# **Positive** Money Greenwich

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Meeting Report

**Wolf, Turner and King on the Global Financial Crisis** — Martin Wolf, Mervyn King and Adair Turner have all published significant and important books* about the view from their ring-side seats, respectively at the FT, Bank of England, and the Financial Services Authority, during the financial crisis of 2008 and its aftermath. The three share a common critique of the banking system and its reliance on private debt, yet each has a distinctive slant on these events and their causes and, most importantly, their proposed remedies. In this, all three indicate a sympathetic understanding of Positive Money's own reform proposals, yet fall short of whole-heated endorsement. In this talk, **Mike O'Keefe** will examine the commonalities and contrasts between the three authors and our own diagnosis and prescription.

*The three books, of course, are **Martin Wolf**'s *The shifts and the shocks, 2014,* **Mervyn King**'s *The end of alchemy, 2016* and **Adair Turner**'s *Between debt and the devil*, 2016.

But there is no reason why you should have read the books in order to participate in a lively and informed discussion of their conclusions.

The meeting was hosted by Michael O'Keefe in the upper room of The Prince of Greenwich pub, 72 Royal Hill, Greenwich, London SE10 8RT – Map. "Sign up on the Positive Money website. Register on Meetup. This meetup is for everyone interested in how money system works and how it could be changed to be constructive and socially beneficial. Feel free to invite your friends who might be interested too. Everyone is welcome! www.positivemoney.org.

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**Martin Wolf on Reforming Finance**
**Baron (Mervyn) King of Lothbury**
**Baron (Adair) Turner of Ecchinswell**

Three establishment figures, all public-school educated, all three critical of system, but disregarded the veil of money. All thought that liberalisation was a good thing. They give credit to Alastair Darling and also Hank Paulson, USA:

• America's bail-out plan: I want your money - The Economist 25 Sep 2008 - SAVING the world is a thankless task. The only thing beyond dispute in the $700 billion plan of Hank Paulson, the treasury secretary, and Ben Bernanke, chairman of the Federal Reserve, to stem the financial crisis is that everyone can find something in it to dislike. The left accuses it of ripping off taxpayers … www.economist.com/node/12305249 – *see full article below:*

• American banks have recovered well; many ... - The Economist 6 May 2017 - "THE SHORT ANSWER is Hank Paulson," snorts a European banker. "They got TARPed." The question had been why America's banks recovered so much faster than Europe's from the debacle of ten years ago. Within days of Lehman's demise in 2008 Mr Paulson, then America's treasury secretary, forced … https://www.economist.com/.../21721502 - most-european-banks-were-slow-mark-after...

Commonalities of their accounts: They all share a common narrative of what led to the GFC. All express reservations about banking reforms to date. None of the three anticipated that what has been done, eg the ring-fencing, has been sufficient to avoid repeat of 2008. All three speak about • excessive leverage and risk • primacy of financial rather than productive investment • complacency in light-touch regulation by central bankers • inadequate theoretical grasp of money and macroeconomics • structural imbalances in the global and EU • technical developments as accessories to these developments.

All three books acknowledge the argument for abolition of fractional reserve banking and all, inter alia, reference Modernising Money. Economics. Nevertheless, differences in emphasis and detail are evident and recommendations for the future vary substantially.

Martin Wolf on reforming finance (*The Shifts and the Shocks, 2014)*.
1. FT article 24th April 2014: "strip private banks of their power to create money" - argues PM's case that money would be provided by the state, whilst financing is a private sector function.
2. Looking at various reforms (Basel III, Dodd-Frank & Vlocker (US), Vickers (UK) etc, says the current system is designed such that it is bound to fail again and again • Outlines 100% reserve system, but opines that the upheavel will be huge and risky and be strongly opposed by others • Says the case for compulsory reduction of leverage ratios to say 10:1 as proposed by Basel III is overwhelming • All three are worried about what happened in Japan in 1990,

