Our economic model is based on permanent austerity

By Elisa Barwick

With the Reserve Bank of Australia's tenth consecutive interest rate rise on 7 March, Australians should rightly be asking why banks that are posting record profits have to squeeze *people* harder in order to supposedly right the ship of the Australian economy. The answer is, they don't. There is only one reason they are being crushed with higher rates—to save the current economic system. That is, an economic system which is not there to ensure your livelihood (quite the contrary), but to lock in top-down control by the City of London and Wall Street financial combine. That system must be overthrown. To do so, Australians need to arm themselves with the knowledge required to argue the point with political leaders who have the power to overthrow it. A vital contribution is provided in the 2013 book of Scottish-American political scientist Mark Blyth, *Austerity: The History of a Dangerous Idea*. In the 1 and 15 February *Australian Alerts* we reviewed chapters dealing with the 2008 financial crisis, and how it was created by banks but paid for by governments (meaning you).

Whether their currencies are pegged to the gold standard or to a "euro standard", the sovereignty of European nations is eroded, their economies hitched to impossible standards of "financial stability" that throw their citizens to the wolves and lock in the control of bankers. Pictured, British gold sovereigns that circulated during the classical gold standard period, and a one euro coin. Photos: Wikipedia

Blyth goes on to reveal how the current economic model includes inbuilt austerity mechanisms—imposing budget cuts, wage restraint, regressive taxation, tighter monetary policy and restriction of credit at the first signs of crisis. He uses the European Union as an example, but it is the same in all countries that follow the Bank for International Settlements-IMF playbook. Just as "cuts were built into the script" of the pre-World War I classical gold standard, wrote Blyth, so they were written into the mechanisms of the European Union's single monetary platform.[1] In both cases, cuts are necessary to maintain a currency peg; that is, to maintain your currency's value against another's. The precursor to the introduction of the single currency, the European Exchange Rate Mechanism, he wrote, functioned exactly like the gold standard: "The only way to maintain a currency peg is to either defend it with foreign exchange reserves or deflate your wages and prices to accommodate it. To defend a peg you need lots of foreign currency so that when your currency loses value (as it will if you are trying to keep up with the Germans), you can sell your foreign currency reserves and buy back your own currency to maintain the desired rate." Blyth calls this the "Eternal Recession Mechanism" due to the deflationary impact of acting to increase competitiveness by forcing prices down.

Referencing the 1920s efforts to return to the pre-WWI gold standard, as well as the recent European experience, Blyth notes that people will not accept this trade-off forever: "there would be only so much deflation and unemployment these countries could take before they either ran out of foreign exchange reserves or lost the next election. … In short, attempts to maintain an anti-inflationary currency peg fail because they are not credible on the following point: you cannot run a gold standard (where the only way to adjust is through internal deflation) in a democracy."

The introduction of a single currency, however, removed the ability of European nations to adjust their currencies. They no longer had a sovereign capability to adjust their economies in a meaningful way: "If states cannot inflate their way out of trouble (no printing press) or devalue to do the same (no sovereign currency), they can only default (which will blow up the banking system, so it's not an option), which leaves only internal deflation through prices and wages—austerity. This is the real reason we all have to be austere. Once again, it's all about saving the banks."

A new independent central bank with one job—to keep inflation around 2 per cent using interest rates (sound familiar?) regardless of other economic factors—was established. What they had done, was effectively "built a gold standard into a democracy, again", Blyth wrote. In other words, austerity is the result of imposing an *external model* over nations which could otherwise solve their financial problems by tackling the underlying weaknesses in the real economy, applying national credit to crucial industries and sectors to resolve physical economic shortcomings. That *external model* is dedicated solely to enshrining financial power in the hands of the banking system rather than governments. It is not related to national economic management. Removing it is a matter only of the political will of nations; its removal will not cause some unsolvable inflationary or other problem. If replaced with a new economic framework that fosters economic growth and restricts speculation it will have only a beneficial impact.

Blyth then takes another tack to illustrate this reality, worth sharing in full. He pens a letter that might be written if a European leader decided to come clean about the reasons for austerity policy, rather than claiming it is necessary because sovereign governments have spent too much. "Imagine a major European politician trying to explain why a quarter of Spain needs to be unemployed", he wrote, "and why the whole of periphery Europe needs to sit in a permanent recession just to save a currency that has only existed for a decade. What would it sound like? I suspect that it would go something like this." (Excerpt follows.)

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1. Read more about the classical gold standard and austerity in "The genesis of Austerity" series, available at citizensparty.org.au/australian-alert-service-feature-articles/economic. On the creation of the EU, see *The British Empire's European Union: A Monstrosity Created by the City of London and Wall Street*, available at citizensparty.org.au/publications.

