Renegade INC

In A Crisis? Cook The Books!

Ross [00:00:28] Welcome to Renegade Inc. The line that we hear constantly throughout this pandemic is how it has exposed our systemic frailties and weaknesses. But would this have been the case if we'd prevented the financial sector hollowing out the real economy and democracy itself? So how do we use this crisis to reimagine society and prevent the biggest wealth grab in modern times? Prem, wonderful to have you here on Renegade Inc.

Prem Sikka [00:01:01] My pleasure.

Ross [00:01:03] When people talk about COVID-19, the pandemic, often there are examples made between this crisis and 2008. From an accounting and finance point of view, what do you see, if any, the correlation between 2008 and what we're seeing today?

Prem Sikka [00:01:23] I think the current crisis is affecting almost everyone. Millions of people laid off work. Millions of people who are on minimum wage basically now receiving only 80 percent of that, about 2 million self-employed people not receiving anything, pensioners confined to home and they find they can't really get deliveries because supermarkets can't really cope with the load. And basically, everybody is affected. Whereas in the 2007/8 crash, people are affected slowly. Initially it hit the financial sector, but the government moved in trying to bail out the financial sector. This time they're helping the people a little bit, but it is not really a lot, really, which they have done. So there are some parallels, but there are also differences. This time lots of people are paying with their lives for the current crisis.

Ross [00:02:24] When it comes to a demand shock for the real economy, then talking about 2008 and now, this is chalk and cheese, isn't it? I mean, this pandemic is on a scale, frankly, unimagined in 2008?

Prem Sikka [00:02:37] Well, we are told once in a lifetime you hit a financial crash and you hit a pandemic. We have hit both within our lifetime. So it is quite serious. But I think it also shows the folly of the government policies - reducing investment in the National Health Service, keeping people on low wages, doing nothing about inequalities. So what we find at the moment is whilst millionaires are holed up in their mansions and travelling on their yachts, it is the poorest paid people who are in the front line.

Ross [00:03:10] And it lays bare the idea of trickle down economics and this neo liberal agenda does it not?

Prem Sikka [00:03:16] Well, trickle down economics was one of the biggest fictions that never really did trickle down, though people at the bottom picked up a few crumbs. I mean, if you look at as a proportion of the GDP in 1976, workers collected sixty five point one percent of the GDP. And now we are hovering at forty nine point three percent of GDP. And from that forty nine point three percent, we can't easily isolate the money collected by bankers or Premier League footballers or rich executives. If we were able to extract that, you will find that many people in real terms have not really gained at all since the Thatcher years. Society is the only thing that keeps us going. You know, you can imagine a man living in a cave reads about Thatcher's thing, saying there is no thing called society. And he says, 'right, I'm an individual. I am off now to make my own fortune'. Off he goes. All he will become is a tasty morsel for a lion and then realise that it is society which kept that person in some kind of a decent shape and protected his family. And it is the same with us. So individualism has these huge limits, and even individuals can't flourish unless society provides the necessary infrastructure. So society is the basic pillar of our existence and our well-being, and that is what really needs to be focussed upon. I don't begrudge some people deserving more. But the issue is always how much more. And that has to be a social decision. This is why I have always advocated democracy at work. I believe workers should be voting on executive pay. Customers should be working on executive pay. Can you imagine customers who have been cheated by a mobile phone companies or gas or water or electricity or even airlines now begging for bailouts but refusing to give them refunds for cancelled flights? Their bosses would never, ever flourish if we empower people. We live in an era when we are told there is universal suffrage. But we have a medieval system at work which basically says first, those who invest their human capital, brain, brawn, should not really have any say and then say look, if you buy a few shares you will get some rights. But that is going back to the kind of era of medieval barons where property people had rights and the rest did not. And that is wrong. That is what we need to change.

