Transforming Finance

Fresh thinking on democracy, finance and debt

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The Transforming Finance conference brought together leading academics, finance professionals and campaigners to discuss how to make finance work in the long term interests of people and planet.

This document is an overview of the issues and topics discussed. For more, please visit the Transforming Finance website at www.transformingfinance.org.uk, **where videos of each of the speaker presentations can be viewed,** together with summaries of the main conclusions.

Introductions

Richard Spencer, Head of Sustainability, *Institute of Chartered Accountants in England and Wales*

Craig Bennett, Director of Policy and Campaigns, *Friends of the Earth*

Welcoming participants, **Richard** explained that transforming finance means getting a banking system that is just; one not held to ransom by 'too big to fail' banks; and with a proper role for the state. We must invest as if the future matters, and harness innovation as a force for good.

Craig said that transforming finance is essential for safeguarding the environment. Ending boom and bust is important: in boom times growth can happen unsustainability and with big environmental impacts; in bust times social and environmental regulations are often jettisoned. The short-termist bias in the system is bad for long term investment – and the financial system's privatised gains but socialised losses is bad for everyone.

Privatised gains and socialised losses

How can we avoid a repeat pattern of asset price bubbles, debt crises and costly publicly-funded bailouts of private financial institutions?

Thierry Philopponnat, *Secretary General, Finance Watch*

Professor Stephany Griffith-Jones, *Financial Markets Program Director, Initiative for Policy Dialogue, Columbia University;*

Professor Richard Werner, *Director of the Centre for Banking, Finance and Sustainable Development, University of Southampton*

Thomas Keidel, *Director of Financial Market Relations, German Savings Bank Association (Deutscher Sparkassen- und Giroverband)*

Thierry argued that banks create a theoretically unlimited amount of money and so we need to make sure it goes to the right activity. It is critical to separate the two functions of banks – supporting productive activity and financing assets – or there will always be the risk of bubbles in the economy. The current debate, however, is focused on the wrong thing – separating trading from banking – not separating these functions. Taxpayers will inevitably take the brunt if there is another collapse. So do we need a hard size limit on banks? Thierry argued that at the very least banks in receipt of public subsidy should have their expansion capped; once banks are bigger than $100 billion, they lose economies of scale.

Stephany stated that the functions society needs of a finance sector are (1) to allocate capital to the real economy cost effectively and (2) manage risk. However the finance sector has been actively creating risk by pursuing short-term profits. Money is not going to the right places, like the green economy. We have to shrink the part of the finance sector that is "socially useless". But this isn't rocket science: after WWII we had a regulated financial sector with virtually no crises. UK politicians who talk about the contribution of finance to the economy need to see the bigger picture: the drain away from more productive parts of the economy caused by overinflated city wages. Political will is the real barrier, to tackle vested interests and regulate the sector properly. Stephany praised development banks and also called for a British state investment bank as a priority.

Richard said that we are entirely dependent on banks' actions because they create and distribute 97% of the money supply. Who gets money and for what purpose matters, because this shapes our economy, yet no-one ever requires banks to do something useful with the money they create. Basel accords appear to punish banks for lending to SMEs and rewards them for investing in property. Credit guidance has traditionally been most successfully in avoiding boom and bust and was the core of the East Asian economic miracle: it isn't a 'Soviet measure', but is instead merely about deprioritising harmful speculation. There are other means to do this as well, as shown by the diverse German banking system.

Thomas pointed to the fact that the German banking system withstood the worst of the crisis. Its hidden champions - savings banks - have a public mandate to provide credit to sections of the community for financial inclusion and common good. Profits stay in the region and pay tax, and local savings are converted into local loans: Profit maximization is not the savings banks' sole objective. Not a single savings bank had to be bailed out during the crisis.

Increasing the diversity of UK banking institutions

What does a more decentralised, diverse and localised banking model look like?

David Green, Chief Executive, *Civitas*

Tony Greenham, Head of Finance & Business, *New Economics Foundation*

Fiona Brownsell, CEO, *Tusmor*

Professor Gary Dymski, Chair in Applied Economics, *Leeds University Business School*

Richard Paton, *Occupy*

Times are tough for small business, claimed **David**; they face difficulty borrowing with loans able to be withdrawn at short notice. UK big banks suck money out of regions. In Germany the model is different: Sparkassen are underpinned by a guarantee so there is less collateral required, and they lend countercyclically, empowering local people to get themselves out of trouble.

