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Review: Adair Turner's *Between Debt and the Devil: Money, Credit and Fixing Global Finance*

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**Prime**

## Turner's monetary economics: theoretically radical, but ultimately conservative

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A review of Adair Turner (2015) *Between Debt and the Devil: Money, Credit and Fixing Global Finance*, Princeton University Press, Princeton and Oxford.

“This talk of mine follows on addresses from Sir Josiah Stamp [technocrat and progressive] and Lord D’Abernon [financier and diplomat]. They have told you in different ways how the behaviour of the financial system and the banking system is capable of suddenly going off the rails, so to speak, and interfering with everyone’s prosperity for obscure and complicated reasons which are difficult to understand and probably impossible to explain in a popular way. It is a matter which ought to be left to the experts. *They* ought to understand the machine. And *they* ought to be able to mend it when it goes wrong.

It is hopeless to expect the man in the street even to discover what is amiss; far less to put matters right. Unhappily, however, the machine is not well understood by anyone. In a sense there are no experts. Some of those representing themselves as such seem to me to talk much greater rubbish than an ordinary man could ever be capable of. And I daresay there are people – I am sure there are – who will say the same about me and my ideas. In other words, the science of economics, of banking, of finance is in a backward state.” (Keynes, Radio Address, ‘The Slump’, 12 April 1931)

## INTRODUCTION

Within certain communities, *Between Debt and the Devil* must qualify as eagerly awaited. Over the post-crisis period Adair Turner has emerged as one of the most prominent and respected figures in debate around the theory of money and debt, engaging with both radical and mainstream views. He emerges with two main targets: an economics profession that has failed to understand the nature of money and the manner of its creation, and the liberalisation process that led ultimately to the financial crisis of 2007-2008 and the ongoing economic crisis. The implication throughout is that his two targets are not unrelated, and the blame for the crisis attributed squarely to the economics profession (though with the financial sector seemingly absolved).

I suspect those who operate in this territory will find much that is familiar, and a good deal of the empirical analysis is drawn from existing sources. But Turner brings a wider range of material together in a coherent, compelling and very readable manner, and the work is plainly an important and authoritative contribution to post-crisis debate. It is also of the greatest importance that his work vindicates decades of work in various ‘heterodox’ traditions and constitutes the most profound challenge to mainstream economic theory. To the ‘heterodox’ reader it is of great interest to see how Turner resolves the various theoretical and practical arguments.

To my mind, while his theoretical critique is bold, the end point of his thinking remains basically conventional. His main policy asks are limited and not out of line with the evolving position of policymakers in supranational organisations and central banks, even in spite of vigorous support for more radical uses of expanded central bank balance sheets, notably ‘helicopter money’. His overall philosophy is summed up in this rather feeble credo:

I came to believe that the most fundamental problems of financial and economic instability ... are created by activities ... which in moderate amounts are clearly valuable, but on an excessive scale can cause economic disaster.  
(xiv)

## ANALYSIS

The bulk of his analysis concerns a revival of the theory of money and banking and an analysis of the relation between financial liberalisation and the accumulation of indebtedness.

His statement of the theory of money and banking is in line with post-Keynesian convention and various recent interpretations, e.g. by the new economics foundation (2011), Bank of England McLeay *et al.*, 2014) and Felix Martin (2013). He rejects the financial intermediation account that is common to both undergraduate textbooks and advanced papers as “largely fictional” (58). “Banks create credit, money, and thus

purchasing power” (58). The reader of this review is referred to the previously cited texts for a fuller account. (Though I am uncomfortable with Turner’s use of maturity transformation in his argument and see this more as an extension of the intermediation view.)

