

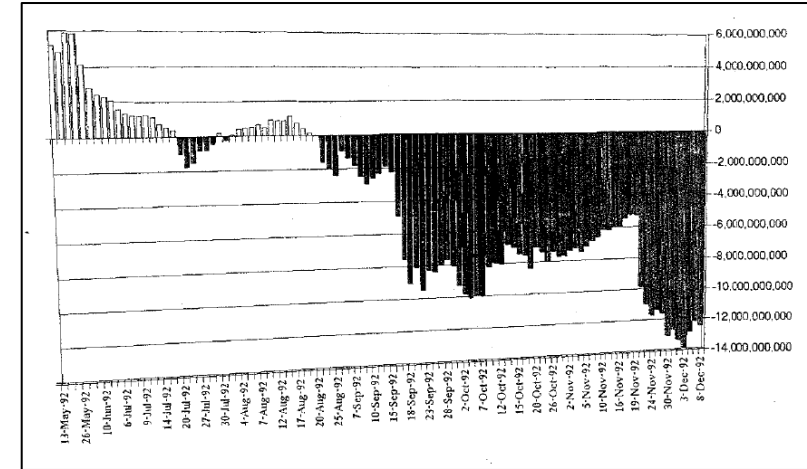
SASE Conference 2022 – Amsterdam  
Network N-12: The Politics of Financialization

**The Financialized Sovereign State  
Risking Law Dispute –  
The Kingdom of Belgium “knocked-out”  
by Merrill Lynch**

Benjamin LEMOINE – Université Paris Dauphine  
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# Introduction

- **Exchange rate swaps** as a technique of “active” debt management by the Belgian Treasury, eager to finance itself at the best price
  - Bets on the stability between EMS currencies;
  - **Yet, EMS crisis** (1992-1993): sharp deterioration
- In a panic, conclusion of 5 risky hedging transactions with Merrill Lynch: **KO & PKO options**
  - Huge losses → Belgium accused ML of **deception**
  - Out-of-court **settlement** (1998): ML paid \$115 million



Currency Options:  
*Merrill Lynch and Kingdom of Belgium*

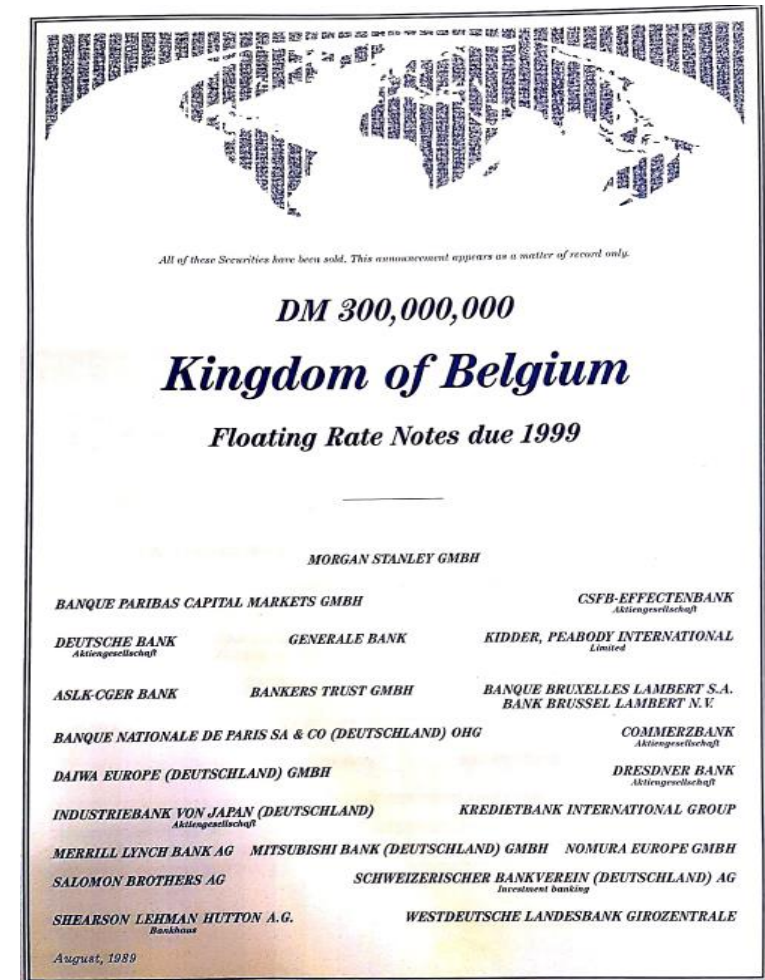
**Merrill Lynch Agrees to  
Pay Belgium \$100 Million  
To Settle Currency  
'Power Options' Dispute**

