Alternatives to austerity

The need for a public utility finance system

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The Great Credit Crunch of 2007–10 was, it is almost universally agreed, brought about by the irresponsibility and greed of bankers. But the huge public deficits needed to prevent a meltdown of the financial system are to be paid for by slashing public spending and shrinking social protection for many decades to come. The welfare state is to be dismantled at a time when higher unemployment and an ageing population make this a certain recipe for misery. The cut-backs are a gamble which makes recovery more difficult but has one certain result – a boost to the privatization and commodification of pensions, health and education.

For the last two decades neoliberals have been insisting that disaster would ensue if we did not have a bonfire of social entitlements. Public pensions were declared to be a nightmare in the making. Now the disaster has happened – because of the vices of financialization not the burden of welfare. The disease had quite different origins and causes from those that were forecast by the doom-mongers, but the medicine needed for this incapacitating ailment is just the same as before.

It is truly astonishing that a crisis caused by the bankers has to be solved at the expense of nurses, teachers, students, pensioners and the unemployed. The bankers are still widely thought to be culpable but few dare to defy the money markets and international financial agencies. Fear of the bond markets is excessive but not irrational. Countries that forfeit the confidence of the markets immediately find borrowing more expensive, but the clincher is that if confidence continues to plummet then default and bankruptcy loom. As citizens of Argentina discovered in 2001, businesses collapse, everyday life becomes an obstacle course and savings are wiped out.

But while it is rational to take the markets seriously, this should not mean capitulation before their false alternatives and truncated perspectives. Just as the draconian cuts menace hopes of recovery so the new regulatory requirements laid on the banks are pathetically inadequate and do little to prevent future financial crises.

The Left's response to the crisis has to be positive as well as negative. It must reach out to alternatives, and these should centrally include the establishment of a public utility finance system, the levying of taxes on capital, the building of local networks of democratically controlled social funds and a programme of diversified development. The aim of this package would be to stimulate investment-led growth, foster sustainability, encourage the formation of human capital, and yield a growth of productivity.

Before explaining what these measures might involve, it will be helpful to identify the features of neoliberalism which ensure that it fails even as it succeeds in gaining access to new sources of profit. The IMF and World Bank have aggressively promoted commercialization of pension provision, as Mitchell Orenstein has shown in his recent study *Privatizing Pensions*. Between 1994 and 2008 thirty countries in Latin America and Eastern Europe were persuaded to abandon their public pension systems and replace them with personal pension funds managed by commercial finance houses. The international agencies resorted to shameless bullying and what Orenstein politely calls 'resource leverage'. As he explains, countries in the midst of a difficult transition to democracy were denied all financial assistance unless they agreed to pension privatization. In addition funds were made available by the World Bank to carry through campaigns of public persuasion, and key individuals were offered inducements and attractive employment if they went along with the process.

Pensions crisis

The success of this campaign for pension privatization has proved a comprehensive disaster for the countries concerned. The rocky state of stock markets has meant that the promised accumulation targets have been missed by a mile. But even in periods where stock markets grew, the commercial funds suffered from exaggerated cost ratios. This is a central defect of the financialized model. Universal public schemes do not have the expense of marketing and customization that plague private provision. In an attempt to solve this problem countries were often persuaded to make participation compulsory, but the cost disease problem has remained. This is because either there is no effective competition, in which case the suppliers exploit their monopoly position, or there is competition ('choice') and an expensive marketing war between rival suppliers.

Other problems that beset the commercial provision of financial services are information asymmetry as regards contributors and information deficits as regards investments. On the one hand the finance houses have much more information than their customers and use this to secure advantages over them. On the other hand the Anglo-Saxon banks fly far above the ground level at which small and medium businesses exist and have no rational criteria to inform their credit decisions. Think of their folly in accepting so much exposure to subprime mortgages. Today a similar problem arises with respect to their reluctance to make any productive investments.

