Keynes and the G20

Altering the World Money

1. On Redistribution of Income

Michael Barratt Brown

Michael Barratt Brown's book Global Crisis *treats extensively the problem of redistribution of wealth (Spokesman Books, 1999, £9)*

'Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on the whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill done.'

John Maynard Keynes

It is said that everyone in the current crisis is a Keynesian – in believing that governments must spend their way out of a crisis rather than cutting back their spending. But it is not recognised that Keynes meant spending on job creation and especially on capital projects, not just bailing out the speculators. The argument is relatively simple, as it applied to the crisis of the 1930s, but I have not seen it being rehearsed in all the articles and correspondence concerning the current crisis. It runs as follows: Keynes distinguished a consumption sequence in the market, and an investment sequence. The first was determined by what he called 'aggregate demand' for goods, the rate of consumers' decisions to spend. The second was determined by the rate of saving for investment, mostly by those richer people and companies with capital to invest in productive activities. During boom years the proportion of incomes going to saving rose, so that there were more savings available for investment, by which Keynes meant actual purchases of capital goods. For a time capital investment rose, but, if consumption did not rise in line with this new capacity to invest in producing goods, a crisis arose. Capital investment in production was suddenly stopped as surplus stocks built up. Those with capital looked for other uses for it.

Keynes argued that there was nothing in the market model to ensure that the balance between savings and consumption was equal to the balance between investment in capital goods and the production of consumption goods. It was supposed that the rate of interest on savings would act as a regulator of the balance. But, while a high rate of interest would encourage saving, it would discourage investment; and a low rate would discourage saving, but would not necessarily encourage investment. The last would depend upon the demand for production of consumer goods. In other words, the interest rate could pull activity down, acting like a piece of string, but string cannot push things up. Keynes never said that the savers were the richer members of any society, and the consumers the poorer. That would have sounded too much like Marx's critique of Capital.

The chief doubt that Keynes had about the efficacy of lower interest rates was that when rates were low and there was little or no more demand for consumption, then most savers preferred liquidity, i.e. to hold on to their cash beyond what was needed for paying debts. This is where everything has changed since Keynes' day. He was thinking of a largely closed economy without freedom of capital movements. The change is that economic globalisation means that controls on capital movements have been eliminated, so that holders of capital – persons and institutions including the banks – who once preferred liquidity can move their funds wherever they can see a profitable move, which is frequently a speculative activity. A large proportion of the sale of derivatives takes place across international borders. The other element in globalisation is the reduction of regulation not only of capital movements, but also of risk taking in general. This is what enabled the banks to indulge in the provision of mortgages without adequate guarantees of repayment, resulting in the widespread housing crisis in the United States and the United Kingdom. Huge sums of money were earned by the speculators, while the incomes of the mass of the population stagnated. Keynes recognised that growing inequality of incomes was the basic cause of crisis. The poorer people could not consume so much; the richer could not find so much demand for their capital investment in production. In the absence of consumer demand for more goods, what the rich turned to was speculation, which Keynes did not think was a good thing, as the epigraph to this article indicates.

Keynes had noticed that when slump replaced boom, the first and heaviest falls took place in the capital investment goods sector as aggregate demand in the market for consumption goods declined. He therefore recommended governments to spend more money on the production of capital goods – houses, schools, railways, roads, energy and other parts of an economy's infrastructure. He would certainly not have given state funds to the bankers who would not necessarily invest it in new production, whether of capital goods or consumer goods, thus creating new employment. He would have given it to local government authorities and regional authorities like the Tennessee Valley Authority in the USA, for providing public and social services and construction schemes, as Roosevelt did in following Keynesian measures in his New Deal legislation to get the US out of the 1930s slump, the last deep slump before the present one.

Income inequality

Growing inequality of incomes was recognised by Professor J.K. Galbraith in his classic work, *The Great Crash 1929,* as the fundamental cause of the 1930s slump. Between 1922 and 1930 profits in US manufacturing industry rose in real terms by 130%, while real earnings rose by only 17%. Similar figures have been recorded for the US in the last decade, and the previous decade of the 1990s saw an actual fall in real wages while profits boomed. The British Government has claimed that inequality of incomes was actually reduced after New Labour took power in 1997. There was a very small reduction up to 2002 in the difference between the share of UK incomes of the top 20% and of the bottom 20%, but the gap widened again thereafter. The distribution of post-tax incomes between high, medium and low quintiles was almost exactly the same in 2007/8 as it had been ten years earlier, when New Labour came to power; and this was after Mrs Thatcher and John Major had greatly widened the inequalities. The rich had continued to become richer, especially the top few per cent of incomes, and New Labour had done nothing to increase the taxes on the rich.