The story begins in part I, which characterises the liberalisation of finance from the 1970s and those who cheered it on its way. At the head of chapter one, AT cites 2004 comments by Raghuram G Rajan, the IMF chief economist (2003-2006) and now Governor of the Bank of India, and Luigi Zingales, Professor of finance at the University of Chicago, seemingly as exemplifying the enthusiasm of professional economists for financial liberalisation:

In the last thirty years, dramatic changes in the financial systems around the world amounting, de facto, to a revolution have brought many ... advances. We have come close to the utopia of finance for all. (19)

Ultimately Turner argues the “confidence was profoundly mistaken and was based on shaky intellectual foundations” (17). Finance may have grown from 4 per cent of the US economy in the 1970s to 8 per cent now, but rather than leading to production and prosperity this expansion led mainly to unsustainable asset and debt inflations. Moreover, in spite of the financial collapse, he reproduces analysis showing world debt (in 2013) still at its highest ever level as a share of GDP.

More specifically he develops three specific “drivers of unnecessary credit growth: real estate, rising inequality and global current account imbalances” (109). Excesses on real estate are obviously very familiar (e.g. Japan in 1990s, Ireland and Spain in 2000s); AT emphasises the interaction between potentially limitless bank credit but highly restricted supply of real estate and land. Secondly (and crudely), with lower earners more likely to borrow more, a more unequal distribution of income leads to higher consumer indebtedness. Balance of payments imbalances exacerbate both of these factors, with high surpluses in some countries recycled in others not as higher investment but as consumption and real estate excess. All such expansions meant boom and bust; moreover unresolved indebtedness continues to inhibit the economy going forward: “rising leverage, crisis, debt overhang, and post-crisis recession” (180).

The era is set in contrast with 1945 – 70, when finance was less important and banking crises were almost non-existent. This stability followed from both “tight domestic regulation” and “an international monetary system that limited global capital flows” (90); the same era was also marked by “robust growth in all advanced economies”. However there is very limited discussion on the rationale for and specific detail of policy or outcomes in this period. AT portrays the fixed-but -adjustable exchange rates of the Bretton Woods era as requiring capital control. This is highly oversimplified: most obviously, the Bretton Woods system was not the motivation for other restrictions; the Bretton Woods system was one of many restrictions on finance that were seen as necessary in the aftermath of the great depression and implemented throughout the 1930s as well as after WWII.

The exchange rate system eventually collapsed in the wake of inflationary policies in the US, which in turn removed the rationale for capital controls. In addition “free capital flows were seen by many economists as positively beneficial: they ensured that capital was allocated in a globally efficient fashion” (92). Turner identifies three dimensions of domestic liberalisation: on the quantity of credit, on the distinctions between different types of financial institution, and on the move to discount rates as the preferred means of control (eventually aimed at inflation).

Notably, in the UK, the 1971 Competition and Credit Control regime effectively freed UK banks from quantitative restraints on credit creation (and led to a monstrous surge in lending and the Secondary Banking crisis). These actions and various other transformations over the next 40 years (most recently securitisation, derivatives, shadow banking) led ultimately to the distortions (as with his ‘drivers’ above), associated excess and finally crisis.

Turner also notes that the confidence in liberalisation was unchecked in spite of frequent financial crises throughout the long process of liberalisation: crises could always be blamed “not on financial liberalisation but to the fact that liberalisation was incomplete or had been executed in an imperfect fashion” (94).

## **POLICY**

In his policy recommendations, Turner is concerned to regulate excess private credit creation while fostering demand through the creation of central bank money. He is lukewarm about fiscal policy. What’s new?

Fundamental to private restraint is a ‘Laffer-curve’-type intuition: “we should instead recognise an ‘inverted U’ relationship, with increasing private leverage potentially positive for growth over some range, but becoming negative beyond some turning point” (172). His detailed recommendations involve a wider remit for interest rate policy and a move to quantitative levers.

