



Speech

# Are we sleepwalking into the next crisis?

**Ann Pettifor**

At the TUC  
12 November 2018

## **Are we sleepwalking into the next Crisis?**

### **Ann Pettifor**

PEF Council member and Co-Director, PRIME

This year is the 150<sup>th</sup> anniversary of the TUC, and the 70<sup>th</sup> anniversary of the Trade Union Advisory Committee (TUAC) to the OECD. As part of the celebration of these achievements, the TUC's Economics and Social Affairs department organised an event "Lessons from the Great Financial Crisis" on 12<sup>th</sup> November, 2018. Several speakers, including PEF Council members Ann Pettifor and Professor Stephany Griffith-Jones, and the Rt. Hon Gordon Brown, were invited to address the gathering of trades unionists, thought leaders and economists. Below is a written, elaborated version of Ann Pettifor's presentation, with added comments that respond to, or reflect on, comments made by others at the event.

The views expressed here are those of the author, and not necessarily those of the Progressive Economy Forum.

# Introduction

Few people will have heard of Thomas Lamont. That is regrettable, as he and his successors on Wall St. are largely responsible for our failure to learn the lessons of the 2007-9 financial crisis. To absorb lessons from the Global Financial Crisis we must tell ourselves the correct story about how we got here, to quote FT journalist, Rana Foroohar. That is difficult because as she argues: “financialisation is the least studied and least explored reason behind our inability to create a shared prosperity”.<sup>1</sup>

Getting the story of financialisation right is difficult. The deliberately opaque and complex activities of the finance sector are designed to obscure. The very nature of money as an intangible, social construct renders finance and financialisation invisible to the public. But if we are to learn lessons from the crisis, and prevent future crises, we must tell ourselves the correct story of how we got here.

So how did we get here, and where are we now?

Gordon Brown reminded us in an earlier [Guardian article](#), but also at this event that “we are in a leaderless world... The cooperation that was seen in 2008 would not be possible in a post-2018 crisis both in terms of central banks and governments working together.”<sup>2</sup>

We must correct one point in that statement: there *has* been leadership and consistent<sup>3</sup> international coordination since 2009. Not by political leaders, but by the world’s central bankers. Thanks to political weakness, they have, since the crisis, taken historically unprecedented and carefully coordinated action to bail out the private finance sector. They have done this by absorbing about [\\$15 trillion of the finance sector’s \(sometimes toxic\) assets](#) (bonds) on to their balance sheets in exchange for liquidity or central bank money (QE).<sup>4</sup> By these actions central bankers have made it possible for the private finance sector to repair their own balance sheets, and to use the liquidity to engage in further speculative activity.

This international coordination saved the finance sector, but not the world.

Instead, as Gordon Brown warned, we are sleepwalking into the next financial crisis.

---

<sup>1</sup> Foroohar, R. (2016) *Makers and Takers: The Rise of Finance and the Fall of American Business*. New York, NY: Crown Publishing Group. (p. 25)

<sup>2</sup> Elliott, L. (2018) “The world is sleepwalking into a financial crisis” – Gordon Brown’. *The Guardian*, 12 September.

<sup>3</sup>

<sup>4</sup> Allen, K. and K. Fray (2017) ‘Central banks hold a fifth of their governments’ debt’. *Financial Times*, 15 August.

# Back to 1919: reviewing the last 100 years of monetary theory and policy

Yesterday, people around the world commemorated the ending of the First World War. We do that because to understand how we got here, it helps to review the past and to place our present predicament in a wider context. So this last weekend's commemorations of one hundred years since the signing of the 1918 armistice provides a useful starting point. I choose to begin the financial story in 1919 – and to locate it in Paris, at the Palace of Versailles. It was there that victorious Allies negotiated the notorious Peace Treaty of 1919.

