

European Central Bank Goes Sub Zero

The Draghi Drag

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On Thursday, European Central Bank chief Mario Draghi dropped rates on overnight deposits to minus 0.1% thereby charging commercial banks to keep their money at the ECB. The move, which was applauded by the media as a “historic measure to fight deflation”, is nothing of the kind. Negative rates have been used in both Sweden and Denmark in recent years, but to little effect. The policy will not “get the banks lending again” as the ECB suggests, nor will it ease the high unemployment and slow growth that have plagued the Eurozone for the last six years. In truth, the rate change will have no impact at all. It’s merely public relations stunt designed to create the impression that the ECB is aggressively addressing the crisis for which it is largely responsible. Here’s how the World Socialist Web Site summed it up:

“The move is an expression of the fact that, nearly six years since the collapse of Lehman Brothers, the world economy remains mired in deep crisis, for which the world’s central banks have no solution outside of pumping trillions into banks and financial firms. While trillions are handed out to the banks, workers throughout the continent are told that there is “no money” to pay for pensions, social programs, and healthcare benefits.” ([European Central Bank cuts interest rate below zero](#), World Socialist Web Site)

Stock traders loved the news that the ECB was going “sub zero”. As we’ve seen before, any indication that the easy money regime is here-to-stay is enough to send equities skyrocketing, which it did. All the main indices notched substantial gains on the day while the SandP 500 surged to a new record of 1,940.

The idea that charging the banks a small fee on overnight deposits will induce them to lend more freely, demonstrates a laughable misunderstanding of how the system really works. Banks don’t need piles of reserves to issue loans. What they need is creditworthy customers and strong demand. But, of course, demand is weak because the ECB has taken steps to keep the EU in a permanent state of Depression through its austerity policies. What this shows, is that the objectives of the class war precede the requirements for a healthy economy. Draghi and his cohorts would rather decimate the welfare state and reduce EU working people to abject poverty, then implement the policies that would generate a strong economic recovery.

But won’t the lower rates lead to more lending, you ask? After all, when the price of money falls, borrowing becomes more attractive, right?

It’s a persuasive theory, but it doesn’t work that way. For example, check out this blurb from Reuters and you’ll see what I mean:

“Lending to companies in the euro zone contracted at the fastest pace on record in November, piling pressure on the European Central Bank to do more to revive the currency bloc’s economy...

“Worryingly, there is still no sign of any trend change in bank lending to euro zone businesses...” said Howard Archer, chief European economist at IHS Economics...

Corporate borrowing in the euro zone overall declined at the fastest pace on record, November’s 3.9 percent drop comparing with a 3.8 percent decline on the year in the previous month.

Bank lending to Italian firms fell at an annual pace of 5.9 percent in November, the sharpest decline in the measure’s 10-year history. That was also true for the euro zone’s smallest economy, Malta, which recorded a 10.4 percent drop....The biggest decline was in Spain, where lending to companies fell 13.5 percent.” ([Euro zone corporate lending shrinks at record pace in November](#), Reuters)

The reason bank lending saw “the sharpest decline in the measure’s 10-year history”, is because the economy is in a depression, and people don’t borrow tons of dough in a depression. They cut back, hunker down and squirrel-away whatever they can. Draghi knows this. He’s just going through the motions to make it look like he cares. It’s all PR. What he really cares about is his constituents, and what they want, is an end of the welfare state.

What’s so irritating about all of this, is that we know how fix the economy. We know how to increase activity. We know how to boost demand, create jobs, and raise GDP. None of this is new.

When the private sector (consumers and businesses) can’t spend for some reason, then the government has to step up and spend like crazy to keep the economy going. The only alternative is to allow consumption to fall sharply, which will push up unemployment, push down GDP and do vast damage to both the economy and financial system. Why would anyone want to do that, especially when all they have to do is increase the budget deficits temporarily while consumers patch their balance sheets and get back on their feet again?

Monetary policy has not and will not fix the economy. How many years are we going to repeat the same mistake before we acknowledge that? The whole presumption that this pointless, circle-jerk policy is designed to do anything other than provide another bailout for underwater, insolvent financial institutions and the crooked bank bondholders who own the whole friggin’ planet is laughable in the extreme. Check this out from Bloomberg:

“In a bid to get credit flowing to parts of the economy that need it, the ECB also opened a 400-billion-euro (\$542 billion) liquidity channel tied to bank lending and officials will start work on an asset-purchase plan. While conceding that rates are at the lower bound “for all practical purposes,” he signaled the the ECB is willing to act again.” ([Bloomberg](#))

So that’s what this is really all about, eh? Draghi is just laying the groundwork for a European version of QE?

