Credit, Debt-deflation, Globalisation and 'Austerity'.

By Ann Pettifor

Debtonation: The Global Financial Crisis

What is barter?

What is bank money?

What is credit?

What is the difference between credit and cash?

What is the ‘price’ of money called?

What is simple interest?

What is compound interest?

The Magic of Compound Interest

Calculate the interest on £10,000 loaned over five years at 10% per annum –

at a *simple* interest rate

and

at a *compound* interest rate

£10,000 lent at 10% over five years

Time	Simple Interest	Compound Interest
Year 1	£1,000	£1,000
Year 2	£1,000	£1,100
Year 3	£1,000	£1,210
Year 4	£1,000	£1,331
Year 5	£1,000	£1,464.10

10% of £1000 = £100.
Add to principal = £1,100

10% of £1100 = £110
Add to principal of £1100 = £1210

10% of £1210 = £121
Add to principal of 1210 = £1331

10% of £1331 = £133.10
Add to principal of 1331 = £1464.10

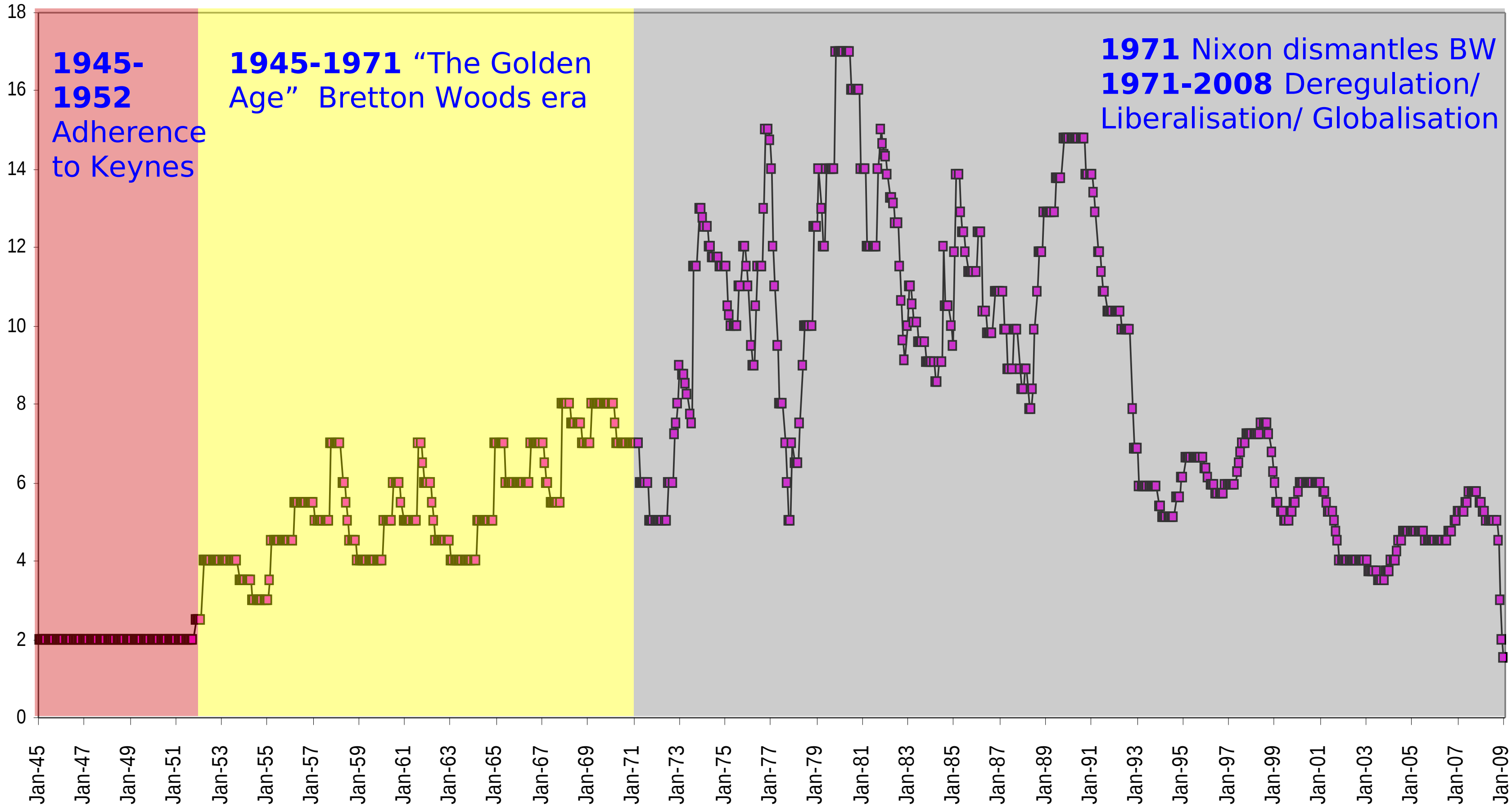
To illustrate the power of compound interest, examples of ten-, fifteen- and twenty-year debts are shown below. Notice that while the compounded interest continues to grow, the simple interest remains constant at £1,000

The Magic of Compound Interest

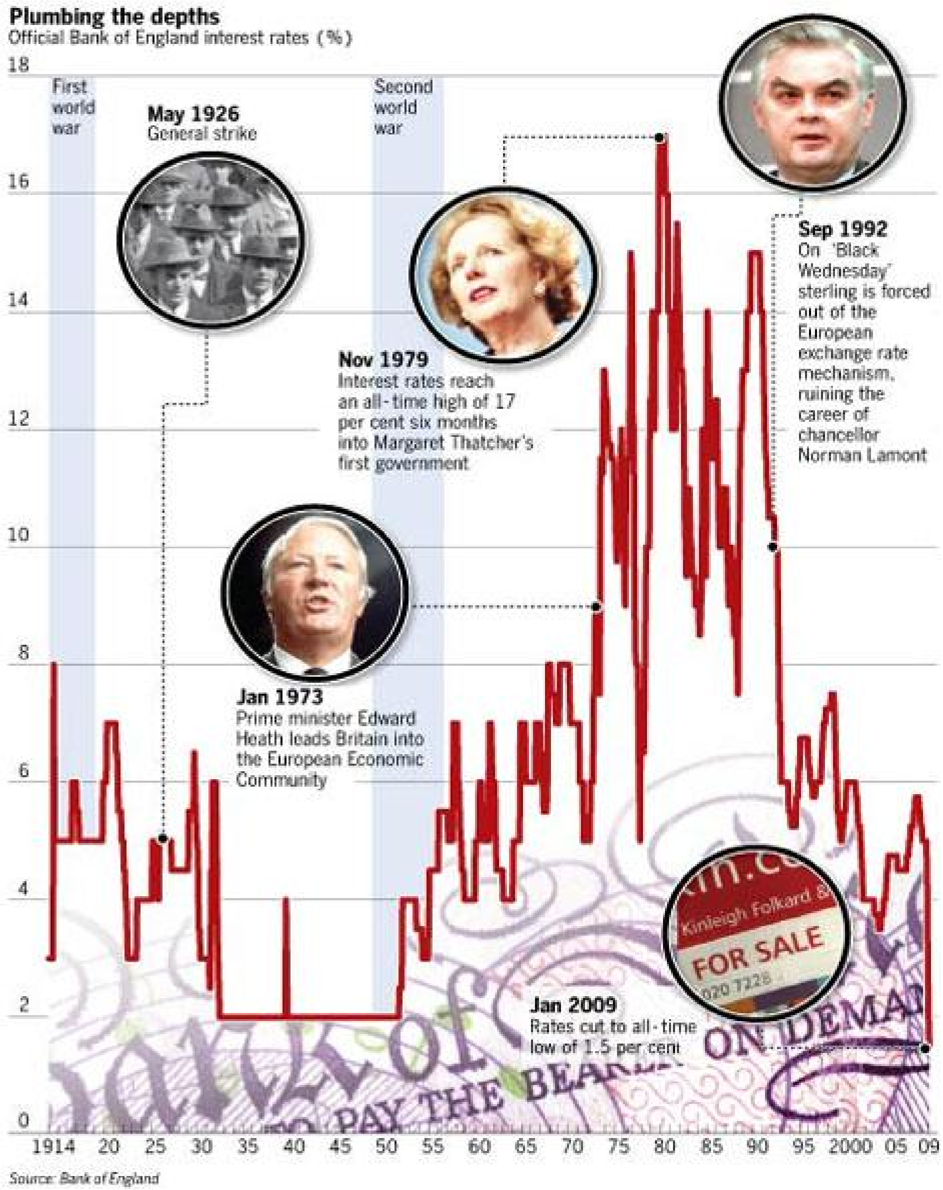
Time	Simple Interest	Compound Interest
Year 10	£1,000	£17,070
Year 15	£1,000	£34,492
Year 20	£1,000	£62,551

Bank of England Base (official) Rate 1945 – 2009

(not adjusted for inflation).



