Funding the Future

We can survive the climate crisis, but only if we're wi...

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I owe thanks to those who drew my attention to a new paper published by James Galbraith in the last few days. The blurb from the Levy Economic Institute of Bard College in the USA says:

Publications

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In Defense of Low Interest Rates

In recalling John Maynard Keynes's revolutionary theory of interest, reviewing the doctrines Keynes sought to overthrow, and analyzing the structural transformations of the US economy, James K. Galbraith maintains there is no alternative to a policy of low interest rates. However, such a policy cannot be effective, he argues, without a radical restructuring of the US economy as a whole.

In the paper, James Galbraith first demolishes arguments for the loanable funds model of banking, still beloved by most macroeconomists and so absurdly untrue that it is shocking that they can still teach this nonsense to most undergraduate students.

What he then argues is that there is no such thing as a market rate of interest. Firstly he says that is because there is no free market in money given the barriers to entry that banking has. More importantly, that is because of the power of central bank regulation on this issue.

As a result he suggests that the aim of all interest rate policy should be to keep rates as low as possible. This, he argues, was Keynes' preferred option. As Galbraith summarises this:

Interest was the return to the provider of funds, typically the idle rentier. Thus, a low rate of interest and a high rate of investment would yield, in the long term, a "euthanasia of the rentier"—leaving capitalist society in the hands of its active elements, namely businesses, their workers, consumers, and the government—perhaps requiring a "socialization of investment."

Galbraith makes it quite clear that he is on the side of this euthanasia of the rentier. He argues that regulation has to deliver the active economy that we need.

As he then notes, since Keynes' death, everyone has rowed back from this critical idea. Having reviewed the failures resulting from doing so, Galbraith asks:

The analysis above leaves an open question. Apart from the illogical and the illusory, are there solid—if not necessarily defensible—reasons why the Federal Reserve would raise interest rates?

He offers two. The first is this:

Two possibilities come to mind. The first is venal. The Federal Reserve works, in the main, for the largest banks, and since 2008 it pays interest directly on their reserves. Thanks to "quantitative easing," the policy of buying at-risk assets such as mortgage-backed securities from the private sector and warehousing them in special purpose vehicles, the big banks are flush with reserves. Paying interest gives them income; paying more interest gives more income. In return for this, nothing is demanded. As smaller banks with unstable deposit bases are hit by runs, the biggest banks can (and do) ride to the rescue, consolidating their hold on the banking system as a whole. All of this must be very well appreciated by the big bankers.

I think this is highly likely to be true.

His second explanation is this:

The other possible reason is global and strategic. Although legal responsibility for the dollar rests with the Treasury, not the Federal Reserve, power over the dollar exchange rate rests largely with the central bank, its interest rate, and their effect on capital flows. Although the topic rarely surfaces in public, there is little doubt that preserving the centrality of the dollar as the global reserve asset is a paramount US policy goal. So it was when Paul Volcker assumed office in 1979, flying back from an IMF meeting in Belgrade to announce the first "Volcker shock," and so it remains today.

US hegemony is, then, core to interest rate policies. It is, once again, very hard to disagree.

As Galbraith notes, the first of these issues is relatively easy to address. The second is much harder. Doing so would, as Galbraith puts it, "shatter the illusion of American prosperity."

How does he conclude? Like this:

In sum, there is no alternative, consistent with minimum economic functionality, to a policy of low interest rates. Keynes was right. ... But such a policy cannot be effective, in fact no policy can be effective, without a radical restructuring of the US economy as a whole. For this, definancialization, effective control of the speculative/predatory elements in the financial classes, and acceptance of—what is inevitable—a multipolar financial world are the key first steps. There is little doubt, at this stage, that the *adjustment will be quite harsh at first. Adjustments typically are. But after forty years in the pursuit of a failed strategy, an easy path forward is not realistic.*

Once more, I agree. As I have said here recently, to survive we have to break from the model of economics that we have that has been driven by the power of advertising to promote consumerism, all of which exists with the ultimate goal of firstly making us unhappy and secondly of keeping us in debt.

That model was always bad for well-being.

Now that model is also destroying the planet.

We have no real choice but change. But as is becoming very apparent, politicians are finding it very hard to deliver against that need because of their own indebtedness to big business and the financial hierarchy of power.

There can only be one winner here. The trouble is power is on the side of losing.