



“Restructuring Finance to Better Serve Society”

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Transatlantic Agenda for Shared Prosperity

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Question to be Addressed:

What is the relationship
between the financial sector
and the real sector?

One simple Answer:





Andrew Haldane of Bank Of England Estimates:

Cost of Current Crisis: \$60 – 200
TRILLION

Andrew Haldane “ The 100 Billion Dollar Question”
March, 2010

<http://www.bankofengland.co.uk/publications/speeches/2010/speech433.pdf>

Financialized Capitalism:

Locked in A Devastating Dynamic of
De-regulation, Financial Innovation,
Explosion, and Bail-out

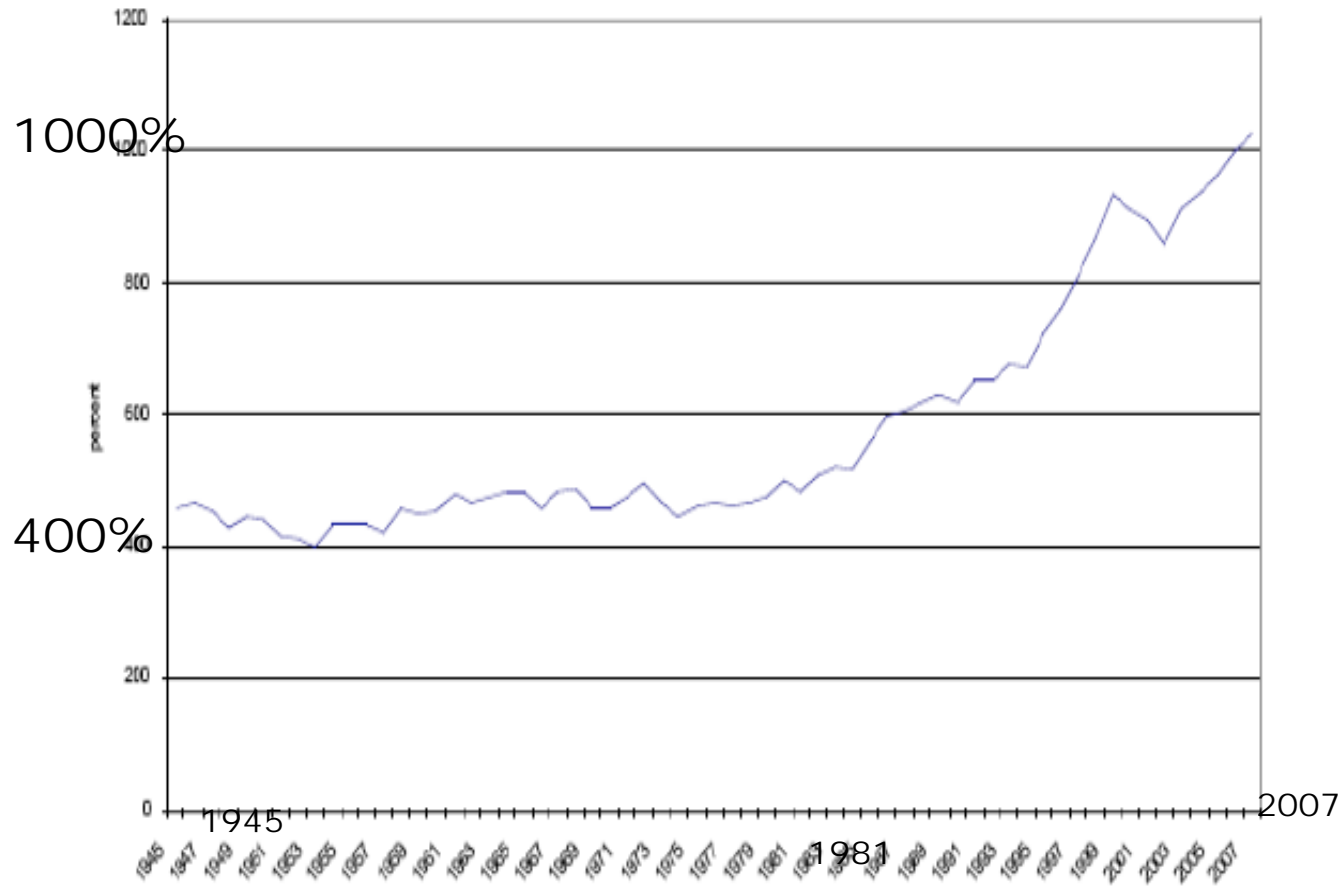


This cycle of de-regulation, boom, bust and bail-out has also lead to an enormous growth in the financial sector in the U.S., U.K., and, indeed in many parts of the world.



US: TOTAL FINANCIAL ASSETS AS % OF GDP

Total Financial Assets as a Percent of GDP



Source : Flow of Funds Table L5, NIPATable 1.1.5.

