To the Bankers, He's "Super Mario 2.0" Draghi: Neoliberalism Prevails. The Devastating Impacts of the ECB's Policies

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The ECB announced on Thursday 4 September, 2014 that it would maintain and extend the measures adopted at the meeting of 5 June, 2014. This is being done at a time when it is clear that the policies the central bank has been applying since the start of the crisis have failed [1].

Italy is in recession: The GDI is down by 0.2% in the second quarter of 2014, after a drop of 0.1% in the preceding quarter[2].

In Portugal, which had supposedly weathered the crisis, the near bankruptcy of the country's second-largest bank, Banco Espírito Santo (a veritable economic empire given the scale of the country) is an enormous drain on the public treasury, which once again is socialising the losses. In Germany, industrial production increased by only 0.3% in June 2014, whereas an increase of 1.2% had been expected.

In the space of one year, Germany's industrial activity has contracted by 0.5% (whereas a 0.3% increase was expected). Inflation fell to 0.4% in July 2014 in the Eurozone, whereas the ECB Statute calls for it to keep the inflation rate near 2%. In the single currency zone, the unemployment rate remains high, at 12%. Despite these poor economic results, Mario Draghi is still praised by the mainstream media. The rest of this article analyses the measures taken by the ECB since June 2014.

It is complementary to the series, "Governments submit to 'Too Big to Fail' banks" see: http://cadtm.org/Central-Banks-lend-massively-to; http://cadtm.org/Governments-make-Gifts-Galore-to; http://cadtm.org/Private-banks-shamefully-enjoy-a.

On the day following an important meeting of the ECB, the Paris daily *Le Monde* was effusive in its praise for the president of the Frankfurt-based financial institution:

> "On Thursday 5 June Mario Draghi once again showed the maestria with which he leads the European Central Bank. More than ever, the Italian is at the controls – **the right man in the right place.**" [3] (see the inset on Mario Draghi's CV)

The *Financial Times* and the dominant press in its entirety agreed enthusiastically. The financial markets reacted very positively, and the stock exchanges purred contentedly.

Inset on Mario Draghi: From 1991 to 2001 Mario Draghi was general director of the Italian Ministry of the Treasury, in charge of privatisations. From 1993 to 2001, he chaired the Committee for privatisations. In that capacity, he was a member of the Board of Directors of several banks and companies which were in the process of being transferred to the private sector (Eni, IRI, Banca Nazionale del Lavoro-BNL and IMI). From 2002 to 2005, Mario Draghi was vice-president of the European branch of the American investment bank Goldman Sachs. It was during that period that the investment bank offered its services to the Greek authorities to doctor the public accounts. Goldman Sachs profited greatly from that operation. On 16 January, 2006 Mario Draghi became governor of the Bank of Italy, appointed by Prime Minister Silvio Berlusconi for a renewable term of office of six years. Mario Draghi became president of the ECB on 1 November, 2011

One thing is certain: The decisions made by the ECB will not improve the economic situation and will not generate employment, and living conditions will not improve for the population of the Eurozone. Yet the ECB is holding to the same course – total support for the large banks and the financial elite over the interests of the overwhelming majority of the population.

What measures were announced by the ECB on 4 September, 2014 ?

Fixing the interest rate paid by banks on money borrowed from the ECB at 0.05%.

The ECB has decided to lower the rate at which it lends money to private banks yet again. That rate (in force since November 2013) was reduced from 0.25% to 0.15% in June 2014, and again to 0.05% as of 10 September, 2014[4]. That means more profit for the private banks, who can then lend the money to States at a rate which varies from 1.40% (in the case of Germany as of late June 2014) to 6.00% for Greece[5]… Officially, the lower rate is supposed to encourage the banks to grant more loans to businesses (especially small and medium enterprises – SMEs –, which are Europe's biggest employer) and households. But as we see, the banks prefer to lend to States. It's more secure and/or more profitable. And, buying sovereign debt securities makes it easier for them to attain the required minimum ratio between their equity and their total assets imposed by the banking regulatory authorities [6].

Fixing the rate on deposits in the ECB at 0.20%

The ECB also decided that banks that deposit money overnight for safekeeping will have to pay a rate of 0.20%. Officially this is also aimed at inciting banks to lend the money they have on hand to SMEs and households rather than depositing it with the ECB. In reality, this has proved to be ineffective. Loans to SMEs and households are either stagnating or decreasing, depending on the country.

