

Funding the Future

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Summary

This blog post is, in effect, an essay of almost four thousand words. I did not intend that when I started to write it. If I had known it would be that long I might have used a different style. But as I wrote it just kept growing. That is because what I think it is about is vital, in the sense that the issues I address cannot be avoided.

What I am suggesting is that whatever we think or do we are heading for the most almighty economic crash. The things that we have treated as stores of value - which are mainly shares and both commercial and residential property - are massively overvalued now. And there is nothing we can do to prevent the value of them crashing because the Ponzi style financialisation that has gripped western economies - and those of the US and UK in particular - for the last forty years was always heading for a massive crash, and now it has arrived. The genie is out of the bottle and it will not go back in again.

But that is not to say that our government (and other governments) are left powerless in the face of this. They are not. They can still make a decision about which factor of production - labour, business (enterprise), banks (capital) or landlords they wish to favour in the crisis to come.

If they favour people and business and sacrifice landlords (whos assets will survive, come what may, albeit at considerably less worth) and banks (which will inevitably need to be nationalised) then more people and many more businesses might make it through the coming crisis. If they favour landlords and banks - as the UK government is at present - then the chance that much business at all will survive this is pretty remote. And in the end, nor will the banks or the landlords either. That's my bleak prognosis. And either way, pension funds and pensioners are in deep trouble: most will now be dependent on the state, which means much more generous provision has to be thought about now than we have ever previously imagined.

I didn't enjoy writing this post. I'm not suggesting it's a fun read. It is not.

And yet, I do see hope. Our economies have been blighted by the curse of financialisation. I would not have chosen to end it the way that it's going to happen. But wise governments will realise that the end of financialisation is now nigh, and act accordingly.

And some won't.

On that decision rests the fate of millions of people.

I wish I thought I could rely on our government to make the right choice. Time alone will tell if they will.

The lockdown threat to business viability

At the beginning of May 2020 it is very apparent that life is not returning to normal. Plans to end lockdown do, according to the Financial Times, include staggered working hours; rules to require social distancing in the workplace and shops; a ban on workplace canteens; a requirement that employers provide extra car parks (seemingly overnight) so that employees need not share lifts to work; a reduction in the number of people allowed to share lifts and a great deal more that makes it apparent that whatever work might be like after lockdown it will be nothing like what it was before it.

It is easy for the government to say this. And the rules could, possibly, be enforced. But the consequences need to be thought through, because they are staggering.

Of course it is theoretically possible that some companies could actually survive the substantial new costs that this way of working will impose. But I stress that the word 'theoretically' is doing a lot of work in that sentence. That is because the reality is that in all likelihood almost none can, or will. Our economy is not geared to work in this way. And by geared I do not mean physically, where it is apparent that our capacity for adaptation is already quite phenomenal. Instead I refer to financial gearing, interpreted broadly.

The financial burden on business

Like many households, a great many businesses are massively debt-burdened. They have both significant financial borrowings and / or substantial rent payment commitments. That is because they are both under-capitalised in many cases and do not own their own properties, with rent in that case pretty much representing interest on an expensive loan that they might have had to take if they were to have bought their property instead.

Importantly, these obligations are fixed at present. The government might have shrunk official interest rates to near enough zero, but the reality is that in the actual economy that is not the case. The burden on businesses to repay loans, interest on those loans, and rents, might have been subject to some minor concessions for strictly limited

periods at present, and then only for some lucky businesses, but for many the obligations will be ongoing. And there has been not a hint, so far, of long term support on these issues. Instead new government-backed loans under coronavirus schemes will just add to these debt mountains.

What this will mean is that companies working with reduced efficiency and increased costs in markets where demand will be reduced will be under enormous stress. They will, absolutely inevitably, suffer reduced profitability from their trading activities, but will nonetheless be facing fixed financial obligations created in an entirely different era and market and, quite crucially, legally these obligations are not re-negotiable in most cases.

It does not take a financial genius to realise that this is a situation that literally cannot work. The vast majority of businesses cannot now survive if they are to meet those financial obligations. We are seeing this on High Streets already, where refusal to pay rents is becoming commonplace, but the problem will now extend to every industrial estate, office block and workshop in the country.

The tiny minority of businesses with no borrowings and their own, paid for, freehold premises might make it through this crisis. In addition, micro-enterprises working at home and with almost no employees might also do so. But with the lockdown conditions that are going to be imposed, the rest cannot. It will be as simple as that. I cannot be more blunt: on this occasion comments based on the extrapolation of obvious heuristically derived conclusions that reduce analysis of a situation to its barest essentials are both necessary and true.

