

Robert Peston's Questions

This paper was written in response to four options suggested by John Reader from Robert Peston's 'The New Capitalism':

- ❖ A process of readjustment and rebuilding of confidence until there is a return to "business as usual" and perhaps a slightly more regulated form of "turbo-capitalism", "impatient capital" etc. This will be achieved in the short term by the recapitalisation of the banks and the use of Keynesian strategy of governments injecting capital into the economy through public spending on infrastructure.
- ❖ A more radical reconfiguration of capitalism which might be based on non-financial values and non-economic drivers playing a more significant role in both financial and business sectors – this raises the question of how faith-based groups might contribute to such a process. Possibly environmental values might have an opportunity to influence future policy directions. So this would be a more benign capitalism, a more humanised form in contrast to the values and methods of the "old" Washington consensus.
- ❖ The reconfiguration might mean a return to the economics of the 1970s before the advent of Reagan and Thatcher and their apparent espousal of Milton Friedman, monetarism etc. The image for me is of a fire that has been stoked too high and gone out of control and is now being seriously dampened down but will continue to burn less fiercely at a lower and possible more sustainable level. So rates of growth of national and global economies will fall – risks then of a less dynamic economic system, deflation.
- ❖ A more drastic collapse of the current system where all attempts to reconstruct it fail and no one clear alternative emerges. Nations resort to protectionism in order to salvage what they can; no global attempt to create a more prudent regulatory system succeed as national interests predominate. Some will be better placed to ride out the crisis than others but this will lead to heightened political tensions and differences.

Of the four options outlined nos. two and four seem more likely than one and three. The sheer scale of the meltdown makes it unlikely that we can return to the status quo with just some minor additional regulation (option one). The rhetoric at the moment about getting people back into work quickly is to let people down gently, but the scale of financial carnage is so immense that banks are unlikely to be able to find the money to borrow on the scale that would be needed to return to how we have been. Given their much weakened state few of those who have funds which they might lend to the banks would trust them with their money, hence the seizing up of the financial markets. More widely, we are coming towards the end of the western financial and political hegemony and a shift of power to the East – effectively we have been trying to sustain the Western way of life (to an obscene degree) on credit when the fundamentals wouldn't support it. Hence the huge bust now. For the past 20+ years real incomes (of ordinary people) in the US have been flat and so the only way to expand the standard of living is through credit. Because of the shift of power from labour to capital with increasing asset prices (especially of houses) many in this country have been forced to support their standard of living with two incomes and/or have then done so by equity release from the value of their houses, which, of course, they then have to repay over a long period due to their increased indebtedness (or else sell the house and move into something smaller).

Option three of a return to the large-scale regulation of the economy that existed up until the 1970s seems unlikely. We are in a different place to the regulation to tame the swings of the market also espoused by Keynes in addition to his better known counter-cyclical fiscal policies. Although the G20 conference of April 2009 will have proponents of greater regulation of the global economy, especially from Europe, it is unlikely that we will return to anything like the Bretton Woods arrangements. With thirty years of deregulation still part of the mindset some extra rules to tie down 'bankers' may be sought, but the global economy is so complex and wide-ranging that few

can see how to control it, and we have yet to suffer the economic carnage of the thirties and the trauma of WWII to feel that such a level of regulation is necessary. Most of the regulation so far proposed seems to be adjusting the present system (e.g. Turner's report on revamping the FSA) not about asking fundamental questions about the purpose of the financial system and how it can be best organised and regulated.

