Brexit Shows Need for New Rules on Money

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The vote for Brexit is about much more than the UK and Europe. It shows that new rules to guide the process of globalization are needed.

The policies followed since the financial crisis have two major errors.

First there is a failure to diagnose the true causes of the crisis. Second, governments have failed to ensure that all sections of society paid their fair share of the cost.

Governments and central banks saw the problem as one of lax regulation and inadequate bank capital. They tightened regulation and raised capital requirements. In other words, the system was patched up. It was all basically "business as usual".

Governments attempted to deal with the recessions by stimulating demand through easy money. Again, business as usual. That is what they had always done.

Preventing a widening of economic inequality was not one of the aims of these programs. On the contrary. Central banks quantitative easing and other non-conventional monetary policies relied on boosting asset prices for their effectiveness, thus benefitting sections of society that already possessed significant financial or real estate assets. They made inequality worse.

Another highly damaging effect of these monetary policies was to cause wide swings in nominal and real exchange rates among major economies, amounting to competitive depreciation and currency wars.

All this helped to create the conditions for protests, culminating in BREXIT.

But as I argue in The Money Trap, the diagnosis used to justified these policies was always faulty. The policies have not cured the underlying liability to further crises.

They are not only insufficiently radical. They are just plain wrong.

Ordinary people sense this. They see that authorities do not have a real grip on banking and finance. They sense that banking systems have not been reformed. Ordinary people pay through their taxes for bank recapitalization and continuing subsidies to the finance sector. This is grossly unfair. Banks are still not supporting the real economy and small businesses as they should.

Economic recovery has been slow precisely because neither business leaders nor consumers feel the underlying problems have been addressed.

Meanwhile, Brussels, London and Washington have all become honeypots for corporate lobbyists securing special deals and favorable regulation for the interests they represent.

To prevent another Brexit, address the real causes

The major causes of the financial crisis lay in bad national banking and international monetary systems. They remain unreformed.

Good systems provide incentives to governments and the finance sector to behave well – i.e. to serve the general interest. They lead governments and other actors to promote equilibrium by following good policies.

At the international level, that is what the gold standard did. I am not calling for a return to gold. But we have to recognize its achievements, otherwise we shall make no progress. It is essential to restore an automatic, impersonal, decentralized system for effecting adjustment of nations' external positions, as David Hume described. This can only be done though a system of fixed exchange rates and a single, respected international monetary standard.

Policies to overhaul banking and finance

Bank managers must personally bear the cost of mistakes. In turn, that can only be done by a system based on equity with no bail-outs, where decision-makers have (or are effectively controlled by people with) their own money at stake.

Policy options for proper reforms are described in The Money Trap. Only radical reforms to create appropriate international and national monetary systems for the age of globalization will provide a decent framework for the process to be seen to be fair. Given such a framework, individual efforts by private sector institutions will again serve the common interest (as described by Adam Smith).

Held within a strong, global, rules-based framework, nation states could then be let free to use tax and social security policies as desired to cushion the short-run adverse effects of globalization on their citizens.

Without such actions, however, more BREXIT earthquakes should be expected.