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The Real Economy, Inequality and Finance

The present paper attempts to situate elements of Lonergan's highly technical analysis of the circulation of money in the macro economy in the context of some of the questions which the recent financial crisis has and continues to pose worldwide.[1] Unlike almost all of contemporary economic theory and financial engineering Lonergan's analysis of the circulation of money is always correlated with flows of commodities and services in the productive dimension of the economy. It links the velocities and accelerations of the flows of monies from consumers to retailers and from retailers to producers with the parallel flows of commodities and services from producers to retailers and consumers and more generally into the standard of living. Money is largely in movement, from someone to someone else and so on. It circulates.[2] The economy for Lonergan is the seamless whole of production, exchange (sales), and finance, all elements being causally interdependent.

This is in contrast with recent usages of the term, the real economy, by many analysts and politicians. Because of the present status of finance they have taken to using that term to refer to the sections of the economy concerned purely with producing actual goods and services. Finance is considered by them as an almost separate, disconnected world concerned with buying and selling on the financial markets. This for Lonergan is a most unnatural division of an indivisible unity. Subsequent use of the term, the economy, one and real, will refer to the unity of what is being separated by this undesirable division. Every financial activity has its causal consequences in the standard of living.

If money is to make the world go round, might healthy and unhealthy manners of its circulation be in its own different way just as significant for the economy as parallels in the circulation of blood in the human body. The recent financial crash was not caused by problems in the mechanics of producing a standard of living in the world. The machinery and its willing operatives are in place. Perhaps the source of the problem is a malfunction in the structure of the circulation of money in the exchange process. Does the existence of tax havens suggest that there are concealed pathways into which money moves non-productively. Does significant financial inequality harm the circulation and exchange process and the possible overall standard of living of the world? Ought the pathways of circulation and flows of such monies to be more transparent to the global community? In the light of the recent financial crisis is there a need, worldwide, for greater literacy and active participation in the realm of economics and for real accountability from those who manage the system to the population at large?

I. Background: Are We Economically Out of Our Depth?

Lonergan's long term interest in economics was awakened in 1929 by the publication by Lewis Watt, his teacher, of *Capitalism and Morality* and the coincident Wall Street crash and subsequent Great Depression. For Watt the essential moral purpose of the economy was to raise the standard of living in order that through better education and work people would be able to live more moral and dignified human lives. Concern for the quality of life should be central. Long before it had become complicated by the modern deregulated non-system of global finance the book addressed a central problem of the capitalist system: the tension between paying a living wage to workers and remaining solvent.[3] For him companies who were profitable had a moral obligation to pay a living wage.

Many today argue the contrary in their constant pursuit of maximum profits for their shareholders. Only recently introduced in Germany, there has been widespread economic resistance to a minimum wage, usually below the basic standard of living which contravenes the United Nations Declaration on Human Rights. In this light what humanitarian obligations do our currently hugely profitable global banks, internet giants and industrial complexes take on, if any? The economics profession is split on the issue, tending to favor the profit rather than the wages and humanitarian side of the equation. Admirable is GlaxoSmithKline's current project to produce a malaria vaccine to be sold at almost cost price.

Inspired by Watt, Lonergan's declared aim was to find moral precepts based on the actual mechanics of the way the economy works. In order to pursue this he found it necessary first to address the question of alternatives to the damaging boom and bust of the trade cycle which he was experiencing in Montreal in the 1930s. Are such disturbances in the nature of things or can they be replaced by something better? For reasons of stability many would like to see constant economic growth of about 3% but that may not be how the production process works. Lonergan suggested the possibility of a pure as contrasted with a trade cycle in which over a time interval the standard of living advances from one plateau to a next without any negative downturns. The moral questions are concerned with the management or not of such possibilities.

The problem was not new. It occupied von Hayek, the Austrian economist, who early in 1929 had predicted that the US stock market would crash. Noting that the 19th century had been one of continuous booms and slumps Hayek became the director of the recently founded Institute for Business Cycle Research in Vienna. He was greatly distressed by the fact that in 1920 Benjamin Strong, the central banker of the US Federal Reserve began buying government debt on the market. According to Stephanie Flanders, this paved the way for the financial system of today with its low interest rates and low cost of borrowing.[4] As a result large sums of money were borrowed and invested in the stock market with the inevitable consequences.

It was Hayek's position that the 1929 crash had been caused, largely by government intervention dropping interest rates too low. For him the "free market" was wiser and would not have allowed such cheap money. What he seemed to overlook was the possibility that the free market, left to its own devices, might become a form of Social Darwinism out of sync with the circulation of money needed to meet and grow the needs of the economy. That was where Lonergan hoped to find a solution to the problem of booms and slumps. Hayek's free market approach also seems to have overlooked the fact that the levels of inequality between the rich and poor had peaked significantly just before the 1929 crash, a pattern that will repeat itself in 2008.

