Rethinking Sustainability, Development and Economic Justice

OVERVIEW AND INTRODUCTION

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Mexico City, pop. 20 million

Graffiti in downtown Mexico City, June 2013

Background

- During past four decades world economic regime was organized around financial and commercial liberalization
- Fiscal and monetary policies were dominated by the dogmas of balanced budgets and price stability
- Sector level policies (agriculture and industry) were abandoned or relegated to play a role of enabling conditions for business and free markets
- After 1975 the world economy expanded at a slower rate, unemployment increased, inequality intensified, poverty rose…
- …inflation decreased marginally, but volatility in exchange rates increased, financial crises multiplied…
- …and environmental degradation deepened (MEA, IPCC)

Global Economic and Financial Crisis 2007

- This is the model that delivered the Great Recession (starting 2007)
- Not a market failure crisis
- Macroeconomic crisis of a flawed economic model (based on unregulated markets, low labour costs, asset bubbles and social-environmental dumping)
- Conclusion: capitalist economies are inherently unstable and capable of sustaining socially unacceptable levels of unemployment and environmental destruction for long periods of time – policy intervention is required

Global Crisis: Implications for Sustainability

- Sustainability will be deeply affected – our struggles will become harder and more decisive
- Cuts in allocations for health, education, housing and environmental stewardship (as a result of bailouts and fiscal austerity) will mark fiscal policy for decades
- Environment displaced in global agenda (priorities: growth and ‘recovery’, jobs, macroeconomic stability)
- Sluggish growth: persistent unemployment, poverty and inequality
- Greater pressure on natural resource base
- Policy response (fiscal retrenchment) worsens situation
- Policy discussion is essential: this is where macroeconomics comes in

- Thus, today everything is marked by the worst crisis in 80 years…
- …a macroeconomic crisis
- And yet, at Rio+20 there was no mention of the crisis
- Why?
- **Because the way in which we think about macroeconomics (and the crisis) opens a political dimension to the crucial themes of our times**
  - For critique
  - For alternatives
- Economic theory is important, so is history
- Macroeconomic theory and policy: are we sitting at the table?
- So, this is the structure of this presentation
  - Objective: start generating a common language

Outline

- Economic theory and peoples' struggles
- Principles of economics: autonomy, system, money
- Macroeconomics: an abandoned battlefield?
- Overview of the world economy today

Economic Theory
and Peoples' Struggles

The Fundamental Assumptions of Economic Theory

- Autonomy of ‘the economy’ from other dimensions of social life
  - Separated from ethics, politics, law, religion, art
  - A momentous ideological ‘tour de force’
- The economy has the structure of a system: it has its own rationality
- Economic theory: its object is to unravel the laws that drive/rule the economic system
- Marx: critique of this discourse
  - Political economy (or economic theory) is the discourse of capital
  - Capital: historically determined mode of production

Critique of Economic Theory

- Political economy and economic theory
- A-historical (‘pure’) theory
- Rationality at level of individual agents marks all social relations
- Reductionism
- Economic theory: the discourse of capital
- Science or an apology of capitalism?
  - Education or indoctrination?
  - What about people like Keynes?
    - Capitalism inherently unstable
  - Marx?
    - Science and class exploitation

Relevance of the critique of economic theory to peoples' struggles: one example

Money is key economic object, but theory always had a deep problem with money

Money is key political object and threatens to unveil the synthetic nature of the "autonomy" of economics

As a result, political economy chose to expel money from its analytical space: the analysis of economics would be carried out in terms of "value" theory

The hypothesis of nomenclature (C. Benetti)

- Value theory restores the functions of unit of account in a non-monetary world (the world of 'pure' economic theory)

This seems very arcane – but today we are rediscovering the relevance of this essential weakness of economic theory with the most 'sophisticated' macroeconomic models that cannot deal with monetary issues

Relevance of critique to peoples’ struggles (continued)

