Funding the Future

The new economy

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I was searching yesterday for new economic manifestos simply to see what people were saying in them, and came across my own work on this issue. This blog post was [published on the blog on 2 July]() 2022, having previously [been on Byline Times.]() I think it is worth sharing again. It may need development, though. Suggestions will be noted:

Left-of-centre thinking has only dominated the economy for one period in history. The post-war consensus was built on the ideas of social democracy. That consensus collapsed in the 1970s.

The rigidity of the post-war international economic architecture that initially underpinned the prosperity of that era could not withstand the pressures of an increasingly global world where imperialism was ceasing to play a role. In addition, the command and control approach to macroeconomic management within governments, learned by so many politicians of the era from the wartime economy, fell into conflict with people seeking greater economic freedom.

The failure of the left to adapt opened the door to neo-liberalism. That led parties of both left and right to the era of non-government, where light-touch regulation was the creed and the 2008 financial crisis the consequence. It is only the absence of an alternative vision that lets this vision stagger on. That vision is that:

"Neo-liberalism offers economic growth through a faith in market solutions."

It is my suggestion that the left should replace this with a new ethos:

"The left wants to create a sustainable economy by putting all the resources available within society to best use, including those that the market fails to use to best effect."

In doing so, I draw on some serious changes in economic understanding over the last decade or so.

A Revolution in Economic Thinking

Neo-liberal dogma might have survived the 2008 financial crisis, but the practice of government and its financing since then has suggested that much has changed. The idea that governments cannot create money to fund their own activities without dependence on either taxpayers or borrowing has been shattered by quantitative easing.

That governments can increase inequality by use of this new funding mechanism has also become clear, although nothing is being done to tackle it, resulting in growing tensions within society. And throughout this era, the disconnect between people's savings, stock markets, bond markets and the financing of the needs of society has become apparent as corporations fail to respond to the crisis of climate change and ask for government support to do so, despite ever-increasing apparent financial wealth within the economy as a whole.

Government claims as to its own inability to act due to the retention of the neoliberal demand that it balances its books are creating a tension that needs resolution. The opportunity to resolve this crisis comes from new economic thinking that has developed over the past decade:

Money is Made by Lending, not Saving

We now know that all bank-made money is created by lending. As a result, we know that no bank lends savers' funds. They are not the intermediaries that they were once supposed to be. The reality is that cash savings in banks are macro-economically inconsequential because they almost never create new employment or jobs in the way they are saved at present.

Government Doesn't Borrow: It Provides Opportunities for Savers

We know that the government creates new money via the Bank of England literally every time it spends. As such tax does not fund government spending, nor does borrowing. Instead, both are funded by government money creation. Tax exists primarily to control inflation as a consequence, by cancelling the money the government creates through its spending (in the same way as loan repayment cancels bank-created money). What has been called government borrowing is nothing of the sort but is instead an incredibly secure savings facility offered by the government largely as a favour to the banking sector who need it to underpin their operations.

Company Shares Do Not Finance Investment

Based on research colleagues and I have been doing at Sheffield University and *elsewhere, we know that FTSE companies do not rely on or need new share issues to finance their investment activity. In fact, they are repurchasing shares faster in most cases than they ever issue them. What that means is that saving in shares also rarely if ever creates new investment or jobs now. This is as true of property companies as any other quoted company.*

Financial Services Do Not Provide Capital

The conclusion is that as things stand, the whole edifice of the financial services industry has ceased to be an intermediary between savers and investors, which was once its raison d'etre. Instead, it merely provides cheap capital for banks in the case of cash savings or money to be used in endless, but unproductive, speculation in the case of stock exchange-related savings activity, including most of that in property.

Not to put too fine a point on it, financial capitalism has become so focussed on engineering financial returns from smart accounting, takeovers and mergers, and capturing public revenues for private gain that it has forgotten that its role was once to supply capital for useful purposes. Neoliberal capitalism has now developed to the point where capitalism itself has in any meaningful way ceased to exist.

Government Subsidies to the Failing Financial System

Despite this, there is about £8.4 trillion of financial wealth in the UK, according to the Office for National Statistics, and of that sum, more than 80% attracts tax subsidies on an annual basis at a total cost in terms of tax foregone on pensions and ISA reliefs of very nearly £60 billion a year;

Of this sum, at least £28 billion goes to the top 10% of wealth owners in the UK: this system shovels government support upwards through the wealth hierarchy of the UK, and all to no overall economic effect, except to increase inequality;

So not only has neo-liberalism failed, but so too has the government by not noticing or responding to this. It's subsidising a financial system run by an elite for the benefit of an elite in a way that has ceased to add any value to the rest of society.

Breaking the Pension Contract Across the Generations

Worse, that system has failed the fundamental pension contract: this is the tacit agreement 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, the 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. Ours is now tottering on the brink of doing so.