History also leaves us with the distinct lessons to be learnt about the involvement of the political in the economic realm. In 1926 the punitive Versailles Treaty had insisted that Germany pay off all the war debts of the nations involved in the war.[5] The subsequent debt burden was so massive that it made any form of significant economic growth in Germany and Austria impossible. Efforts to deal with the debt by printing ever more money resulted in stagflation from which, mentally, Germany and more recently the European Central Bank, have not yet recovered.[6] The debt problem in time became a major causal factor of the events that led to the Second World War. That the imposition of excessive austerity and emergency loans might have dangerous long term social consequences is largely ignored by EU politicians and finance ministers.[7] Unsustainable debt is ultimately economically destructive and can threaten the stability of the entire system.

Two other events in the past would have a significant positive impact on the subsequent economy: the Glass Steagall act of 1933 and the Bretton Woods meeting in 1944. The act passed by the US senate was a response to the observation that the investment side of banking dealing then largely with the stock market needed to be separated from household and commercial banking because of the financial inequality that had preceded the crash. There were many lesser booms and busts in the subsequent 20th century economy, but none on the level of 1929 until 2008. The act would stabilize the financial world for almost 60 years until it was reversed in 1999 by the Gramm-Leach-Bliley act.

It is held that the basic idea behind the Bretton Woods conference was the opening up of global markets. In the beginning, before even philosophy, there was human trading, from barrels of wheat in Mesopotamia through the silk roads to the World Trade Organization. Bretton Woods advanced the practice in a manner that is still being worked out.

> In Henry Morgenthau's farewell remarks at the conference, he stated that the establishment of the IMF and the World Bank marked the end of economic nationalism. This meant countries would maintain their national interest, but trade blocks and economic spheres of influence would no longer be their means. The second idea behind the Bretton Woods Conference was joint management of the Western political-economic order, meaning that the foremost industrial democratic nations must lower barriers to trade and the movement of capital, in addition to their responsibility to govern.[8]

From simple origins trade has reached a level of global complexity that is impossible to follow. Just study the origins of foodstuff in the local supermarket; of clothing in the local clothes stores, of technology in computer stores, the fittings in one's house as well as the diversity of commodities sold on Amazon. With it come progressively enormous problems for managing smaller national economies. World finance and trade has since established global structures beyond democratic accountability.

At Bretton Woods Keynes insisted that we are all in these problems together and must work together to solve them. European cooperation at its best produced Airbus and CERN, global cooperation the Space Station. The advanced manufacturing and productive potential of such technologically advanced collaboration is awesome. No one nation on its own could have achieved those levels of success. The same is true for the need for cooperation in the realms of energy and food resources, drug research in relation to such health issues as dementia, cancer, autism, and other major illnesses. The future for Europe, and ultimately the world, is not in potentially destructive competition with the strong getting stronger and the weak weaker, but in cooperation, promoting both strong and weak economies. For Keynes strong economies should strengthen rather than dominate weak ones.

Such global trade has had its downside as highly profitable companies search the world for the cheapest labor and the lowest tax. The recent scandals surrounding the working conditions in the clothing trade in Bangladesh and of the construction workers involved in the construction of the World Cup Soccer stadium in Qatar are harmful of both workers and the system. Similarly the low entry wage levels in very prosperous countries show that minimizing wages overrides any moral or humanitarian concerns. The fair trade movement reminds us we as consumers need to be vigilant in the matter of fair employment and trade. Buying as cheap as possible in some cases may come at considerable human cost.[9]

Taxes on national and global trade are further issues. Wealth inequality has a long history. Cleopatra through taxing everyone and everything became one of the richest persons in history.[10] In our day, as Nicholas Shaxson in his *Treasure Islands: Tax Havens and the Men Who Stole The World* make clear, tax evasion is a huge moral issue in the modern economy.[11] Corporation tax, it is claimed by some, ought to provide the funding for society's infrastructure, schools, hospitals and so forth. Only at the present time is Pascal Saint-Amans, Head of Tax policy at the OECD which represents 34 countries, coming to grips with the Double-Non taxation strategy practiced by some multinationals.[12] As a result of a loophole in the International Tax regulations, not those of any particular country, they pay no taxes at all, anywhere. At best estimates the problem will take two years to sort out.

At the heart of all of these elements of the economy is the question of currencies and the meaning and function of money.[13] Presently the money supply in the US is increased by issuing government bonds, that is to say selling debt. Hand in hand with the increase goes an increase somewhere in debt. With it there comes the division of society into creditors and debtors.[14] A hundred years ago almost every country had its own currency notes, the gold standard being employed as a common measure. Each country could "print" and devalue its own money. At the present time members states of the Euro have surrendered that right to the ECB at, in some instances, considerable cost.

Who, and on what grounds, controls the global money supply and its exchange rates?[15] How much money actually exists in the world at the present time? What is it doing? Who knows how much money is needed humanely to run and grow the world economy? There is no doubt that "money makes the world go round," but it has countered by the precept: "money is the root of all evil." Anyone who knows anything about the problem of a contentious will being fought over by a family will know what that means.