- World suffers from a severe case of financial macrocephaly but the theory that justifies neoliberalism does not not know what to do with money!
- All theoretical models of the market (and its “virtues”) correspond to non monetary or pure barter economies
  - Microeconomic theory
- When it comes to macroeconomic models we observe models that maintain a totally erroneous view of the origins and nature of money
  - This view is logically and historically flawed
  - Money did not originate from barter
    - Money is not part of a ‘maximizing’ project
  - Money’s origins are closer to its role as unit of account and debt
  - Money is not created by the central bank (the CB does not control money supply)
  - The function of monetary creation is in private hands: the commercial banks create money “out of thin air” (they do not need deposits to make loans)
  - **Loans make deposits**

Relevance of critique to peoples' struggles (continued)

- This analysis has vast implications: everything changes
  - The theory of loanable funds
  - The interest rate
  - Banks are **not** simple intermediaries
  - The myth of the monetary multiplier
  - How do we interpret the global financial crisis
  - The received narrative of the crisis in Europe
    - Did the PIIGS squander the savings of the virtuous people of Northern Europe?
  - What about the policy response and the bailouts of the banking system
  - What about the capacity of governments to finance their own deficits with their own central banks?

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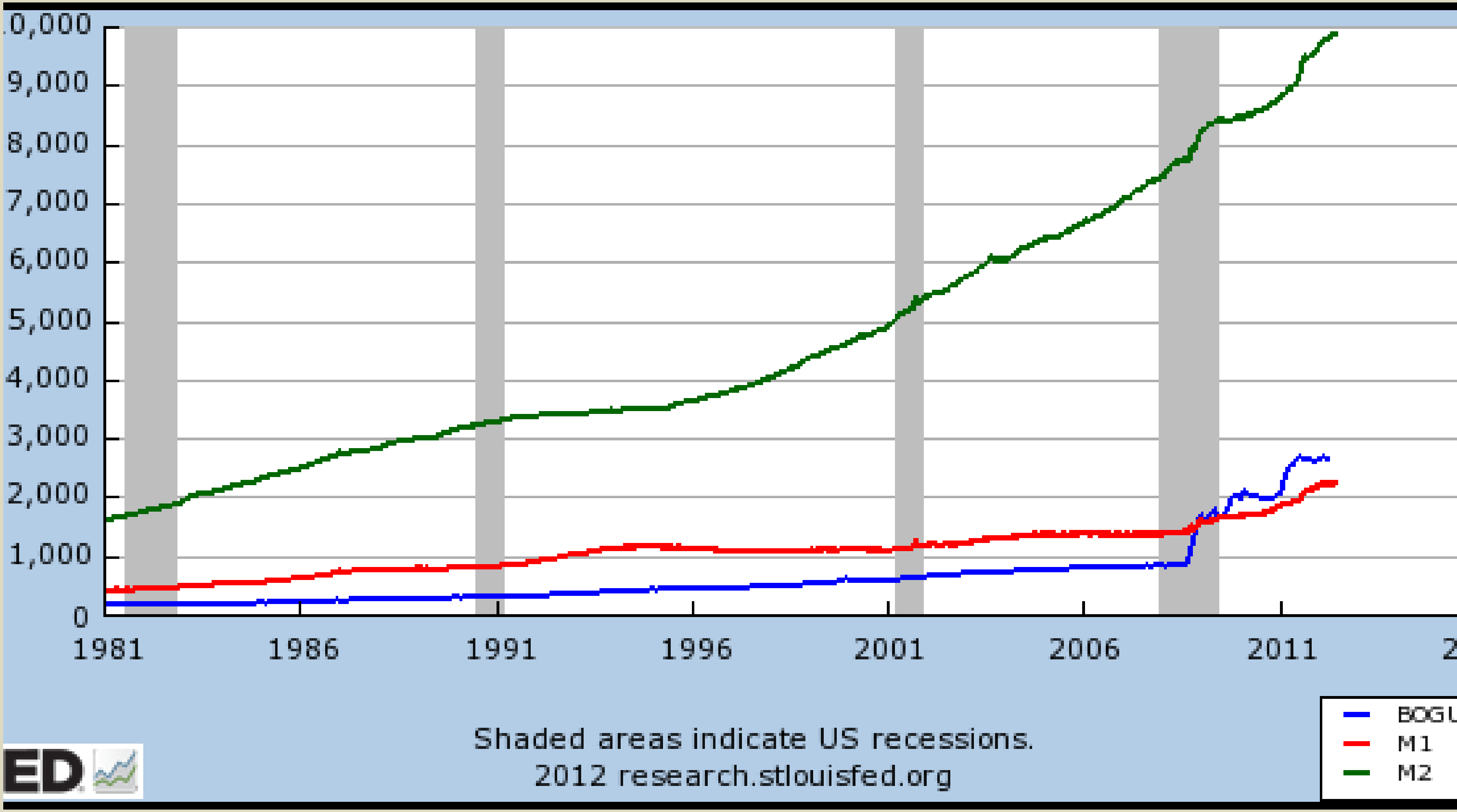
Money creation by private commercial banks