1945

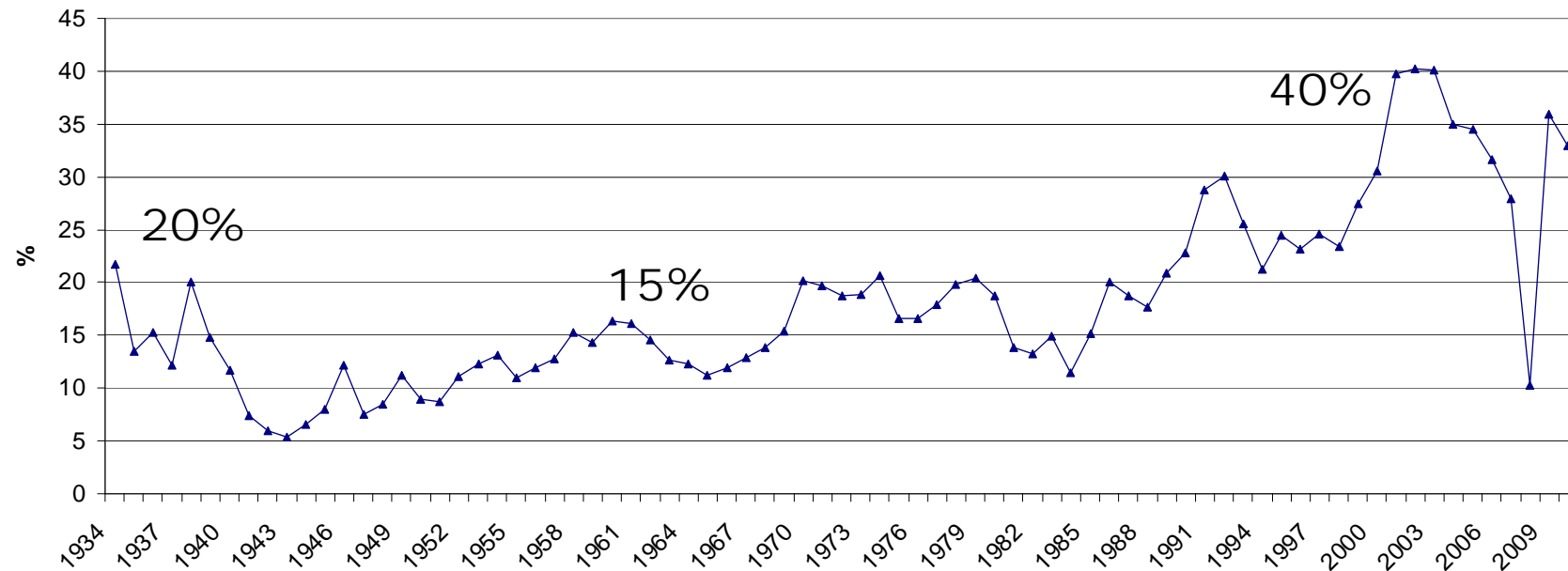
1981

2007



Financial Sector Profits as Share of Total Profits, USA

Financial profit as a share of total domestic profit (USA, 1934-2010)



Source: calculated from NIPA, Table 6.16, Profits are with IVA and CCAAdj

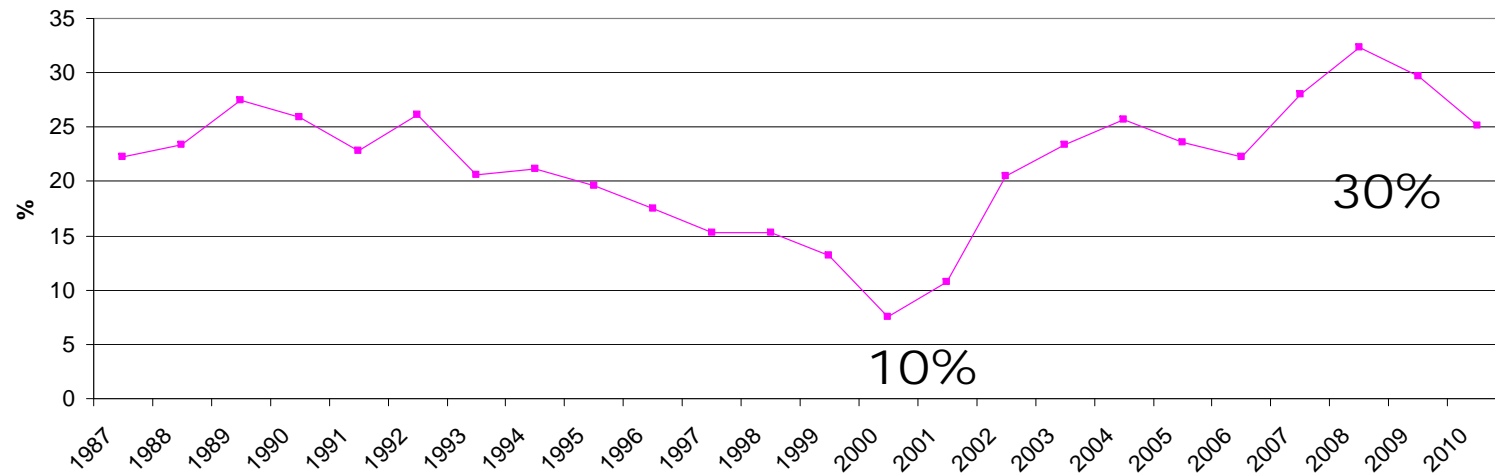
1934

1960

2009

Financial Sector Profit Share in UK, 1987 - 2010

Pre-tax profits of financial corporations as a share of total domestic pre-tax profits: UK, 1987-2010



Source: ONS, UK Economic Accounts, Income and Capital Accounts. Pre-tax profits are calculated as a sum of gross disposable income and taxes on income. Domestic sectors include fin corporations, public corporations, non-fin private corporations.

