The Macroeconomics and Financial System Requirements for a Sustainable Future

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Introduction

- **Macroeconomic analysis of a lower growth rate**
- Aggregate demand, aggregate supply and the sustainable growth rate
- A circuitist view of the nature and role of the banking and financial systems
- **Constructing a sustainable financial system**

Macroeconomics of slower growth

- Start with simple observation from (treating net exports as zero):
- Savings equals Investment plus Budget Deficit
- With slower growth investment will be lower (relative to GDP), implies need for some combination of lower savings, higher budget deficit if capacity utilisation and employment rates to be maintained

Macroeconomics of slower growth

- Consumption relative to income would be higher under lower growth.
- Savings in excess of investment would require budget deficits
- In a low growth economy, savings could well be lower, e.g. related to pension provision
- Choices to be made over public expenditure and the ways in which it provides beneficial services and employment.

Macroeconomics of slower growth

- Savings = swW + spP (W wages, P profits)
- Hence sw(Y – P) + spP = I + BD
- (P/Y).(sp – sw) = (I + BD)/Y
- With causation running right to left
- Well-known classical case: sp.P = I, and hence sp(P/K) = (I/K) = gk
- Some obvious implications for the rate of profit (and that budget deficit in the interests of profits)

Macroeconomics of slower growth

- The relationship between rate of interest and the rate of growth is significant for sustainability of, e.g., budget deficits
- From a number of perspectives can be argued that rate of interest (on risk free financial assets) ≈ rate of growth (both measured in inflation adjusted terms or in nominal terms)
- Lower growth likely to go alongside lower interest rate.

Macroeconomics of lower growth

- Investment based on a range of factors including ‘state of technology’, ‘animal spirits’, profitability and (changes in) capacity utilisation
- The end of ‘accumulate, accumulate, that is the law of Moses and the prophets’ ?

A financial system for sustainability

- Financial systems inherently unstable and prone to crisis; even apart from the power of the financial system, it is not possible to construct a financial system which will not be prone to ‘booms and busts’
- The financial system should be structured for finance to serve the economy rather than the reverse.

A financial system for sustainability

- Under financialisation the positive relationship between ‘financial development’ and economic growth may well have ceased;
- The era of financialisation (since circa 1980) has been associated with somewhat slower growth in industrialised countries (and could add rising inequality has also been a feature of this period).
- Negative effects of financialisation on investment;

A financial system for sustainability

- Financial sector has become ‘too large’
- Financial crises and recession
- Tempting to argue that financialisation should be encouraged as it slows down growth!

A financial system for sustainability

- The thrust of the argument here is that the size of the financial sector should be shrunk, and policy attention focused on the channelling of funds in socially desirable directions
- Overcoming discriminatory credit rationing

A financial system for sustainability

- The key roles of the financial system should be (in addition to providing a payments technology) the financing of investment, efficient linkage of savings and investment, and the appropriate direction of finance and funds (no presumption that the financial system is efficient nor that it allocate funds in a socially appropriate manner)

A financial system for sustainability

- Financial transactions taxes (and similar) to reduce the trade in existing financial assets, particularly high frequency trading and similar
- Purpose of such taxes are to discourage such trading, to raise revenue and to release mathematical trained workers for more productive research.

A financial system for sustainability

- The development of a diverse banking system with alternative forms of ownership: private, public, mutual and co-operative
- The need for State development banks

A financial system for sustainability

- A ‘green’ Community Reinvestment Act: placing requirements on banks that a high proportion of their loans are directed to environmentally friendly investment (recognising the difficulties of monitoring such a scheme)