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Europe's Deadly Transition from Social Democracy to Oligarchy

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The easiest way to understand Europe's financial crisis is to look at the solutions being proposed to resolve it. They are a banker's dream, a grab bag of giveaways that few voters would be likely to approve in a democratic referendum. Bank strategists learned not to risk submitting their plans to democratic vote after Icelanders twice refused in 2010-11 to approve their government's capitulation to pay Britain and the Netherlands for losses run up by badly regulated Icelandic banks operating abroad. Lacking such a referendum, mass demonstrations were the only way for Greek voters to register their opposition to the €50 billion in privatization sell-offs demanded by the European Central Bank (ECB) in autumn 2011.

The problem is that Greece lacks the ready money to redeem its debts and pay the interest charges. The ECB is demanding that it sell off public assets – land, water and sewer systems, ports and other assets in the public domain, and also cut back pensions and other payments to its population. The bottom 99% understandably are angry to be informed that the wealthiest layer of the population is largely responsible for the budget shortfall by stashing away a reported €45 billion of funds stashed away in Swiss banks alone. The idea of normal wage-earners being obliged to forfeit their pensions to pay for tax evaders – and for the general un-taxing of wealth since the regime of the colonels – makes most people understandably angry. For the ECB, EU and IMF "troika" to say that whatever the wealthy take, steal or evade paying must be made up by the population at large is not a politically neutral position. It comes down hard on the side of wealth that has been unfairly taken.

A democratic tax policy would reinstate progressive taxation on income and property, and would enforce its collection – with penalties for evasion. Ever since the 19th century, democratic reformers have sought to free economies from waste, corruption and "unearned income." But the ECB troika is imposing a regressive tax – one that can be imposed only by turning government policy-making over to a set of unelected technocrats.

To call the administrators of so anti-democratic a policy "technocrats" seems to be a cynical scientific-sounding euphemism for financial lobbyists or bureaucrats deemed suitably tunnel-visioned to act as useful idiots on behalf of their sponsors. Their ideology is the same austerity philosophy that the IMF imposed on Third World debtors from the 1960s through the 1980s. Claiming to stabilize the balance of payments while introducing free markets, these officials sold off export sectors and basic infrastructure to creditor-nation buyers. The effect was to drive austerity-ridden economies even deeper into debt – to foreign bankers and their own domestic oligarchies.

This is the treadmill on which Eurozone social democracies are now being placed. Under the political umbrella of financial emergency, wages and living standards are to be scaled back and political power shifted from elected government to technocrats governing on behalf of large banks and financial institutions. Public-sector labor is to be privatized – and de-unionized, while Social Security, pension plans and health insurance are scaled back.

This is the basic playbook that corporate raiders follow when they empty out corporate pension plans to pay their financial backers in leveraged buyouts. It also is how the former Soviet Union's economy was privatized after 1991, transferring public assets into the hands of kleptocrats, who worked with Western investment bankers to make the Russian and other stock exchanges the darlings of the global financial markets. Property taxes were scaled back while flat taxes were imposed on wages (a cumulative 59 percent in Latvia). Industry was dismantled as land and mineral rights were transferred to foreigners, economies driven into debt and skilled and unskilled labor alike was obliged to emigrate to find work.

Pretending to be committed to price stability and free markets, bankers inflated a real estate bubble on credit. Rental income was capitalized into bank loans and paid out as interest. This was enormously profitable for bankers, but it left the Baltics and much of Central Europe debt strapped and in negative equity by 2008. Neoliberals applaud their plunging wage levels and shrinking GDP as a success story, because these countries shifted the tax burden onto employment rather than property or finance. Governments bailed out banks at taxpayer expense.

