Five Tools & Six Steps towards global economic recovery: making finance servant, not master of the economy.

Just Banking Conference, 20 April, 2012

Ann Pettifor, Director, Policy Research in MacroEconomics
www.primeconomics.org

Prime

POLICY RESEARCH IN MACROECONOMICS

Chart 1.1: Private sector debt in the UK

Per cent of GDP

Gross interest-bearing liabilities

500
450
400
350
300
250
200
150
100
50
0

1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010

Non-financial companies | Households | Financial companies

Source: Office for National Statistics.

Ann Pettifor PRIME Just Banking
Conference, 20 April, 2012

Budget Report 2011: Rebalancing the UK economy

1.1 Over the pre-crisis decade, developments in the UK economy were driven by unsustainable levels of private sector debt and rising public sector debt. Indeed, it has been estimated that the UK became the most indebted country in the world.

Budget Report 2011 (cont)

1.2 Chart 1.1 highlights the rise in private sector debt in the UK. Households took on rising levels of mortgage debt to buy increasingly expensive housing, while by 2008 the debt of nonfinancial companies reached 110 per cent of GDP.

Budget Report 2011 (cont)

Within the financial sector, the accumulation of debt was even greater. By 2007, the UK financial system had become the most highly leveraged of any major economy. The level of public sector net debt as a share of GDP steadily rose from 2001-02, as the government ran a persistent structural deficit, despite continued economic growth.

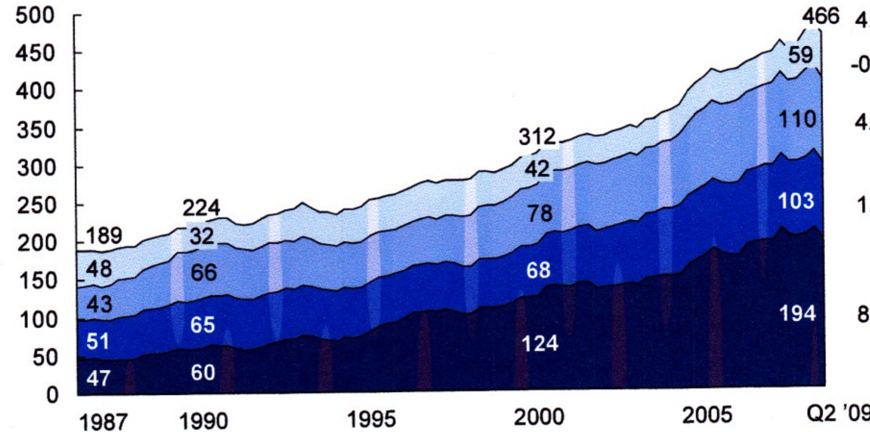
McKinsey Global Institute: Debt and De-leveraging the global credit bubble and its consequences. Jan 2010.

Exhibit A.5

UK borrowing grew to 466 percent of GDP, driven by growth of the financial sector

UK debt[1] by sector,[2] 1987-Q2 2009
% of GDP

- Government
- Nonfinancial business
- Households
- Financial institutions



	CAGR[3] % 1987-2000	CAGR[3] % 2000-2008	Change % of GDP 2000-2008
Total (466)	4.0	5.2	157
Government	-0.6	2.9	11
Nonfinancial business	4.6	4.9	36
Households	1.9	5.0	32
Financial institutions	8.2	6.2	77

1 Includes all instruments that constitute direct credit market borrowing (includes all bond market borrowing and commercial paper); excludes asset-backed securities to avoid double counting of the underlying loan.
2 Some figures do not sum due to rounding.
3 Compound annual growth rate.