Ross [00:05:54] The stock markets have been likened to a Ponzi scheme, certainly of late. A lot of that comes down to accounting rules, something that you're very affy with. In the years after 2008, the accounting rules have changed, we marked from market, which is the real value of an asset to mark to model. Just talk a little bit about this in context of society and who actually bears the losses for reckless speculation within the financial sector.

Prem Sikka [00:06:21] I was called up after the banking crash to give oral evidence to the Parliamentary Banking Standards Commission. My view is that the accounting rules were then and now are unfit for purpose. So when we talk about mark to market, there are many things for which there is no market, because active market presupposes that there are millions and millions of buyers and sellers and nobody is a price maker. Everybody's a price taker. Yet all around us, we will see inequalities. We will see monopolies. So the idea that you can easily get hold of a market price for everything is somewhat fallacious. And so what companies end up doing is building models and invariably they build models which favour them. They are very keen to recognise higher values now that we are in a kind of a depression that won't easily pick up the downside. So by selecting a higher prices, they are able to report higher earnings. They are able to report higher equity in the balance sheet and thereby manage to secure higher bonuses and performance related pay. And we have to remember that these rules are not made by some independent body. They've been made by Financial Reporting Council, which have been colonised by big business and big accounting firms. And they've really been making their own rules as they go along. And that is wrong as well. Look, we all know accounting rules affect the distribution of income, wealth risks, dividend, wages. And there is only one body in the UK which has a democratic mandate to set them. That is parliament. But the parliament has abdicated its responsibility and given it to a private organisation. And that private organisation behaves just like any other private organizations behave. They belt out the rules for the benefit of the people who fund it.

Ross [00:08:24] When you see such corporate capture of that organisation, how do you begin to address that? Because obviously it's not doing the real economy any good. It's obviously driving inequality. How do you begin to address those issues?

Prem Sikka [00:08:41] Well, I think you we have a real problem with the whole of our regulatory system. I published a report last year. We have about 700 plus regulators in the UK. We have 25 dealing with money laundering, 41 dealing with even more than possibly that dealing with a financial sector. We have five, six, seven, maybe more dealing with a world of accounting. And there is no coordination, nothing joined up, no independence. They all use the phrase, we serve the public interest. But you don't find the public on any of their bodies. On accounting bodies like the Financial Reporting Council and the professional accountancy bodies, they are even outside the freedom of information net. You can't even collect the information about them. So the first remedy has to be we have to have a cull of these regulatory bodies. We need to get parliament to set accounting rules. We need to have ordinary people so that their concerns are addressed, sitting on regulatory bodies. We had an opportunity after the banking crash, but the governments did absolutely nothing. So this is a time for civil society, trade unions, Labour Party, anybody else who wants to see durable change in society to get together and address these issues because my fear is left to itself the government would not really do anything. Governments talk about getting back to normality, but the problem is normality itself was the problem.

Ross [00:10:19] And when we do begin to address these, what then do the society begin to look like? What's this renaissance, if you like? what does that look like for the man, woman on the street?

Prem Sikka [00:10:30] I think we want a society where people can live fulfilling lives and people's interests must be protected. We have seen so many scandals where people's pensions have vanished into thin air. Carillon, BHS, many others come to mind. We have seen so many scandals where very few benefit. We have seen insolvency practitioners charge mega fees and walk away. Absolutely no public accountability. And after this Corona virus crisis, we will see a real cull of the SMEs, because what would happen is as companies go bust, the secured creditors, which are hedge funds, private equity, banks will walk in and walk away with most of the assets because they are secured creditors. The rest will get absolutely nothing. That is wrong. We need to change that. As part of reforming our society, we need to challenge the power of finance. For far too long it has really strangled the development of an emancipatory society. And that is just one of the many things we need to do.

Ross [00:11:36] We talk about corporate capture of the accounting discipline - the accounting bodies, the accounting trade - but the bigger point really is the one that you raise, which is the financial capture of parliament. Never has that been more glaring.

