Financial Repression and Regulation

It has now been about five years that orthodoxy has been paralyzing all economic recovery and political correctness paralyzing the central banks. High unemployment – which will only worsen in 2013 in a country like France – changes nothing here. The obsession with deficits and anxiety about punitive markets unite the best of adversaries – the right and the left – in the same battle against the common enemy, though imaginary, namely inflation! Nothing should be done to stoke inflation, and everything must be sacrificed in terms of austerity. For it is said that we will one day be rewarded in return: in this life, or more likely in another life… A major nation – Japan – however just found the guts to break the touching consensus. In deciding to approach the problem from the right point while finally identifying its real priorities. It is indeed long before the Western world went dark, in 2007, that the dress rehearsal of our economic crisis wreaked havoc in this country. However late and timid were the reactions and actions of governments which followed since the implosion – in the early 1990s – of its real estate and stock markets. Constrained by the neo-liberal dogma that sees deficits equal to the Antichrist, the Japanese leaders systematically committed the childish mistake of reducing public spending before the current economic recovery was strong enough. To make room for a chronic deflationary regime to reign supreme in the late 1990s. A man – Shinzo Abe – who was just elected Prime Minister of that country by a sweeping majority nevertheless just decided to implement an “audacious monetary policy, a flexible fiscal policy and a strategy to encourage private investment”, in the words of his statement after his election victory. The sequence of this unconventional man’s arrival to power, as a radical change in approach to remedy this endemic evil, inflation, should not, however, leave anything to chance. Indeed, for the first time since 1980, this country is carrying clearing a trade deficit! If the Japanese fiscal deficit was actually tolerated by its citizens and its elite, just as was until now the anemia to its economic climate. If it did not matter after all that Japan’s public debt stood at 230% of its GDP (this figure being 110% in the U.S.), because 85% owned by nationals. The fact that Japan is no longer a creditor nation and that Japanese begin to owe money to foreign creditors has caused a national revival, intelligently operated by Mr. Abe, who has promised to transform the country’s
deficits into surpluses. To achieve this objective, the new Nippon government urgently needs the unwavering cooperation of its central bank – the Bank of Japan – which proved to be the least failed in its fight against deflation, as against the huge appreciation of its currency – Yen – having seen its value doubled since the early 1990s! These are the foundations of this new Japanese policy where “audacity” means weakening the Yen and inducing beneficial reflation into the economy through the lever of quantitative rate cuts, so deserved. Why preserve the independence of central bankers – personalities who occupy strategic positions of the first order without benefiting from the popular vote – if they refuse to make their ammunition available to economic growth, under the false pretext of the fight against inflation? As the monetary policy of a nation and the level of its national currency should serve business and employment, it is only natural that political leaders – elected officials – control them. Shinzo Abe’s platform consists precisely of intensive money creation which will also weaken the Yen, and at the same time allow the recovery of Japanese exports. Hence the stimulus program very recently enacted by Abe and which will reach the equivalent of 103 trillion yen ($ 116 billion). An impressive amount that will inevitably produce positive results on the front of the fight against deflation, particularly in light of the bleak Japanese demographics. The Japanese example can inspire our European economic and monetary officials for the Japanese experience – the current one with Abe but also that of the “lost decades” – demonstrates the urgent need for determined and energetic measures to fight the recession.

Which already produce significant results, since the Yen began to depreciate greatly and optimism is gradually taking hold of the economy and investment in this country. Japan, widely studied and analyzed for its deflation and dramatic implosion of its speculative bubbles, will it one day ever be cited as an example for its about-face against orthodoxy? Accustomed to deflation, the – aging – Japanese population prefers by far saving to consumption. A very understandable attitude because it is actually better to refrain from buying today, if we know that the prices will be lower tomorrow or after tomorrow. As the Japanese economy has been stagnant for too long and Keynesian-like public spending virtually no longer has an effect on a jaded population,accustomed to an endemic recession, only a revolution in attitudes is likely to recover the activity of this country. In this regard, the most efficient way to induce such a psychological change is to reignite the appetite for consumption by adopting explicitly a target for inflation. The clear message sent by the new Japanese government and its central bank to their citizens is: “as your Yen is worth less tomorrow spend them today!” Posture for less heterodox, coupled with a completely new growth target fixed to the country’s stock market index. Indeed, the Japanese
Minister of Finance, Akira Amari, who said that his government would do everything possible so that the Nikkei reached 13,000 points by the end of the first quarter of 2013. This is the first time in world history that a government – responsible for the conduct of the affairs of the second or third largest economy in the world – clearly defines to its country’s stock markets a goal to be achieved! “Let the party begin”, is therefore the directive to the Nikkei required to take 17% more in six weeks. In reality, “the party continues”, since this index – which has already soared more than 30% since November 2012 – now finds itself at its September 2008 levels. Thus it has enriched domestic firms by about 38 trillion Yen in favor of the appreciation of their security, according to Mr. Amari’s calculations. The directives formulated by the Japanese Minister of Finance define therefore a general framework for increasing this index, with the knowledge that the operators, investors and speculators will only experience respite and “inner peace” when the 13,000 points will be met or exceeded. This, in order to unveil the new objective which will be defined therefore by the Japanese executive. Knowing that their investment stock – just like a car trip – always moves in the direction where we look… Still, will this chronicle of a spike announced by the Japanese stock market – which will further enrich and certainly the caste of traders and bankers – probably only do very little to benefit the vast majority of citizens of this country? To be useful, the nominal appreciation of the Nikkei – just as spectacular as it was, and it is! – combined with the devaluation of the Yen, should also result in an increase in the average Japanese income, and not only in a higher cost of living. In fact, Mr. Amari is not the first leader to designate the stock market with a goal to attain, since the President of the Federal Reserve Bank of Minneapolis, Narayana Kocherlakota, claimed in 2011 that the market capitalization would be “a central ingredient to economic recovery”.