FINANCIAL TIMES



Bank money, unlike commodity money, is *intangible* – you never see or hold it.

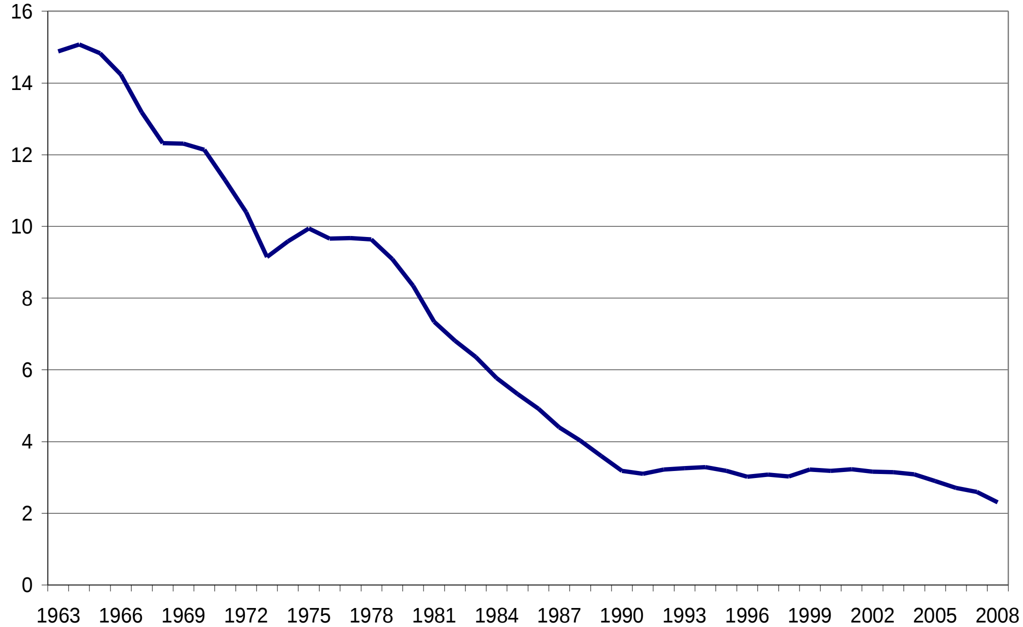
Bank Money

Not tangible

ebay®

Notes and coins – tangible

Cash/Money Stock (BoE)



Only 2% of total money is cash

Bank money is *not a commodity. There is no limit to the availability of bank money.*

It is not visible/tangible

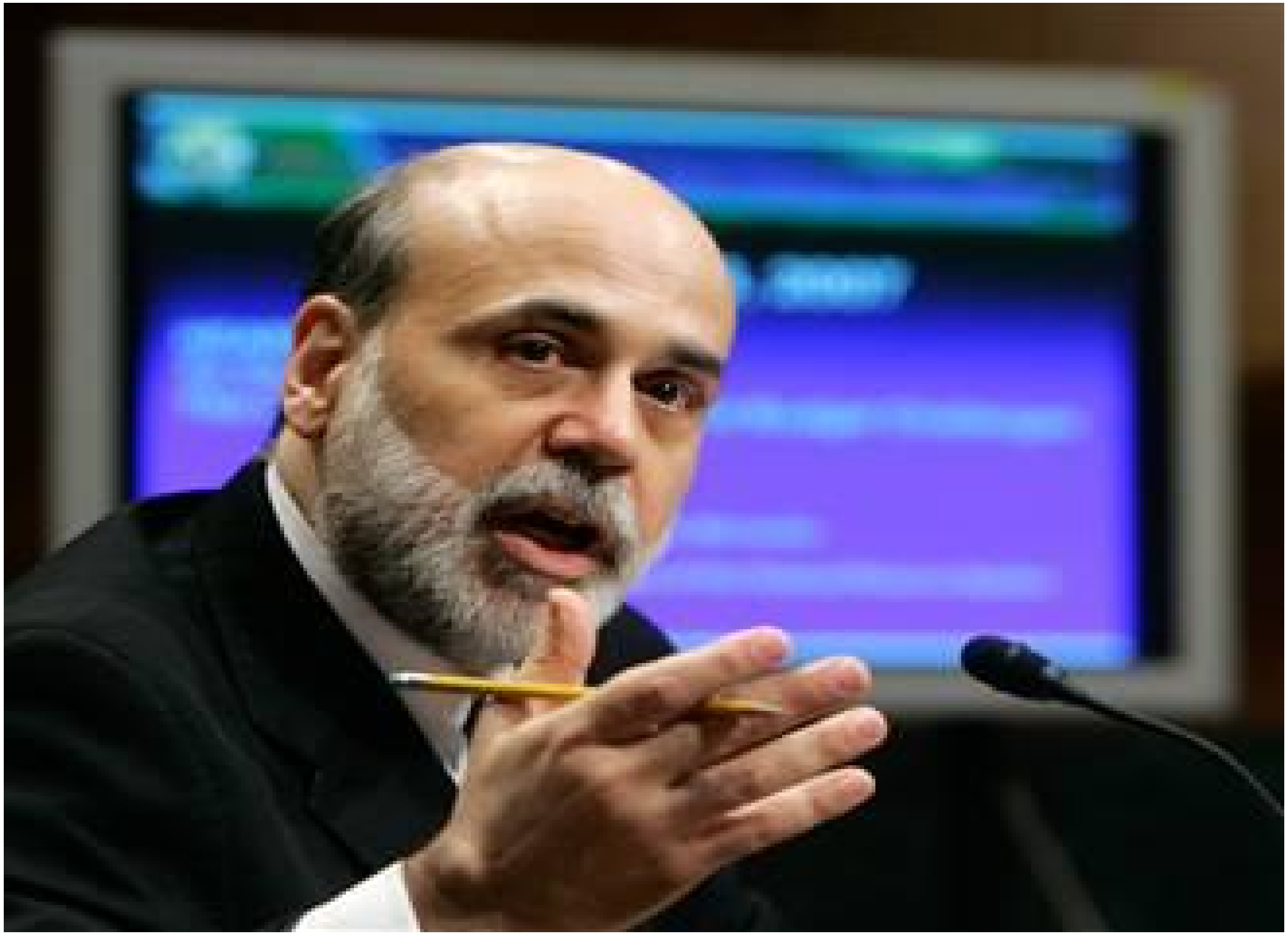
Unlike like oil

Or gold

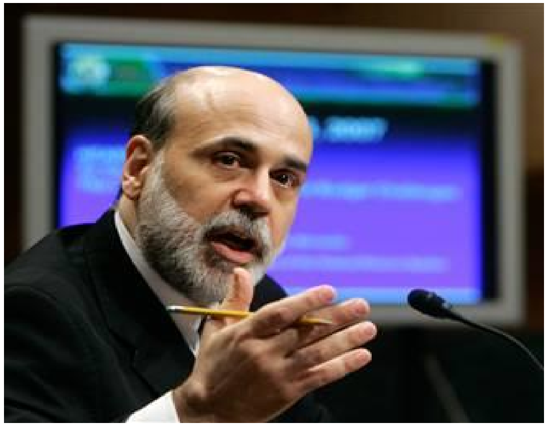
Or tulips

“Why then…if banks can create credit, should they refuse any reasonable request for it? And why should they charge a fee for what costs them little or nothing?

