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Bailing Out or Bankrupting Britain?

Ross Welcome to Renegade Inc. The governor of the Bank of England is a public servant. He recently claimed that the U.K. almost went bankrupt at the beginning of the Corona virus pandemic. But how does a country that issued its own currency go bust? Josh, welcome back to Renegade Inc.

Josh Ryan-Collins Thanks. Great to be here, Ross.

Ross What a difference six months makes. At the beginning of the year Boris Johnson was talking about the U.K. becoming Singapore-On-Thames. He was saying on Twitter that this is going to be a brilliant year for the UK. Turns out that isn't the case. The Treasury have had to bail out many, many businesses in the UK, indiscriminately it seems. They've fired cash at businesses with old business models and airlines, whatever it might be. Were they left with no real option? Do they just have to take that action?

Josh Ryan-Collins I think in the short term, they have taken the right approach to provide support for firms fairly indiscriminately just to try and keep jobs going, essentially, and maintain a level of productive capacity in the economy. However, at some point there needs to be a transition. And already we've had some discussion about it, to start thinking about this crisis also as an opportunity, an opportunity to actually reshape our economy and restructure our economy to meet what will be the next crisis that's coming down the road, which is the climate emergency, as well as, you know, wider threats to our environment, which will have massive economic impacts.

Ross Do you think that the Treasury missed the beat insofar as the only caveat, really, to qualify for bailout money is that you make, a quote, ' material contribution to the UK economy'? That's such a broad brief. Wasn't it an opportunity to say, well, actually, unless you've got credentials that are going to push us towards a carbon neutral economy or unless you've got some caveat within this bailout package which talks about executive pay, share buybacks, your tax status, did the Treasury miss a trick their by giving such a wide remit?

Josh Ryan-Collins I think they have put it in some conditionalities around things like paying dividends and share buybacks. But it's probably not sufficient going forwards. You're right to point to these sort of corporate governance issues which are driving inequality and driving the sort of financialization of UK industry, and they do need to be dealt with. I think it's not just the Treasury though, it's also the Bank of England that needs to be implementing these sorts of conditionalities. And I guess a sort of broader issue is the type of financing that firmed companies are getting. So I think, initially, there was a thought that this would be a much shorter term sort of shock than it looks like it's now going to be. And there was an idea that debt financing would sort of be sufficient, particularly on the part of the Bank of England. But now it's becoming clear that actually many of these firms, some of the larger firms that are in less sustainable industries - aviation, the oil and gas sector, to some extent, other sectors like restaurants, catering - are not facing a liquidity problem. They're not facing such short term lack of cash. They're actually facing an insolvency problem that their business models are not sustainable. And of course, that means that if you just give them more loans with interest, you're actually just going to be building up debt, which they're not going to be able to pay back. So you're actually almost making the problem worse. So then the question I think is, is there a different type of intervention that might still preserve jobs but enables the government that's, you know, the taxpayer who's putting this money in, to have a stake in those firms and be able to perhaps help transition them towards a zero carbon economy or a more socially acceptable business model, corporate governance model. And obviously, equity is is one of the options that could be considered. At the moment we're just in danger of propping up sectors that in the medium term just really don't have a future.

Mitch Feierstein (video clip) It seems that the central banks across the world on a coordinated basis don't seem to understand the difference between provision of liquidity and solvency. You can't keep providing money to an insolvent zombie institution and expect that's going to rectify chronic management problems to that company. Prime examples are a couple in the airline sector. If you take American Airlines, they went out and did 13 billion dollars in Ponzified stock buybacks. The CEO paid himself one hundred and fifty million dollars. Now they're seeking 10 billion dollars in taxpayer bailouts. That money, the 13 billion that they used to buy their own shares back, should have been used to strengthen their balance sheet before they went out on a reckless spending spree to buy their shares back because the CEO was paid in equity. I've never seen that in my career where a CEO is paid entirely in stock. However, in the long run, this will see the company go into bankruptcy. The company is a walking zombie. You have a lot of the Robin Hood vigilantes out there that are buying bankrupt shares. I mean, you know, the stock is absolutely worthless and they've had to go out to the government and ask for 10 billion dollars in bailouts. Ten billion in bailouts will not be enough for American Airlines. American Airlines will be one of the casualties. But I've seen this time and time again in several different sectors that this happens - the central banks not understanding the difference between liquidity and solvency.

