, 2012.

indirect consequences, I conclude that if speculation in the stock market is a case of parasitic exploitation, it is likely a stronger case of exploitation than the case of UBI.

3.1- Speculative markets

Before applying the framework presented in the last section to the case of the stock market, I will say more about speculative markets and about speculation. Speculative markets are markets in which the price of the assets does not only depend on forces of supply and demand for these products, but mainly due to speculation.[37] These markets include the stock market and the prices of shares, the Foreign Exchange and the prices of currencies, and some commodity markets such as gold, oil, and more recently water, among others.

3.2- The Stock Market and its importance: Allocation of capital

Before arguing that in some cases stock market transactions are exploitative, I will explain briefly how the stock market operates, and its importance.[38] When a firm opens to the stock market, instead of having one or few owners, the firm issues shares, which represent the ownership of part of the firm, and those who buy these shares have a claim over this part of the firm. The stock market is important because it allows the allocation of capital between investors and firms. On the one hand, the stock market is beneficial for investors who may invest their capital in companies they believe in. By buying these shares, the owners receive dividends, or payments over time that a firm distributes to its shareholders from its profit. Another way in which shareholders may make profit is by buying relatively cheap shares and selling them when these shares increase in value. On the other hand, the stock market is beneficial for firms who may issue shares to raise capital, called shareholders' equity, as an alternative other than issuing more debt.

3.3- Framework of parasitic exploitation

In this sub-section I will argue that the case of speculation in the stock market satisfies the three conditions of the framework of parasitic exploitation: build in mechanisms, vulnerability and non-proportionality.

3.3.1- Build in mechanisms

In the case of the stock market, build in mechanisms allow traders to obtain additional profit for two reasons. The first reason is that the system is structured in such a way that the rules offer traders the possibility to determine prices as a collective. In order to make this point I will briefly explain how this market operates. When a firm wants to become public

[37] Vernimenn, 2018: 260. More specifically, speculative markets are markets in which "participants are speculators. Market forces, divorced from economic reality, become self-sustaining because everyone is under the influence of the same phenomenon. Once a sufficient number of speculators think that a stock will rise, their purchases alone are enough to make the stock price rise" (idem).
[38] See Brigham and Houston, 2015: chapter 2; Vernimmen, 2018: chapter 1.

and raise capital by selling shares they raise an Initial Public Offering (IPO), in which it sells these shares in a primary market raising an initial amount of capital.[39] Then these shares are traded between traders in the secondary market.[40] In this secondary market traders trade with one another and, as a collective, determine the value of shares, or quote them.[41] This value is relevant because further share sales made by the firm in the primary market will be quoted at this value.[42] On the other hand, firms that issue shares, or consumers of the firms' products and services, do not participate in the secondary market that quotes the value of its shares, this value is completely independent from the firm and consumers.[43]

This coercive mechanism is different from the classical concept of market power. Market power necessarily entails one party being stronger than the other one in terms of volume or capacity. For example, a monopoly is strong because it is the only firm in a position to provide a certain good, which leaves the monopoly in a strong position in comparison to consumers who depend on these goods and are vulnerable due to their dependency to the monopoly. Similarly, big retailers have the capacity to set prices because of their large size, which offers them the ability to engage in activities such as dumping, or selling goods at very low prices to leave smaller competitors out of business. As opposed to these cases, traders are not necessarily stronger or more powerful than firms, instead their power comes from the rules. Because the system, and its rules, establish that prices should be determined by the result of traders' interaction, build in mechanisms give traders as a collective the possibility of being price setters. Like in the cases of nature and UBI, the parasite and the free-rider are not necessarily stronger than the other party, instead it is the rules – or other coercive forces - that offer them the power over the other party.

The second reason build in mechanism that offers traders advantage over firms is also systemic, there are no rules that identify between different types of transactions, and prohibit specific types of transactions that cannot be justified to the other parties. Later, I will argue that speculative transactions cannot be justified. In this case, the absence of rules that regulate different forms of transactions, allows traders to engage in, and obtain profit from certain activities, such as speculation, that ultimately harms others by reducing the value of their assets. In this case, because of the lack of coercive rules, that rule out these activities, people affected by speculation cannot avoid this type of activity and the harm that results from it.

3.3.2- Structural vulnerability

Structural vulnerability is the other side of the build in mechanisms. The way in which the system is structured, and its rules, on the one hand, offer traders as a collective the capacity to determine prices, and, on the other hand, leave firms vulnerable to accept these prices. The problem in this case arises when traders engage in specific types of interactions, such as speculation, which moves prices away from a counterfactual scenario. Like in the case of UBI, in which contributors could not avoid paying higher taxes due to a group of people engaging in free-riding activities, in the case of the Stock market, firms cannot avoid

[39] Brigham and Houston, 2015: 29, 42.
[40] Vernimmen, 2018: 7.
[41] Vernimmen, 2018: 8.
[42] Idem. In other words, the secondary market, which is constituted by traders' transactions only, determines the price at which firms can sell shares in the primary market.
[43] Brigham and Houston, 2015: 29; Vernimmen, 2018: 8.

receiving a non-proportional price for their shares as a result of speculation. In this case, firms are not only vulnerable because rules allow traders as a collective to determine prices, but they are also vulnerable because of the absence of rules that prohibit these types of interaction.

This vulnerability is a necessary condition. Consider for example the case of a trader who loses. In this case, because the trader choses to participate in the activity and belongs to the group that determines prices, she is not vulnerable to changes on prices, as opposed to workers of a firm who cannot avoid changes on prices that happen due to speculation. Like in the case of a free-rider who does not exploit another free-rider, the case of a trader who loses is not a case of exploitation, since she is not vulnerable to the rules. In the literature, speculation in markets is often compared to gambling in a casino.[44] However, the main difference between the case of the casino and cases of speculative markets is that while in the former case the effects of speculation are contained within those who decide to take part in the risk-taking activity of gambling and are not vulnerable, in the latter case these activities also affect other people. In other words, speculation affect prices, impacting other people. The benefits of speculation come at the expense not only of those traders who make a loss, but also from other people, and it is these latter people who are potentially exploited.

While vulnerability to the rules is a necessary condition for this case of parasitic exploitation, there is another type of pre-existing vulnerability that may make a situation more or less exploitative. Traders analyse many aspects of firms and their environment to determine how these aspects will affect a firm's strength or vulnerability and speculate depending on these views.[45] When traders speculate on a firm's strength they overvalue the price of their shares, which may be harmful for the firm since having overvalued shares, or a bubble on this price, leaves the firm vulnerable to the burst of this bubble and to a sudden decrease in the shares value. The opposite scenario happens when traders speculate on a firm's pre-existing vulnerability, when traders identify a weakness in a firm and offer the value of shares a non-proportionally low value. Even if both cases, of speculating on the strength and on the vulnerability of a firm can be considered exploitative, speculating on vulnerability is more exploitative than speculating on strength because it leads to more harm. Because firms are already vulnerable, a sudden decrease of the value of their shares to a non-proportional value reduces the capital of the firm and its ability to pay workers, among other consequences, and may ultimately lead to bankruptcy and harm workers who are made redundant.

3.3.3- Non-proportionality

Earlier I presented the idea of non-proportionality as deviations from a counterfactual scenario. This counterfactual scenario can be a hypothetical one, we need to know that the parasitic activities are harmful to the vulnerable party but we do not necessarily need to know exactly how the vulnerable party would have been in the absence of the parasitic activities. In cases of parasitic exploitation, we only need a causal connection between the two parties, we need to show that the parasitic activities are harmful and we need a hypothetical

[44] For an analogy between gambling and speculation in the market, see Hendry, 2013; Angel and McCabe, 2009; Sinn, 2010; Borna and Lowry, 1987; Strange: 1986;

[45] Brigham and Houston, 2015: 9. Some of these aspects are managerial actions, the economic environment, taxes, the political climate, analysts' recommendations, rumours, among others.

counterfactual scenario. In what follows I will show a connection, I will argue that speculation is harmful, and I will explore the possibility of a possible proxy for the counterfactual scenario, the Fundamental Value (FV) of shares.

The Stock Market, Justification and non-proportionality

The stock market can be justified to citizens because it allows the efficient allocation of capital between investors and firms. On the one hand, the stock market allows investors to invest their capital on firms, receiving dividends as a reward for their investment, and on the other hand, the stock market is beneficial for firms who issue shares to raise capital. This allocation of capital is beneficial to society, since everyone benefits from the possibility of firms to grow and expand and be able to offer more goods and services to consumers. Like in the case of UBI, our counterfactual scenario will involve prices that result from this aim of the system and justification.

The price of shares that results from this justification is the Fundamental Value (FV or intrinsic value) of shares, since it reflects the interaction between investment and the benefits that this investment brings to society and consumers. The FV is a "value which is justified by the facts", such as assets, earnings, or dividends and balance sheets.[46] There are two ways in which the FV value of shares is determined. The first way is the corporate valuation model (see Annexe 4), which calculates the fundamental value of shares as the present value of the firms' cash flows.[47] In other words, it considers balance sheets, sales, earnings – among others- in order to determine the value of the firm and its shares. This value of shares reflects how a firm is doing in an economy, the interaction between the firms and consumers, and the demand of the latter for the firm's products. In other words, the valuation of firms and its shares made considering the cash flows reflects the contribution of the firms to consumers and to society.

The second way in which the FV of shares is determined is through the discounted dividend model (see Annexe 5), which is connected to the previous idea of cash flows. This model calculates the FV of shares as the sum of the present value of dividends of these shares. From the perspective of traders, or investors, they receive dividends from holding these shares. These dividends are paid several times, and correspond to the payment that shareholders receive at the end of each period, after knowing earnings and balance sheets.[48] The idea is that after each period, the firm has earnings and makes profit, which generates a "surplus value", that is then distributed between shareholders in the form of dividends. Because these dividends depend on cashflows and earnings, they are connected to the interaction between firms and consumers, and will reflect the contribution of the investments. When investors invest in firms that are useful to consumers, they contribute to activities that generate social benefits, and receive a reward for this contribution in the form of dividends. Because these dividends depend on cash flows and earnings, they will reflect how the firm is doing related to consumers and their interaction.

There is a second reason, apart from justification, for why there should be a presumption for this FV as a counterfactual scenario for parasitic exploitation. This reason is that the FV, that results from the interaction between firms and consumers, works as an anti-

[46] Graham et al, 1962.
[47] Brigham and Houston, 2015: 319-22.
[48] Vernimmen 2018: 385-6.

power.[49] The cash flows, and the dividends that investors receive, that result from the interaction between firms and consumers is a price that no one has the power to decide. Instead, this price derives as a result of the organic interaction between these agents. Also, anyone can participate in this interaction, since there are no considerable barriers to being consumers. Because this FV results from this interaction, no single or group of individuals is price chooser. In other words, prices are determined in a bottom up way, in which no one determines this price, instead of a top down setting of prices by a group which has advantage due to build in mechanisms. The latter situation would leave the firm vulnerable to accept the price set by the group with advantage or to be price taker.

While there is a presumption towards the FV because of the two reasons presented above, we may think of situations in which deviations from this price can be justified to citizens. For example, making an analogy to the case of the foreign exchange market, the government may have reasons for intervening in this market, deviating the price of the exchange rate from its FV in order to achieve social justice at home. Similarly, making an analogy with the case of the commodity market, we may think that a country which is strongly dependent on a specific commodity - e.g. coffee – may be justified on intervening in this market in order to maintain employment and the overall macroeconomic conditions of the country. In other words, while there is a presumption towards the FV deviations from this value can still satisfy the counterfactual scenario as long as they can be justified to citizens.

Different from, but incorporates elements of, Karl Marx's concept of parasitism

From this definition of the counterfactual scenario for the case of the Stock market, we can conclude that the idea of parasitism presented here is different from, but shares elements with, Karl Marx's concept of parasitism.

Marx offers two main accounts of exploitation, one is the idea of surplus value, and the other is the idea of parasitic exploitation. He argues that under a capitalist system, workers are forced to work, since they lack ownership over the means of production, hence, they either sell their labour to capitalists or they starve. The workers' labour adds additional value to products, but these workers are paid by the capitalist less than the value they create, and the capitalist appropriates the surplus of the workers' labour. According to Marx, this capitalist system is exploitative for two main reasons. First, because of the idea of surplus value. Because workers are dependent on capitalists - given their lack of ownership of means of production – they are forced by their situation to work for the capitalists for a lower value than the full value that they produce, and the surplus value is appropriated by the capitalist. Second, because capitalists have a parasitic relationship vis-à-vis workers. Capitalists do not need to work, since they own the means of production, and live from the profits – or surplus value - generated by the worker's labour, which ultimately strengthens the power of capitalists.[50] In other words, Marx considers that the capitalist engages in parasitic exploitation of workers, since she lives from the labour of these workers. Because the capitalist lives from the surplus value generated by the labour of workers, instead of her own work, she exploits workers. If we make an analogy between the case of the capitalist presented by Marx and the case of the Stock Market, Marx would consider that traders, or

[49] For the idea of competition as an anti-power see Pettit, 2006; Dagger, 2006; Taylor, 2017.
[50] Marx, 1867. Also, in Marx, 1847: 40.

investors, always exploit firms, since they live from the dividends of their investments, which ultimately come from the labour of workers in the firm and from their productive interaction with consumers.

The concept of parasitic exploitation presented here is different from Marx's, since it does not consider parasitic exploitation as *living from the labour of others*, but instead considers parasitic activities as profiting from activities or forms of interactions that cannot be justified to others. In the case of the stock market, even if investors live from the dividends that they receive from their investments, because this interaction brings social benefits to society and allows for productive contribution to happen – firms are able to engage in projects as a result of this capital – these interactions are not candidates for parasitic exploitation. However, the concept of parasitic exploitation presented here shares Marx's and van Donselaar's idea that engaging in parasitism involves a form of free-riding. Instead of free-riding on others' labour, here I consider free-riding as interacting in non-justifiable ways, or misusing a system, to obtain benefits at the expense of others.

Market price: Investment and Speculation

The market price of shares is determined by traders as a collective and is a result from their interaction. Traders in the stock market alternate between buyers and sellers, and the more traders want to buy shares from a firm the higher the market value of that share will be. Traders in the stock market have two main motivations for their transactions.[51] The first motivation is investment, traders want to benefit from the dividends that a firm will offer them for their shares.

The second motivation is speculation. Speculation can be defined as "the purchase (or sale) of goods with a view to re-sale (re-purchase) at a later date, where the motive behind such action is the expectation of change in the relevant prices relative to the ruling price and not a gain accruing through their use, or any kind of transformation effected in them or their transformation between different markets".[52] However, traders do not know what the market price of assets will be in the future, since this price depends on the combined actions of all traders. Because of this uncertainty speculation also involves risks, since a trader may intend to profit from this change in prices, but because she does not know these future prices in advance, these changes may happen in a different way from the way she expected, she would make a loss.[53] Hereafter, I will use the term speculation as a non-moralized concept, assuming that there is nothing *a priori* wrong with speculation – e.g. I assume there is nothing wrong with speculating in a casino.

These two motivations often happen as a continuum. Traders analyse many aspects, such as managerial actions, the economic environment, taxes, and the political climate, to try to determine the market price of shares.[54] In some cases traders will be motivated by speculation only, they will buy shares of a firm that will likely increase, given this information, motivated by the possibility of selling them later when the price increases. In other cases, the motivation can be a combination of investment and speculation. A trader may

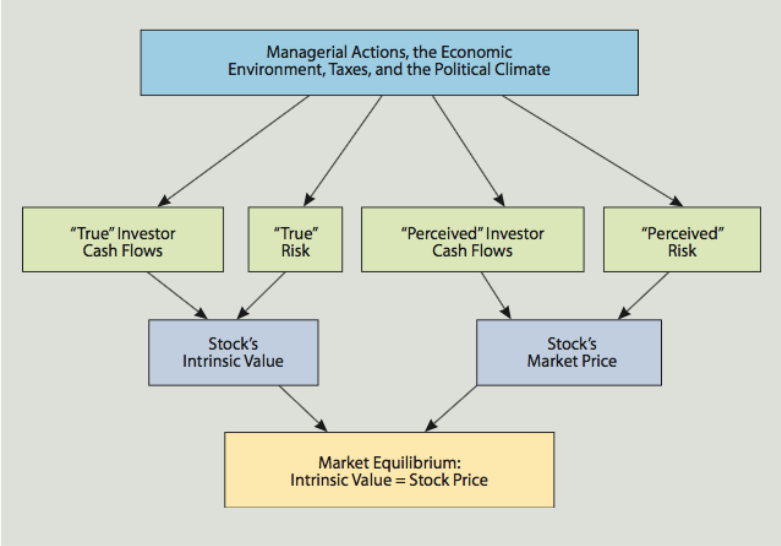
[51] In next chapter we will see that in the case of the foreign exchange market there are more reasons for transactions: need, arbitrage, hedging and speculation.
[52] Kaldor, 1939.
[53] Steiner, 2002: 317.
[54] Brigham and Houston, 2015: 306.

buy shares in a firm, given this information, because she thinks that because the firm will likely do well, she will receive higher dividends in the future.[55]

Market price and Fundamental Value

As opposed to the FV or intrinsic value of shares, which depends on facts about the interaction between firms and consumers, the market price depends on traders' perceptions of a how a firm is doing. There is a consensus in the literature that the value set by traders as a collective, the market value of shares, is determined in a different way from the FV or intrinsic value. All contemporary books in corporate finance present this idea, when these two values are the same the market is said to be in equilibrium.[56] This idea is presented in the Figure below.

Figure 1: Intrinsic (or Fundamental) Value differs from the Market Price



Source: Brigham and Houston, 2015: 306

Debate over deviations

While there is a consensus that these values have a different origin, there is still debate over the causes and effects of these differences. There are two different set of causes and effects of deviations that derive from two different schools of thought. The first set of causes and effects derives from the Chicago school of neoclassical economics, more specifically from the *efficient market hypothesis* (EMH) and the theory of random walks. Defenders of this theory argue that in perfectly efficient markets, where all participants are rational, there are no transaction costs, information is available to everyone, and there is a sufficiently large

[55] Vermimenn, 2018: 259-60.
[56] Brigham and Houston, 2015: 305-6. Berk and DeMarzo, 2020, chapter 9; Vernimmen 2018: chapter 16; Shiller, 2001: 188.

number of participants, the market is always in equilibrium.[57] In other words, in these markets the market price will always be a good estimate of the FV or intrinsic value of assets.[58] In an uncertain world the market price may differ from, but will tend to move towards to, the FV or intrinsic value.[59] According to this school of thought, the market price that results from traders' perceptions is beneficial, since traders or investors immediately incorporate all information available into prices, making markets more efficient and the market price differs from the FV only when new information is available.[60]

The second set of causes and effects of these deviations derives from a Keynesian school of thought. There are two main causes for deviation according to this school of thought. The first cause is that traders are not fully rational, instead they are motivated by *animal spirits*: the bull, or situations in which market participants are optimistic and think that prices will continue to raise, and the bear, or situations in which market participants are pessimistic, which lead them to a decrease in prices. The alternation of these moods of the market, leads to a succession of boom and bust cycles. The second cause for this deviation, is that traders do not aim to determine the FV or intrinsic value of assets, instead they aim to predict the future market price.[61] According to Keynes, traders do not have incentives to determine the FV, since their profit does not come from determining this value but rather from determining the future market price.[62]

This second school of thought has led to the creation of the established field of behavioural finance. The main idea defended by this field is that traders are irrational and face a series of cognitive bias when trading with each other, which leads to bubbles. These "bubbles happen when the price of an asset rises above its fundamental value, and the gap between price and fundamental value grows over a long-period of time".[63] There is a wide variety of studies that show this idea, among which I can highlight two Nobel prizes: that of Vernon Smith in 2002,[64] and more importantly that of Robert Shiller in 2013.[65] One of these biases is the phenomenon of herding.[66] This phenomenon arises since most market participants imitate each other's behaviour. In this context, even the rumour or the idea that an asset will be worth less in the future leads to a self-fulfilling prophecy: because most market participants think that an asset will be worth more in the future, they all start buying the asset, ultimately increasing its value. Also, because market participants have access to

[57] Vernimenn, 2018: 256.
[58] Fama, 1995: 76.
[59] Idem
[60] Fama, 1995: 80.
[61] Keynes, 1936: 156. More recently, Bogle, 2012.
[62] Keynes, 1936: 156
[63] Burton and Shah, 2013: chapter 21.
[64] Smith shows that - as opposed to production and consumption markets, in which market participants tend to reach theoretical equilibriums - in asset, capital and the stock market, market participants do not converge to equilibrium values.
[65] For Smith's and Shiller's studies see Smith et al, 1988, Porter and Smith, 1995; Shiller, 1981. For a selection of other empirical studies that present this idea see De Bondt and Thaler, 1985; Egan et al 2014; Fellner-Rohling and Kruger, 2014; Frydman and Rangel, 2014; Hirshleifer, 2001; Hoffmann and Shefrin, 2014; Lugovsky at al 2014; Hwang and Salomon, 2004; Shefrin and Statman, 1985; Bange and Miller, 2004; Dufwenberg at al, 2005; King et al, 1993; Ackert et al, 2001; Haruvy and Noussair, 2006; Anderson et al, 2007; Pontiff, 1997. There is also a third Nobel-prize winner whose work relates to this idea, that of Daniel Kahneman (2002). Kahneman and Traversky propose a prospect theory, and show that humans are more affected by loss than by gains, and they reflect this bias in their trading see Kahneman and Traversky, 1979. While studies in prospect theory support the idea of cognitive bias, they do not compare prices with fundamental values.
[66] Most books of Behavioural Finance present this idea, see for example Burton and Shah, 2012: chapter 7; Pompain, 2012: chapter 9; Baker and Nofsinger, 2010: chapter 6 and 35; Forbes, 2009: chapter 11. See also Stiglitz et al, 2006: 175-6, Ocampo et al, 2008: 5-8, Ocampo 2017: 120-5.

the same sources of information, this information is included in prices multiple times, which also reinforces each other's interpretations, which is known as herd behaviour. In bull markets, market participants are optimistic and everyone is buying, copying each other's behaviour, leading to an exaggerated increase in prices or to *irrational exuberance*.[67] In this case, the market sets an unrealistically high price for the asset. This excessive optimism of market participants leads to a bubble, that eventually bursts. This is followed by an opposite phenomenon of pessimism, that creates a bear market, where panic is spread among market participants. During this phase everyone sells their assets, which leads the market to set an exaggeratedly low price.

While there is a consensus among these two schools of thought, the Chicago and the Keynesian schools, that the market value, results from the interaction of traders, while the FV or intrinsic value can be estimates using the two models above, there is still empirical disagreement about whether these values converge or diverge. In 2013, there were three Nobel prizes winners of which two, Eugene Fama and Robert Shiller, have opposing views. On the one hand, Fama, one of the creators of the EMH, offered evidence to support the idea that traders bring information into prices, and lead to more efficient markets. On the other hand, Shiller offered evidence that supports the opposite conclusion, irrational behaviour among traders leads to a series of boom and bust cycles, which are related to financial crises.

Can speculation in this market be justified?

Given this ongoing debate in the empirical literature about the causes and effects of traders' actions in determining the market price, we can acknowledge both schools of thought and consider that while in some cases traders incorporate information into prices, there are other cases in which traders' actions lead to bubbles, and to boom and bust cycles. Hereafter, I will work with this idea as an assumption. I think that even if we acknowledge both schools of thought there are still three main reasons to reject the justifiability of speculation in this market.

First, the social benefits of traders' speculation are limited, since the incorporation of information into prices would have happened anyway. Markets that share a similar pricing system, in which a group of traders are constantly looking for information to incorporate into prices, include the Stock market, the Foreign exchange market, and some commodity markets, such as the prices of oil, gold, water, among others. There is nothing substantially different between these markets and other markets, that have a traditional pricing mechanism that happens as a result of supply and demand of producers and consumers, that justifies the ex-ante price setting by traders, as a result of their perceptions. Therefore, it is not clear why prices in these speculative markets should not follow a similar price determination mechanism of other markets, which happens ex-post, as a result of forces of supply and demand of producers and consumers, who ultimately incorporate the relevant information into prices. In the case of the stock market, Fama and supporters of the efficient market hypothesis, would argue that traders allow to incorporate information into prices sooner. For example, if an event suggests that the earnings of a firm will decrease in the future, traders will incorporate this information into prices immediately. However, if this event actually decreases earnings of the firm, this will affect cash flows and dividends, hence, will

[67] Shiller, 2001

ultimately affect the FV. In other words, this information is incorporated into prices at some point anyway.

Second, apart from the isolated contribution of sometimes incorporating information into prices, speculation is not an activity that contributes to society or to the real economy. Speculation is different from investment, which allows allocation of capital and allows firms to have the capital to engage in projects which ultimately benefits consumers and society as a whole. Instead speculation, involves free-riding on the possibility to profit from a change in prices without a productive or (relevant) social contribution.[68] This is problematic because, like in the case of UBI, when this free-riding activity is done by a collective of individuals they have the possibility to move prices.

Third, even if traders sometimes allow the incorporation of information into prices, there are other times in which they exaggerate this information, leading to bubbles that create the possibility of considerable harm. I will say more about this harm later but there are two main types of harm that result from speculation: first, the harm made to the firm – and its workers - by changing the price of its shares; and second, a harm that happens as an externality to society, such as financial crises triggered by these bubbles. Here we can also make a distinction with the case of the casino. While there is nothing wrong in speculating when the results of this speculation only affect the person who bears the costs of losing, speculation in markets is problematic because it opens the possibility to modify prices in ways that are harmful to other people. Even if we acknowledge that speculation can have some benefits, because the harms considerably outweigh the benefits, this activity cannot be justified.

Market price:

From the above I conclude that the current market price of shares, as it exists today, cannot meet the conditions of a non-exploitative price for three main reasons. First, the market price includes types of transactions, or interactions that cannot be justified to individuals, and specifically to workers in a firm. Because the market price, includes speculative transactions, this is a candidate for an exploitative price. Making an analogy with the case of UBI, the market price is like the increased price of taxes that contributors have to pay when many people free-ride this system. However, as opposed to the case of UBI, in which we could have cases of one or few individuals acting in isolation, in the case of the stock market, traders always act in combination and prices are necessarily determined by their combined actions. Because in this case traders always act in combination and prices are determined by their interaction, the potential to move prices is much stronger in the case of the Stock market than in the case of UBI. This point is relevant because given the current rules, according to which prices are determined by traders, and given that there is no regulation against speculation, firms are vulnerable to have their shares quoted at the market price that includes these speculative transactions.

Second, the market price is determined by a selected group of people who obtain advantage from build in mechanisms, as opposed to the whole population of consumers and their interaction with firms. Fama argues that the stock market is competitive, since there is a sufficiently large number of participants. However, these participants or traders, are a very

[68] Also see in Ryan, 1902.

specific group of people, different from the whole population of consumers. Also, while there is a large number of participants in the stock market, there are considerable barriers to be one of these participants and to enter this group.[69] As opposed to this selected group of traders, anyone with an interest in the products of a firm can participate in the exchange of goods and services, which leads to the FV. Due to this difference, we still have a presumption towards the fundamental value, since it involves more actors. This difference is relevant because, while the market value set by traders considers the views and perceptions of these traders only, the fundamental value considers also the views and preferences of consumers, which are reflected in earnings and balance sheets.

Third, the market price may open the possibility to misuse the system. Shiller observed that while Fundamental Values of shares tend to follow a smooth trend, and do not vary considerably, the market price "jumps around erratically over time".[70] Shiller's and behavioural finance's reason for explaining this, is that because the market price incorporates speculative transactions, it suffers boom and bust cycles, and deviates prices from the FV. This increased volatility in prices opens the opportunity for traders to benefit from changes in prices, or speculation. In other words, the market price offers incentives for a system that is created for investment to be used to profit from changes in prices, due to an increased volatility, instead of profit that results as reward from contribution in the form of dividends. As opposed to the market price, the real social benefits of investors are captured in the FV. I will say more about this profit from volatility and changes in prices in what follows.

3.3.4- Speculation in the stock market satisfies the framework criteria

From this subsection I conclude that because speculation in the stock market satisfies the three conditions of the framework of parasitic exploitation, this case is a candidate for exploitation. In the next subsection I will argue that these cases also satisfy the three elements needed for cases in which exploitation happens as a process.

3.4- Three conditions for exploitation as a process: the case of the Stock market

Earlier I suggested that in cases in which exploitation happens as a process, or in cases in which the exploiter party does not transact directly with the exploited party, we need three elements for exploitation. First, the exploiter party makes additional profit from the vulnerability of the other party, or more profit compared to a non-exploitative scenario. Second, the profit made by the exploiter could not have happened in the absence of the weak party. Finally, this profit comes at the potential expense of the weak party. I will now show that these three elements are present in the case of the Stock Market.

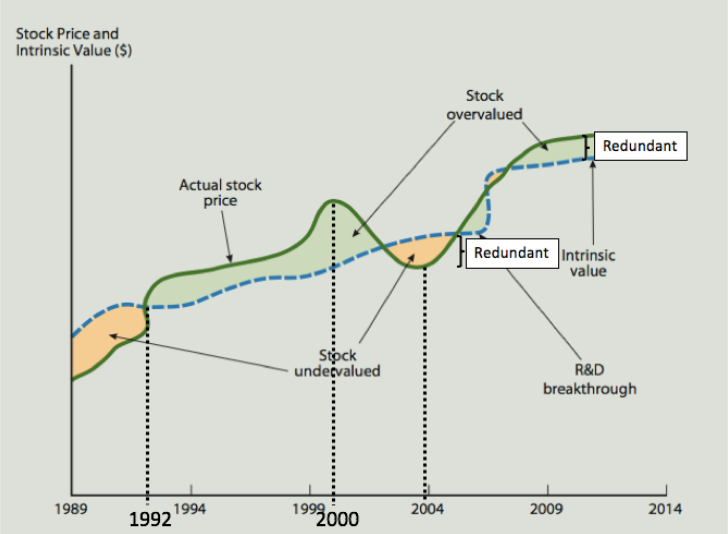
3.4.1- An exploiter party who makes additional profit from vulnerability

As we saw in the definition of speculation, traders make a profit by buying an asset when it is cheap and selling it when it is expensive. In other words, they profit from changes

[69] The New York Stock Exchange traders have membership, and there are 1366 seats, which cost around $40.000 monthly (Teall, 2013: 29). There are also traders who operate Over the Counter (OTC), but there are still many differentiated trading platforms and trading systems for different traders (Teall, 2013: 36-39). Information is mainly is obtained mainly from Bloomberg terminals, which in 2009 the cost $1.800 monthly (Teall, 2013: 19).
[70] Shiller, 2001: 188.

in the market price, which is the value that results from the interaction of traders as a collective, shown in green in Figure 2. In the example of a firm offered by Brigham and Houston, shown in the figure below, traders would make a profit if, for example, they buy shares from this firm when they are cheap – e.g. before 1992 – and then sell them when they are expensive – e.g. in 2000 – profiting from the change in prices. We can also illustrate Keynes' idea in this example. Consider a trader who bought cheap shares before 1992, and in 1991 – when the market price of shares is slightly above the FV or intrinsic value - she had to decide whether to keep these shares or sell them. In this scenario, traders do not have an incentive to sell these shares – and approximate to the fundamental value in the blue line – but rather they have incentives to keep them, since the market price is still increasing, and sell them in the year 2000 making even more profit. On the other hand, traders can also make a loss. If a trader bought expensive shares in the year 2000 and sold then in 2004 when they were cheap, they made a loss.

Figure 2: Graph of Actual prices versus intrinsic values modified



Source: Modified, originally in Brigham and Houston, 2015: 11

In this case, the profit obtained by traders through speculation takes additional advantage of the structural vulnerability of the other party. In the counterfactual scenario in which there were rules that prohibited speculation, traders could not make the same profit from these fluctuations in the market price. I argued that a good proxy for a counterfactual scenario was the FV or intrinsic value. Therefore, when traders deviate from this counterfactual scenario, they make additional profit compared to the case in which speculation was regulated and variations of the market price followed a smoother trend.

In the absence of the condition of profit, we have a situation of exploitation but the agent who is exploiting is someone else. An example, of this is the case of trader A who intends to make a profit from speculation but instead makes a loss.[71] Speculation in the stock market is a zero-sum game, for every buyer there is a seller among market participants. This means that before 1992 for every trader that bought at a non-proportionally low price there was another one that sold at this price and made a loss. Similarly, in 2000 for every seller

[71] In the next chapter we will see the problem of moral luck associated with the issue of responsibility in the case of the trader who makes a loss.

that sold at a non-proportionally high price and made a profit, there was a buyer that bought at this price and made a loss. In this case, there is a situation of exploitation but the agents who exploit are other traders who make a profit, not trader A. We will see this case in detail in the next chapter.

3.4.2- The exploiter party could not have obtained her additional profit in the absence of the weak party.

In cases in which exploitation happens as a process, agents are connected through a causal mechanism, which in some cases may involve changes in prices. In the case of UBI we saw that this connection between the exploiter and the exploited party could happen when many free-riders who stopped working and relied on UBI increased the level of taxes needed to be paid by contributors to maintain UBI at a fixed price. Similarly, in the case of the Stock market, the causal mechanism also happens through prices. When traders speculate on a firm's shares, they increase or decrease the market price of these shares. However, the main connecting feature in cases of parasitic exploitation happens because the additional benefit could not have happened in the absence of the weak party nor in the absence of her vulnerability. In the case of UBI, the possibility of free-riding the system could not have happened without contributors. Similarly, in the case of the Stock market, traders could not speculate on a firms' shares and profit from changes in prices in the absence of the workers that constitute the firm. The profit from speculation also could not have happened in the absence of structural vulnerability, or in the presence of rules that discriminated between justified and non-justified types of interaction, and that prohibited speculation.

3.4.3- The additional profit made by the exploiter party comes at the potential expense of the weak party.

Before I continue there is a need to distinguish between the idea that the profit from the exploiter party "comes from" the weak party, and the idea that the profit "is made at her potential expense". The former idea refers to obtaining profit from assets or labour that belong to someone else. Think of the case of the capitalist as described by Marx and the free-riders in the case of UBI, who profit from the labour of others or from the contribution of others to a fund. The latter idea, that profit is made at the potential expense of the weak party, is broader than the former one. It refers to the possibility of the weaker party being worse off due to parasitic exploitation, but it does not necessarily entail that the profit made by the exploiter is obtained from resources or labour of others. Nor it entails that the weak party is worse off due to this appropriation.

In my view, this broader idea of profit made at the potential expense of the weak party is enough for parasitic exploitation, since there may be cases in which there is parasitic exploitation, but in which the profit does not come from the resources or labour of others. Think for example in the case of a parasite that does not take resources – e.g blood – from the host, but who only by living in the hosts´ body has the potential of leaving the host worse off – e.g. the potential of causing her disease. In this case there is parasitic exploitation not because the resources of the parasite come from the host (and the host is not worse off because her resources are being taken away), but because the parasite benefits from living in the host at the host´s potential expense (the possibility of disease). In this case the host is not worse off because her resources, or labour, are being taken away or appropriated by the

parasite. Instead, there is parasitic exploitation because the benefit of the parasite comes at the potential expense of the host. The case of the stock market is similar to this case.

In what follows I will present the process through which the additional profit made by traders comes at the potential expense of workers. While this process also involves other shareholders or traders and the firm as a whole, these are not the exploited parties. On the one hand, traders and shareholders agree to enter the zero-sum game of speculation without being vulnerable in the first place, and hence, they are not exploited even if they are negatively affected by the profit made by other traders. On the other hand, the whole firm is a collective of people, or an entity, rather than a person. Because we are interested in determining when *people* are exploited, we need to focus on when the individual workers that conform the firm are exploited.