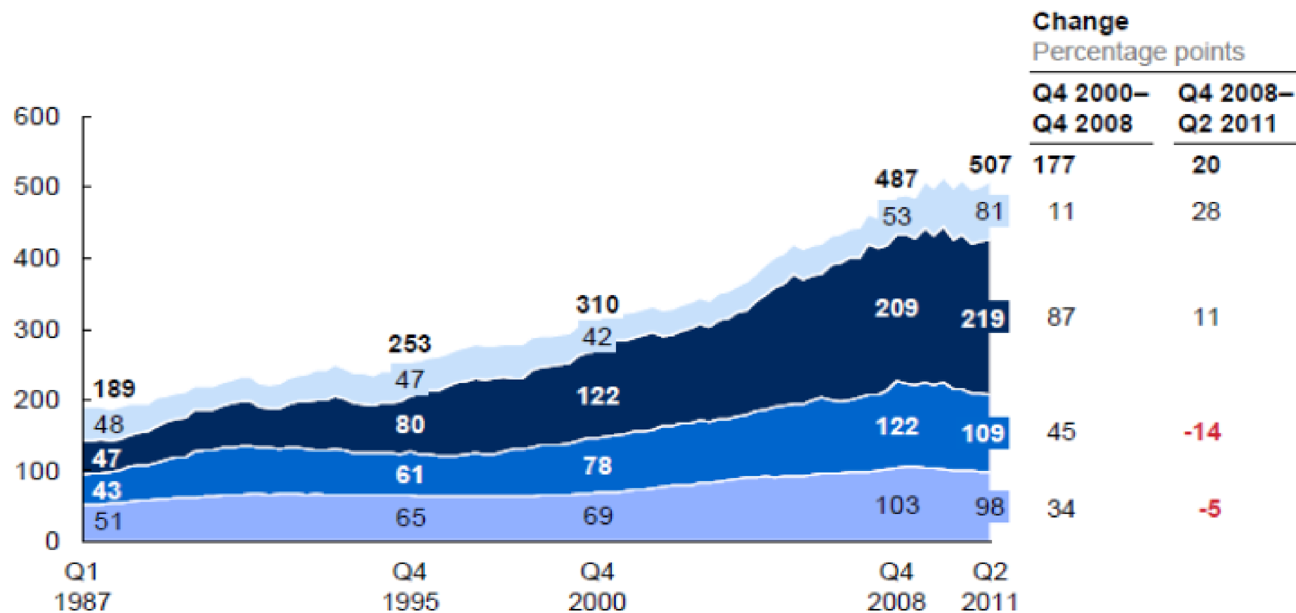
SOURCE: Haver Analytics; McKinsey Global Institute

Exhibit 10

UK financial sector and government borrowing has continued to grow since 2008

Debt[1] by sector, 1987–2011

% of GDP



1 Includes all loans and credit market borrowing (e.g., bonds, commercial paper); excludes asset-backed securities to avoid double counting of the underlying loan.

NOTE: Numbers may not sum due to rounding.

SOURCE: Haver Analytics; UK Office for National Statistics; McKinsey Global Institute

HM TREASURY

Budget Report 2012: A Stable Economy.

1.1 The financial crisis of 2008 and 2009 exposed an unstable and unbalanced model of economic growth in the UK based on ever-increasing levels of public and private sector debt. As a result of that crisis, and unsustainable levels of public spending, the Government inherited the largest deficit since the Second World War and the UK economy experienced the biggest recession of any major economy apart from Japan.

The time for deception, delusion and evasion is over.

It is time for plain speaking.

1. The primary cause of the continuing financial crisis is the unprecedented explosion of a vast expanse of de-regulated, liberalised private credit created by banks and financial entities.

Easy, but ***dear*** credit financed and blew up *asset* bubbles across all economies.

“Easy, dear Money” (Credit)

fuelled

“Easy Shopping” (Consumption)

which in turn fuelled

“Easy Jet” - (Emissions)

Who Benefited?

Chart 1: Cumulative excess returns to finance

%
12000
10000
8000
6000
4000
2000
0
-2000

1900 1920 1940 1960 1980 2000

Sources: Global Financial Data and Bank calculations.

Chart taken from a speech, on the 8 May, 2009 by Andy Haldane, Executive Director, Financial Stability, Bank of England.

2. The eventual puncturing of this vast bubble of credit – by high real rates of interest

(%)

8 7 6 5 4 3 2 1 0

Australia

UK

EU

US

Japan

2003 2004 2005 2006 2007 2008 2009 2010 2011 2012

Sources: BOJ, FRB, ECB, BOE and RMB Australia. As of Mar. 23, 2012.