Josh Ryan-Collins The challenge here is that governments for too long, I think, have have taken this approach that they should only intervene in the private sector, in the markets, where there's a clear case of a sort of market failure and it just requires the government to come in and tax a little bit here, tweak a little bit there, level the playing field, de-risk - you know, these.types of phrases. What we actually need now is a very different sort of approach. When companies are facing insolvency and mass unemployment, we need the state to come in with a clear direction, future direction, for that sector in mind - whether it's to decarbonise it, whether it's just to create more job rich types of business models - and push that through. And that is what we call at Institute for Innovation and Public Purpose, a market shaping rather than a market fixing type approach to policy. And there's plenty of evidence from history that states can do this, right? So if you look at the US, for example, much of the defence spending in the US has been at the heart of the innovation that's led to things like the Internet and mobile smartphones. And we can do the same here in the U.K. if governments, I think, have the ambition to do that. That's the question. And my concern is governments are still very much in this kind of intervene on a short term basis, provide the liquidity, hope that the market sorts itself out.

Ross But that for me is a concoction for zombification because there isn't enough strategic thought about where to put onus, energy and capital. But when you then cross to Germany and look at what Angela Merkel is doing, she found it very, very difficult to get private sector businesses and public sector businesses to work with the state because Wolfgang Schauble, the then finance minister, was not an interventionist as he would call it. He's now out the way and she's been able to get that bill through to say, actually, this public private partnership could work quite nicely. We've looked at China and, actually, we're interested in this. Why aren't we doing that in the UK?

Josh Ryan-Collins Clearly, there's potentially some political issues as to whether the Conservative party is the right party to bring about this kind of shift.

Ross But they're free market capitalists. I mean, when you say they're the right party surely they can't be because it's not in their DNA. However, they're being taken kicking and screaming towards this idea.

Josh Ryan-Collins One might say that, you know, I think the Furlough scheme, you know, was one of the more ambitious and large scale interventions of any government, just if you look at it relative to GDP. I think there's another issue, though, which is just whether there's a sort of the right kind of culture and ambition within the civil service and within the Treasury below the leadership level around, you know, issues such as how you kind of evaluate what the returns you're going to get from different types of spending and fiscal policy. So there's this strong focus on cost benefit analysis where you only give the go ahead for a project to go ahead if you can clearly demonstrate that in three years time, you're going to have got more money than you put it. And there's a very strong culture of that in the Treasury. And we really need to be challenging that and saying if you're making kind of what we would call mission oriented investments that you don't know exactly whether you will succeed, you might not succeed. But if you do enough of these type of investments, you might get a company or technology that gives you returns on a much bigger scale. So this is almost a sort of venture capital, public venture capital, fund type model. And of course, often it will take longer than a couple of years to get that return. So that's also part of it, is can we shift that mindset within the Treasury? And of course, that ties back to this austerity debate and whether or not the government can run out of money and whether or not, you know, debt is sustainable relative to GDP. And of course, that issue is an interesting one because it looks like the current government has kind of turned a blind eye, as it were, to that issue. We are looking at record levels of debt to GDP, potentially.

Ross MMT. There is a magic money tree, it turns out.

Josh Ryan-Collins Yeah, indeed. And I think, you know, MMT is having a renaissance, obviously, in the US, but my sense is that the government has realised that there is no alternative here to a massive expansion in deficit financing. The other interesting development has been that the Bank of England has, you know, come about as close as any central bank will do to admitting that it is engaging in a form of monetary financing, even if it claims it's not being forced to by the government. Clearly, the fact that it's opened up this overdraft facility, the Ways and Means Facility, which essentially gives the Treasury unlimited free borrowing from the bank, which obviously creates money. I mean, I think the cat is out of the bag here. And hopefully this issue around debt sustainability willl kind of quietly go away. But we shall see.