Whether then we end up with option two or option four remains to be seen. It is unlikely we will have a V-shaped recession (i.e. a sharp dip with a return to normal fairly quickly), effectively option one, for the reasons outlined above. The optimists are suggesting we will have a U-shaped recession (i.e. a rather longer bottoming out before a recovery takes place). Some are hopeful of an improvement in late 2009. Most commentators think we are more likely to be looking at 2010 at the earliest. If there is a general election and the Conservatives win because Gordon Brown's medicine hasn't worked quickly enough and then slam on the brakes by restricting government borrowing or cutting spending to balance the budget then the recession could go on for a lot longer and there is a real danger of it turning into a slump – unless we really do see a pick-up in activity, in which case finely balanced slowing down might be needed to prevent inflation taking off. There are a lot of other dangers of recession turning into a slump as well, not least if we do end up with deflation or if no one can overcome the lack of lending so not just credit but liquidity dries up. Some companies will go to the wall because they are unsound in one way or another (e.g. most obviously Woolworths) but from what I have heard from my local Chamber of Commerce and others there is a real worry that smaller companies (and probably bigger ones too) which are perfectly sound could fail because banks are pulling in overdrafts and other credit lines or re-pricing prohibitively. There is a flight from risk which it could be argued is an over-reaction. Banks are in a bind at present because they need to build up their balance sheets and capital ratios whilst being under pressure to keep lending. The trouble is the money to supply the lending is not there with the collapse of the wholesale market. Rates are still high too (despite reductions in bank rate) because the interbank Libor rate is still higher because of fear, depositors still need reasonable rates to attract them to save, and banks tend to add a premium over base in bad times because of the generally more risky environment.

All the government's attempts to 'bail out' the banks have been of limited success because of their need to rebuild their balance sheets and capital ratios and because of the disappearance of many foreign banks from the UK lending market. This has been exacerbated by continuing anxieties about losses from toxic assets that can't be priced hidden in bank's balance sheets, which have necessitated the various guarantee schemes the government has subsequently had to offer. The numbers involved are hard to comprehend and the risks are uncertain.

None of this bodes particularly well for the future. The rhetoric is still about getting people back into jobs as quickly as possible, because to say any other would be to invite an outcry. The Government's and other agencies' views are undoubtedly different to the early '80s so that now there is a whole raft of supply side measures to enable people to be helped towards vacancies and to retrain, for example, the regional task forces (see Appendix 1) and the LSCs have many schemes they are bringing forward. The biggest question is whether demand can be built up and this is where the debate over the whole Keynesian issue comes in.

Firstly, one has to distinguish between Keynesian counter-cyclical easing of financial conditions to reduce the effects of a down-turn from accusations of more of the same lax credit as we have had for the past few years. That is where I think the Archbishop of Canterbury and other church leaders may have been mistaken in some of their comments around Christmas-time, though I agree with

their Advent-tide theological sentiments. What almost all Western governments are trying to do is prevent a deeper recession by effectively putting money into the economy because the consumer is not; either by public spending or by giving money to the consumer who would not otherwise have it, by tax breaks or through central banks by lowering interest rates. One can argue as to which will be the most effective. Public spending, particularly public works have time lags built in and the need is for a faster response; giving consumers extra money risks them saving it or paying off accumulated credit rather than spending it.

This takes us, secondly, to quantitative easing, where central banks buy up long term government bonds (and possibly commercial bonds too), putting up their price and reducing their effective interest rates. Now that the short term bank rate is almost down to zero this is the next place to go in the Keynesian scheme of things, as we are now seeing. It brings down other longer term interest rates such as fixed rate mortgages and again has the effect of increasing the money supply. The big fear with all these measures that increase money supply is inflation. In the short term with GDP falling this is not an issue but there must be a real concern for the longer term, especially given the lags in the system with all these measures that means it is difficult to be sure of their effects and whether they might actually overshoot what is required. Lowering interest rates also has the effect of depressing the exchange rate because of the outflows of capital, depending on interest rates elsewhere, which is also inflationary. On the other hand this should give a boost to exports, provided there is demand elsewhere, and reduce imports, particularly of consumer goods, thus rebalancing the economy and the balance of payments.

The third Keynesian policy option is increased public works as in the Roosevelt New Deal, which President Obama seems to be very keen on. Again, this is necessarily a long term measure, though it also has the merit of rebalancing the economy (unless you are an American conservative) away from excessive reliance on the consumer and rebuilding the infrastructure (which seems to be in a parlous state in some parts of the US), which should also enable the economy to function more efficiently. Some argue that putting public money into affordable housing schemes would both help the housing crisis and produce a quicker economic impact than other public infrastructure schemes such as building schools or roads.