Prem Sikka [00:11:52] Absolutely. And the MPs are there. They're making far more money from consultancy and other services. They're using publicly funded offices, secretaries, phones, for their private business. And their disclosures in the House of Commons registrar of interests are incredibly poor. So my first suggestion would be I personally would not ban any donation to of any kind. But the money should not go directly to any political party or MP. It should end up what I would say I would like to create is some kind of a foundation for democracy. OK. So this foundation could be administered, let's say, by the electoral commission. This foundation then allocates that money to political parties in accordance with their share of the vote at a general or local election or membership. Of course, because if you try to ban things, these people always say, I want to serve democracy. So my response is, go ahead, serve it. OK, give some money to this foundation. And of course, then they will back off. They will not really want to do that. And then we can really talk about state funding of political parties. I will also similarly ban MPs doing any other job. Earning 82 K is a full time job. Dealing with the country's problems is a full time job. And the rhetoric from MPs is 'well, I need to consult corporations because I need to know what's going on. Then I can intervene in parliamentary debates'. My response would be, 'please, you continue to do that. But any fees you charge will go to this foundation for democracy. Thank you very much for serving and getting to know what is going on, but you shall not benefit'. So at the moment, people say Britain has the best democracy that money can buy. That is true because money has bought it.

Ross [00:14:07] Welcome back to Renegade Inc. Before we go to L.A. to talk with the author, Tan Liu, about his book, The Ponzi Factor, let's have a look at what you've been tweeting about in this week's Renegade Inc. index. First up from Professor Alice Roberts: 'Elites often prioritise profits over human life and community. Ordinary life before the pandemic was already a catastrophe of desperation and exclusion for too many, an environmental and climate catastrophe, an obscenity of inequality. All this from the Guardian article'. Next from Laura Seebohm: 'This is the biggest opportunity we will probably ever have to change our broken systems and challenge inequality. We must not succumb to the pressure to return to normal when normal has not worked for so many'. And finally, we have a tweet from Alexandria Ocasio-Cortez: 'The COVID data continues to expose the truth we've long been warning about. Inequality is America's pre-existing condition and it's lethal'. This is referencing this tweet from The Intercept: 'The five New York City's zip codes with the highest rates of positive tests for the Corona virus have an average per capita income of twenty six thousand seven hundred dollars, whilst residents in the five with the lowest rates had an average income of one hundred eighteen thousand dollars'.

Ross [00:15:33] Tan, lovely to have you on Renegade Inc.

Tan Liu [00:15:34] Thanks for having me.

Ross [00:15:35] The Ponzi Factor, your book, seems to me that you've sort of caught a moment in time, if you like. Just explain why you wrote it.

Tan Liu [00:15:43] Well, in the very beginning, like many people, I was a young finance person who was very passionate about finance, very passionate about Wall Street and I tried to make money on Wall Street. At one point, I worked for a hedge fund that were trading life insurance policies like bonds. It had nothing do with stocks. But what I realised with that hedge fund was that the money they were making was not real because they weren't making any money. They were actually just recording it from an accounting point of view and they were able to write and record essentially phantom profits that they never made, legally. Legally is a key word - legally - and project these returns and sell them to clients.

Ross [00:16:23] When you say legally, explain how they did it.

Tan Liu [00:16:25] So normally we had this idea of you make money and finance by buying something for five and selling it for six, right? Except for, the thing is for esoteric things such as life insurance policies that really only get sold once in the whole duration of this trade, or even housing, for example, or even more esoteric products. You don't really have this aspect of what the price is today, tomorrow or the next day. So what you can do is you can simply say, I'm going to buy for five right now, I will sell for six in two years. And during this time you can accrual this profit. It's called accrual accounting, as if you're going to make 20 percent on this investment. The problem is, no one actually knows if you'll be able to sell for six at the end of the two years. When the time comes and they actually have to pay back the loan. They actually have to get the six dollars they promised, right? What happens if they don't sell it? Because at the end of the two years, what happened is they couldn't sell it. What they did is simply bring in more investors and they bought their previous asset that they valued at six and they couldn't sell it in the market for six. So they brought in more investors to buy the six to justify their valuation at the very beginning. And that's when I realised this whole game is really messed up. It has nothing to do with actually making money and being smart or out gambling somebody. A lot of it has to do with accounting tricks. And that's when I realised that also these synthetic instruments that they create, whether it's a life insurance policy, whether it's a stock or something else, that is not real, that is not tangible.The only way people can make money, as in the real cash currency, the legal tender, is by taking it from a new investor that puts more money into it.