Keynes, Treatise on Money, 1930.



Credit and the banking system



Ben Bernanke, Fed Reserve Governor, interviewed on CBS. 60 Minutes Show 15 March 2009, soon after Fed had made $160 billion available to AIG. Was it tax money?

Bernanke: "It's not tax money. The banks have accounts with the Fed, much the same way that you have an account in a commercial bank.”

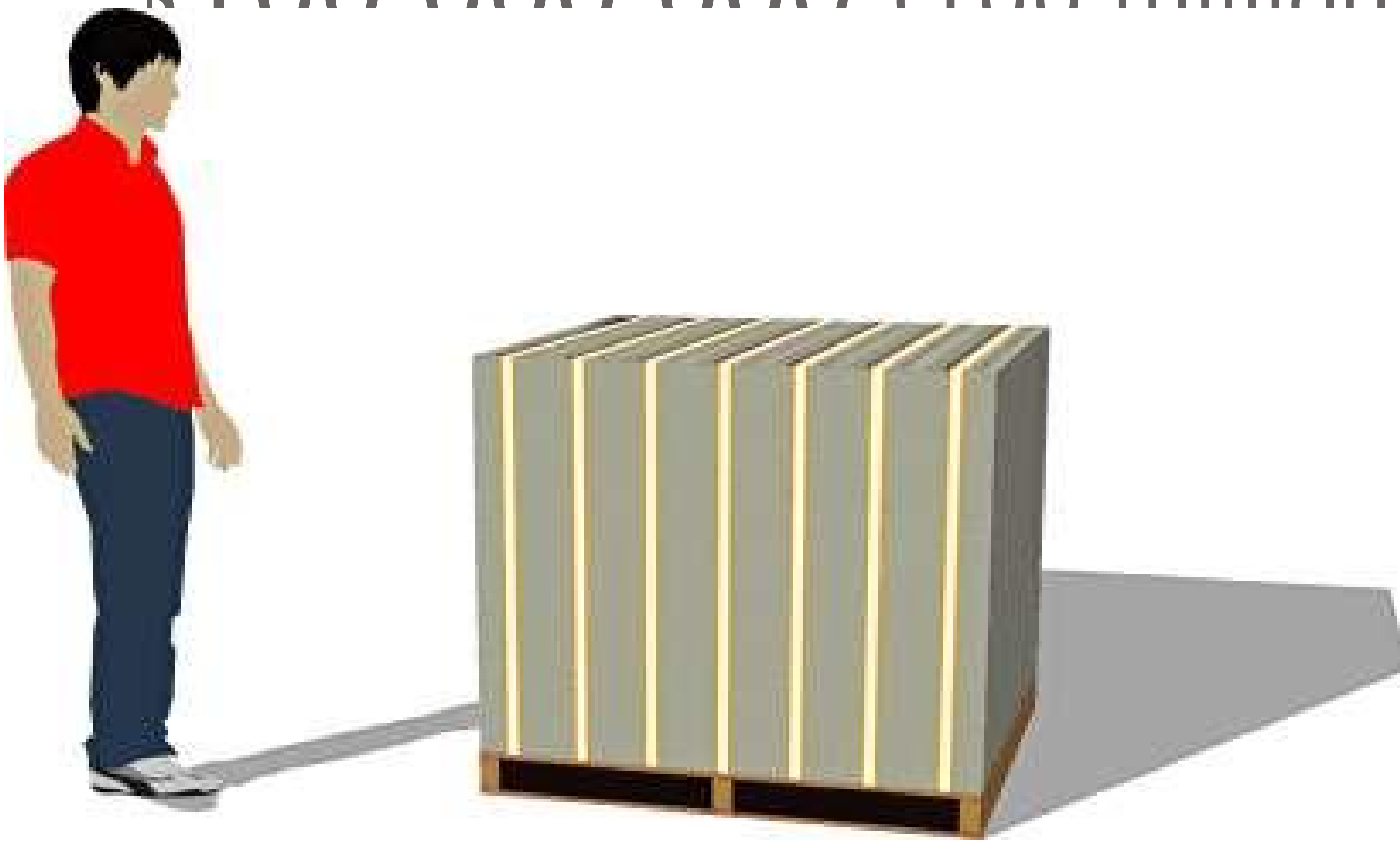
Bernanke: “So, to lend to a bank, we simply use the computer to mark up the size of the account that they have with the Fed.”

$16,000,000,000,000

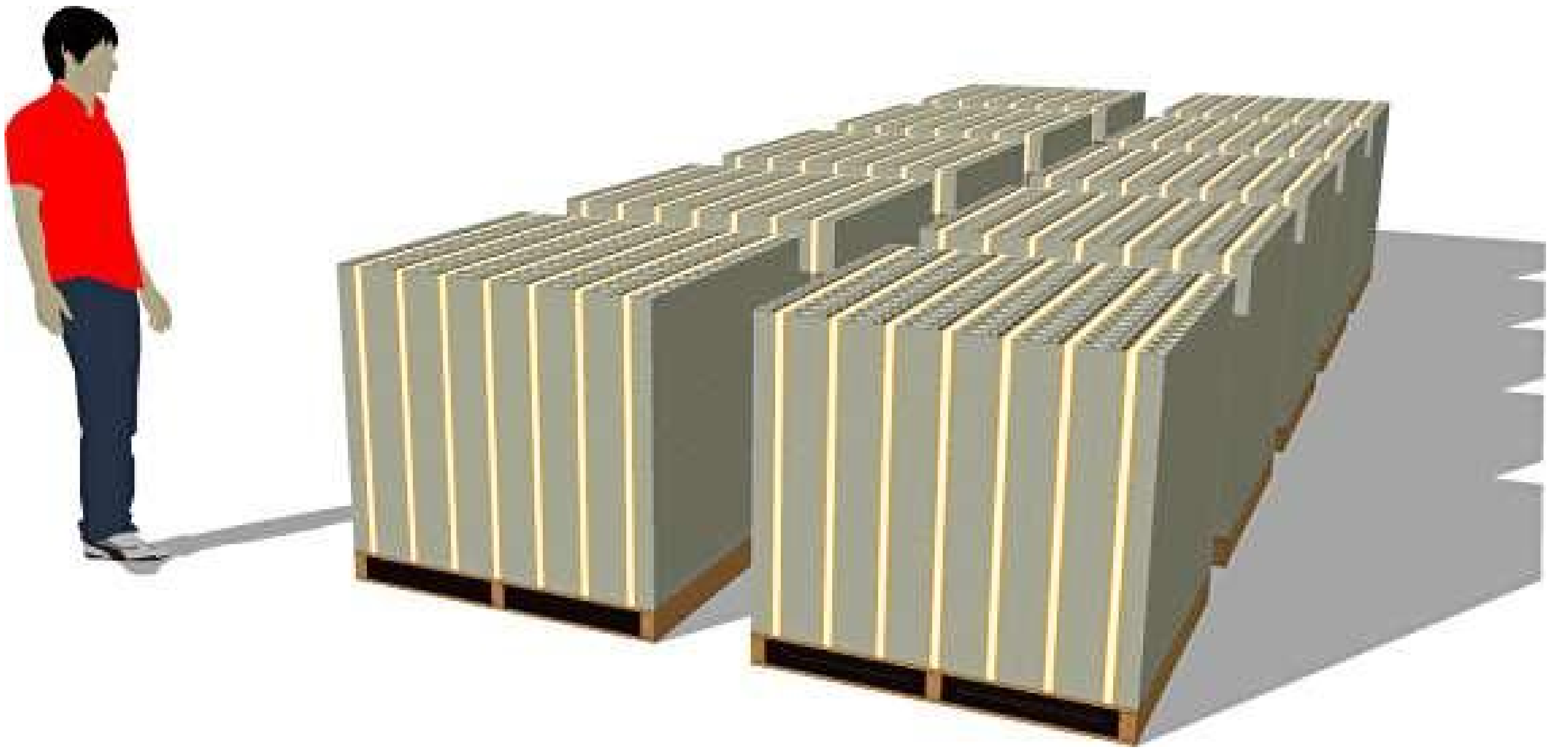
$10,000 ½ inch thick

$1,000,000 (100 packets of $10k.)