1987

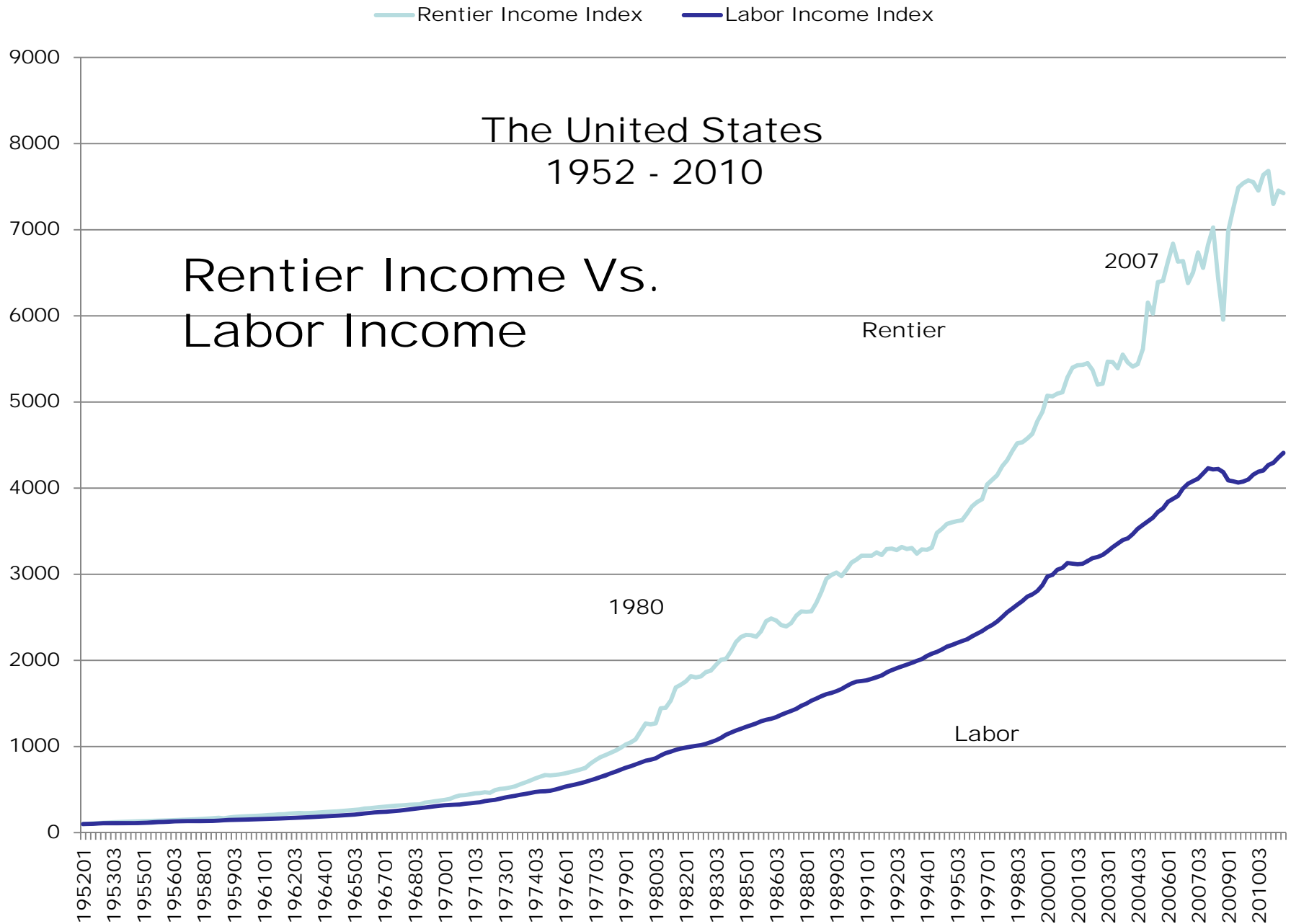
2000

2009



ONE Additional clear cost:

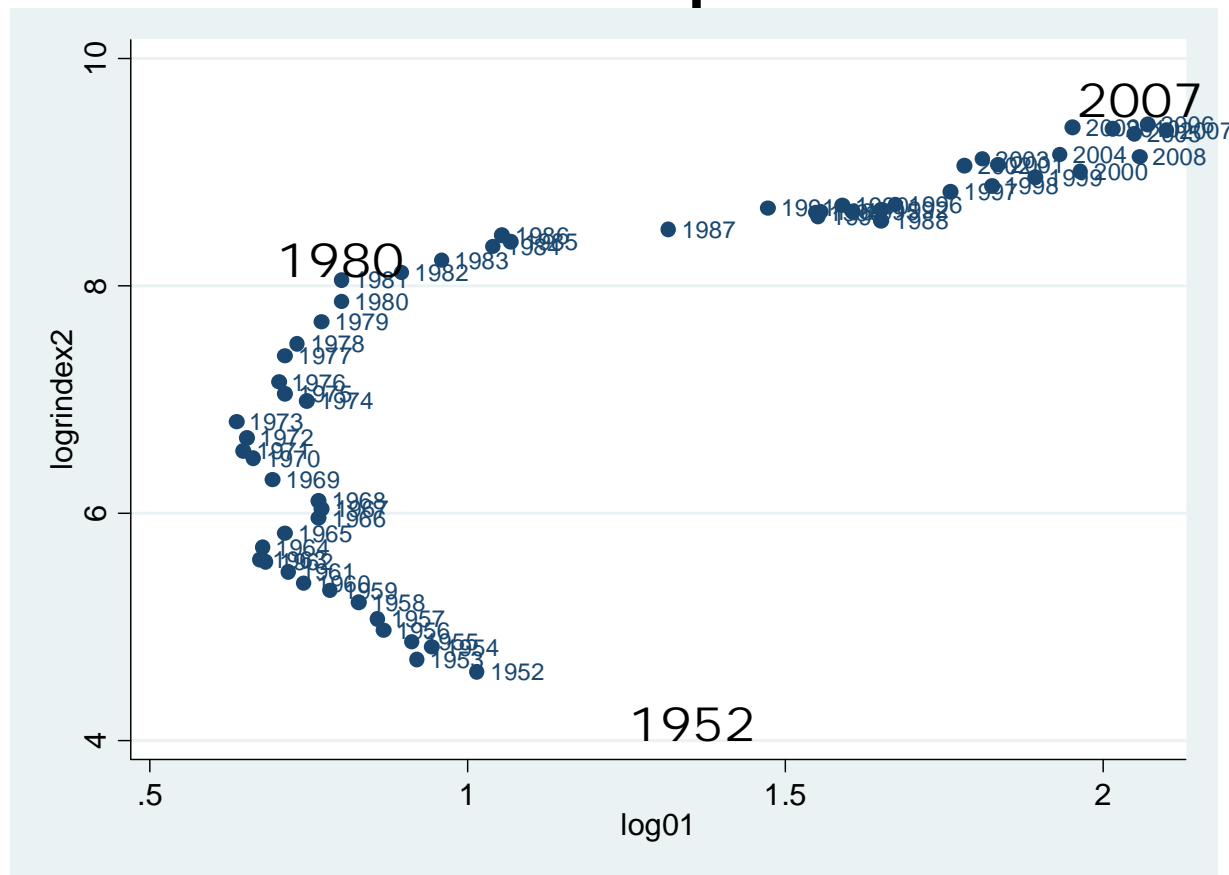
Massive growth in financial
incomes contribute to
inequality