The choice the government has to make

In that case it is also true that in the economy to come some fairly stark decisions have to be made if it is the plan of the government that we survive this crisis. Of these the most important (as ever when the reality of these situations is faced) is whose interests are to be prioritised?

Is it labour, and the need to preserve jobs, that has the highest priority?

Or is it enterprise, meaning that the preservation of trading entities becomes the core goal?

Alternatively, assuming that this can be done, is banking to be pre-eminent to prevent a crash? In other words, is capital preserved?

Finally, might instead the interests of landlords feature most highly?

To go right back to this most basic of economic questions, which factor of production is to have priority? Unavoidably, that question does, of course, have implicit class connotations attached to it.

Right now it seems quite clear that the government is setting its priorities in the reverse ordering of the above list.

To be precise, landlords have not really been asked to make any sacrifices to date: their interests and income streams appear to have survived almost unscathed to date.

Banks on the other hand are already subject to massive support for which they did not pay and are also now enjoying significant effective additional funding for loans from which they will make money. Quantitative easing has also helped them, and it's back on the agenda.

Business loans, most especially to larger companies are getting through, but as loan capital those funds simply defer the day of reckoning that is to come because, as yet, the government is quite unable to differentiate cash flow, liquidity and solvency, let alone loans from capital. As such the wrong support is being provided, and the stress is growing as a result.

And furlough just disguises the fact that more than 6 million people are now likely to be unemployed in the UK. When the self-employed whose businesses have failed are added in it could be much higher.

My point is that this ranking of priorities - so natural to a political party established to support the interests of unearned wealth - is fundamentally misjudged now.

The choices that have to be made

We need to be prioritising work at present.

And we need to keep trade alive.

At the same time we also need to preserve the operational aspects of banking, as best we are able, because we cannot survive without it: those systems are the plumbing on which the economy runs. And because we have done no real banking reforms since 2008 that may yet require nationalisation of the whole banking sector fails as the property market collapses, and with it all the collateral on which banks have relied for around 85% of their loan books.

But I stress, even if we are concerned that the property sector might collapse that is not a reason to priorities the interests of landlords. They have to be at the bottom of the pile for support right now. In other words, the government has everything the wrong way round.

The lack of any alternative

There are practical reasons for this. As I have said since this crisis began, even if every landlord fails now, the properties that they own will still be there: in other words, even if

their financial capital disappears, their physical capital does not. What that means is that the economy can survive the failure of landlords more than it can survive anything else because whatever happens to the current owners of these properties they will still exist. We cannot say that of any other part of the economy.

In that case what is required now are statutory rent holidays. The rest of this year should be required, at least. And thereafter rents should be reduced, drastically, and by law, and right across the board. Eighty per cent cuts may be appropriate. It may be more. Whatever is necessary to ensure business can survive must be done.

I stress though that I am not seeking to wipe out the rentier: I have also argued, and repeat that argument now, that if, as I think appropriate, there should be long-term statutorily enforced rent holidays and then mandatory rent reductions I would match that with a right to bank loan holidays, and a right to a statutory reduction in loan liabilities so that the sum secured on a property cannot exceed its market value, whatever that might be in the future. To be fair over time to all involved, this would have to be subject to periodic reviews. This is hardly a concept landlords are unfamiliar with. Rentier insolvency is not my aim: rent reduction is so that businesses and people might survive.

I should add that because such a programme of liability reduction would make no sense for landlords alone if not matched by a similar scheme for owner-occupiers, who I predict will see the value of their houses crash in the near future as it becomes apparent that there is no market for them at anything like recent prices, then they too must have a statutory right to owe no more on a mortgage than can reasonably exceed the market worth of their property. This might again be subject to periodic review, but the key point is that mortgage interest holidays (with waiver happening on sale) could be made available on sums owing in excess of this sum. Again, my aim is simply: it is to keep people in their homes, and solvent.

And there is no point putting off these essential adjustments. Businesses that must decide if they are solvent or not must know about such arrangements now. Nothing less will do.

Bank lending

Statutory bank (and other) loan deferral arrangements of two years, at least, have also to now be in the mix for survival now. Interest only arrangements must be allowed in the meantime. And even that must be subject to the right to roll it up as part of the balance if it is necessary for the borrower to get through this. Again, nothing less will do if the government wants people and business to survive.