It is axiomatic that the solution to any major social problem tends to create even larger problems – not always unintended! From the financial sector's vantage point, the "solution" to the Eurozone crisis is to reverse the aims of the Progressive Era a century ago – what in 1936 John Maynard Keynes hopefully termed "euthanasia of the *rentier*". The idea was to subordinate the banking system to serve the economy rather than the other way around. Instead, finance has become the new mode of warfare – less ostensibly bloody, but with the same objectives as the Viking invasions over a thousand years ago, and Europe's subsequent colonial conquests: appropriation of land and natural resources, infrastructure and whatever other assets can provide a revenue stream. It was to capitalize and estimate such values, for instance, that William the

Conqueror compiled the Domesday Book after 1066, a model of ECB and IMF-style calculations today.

This appropriation of the economic surplus to pay bankers is turning the traditional values of most Europeans upside down. Imposition of economic austerity, dismantling social spending, sell-offs of public assets, de-unionization of labor, falling wage levels, scaled-back pension plans and health care in countries subject to democratic rules requires convincing voters that there is no alternative. It is claimed that without a profitable banking sector (no matter how predatory) the economy will break down as bank losses on bad loans and gambles pull down the payments system. No regulatory agencies can help, no better tax policy, nothing except to turn over control to lobbyists to save banks from losing the financial claims they have built up.

What banks want is for the economic surplus to be paid out as interest, not used for rising living standards, public social spending or even for new capital investment. Research and development takes too long. Finance lives in the short run. This short-termism is self-defeating, yet it is presented as science. The alternative, voters are told, is the road to serfdom: interfering with the "free market" by financial regulation and even progressive taxation.

There is an alternative, of course. It is what European civilization from the 13th-century Schoolmen through the Enlightenment and the flowering of classical political economy sought to create: an economy free of unearned income, free of vested interests using special privileges for "rent extraction." At the hands of the neoliberals, by contrast, a free market is one free *for* a tax-favored *rentier* class to extract interest, economic rent and monopoly prices.

Rentier interests present their behavior as efficient "wealth creation." Business schools teach privatizers how to arrange bank loans and bond financing by pledging whatever they can charge for the public infrastructure services being sold by governments. The idea is to pay this revenue to banks and bondholders as interest, and then make a capital gain by raising access fees for roads and ports, water and sewer usage and other basic services. Governments are told that economies can be run more efficiently by dismantling public programs and selling off assets.

Never has the gap between pretended aim and actual effect been more hypocritical. Making interest payments (and even capital gains) tax-exempt deprives governments of revenue from the user fees they are relinquishing, increasing their budget deficits. And instead of promoting price stability (the ECB's ostensible priority), privatization increases prices for infrastructure, housing and other costs of living and doing business by building in interest charges and other financial overhead – and much higher salaries for management. So it is merely a knee-jerk ideological claim that this policy is more efficient simply because privatizers do the borrowing rather than government.

There is no technological or economic need for Europe's financial managers to impose depression on much of its population. But there is a great opportunity to gain for the banks that have gained control of ECB economic policy. Since the 1960s, balance-of-payments crises have provided opportunities for bankers and liquid investors to seize control of fiscal policy – to shift the tax burden onto labor and dismantle social spending in favor of subsidizing foreign investors and the financial sector. They gain from austerity policies that lower living standards and scale

back social spending. A debt crisis enables the domestic financial elite and foreign bankers to indebt the rest of society, using their privilege of credit (or savings built up as a result of less progressive tax policies) as a lever to grab assets and reduce populations to a state of debt dependency.

The kind of warfare now engulfing Europe is thus more than just economic in scope. It threatens to become a historic dividing line between the past half-century's epoch of hope and technological potential to a new era of polarization as a financial oligarchy replaces democratic governments and reduces populations to debt peonage.

For so bold an asset and power grab to succeed, it needs a crisis to suspend the normal political and democratic legislative processes that would oppose it. Political panic and anarchy create a vacuum into which grabbers can move quickly, using the rhetoric of financial deception and a junk economics to rationalize self-serving solutions by a false view of economic history – and in the case of today's ECB, German history in particular.