Source: Jayadev and Epstein

After 1980, positive relation between rentier share and income of top 1% in US

Share of Income to Top 1%



Source: Jayadev and Epstein

Rentier Share Index

Regulators in US and Europe now try to regulate the financial sector ostensibly to reduce the likelihood of a crash and another tax payer bail-out



Bankers and Politicians Fight Back

- Rules will harm banks and reduce their competitiveness
- Banks will move abroad
- Intermediation will become more expensive
- Banker Brain Drain
- Stifle Financial Innovation
- Jamie Diamon of JP Morgan: "We can manage our own risk just fine."

But if Financial Sector Is Highly
Bloated

Good bye and Good
Riddance?

The questions we ask:

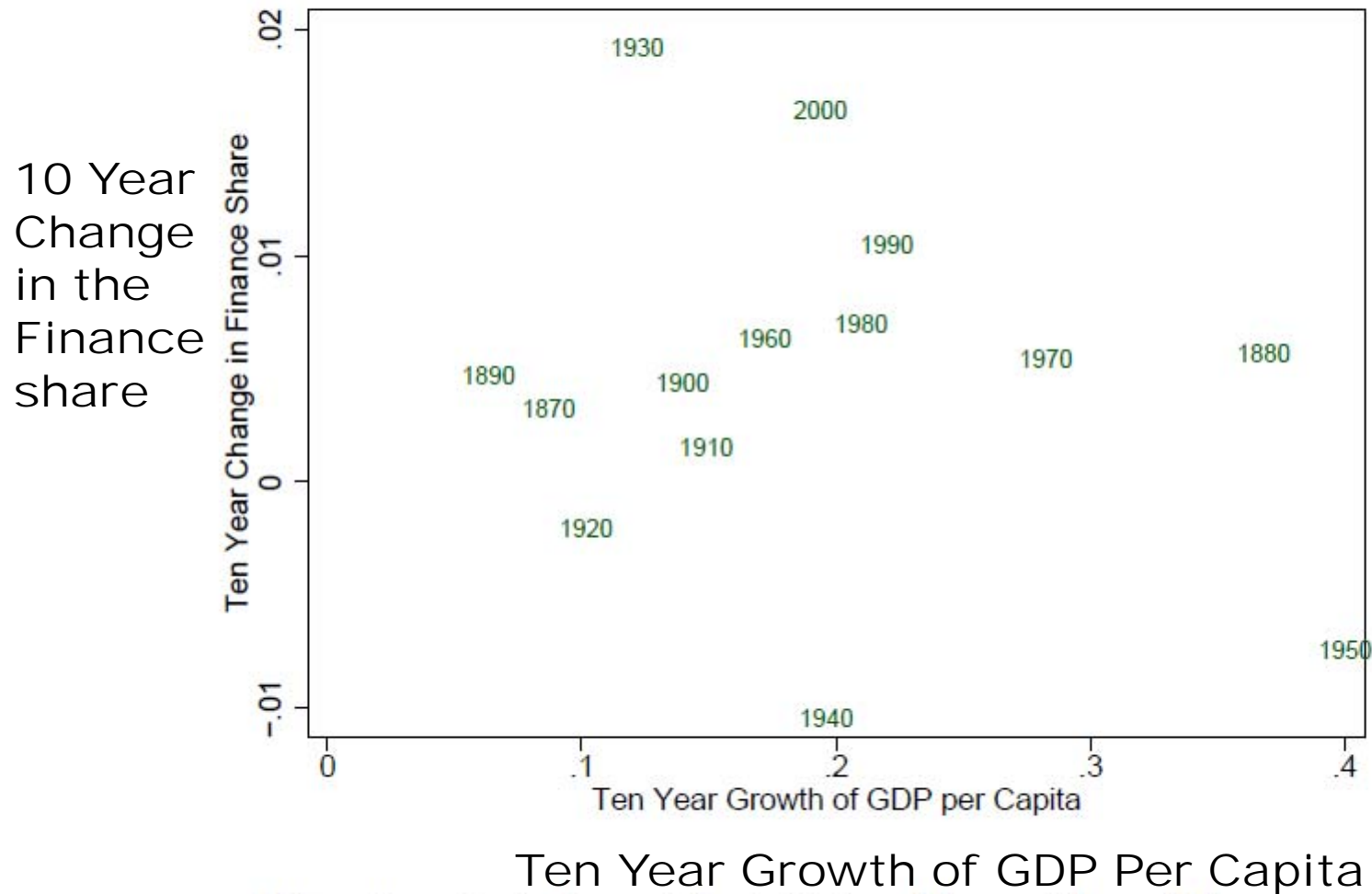
- How Socially productive are these massive financial sectors?
- Can and Should they be Cut Down to Size? By how much?
- What should be kept? How Should the Financial Sector be Reoriented to play a more socially productive role?

Has this growth in the financial sector contributed positively to the economy commensurate with its size?