So, what can be done about this?

A Renewed Social Contract: the Uses of Capital

Government has to take on a new role in society. It has, in effect, to become the intermediary between savers and investors to make sure that the nation's capital is once more used for social purposes.

The significance of this cannot be overstated. Whenever there has been a major shift in economic thinking it has always been about how capital is used by society, for what purpose, and to benefit whom.

The change always happens when the structure in place has been corrupted and then abused. So feudalism gave way to monarchical government, which in turn was replaced by early forms of parliamentary government, albeit on a very limited franchise, which did, in turn, by the end of the 18th century give rise to the industrial revolution and the growth of the joint-stock company. That era was then replaced by the welfare state in 1945, only to then pass on again in the 1980s to neoliberalism, with its focus on returns to financial capital above all else.

As those changes took place, the use of capital always changed. So too did the beneficiaries change. It is never the routine of day-to-day of spend and tax that changes society. It is the way capital is allocated, and rewards are distributed that does that.

The proposal made here is to change how capital is used. Using the very obvious power that tax reliefs have to direct the use of savings it is suggested that the tax reliefs attached to ISA and pension savings accounts should be changed to mandate their being saved in new Green New Deal bonds to be issued by National Investment Banks in the case of ISAs and to encourage that same use in the case of pensions.

The types of bond will vary to suit the different markets, but the goals will remain the same. The focus will be on cash savings bonds in the case of ISAs, with simple-to-understand structures. Bonds more akin to hypothecated gilts might be available for pension use.

In both cases, the National Investment Banks of each of the countries of the UK would be directed to use the funds that they can generate from these Green New Deal bonds to fund the transition that is required to a sustainable economy faster than might be possible by relying on any existing decision making or funding process. As a consequence, additional investment will be made in:

* *New social housing*

* *New sustainable energy generation systems*

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New energy efficiency systems, including in public and private housing

* *Sustainable transport systems*

* *The renovation of many existing public buildings to make them energy-efficient and sustainable*

* *R&D into:*
* *New food production systems*

* *Reduction in food waste*

* *Alternative energy systems*

* *The support mechanisms for society, most especially in health and publicly provided social care, whether at home or in residential* [*provision*]

* *Education and related facilities to support all these programmes*

Doing so will also release funds for significant new spending on the regular programmes of government since there will be reduced demand on these for investment purposes.

That is because it is assumed that ISAs will, if the interest rates offered are as good as those available from commercial banks, generate funds of maybe £60 to £70 billion a year for this purpose, which is the amount regularly saved in these accounts a year at present, whilst if just one-quarter of all new pension contributions is diverted for social investment as a result of the changed conditions of pension relief then more than £25 billion of additional funds for this purpose might also be available from that source each year.

Because the proposed changes redirect tax reliefs, no new taxes are likely to be required to achieve this goal. It might, however, be appropriate to restrict some of the reliefs for saving available to the very wealthiest.

A New Economic Vision for the Left

The aims of this proposal are quite straightforward. One is to make capital a mechanism capable of delivering change for social advantage again. Another is to turn currently wasted tax reliefs into focused subsidies that deliver benefits on a host of fronts, meaning that they are used productively once more. Third, the aim is to restore the social purpose of saving. That then leads to the goal of creating a restored pension contract within society as a whole, as a part of which the aim is to rebuild inter-generational solidarity.

But perhaps most of all, the purpose is to recreate the link between the saver and the investment that they fund, that has been entirely destroyed in modern financial *capitalism when the saver in a pension, ISA of any sort, or any structured fund has no real idea what their money might be used for. That it so happens that the investments with which the saver might associate themselves resulting from this proposal could also be of their choosing, either by offering dedicated (e.g. climate, health or transport funds) or regional funds so that the saver might associate their money with new projects in their own region or devolved country, enhance this goal.*

What is the downside? There can be no doubt that this will be felt in the City of London and the financial services industry, which have come to see the financial wealth of the UK as their plaything for gain, with tax reliefs thrown in to comfort the blow for savers if markets do not work out as the financial forecasters suggest they might. I suspect that if funds flow towards savings of the sort I describe on the scale that I suspect likely, then the demand for other financial services products will fall. But I would welcome that.

Any change to the allocation of capital in society must have the goal of putting resources wasted by the existing allocation to better and more productive use. Many of those now engaged in generating little or no return for society at all in the financial services sector might very well be much better employed elsewhere in society.

Could the parties of the left in the UK sell this idea as the basis for the revolution that we need to deliver the transformation that the country requires? That would require imagination. But, while the theoretical implications of what is proposed are not easy to communicate, the practical dimensions – including the fact that existing tax reliefs are being very unfairly distributed for no social gain – should be easy to explain, as should be the idea of creating new funds to direct investment for social purposes.