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Governments do not need to borrow from commercial bankers or other lenders. Ever since the Bank of England was founded in 1694, central banks have printed money to finance public spending. Bankers also create credit freely – when they make a loan and credit the customer's account, in exchange for a promissory note bearing interest. Today, these banks can borrow reserves from the government's central bank at a low annual interest rate (0.25% in the United States) and lend it out at a higher rate. So banks are glad to see the government's central bank create credit to lend to them. But when it comes to governments creating money to finance their budget deficits for spending in the rest of the economy, banks would prefer to have this market and its interest return for themselves.

European commercial banks are especially adamant that the European Central Bank should not finance government budget deficits. But private credit creation is not necessarily less inflationary than governments monetizing their deficits (simply by printing the money needed). Most commercial bank loans are made against real estate, stocks and bonds – providing credit that is used to bid up housing prices, and prices for financial securities (as in loans for leveraged buyouts).

It is mainly government that spends credit on the "real" economy, to the extent that public budget deficits employ labor or are spent on goods and services. Governments avoid paying interest by having their central banks printing money on their own computer keyboards rather than borrowing from banks that do the same thing on their own keyboards. (Abraham Lincoln simply printed currency when he financed the U.S. Civil War with "greenbacks.")

Banks would like to use their credit-creating privilege to obtain interest for lending to governments to finance public budget deficits. So they have a self-interest in limiting the government's "public option" to monetize its budget deficits. To secure a monopoly on their credit-creating privilege, banks have mounted a vast character assassination on government spending, and indeed on government authority in general – which happens to be the only

authority with sufficient power to control their power or provide an alternative public financial option, as Post Office savings banks do in Japan, Russia and other countries. This competition between banks and government explains the false accusations made that government credit creation is more inflationary than when commercial banks do it.

The reality is made clear by comparing the ways in which the United States, Britain and Europe handle their public financing. The U.S. Treasury is by far the world's largest debtor, and its largest banks seem to be in negative equity, liable to their depositors and to other financial institutions for much larger sums that can be paid by their portfolio of loans, investments and assorted financial gambles. Yet as global financial turmoil escalates, institutional investors are putting their money into U.S. Treasury bonds – so much that these bonds now yield less than 1%. By contrast, a quarter of U.S. real estate is in negative equity, American states and cities are facing insolvency and must scale back spending. Large companies are going bankrupt, pension plans are falling deeper into arrears, yet the U.S. economy remains a magnet for global savings.

Britain's economy also is staggering, yet its government is paying just 2% interest. But European governments are now paying over 7%. The reason for this disparity is that they lack a "public option" in money creation. Having a Federal Reserve Bank or Bank of England that can print the money to pay interest or roll over existing debts is what makes the United States and Britain different from Europe. Nobody expects these two nations to be forced to sell off their public lands and other assets to raise the money to pay (although they may do this as a policy choice). Given that the U.S. Treasury and Federal Reserve can create new money, it follows that as long as government debts are denominated in dollars, they can print enough IOUs on their computer keyboards so that the only risk that holders of Treasury bonds bear is the dollar's exchange rate vis-à-vis other currencies.

By contrast, the Eurozone has a central bank, but Article 123 of the Lisbon treaty forbids the ECB from doing what central banks were created to do: create the money to finance government budget deficits or roll over their debt falling due. Future historians no doubt will find it remarkable that there actually is a rationale behind this policy – or at least the pretense of a cover story. It is so flimsy that any student of history can see how distorted it is. The claim is that if a central bank creates credit, this threatens price stability. Only government spending is deemed to be inflationary, not private credit!

The Clinton Administration balanced the U.S. Government budget in the late 1990s, yet the Bubble Economy was exploding. On the other hand, the Federal Reserve and Treasury flooded the economy with $13 trillion in credit to the banking system credit after September 2008, and $800 billion more last summer in the Federal Reserve's Quantitative Easing program (QE2). Yet consumer and commodity prices are not rising. Not even real estate or stock market prices are being bid up. So the idea that more money will bid up prices (MV=PT) is not operating today.