- “The essence of the contemporary money system is creation of money, out of nothing, by private banks’ often foolish lending”

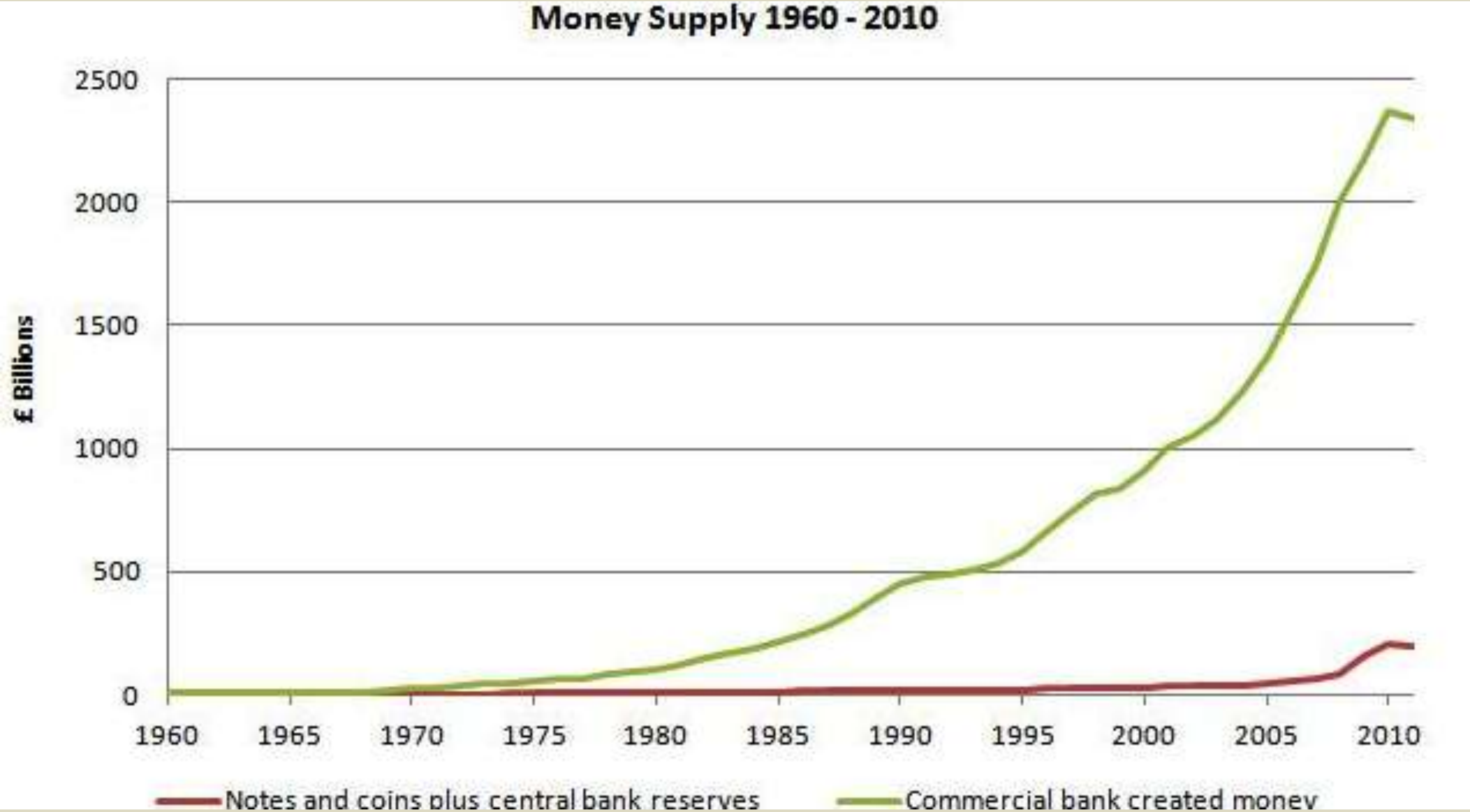
  Martin Wolf Chief Financial Editor

