

QUAKER ECO-BULLETIN

Information and Action Addressing Public Policy for an Ecologically Sustainable World

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The Financial Economy and the Earth's Ecosystems: A Primer

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The mission of Quaker Eco-Witness is to help Friends promote ecologically sound public policies. Moving toward an ecologically sustainable society will require the emergence of ecologically sound economics. As things now stand, an unrestrained financial system drives the production system, the operation of which is degrading the earth's ecosystems. This dynamic must be transformed so the health of earth's ecosystems guides the behaviour of the production system and the financial system. Much work is being done to propose changes in monetary institutions so they will promote ecological and social integrity. This issue of QEB is intended to help Friends understand the need for monetary reform.

There are two clear trends in the US and world economies. One is that economic growth is increasingly damaging the earth's ecological integrity. The other is that financial wealth is becoming ever more concentrated among the rich, while the standard of living is deteriorating for a growing number of impoverished people. During the past quarter century economic institutions have changed in ways that exacerbate these trends. One of the greatest changes relates to the amount of money in circulation and the nature of the values that money represents.

The real economy is about producing and exchanging goods and services. It uses money to help make and do things people want and need. The financial economy helps to develop the real economy, but it also invites speculation — the practice of buying and selling financial instruments in order to make a profit on their shifting values. Buying stock in a company is an investment in the real economy when a reasonable rate of return is expected from the sale of a useful product, but buying to sell when the value goes up is pure speculation.

In 1970, the financial economy (FE) was about twice the size of the real economy (RE). The dollar value of all stocks, bonds, and other paper contracts was about twice the dollar value of all goods and services, farms and factories, schools, hospitals, etc. By the 1990s, the financial economy had become 20 to 50 times as large as the real economy. The financial economy changes constantly and there is no way to determine its actual size.

Many things have brought about the expansion of the financial economy, but they all involve reducing the ability of governments to manage the amount of money in circulation by influencing banking activity and interest rates. This has dramatically increased the profitability of speculation, which has

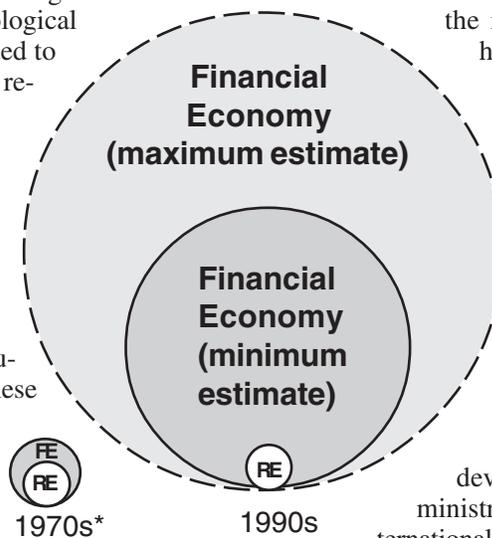
created unregulated expansion of the money supply. Speculation is now a core activity of most mutual funds, pension funds, insurance companies, corporations, investment banks and currency traders.

Before 1971, the US dollar functioned as a stable international currency. Even though the US went off the gold standard in 1933, it maintained the value of the dollar at \$35 per ounce of gold that was stored in Fort Knox. The Federal Reserve Bank was able to maintain the stability of the dollar, the money supply and interest rates at home by influencing the activities of the US banking system. Other nations maintained the international value of their currencies by exchanging them for dollars, which could in turn be exchanged for gold.

This arrangement, established at the Bretton Woods Conference after World War II, worked well until late 1960s, when the world economy outgrew the US supply of gold, and the supply of US dollars overseas expanded due to military spending and development aid. In 1971, the Nixon administration abandoned this system of international financial management in order to prevent the collapse of the dollar's value as there were no longer enough gold reserves to support it. This was the first step in the evolution towards the current system, in which the volume of money in circulation is now determined primarily by international financial transactions and is beyond the control of any government.

The second major step in this evolution was computerizing international financial accounts, which led to the creation of electronic money with no reference to any tangible assets — financial markets operating 24 hours a day seven days a week, and a multi-trillion dollar currency trading industry. Banking deregulation, tax cuts, increased government debt, and new financial products like stock options and derivatives also help to increase speculation as profits are fed back into the financial markets. The expansion of the financial economy is a complex process based on the multiplier effect that comes into play when banks create new money by making new loans. It is no longer possible to know how much money there is because so much of the world's money is created through computer transactions — even borrowing for the buying and selling of money itself.