Mervyn King on reforming finance (*The End of Alchemy, 2016)*
• Clear and favourable treatment of proposals for 100% reserve (narrow) banking as end to conventional bank runs and instability. BUT he fails to endorse this reform (as against his own proposal);
(a) The banks would lose their implicit taxpayer subside and will vigorously lobby against structural change (b) might increase cost of capital for productive uses (c) impossible to remove risks of maturity transformation due to radical uncertainly (government standby still needed). (d) Bank inter-trading is such that the quality of collateral for Lender of Last Resort rescue is far less easily assessed in a crisis than in Bageshot's day.
His own proposals is for BOE's LOLR role to be augmented, replaced with role as Pawnbroker For All Seasons. The way forward is to recognise that the prohibition on the creation of money by private banks is not likely to be sufficient to eliminate alchemy in our financial system.
Doesn't like lax lending, bankers didn't care because problems would be taken on by tax-payer.
King also points out that investment in productive projects, ie maturity transformation bears a risk, so ou still need government standby.
3. Paul: broker For All Seasons idea. Banks will agree value of their collateral. Banks can still create money on demand, can have greater influence on asset bubbles by varying the "haircut".
Ben Dyson comments that the effect of the proposal is to require banks to hold slightly more longer term funding….

Adair Turner on reforming finance (*Between Debt and the Devil*, 2016)
• Overt permanent monetary finance (OPMF) of Helicopter Money by BoE + much lower leverage, but still private money creation. • Objective is macroeconomic stabiity (nominal GDP) and worry that Japan's "lost decades" will happen here.
• The OPMF financing will be permanent to avoid the debt overhang problem • concerns are that government printing money is taboo, debt contracts are essential, banks still need to perform maturity transfer.

All three aiming at slightly different targets, all dealing with the same problem, privately debt-created money. The question is why they are different from Positive Money's prescription.

Discussion, led by Mike:
• Paradigm shifts / rediscover? (intellectual straight-jackets. The silo-effect?)
• The grip of the establishment (comfortable conventional approaches + old personal loyalties)
• The absence of constituency (who will march behind you?)
• Consensus-seeking conservatism (make do with what you can get away with; gradualism not radical/risky change
• Defeatism (fear of lobbying power of big finance)
OR
Some of all of the above?

The following points, amongst others, were raised in a lively discussion by a well-informed audience:
- MF: Authors in public meetings discuss peripheral scandals, eg financialization, manipulation of share markets, asset -stripping, being safer to discuss, rather than the basic issue of money creation
- Our economy depends on the financial system, the changes would be too huge
- It's a global system – how do we control it – broken window system – can't change the whole thing in one go? Wolff suggested trying reforms on a small economy first.
Is anyone doing it? Iceland toying with it, most economies have ideas like Positive Money,
AB: says these guys are not going to propose something that isn' their idea, ie they are not going to fall in with anyone else's suggestion.
Mike: Thatcher/Regan, two changes, free flow (not China and India) plus regulations….The point that in 2014 Wolf appeared to support Positive Money, later the same year he came out with a book that is much more guarded. AB says people think that's how it already works, so it's hard toi get them on board, they are just not interested in the problem.
- MF: it's clear that the economy is struggling, it could collapse, and we need to be ready with a plan: there are many campaign groups each declaring that they have the total answer, but what they need to do is to put a coalition of ideas together.
The Shadow Chancellor is aware of all these ideas, and proposes a National Investment Bank. See: **https://www.ft.com/content/7cd0ab60-43c9-11e8-803a-295c97e6fd0b**

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**BACKGROUND on Hank Paulson, USA: https://www.economist.com/node/12305249 -** Sep 25th 2008 - **America's bail-out plan:** I want your money: **No government bail-out of the banking system was ever going to be pretty. This one deserves support**

SAVING the world is a thankless task. The only thing beyond dispute in the $700 billion plan of Hank Paulson, the treasury secretary, and Ben Bernanke, chairman of the Federal Reserve, to stem the financial crisis is that everyone can find something in it to dislike. The left accuses it of ripping off taxpayers to save Wall Street, the right damns it as socialism; economists disparage its technicalities, political scientists its sweeping powers. The administration gave ground to Congress, George Bush delivered a televised appeal and Barack Obama and John McCain suspended the presidential campaign. Even so, as The Economist went to press, the differences remained. There was a chance that Congress would say no.

Spending a sum of money that could buy you a war in Iraq should not come easily; and the notion of any bail-out is deeply troubling to any self-respecting capitalist. Against that stand two overriding arguments. First this is a plan that could work (see article). And, second, the potential costs of producing nothing, or too little too slowly, include a financial collapse and a deep recession spilling across the world: those far outweigh any plausible estimate of the bail-out's cost.