  Financial Times November 9 2010

Monetary Aggregates in the US



Monetary Aggregates in the UK



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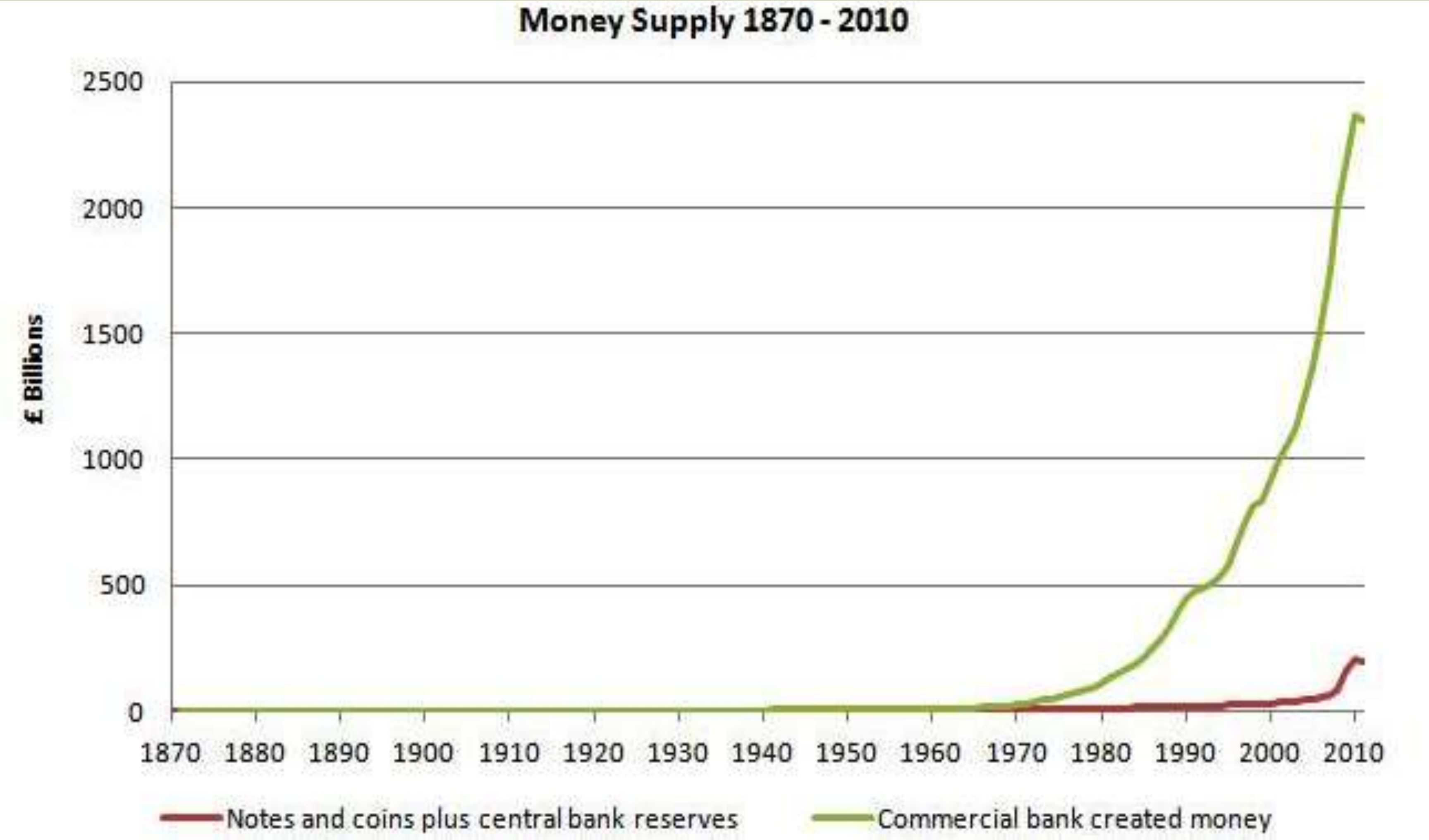