Tony suggested that is much less diversity in UK banking than aboard. There is a gamut of alternative models: cooperatives, mutuals, credit unions and savings banks. These kind of bodies are more crisis resistant because of more prudential balance sheets, with local knowledge leading to a more healthy loan book. The Government should provide central infrastructure for local banks to overcome cost barriers.

Fiona said that in the UK the proportion of banks that are local is 'very low', compared to the vibrant US landscape. Yet she was positive about current changes to regulations which may get more competition into the sector. The Prudential Regulatory Authority is accelerating the time to set up a new bank from two years to just nine months - and Treasury consultations into the payments system hopefully breaking the monopoly of the big banks. RBS should be broken up into a series of local banks.

Gary said that new rules are needed for megabanks, and a change of culture so that they see themselves as fiduciaries. It is unsatisfactory for Goldman Sachs to say that they owe no fiduciary duty to their clients. Gary proposed outlawing predatory lending; reigning in bank subsidies; creating limits on leverage; and breaking the monopolies in the interbank lending market. More must be done to stimulate cash flow in local communities to create demand. Financial literacy and bringing economic activity into marginalised communities is vital.

Politicians claim to support mutuals but this is hollow, suggested **Richard.** The political focus on the morals, ethics and standards of the banking sector is a red herring that allows leaders to avoid focusing on the deep structural incentives built into the system: what allowed the genie to get out of the bottle in the first place?

Fresh thinking on debt and recovery

Must the debate come down to austerity vs more borrowing, or are there more options?

Costas Lapavitasas, Professor of Economics, *SOAS*

Victoria Chick, Emeritus Professor of Economics, *UCL*

Ben Dyson, Founder, *Positive Money*

Nick Dearden, Director, *Jubilee Debt Campaign*

This is ultimately a crisis of financialisation, and thus a crisis of debt, claimed **Costas**: everything has been financialised – households, banks, and non-financial enterprises. The banks themselves have changed, opening themselves to the open market for funding, thus also taking on debt themselves. There is an accumulation of debt across the board. The solution is debt reduction for banks and households, yet austerity actively does not help: the most important thing to do is restore flows of production and income. On capital controls, he warned that separating good loans from bad loans is harder than you might think, and suggested that the broader issue is social transformation, not simply better money policies.

Victoria suggested that we need to take a historical perspective on the Government debt, dropping the hysteria and getting down to some sensible discussion. There is good and bad debt: good debt pays for itself, whereas bad debt is loans for unproductive purposes. Governments that borrow for capital investment need not have to worry about fully paying back the loan through a new revenue stream because this investment has multiplier effects across the economy, increasing tax revenue. The private sector is calling for more government intervention in taking the lead on directing stimulus. We need a 'courageous' state prepared to argue its case, pick winners, and build political support.

The issue isn't government debt, suggested **Ben**, but personal and private debt: this is much bigger than the size of the national debt and more expensive to service, yet the media debate largely ignores this. Adair Turner has warned that it was debt that got us into this crisis and creating more debt is unlikely to be a good way out. Despite being in the depths of an economic slump and austerity, the FTSE is at a peak: trickle-down economics is still ensuring that ordinary people are "being trickled on from a great height". We need to have money created in the public interest, and injected into the real economy.

Developing world debt crises are crimes against humanity, claimed **Nick**, and a debt jubilee containing a large element of debt cancellation is essential. Cancelling debt must also lead to redistribution of wealth across societies. A look at Germany's post war success shows the effect that debt cancellation can have. We need debt audits where society comes to decisions about what to do with government, public and private debts. Capital controls are needed as part of the redemocratisation of finance, with governments starting to regain control – but unless society fights for it, this will not happen.

Socially useful investment: making money work for people and planet

How can we ensure our financial institutions create long term social and environmental value?

Tim Jackson, Professor of Sustainable Development, University of Surrey

Mariana Mazzucato, Professor of Science and Technology Policy, University of Sussex

Catherine Howarth, CEO, ShareAction

James Vaccaro, Head of Market and Corporate Development, Triodos Bank

We have a dirty brown economy, not a green one, said **Tim**, and the things that are financed are at the heart of that. We need to build a genuinely green economy which is about much more than just green technology: the right infrastructure, ensuring ecological protection and safeguarding critical services like healthcare, the arts and community spaces. This green economy prioritises resource productivity over labour productivity: enterprise is resource light and employment rich. Small scale finance must be encouraged, such as community banking; investment should go towards ecological and social gain, and money controlled by appropriate institutions. Proper macroeconomic regulation is needed and the fiduciary duty redefined. Tim called for 'green quantitative easing', better fiduciary duty, and a financial transactions tax.