A simple picture gives an initial hint

In US: No Obvious relation between share of finance and Economic Growth, 1860 - 2010

Figure 4: Finance and Income



Notes: See notes to Figure 1 for definition of Income Share of Finance.

Source: Philippon

Increasing Evidence of U –
shaped relationship between
size of financial sector and
economic growth



Some References to this literature:

- Thomas Phillipon "Has the Financial Sector Become Less Efficient"?
<http://www.voxeu.org/index.php?q=node/7376>
- Arcand, J-L, E Berkes, U Panizza (2011), "[Too much Finance?](http://www.voxeu.org/index.php?q=node/6328)", VoxEU.org, 7 April.
<http://www.voxeu.org/index.php?q=node/6328>
- Haldane, AG and V Madouros (2011), "What is the Contribution of the Financial Sector, VoxEU.org, 22 November.
<http://www.voxeu.org/index.php?q=node/7314>

But this does not tell us what type of financial activities contribute to socially useful real sector outcomes like job creation, risk reduction, retirement protection and the financing of socially useful investment.





Roles of the Financial Sector

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- Financial innovation

Private roles of finance:

- 1) Make profit for shareholders
- 2) Make incomes and bonuses for management and “rain-makers”.

Claim: Finance has done much better at furthering private roles than social roles (greater private efficiency than social efficiency) (to put it mildly)





Estimates of the Contribution of the Financial Sector



Channel Finance to Productive Investment?



High share of lending in US and UK going to households and property development, and to support trading in financial assets. True in other countries as well.



Epstein/Crotty/Levina

- Finance Gap measured as Investment minus saving so looks at how much finance is needed to finance investment.

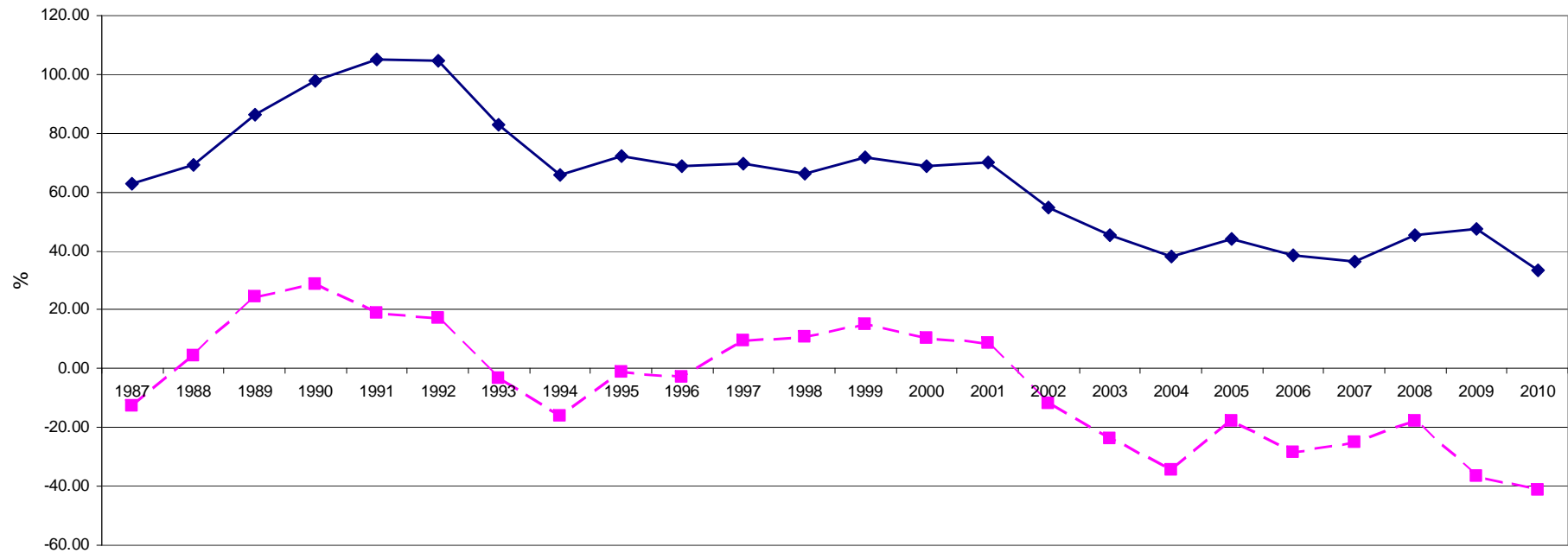
Financing Gap Relative To capital expenditures: Non- financial Corporations, US

Table 4: Financing gap relative to capital expenditures, descriptive statistics; nonfinancial business

	<i>1950-1959</i>	<i>1960-1969</i>	<i>1970-1979</i>	<i>1980-1989</i>	<i>1990-1999</i>	<i>2000-2009</i>
<i>Average</i>	11.5%	12.5%	21.0%	11.2%	5.0%	-0.2%
<i>Minimum</i>	-4.0%	3.5%	-1.3%	-1.1%	-5.0%	-41.7%
<i>Maximum</i>	32.3%	26.0%	34.1%	26.6%	18.1%	25.7%

Financing Gap, UK Non-Financial Corporations, 1987 - 2010

Financing gap as a share of capital expenditures, in percent (non-financial corporations, UK, 1987-2010)