The processes though which the profit of traders is made at the potential expense of workers is the following. Firms do not sell all of their shares in the IPO, they usually keep some shares in order to raise capital at a later moment. As we saw earlier in this chapter, when firms sell these shares in the primary market, these shares are quoted at the value set by traders in the secondary market, which in this case is non-proportionally low. When the value of shares is non-proportionally low this affects both shareholders who hold these shares, since their assets are worth less, and the firm. The firm is affected in two ways. First, because the shares that they kept are worth less, and hence, the capital they have for investment in projects and other purposes decreased. Second, it makes it harder for the firm to obtain capital through equity, since firms avoid selling shares when their value is depreciated, otherwise if they sell them they would obtain less capital than they should for these shares.[72] Ultimately, this situation has the potential to affect workers. For example, if the firm goes bankrupt, or has to reduce itself, due to speculation, this affects workers who are made redundant.

From the above we can infer that as opposed to the case of UBI, in which changes in prices affected the exploited party directly, in the case of the stock market the exploited party is not always affected. Instead, in the latter case, the profit comes at the *potential* expense of the weak party. A reduction in prices of shares involves a reduction of equity, which harms both the firm and traders or shareholders who hold the shares of that firm. In normal times workers are not necessarily impacted by a reduction of the firms´ shares, since their wages do not necessarily come from equity. In this case, workers are actually harmed in specific and rare cases only, such as cases of bankruptcy, or reduction of the firm, since workers are made redundant.

In the case of the stock market it is rare for speculation to harm workers, but very common for speculators not to care whether they contribute to harm to the workers, and this is enough to justify a charge of exploitation. This negligence or recklessness about whether profit causes actual harm is enough to justify a charge of exploitation, since traders know in advance that there is a possibility that their profit causes harm, and whether their profit causes actual harm depends on factors that are out of traders´ control. In the next chapter I will come back to this issue and suggest that this case is similar to one of two drunk drivers, in which one of the drivers kills someone and the other one does not since no one came on her way. As in the case of the two drunk drivers, whether the benefit of traders causes actual harm is not under their control. Because in this case there is a potential for harm, then obtaining profit by engaging in this activity is enough to justify a charge of exploitation.

[72] Brigham and Houston, 2015: 306.

3.5- Background conditions and indirect consequences

Earlier in this chapter we saw that a situation can be more or less exploitative depending on background conditions. The same happens in the case of the stock market. Exploitation is not as severe when it happens to a strong firm like Apple, which is overall not that affected by speculation in the long-run, as when it happens to a more vulnerable one, because of the impact that speculation has on people's lives. For a vulnerable firm the impact of speculation on people's lives is much higher, since bankruptcy of the firm entails making all workers redundant. We may also think that some workers within the firm may be more exploited than others, for example, when a firm has less capital due to speculation it may reduce some of its workers' wages or make some of them redundant.[73] In this case, it is mainly these workers who are exploited, since the profit of traders comes at their expense.

As opposed to the case of UBI, in which free-riding is likely to be a case of poor exploiting rich, in the case of the stock market we can have either a situation of rich exploiting rich or rich exploiting poor. In a firm there are many types of workers, some of them may be rich, such as high executives, but there are also other workers who are poorer, such as low skilled workers. Parasitic exploitation in the case of the stock market will be more exploitative in the latter case than in the former one. In the next chapter, we will see that in the case of the Foreign exchange market, exploitation usually takes a form of rich exploiting poor.

Someone may object that cases of speculation seems closer to cases of harmful externalities than to a case of exploitation. In order to distinguish between cases of exploitation and externalities, I will offer the example of the Wall Street Crash of 1929. In this case, because of cognitive bias, during the 20's traders' speculation in the Stock market, led to bubble, or to an over appreciation of the value of shares.[74] When traders realized that shares were over appreciated, they panicked and generated a general bear market, in which many traders sold the shares of many firms at the same time, which led to a non-proportional low price and ultimately to several bankruptcies and to general unemployment. This general unemployment had harmful consequences on the whole country, since it reduced consumption, which ultimately led to the Great Depression.[75]

In this case, even if the whole country was affected by speculation, it is not the whole country that is exploited, it is only workers of firms that have their shares speculated on, and the connection criteria allows us to make this distinction. First, speculation could have happened in the absence of some sectors of society, but not in the absence of firms and their workers. Second, society as a whole is not being offered a worse deal or does not have the value of their assets reduced, only firms and their workers, have less capital as a result of speculation on their shares. Third, vulnerability in this case – a type of vulnerability that arises from the absence of rules that regulate speculation on shares - is specific to firms, not to society as a whole. Instead, we could argue that speculation in this case is violating conditions of background justice for society as a whole, such as sovereignty and the ability

[73] The topic of how the firm distributed costs and burdens internally is out of the scope of this thesis.
[74] Shiller, 2001: 186. Shiller calculated the fundamental value of shares and shows that the value at the end of the 1920's was overappreciated, but after the great depression, the market value of shares was below the fundamental value, or non-proportionally low.
[75] Eichengreen 2015:118.

to deliver social justice at home, since it is modifying general macroeconomic variables, in an analogous was as argued in chapter 1 for the case of the Foreign Exchange market.

The connection criteria allow us to identify the group of people who are exploited. Because the case of shares is not connected to citizens in a country – but to workers in a firm- we may have cases in which exploitation happens only to a specific group of people within a country, but which may harm the country as a whole. In the next chapter, we will see that in the case of currencies, because most citizens are currency holders, most citizens are exploited by speculation on their currency assets.

Here we can also make a distinction with the case of UBI. While in the case of UBI the implementation of this income can generate positive externalities that may ultimately leave the potential exploited party better off overall, in the case of the stock market we have the opposite scenario. Externalities in the case of speculation in the stock market are usually cases of negative externalities, such as the case presented above. Crises that arise as a result from speculation creates additional burdens on the exploited parties – e.g. externalities that generate a situation of increased unemployment make it harder for workers who are made redundant to find another job. This is another aspect that makes the case of the stock market a stronger case of exploitation than the case of UBI.

3.6- Speculation in the stock market can be considered a case of parasitic exploitation

From this section, I conclude that cases of speculation in the stock market can be considered cases of parasitic exploitation since they meet both the three conditions of the framework and the three elements necessary for exploitation as a process. I have also suggested that these cases of parasitic exploitation are likely to be stronger cases than the case of the free-rider in the system of UBI.

Section 4) Need for regulation in the case of the stock market, but not in the case of UBI.

There are at least three differences between the case of the stock market and the case of UBI that leads me to conclude that regulation should be implemented in the previous case but not in the latter case. The first difference, is that while regulation in the UBI case undermines the ability of the system to achieve its purpose, in the stock market case we do not have this problem with speculation, since investment can still happen in the absence of speculation. Second, the presence of positive externalities in the case of UBI mitigates the possibility of parasitic exploitation, since a person may be worse off in terms of paying taxes, but considering these externalities may be better off overall without regulation. In the case of the stock market, we have the opposite scenario, speculation creates negative externalities, which reinforces the harm to the exploited parties. Finally, the case of UBI is likely to be a weak case of exploitation, in which poor exploits rich. Because this is a weak case of exploitation, this type of parasitic exploitation can be overweighed by other types of transactional exploitation. As opposed to this case, in the case of the stock market we have either a mild case of rich exploiting rich, or a strong case of rich exploiting poor.

Section 5) Objection

In this chapter I have argued that the Fundamental Value of shares is a good proxy for the counterfactual scenario for the case of speculation in the stock market. I also suggested that, as stated in contemporary corporate finance, this value can be calculated by using either the corporate valuation model or the discounted dividend model. Someone may object to this idea by arguing that any valuation, including the FV, involves a risk calculation. In the case of the FV of shares, this price also includes predicted future values of cash flows and dividends.

I think there are two ways to answer this objection. The first one, is to defend the models for calculating the FV, the corporate valuation model and the discounted dividend model, and argue that they are good proxy for estimating the counterfactual scenario. The second one, is to argue that we do not need to calculate this value at all, since if it is speculation what is driving prices away from this value, if speculation is regulated we would naturally go back to this value. In what follows I will focus on the first way to answer this objection, and will argue that while the two models that calculate the FV may involve risk, they are still a good proxy for estimating the counterfactual scenario. I will argue this in what follows, but before I will say more about how these models work.

The corporate valuation model considers the cash flows at the end of each period, and calculates the FV for that period assuming that everything else stays the same. More specifically, assumes that the future cash flows will remain the same – more complex models include a growth rate and consider that the cash flows will continue to grow in a similar trend to the one they have had until that point – and bring these values to the present by using a discount rate. The discounted dividend model works in a similar way, but instead of considering cash flows, it considers the dividends paid to shareholders, and uses its respective discount rate. The objection refers to this assumption of the models, since there is also risk in assuming that everything else will remain the same, or that it will follow a specific trend.

Consider the following example, in time t_0 an event happens that may change the value of a share. The market price will reflect the views of traders on how they think that this new information will affect prices. This market price includes the risk that traders may have the wrong perception about prices, since the value that traders assign to shares is not necessarily the value that will result from the interaction between the firm and consumers. As pointed out by the objection, the FV value also includes a risk, the FV for period t_0 will not include the new information, and will –mistakenly – assume that everything remains the same when offering the price at this time, I will call this the uncertainty risk. We should also observe that the uncertainty risk happens when we want to estimate the FV *ex-ante only*, since we do not know what the cash flows (or dividends) will be in the future *ex-ante*, but we do know these values *ex-post*. For example, if we want to calculate the FV for shares in the 1920s, the future cash flows for this period are known today, but if we want to calculate the FV for today's shares, we will have to make an estimate of their future values. This distinction between *ex-ante* and *ex-post* calculations is relevant because it explains why the previously mentioned studies – such as Shiller's one - are reliable, they study past trends and show that the market price deviates from an *ex-post* known FV.

Even if the two models involve an uncertainty risk when calculating the FV *ex-ante*, I still think they are a good proxy to estimate the counterfactual scenario for two reasons. First, because they include all the real information available in each period, as opposed to the perceived information of traders. By real information, I mean the information that results

from the interaction of firms and consumers in the real economy. Balance sheets reflect the real information, or the real impact that an event has on the interaction between producers and consumers, and the FV is a bottom up value that considers this real information, rather than perceptions of a group of people. Continuing with the example above, if an event happens at t_0, balance sheets of that same period may not include the information on how this event affects consumption. However, this is the FV for time t_0 *only*, and if this event has a real impact - e.g. consumers consume less products of the firm as a result of the event - this information will be considered in next period t_1 when we have the information of how this event impacted balance sheets, and successively the FV for all next periods will include the real information on how the event modified balance sheets over time. Second, the risk of uncertainty is likely to be lower than the risk of perception, since as Shiller noticed the FV follows a smooth tend, whereas the market price is subject to considerable fluctuations.

Section 6) Conclusion

In this chapter I offered a framework of exploitation that includes three elements: build in mechanisms, vulnerability and non-proportionality. Build in mechanisms, such as coercion and absence of rules, allow some participants to misuse the system. This is related to the second element of structural vulnerability, participants in the system are vulnerable because the absence of rules that regulate this misuse of the system makes these participants worse off when others engage in non-justifiable forms of interactions. The final element of non-proportionality is related to this idea. Participants are worse off compared to the counterfactual scenario in which rules regulated and prohibited these types of interactions. I also offered three conditions for exploitation as a process. First, the exploiter party makes additional profit because of the vulnerability of the other party. Second, this profit could not have happened in the absence of the exploited party. Finally, the profit comes at the potential expense of the weak party.

Chapter 4: The Case of Currency Speculation

Section 1) Introduction

In chapter 1, I identified two problems of background justice, the case of monetary spillovers and the case of currency speculation. Here I focus on the latter problem. This chapter starts by arguing that the case of currency speculation is not only a problem of background justice, but in some cases, it can also involve parasitic exploitation. Currencies are traded in the Foreign Exchange market, and in a globalized world like the one we have today, this currency convertibility is fundamental for trade and for people's lives. For example, a business that obtains its supplies from abroad needs foreign currency in order to buy these supplies. Similarly, when people travel abroad they usually need the foreign currency to be able to make purchases in this country. However, like in the case of shares and the stock market presented in the last chapter, the price of currencies in this market does not always derive from forces of supply and demand based on need of consumers and producers. There are other reasons that move the market and one of these additional reasons is speculation. In this chapter will argue that while the normal exchange of currencies is justifiable, currency speculation on the currency of vulnerable countries is parasitically exploitative.

This chapter proceeds as follows. In *section 2*, I argue that some cases of currency speculation can be considered cases of parasitic exploitation. In order to argue this, I show how these cases satisfy the three conditions of the framework of exploitation presented in the previous chapter. In *section 3*, I address the question of responsibility. Here I make a distinction between two problems. First, I address cases in which traders profit from exploitation. Second, I focus on the case in which the combination of traders' actions leads to a disaster in the country that has its currency speculated on. For the first problem, I argue that only traders that profit from exploitation are morally responsible for their actions. For the second problem I argue that while traders have some responsibility for contributing to the harm, traders as a collective cannot be held responsible for the complete harm generated by their combined actions. I argue that, in both cases, it is the state – or the international basic structure – as a regulatory agent, which has a forward-looking responsibility to change or implement rules and regulation. *Section 4* goes back to the problem of background injustice presented in the first chapter, and concludes that the case of currency speculation is both problem of justice and a problem of exploitation. *Section 5* explores some possible regulatory mechanisms and compliance strategies. *Section 6* an objection. Finally, *section 7* concludes.

Section 2) Framework applied to the case

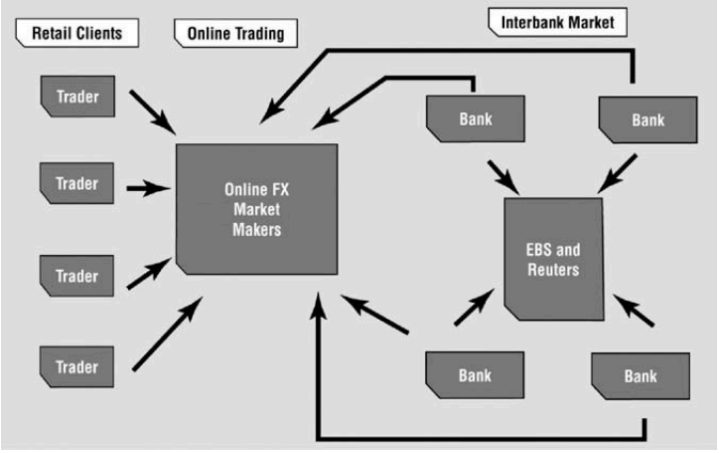
In this section, I argue that cases of currency speculation are cases of parasitic exploitation. In order to do so, I will argue that these cases satisfy the three conditions of the framework of exploitation presented in the previous chapter: build in mechanisms, vulnerability and non-proportionality; and the three connection criteria: the exploiter party

obtains additional profit, this profit could not have happened in the absence of the weak party, and the profit comes at the potential expense of the weak party.

2.1- Build in mechanisms

In the case of the Foreign Exchange market, build in mechanisms offer traders advantage for two reasons. First, the way in which the system is structured offers traders the possibility to determine prices, and to be price setters, as a collective. In this market, "prices are set by the interbank market – large banks and other participants who are big-volume buyers and sellers deal currencies between themselves... The prices they determine in their trading are passed onto the brokers, who in turn quote them to traders".[1] This idea is illustrated in Figure 3. Interbank market traders trade 53 percent of the overall volume in the Forex market.[2] Also, these traders have access to specific trading platforms, have access to expensive sources of real-time information about prices, are legally allowed to trade in representation of financial institutions and in the case of interbank traders they are able to set prices as a collective both because of the large sums of money they are able to move and because this is how it is determined by the rules of the system.[3] All these build in mechanisms offer traders, and especially those who trade in the interbank market advantage.

Figure 3: The Foreign Exchange Market Structure



Source: Lien, 2009: 17

Other smaller market players in the market, such as exchange houses – or bureau de change – make money by charging spreads and commissions to their clients over the market price.[4] In this system traders are price choosers as a collective, since the price of currencies is set by their interaction. On the other hand, common citizens and currency holders are price takers, since they are not market participants in the Foreign Exchange market, even if they hold, use and have an interest on currencies. Whenever individuals or business need foreign

[1] Fieldhouse, 2015: 10. The interbank market is composed by a small number of the largest banks in the world, such as Citigroup, JP Morgan Chase, Goldman Sachs, Deutsche Bank, among others (Thomas, 2014: 5).
[2] Lien, 2009: 18; DeFalco, 2010: 125-6
[3] Even if individual people could also have access some less sophisticated trading platforms, individuals are subject to legal restrictions to trade currencies, have a much higher personal risk for trading with their own money, and do not move the market because of the low volumes that they trade (Fieldhouse, 2015: 133-4). See also, Lien, 2009: 19, 91-2.
[4] Thomas, 2014: 7. These prices tend to be close to the price set by the interbank market (IMF, 2000: 659).

currencies, they go to a bank or to an exchange house, which will charge them the market price – set by traders – plus spreads and commissions.

The second reason why build in mechanisms offer traders advantage is also systemic, there are no rules or regulations that identify the different types of transactions that traders engage in. In the last chapter I argued that in the case of the stock market, specific types of transactions, such as speculation, could not be justified to others. I will argue later in this chapter that, like in the case of the stock market, in the Foreign exchange market speculation cannot be justified. Because the current system does not distinguish between types of interactions or transactions that are justified and those that are not, and does not prohibit the latter, this lack of rules leaves people affected by speculation vulnerable and unable to defend themselves from this speculation. Also, this absence of rules allows traders to make additional profit from speculation, which harms other parties by reducing the value of their assets.

2.2- Structural vulnerability

The condition of structural vulnerability is related to the previous condition of build in mechanisms. Build in mechanisms offer traders the possibility to be able to determine prices as a collective, which leaves citizens vulnerable to accepting these prices. Citizens are not only vulnerable because of price setting, they are also vulnerable since there are no rules that distinguish between justifiable and non-justifiable forms of transactions, and there is an absence of regulation on the latter types of transaction, such as prohibition on speculation. In other words, this is a systemic vulnerability, since it is the way in which prices are determined and the absence of rules and regulations that discriminate between different types of transactions, that make citizens vulnerable. Like in the case of the stock market, in which firms cannot avoid receiving a lower value for their shares as a result of speculation, in the case of the Foreign Exchange market, citizens cannot avoid receiving a lower value for their currency because of speculation.

While this systemic vulnerability is a necessary condition for parasitic exploitation, there is another type of vulnerability that may make a situation more or less exploitative, a pre-existing vulnerability that is antecedent to any actions of the exploiter party. Currency traders analyse many aspects of countries in order to decide whether to buy or sell their currencies. Some of the variables that traders analyse in order to determine whether a country is vulnerable or not are: general macroeconomic variables – such as inflation and unemployment -, business and consumer confidence, trade, natural disasters and conflict, commodity prices and natural resources, and levels of sovereign debt.[5] For example, in 2011 Japan faced an earthquake and a tsunami that killed thousands of people. This disaster was seen by traders as a negative signal and started selling the currency, which lead to a sharp depreciation of the Yen.[6]Another example is the case of Turkey. In 2001 a case of political corruption, and in 2018 a political conflict with the United States, led to the currency speculation and depreciation of the Turkish Lira.[7]

[5] Fieldhouse, 2015: chapter 6.
[6] Fieldhouse, 2015: 80-81.
[7] https://www.ft.com/content/9c792596-b1b5-11e8-8d14-6f049d06439c
https://www.bbc.co.uk/news/world-46866661

Countries that have their currency pegged have other reasons to have their currency speculated on. Traders may think that the government will devalue the currency, either because the currency is overvalued or because the government does not have the capacity to maintain the commitment of a specific value due to their debt/reserve ratio.[8] When the currency of countries is pegged, speculation can also lead to currency, balance of payment and to a banking crisis.[9] This is what happened in Mexico in 1994. The government tried to defend the currency from speculation, but ultimately run out of reserves and had a balance of payment crisis and a debt crisis.[10] In this case, the government had to take an emergency loan of $50 billion, from the U.S Treasury and the IMF, to avoid complete disaster.[11] The same happened in Argentina and Brazil in 1999-2000. In order to defend the currency against speculation, the Argentinian government took a $40 billion support package from international financial institutions and other creditor countries.[12] However, this was not enough, and in 2001 Argentina defaulted on its debts and faced political and economic chaos.[13] Brazil also faced speculation and negotiated a support package of more than $40 billion from the IMF, the World Bank and creditor countries, in order to maintain the value currency stable.[14] However, this package was not enough and the depreciation of the currency led to 5 years of recession.[15]

The Asian financial crisis shares similarities with the cases presented above. In 1997 traders speculated about a possible devaluation of the baht, which made Thailand loss reserves and led to a sharp depreciation of its currency's value.[16]. Traders also speculated on the currencies of Thailand's neighbours, such as Malaysia, Indonesia, South Korea, on similar grounds. All of these countries, except Malaysia, received loans from the IMF to contain the effects of speculation, but despite these loans the countries faced currency crises. In the case of Indonesia, the currency lost 85 percent of its original value, there was mass unemployment, people were unable to afford basic foodstuffs, and ethnic violence broke out.[17]

All the cases presented above share that in addition to a systemic vulnerability, countries that face speculation on their currency are pre-existingly vulnerable. However, there are other cases in which traders speculate on a country's strength. Consider the following example. In 1971, traders speculated on Germany's strength, generating an over appreciation of the Deutsche Mark.[18] Germany tried to counteract this appreciating speculation by buying $1 billion in the Forex market, but then let its currency appreciate. Having an over appreciated currency brings harmful consequences to the country that has its currency appreciated due to speculation. Because of this appreciation, the exports of this country become relatively more expensive to others, which harms export industries and generates a tendency to a misallocation of resources away from industrialized sectors. In cases in which traders speculate on a country's strength, citizens of this country are still

[8] Ocampo et al, 2008: 10.
[9] Krugman and Obstfeld, 2003: 674.
[10] Krugman and Obstfeld, 2003: 506, 687
[11] Idem.
[12] Frieden, 2015: 241.
[13] Frieden, 2015: 242. Krugman and Obstfeld, 2003: 685, 695.
[14] Frieden, 2015: 238; Krugman and Obstfeld, 2003:694.
[15] Idem
[16] Krugman and Obstfeld, 2003: 691.
[17] Idem
[18] Krugman and Obstfeld, 2003: 558, 560, 564

systemically vulnerable, since they also cannot avoid their currency being appreciated due to the background rules and the absence of regulation on speculation. In other words, both cases of speculating on pre-existing vulnerability and speculating on strength can be exploitative, since in both cases citizens are systemically vulnerable. However, while both cases are exploitative, speculating on pre-existing vulnerability is more exploitative than speculating on strength, since it leads to more harm.

2.3- Non-proportionality

In the previous chapter I argued that non-proportionality cases of parasitic exploitation happen when a group of individuals who obtain advantage from build in mechanisms transact in non-justifiable ways, deviating prices from the counterfactual scenario. In this subsection, I will argue that, like in the case of the stock market, the Fundamental Value of currencies is a good proxy for the counterfactual scenario, hence, we should have a presumption towards this value. I will also argue that, as opposed to the FV, the market price includes transactions that cannot be justified to others, such as speculation. Because the market price deviates from the FV, or the counterfactual scenario, this is a non-proportional price.

2.3.1- Forex, justification, and non-proportionality

The Foreign exchange market can be justified to citizens since it allows the exchange of currencies, which brings social benefits to society. Currencies are traded in the Foreign Exchange market, and in a globalized world, this currency convertibility is fundamental for international trade and for people's lives. For example, a business that obtains its supplies from abroad needs foreign currency in order to buy these supplies. Similarly, when people travel abroad they usually need the foreign currency to be able to make purchases in this country. The foreign exchange market allows for these transactions to happen, which brings social benefits. Other types of transactions in these markets, such as hedging are also essential for trade. For example, a business which obtains its supplies from abroad, and wants to know in advance how much costs the business will have in the future, may want to avoid risks involved in fluctuations of the exchange rate. In order to mitigate the effects of these fluctuations it may sign a contract with a bank to buy foreign currency for a specific price at a specific time in the future.

The Fundamental value of the exchange rate is a price that results from this justification, since it reflects the interaction between consumers and producers, both foreign and abroad, in the real economy. Like in the case of the stock market, in the case of Forex, the fundamental value of the exchange rate is a value that can be justified by facts, such as output, or industrial production, terms of trade, net foreign assets, among others. There are different models for calculating the fundamental value of the exchange rate, and they can be classified into two main types. The first type of models considers real variables in an economy and calculate the fundamental value of the exchange rate as a function of these variables. Within this category we find the composite model, which calculates the FV value of the exchange rate as a function of the price of non-tradables, the real interest rate, the

government debt to GDP ratio, terms of trade and net foreign assets.[19] Within this category we also find the Balassa-Samuelson models, which calculate the FV of the exchange rate as a function of productivity differentials between two countries.[20] Finally, within this category there is the Taylor rule of central banks' model, which calculates the FV of the exchange rate as a function of output, or industrial production, inflation, and interest rate.[21]

The second type of models are based on the purchasing-power-parity (PPP) condition and the monetary model.[22] In order to illustrate the idea behind this model, let us consider the following example. If traders set a very low market price for the Argentinian peso, Argentinian goods become relatively cheaper for foreigners, which incentivises foreigners to buy more Argentinian products. Because foreigners need Argentinian pesos to buy these products, the demand for Argentinian pesos increases, ultimately bringing the exchange rate of the Argentinian peso back to the FV. The same happens if the prices of goods in one country are lower than the prices in another one, the exchange rate ultimately adjusts because of the demand for these currencies. According to PPP, there is a tendency for price levels in different countries to be the same in the long run when measured in terms of the same currency. In other words, "the monetary approach therefore makes the general prediction that the exchange rate, which is the relative price of national [American] and foreign [European] money, is fully determined in the long run by the relative supplies of those monies and the relative real demands for them".[23] This model presumed that the market price tends to revert to the FV after a period of time.[24]

There is a presumption towards the FV of exchange rates as a good proxy for the counterfactual scenario in this case for two reasons, which are analogous to the two reasons offered for the case of the stock market. The first reason is justification. The reason why a Forex exchange rate market is important and necessary is because we need convertibility of currencies for international trade. The FV is a value that results from this justification, since it derives from the supply and demand of consumers for currencies of different countries, based on the need to cover their trade demands. As explained by the PPP model, the FV depends on the demand of consumers for a certain currency, and this demand depends on the demand for trade and products of this country. Similarly, models that calculate the FV as a function of variables, consider how a country is doing overall on the real economy, which also depend on trade and their industrial production. This is relevant because how a country is doing in the real economy reflects its contribution to activities that generate social benefits such as international trade.

The second reason why there is a presumption towards the FV as a proxy for the counterfactual scenario, is that this value works as an anti-power. In the case of the stock market, I argued that the FV value of shares worked as an anti-power because they resulted from the interaction between firms and consumers, which is a price that no one has power to

[19] See Cheung et al, 2005; Clark and MacDonald, 1999; Stein, 1999; Edwards, 1989
[20] See Cheung et al, 2005, De Gregorio and Wolf, 1994; Clements and Frenkel, 1980; Chinn, 1997
[21] This model is also related to the next category of models, since this rule derives from a PPP model. See De Grauwe and Markiewicz, 2013; Engel and West, 2006; Mark, 2009; Molodtsova and Papell, 2009; Clarida and Waldman, 2007;
[22] See Goldbaum and Zwinkels, 2014; Menkoff et al, 2009; Manzan and Westerhoff, 2007; De Grauwe and Grimaldi, 2006, 2001; Cheung et al, 2005; Westerhoff and Reitz, 2003; Mark, 1995; Krugman, 1991; Frankel and Froot, 1990a, 1990b; Stockman, 1980; Lucas, 1982; Dornbusch, 1976; Frankel, 1979; Mussa, 1976; Bilson, 1978.
[23] Krugman and Obstfeld, 2003: 393. Another reason why the values considered are in the long run is because of *sticky prices*, or the idea that price levels take time to adjust, since there are previous contracts that are unaffected by changes, hence wages take time to adjust, and price levels as a result of wages take time to adjust.
[24] Goldbaum and Zwinkels, 2014: 669; Mark, 1995: 204; Frankel and Froot, 1990: 183

decide. Similarly, in the case of the Forex market, the FV is a value that results from producers and consumers – both nationally and foreign – in the real economy and it involves more agents than the market price, which is only set by traders with advantage. The FV works as an anti-power, since no one is a price setter. Instead it is a price that results from the organic interaction between people who have a need for these currencies to pursue activities such as trade and business. As opposed to this value, the market price is a price that derives from the views of a specific group of agents.

2.3.2- Market price: Types of transactions in the Forex market

The market price is the price that results from traders' interaction. Traders' transactions in the Foreign Exchange market happen due to four main reasons.[25] The first reason is need. For example, when someone travels abroad, this person needs foreign currency to be able to purchase goods in the foreign country. The second reason is arbitrage, which happens when someone is selling - or buying - an asset at a price below - or above – the market price of one market in another market.[26] The third reason is hedging, which is a way to mitigate future risk, by taking the opposite position. For example, a business that obtains its supplies from abroad is subject to exchange rate risk from fluctuations. In order to avoid this risk, the business may want to take a derivative, or make a contract with a bank, in which the business agrees to buy (or sell) an amount of foreign currency in the future from the bank at a specific price that is agreed in advance. Finally, the last reason is speculation, or transactions that aim to make a profit by changes in prices only.

The reasons presented above may happen as a continuum. In other words, transactions may happen for more than one reason. We may have transactions that involve both hedging and speculation. For example, the hedger who took a derivative because she needs to buy supplies from abroad and thinks that the foreign currency will appreciate, may want to set a contract to fix the price to today's price. However, this may also contain an element of speculation, since if the foreign currency appreciates, this person will make a profit from buying this currency cheaper than the market price.[27] On the other hand, if the foreign currency had depreciated, she would have made a loss compared to the scenario in which she did not take the derivative and bought at the market price. According to financial theory, we can disentangle these motives, or distinguish between these cases, by incorporating a risk premium to hedging, which is equal to the expected cost of hedging.[28] Because speculators and hedgers have a different risk tolerance, applying this premium differentiates between the two cases: "a high-risk premium would not be a deterrent to hedging because there would also be a comparable benefit", but it will be a deterrent for speculators.[29] This is why, hedging transactions today pay a risk premium.

From this subsection we can conclude that, as opposed to the FV value of the exchange rate that considers the demand of consumers for currencies and the economic

[25] Steiner, 2002: 3-4. Steiner also explains each of these reasons as presented in what follows.
[26] For example, a trader in London may notice that a specific currency is selling cheaper in the Brussels market, then the former trader has incentives to buy the currency un the Brussels market and sell it in the London market. For this example, see Vernimmen, 2018: 260
[27] For this example, see Levi, 2009: 341
[28] Levi, 2009: 340-4
[29] Levi, 2009: 343

fundamentals of an economy, the market price also contains traders' speculative views. In what follows, I will show that the latter price deviates from the former one.

2.3.3- Market price and deviations from FV

In the last chapter, we saw that there are two different approaches to the question of whether the market price converges or deviates from the FV in the case of the stock market. On the one hand, according to the Efficient Market Hypothesis the market price converges and always reflects the FV. On the other hand, studies in behavioural finance show that the EMH does not hold empirically, and argue that deviations of the market price from the FV happen because traders are not fully rational and face a series of cognitive bias when transacting with each other. In the case of the Forex market we have a similar dichotomy. The analogous version of the EMH for this market is the Rational Expectations Efficient Market (REEM) hypothesis, initially proposed by Milton Friedman.[30] The REEM assumes that agents in this market are rational: they maximize their utility, they incorporate all the available information, and they do not make errors when forecasting. The REEM also considers that markets are efficient, and that they immediately incorporate all the available information of fundamental variables into prices. According to Milton Friedman's model, speculators have incentives to buy when prices are low and to sell when prices are high, compared to the FV. Therefore, speculation should have an overall stabilizing effect on the market: if a speculator realizes that the price of an asset has overshoot its FV, she has incentives to sell this asset, bringing this price closer to its FV. Two corollaries of the REEM are that the market price reflects the FV and that there are no bubbles in this market.

In line with studies in behavioural finance, there is a wide variety of empirical evidence against the REEM theory. Maurice Obstfeld and Kenneth Rogoff present the *exchange rate disconnect puzzle* as one of the six major puzzles in international macroeconomics.[31] According to this exchange rate disconnect puzzle, the market price of the exchange rate is disconnected from any macroeconomic aggregate or underlying fundamentals of the economy most of the time. Precursor studies leading to this puzzle include the work of Richard Meese and Rogoff, who conclude that FV models for the exchange rate, even when using *ex-post* data, cannot explain the market price in short to medium horizons, and the market price in such horizons just follows a random walk, or random deviations from this value.[32] Other studies show that the exchange rate's market price suffers considerable variation and volatility, with no corresponding changes in the distribution of fundamental macroeconomic variables,[33] and most of the changes in the exchange rate's market price happen when there is no observable news in the fundamental economic variables.[34] Overall, Obstfeld and Rogoff conclude that there is a remarkably weak link between the exchange rate's market price and the rest of the economy and that this market price is extremely volatile compared to any model of underlying fundamentals. One specific application of this puzzle is the *PPP disconnect puzzle*, according to which there is a weak relationship between the exchange rate's market price and national price levels in the

[30] See Friedman, 1953, 1975; 1985; 2010
[31] Obstfeld and Rogoff, 2000
[32] Meese and Rogoff, 1983
[33] Ehrmann and Fratzscher, 2005; Baxter and Stockman, 1989; Flood and Rose, 1995
[34] Faust et al, 2002; Goodhart and Figliouoli, 1991; Goodhart, 1989

short and medium run.[35] Jeffrey Frankel and Kenneth Froot calculate the FV and observe, that while in the long run there is a return to the equilibrium given by the PPP, in the short and medium run there are considerable deviations of the market price from the FV, because of speculative bubbles.[36] More recent studies show that while in the long run there is a tendency towards the FV, in the short and medium run the market price follows a random walk and deviates considerably from this value.[37] Finally, evidence of any bubble is an empirical evidence against the REEM, since this theory does not allow for bubbles to exist.[38]

2.3.4- Speculation versus Government intervention

Up to this point I have argued that we should have a presumption towards the FV and that actions that make prices deviate from this value, if they cannot be justified, are candidates for exploitation. Here I take a step back to make a distinction between speculation and another type of interaction, interventions in the market made by the government. As we saw in chapter 2 of this thesis, central banks sometimes intervene in the Forex market, and deviate the value of the exchange rate from its FV. My view is that these types of interactions are not exploitative. In contrast to cases of unacceptable deviations, such as speculation, in which agents deviate prices to make additional profit, deviations made by the central banks are acceptable deviations, since they aim to obtain social justice at home. Thus, these latter actions can be justified to citizens. In the case of government intervention, the discretion to intervene in the Forex market is justified, since the use of monetary policy is a public good, which satisfies conditions of non-rivalry and non-excludability. As opposed to traders, who deviate the value of a currency from its FV in order to make profit from speculation, in the case of a government, this deviation happens because of fairness related reasons. In this case, even if the value that the government – or its central bank - is assigning to the currency differs from its FV, there is nothing *a priori* wrong with this deviation.