We have to 'definancialise' the real economy, warned **Mariana**. Suggested SMEs should not be placed on a pedestal; the 'entrepreneurial SME' is a myth, and in practice the problem is demand for SME finance, not supply. The idea of the venture capitalist driving innovation is also a myth: governments are actually behind much innovation. Venture capitalists capture the returns from original government investment, be that direct or through, for example, infrastructure support, and rely on the 'entrepreneurial state'. This makes Apple's low tax payments all the more unacceptable, as much of the underlying technology in a iPhone (such as Internet and GPS) was originally state funded.

Catherine warned that like other parts of the financial system, pensions funds are not serving us well. Pensions fund destructive activity but there is very little in the system to check this. Fiduciary duties are interpreted very narrowly as a straightforward duty to maximise profits in the short term, and the law needs clarification. Civil society and pension holders also do not exert enough pressure, in part because of limited rights to information. Pension funds should be engaged owners of the shares they hold with an active role challenging companies, and ensuring much more engagement with issues like the carbon bubble. Pension funds have hardly heard of climate change yet funds should be playing a part in funding the green economy, and many people would like the idea of a part of their contributions flowing into for example local renewable energy.

James asked when sustainable banking came to mean a sector that didn't take down the whole economy when it crashed. We must fix the system but with thought and thoroughness, not just stopping crashes but making the system work in the active interests of people and planet. Regulators must ensure a diverse system, not as a one-off but as an ongoing challenge. If you don't get your act together on finance, he warned, you are wasting your time because you are building a future that will undermine everything else you are doing.

Rehumanising money: innovative and 'bottom up' solutions for getting finance into the right places

Can innovative finance disrupt the system?

Emanuela Vartolomei, Managing Director, *All Street*

Becky Booth, Co-Founder, *Spice*

Louis Brooke, Co-Founder, *Move Your Money* and Communications Manager, *London Rebuilding Society*

Michael Norton, Co-Founder, *Buzzbnk*

Simon Dixon, *Bank to the Future*

Emanuela's organisation, Allstreet, has created a map of the alternative finance space, illustrating where new entrants and startups can disrupt mainstream financial services – for example, 'peer-to-peer' networks and alternative currencies. She painted a vision of the future where due to what she called 'disintermediation' everyone could become their own bank.

Becky said that 'traditional' money has a distancing effect which puts barriers between the user and the underlying economy in which they operate. Instead, alternative currencies allow people to re-engage with society. There are different purposes for different currencies, she advised: currencies like the Brixton pound are a deliberately localising force, whereas time-based money challenges the way we perceive money and value.

Michael suggested that crowdfunding creates engaged supporters, and there are many ways to do it – from quasi-equity to loans and even donations such as Pants to Poverty. People support crowdfunding not just because of returns but also because of relationships. He ran through other innovations, such as Alia charity bonds, which fund housing associations with interest foregone and given to charity.

The big question, said **Louis,** is about how small players in finance get to a useful scale, rather than getting consumed by larger, more aggressive partners. He appealed to the alternative finance movement to up its game. Alternative finance must be relevant to ordinary people: it must be lightweight and nimble, aspirational, and dynamic. There could be value in partnerships with big players to get off the ground.

Simon said that from a bottom-up perspective there are new innovations and things are changing: finance based around localities is coming back, and finance that aligns with particular specific values. 'Equity crowdfunding' is fast democratizing finance: global distribution networks have lowered the costs of start-up, and Government incentives have helped to derisk investments. In response to a question from the floor, he stressed that we should take personal responsibility for investment so that what we invest in starts to reflect our values – not leave it to professionals to tell us what our values should be.

Where do our savings go? Capital markets and accountability

Paul Woolley, Founder, *Paul Woolley Centre for the Study of Capital Market Dysfunctionality, LSE*

Christine Berry, *ShareAction*

Hannah Griffiths, Head of Campaigns and Policy, *World Development Movement*

Bruce Davis, Joint Managing Director, *Abundance*

James Featherby, Chair, *Church of England's Ethical Investment Advisory Group*

Almost everything is wrong with finance, said **Paul,** and almost everything we are doing to try to fix it is also wrong. The financial sector has become a monster that risks endangering capitalism itself. The problem with finance begins with the economic theory that says markets are efficient. A better theory of how finance works would incorporate the role of financial intermediaries, which then invokes the principle/agent problem. We need supra-national cooperation: Two months ago the G30 brought out a code of practice for asset holders on strategies that should be adopted to reduce the principle/agent problem for asset holders. Without tackling this, asset mispricing and rent extraction result.