Source: ONS, Blue Book, Calculatins by author

—◆— Financing gap, net saving - - -■- - Financing gap, gross saving

Source: Epstein and Levina, 2012

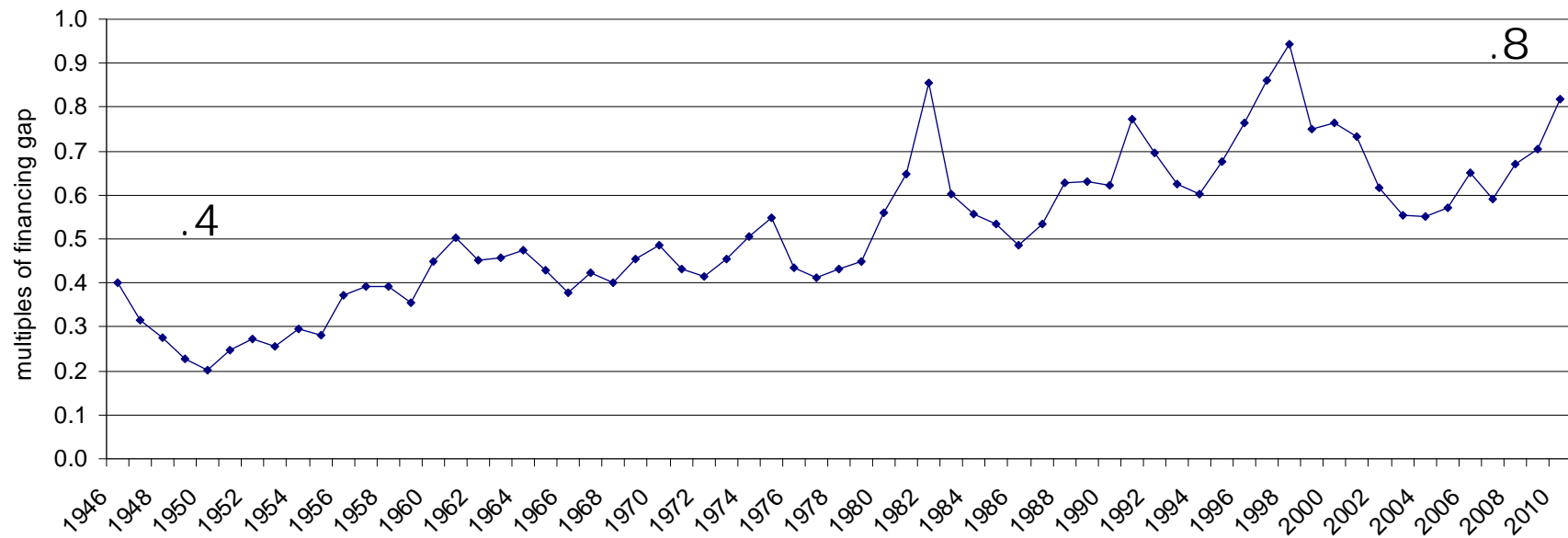


Key Results from Epstein, Crotty, and Levina:

Income extraction by the financial sector relative to its filling the financing gaps has dramatically increased.

Income of the Financial Sector Relative to The Financing Gap in The US, 1946 - 2010

Gross value added of the financial corporate business as a share of financing gap



Source: calculations based on the Flow of Funds and NIPA, Table 1.14

Income Extraction by the Financial Sector in The US Relative to Financing Gap
(Including the Federal Government Financing Gap)

Financial Sector might be as much as two times too big

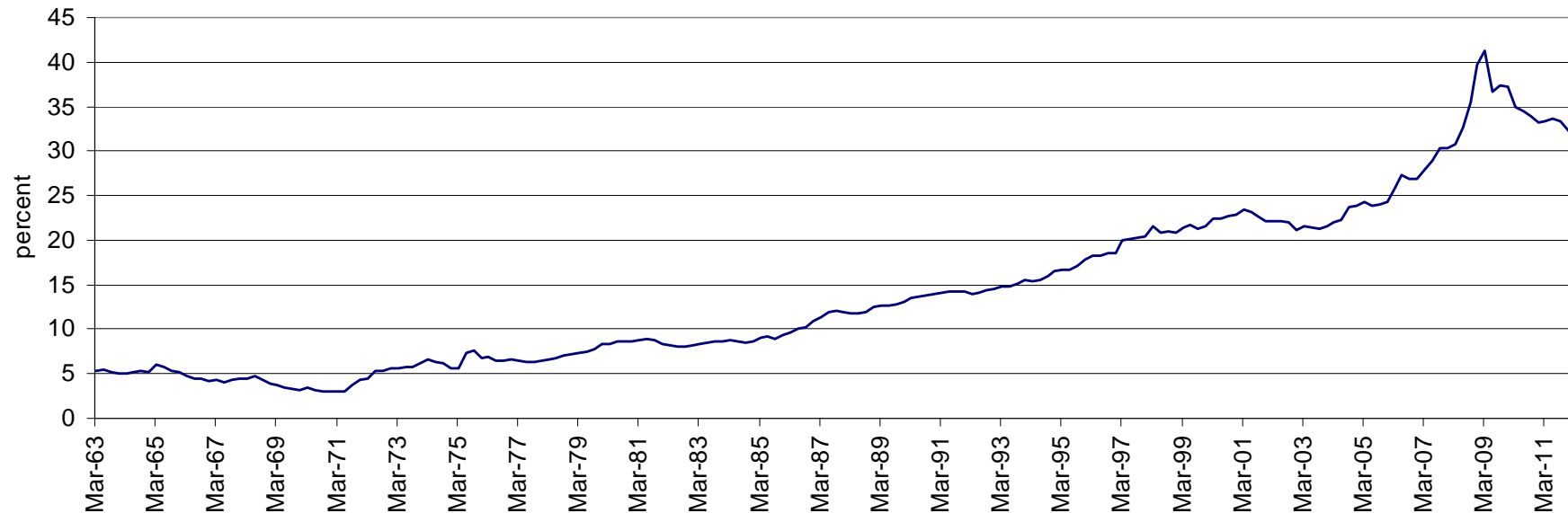
	Simple average
1946-1959	0.31
1960s	0.44
1970s	0.46
1980s	0.60
1990s	0.73
2000-2010	0.66

From Point of View Of Financial Sector

- So what has finance been doing?
- For one thing: lending to itself to finance proprietary trading.