Why do the banks deposit cash with the ECB? Because they need to show other bankers and private suppliers of credit (money market funds, pension funds, insurance companies) that they have ready cash to face the potential explosion of the time bombs that are on their books. Without this, potential lenders would shun them, or else demand very high interest rates, their stockholders would run and their stock market quotations would crumble.

Granting 400 billion euros of additional long-term credit to banks

The ECB also announced that it will lend private bankers €400 billion at a fixed rate (which will probably be very low, around 0.05% – we'll wait and see). Officially this measure is supposed to encourage the banks to loosen the purse strings for SMEs in order to kick-start production and create jobs. The ECB has led us to believe that it will grant these new long-term credits on condition that the banks lend the money to small and medium companies. We'll need to watch closely what the concrete application of that announcement will be, because up until now the ECB has never forced the banks to do anything specific with the funds it lends them. What is sure is that a whole series of banks who had borrowed €1,000 billion between December 2011 and January 2012 in the context of LTROs (Long Term Refinancing Operations) for a period of three years urgently need those €400 billion in new long-term credits, called TLTROs (Targeted Long Term Refinancing Operations). These new credits could let them bridge the gap and avoid having to declare insolvency due to their inability to reimburse the debt.

To understand why this new €400-billion credit is vital for a series of major banks, you need to understand what an **LTRO** is **(see inset).**

Inset: LTRO: What is it?

An LTRO (Long Term Refinancing Operation) consists in granting long-term loans to banks. Between December 2011 and February 2012, the ECB lent over €1,000 billion to more than 800 banks for a period of 3 years at an interest rate of 1% (at a time when the inflation was about 2%). In fact, the gift to Banks was more lavish than is suggested by an interest rate of only 1% (already very advantageous). Why? For two simple reasons:

1. The interest is not due until the repayment date of the loan. If a bank borrows over three years for the full period and does not reimburse the loan early, it pays the interest only after three years;

2. This rate has since been lowered several times, down to 0.05% in September 2014.

Let's take a bank like Dexia[7], which borrowed over 20 billion euros from the ECB for a period of 3 years in early 2012; it won't need to reimburse the 20 billion until early in 2015. To that amount will be added the interest payments, which are calculated in the following way: A 1% interest rate until July 2012, 0.75% for the period July 2012 to May 2013, 0.50% from May 2013 through November 2013, 0.25% between November 2013 and June 2014, 0.15% from June 2014 through September 2014 and 0.05% interest starting in September 2014[8].

So, a bank like Dexia will pay the interest only at the point in time when it reimburses the amount it borrowed. What happens at that point? Obviously many banks – like Dexia, the main Italian bank, Intesa Sanpaolo (ISP.MI) (which received 24 billion euros in LTROs), and Espírito Santo (the 2nd-ranking Portuguese bank), threatened with collapse since July 2014 – will not be able to reimburse the amount borrowed unless they secure a new loan more or less equivalent to the previous one. Who can these banks borrow from? Why, from the ECB – under a TLTRO (Targeted Long Term Refinancing Operation)

. **And in fact that's the real *raison d'être* of the TLTROs. But the ECB can't say so officially, because it needs to contribute to the illusion that the banks are healthy, that they've cleaned up their books, are not short of cash, etc. And that's why Mario Draghi announced that the TLTROs will be used to finance SMEs.**

The ECB pressures private banks to produce more structured products

The banks have reduced loans to households and companies – especially the small and medium ones (SMEs) that provide the majority of jobs. In 2013, bank credits dropped by 2% in the Eurozone, and credits to non-financial companies fell by approximately 3.5%. The peripheral economies of the European Union, of course, are most affected.

What Mario Draghi proposes to European bankers to encourage them to increase the credit the grant to SMEs is to increase production of structured products made up of a group of loans to SMEs. What is this about? Banks that grant loans to SMEs can take the risk entailed off their balance sheets by securitising the loans as Asset Backed Securities. Then the BCE will allow the banks to deposit these structured products as collateral (that is, as guarantee) in exchange for credit at 0.05%. Since in 2014 the rates banks demand for loans to SMEs are between 5% and 6% in Spainand Italyand 3% and 4% in Franceand Germany, this is an opportunity for banks to turn a good profit, Draghi points out. But despite this juicy proposal, the banks remain shy of increasing their credits to SMEs and creating more structured products as proposed by the BCE's president[9]. Mario is very disappointed at this and takes every opportunity to repeat the offer. He did it once again at the meeting of the ECB's Executive Board on 5 June, 2014. Going a step farther, on 4 September, 2014, he announced that the ECB would soon purchase several hundred million € worth of ABSs. At a press conference at the ECB meeting, Draghi told the press that the ECB would "purchase a broad portfolio of simple and transparent asset-backed securities (ABSs) […]" based on underlying loans[10].