British and US savers have long experience of all these problems and have not been able to identify an effective remedy. Two problems are worth signalling since they go to the core of the neoliberal regime. The advocates of neoliberalism have been – as Peter Mandelson, the 'New Labour' strategist once put it – 'intensely relaxed' about greater inequality. Yet at the root of today's crisis is precisely the poverty associated with this inequality. The credit crunch in the USA was triggered by the breaking of a speculative bubble in subprime mortgages – namely mortgages taken out by poor people ('subprime' borrowers) who could not keep up payments expected of them. And at an international level the poor earnings of Chinese workers and farmers furnish too little demand to the world economy, generate huge trade imbalances and asset bubbles – and consequent threats to growth.

British and US savers now face ruinous shortfalls as a consequence of all the above problems – swooning markets, excessive costs, poor information and ballooning inequality. Yet in the UK the drastic cuts recommended by the Hutton report will push public employees into reliance on private-sector suppliers who are insecure and costly. They will also weaken public-sector pension funds that have a good record, with low cost ratios and at least a few attempts to favour social responsibility. The Hutton report itself acknowledges that public-sector pensions are not 'gold-plated' and that, at current rates, are set to decline as a proportion of GDP. The 'average' public-sector pension is a little over £7,000 and half of all beneficiaries receive only £5,600. Britain's pension problem is that provision is too low and too patchy. The state pension is among the lowest in Europe and half of the huge subsidy going to private pension savers goes to the top 10 per cent of earners.

The recent attempts to widen coverage and improve regulation will make little difference. In the UK many employees are likely to opt out of the new personal pension accounts, and the savings they make are to be managed by commercial suppliers. According to the logic of a 'race to the bottom' it is sometimes asserted that because so many private-sector employees have poor provision, public-sector workers should be reduced to the same unfortunate position. Governments throughout Europe are seeking to impose this dismal proposition. The degradation of public provision leads to 'implicit privatization' as citizens are urged into the clutches of the financial services industry.

It might seem that President Barack Obama's health-care scheme bucks the trend, but sadly this is not so. The scheme was vetted in advance by the insurance industry and Big Pharma. The new scheme offers new business to these interest groups and will lead to escalating costs. To rescue the programme from rising costs it will be found necessary to curtail the service available to patients, and Obama has already cut back what is offered by Medicare to pay for the new programme – robbing Peter to pay Paul.

Investment-led growth?

So what is the best way to tackle all these problems? We should note that elements of a public utility finance system – as in China, Germany and parts of Scandinavia – have proved more compatible with industrial investment. On the other hand public stakes in the banking system are useless unless there is a determination to use them. The US and British authorities have huge majority holdings in giant 'zombie banks' like CitiBank and RBS and yet they have refused to use their power to revivify these concerns and ensure that they make credit available to small and medium enterprises.

If there was a willingness to foster investment-led growth, where could the resources come from and where should they go? The Group of Twenty have been obliged to consider a banking levy and a financial transaction tax, something like the Tobin tax. There is obviously great scope for such levies and they would have the double benefit of restraining speculative activity and raising revenue. While there can be a place for rather modest levies on some types of transaction, the banking levy should not be modest at all. Justice and strategy both demand very stiff measures, tantamount to the socialization of a swathe of the financial institutions. These banks were faced with ruin in 2007–08 and were saved by the public treasuries. For nearly two years the banks have been nursed and mollycoddled by the central banks. They have been able to borrow very cheaply and then lend the money out at very safe and advantageous rates. In some cases they could borrow from the central bank at less than 1 per cent and lend that same money back to the government (by purchasing bonds) at 3 or 4 per cent. Taking only a tiny amount of risk they could lend at 8 or 12 per cent to those with good collateral. Concerned mainly with reducing exposure, they have denied credit to small and medium firms – hence the tenacity of the credit crunch. Thus the British government's Special Liquidity Scheme allowed the British banks to borrow £165 billion at a discount to market rates; bonds floated by the banks worth a further £120 billion were made palatable by a government guarantee.[1] These figures should be borne in mind when considering the proposed annual yield of the levy on the banks in the UK – just £2 billion.