# ML vs. KoB: Theoretical overview

- Studying the **ambiguous relationship** between States and financial actors/devices:
  - **'Infrastructural' power of finance over states** (Braun, 2020), which depend on banking intermediaries and legal-financial codes for underwriting risky transactions and defend themselves;
  - **States as 'Janus-faced'** (Livne & Yuval, 2016) actors on financial markets: 'Banal' actors, conforming to the rules "like any other", but also able to reassert their sovereign power
- **Contribution to and dialogue with literature on:**
  - Political Economy of sovereignty embedded in financial markets (Trampusch, 2015; Fastenrath *et al.*, 2017; Lagna, 2016; Chiapello, 2017; Potts, 2017)
  - Law, Finance & Sovereignty (Angeletti, 2019; Cornut St-Pierre, 2019; Pistor, 2018);
- **Original material:**
  - Unpublished archives of 2 architects of the financialization of Belgium's public debt management;
  - Semi-structured interviews with Treasury managers, investment bankers and business lawyers

# I. The uneven financialization of sovereign debt management

- Degree of financialization strongly related to position in international financial hierarchy
- **In Europe**, intertwinement between monetary integration and debt financialization
  - Maximizing sovereign power in a constrained monetary and capital market environment
- **The “strategist” state as a new target of banks’ canvassing**
  - **Race to financial innovation:** foreign currency debt as a laboratory for testing new borrowing techniques (taking advantage of market opportunities)
  - “Arbitrage swaps” as **bet on EU monetary integration** to achieve quick savings
  - **Underlying social and political cost:** alignment on German economic fundamentals
- **EMS crisis:** Merrill Lynch to the rescue of the Belgian Treasury?
  - Highly leveraged options – High virtual losses → Long negotiations



# II. State's idiosyncrasy reaffirmed through (quasi-) litigation

- **(Quasi-) litigation** as playfield of state financialization  
→ How deep are legal financial norms and codes internalized by states (Pistor, 2018)?
- **Belgian defense strategy:** Treasury depicted as 'unsophisticated' victim of ML's canvassing ('breach of trust')
  - Focus on technical and cognitive asymmetries: Self-claim of lack of competence and sophistication
- *Yet*, sophisticated defense strategy and reaffirmation of sovereign prerogatives:
  - Mobilization of **important resources** to dominate ML: prestigious lawyers and recognized financial experts;
  - **Threats** of formalized trial, moving before national judges (instead of NY courts) and damaging ML's reputation

V. TRUST  
=====

1. KOB TRUSTED ML  
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.No rejection by the KOB of any proposal as to short term hedges of the arbitrage book (5 proposals = 5 trades)  
.No questions or negotiations ever about the offered "prices" (= the proposed barter)  
.All trades executed a best (with multi-million USD adjustments along the way without explanations)  
.Executed prices never questioned by the KOB ; no request for disclosure of premiums.

2. ML WAS AWARE OF KOB'S TRUST  
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."We thank you for your trust in the structure and in ML"  
."We are honoured to having been entrusted the execution of this KO strategy".

Such statements are far too unusual to be considered as mere commercial puffery.

."We are pleased to have been able to execute this transaction in the KOB's interest and we look forward to filling the next mandate at attractive levels" (= Nov. 93 statement but indicative of the nature of the relationship).

3. ML EXPECTED TO BE TRUSTED (did not expect to be checked)

CONFIDENTIAL  
SUBMITTED FOR  
PURPOSES OF  
SETTLEMENT  
DISCUSSIONS ONLY

April 20, 1998

KINGDOM'S LACK OF TECHNICAL SOPHISTICATION  
IN DERIVATIVES TRADING DURING THE PERIOD UP TO MID-93

RESUME OF MR. J. BASECQ

.Born in 37; died Jan 96

.Academic training:  
Bachelor degree in administrative sciences

.Professional career:  
Mr. Basecq has spent his entire career with the Administration of the Treasury in the Ministry of Finance

# Conclusion: The paradoxical (?) rehabilitation of financialization and sovereignty

- Belgium alternatively played *both* on its **banalized status** on the market *and* its **sovereign prerogatives**
- Settlement enshrined in **the structures of financialization**: Challenging *specific* transactions to avoid the *general* trial of financialization
- Disputed contracts as **exceptions confirming the rule of financialization**
- Completing the “modernizing” of Belgian public debt management as a way of reasserting a **(renewed) form of financial sovereignty and general interest**
  - Establishing “adequate” institutions to maximize the benefits of financial markets while minimizing risks;
  - Deep bond market and controlled primary dealers as instruments of a more controlled and codified sovereignty, within the configuration of global financialization



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