The United Kingdom was not, however, the only place where inequalities had increased. The widest gap had opened up in the United States, where profits had risen steadily while wages in real terms had hardly risen over two decades. In the 1990s similar gaps had opened up elsewhere, especially in Latin America, but also in the areas of economic growth, most especially in China, but in India also. The gap between rich and poor in Russia was unparalleled. Moreover, average incomes in the Developing Countries, as a whole but particularly in Africa, were falling behind those in the Developed. This was partly due to falling prices of primary commodities relative to those of finished manufactures, when Developing Countries were still dependent on income from their commodity exports. But other reasons were even more important, associated with the privatisation of state assets.

Privatisation of public companies was begun by Pinochet in Chile, and under the Thatcher and Reagan governments in the United Kingdom and United States in the 1980s, but it became widespread in the 1990s. Russia provided the most extreme example, but the privatising process was taking place elsewhere in Europe, and most particularly in China and also in Latin America. Instead of raising taxes, which were unpopular, especially among the rich, governments were meeting the demands of public spending by selling off state assets. Two reasons were given for these sales. The first was that state enterprises were a drain on public resources. In fact, World Bank reports record that foreign borrowing was generally covering any deficits in public accounts in most Developing Countries; the second was that public enterprise was inefficient. This reason for privatisation has always been used, and still is adhered to quite religiously by British Governments. The late lamented Andrew Glyn in his major work on British capitalism, in 2006, argued that there was no evidence of improved efficiency, in productivity for example, after privatisation in the United Kingdom. Nor can the argument of harmful vested state interest stand up against similar arguments against crony capitalism. What is clear is that political pressures and not any economic rationale were driving privatisation, and in Developing Countries the main pressure was coming from the IMF and the World Bank. The neoliberal consensus had become universal, that the market should be left to allocate resources with minimal state regulation and maximum freedom for capital movements.

The changed role of the banks

This has led to a new role being taken by the banks. Instead of simply holding their customers' moneys and lending money out beyond the value of their holdings, at agreed rates of interest related to the official bank rate, in order to finance business activity, the banks had begun to conduct trading operations themselves. Much of this has been speculative, buying or borrowing company shares in order to sell them at a profit, and lending money for mortgages without guarantees that the mortgage payments could be maintained. It was, as we have seen, the latter that led to the crisis in the United States and also in the United Kingdom. The banks' buying of shares, often in very large companies, encouraging a great number of mergers and take-overs, also led to much risk taking of debt and ultimate bank failures. The development of hedge funds and private equity groups has been a particularly large element of what Peter Gowan, in a brilliant editorial in *New Left Review* (no 55 Jan/Feb 2009, pp.5-29), calls 'The

New Wall Street System' and has led to the current financial crisis. Gowan makes it clear that the City of London has not just been an adjunct of Wall Street but a major player, boasting of the most unregulated market in the world and, in 2007, having a global share of 42.5 % of derivatives. (That is to say, moneys whose value depends on the value of something else, i.e. varying forms of credit.)

What, then, should be done with the banks, to start with the British banks? Just bailing them out hasn't worked and cannot be made to work with the banks' accumulated mass of mortgage and other debt. Money will have to be made available by government to help those in danger of dispossession of their homes, but not once more in the hands of the commercial banks. There is an obvious alternative, which would have popular support – the Post Office. Closing it down as was originally intended by Lord Mandelson, to have some of its functions replaced by the giant retail companies, was no solution. Mandelson has now apparently recognised that the Post Office Bank needs to be brought into action as an agent of public sector finance, starting with houses and going on to providing credit for small businesses. This must be a good move if the commercial banks can be left to return to their original role. Their shareholders and chief executives could then be made to suffer; it was they who got us into the mess we are in. A distinction must be made among the banks. Some like the Co-op Bank and Nationwide and some other Building Societies are mutual associations, which do not have shareholders, receiving a dividend; all members are owners. Many mutuals went private in the last two decades, which looks like a mistake because it is a significant fact that those that remained mutuals have not engaged in the risky investments of the private banks and have not suffered the same failures. Nor for that matter has the Post Office Bank.