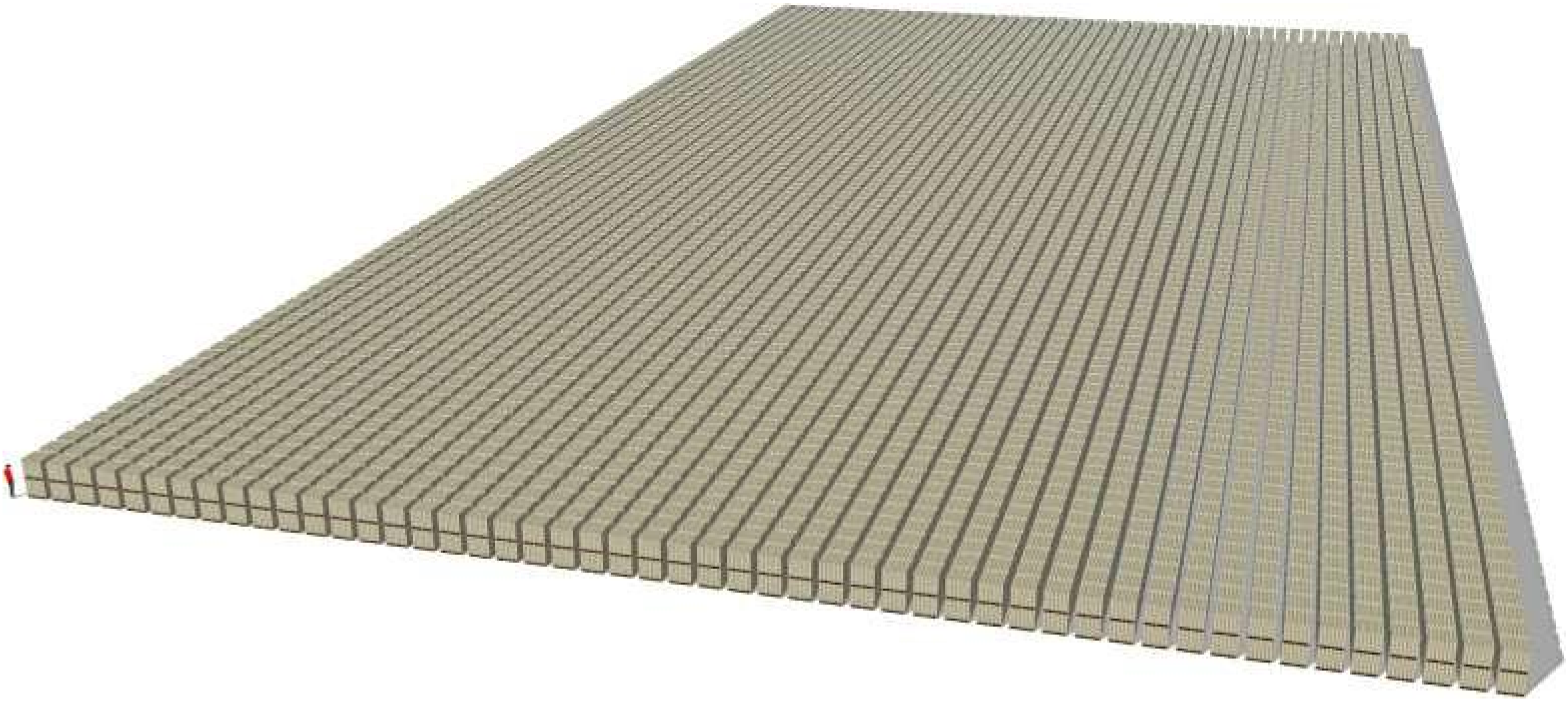
$100 000 000 (100 million)



$1,000,000,000 ($1bn)



$1,000,000,000,000 ($1 trill)



$16,000,000,000,000

Quantitative Easing

Keynes:

Bank money *creates* economic activity

In understanding bank money we need to understand that money held in banks does not correspond to what we understand as *income.*

Nor does it correspond to *savings.*

It does not correspond to *any* economic activity.

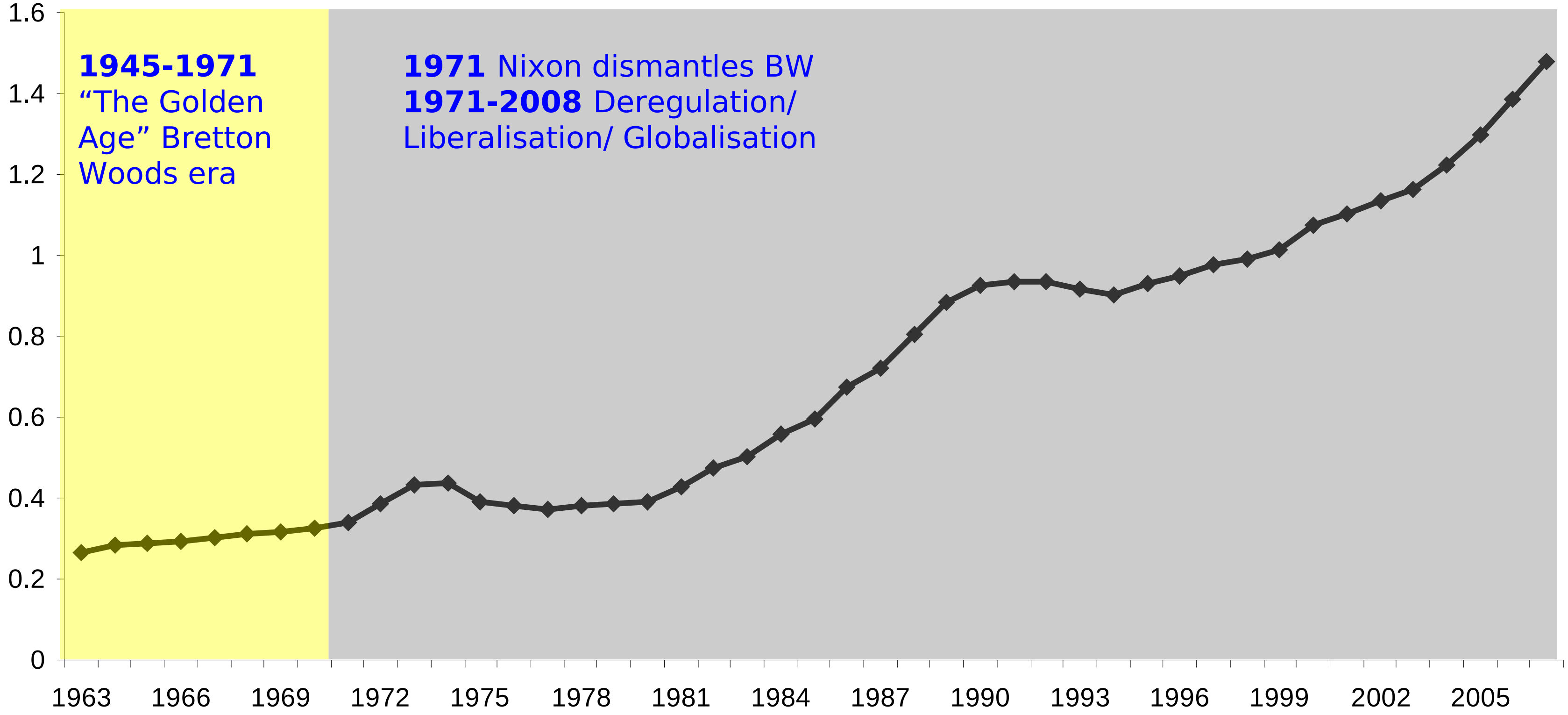
Bank money does not exist *as a result* of economic activity.

