Lord Adair Turner on the “largely fictional” world of finance

Interview by Matt Phillips 20 January 2016 on Quartz.com

With his silver hair, rich baritone, Cambridge education, and British peerage, Adair Turner, Baron of Ecchinswell, would be last person you’d suspect of being an economic radical.

But Turner came away from a four-year stint as the head of Britain’s chief financial regulator, the Financial Services Authority (FSA), with a range of ideas that just a few years ago would have been considered unmentionable in polite political or financial company.

In his recent book, *Between Debt and the Devil*, Turner’s conclusions are dictated by what he sees as the paradoxical character of modern developed economies. As currently structured, rich economies seem to need to borrow ever more money to generate economic growth. But that very addiction to debt makes them vulnerable to periodic busts that deeply damage the economy.

Turner was deeply involved in the clean-up after the latest global debt crack-up. The former vice chairman of Merrill Lynch Europe took over the FSA on Saturday Sept. 20, 2008. (The financial crisis had crested just five days earlier with the bankruptcy of US investment bank Lehman Brothers.)

The sometimes harrowing experience there, as well as his extensive work both at financial institutions and in academia, have given Turner an insider’s view of the world of finance and economics. But his conclusions—that the banking system needs to be fundamentally restructured, and that periodically, instead of a government running up debt, the central bank should just print money for the government to spend—are far from conventional.

Turner recently visited Quartz’s New York offices to talk about the book, why what most people understand about banking is “largely fictional”, and why, in some instances, central banks just need to bite the bullet and print more money.

Here are excerpts of our conversation, edited for clarity and concision.

Quartz: This book makes some recommendations that would have been unthinkable before the crisis, for someone coming from your background. You don’t strike me as a wild-eyed radical. So tell me a little about how you came to some of these positions?

Adair Turner: I took over as chairman of the UK Financial Services Authority on Sept. 20, 2008, five days after Lehman Brothers Collapsed, lived with the emerging responses of that autumn, and spent four years of my life as the chair of the Financial Stability Board’s policy committee, redesigning the global financial regulation system.

But increasingly I thought, “We’ve got to think more deeply than we are about why the crisis of 2008 occurred and why there’s been such a long post-crisis malaise.” Why the recovery has been so weak? And then I just started reading and thinking.
And I’ve always had a tendency to take my thinking wherever it goes. Even if it ends up in uncomfortable directions. And I think I’m getting more and more like that as I get older.

One of the things that I really liked about the book is how frank and plainspoken it is. It struck me that you describe the typical textbook description of banking as "largely fictional."

Turner: It's a myth.

And maybe I should just say, this "myth" is that people deposit money and banks take that money and lend it out to make productive investments of that capital into businesses.