Yep. Sure is. And that means another \$542 billion will go to the chiseler class. Another \$542 billion propping up crooked banks by purchasing their unwanted, toxic Asset-Backed Securities. (ABS) Do you think I'm kidding? I'm not. That's what the money is earmarked for.

The point is, monetary policy alone will not produce a strong, self sustaining recovery, which is a point that Keynes makes in Chapter 12 of "The General Theory of Employment, Interest and Money". Here's what he says:

"For my own part I am now somewhat skeptical of the success of a merely monetary policy directed towards influencing the rate of interest. I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment; since it seems likely that the fluctuations in the market estimation of the marginal efficiency of different types of capital, calculated on the principles I have described above, will be too great to be offset by any practicable changes in the rate of interest." (John Maynard Keynes, "[The General Theory of Employment, Interest and Money](#)", marxists.org, 2002)

Keynes is just stating the obvious, that during periods of weak demand, the sensible option is for the government to take up the slack by "directly organizing investment", in other words, spending money to keep the economy running. Doesn't that seem infinitely more reasonable than the Draghi approach which involves a decade of experimental monetary policy that ends in social upheaval, high unemployment, and political unrest?

And here's the thing: Keynes "The General Theory" was published in 1936. That's nearly 80 years ago! This isn't some new-fangled theory concocted by pointy-head crackpots like Bernanke. This is settled science. Fiscal stimulus works. If the government spends, unemployment will drop. If the government spends, the economy will grow. What else do you need to know?

We've been hoeing this same row for 6 years now and the economy is still in the dumps. And, in the EU, it's even worse. Youth unemployment is above 50 percent in Spain and Greece, GDP stuck at a miserable 0.2 percent, business and consumer lending still shrinking, bond yields on sovereign debt are in the toilet, civil disorder and fascism are on the rise, and with the entire 17-member union is rushing headlong into deflation.

And Draghi thinks that negative rates are going to fix all this and put the economy back on the road to recovery?

In your dreams! The only way out of a mess like this is to spend like a madman, which is what Keynes recommended in his famous statement about bottles stuffed with banknotes. Here's what he said:

"If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coalmines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well-tryed principles of laissez-faire to dig the notes up again... there need be no more unemployment and, with the help of the repercussions, the real income of the community, and its capital wealth also, would probably become a good deal greater than it actually is. It would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would

be better than nothing.” (p. 129)

Okay, so it sounds crazy, but it's really no different than Bernanke's "helicopter drop" theory, that is, that -during a severe downturn-the government needs to find a way to stimulate demand. The best way to do that, is to avoid the normal transmission mechanisms (which don't function properly during a slump) and get money directly into the hands of the people who will spend it quickly and get the economy growing again. It's all about spending, spending, spending. It doesn't matter if people buy Ipads or Ant Farms. Just spend, dammit. Spending is activity, activity is growth, growth reduces unemployment, which leads to more investment, more jobs and a virtuous circle.

If it seems to you, dear reader, that Keynes antidote for the ailing economy is more likely to succeed than Draghi's, then you are certainly right. Massive doses of fiscal stimulus WILL revive the EU economy, lower unemployment, and boost growth. The question is whether that's a goal the public should really support or not? In other words, is there any point in trying to restore a system which, at its very core, is unstable, self destructive and exploitative? Here's how Counterpunch economics writer Rob Urie sums it up:

“John Maynard Keynes created a host of economic patch-jobs to save capitalism from more effective solutions. In the pit of the Great Depression FDR implemented programs based on Mr. Keynes' ideas (which) produced minor relief now deemed by the economic insightful-lite to be a 'robust' economic recovery..... But the cause, leveraged (finance) capitalism gone wild, was only temporarily tamped down by regulation while its intrinsic instability was left intact...

Calls for re-regulation, managed capitalism, beg the question: re-regulate what? As demonstrated by history, the system of finance capitalism is intrinsically unstable and economically destabilizing. Under the guise of reviving a functioning financial system a dysfunctional system has been revived, not revived, and nearly all benefits continue to accrue to a tiny economic elite.” ([Financial Crises and Economic Depressions](#), Rob Urie, CounterPunch)

So, yeah, Keynes' remedies will work. They'll definitely get the economy up-and-running again and keep it sputtering-along until the next crisis. But why bother?

Why not just scrap the whole thing and move on to Plan B.

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