Funding the Future

How to use local and hypothecated bond issues to fund t…

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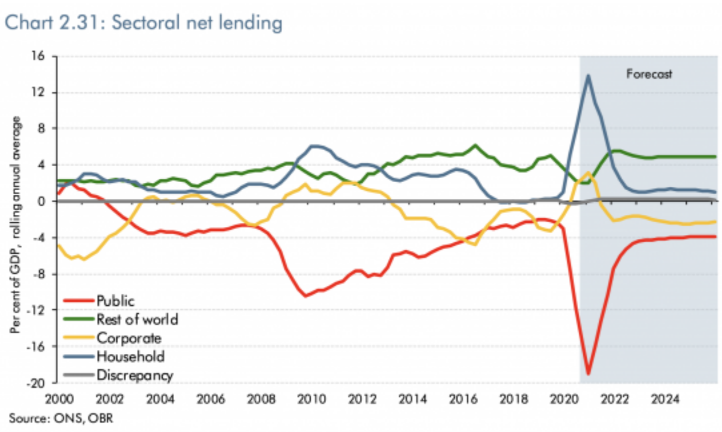
I made a suggestion in a video yesterday that it is now essential to the restoration of balance within the UK economy that the accumulating pile of savings that the last decade has created should be directed towards social and productive purpose when that is not the case at present.

To give some illustration, wealth has increased dramatically over the past decade. As indication, maybe £70 billion a year goes into ISAs, and more than £100 billion a year into pensions. The tax subsidy to achieve these contributions costs almost £60 billion a year. In itself that is a cause for asking why a social dimension is not required with regard to these savings, but there is another aspect to this.

Savings have not just gone up because of the sums saved. The extraordinary increases in wealth cannot have happened for this reason alone. Instead, they have also happened because of the deficits that the government has run over the last decade.

Those deficits have been necessary and appropriate. Indeed, they may well have been too small. But they had an inevitable consequence. When the government runs a deficit someone else has to run a surplus. That's a fact dictated by double-entry accounting. The sectoral balances show this. This is the latest UK version, from the Office for Budget Responsibility:



As deficits go up so too do savings. And so, the stock of savings in the UK has grown.

This has had an exponential consequence. Since almost all this saving has gone into land, housing or shares, all of which are kept in deliberately short supply by markets keen to maximise profit, the prices of those assets have risen, considerably. The result has been an even greater increase in wealth than there has been in savings. This is data from the ONS from last April when I last looked at the data on this in detail:

Breakdown of total aggregate wealth by component (£ trillion)	July 2006 to June 2008	July 2008 to June 2010	July 2010 to June 2012	July 2012 to June 2014	July 2014 to June 2016	April 2016 to March 2018
Property Wealth (net)	3.54	3.38	3.53	3.81	4.52	5.09
Financial Wealth (net)	1.04	1.09	1.31	1.56	1.63	2.12
Physical Wealth	0.96	1.02	1.08	1.13	1.23	1.32
Private Pension Wealth	2.89	3.47	3.53	4.39	5.35	6.10
Total Wealth (including Private Pension Wealth)	8.43	8.96	9.44	10.89	12.73	14.63
Total Wealth (excluding Private Pension Wealth)	5.54	5.49	5.91	6.50	7.38	8.53
GDP	1.57	1.56	1.67	1.81	1.93	2.09

I am sure that not much has changed since then in terms of the trend.

But there is a problem here. QE, rightly or wrongly, has been in use for a decade now. And what QE does, quite deliberately, is to force money out of safe bonds and into speculative investment, so pushing up the price of both with the intended aim of reducing effective interest rates. It does then, effectively, inject hot money to fuel speculative activity into the economy.

There are massive consequences of this. One is the resulting enormous increase in financial wealth, and so an increase in inequality.

Another has been an increase in the return to speculation that has discouraged any form of real investment, at cost to real production and jobs within the economy.

The third is a complete disconnect between financial markets and real investment return.

And fourth there is always a risk that the financial markets might crash, simply making overall economic well being worse, and not better.

And fifth, whilst all this is going on, many quite reasonably resent it and become alienated from society and politics which they correctly see as offering them very little of real consequence, whilst the returns to a few rise exponentially. This is a recipe for the social breakdowns that we are now witnessing politically.

My remedy is to address the disconnect between savings and investment in society. My logic is as follows.

First, there is a massive investment shortfall in society if we are to meet current needs for new infrastructure as well as creating the transition to sustainability that we require.