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To: The Voting Public
From: Prime Minister of Eurozone Periphery X

My fellow citizens. We have been telling you for the past four years that the reason you are out of work and that the next decade will be miserable is that states have spent too much. So now we all need to be austere and return to something called "sustainable public finances". It is, however, time to tell the truth. The explosion of sovereign debt is a symptom, not a cause, of the crisis we find ourselves in today.

What actually happened was that the biggest banks in the core countries of Europe bought lots of sovereign debt from their periphery neighbours, the PIIGS. This flooded the PIIGS with cheap money to buy core country products, hence the current account imbalances in the Eurozone that we hear so much about and the consequent loss of competitiveness in these periphery economies. After all, why make a car to compete with BMW if the French will lend you the money to buy one? This was all going well until the markets panicked over Greece and figured out via our "kick the can down the road" responses that the institutions we designed to run the EU couldn't deal with any of this. The money greasing the wheels suddenly stopped, and our bond payments went through the roof.

The problem was that we had given up our money presses and independent exchange rates—our economic shock absorbers—to adopt the euro. Meanwhile, the European Central Bank, the institution that was supposed to stabilise the system, turned out to be a bit of fake central bank. It exercises no real lender-of-last-resort function. It exists to fight an inflation that died in 1923, regardless of actual economic conditions. Whereas the Fed and the Bank of England can accept whatever assets they want in exchange for however much cash they want to give out, the ECB is both constitutionally and intellectually limited in what it can accept. It cannot monetise or mutualise debt, it cannot bail out countries, it cannot lend directly to banks in sufficient quantity. It's really good at fighting inflation, but when there is a banking crisis, it's kind of useless. It's been developing new powers bit-by-bit throughout the crisis to help us survive, but its capacities are still quite limited.

Now, add to this the fact that the European banking system as a whole is three times the size and nearly twice as levered up as the US banking system; accept that it is filled with crappy assets the ECB can't take off its books, and you can see we have a problem. We have had over twenty summits and countless more meetings, promised each other fiscal treaties and bailout mechanisms, and even replaced a democratically elected government or two to solve this crisis, and yet have not managed to do so. It's time to come clean about why we have not succeeded. The short answer is, we can't fix it. All we can do is kick the can down the road, which takes the form of you suffering a lost decade of growth and employment.

You see, the banks we bailed in 2008 caused us to take on a whole load of new sovereign debt to pay for their losses and ensure their solvency. But the banks never really recovered, and in 2010 and 2011 they began to run out of money. So the ECB had to act against its instincts and flood the banks with a billion euros of very cheap money, the LTROs (the longterm refinancing operations), when European banks were no longer able to borrow money in the United States. The money that the ECB gave the banks was used to buy some short-term government debt (to get our bond yields down a little), but most of it stayed at the ECB as catastrophe insurance rather than circulate into the real economy and help you get back to work. After all, we are in the middle of a recession that is being turbocharged by austerity policies. Who would borrow and invest in the midst of that mess? The entire economy is in recession, people are paying back debts, and no one is borrowing. This causes prices to fall, thus making the banks ever more impaired and the economy ever more sclerotic. There is literally nothing we can do about this. We need to keep the banks solvent or they collapse, and they are so big and interconnected that even one of them going down could blow up the whole system. As awful as austerity is, it's nothing compared to a general collapse of the financial system, really.

So we can't inflate and pass the cost on to savers, we can't devalue and pass the cost on to foreigners, and we can't default without killing ourselves, so we need to deflate, for as long as it takes to get the balance sheets of these banks into some kind of sustainable shape. This is why we can't let anyone out of the euro. If the Greeks, for example, left the euro we might be able to weather it, since most banks have managed to sell on their Greek assets. But you can't sell on Italy. There's too much of it. The contagion risk would destroy everyone's banks. So the only policy tool we have to stabilise the system is for everyone to deflate against Germany, which is a really hard thing to do even in the best of times. It's horrible, but there it is. Your unemployment will save the banks, and in the process save the sovereigns who cannot save the banks themselves, and thus save the euro. We, the political classes of Europe, would like to thank you for your sacrifice. [End letter.]

This is a speech that you will never hear because if it were given the politician making it would be putting a resume up on Monster.com ten minutes later. But it is the real reason we all need to be austere. When the banking system becomes too big to bail, the moral hazard trade that started it all becomes systemic "immoral hazard"—an extortion racket aided and abetted by the very politicians elected to serve our interests. When that trade takes place in a set of institutions that is incapable of resolving the crisis it faces, the result is permanent austerity.