A contemporary unanswered question is simply: how do all these different pieces work and fit together in the now massively interdependent global economy? Europe thinks in terms of austerity in a time of crisis which causes the poor to suffer, the US of quantitative easing which seems to benefit the rich. The answer by and large has to be that no one really knows what the best thing to do is. The financial, political and productive forces of modern society have the power and capability to do great good and great harm. They can be agents of both progress and decline. The contemporary challenge is to develop a critique that enables the creative forces to flourish while tempering the harmful or dysfunctional.[16] How can they do so in a manner that is liberating of humankind, agents of progress rather than dysfunctional and harmful of community? The most creative and innovative minds in the world are desperately needed to apply themselves to these problems. But they will only do so when they have really begun to accept that we are currently out of our depth.

II. The Emergent World Standard of Living: The Basic Ethical Challenge

In line with Watt, it is Lonergan's position that the purpose and goal, the product of the economic process is the transformation of the potentialities of nature into a standard of living. The criteria for its ultimate success or failure will be measured by the manner in which it achieves this goal. Through the process of production, distribution and sales the potentialities of nature are transformed into the commodities that enter into the standard of living. On this level economics involves an interface with the natural sciences but is essentially a human science with all that that implies. Those resources are not infinite. We must frequently remind ourselves how much we take them for granted. Peter Singer's *One World: The Ethics of Globalization* has heightened our awareness of the fact that the human family has to live together on this fragile planet and prudently share its oceans, atmosphere, natural resources, economy and international laws. We must cooperate with the potentialities of nature without harming them, in a sustainable manner.

There is a great need for our educational systems, from an early age, to impart an adequate knowledge to the emerging population of the actual phenomena of the standard of living and related lifestyles in our world. Only a thumbnail can be offered focusing on two features: diversity and inequality.[17] On the national statistics of GDP per capita Qatar and Luxembourg feature at the top end with $83,460 and $91,388; Congo, Democratic Republic and Zimbabwe at the lower end with $400 and $600. On the Quality of Life Statistics measuring Purchasing Power, Safety, Health, Consumer Price Index, Property, traffic commute and Pollution, Switzerland, Germany and the United Stated sit at the top, Indonesia and Venezuela at the lower end.[18]

Such knowledge of the varying needs of the human world poses a number of challenges for economists. There can be no one fixed economic and financial solution for all human situations. Ones which are appropriate in an advanced at peace with itself and the technological world are not the kind of solutions a post-war Syria will need. Financiers on the whole are familiar with life at the upper end of the scale and seem largely incapable of grasping the realities of life at the other end. There is an enormous psychological and empathy barrier between it and them. The Quality of Life index indicates that there are many features, personal as well as cultural that could be taken into account in a definition of the Standard of Living. All of them are to be pursued in and through the economic process.

As our meeting is taking place in Oxford I would like to draw attention to the work being done by the Oxford Poverty and Human Development Institute, (OPHI) in relation to the question of poverty in the world.[19] An earlier standard measure of poverty was in terms of income: $1.25 per day or below was considered as a measure of basic poverty. OPHI broadened the criteria from a single to a multidimensional criterion. As well as income, these added a basic measure of education, health and some overall services. On this basis the count of the poor of the world increased from around 1.2 billion to around 1.6-1.8.[20] In the light of these global statistics one significant element in any definition of the goal of the global economy must be that of raising the standard of living of all those in the world from below to above the currently defined poverty levels. The dogma for some of trickle down is a highly offensive rationalization of poverty. The human right not to live below the poverty level ought to be shown some respect.

Jeffrey Sachs in his *The Price of Civilization*, *Economics and Ethics after the Fall*, poses questions about "how to pay for public goods; quality education, college completion, advanced energy technology, improved roads, safe childcare, and decent health." It seems the only way at present is through borrowing as these are rarely dealt with by the private sector.[21] One can be struck by the moral "commandment" of the philosopher Peter Singer to the effect that if there are rich people who have a surplus way beyond their needs there is a moral imperative to direct some of it towards the alleviation of the condition of the extreme poor.

Not unrelated are the vexed questions of natural disasters, wars and health problems associated with infancy and ageing. How should the economy, globally considered, address the question of refugees from war zones? What real responsibilities should the G20, United Nations, World Bank and the IMF be expected to exercise in such situations? Are they adequately funded by the global economy to deal with the catastrophes which nature and human waywardness can visit on us? Granted that we are in an exchange economy in which goods and services are only provided through the interchange of money, how are such victims of the forces of evil, of one kind or another, to live? This poses questions about the need for global emergency rescue components in the economy which can rapidly come to the rescue with the necessary funding in order to enable them to begin to heal from their terrible ordeals. Addressing the question of the emergent standard of living proves to be a much more complex matter than might seem to be the case.[22]

III. Boom Times and Implosions of Production and Exchange

In a chapter significantly entitled "A Consumer Society without the Capacity to Consume" Stewart Lansley recalls a famous event in Detroit on 5 January 1914 in which Henry Ford announced that he was increasing the wages of his 22,000 workers to $5 per day.[23] He had come to acknowledge "one of the central contradictions of a capitalist." Firstly, the workers could not afford to buy the product they were assembling and were becoming alienated in their work. Secondly, by the increase he was creating a new customer base for the product. Despite increasing his profits his actions were solidly condemned by the surrounding capitalists. Lansley puts his finger on the present situation when he adds that the political solution to this problem in the 1929s and the 1990/2000s was cheap credit rather than an increase in wages. With it comes rising debt levels, now epidemic and a constant source of problems in the financial system.