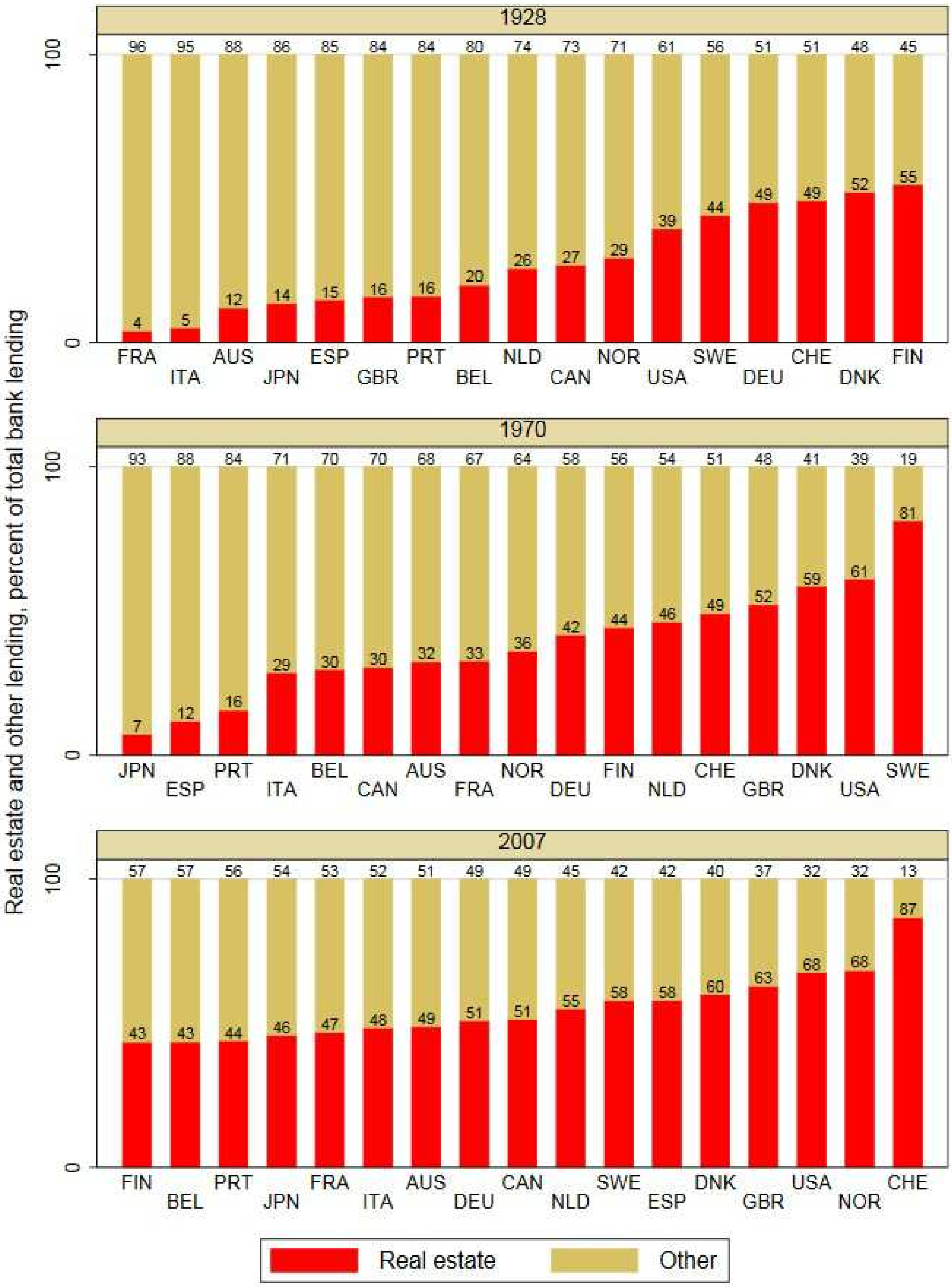
It's fictitious in two elements. One of which is to suggest that banks merely take pre-existing money and lend it on. It does not capture the reality that banks are able—unless they are constrained by capital and liquidity and reserve asset requirements—to create new credit money and purchasing power.

So, they don't just re-loan money. They create money.

Turner: They create money…And that's an incredibly powerful capability. It's an incredibly powerful, important thing that happens in the economy.

The other fictitious element has to do with banks, when they lend money, and when they allocate that purchasing power, [the myth] is that they give it to entrepreneurs and businesses to fund capital investment. That is simply empirically not true. [In his book Turner points out that the vast majority of bank lending finances the purchase of property.—*Eds*]

But what is extraordinary about the myth is that, although when you look at the figures it's obvious that it's not true, people have just said it for years.



Share of real estate lending to total lending averaged across17 countries.

It's interesting because that willingness to simply repeat this rote story, it sort-of mirrors the shift of economics toward these streamlined models that elide over the details of how the economy actually works.

Turner: I think that's absolutely right. A lot of economics, as it grew up from the 1960s onwards in a highly mathematical fashion, trained undergraduate economists to understand a set of theoretical model constructs and then to work within the constraints, exploring further the complexities of those constructs.

Often economists didn't step back and say, "is this describing the real world, what the banking system does and where wealth comes from?"

The core argument out of your book is that the engine of modern developed economies, as they're constructed now, is that they need debt in order to grow.