The proliferation of structured products was at the root of the banking crisis that began in 2007-2008, and the only solution Mario Draghi can come up with for re-starting credit to SMEs is to inciteEurope's banks to produce more!

The ECB will increase the cash in circulation

Since 2008-2009, the ECB has continued to increase the cash it makes available to banks, to the point where these funds are flooding the real economy **(see below)**. On 5 June, 2014 it announced a change in its policy of buying back sovereign debt, which will have the result of increasing cash a little more. In the jargon, this is called ending the **sterilisation** of the program of buying back sovereign debt (the Securities Markets Program). Until now, when it purchased sovereign securities (Italian, Portuguese, Greek, Irish, Spanish, etc.) from banks that the latter had acquired on the primary market, the ECB took an equivalent volume of cash from the banks. Beginning in June 2014, the ECB will pay the banks for the securities they purchase from them without demanding the equivalent in liquidities. By doing this, "*The ECB will mechanically increase the cash available to the banking system*" says Frédéric Rollin, a strategy advisor with Pictet[11]. The amount is approximately €170 billion.

The European economy has fallen into the liquidity trap

Because of the policies pursued by the central banks and governments, the economy of the most industrialised countries has fallen into what J. M. Keynes called the "liquidity trap." Whereas the central banks inject liquidity and reduce interest rates, banks and major private corporations prefer to keep that cash available. The banks keep it to use in facing blowback from the "time bombs" they have on their balance sheets and the new bubbles they actively contribute to creating[12]. Industrial and service companies feel that there's no point in investing since the private and public demand is low. And so they sit on an enormous pile of cash, or else use it to speculate with. In 2012, European companies held liquidities worth €2,400 billion (or 16 times the European Union's annual budget!)[13]. That is an all-time high.

According to Keynes, to get out of the liquidity trap, governments must increase public expenditures in order to stimulate demand, and thus stimulate the economy – expenditures for investments (obviously there could be massive investments in the ecological transition, renewable energy sources, major public works, scholastic and community buildings), expenditures to hire and better remunerate public-service workers, social expenditures (health, education, social services), expenditures to increase retirement pensions and various social allocations, and so on. But central bankers and governments have no use for such ideas.

Mario Draghi, the ECB and the BIS argue and act offensively in order to further neoliberal policies

Mario Draghi has recently made a number of declarations[14] and initiatives to extend budgetary austerity measures and further structural measures to increase the precarity of social benefits and collective solidarity mechanisms – increasing the flexibility of work contracts to facilitate layoffs, reducing wages, increasing the intensity and duration of work, attacks against retirement pensions, etc.

The annual report of the Bank for International Settlements (BIS), published in June 2014, takes exactly the same approach: "*The mix of structural policies will necessarily vary according to the country. But it will frequently include deregulating protected sectors, such as services, improving labour market flexibility, raising participation rates and trimming public sector bloat.*

More emphasis on repair and reform implies relatively less on expansionary demand management.

This principle applies to fiscal policy. After the initial fiscal push, the need to ensure longer-term sustainability has been partly rediscovered. This is welcome: putting the fiscal house in order is paramount; the temptation to stray from this path should be resisted."[15] In other words, the BIS wants governments to go even farther in their attacks on the social progress made after the Second World War and in reducing public expenditures.

Conclusions

The enormous growth in liquidities Europe has experienced since 2007-2008 has served to maintain the power of the large private banks intact, yet has not put an end to the crisis for the economies concerned. Thanks to the intervention of the ECB and other central banks (and of course, the decisions made by governments), the large private banks are continuing their massively speculative and often fraudulent – not to say criminal – activities. They are supported by a mechanism that provides permanent transfusions of resources (unlimited public credits at interest rates that are nil or even negative). Certain banks – and they are not minor ones – are simply kept on artificial life support (added to the unlimited public credits is an injection of public capital to recapitalise them and public guarantees of their debts). **The banking function is too serious to be left in the hands of the private sector. The banking sector must be socialised** (which requires expropriation) **and placed under the control of citizens** (bank employees and customers, non-profit associations and representatives of local public stakeholders), because it must be subject to the rules of a public service[16] and the revenues it generates must be used for the common good.