While he is cautious about using interest rates to contain credit booms (i.e. when they are “set higher than pure inflation targeting would suggest is appropriate”, 198), they should “certainly have a role”. “Quantitative levers” include (taken from various sub-headings of his Chapter 13): ‘capital requirements’, ‘countercyclical capital’, ‘reserve asset ratios’, ‘risk weights to reflect social, not private, risk’, ‘regulating shadow banking : less liquid markets for credit securities’, ‘constraints on borrowers and high interest lending’, ‘Structural reform: ring-fencing in and between countries’. While none of these are perfect and measures should be operated judiciously and in combination, he is unequivocal about the necessity of such measures:

Unavoidable uncertainty about precise optimal results cannot be an excuse for reverting to the comfort zone of pre-crisis orthodoxy. ... As Hayek, Minsky,

and Simons rightly argued, private credit creation is inherently unstable, and there is no set of rules that can be defined once and forever to fix that problem. (209)

There is then the question of the present inflation targeting regime. Plainly it is impossible to avoid its failures; according to the theory underpinning the practice, the “free market could be trusted to ensure the optimal level of debt in the economy, the fact that the free market choice drove a relentless increase in private-sector leverage was of no concern so long as inflation remained low” (93). But even though policymaking (in practice as well as for Turner) has now moved beyond ‘pure inflation targeting’, there is no comprehensive appraisal of the validity of inflation still as the key target for monetary policy – even as the current regime is now failing to prevent near deflationary outcomes (in spite of a good deal of operational flexibility, e.g. under forward guidance).

His perspective on the role of the public sector is basically conventional, though moderate. Up front he recognises that the crisis is not about government spending, but he comes at the theory through “Ricardian equivalence” and “crowding out” arguments (p. 115) rather than the multiplier (which is not mentioned). While he supports the initial 2009-2010 stimulus (rather, running large deficits, 85 – see below), ultimately “once large public debt levels have already been accumulated, some fiscal consolidation – through public expenditure cuts or tax increases – appears essential” (84-5). Though it is a question of pace: “a strong case can be made that in several countries fiscal policy was tightened too rapidly after 2009, depressing the rate of recovery” (84).

On the other hand, he recognises real investment needs, not least for climate change and transport infrastructure. With private finance potentially not readily available, “infrastructure investment may be most efficiently delivered by direct public capital expenditure” (129). And under certain conditions, “money-financed public investment could be the lowest risk strategy” (130). I note here and elsewhere (e.g. Newsnight, 7 January 2016) Turner repeatedly conflates expansionary fiscal policy with deficit spending, and uses the deficit as a measure of the scale of fiscal expansion. He is oblivious to Keynes’s central intuition “look after the unemployment, and the budget will look after itself”.

Ultimately his account drives in part V (‘escaping the debt overhang’) towards “monetary finance – breaking the taboo” (the title of chapter 14). Dismissing a supply-side explanation of the weakness of post-crisis growth rates, he (rightly in my view) argues that “Low rates of inflation and nominal GDP growth meanwhile make it clear that inadequate demand has played a major role” (214). (Earlier he suggests ‘chronic demand deficiency’, 126.) Most obviously, while attempted deleveraging has depressed economic growth, no overall deleveraging has been achieved. In addition, and fleshing out the above, demand has been depressed by fiscal policy: Turner cites an estimate “that UK GDP growth was depressed by 3% as a result of unnecessary

aggressive fiscal consolidation after 2010”, and the unambiguous case of Eurozone austerity “significantly depress[ing] growth” (216).

He first reverts to convention: “But the constraints on our ability to use fiscal stimulus must still be recognised”; “Thus there are limits to our ability to use traditional fiscal stimulus to escape the debt trap”. Therefore the only way to revive demand is monetary financing. However conventional QE is questionable as it has not delivered robust growth, and has operated via asset values thus advantaging wealth holders and exacerbating the undesirable inequality effects.

The sentence “Fortunately however, there is an alternative.” precedes the heading “helicopter money with fractional reserve banks”. Turner advocates the government allocating funds to citizens by electronic transfer to bank accounts, funded by the creation of central bank reserves. “Nominal demand would be stimulated, and the extent of that stimulus would be broadly proportional to the value of new money created” (219). The approach is regarded as more effective than both conventional QE (as above) and “funded fiscal stimulus” (as there is “no danger of either crowding out or Ricardian equivalence effects”, 220). Though – at this critical juncture – this is hardly a comprehensive discussion of the alternatives and the associated pros and cons.