As constructed now, they need debt. Or as constructed now, they inevitably produce too much debt.

We end up with year after year in which private debt grows faster than nominal GDP. We end up with it looking as if we need that debt to grow nominal GDP.

And yet, if that is the case, the system is bound to blow up in the end and is bound to put us in a malaise we were placed in after the blow-up of 2008.

I want to touch on some of the more radical proposals of your book. You propose taking away the ability of banks to create money, constraining them merely to lending out the money they receive as deposits. [This is known as 100% reserve banking.] You also talk about the prospect, every once in a while, of saying it's OK for the central bank to just print a lot of money. To many people that might sound like Peronist economic policy.

I think that is the most radical policy recommendation. I think actually the most radical bit of my book, in theory, is putting together the story of the interrelationship between the ability of the banks to create credit and the importance of irreproducible real estate assets.

What Friedman argued is … you can always get the economy going if the central bank essentially prints money, gives it to the government, and the government spends it.

But what has captured the imagination of in the public debate is that I have said that, under some circumstances, you could do what Milton Friedman called "helicopter money," which is [when] you're stuck in a liquidity trap, you're stuck with deflation you don't seem to able to get the economy going again.

What Friedman argued is, in those circumstances, you can always get the economy going if the central bank essentially prints money, gives it to the government, and the government spends it.

Now there's a point about Peronism. Perón may have been in favor of it. But so was Milton Friedman and Milton Friedman is not exactly known as [a] left-wing, socialist, lover of inflation. And he ended up there because [helicopter money] is logically the policy which will always deal with deflation.

And I argue, as a way of stimulating demand in the economy, it is a safer way of doing it than the way that we're doing it at the moment, which is to try to rely on interest rates kept incredibly low, year after year after year.

So yes, there are risks to it. But you've got to compare them to the risks of what we're doing at the moment.

Now can you contain the risks? The essence of overt money finance—helicopter money—as I call it, I don't think there are any technical arguments against it. I think technically, it is always possible. Technically it is the one thing that will always get us out of a deflationary recession when all other tools don't work.

And technically there is no reason whatsoever that we shouldn't do an appropriately moderate amount of it, rather than too much. There's no mathematical knife-edge to this that says …

…that it has to get out of control.

That it has to get out of control. So the whole issue—and that's why I called the paper I gave at the IMF three weeks ago "The Case for Monetary Finance—an Essentially Political Issue"—the whole issue is once you break the taboo, once you tell people, and in particular you tell politicians, that this is possible, what's to stop them from wanting to do it all the time? And in large quantities? In inappropriately large quantities, rather than in appropriate quantities in appropriate circumstances? So the whole issue is the political risk.