The policy applied up until now by the ECB, the other central banks, and governments has brought about a very substantial increase in public debt as a result of several related factors: The cost of rescuing banks; the cost of the crisis, for which the central banks, the governments, the private banks and other major corporations bear the responsibility; the prohibition against allowing States to borrow from the central bank; and the continued fiscal gifts lavished on major corporations and large fortunes. This means that a very large share of public debt is clearly illegitimate. In particular, **the public debt contracted to bail out the banks is clearly illegitimate and must be repudiated. A citizen audit must be conducted to determine what other debts are illegitimate, illegal, odious, unsustainable…**[17] and bring about a mobilisation so that a credible anti-capitalist alternative can take shape.

In this context, the ECB's policy is **illegitimate, odious, unsustainable and illegal**. It is **illegitimate** because it favours an infinitesimal minority of the population, who are in fact responsible for the crisis and profit from it. It is **illegitimate** because it harms the overwhelming majority of the population. This policy of the ECB is even more **illegitimate** given the fact that those who design it are aware of its ongoing failure. In the case of the countries which are subjected to the Memoranda imposed by the Troika, in which the ECB is a central player, this policy is **odious** because it violates conventions and treaties on human rights (economic, social, civil and political) and is imposed by institutions having no mandate from the people to carry out such acts. This policy is also **unsustainable**[18] because it leads to the impoverishment of a large part of the population, to the deterioration of public health and education, to increased unemployment, etc. And finally, this policy is **illegal** because it does not adhere to the Statute of the ECB (to which, by the way, we object). Just as one example, the ECB's Statute includes no mandate for it to intervene in labour relations. And yet, in an ongoing way, the central bank seeks to dictate modifications to labour legislation.

The ECB's monetary policy, along with its Statute and its practice, need to be radically altered. The ECB, and the central banks in general, need to be able to finance States directly in order to promote social and environmental goals that guarantee that the fundamental needs of the people are met. Direct financing by the ECB and the central banks is not enough in itself; the financing needs to have a social dimension and serve the general interest. Whereas the USA and the UK finance their debt largely via their central banks[19], that policy cannot be said to be conducted in the interest of the majority of their populations.

Citizen mobilisation and self-management are the condition *sine qua non* for creating a program for reversing the crisis that is favourable to the people[20]. Without them, there can be no true emancipation from the current crisis.

Translation: Snake Arbusto

Notes

[1] Note that while the failure is obvious in light of the goals officially being pursued, it's less of a

failure if we take agenda hidden of the ECB and European leaders into account. The goal of the European leaders of the strongest countries and the executives of the major corporations, at the current stage of the crisis, is not to stimulate growth and reduce the asymmetries between the strong and weak economies within the EU. In fact they're happy with the existence of a common economic, commercial and political zone in which they derive profit from the debacle affecting the periphery and from the sacrifices forced on all Europe's working people to strengthen corporate profitability and gain points in terms of competitiveness. To further the most massive offensive against the economic and social rights of the majority of the population since the Second World War on a European scale, governments and corporate leaders are using several weapons: a strong increase in unemployment; reimbursement of public debt, which has greatly increased; using the pretext of balancing the budget to justify severe cuts in social expenditures and public services; improving the competitiveness of the EU member States among themselves and over their worldwide competitors. From that point of view, the ECB's policy is not a failure. I'll return to this in subsequent articles. Also see *Bancocratie*, Chapter 33.

[2]http://www.lesechos.fr/finance-marches/marches-financiers/0203688232137-litalie-en-recession-pousse-les-taux-allemands-a-un-plus-bas-historique-1030888.php#gauche_article (in French)

[3] *Le Monde*, "*L'arsenal de Mario Draghi contre la déflation" (Mario Draghi's arsenal against deflation)*, 6 June, 2014, http://www.lemonde.fr/idees/article/2014/06/06/l-arsenal-de-mario-draghi-contre-la-deflation_4433369_3232.html (in French)

[4] The ECB began reducing its key interest rate in successive steps beginning in 2008. In October 2008 it stood at 3.75%. See: https://www.banque-france.fr/en/economics-statistics/rates/policy-rates.html

[5] These are the rates for 10-year sovereign bonds. The rates charged to other countries as of late June 2014 were 1.75% forFrance, 1.86% forBelgium, 2.75% forSpain, 2.85% forItaly, 3.57% forPoland, 3.60% forPortugal, etc.

