GlobalResearch
Center for Research on Globalization

Austerity Fails in Euroland: Time for Some Deficit Easing?

By Ellen Brown
Global Research, December 22, 2010
webofdebt.com 22 December 2010

Region: Europe
Theme: Global Economy

"Doubtful it stood, as *two spent swimmers that do cling together,* and *choke their art*."

–Shakespeare, "Macbeth"

The Greek bailout was supposed to be an isolated case, a test of the EU's ability to quarantine an infected member, preventing it from spreading "debt contagion."

But that was before Ireland failed. Ireland was the poster child for how to conduct a successful austerity program. Unlike the Greeks, who were considered profligate spendthrifts, the Irish did everything their creditors asked. The people sacrificed to pay for the excesses of their banks, but still the effort failed. Ireland was the second domino to fall to an IMF/EU bailout. On December 17, Moody's Investors Service rewarded it for voting to accept the "rescue" package with a five-notch credit downgrade, from AA2 to BAA1, with warnings that further downgrades could follow.

Spain is rumored to be the next domino poised to fall. If it falls, it could bring down the EU.

A Design Flaw in the Euro Scheme?

Richard Douthwaite is co-founder of an Irish-based economic think tank called FEASTA (the Foundation for the Economics of Sustainability). He reports that the collective deficit of eurozone countries was a very acceptable 1.9% in 2008. It shot up to 6.3%, exceeding the cap imposed on EU members (3% of GDP), only in 2009. This spike was not due to a sudden surge in government spending. It was due to the global financial crisis, which shrank the money supply globally. Douthwaite writes:

[A] shrinking money supply means shrinking business profits simply because there is less money available to appear in corporate accounts at the end of the year**.** This means less tax is paid.

When taxes go down, revenues go down; but budgets don't.

In an article called "Understanding Modern Monetary Systems," Cullen Roche explains that the Euro system is the modern equivalent of the gold standard. Both are "revenue constrained." Countries on these restrictive systems cannot expand their revenues because there is nowhere to get the money. They cannot get more Euros except by borrowing from each other, and all the member countries are in debt. In June 2010, 26 of 27 EU countries – all but Luxembourg — were on the "debt watch list" for exceeding the 3% cap. Euros can get shuffled around to keep the game going; but in the end, as Shakespeare said, the eurozone countries are "as two spent swimmers that do cling together," pulling each other down.

Douthwaite writes:

[I]ndividual eurozone countries [cannot] create money out of nothing by quantitative

easing. Only the European Central Bank has that power but it has not yet used it to inject money into the system without withdrawing an equal amount. Consequently, every cent in use in eurozone economies has to have been borrowed by someone somewhere, at home or overseas. As a result, while countries with their own currencies can handle a debt-to-GDP ratio of over 100% because they have the tools to do so (Japan's is approaching 200%), countries using a shared currency must keep well below that figure unless they can agree that their shared central bank should use its interest rate, exchange rate and money creation tools in the way that a single country would.

Roche comments:

The Euro system, which is also a single currency system (like the gold standard) adds significant confusion to the current environment and is often confused as a flaw in fiat money. In reality, the Euro proves why single currency systems are inherently flawed.

By a "single currency system," Roche means multiple nations sharing a single currency (whether Euros or gold). Governments need the ability to expand their own money supplies as required to meet the needs of their own economies. Without that flexibility, they are reduced to trying to balance their budgets through brutal austerity measures. In a November 19th article in the UK Guardian called "There Is Another Way for Bullied Ireland," Mark Weisbrot observed:

The European authorities could . . . allow for Ireland to undertake a temporary fiscal stimulus to get their economy growing again. That is the most feasible, practical alternative to continued recession.

Instead, the European authorities are trying what the IMF . . . calls an "internal devaluation". This is a process of shrinking the economy and creating so much unemployment that wages fall dramatically, and the Irish economy becomes more competitive internationally on the basis of lower unit labour costs. . . .

Aside from huge social costs and economic waste involved in such a strategy, it's tough to think of examples where it has actually worked. . . .

If you want to see how rightwing and 19th-century-brutal the European authorities are being, just compare them to Ben Bernanke, the Republican chair of the US Federal Reserve. He recently initiated a second round of "quantitative easing", or creating money – another $600bn dollars over the next six months. And . . . he made it clear that the purpose of such money creation was so that the federal government could use it for another round of fiscal stimulus. The ECB could do something similar — if not for its rightist ideology and politics.

Deficit Easing

For Ireland, Douthwaite recommends a modified form of quantitative easing he calls "deficit easing." He explains:

Both approaches involve central banks creating money. With quantitative easing, the new money is generally used to buy securities from the banking system, thus providing the banks with more money to lend. Unfortunately that is where problems have been arising in the US and the UK. Because the public has been unwilling to borrow, or the banks have been unwilling to lend, quantitative easing has not increased the supply of money in circulation in the US, where M3 began to decline in the second half of 2009 and was still falling a year later. . . .