Ross [00:18:18] You have created a really wonderful animation which clarifies the book perfectly. It accompanies the book. Let's have a quick look at it.

Video clip [00:18:25] When we think about the stock market, we think about money, the finance industry, businesses and making money from investing in successful businesses. The belief is investing in successful businesses is what leads to investment profits. And there's a direct connection between the success of the underlying company and the profits investors experience. This is a reasonable idea, which is why it's in textbooks and recited by finance professionals who sell stocks and stock related services. However, this is not how stocks actually work. Most finance professionals have no idea where profits from stocks come from. They just assume it gets magically generated from the complexities of the market. The myth is profits from stocks are generated from the earnings and growth of the underlying companies. And when a company makes money, they share the profits with their investors. But in practise, most public companies never pay dividends on their stocks. And when they make money, which can be millions or even billions, they keep everything. The reality is profits from stocks come from other investors who are buying and selling stocks. When an investor buys a stock for $10 and sells it for $11, then $11 comes from another investor, someone who will then start hunting for yet another investor who will give him $12 and so on. This is technically a negative sum scenario for investors because they are contributing all the money and there are fees attached to every transaction. The company that issued the stock isn't involved in these transactions, so whether the business is making or losing money is irrelevant. This is why companies like Tesla Motors, who has lost billions since they became a public company, can still have stocks that appreciate in value. But in a situation where investors profits are strictly dependent on money from other investors, investors can make or lose money regardless of whether the company they invested in is making or losing money. In reality, the stock market is a massive system that shuffles money between investors. It is a system where current investors profits are directly dependent on the inflow of money from new investors. And such a system is also known as a Ponzi scheme.

Ross [00:20:52] So we are right in the midst of a Ponzi scheme. In fact, if you look at all capital markets now, specifically in the US, this is arguably the biggest Ponzi scheme ever created.

Tan Liu [00:21:04] Absolutely. Right now we have investors who are holding 36 trillion dollars of value. Well, perhaps not right now, given April, but definitely in January, they were holding 36 trillion dollars of value. That is a number that comes from the exchange of money. But the problem is those investors think they have money. They are entitled to thirty six trillion dollars. That is simply not true. There is only 13 trillion dollars in the M1 money supply. There is only three point six trillion dollars of hard currency in the entire U.S. economy. Yet investors think they are entitled to thirty six trillion dollars. It is clearly a Ponzi scheme. On a typical day, only about 1 percent of shares outstanding is actually traded, meaning only one percent of investors can actually cash out. It just so happens that we'd never really get that much of a spike in terms of over 1 percent. The reason 1 percent of people, by the way, can always cash out - you always feel you can cash out when you own stock - is because in a legitimate Ponzi scheme, a majority of the time investors can cash out as well. A Ponzi scheme is not a scenario where everyone always loses money. You can't cash out. How do you think Ponzi schemes grow? It's because earlier investors can't cash out. Get some more money, more people get in and so forth. At one point, though, obviously, if everyone tries to cash out, no, it's going to collapse. And what I always get is this other analogy. Why isn't that the same as a run on the bank? It is not the same as a run on the bank.

Ross [00:22:36] Why?