[6] I explain this in http://cadtm.org/Banks-bluff-in-a-completely-legal, published 19 June, 2013; http://cadtm.org/Banks-Fudged-health-report, published 23 July, 2013. Also see my book *Bancocratie*, Aden, Brussels, Chapters 8 and 9. Order at: http://cadtm.org/Bancocratie (in French; English translation to be published by the end of 2014).

[7] Dexia Bank came into existence through the privatisation, during the 1990s, of public funding structures inBelgium andFrance. It is one of the principal actors, since the crisis, of a local-government financing scandal inFrance where it proposed over a hundred – often faulty and/or toxic – financial products to local governmental entities. It has currently been re-nationalised as a rescue measure, under guarantee by the Belgian, French andLuxembourg governments and has twice been bolstered with public money. Several associations, such as ATTAC Belgium and CADTM, have instigated legal actions against this guarantee.

[8] See the BCE site: "*In this longer-term refinancing operation, the rate at which all bids are satisfied is indexed to the average minimum bid rate in the main refinancing operations over the life*

of the operation,” http://sdw.ecb.europa.eu/servlet/desis?node=100000133

[9]In 2013, in Europe, issuance of all types of ABS taken together dropped by 38% compared to 2012 (*Financial Times*, 18 February, 2014). In four years, the decrease has been more than 80%! (*Financial Times*, 3 September, 2013).

[10] See *Bloomberg.com*, 4 September, 2014, http://www.bloomberg.com/news/2014-09-04/draghi-says-ecb-readying-sizable-abs-purchases-after-rate-cut.html

[11] Quoted in *Le Monde*, 7 June, 2014

[12] Several speculative bubbles are expanding and threaten to burst: The stock bubble, the commodities bubble, a new real-estate bubble, a sovereign-debt bubble and a corporate-bond bubble, etc. See Eric Toussaint, *Bancocratie*,Aden,Brussels, 2014, Chapter 38 (English translation to be published by the end of 2014).

[13] *Financial Times*, “European Corporate buybacks sink to 2009 lows”, 2 November, 2012. The article refers to the Thomson Reuters calculations. According to *The Economist*, Canadian companies held 300 billion dollars in cash in 2012 – 25% more than in 2008. This phenomenon is visible in all of the highly industrialised countries: In Japan, in 2012, companies held liquidities equivalent to 2,800 billion dollars, or 75% more than in 2007! (*The Economist*, “Dead money. Cash has been piling up on companies’ balance-sheets since before the crisis”, 3 November, 2012).

[14] See, among others, *Financial Times*, “Draghi coaxes politicians to take lead in next batch of reforms”, 11 July, 2014.

[15] BIS, 84th Annual Report, 1 April 2013–31 March 2014, Basel, 29 June, 2014, p. 15 http://www.bis.org/publ/arpdf/ar2014e1.pdf

[16] The banking sector should be entirely public except for a small cooperative sector with which it could cohabit and collaborate.

[17] See CAC, *Que faire de la dette ? Un audit de la dette publique de la France*, May 2014, http://www.audit-citoyen.org/wp-content/uploads/2014/05/note-dette.pdf (in French). For Belgium see: ACiDe, *BRISER LE CERCLE VICIEUX DE LA DETTE ET DE L’AUSTÉRITÉ*, (memorandum on citizen audit of debt in Belgium), April 2014, http://www.auditcitoyen.be/wp-content/uploads/memorandum.pdf (in French).

[18] At the economic level, this policy is **sustainable** from the point of view of capitalists, but is **un**sustainable from the point of view of human rights.

[19] In recent years, the Fed has purchased more than $2,400 billion in US treasury bonds (in October 2014, the volume of treasury bonds held by the Fed will reach $2,450 billion), which

amounts to 18% of the total volume of treasury bonds in circulation. Source: *Natixis, EcoHebdo*, 25 July, 2014, No. 29, *http://cib.natixis.com/flushdoc.aspx?id=78192* Please note that, contrary to wide belief, the Fed does **not** purchase the treasury bonds directly from the US Treasury, but via open-market operations from private banks who have previously purchased them. See the US legislation in this area: http://www.federalreserve.gov/aboutthefed/section14.htm

[20] For a broad range of proposals see: Eric Toussaint, "Alternatives to reverse the crisis in Europe", April 2014, http://cadtm.org/Alternatives-to-reverse-the-crisis.