Funding the Future

Rachel Reeves really is a very big threat to the well-b...

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As Rachel Reeves made clear in her Mansion House speech last night, she wants to relax banking regulations. Big bonuses will be coming back, paid much sooner than has been permitted of late. The aim is to increase risk-taking in financial services. She is issuing new remit letters to the Bank of England and others, emphasising that this is her expectation, although copies do not appear to be available as yet. Her belief is that this will boost the economy. She is wrong.

Aristotle noted a very long time ago that money cannot be made from money. His reasoning was clear. Value is created from the production of goods and services that meet needs. Bankers cannot do that. No one can eat money.

The counterargument to that suggestion is that banking and financial services facilitate the aggregation of capital, which can release productive capacity. I disagree with that claim in the modern fiat-currency economy. Banks are the primary source of capital for many companies where growth is most likely. But they do not aggregate depositor money to make loans. Instead, they make loans out of funds they create under a licence from a government-run central bank. Bankers, as most people understand them to be, do not, therefore, fulfil the task of lending depositor funds. Rachel Reeves has fallen for a fallacy that her former employers at the Bank of England have admitted is not true.

Investment bankers might fulfill this task of aggregating capital, to some degree, but bankers, as most people know them, don't.

So what do banks do? Fundamentally, they do three things.

First, they charge massively for the use of loaned funds created costlessly by them. The return to them on their government-created right to create such funds is phenomenal and wholly inappropriately charged for by the government as the facilitator of this oligopolistic exploitation of millions in the UK and beyond.

Second, they use the capital provided by depositors to speculate. This is not a creative process. It is, in effect, gambling. The net contribution to society is negative. The costs incurred necessarily prevent it from being a zero-sum game, after all. The returns are biased toward those with the most capital. The upward redistribution of resources within society exacerbates the similar inequalities created by the core banking function.

Third, they supposedly advise others with financial capital that might be aggregated, such as pension funds. In this role, they, and others in the financial services sector, face three major problems.

Firstly, they are not competent to advise on the productive use of capital because bankers and financial services specialists have never been engaged in such activities.

Secondly, bankers only understand financial capital, which is fundamentally different to productive capital, and since accounting post-2005 has only concentrated on reporting returns to financial capital, the ability to differentiate the two has been almost entirely lost, at least within the City.

Third, since bankers only take a microeconomic and financial view of the world, and accounting still fails to recognise the cost of the externalities created by capital when used by companies, the advice provided by bankers is inevitably counter-productive to the necessary goal of achieving climate stability upon which human life depends.

Despite all this, Rachel Reeves went out of her way in her speech to describe the financial services sector as ‘the crown jewel in our economy’. This is total nonsense because there is literally nothing that the financial service sector can do to add value to the economy without there being opportunities for them to fund within the remainder of the economy. In other words, the financial service sector that Rachel Reeves describes can only have a parasitical role, extracting value from the real productive value of the economy created entirely outside the walls of the City of London. Reeves appears unaware of this.

I stress, when saying this, that I am not passing judgement on the routine supply of basic banking services, or accounting services, or of routine insurance. The value of all of these I recognise, but it was also glaringly obvious that this was not the focus of what Rachel Reeves was describing when referring to financial services in her speech. It was the growth capacity of the supposed speculative capital aggregation activity to which she was making reference, and there is no evidence this adds value, or that changes to it can produce beneficial outcomes.

Let me take local authority pension funds as an example. Rachel Reeves wishes to aggregate the 86 existing local such funds and create eight mega funds from them. She claims that this will improve their contribution to the UK economy. What she ignores is that the criteria for the success of these funds is whether they are able, or not, to meet the likely financial requirements of their members when they are in retirement. Nothing else matters and at present, these funds have between them an aggregate surplus of approximately £100 billion. In other words, they are more than succeeding at delivering for the people to whom they have obligation. Unless she can demonstrate that aggregating these funds to create a pool of opportunity for higher risk, and so potentially lower return investment, can deliver better outcomes for the members in question (who have never got a mention in her discussion of this issue) then her proposal is recklessly irresponsible.

I very strongly suspect that she is being that irresponsible. What she has forgotten, as have all within the financial services sector, is that they only exist to service the end consumer, who is the individual saver. They do not exist to service the collective interest of the City. Nor do they exist to provide funds for speculative purposes that might promote bankers' bonuses. Their sole purpose is, in the case of pension funds, to supply a secure income to a person in their old age. It should be added that when seeking to do so, they should also seek to ensure that the opportunity for such old age should exist, which means that they must be inherently engaged in tackling climate change, which never got a mention in anything that Rachel Reeves had to say last night, so obsessed with her growth mantra is she, which is so contrary to the likelihood of achieving that goal of sustainability.

Did Reeves have anything useful to say about the economy as a consequence yesterday? No, is the answer to that. She added no value at all. But, she did threaten the well-being of a group of pensioners who are currently very well served by their local authority trustees.

She also significantly increased the chance that there will be future significant financial instability in the City of London by encouraging the taking of short-term speculative positions that are highly risky but which do fuel the payment of bonuses wholly inappropriately to people who have no downside consequences from undertaking this activity, of which asymmetry she appears to have no understanding.

So, was this a good night for the economy? No, it most definitely was not. Rachel Reeves is really a very big threat to the well-being of this country.