Chart taken from presentation by Richard Koo, Chief Economist, Nomura Research Institute, Tokyo, to the INET Conference, Berlin, 14th April, 2012.

Debt that is now slowly, but chaotically being **de-leveraged** (or not)

blocked by:

- denial
- forbearance
- ‘hands-off’
- ‘market clearing’
- political sclerosis

The de-leveraging process is slow:

- Firms are already indebted, and so are hoarding cash, and withholding investment fearful that austerity means customers will not walk through their doors
- Austerity is contracting income – for indebted public employees, firms, households and the unemployed
- Government is taking a ‘hands off’ ‘leave it to the market’ ‘nothing to do with us Guv’ approach.

There is a way through to recovery.

We have the economic tools
- they are known & understood

They have been used before, and proven extremely effective.

They were used by Roosevelt’s 1933 Administration – and led to the US recovery pre-war

- They were subsequently used by the British Conservative government – after being turned down by Ramsay McDonald's Labour and later, Coalition government.

- Above all, they were used during **the Golden Age: 1945 – 71** to ensure financial stability; high rates of employment and a sense of well-being.

Capital Mobility and the Incidence of Banking Crisis: All Countries, 1800-2007:

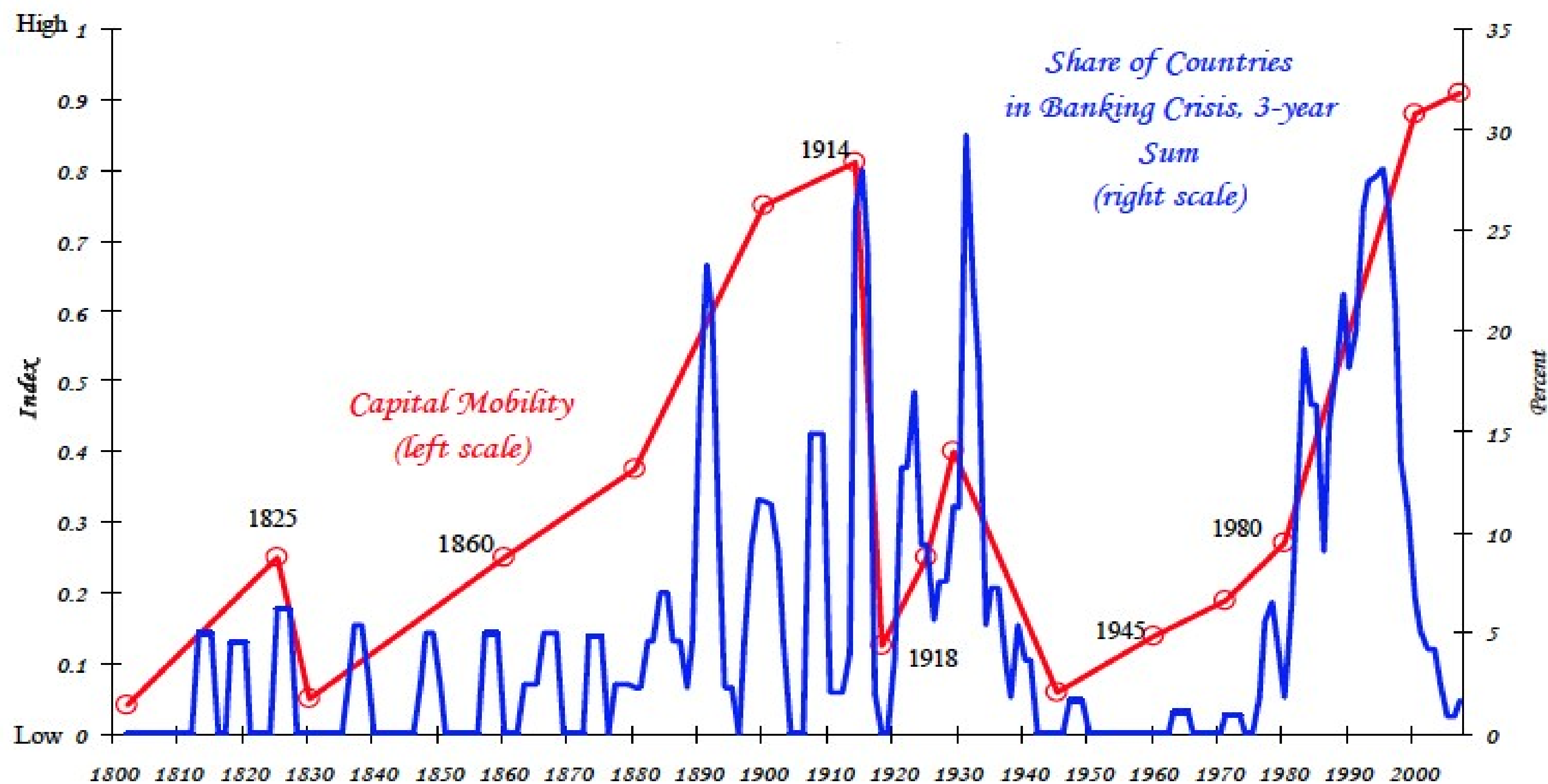


Chart taken from "[This Time is Different: A Panoramic View of Eight Centuries of Financial Crises]" by Carmen M. Reinhart, University of Maryland and NBER; and Kenneth S. Rogoff, Harvard University and NBER.

FINANCIAL TIMES

Plumbing the depths
Official Bank of England interest rates (%)

18
16
14
12
10
8
6
4
2
0

First world war

Second world war

May 1926
General strike

Nov 1979
Interest rates reach an all-time high of 17 per cent six months into Margaret Thatcher's first government

Sep 1992
On 'Black Wednesday' sterling is forced out of the European exchange rate mechanism, ruining the career of chancellor Norman Lamont

Jan 1973
Prime minister Edward Heath leads Britain into the European Economic Community

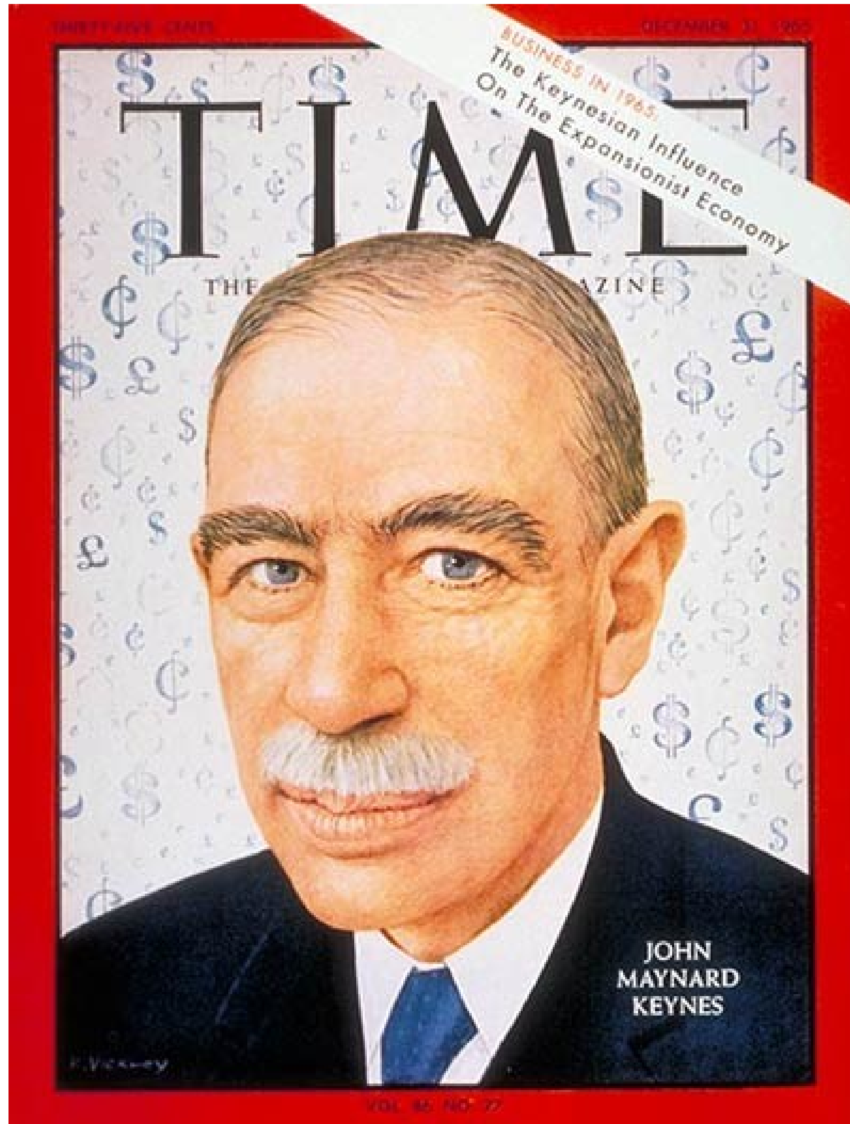
Jan 2009
Rates cut to all-time low of 1.5 per cent