I am well aware of the implications of what I am saying. No one need post here and say 'you're being so unfair to poor, honest landlords'. I am saying that such appeals count for nothing now. That is because unless something like this happens then landlords are

going to face a disaster in any case. That is because, to reiterate a point already made, right now most businesses in the UK cannot be profitable unless major costs and cash flow outgoings are immediately removed from their overheads. And since very few have the capital to survive any significant losses the reality is that unless rents are firstly frozen and then cut, alongside bank loan payment deferrals, then most (and I mean, the majority) of UK businesses are going to fail.

In that case the 30% effective unemployment that we see today is both going to become permanent, and grow. That would be unavoidable. And I promise you, landlords and banks are both going to lose heavily, come what may whatever happens as a result.

Jobs and businesses have to be in the lifeboat – bankers and landlords have to be left behind

So, to return to my theme, the essential challenge facing government is to choose priorities. It can choose landlords and then banks as the priority and the result will be the real economy will almost completely fail, at catastrophic cost.

Or it can choose people and then business as the priority instead and as a result reduce the payments due to landlords and banks. In that case a great many businesses might survive the crisis as it unfolds, because the pressure on them will be greatly reduced. Effectively, if they could then just cover their marginal costs they might be in a vastly better position to survive, and many will. As a result the jobs that they provide will also be retained. But that will be impossible if rent and bank obligations continue.

The choice appears to be between seeking to preserve the appearance of value and wealth that is implicit in our overinflated property values at present, which also underpin all UK banking, or seeking to preserve the ability of this country to make a living.

But, and I cannot stress the point enough, the choice is illusory. In reality, the value implicit in land has already disappeared. It is folly to pretend otherwise. The only reason no one has yet begun to realise this is that we have a completely frozen property market at present. When that reopens prices will, as a matter of fact, tumble. And so too will new rents. All I am saying is that old ones have to follow suit: if we want an economy that generates income in the future then the blunt fact is that we now have to trash our balance sheet. Or rather, we have to accept that it has already been trashed and now deal with the consequences.

Landlords

So what will become of landlords? For small ones, I have argued for state support, just as I have other unemployed people. I can see no special case that might be made for such landlords now, especially since what I suggest will preserve some of their asset

value, and an income stream, albeit a much reduced one.

For larger landlords, the suggested arrangement will massively reduce the balance sheet value of the enterprise. But because of the matching loan suggestions it does not guarantee insolvency. It is very likely that these landlords will survive, but with vastly smaller market worth, and with their focus in the future being upon service supply, rather than asset accumulation. In that case, again, I see little reason for special treatment.

Banking

The real issue is, then, not for landlords but for banking, without which we cannot survive. 85% of UK bank loans are supported by property collateral. Whatever happens (and I cannot stress this enough) property values are going to collapse across the board very soon. It may be worse for business property than private property because of changes in work patterns and the number of business failures that the UK is going to suffer come what may, but it is going to be universal.

And so bank balance sheets are going to collapse. It's just a case of when, and not if. The value that underpinned them has gone. Let's not pretend otherwise. That just puts off planning for the inevitable.

Let's also be clear that banking cannot survive this in its current form. The losses are many, many times greater than any capital that they possess. They are greater too than GDP of the country in all likelihood, and by some way. This is not, then, a matter for the private sector to deal with. Every single bank in this country, and across the world in all likelihood, will be insolvent. No bank will survive without nationalisation. And the only way the losses can be managed is by wiping them out by the issue of perpetual bonds of the type that I have referred to on the blog today, which will then be subject to QE and thereafter be forgotten forever.

I stress that can be done. The balance sheets of the banks can be restructured. That is possible. But only by states willing to act, and who appreciate the need to do so now. The rearrangements will look to be drastic, but they can be managed.

There will, however, be real costs. First, it will not be possible to guarantee all bank deposits. Some amongst the wealthy will take a haircut (which refers to a writing off of value).

There should also be a refusal to settle claims against banks where the beneficial ownership it arises from cannot be proven. And if the claim is from a tax haven there should also be a considerable haircut, come what may.

Pensions

But it is not in banking where the biggest haircuts will occur. Those will be in pension

funds. This is where the crisis will really be felt.

I have written, many times, on the economic stupidity of sending vast sums of cash to be saved in financial assets, month in and month out, creating an apparently never ending Ponzi style growth in value because the money coming in always exceeded the money going out when the stock of assets (shares and commercial land) is deliberately constrained. It was inevitable that one day the pretence that there was any value in this system would disappear, and the whole edifice would collapse. That day has arrived.