John Maynard Keynes, a member of the British delegation, played a key role in the negotiations, as Eric Rauchway documents in his book [The Money Makers](#) (2015).<sup>5</sup> Rauchway paints a vivid picture of the streets of Paris on a key date at the height of the negotiations:

*On May Day 1919... the city's workers had agreed to a general strike, and to these squares they came, on behalf of the revolutionary ideals of 1919. Some signed their names to cards saying they were striking for an eight-hour day, for a just peace, and for an end to the Allies' ongoing military expedition to Russia, where the US, the UK and France had sent soldiers to fight against the Red Army...*

*[S]ocialism certainly propelled some workers into the Paris streets that day... (They) took to the streets of the city in the name of socialism, but they were also demanding what they thought they had just fought a war for: better working conditions and a just, and lasting, peace...*

*From around the city came the sounds of gunshots, and ambulances. After the fighting stopped, diplomats who ventured into the streets had to step over, or around bodies. (pp. 2-3)*

While the streets of Paris were chaotic, there was turmoil in Germany. The humiliation of the armistice signing had led to a naval uprising, the forced abdication of the German Kaiser, and to the election of revolutionary councils. And by then the Bolsheviks were firmly entrenched in Russia.

Keynes was well aware of the dangers posed to capitalism at this pivotal moment in economic history. To prevent further bloodshed and violence, and to block the emergence of Bolshevik-style governments in Europe, it was necessary, he believed,

---

<sup>5</sup> Rauchway, E. (2015) *The Money Makers: How Roosevelt and Keynes Ended the Depression, Defeated Fascism, and Secured a Prosperous Peace*. New York, NY: Basic Books.

to resolve debts and to restore employment, incomes and economic stability to Europe.

He set about producing a simple, but nevertheless revolutionary plan for [the rehabilitation of Europe](#).<sup>6</sup> It was a back-of-an-envelope plan, constantly checked and amended as he improved his understanding of German and Allied economies' assets and liabilities.

Central to his plan was his understanding of money as a social technology, rather than 'real exchange' based on barter.

The problem he addressed was this: the Germans owed the British money but had no capacity to pay, nor capital to invest in reconstruction of those assets that would generate income for repayments of debts. The British owed the Americans money, but they too had no capacity to pay unless the Germans paid – which they could not.

His “cunning plan” can be briefly summarised as follows:

- Germany would issue £1 billion in bonds.
- The bonds would pay 4% annual interest.

“[T]he prostrate Reich could use the bond market to raise finance to pay most of what it owed in reparations and debt”.<sup>7</sup>

- There would be a 1% sinking fund to retire (repay the principal) by 1925.
- 70% of the money raised would go to reparations.
- 30% was for reconstruction.
- The bonds would have priority over all other German obligations.
- Enemy nations would guarantee them jointly & severally.
- The US, UK and France would guarantee 20% each
- The League of Nations would impose penalties or foreclosure if Germany defaulted.

The bonds would be acceptable as payment between Allied governments and as first-class collateral at central banks. In other words, they could act as a form of inter-governmental currency or ‘money’ – backed not by gold, but by the economic strength of Allied nations. In this sense, Keynes’s idea was revolutionary, the first step in the abandonment of the gold standard. But Keynes was thinking even more ambitiously:

---

<sup>6</sup> Rauchway, E. (2012) ‘Some notes on Keynes’s 1919 “grand scheme for the rehabilitation of Europe”. *The Chronicle*.

<sup>7</sup> Rauchway, E. (2015) p. 10

he hoped that in the future the Allied-backed bonds would form the basis of a new international reserve currency.

The Germans could use the bonds to raise finance for debt repayment and reconstruction. The French could use the bonds to pay debts to the British and the British could use them to pay debts to the Americans. His plan included provisions for other Central Powers and new nations to issue similar bonds, similarly secured by richer allies.