Kinleigh Folkard &
FOR SALE

PAY THE BEARER
ON DEMAND

1914 20 25 30 35 40 45 50 55 60 65 70 75 80 85 90 95 2000 05 09

Source: Bank of England



John Maynard Keynes gave us the **tools** with which to stabilise a chaotic, out of control financial system.

JMK devised these policies as a result of his direct experience of post First World War ‘austerity’ – and of the collapse of the vast credit bubble of the 1920s 1929.

The five economic tools we have to fix the economy – and address climate change are:

1. QE – the creation of finance/money by the BoE - ‘out of thin air’ – and aimed at sound govt investment – not speculation.

2. The **spending** of this money via government investment in sound infrastructure – Green – projects

"The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse, but to do those things which at present are not done at all."

J.M. Keynes: "End of Laissez-Faire" p. 291 in "Essays in Persuasion" Volume IX of Collected Works, MacMillan, 1972.

3. The regulation of credit creation by the banks - directed at productive investment not speculation.

4. Permanently low rates of interest across the spectrum – short & long, real, safe & risky - to ensure debts are affordable, and ecologically sustainable; and to encourage new, private investment

5. Capital control – to facilitate permanently low rates – and limit speculation.

Managed finance as opposed to liberalised, globalised finance

(Aug. 2008 =100, Seasonally Adjusted)

180
170
160
150
140
130
120
110
100
90

Base Money
Money Supply (M3)
Credit to Euro Area Residents

(%, yoy)

2.2
2.0
1.8
1.6
1.4
1.2
1.0
0.8
0.6

CPI core

08/1 08/4 08/7 08/10 09/1 09/4 09/7 09/10 10/1 10/4 10/7 10/10 11/1 11/4 11/7 11/10 12/1

Sources: ECB, Eurostat
Note: Base money's figures are seasonally adjusted by Nomura Research Institute.

Presentation by Richard Koo, Chief Economist, Nomura Research Institute, Tokyo, to the INET Conference, Berlin, 14th April, 2012.

The Six Steps - to economic recovery

The Six Steps - to economic recovery

1. Introduction of capital controls

2. Large scale reform of the banking system, including regulation of credit creation

3. Large scale reform of debt management policy

4. Government expenditure – investment in the Green New Deal

5.Creation of fossil-fuel-substituting jobs – in public & private sectors

“Look after unemployment, and the budget will look after itself.” JMK

6. Generation of income –

- Wages & salaries
- Profits for SMEs and other firms
- Tax revenues for government-

Result?

6. Recovery

“What **we** can create, we can afford.”

JM Keynes

“National Self-Sufficiency” The Yale Review, Vol 22, no4 (June 1933), pp.755-769

Thank You

Prime

POLICY RESEARCH IN MACROECONOMICS. .

www.primeeconomics.org