The Japanese laboratory shows that it is therefore possible, under certain conditions, for a united regional group to take control of their destiny. To do this, a genuine financial repression must be put in place that can take many forms and paths. The objective is to smoothen the economic climate and healing, under duress, from the financial actors. In this context, it is vital to develop tools that will curb the appreciation of interest rates on the public debt, even that will cap them. In so doing, several avenues are possible which could be alternatively explored by government depending on the national context and the extent of the crisis. These very strict or more subtle measures will have the ultimate goal of containing certain capital funds within the national arena so that stakeholders benefit from the real economy or that they can be used by the state in the interest of collectivity. They are available in foreign exchange control and capital flow. Requiring higher reserve ratios from
financial institutions. Legally requiring banks to hold a certain portion of their reserves in Treasury bills of their home country or the regional organization to which they belong. Establishing a cap on the compensation of banking deposits and on the applicable taxes but also on fees collected on credit granted to economic actors. Offering preferential privileges and conditions to banks holding deposits with their central bank. Prohibiting or at the very least establishing a tightly controlled regulatory framework and taxing certain financial transactions. Taxing trading which would naturally lead investors to prefer tax exempt tools such as bonds, even those issued by certain corporations. The objective of these measures is to clearly channel funds which would have otherwise fled the country into maximizing the benefit to the real economy while facilitating the financing of public debt. This arsenal of financial suppression therefore leads to intense pressure applied on interest rates, which logically allows a reduction in public spending linked to the repayment of debt. Even better, since the energetic and intelligent implementation of this suppression may – with buy-in from the private sector and business which “would play the game” – bring about real interest rates which would become negative. That is to say that, in other words, these liquidities would have more interest in being invested in the economy that finding refuge in bank accounts, and this is precisely when interest rates would become negative that it is possible to repay its debts and economic growth benefits us all! That is why the state should finance ideally its budget by borrowing instead of taxing in the context of negative real interest rates. The efficiency of this financial suppression is even more assured when it offers the considerable advantage of being much more easily accepted and adopted than the increase in taxes or VAT. It is applied through leverage, like financial regulation, even inflation, otherwise less delicate and less direct than very unpopular (and often unfair) tax increase. Of the rest, increased regulation within the framework of this repression only responds to lax financial regulations, systematic during prosperous economic times. Since a so-called regulation must be evidently counter-cyclical, that is to say, that it must be shown to be stricter during the good times, whereas, the facts show, it is released under a stronger financial and banking system when the situation is more favorable. Indeed, it goes without saying that the first interest of finance is to manoeuvre within a minimal regulatory framework which stimulates and maximizes its profits. Still, this financial repression may (and should) be limited in time, a time necessary to proceed with liquidating (partially or wholly) the debt load. This financial repression is only repressive for a privileged minority, since it defines a new way of how a transfer of wealth and resources is carried out from the creditor and the investor towards the consumer and debtor.
Let us note that these “liquidations” are also likely to be conducted through a resurgence of inflationary pressures which suddenly reduce the debt load. Contrary to the biases of the majority of the economists, this phenomenon of deficit reduction as another form of financial repression which is inflation is beneficial provided that it is operated properly, knowing that there are only a few countries like Argentina or Zimbabwe which profited from it and, in these last two examples, have suffered. Thus it is Great Britain which benefited from liquidating its debts in phases for nearly half the period between 1945 and 1980 while the U.S. themselves could have offloaded part of their deficits thanks to negative interest rates for approximately twenty-five years during this same period. It is therefore possible to infer that each of these two countries could have reduced its deficits by 3 to 4% per year within this “liquidation” context permitted by financial repression knowing that the U.S. could have even reduced their debt at a significantly higher rate between 1945 and 1947, when they had negative rates of 9%! As for Australia, where the inflation rate was even higher, it would have been able to shave off deficits of 5% per year during this same period. As noted, the episodic use of this type of financial repression can reduce 30% of deficits if 3% is earned annually... There are therefore only developing or badly managed nations which experience a resurgence of inflationary pressures, and our central banks should have the wisdom to agree to let inflation run occasionally with the objective of relieving populations and deficits of all kinds since it can precisely slice quickly through all debt, both public and private. Our monetary and financial regulators could therefore do better by being more flexible and less stringent behind their ideological barriers by admitting that even remedies like inflation should be administered depending on the circumstances. From a practical point of view, it is enough that interest rates do not rise at the same rate as inflation. It is actually this delay – or this disconnection – between nominal interest rates (fixed by the central bank) and the inflation rate which sets off this gradual liquidation of debts in a quantity equivalent to the differential which is established annually between these two rates above. This financial repression must therefore be orchestrated with intelligence, even harmoniously, by the central banker, who must therefore work hand in hand with the executive branch of the country in question, and in the public interest. Cooperation even more precious than establishing these liquidations in favor of high inflation may only successfully implemented if the state has a more or less long term debt (five years) at fixed rates. Fixed rates which would avoid having to increase its repayments to adjust them when rates rise, inevitable during high inflation.