Tan Liu [00:22:37] Because at a bank, we have a reserve system, so we know all the money is not there. However, whoever borrowed that money has a responsibility to pay it back. Now, defaulting on a loan or not, that's different. But there are names attached to every dollar that is owed to you - every dollar that is lent out. On the other hand, this is selling an imaginary asset in a market. It is completely different. A bank you deposit what's yours there and you're gonna get it back later. Here, though, all your stocks are there. You just can't get the money for it because everything you have is actually equal to zero dollars.

Ross [00:23:14] There's another author, Wall Street veteran investor that we've spoken to, Mitch Feierstein. He wrote a book called Planet Ponzi. And his line of that book is that you can't ever taper a Ponzi scheme. Do you agree with that?

Tan Liu [00:23:28] Yeah. He might have a point there. We would like to think that we can taper it. And I'm an optimistic person thinking that there might be a way to taper it. But indeed, he does have a point in terms of how do you prick a bubble slowly so it doesn't pop as badly. I do think there are possible methods and I'll share one. For the companies that don't make money like Tesla, who want to innovate and stuff like that, and they don't make any money, let them issue stocks. Let them issue non dividend stocks. So the thing is, do not let their stocks trade openly in the market - as in, they can borrow money from the people who believe in their company. Just don't let it trade. Don't let it trade until they actually start making money, they start paying dividends, they start paying shareholders and becomes a legitimate equity instrument.

Ross [00:24:16] And your thesis is to separate the two, isn't it when it comes to stocks? Those that pay a dividend and those that don't, really that's central to your thinking?

Tan Liu [00:24:25] Absolutely, because it's fundamentally different. One is non dividend stocks you receive nothing from the company. That is also why it is not equity. It is not an ownership instrument. Why on earth is that thing an ownership instrument if the owners never received money from the underlying company? Whose crazy idea is that, right? So yeah, one, you received money from the owner. You don't receive money from the underlying company. Dividend stocks, you receive money from the underlying company and you can possibly get capital gains from other people who want to receive more dividends later or something, right? The two are fundamentally different. Yet we think of all them all as stocks. No, that's just crazy.

Ross [00:25:05] As we conclude, you had a very successful tweet you put out. Let me read it. 'It's funny how the economy is about to collapse because people are only buying what they need'. It seems to me that this pandemic has pushed people back to really thinking about what is necessary, what they really need in their life to reassess some assumptions that maybe they've had wrong.

Tan Liu [00:25:27] Absolutely. Even though that doesn't have anything directly to do with the whole Ponzi process. But it does have to do with just this whole idea that does also push stocks and where all the finance journalists focus on, which is value and growth, value and growth. Growth, growth, growth, right? Where does that growth come from? If somebody spends, like, you know, $600 on an iPhone today, they're gonna be lacking $600 somewhere else. Yet you're saying all these companies are gonna be growing, growing, growing. And at the end of day, real growth should not be measured in terms of how much money you spend. Real growth should not be measured based on the dollar amount a company sells. It should be actually measured in an economy as zero inflation. Rent today costs the same way, same thing as five years ago. But innovation in a non monetary sense - that is real growth. It is not about how much more this company can sell. It's more about how did this company innovate? How did their product improve the lives of other people? Not hey, we sold 10 billion dollars last year. Let's try to sell twelve billion this year. I mean, heck, I was never like a big go green person. But one thing I've always said, and one thing I find very remarkable, is how during this week or two weeks or three weeks, within two or three weeks, we saw Venice canals clearing up. We saw all these environmental things just heal itself. It's almost like I think at the end of this we might want to think about everybody just shutting everything off for three weeks out of the year just to let the earth heal, because the results right now are remarkable. We can see the difference from space. It's not like we have to shutdown things all the time, but just within three weeks or a month, we've seen just much progress. All from what? All from us just shutting things down and realising we don't need all these excess things to survive.

Ross [00:27:25] That's it from Renegade Inc. this week. We'd love to hear from you. So studio@renegadeinc.com or tweet us at Renegade Inc. Join us next week for more insight from those people who are thinking differently. But until then, stay curious.