Someone may object that if I accept that the exchange rate set by the government is fair, then the FV is not doing any work. Why not consider deviations from the exchange rate set by the government as a benchmark for parasitic exploitation, rather than the FV? My answer to this objection is that while the FV is not necessarily an adequate benchmark of fairness, it is a good counterfactual scenario for parasitic exploitation. The idea of parasitic exploitation in the Forex market is that market agents misuse the system, interacting in ways that cannot be justified to others to obtain additional profit. Therefore, the adequate counterfactual scenario in this case, is the case in which market participants act in ways that are consistent with the aims of this system, e.g. in an organic way. The exchange rate set by the government, while fair, is not a good counterfactual for parasitic exploitation, since deviations from this benchmark from market participants may not necessarily be due to parasitic exploitation. There may be cases in which all market agents interact in ways that are justifiable – e.g. cases in which there is no parasitic exploitation - and in which the organic

[35] Rogoff, 1996. Rogoff observes that PPP holds in the long run, and suggests this happens because consumers have an input in the market price, but this process takes a long time.
[36] Frankel and Froot, 1990a, 1990b
[37] These studies conclude that in the long run the market price can be modeled using FV models, while in the short and medium run it is best modeled by a random walk, or chartist model. See Goldbaum and Zwinkels, 2014; De Grauwe and Markiewicz, 2013; Menkoff et al, 2009; De Grauwe and Grimaldi, 2006; Mark, 1995
[38] For an account of bubbles in history see Garber, 2000

interaction of the market leads to unfair outcomes, or to an exchange rate level that is different from the one needed to achieve social justice at home. This is another issue, different from parasitic exploitation, that needs to be addressed by the central bank. Here I focus on the FV, since, as suggested throughout this thesis, the main problem in the Forex market is that of speculation, rather than the issue that the organic interaction of the market may lead to an exchange rate level that is not the exact one desired by the government.

2.3.5- Can speculation be justified? The overvalued peg objection

Until now I have argued that speculation in the Forex market cannot be justified. However, someone may argue that another benefit of speculation in the case of the Foreign Exchange market is that it allows to break overvalued pegs.[39] For example, someone may suggest that in the case of the British withdrawal from the European Exchange Rate Mechanism (ERM) in 1992, the value at which Britain had committed to maintain the currency was too high. This overvaluation of the exchange rate was detrimental for the economy, since it hindered exports. Consequently, after speculation on the pound in 1992, the British economy flourished, since the lower exchange rate increased exports and led to economic growth. Similarly, for the case of the Asian financial crisis George Soros argues that "the most immediate cause of trouble was a misalignment of currencies".[40] In other words, the exchange rate value that the government had committed to maintain was overvalued. Soros argues that when his investment company sold the Thai baht short in January 1997, he sent a market signal that Thailand's currency was overvalued, and if the authorities had depreciated earlier "the adjustment would have been sooner and less painful".[41]

My first answer to this objection, is that we can question the desirability to break the government's commitment to the overvalued price of the currency. Earlier in this chapter I argued that government intervention in the Forex market, and the consequent deviation of prices from the FV by these actions, is justified, since the use of monetary policy is a public good, necessary to bring social justice at home. Within a country specific values of the exchange rate will be beneficial or detrimental for different groups of people, e.g. people who work in export industries prefer a low exchange rate whereas those who consume products from abroad will prefer a high exchange rate, for this reason not all citizens will agree with a particular exchange rate value.[42] The role of the government is to consider the demands of all citizens and determine a value that brings social justice. We also need to consider that in the current IMS there are structural features that sometimes pressure governments to peg their currency at specific values, which I defined – in chapter 1- as *fear of floating*. These structural pressures also need to be considered and acknowledged by those who argue against governments pegging the exchange rate at a specific value.

My second answer is that the way in which these pegs are broken by speculation are both harmful and generate additional problems of justice. In order to avoid breaking the peg, governments who face speculation - including the case of Britain 1992 - spend billions of US dollars trying to counteract the effects of speculation. This additional billions of US dollars

[39] I thank Stuart White for this objection.
[40] Soros, 2000: 209
[41] Soros, 2000: 216
[42] Frieden, 2015.

in cases of developing countries usually come from loans that involve conditionalities, which are ultimately paid by taxpayers. These billions of US dollars injected in the Forex market, break the zero-sum game and offer traders additional benefits than the ones they already have,[43] generating additional problems of justice. Also, when traders speculate there is a tendency to exaggerate prices and to lead to a deep depreciation of the exchange rate, which goes beyond the FV. In cases in which this non-proportionality has been considerable, such as the cases of Thailand and Malaysia during the Asian crisis, or the case of Argentina, the harm made to these countries as a result of speculation on their currency is evident.

From this subsection I conclude that, like in the case of the Stock market, speculation in the case of the Foreign Exchange market cannot be justified to citizens.

2.3.6- Market price

From the above, I conclude that the market price does not necessarily satisfy the conditions for a non-exploitative price for the same three reasons that I offered for the case of the Stock market. First, it is partly determined by, or includes, transactions that cannot be justified to citizens, more specifically, it includes speculative transactions. Second, this market price is determined by a specific group of people, as opposed to producers and consumers in the real economy. Because the FV includes more actors, such as normal people with a real interest in foreign currency, we have a presumption towards this value. Third, the market value opens the possibility to misuse the system, since increased volatility opens the possibility for traders to benefit more from changes in prices and speculation. I will say more about this in the following section.

2.3.7- Speculation in the Foreign Exchange market satisfies the framework criteria.

From this subsection I conclude that because the case of speculation in the Forex market satisfies the three conditions for the framework of exploitation, these transactions can be considered candidates for exploitation. In next sub-section I will argue that these cases also satisfy the three connection criteria for cases in which exploitation happens as a process.

2.4- Three conditions for exploitation as a process

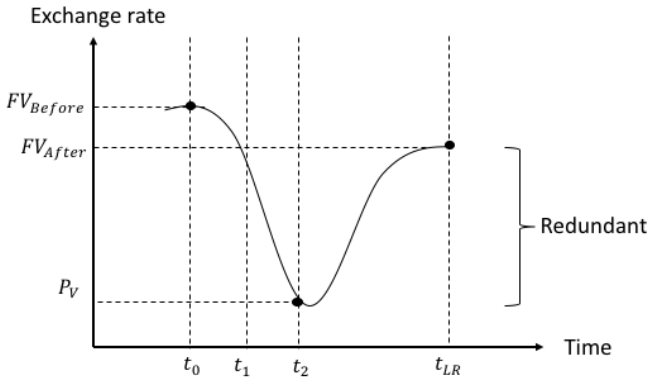
In the last chapter I suggested that in cases in which exploitation happens as a process, rather than in a single transaction, we need three elements for exploitation. First, we need an exploiter party who makes additional profit compared to the counterfactual scenario. Second, this additional profit could not have happened in the absence of the weak party. Finally, this profit comes at the potential expense of the weak party. In this section, I will argue that the case of speculation in the Forex market satisfies these criteria.

[43] Stiglitz, 2002: 239; Stiglitz et al 2006: 184-5; UN, 2009: 32-4

2.4.1- The exploiter party makes additional profit from vulnerability

Consider the case of a country which is affected by an event – e.g. subjected to economic sanctions - and as a result faces speculation. As shown in Figure 4, the FV of the currency may actually change before and after the event – e.g. sanctions hinder trade and as a result the demand for currencies. However, speculation deeply depreciates the currency to a non-proportional value. As suggested by the studies mentioned previously, the value of the exchange rates stabilizes and leads towards the FV in the long run t_{LR}, when more actors are involved in pricing, since the low exchange rate makes national products of this country cheaper to foreigners, who are incentives to buy these products increasing the demand for the currency and leading to a PPP equilibrium in the long run. For the graphs of real examples see Annexe 6.

Figure 4: Exchange rate in time



Source: Own elaboration

In this case, traders who buy at P_V when the currency is cheap and sell it when it has increased its value in t_{LR} make additional profit compared to the counterfactual scenario, in which vulnerability was not present. In other words, these traders make additional profit compared to the case in which rules and regulations prohibited speculation, hence, a scenario in which these considerable deviations of the market price from the FV did not happen. This example shows that the current market price as it is, with considerable fluctuations, opens the possibility for traders to obtain additional profit from these considerable changes in prices.

Now consider a trader who has to decide whether to buy currencies in t_1. According to Friedman, because at this point the exchange rate value is below the FV, the trader has incentives to buy currencies, since the value is low. However, because the market price is still depreciating, if this trader wants to maximize her profit, she should not buy currencies at this point, instead she should wait and buy later in t_2 when the market price is even lower. This example shows, against Friedman, that because traders profit from buying or selling in comparison to the market price – rather than in comparison to the FV – they do not necessarily have incentives to lead prices closer to the FV.[44]

[44] For this argument see also, Frankel and Froot, 1990: 184

2.4.2- The additional profit of the exploiter party could not have happened in the absence of the weak party

In cases in which exploitation happens as a process, agents are connected through a causal mechanism, which usually involves prices. As in the case of the stock market, in which traders decrease or increase the value of shares when they speculate, in the case of the Forex market trader increase of decrease the value of currencies, away from the FV value. Apart from this casual mechanism given by changes in prices, there is another connecting feature in cases when exploitation happens as a process. This feature is that the additional profit could not have happened in the absence of the weak party, nor in the absence of her vulnerability. When traders obtain additional profit by speculating on the currency of a country, the profit they obtain could not have happened in the absence of the economy and of the people of that country. In the case of the stock market I made a distinction between the firm and its workers. In the case of the Forex market we can make a similar distinction between a country, or economy, and its citizens. In the former case, I suggested that because it is people – as opposed to entities - who can be exploited, and firms are a collective of workers, then we should focus on when the individual workers that make up the firm are exploited. Similarly, in the case of the Forex market, we should focus on when individual citizens that constitute a country, or an economy, are exploited.

2.4.3- The additional profit is made at the potential expense of the weak party

The last condition is that the profit of the exploiter party is made at the potential expense of the weak party. When traders speculate and depreciate the value of a currency, their profit comes at the potential expense of the people from the country that has its currency speculated on, since their assets are now worth less. When the currency depreciates to a non-proportional value, people have less purchasing power of foreign goods, which has an impact on peoples' lives. For example, people who consume imported basic goods or foodstuff will have to pay more in real terms for these goods. Similarly, the business owner who obtains its supplies from abroad, will have to pay more in real terms for these supplies. Also, people who travel abroad and need to buy foreign currency, will receive less foreign currency than they would have received if the exchange rate was at its fundamental value, for the same amount of domestic currency. When traders speculate and appreciate the value of a currency to a non-proportional value, their profit is made at the potential expense of exporters. Exporters lose competitive advantage compared to foreign sellers when the currency appreciates, since their products are made relatively more expensive to foreigners. If sustained for a long time, an over appreciated currency can also lead to misallocation of resources, which ultimately harms citizens.

From this section I conclude that, like in the case of the stock market, cases of speculation in the Foreign Exchange market can also be considered cases of parasitic exploitation.

Section 3) Responsibility for currency speculation

In this section, I will address the question of responsibility, or who is responsible in cases of currency speculation. In order to do so, I will consider two different problems that happen in this case. The first problem is there are individual actions, that involve exploitation. I will argue that traders who obtain profit from exploitation have *some degree* of individual responsibility for wrongdoing. However, this individual moral responsibility is mitigated by four considerations: role in harm, background conditions, absence of knowledge, and degree of non-proportionality. The second problem, is that it is the combination of traders' actions, as opposed to individual actions, what leads to disastrous outcomes. Here I aim to argue that traders have *some* responsibility for the outcomes they generate, but they are not, as a collective, completely responsible for the disastrous outcomes of their combined actions. Because the absence of regulation also contributes to these disastrous outcomes, states – and the international community or regulatory agency - are both morally and remedially responsible for regulating and avoiding these situations.

3.1- First problem: Responsibility of traders who make a profit

This subsection addresses the first problem, that of traders who make an exploitative profit that takes additional advantage from the vulnerability of a people. I start this section by addressing two models of responsibility for cases of structural exploitation, which aim to turn the moral responsibility of agents into a forward-looking responsibility. I will argue against the exemption of moral responsibility from traders who obtain profit from exploitation.

3.1.1- First Model of Responsibility in cases of Structural Exploitation: Robert Mayer

The first model of responsibility in cases of structural exploitation is offered by Robert Mayer. Mayer argues that cases of structural exploitation, in which the problem are rules, those who engage in these practices are morally responsible, but in a different way from other cases of exploitation.[45] This difference derives from what Mayer calls "the dilemma of structural exploitation". In cases of structural exploitation, given unfair rules, many businesses cannot remain competitive and survive without engaging in competition. However, these businesses have a choice: they can either quit the business and stop exploiting, or they can continue competing and exploiting.[46] However, if the business decides to quit, its workers would be worse off, since they would be left without a job, which leads to a "dirty-hands dilemma".[47] Therefore, in this case, businesses owners have a *right to do wrong*, since given the unfair rules, it is preferable to continue exploiting the workers that not doing so. Mayer concludes that the responsibility of business in this case is to press for structural solutions and to do their fair share to change background circumstances.[48]

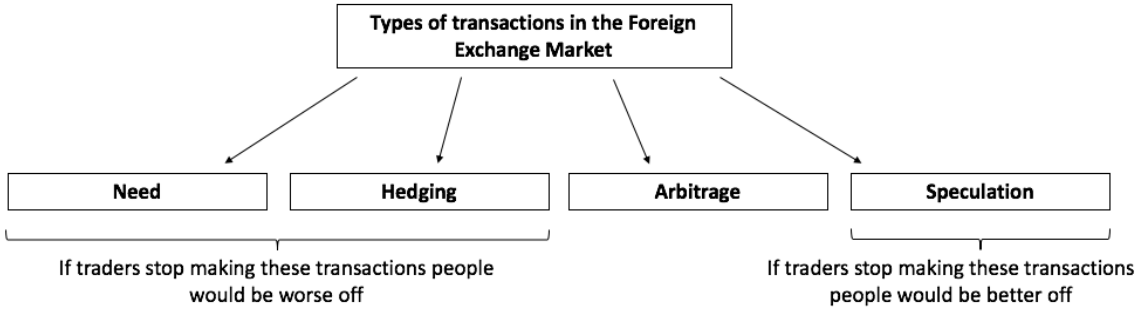
[45] Mayer, 2007b:614
[46] Mayer, 2007b: 615
[47] Mayer, 2007b: 616
[48] Mayer, 2007b: 618

3.1.1.1- Against the first model: no dirty-hand dilemma, nor right to do wrong in this case

Mayer turns the moral responsibility of agents involved in cases of structural exploitation into a forward-looking responsibility to change the structure, on the grounds of the dirty-hands dilemma. However, while this dilemma happens in the cases presented by Mayer, this does not always happen. There may be cases in which the interaction with the exploiter is overall fair, but there are elements of the interaction that make it exploitative. Making this distinction between the overall interaction and those elements that involve exploitation avoids falling into a dirty hand dilemma, since if these exploitative practices can be avoided, while maintaining the whole interaction, regulating these exploitative practices does not necessarily leave the vulnerable parties worse off.

In the case of currency speculation, counties would be worse off if they were excluded from the whole Foreign Exchange market, or if some *specific* types of transaction were prohibited. For example, if traders stop making transactions based on need or on hedging, this would have disastrous consequences to these countries, since this would inhibit trade and other activities. However, as we have seen, not all transactions that happen in this market are exploitative, and there is nothing wrong with the types of transactions described above. It is speculative transactions *only* that are candidates for exploitation, and there are reasons to think that if traders stop speculating, but continue engaging on the other types of transactions, the people of countries that would have had their currency speculated would actually be better off. As opposed to the case of sweatshops, in which if the employer withdraws from business and stops hiring people at exploitative conditions, this would leave the exploited party worse off, if traders stop speculating, but continue with their other transactions, people would not be worse off. Therefore, in this case, the dirty hands dilemma is not a reason to exempt participants in these practices from moral responsibility for their exploitative transactions.

Figure 5: Types of transactions in the Foreign Exchange market



Source: Own elaboration

3.1.2- Second model of Responsibility in cases Structural Injustice: Iris Marion Young's connection model

In cases of structural exploitation or injustice, Young argues that because the problem are unfair rules, we should not focus on moral responsibility of agents, but rather on forward-

looking responsibility, since these agents may not do anything wrong or may be constrained by the rules. In order to introduce her concept of structural injustice Young presents the case of Sandy whose salary is not enough to pay her rent and faces the possibility of homelessness.[49] Young argues that in this case, none of the agents that Sandy may have encountered have *done anything wrong*, "the causes of being vulnerable to homelessness are multiple, large scale and relatively long term".[50] All these factors put into a mix, lead to some individuals being in the social position of vulnerability to homelessness.[51] Young extends this idea to the global case and offers the case of sweatshops, and argues that the structure of the global apparel industry diffuses responsibility for the conditions in which sweatshop workers are in.[52] There are many actors who could be blamed in this case, but because these actors are constrained by the structure in the actions they can take, this limit and diffuses their responsibility.[53] This is why Young proposes a political responsibility, which is forward-looking or remedial, as opposed to causal responsibility, which aims to identify who is to blame.[54]

3.1.2.1- Against the second model: individual traders' actions may be exploitative

Young would argue that individuals that participate in situations of structural injustice, do not do "anything wrong" or are exempt from responsibility because they follow the rules, and these rules shape their actions and narrow their options. However, the fact that an action is legal or allowed by the rules does not imply that it is not wrong or exploitative. For example, as we saw in last chapter, the act of gouging is exploitative *per se*, and this is independent on the law of each state, which may allow or prohibit gouging. Also, the fact of having fewer options, because of the law, cannot exempt agents from moral responsibility, since there is always an option of not participating, as we saw before. In the case of housing, I am sceptical of the claim that "no one has done anything wrong".[55] In our case of currency speculation, I have argued that this is sometimes a case of exploitation, and because exploitation is considered as a moralized concept, traders engage in wrongdoing. On the other hand, Young seems to consider that no one is doing anything wrong because it is the combination of individual actions "put into a mix" that lead to the harmful or unfair outcome. But the question of outcomes is another question, and an action may be exploitative even if it did not generate the unfair or exploitative outcome on its own.

3.1.3- Individual moral responsibility for exploitation

Earlier I have argued that, in some cases, speculation can involve wrongful exploitation. In this section, I will argue that traders who profit for exploitation have some degree of individual moral responsibility. I will assume that because exploitation is a

[49] Young, 2011: 43-50
[50] Young, 2011: 47. Some of this include the wages people earn, rents that landowners and banks require, forces of demand and supply, different laws of construction, the local housing industry, the Federal Reserve, among others.
[51] Young, 2011: 52.
[52] Young, 2011: 125-9
[53] Young, 2011: 131
[54] Young, 2006: 123
[55] Young, 2011: 47.

wrongdoing, traders who profit from exploitation have individual moral responsibility for this wrongdoing. However, there are some considerations for the specific case of currency speculation that mitigate this responsibility, such as the role the individual has in generating harm, background conditions, absence of knowledge, and degree of non-proportionality. While these considerations mitigate the degree of moral responsibility, they do not completely eliminate it.

The first consideration is that, as opposed to other cases of exploitation, traders' actions or omissions do not necessarily have an impact in outcomes, or do not change the situation of the other party. We can illustrate this idea by making a comparison with the case of gouging. While in the case of gouging sellers have a *direct role* in setting the disproportionate price, in the case of traders, individual traders do not set a price, instead, this price is a result of the combined actions of traders. In the case of gouging, the seller has a direct role on setting a price, for at least two reasons. First, this price is mainly a result of her decision, as opposed to other reasons that are out of the seller's control. Second, and related to the first, this choice of price has an impact in the other party. Because the price is mainly a result of her decisions, the seller could have acted in good faith and offered the other party a proportional price, which would have ultimately had an effect in the world, by leaving the other party better off. In the case of traders, traders do not have a direct role on price setting.

This first consideration mitigates but does not completely eliminate individual responsibility. I started this section on responsibility by making a distinction between responsibility for exploitation and responsibility for harmful outcomes. The reason for making this distinction is that not all cases of wrongful exploitation involve generating harm, instead exploitation consists on a process of extracting wrongful gain.[56] In other words, wrongful exploitation may or may not change the other party's situation. In the case of individual traders, their own exploitation does not change the other party's situation, but the wrongful gain still happens, hence, they have *some degree* of individual moral responsibility. On the other hand, the degree of moral responsibility of traders is less than other cases of exploitation such as gouging, since – as opposed to individual traders - the gouger is not only responsible for wrongful gain, but also individually responsible for generating harm to the other party. There are some specific cases in the Forex market in which a single trader may move market prices on their own in order to obtain additional gain. For example, someone with a large number of assets who sells these assets at once generating panic and a sharp drop in the price who then rebuys more of these assets at a low price.[57] In these cases, the individual trader has a degree of responsibility similar to the gouger, since she does not only obtain wrongful gain but is also responsible for generating harm.

A second consideration are background conditions. Given that traders operate within a context of unfair rules; they need to take certain actions in order to avoid losing profit. In other words, their actions are constrained by the background structure. Like with the previous reason, this reason cannot fully eliminate individual responsibility, since, as we saw before, there is always the option of opting out. Traders are well educated people who would be able to find another - maybe not as profitable but still profitable - job. However, background conditions can mitigate individual responsibility. As we saw in last chapter, background conditions can make a situation more or less exploitative – remember Arneson's example in

[56] See Feinberg, 1988: chapter 31
[57] See Sinn, 2010: 287-8

which rich exploiting poor was more exploitative than the opposite scenario. These differences in the degree of exploitation also lead to differences in the degree of responsibility for this exploitation: individuals will have more responsibility for their actions the more exploitative they are. In our case, a trader who sells her own assets in a context of panic in order to avoid losing too much profit exploits less than another trader who just sees an opportunity to make more profit and buys assets when they are non-proportionally cheap. In these cases, because the former case is less exploitative the former trader also has a lesser degree of responsibility.

A third consideration is absence of knowledge. Because traders do not know what the fundamental value of currencies is, then they do not know when they are exploiting. Traders may know that the price at which they transact is almost always non-proportional, but they do not know when they are above or below the fundamental value (FV). This absence of knowledge of the fundamental value leads to the absence of knowledge of when they are exploiting.[58] Absence of knowledge mitigates individual responsibility because of its connection to intention. Traders may argue that they intend to make profit in general, they do not specifically intend to make wrongful profit from exploitation, and because they do not know when they start exploiting, they may engage in exploitation without intention to do so. However, absence of knowledge cannot completely eliminate individual responsibility because the business of speculating also consists in profiting from exploitation. In other words, traders know in advance that once in the game, they will have no knowledge of the fundamental value, and that their profit may or not come from exploitation. Because they agree to enter an activity which will likely involve making profit from exploitation, their individual responsibility cannot be completely eliminated by this consideration even if they do not know exactly at which price they are exploiting. This is especially relevant in a context of competition, since once agreeing to enter the activity, even if traders knew the FV they would still have to exploit to avoid losing profit.

A final consideration is degree of non-proportionality. As we have seen, exploitation involves a non-proportional price. However, a price may be more or less exploitative. On the one hand, a price that is non-proportional but still relatively close to the FV will be less exploitative than a price that deviates from this value in an exorbitant magnitude. While the latter case will be very exploitative, the former one will be almost not exploitative. Therefore, the degree of responsibility in both cases will also vary depending on the degree of exploitation.

3.1.4- Traders and moral luck

In this subsection, I will argue that, while all traders have some responsibility for contributing to potential disastrous outcomes, traders who make a profit from exploitation have additional responsibility in a way that traders that make a loss do not. Assigning this additional moral responsibility to those traders who profit from exploitation only, generates an additional problem. Because traders profit or fail as a result of factors that are outside their

[58] For example, a trader may identify a bear or pessimistic market, in which the value of a currency is depreciating and may buy currencies. In this case if the trader bought early, when the market price was still above the fundamental value, this situation was not exploitative. However, there is an inflection point, that happens when the market price curve intersects the fundamental value curve, in which a situation that was not exploitative such as buying currencies, starts being exploitative because now the value is non-proportionally low. We may think that this point is arbitrary, since traders do not know its value.

control, it appears that this way of assigning responsibility is based on luck. Traders' profit or loss depends on the future value of the asset. However, this future value is unknown to individual traders, and it depends on factors that are outside their control, the general decisions of the market or the value that traders as a collective set for currencies.[59] Therefore, this differentiation which assigns additional moral responsibility for exploitation, seems arbitrary. In what follows I will argue it is not. Instead of offering a new argument for accepting moral luck for the case of traders, I will adopt a view that already exists for the case of retribution, and then I will explain why this view can be extended for the case of responsibility in markets. The argument for addressing the problem and accepting moral luck adopted here is that what *triggers* responsibility is obtaining an unfair or tainted profit.

3.1.4.1- What is the problem of moral luck?

Bernard Williams and Thomas Nagel introduce the concept of "moral luck", which happens when we can correctly assign moral judgement to a person, and not to another, even if a significant part of what this person achieves depends on factors that are outside this person's control.[60] For example, criminal law punishes more someone who committed murder than someone who merely attempted to murder someone but failed, even if the factors that led to the latter agent's failure were outside her control – e.g. a bird or a strong wind deflected the bullet.[61] Similarly, even if two people are doing the same action of driving drunk, but one kills one person while the other is lucky that no one came across her path, we tend to blame more the former driver than the latter one. It is interesting to observe that, most current legislation in the United States applies differential punishment for attempted and committed crimes such as murder.[62]

3.1.4.3- The argument from corrective justice to retributive justice

The view from retributive justice that I will adopt is the argument from corrective justice to retributive justice.[63] This view sees the completion of a crime as an unfair profit, that those who fail do not obtain, and for which those who succeed can be blamed for. The main defender of this view is Michel Davis. According to Davis, criminal law is a means to maintain a fair balance between benefits and burdens, and punishment serves to make individuals comply with the law, and is justifiable when it restores this balance.[64] Davis argues that breaking the law is generally advantageous to those people who break it. This advantage happens because the law works as a system of cooperation, and breaking the rules

[59] This value is unknown for traders, since they don't know what are the views of other traders and what will be the value of the currency that will result from the combination of their actions.
[60] Nagel, 1979: 59. Williams, 1981
[61] For the example of the bird that deflects the bullet see Nagel, 1979: 29, 31, also in Otsuka, 2009: 375. For both the examples of the bird and the wind see Moore, 1997: 194
[62] Nelkin, 2019. This is true for criminal and tort law. However, the prescription time for these offenses, of attempted and completed crimes is similar.
[63] See Moore, 1997: 203. Michael Moore does not adopt this view. He offers a list of twelve arguments or views that exist to accept the problem of moral luck for the case of retributive justice, then he argues against all of them and proposes his own view.
[64] Davis, 1986: 8-9. This view has led to several metaphors that explain retributive punishment as a way to pay for an unfair profit, such as the "debt to society that an offender owes by offending, the need to restore moral balance in the universe, the need to pay for the unfair advantage one has taken over the self-restraint exercised by more peaceful citizens" (Moore, 1997: 209).

is a "sort of cheating... in which one takes the fruits of social cooperation one is not entitled to, while depending on others not doing the same".[65] Therefore, breaking the law is obtaining an unfair advantage.

According to Davis, both the consequences and the intention to achieve these consequences are necessary conditions for a committed crime, to which moral responsibility can be assigned to, but the presence of each of these conditions on their own is not sufficient.[66] In the example of attempt and murder, the person who attempts to murder but fails, does not satisfy the consequence condition. When the murder kills his victim he profits, since he has the satisfaction of being able to inflict the harm he intended on the other person by depriving him of his life. In this case the murder takes an unfair profit, that the person who fails does not take. In Davis words, "to attempt murder is... not worth as much as to succeed because one who attempts but fails does not have the advantage of having done what he set out to do".[67] As opposed to this case, in the case of failed attempt there is no injustice done, nor imbalance to correct.[68] Therefore, a difference in punishment is justifiable.

As opposed to the cases presented above, in the case of a drunk driver, the driver does not have the intention to kill a person.[69] Instead, in this case both drivers have the intention to drive drunk, their intention materializes in the act of driving drunk, and as a consequence they expose others to harm. In this case, both drivers obtain an unfair profit by benefiting from inflicting the law and driving drunk. Because the drivers are not making an unfair profit from killing a person, but this profit happens before, these consequences should not matter when assigning responsibility. In this case, while both drivers share the same moral responsibility, the unlucky driver who kills a person may have other types of responsibility, such as causal responsibility for killing a person, or responsibility to rectify for the death, which may lead to additional punishment.[70]

3.1.4.4- The argument extended to the case of markets

Here I am not arguing that reconfiguring corrective justice as retributive justice is adequate in retributive cases, but rather that the corrective view is useful for accepting moral luck in cases related to markets. The idea that we are morally responsible for obtaining an unfair profit, is an adequate argument for market related cases because this view has an implicit idea of unfair exchange and unfair profit, which is what markets are ultimately about: exchanges and profit. In the cases of markets, it is the completion of an unfair exchange, or obtaining an unfair or tainted profit, that *triggers* moral responsibility, whereas the absence of this tainted profit absolves us from this blameworthiness. This tainted profit triggers responsibility, since it creates an imbalance, in which on the one hand we are profiting more than we are entitled to, and on the other hand, the other party has to bear additional costs. In other words, what makes us morally responsible is profiting from something that we should

[65] Davis, 1986: 11-12
[66] Davis, 1986: 15
[67] Davis, 1986
[68] Davis, 1986: 28
[69] Davis, 1986: 18
[70] Andre, 206

not, even if the factors that allow us to benefit from these unfair profits – that exclude others from obtaining the same benefits – are out of our control.[71]

The case of traders who speculate with the intention of making profit is similar to the case of murders, since in both cases the agents attempt to achieve an outcome, and while one of them achieves the outcome the other does not, because of factors that are out of their control. Like in the case of murders, we can make a distinction when assigning moral responsibility between traders who make a profit and those who do not. Because traders who make a loss have not taken unfair advantage or unfair profit from others, they have not created an unbalance, nor engaged in a wrongdoing such as exploitation. In other words, they cannot be held responsible for engaging in a wrongdoing, such as exploitation, since exploitation necessarily involves making additional profit from another vulnerable party. This is why making this tainted profit triggers responsibility. If traders have not made a profit, they have not engaged in exploitation, hence, they cannot be held responsible for this wrongdoing. Therefore, unfair or tainted profit acts as a double-edged sword. On the one hand, we obtain the monetary benefit of this profit, but on the other hand, it binds us to the burdens of moral responsibility.

Someone may object that the case of traders is different from the case of murders, since in the latter case the intention of killing someone is always wrong, whereas in the former case profit from speculation is not necessarily exploitative – e.g. they may be trading at the FV. In other words, traders may not have the intention to exploit. However, as we saw earlier, the absence of knowledge about when profit is exploitative can mitigate this responsibility of traders who are exploiting, but cannot completely eliminate it. In this case, when traders agree to enter the game they agree to make profit, which also involves the possibility of making profit from exploitation. Therefore, the intention of profiting from exploitation still exists, even if this intention to profit is not exclusive to profit that comes from exploitation. Among traders who profit, it is only the ones who profit from exploitation that have this responsibility, since it is only them who obtain unfair or tainted profit, even if the factors that make this profit tainted or not are out of traders' control.

3.2- The second problem: Collective actions lead to a disaster

Another reason for why speculation is wrong is because it is an activity that generates private benefits, with no social benefits, and may generate harmful or disastrous consequences.[72] In other words, when people engage in this activity for their own benefit, they expose others to harm and disastrous consequences.

We can make an analogy between this case and the problem of drunk drivers and moral luck presented in last section. Speculating in analogous to driving drunk, since we know that speculation almost always deviates prices away from the fundamental value. In last chapter we saw that the market is rarely in equilibrium. In other words, the market price set by traders is almost never the same as the fundamental value, it is only the same in rare cases in which the market price curve intersects the fundamental value curve during the alternation of pessimistic and optimistic moods of the market. When participating in speculating activity traders may not know what the fundamental value is, but we do know –

[71] This type of responsibility is prior to any law, since – as opposed to breaking the rules of social cooperation with others – in this case what is broken are principles of fairness in trade among those who are involved in this social practice, in particular a responsibility not to engage in exploitation.

[72] Ocampo et al, 2008: 38; Stiglitz, 2002: 239; Stiglitz et al 2006: 184-5; UN, 2009: 32-4

and they also know - that traders rarely transact at this value, and we also know that the market price deviates from the market price because of speculation. Therefore, speculating is like driving drunk, since both activities entail a considerably increased tendency to deviate from the correct path, which exposes others to harm.

The case of traders is also similar to the case of drivers since in both cases parties benefit from, and intend, a previous action. In the case of traders, traders intend and benefit from engaging in speculation. They may not obtain material profit, but they still benefit from participating in this activity, which offers the possibility of obtaining material gain. In the case of drivers, drivers intend and benefit from driving drunk. On the other hand, in both cases the harmful unintended consequence may happen or not depending on luck. In the case of drivers, a person may or may not cross their path, leading to killing the person in the former case but not in the latter one. Similarly, in the case of speculation, speculation may or may not lead to harmful outcomes. Also, like in the case of drivers, traders know that their actions may lead to harm. We know that cases of harmful outcomes such as Mexico 1994, Argentina and Brazil 1999-2000, the Asian financial crisis, were all harmful consequences of speculation.

From this analogy we can conclude that because in both cases, drivers and traders intend to participate in - and obtain a previous benefit from - the activity, they have moral responsibility regardless of the outcome. Like in the case of drivers, in which the driver who actually kills the person can have additional causal responsibility, traders whose actions lead to harmful consequences may also be causally responsible, but similarly morally responsible to those whose actions do not lead to harm.

This argument is slightly different from Davis' one, since Davis considers that drivers are only morally responsible because they break the law. However, here I consider driving drunk as a wrong that is previous to any law. Driving drunk is wrong because - like speculation - it is an activity which entails only personal profit with no social benefits, and exposes others to harm. For this reason, even if driving drunk was legal, we would still think it is wrong and drunk drivers would still have moral responsibility for doing so. This responsibility would not be as strong as the one they would have if they were *also* breaking the law, but they would still have some degree of moral responsibility. In that case, the state would also share responsibility for failing to regulate this activity. Similarly, in the case of speculation traders have some degree of moral responsibility, and the state – or regulatory agency - as well for failing to regulate.

Someone may object that the case of traders is different from the case of drivers, since in the case of drivers the drivers kill the person on their own, whereas in the case of traders it is *the combination of actions* of traders that lead to the disastrous outcome. This leads us to a second question. Can traders in the Forex market be held responsible for harmful outcomes that happen as a result of their combined actions?

We find cases that share some similarities with our case in the literature about collective responsibility. Anna Stilz offers the case of a plane accident.[73] In this case it is the combined actions of many employees, which lead to this outcome. However, while many of these employees contribute with their actions to the accident, none of their actions, on their own, would have caused the disaster. It is only when their actions are combined and interact, that the accident happens. Similarly, Philip Pettit offers the case of a ferry that drowns killing

[73] Stilz, 2011: 193

two hundred people.[74] In this real-life example, no one was penalized nor held liable in any way, since no one was found guilty enough to have caused the harm on their own.

The problem in all these cases is that assigning each individual responsibility for their own actions creates a "responsibility shortfall".[75] If we add the amount of responsibility that each individual has for their own actions, this amount of responsibility is lower than the amount of responsibility that should be assigned for the whole harm. This happens because of an "emergent effect".[76] This is a phenomenon that makes the total harm, that results from the combination of many actions, bigger than the individual harms made by contributors. This is a problem because if we only look at individual responsibility for their own contributions, no one will be assigned enough responsibility, which is unfair for the victims.

In order to solve this problem, and other problems of collective responsibility, most authors follow a similar strategy. They argue that the collective has certain characteristics that allows it to bear responsibility, such as sharing similar goals, having a deliberative decision-making process, intending and having control over their actions, among others.[77] In other words, they argue that models of individual responsibility can be extended to the collective if this collective satisfies certain conditions. After they conclude that the specific collective in their case satisfies the conditions to be assigned collective responsibility, they either argue this collective responsibility can be distributed among participants or that the collective as a separate entity has this responsibility. This solves the responsibility shortfall problem.