All this new money accrues to those who participate in the system that creates it. Much of the US population partakes indirectly through insurance policies and pension funds, but the main recipients are wealthy individuals and corporations that trade in the financial markets. The investors and managers who



*The graphic shows only the relative sizes of the real and financial economies, but does not reflect the substantial increase in the size of the real economy from the 1970s to the 1990s.

control this wealth, influence governments to protect it. The government maintains growth by reducing taxes and by limiting regulations that would restrain growth. Taxpayer money is used to prevent the collapse of parts of the economy. The current US administration lowered taxes for this purpose. It also blocked efforts to regulate offshore banks, under pressure from US banks who use them to shelter the money of wealthy clients, in spite of the fact that money flows to terrorists, drug cartels, and other corrupt elements through this channel.

Those with wealth in the financial economy shift it to the real economy whenever they buy goods and services instead of more stocks and bonds. With so much more money in circulation, price inflation is a constant danger. Two factors have worked to moderate price inflation of goods and services. One is that rising prices and profits (inflation) on the financial exchanges, and more financial products like new futures, options, and derivatives, have increased investment in the financial economy and absorbed the increasing supply of money. Thus, accelerated growth in the financial economy provides short-term protection for the real economy.

The second factor that moderates price inflation of goods and services is growth in the real economy so transfers from the financial economy are offset by increases in real value. Over time, the real economy has responded to the pressure of the expanding financial economy by incorporating ever more land and natural resources into itself.

But never before has the financial economy expanded so fast or become so large. Now the draw-down of "natural capital" is apparent, much as the draw-down of gold in Fort Knox became evident forty years ago.

There is public concern about Social Security as baby boomers retire and fewer workers must support more retirees. But no one seems to ask what will happen to pressures on land and resources when baby boomers shift money from the financial economy to the real economy to live off their pension plans.

It is easy to understand that uncontrolled expansion of the financial economy is driving expansion of the real economy, which in turn is eroding the fabric of life. It is harder to understand why, with the huge expansion of the financial economy, the gap between rich and poor isn't growing even faster than it seems to be.

Few economists seem to deal with these issues. In otherwise excellent reviews of recent economic trends and theories by economist Paul Krugman and historian Robert Collins, there are no considerations of the relationship between the financial and real economies or of the ecological impact of continuing economic expansion, and very little consideration that extremes of wealth and poverty within and between nations may relate to the huge expansion of the financial economy.

What Can Friends Do?

If, as Friends, we want to promote peace and justice and reduce the damage human activities are doing to the earth's ecosystems, it will be necessary to look beyond issues of personal consumption to the effects of the financial economy's expansion.

QEW is developing plans to bring this area of concern into clearer focus. We believe that once Friends as a body understand its ethical and spiritual implications, we will become participants in an essential transformation of our economic institutions.

For Further Information:

Collins, Robert. *More*, Oxford, 2000.

Dillon, John, *Turning the Tide*, Canadian Centre for Policy Alternatives, 1997.

Krugman, Paul. *Peddling Prosperity*, Norton, 1994.

Kurtzman, Joel. *The End of Money*, Simon and Schuster, 1993.

The authors are preparing a fuller description of the concern described here, including the role of the banking system in expanding the money supply, and the relationship of Friends testimonies to this concern. It will be available soon at www.fcun.org, or call 609/261-8190 to receive it by mail.

Quaker Eco-Bulletin (QEB) is published bi-monthly as an insert in *BeFriending Creation* by **Quaker Eco-Witness**, a project of **Friends Committee on Unity with Nature (FCUN)**.

Quaker Eco-Witness (QEW) promotes government and corporate policies to help restore and protect Earth's biological integrity. It works within and through the Religious Society of Friends for policies that enable human communities to relate in mutually enhancing ways to the ecosystems of which they are a part. This witness seeks to be guided by the Spirit and grounded in reverence for Earth's communities of life as God's creation.

QEB's purpose is to inform the **QEW** network to advance Friends' witness on government and corporate policy as it relates to the ecosystems that sustains us. Each issue is an article about timely legislative or corporate policy issues affecting our society's relationship to the earth.

Friends are invited to contact us about writing an article for *QEB*. Submissions are subject to editing and should:

- Provide background information that reflects the complexity of the issue and is respectful toward other points of view.
- Explain why the issue is a Friends' concern.
- Describe the positions of other faith-based and secular environmental groups on the issue.
- Relate the issue to legislation or corporate policy.
- Provide sources for additional information.

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