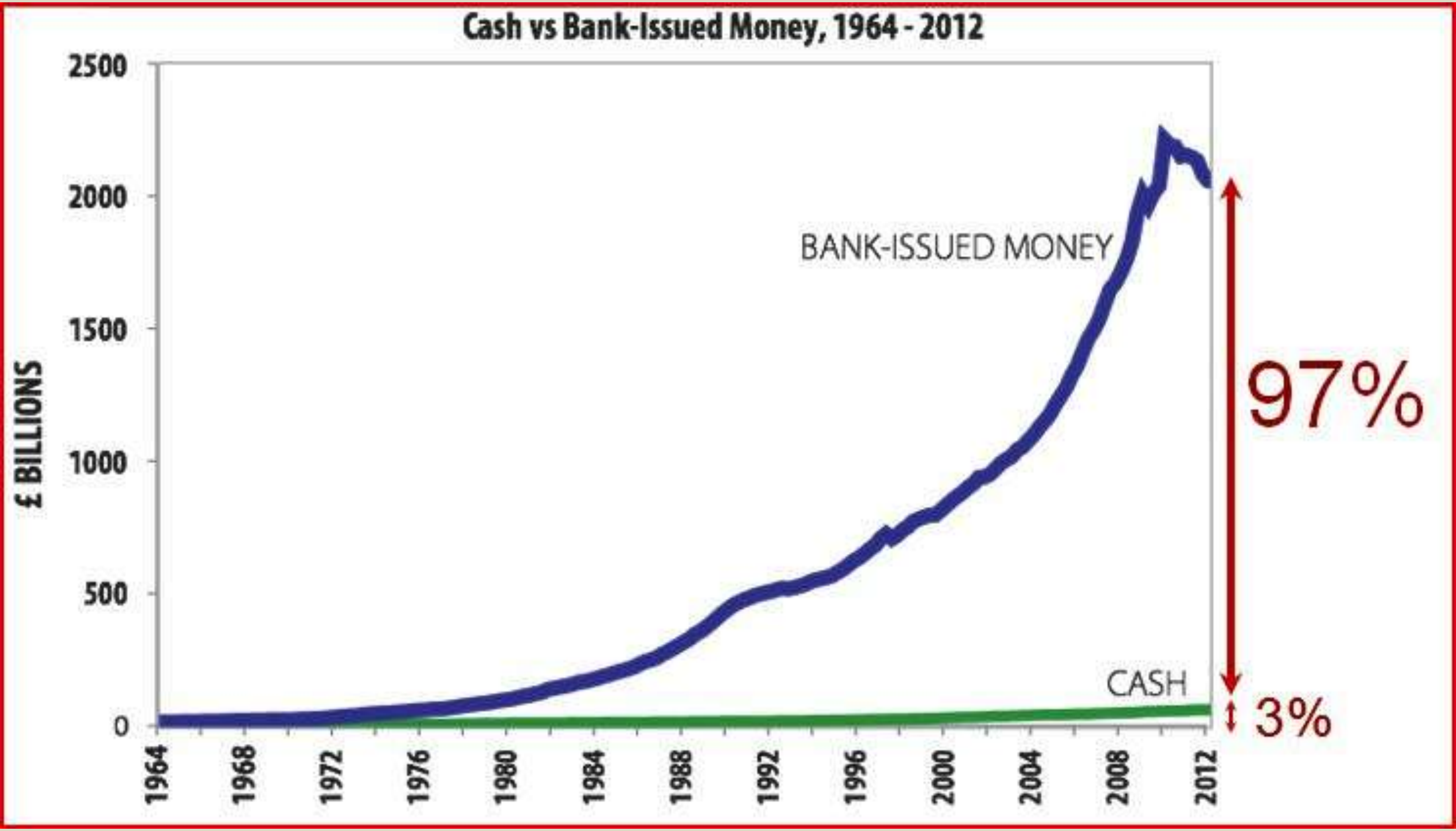
Monetary Aggregates: some definitions

- Measures of the total money supply in an economy:
- M0 = physical cash and coin in public's hands and in reserves in banks
- M1 = M0 + demand deposits, checks and TCs
- M2 = M1 + time savings deposits and retail money market shares (*)
- M3 = M2 + larger time deposits and large scale institutional funds