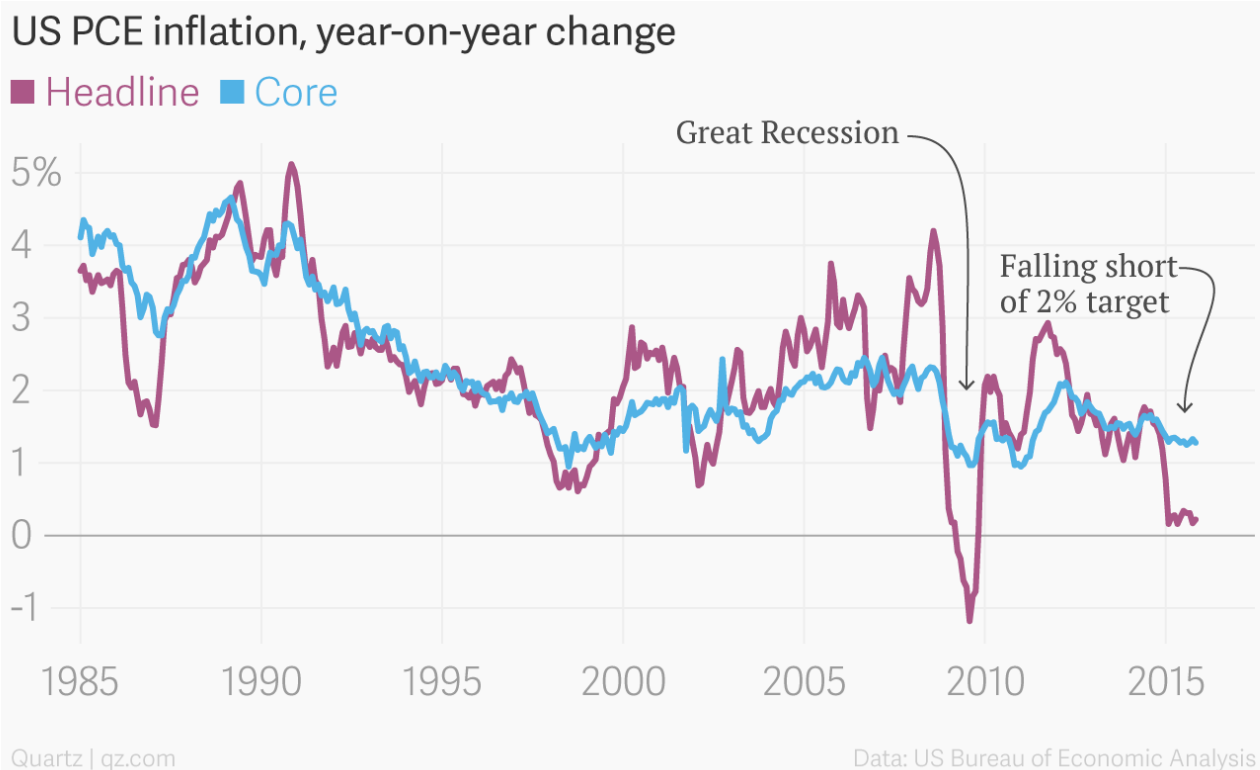
So who's in charge of the printing press?

And that's why I argue that the most logical thing to do is to give it to an inflation-targeting central bank. So that you say the central bank has the authority to recommend a certain element of money finance but without that authority, the government can't do it.

This sheer amount of monetary-policy ammunition we fired and the small effect it's produced is really extraordinary.

So I would say the Bank of England back in 2009 should have had the option of saying, "We're not going to try and stimulate the economy indirectly by driving up bond prices and equity prices [with quantitative easing.] We are going to simply say we want $40 billion this year, and $20 billion next year of direct fiscal stimulus to the economy, which, we, the central bank, are printing the money to provide." It doesn't have to be borrowed money.

After all, look what we've done for the last seven years. We have done the most extreme monetary policies we could imagine. We've had interest rates at zero. We've used forward guidance to try to convince people that they're going to stay at zero. We've used quantitative easing to try to bring down the long end of the yield curve as well as the short end. And seven years into this, inflation is below target in all the major economies of the world.



So you can't call this a great success. This sheer amount of monetary-policy ammunition we fired and the small effect it's produced is really extraordinary.

So just to clarify, your proposal is that the central bank would, sort of, order up fiscal spending? Who's in charge of how it is spent?

You need a degree of coordination. And actually Ben Bernanke said this very clearly in his famous speech for which he got the name "Helicopter Ben" in Japan. And he said then exactly what I'm saying: There exist some circumstances in which the government should have a tax cut or public expenditure and it should be funded by permanent money creation by the central bank.

Now what I'm saying is, it should be for the central bank to say, "In these circumstances, in order to get nominal demand up to the level we want, we believe we have to have a fiscal stimulus financed by central bank money."

It then has to be for the government to decide where it is spent. I think you can—and you should—outsource to the independent central bank the decision on how much.

But you cannot have the central bank saying, "OK, is it going to be a tax cut, or is it going to be public expenditure. And if it's a tax cut is it the same amount for everybody or is it proportional to their income." Those are inherently political decisions.

But you can have the decision on how much [money will be printed] residing in the central bank, and the decision on how precisely it is spent, in the government. As long as you've located the authority on the absolute amount within the central bank, I think you have an answer to the political danger question.