The concern with all this is that one day it has got to be paid for, as the Conservatives were arguing earlier in the year. This also seems to be reflected in the position about the level of fiscal stimulus required of the Germans and others in the run-up to the G20 Summit. It may reflect anxieties about finding themselves bailing out the rest of Europe, but perhaps also reflects a more cautious outlook. The sense, though, that we have done enough for now flies in the face of the arguments of Keen in John Reader's paper on this website, which argues that the unwinding of the positions of the financial system will be so massive that any fiscal stimulus will be inadequate. Discovering which of these arguments is wrong could be an uncomfortable experience. Two responses to the need for the present fiscal stimulus needing to be paid for would be that monetary policy will be tightened when an improvement begins (hence the Government's tax increases in 2010) and that once the improvement does come greater prosperity will help pay for it. We hope we don't reproduce the slump of the thirties but we might also remember the boom of the fifties. However, if we are not to go back to boom and bust and not to reproduce a return to how things have been with option one, we need to find a via media, which might be like option two.

If we are to avert a slump of option four and move towards the more balanced economy of option two we need to pave the way in the policy decisions now being made. Some things are already being talked about like the greening of the economy with many new jobs in energy conservation

financed in part at least by government spending. This hopefully means that any upturn will not simply result in worse climate change – though it seems there is a long way to go in terms of joining up the thinking in this area. There seems to be a more humane attitude to those who become unemployed with the help in getting back into work that I have alluded to above, but this will have to be maintained in more difficult circumstances. The attitude to the long term unemployed and those on incapacity benefit and single parents, which seems to be more of a response overtaken by events to an overheating economy with labour shortages, needs to be modified to help rather than punish people. For we will have many more long-term unemployed, if this is defined as more than six months or a year, if as seems likely we hit three million in 2010. All those people are not going to get back to work quickly – even accepting that this is not a static population.

This, however, is in the short term and all that has gone before is a long preface to saying what sort of principles ought we to be constructing the new capitalism? Of course, analysis is easier than prescription. So I ask the question, what might be some Christian principles? In the light of Peston's book 'Who Rules Britain?'¹ which sets out the vast inequalities and distortions to the British economy of the growth of the financial sector over the past 10+ years, if one were being biblical, might one look at the Jubilee principle in the Old Testament or perhaps some of the prophets like Amos and Hosea. I suppose in the New Testament the Beatitudes or the Magnificat, Jesus in the Temple in Lk.4 or Galatians 5 and Colossians 3 might be a starting point, but they are a very long way to enabling us to be able to say anything that translates into what the present world would comprehend.

John Atherton in his paper on this website refers to middle axioms, and so what sort of principles might we want to express as the basis of any suggestions as to how the new capitalism might function? For as has been recently said by the Bishop of Worcester, among others, vision without values is pretty worthless. Is there anything in developing the notion of Faithful Capital and the theological principles underlying it as set out in 'Faithful Cities' and trying to develop social capital. It was interesting to hear the Chief Executive of the Community First, the (rural) community council for Herefordshire and Worcestershire suggesting that an enhanced role for the community and voluntary sector in helping those in need in the difficult times ahead might make us more aware of the social capital this sector provides (of which, though he didn't say it, the churches are to some degree a part).

In 'A New pact to Re-establish the International Financial System' (reported in the Church Times, 12 December 2008) the Vatican says that ethics are not something extra to the economy: they are 'essential, and must be constantly take into consideration and really make a difference.' It continues, regulations are not enough, people need to be re-educated, which should be based on the social doctrine of the Church that includes the universal common good and giving work priority over capital. Investments should be directed towards 'real' development. Only when money was invested in sustaining work in the real economy could there be any hope of a healthy financial system. Going back to Peston's book, there is a real question here about what the financial system is for, given the argument that can be made (Chapter 5) that hedge funds and the like are about making the system perform more efficiently and therefore allocating capital more effectively, which is for the overall economic good. On the other hand it is hard to escape the sense that much of this is incredibly sophisticated financial gambling on almost any product you care to think of, which seems to do little other than make some people obscenely rich. The Governor of the Bank of England has spoken of separating 'casino banking' from ordinary banking services.

¹ Robert Peston, Who Rules Britain?, Hodder and Stoughton, London, 2008

In a similar vein to the Vatican report, the Archbishop of York in a lecture at the Royal Society (reported in the Church Times, 28 November 2008) says that the road to recovery is not 'a path to riches, but to service.' He continues, 'The opportunity which is before us as a nation is to use this time of crisis to create a renewed shared vision of community, based on service rather than caring for number one, on covenant rather than contract, on duty rather than entitlement.'