## A revolutionary plan

The key point of the “*Scheme for the Rehabilitation of European Credit and for Financing Relief and Reconstruction*” was this: it redesigned and reconceptualised the world’s economic and financial architecture. It proposed a new *international* financial order based not on bars of gold, but on economic strength and *public authority*. It was a plan that would permit domestic economies to be restored to stability and prosperity within a sound and very necessary *international* framework. His ‘Scheme’ was a radical departure from the “architecture” of the gold standard, that “fantastic machinery of global self-regulation by international bankers and financiers”<sup>8</sup>. A system in which the ‘invisible hand’ played a pivotal role in cross-border capital mobility, in the allocation of finance and in determining interest and exchange rates. In other words, the gold standard was a system that stripped elected policy-makers of the monetary tools and powers needed for the management of their economies.

The revolutionary element of Keynes’s plan was that it replaced a system governed by the *private* authority of financial markets with one governed by the *public* authority of states.

He sent his proposal to the British Treasury and to the Prime Minister, David Lloyd George. They enthusiastically backed the scheme and proposed it to their allies, including President Wilson of the United States. The President rejected the proposal outright, for fear, it was said, the Americans might be left “holding the bag”. Keynes agreed that might indeed be so, but America could afford to. It had not incurred foreign debts to finance the war, and had profited immensely from it, thanks to both foreign lending by Wall St. and increased munitions exports to warring Europeans. Furthermore, if the American economy was to remain buoyant, then it was vital for American goods to find export markets abroad – and for those exports to be financed.

---

<sup>8</sup> Block, F. (2001) Introduction. In Polanyi, K. (2001 (1944)) *The Great Transformation*. Boston, MA: Beacon Press. (p. xxx)

Unbeknown to Keynes, but recently revealed by Rauchway, Wilson's letter of rejection was not by his own hand but was drafted by the Chief Executive of J P Morgan, Thomas W. Lamont – described in his biography as *'The Ambassador of Wall St.'*

When Wilson seemed to write about “the desirability of post war lending going through ‘the usual private channels’, it was the voice of the usual private channels speaking about its own desirability”.<sup>9</sup>

Lamont would have objected to any proposal that prioritised Allied-backed bonds “over all other obligations”, meaning private bank bonds, as his bank J.P. Morgan had massively expanded its foreign lending to governments during World War I.

The consequence of the American decision to reject Keynes's Scheme were to be catastrophic, and, as the years passed, must have caused him great personal as well as professional anguish. The gold standard was restored – followed by bouts of credit inflation and debt deflation. The 1920s and 30s witnessed mass unemployment and industrial unrest. Post war industrial production in the USA peaked in January 1920 as the economy moved into a major depression, with production levels dropping by 32.5% by March 1921.<sup>10</sup> After the 1920-21 bust, Wall St bankers financed the “Roaring Twenties” boom – and the massive inflation of debt. This was followed by a debt deflation, the Wall St. Crash and the Great Depression. In Europe, economic instability, unemployment, deflation and austerity led to the rise of Fascism, and culminated in a devastating World War.

Worldwide there were further consequences. Monetary hegemony passed to the United States. Central banks were made independent of political authority. Capital markets were liberalized. High, real rates of interest prevailed. And the UK was burdened by a colossal and crippling War Loan of £2 billion issued at 5% annual interest.

Thankfully the agony was extinguished in Britain in 1931 when Britain's Conservative government suddenly abandoned the gold standard. Then in 1933 on the first night of his inauguration, President Roosevelt began dismantling the American gold standard.

The consequence of these decisions was that both Britain and the United States turned away from austerity, deflation and the threat of nationalism and fascism – and embraced a monetary system based on *public authority, policy autonomy and democracy*. Germany and Italy embarked on a different path – one that was to lead to fascism and world war.

---

<sup>9</sup> Rauchway, E. (2015) p. 15

<sup>10</sup> Kuehn, D. (2012) 'A note on America's 1920-21 depression as an argument for austerity'. *Cambridge Journal of Economics* 36(1), pp. 155-160.