3.2.2- Collective responsibility and the case of currency speculation

3.2.2.1- The Foreign Exchange Market

Do traders bear responsibility for the disastrous outcomes that their combined actions generate? As we saw, the strategy of models of collective responsibility, is first to determine that the collective is a moral person, or an entity with certain characteristics, to which responsibility can be assigned to. Therefore, a previous question is whether the group as a whole, in this case the Forex market, meets these characteristics.

The Forex market does not meet the characteristics to be considered a moral person. There is no deliberation between traders on the choices they make, instead outcomes are a result of the combination of separate actions that each individual makes and from the combination of different transactions. There are also no common goals or objectives, even if traders influence each other's views on the possible future value of certain assets, they do not intend the outcomes of their actions. Also, the market does not aim the disastrous consequences that their actions have on countries victims of currency speculation. Therefore, because the market does not satisfy the conditions to be an agent to which responsibility can be applied to, there is no collective responsibility for disastrous outcomes, which could then be distributed among individual traders.

Does this lack of collective responsibility mean that in this case we have a responsibility shortfall? In my view we do not have this problem in the case of currency speculation, since there is an additional actor - the state or a regulatory agency – that also has

[74] Pettit, 2007: 171
[75] Stilz, 2011: 193. Originally in Copp, 2006: 216
[76] Stilz, 2011: 193. Originally in Kutz, 2000: 197-200
[77] See Miller, 2007: 114-9; Pasternak, 2014; Stilz, 2011: 192-5; Pettit, 2007: 176-88..

responsibility. The state has a responsibility to regulate, and by failing to do so is contributing to the harmful outcome, hence, can also be considered an actor to which responsibility can be assigned to.

Someone may object that Anna Stilz's case of the plane accident, is considered a case of collective responsibility, not only an individual one. However, in this case we could also say that the state has responsibility, because it is tolerant to negligence or because there are not enough rules that regulate plane accidents. In other words, there is a broader structure in which the plane and the ferry operate in, which allowed for the disaster to happen in the first place. Therefore, it is not clear how this would be different from the case of currency speculation in which the problem is also the absence of rules.

My answer to this objection is that in cases of negligence and accidents, as opposed to the case of currency speculation, the state only has an indirect responsibility. In this case, the state can be exempted from regulating *ex-ante* each individual action related to these disasters for three reasons. First, it unfeasible to regulate every single action involved in every process. There may be general legal standards for some industries, but we cannot expect the state to have laws on how to put every single nut on a plane or ferry, make it illegal to put a nut wrong and enforce this regulation. Second, regulating these mistakes would not be effective, since mistakes may happen with or without regulation. Individuals do not intend to make these mistakes. The business of planes and ferries does not consist in making mistakes in order to profit from these outcomes, and these mistakes may even harm the profits of these firms and individuals.[78] Third, the intended actions are not wrong and bring social benefits, it is only when individuals, by mistake fail to execute their intended actions properly that the possibility of disaster arises. For example, the state has an interest in that the airline is able to transport people, hence, it has an interest for all the individual actions that lead to this outcome to happen.

In this case, the state has another type of responsibility to regulate outcomes *ex-post*. For example, by generating laws enforcing compensation to victims for accidents, and enforcing mitigation and reparation for environmental damages in cases of oil leaks. Even if in this case the state still has a responsibility to regulate these outcomes, this responsibility is indirect, since regulation ultimate aims to allocate additional responsibility on the collective – e.g. it is the collective who should take more precautionary measures to avoid disasters or who should pay compensation for damages – and we may think that the collective had this responsibility anyway even in the absence of this regulation.[79]

As opposed to cases of negligence and accidents, in the case of currency trading the state cannot be exempted from implementing *ex-ante* regulation for the same reasons. First, there is only one action in one process, speculating on currencies, which is feasible to regulate. Second, because the business consists in taking this action, this action necessarily happens. For this reason, regulation would have an impact if speculation was prohibited. Third, the outcomes of currency speculation are not socially beneficial and these actions are inherently wrong. The state does not have an interest on the outcomes of currency speculation, and currency speculation may be exploitative and unjust. Therefore, in this case

[78] For example, an airline company which constantly has plane accidents will be seen as less trustworthy by customers and may decrease their sales. Similarly, an individual that contributes to these outcomes by her individual actions, risks being made redundant for her mistakes.

[79] If the state fails to regulate these outcomes, then it also shares responsibility for failing to make the actors involved take all the necessary precautions to avoid these outcomes and because it has the moral responsibility as an agent to regulate these situations.

the state has a responsibility for regulating an prohibiting these actions *ex-ante* and having preventive laws, rather than having *ex-post* laws on outcomes.

When the state is responsible for applying *ex-ante* regulation on individual actions, we avoid the responsibility shortfall problem, because we have an additional actor. In this case, the state (or regulatory agency) is causally responsible for the outcome by failing to regulate these actions, since it does not dissuade individuals from engaging in the activity that leads to a disastrous outcome. Therefore, when the state fails to prohibit individual speculative actions, it also acts as an actor in the creation of the outcome. In this case, we can conclude that traders have some responsibilities, but even if their individual responsibilities do not add up to the responsibilities for the whole harm, there is no responsibility shortage because the state or regulatory agency is also responsible. In other words, speculation is a moral wrong that should also be a legal wrong, or should be made illegal.[80]

3.2.2.2- Banks

Now that we have seen that the problem of responsibility shortfall does not apply for the case of currency speculation, I will briefly address another problem of collective responsibility that happens in this market: that between traders and banks in which they work in. Do banks also share collective responsibility for these actions?[81] Yes, because individuals act on behalf of a corporation, and if they do not fulfil their role, the corporation can replace them.[82] Also, banks also profit from traders' profit. Therefore, assuming that banks satisfy all the conditions to be considered a moral agent to which responsibility can apply to, they also share moral responsibility for these exploitative transactions. Someone may also argue the opposite, that it is *only* the bank, but not individual traders have responsibility for exploitative transactions, since traders only act in representation of a corporation and can be replaced if they do not act according to their role. However, traders chose to take part in this activity and benefit from it. Therefore, they also have responsibility.[83]

3.2.3- Back to Young: Political responsibility and the case of currency speculation

As we saw, Young's connection model offers individuals involved in a process that generates a wrong outcome a specific type of forward-looking responsibility, the political responsibility to take collective action to change the structure. She considers the case of currency speculation as one example of structural injustice that can be addressed with this model. Young argues that when traders follow their interests within stablished rules they do not intend to generate the harmful effects such in the case of the Asian currency crisis of

[80] Currently, speculation is not illegal, hence, traders cannot be committing a legal wrong, but a moral one. As opposed to this case, someone who tries to stop traders from speculating, say by disabling or hacking their IT systems, is not doing a moral wrong, since traders do not have a moral right to speculate in the first place. However, given the current laws, this person is doing something illegal.

[81] According to a *vicarious approach* they would not, since corporate groups only act vicariously, through individuals who are the responsible for their actions (Stilz, 2011: 191; May, 1987: 41-8, 83-106; Cane, 2002:171-9).

[82] Stilz, 2011: 191, Pettit, 2007: 190-2

[83] We may also think that background conditions may also reduce the degree of moral responsibility. Consider the case of a poor person who's only job possibility involves wrongful – or exploitative - activities. We may think that this person has a lower degree of moral responsibility than traders, since the latter are well educated individuals who could get another job elsewhere.

1997.[84] These are unintended consequences, and traders would have a political responsibility to change background rules. In my view, there are three main problems with applying this model, on its own, to this case.

First, it does not solve the responsibility shortage problem. In Young's view, traders do not have moral responsibility for their own actions, but would have a political responsibility to generate pressure to change the rules, in order to avoid the bad outcome. However, this type of forward-looking responsibility is less demanding than other types of forward-looking responsibility, such as task responsibility. In other words, traders are not asked to pay compensation or to repair the damage they have generated. On the other hand, traders are not the agent responsible for making and enforcing rules, and while they may make efforts to try to change these rules, nothing assures that they will succeed. Because there is a disconnection between the regulatory authority and subjects assigned with responsibility, in cases in which problems are the rules, we can have the situation above, in which traders may satisfy their political responsibilities of trying to change the rules, but not actually changing them, in which there is still a responsibility shortage.

Second, when the problem is unfair, or the absence of, rules, there is a regulatory authority that can be held responsible, with both backward, and forward-looking responsibility to change these rules. As opposed to the case presented above, in which traders may satisfy their political responsibilities without changing the rules, in this case because responsibility falls on the regulatory authority, these responsibilities can only be satisfied by actually changing the rules. Young would argue that in cases of structural injustice, because of an absence of background rules, states cannot implement unilateral laws to regulate these situations. As we saw, she offers the example of sweatshops, in which vulnerable states desperately need investment in their countries, failing to implement labour laws for their citizens. However, as we saw in chapters 1 and 2, here I take Ronzoni's approach and consider that in cases of global background injustice, what is needed are new social practices that regulate existing ones. Later in this chapter I will argue for a specific regulatory agency that can be held responsible.[85]

In the case of currency speculation, I do not deny that traders and banks may have political responsibility to try and change the rules. Instead what I am arguing is that in this case, assigning political responsibility to these agents is not enough to solve responsibility shortage problems. Therefore, we should also, and *mainly*, assign responsibility to the regulatory authority.

[84] Young, 2011: 63

[85] After the 2008 financial crisis, the United States strengthened regulation on financial markets and the use of derivatives, and created the Volker Rule in the framework of the Dodd-Frank regulation. This regulation was also enforced on other countries, since United States' Banks were only allowed to trade with foreign Banks that also followed these rules. Because the United States is such an important trading partner for many countries, many foreign banks also implemented this regulation. In this case we may conclude that responsibility falls on regulatory authority of strong countries.

Section 4) Currency speculation and background injustice

This section aims to make a connection between the problem of background injustice, introduced in chapter one and the problem of exploitation addressed in this chapter. In chapter 1, I argued that there are two problems of background injustice in the IMS: the problem of monetary spillovers and the problem of currency speculation. In this chapter, we also saw that speculation in some cases can also be exploitative. These two problems, of background justice and exploitation raise the following question. Is the problem of background justice for currency speculation the same as the problem of structural exploitation for the same case? Is structural exploitation the same as background injustice? Here I will argue that, while there are some similarities between these two problems, these problems are also different from each other, since one is a problem of justice and the other one is a problem of exploitation.

Since we are considering the problem of background injustice and the problem of parasitic exploitation for the same case of currency speculation, we may think that they are the same problem, but they are not. The main difference between these two problems relies on the benchmark. In chapter 2 I made a distinction between mere interdependence and a problem of background injustice, and I argued that the point at which interdependence becomes a problem of background injustice is when there is domination, or in the presence of a crisis. While I argued this for the case of monetary spillovers, the same argument can be applied to the case of currency speculation. This argument can be extended to this case by saying that while currency speculation may erode the three conditions of background injustice to some degree, this erosion only becomes a problem of background injustice when there is domination, or a crisis. The benchmark of parasitic exploitation is different from that of background injustice, since it does require the presence of a crisis. Instead, any deviation from the FV that allows traders to make additional profit at the expense of the people of the country that have their currency speculated on can be considered a case of parasitic exploitation. Therefore, the benchmark of parasitic exploitation is more demanding than that of background injustice.

Section 5) Regulation of currency speculation

Currency speculation is an activity that on the one hand, brings private benefits to those who engage on this risk-taking activity and make a profit, but on the other hand, externalises the costs and generates social harms.[86] These harms are not only cases of harmful externalities, but in some cases are problems of justice and problems of exploitation, as we have seen in this chapter and in chapter 1. On the other hand, profits are private rather than social. As opposed to other markets in which consumers obtain a benefit from trade and competition, in the case of currency speculation, the possible benefits of speculation such as incorporating information into prices, would have happen anyways and because of cognitive bias traders exaggerate this information. Benefits for people from the Foreign Exchange market come from other types of transactions, such as hedging, and transactions for need,

[86] When crises occur because of speculative attacks speculators receive the benefits of speculation at the expense of taxpayers in developing countries, who are made the worst off by this practice (Stiglitz, 2002a: 239, Stiglitz et al 2006: 184-5; UN, 2009: 32-4). For example, when the IMF acts as a lender of last resort and offers bailout to the banks of countries that have been victims of speculative attacks, it offers loans that are debts that must be paid by taxpayers in the future.

rather than from speculation. Because of this lack of social benefits, as opposed to private ones, and the generation of problems of justice and in some cases of exploitation, speculative activity on currencies cannot be justified, hence, should be prohibited.

A sceptic may argue that we cannot know in advance if speculative activity will generate exploitative or unfair or harmful outcomes, thus, it seems too demanding to ban *all* cases of currency speculation. For example, we have seen that the degree of the impact may not raise considerable concerns to raise an issue of justice or harm. The problem with this argument is that we cannot know in advance which cases will be exploitative, or harmful and unfair. This brings us back to the problem of moral luck, and the case of the two drivers that drive drunk and one kills someone, while the other one is lucky that no one came in her way. When we think about rules, and problems of structural exploitation and background justice, the focus should be on avoiding injustice and exploitation *ex-ante*, and preventing these outcomes, that depend on luck, from happening by imposing rules, even if there is a possibility that these activities will not generate injustice or harm.[87] In the case of drivers, a rule that prohibits people from driving drunk is reasonable even if there is a chance that someone who drives drunk will not kill anyone. Similarly, in the case of currency speculation, banning this activity is reasonable even if there is a possibility that currency speculation will not result on either injustice nor exploitation.

5.1- How to regulate?

After the global financial crisis of 2008, the United States increased financial regulation and implemented the Volcker Rule, which is a section (619) of the Dodd-Frank Wall Street Reform and Consumer Act, on banks. The aim of this law was to diminish the probability of banks' default. Before 2008, banks had the idea of being *too big to fail*, or in other words, they thought that in the event of a possible default they would be rescued by the government with tax payers' money. This led to moral hazard, or for banks to take excessive risks, since they thought that if they failed they would not be the ones to assume these costs.

In this context, the Volcker Rule aims to ban speculative proprietary trading, or in other words, to limit speculative activity with the banks' own resources.[88] As stated in the law, the Volcker Rule "prohibits banking entities from engaging as principal in proprietary trading for the purpose of selling financial instruments in the near term or otherwise with the intent to resell in order to profit from short-term price movements".[89] Proprietary trading is trading activity made with the bank's own resources. For example, when a bank offers a loan to a client, this client has to pay the loan plus interests. These interests are part of the bank's own resources, and because these resources are necessary for the bank to remain liquid, if the bank loses these resources it may fall into default. The financial instruments included in the law are securities, derivatives, commodity futures, and options on such instruments, but excludes loans, spot foreign exchange or spot physical commodities.[90]

Because the aim of this law is to avoid bank's default, rather than avoiding speculation itself, banks can still speculate with their customers' money (with their permission), with

[87] This idea is different from the case of individual exploitation from a trader, in which given the absence of rules, she may obtain a tainted profit which we can only know *ex-post*.
[88] Volcker Rule, 2014: 5546, also in 62106
[89] Volcker Rule, 2014: 5538
[90] Volcker Rule, 2014: 5542

insurance company's money, and can also engage in risk-mitigating hedging activities.[91] The Volcker rule considers a speculative transaction that aims to profit from short-term price movements, when "the banking entity holds the financial instrument for fewer than 60 days or substantially transfers the risk of the financial instrument for fewer than 60 days of the purchase or sell".[92] According to the law, if the bank engages in transactions that violate the 60 days rule, it must show that the trade is for clients, or that the funds do not come from the banking's entity trading account.[93] On the other hand, other financial institutions, such as hedge funds and private equity funds are allowed to engage in speculation, the law only prohibits banks to own, sponsor or have certain relations with any of these former entities, in order to avoid a transfer of risk.[94]

While the American regulatory agency only has coercive force over American banks, the Volker rule also prohibits American banks to trade with foreign banks that do not comply with this rule. In other words, this law is subject to US-entities and their transaction with foreign banks, and exempts only those transactions in which US-entities are not involved at all.[95] Because the United States is a strong trading partner for many countries, many foreign banks have also implemented the Volker rule in order to continue trading with American banks. In 2014, even "some European banks [were] complying with the American rule because some of their largest corporate clients [were] in the United States".[96]

Increased financial regulation after the 2008 crisis, also led to the creation of several laws, such as the European Market Infrastructure Regulation (EMIR), which aims to offer more transparency and risk mitigation measures for derivatives, and Basel III, which is an international agreement to decrease bank leverage and risk, and to increase liquidity. Structural banking reforms, with similar aims to the Volcker Rule, were implemented in the United Kingdom through the Vickers Report, and in Europe, the European Commission withdrew the Structural reform proposal, since the aims of this proposal were already being addressed by other regulatory measures in the banking sector.[97]

From this chapter we can conclude that, while regulation such as the Volcker rule is a good starting point, it should be extended in order to address the problems of fairness and exploitation presented in this chapter and in chapter 1. First, the Volcker rule focuses on the sources of the funds for speculation, or where the money used for speculation comes from, since its main aim is to avoid banks' default. In this thesis we have seen that speculation in the Foreign exchange market is a problem in itself, hence, instead of only focusing on where the money comes from, what should be regulated is speculation regardless of this issue. This can be done by generalizing the 60 days rule to any source of income.[98] Second, the Volcker rule mainly regulates derivatives and futures, but excludes the Foreign Exchange *spot* market, which is the market that we have addressed in this thesis, an adequate rule, should also include this market.[99] This can be done by extending the 60 days rule to the spot market.

[91] Volcker Rule, 2014: 5538
[92] Volcker Rule, 2019: 62040
[93] Volcker Rule, 2019: 62063
[94] Volcker Rule, 2014: 5538
[95] Volcker rule, 2018: 33467-8.
[96] https://www.gfmag.com/magazine/february-2014/cover-story-the-volcker-effect
[97] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/structural-reform-eu-banking-sector_en
[98] The idea is that instead of Banks having to prove that the source of the funds comes from the client, or are not connected to the bank's account, these short-term transactions can be prohibited regardless of the source.
[99] This is the market of Foreign Exchange transactions without derivatives or futures.

Third, the Volcker rule regulates specific agents such as banks, which have a social role in society and would eventually need to be bailed out by the government in case of default, and excludes other agents such as hedge funds and private equity funds, which in case of default the cost would have to be borne by private people. Here again because of a difference on focus from the Volcker rule and this proposal, the latter would consider all agents, including hedge funds and private funds.[100] This can be done by imposing the 60 days restrictions to these agents as well.

Even if this proposal is broader than the Volcker rule, we can still notice two relevant issues from this rule. First, we can observe that distinguishing speculative transactions from other transactions, and regulating them, is not only possible, but also currently being done, for specific agents on specific markets with specific sources of income, and it can be done more generally by extending the 60 days rule, as proposed above. Second, we can observe that the compliance method with respect to foreign banks also works as a form of coercive enforcement abroad. Because many countries have main trading partners in the United States, and in order to continue trading with them they need to comply with this rule, this system "sweeps them [these countries] into a US-centric compliance regime".[101] This is relevant because this system offers a solution to both the problem of background structure and the problem of responsibility. On the one hand, it solves the problem of background structure, since we find an international coercive method in the absence of a global coercive basic structure. On the other hand, it solves the problem of responsibility, since regulatory agencies of strong countries, such as the one of the United States, is an agent that can be ultimately held responsible in cases of coordination problems and in the absence of a global state.

The regulatory proposal made in this thesis is different from Gabriel Wollner's. Wollner argues for the implementation of a Tobin tax, on the grounds that this would increase peoples' well-being, sovereignty and social justice. [102] My proposal is less demanding than Wollner's in some respects, but more demanding on others. On the one hand, my proposal is less demanding than Wollner's, since it includes regulation of speculative transactions only, as opposed to a Tobin tax which aims to regulate *all* foreign exchange rate transactions. Here we have seen that it is not *all* transactions in the Foreign Exchange Market that are wrong or exploitative. For example, there is nothing wrong with transactions made out of need, such as those that happen when someone needs foreign currency to travel abroad or for business to conduct their normal international transactions. The problem arises with the speculative ones only. On the other hand, my proposal is more demanding than Wollner's, since it does not aim to put a tax on these transactions, but rather to prohibit them.

5.2- Short-term versus long-term speculation

Someone may question the efficacy of the extended Volcker Rule to mitigate speculation on the grounds that it ignores long-term speculation. The 60-day rule would mitigate short-term speculation, but would be ineffective in addressing long-term speculation. This raises the question of whether long-term speculation is so harmful in provoking crises, or if crises are mainly a result of short-term speculation.

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[100] The extension of the Volker rule to hedge funds and private equity funds has also been proposed on the grounds, that imposing limitations on banks only, would lead speculators to speculate through these other entities, making them grow in size, and not solving the problem. See Acharya *et al*, 2011: 364.

[101] https://www.gfmag.com/magazine/february-2014/cover-story-the-volcker-effect

[102] Wollner, 2014

Most currency and balance of payment crises are caused by short-term speculation and follow a similar pattern. When countries have their currencies pegged and traders lose confidence on the government´s commitment to maintain the currency at a certain level, the latter engage in a *sudden* "speculative attack" against the currency.[103] In other words, traders suddenly start selling the currency. In order to maintain the value of the exchange rate the central bank of the country uses reserves to counteract the effects of speculation. When the country runs out of reserves there is a balance of payment crises, and is forced to allow the currency float, which leads to a *sharp* depreciation. Both types of crises happen *suddenly* and there is a sharp change in reserves and exchange rates. On the one hand, a balance of payment crisis is defined as a situation in which a country experiences a sharp decline of reserves.[104] On the other hand, a currency crisis is defined as a situation in which a country experiences a sharp depreciation of their exchange rate as a consequence of speculation, and the change in nominal exchange rate exceeds a certain threshold.[105] Examples of how short-term speculation leads to a sharp depreciation of the exchange rate, that usually happens within a few days or a month, include de cases of Thailand in July 1997; Brazil in January 1999; Mexico in December 1994; Russia in August 1998; and Britain in September 1992.[106]

While most currency crises follow the pattern described above and are a result of short-term speculation, there are exceptions. One exception is the case of Turkey, which between 2018 and 2021 has faced a long-term downward trend of its floating exchange rate.[107] While there has been a long-term depreciation of the Turkish lira, there have also been sudden episodes of short-term speculation in this case. For example, in August 2018 after the US doubled the metal barriers on Turkey, the lira fell by 20 percent in 24 hours.[108] The extended Volcker Rule mitigates the latter cases of speculation, but not those that are long-term, and hence, I acknowledge that this policy mechanism has limitations in these cases. However, throughout this thesis I suggest a combination of policy mechanisms, such as the Global Fund, non-extensive capital controls, and the extended Volcker Rule. Therefore, because the extended Volcker Rule is not an isolated policy mechanism, other policies could be used in a more effective way in these exceptional cases.

Section 6) Objection

According to George Soros harmful outcomes happen even if one specific trader stops her actions. According to Soros, because harmful outcomes that derive from speculation are not the result of one single market participant's action, these participants are exempted of moral responsibility, as long as they play by the rules.[109] One single trader does not generate the bad consequences, since she cannot move the market, and similar outcomes would happen even if this single trader abstains from making profit. Given the rules, if

[103] I borrow the explanation of the pattern from Krugman, 1979; and Krugman et al, 1999
[104] Krugman and Obstfeld, 2003: 504-6
[105] Idem
[106] I borrow these cases from Krugman et al, 1999
[107] https://www.reuters.com/business/turkish-central-bank-surprises-with-rate-cut-sought-by-erdogan-2021-09-23/
[108] https://www.bbc.com/news/world-us-canada-45123607
[109] Soros, 1998: 197

individual market participants act considering the social consequences of their actions, they only lose profit, while not generating any real changes in the world.

I have already partly answered this objection in this chapter, since I have argued that while considerations, such as background structure and role in generating the harm, mitigate individual responsibility, they cannot completely eliminate it. By analysing individual cases we can assign more or less responsibility depending on these considerations. Let us, for example, consider Soros' case of Britain 1992.

The first consideration was role in harm. We saw that individuals may have more or less degree of responsibility depending on the role they had in contributing to the harmful outcomes. In this specific case, Soros was a catalyst for speculation, since he sold an amount equivalent to $10 billion in British pound sterling (GBP), creating a panic and offering an incentive for others to do the same. In an interview, Soros said, "we [his hedge fund] must have been the biggest single factor in the market in the days before the E.R.M. fell apart... our total position by Black Wednesday had to be worth almost $10 billion".[110] Because of Soros' role in triggering the devaluation, he has more responsibility than a trader who has less – or no - power to move the market, and who has no role in the generation of harm.

A second consideration is background conditions. We saw that a trader who, constrained by the background structure, sells in order to avoid losing profit is less responsible that one who just sees an opportunity. In this case, Soros has more responsibility, since he is someone who saw an opportunity. Soros did not initially have GBP, but he thought that the British government might devalue the currency and sold short. In other words, he borrowed GBP from banks, sold them in the Forex market, generated a panic that led to devaluation, then, when the GBP was low, he repurchased the GBP, paid his debt, and his hedge fund made a $ 4 billion additional profit and Soros made a personal profit of around $ 1 billion.[111]

The third consideration was absence of knowledge. Because traders do not know the fundamental value of currencies, they do not know when they are exploiting. In this case, we can say that traders knew that they were speculating on a country's vulnerability, see Annexe 7. We can also say that traders do know that because of cognitive bias, when speculating, there is a tendency to reach non-proportional prices, and in this case, the price was also likely non-proportional, see Annexe 7. Traders in this case also knew that their gains came from British tax-payers, since Britain purchased £ 27 billion in the Forex market to counteract the effects of speculation.[112] As we saw, absence of knowledge was a relevant consideration because of its connection to intention. But we can question traders' intentions when entering a game that aims to profit from exploitation – even if it is not exclusively from exploitation. In particular, we can question Soros' intentions of buying at non-proportional prices, since this is what he was aiming to do. When talking about the Asian financial crisis, Soros explains that he was intending to buy at cheap prices, but he made a mistake by thinking that the price would not depreciate more, and bought "too soon, as it turned out… we left most of the potential gain on the table".[113] Because Soros has the intention of buying at non-proportionally cheap prices in a context of vulnerability, we can say he still has some responsibility even if he does not know the fundamental value of currencies.

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[110] https://www.nytimes.com/1992/10/27/business/big-winner-from-plunge-in-sterling.html
[111] Idem
[112] Owen, 2009: 45. Also in,
https://www.ft.com/content/e9c65160-8c3b-11e8-b18d-0181731a0340
[113] Soros, 1998: 208-9

The final consideration is degree of non-proportionality. In this case, we cannot know exactly what the degree of non-proportionality is, since we do not know when Soros bought GBP and we do not know the fundamental value of GBP at each moment of time. However, we can make some general remarks. First, as opposed to the case of the Asian crisis in which Soros bought *too early*, in the British case, if Soros bought when the currency was at its lowest value, the price at which he bought was likely non-proportional, see Annexe 7. Second, when comparing the graphs of the value of the exchange rate for the case of Thailand in 1998 – in Annexe 6 – and the case of Britain in 1992, we can see that the currency depreciated more in the case of Thailand, compared to its stabilized value, than in the base of Britain. Therefore, we may think that traders who bought at the lowest value exploited more in the former case than in the latter one.

Section 7) Conclusion

In this chapter we saw that because some cases of currency speculation satisfy the three conditions of the framework criteria, and these cases involve a process in which we can connect third parties to the transaction, these can be considered cases of parasitic exploitation. Traders who obtain profit from exploitation can be considered morally responsible. However, traders in general cannot be considered responsible for the disastrous harm that happens as a combination of their actions. Instead, it is states, as regulatory agent, which have forward-looking responsibility to change the rules and implement regulation.

PART II

Chapter 5: Fixed Currencies: The Cases of the Gold Standard, the Reserve Currency Standard, and the Eurozone

Section 1) Introduction

In the introduction of this thesis, I presented the Mundell-Fleming trilemma of international macroeconomics, according to which countries cannot have at the same time stable exchange rates, autonomy in monetary policy, and open capital markets. States within the IMS can only have two of the three elements at the same time. From this trilemma, we obtain three stylized scenarios. In the first part of this thesis I addressed the general scenario that exists in the IMS today, a scenario with generally open capital markets in which countries are allowed to float their exchange rate. In the second part of this thesis, I focus on the other two stylized scenarios. In this chapter, I will address the case in which we still have open capital markets, but in which states have fixed currencies. Finally, in the next chapter, I will consider the third scenario of closed capital markets.

In order to address the case of a fixed currency, I will use a real-world case. In the history of the IMS, there was a period between 1870 and 1914, called the Gold Standard period, in which all countries had their currency fixed to gold. Similarly, there was a sub-period at the end of the Bretton Woods system, in which all countries had their currencies fixed, but in which there were open capital markets. The Bretton Woods system that was implemented from World War II until 1973 was initially designed as a system of fixed currencies and closed capital markets. In this system, all countries fixed their currency to the dollar, and the US fixed its currency to gold at the price of $35 an ounce. However, after the implementation of currency convertibility in 1958, there was a gradual dismantling of these controls and an increase in capital flows, which made the final sub-period of Bretton Woods work as one of fixed exchange rates and open capital markets.[1] This sub-period, which I will refer to as the Reserve Currency Standard, is another case of a stylized scenario of fixed currencies. Another possible alternative is to consider a monetary union, such as the Eurozone, in which all countries have their currency fixed with respect to other members of the union.

Each of these cases, the two stylized cases and the Eurozone, has benefits and drawbacks as examples for this chapter. On the one hand, the Gold Standard and the Reserve Currency Standard are stylized cases of fixed currencies, in which all countries had their currency fixed. However, these are historic, rather than current, cases. On the other hand, while the Eurozone is a current case, relevant to contemporary debates and policy discussions, it is both a hybrid and a special case of fixed currencies. The Eurozone is a hybrid case, rather than a stylized one, since it is a case in which a specific group of countries agree to having fixed currencies, within a general context of floating exchange rates. In other words, a monetary union is an agreement between a group of countries, within the general agreement made by all other countries to participate in the IMS. The case of the Eurozone is also a special case of fixed currencies, since these countries do not only have their currencies fixed, but they also agree to share the same currency. This generates changes on how the market operates. Because countries in the Eurozone share the same currency, the perceptions

[1] Krugman and Obstfeld, 2003: 550.

of the market on each individual country are no longer associated with their exchange rate in the Forex market, since countries in the Eurozone do not have individual currencies. Instead, these perceptions are reflected in the money market, specifically in the spreads on interest rates on individual countries' assets.[2] Also, having a common currency puts stronger constraints on countries compared to having a fixed currency. For example, countries that have fixed currencies still have some ability to pursue monetary devaluations (or revaluations), or to change the parity of their currency, from time to time, whereas countries that share the currency also lose this ability.

Given the benefits and drawbacks of these two cases - the two stylized regimes and the Eurozone - I will consider both the Gold Standard and the Reserve Currency Standard, and the case of the Eurozone. Some economists and political scientists have argued that the cases of the Eurozone and the Gold Standard share the same economic and political problems, respectively.[3] Similarly, economists point out the relevance of studying fixed exchange rates, not only to understand historic cases such as the Gold Standard and the Reserve Currency Standard, but also because some of the same *economic* principles apply in contemporary cases of monetary unions such as the Eurozone.[4] Therefore, it makes sense to compare them and to ask whether similar *normative* principles also apply in these cases. I will argue that even if these cases share the same *economic* principles, the *normative* principles that arise in these cases are different. Also, considering the stylized, but historic, cases will allow me to identify the relevant moral features of the contemporary case of the Eurozone, and why special principles of additional solidarity arise in this case, but not in the general cases.

1.1- Structure of Chapter

This chapter proceeds as follows. *Section 2* considers the two stylized regimes of fixed currencies and open capital markets, the cases of the Reserve Currency Standard and the Gold Standard. I suggest that, because cases of currency speculation were common in these cases, the framework of parasitic exploitation can be extended to the fixed scenario. I also argue that in these cases domination necessarily occurs, since the three criteria of arbitrariness, imbalance of power and dependency are met in a strong way. Therefore, the LRP cannot be extended to this case. Instead, there is a forward-looking responsibility to change the system to a floating scenario. *Section 3* considers the case of monetary unions, and specifically the Eurozone. My initial hypothesis is that when countries join a monetary union they are less likely to be dominated and exploited. I start by asking what the benchmark for domination is in this case. I argue that as opposed to the floating case, in which domination happens when there is a crisis, in the case of monetary unions the benchmark for domination is the absence of mutual advantage. I also argue that since the benchmark for domination is different, the principle that applies in each case is also different. I suggest that the adequate principle to address the case of monetary unions is Juri Viehoff's equitable risk-sharing principle. I also argue that parasitic exploitation also takes place in the case of

[2] Stiglitz, 2016:129

[3] Eichengreen and Temin, 2010; Eichengreen, 2002; Matthijs, 2012.

[4] Krugman and Obstfeld, 2003: 481-2. Different economic principles apply in each of the three cases of the trilemma. For example, in the case of a regime with fixed exchange rates and open capital markets, the central bank loses the ability to affect internal macroeconomic conditions by using monetary policy, currency speculation in this case leads to the loss of reserves and ultimately to balance of payment crises, among other features of this case. As opposed to this case, in the case of closed capital markets, central banks can have both autonomy in monetary policy and stable exchange rates. Because of the differences between the three cases, books of international macroeconomics usually present these cases separately.

monetary unions. This raises an apparent paradox. Contrary to the initial hypothesis, countries that join a monetary union, in which there is capture and no solidarity, are more dominated, and similarly exploited, than in the floating case. I suggest that this apparent paradox occurs both because, in this case, countries are objectively worse off compared to the floating case and because the benchmark of domination is different in the two cases. *Section 4*, offers policy proposals for the case of the Eurozone, a fiscal federalism and additional banking regulation. *Section 5* addresses the objection that more solidarity within the Eurozone will generate democratic opposition from the different peoples or *demoi* within the union. Finally, *section 6* concludes.

Section 2) The cases of the Reserve Currency Standard and the Gold Standard

In this section, I consider two cases of stylized regimes of fixed currencies and open capital markets, the cases of the Reserve Currency Standard and the Gold Standard. I ask whether the framework of parasitic exploitation and the LRP offered for the general case of floating currencies can be extended to the general case of fixed currencies. Before I introduce these systems and explain how they work, I will briefly observe that cases of currency speculation were common during both regimes; hence, I will infer that the framework of parasitic exploitation can be extended. I will then explain how these regimes work and show that the problem of monetary spillovers also applies in these cases. I will argue that because in this case there is always domination, the LRP cannot be extended to this case. Finally, I consider the issue of responsibility. I suggest that in this case there are no additional responsibilities between countries compared to the floating scenario. However, the absence of additional responsibilities leaves the majority of countries worse off compared to the alternative scenario of changing the IMS to a floating regime. Therefore, I conclude that in this case, the type of responsibility is a forward-looking responsibility to change the system to a floating one.

2.1- Currency speculation and Framework of Parasitic exploitation

The Bretton Woods system had different periods. This system was created after World War II, and was originally conceived as a system of closed capital markets and fixed currencies. However, after currency convertibility in 1958, these capital controls were gradually dismantled, and capital flows increased dramatically, turning the system into one of fixed currencies and open capital markets. While currency speculation in the initial sub-period of Bretton Woods was absent due to extensive capital controls, speculation became more common after 1958. Balance of payment crises due to currency speculation also became common in the 1960s and 1970s. A series of cases of currency speculation happened against Britain, between 1964 and 1967, and Britain finally had to devalue the pound in 1967. Similarly, France and Germany had to devalue their currency in 1969, and the United States in both 1971 and 1973, due to speculation. "These crises became so massive by the early 1970s that they eventually brought down the Bretton Woods structure of fixed exchange rates".[5]

[5] Krugman and Obstfeld, 2003: 551

When considering cases of currency speculation during the Gold Standard, we need to distinguish between the periods before and after World War I (WWI).[6] Before WWI, currency speculation was uncommon. During this period Britain acted as a hegemon, which encouraged cooperation between central banks. When a country, or a group of countries, needed a devaluation (or a revaluation), the central banks of different countries would join and take the same devaluation as a group, which avoided currency speculation against specific countries that seemed weak to traders. However, after WWI, Britain no longer held this hegemonic power and a lack of cooperation between countries made currency speculation more common. Currency speculation became even more common after the Great Depression, and many countries – such as Britain, Japan, and several Scandinavian countries - were forced out of the fixed currency system due to currency speculation against their currencies in 1931.[7]

According to the framework of parasitic exploitation offered in the first part of this thesis, traders engage in exploitation when they obtain additional profit from misusing a system in ways that cannot be justified to others. I argued that currency speculation was one of the cases in which the framework of parasitic exploitation applies. Because cases of currency speculation happened during the two stylized regimes of fixed currencies, the framework of parasitic exploitation can be extended to this case. In what follows, I will leave the tension between the market and the state aside, and focus on the relationships between states, and ask whether the LRP can also be extended to this general case.

