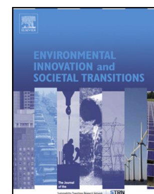
Environmental Innovation and Societal Transitions 9 (2013) 26–32

Contents lists available at ScienceDirect

Environmental Innovation and Societal Transitions

journal homepage: www.elsevier.com/locate/eist



Climate change and economic growth enigma: An investment suggestion from Wall Street

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ARTICLE INFO

Article history:
Received 10 September 2013
Accepted 10 September 2013
Available online 7 October 2013

Keywords:
Climate change
Demographic trends
Exergy
Fossil fuel
TBTF

ABSTRACT

A unique opportunity to deal with climate change and stimulate faster economic growth exists today because of the 2007–2009 financial crisis coincidence with secular structural changes in the global economy. A massive investment shift from fossil to non-fossil fuels could offset sub-par economic growth and high unemployment in the developed economies caused by the financial crisis and aggravated by demographic trends and the shift of economic dynamism to emerging markets. The 2008 and dot.com crises demonstrate that our financial system is inherently unstable and that "bubbles" are not only inevitable but occur at shorter intervals and inhibit long-term investment. Financing massive investment in non-fossil fuels could be done, however, with long-term securities whose rate of return, based on exergy efficiency improvement, would attract global institutional investors with long-term investment needs. Such a massive new securities market would reduce the volatility and systemic risks inherent in today's Wall Street-with-Wall Street markets.

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1. Introduction

Wall Street has inadvertently created a unique opportunity to invest in exergy efficiency based on non-fossil resources while promoting faster economic and employment growth than can be expected today. Thanks to the financial crisis of 2007–2009 caused by the financial system ("Wall Street"), and its

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http://dx.doi.org/10.1016/j.eist.2013.09.004

consequent Great Recession and debt crisis; combined with structural changes in the global economy and demographics, the U.S. and Europe are facing slower economic growth and higher unemployment than that experienced since WWII. Moreover, the dynamics that created the crisis of 2007–2009 are inherent in the system itself, which means that – barring fundamental change – something similar, or worse, could happen again.

To counter this grim prospect, and to mitigate the worst consequences of global climate change, wise government policy supported by financial creativity, should encourage intensive capital spending on renewable sources of energy and exergy efficiency. The large scale of investment needed to increase efficient use of non-fossil fuel and to wean the global economy from its addiction to fossil fuels could significantly boost long-term economic growth and job creation.

A major caveat: The financial community (“Wall Street”) must be prevented from causing another financial crisis – especially one triggered by a resource-based asset bubble. Given the limits on the U.S.' over-extended monetary and fiscal policies today, such a bubble would be far more difficult to manage and could lead to a global depression worse than the current below-trend global economic growth.

2. The view from Wall Street

This time IS different on Wall Street. Although guilty of triggering the worst global financial crisis since 1929, which caused the Great Recession and subsequent debt crisis, Wall Street, or banks and non-bank financial institutions, were saved from bankruptcy by tax payers and the Federal Reserve. The justification for that intervention was to prevent the collapse of our financial system and another depression. In fact, only a few banks – notably Lehman Brothers – and non-bank financial institutions such as specialized insurers, were allowed to fail. This was in contrast to what happened in the 1930s, or during the Savings & Loan crisis of the 1980s (FDIC, 2013) when thousands of financial institutions went bankrupt.

Another difference: Unlike the 1930s and the S&L crisis, no senior financial figures responsible for mismanagement of their institutions and systemic risk have yet been punished, still less gone to jail. Only a few low level individuals have been prosecuted, as though they were exceptional “bad apples” and not cogs in the larger machine. Even more remarkable is that only five years after the crisis, financial markets, including both equity and debt markets, are again near all-time highs (see Fig. 1). In fact, Wall Street institutions' profits and bonuses are as exaggeratedly high as they were before the crisis erupted in 2007. Few Wall Streeters are willing to admit that their good fortune is due to their bail-out by the government, plus uniquely low interest rates (Fig. 2) and the tsunami of liquidity engineered by Quantitative Easing (QE) by the Federal Reserve since 2008 (St. Louis, 2013). They also fail to acknowledge their role in costing the middle class home-owners on “Main Street” a large fraction of their life savings, i.e. their home equity.

Another difference: After the financial shenanigans of the 1920s, strict regulatory controls such as the Glass–Steagall Banking Act of 1933 (http://www.en.wikipedia.org/wiki/Glass%E2%80%93Steagall_Act), were imposed on Wall Street. Despite the laboriously negotiated, 848-page Dodd–Frank Act of 2010 (Securities and Exchange Commission, 2013), no strict re-regulation of U.S. finance has been imposed as of summer 2013, thanks to the powerful Wall Street lobby's success in diluting and delaying the act's implementation. In reality, the financial industry seems to have been empowered by the crisis because of the “Too Big To Fail” (TBTF) phenomenon. TBTF has become the key new factor in the U.S. economy. The advocates of “universal” banking – as opposed to separation of investment banking (i.e. gambling) from conventional banking – are still in the saddle.

Knowing that if a major financial institution risks bankruptcy, the Federal Reserve and the taxpayer will be forced to bail it out (in order to preserve the national payments system) gives TBTF institutions enormous leverage. This creates a “moral hazard” that we believe is inducing Wall Street to again take on unmanageable risks. If Wall Street titans get into serious trouble, they know the Federal Reserve and taxpayers will have to bail them out yet again. And they will keep their exaggerated salaries and bonuses meaning there are almost no constraints on their willingness to take on new risk, even systemic risk.

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