In the sub-prime mortgages debacle in the US, banks assuming that profits could be made on the basis of the dogma of the ever increasing price of houses made reckless loans to very many who longed for a home of their own but who had not the money to pay for it.[24] Those loans were bundled in packages with good loans and sold on with triple A rating by and to investment banks. Their assumption that if the repayments failed the house could be repossessed and sold for a profit was proved to be wrong by the arrival of a tipping point when the consumer side of the market lost the capacity to pay. Market collapse followed. With the loss of mortgage repayments many banks like Lehman's became bankrupt. The prospective home owners found themselves massively in debt and negative equity; many became bankrupt.

The impact of the Lehman's crash in Ireland was extreme. In 2007 Ireland had a GDP of about €180 billion, GDP to debt ratio of 60% and an annual budget substantially in surplus, 5% unemployment and was referred to as the Celtic Tiger. Appearances were deceptive. On 29 September 2008, fourteen days after the Lehman's' crash, Brian Lenehan, the finance minister committed the Irish taxpayers to guarantee the five major banks, which were on the verge of collapse, to the tune of €450 billion.

The Irish taxpayers were to learn over the subsequent years that they had been steered largely by the unregulated global financial system into the equivalent of a transatlantic air crash. Unlike the US where the Senate Investigations of Lehman's started almost immediately, there has still been no satisfactory explanation of what went on behind closed doors between Lenehan, his colleagues, the bankers and Trichet.

Only slowly are the pieces being stitched together. In the boom years careless flows of foreign money at low interest rates poured into the Irish Banking system from European and Global banks. The Irish Banks in turn carelessly loaned it on at a profit to prospective property developers and house buyers who were forced to pay unbelievable prices for very basic dwellings. Few knew where the money that was feeding the bubble was coming from. In the years before the crash house and commercial property prices rose astronomically. The financial health of the banks at the time was an unknown unknown. The crash and subsequent collapse of house and property prices over the next five years by 50% of their pre-crash value was a bitter education.

Slowly, after the bank guarantee, did it become clear that for some time the European Central Bank had been supporting the insolvent banking system with funds of the order of €150 billion. The point was now reached at which this could continue only if there was a Government guarantee. As a consequence the Irish taxpayers became joined at the hip by the Irish banking debts to the global financial system. A major causal consequence of the freezing of interbank loans in the wake of Lehman's was the dogma at the time of Trichet in the ECB and the G20 that no bank, however small on the world scale, could fail. This despite the fact that the head of the Bundesbank at the time and others in the IMF and elsewhere wanted the Irish government to renege on the loans from the senior bondholders, all foreign nationals. The Irish taxpayers are currently being forced to foot the entire bill down to the last euro. Many of those same taxpayers also found themselves in negative equity and unable to pay their excessively inflated mortgages to their national Irish banks.

As a result the cost to the Irish government of borrowing on the global markets became prohibitive. The state became financially inoperable and emergency funding, a so called bailout, of some €85 billion was necessary. Ireland's subsequent fate was determined by the ECB, the Euro finance minister and Wolfgang Schauble. There was initially the mantra, one solution fits all, from the EU finance minister. All were primary examples of what Lonergan refers to as bookkeepers exercising a dominant role, regardless of the human consequences. The focus was on reducing the now huge annual budget deficit of some €13 billion to a respectable €3billion. As a result 145,000 largely young people emigrated and unemployment rose to 13.76%, the austerity of the last six years only reducing it to 12%. Education and health services have been under crippling stresses and strains.

After five years of austerity Ireland exited the restructuring program of the IMF troika on 15th December 2013. Having reduced its annual budget deficit to close to 3% it can now borrow at reasonably low rates on the global market. Politicians are proclaiming what a good job they have done and austerity seems to have won the day. What has been done was necessary but has left an enormous elephant, unnoticed, in the room. It has to do with the Debt to GDP ratio as well as personal debt levels.