Instead, bank money *creates* economic activity.

“Human effort and human consumption are the ultimate matters from which *alone* economic transactions are capable of deriving any significance”.

John Maynard Keynes. (*Treatise on Money*, Vol. I, *CW* V, p. 120).

UK Corporate, consumer & mortgage debt as % of GDP



Source: Office for National Statistics, Financial Statistics Freestanding, Table 3.1G Sectoral analysis of M4 and its sterling lending counterpart; National Accounts, Time Series Data, Blue Book

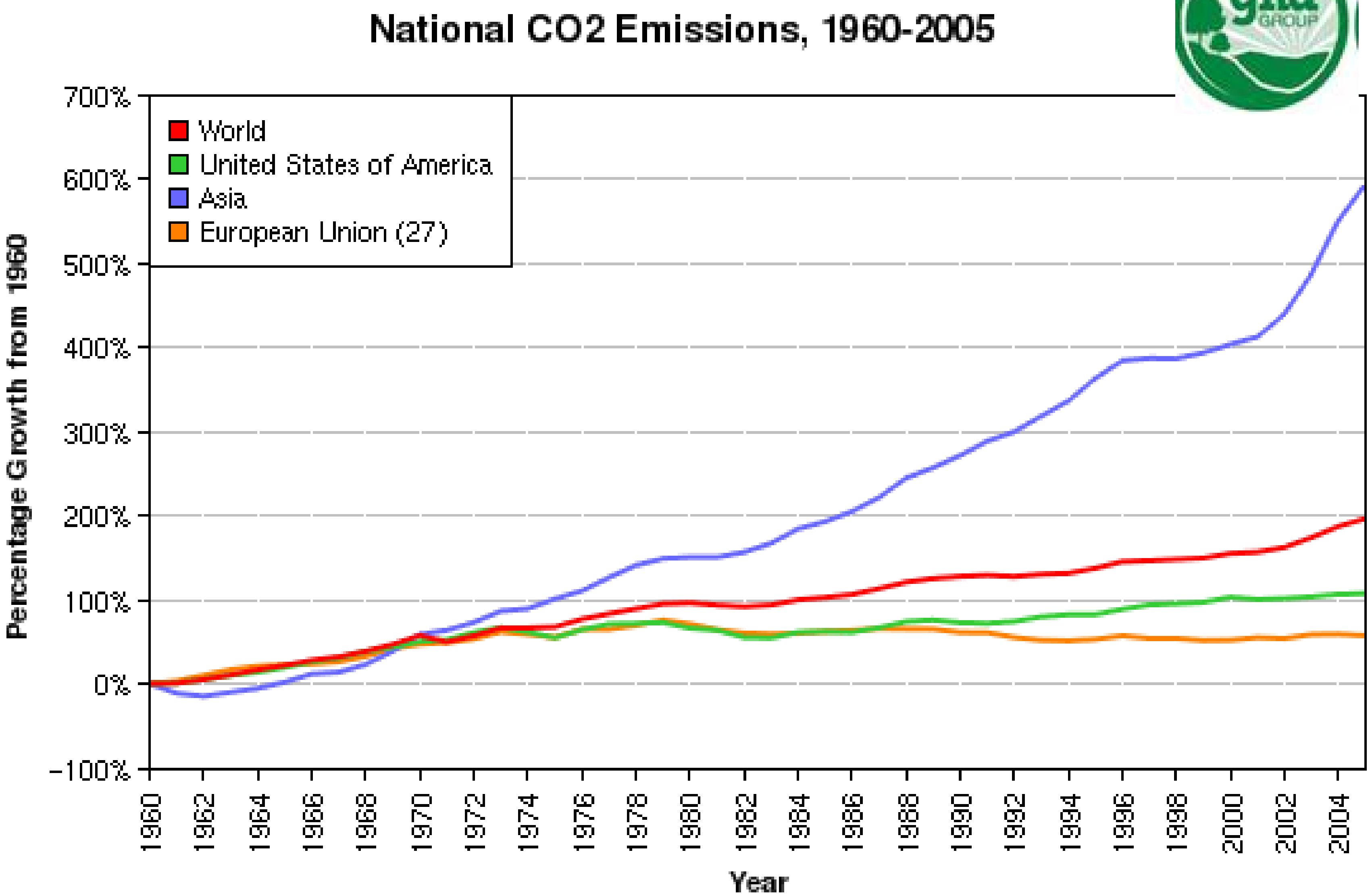
“**Easy, dear Money**” (Credit)

fuelled

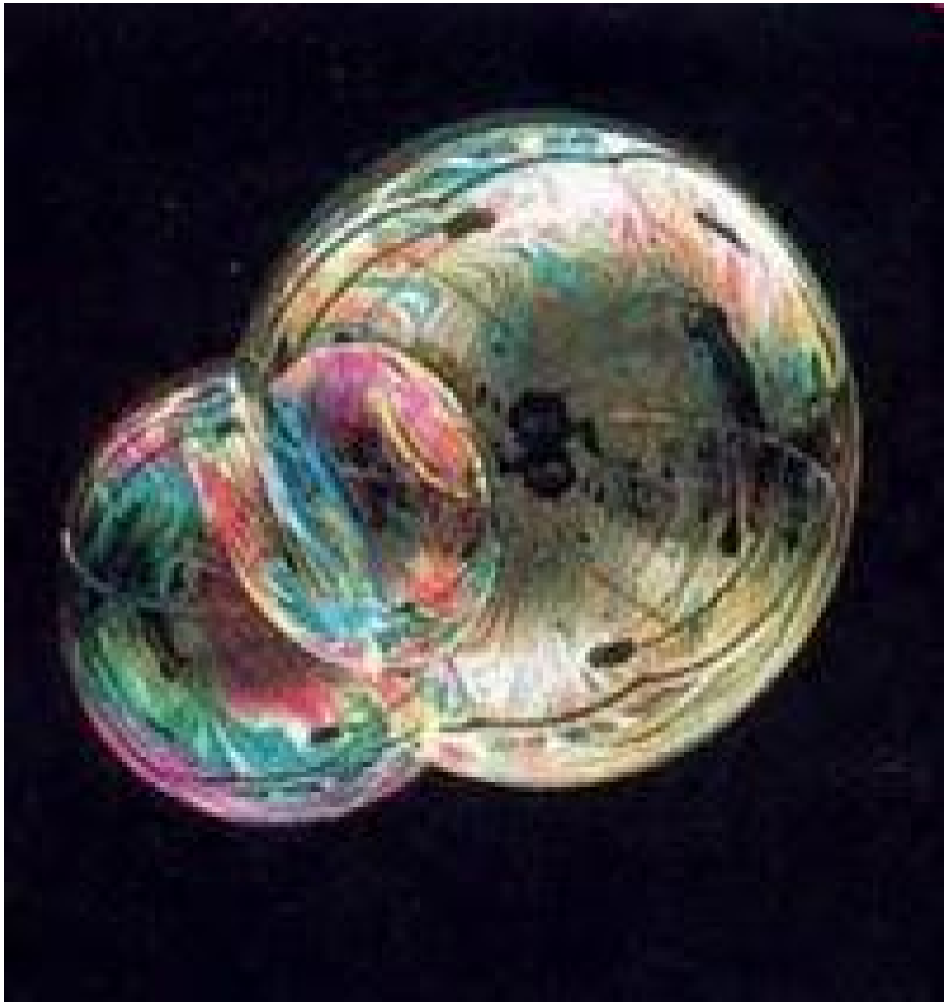
“**Easy Shopping**” (Consumption)

which in turn fuelled

“**Easy Jet”** - (Emissions)



Source: World Resources Institute, http://cait.wri.org



With *easy*, but *dear* credit financing and blowing up *asset* bubbles across all economies.


slump
Slowdown
RECESSION
credit crunch
DOWNTURN

How to resolve the crisis?