# Bretton Woods: the revival of the revolutionary Scheme of 1919?

Towards the end of the war in 1944, Roosevelt convened a conference of economists from all over the world – Europe, Latin America, Russia, India and Africa – and insisted that bankers be excluded from deliberations at a special venue, the Bretton Woods hotel in Hampshire, USA.<sup>11</sup>

The scheme that emerged from Bretton Woods was a bastardised version of Keynes's 1919 Scheme. While markets in capital and goods were to be managed, there was to be no jointly-backed asset to serve as a reserve currency. Instead the US dollar alone was made dominant. Keynes's proposal at Bretton Woods was for an international clearing agency/central bank, that would be *jointly* backed by the government bonds of its member countries. It would undertake the role of debiting and crediting payments between countries and setting these against countries' reserve accounts. In addition to clearing, the central bank would have powers to discipline countries that built up surpluses or deficits.

In the event, Keynes's proposal was abandoned, and the Bretton Woods system made dependent on a single national central bank, the US Federal Reserve, while the dollar was to become the world's reserve currency. This had the effect of transferring global savings to the United States.

## 1945-1971

Nevertheless, the imperfect (and for Keynes disappointing) Bretton Woods system ushered in a new more stable, international monetary architecture. For a period, until the 1960s and the creation by the City of London of the Eurodollar market, the Bretton Woods regime subordinated the finance sector to the interests of domestic economies, and to *public authority*. Most importantly, it permitted countries *the policy autonomy* needed to aim economic policy at full employment.

From Bretton Woods the Marshall Plan evolved, and this in turn led to the establishment of the Trades Union Advisory Committee at the OECD, whose 70<sup>th</sup> anniversary we are commemorating today.

---

<sup>11</sup> For a colourful and insightful account of the Bretton Woods Conference, see Conway, E. (2014) *The Summit: The Biggest Battle of the Second World War – fought behind closed doors*. London: Little, Brown; and for an account of the range of economists present at Bretton Woods, see Helleiner, E. (2014) *Forgotten Foundations of Bretton Woods: International Development and the Making of the Postwar Order*. Ithaca, NY and London: Cornell University Press.



The Bretton Woods era came to be understood as a “golden era of tranquillity in international capital markets”, to quote Barry Eichengreen and Peter H. Lindert.<sup>12</sup> West Germany experienced the ‘economic miracle’ that led unemployment to fall to 0.5% in 1966. It was the ‘era of high economic growth’ in Japan, and *Les Trente Glorieuses* (the 30 glorious years) in France.

In the English-speaking world, this period was, and is still known by both Keynes’s friends and enemies as *The Golden Age* of economics. It was an age in which the welfare state expanded, with pension schemes, national health insurance, unemployment insurance etc. It was also a period of strong productivity growth, when living standards improved year after year.

### **1971-2007 – the era of debt inflation**

Bretton Woods was followed by a period of renewed inflation and deflation: 1971–2007.

In August 1971, President Nixon had unilaterally dismantled the Bretton Woods system: the biggest debt default in history, some economists have argued, as the US reneged on its obligation to repay its debts in gold, and instead offered its creditors ‘greenbacks’.

The IMF, whose staff were not consulted about the Nixon decision, was given the task of rebuilding the international system. It failed to come up with a plan. No international financial architecture was put in place of Bretton Woods. From thereon, the US Treasury bill (bond) served, almost by default, as the world’s reserve currency. In future the world was to be governed by the ‘fantastic machinery’ of ‘free’ markets in capital, goods and services. Cross-border capital flows were made mobile. Self-regulation by commercial bankers and subsequently shadow bankers led to a massive expansion of credit at high real rates of interest.