Ross Culturally in the Treasury and the Bank of England and the political class and the business world, do we have the leadership, the innovation and the ambition necessary to start this again and say, you know what, we're going to do it properly this time?

Josh Ryan-Collins Well, the short answer, if you press me, would be, no. But I think one has to be an optimist in this kind of situation.

Ross Panglossian, isn't it?

Josh Ryan-Collins Yeah, yeah. Just because of the sort of the sheer kind of disaster that will occur if we don't take that approach. I mean, we are talking about potentially setting back the economy decades if we don't act rapidly and scale up government investment in the real economy and shape our mode of capitalism in a way that actually both creates jobs, but is also more ecologically sustainable. I think we've got a sort of two year window here to make those radical changes. And I'm hopeful that we can. There are clearly vested interests. But even the vested interests, I think, are gradually realising that the current model is just not sustainable. I think you can see with the reaction to the killing of George Floyd that people are essentially losing patience with the current model. So that's why it is a genuine opportunity. But it remains to be seen whether, as you say, the cultural change that we need can happen fast enough.

Ross Welcome back to Renegade Inc. Before we go up to Scotland to talk to the economist and author Laurie Macfarlane, let's have a look what you've been tweeting about in this week's Renegade Inc index. First up from Dave Goulson: 'In times of social, financial, ecological and climate change chaos, luckily we still have enough money to bail out pesticide companies with hundreds of millions of taxpayers money. Next, from Existential Comics: Capitalists during the good times: 'We took all the risk. So we deserve all the profit.' Capitalists during the bad times: 'Our risk didn't pay off. We need a bailout.' Next from Jonathan Bartley: 'Bailouts - Ryanair and EasyJet, 600 mil each, B.A. and Wiz Air - 300 million, Nissan 600 m, Toyota - 365 m and a cool 300 million to Rolls Royce, children who don't have enough to eat over the summer holidays -nothing. Tells you everything you need to know about this government'. And finally, we have a tweet from Prem Sikka: 'Privatised UK rail companies get 3.5 billion pounds bailout. This is in addition to the government's support of 7.1 billion pounds in 2018/19. UK railways are almost entirely state owned by foreign countries. Fat cat salaries and tax avoidance is rife. Huge export of capital'. Laurie, great to have you back on Renegade Inc.

Laurie Macfarlane Thanks for having me.

Ross And by the way, great new hair.

Laurie Macfarlane .Thank you. Yeah, this is what happens when you have a holiday on lockdown in your house. You end up with a stupid haircut.

Ross It's one of the great lockdown moments. I love it. When we're thinking about these bailouts, bailout Britain. We talked in that first half about the indiscriminate nature of the Treasury, the Bank of England, the government more broadly, just firing money at any businesses really. There's an arbitrary nature to this. Does that arbitrary nature worry you at all?

Laurie Macfarlane It does. The Treasury and the Bank of England in conducting the way that they're bailing out companies or rescuing the economy in their mind, they like to take the view that they're taking a sort of a neutral perspective so that they're not favouring some sectors over others, They're really looking at things like whether a company makes a material contribution to the economy, for example, as if they're not making overt choices. But, of course, in reality, they are making choices, very implicit choices, which have a big impact. Obviously, on the Bank of England side, we've seen through the corporate Covid Financing Facility, giving cash to very carbon intensive industries, for example, that don't really align at all with even the Tories commitment to decarbonising the economy. And at the same time, sort of protecting, if you like, sort of holding up the sort of rentier economy quite significantly at a time when, of course, there are, you know, households and indeed many small businesses who are really, really struggling.

Ross You touch on something really interesting here, because it's the, let's say, insidious nature or surreptitious aspect of this, because there are companies out there, 53 of them, the Bank of England have overtly well, not overtly, but they've bailed out and all that money has gone to. But what you're touching on is something which is unspoken, unsaid, and it divides the economy into two. It divides the economy into rentier economics and the real economy economics. And what you're saying is the establishment has closed ranks and bailed out the vested interests?