For Turner the dangers are not about efficacy in the short run, but “whether we can contain their long-term impact in a modern economy with fractional reserve banks” (220). His worry is that the creation of public credit and successful revival of activity will then lead to an even more excessive issue of private credit. At this point Turner seeks to restore the 1930s ‘Chicago plan’ for 100% reserve banking, which aimed to stifle the banks’ capacity to create credit.. He does not seem to want to go so far, but he considers various ways to strengthen policy towards reserves.

## **ACADEMIC ECONOMICS**

Throughout the work his critique of academic economics is hard hitting. At root is the failure to understand banks and the consequent failure of economic models which did not include finance (28). This is all the worse for a “strange amnesia” (245): throughout the work there are references to monetary economists of the 1930s, not least Keynes, Hayek and Fisher, who: “... believed that the operation of the financial system, and in particular of the banking system, carried vital implications for overall macroeconomic stability. But increasingly from the 1970s on, their insights were ignored” (31).

Even after the war this understanding was prominent in the contributions of only a handful of economists. Turner confines his attention to Hyman Minsky and Charles Kindleberger, though there were many others operating in the post-Keynesian tradition, starting perhaps with Sidney Weintraub and extending to a significant number of scholars today, none of whom are mentioned. He recognised that these economists “were marginalized” from the 1970s on (245).

Happily, since the crisis, reality is dawning in parts the mainstream profession; Turner cites a 2012 lecture by Mervyn King (then Governor of the Bank of England): “[the dominant theoretical model of modern monetary economics] lacks an account of financial intermediation, so money, credit and banking play no meaningful role” (31). (The word ‘intermediation’ should set off alarm bells, as it evokes the mainstream misunderstanding of banking.)

But Turner wants us to think that, with credit restored, we can simply move forward. While the monetary theory of the inter-war period is recognised and various economists of the time celebrated for their contributions, he seems to want their interpretations to be mutually compatible. Keynes and Hayek may have begun in the same place, but we all know that they ended up in *very different* places. Most obviously on fiscal policy Turner’s position is far closer to Hayek’s and, as above, he does not concede Keynes’s insights on spending and income. In terms of monetary policy, Keynes’s fundamental policy insights from the start of the great depression were less about the quantity of money and more about action to reduce the short-term and long-term rates of interest.

Like Turner, Hayek sought to restrict the ability of the private banking sector to create money. Missing Keynes’s central insight, Turner is generally content to regard low interest as synonymous with excessive money and debt creation and *vice-versa*. He also conflates the usury doctrine with a doctrine against lending per se, rather than a doctrine against lending at *excessive* interest. “Modern economic theory sees debt contracts as vital to spur economic activity” (52). The rate of interest scarcely features in Turner’s account, beyond its role as potentially detrimental from a distributional point of view. The implication is that he is content with a variant of Wicksell’s theory of a natural rate of interest (though with multiple rates according to risk, p. 198), which was fundamentally opposed to Keynes’s scheme and was categorically rejected by Keynes.

That said, he is more generous toward Keynes than most of those involved in the present revival of monetary theory: “while Keynes himself wrote insightfully about financial system instability in both the *General Theory* and *Treatise on Money*, post-war Keynesian frameworks and models tended to focus on overall aggregates and broad policy tools” (245). Here Turner also draws a distinction between Keynes’s work and the work of his post-war ‘Keynesian’ ‘followers’. Sadly he takes this no further than a rather patronising and dismissive footnote:

There is, however, a lively debate as to whether the ISLM framework, first developed by Sir John Hicks in 1937 in an attempt to reconcile Keynesian theory with pre-Keynesian classical economics, does indeed reflect the essence of Keynes’s macroeconomic theory. For example, see Leijonhufvud (1968).

The choice of reference, while relevant, is hardly today the state of this particular art.



Turner lists what he sees as the major “critical failures” (245) of modern macroeconomics: first, that it is based on agents operating with “rational assessments of probability distributions of future possible results” (243) and second, that it “largely ignored the operation of the financial system and in particular the role of banks” (245). I think it is reasonable to argue that most economists operating outside the mainstream would regard the resolution of these shortcomings as the essence of Keynes’s macroeconomic theory. It is hard to believe that Turner is unaware of this. Why will he not go there?

