Adair Turner (2015),
Between Debt and the Devil: money, credit and fixing global\ finance**,**
Princeton University Press

Diagnosis, policy solutions and relevance for low- and middle-income countries.
(Compiled by Dirk Willem te Velde, ODI, for the SET/DFID-ESRC Growth Research Programme (DEGRP) meeting at ODI, 24/11/2015)

Diagnosing the problem: a summary in 10 notable points in the book:

The rapid rise in private sector debt, especially around real estate, caused the financial crisis.

1. Modern financial systems left to themselves inevitably create debt in excessive quantities. In particular, the type of debt that does not fund new capital investment but rather the purchase of already existing assets, above all real estate (p.3-4).
2. At the core of financial instability in advanced economies lies the interaction between the potentially limitless supply of bank credit and the highly inelastic supply of real estate and locationally specific land. Credit and real estate price cycles have not just been part of the story of financial instability in advanced economies, they are close to the whole story (p.175).
3. Three underlying drivers of increasing credit intensity (p.8) are (i) importance of real estate; (ii) increasing inequality; and (iii) global current-account imbalances. Credit growth based on these notions is unlikely to support productive capital investment.

Banks are not the institutions that traditional thinking would have us believe. They have been central to useless intra-financial sector credit growth. However, they alone cannot be blamed for the crisis.

4. Banks do not only "take deposits from households and lend money to business," but they also "create credit, money and purchasing power" (p.58).
5. Three decades of financial innovation led to disaster (p.104); the social scorecard for increasing intra-financial intensity is negative (p.106).
6. Debt can be dangerous, even if all bankers are as honest, responsible and professional as possible, and even if each individual loan seems in itself socially useful and economically sustainable (p.166).

Directed credit for productive investment did play a role in successful developing countries, but emerging markets now also face major challenges.

7. In the past, successful developing countries have used credit direction rather than free markets to foster rapid and productive capital accumulation (p.131). Their policies included land reform, industrial policy, and a directive approach to the financial system (p.136).
8. Credit was made available to the manufacturing industry, not real estate development; to export industry, not importers or traders; and to support strategic priorities, such as Korea's heavy industrial development (p.139).
9. Germany's current account surpluses have been underpinned by public debt increases in the UK and the US, and by China's huge credit boom. Leverage has not gone away, it has simply shifted from one country to another (p.83).

10. China's decisions on capital account liberalisation will have major global implication. It introduces challenges for other countries as China faces a credit-financed overcapacity in capital-intensive industries and a vulnerability around real estate and infrastructure (p.145).

Imagining solutions: a summary in 10 policy-related points in the book

We need a fundamental rethink to ensure less credit-intensive and more stable economies in the future

1. Our objective cannot be simply to make the financial system more stable, or to fix "too big to fail," but must be to manage the quantity and influence of the allocation of credit in the real economy (p.164).
2. Effective reform requires *rejecting* three notions: (i) market completion and increased market liquidity always improves allocative efficiency (ii) low and stable inflation is sufficient to ensure financial and economic stability; (iii) credit growth is vital for economic growth (p.169).
3. We should recognise an inverted U relationship with increasing private leverage potentially positive for growth, but becoming negative beyond some turning points (p.172).
4. Radical structural reforms could include: abolishing banks, taxing debt pollution, and encouraging equity contracts through useful financial innovation (p.186).
5. Overcoming inflexibility of pure debt, e.g. through GDP-linked government bonds, can help create a more stable system (p.193).
6. Major changes to financial regulation are required: bank capital requirements should be four or five times their current levels; capital to support real estate lending should be much higher; short-term debt capital flows should be constrained through the fragmentation of international financial systems (p.162), and the use of countercyclical capital buffers.
7. Faced with a free market bias toward real estate lending, intervention favouring other types of lending (sustainable development, SMEs) are justified (p. 207).

In order to escape the debt overhang, developed countries face a balance between restricting private credit creation and restoring nominal demand through printing money

8. Both markets and governments can fail (p. 242) and optimal future policy must reflect combining far tighter controls on private credit creation with the disciplined use of fiat money when needed (p. 240).
9. The government printing money is a technically possible alternative to either pure fiscal or pure monetary policy (p. 220) to restore inadequate nominal demand (p. 211), even though printing money is the "work of the devil" (p.250).
10. The money-finance option should be a one-off (p.237), because it is very easy to use it in excess. Technically, continuous money finance could address a secular stagnation.

Five questions from a developing country perspective:

The book raises major issues with potential implications for low- and middle-income countries.

- With debt beginning to be shifted to emerging markets, what will be the impact on them? Will they make the same policy mistakes? Is a further financial crisis likely?
- What level, growth and type of private sector credit is compatible with inclusive economic transformation?
- Successful economic transformers have used directed credit: what exactly are the policy levers to do? Should developing countries use national development banks? How can useful credit be measured? And how can misuse of directed credit be minimised?
- What are the best indicators to measure the emergence of wasteful credit?
- When low-income economies transform to middle and high-income status, is a private credit bonanza likely/inevitable/desirable?

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