Laurie Macfarlane Absolutely. I mean, the protection of rentier interests is quite striking. This is something we looked at in a report quite recently. So if you take, for example, compare the approach between landlords and tenants. So on the one hand, landlords, they're the only group in the economy at the moment, essentially, who the government are saying you are guaranteed to receive your income in full. So at a time when households are being furloughed, they're seeing incomes cut or indeed to be shoved onto universal credit. When businesses are being told they have to shut down and are seeing a collapse in revenue, government is saying to landlords, look, you can continue to extract rents from tenants at the full rate. There is absolutely no haircut that's going to be imposed on landlords. It's similar with the financial sector. What's striking about the UK government's approach to supposedly helping businesses is that it's all been mediated through our private banking sector. So the government's flagship business interruption loan scheme, this isn't - what's important to understand - this isn't a scheme to support businesses. It's a scheme to provide a guarantee to banks. It's a scheme to provide a guarantee to de-risk bank loans, to try and cajole banks to then lend to businesses. And of course, the problem there is that the banks that we have - the big banks in the UK - aren't remotely interested in lending to small businesses. They haven't been for a long time. They want to plough money into real estate and financial markets. And so while Rishi Sunak stood up and said, we've got this unprecedented three hundred and thirty billion pounds of support going into businesses, that was 330 billion pounds of guarantees to banks. And a fraction of that has actually been lent out to businesses.

Ross Rishi Sunak is an ex Goldman Sachs banker. And the vast majority of Tory MPs are buy to let landlords. Do you think that there's cause and effect here?

Laurie Macfarlane Oh, there's no doubt. There's no doubt about it that our whole approach to housing and the financial sector, of course, in this country is reflected very much in the composition of our parliament. I think it's very unsurprising when you look at the UK it's almost the sort of the poster child of the rentier economy, if you like. And when you look at the composition of not just in government, frankly, where you have landlords and former bankers in high places, but also the opposition as well. So it's unsurprising in many ways when you have policies come through that are so generous to landlords and so generous to the financial sector.

Ross Don't people realise that, ultimately, this is a zero sum game? House prices won't just keep going up forever. A over bloated financial sector is a cost centre for the economy. Don't people begin to realise this and don't the vested interest realise, ultimately, we're going to be on the wrong side of this?

Laurie Macfarlane I think you're absolutely right. This is ultimately a zero sum game. And it's an interesting question as to how long the UK economy can kind of sustain this parasitical rent extraction model where we've had, you know, leading up to a financial crisis we had over that massive housing boom, massive explosion in the size of the financial sector. That all came crashing down. After the financial crisis, we saw this huge attempt to basically try and prop all of this back up. We had various schemes in place - bail out the banks, help to buy, let's get the housing market moving again. And again, that was kind of successful. We had a massive housing boom again over the past decade. I think what we're starting to see know, though, is that people who are are suffering the cost of that, if you like, so those who are stuck in the private rented sector, for example, who have got absolutely no prospect of ever owning a home. That group is actually now very large and growing. And in London, renters have actually overtaken owners for the first time, I think it was last year or the year before. And that has a quite an impact on the political economy, I think of the situation. But what will be interesting this time round is we've got another unprecedented economic crisis. We're looking at double digit recession this year. The government's obviously going to be trying to do what it can, as I said, to kind of prop up that rent extraction model to get the economy back to where it was. I think the Treasury and the UK government in general have got themselves in a bit of a bind because on the one hand, of course, large chunks of the population, certainly when it comes to housing, have been benefiting from this system. And this is obviously part, in many ways, of the objective of Thatchers housing revolution. The property owning democracy was to try and ramp up homeownership to as high as possible, give people a stake in the private property, give people a stake in effectively rent extraction and that will make them more likely to be favourable towards the kind of policies that the Tories might be putting forward. Now, we've got to a situation where much of the electorate's wealth, household wealth, is tied up in their property or indeed multiple properties and don't look very favourably on any kind of policies that might seek to, you know, harm that wealth, if you like. And the Tories, it's interesting because I think the penny has dropped, that they really need to do something about housing in particular, because this is one of the key issues for young people. But they haven't, I don't think understood the point which you made earlier, which is that this is fundamentally a zero sum game. I mean, if you just read the press, even the financial press, when house prices go up, it's sort of celebrated as a good thing for the economy. And remember as well, when house prices go up, the amount of wealth, paper wealth in the economy as recorded on the books by the ONS, also increases. So it makes us look wealthier. What isn't captured, of course, in the books is the fact that that wealth that somebody has gained on their own personal balance sheet, there's a cost to that, which is somebody somewhere is going to have to be higher rents if it's going to be rented out or they're going to have to save up more for a deposit and pay more in interest on a mortgage to pay that back. And so it's basically a transfer of wealth. It's not wealth creation, it's a transfer of wealth away from those who don't own property to those who do own property. But I do think I don't think that penny has dropped. As I say, even many economists will still sort of see house price growth as a sort of legitimate form of wealth creation rather than what it actually is, which is wealth extraction.