2.2- The Limited Regressiveness Principle and the general case of fixed exchange rates

In the first part of this thesis I introduced the problem of monetary spillovers, which occurs in the general floating case. Because the exchange rates of two countries are relative to each other, when one country modifies its exchange rate, it also modifies the exchange rate of other countries vis-à-vis this country. I argued that monetary spillovers sometimes erode the three conditions of background justice: the ability to deliver social justice at home, sovereignty, and equality and freedom of agents. The ability to deliver social justice at home is eroded, since changes in the exchange rate affect a country' internal macroeconomic conditions, which affect the ability of countries to deliver social justice at home – to achieve adequate levels of employment, purchasing power of individuals, among other considerations. Because countries' internal macroeconomic environments are influenced by these external decisions – the application of monetary policy by foreign countries – their sovereignty is also limited to a certain degree. Finally, I argued that monetary spillovers increase inequality and make countries more dependent, leading to an erosion of the condition of equality and freedom of agents. More specifically, I showed how in this case, the way in which the system is structured leads to divergence, since there is a series of channels of dependency that make weaker countries more affected by monetary spillovers and fluctuations in exchange rates, while offering additional benefits to stronger countries.

In what follows I will show that the problem of monetary spillovers, broadly understood, also arises in the general cases of fixed currencies. In other words, I will show that cases in which strong countries apply monetary policy that affects the internal macroeconomic conditions of other countries, eroding the three conditions of background

[6] Eichengreen, 1992: 4-10.
[7] Bernanke, 2004

justice, also happen in these cases. I will start by explaining how each of the two systems of fixed currencies, the Reserve Currency Standard and the Gold Standard, worked and then show that the problem of monetary spillovers also happens in these cases.

2.2.1- Reserve Currency Standard

From the end of World War II until 1973 the IMS worked as a system of fixed currencies.[8] In this system, all countries fixed their currency to the US dollar, and the US fixed its currency to gold at the price of $35 an ounce. However, after the mid-1960s, the US no longer fixed the dollar to gold in practice, and the system worked as a Reserve Currency Standard.[9] In this system, all central banks held international reserves in one currency, the US dollar, and fixed their exchange rate against this currency. The need to intervene in the Forex market to keep the currency stable meant that central banks needed a sufficient quantity of US dollars. Because each country fixed its currency to the dollar, all currencies were also fixed to each other, which facilitated trade among countries.

In a Reserve Currency System, the Nth currency, or the country that issues the currency to which all other countries fix their exchange rate, has a privileged position in the system. On the one hand, this country benefits from having fixed exchange rates with others, which is beneficial for trade. On the other hand, this country can apply monetary policy for stabilization purposes, since all other countries peg the currency to this country, but this country does not need to fix its currency to that of another country. In other words, because the Nth country does not need to fix its currency to that of another country, it does not lose the ability to apply monetary policy, in a system in which all other countries lose this ability. This is what the French finance minister, Valéry Giscard d'Estaing, called the *exorbitant privilege* of the United States during this time.[10]

In this system the effects of monetary spillovers were very straightforward. Because all countries had their currencies fixed to the US dollar, when the Federal Reserve applied monetary policy, all other countries needed to implement the same policy to keep their currency fixed to the dollar. For example, if the US applied expansionary monetary policy, other countries would also need to expand their money supply by buying assets (with their currency or taking debt), in order to avoid their currency from appreciating against the dollar. In other words, countries that pegged their currency to the dollar in this system did not only lose the ability to apply their own desired monetary policy, but they also passively imported the monetary policy applied by the reserve currency. The main case of these monetary spillovers happened when the United States applied expansive fiscal and monetary policy between 1965 and 1968, which led to an inflation of 6 percent in the country by the end of the decade. Other countries imported this expansionary monetary policy, which led to worldwide inflation. This worldwide inflation combined with a series of currency speculation, led to the fall of Bretton Woods in 1974.

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[8] I borrow most of this subsection from Krugman and Obstfeld, 2003: 512-3; 558-64.

[9] Krugman and Obstfeld, 2003: 516-7. The Bretton Woods system was intended to work as a Gold Exchange Standard, a system that is halfway between a Gold Standard and a pure Reserve Currency Standard. In a Gold Reserve Standard, all countries fix their currency to the reserve currency, in this case the US dollar, and in turn, the reserve currency is fixed to gold, in this case at $35 an ounce. However, by the mid 1960s the system de facto worked as a pure Reserve Currency Standard, rather than as a Gold Exchange Standard.

[10] Ocampo, 2017: 14

2.2.2- The Gold Standard: How it worked, and costs and benefits

The problem of the Nth currency is solved in a system such as the Gold Standard, in which all countries fix the price of their currency to the price of gold.[11] Because all countries fix their currency to gold, none of them occupies a privileged position in which they are relieved of the commitment to adjust their currency, and in which this country is the only one which can apply monetary policy.

The Gold Standard system had both benefits and drawbacks.[12] As with any fixed currency, one of the benefits of the Gold Standard was that it facilitated trade, since there was an absence of fluctuations in exchange rates, which acted as a barrier for trade. Another benefit of the Gold Standard was that, as opposed to a Reserve Currency Standard, all countries in the system were equal in their need to intervene in the Forex market to keep their currency stable. In other words, no country had the benefit of being the Nth currency, which relieved them from the need to adjust and allowed them the possibility to apply monetary policy. Finally, one of the reasons for adopting the Gold Standard was that it would avoid inflation, since the restriction in monetary policy from having a fixed currency would generate an automatic barrier to unlimited money creation. However, this system also had drawbacks. First, having a fixed currency undermined the capacity of countries to apply monetary policy, which is a useful policy tool to achieve internal macroeconomic stability and to counteract crises. Second, a series of gold discoveries during this period led to inflation in some countries, offsetting the benefit of low inflation. Third, because there was a limited amount of gold in the world to use as reserves needed for keeping the currency stable, countries had to compete for gold by using contractionary policies, which led to worldwide unemployment. Finally, this system gave countries that produced gold, large influence in macroeconomic conditions around the world.

Gold Standard and monetary spillovers

At first glance, one might think that because of the inherent symmetry of the Gold Standard system, there was no problem of monetary spillovers in this case. However, even if this system was more symmetric than the Reserve Currency Standard, monetary spillovers still existed.

Because the Gold Standard was a system of fixed currencies, the role of central banks during this time was to maintain the official parity between their currency and gold. In order to do this, central banks needed to intervene in the Forex market by buying or selling assets, and like in any other system, they used their international reserves to purchase assets. During this time, the main reserves of countries were in gold; hence, countries needed gold to intervene in the Forex market and maintain their currency stable. Thus, any currency misalignment between the official parity and the real exchange rate, would lead to shipments of gold in and out of the country, or between central banks. In the first part of this chapter we saw that when a currency pegs its currency to that of a stronger country, its real exchange rate is usually lower than the one they decide to peg to; hence, these countries need to intervene in the Forex market and spend reserves to maintain the value of their currency at the peg level. The same happened, during this time, in countries that had a weaker real

[11] I borrow most of this subsection from Krugman and Obstfeld, 2003: 514-5; 537-8.
[12] Krugman, 2003: 515-6

exchange from the official parity, had to spend gold or take debt, to maintain the value of their currency at the parity level. This phenomenon can also be understood in the following way. Previously, we saw that the exchange rate influences the flows of trade, having an exchange rate that is higher (than the real exchange rate), makes foreign goods comparatively cheaper than national ones, which incentivizes imports. This creates a situation in which the country imports more than it exports, and this deficit needs to be financed somehow. The result of this system, was that deficit countries either had to take debt or would suffer outflows of gold, whereas surplus countries had inflows of gold.

The problem of monetary spillovers in this case arises because having gold to use as reserves was a zero-sum game. In other words, due to the limited availability of gold, when surplus countries gained gold, this also meant that other countries would lose gold. During this time, strong countries like Britain had considerable high current account surpluses, which made them attract gold.[13] Countries with little gold were forced to contract their economy and apply austerity measures, which led to unemployment, in order to attract gold to maintain their currency stable. The main example of these monetary spillovers is the case of the Great Depression in 1930.[14] In 1929 the United States carried out a monetary contraction, aiming to slow down an overheated economy, which led to large inflows of gold into the US. At the same time France was also absorbing large amounts of gold, and in 1932 both countries had more than 70 percent of the world's total gold supply.[15] Other countries had to compete for gold, which led them to make considerable monetary contractions, and austerity measures. These contractions in most countries, combined with the stock market crash in New York, led to a global recession. Once in the recession, central banks wanted to keep their gold reserves to maintain their currencies fixed. For this reason, central banks did not provide liquidity to local banks, which made many of them fall into default triggering a depression. Because currencies were fixed, countries lacked the natural adjustment mechanism of floating exchange rates, and could not apply monetary policy to counteract the depression, which hindered the recovery process.[16]

2.3- Domination in the general fixed scenarios.

From the above I conclude that the problem of monetary spillovers that arises in the general case for floating rates, also arises in the general fixed case. While the mechanisms of how these monetary spillovers occur differ in each of these cases, the general idea remains the same: monetary policy implemented by strong countries affects the internal macroeconomic conditions of foreign countries eroding the conditions of background justice. In the case of a Reserve Currency Standard, this happens because the country that issues the reserve currency is the only one that can apply monetary policy, and because other countries have their currency fixed to the reserve currency, they import the monetary policy implemented by the reserve currency country. In the case of the Gold Standard, because there is a limited amount of gold, monetary contractions or ongoing surpluses by strong countries,

[13] Between 1870 and World War I, Britain's current account surplus averaged 5.2 percent of its GNP (Krugman and Obstfeld, 2003: 538). Today, half of this ratio would be considered high.
[14] See Choudhri and Kochin, 1980; Temin, 1989, Eichengreen, 1992; Bernanke, 1993.
[15] Krugman and Obstfeld, 2003: 545.
[16] Eichengreen and Temin, 2010; Eichengreen, 2002; Matthijs, 2012. Countries that allowed their currencies to float earlier were less affected by the Depression, than those that remained on gold for longer (Bernanke, 2004)

limit the availability of gold for other countries, forcing them to apply contractionary policy to attract the gold needed to maintain their currency fixed. In chapter 2, I argued that problems of background injustice in the global case are pervasive and unavoidable, but they become worrisome when there is domination.

In chapter 2, I borrowed Frank Lovett's definition of domination, according to which domination happens when the three criteria of arbitrariness, dependency and imbalance of power are met. Arbitrariness can be both procedural and substantive. Procedural arbitrariness happens when a power is not effectively constrained by rules and regulations common to all. Substantive arbitrariness happens when institutions fail to consider the welfare, world view and interests of those affected by them.[17] Dependency happens when one agent is unilaterally dependent on the other, and the degree varies depending on whether there is a possibility of exit from the situation.[18] Furthermore, the costs of exit from a situation may make an agent more or less dependent.[19] Finally, imbalance of power happens when a group has the ability to change what another group does, regardless of whether they use this ability or not.[20] In what follows I will consider each of these conditions and discuss how they change in the fixed scenario.

The first condition for domination is arbitrariness. In the general scenario, I argued that monetary spillovers are arbitrary interferences. These interferences are procedurally arbitrary, since they are not regulated by law, and they are not under the control of those affected by them. These interferences are also substantively arbitrary, since they do not consider the interests, welfare and world views of those affected by them. In the general cases of fixed currencies, such as the Gold Standard and the Reserve Currency Standard, we have a similar situation. In these scenarios each country retained its own independent central bank, and while countries had their currencies fixed, they could engage in devaluations (or revaluations) from time to time. These unilateral devaluations generated similar monetary spillovers as in the general case, which can also be considered arbitrary interferences for foreign countries for the same reasons as in the general scenario, and they also do not consider the interests of those affected abroad.

The second condition of domination is imbalance of power. In the general case of floating rates, we saw that in the current system there are considerable differences in power between states. These power differences allow strong countries to benefit more from the system compared to weaker ones, and offers them power to affect others. In the general cases of fixed exchange rates, we have a similar situation. As in the general floating case, weaker countries are more affected by monetary contractions from strong countries than the reverse due to the large amount of gold that these countries absorbed. Similarly, in the Gold Standard system strong countries obtain more benefits than others, such as attracting gold from surpluses, while deficit countries need to spend reserves or take debt to maintain their currency stable, like in the case of the currency peg in the general floating scenario.

Finally, the third condition of domination is dependency. In the general floating case, we saw that in normal times there was some dependency, but it was weak. Because of the channels of dependency countries are affected by monetary spillovers, which hinder their self-determination, and, to some degree, their ability to control their internal environment. However, countries in this case retain crucial elements of self-determination, such as the

[17] Lovett, 2010: 113; Pettit, 1997, 56.
[18] Lovett, 2010: 43.
[19] Lovett, 2010: 39-40. Also, in Taylor, 2017; Dagger 2006; Pettit, 2006
[20] Lovett, 2010: 55, 82.

ability to apply monetary and fiscal policy and have mechanisms to avoid crises, such as the natural adjustment mechanism. As opposed to this general floating case, in the general fixed cases, countries lose the latter elements of self-determination. When countries decide to fix their currencies, they give up these policy mechanisms that are crucial to self-determination and to achieving internal macroeconomic balance, and to counteract crises. In other words, when countries have their currencies fixed they lose a minimal capacity to control their internal macroeconomic conditions; hence, they are more dependent on, and more affected by, others. Also, because having the currency fixed was part of the general agreement, there is no possibility of unilaterally going back to floating, such as in the case of a currency peg, and the exit from the whole system is considerably costly, making dependency strong. Because the three conditions of domination are strong in the general cases of fixed currencies, I conclude that domination in these cases necessarily happens.

Someone may object to the conclusion that domination necessarily happens in this case, and argue that reducing domination is possible by mitigating arbitrariness. On the one hand, procedural arbitrariness could be mitigated by reducing arbitrary interference from monetary spillovers, by restricting the devaluations (and revaluations) of strong countries. On the other hand, substantive arbitrariness in this case could be mitigated by implementing a system of solidarity that considers the interests of everyone and makes up for the loses in state capacities. For example, in the system of fiscal federalism that exists in the United States today, individual states delegate their ability to implement monetary policy to the Federal Reserve, but in turn, there are fiscal transfers of resources from some states to others to compensate for these loses when some of these states are facing a shock.

My answer to this objection is that mitigating arbitrariness in this case would be too demanding for strong countries. As in the floating case, limiting the ability of countries to engage in devaluations (or revaluations) from time to time, would undermine their minimal capacity to deliver social justice at home, and their sovereignty. Similarly, having responsibilities of solidarity in this case would be too demanding for strong countries, considering that this is a general agreement that includes all other countries. If strong countries have additional responsibilities with all other countries in the world, the benefits of having fixed currencies, such as the benefits for trade, would be outweighed by the costs of the additional responsibilities. In this case, the idea of having a fixed regime would not be mutually beneficial, for these countries, compared to an alternative possible scenario of having floating rates. This does not mean that the fixed regime with additional responsibilities is not beneficial *overall* for these countries. Given the high costs of not participating in the general IMS, this participation is always beneficial regardless of the type of regime and the degree of obligations. Instead, having additional responsibilities would not be mutually beneficial for strong countries compared to the possibility of changing the whole system to a floating one.

2.4- LRP and Responsibility in the general cases of fixed currencies

In chapter 2, I offered the LRP, according to which regressiveness in a social practice must be limited up to a level that avoids domination. I argued that domination in the floating case happens in cases of crisis only. Therefore, I suggested that this principle applies in these cases. In other words, when a country is facing a crisis, other countries in the system have responsibilities of assistance to the affected country. As opposed to the floating scenario, in

the fixed scenario countries are always dominated. Because in this case there is always domination, the LRP principle cannot be extended to this case, since in this case domination is not limited to cases of crisis only. Instead, in this case there is a forward-looking responsibility to move back to the floating scenario. This forward-looking responsibility arises for two reasons. First, the floating scenario is an alternative scenario in which domination does not always occur, it reduces the level of domination of countries in the system. Second, the floating scenario leaves the majority of countries better off.

The main reason why countries would be better off in a floating regime is because of the theory of Optimum Currency Areas (OCA).[21] I will explain this theory in detail later in this chapter, but the main idea is that the benefits of having fixed currencies with other countries outweigh the costs only if the degree of integration – in terms of trade, labour and capital mobility – is above a certain threshold. When the level of integration is above this threshold, a group of countries is considered to be an OCA. Economists have concluded that the degree of integration in Eurozone countries is not sufficient for them to be considered an OCA.[22] *A fortiori*, the world as a whole is not an OCA, hence, the costs of having fixed currencies outweigh the benefits. Another reason why countries are better off in an alternative regime of floating currencies is that, as we saw in part 1 of this thesis, having fixed currencies increases the likelihood of currency speculation, since traders may doubt the commitment of governments to keep the currency stable, hence, having floating currencies makes it less likely to suffer from speculation. Finally, having floating currencies offers countries the possibility to apply policy mechanisms such as monetary and fiscal policy.

Here I suggest only that the majority of countries would be better off in a floating system, but this is not the case for all countries. There are some countries, especially strong ones, which are better off in a system of fixed currencies than in a floating one. For example, under a Reserve Currency System, the country that issues the reserve currency is better off than in a floating scenario, since it obtains both the benefits of trade and is free of the costs of having a fixed currency. However, in this system the majority of countries – all other countries apart from the one that issues the reserve currency – are better off under a floating one. Therefore, there is a responsibility to change this system to a floating one, even if some countries are better off under a fixed regime.

Implementing this forward-looking responsibility is feasible, since it has been done before. For example, after the Great Depression participants of the Gold Standard system concluded that "all countries would have been better off in a world with freer international trade, provided international cooperation had helped each country preserve its external balance and financial stability without sacrificing internal policy goals".[23] This realization led them to create a new IMS, that of Bretton Woods, in which there were fixed currencies – to facilitate trade – and closed capital markets – to allow countries to retain their ability to pursue monetary policy. In the next chapter, I will suggest that an IMS of free capital markets is better than a completely closed one. Also, maintaining the extensive levels of capital controls of Bretton Woods, was unsustainable, which *de facto* turned this regime back into one of fixed currencies and overall open capital markets. As we saw in this section, countries

[21] Mundell, 1961.

[22] For an explanation of why Europe is not an OCA see De Grauwe, 2020, chapter 4; Krugman and Obstfeld, 2003: 625-30. For empirical evidence that Europe is not an OCA, see Eichengreen, 1991; Feldstein, 1997; Neumann and von Hagen, 1991; Bayoumi and Eichengreen, 1993, 1997; De Grauwe and Heens, 1993; De Grauwe and Vanhaverbeke, 1990; Beine et al, 2003; Korhonen and Fidrmuc, 2001. Also, in De Grauwe and Ji, 2016.

[23] Krugman and Obstfeld, 2003: 545

in this system decided to withdraw from, and others were forced out of, the fixed system and adopted floating exchange rates. Because from the three regimes, the majority of countries are better off in a floating one, then there is a forward-looking responsibility to change this system to a floating regime.

As opposed to the general cases of fixed exchange rates, such as the Gold Standard and the Gold Reserve Standard, in the case of monetary unions, such as the Eurozone, there is no forward-looking responsibility to move to floating rates. Countries may decide to go back to floating, but they are not morally required to do so. In this case there is a responsibility of solidarity, rather than a forward-looking responsibility, since the condition of mutual advantage is possible to meet. In the general cases, I suggested that it would be too demanding for strong countries to have responsibilities of solidarity with all the other countries in the system, since this would violate a condition of mutual advantage. In this case, the costs of satisfying responsibilities of solidarity would be considerably higher than the benefit of having fixed currencies for strong countries. As opposed to the general fixed case, in which strong countries have to consider the interests of all countries in the world, in the cases of monetary unions the countries that are taken into consideration are a small group, that the strong countries agreed to associate with, and from which strong countries can also benefit from. Given that in a monetary union there are few countries from which strong countries also benefit, there is the possibility for this agreement to be mutually beneficial with solidarity.

Section 3) Monetary Unions: The case of the Eurozone

In this section I address the case of monetary unions, and more specifically the case of the Eurozone. In the introduction of this chapter I explained that because countries within the Eurozone have a fixed currency vis-á-vis each other, the *economic* principles that apply to stylized cases of fixed currencies and open capital markets also apply in this case. Different economic principles apply in each of the three cases of the trilemma, e.g. in each of these cases the way in which the central bank can (or cannot) affect the internal macroeconomic conditions of a country vary. Because of the differences between the three cases, books of international macroeconomics usually present these cases separately, and consider that two cases of fixed regimes will have similar economic principles. Someone might think that because each of these three cases share the same *economic* principles, then similar *normative* principles would apply in these cases as well. In this section I ask which normative principles apply to the case of monetary unions such as the Eurozone.

I start this section by explaining what the Eurozone is, and by presenting the benefits and costs that countries have when joining a monetary union. My initial hypothesis is that when countries join a monetary union they are less likely to be dominated and exploited. In order to determine if the hypothesis is true, I discuss how domination and parasitic exploitation occur. I ask what the benchmark for domination is in this case, and compare it to the one in the general floating scenario. I argue that as opposed to the floating case, in which domination occurs when there is a crisis, in the case of monetary unions the benchmark for domination is the absence of mutual advantage. I also suggest that there are cases in which countries that belong to a monetary union face double domination, such as cases in which there is a crisis in the context of capture without solidarity. Additionally, I argue that, given that the benchmark for domination is different in the general case and the case of a monetary

union, the principle that applies in each case is also different. I suggest that the most appropriate principle for addressing the case of monetary unions is Juri Viehoff's equitable risk-sharing principle, rather than the Limited Regressiveness Principle, offered for the floating case. I also suggest that parasitic exploitation in the case of monetary unions also happens. This raises an apparent paradox. Contrary to the initial hypothesis, countries that join a monetary union, in which there is capture and no solidarity, are more dominated, and similarly exploited, than in the floating case. I suggest that this apparent paradox happens both, because in this case countries are objectively worse off compared to the floating case, and because the benchmark of domination is different in the two cases.

3.1- What is the Eurozone

In 1979 countries that belong to the European Union created a monetary agreement called the European Monetary System (EMS), in which countries that participated in the agreement mutually pegged their exchange rates to the Deutsch Mark (DM), and Germany set the union's monetary policy.[24] The reasons for creating this monetary system were mainly three. First, to enhance Europe's power within the general IMS. European countries thought that "speaking with a single voice in monetary issues" would give European countries more power to defend their economic interests in a world in which the United States had increasing power. Second, to turn the European Union into a truly unified market. European countries realized that exchange rates fluctuations were a major factor reducing trade within Europe, hence, a truly unified market could not happen without having fixed currencies. Finally, countries aimed to import Germany's credibility of low inflation by fixing their exchange rate against the DM. However, Germany's reunification in 1990, led it to borrow extensively to rebuild east Germany, which led to a boom and inflation. As a result, Germany sharply increased interest rates to avoid inflation. The problem was that in order to keep their exchange rate fixed, given these high interest rates, other countries in the EMS were unwillingly pushing their economies into recession. Additionally, as a result of the implementation of this system, countries that now had their currencies fixed faced the most violent cases of currency speculation on industrial countries since the collapse of Bretton Woods, which led to a partial dismantling of the EMS's fixed exchange rate system.

The EMS was replaced by an Economic and Monetary Union (EMU), a system in which individual country's currencies were replaced by a common European currency, the Euro, and in which there was a sole central bank that operated on behalf of all members of the union, the European Central Bank (ECB). Countries that share the Euro comprise the Eurozone. The reasons for moving from the EMS to a much more ambitious EMU were mainly four. First, the creation of a single currency would lead to greater market integration than a system of fixed currencies, since it would reduce the costs of converting one European currency into another and it would reduce the costs of realignments. Second, the creation of the ECB would take into consideration the interests of all countries in the Eurozone when making monetary policy decisions. As opposed to this, the previous system relied on the German Bundesbank, which took into consideration German interests only. Third, given the elimination of capital controls to increase trade, having fixed currencies left countries vulnerable to currency speculation. Having a single currency reduced currency speculation,

[24] I borrow the explanation of the Eurozone from Krugman and Obstfeld, 2003: chapter 20

since a single currency reflects the credibility of stronger countries and the whole union, as opposed to individual currencies that reflect the credibility of individual countries only. Finally, the creation of the Euro was a symbol of Europe's intention to put cooperation before national rivalries which had led to war in the past.

The reasons why this agreement would benefit countries like Greece were the benefits of trade and the benefits of having a stronger currency. However, the benefits of entering the Eurozone were not so clear to German voters, who feared that the Euro would be a weak currency that would lead to inflation. As a result, there was strong opposition in Germany to change their previous DM to the Euro. In order to convince internal voters that joining the Euro would not lead to inflation, the German government demanded both macroeconomic convergence criteria to enter the EMU and a Growth and Stability Pact for countries that had joined the union. The convergence criteria for entering the union requires countries to have similar inflation and exchange rates to those of the Eurozone, and limits the public-sector deficit and public debt.[25] The European Commission monitors whether the restrictions on deficit and debt are being met even after admission to the union, and sets penalties for countries who fail to meet the conditions. This works as a straitjacket that limits the use of fiscal policy, since an indebted country facing recession may not be able to use expansionary fiscal policy because of fears of breaching the agreement limits and the penalties involved. The Growth and Stability Pact imposes additional fiscal limits, since it sets budgetary objectives and additional penalties for countries that fail to correct their situations of excessive deficit and debt soon enough.

3.1.1- Costs and Benefits of the Eurozone: Theory of Optimum Currency Areas (OCA)

Joining a monetary union is both a political and an economic decision, which has both costs and benefits. In order to determine whether joining a monetary union would be overall economically beneficial for a country overall, economists have developed the theory of Optimum Currency Areas (OCA).[26] According to this theory, the higher the integration of a country - in terms of trade, capital mobility, and labour mobility- with the currency area, the more benefits and less costs, it will have by joining (or staying in) a currency union. The main benefit of joining a union of fixed currencies is that it reduces the costs of, and provides a more stable basis to make decisions on, international economic transactions. The two main costs are a loss of economic stability and a loss of the automatic stabilization mechanism of floating exchange rates. According to the theory of OCA, it is overall beneficial for a country to join, or stay in, a monetary union only when the degree of integration between the country and other countries within the area is above a certain threshold. When the degree of integration is above this threshold, these countries constitute an OCA.

Economists agree that Europe is not an OCA, since the degree of integration – in terms of trade, labour and capital mobility – is not high enough to reach the threshold.[27] Some EU policies have aimed to increase this integration by reducing barriers to trade, to labour, and to capital mobility. However, these policies have not been sufficient to reach the

[25] Krugman and Obstfeld, 2003: 614.

[26] For the theory of Optimum Currency Areas (OCA) see Mundell, 1961.

[27] For an explanation of why Europe is not an OCA see De Grauwe, 2020, chapter 4; Krugman and Obstfeld, 2003: 625-30. For empirical evidence that Europe is not an OCA, see Eichengreen, 1991; Feldstein, 1997; Neumann and von Hagen, 1991; Bayoumi and Eichengreen, 1993, 1997; De Grauwe and Heens, 1993; De Grauwe and Vanhaverbeke, 1990; Beine et al, 2003; Korhonen and Fidrmuc, 2001. Also, in De Grauwe and Ji, 2016.

integration levels needed for the Eurozone to be an OCA.[28] For example, trade between Eurozone countries is much lower than trade between regions of the US, even after the dismantling of trade restrictions in 1992. Similarly, the main barriers to labour mobility in the Eurozone were not the previous border controls, but differences in language and culture. Apart from the policies that have already been done to increase integration between Eurozone countries, which have not been enough to reach the benchmark of integration, there is not more than can be done, by political means, to increase integration. In the absence of restrictions, the level of integration depends on the normal activity of markets and of people. Given this lack of integration needed for the Eurozone to be an OCA, and for the benefits to outweigh the costs for countries of sharing the same currency, some economists have argued for a fiscal federalism within countries in the Eurozone.[29] A fiscal federalism, or the transfer of fiscal funds between countries in the Eurozone, offers a political solution to the problem of costs generated by the lack of integration. Implementing more solidarity between participant countries can be a way to offset, or offer a trade-off for, the costs of sharing a currency.

3.2- Normative assessment of the Eurozone

In this subsection I ask whether the initial hypothesis, that countries enter a monetary union are less likely to be exploited and dominated than in the general floating case, is true. I will suggest that contrary to the initial hypothesis, countries in the Eurozone are more dominated, and similarly exploited, compared to the general floating case.

3.2.1- Domination

In order to address domination in the previous cases, I borrowed Frank Lovett's definition of domination, according to which domination happens when the three criteria of arbitrariness, dependency and imbalance of power are met to a strong degree. Arbitrariness can be both procedural and substantive. While Lovett acknowledges these two types of arbitrariness, he rejects substantive arbitrariness in favour of procedural arbitrariness.[30] Here I deviate slightly from Lovett and consider that both types of arbitrariness are relevant, in line with the background injustice literature. I suggested that in the general floating case, there is domination when these three criteria are met in a strong way. I argued that both arbitrariness and imbalance of power in this case are necessarily violated. In the floating case, monetary spillovers are arbitrary interferences, since they are interferences that are not regulated by law and that are not under the control of citizens, hence, they are arbitrary interferences. Because in this case there are no rules that regulate these interferences, and regulating them would be too demanding, there is strong procedural arbitrariness. Also, because countries consider their interests only and not the interests of others when applying

[28] Krugman and Obstfeld, 2003: 625-7.
[29] For economists' proposals on fiscal federalism see Eichengreen et al, 1990; Sala-i-Martin and Sachs, 1992; Krugman, 1993; Krugman and Obstfeld, 1997: 635; Hallerberg, 2010; Sylla, 2014; Inman and Rubinfeld, 1992; Zahariadis, 2013; Groenendijk, 2011. Similarly, some economists propose a budgetary union with more political integration, see De Grauwe, 2020: 82-7
[30] Lovett, 2010: chapter 4

their monetary policy, there is also strong substantive arbitrariness. Imbalance of power in this case is also strong, since in the general IMS there is considerable differences of power between participant countries. The third condition of dependency varies depending on the conditions in which countries are in. While there is some degree of dependency between countries in the IMS, normally the level of this dependency is weak, since countries in the general IMS retain their individual capacity to implement monetary policy, and other policies crucial to self-determination. Dependency in this case becomes strong in cases of crisis, since in these cases countries are in a vulnerable position and become dependent on others for credit because of their desperate situation. Because the three conditions of domination are strong in cases of crisis, domination in the general case of the IMS happens in these cases.

Domination in cases of monetary unions

In what follows I ask to what extent, if at all, are the three conditions of domination violated in the case of monetary unions. I will suggest that while the condition of imbalance of power remains strong, the level of the two other criteria, arbitrariness and dependency, are different in the case of monetary unions compared to the general case.

Imbalance of power

In the case of the Eurozone the condition of imbalance of power is necessarily strong. In this union there are countries that are inherently weaker, such as peripheral or debtor countries, and others that are stronger, such as central or creditor countries. This imbalance of power, offers strong countries the ability to affect both the decisions of weaker countries – e.g. by imposing conditionalities on credits or by punishing those who leave the union – and the decisions of the ECB. This condition of domination is strong in the case of a monetary union, as in the general case, since the imbalance of power between the United States and Argentina is similar to the one that exists between Germany and Greece.

Someone may object that Eurozone countries integrate because they have a relatively equivalent economic power. Integration would be impossible otherwise. Therefore, it is not the case that the absolute imbalance of power, between IMS countries and Eurozone countries, is similar: the gaps are greater between IMS countries than between Eurozone countries. My answer to this objection is that imbalance of power is not simply that permitted by differentials of economic power, but also that which is exercised via collective decision-making itself. Because strong countries in the Eurozone have considerably more power than weaker countries to affect both the decisions of supranational institutions, such as the central back and the internal decisions of other countries, I conclude that imbalance of power in this case is strong.

Dependency

In the case of monetary unions such as the Eurozone, countries in the union are more dependent than stand-alone countries, or countries that let their currency float in the general case of the IMS. When countries enter a monetary union such as the Eurozone they give up relevant policy tools, such as exchange rate and monetary policy, as well as fiscal policy because of the convergence criteria and the GSP. These policy tools are essential for countries to achieve internal macroeconomic stability, and to counteract and mitigate crises. Countries that have their currencies fixed also lose a natural adjustment mechanism of floating exchange rates, that allows countries to recover from crises faster. Moreover, having a

common currency puts stronger constraints on countries compared to having a fixed currency. For example, countries that have fixed currencies still have some ability to pursue monetary devaluations (or revaluations), or to change the parity of their currency, from time to time, whereas countries that share the currency also lose this ability. For these reasons, countries that belong to a monetary union are more dependent on others than stand-alone countries in the general floating case.

As we saw, according to Lovett, the degree of dependency varies depending on the costs of exit from a situation.[31] The higher the costs of exit, the more dependent agents are. The Eurozone, as it exists today, is a situation in which the costs of exit are high. Countries in the Eurozone do not only have an agreement to keep their currencies fixed but they also share the same currency, which creates considerable costs for exiting the union – e.g. the costs of going back to their old national currency, of creating an independent central bank, among others. In other words, when countries give up their own currency for a common one, they are locked into a situation in which the costs of exit are high. Also, one may think that other countries in the Eurozone might impose additional punishments to those who exit the union as a means of deterring other countries from exiting as well. Because of the high costs involved, the possibility of exiting the monetary union is not a reasonable possibility for many countries, which makes dependency stronger. This lack of exit, also makes countries in this case more dependent than in the case of a unilateral peg, since in that case the country that pegs its currency to another one, can decide to exit the peg and move to floating at any time.

Because the two conditions of imbalance of power and dependency in this case are necessarily strong, in order to know if there is domination in this case we need to ask whether the third condition of arbitrariness is also present. *A priori* this idea makes sense. We may think that when countries enter a monetary union they agree to more interdependence, or to become more dependent, but as a trade-off they also expect more solidarity, or less arbitrariness.

Arbitrariness

Arbitrariness can be either procedural or substantive. Arbitrariness is procedural when a power "is not externally constrained by effective rules, procedures, or goals that are of common knowledge to all persons and groups concerned".[32] In the case of monetary unions, procedural arbitrariness is different from the general scenario. When countries agree to enter a monetary union they all agree to delegate exchange rate and monetary policy to a supranational entity as part of the agreement, which is why the exchange rate of the union becomes an issue that concerns all members. Having a single exchange rate and monetary policy, which is not the adequate one for internal macroeconomic considerations, is not necessarily procedurally arbitrary for countries in the union. Because these countries have delegated their monetary policy to the ECB, the decisions of the ECB are not arbitrary interferences for countries that belong to the union. This is because, as argued by Philip Pettit, those interferences that are under our control, such as the law, are not arbitrary.[33] Similarly, in a monetary union when the decisions of the ECB consider the will and interests of all

[31] Lovett, 2010: 39-40. Also in Taylor, 2017; Dagger 2006; Pettit, 2006
[32] Lovett, 2010: 112
[33] Pettit, 1997: 148-9

participants these decisions are not arbitrary, even if they are not the ones needed by some countries.