1. Cancel unpayable debts – individual, household, corporate and sovereign

1. Help in the orderly re-structuring of debts

1. Lower interest rates across the board – which means capital control

4. Quantitative easing – to pump credit into banks and then into productive investment (not speculation and gambling)

5. Fiscal stimulus – government to fill the hole created by the implosion of private sector investment – which fell by £70 billion in the UK between 2007-2009.

There <u>must</u> be a ‘plan to cut the deficit’.

The question begged: will expenditure-cutting (and tax-raising) cut the deficit?

Debate not between cutters and postponers…

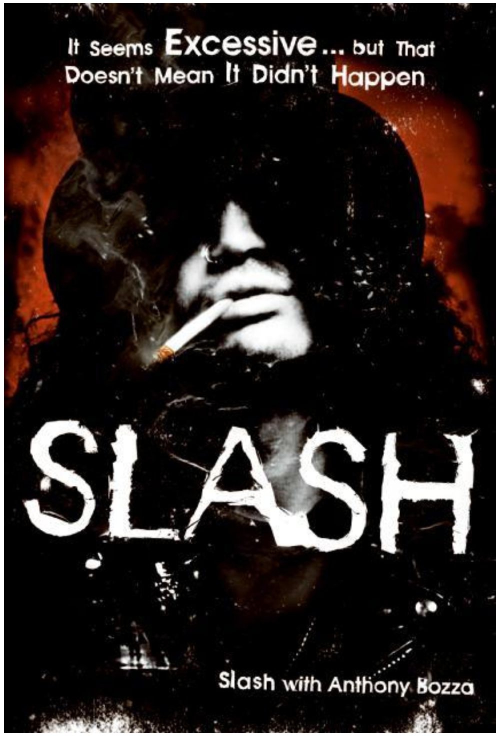
Not between deficit-cutting and stimulus….

But between expenditure-cutting and stimulus.

Because government <u>not</u> in a position to control its own deficit/surplus – unl

Since government can't control the deficit, trying to reduce the deficit is looking at the problem the wrong way around…..

Who will *cut* the deficit?



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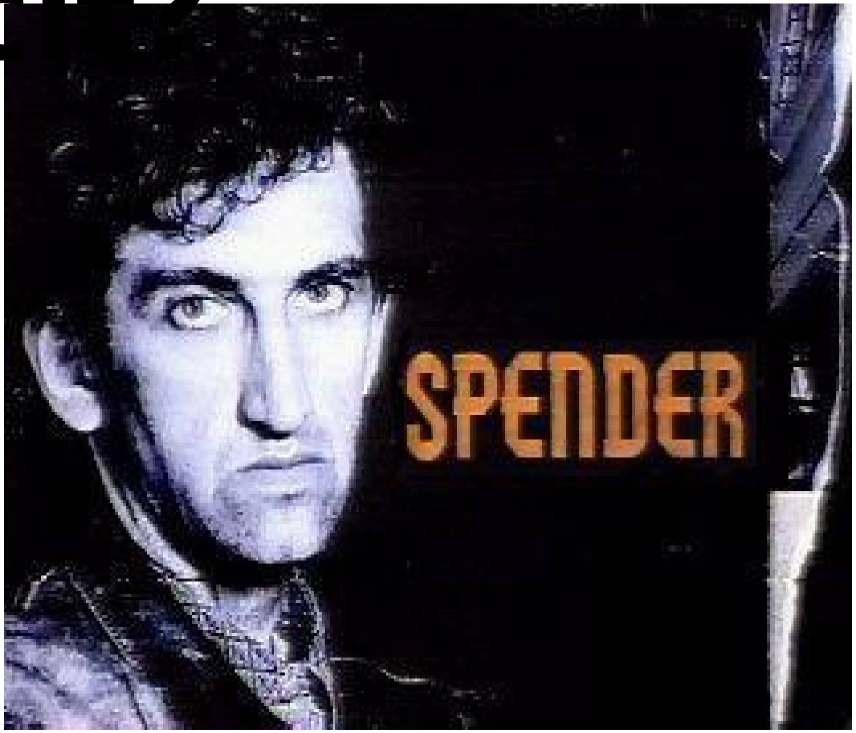


Major risk:

using
***micro*economic**
reasoning
to predict
***macro*economic**
outcomes.

“ Britain has a £109bn a year structural deficit. Let me tell you what a structural deficit is.

........It's like with a credit card.

The longer you leave it, the worse it gets.”

Differences between government budget and credit card balance.

1.Govt can cut spending, but *can't cut*

2. Government can’t go bankrupt – credit card holder can.

3. Government spending generates income (taxes) and saves on benefits and interest rates. Not so for cred

4. Government can conjure money out of thin air – ‘Quantitative Easing’.

Credit card holder
can’t!

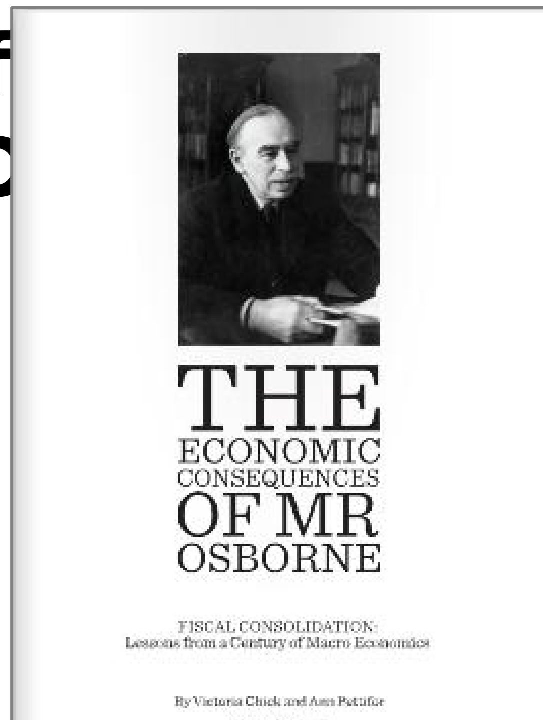
Using QE, the BoE in 2009 created between £175 and £200 billion of new credit. It was not borrowed from anyone, nor was it raised in taxes. It was simply created.

This new money used to buy up gilts (government bonds) from investment banks. The banks receive new money (deposits)

Government deficit, therefore financed by *domestic* finance.

Giving the lie to: ‘Bond Holder Vigilantes raising interest rates’ – a red herring!

Prof Victoria Chick's and my research shows: Fiscal consolidation (spending cuts) <u>increases</u> rather than reduces the level of



t as a share of GD

Note:

- Public expenditure is measured as the final consumption and fixed capital formation of central and local government; transfer payments are deliberately excluded;
- public debt is measured as a share of GDP;
- interest rate figures are for the yield on long-term government bonds; and
- the unemployment rate is used as

Annual Average % Change in Govt. Finances

Period	Expenditure	Debt
1909 -13	4.3	-1.5
WW1 1913-18	62.7	17.4
1918-23	-20.9	13.2
1923- 31	2.2	-0.9
1931-3	-5.4	5.0
1933-39	18.3	-7.0
WWII 1939-44	38.1	10.6
1947-76	10.1	-6.8%

Public Spending expands 1909 – 13

Year	Public Expen £ Million	Exp as % of GDP	Public Debt as % of GDP	Interest Rate	Real GDP growth	Unemployment rate
1909	197	9.2	33	3.0	3.3	7.7
1910	206	9.2	33	3.1	3.5	4.7
1911	211	9.1	30	3.2	2.3	3
1912	221	9.3	29	3.3	-0.3	4
1913	233	9.3	27	3.4	5.2	3.6