Deficit-easing avoids this 'won't-borrow-won't-lend' bottleneck by giving the new

money to governments to spend into use, or to pass on to their citizens to reduce their

own debts or to invest in approved ways.

The U.S. Federal Reserve may be considering a similar approach. So says Professor David Blanchflower, a former member of the Bank of England's Monetary Policy Committee, who stated on October 18 that he had been at the Fed in Washington for one of its occasional meetings with academics.

"Quantitative easing remains the only economic show in town," he said, "given that Congress and President Barack Obama have been cowed into inaction."

What will the Fed buy with its quantitative easing tool?

"They are limited to only federally insured paper," said Blanchflower, "which includes Treasuries and mortgage-backed securities insured by Fannie Mae and Freddie Mac. But they are also allowed to buy short-term municipal bonds, and given the difficulties faced by state and local governments, this may well be the route they choose, at least for some of the quantitative easing."

The Fed could buy short-term municipal bonds from the states, easing the states' budget crises. It could set up a facility for bailing out the states at very low interest rates, along the lines of those facilities set up to bail out the Wall Street banks.

A similar plan might be pursued in the eurozone. The European Central Bank (ECB) has already engaged in something equivalent to "quantitative easing." In a post titled "ECB credit easing by buying debt from Greece and Spain analogous to Fed buying California and Illinois munis," Ed Harrison remarks:

When the European experiment threatened to unravel, the ECB chose the nuclear option and stepped into the breach to start buying up the debt of its weakest debtor states. Now, the ECB claims these actions are unsterilized i.e. it is not just printing money. But I have my doubts. In any event, the ECB is the New "United States of Europe" as Marshall Auerback puts it.

Douthwaite adds:

The neatest solution would be for the European Central Bank to create money and to give it (rather than lend it) to governments in proportion to their populations. This would allow further public spending cuts to be avoided and, in countries with relatively small budget deficits, national debts to be reduced.

Printing Euros and giving them rather than lending them to the member countries would be akin to the "Greenback solution" – simply allowing governments to issue the money they needed directly, interest-free and debt-free. As Thomas Edison observed:

If the Nation can issue a dollar bond it can issue a dollar bill. The element that makes the bond good makes the bill good also. The difference between the bond and the bill is that the bond lets the money broker collect twice the amount of the bond and an additional 20%. Whereas the currency, the honest sort provided by the Constitution pays nobody but those who contribute in some useful way.

To avoid inflating prices when the economy reaches full employment, the money could be taxed back to the government or returned as user fees for public services.

Restoring Credit with a Publicly-owned Bank:

The Model of the Bank of North Dakota

There is another possible solution to this dilemma. Neither states in the U.S. nor those in the eurozone can print their own money, but they CAN own banks, which can create bank credit on their books just as all banks do. Most of our money is now created by banks in the form of bank credit, lent at interest. Governments could advance their own credit and keep the interest. This would represent a huge savings to the people. Interest has been shown to make up about half the cost of everything we buy.

Only one U.S. state actually owns its own bank – North Dakota. As of last spring, North Dakota was also the only U.S. state sporting a budget surplus. It has the lowest unemployment rate in the country and the lowest default rate on loans. North Dakota has effectively escaped the credit crisis.

The Bank of North Dakota (BND) is a major profit generator for the state, returning a 26% dividend in 2008. The BND was set up as "North Dakota doing business as the Bank of North Dakota," making the assets of the state the assets of the bank. The BND also has a captive deposit base. By law, all of North Dakota's revenues are deposited in the BND. Municipal government and private deposits are also taken. Today, the BND has $4,000 in deposits per capita, and outstanding loans of roughly the same amount.

Extrapolating those figures to Ireland's population of 4.2 million, a publicly-owned Irish banking system might generate credit of $16.8 billion. That would be enough to fund most of Ireland's deficit of 14.4 billion Euros (19.6 billion USD), and this money would effectively be interest-free, since the government-owned bank would return its profits to the state. Funding through its own bank would remove most of Ireland's deficit from the private bond market, which is highly vulnerable to manipulation, speculation and crippling downgrades.

Alternatively, this bank credit for building sustainable infrastructure and putting people back to work.

Governments everywhere are artificially constrained by having to borrow at market interest rates, which means whatever interest banks can extract. Governments can throw off the shackles of this scheme, in which private banks create the national money supply and lend it at interest, by forming publicly-owned banks. These banks can then advance the credit of the nation to the nation, interest-free. And if this credit is advanced against future productivity, prices will not inflate. Supply (goods and services) will rise along with demand (money), keeping prices stable.

Ellen Brown is an attorney and the author of eleven books. In Web of Debt: The Shocking Truth About Our Money System and How We Can Break Free, she shows how the Federal Reserve and "the money trust" have usurped the power to create money from the people themselves, and how we the people can get it back. Her websites are webofdebt.com, ellenbrown.com, and public-banking.com.

The original source of this article is webofdebt.com

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: Ellen Brown