## **Keynes abandoned**

In the UK, the Bank of England began the deregulation of credit creation, lifting lending ceilings, and removing limits on interest-rate setting. The 1971 ‘Competition and Credit Control’<sup>13</sup> regime (widely known as ‘all competition and no control’) provided the framework for deregulation. This led to excessive credit creation which, coupled with the decision to establish a system of exchange rate flexibility, led to the 1970s price inflation. In 1956 post-war inflation had peaked at 7%. But for most of the Bretton Woods years it remained subdued, turning negative at the end of the 50s. The gradual

---

<sup>12</sup> Eichengreen, B. and P. H. Lindert (1991) ‘Overview’. In: B. Eichengreen and P. H. Lindert (eds.) *The International Debt Crisis in Historical Perspective*. Boston, MA: MIT Press, pp. 1-5. (p. 1)

<sup>13</sup> For more on the impact of C&CC, see Needham, D. (2014) *UK Monetary Policy from Devaluation to Thatcher*. Palgrave Studies in the History of Finance. Basingstoke: Palgrave Macmillan.

deregulation of the finance sector under first the Labour Chancellor, Roy Jenkins, followed by the City of London's opening up of the Eurodollar market in the late 60s, led to a rise in inflation. But it was after 'Competition and Credit Control' was put in place under the Conservative Chancellor Anthony Barber that inflation took off. In September 1971, inflation had risen to almost 10%. In August 1975, it rocketed to 27%.

## Blaming Keynes and workers for inflation

Ever since then, both Keynes and trade unions have been blamed for the 1970s inflation. That is nothing less than a calumny. It is a calumny that has succeeded spectacularly. It has displaced and discredited Keynes's monetary theories and policies for the management of capital flows, interest rates and credit creation. And it has succeeded in redefining 'Keynesianism' as fiscal stimulus. (Remember that the *General Theory* is a Theory of Employment, Interest and Money: not a Theory of Tax and Spend.)

Regrettably the labour movement itself regularly takes on responsibility for the inflation of that period – while steadfastly ignoring the activities of the largely opaque finance sector.

John Evans, previously Secretary of the TUAC, has argued that at the time the TUC was having to grapple with demands for wage rises of 32% in 1975. But demands for wage rises were a *reaction* to the rise in inflation to 26% - caused by 'too much money chasing too few goods and services' coupled with price rises associated with the fall in sterling, brought on by 'exchange rate flexibility'.

While there can be no doubt that union wage demands exacerbated inflation, they were not *causal* of inflation. Financial deregulation – as it had done in the 20s and 30s – was causal of credit/debt inflation which in turn inflated asset values, wages and prices. The consequences were to be made clear much later. By 2010, when it peaked, private debt in the UK had risen from under 60% of GDP in 1980 to 200% of GDP.<sup>14</sup>

### The era of financial deregulation

After the collapse of Bretton Woods, central bank rates rose, and were to be used by public authorities as the *sole monetary instrument* with which to target both inflation and the exchange rate. Mobile capital markets were given a free hand to pressure and determine both exchange rates and a nation's Bank Rate. Rates for commercial bank lending were left to the whim of 'the invisible hand'. The result was a dramatic rise in the riskiest lending by commercial bankers. Risky loans commanded the highest rates,

---

<sup>14</sup> See Keen, S. (2017) '[The ten graphs which show how Britain became a wholly owned subsidiary of the City of London \(and what we can do about it\)](#)'. *openDemocracy*, 24 April.

and were therefore the most profitable. Regulators effectively shrugged their shoulders, complacently arguing that the 'invisible hand' of the market could be relied upon to discipline bankers for excessive lending.

Sub-primers were to prove them catastrophically wrong in 2006-7.

And of course, as elsewhere in the world, the economic goal posts had been moved from full employment to the OECD's plan for (essentially) exponential 'growth'.<sup>15</sup>

After 1973, bankers embarked on a huge international loan boom to countries in Latin America, Africa and Asia. Periodic debt inflations were then followed by debt deflations. There were recurring financial crises and private bank bailouts (largely engineered through the IMF and World Bank). These crises began on the periphery of the global economy, but then gradually moved towards the core – the Anglo-American economies.