The type of procedural arbitrariness that happens in the case of the Eurozone is different. Procedural arbitrariness also happens in cases in which an agent or group A can interfere with a decision-making process, without being constrained by rules and procedures. Consider the case of a society in which a group of wealthy and powerful people have such a strong lobby, that the decision-making process of laws and policies becomes captured in a way that reflects the interests of this group only. This is a case of procedural arbitrariness, since the power of lobbies is not constrained by laws and regulations. In this case, if regular citizens do not have *de facto* control over the law and policy decisions, then these decisions become an arbitrary interference for them.[34] This is the type of procedural arbitrariness that exists in the Eurozone today. As suggested by Juri Viehoff, weaker countries in the Eurozone do not have accountability for the decisions of Eurozone institutions, since they cannot threaten to leave the union.[35] For this reason, the decisions of Eurozone institutions become accountable to the most powerful members only.[36] As in the case of lobbies, in the case of a monetary union a situation is procedurally arbitrary when the decisions of supranational institutions become captured by a group of countries in the union, or in the absence of clear rules and procedures that establish how the ECB should operate.

The second type of arbitrariness is substantive arbitrariness. As we saw, Lovett defines substantive arbitrariness as situations in which the interests, welfare, and world views of a group are not considered in the decisions that affect them. This type of arbitrariness is related to the former one, since the problem with capture is precisely that when a group of people capture the decisions of an institution, they do so to advance their own personal or collective interests at the expense of the interests of others. Therefore, when the decisions of an institution are captured by a group – or when there is procedural arbitrariness – there is also substantive arbitrariness, since the interests of those who do not belong to this group are neglected. However, this type of arbitrariness is different from the former one. While procedural arbitrariness places an emphasis on the process, substantive arbitrariness focuses on outcomes – e.g. the interests of a group are not sufficiently considered if they do not reach minimal levels of welfare, and minimal self-determination.

Because substantive arbitrariness focuses on outcomes, there may be situations in which there is procedural arbitrariness but no substantive arbitrariness, since even if a specific decision-making process is captured, the interests of those affected may be considered by other means. Substantive arbitrariness in the case of the Eurozone can be mitigated by the presence of solidarity, or by the transfer of fiscal resources from one state to another to off-set the problems of having inadequate monetary policy. In a monetary union in which there is a trade-off between greater interdependence but also greater solidarity, substantive arbitrariness from neglecting the interests of some states in monetary decisions becomes weaker, since the interests of those ignored by monetary decisions are being considered by other means, e.g. fiscal means. For example, in the case of the US, a fiscal federalism offsets the impacts of inadequate monetary policy by using fiscal policy. While

[34] Pettit, 1997: 183-6

[35] Viehoff, 2018: 399

[36] Someone may object that European countries did everything they could to "save the Euro" – i.e. keep Greece in the Eurozone – at great cost. My answer to this is that even if these costs were great, such as the costs of bailouts, the allocation of these costs was unfair, since they were ultimately allocated as debts to countries that suffered the crisis. I will come back to this point later in this chapter.

the monetary policy of the country as a whole may reflect the needs of some states only, the effects of misalignments in states where this monetary policy does not match their real exchange rate, is counteracted by using fiscal policy. Procedural arbitrariness, or capture, also becomes less problematic in the context of solidarity. Because in this case the interests of other members are considered by fiscal means, capture of the monetary process becomes less harmful. As opposed to this case, in the absence of solidarity, or when there are no alternative fiscal to address the interests of participants, procedural arbitrariness becomes more relevant.

Because arbitrariness is a dual condition, there are two main different types of considerations that need to be balanced when thinking about a benchmark of domination for cases of monetary unions. On the one hand, there is the consideration of the process, and more specifically about whether the decisions of the ECB are captured by a specific group of countries. On the other hand, there is the consideration of outcomes, and whether the interests and welfare of all members are being considered. While these two considerations are relevant, I think that we should focus on outcomes rather than on the process to offer the benchmark of domination in this case, since this consideration offers a wider approach to the situation. Emphasis on the process of the decisions made by the ECB considers the processes related to monetary policy only, and while this is the only type of policy available today, it is not the only type of policy possible. A focus on outcomes offers a wider approach, since it offers space to policies that have not implemented yet, such as fiscal policies. And solidarity plays a crucial role when determining if countries are being dominated or not.

The question that I need to answer to determine the benchmark is up to which point should the interests of all members be considered. A monetary union, like a trade agreement, is an agreement between parties to participate in a mutually advantageous activity. Therefore, the interests of members are not being sufficiently considered when participation in the union fails to be beneficial, or when these members would have been better off out of the union. When the interests of members are not sufficiently considered, by definition there is substantive arbitrariness. In this case, there is also procedural arbitrariness, since the processes considered from a wider perspective – that considers the presence or absence of solidarity - fail to reach the minimal outcomes that they should provide. In other words, the benchmark for domination in this case is the absence of mutual advantage. This mutual advantage can be achieved by different means. One possibility is by considering the interests of all in the decisions of the ECB. Another possibility is by implementing solidarity when monetary policy cannot meet this condition.

Benchmark: domination in monetary unions happens when there is an absence of mutual advantage

From the above, I conclude that the threshold of domination is lower in the case of monetary unions, or when solidarity is expected. Earlier in this chapter and in chapter 2, I argued that the benchmark for domination, in these general cases, was the presence of a crisis. As opposed to this benchmark, in the case of monetary unions, the benchmark for domination is lower. In this case, the presence of a crisis is not a necessary condition for meeting the benchmark. Instead, this benchmark is violated when participating in the monetary union fails to meet a condition of mutual advantage.

Table 2: Conditions of Domination in General IMS and Eurozone

	Arbitrariness	**Dependency**	**Imbalance of Power**
General IMS (Argentina)	Strong	It becomes strong in cases of crisis	Strong
Eurozone (Greece)	It becomes strong in cases of no mutual advantage.	Strong	Strong

Source: Own Elaboration

From the benchmark of domination offered above, I conclude that in the case of monetary unions capture in the absence of solidarity is a situation in which there is domination, since it fails to meet the condition of mutual advantage. Capture in the absence of solidarity was clear during the EMS, in which countries pegged their currency to the DM, and the monetary decisions were made unilaterally by the Bundesbank, but there are examples that suggest that this is the case in the Eurozone as well. For example, in the years previous to the Euro crisis, the exchange rate and monetary policy of the Eurozone allowed Germany to have nearly zero-inflation, while inflation was high in rapidly growing economies.[37] During the crisis, the exchange rate of the Eurozone was also high, even if some countries were facing major recessions during this crisis.[38] Furthermore, this took place without other actions of solidarity, since the Eurozone is not a fiscal federalism, and has a policy of no solidarity regarding bailouts. After the crisis, bank bailouts were made by the countries that faced capital flights.[39] For example, Spain had to bailout its own banks by taking debt which ultimately had to be paid by Spanish tax-payers.

Cases of double domination in Monetary Unions

Because there are two different benchmarks for domination, one for the general scenario and one for cases of monetary unions, there may be cases in which countries in a monetary union face double domination, such as in cases in which they experience a crisis. In a monetary union in which there is a context of capture and no solidarity, countries are objectively worse-off than in the floating scenario. They are worse off, not only because of the OCA theory, but also because they lack the mechanisms necessary to respond to a crisis. If we compare a country like Argentina or "stand-alone" countries – those that let their currency float- such as the UK, with countries that belong to the Eurozone, the former countries had more mechanisms to respond to the crisis, hence, they were objectively better off.[40] Because the former countries had floating exchange rates, there was a natural

[37] Frieden, 2015: 173

[38] Stiglitz, 2016: 150

[39] Here I consider capital flight in a different way from that addressed by Peter Dietsch and Thomas Rixen. Dietsch and Rixen focus on the effects of taxation on capital flight. They argue that there is a problem of background structure, since the lack of rules on taxation induces countries to reduce their tax levels in order to attract capital, which is ultimately harmful to these countries Dietsch, 2015, 2016; Dietsch and Rixen, 2014, 2016. Instead, I consider a different aspect of capital flight, the one that happens as a result of additional risk-taking and moral hazard.

[40] Paul De Grawue compares how the Euro crisis hit two different types of countries in the EU. First, stand-alone countries, or countries that have their currency floating, such as the UK, and countries that belong to the Eurozone, such as Spain and

adjustment mechanism that allowed them to recover from the crisis much faster than in the latter scenario. As opposed to Argentina and to countries that let their currency float, countries in the Eurozone shared the same currency and, hence, they were locked into a situation in which the exchange rate was higher than the one they needed, which brought additional burdens to a situation of crisis. They also had stronger constraints and lacked the mechanisms to address this crisis, such as monetary and fiscal means.

In this case, countries facing a crisis experience double domination. On the one hand, they are worse off than "stand alone" countries, which breaches the benchmark for domination within monetary unions. On the other hand, these countries are below a general benchmark that allows them to have minimal self-determination, since they are experiencing a crisis. As in the general case, in the case of the Euro crisis, creditor countries and institutions asked for the implementation of austerity as a conditionality in exchange for loans, in countries such as Greece, which deepened the degree of the crisis even further.[41] In this case countries faced double domination since, on the one hand, they were required to implement similar conditionalities to the ones that were asked in the general cases, in a context in which they were already subject to additional constrains and burdens, and in which there were additional solidarity responsibilities that were not being met. The imposition of conditionalities from strong countries in this case was a double wrong, since it was a case of double domination. In this case, countries did not only fail to meet their general responsibilities of assistance, but also their additional responsibilities of solidarity.

Someone may object to the view that imposition of conditionalities in the case of monetary unions is a case of double domination, and argue that when countries agree to share the same currency, the stability and credibility of this currency will not only depend on one individual state, but on the combination of members of the union. For this reason, the policies that individual states take will concern all members of the union. For example, as we saw earlier, the German government had to convince its voters that the Euro would not lead to inflation, because of a weakening of the currency compared to the DM, by establishing the convergence criteria and the Growth and Stability Pact (GSP). Like the convergence criteria and the GSP, the austerity measures required by creditor states and the Troika were measures that concern and affect these countries directly, since trouble in some countries of the Eurozone affect the stability of both the currency and the financial system of the whole union. As opposed to this case, in the general case the conditionalities in exchange for loans do not directly concern creditor states and institutions. Some of these conditionalities may allow states to obtain unfair benefits, such as those from liberalization, but the stability of their currency and of their financial system is not at stake when asking for these conditionalities. Also, we may think that states that belong to a union with a common currency also have some degree of responsibility to maintain the stability of the currency and of the financial system of the union and, hence, that some degree of limits to their debt taking does not necessarily count as domination. For example, as opposed to the cases of Spain and Ireland, in which debt was taken privately, in the Greek case, the state was involved in too much debt taking.[42]

My answer to this objection is that, as pointed out by Viehoff, the first idea that debtor countries should be fully responsible for taking too much debt, which contributes to

Greece. He concludes that even if the pre-existing conditions in the UK were worse than in Spain, the UK was less affected by the crisis, and it recovered faster than countries in the Eurozone, due to the additional constraints and costs that the latter countries face when sharing a currency (De Grauwe, 2011: 1-5).

[41] Stiglitz, 2016: chapter 7

[42] Lane, 2012: 51

instability of the currency and the financial system, is limited, since much of this debt happens as a result of structural features of the system within a monetary union. Even if in the case of Greece, the debt was taken by the state, rather than privately, some of the reason for taking this debt was structural, such as the need to finance trade deficits due to misalignments. Also, as Viehoff argues, because this debt was not only a responsibility of countries who asked for these debts, but also from lenders, it is unfair to place all the costs and burdens in debtor countries. Finally, we can question whether countries can force any conditionalities that threaten the stability of the currency. We may think that there are limits to the conditionalities, up to a level that they do not erode a minimum condition of sovereignty and welfare. We can still acknowledge that creditor countries within the union had more at stake when engaging in domination, than creditor countries in the floating case. However, because placing all the costs and burdens of stabilizing the currency and the system on weaker countries facing a crisis was unfair, then domination in this case was strong, even if creditor countries had much at stake.

Bottom Line for domination on Eurozone

From the above I conclude that the benchmark of domination depends on the type of agreement, since the way in which each of the conditions of domination is impacted in each of these cases is different. For example, in the general floating scenario interferences – or monetary spillovers - are necessarily arbitrary because they take place in a system of no rules. Conversely, in the case of the Eurozone these interferences are not necessarily arbitrary, since countries delegate the use of monetary policy to the ECB. The fact that the three conditions of domination are affected differently in the two cases allows the Eurozone the potential to have similar, and even lower, levels of domination between countries than in the general floating case. Because arbitrariness in this case is not necessarily strong, it is possible to reduce domination by reducing arbitrariness – by either incorporating the interests of weaker countries in the decisions of the ECB or by implementing a system of solidarity. In a system with solidarity countries facing a crisis would be assisted by others, hence, this case has the potential of having less domination than the floating case. However, because in the current Eurozone, there is a situation of capture in the absence of solidarity, there is actually more equivalent domination than in the floating case. As opposed to the floating case, in which the three conditions of domination only become strong in cases of crisis, in the current Eurozone these conditions are always strong.

From the LRP to the Equitable risk-sharing principle

In the previous sub-section, I argued that the benchmark for domination in the cases of the general floating regime and the case of a monetary union are different. In the floating case, domination happens in cases of crisis, whereas in the case of a monetary union domination happens when there is no mutual advantage. Because the benchmark of domination is different, the principle of fairness that applies in each case is also different. In chapter 2, I offered a Limited Regressiveness Principle to address the general floating case. According to this principle, the regressiveness of social practices should be constrained in a way that it avoids domination. In the general floating case the benchmark for domination is

the presence of a crisis, hence, the LRP generates responsibilities in cases of crisis only. Because in the cases of monetary unions the benchmark of domination is different from that if the general fixed case, we need a different principle to address this case. In what follows, I will suggest that a possible principle for this case is Juri Viehoff's equitable risk-sharing principle.

Juri Viehoff offers an equitable risk-sharing principle to address cases of monetary unions. According to this principle, institutions of monetary unions must meet three conditions.[43] First, insure states from the risks of monetary integration up to a level where participation is beneficial. He suggests that this benefit could be estimated by using the OCA theory. This includes insurance mechanism for all risks that arise in virtue of monetary integration. Second, make decisions that threaten stability equally costly for all states. Viehoff argues that not only vulnerable countries should be made liable for their deficits, but that strong countries should also be made liable for creating trade surplus, since these surpluses also threaten the stability of the system. In these cases, decisions that generate risk externalities trigger insurance contribution to make up for these externalities, and if states create risks for others there should be equal liability or equal prohibition. Third, each state should have full fiscal and regulatory autonomy unless they undermine the two first conditions. Some choices may constrain liberty, since they trigger insurance contribution to make up for externalities that arise due to participation in the monetary union.

I think Viehoff's equitable risk-sharing principle applies to the case of the Eurozone, but not for the reasons that Viehoff offers. According to Viehoff this principle arises in the case of the Eurozone because of structural factors, to which all countries in the Eurozone contribute, that generate the need to take debt. Therefore, these responsibilities should be distributed between those who contribute to the structural issue. The problem with grounding the principle on this idea of contribution to systemic risk is that the same structural problems arise in both the general and floating scenarios, but applying this principle to these cases is too demanding. In the general case, countries that unilaterally peg their exchange rate to that of a stronger country because of structural constraints need to finance the misalignment of their exchange rate with either reserves or debt.[44] Similarly, in the general case of fixed exchange rates, such as the Gold Standard, the general exchange rate is necessarily misaligned with the real exchange rate of individual countries, generating trade deficit and surpluses. Like in the case of the Eurozone, debtor countries during the Gold Standard needed to finance their misalignments with either reserves or debt. In the current floating case, grounding the principle on the idea of contribution to systemic risk would lead to the conclusion that the United States has to contribute to all countries that peg their exchange rate to the dollar, and in the case of the Gold Standard it would lead to the conclusion that Britain would have had to contribute to part of the misalignment of all other countries. In the general cases assigning strong countries with the responsibility to contribute to the risks generated to all countries would be overall more dominating. Therefore, we need an alternative reason for why this principle arises in the specific case of the Eurozone and not in the general cases.

I think that instead this reason relies on the nature of the agreement. The nature of the two agreements – participation in the general regimes and participation in a monetary union- is different. Participation in the general IMS is an agreement to participate in the social

[43] Viehoff, 2018: 407-11
[44] Stiglitz, 2016: 93.

practice of the IMS only, whereas participation in a monetary union is a second agreement between some countries that already participate in the social practice. The nature of the agreement offers reasons to apply the equitable risk-sharing principle in the case of monetary unions, but not in the general cases for three reasons.

First, because the aim of this second agreement is to be mutually beneficial, participation in a monetary union should leave countries who join the union better off, or at least not worse off, compared to the counterfactual scenario of staying in the general first agreement of the IMS. The agreement to participate in a monetary union happens within the general scenario of floating rates and, hence, the move from participating in the general IMS of floating rates to participating in the union needs to be justified to citizens. As opposed to this case, in the general fixed case there is no second agreement, there is only a possibility to participate in the social practice or not to participate. Because countries are always better off participating in the IMS - regardless of the type of regime - compared to the counterfactual scenario of not participating, participation is always justified. In this case, the move to a floating scenario is not a unilateral decision, as it is in the case of a monetary union. Instead, the move to floating is a collective decision to change the way in which the social practice operates.

Second, participation in a monetary union is a multilateral agreement between a few countries, with which strong countries choose to associate with and from which strong countries also benefit from. This allows for the agreement to be mutually beneficial for strong countries, when there is solidarity. As opposed to this case, the general fixed regimes, such as the Gold Standard and the Reserve Currency Standard, are general agreements that involve all the countries in the world. Therefore, implementing solidarity would necessarily undermine the condition of mutual advantage for strong countries.

Third, in the case of the Eurozone it is possible to reduce arbitrariness by considering the interests of all in monetary policy decisions. As we saw earlier in this chapter, in the case of the Eurozone, countries give away their own currency and delegate the use of monetary policy to the ECB. Because in this case there is one supranational entity that sets monetary policy for the whole union, this policy is a collective issue that should consider the interests of all. When the interests of all are considered in the decisions, arbitrariness is reduced. As opposed to this case, in the general fixed cases, every country kept their own central bank and applied their own monetary policy, by engaging in devaluations (or revaluations) from time to time. In this case monetary policy of countries was a national, rather than a collective, decision. Therefore, reducing arbitrariness from monetary spillovers as arbitrary interference would be too demanding, in the same way that it was too demanding in the general floating case.

From the above I conclude that the type of monetary regime, in economic terms, does not necessarily offer a normative criterion for evaluating responsibilities and principles that arise in each case. For example, in economic terms the Gold Standard and the Reserve Currency Standard work in the same way as the EMU (or Eurozone) and the previous EMS, respectively. However, because the EMU and the EMS are agreements within a general agreement, in these cases there are stronger responsibilities of solidarity than in the general cases of the Gold Standard and the Reserve Currency Standard. In other words, the type of monetary regime in terms of floating or fixed, does not offer a relevant criterion to evaluate the normative principles that arise in each case, since two cases of similar monetary regimes that have the same *economic* principles can have different *normative* principles depending on the nature of the agreement.

3.2.2- Parasitic Exploitation

I have suggested that in both general cases, the floating and the fixed, countries are likely to experience parasitic exploitation when they face currency speculation. Are countries that belong to a union, less likely to suffer this type of exploitation? As we already saw, currency speculation during the EMS period was common. Avoiding this was one of the reasons why European countries decided to share the same currency. From this we know that in a monetary union like the EMS there can still be this type of exploitation, but what about in the EMU? Was there parasitic exploitation in this case? My view is that there was. However, parasitic exploitation in this case did not happen in the Foreign Exchange market, through speculation on exchange rates. Instead, this type of exploitation moved to the money market and interest rates. I do not want to offer a mechanical argument, and repeat all the elements of parasitic exploitation in this case, but I will briefly sketch the main issues that on my view, suggest that there was parasitic exploitation.

In chapter 3, I suggested that parasitic exploitation occurs when agents misuse a system in ways that cannot be justified to others. In the case of the Eurozone, this happened in the money market, when investors who bought assets – bonds and deposits - of peripheral European countries engaged in what economists call *moral hazard*, or situations in which investors take additional risks on the assumption that the government will step in and bailout the banks in case of financial trouble. We should start by noticing that the two first elements of the framework apply in this case. First, there are build in mechanisms, since the market of bonds and deposits work in a similar way to the stock market, in which there is a primary and a secondary market, and prices are set by investors in the secondary market.[45] Also there is no regulation against moral hazard, hence, both the pricing rules and absence of regulation against moral hazard, offer investors the possibility of engaging in these activities. Second, these build in mechanisms leave citizens vulnerable, since they cannot avoid investors from engaging in moral hazard, and the excessive capital inflows that happen as a result, and outflows that happen when investors realized they had taken additional risk.

Finally, there was a third element of non-proportionality. Before explaining why there was non-proportionality in this case, I will explain what justifies the money market. The main justification for this market is the allocation of capital.[46] On the one hand, when banks and governments sell deposits and bonds, they can raise capital to either lend and to pursue projects. On the other hand, investors obtain yields for assuming risks of default and not being paid for their investments. Banks in weaker countries, tend to offer higher yields than in stronger countries because their risk of default is higher, due to fewer regulations on their banking systems. This is why in theory money should flow from rich to poor countries. The interest rate in this case reflects the risk of a country, since the returns that investors obtain will depend on this rate. The lowest the risk, the lowest the interest rate and the returns. From this justification, we can know that the counterfactual scenario in this case will be, analogous to the case of currencies, the Fundamental Value (FV) of interest rates.[47] This value considers the real risks in an economy and offers investors a proportional reward for their risk-taking.

[45] Vernimmen, 2018: chapter 20
[46] Krugman and Obstfeld, 2003: chapter 21
[47] Similarly, many economists have turned to analyzing the interest rates to analyze the Euro crisis. See for example, De Grawue, 2011; De Grawue and Ji, 2013; De Grawue et al, 2017; Frieden, 2015: 176-9; Bird et al, 2017

The models offered by economists to calculate the FV of interest rates consist in an econometric model that includes variables of systemic risk, such as government debt to GDP ratio, current account position, among others.[48]

As in the case of exchange rates, the interest rate in the money market is determined by investors, who collectively determine the market price.[49] This market price includes different types of transactions of investors, some of them may be motivated by profiting from risk taking but others may involve making additional profit from moral hazard. This moral hazard is inconsistent with the aims of the system, since the system aims to offer a reward from risk-taking, but when investors take additional profit on the assumption that the government will bailout banks and assume the costs of risks, they intend to profit without bearing the risks. This cannot be justified to citizens, since it is taxpayers who ultimately pay for government bailouts. As I argued in chapter 3, taking additional risk is not necessarily exploitative if contained within a group of people who decide to take part in the activity. Instead, it becomes problematic when this involves others through a change in prices; hence, we need to ask if the market price, which includes moral hazard, deviated or not from the FV in the case of the Eurozone.

As in the case of exchange rates, there are two views as to whether the market value and the FV of interest rates converge or diverge. On the one hand, the Efficient Market Hypothesis, considers that because investors are rational and they include all the information into prices, the market price or the return premia for assets reflects the intrinsic risk of these assets.[50] On the other hand, in line with the behavioural finance approach, economists have argued that before, during and after the crisis, market participants mis-priced risk. More specifically, economists have argued that in the case of the Euro crisis there was an *irrational exuberance* previous to the crisis.[51] Market participants thought that with the creation of the Euro, the elimination of exchange rate risk meant the elimination of all risk, and they thought that since the financial system of countries in the Eurozone were intertwined, if financial trouble happened in one country, other countries in the Eurozone would step in and bailout the banks.[52] Because of euphoria and optimism, and the aim to profit from higher returns, investors took excessive risk, leading to large capital flows into peripheral countries. The excessive liquidity in these countries' banks led to a boom and a bubble in their real state and housing sector. When, after the global financial crisis, market participants realized that they had been excessively euphoric, they became pessimistic and withdrew their assets from these countries, since they feared payment difficulties, and took their assets to safer places to invest.[53] This phenomenon of capital outflows is known as *sudden stop,*[54] which led to both

[48] De Grawue and Ji, 2013; Beirne and Fratzscher, 2013; Bird et al, 2017; Attinasi et al. , 2009; Arghyrou and Kontonikas, 2010; Gerlach et al., 2010; Schuknecht et al., 2010; Caceres et al., 2010; Caporale and Girardi, 2011; Gibson et al., 2012; Aizenman and Hutchinson, 2012. For literature on this topic for other countries see Eaton et al., 1986 and Eichengreen and Mody, 2000; Edwards, 1984; Edwards, 1986; and Min, 1999. Other studies that follow this methodology of calculating fundamental values and compare it to market prices for other countries see Dell'Ariccia et al., 2006.

[49] Vernimmen, 2018: chapter 20. The market's trust in a country is reflected in the interest rate. For example, a "low interest rate embodies a belief that the risk of default is low. Markets trust that, say the UK government, will not default, and as a result the UK enjoys a low interest rate" (De Grawue, 2011: 6).

[50] I take the definition of the EMH applied to capital markets from Bird et al, 2017: 273-5. However, these authors offer empirical evidence to argue against this hypothesis in the case of the Euro crisis.

[51] Stiglitz, 2016: 14

[52] Frieden, 2015: 177-9

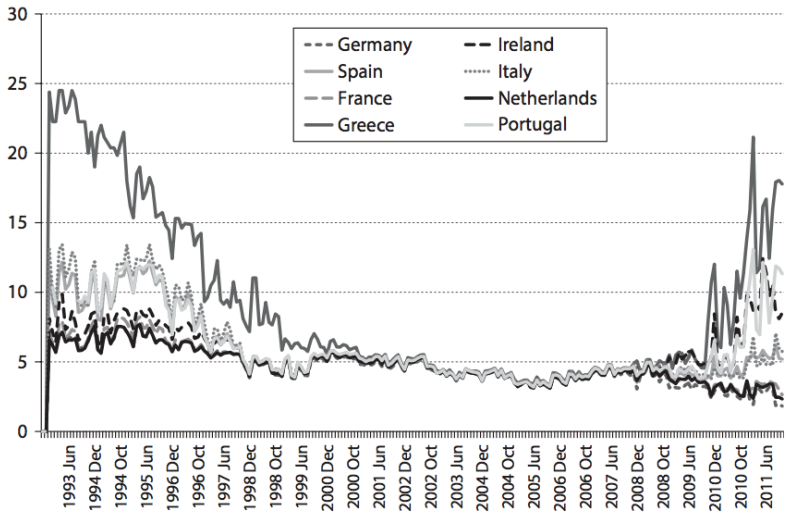
[53] Stiglitz, 2016: 127-8

[54] Calvo, 1988

an increase in interest rates and a decrease of liquidity due to capital flight.[55] As a result, the governments and banks of peripheral countries could not find funds to roll over their debts at reasonable interest rates. This situation acted as a self-fulfilling prophesy: the fear of default, or insolvency, by investors makes them withdraw their assets, which ultimately triggers insolvency.

Empirical evidence shows that in the case of the Eurozone, the interest rate of countries moved significantly during short periods of time and these changes were disassociated from fundamental variables.[56] Before the crisis, investors neglected the fundamentals and the risks associated with the assets of peripheral countries, and rushed to these countries to benefit from high returns.[57] As a result, they set extremely low interest rates, or risk premia, for these countries. During 2010-11 investors became increasingly worried about risk, and collectively rose the interest rate of these countries, which lead to a switch from under-pricing to over-pricing risk. This significant rise of the interest rate of peripheral countries was disconnected with from fundamental variables of these countries – with the exception of Greece – and rose to excessively high levels, which reflected the negative market sentiments of investors after 2010. Figure 6 shows how the interest rates fluctuated before and after the crisis in different Eurozone countries.

Figure 6: Interest Rates of Eurozone countries 1993-2011[58]



Source: Frieden, 2015: 179.

There are also reasons to think that this case also meets the connection criteria for parasitic exploitation. First, investors made additional profit from bailouts and from deviations of prices from the FV. Investors obtain returns for their risk taking, but when they obtain these returns and the costs of risks are borne by taxpayers because of bailouts, investors obtain additional profit. Also, when interest rates are higher than the FV, investors

[55] De Grawue, 2011: 2-5..
[56] See De Grawue and Ji, 2013; De Grawue et al 2017; De Grawue, 2011; Bird et al 2017; Bernie and Fratzscher, 2013; Gibson et al 2012; 2014; Willett et al 2014.
[57] Frieden and Walter, 2017: 374
[58] Measured as sovereign bond spreads

obtain more returns for the real risk they take. Second, this additional profit could not have happened in the absence of citizens of peripheral countries. This involves a connection mechanism, that happens through prices of interest rates. When citizens of a country receive higher interest rates than the ones that their real risk can explain, the additional profit of investors comes at their potential expense. We can make an analogy with the case of national banking. If a bank offers vulnerable people higher interest rates than what can be explained by their risk of default, the bank obtains additional profit at the expense of these people. The same happens between investors and citizens, since local banks only act as intermediaries.[59] Another way in which the additional profit could not have been gained in the absence of citizens of peripheral countries was because of bailouts, since it was taxpayers in peripheral countries who ultimately had to pay for the costs of these bailouts. Finally, the additional profit is made at the potential expense of citizens of peripheral countries. On the one hand, these citizens were harmed, since they the credit that they could obtain after the crisis involved prohibitively and non-proportionally high interest rates.[60] On the other hand, because of a decrease in liquidity,[61] access to credit was reduced for these citizens.[62] Also, these citizens had to pay for the costs of bailouts.[63]

As with the previous types of domination and exploitation, we can ask whether parasitic exploitation in this case was more or less exploitative than parasitic exploitation in the general cases. Someone could argue that parasitic exploitation in this case was more exploitative than in the general case, since one of the reasons countries had for adopting the Euro was precisely to avoid these types of exploitation. My view is that, while this is unfortunate, this case is not necessarily more exploitative than the general case.[64] As opposed to the previous cases of domination and exploitation, in which the actors involved were strong and weak countries who had an agreement, in this case the actors involved in exploitation are peripheral counties, and investors or market participants. From the perspective of these market participants, the fact that peripheral countries adopted the Euro, is not a relevant moral concern, since it was not these market participants who entered a special agreement with these countries. These market participants stand in similar relationships with both countries that belong to a union and with countries that do not belong to the union. At most we can say that responsibilities of assistance between countries in the union are stronger, but we cannot say that exploitation in this case is stronger.

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[59] Stiglitz, 2016: 111

[60] Stiglitz, 2016: 128

[61] Banks are especially vulnerable to runs due to the structure of their assets and liabilities (De Grawue and Ji, 2013: 17). If investors collectively withdraw their assets from the banks of a country they precipitate the liquidity crisis that they fear, leading to a self-fulfilling crisis (Originally in Diamond and Dynvig, 1983).

[62] During 2013 the volume of loans for less than one million EUR, halved in Portugal, was reduced by two-thirds in Greece and Spain and was reduced by more than 80 percent in Ireland (Stiglitz, 2016: 127). This is a proxy for lending to small to medium size enterprises (SMEs).

[63] Governments of peripheral countries had to bailout their illiquid and insolvent banks at extraordinary expense (Frieden, 2015: 179). For example, Spain had to borrow heavily to nationalize and bailout its troubled banks (Frieden and Walter, 2017: 377).

[64] We may say that countries in the Eurozone have stronger responsibilities to assist countries that face a crisis due to parasitic exploitation by market participants, both because of the stronger responsibilities inherent to belonging to a monetary union and because these countries failed to regulate the market. Therefore, when these countries fail to deliver this assistance to countries facing a crisis, the wrong of this failure is worse than the failure of assistance in the general case. However, because the other countries in the Eurozone are not the agents involved in parasitic exploitation, I cannot say that the level of parasitic exploitation was higher in this case than in others.

From this subsection I conclude that, contrary to the initial hypothesis - that countries in a monetary union are less dominated and exploited - countries in a union such as the Eurozone are more dominated and similarly exploited.

3.3- The apparent paradox of the Eurozone

I have argued that countries in the Eurozone were overall more dominated and equally exploited than countries in the general floating case. This raises an apparent paradox of the Eurozone. According to our initial hypothesis, countries enter a monetary union to reduce their level of domination and exploitation, but in fact, they are more dominated than in the general case. This is an *apparent* paradox, since when countries in the Eurozone enter the monetary union, they must give away relevant policy tools and are subject to considerable constraints that leave them objectively worse off than in the floating case. Because joining a monetary union is supposed to be a mutually beneficial agreement, this also raises additional responsibilities of solidarity to make up for these losses. In the absence of solidarity, the same actions applied in a monetary union become more dominating than in the floating case, precisely because the absence of solidarity in the context of additional constraints leave participant countries worse off.

We can make an analogy with the case of a family and ask what is more dominating, to be neglected by your family or to be homeless?[65] One possibility is to argue that being neglected by your family objectively leaves you worse off compared to being homeless. Another possibility is to argue that the benchmark for domination changes in the case of the family. Here I have suggested that in the case of monetary unions we have both cases. On the one hand, when countries enter a monetary union with no solidarity, they are objectively worse off than in the floating scenario, since they give away relevant policy tools and are more constrained. This suggests that the analogy with the family is better represented as a case in which the homeless can opt into safety nets – such as a natural adjustment mechanism, the possibility to apply monetary and fiscal policy, among others - which are denied to those who belong to a family. Because those who belong to a family give away the possibility to accessing these safety nets, they are objectively worse off than the homeless when they are neglected by the family. On the other hand, the benchmark for domination is different in the case of monetary unions and in the general cases. In the general case, the benchmark for domination is the presence of a crisis. In the case of a monetary union, this benchmark is that the condition of mutual advantage is not met. Because these benchmarks are different, there are cases that are dominating in the case of monetary unions, but not in the general case – e.g. when there is no mutual advantage but there is no crisis. Furthermore, there are cases in which a situation is dominating in the general cases but is a case of double domination in the case of a monetary union without solidarity, such as cases of crisis.

This does not necessarily mean that creating, or joining, a monetary union such as the Eurozone was a move in the wrong direction. It only means that what is needed is more solidarity. What we have in this case is three scenarios: a baseline scenario, the general floating scenario; an ideal scenario, a monetary union with solidarity; and an approximation to the ideal, a monetary union without solidarity. In the ideal scenario of a union with solidarity, states are better protected from domination and exploitation than in the baseline

[65] I thank Cécile Laborde for this analogy.

floating case – e.g. a small state in the US is more protected from domination and exploitation by being in the country and sharing the currency than having their own currency. However, as we have seen, in the case of a monetary union without solidarity, domination and exploitation of countries is stronger than in the general floating one. I think this is a case in which an approximation to the ideal, actually leaves countries worse off in terms of domination and exploitation than the baseline scenario of floating exchange rates.[66] Normative work on this topic, points out a similar problem that arises when aspects of the ideal are not attainable: if aspects of the ideal are not attainable approximating this ideal as closely as possible may not be the optimal solution.[67] However, as opposed to cases in which the ideal scenario is unattainable, implementing more solidarity between Eurozone countries is a feasible policy, I will return to this point in section 5. Because reaching the ideal scenario is feasible, approximation or advancing towards integration was not necessarily a wrong move. Instead, what is needed is to move from this approximation, to the ideal scenario of a union with solidarity. This solidarity could be satisfied by implementing a system of fiscal federalism similar to the one that exists among the different states of the US.