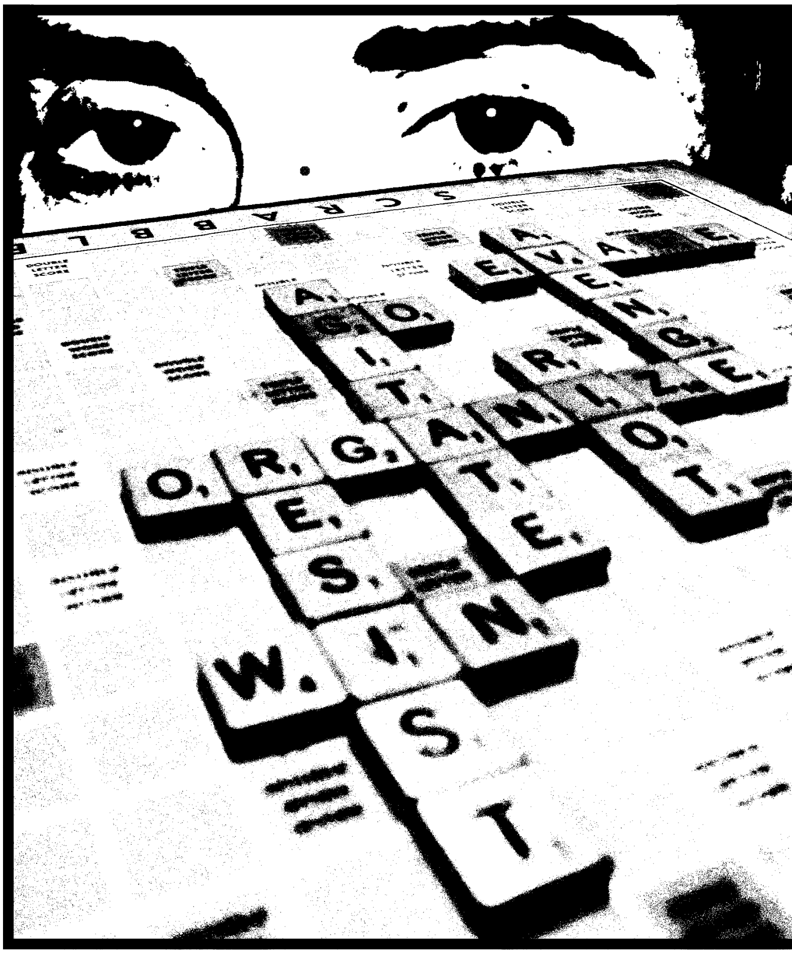
The banks have been so dependent on the taxpayer and public support that there is an overwhelming case for large public stakes. The banks – large and small – could be obliged to issue shares equivalent to 40 per cent of their annual profits to a regional network of social funds. Using these funds as their security the regional funds could then draw up – in association with local elective bodies – a ten-year programme of productive investment, embracing both public and private ventures. Such a programme might include public universities and research institutes, Green energy schemes, and universal access to broadband and other informational systems. The German experience of publicly owned Sparkasse and Länderbank linked to manufacturing, and the *Mittelstand* or medium-sized companies would be well worth studying. Also relevant is the experience of public-sector pension funds in the USA and UK and the Mondragon Group co-operative in Spain, with its special finance arm.[2]

While I believe that this is the best way to finance the emergence of a public utility finance system, other sources of capital might come from a land tax on commercial real estate and a general share levy on large corporations. I have outlined these possibilities in the conclusion to my book *Age Shock: How Finance Is Failing Us* (2006). The key device of the share levy requires corporations to issue shares annually worth 10 per cent of their profits to the regional network of public funds. The shares acquired in this way are not sold, but the dividends they earn are applied to specific social priorities, such as funding pension provision. In Britain another potential source of public funds would be a rebate on the statutory interest payable on capital injected by the private finance initiatives. Some £210 billion of PFI capital assets now earn an enticing rate of interest. Simply reducing the interest rate charged by NHS hospital contractors by 0.02 per cent could save £200 million a year.[3]

The classic device of twentieth-century socialism was the nationalization of industry. In the twenty-first century the key institution may well prove to be a network of publicly owned and controlled financial funds. Private financial institutions are inefficient and risky, in contrast to the potentially greater security, social justice and economy of public finance.

Notes

1. 'Banks on Methadone', *The Economist*, 24 July 2010.
2. For additional arguments along these lines, see Gerald Holtham, 'A National Investment Bank Can Raise our Growth', *Financial Times*, 27 October 2010.
3. Jesse Norman, 'Hard Times Call for Rebate on PFI Deals', *Financial Times*, 17 August 2010.



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