As was typical of the 1920s and 30s, the deregulation of credit creation at high real rates of interest led initially to a massive debt inflation, to the non-payment of debts, and then to a debt deflation.

The system imploded on 8 August 2007, when inter-bank lending froze, and the 'credit crunch' began. The crisis culminated in the bankruptcy of Lehman Brothers in September, 2008.

The Global Financial Crisis led to an era of lost growth and ensuing recession, the cost of which is estimated at over \$10 trillion (more than one-sixth of global GDP in 2008). 2009 became the first year on record where global GDP contracted in real terms. Between 2007 and 2009 unemployment worldwide rose from 164 million to 188 million. Between the first quarter of 2008 (2008 Q1) and 2009 Q2, the UK's GDP shrunk by more than 6%. The number of unemployed in UK rose from 1.6 million in 2008 to almost 2.7 million in late 2011. Austerity in 2010 nipped a nascent recovery in the bud. GDP only reached pre-crisis levels in 2013 Q3. This led to the slowest recovery from recession in over 300 years.<sup>16</sup>

## **Lessons were not learned from the crisis**

Instead, policy-makers resorted to the deflationary policies of the 1930s. Monetary radicalism was coupled with fiscal conservatism. Monetary radicalism via Quantitative

---

<sup>15</sup> For a discussion of the OECD's role in promoting 'growth' see Tily, G. (2015) [\*The National Accounts, GDP and the 'Growthmen'\*](#). Policy Research in Macroeconomics (PRIME).

<sup>16</sup> Davies, M. (2018) 'Consequences of the crash'. In Allen, P. (ed.) [\*10 Years Since The Crash: Causes, Consequences and the Way Forward\*](#). Progressive Economy Forum, pp. 18-19.

Easing and negative real rates of interest led to a massive expansion of central bank largesse in the form of liquidity, which in turn inflated debt and asset prices.

Global debt rose by over \$8 trillion in the first quarter of 2018 to more than \$247 trillion or 318% of world GDP. That is almost double the level of debt which imploded and caused the crisis of 2007- 9. At that time, global debt stood at \$142 trillion and at 269% of GDP, according to McKinsey.

Fiscal contraction and austerity transferred the burden of adjustment onto those innocent of the crisis – the 99%. This in turn led to rising inequality, popular unrest and the rise of nationalisms around the world, and even fascism in parts of Europe.

Ten years after the crisis, Europe and much of the world are experiencing social insurrections and political crises reminiscent of the 1920s and 30s.

As this goes to press, central bankers are again coordinating, this time around a process of Quantitative Tightening – or ‘normalisation’, as it is framed by its adherents. This involves shrinking central bank balance sheets by dumping assets (bonds) purchased at the height of the crisis back into capital markets. This has the effect of lowering the price of these assets (securities or bonds) and increasing their yield. ‘Tightening’ by the US’s Federal Reserve is leading to a strengthening of the dollar, and to a rise in market interest rates, which in turn is destabilising the currencies of emerging, dollar-indebted markets such as Argentina, Turkey and South Africa.

Higher interest rates aimed at vast bubbles of debt pose a real threat to the global economy, as they render debt unpayable. In this sense, the Fed is repeating the errors of the both the gold standard era and the Greenspan era. Between 2003-6 the Fed steadily raised interest rates intending to take away the ‘punchbowl’ from financiers ‘drunk’ on debt. Instead, higher rates took the form of a ‘dagger’ aimed at, and then bursting, a vast bubble of debt.

So no, madam Chair, we have not learned the lessons of history, or of the last financial crisis. And John Maynard Keynes’s monetary theories and policies for a stable international financial framework aimed at international recovery have been firmly killed off by Thomas Lamont’s successors on Wall St and the in the City of London.

And yes, we are sleepwalking into the next globally interconnected financial crisis.