Net Lending of the Financial Sector to Itself, UK, 1963 – 2012 (from 5% to 35% of lending)

MFI net lending to other financial corporations as a share of total MFI net lending (UK, 1Q1963 - 1Q2012)



Source: calculations based on data from Bank of England, Bankstats, Table A4.1. Data are not seasonally adjusted and include only sterling lending. Lending in foreign currencies is excluded

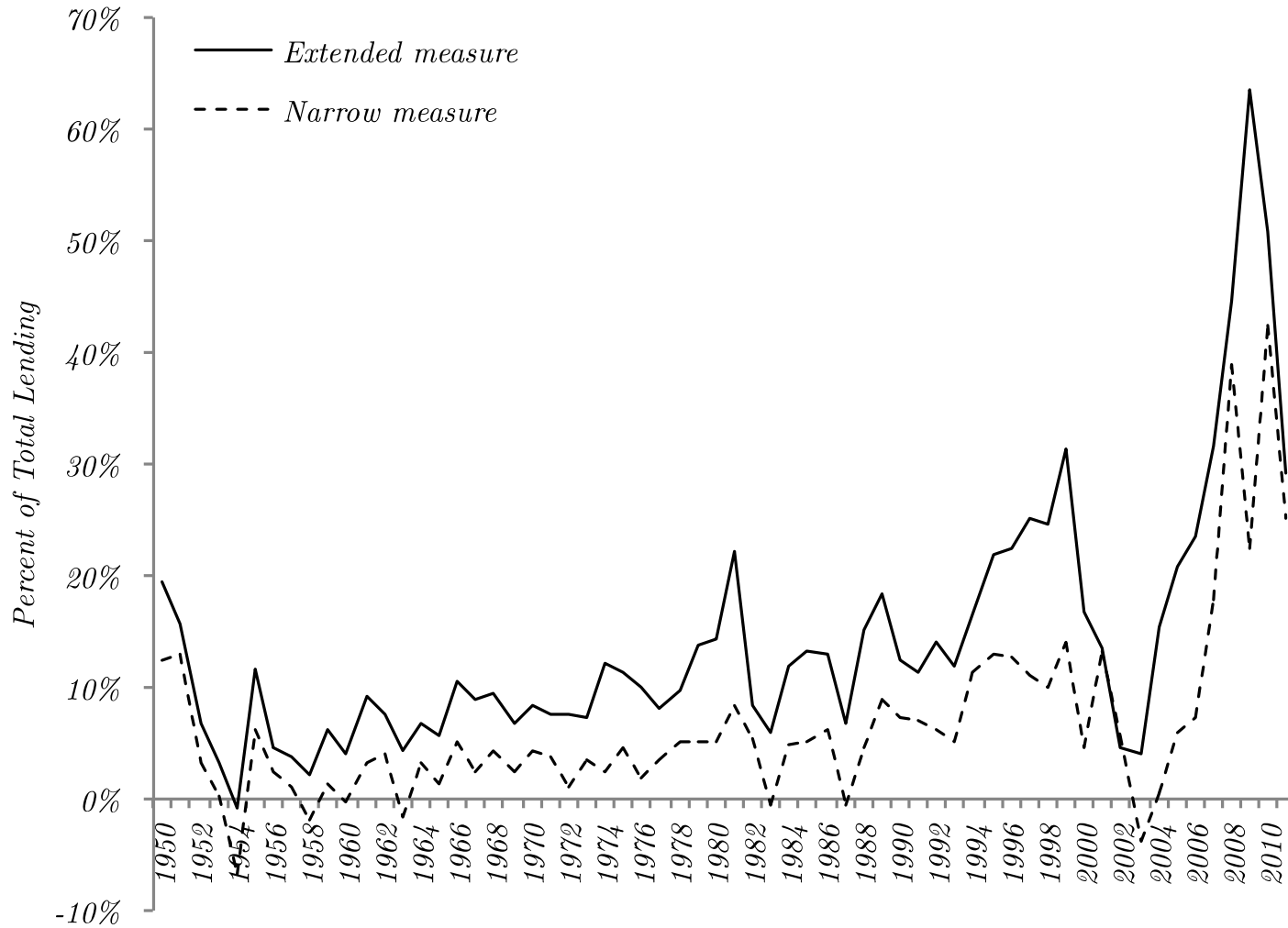
Source: Epstein and Levina, 2012

Decadal Average of UK financial
sector lending to itself as share of total
lending, 1960 - 2012

1960s	4.64
1970s	5.84
1980s	9.85
1990s	17.13
2000s	26.48
2010s	33.38



US: Inter-Financial Lending: Narrow vs. extended measures in flows (percent of total lending)



Source: Epstein and Montecino calculations based on the Flow of Funds.