Section 4) Policy Proposals for Eurozone: Fiscal Federalism and Banking Regulation

In this chapter I have showed that the first problem of background justice that arises in the general floating case also occurs in fixed regimes. I also suggested that while the LRP that arises from this problem can be extended to general fixed regimes, such as the Gold Standard and the Reserve Currency Standard, a stronger principle is needed for cases of monetary unions. The application of the LRP supports the idea of some solidarity, but a minimal one. Because the LRP only aims to avoid the type of domination that arises in cases of crisis, a transfer of fiscal funds would only apply in some of these cases as suggested in chapter 2.[68] However, I argued that because monetary unions are cases of an agreement within a general agreement, the responsibilities of countries to each other in this case are stronger than the ones that arise in the general agreement. This is both because the deviation from the counterfactual scenario of the general agreement needs to be justified to citizens – they need to be better off or at least not worse off than in the counterfactual scenario – and also because in this case there is a trade-off between greater interdependence and also greater solidarity. From this, I have suggested that a better principle for the case of monetary unions is Viehoff's equitable risk-sharing principle, which aims to share the burdens of monetary integration up to a level where participation in the union is beneficial. A possible way of applying this principle in the case of the Eurozone, is by establishing a fiscal federalism, similar to the one that exists among states of the United States. Under a fiscal federalism, fiscal policy is used to offset the costs of giving away the use of monetary policy to a higher entity, the Federal Reserve or the ECB. The funds collected from taxes are used to assist different areas or states within the United States that are facing misalignments or a shock.

[66] As suggested by Joseph Stiglitz, the Eurozone as it is today is not sustainable in economic terms, and both going back to floating currencies, or having more solidarity within the union are two possible moves forward (Stiglitz, 2016: Part IV).
[67] See Raikka, 2000 and Goodin, 1995. For this reason, approximation to the ideal may not be a good idea when the ideal is unattainable (Lipsey and Lancaster, 1956). This generates a challenge to ideal theorizing, ideal theories of justice do not offer action-guiding specifications when some aspects of the ideal are not attainable (Goodin, 1995; Weins, 2012, 2016, Sen, 2006, 2011).
[68] Cases in which crises happen because of structural reasons to which stronger countries contribute to.

The fiscal union in the European case does not need to aim for ideal conditions like in the US, but up to a level where participation is beneficial as suggested by Viehoff.

I also considered the tension between the state and the market. I argued that build in mechanisms, such as the lack of rules preventing moral hazard or excessive risk-taking, along with the pricing mechanism, offers investors advantage, which leave citizens vulnerable to the decisions of these investors. One way to mitigate this advantage, and to avoid parasitic exploitation of citizens by investors in the market, is to regulate excessive credit expansion and excessive risk-taking.[69] As we saw, the Euro crisis was triggered by bubbles in peripheral countries, which happened not only because of lending by local banks, but mainly because of the excessive inflow of capital by investors to these countries before the crisis. Investors, motivated by moral hazard, took excessive risk and rushed to peripheral countries to obtain higher yields. Therefore, what needs to be regulated is this excessive risk-taking by international investors. In Joseph Stiglitz words, "An important part of preventing recessions and depressions is to prevent the excesses that give rise to them. Successful control of this excessive expansion needs to be a joint undertaking of the ECB, banking regulators and supervisors, and the broader regulators of the financial system… There are tools that the ECB and financial regulators already have, or should have, that can prevent, or at least control the size of, these bubbles".[70] While free capital markets can still continue to operate in this case, it is the excessive flows due to moral hazard, specifically that needs to be regulated.

Section 5) Objection

Richard Bellamy offers an objection to the idea of establishing a fiscal federalism, on the grounds that it would undermine democracy of individual states.[71] Bellamy suggests that a multi-state federation, such as a fiscal federalism, would not have the democratic support needed to implement solidarity, or redistributive measures from one state to another, since the lack of national identity and the cultural heterogeneity between states that would generate resistance from one or more of its constituent peoples – e.g. the French will not be willing to pay more for the British.[72] Instead, he argues that what is needed is an integration that is limited in scope and not redistributive. As an alternative, he proposes to implement a Banking Union combined with rules limiting the holding of bonds, to prevent banks holding too much government debt, which would share the risks between creditors and borrowers.[73] According to Bellamy, having a banking union would allow fiscal policy to be returned national governments, since it would reduce the risk that fiscal mismanagement in one country would spread to other countries due to an intertwined banking system. "If governments make bad decisions and overspend, they would need to restructure their debts rather than receiving a bailout from other states".[74] He suggests that a European Monetary Fund should replace the ECB and European Commission, and should be able to provide liquidity, given a European

[69] For this type of regulation see Stiglitz, 2015: 250
[70] Idem.
[71] According to Bellamy, the European Union is not a *demos*, since participants in the EU lack a common cultural and national identity (Bellamy, 2013). Instead, following Kalypso Nicolaïdis' definition, Bellamy considers the EU as a *demoi*cracy, or an agreement between the peoples of different member states.
[72] Bellamy, 2019: 204-5
[73] Bellamy, 2019: 206-7
[74] Bellamy, 2019: 206

debt restructuring program. He points out that the main benefit of this union would be that the fiscal policy of individual countries would not need to be restricted to enforce discipline through a binding set of common spending rules.

I think the idea of a Banking Union is a good proposal, which addresses the tension between the market and the state well.[75] However, I think that the idea of a Banking Union on its own may not be enough to satisfy the condition of leaving all countries better off, which is necessary for justification, since it ignores the structural problems that arise among states.[76] As we have seen in this chapter, having a single exchange rate necessarily leads to misalignments between the exchange rate of the union and the real exchange rate of individual countries, or to trade surplus and deficit, which need to be financed somehow. As Viehoff points out, the current EMU places this debt, the costs of which are structural, on deficit countries only. It is not clear that a banking union, would solve this problem. Bellamy suggests that if countries take too much debt, the costs of these bailouts should be turned into debt, hence, borne by taxpayers of the country. The question is what happens with the debt that results not from overspending, but from structural reasons, such as the cases of Spain, Portugal and Ireland. Should these bailouts be financed from other states or from local taxpayers? Bellamy does not answer this question, which raises a dilemma for him. On the one hand, if these costs are borne by local taxpayers, the unfair distribution of benefits and burdens cannot make the decision of staying in the union justifiable to these citizens. On the other hand, if the costs are borne by other states, Bellamy faces the same objection that he offers to fiscal federalism. Bailing out other states involves a transfer of resources, which might generate democratic opposition.

My answer to Bellamy's objection to fiscal federalism is that the fact that specific policies within the monetary union are not democratically accepted by some countries is not problematic, as long as the overall decision to join and stay in the union as a whole is justified, and democratically accepted. Joining a union involves some benefits for countries, but also involves some responsibilities. What is relevant is to have a fair distribution of benefits and burdens, in a way that it is overall beneficial for all countries to stay in the union, compared to being in a floating regime. Specific decisions may benefit some countries at the expense of others - e.g. transfer of resources from central to peripheral countries during the Euro crisis. As Bellamy points out, these decisions are not likely to be democratically endorsed by countries that bear the costs. However, the fact that redistributive policies are democratically opposed by those who should contribute, does not mean that these policies are not fair, in the same way that redistributive policies within a country are fair even if they are not accepted by rich individuals. Instead, what matter is that all countries are overall better off from the agreement, even if this also means accepting some costs that are undemocratic.

Bellamy also raises an issue of feasibility, if the decisions of supranational EU institutions are not democratically endorsed by the different peoples (or *demoi*), these people may decide to opt out of the union. However, this feasibility also depends on how the benefits

[75] Having a common lender of last resort avoids the issue of capital flight, in which investors move their assets to places that they trust that the government will bailout banks, since there is a common supranational lender of last resort, the bailout from this entity will happen in for any country within the union, hence, there is no need to move their assets abroad. Similarly, restrictions on bond holdings may help prevent the problem of moral hazard, in which investors take additional risk, since they think that they can externalize the costs to the government. Also, as Bellamy points out there is the benefit of offering more fiscal control to individual countries.

[76] Joseph Stiglitz has argued that while a banking union is one of the policies that Europe should take, others such as the mutualization of debt and additional solidarity, or transfer of resources, is also necessary along with this policy (Stiglitz, 2016: 242-6).

and burdens are distributed within countries. In other words, many of the current feasibility problems of offering more power to supranational structures within the EU may arise because the benefits of integration are not well distributed internally, hence, a better internal distribution of benefits might mitigate this problem. If the benefits of belonging to the union are not well distributed within citizens of a country, there may be cases in which poor people in some countries are worse off by staying in the union even though the country as a whole is better off, which may raise the problem of feasibility for solidarity policies. As opposed to this case, if the benefits of belonging to a union are well distributed within countries, then what matters is that citizens are better off overall, even if some specific policies involve the country incurring some costs. In any case, the responsibility of internal redistribution falls on individual countries and, hence, what matters in this case is to consider whether these countries, or peoples, are better off by staying in the union.

Section 6) Conclusion

From this chapter I make two main conclusions. First, while the framework of parasitic exploitation offered in the first part of this thesis can be extended to the case of fixed currencies, the LRP cannot. The LRP is a principle that aims to avoid domination. Because in the general fixed scenario there is always domination, this principle cannot be extended to this case. Instead, there is a forward-looking responsibility to change the system to a floating one. In the case of monetary unions, the benchmark of domination, and the way in which it occurs is different from the one in the floating scenario. Therefore, a principle that suits this case better in Juri Viehoff's equitable risk-sharing principle, rather than the LRP. The second main conclusion is that even if cases of monetary unions and stylized cases of fixed currencies share the same *economic* principles, the *normative* principles that apply in each case are different. I argued that because a monetary union is a case of an agreement within an agreement, deviations from the counterfactual scenario of the general agreement need to be justified to participants. This trigger additional responsibilities of solidarity among states that belong to the union. In this case here is a trade-off between more interdependence but also more solidarity that should make all countries better off by participating in the union.

Chapter 6: Closed Capital Markets: The Case of Bretton Woods

Section 1) Introduction

In the previous chapters I presented the problems of today's IMS. I introduced the problem of monetary spillovers, such as the case of the Latin American crisis of 1980s, and how this problem contributed to domination in the IMS. I also presented examples of currency crises, including the cases of Argentina, Mexico and Brazil, and how some cases of currency speculation can be considered instances of exploitation. Finally, we saw that capital flight and speculation on interest rates can also be considered exploitative, such as in the case of the Eurozone crisis, and for this case we also saw that the idea of domination also applies to this case. Because of these problems that arise in both scenarios of floating and fixed exchange rates and open capital markets, James Tobin has suggested that the problem of the IMS relies on the free movement of capital, and argued for a Tobin tax that limits capital mobility.[1] Some people think that, because this capital mobility is so harmful, financial autarky - or a world with closed capital markets - can be justified to individuals.

In the introduction of this thesis we saw the Mundell-Fleming trilemma of macroeconomics, according to which countries cannot have at the same time stable exchange rates, autonomy in monetary policy and open capital markets: they can have at most two of these elements. In the first five chapters of this thesis I assumed a world with generally open capital markets. Here I question this assumption and consider a case with closed capital markets.

In this chapter I consider two pure scenarios: a world with completely closed capital markets, or the case of financial autarky, and a case with completely open capital markets. I argue against these two scenarios. Against the former scenario, I argue that having completely closed capital markets would be too demanding, would impose unreasonable burdens on individuals, and could lead to other problems such as a reduction of trade, among other things. The latter scenario is the general scenario of today's world, and the scenario considered in the first five chapters of this thesis. As we saw in the previous chapters, this scenario sometimes generates normative problems, since it allows for problems such as exploitation and domination to happen. Instead of these two pure scenarios, I argue that the best solution is a third scenario between these two, or a case of open capital markets embedded within regulating institutions, such as the proposals offered in previous chapters. I argue that this scenario is better than the two previous pure scenarios, since it avoids the problems of these two pure scenarios.

This chapter proceeds as follows. *Section 2* offers a general overview of the problem, defines capital markets, and distinguishes between different types of capital controls. *Sections 3* and *4* offer two pure scenarios regarding capital markets: a completely closed scenario and a completely open scenario, respectively. *Section 3* addresses the first pure scenario of closed capital markets, or the case of financial autarky, such as the world that

[1] Tobin, 1978: 153

existed during Bretton Woods. The main defender of financial autarky is Aaron James. In this section I argue against James and conclude that the implementation of permanent and extensive capital controls à la Bretton Woods would be too demanding and could generate additional problems in other areas, such as reducing trade. In *section 4*, I consider the opposite scenario, that of completely open capital markets, or a world with unregulated capital markets similar to the world we have today. This is a short section, since this is the case I already addressed in the first five chapters of this thesis. The argument of this section is that while capital markets may bring benefits, there are cases in which these markets generate problems of exploitation and domination, such as the ones presented in previous chapters. *Section 5* argues for a third scenario between the two previous scenarios, or a case of open capital markets embedded within regulating institutions. This scenario, on the one hand, is not as demanding as financial autarky, and on the other hand, institutions aim to address the problems of domination and exploitation that arise in open capital markets. In this section I also suggest states have a responsibility to apply non-extensive capital controls, but these controls are not a substitute for the previous proposals. Finally, *section 6* concludes.

Section 2) Capital markets and types of capital controls

This section starts by defining and explaining what capital markets are. Then, I present the benefits of these markets and situations in which capital markets generate problems. Finally, I identify different types of capital controls that exist to address problems of capital markets.

2.1- What are international capital markets?

Before we continue with this chapter, we need to define and explain what capital markets are. Capital markets are markets in which there is an exchange of capital, such as savings and investment, between suppliers who have capital and those who need this capital.[2] These transactions can take the form of either foreign investment or loans. There are at least three main types of foreign investment. First, foreign direct investment – hereafter FDI – happens when a firm invests in a foreign firm to obtain certain control and influence over the latter firm's decisions – e.g. there might be an interest in investing in a supplier. In such cases firms can establish new factories, merge with the firm, or invest in other ways such as providing technical skills and technology. A second type of foreign investment is portfolio investment, which is investment in the capital market of a foreign country. This is the case of investors who invest in securities, such as stocks and bonds, or other financial assets, such as bank deposits denominated in the foreign country's currency, mutual funds and financial derivatives of a foreign country. Finally, the third type of foreign investment is foreign institutional investment, which happens when a group of people operate in a country that is not their own, such as hedge funds, mutual funds, pension funds and insurance companies. Other types of transactions in the capital market include loans. These loans can be loans to a state which needs financial assistance from other creditor countries or institutions, or it can also be commercial borrowing, such as when firms take loans from banks.

[2] See Krugman and Obstfeld, 2003: chapter 21.

2.2- Benefits of the international capital market

The different types of capital transactions presented above bring different benefits to those who take part in these transactions. FDI is a type of investment that is considered to be beneficial for developing countries since they can benefit from long lasting technical skills and technology, and from this investment in their firms. Also, as we saw, this type of investment brings benefits to investors who can have more control over strategic firms in their sector. International portfolio investment can also yield benefits to residents of all countries involved, who can invest in a wider range of assets from different countries.[3] Having more assets to invest in allows portfolio diversification, which reduces the risk of return for investors by allowing them to place their investments or "eggs" in different foreign "baskets".[4] In general international capital markets also allow allocation of capital between investors and those who need capital. For example, when a developing country borrow funds from abroad – either by a loan or by selling bonds to foreigners – it benefits from being able to pursue projects that it would not have been able to do without domestic savings only, and the lending country benefits because it is able to yield higher returns than those it can yield at home.[5] The same happens with other types of investments, in which investors benefit from returns and those who need capital benefit from being able to obtain these funds from abroad.

2.3- When the capital market is inefficient

There are at least four different cases in which open international capital markets can be inefficient: large inflows, currency appreciation, hot money and loss in monetary autonomy.[6] I have already discussed these inefficiencies, and how they lead to normative problems in the previous chapters of this thesis that consider the problems of both floating and fixed regimes with open capital markets. According to James Tobin, "the basic problem today is not the exchange rate regime, whether floating or fixed. Debate on the regime evades and obscures the essential problem. That is the excessive international - or better, intercurrency - mobility of private capital".[7]

These inefficiencies associated with open capital markets have led to the implementation of capital controls to avoid or restrict international capital movements. In what follows, I present different types of capital controls.

2.4- Types of capital controls

In the literature capital controls are classified into two main types - extensive and non-extensive capital controls - and the latter type can be sub-classified into direct or indirect. Also, capital controls can be imposed on capital inflows, on outflows or on both. Let us see each of these types in more detail.

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[3] Krugman and Obstfeld, 2003: 639-40
[4] Idem
[5] Krugman and Obstfeld, 2003:637-9
[6] Magud et at, 2018. Idem, also in Reinhart and Reinhart, 2009
[7] Tobin, 1978: 153

2.4.1- Non-extensive capital controls

Non-extensive capital controls can be either direct (or administrative) or indirect (or market based). Direct or administrative capital controls aim to restrict some forms of capital transactions or transfer of funds by directly prohibiting them or by imposing quantitative limits or approval procedures. For example, after 1992, Brazil implemented an outright prohibition, or minimum maturity requirements, on certain types of capital inflows.[8] Similarly, during this period Chile implemented a minimum stay requirement for direct and portfolio investment.[9]

The second type of non-extensive capital control, indirect or market-based control, discourages international capital market transactions, and capital movement, by making them costlier. One type of indirect capital control is the taxation of cross-border financial flows, which can be on foreign exchange transactions. Examples of this capital control include a Tobin tax, taxes on external financing or loans, and taxes on income for holding foreign financial assets for residents and domestic financial assets for non-residents. Another type of indirect capital control is the creation of a dual (two tier) or multiple exchange rate system, which comprises splitting the domestic currency market into two: those of residents and non-residents. Assuming that the latter are involved in speculative activity, financial institutions are instructed not to lend to them in order to make it costlier for them to take a short position in the domestic currency. Other types of indirect controls involve setting provisions for the external position of banks, limits on currency position, and requirements to borrow abroad. Together with administrative capital controls, Brazil and Chile implemented an "entrance tax" on certain foreign exchange transactions – similar to a Tobin tax – and on foreign loans, and taxation on inflows through an unremunerated reserve requirement.

These non-extensive capital controls can be implemented either on inflows or on outflows. As we saw, countries like Chile and Brazil applied controls on inflows to avoid upward pressure on the exchange rate, and to avoid large inflows and hot money. Other countries – such as Spain during this same time - have implemented controls on outflows to avoid depreciation of their exchange rate and capital flight. Finally, other countries, such as Malaysia and Thailand after the Asian financial crisis implemented controls on both inflows and outflows. The capital controls implemented by the latter three countries targeted activities of non-residents, considered as speculators, and restricted their access to domestic currency. These controls also exempted some types of capital movement such as FDI and some types of portfolio investment.

2.4.2- Extensive capital controls

One example of the use of extensive capital controls is the case of the Bretton Woods system. The Bretton Woods agreement was signed by 44 countries in 1944, in which they agreed to establish a monetary system for the post-war world. The system established in Bretton Woods consisted in all countries having fixed exchange rates against the US dollar, and a stable dollar price against gold at $35 an ounce.[10]

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[8] Ariyoshi et al, 2000: 11

[9] Ariyoshi et al, 2000: 12

[10] For the Bretton Woods system see Krugman and Obstfeld, 2003: 546-61

At the time of the agreement, currencies were not convertible, but the US and Canadian dollars became convertible in 1945. A convertible currency is one that can be exchanged for others – e.g. a Canadian citizen could sell goods to an American in return for US dollars and then exchange these dollars for Canadian ones in the foreign exchange market. General inconvertibility of currencies would have made trade extremely difficult – e.g. a French citizen would be unwilling to sell goods to a German one in exchange for DM that could not be converted to francs and the latter citizen would not have access to francs to make this purchase. However, because the US dollar was convertible most trade was invoiced in dollars. The currencies of most countries in Europe did not become convertible until the end of 1958, with Japan following in 1964.

The IMF during the Bretton Woods period called for countries to make their currencies convertible for current account transactions – or transactions of goods and services – but not for capital account transactions (i.e. transactions of capital). Policy makers restricted capital movements, since they feared that speculation, hot money and large capital inflows may threaten their fixed currency system. These extensive capital controls that restricted capital movement were not only directed at international investors and banks, but also to citizens. For example, during the 1960s British citizens were prohibited to take more than £50 on their holidays abroad.[11] Also, during this time, governments intervened a large part of the states' economic and financial activity.[12] For example, governments intervened in financial markets to channel funds to strategic sectors, set restrictions to the assets in which banks could invest, among other interventions.

A similar type of extensive capital controls to that of Bretton Woods has been in place in both contemporary China and India. However, both countries have started a gradual process of liberalization since the early 2000s. Before this liberalization, in these countries, citizens were limited in the assets that they could hold, being the only available options cash and deposits in banks at artificially low rates.[13] Given this limited availability of options, citizens put much of their savings in banks. In India, banks lend mainly to the government, which got much lower rates than it would in a liberalized capital market. In China, banks mainly lend to state companies and infrastructure projects, also at much lower rates than those obtained in open financial markets. These extensive capital controls implemented in India and China prohibited most capital flows, but allowed for FDI which allowed foreign long-term investment.[14] Like in the case of Bretton Woods, extensive capital controls and restrictions in capital markets in both China and India have historically been only one facet of a generally closed and heavily state-controlled system.[15]

Some countries have implemented temporary extensive controls to address crises, such as Venezuela in 1994, Romania in 1996, and Russia in 1998.[16] These extensive capital controls mainly involved closing or generally restricting the foreign exchange market for international payments and transfers, and capital movements. In Venezuela there were restrictions on foreign exchange for imports, exports, and other transactions, and prohibition of non-residents capital transactions. Romania suspended most of foreign exchange traders'

[11] Wolf, 2009: chapter 3
[12] Eichengreen, 2008: 92
[13] Reinhart et al, 2009: 66
[14] Stiglitz, 2002b: 66-7; Stiglitz; et al, 2006: 181; Ocampo et al, 2008: 19
[15] Ariyoshi et al, 2000: 30
[16] Ariyoshi et al, 2000: 28-9

licences and put limits on the overnight cash positions. Russia temporarily closed the interbank foreign exchange market.

Section 3) The case of closed capital markets or financial autarky

This section starts by considering the case of closed financial markets or the case of financial autarky, and then I argue against it. Because Aaron James is the main defender of this case, I will start this section by presenting his argument. James argues for financial autarky, since financial crises cannot be justified to the worse off, and proposes non-extensive capital controls as an application of this autarky. Then, I will argue against James' idea of financial autarky, and James' argument on four different grounds.

3.1- Aaron James' case for financial autarky

In what follows I will present James' argument, following his own steps. James considers capital market liberalization as an ultra-hazardous activity that generates a risk of severe harm on individuals because it allows for financial crises to arise.[17] He observes that this has not always been the case by offering the case of the Bretton Woods period, in which there were no banking crises. Considering that financial crises generate a considerable harm for people who suffer them, and especially the vulnerable ones, James raises the question of justifiability, or to what extent can the risks of financial crises be fairly imposed to those who suffer them? In order to answer this question, James offers the principle of Collective Due Care, which states that financial markets are only justified if there are institutions in place that can compensate for the harms they create, and we can only allow those crises that institutions can reliably address.

James argues that there are two ways to achieve the Due Care standard. The first one is compensation, in which liberalization could be established if there is a system that compensates for its harms. The second one is precaution, or to impose capital controls to eliminate the risk of harm, or reduce it to a level at which compensation can be reliably provided. However, he opts for the second way of precaution for two reasons. First, governments have limited powers to compensate, and the damages of financial crises are so high that they outweigh governments' capacity to adequately compensate people. Governments' measures to address a crisis have often been insufficient and late, and most governments do not have the policy measures to compensate for a lost decade of growth or for long-term unemployment. Second, Due Care only allows liberalization once institutions are in fact set up, and since there is no such a global structure, precaution is the only course of action until the necessary structures and institutions that compensate are in fact in place.

The Due Care principle asks how a person is worsened in an open society compared to a scenario with capital controls, in which crises did not happen or were less severe. As an example, James offers the case of a person born in the US working class during Bretton Woods, who then lost her job and home in the 2008 financial crisis and faces long-term unemployment.[18] In this case, James argues that the current scenario that this person faces

[17] In what follows I will refer to James, 2012: chapter 8
[18] James, 2012: 274

can only be justified if in the alternative scenario - in which governments had not abandoned Bretton Woods or refashioned it with capital controls that limit capital mobility in the same way - this person would have been the same or worse off than she is today.

James considers financial autarky, such as the case of Bretton Woods, as a baseline scenario for comparison, since it was financial crises free. However, he argues that financial autarky does not mean *economic* autarky, nor *full* financial autarky. On the one hand, financial autarky does not mean *economic* autarky, since there can be an exception on capital flows that correspond to trade. As an example, he offers the case of Bretton Woods, in which countries still traded goods and services with each other despite capital controls. On the other hand, *full* financial autarky is also not necessary. What should be avoided is capital movement that is correlated with financial crises, but other types of innocuous capital flows, such as those related with trade or FDI can be allowed. Given this baseline, James considers that there can be two different regulatory dispositions towards capital controls. One that considers liberalization as a baseline, which requires controls to be justified, and another one that considers autarky as a benchmark, which requires different forms of liberalization to be justified, and opts for the latter disposition. He argues that "because the likelihood of severe and potential irreparable harm is particularly high in a world of liberal capital flows, the fundamental question is not one of mere regulatory depth but of whether international financial markets should be allowed to exist at all. The latter, risk averse regulatory disposition accepts this and so proceeds with extreme caution".[19]

James offers three reasons against capital financial liberalization and to defend this baseline scenario of financial autarky. First, he is sceptical of the inevitability of financial liberalization. James presents Barry Eichengreen's argument for inevitability, according to which international financial liberalization and capital flows are inevitable and irreversible. Eichengreen argues that because of this inevitability, we should aim to improve the trade-off between financial liberalization and stability. Even if in this case crises will still happen, we should aim for policies that minimize their incidence and address them at a lower cost in order to make financial integration more attractive. Against Eichengreen, James argues that it is possible to achieve a world with financial autarky, since this has already been done before during the period of Bretton Woods. He argues that the problem is not that governments are *incapable* of implementing strong capital controls, but the question is about costs, and about which costs would be unacceptable. James argues that when there is risk of considerable harm, then taking high costs to prevent this harm is acceptable. He illustrates this idea with the example of a pandemic. We would accept very high costs to prevent a pandemic disease from spreading. As in the case of the pandemic, "even if the costs of effective capital controls were also very high, we might think they are required to prevent people from suffering severe and irreparable harm because of financial crises".[20] James also argues that the question about costs relies on the type of capital controls that we implement, and suggests that we should prefer the type that is the least costly among those that bring equally effective results, such as capital inflow limits à la Chile or securities taxes.

Second, James argues against the argument of personal liberty and welfare. According to this argument, free markets allocate resources and outcomes in socially beneficial ways, therefore, free markets – and personal liberty to conduct our desired transactions - are better than bureaucratic control. Against this argument James follows John

[19] James, 2012: 272
[20] James, 2012: 258

Stuart Mill on the idea that personal liberty should be restricted when it imposes severe risks of harm to others. James also argues that restrictions on financial transactions do not restrict personal liberties as understood in liberal societies – e.g. liberty of speech, of consciousness, or movement – nor economic liberties – e.g. choice of occupation, place of work, country of residence. Even if these liberties could be restricted, James argues that these restrictions are justified in order to avoid harm, such as in the case of strict controls that prohibited the removal of the currency from the country implemented in Malaysia in 1998. James argues that it is the role of politics to restrict some forms of personal freedom to prevent unacceptable harm, and this includes the area of financial liberties, since the benefits of capital markets tend to be mainly to rich people and governments err to allow liberalization when restrictions are justified.

Finally, James argues against the idea that financial transactions should be allowed, since they make people better off. Instead, James argues that financial transactions are not mutually beneficial for three reasons. First, because trade in financial assets is not welfare enhancing in the direct way that trade in goods and services is, since financial assets represent a claim on future goods and services, but not the actual consumption of these goods. Second, he argues that the main actors that benefit from financial transactions are banks and large financial institutions, which do not have morally relevant interests, but that instead represent the interests of rich people. Because of diminishing marginal utility, the welfare increase that the rich obtain from financial transactions is small, since they already have enough money. This leads us to the last of James' points, that not all welfare improvements have the same moral relevance. For example, the interests of a person to make a decent standard of living and avoiding the hardships of crisis is more relevant than rich people's interests in making additional gains from financial transactions. James concludes that because the costs of crises are so high, they wipe out the benefits that financial liberalization brings to wealthy people. Because the costs of liberalization exceed its benefits, it cannot be justified.

3.2- James' mismatch between theory and practice

Before I argue against the idea of financial autarky, I will briefly stop to point out a mismatch between James' theory and his policy proposals. As we saw, James argues for financial autarky à la Bretton Woods, but argues that going back to the Bretton Woods system is not necessary, instead he proposes an updated set of capital controls that can lead to similar results, or that are equally effective, as the former system. As examples of these updated capital controls, he offers the cases of non-extensive capital controls, such as controls on inflows à la Chile, securities taxes and prohibition of currency outflows à la Malaysia. However, empirical evidence suggests that the use of non-extensive capital controls do not lead to similar results, or are not as effective, as extensive capital controls such as the ones that existed during Bretton Woods.

In recent years there have been several studies that show that non-extensive capital controls have limited effectiveness in addressing financial crises and the effects of capital flows. Nicolás Magud, Carmen Reinhart and Kenneth Rogoff analysed the effectiveness of non-extensive capital controls, in a study with more than 40 cases of implementation of this type of controls. They found different results in terms of efficacy and magnitude in each case, with most cases not being efficient and with the cases of Chile and Malaysia being rare cases

in which controls worked well.[21] Michael Klein and Jay Shambaugh, found that, as opposed to extensive capital controls, which are effective, non-extensive capital controls have limited effectiveness.[22] There is also a debate about the efficacy of controls in other areas such as in the appreciation of the exchange rate,[23] and on the effectiveness of these capital controls depending on whether they are temporary or permanent. Some argue that the limited effectiveness of non-extensive capital controls is due to the fact that the countries that implement them do not have a legal, institutional and administrative framework to implement extensive capital controls.[24] Because of this, it has been argued that capital controls are more effective in countries such as China or India that have not dismantled the structure that allows them to have permanent capital controls.[25]

Evidence also suggests that extensive capital controls were more effective in China and India before their gradual dismantling in the early 2000s than they are today, but even then, they were not completely effective in insulating these countries from financial crises.[26] While China and India were less affected by the Asian financial crisis of 1997-8 than other countries in the region, they were not immune to it.[27] Also, these extensive capital controls did not protect China from an internal banking crisis that arose from large-scale lending to state companies that were inefficient and went bankrupt.[28] This vulnerability to crises has become even stronger in more recent years after the gradual liberalization of these countries' capital markets. During the great recession of 2008, capital controls in these countries did not prevent them from having capital inflows that generated bubbles in the equity and in the property market.[29] Also, after the financial crisis of 2008 there were capital outflows in India and the government had to use large amounts of reserves to avoid exchange rate fluctuations.[30] Therefore, the presence of a legal framework for long-term capital controls was not enough to prevent capital flows of hot money.[31]

This distinction about the effectiveness of different types of capital controls is relevant because it shows that there is a false assumption in James' argument. James assumes that non-extensive capital controls, such as securities taxes and controls implemented in Chile and Malaysia, will have equally effective results in avoiding crises, as a system à la Bretton Woods.[32] Based on this assumption he argues that these kinds of non-extensive capital controls are feasible to implement, do not restrict personal liberty, and are justified in terms of welfare, benefits and costs - compared to a scenario with financial crises. However, as we saw, evidence shows that James' assumption is false, and that the implementation of non-extensive capital controls does not necessarily prevent – nor necessarily mitigate - countries suffering the effects of a crisis. Therefore, instead of explaining why and how the implementation of non-extensive capital controls is less costly than having crises, James

[21] Magud et al, 2018
[22] Klein and Shambaugh, 2015
[23] See Benigno et al, 2013; Buss 2013; Chamon and García 2013; Magud et al, 2018.
[24] Habermeier et al, 2011
[25] Patnaik et al, 2012: 439-40
[26] Akyüz, 2010: 220-1; Yu, 2010: 219-20, 227.
[27] Ariyoshi et at, 2000: 29.
[28] Reinhart et al, 2009: 403.
[29] Yu, 2010: 230
[30] Aizenman et al, 2013: 125
[31] Patnaik et al, 2012: 450; Cheung et al, 2014: 132; Ocampo, 2017: 117.
[32] Let us remember that James' objective is to eliminate crises, since their costs cannot be justified unless there are already institutions in place that can reliably compensate for their costs (James, 2012: 253). His presumption is that capital mobility should be reduced to Bretton Woods levels by adopting an updated set of strong capital controls (James, 2012: 254).

should explain how extensive capital controls à la Bretton Woods compares to this scenario of being crises free, and that the implementation of the latter system is feasible and does not restrict liberty.[33] Otherwise, James' argument collapses into a similar argument to that of Eichengreen, which he criticizes, that the aim of capital controls and restrictions in international markets is to balance the harms of financial crises and the costs of diminishing them, but not completely abolish these crises.

3.3- Against financial autarky

There are at least four reasons to argue against James' proposed scenario of financial autarky. Some of these reasons have already been offered by Matthias Risse and Gabriel Wollner, who offer a philosophical critique of James within the global trade literature.[34] Here I do not only offer a philosophical critique, but I also offer empirical reasons against James.

3.3.1- Empirical argument

My first critique of James is empirical. In what follows I will suggest that the costs James considers are not as low, that the benefits are not as high, and that there are still feasibility problems with his proposal.

Costs are not as low

James ignores the empirical limitations of his proposal and the real costs associated with having no financial crises. As we saw in last sub-section, there are several studies that show that non-extensive capital controls are usually not effective in avoiding the effects of a crisis; hence, if James aims to compare a scenario with crises against one that is crisis free, he should instead use as an example of policy application the case of Bretton Woods. However, the costs and measures implemented in the Bretton Woods system were much higher than the costs of implementing non-extensive capital controls. As we saw earlier in this chapter, in Bretton Woods *most* governments – like in contemporary India and China before the 2000s - intervened in large part of the economic and financial activity of the state, and the assets that could be held were not only restricted to banks but also for individuals.[35] We also saw that during Bretton Woods most currencies were not convertible, or in other words, they could not be exchanged for the currency of another country in the foreign exchange market. The only two currencies which were convertible were the US and the Canadian dollar, which led to trade being invoiced in US dollars and to worldwide dollarization. However, lack of convertibility has the considerable cost of making trade almost impossible unless there is dollarization, or a situation in which a foreign currency of a strong country is used as a means of exchange and store of wealth. However, this system which depended on the US dollar also had considerable costs, such as a problem of dollar shortage, countries imported inflation from the United States and other problems, such as a

[33] The updated analogy would be extensive capital controls à la India and China before their gradual dismantling in the 2000s. But even the we saw that these controls were not as effective as Bretton Woods, this might be because in Bretton Woods all countries implemented these extensive controls, instead of just a few outliers. Therefore, going back to a Bretton Woods system seems like the best application of James' idea of financial autarky.

[34] Risse and Wollner, 2013, 2014.

[35] Reinhart and Rogoff, 2009: 66.

reduction of freedom and equality, which I will introduce that we will see in more detail below.[36]

James could argue that dollarization is not necessary and that convertibility of currencies could be allowed for trade. However, the case of Bretton Woods shows us that convertibility – even if it is only for trade - allows balance of payment crises to occur. After 1958 currencies gradually started to become convertible, for trade purposes, and financial markets started to become more integrated with the creation of a foreign exchange market. With the creation of this market, the opportunities for speculative capital flows increased dramatically.[37] Speculation in this time used to be covered by having trade as an excuse. For example, people would borrow foreign assets by delaying payments to foreign suppliers. Analogously, they could purchase foreign assets by accelerating payments to suppliers relative to the actual shipment of goods. This increased speculation led to a series of cases of currency speculation, which in turn led to frequent and violent balance of payment crises during the 1960s and early 1970s. Some examples are the cases of Britain in 1964 and Germany and France in 1969. Two episodes of currency speculation against the US dollar in both 1971 and 1973 ultimately led to the fall of Bretton Woods. While Carmen Reinhart and Kenneth Rogoff show that *banking* crises did not happen during the Bretton Woods period (between 1940-1970s),[38] *balance of payment* crises were common in the convertible period of Bretton Woods after 1958. Therefore, if James argues for eliminating financial crises, he should also consider the cost of having no convertibility.