Contraction: post-WW1 and the ‘Geddes Axe’, 1918-23

Year	Public Expen £ million	Money GDP £ mill	Expenditure as % of GDP	Public Debt as % of GDP	Interest Rate	Unemployment rate
1918	1850	5243	35.3	114	4.4	0.8
1919	968	6230	15.5	136	4.6	6
1921	648	5134	12.6	150	5.2	16.9
1923	483	4385	11.0	180	4.3	11.7

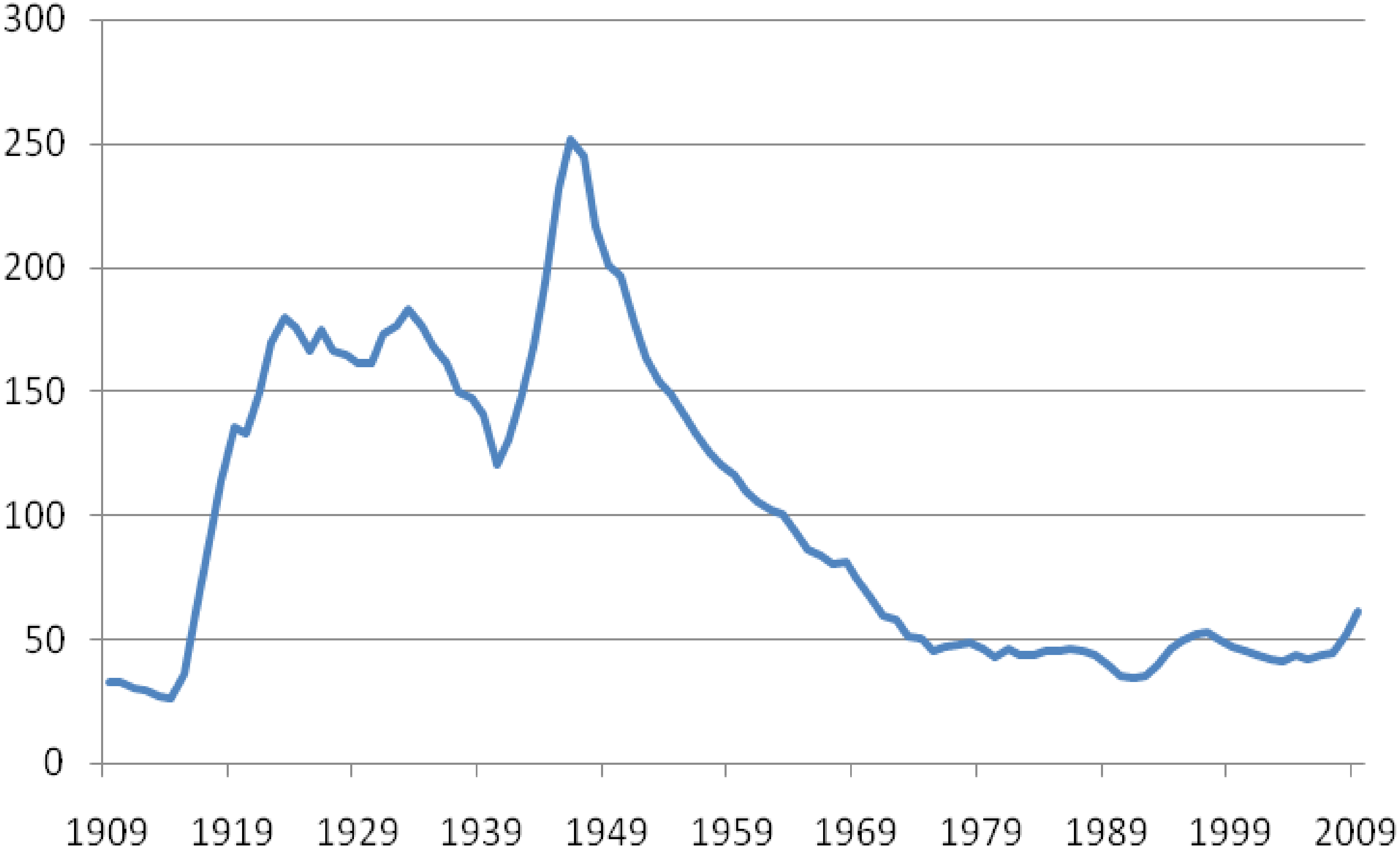
Public Spending expands: 1933-39

Year	Pub Expen £ Mill	Nom GDP	Expen as % of GDP	Public Debt as % of GDP	Interest Rate	Unemployment Rate
1933	514	4259	12.1	183	3.4	19.9
1935	591	4721	12.5	168	2.9	15.5
1937	782	5289	14.8	150	3.3	10.8
1939	1359	5958	22.8	141	3.7	9.3

The Long Expansion

Average over years	1947-1976	1976-2009
Govt expend (%of GDP)	22.7	22.5
Change in public debt (%)	-6.8	+0.6
GDP (real growth)	2.7	2.2
Unemployment	2.3	7.7
Real interest rate	0.9	2.5