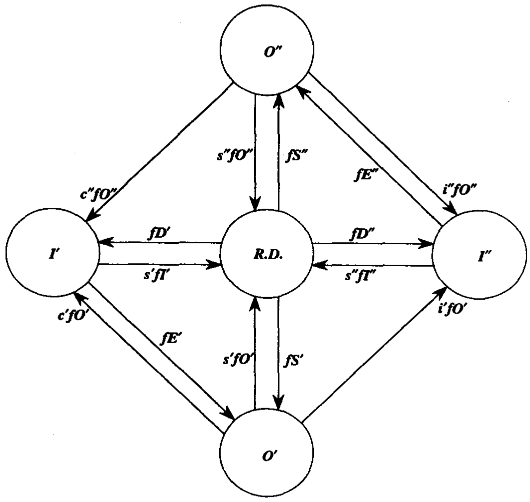
Ireland's national debt in 2012 was €190 billion. If it reduces its annual budget debt to 3% by 2015, the national debt is still estimated to increase to about €210 billion, about 120% of GDP. According to Peter Cross if the country gets an annual nil-budget and keeps it that way, our total debts will continue to rise by about €10 billion annually forever, largely it is assumed because of interest payments![25] Colm McCarthy, an economist, comments that the only hope for the country is in strong exports in a weak global economy.[26] Currently just over 1%, unless they quickly rise to over 3%, the debt problem is unmovable. There is also the fact that the youth unemployment level is still too high. It is now widely admitted in Europe that the effect of the imposed austerity program on both unemployment and Debt to GDP ratios was seriously underestimated but one cannot be optimistic that they will change their tune.

According to Schiller, there is no real reason why, taking currency inflation into account, the price of houses from one generation to the next needs to increase. In fact house prices were stable for most of the 20th century only rising out of control in the mid-1990s. What is needed in an economy, taking monetary inflation into account is a relative stability of standard middle-of-the-road family house prices and rental costs and related necessities, from generation to generation. One generation should not profit excessively from another in the basic essentials of life. The fact of the matter is that the recent slump of the economy was built on the exuberant irrational expectation that the price of house prices and with them the profits to be made would always increase. This brings into question one of the fundamental emotional foundations of capitalism; the feeling that the constant maximization of profits is the criteria of success. How could it be otherwise? Yet there is much evidence that such irrationality can in fact in the longer term be destructive of the economy and people's lives. It might even be connected with the excessive debt levels characteristic of modern economies. There is needed a rational analysis of the positive functions of profit and critique of the negative in an economy.

IV. A dialectic of profits and the standard of living?

In his *Lonergan's Discovery of the Science of Economics* Michael Shute remarks that "Lonergan's account of the production process provides a basis for two key elements of a theory of macroeconomic dynamics: the division of the economy into two distinct circuits and the pure cycle."[27] The circuits, basic and surplus, with their crossovers and connections with the redistributive zone are shown in the diagram. From that base it was through articulating the related structure of exchange, flows of money necessary for the pure cycle, that Lonergan gave a scientific structure to macroeconomics.

Lonergan's 1982 Circulation Diagram[28]



I" = basic consumer demand (buyers of cars, etc.)
O" = basic consumer supply (car assembly, etc)
fE" = expenditure to supply (paying for cars, etc.)
cfO" = wages/outlay to demand (paying assembly of)

I" = surplus consumer demand (buyers of car factories, etc.)
O" = surplus consumer supply (makers of car factories, etc)
fE" = expenditure to surplus supply (paying for factories)
I"fO" = wages/outlay to surplus demand (paying assembly of)

I"fO" = crossover
c"fO" = crossover

R.D. = redistributive zone (Banks, Stocks, Government) where the fantasy inflation of the money supply occurred.

fD" = loans to basic demand (mortgages or cars)
fD" = loans to surplus demand (car factories)
fS" = loans to basic supply
fS" = loans to surplus supply

s"fI" = taxes, repayments from basic demand
s"fI" = taxes, repayments from surplus demand
s"fO" = taxes, repayments from basic supply
s"fO" = taxes, repayments from surplus supply

In the well-known trade cycle there occurs a succession of positive and negative accelerations in the circulation flows and exchange of money and correlative booms and slumps in production and exchange. The significance of the term "pure" in the pure cycle is that no negative accelerations or slumps are involved in it. "A pure cycle of the productive process is a matter, simply, of the surplus stage accelerating more rapidly than the basic, then of the basic stage accelerating more rapidly than the surplus."[29] In this manner the overall standard of living is raised from an initial to a higher level. By the surplus stage Lonergan means the stage of massive investment in the building of major technology, research and manufacturing structures to build the production lines for the products of the future: apartments, offices, agriculture, aircraft, cars, trains, tablets, infrastructure. Only when the surplus stage is completed and commissioned can its potential to manufacture and exchange its products in the markets begin and so raise the standard of living.