In Eichengreens' words, in Bretton Woods capital "controls held back the flood because they were not just one rock in a swiftly flowing stream. They were part of a series of levees and locks with which the raging rapids were tamed".[39] This leads us to the conclusion that having a system that eliminates financial crises involves stringent restrictions. And these costs are much higher than the ones assumed by James.

Benefits are not as high

James assumes that the worse off will be better off in a system with closed financial market than in a liberalized financial one, but this is an unknown and questionable fact. We do not know what the overall effects of closed financial markets would have on developing countries today, since this is a counterfactual scenario.[40] James, like Dani Rodrik, could argue that world trade during the Bretton Woods period grew considerably at an annual average rate of almost 7 percent.[41] Similarly, Michael Bordo emphasises the high growth rates during Bretton Woods, and observes that within this period, the convertible subperiod had the highest growth rates.[42] However, we do not know what would have happened in a counterfactual scenario, with another monetary system. Maybe in an alternative scenario this increase in trade and growth would have happened anyway, or could have even been higher, due to the reduction in trade and growth on the previous years, in which the world

[36] Krugman and Obstfeld, 2003: 557- 63.
[37] Krugman and Obstfeld, 2003: 551.
[38] Reinhart et al, 2009: 155.
[39] Eichengreen, 2008b: 92.
[40] Matthias Risse and Gabriel Wollner make a similar point for the case of trade. Risse and Wollner argue that the counterfactual scenario of economic autarky is unknown, and hence, it is impossible to say that the worse off would have been better off (or worse off) in this scenario compared to the actual scenario. See Risse and Wollner, 2013, 2014.
[41] Rodrik, 2011: 71
[42] Bordo, 1993: 12

experienced two world wars. Also, Bordo points out that the convertible subperiod was the one with the highest growth rate but, as we saw, this subperiod had several balance of payment crises. What we know is that in theory in a system such as the early subperiod of Bretton Woods – with no convertibility - there will be no financial crises, but there may be other factors that make the worst off – poor people in poor countries – worse off *overall* in a closed financial system, such as the possibility of having a reduction in trade and economic growth. If the worst off are made worse in a closed system than in a world with free capital markets, then there is no reason for considering the closed scenario.

Feasibility again

James argues that feasibility is not a problem, since a world without financial crises had already been established during Bretton Woods; hence, the question is not about feasibility but about costs. However, today's conditions are not the same as those that existed during Bretton Woods, and while the general international conditions during the mid-twentieth century allowed the Bretton Woods system to be implemented, today's conditions make this implementation less feasible. I can point out at least two differences between the global context in the two scenarios that are relevant since they facilitate, or difficult this implementation. First, during Bretton Woods, the United States occupied a strong central position in the international context, which allowed it to be the centre of the system. All other currencies were pegged to the US dollar, which was used as the main currency for trade and for storage purposes. As opposed to this scenario, today we can question the absolute central role of the United States in the international system, as we move towards a more multi-polarized world, with emerging economies, such as China, gaining more global power.

There is another difference between the period from 1944 to the 1970s and today: now we have more technology and innovation, which is another feature that hinders the implementation of a system like Bretton Woods. During the last period of Bretton Woods, financial innovation and advances in communication technologies - such as the emergence of offshore banking - led to movements of capital despite the heavy structure designed to contain these capital flows. This has also been pointed out as one of the main reasons for the fall of Bretton Woods. This is why Eichengreen argues that a return to this system, which contained capital flows and avoided financial crisis, would be unsustainable today, since even more sophisticated financial innovation has emerged in recent years than before. According to Eichengreen this new technology would necessarily lead to *pores* in the system, and to a breakdown of the whole structure.[43] This leads us to the conclusion that having a system with no financial crises still involves a feasibility problem.

[43] See Eichengreen, 1999: 2; Eichengreen, 2008b: 119, 132

3.3.2- Reductions on freedom and Equality

Second, we can question the desirability of going back to a system like Bretton Woods, on the grounds that it would reduce freedom and equality levels. Earlier we saw that during the convertible period of Bretton Woods there were still various balance of payment crises, and hence a scenario with no crises would be one similar to the non-convertible period of Bretton Woods. As we saw, a system with no convertibility, or in which currencies cannot be exchanged for others in the Foreign Exchange market, would make trade almost impossible, since sellers of one country would not be interested in exchanging their goods for the currency of a foreign country. This would certainly limit freedom of work and freedom of movement, among other liberties. During the non-convertible period of Bretton Woods, this problem was solved by making US and Canadian dollars the only convertible ones, and by having a system that was centred in US dollars. However, as we saw earlier in this thesis, dollarization, and a system that is centred in the currency of one strong country, offers this country additional benefits and power, and makes other countries more dependent upon this country for various reasons.

I can point out at least three reasons for increased dependency from dollarization. [44] First, when countries hold liabilities – including liabilities for trade purposes – in foreign currency, it makes the person who holds these liabilities more affected by changes in the exchange rate between the home currency and the currency of the strong country. Second, when citizens hold a foreign currency, this reduces the possibility of the home government enjoying the benefits of seigniorage. In other words, when central banks issue coins and notes, they act as an interest rate free loan to the central bank. Similarly, when citizens of the home country hold a foreign currency rather than a domestic one, this offers the possibility of having an interest rate free loan to the foreign country, while denying this opportunity to the home country. This decrease in the cost of borrowing for the strong country acts as an interest rate subsidy from dependent countries to strong countries. Third, the Bretton Woods system, in which the US dollar had a central role, allowed the United States to have autonomy in monetary policy, but denied this possibility to other countries. This was described by Valéry Giscard d'Estaing, French finance minister in the 1960s, as an *exorbitant privilege* for the United States that was denied to others, and that increased inequality and dependency.

Also, we do not know what the effects of financial autarky would be on trade, and there is a possibility that this autarky would have a negative impact on trade. If trade were limited, there would also be limitations on freedoms as described by James, such as less freedom of employment. I will say more about the issue of trade below.

3.3.3- Need for distribution of costs and benefits

Third, what is needed is a balance of benefits and costs between generations, classes and countries, rather than completely eliminating financial crises because they cannot be justified to the worst off. Let us assume that James' assumption is correct and that the worst off would be better off in a world of financial autarky – we already saw that this assumption is highly questionable, but let us assume this for the sake of the argument. As we saw, James makes an analogy between financial crises and the case of a pandemic, and argues that

[44] See Cohen, 2015: chapter 1

because pandemics are very harmful, they cannot be justified, and governments should take huge costs to avoid this pandemic from spreading. Let us continue with this example and think about the current Covid-19 pandemic.

In this case of the pandemic, old people, who are more vulnerable to the virus and more likely to die are the worst off, since they risk the highest costs of the pandemic. Let us consider that there is a possibility of completely eliminating the virus in the shortest possible period of time, say in two weeks, but that doing so would bring huge costs to other sectors of society, say younger generations. Imagine that old people would be better off in this scenario – e.g. the economic costs do not affect them much because they are retired – compared to a scenario with virus. According to James because the worst off would be better off in this scenario, any cost would be justifiable. Consider now a second scenario in which the government can reduce, but not completely eliminate, the virus and that this scenario would also imply costs to others but in a way that it balances the benefits and costs between different sectors. I think that from these two scenarios the second one is fairer, since it balances benefits and costs between sectors and does not impose unreasonable burdens on one specific sector. Similarly, in the case of financial crises the assumption that the worse off will be better off in a world without crises cannot justify everything.

I think that, in general, the idea that the worst off will be better in a specific scenario is not the only way to justify a system to them. Continuing with the example of the pandemic, imagine that the difference between the first scenario – of eliminating the virus - and the second one – of reducing the virus - implied only a marginal improvement to the worst off's conditions, while it implied a huge difference to others. In this case, even if the worse off are marginally better in the first scenario, the second can still be justifiable to them. We could still tell the worse off that society is making an effort to considerably improve their situation – compared to a baseline of absolutely no restrictions – but completely eliminating the virus imposes unreasonable burdens on others and only a marginal improvement to the worst off. In this case the second-best option for the worst off - of not completely eliminating but reducing the virus - is still justifiable to them, even if there is an alternative scenario in which they will be (marginally) better off.

3.3.4- Possibility of creation

Finally, James rules out the possibility of creating new institutions without offering any reason, which creates two problems. The first problem is the possibility of creation of new institutions. As we saw, James argues that because embedding institutions, such as safety nets and other measures that would compensate for the effects of a crisis, are not established yet, then crises cannot be justified to the worse off. However, these institutions can be created. In my view, if institutions that regulate the IMS today do not exist and are necessary to regulate the social practice of the IMS, they should be created, as proposed in Part I, which may justify a "free" system embedded within these new institutions.

The second problem is that James assumes that institutions that would lead to financial autarky can be easily created, while those that compensate for the costs of crises cannot. As we saw, James argues that because these latter institutions do not exist, crises cannot be justified, and he concludes that we should opt for financial autarky, and gradually liberalize as reliable compensating institutions are set in place. However, as we saw, financial autarky also involves considerable institutions and restrictions. These institutions are even more demanding than *embedding* institutions. Therefore, it is not clear why we should first

create a Bretton Woods type of scenario that eliminates crises, with extensive institutions and all the hugely costly paraphernalia – such as no convertibility, considerable intervention of the state in most areas of the economy, extensive capital controls, and so on – instead of directly creating embedding institutions.

Because of these four reasons I conclude that the application of a world with completely closed capital markets, or the case of financial autarky, has normative problems. Now I turn to the second pure case, the case of completely open capital markets.

Section 4) World with completely free capital markets

A second possibility in regards to capital markets is a case of completely free capital markets. This is the opposite scenario as the one offered by James in his case for financial autarky. A world with completely free capital markets would be similar to the world we have today, in which capital can move freely and without restrictions nor institutions that regulate it. Banks and investors can freely move their capital to places that offer higher interest rates, and currencies and other portfolio assets can be freely exchanged without restrictions.

In the previous chapters I explained how capital markets are beneficial. On the one hand, capital markets offer benefits to investors who want to invest their capital and obtain returns for these investments. On the other hand, capital markets offer benefits to those who need access to loans and credit. We also saw the argument for portfolio diversification and the idea of having less risk and the possibility of having better rates. Throughout this thesis I argued that even if capital markets bring benefits, they also generate some problems. I argued that in some cases, completely free markets can raise issues of exploitation and domination, and suggested policy mechanisms, or the creation of institutions and regulations, to address these problems.

I will not spend too much time writing about the problems of completely free capital markets here, since I already considered these problems in the first five chapters of this thesis. Here I will briefly summarize the problems already raised before. In the first four chapters of this thesis, I considered the general scenario of the IMS, that of open capital markets and floating exchange rates. In chapter 1, I argued that an unregulated system of free capital markets raises two problems of background injustice. First, I suggested that a system in which countries can freely modify their exchange rate, reinforces weaker countries' vulnerability, and makes them more susceptible to financial crises. Second, a system in which currency speculation – as opposed to other types of currency trading – is allowed, also makes weaker countries more vulnerable to crises. In chapter 2, I addressed the first problem of background injustice. I argued that the erosion of the conditions of background injustice – the ability to deliver social justice at home, sovereignty and freedom and equality of agents – to some degree is pervasive and unavoidable. This problem becomes intolerable and strong when there is domination. I suggested that in this case there is domination in cases of crisis, since countries lose a minimum capacity to conduct their internal affairs and become dependent on conditionalities imposed by others to obtain loans to remedy their situation. In chapter 3 I offered a framework of parasitic exploitation, according to which this type of exploitation happens when the three conditions of build in mechanisms, structural vulnerability and non-proportionality are met. I also suggested that there are three connection criteria between the exploiter and exploited parties in these cases. In chapter 4 I suggested that the second problem of background injustice in some cases is also a problem of parasitic exploitation.

Finally, in chapter 5, I considered the case of open capital markets and fixed exchange rates. I considered two stylized scenarios, the cases of Bretton Woods and the Reserve Currency Standard. In this case I argued that domination necessarily happens, which raises a forward-looking responsibility to move to floating rates. I also considered the case of monetary unions, specifically the case of the Eurozone, and argued that in this case domination happens in the absence of mutual advantage. Because in the Eurozone today there is a situation of capture in the absence of solidarity, there is always domination. In this case, Eurozone countries have solidarity responsibilities with each other, in order to reduce domination. I also argued that in both the general fixed scenario and in the case of monetary unions, there is parasitic exploitation. Because of these problems, I conclude that a scenario of completely free capital markets also raises normative problems of exploitation and domination.

Section 5) A Third Scenario: Free capital markets embedded within regulating institutions

Until now I have argued that the two pure scenarios considered in this chapter - a world with completely closed capital markets, or financial autarky, and a world with completely free financial markets - raise problems. The former scenario is very demanding, while the latter scenario raises problems of exploitation and domination. Instead of these two pure scenarios, the best solution is to have a scenario in between these two, or a scenario with free capital markets embedded in regulating institutions, since on the one hand, this scenario is not as demanding as a scenario of financial autarky, and on the other hand, these institutions should aim to avoid the problems of exploitation and domination on the system.

I have already proposed several institutional implementations to address the problems of exploitation and domination in the previous chapters of this thesis. Some of these proposals include: (i) the creation of a global fund; (ii) to extend the Volcker rule to cases of spot foreign exchange market operations, in order to lead to longer maturities and reduce speculation; (iii) a fiscal federalism in cases of monetary unions such as the European Union; and (iv) regulation of international banking and investment to areas of higher interest rates to avoid exploitation in this case.

These proposals avoid the problems raised for the two pure scenarios. On the one hand these proposals are not as demanding as the case of financial autarky, and avoid problems related to subjecting people to unreasonable burdens. On the other hand, these proposals aim to specifically address the problems of free capital markets, while also allowing people to enjoy the benefits of these markets.

These proposals are international and it is important that most countries comply with them, since all of the problems raised in the previous chapters are international. For example, if one country only generated regulation prohibiting speculation, traders and investors may still speculate from other countries. Also, the application of regulation by some states only could lead to additional coordination problems. For example, if only some states apply controls then speculators and investors could deflect their inflows to other countries, increasing the magnitude of the flows to those countries that do not implement restrictions.[45]

[45] Ostry et al, 2012. Similarly, for the case of capital flight and taxation see Dietsch 2015, 2016; and Dietsch and Rixen 2014, 2016.

5.1) What about non-extensive capital controls?

The proposals offered in previous chapters aim to reduce exploitation and domination in the system by reducing speculation and by offering compensatory measures that reduce domination. However, because these proposals are focused on reducing these two problems *only*, they do not guarantee that countries will not be affected by shocks. There may be cases in which capital flows are not exploitative or do not lead to domination, but which still disrupt the internal conditions of a state. For example, capital inflows may not raise problems of exploitation, but may still contribute to internal macroeconomic instability.

The question that arises from this is the following: can the application of non-extensive capital controls be justified to citizens? As we saw, James answers this question and argues that, because financial crises cannot be justified to the worse off, and because this type of controls are not very costly, they should be implemented by developing countries. Like James, I also think that these kinds of controls can be justified to citizens, but for a different reason. I have already argued that the application of these kinds of controls do not necessarily prevent states from suffering a crisis; hence, as opposed to James, I do not think that states have the responsibility to completely prevent crises from affecting the country. Instead, I think that the reason relies on the fact that the state has a responsibility to maintain macroeconomic stability, as long as these measures do not impose unreasonable burdens on citizens. This can justify the application of non-extensive capital controls, as also suggested by James, but cannot justify financial autarky à la Bretton Woods, as I argued earlier in this chapter.

The application of these non-extensive capital controls is justified, since it is the role of the state to ensure internal macroeconomic stability and to use tools that have the potential to mitigate shocks. In chapter 2, I argued that the application of monetary policy by states is justified, since it allows states to achieve social justice at home and because it is a public good. The same happens with capital controls; these controls are a tool, analogous to monetary policy, that the state has to obtain conditions of macroeconomic stability, to maintain internal distributive justice and to provide for this public good. This explains why states are justified in applying monetary policy and intervening in the foreign exchange market, and also why states are justified in implementing non-extensive capital controls. We should also notice that some of the proposals offered in the previous chapters, such as the 60-day rule to reduce speculation, are also types of non-extensive capital control.

There is also a reason to think that some types of non-extensive capital controls should be implemented globally, rather than individually. As observed by Miriam Ronzoni, Peter Dietsch, Thomas Rixen and Gabriel Wollner, the implementation of individual taxes may lead to tax competition, which generates a problem of background injustice.[46] Tax competition happens when countries compete to attract capital by lowering their taxes, which ultimately leaves all countries worse off. Tax competition affects sovereignty because it undermines the state's capacity to choose the size of its revenue and level of redistribution. This happens because tax cuts decrease the state's budget and its capacity to provide public goods and maintain a welfare state. Tax competition is a problem of background injustice, since the lack of global rules on taxation encourages countries to reduce their tax levels in order to attract capital, which is ultimately harmful to these countries. As in the case of tax

[46] See Ronzoni, 2016; Dietsch, 2015, 2016; Dietsch and Rixen, 2014, 2016; Wollner, 2016; Rixen, 2016.

competition the implementation of non-extensive capital controls by some countries only could lead to a problem of background injustice. The implementation of global non-extensive capital controls would mitigate this problem.

The implementation of non-extensive capital controls is a complement, but not a substitute, for the policy measures suggested in the previous chapters of this thesis. As we saw, non-extensive capital controls are not always effective in mitigating the effects of inflows, currency appreciation and financial crises. While they have worked in some cases, such as the cases of Chile and Malaysia, they have failed in others. Therefore, states should use all the means that they have at their disposal, as long as they do not impose unreasonable burdens.

Section 6) Conclusion

In this chapter, I have argued for a world of open capital markets, or free finance, that is embedded within regulating institutions. I considered two pure scenarios. First, I considered a world with closed capital markets, or financial autarky à la Bretton Woods. I argued against this scenario, since it would be too demanding, would impose unreasonable burdens and could lead to additional problems, among other reasons. The second scenario is a world with completely open capital markets, such as the world we have today. This is also the scenario considered in the first five chapters of this thesis. I argued against this scenario, since as we saw in the previous chapters, it allows for problems of exploitation and domination to happen. I concluded that the best scenario is a third one: a world with open capital markets embedded within the regulating institutions proposed in the previous chapters. I also argued that, because these regulating institutions aim to avoid exploitation and domination problems *only*, states may also apply non-extensive capital controls. However, these non-extensive controls are not a substitute for the previous proposals.

Conclusion

In this thesis, I have discussed the normative aspects of the IMS. I started this thesis by presenting the Mundell-Fleming trilemma of international macroeconomics, according to which countries cannot have at the same time stable exchange rates, autonomy in monetary policy, and open capital markets. From this trilemma I identified three stylized scenarios, one with open capital markets and floating currencies, one with open capital markets and fixed currencies, and one with closed capital markets. The proposed view is a balance between the three "horns of the trilemma", rather than a stylized scenario: it is a system of floating exchange rates and in which capital can move, but with embedding institutions that set limits and remedies.

The first part of this thesis considered the general case that exists in the IMS today, the case of floating currencies and open capital markets. Within this scenario, I identified two problems of background injustice, the case of monetary spillovers and the case of currency speculation. In order to address the first problem, I offered a Limited Regressiveness Principle, according to which the regressiveness of a social practice should be constrained up to a level that avoids domination. I argued that, in the case of floating exchange rates, domination happens when there is a crisis. I also argued that there was an agential remedial responsibility and a forward-looking responsibility to create institutions that facilitate the application of this principle, such as a global fund. I offered a framework of parasitic exploitation, according to which exploitation happens when the three conditions of build in mechanisms, structural vulnerability and non-proportionality are present. I argued that the second problem of background injustice can also sometimes be considered a problem of parasitic exploitation, and I suggested policies to reduce currency speculation.

In the second part of the thesis, I addressed the two other scenarios. I started with the fixed scenario. I argued that while the framework of parasitic exploitation offered for the floating case can be extended to this case, the principles and the responsibilities in the fixed case are different from the floating one. I considered two stylized scenarios of fixed currencies, the cases of the Gold Standard and the Reserve Currency Standard. I argued that, because in these cases there is always domination, there is a forward-looking responsibility of countries to change the system to a floating one. I also considered the case of monetary unions, specifically the Eurozone. In this case I argued that domination happens when there is no mutual advantage from participating in the union. Because in this case the benchmark of domination is different, I suggested that a better principle to address this case is Juri Viehoff's principle of equitable risk-sharing. Finally, I argued that in this case there are responsibilities of solidarity between countries to create a fiscal federalism and banking regulation.

Finally, I discussed the case of closed capital markets. I argued that a generally open scenario is better than a completely closed scenario. However, as I argued throughout the thesis, unregulated open capital markets also raise normative problems of domination and parasitic exploitation. From this, I concluded that the best scenario is a third one, that of open capital markets embedded within the regulating institutions suggested in this thesis. These embedding institutions can include the implementation of non-extensive capital controls.

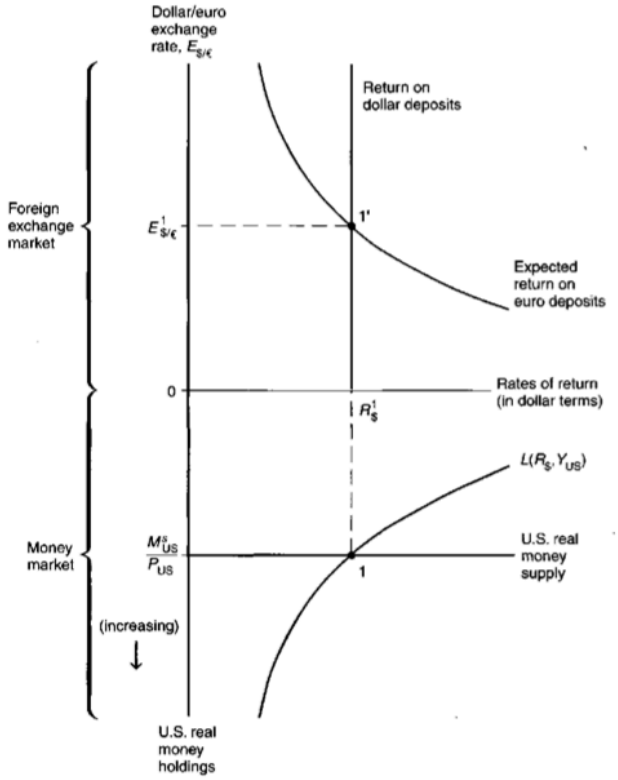
However, these non-extensive controls are not a substitute for the previous policy proposals offered throughout the thesis.

Annexes

Annexe 1: Interaction of the Domestic money market and the Foreign Exchange Market

In an open economy the domestic market – shown in Figure 7 as Money market – interacts with the Foreign Exchange market through the interest rate. For the domestic market this rate relates to the interest rate at which individuals may take loans or borrow money. In the foreign exchange market, this rate represents the rate of return of to investors for their investments in the country's domestic assets.

Figure 7: Interaction between the domestic market and the Foreign Exchange market through the interest rate



Source: Krugman and Obstfeld, 2003: 368

Annexe 2: Intervention of central banks in the Foreign Exchange Market

Central banks intervene in the market by implementing monetary policy, in an open economy this generates changes in the exchange rate, which ultimately affects real variables. In this annexe we will see how a central bank modifies its country's exchange rate in the Foreign Exchange market by implementing monetary policy. As an example, I will use the case of the central bank of the United States – the Federal Reserve - that implements expansive monetary policy.[1]

Central banks implement monetary policy by either buying or selling assets. When a central bank decides to carry out an expansive monetary policy, it buys assets – e.g. domestic assets. This purchase makes the central bank have to pay for the asset, releasing cash to the market, which increases the money in circulation or money supply. This is shown in Figure 8 by the movement of point 1 to point 2.

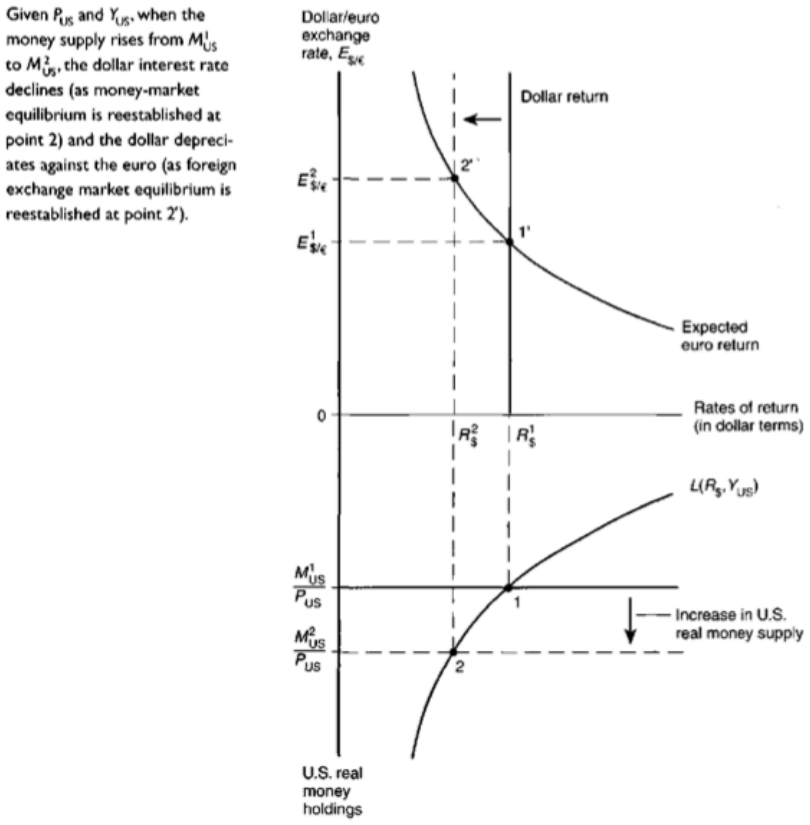
This increase in money in circulation makes everyone have more money than they want, so everyone will want to lend or invest. This increased desire for lending, or reduced demand for borrowing, leads to a lowering of the interest rate. This is shown in Figure 8 by a decrease of the interest rate from point $R_{\$}^{1}$ to point $R_{\$}^{2}$.

As we saw in Annexe 1, the domestic market and foreign exchange market interact through the interest rate. In the domestic market this interest rate is the one that consumers use to borrow, while in the foreign exchange market this is the rate of return that agents receive for the deposits. By lowering the domestic interest rate - or what is the same by decreasing the rate of return in foreign exchange market-, domestic assets or deposits are comparatively less valued than foreign ones, since the return of the former returns now are worth less. Now in the foreign exchange market nobody wants domestic assets or deposits which generates a depreciation of the domestic currency. This is shown in Figure 8 by exchange rate $E_{\$/€}^{1}$ depreciating to point $E_{\$/€}^{2}$.[2]

[1] I borrow this example from Krugman and Obstfeld, 2003: 369-71

[2] Note that this is a depreciation of the US Dollar against the Euro even if the second point is higher in the graph than the first one. Compare the following exchange rates of 0,5 USD/EUR with the exchange rate of 1 USD/ EUR. In the former case 1 US Dollar is worth 2 Euros, whereas in the latter case 1 US Dollar is worth 1 Euro. Therefore, in the former case the United States' exchange rate is worth more against the Euro than in the latter scenario, even if the number 0,5 is smaller than 1.

Figure 8: The effects of monetary policy on the exchange rate

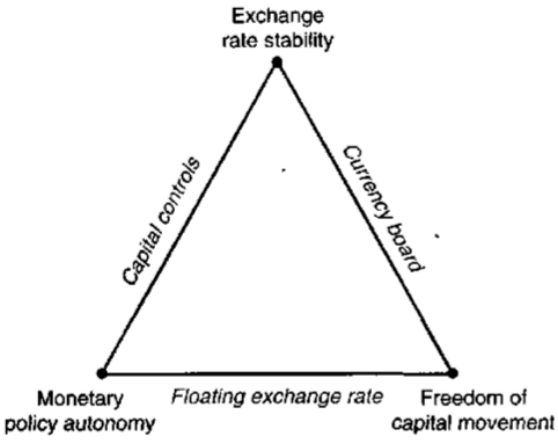


Source: Krugman and Obstfeld, 2003: 371

Annexe 3: Cases of the Mundell-Fleming trilemma

One of the main principles in international macroeconomics is that countries cannot have at the same time exchange rate stability, autonomy of monetary policy, and open capital markets. They may have at most two of these elements. This creates three scenarios. First, a floating exchange rate scenario, in which countries have open capital markets and autonomy in monetary policy, but no stability in their exchange rate. Second, a scenario of closed capital markets (or capital controls), in which countries have both autonomy in monetary policy and exchange rate stability, but no freedom of capital movement. Finally, a fixed exchange rate, which can take the form of a currency board, a unilateral peg, or participation in a currency union with a fixed currency. In the latter scenario, countries have a stable exchange rate, open capital markets, but they cannot apply independent monetary policy. See Figure 9.

Figure 9: Cases that arise from the Mundell-Fleming trilemma



Source: Krugman and Obstfeld, 2003: 700

Annexe 4: Corporate Valuation Model

According to the discounted dividend model the intrinsic or fundamental value of a shares is the present value of all the future free cash flows of the firm. Here I consider the simplified version of the model the estimated intrinsic value of the stock at the end of period 0 or in other words, the present value of the sum of all future free cash flows, $FCF_{t,t=0..\infty}$ is the cash flow at the end of each period t, and WACC, is the discount rate, or the weighted average cost of all the firm's capital.[3]

Formula 1: Corporate valuation model

$$V_{Company} = \ Present\ Value\ of\ expected\ Free\ Cash\ Flows$$

$$= \frac{FCF_1}{(1+WACC)^1} + \frac{FCF_2}{(1+WACC)^2} + \cdots + \frac{FCF_\infty}{(1+WACC)^\infty}$$

$$= \sum_{t=1}^{\infty} \frac{FCF_t}{(1+WACC)^t}$$

Source: Brigham and Houston, 2015: 320

The free cash flows "represent the cash generated from current operations less the cash that must be spent on investments in fixed assets and working capital to support future growth".[4] These cash flows for each period can be calculated by the balance sheets for each term presented in Formula 2, where EBIT is earnings before interest and taxes, and T is taxes.

Formula 2: Calculating the free cash flows

$$FCF = \left[\begin{matrix} EBIT\ (1-T) + \ Depreciation \\ and\ amortization \end{matrix} \right] - \left[\begin{matrix} Capital \\ expenditures \end{matrix} \ + \begin{matrix} \Delta\ Net\ operating \\ working\ capital \end{matrix} \right]$$

Source: Brigham and Houston, 2015: 320

[3] The firm finances itself with debt, their stock, and common equity. The WACC is the weighted average of these three types of capital. See Brigham and Houston, 2015: Chapter 10.
[4] Brigham and Houston, 2015: 320

Annexe 5: Discounted dividend model

According to the discounted dividend model the intrinsic or fundamental value of shares is the present value of all the future dividends. We could either calculate this value *ex-post*, when we know what the value of these dividends were, but we could also estimate them *ex-ante* by considering the value of dividends paid today and a rate of growth given by the trend of growth of past dividends.[5] Here I consider the simplified version of the model in which $\hat{P}_0$ is the is the estimated intrinsic value of the stock at the end of period 0 or in other words, the present value of the sum of all future dividends, $D_{t,t=0..\infty}$ is the dividend paid at the end of each period t, and r_s is the rate of return for holding the shares.[6]

Formula 3: Discounted dividend model

$$\hat{P}_0 = Present\,Value\,of\,expected\,future\,dividends$$

$$= \frac{D_1}{(1+r_s)^1} + \frac{D_2}{(1+r_s)^2} + \cdots + \frac{D_\infty}{(1+r_s)^\infty}$$

$$= \sum_{t=1}^{\infty} \frac{D_t}{(1+r_s)^t}$$

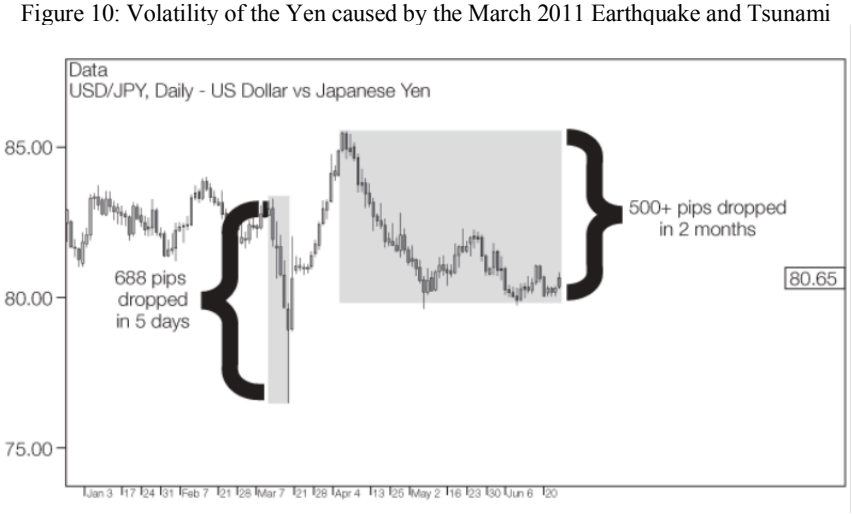
Source: Brigham and Houston, 2015: 309

[5] Brigham and Houston, 2015: 309-19
[6] Brigham and Houston, 2015: 307-8

Annexe 6: Real cases examples of deep depreciation and stabilization in the long-run

Figure 10 presents the case of Japan's earthquake and tsunami.

Figure 10: Volatility of the Yen caused by the March 2011 Earthquake and Tsunami



Source: Fieldhouse, 2015: 81

In the first part of Figure 11, which covers the value of Thailand's currency, the Baht, during the years 1996 to 1999, we can see that after the 1997-8 speculation on this currency, its value deeply depreciated, but then stabilised in the long run, after a year.

Figure 11: Volatility of the Baht's before and after speculation

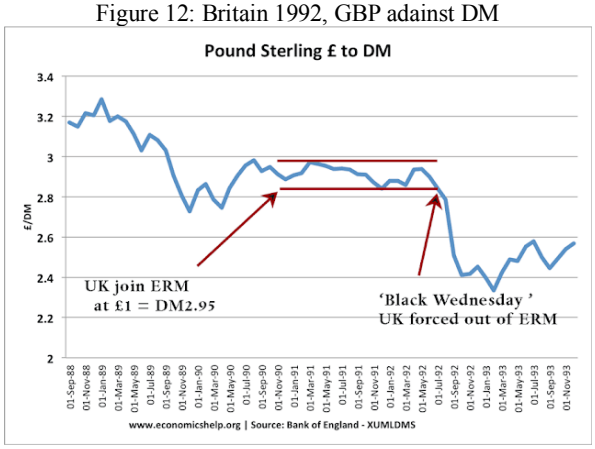
Source: Bloomberg[7]

[7] https://www.bloomberg.com/news/articles/2019-10-25/the-thai-baht-reached-a-new-6-year-high-here-s-why-it-s-surging

Annexe 7: Britain 1992

In Figure 12 we can see this situation and how the GBP moved against the Deutsche Mark. We can see in the graph that one year later, in 1993, the value of the GBP starts recovering.

Figure 12: Britain 1992, GBP adainst DM



Source: https://econ.economicshelp.org/2008/12/exchange-rate-mechanism-crisis-1992.html, with data from the Bank of England

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