There is, supposedly, **£6 trillion of pension wealth in the UK at present. I suspect that a very great deal of that will now disappear. I also stress that if what I suggest does not happen then it is likely that almost all of it will disappear: only the bank and land based assets need vanish into thin air if what I suggest is done. In either case, the haircut is going to be massive and is bound to be reflected in the pensions of current and future old people.**

There is, quite literally, no way to avoid this. Yet again, the pretence of value on which the whole edifice financial capitalism has been built has been shattered: coronavirus will have killed it.

So what to do for pensioners? I am afraid that they, like so many who have until recently been in work, will have to fall back on the state: there is simply no alternative. But, and I stress this, it cannot require that people be reduced to living on the basic state pension: that is an impossibly low sum which it is repugnant that we pay at present. But as for so many others, incomes of pensioners will fall in a great many cases. And the sums that they hoped to leave to next generations may collapse. But if (and I have to keep repeating that this is a massive 'if') the government acts to preserve jobs now pensioners have a hope of surviving. If the government does not act in that way pensioners will then be amongst the many whose literal risk of survival will be at risk.

Looking forward

Finally, let me be a little more forward looking to conclude. There will be a time to restore value after this crisis and the shockwaves it creates are dealt with.

The problem that this crisis will have eventually highlighted is the fact that we have focused our attention on what has, in effect, been the creation of balance sheet wealth during the course of the last 40 years. This has not been generated from work, or from the investment of resources in the creation of real value. It has instead been generated by encouraging the flow of ever-increasing sums of money for what has been called investment (but which has actually been saving) towards a limited range of financial and property assets whose availability has been shamelessly restricted in supply, so guaranteeing almost perpetual increases in value. That sham, for that is what it has

been, has now been shattered. The genie cannot be put back in the bottle. And nor can anyone now seriously believe that value can be created in this way, ever again.

We have, then, to understand that value creation does not come from financialisation, or balance sheet manipulation of the type we have got used to. It does, instead, come from work, which produces value as a consequence of the inherent worth of the activities undertaken. And, if (as most societies think desirable) one generation is to look after its predecessors when they reach old age then what I have long described as the fundamental pension contract must be respected. This contract, which is implicit within society, and not legal, is that one generation (the older one) will through its own efforts create capital assets and infrastructure in both the state and private sectors which the following younger generation can use in the course of their work. In exchange for their subsequent use of these assets for their own benefit that succeeding younger generation will, in effect, meet the income needs of the older generation when they are in retirement. Unless this fundamental compact that underpins all pensions is honoured any pension system will fail.

This fundamental pension contract does then also respect that value comes, not from financialisation, but from the creation of value through work which is not transferred between generations through the transfer of ownership of savings products, but is instead transferred through the creation of real added value resulting from actual investment activity.

We can rebuild society. It can be sustainable if we respect the constraints that our planet puts upon us. We can transfer value within it. We can sustain populations. But we can only do these things if we simultaneously recognise that there is no magic way to do so: financialisation as a source of value creation was, and always will be, a myth. It is work, and work alone, that generates value, and even then it can only do so if we respect the constraints that nature imposes upon us.

The crisis that coronavirus has created will be fundamental, and could be existential, quite literally. But it need not be the latter if we take action now. What it does require is that we accept that it is not a few working in financial markets that create value in our society, letting them claim that they are the masters of the universe. That is not true. Instead what we have already learned from the coronavirus crisis is that it is care that is the most valuable commodity that we can create, whilst friendship and community are the things that we value most. Each requires effort and so too does all value creation. Nothing can shortcut this, but we've been sold the myth that there was a fast-track, and that has proved to be untrue.

To survive our government now have to make a choice. They can seek to preserve the myth. They can pretend that the asset values that the myth created are still real and seeks to preserve them. Alternatively, they can face reality. They can give up the pretence that there are assets of worth left within very large parts of the financial system. They can take the necessary steps to deal with the consequences. And they

can, as a result, seek to preserve jobs and the businesses that help create them whilst building an entirely new basis for banking and pension provision.

Alternatively, they can crash what remains of the economy that provides us with work in a vain attempt to preserve the interests of the rentiers who have dominated our economy for decades. That attempt would, however, be in vain: there is now nothing left to save.

The only difference between the two routes is that one preserves some value, and the other preserves none at all. Whatever we do we face the most staggeringly difficult economic decisions, but some at least have good outcomes, and others have none.

What will our government do? Who knows.....