Having identified the scientifically significant macro dynamic circuits in which money flows, Lonergan was faced with the challenge of understanding the details of how exchange has to function to produce the distinct series of stages that make up a pure cycle. How in each of those stages does basic and surplus income, prices and profits vary? In a surplus growth phase basic incomes have to remain constant, surplus incomes rise, surplus profits and prices are high. In a basic expansion basic incomes have to rise, surplus incomes contract, surplus profits have to contract from excess to normal.[30]

Within that cluster of variables one stands out, pure surplus income which Lonergan defines as follows:

> At the root of the depression lies a misinterpretation of the significance of pure surplus income. In fact, it is the monetary equivalent of the new fixed investment of an expansion: just as the production of new fixed investment is over and above all current consumption and replacement products, so pure surplus income is over and above all current consumption and replacement income.[31]

Pure surplus income is that fraction of surplus income/profits which is a form of pure economic potential. Not being committed to any particular task it is available to be put to work for any task. In this sense it can become a social dividend. Continuing the above quotation:

> …just as the products of new fixed investment emerge in cyclic fashion, so also does pure surplus income emerge in cyclic fashion. It is mounting from zero at a moderate pace in the proportionate expansion; it is mounting at an enormous pace in the surplus expansion; but in the basic expansion first average, and then aggregate pure surplus income begins to decline, and eventually they have reverted to zero. Now it is true that our culture cannot be accused of mistaken ideas of pure surplus income as it has been defined in this essay; for on that precise topic it has no idea whatsoever.

The contraction of pure surplus income eventually to zero is a condition of possibility of the successful basic expansion of the economy and with it the overall standard of living. That contraction to zero is just for "this" present pure cycle alone. In doing so it enables it to raise the standard of living to the new higher level. If it does not do so it interferes with that process in this cycle. The cyclic pattern of pure surplus income will repeat itself in successive pure cycles.

In *For a New Political Economy* Lonergan comments that his definition of surplus income corresponds with "excess profits" rather than with "profits," lists five causes of surplus income, defines it as a fraction of total surplus income, as at the nerve center of free economies and subject to cyclic variation in a long term acceleration.[32] In *Macroeconomic Dynamics: An Essay in Circulation Analysis* he defines pure surplus income as:

> the aggregate rate of return upon capital investment: entrepreneurs consider that they are having tolerable success when they are not merely making a living, no matter how high their standard of living, and not merely obtaining sufficient receipts to purchase all the equipment necessary to overcome obsolescence, but also receiving an additional sum of income which is profit in their strong sense of the term. An aggregate profit in that sense is precisely what we have found pure surplus income to be.[33]

It results from an expanding economy, receives contributions from basic as well as surplus outlay and is a form of social dividend. A fraction of surplus income, it is a proper macroeconomic category and as such has to be distinguished from the normal meaning of profits as used by accountants.

Frederick Lawrence in his Editor's Introduction to *Macro Dynamics: Essay on Circulation Analysis* draws a crucial distinction between profits as motives and profits as defined by rational analytical criteria within a macroeconomy.[34] The significance of the pure cycle of surplus income will run counter to the feelings of very many. Analytically there has to be a first movement of financial capital into the surplus stage in order to get it started. To those mainly involved in the basic stage this will seem unjust. Analytically, when the surplus stage is completed there has to occur a movement of financial capital into the basic stage. For Lawrence "The movement from an anti-egalitarian flow to the egalitarian flow that naturally should follow it is not something that happens automatically; *it demands understanding and moral choice*."[35] It is precarious. In history there have been successful surplus expansions but instead of basic expansions there tends to occur "the contractions, the liquidations, the blind stresses and strains of a prolonged depression."

Lonergan's account here of the failure to effect the basic expansion of the economy fits perfectly with the Irish experience over the past six years. As long as entrepreneurs and financiers continue to attempt to suck pure surplus profits/income out of an economy regardless of where it is in the cycle of growth, the basic expansion of the pure cycle will remain incomplete and the overall standard of living low. The analytical alternative will lead to an increase in basic incomes and with it a reduction of borrowed debt.

V. 21st Century Finance – Deepening the Dialectic

> 'We are all sinners.' – Wolfgang Schauble,
> German finance minister after a visit to Greece

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The influence of Keynes waned in the 1970s, the Milton Friedman school succeeding him with the oil crisis and high interest rates. But around the start of the 1980s Regan and Thatcher, disciples of Hayek, inaugurated the era of the unregulated free market. It was simply assumed that the problem of booms and slumps was solved forever. Research in the topic became marginal, even ridiculed. Around 1998 the idea of derivatives was invented and with it the investment banks were straining at the leash. In 1999 with the passing of the Gramm-Leach-Bliley act, which abolished Glass Steagall, was passed. In the following year Greenspan was behind a movement which resulted in a law against the regulation of derivatives. The mood was such that there was in the financial world almost zero toleration for any kind of regulation.