Christine summarised the analysis by Carbon Tracker (www.carbontracker.org): the valuation on the stock market of major fossil fuel companies is largely based on reserves which in cannot be burned if we are to keep temperature rises to below two degrees. This 'carbon bubble' threatens investors and pension funds. Divestment is one option for pension funds but as important is that funds begin to challenge fossil majors about their long term assumptions. It is difficult for an individual fund to take a lead, so we must collectively act to 'rehumanise' investment: pensions are our money, and we must assert our interests to funds.

Hannah discussed the rise of highly damaging food speculation: derivatives based on the price of food are being increasingly traded, leading to massive price spikes with particular impact on the global south. Deregulation is the cause, she argued, and regulation is the answer. We need to demand more of government to step in and change the rules, and come up with radical new investment mechanisms that shift the mainstream.

Bruce said moving your money is important – but this isn't just about moving your current account: you need to put all of your financial activity into the system you trust and want to see. The war is cultural, not economic: we need to reclaim money and power from the banks. We have become passive, but the banks were terrified by the queues of people outside Northern Rock. Democratising finance is ultimately simple: instead of walking into a bank, we should walk into somewhere where we feel in control of the system.

James would estimate that hardly any pensioners could name the top companies that are funding their pensions: what you don't know about, you don't care about. There isn't enough pressure for change coming from savers, who must make the case that social and environmental considerations are the bedrock of financial success. 70% of the FTSE 100 is represented by 'value above net assets': good will towards business. We have to demonstrate that we value something other than the highest short term financial return: there is no reason for those in the investment community to be exempt from the moral rules that apply to the rest of us.

Final panel: what to do?

Ann Pettifor, Director, *Policy Research in Macroeconomics* and Fellow, *New Economics Foundation*

Sony Kapoor, Managing Director, *Re-Define* and Senior Visiting Fellow, *LSE*

Steve Waygood, Chief Responsible Investment Officer, *Aviva Investors*

Nicola Smith, Head of Economics and Social Affairs, *TUC*

Ann said that there is a deep misunderstanding of the way the financial system works: the powers that be think that the problems of EU or Japan can be solved by money creation but that is only part of the issue. The real concern is: how is the money spent? At the moment quantitative easing is being spent on speculation. We should say that we want the Bank of England to create overnight the finance that we need to tackle climate change, which will be more than the money we spent to bail out the financial system. There should never be a shortage of finance: the question is what do you do with it, and who decides? Fix the financial system and we will become more democratic overnight: all of our institutions have been corrupted by finance, but in particular our democracies and our parliaments. Capital controls are essential.

It is governments and policy makers that structure the economy, claimed **Steve**. Civil society and progressive finance can ally to secure big systemic change. The priorities should be to address the massive asymmetry of information in the financial sector, embark on a major programme of financial education, and clarify the fiduciary duty for institutional investors. Until costs like the risk of stranded assets are 'reinternalised' onto the balance sheets of corporations, companies will continue to be overvalued. Shareholder democracy should be increased, with people who entrust their money to the big institutional investors able to have a say in what happens to that money. Measures should be taken to stamp out the huge lobbying power of governments by (for example) chambers of commerce.

The IMF has traditionally been part of the problem, but has become the best ally that we currently have 'within the mainstream', advised **Sony**. The finance system is like a traffic system: it is supposed to transport money from one place to another, but is actually like a system of drunken truck drivers with no public transport: a better mix of transport is needed with lower speed limits and more traffic police. The perverse incentives must be taken out of the system, with salaries capped and a better alignment of risk to reward. Only when governments convince investors that climate change will be tackled will investors respond.

Nicola's priorities would be to create a state investment bank; rebalance the economy to reduce the share taken up by the financial sector; create more diverse ways of doing banking; and push for reforms to corporate governance. She agreed that some current IMF thinking is interesting. The TUC has done lots of work on how to deliver a just transition, and how to make sure the impacts and costs of climate change are fairly shared.

Find out more

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