Ross Progress and poverty aye? Someone should write a book on that. So I'm going to make you UK chancellor for the day. Which three things would you begin to do to start to pivot away from a property owning democracy where you get all this unearned wealth in housing to starting to refloat the real economy, especially in light of what's coming down the track and climate breakdown?

Laurie Macfarlane So the first thing I would do is something which the government has sort of hinted that it's looking at. So a couple of weeks ago, it was reported in the FT that the Treasury has a project called Project Birch and that's looking at starting some kind of state holding company, a sort of social wealth fund, public wealth fund, which in their eyes, it's role would basically be to buy stakes in companies who are really struggling - strategically important companies who are struggling under Covid - and basically buy stakes in them, help them get through the crisis. And then no doubt, knowing this government, probably flog them back to the private sector. What I would do is absolutely start a state holding company or public wealth fund, buying up strategic assets in companies, but doing that, not in a way to just socialise losses and then privatise them again, but to do that and transform them. So maybe we should bailout the airlines, but not to just hold on to them and then sell them off but to transform them, decarbonise their operations entirely, put them on a path, a sustainable path. Same with other industries, the steel industry, for example. Yes, let's take some equity stakes in there. Let's link it to a proper industrial strategy that's going to take us from here to a much more sustainable economy in the future. The second thing I would do, is we should remember, that after the last crisis, the government bailed out the banks and we still own the majority shareholding in RBS.

Ross Right.

Laurie Macfarlane It's about 63 percent or something like that. And the government still pretends that it's going to sell this off again as soon as the share price gets back to the right level. Of course, it's probably not going to get back to the right level. So what I think we should do is they should basically buy up the rest of the stakes, the remaining 30 percent or whatever it is, it's dirt cheap at the moment, and transform RBS into a proper public interest bank that's geared towards serving the real economy, that's geared towards helping businesses and households with their finances, helping businesses and households make that green transition, for example. The third thing I would do if I was the chancellor, is set out basically an announcement that basically sets the expectation, puts a flag down on the ground that says, look, going forward, we are going to end house price inflation in this country. Going forward we are not going to be tolerating or promoting, you know, the kind of house house price inflation that you've become accustomed to over recent years and make it clear to people, look, if you thought you could rely on property to pay off your pension in future, well, actually, you can't because, you know, best isn't going to be where it was before. And setting that expectation, but backing it up with some clear policies about what's going be implemented, I think can begin that process of starting to change people's behaviour, change incentives in the economy, to wean us off this dependence on property asset price inflation and move us into a more sensible kind of economy.

Ross Laurie Macfarlane, thank you so much for your time.

Laurie Macfarlane Thanks for having me.

Ross That's it from Renegade Inc. this week. You can drop the team a mail, studio@renegadeinc.com, or you can tweet us at Renegade Inc. Join us next week for more insight from those people who are thinking differently. But until then, stay curious.