Very quickly the large multinational investment banks started to replace the high street sector with their global tentacles. The expansion since the early 1980s has been described as follows:

> The American Economy increasingly serves only a narrow part of society, and America's national politics has failed to put the country back on track through honest, open, and transparent problem solving. Too many of America's elites – among the super-rich, the CEOs, and many of my colleagues in academia – have abandoned a commitment to social responsibility. They chase wealth and power, the rest of society be damned.[36]

Whereas Watt in his *Capitalism and Morality* asserted a moral element, there would be no such element in late 20th century finance. The community worshipped in accordance with the creed: we believe in the unfettered maximization of profits, whatever the cost. These sentiments are echoed by William Reich in his *Beyond Outrage*:

> *The first dot*: For three decades almost all the gains from the economic growth have gone to the top. In the 1960s and 1970s the wealthiest 1% of Americans got 9-10% of our total income. By 2007, just before the Great Recession, that share had almost doubled to 23.5%. Over the same period the wealthiest one-tenth of 1% tripled its share. We haven't experienced this degree of concentrated wealth since the Gilded Age of the late nineteenth century. The 400 richest Americans now have more wealth than the entire bottom half earners – 150 million Americans – put together. Meanwhile, over the last three decades the wages of the typical worker has stagnated, averaging only about $280 more a year than thirty years ago, adjusted for inflation. That's less than a 1% gain over more than a third of a century.[37]

There emerged a component in the world economy that began effectively to disconnect itself in its activities from the real productive economy. It became more profitable to make money out of money. But as noted by Keynes, you cannot isolate a segment of a unity, the world economy, in which every element is in some way related to every other element. The financial engineers might have thought that their profit seeking had no consequences in the world but that was not at all how the rest of the world subsequently experienced it. In a quite destructive manner it impoverishes the resources of both the consumer and producer circuits of the economy and related standard of living which should be the first priority.

V. Lonergan on the Need for Monetary Flexibility

It is clear that Lonergan considered his *Essay on Circulation Analysis* as a necessary foundation, a first step from which to work out the more complete dynamics of financing a massive expansion of an economy.

> Second, there is the fact that the economic process runs through a series of transformations and exploitations; the real flow varies, and the dummy flow has to vary concomitantly or else suffer inflation or deflation; moreover, the real flow attains volumes that greatly exceed previous maxima, and these peaks can be scaled only if the dummy has a notable elasticity. By finance we understand the effort made to solve these problems. For the present, we may be content with that definition, for further discussion becomes possible only after we have analyzed the general exchange process.[38]

His longer term goal was to integrate that analysis within the world of finance. Lonergan's is insisting that the proper context for the analysis of finance is in terms of its correlates with the productive process of the economy. You must understand that first. Then one can address financial questions in relation to massive expansions within it. Lonergan is talking here about massive flexibility resulting in massive expansions of the money supply at periods of great economic expansion in order to facilitate the hugely creative process involved.

> On the other hand, when we say that the idea of money as a system of public bookkeeping has to be worked out and applied, we mean above all the necessity of a money whose laws coincide with the laws of the objective process, so that instead of a conflict between real possibility and financial possibility we shall have harmony, and instead of bookkeeping exercising a dominating role they will fill a duly subordinate position.[39]

There is the challenge here to work out a flexible and elastic concept of money that can adjust itself constantly to serving the very reals needs of the global human community by unlocking rather than stifling all the available potentials for creativity. We do not have such a concept of money at the present time. What we have is a rigid and inflexible system of bookkeeping that by its austerity dictates the fraction of those real needs that are to be addressed and no more. In Europe it is currently condemning the youth to long term unemployment or emigration and so stifling the creative responses to many of real needs in society. The alternative of quantitative easing in the US and UK, although acting as a stimulant, tends to make the rich richer and leave the less well off as before. There must be a more equitable way of implementing it. We need a future economist with the childlike wonder of an Einstein to ask questions about the flexibility of money, profit, credit and debt, and lead us out of the dominance of the concept that simply dictates human needs rather than encountering them.

The economic and financial functions of money in their presence or absence touch the lives of everyone on the planet yet remain zones of widespread ignorance. There is a global need for much greater literacy in the potential for progress and decline, creativity and destructiveness that resides in the economic and financial community. Economic thinking has to become more rooted in the ethics of the standard of living on the planet. The emotional force of the uncritical profit motive has to give way to a critical analytical stance. The burden of debt has to be moderated in the basic expansion by a social dividend.

[1] I have previously addressed aspects of these questions in "Finance Ethics," *The Lonergan Review*, Vol II, No 1, Spring 2010, 150-174 and "Euro Lessons in Context" in www.thinkingfaith.org/articles/20111111_1.htm The present article is of the form of further points for discussion.

[2] Consider various purchases which can be made and try and imagine where the money they pay for the purchase to the retailer goes ultimately? Similarly with wages: where do the wages or pensions that are paid come from ultimately?

[3] In 1926 the Labour Party adopted the concept of A Living Wage as its policy. More recently "Labour was also relaxed about the greater concentration of income and wealth that had occurred under the conservatives. The Party's leaders took the view that while it was important to tackle poverty, reducing inequality was not a priority. In his introduction to the 1997 Labour manifesto, Tony Blair wrote that he has "no time for the politics of envy." Stewart Lansley, *The Cost of Inequality, Three Decades of the Super-Rich and the Economy*, (London: Gibson Square, 2011) 88.