Public Debt as % of GDP



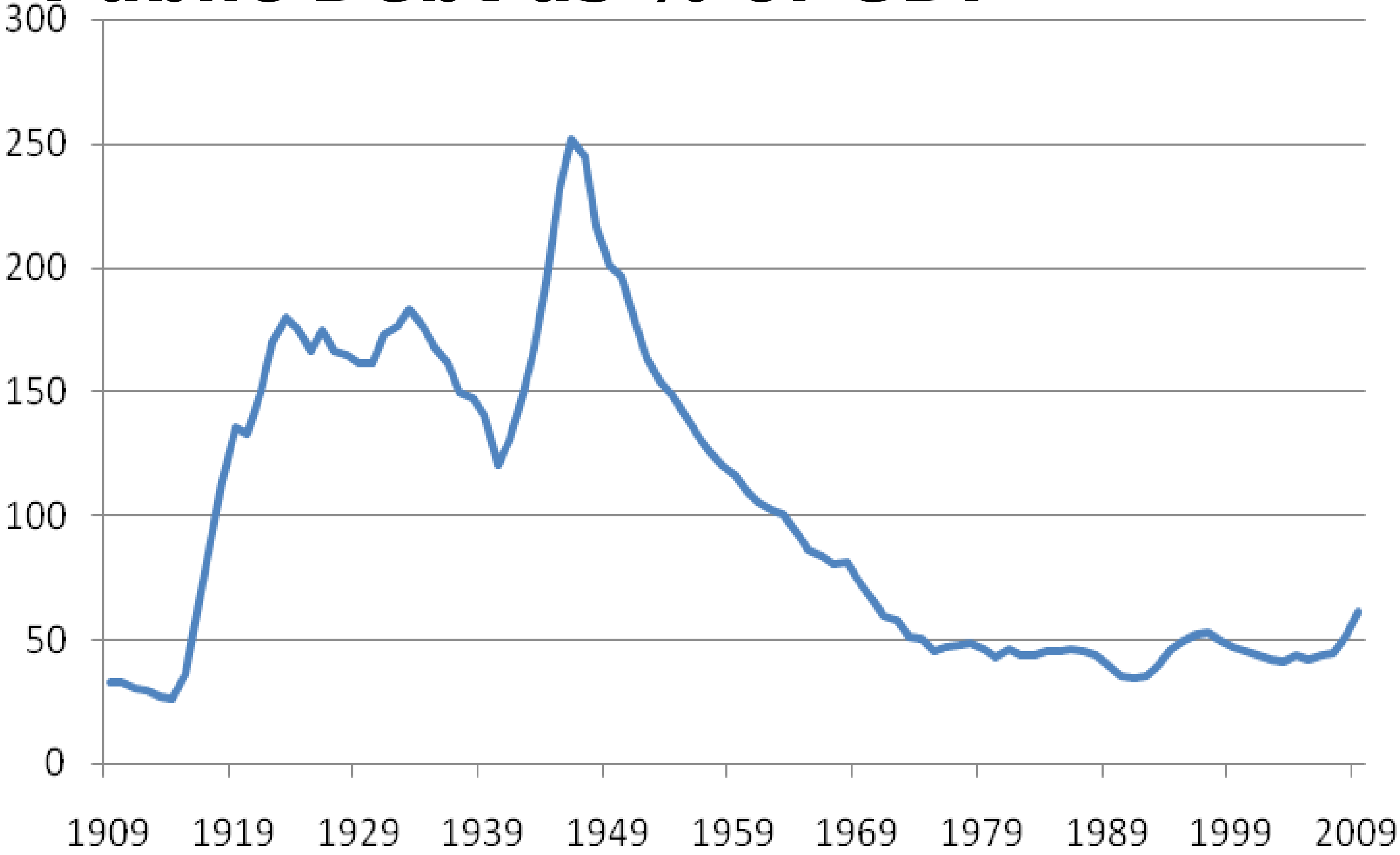
1946: Labour Govt S[illegible]ng

NHS

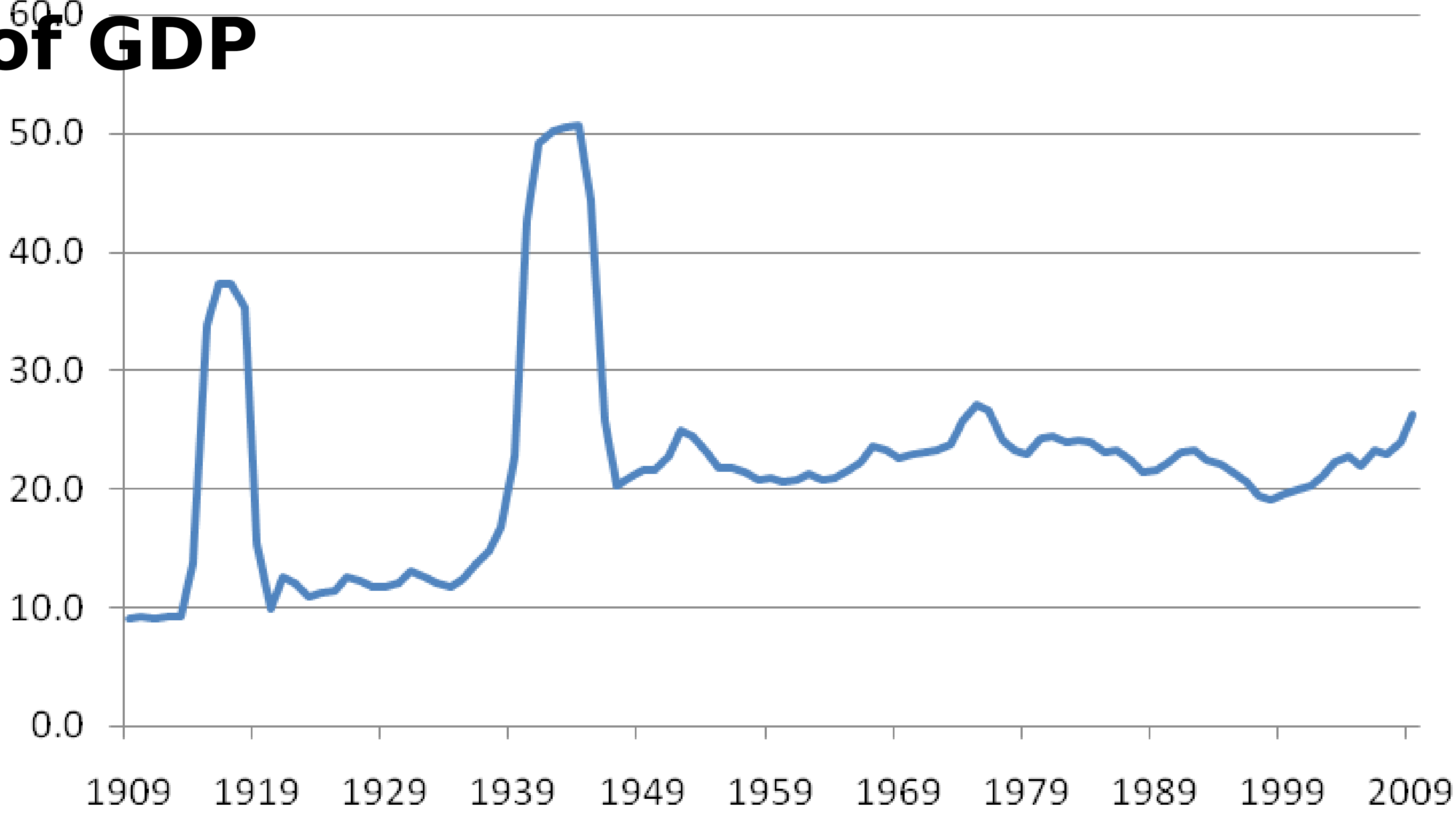
Public Housing

Butler Education Act 1944

Public Debt as % of GDP



Public Expenditure as a percentage of GDP



Since government can’t control the deficit, trying to reduce the deficit is looking at the problem in the wrong way …..

The way to reduce a deficit in a time of unemployment, climate change and peak oil is to spend (preferably wisely on e.g. green technology) to promote energy security, climate security and job security.

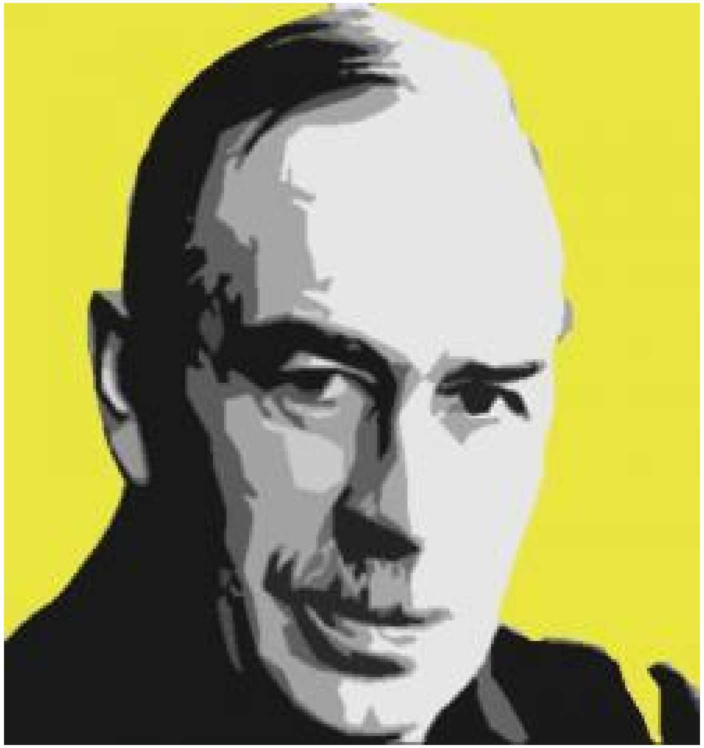
<u>The Gre</u>
foundat

In monetary economies, the relevant consideration is the availability of finance, not savings, *and there need be no constraint on finance*

Credit, unlike gold or oil, not a commodity and so not subject to the laws of supply and demand. *There need be no limit to its creation*.

Because credit not subject to supply and demand, its price – or the rate of interest – necessarily *a social construct, and should be low*.

Therefore: employment not constrained by finance/income: income only earned through



Keynes looked through the telescope the right way round: **‘Look after the unemployment, and the budget will look after itself.’**

Thank you

Ann Pettifor

www.debtonation.org

Debtonation: The Global Financial Crisis

Recommended Reading:

"The Economic Consequences of Mr Osborne" – Professor Victoria Chick (University College, London) and Ann Pettifor (PRIME). (www.primeeconomics.org)

"**The Cuts Won't Work"** – Green New Deal Group (including Ann Pettifor) published by the new economics foundation. (www.neweconomics.org)