Note: broader monetary aggregates reflect less liquidity

(*) Market for short term financial instruments that move large sums of money (interbank lending with commercial paper, repurchase agreements, typically benchmarked with LIBOR; financial companies issue large amounts of asset-backed securities, etc. Money market move large amounts of money

Monetary creation by private commercial banks UK



Where the money goes UK

- Increased lending by UK banks between 1997 and 2007 went to the following uses:
  - 40% housing
  - 37% financial sector
  - 13% non-financial businesses
  - 10% credit cards and personal loans

Source: Positivemoney.org

On final point: the role of central banks

- Central banks do not control money supply
- Regulations (reserve and capitalisation requirements) imposed on private commercial banks by central banks are quite ineffective
- **But perhaps even more important: why did governments/states relinquish their capacity to create money and to finance their own operations?**
  - **Lessons from the European experience**

Macroeconomic Policies:
An Abandoned Battlefield?

Macroeconomics

- Based on relations between economic aggregates: essentially different from relations between individual agents (micro)
  - **Aggregation does not conserve characteristics of individual agents**
  - “More is different”
- Policies:
  - Monetary, financial and banking policies
  - Fiscal policies (revenues and expenditures)
  - Trade policy
  - Incomes’ policy
  - Economy wide prices (energy, foodstuffs and wage goods)
- Role of the State and public policy (privatization and deregulation)

Relevance of Macroeconomic Policies

- Macroeconomic policies determine
  - Rate of economic activity and investment dynamics
  - Usage rates of natural resources
  - Relations between real and financial sectors
  - Asset composition of investment portfolios
  - Income distribution
  - Structural economy-wide transformations
  - Insertion in the international economy
- They affect production strategies and resource management capabilities of all economic agents, from the largest corporations to the smallest farmer
- Powerful instruments of change
- Control the aggregate amount of resources allocated for environmental stewardship and conservation

Some Myths in Macroeconomics

- Governments are not households
- Macroeconomics is not the result of aggregating behaviour of individual agents
  - Properties at micro or sector level are not conserved in aggregation
  - Fallacy of “micro foundations”
- Uncertainty is essential feature in capitalist economies
- Fallacy of rigid vs. flexible prices
  - Flexible prices may lead to explosive trajectories
  - Markets do not converge to equilibrium (no such thing as efficient allocation of resources)
  - Instability is essential characteristic of all markets (especially financial markets)

Macroeconomic and Sector Level Policies

- Under neoliberalism sector level policies have been <u>disciplined</u> by macroeconomic imperatives (especially price stability and balanced budget):
  - Resources for health, education, housing and environmental/conservation policies not determined by respective ministries but by Ministry of Finance
- Sustainability objectives and policies need to be designed in the context of a comprehensive discussion of macroeconomic policy priorities and instruments
  - Macroeconomic policies can neutralize or even destroy sustainability: from a reformist perspective we need to avoid inconsistencies

Macroeconomic Policies Systematically Ignored

- Green Economy Initiative, UNCED Rio+20, UNFCCC-IPCC, MDGs, ignore economic policy
  - Sustainability left as a question for business and markets, policy is limited to enabling conditions
  - Will it be the same with post-2015 SD agenda?
- Microeconomic and sector level analysis creates illusion that things are being done. Macroeconomic policies have indirect effects. The lines of transmission are long and frequently opaque.
- **Most important: a discussion at the macroeconomic level uncovers the entire model and reveals how it works. Microeconomic focus does not challenge the rationale of the entire model.**
- Macro perspective invites controversy. For example, there is nothing technical about priorities. From price stability to sustainability

Thank you