Second, we need this investment to deliver the recovery that is now required post-Covid.

Third, the subsidy that the state gives to the already wealthy by providing them with incentives to save must be applied for social gain. It's hard to imagine a counter-argument.

Fourth, inequality must be tackled. Even the IMF and OECD now say so.

Fifth, we must seek to avoid a financial crash which continuing QE of the type now used might promote.

Sixth, further QE of that type plus any increase in tax or borrowing must be avoided, as all work against achievement of the above objectives.

Seventh, so too does simple money injection work against that objective since it too increases the sectoral imbalances and does therefore increase savings, whether that is the intention or not, meaning that modern monetary theory has not got all the answers on this.

Which means we have to do something more radical, which is to now reconnect savings, and those that we subsidise through the tax system in particular, and the real economy by encouraging the rather novel (as it turns out) idea that savings might be used as capital to fund the investment that we need for the benefit of all in society.

Doing this is easy. As I have noted, the relationship between tax reliefs and savings in the UK is very marked. Something like 80% of all private wealth is saved in tax incentivised assets, whether that be pension funds, ISAs, other tax driven schemes, and housing, which is massively tax subsidised by being free of capital gains tax.

So, ISAs must only be allowed in future if the ISA funds are invested in bonds that in turn fund activities that can be shown, without doubt, to produce new jobs that support the required transformation of the UK.

I also suggest that 25% of all new (not existing) pension contributions should be required to be invested in the same way.

Together these two measures could result in maybe £100 billion a year of capital being available for investment in the UK, which is more than enough to fund the Green New Deal (which the Climate Change Committee thinks might cost £60 billion a year) and ample other social investment as well, whilst freeing government revenue budgets to address other vital issues, like health, care, education and justice issues.

How could this be done? I suggest that hypothecated bonds be issued. These could be regional (big enough to be effective, but small enough to be local e.g. East Anglia or South Wales) or they could be activity focussed e.g. health, housing, the Green New

Deal, and so on. There is no reason not to do both, and mix the benefits.

The bonds would be invested fir the use for which they were subscribed. But the investment projects and their amounts would be set by government. So investment limits may have to be set, and government should also make good shortfalls: this should not be a rationing mechanism.

As important, the interest rate should be the same for all funds, and be both attractive in the market (above average, towards top end for the periods offered, and locking up funds for a period would be part of the deal) and guaranteed by the government. It could also be tax free, as ISAs are.

Redemption should always be possible. Normal circulation should cover this issue. If not QE could, but that would be Green QE in this case, because the funds would then be linked to a specific purpose and not be randomly allocated within markets.

Long term capital redemption would be funded by renting assets created to the government. If funds were made available to the private sector (and they might be, via a National Investment Bank, acting like a venture capital fund) they would obviously be expected to pay a return.

And the interest would be covered by government. Suppose the rate might be 1%. On £100 billion that's a £1 billion annual cost. Let's not over-sweat the cost in that case. Putting a cap on balances that might be held in these accounts (less than £500,000 I would suggest, and maybe more like £100,000) would make sure that not to much of this is captured by the already wealthy.

So why do this? Because it solves the problems I note, which are real, politically, socially and economically.

And why do this, rather than do existing bonds as I have been asked? Simply because these existing bonds might be economically 'efficient' but they create the social, political and economic consequences I note. Efficiency is a very long way from being the criteria for success in the political economy that I care about.

So will they work? In terms of attracting funds I have not a shadow of a doubt. I think people would be queueing to get them.

In terms then of freeing the government to fund other activities, I again have not a doubt.

In terms or promoting an awareness of the relationship between savings and investment, that will depend on the marketing and reporting. It will be vital that people think there is a relationship between their savings and outcomes. Good reporting will then be vital.

And in terms of additional funding for investment? I am sure that will happen.

Whilst tax reliefs will be better spent.

And two other things will be achieved. Savers are older. Those who will get work from this will mainly be younger. This activity could promote inter-generational solidarity in that case, which is now vital.

In the process it could also underpin what I call the real pension contract (explained here) which requires inter-generational transfers of income and wealth.

We will also get a Green New Deal, better housing, schools, hospitals, transport and other infrastructure. And by freeing government budgets for alternative use other than funding investment we will end up with better services too.

We could even have full employment. And for those who worry about such things, balanced budgets follow on from full employment.

Now, what is not to like?