Turner is instead at pains to associate his proposals not only with economists of a more conventional orientation, but monetarist thinkers and Chicago more specifically. As we have shown, he gives a prominent role to the ‘Chicago plan’. Likewise he repeatedly emphasises Milton Friedman’s association with various proposals, in particular with his headline initiative for helicopter money (if you are of a Keynes orientation, brace yourself):

It was Milton Friedman who explained most clearly why inadequate nominal demand is one problem to which there is always a possible solution. If an economy was suffering from deficient demand, he suggested, the government should print dollar bills and scatter them from a helicopter. (218-19)

(It should be added that the monetarist perspective is based on the money multiplier, now widely regarded as another illegitimate account of banking.)

But while celebrating the Chicago initiative of the 1930s, he ignores not only rival policy initiatives, but rival policy initiatives that had been implemented to bring the financial sector to heel. Roosevelt effectively brought the US Federal Reserve and banking system under public control. Mariner Eccles, who was Chairman of the Federal Reserve between from 1934 and 1951, was a political appointee of Roosevelt. The two Banking Acts of 1933 and 1935 included fundamental and detailed reforms of banking and monetary policy that overlap with those that Turner proposes. The sum of the parts was the setting of long and short interest rates on a permanent downward trajectory (that lasted until Roosevelt’s death).

It is difficult to avoid the sense that Turner gives with one hand in order to take away with the other. In spite of his theoretical radicalism, his policy is not far out of line with the evolving thinking of central banks and supranational organisations (notwithstanding repeated claims of busting taboos) and portrayed as compatible with inflation targeting. It is disarming that a great number of the contributions he cites as indicative of the way forward are by those who are closely associated with pre-crisis theoretical and/or practical doctrine, e.g. Rajan on inequality, (255, n.25), Edmund Phelps on uncertainty, Michael Woodford on monetary financing (232), Buiter on the efficacy of helicopter money (221). The Chicago plan was revived a few years ago by the IMF; one of the authors, Michael Kumhof, is now at the Bank of England. And of course we are all used to the propaganda about the great helmsman Bernanke

steering us out of the great recession thanks to his scholarship on the great depression (see Turner, p. 13).

Moreover the same characters will continue to be responsible for policy. Institutional issues are not discussed in detail, but Turner still prizes central bank independence. The associated policy committees “could also be used to approve or disapprove a Bernanke-style helicopter drop or a one-off government debt write off. And they could determine the appropriate size of such operations in the light of their independent judgements on the prospects of inflation relative to target” (223).

As his references to the monetarist school through history indicate, there is nothing radical about extending central bank money to support the financial and economic system in crisis. Remember that in his inaugural address on 4 March 1933 Roosevelt proclaimed “Faced by failure of credit, they have proposed only the lending of more money”.

As the comparison with Roosevelt’s subsequent initiatives would suggest, there must be a very real concern that Turner’s policies fall far short of what is needed for a sustainable restoration of prosperity.

Turner rejects both socialist planning and unrestrained free market as ‘fatal conceits’ and instead chooses a middle course: “we must accept that both governments and markets can play positive roles but that both are inherently imperfect instruments”. He also warns that we must avoid any “unjustified confidence” in the certainty of conclusions from economics (250) and “be wary of the belief that policy interventions can produce an alternative utopia of perfect results” (251). But is this not also a conceit? As far as I am concerned, the whole point of monetary theory was that it set economics (and ultimately politics) away from the stale spectrum of right to left, market to state.

With the assistance of Keynes, Roosevelt overthrew financial orthodoxy and ultimately set the US and global economy on a very different course for the next 40 years. Turner’s position does little to challenge the broader status quo. At an event promoting his book, provoked to address more fully the prosperity of the golden age, he gave the impression that he was concerned with the politics of the possible. The alternative is that he doesn’t want to rock the boat too vigorously. While his attention on the economics profession is profoundly valuable, a serious discussion of the role of vested interest is conspicuous by its absence.

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