If these might be something of the sort of values that could underlie a renewed capitalism, we then have to ask what it might look like? Madeleine Bunting in the Guardian (15 December 2008) after talking about *kairos* as both the origin of the word chaos and also that moments of crisis which are decisive suggests that this could be an opportunistic moment when boldness is needed (akin to the New Deal). The pendulum swings back and forth between public purpose and private interest and we could be entering a time when it is not just possible to reassert public purpose but necessary and effective. 'We are all in this together' may be the only appropriate political imperative involving a proportionate sharing of the hardship as the only strategy to contain anger and ensure a degree of social stability. Some of the practical suggestions include giving councils the power to purchase homes at the point of repossession to keep roofs over people's heads; a new national volunteer force to mop up the flood of school leavers and graduates who will be unemployed; doubling the number of staff in primary schools in deprived areas to reduce unemployment and increase standards. These don't sound like much of a programme to me but they might point in the direction of the sort of things that might be done to ease pain and enhance solidarity. An article in the December 2008 ECCR (Ecumenical Council for Corporate Responsibility) Bulletin, 'What now? The future of finance', as well as supporting the kind of green economics point mentioned above and referring to the contrary free-market view about subsidies distorting the market, says that investment must focus on real value rather than bubbles of paper wealth and encourage more sustainable models.

It continues:

'Crucially, the church should continue to stress the importance of the concept of 'having enough' – embracing the example and teaching of Jesus to live simply, in communities that are stable and life affirming, pursuing what is spiritually meaningful rather than more and more material consumption and wealth. Many faith-based investors will have been involved in micro-finance, and much can be learned from their conservative and ultimately more responsible lending models.

We should now push for wider acceptance of the UN Principles for Responsible Investment, promoting long-term responsible shareholder ownership. And let us not forget the pressing needs of the Millennium Development Goals. Aid budgets, already small, must not be cut back. Our duty is to deliver sustainable growth to developing countries, not pass on the shock from our financial excesses.

The church and its investors can also make a key contribution by promoting the kind of economic growth that contributes to social equality. Our values must now be worked out in practice – in our lives as workers, investors and community members – with renewed vigour. Among those who campaign for change - whether on the environment or social justice - the complaint has often been that people in power are not listening. Now that our political and economic leaders are desperately seeking sustainable solutions, faith-based investors should speak up for a more just, values-led system of international trade and finance as if people and planet mattered.²

² Matt Crossman, 'What Now? The future of finance', in ECCR Bulletin, December 2008, ECCR, Oxford

It is clear that a number of people are beginning to think around what some form of new capitalism, or at least how we might get through the next year or two without too much social destruction, might look like. Our debates within the churches about the basis of what that looks like are important for us, but I am aware of Malcolm Brown's view (in Putting Theology to Work) that the world has moved on from when 'Faith in the City' and 'Unemployment and the Future of Work' were written, reinforced by the challenge to prophecy of 'Exit, Voice and Loyalty' as set out in 'Moral, But No Compass'³ so we need to think carefully about how our voice might be heard in the places of power and policy development.

Appendix 1

The West Midlands Regional Taskforce (and there will be one for each of the Government Regions) is to coordinate responses to mitigate the effects of the slowdown. The difficulty they have is that compared with the Rover Taskforce in 2005 it is more difficult to know where the problems are when spread across many firms across the region. It is acting in six ways:

- a. Business support (construction, automotive, retail and finance are hardest hit in the region).
- b. Workforce retention, e.g. wage subsidies for short-time working and the high level rapid response team from Jobcentre Plus with big redundancies – though there are fears about resources if it gets bad in the New Year.
- c. Infrastructure development – bringing forward capital spending to create more work, procurement practices of public agencies to keep money in the region.
- d. Communities – those already hardest hit will be hit worst again. There is also concern about the rural areas that are most vulnerable.
- e. Monitoring and early warning of when people or places are in trouble. A risk register will be compiled of those firms/places that are fundamental either for the future, or to heavily dependent communities, or which have extended supply chains. Support will be prioritised.
- f. Communication both in finding out what is happening and in telling people about help available.

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³ p 36-38 Francis Davis, Elizabeth Paulhus and Andrew Bradstock, Moral, But No Compass, Matthew James, Chelmsford, 2008