Next steps

The international monetary authorities have rightly judged that the United Kingdom will have the greatest difficulty of all states in recovering from the current crisis, and this for three reasons. The first is the scale of the house mortgage debt; the second is the extent of British commercial banks' involvement in hedging and trade in derivatives; the third is the failure of government fiscal policy, to build up a surplus in the good years to be available when things went bad. The first two can only be dealt with by abandoning the commercial banks so that they cannot repeat past errors and, as already suggested, by reactivating the Post Office Bank with heavy state support. The third problem of the government deficit can be overcome by taking ruthless steps to retrieve the vast sums that the rich have squirreled away in tax havens in British territories, chiefly the Isle of Man, the Channel Islands, Cayman Islands and the Bahamas. Before becoming Chancellor, Gordon Brown promised to address this leaking of funds, but in fact it grew steadily year by year under his chancellorship, to a figure quoted even by the Government Department of Customs and Revenue as amounting to over £13 billion. Other estimates are much higher, at twice that figure.

What remains to be decided is how to spend the resources available to government so as to increase employment and offset the increasing loss of confidence in the British economy, and especially what not to spend money on. The first and most obvious step is to end the useless and dangerous military expenditure in pursuing the wars in Iraq and Afghanistan and replacing Trident. Government expenditure which encourages road and air travel could be cut, but there is a positive alternative. A great window of opportunity opens up for combining recovery with essential steps to stave off the disastrous effects of our wasteful carbon emissions, contributing greatly to what is euphemistically called 'climate change', but is in effect a climate disaster already overwhelming the planet . A massive programme of house insulation and adaptation needs to be launched, combined with projects for developing sources of energy from wind, solar and wave power. All such activities would be highly effective in generating new employment and business confidence. The agents for managing these programmes and their owners should be local and regional authorities and specially created and designated public bodies. The success of Roosevelt's Tennessee Valley Authority is already being recalled by President Obama. Management of recovery should not be through what is quite absurdly proposed by Gordon Brown – the extension of Private Finance Initiatives. These have been failing in recent months and depend on commercial bank credit, which thanks to bank failures is just what is not now available.

If Gordon Brown and Alastair Darling fail to end the 'New Wall Street System' in Britain and set sail on a new course, it seems possible that the Tories might do it. Philip Blond, director of the Progressive Conservatism Project at the DEMOS think-tank, has already in an article in *Prospect* (February 2009, pp.32-36) proposed some of the measures that have been suggested above, including a revamped Post Office Bank. This may have been what persuaded Lord Mandelson to change his mind about the Post Office. What is for sure is that Mandelson and Brown have to be held to their promises. There must be a real ban on the rich salting their money away in tax havens, and the Post Office Bank must be given the resources to be a major agent of the Government's recovery programme. None of this will happen without a groundswell of support for alternative policies to end the bankers' ramp. Massive demonstrations in France and near civil war in Greece have begun to be echoed by the strike of construction and power workers in England, with sympathy actions elsewhere, especially in Wales and Scotland. At some point, anger will have to be turned into positive action.

Ditch the Dollar

A UN panel will recommend that the world ditch the dollar as its reserve currency in favour of a shared basket of currencies, a member of the panel has said. Avinash Persaud, one of the Commission of Experts on International Financial Reform, said in Luxemburg that the proposal was to create something like the old Ecu, or European currency unit. 'There is a moment that can be grasped for change,' he said. 'Today the Americans complain that when the world wants to save, it means a deficit. A shared (reserve) would reduce the possibility of global imbalances.'

Persaud said the UN panel had been looking at using something like an expanded Special Drawing Right, originally created by the International Monetary Fund in 1969. The SDR and the old Ecu are essentially combinations of currencies, weighted to a constituent's economic clout, which can be valued against other currencies and indeed against those inside the basket.

Persaud said there were two main reasons why policymakers might consider such a move, one being the current desire for a change from the dollar. The other reason, he said, was the success of the euro, which incorporated a number of currencies but roughly speaking held on to the stability of the old German deutschemark compared with, say, the Greek drachma.

Persaud has long argued that the dollar would give way to the Chinese yuan as a global reserve currency within decades. A shared reserve currency might negate this move, he said, but he believed that China would still like to take on the role.

Source: Reuters, 18 March 2009