### Mr Market goes to Congress

America's financial system has two ailments: it owns a huge amount of toxic securities linked to falling house prices. And it is burdened by losses that leave it short of capital (although the world has capital, not enough has been available to the banks). For over a year, since August 2007, central bankers, principally Mr Bernanke, have been trying to make this toxic debt liquid. But by September 17th, following the bankruptcy of Lehman Brothers and the nationalisation of American International Group earlier that week, the problem started to become one of the system's solvency too. The market lost faith in a strategy that saved finance one institution at a time. The economy is not healing itself. If credit markets stay blocked, consumers and firms will enter a vicious spiral.

Mr Paulson's plan relies on buying vast amounts of toxic securities. The theory is that in any auction a huge buyer like the federal government would end up paying more than today's prices, temporarily depressed by the scarcity of buyers, and still buy the loans cheaply enough to reflect the high chance of a default. That would help recapitalise some banks—which could also set less capital aside against a cleaner balance sheet. And by creating credible, transparent prices, it would at last encourage investors to come in and repair the financial system: this week Warren Buffett and Japan's Mitsubishi-UFJ agreed to buy stakes in Goldman Sachs and Morgan Stanley. Some banks would still not have enough capital, but under Mr Paulson's original plan, the state could put equity in them, or, if they become insolvent, take them over and run them down.

The economics behind this is sound. Government support to the banking system can break the cycle of panic and pessimism that threatens to suck the economy into deep recession. Intervention may help taxpayers, because they are also employees and consumers. Although $700 billion is a lot—about 6% of GDP—some of it will be earned back and it is small compared with the 16% of GDP that banking crises typically swallow and trivial compared with the Depression, when unemployment surged above 20% (compared with 6% now). Messrs Bernanke and Paulson also have done well by acting quickly: it took seven years for Japan's regulators to set up a mechanism to take over large broke banks in the 1990s.

Could the plan be better structured? Some economists want the state to focus on putting equity into the banks—arguing that it is the best way to address their lack of solvency. In theory you would need to spend less, because a dollar of new equity would support $10 in assets. Yet the banks might not take part until they were on the ropes and, if house prices later fell dramatically more, the value of the banks' shares would collapse. The threat of the government taking stakes would scare off some private investors. And in the charged atmosphere after this bail-out meddling politicians, as part-owners, would have a tempting lever over the banks.

Mr Paulson's plan also has its shortcomings. He will find it hard to stop sellers from rigging auctions, if only because no two lots of dodgy securities are exactly the same. Taxpayers may thus pay over the odds and banks may be rewarded for their stupidity. Yet these costs seem small against the benefit of putting a floor under the markets. And fine calculations about moral hazard are less pressing when investors are fleeing risk.

If the economics of Mr Paulson's plan are broadly correct, the politics are fiendish. You are lavishing money on the people who got you into this mess. Sensible intervention cannot even buy long-term relief: the plan cannot stop house prices falling and the bloated financial sector shrinking. Although the economic risk is that the plan fails, the political risk is that the plan succeeds. Voters will scarcely notice a depression that never happened. But even as they lose their houses and their jobs, they will see Wall Street once again making millions.

### Buckle a little, but do it briefly

In retrospect, Mr Paulson made his job harder by misreading the politics. His original plan contained no help for homeowners. And he assumed sweeping powers to spend the cash quickly. He was right to want flexibility to buy a range of assets. But flexibility does not exclude accountability. As complaints mounted, Mr Paulson and Mr Bernanke buckled—agreeing, for instance, to more oversight. Now that Messrs McCain and Obama have returned to Congress to forge a deal, more buckling may be necessary. Ideally, concessions should not outlast the crisis: temporary help for people able to stay in their houses, a brief ban on dividends in financial firms, even another fiscal package. They should not be permanent or so onerous that the programme fails for want of participants—which is why proposed limits on pay are a mistake (see article). Mr Paulson's plan is not perfect. But it is good enough and it is the plan on offer. The prospect of its failure sent credit markets once again veering towards the abyss. Congress should pass it—and soon.

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