[4] Stephanie Flanders, BBC 2 TV Masters of Money, Hayek, Marx and Keynes, 2012 - program on Hayek. For further essential background consult Liaquat Ahamed *Lords of Finance: 1929, The Great Depression, and the Bankers Who Broke the World*, (London: Windmill Books, 2010).

[5] Liaquat, op cit, 501f. Some are currently disputing the traditional interpretation of the causal connection between the treaty and the war.

[6] Stephanie Flanders, BBC 2 Masters of Money, 2012 - Program on Keynes.

[7] Many in Europe think a bailout is a matter of one country's tax payers paying off of the debts of another. In fact it is an emergency loan at sometimes quite high interest rates that has to be paid back in full. Bailout is an emotive term for both lenders and borrowers that should be banished from financial discourse.

[8] Wikipedia.org, Bretton Woods entry.

[9] In Lonergan's *Method in Theology* (London: Darton, Longman & Todd, 1972) the making and selling commodities comes under the category of efficient meaning with its scale of values: vital, social, cultural, personal and religious, 31-2, 77-78.

[10] Stacy Schiff, *Cleopatra, a Life*, (Little, Brown and Company: New York, 2010) 90-98.

[11] (London: The Bodley Head, 2011) 156ff for an account of capital flights from Russia, Angola and the Philippines.

[12] http://www.huffingtonpost.com/pascal-saintamans/international-tax-rules_b_3943150.html

[13] Michael Shute, *Lonergan's Discovery of the Science of Economics*, (Toronto: University of Toronto Press 2010) index under money.

[14] http://www.economist.com/content/global_debt_clock http://www.worldclock.com/news+global-wealth-hits-$241-trillion_151.html

[15] Some have suggested that the hundreds of trillions of dollars of derivatives in circulation in the financial world with no purchasing power in the economy could be a Ponzi scheme.

[16] My "Finance Ethics" attempted an expose of the oversights that led to the 2008 crash. To them I now add Greenspan"s law against the regulation of derivatives and the abolition of the Glass Seagall Act.

[17] See http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(PPP)_per_capita.

[18] http://www.oecd.org/site/progresskorea/globalproject/44227733.pdf

[19] Oxford Poverty and Human Development Institute, (OPHI) website http://www.ophi.org.uk/

[20] http://www.ophi.org.uk/

[21] Jeffrey Sacks *The Price of Civilization: Economics and Ethics After the Fall*, 211 ff.

[22] There remains the challenge of integrating Lonergan's earlier statistical notion of the standard living with his later view of the properly human sciences in his "Dimensions of Meaning" and the chapter on The Human Good in *Method in Theology* with its efficient function of meaning.

[23] Stewart Lansley, *The Cost of Inequality, Three Decades of the Super-Rich and the Economy*, (London: 2011, Gibson Square), chapter 8. For Lonergan's approach see *CWL 15 Macroeconomic Dynamics, An Essay in Circulation Analysis* (Toronto: University of Toronto Press, 1999, Hereafter MD: ECA) 133-144 on "The Cycle of Basic Income."

[24] See Robert J Schiller, *The Subprime Solution*, (Princeton: Princeton University Press 2008), Chapter 2 Housing in History.

[25] *Irish Times*, 30 August 2013. "National Debt is a Burden We Really Need to Erode."

[26] *Irish Independent*, 2 March 2014, where he provides a necessary reality check on the situation.

[27] (Toronto: University of Toronto Press, 2011) Chapters 5 and 6, especially 167f. In his later analysis of the functions of meaning in *Method in Theology*, 77-78, Lonergan asserts that the economy does not exist naturally like the chemical elements or the force of gravity; it is entirely decided, meant, chosen by human beings. In this sense economics is a human science. MD:ECA puts before us the fact that there is also a

logic, grammar, intelligibility underpinning it.

[28]*MD: ECA* 195.

[29] *CWL Volume 21, For a New Political Economy*, (Toronto: University of Toronto Press, 1998, hereafter FNEP) 245. Interesting is Lonergan's use of the terms, pure desire to know, pure cycle, and pure surplus income.

[30] FNEP 286-7.

[31] FNEP 297-8.

[32] FNEP 50, 89-93, (see in particular 92, 3rd paragraph on profits) 292-301.

[33] MD:ECA 146, section 27, 144-156 is key.

[34] MD: ECA, lix-lxxii.

[35] MD: ECA 135, 117 note 150, 115 note 148, 135-7, 140 note 197, 151, 153, 147.

[36] Jeffrey Sacks recent *The Price of Civilization: Economics and Ethics After the Fall*, 4-5.

[37] *Beyond Outrage*, *What has Gone Wrong with Our Economy and Our Democracy and How to Fix It*, Kindle books, 2012, Introduction.

[38] *FNEP*, 41

[39] *FNEP* 105