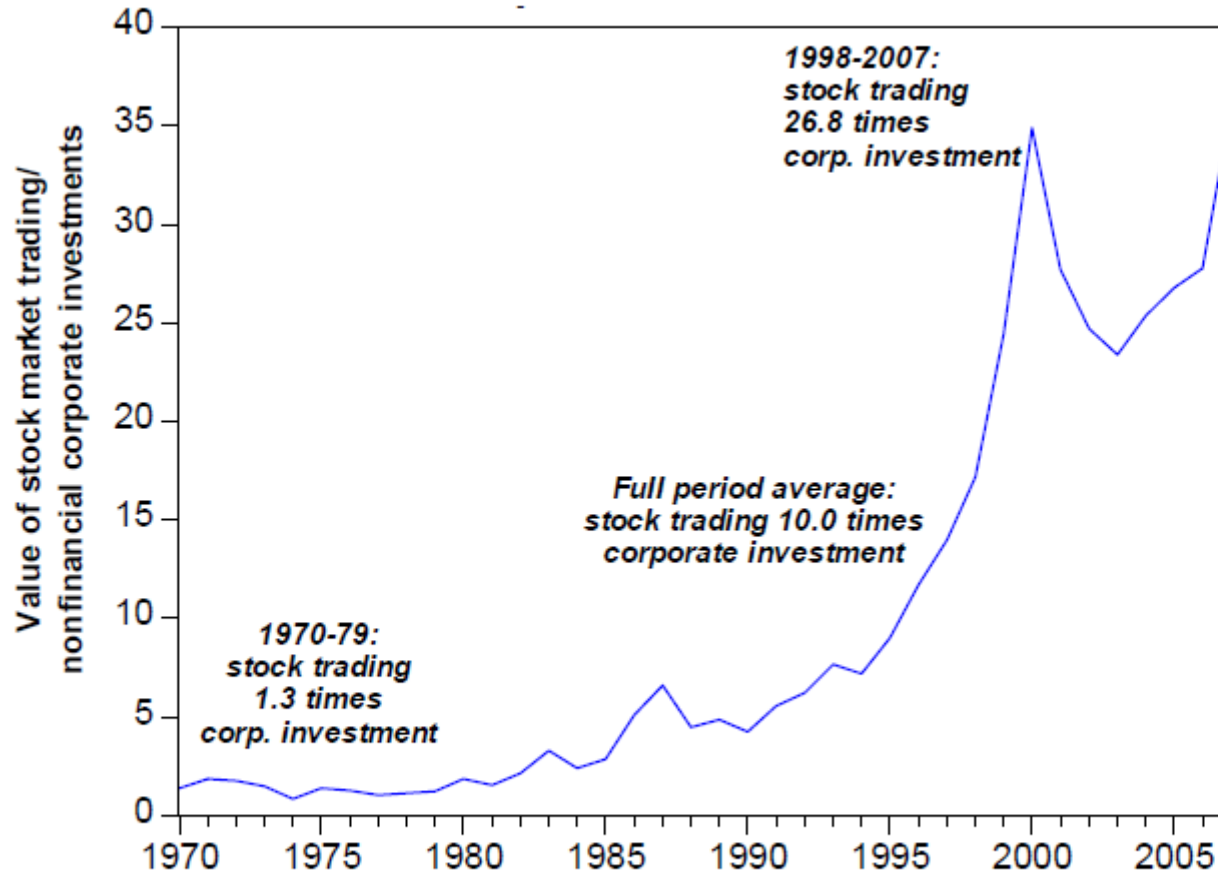


Trading



Trading: US Stock Market Trading Relative To Corporate Investment

FIGURE 3: U.S. STOCK MARKET TRADING RELATIVE TO CORPORATE INVESTMENT



Sources: Securities Industry and Financial Markets Association Fact Sheet 2008;
Flow-of-Funds Accounts of U.S. Federal Reserve

Source: Pollin, 2011

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- Help provide stable and elastic LIQUIDITY
- Financial Innovation

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Simple Answer:

Haldane Estimates of Cost of Crisis: \$60 – 200 Trillion

Roles of the Financial Sector

- *Help provide stable and elastic LIQUIDITY*

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Liquidity Defense: Last refuge of scoundrels: “Financial regulation will reduce liquidity and raise transactions costs”

Roles of the Financial Sector

- *Help provide stable and elastic LIQUIDITY*

Financial Sector has generated liquidity cycles: excess liquidity driving asset bubbles, and private liquidity drying up in Crisis.

Financial Innovation

Surveys of financial innovation cannot find any link between “financial innovation” and economic growth

(White and Fame 2004 JEL survey article)

Innovation: Tax and Regulatory Arbitrage (Epstein and Crotty)

Study	Total Number of Security Innovations (1)	Number motivated at least partly by tax or regulatory reasons (2)	Percentage of total innovations motivated by tax or regulatory reasons $(2)/(1) \times 100$ (%)
Finnerty, 1988	103	45	44
Finnerty, 1992	65	21	34
Finnerty and Emery, 2002	80	25	31



Restructuring Finance to Better Serve Society



Reduce Size of Financial Sector

Current Policy:

- Capital Requirements
- leverage requirements

Useful: but problems with evasion; also, capital requirements can be pro-cyclical

Reduce the Size of Financial Sector

- Financial Transactions Tax
- Bank Profit Tax
- Tax Surcharge or Clawbacks on Financial Salaries and Bonuses



Make Sure Financial Innovation is Safe and Effective

- A Financial Products Safety
Commission
(Financial Precautionary Principle)



Limit destructive risk taking by large financial firms

Splitting large financial conglomerates through mandatory separation of commercial and investment banking activities

Limit destructive risk taking by large financial firms

Phase out crisis-driven government guarantees and limit bailouts

Limit destructive risk taking by large financial firms

Reform rating agencies, reducing reliance and shifting their business model back to an investor-pay model

Re-orientate financial institutions and markets and reverse the balance of power between democratically governments and the financial markets

FINANCE WITHOUT FINANCIERS

Diversifying the financial sector through a larger array of public and cooperative financial institutions

Re-orientate financial institutions and markets and reverse the balance of power between democratically governments and the financial markets

RE-DEMOCRATIZE THE STATE

GET MONEY (FINANCE) OUT OF
POLITICS

Re-orientate financial institutions and markets and reverse the balance of power between democratically governments and the financial markets

Protecting financial reforms processes from regulatory capture by bankers, including through stronger regulation of political parties' financing



Bankers are Now Blocking Reform on Both Sides of Atlantic

We need to continue trans-Atlantic Cooperation on Financial Reform to fight back.





THANK YOU VERY MUCH