Commercial banks create debt. That is their product. This debt leveraging was used for more than a decade to bid up prices – making housing and buying a retirement income more expensive for Americans – but today's economy is suffering from debt deflation as personal income, business and tax revenue is diverted to pay debt service rather than to spend on goods or invest or hire labor.

Much more striking is the travesty of German history that is being repeated again and again, as if repetition somehow will stop people from remembering what actually happened in the 20th century. To hear ECB officials tell the story, it would be reckless for a central bank to lend to government, because of the danger of hyperinflation. Memories are conjured up of the Weimar inflation in Germany in the 1920s. But upon examination, this turns out to be what psychiatrists call an implanted memory – a condition in which a patient is convinced that they have suffered a trauma that seems real, but which did not exist in reality.

What happened back in 1921 was not a case of governments borrowing from central banks to finance domestic spending such as social programs, pensions or health care as today. Rather, Germany's obligation to pay reparations led the Reichsbank to flood the foreign exchange markets with deutsche marks to obtain the currency to buy pounds sterling, French francs and other currency to pay the Allies – which used the money to pay their Inter-Ally arms debts to the United States. The nation's hyperinflation stemmed from its obligation to pay reparations in foreign currency. No amount of domestic taxation could have raised the foreign exchange that was scheduled to be paid.

By the 1930s this was a well-understood phenomenon, explained by Keynes and others who analyzed the structural limits on the ability to pay *foreign* debt imposed without regard for the ability to pay out of current domestic-currency budgets. From Salomon Flink's *The Reichsbank and Economic Germany* (1931) to studies of the Chilean and other Third World hyperinflations, economists have found a common causality at work, based on the balance of payments. First comes a fall in the exchange rate. This raises the price of imports, and hence the domestic price level. More money is then needed to transact purchases at the higher price level. The statistical sequence and line of causation leads from balance-of-payments deficits to currency depreciation raising import costs, and from these price increases *to* the money supply, not the other way around.

Today's "free marketers" writing in the Chicago monetarist tradition (basically that of David Ricardo) leave the foreign and domestic debt dimensions out of account. It is as if "money" and "credit" are assets to be bartered against goods. But a bank account or other form of credit means debt on the opposite side of the balance sheet. One party's debt is another party's saving – and most savings today are lent out at interest, absorbing money *from* the non-financial sectors of the economy. The discussion is stripped down to a simplistic relationship between the money supply and price level – and indeed, only consumer prices, not asset prices. In their eagerness to oppose government spending – and indeed to dismantle government and replace it with financial planners – neoliberal monetarists neglect the debt burden being imposed today from Latvia and Iceland to Ireland and Greece, Italy, Spain and Portugal.

If the euro breaks up, it is because of the obligation of governments to pay bankers in money that must be borrowed rather than created through their own central bank. Unlike the United States and Britain which can create central bank credit on their own computer keyboards to keep their economy from shrinking or becoming insolvent, the German constitution and the Lisbon Treaty prevent the central bank from doing this.

The effect is to oblige governments to borrow from commercial banks at interest. This gives bankers the ability to create a crisis – threatening to drive economies out of the Eurozone if they do not submit to "conditionalities" being imposed in what quickly is becoming a new class war of finance against labor.

Disabling Europe's central bank to deprive governments of the power to create money

One of the three defining characteristics of a nation-state is the power to create money. A second characteristic is the power to levy taxes. Both of these powers are being transferred out of the hands of democratically elected representatives to the financial sector, as a result of tying the hands of government.

The third characteristic of a nation-state is the power to declare war. What is happening today is the equivalent of warfare – but *against* the power of government! It is above all a financial mode of warfare – and the aims of this financial appropriation are the same as those of military conquest: first, the land and subsoil riches on which to charge rents as tribute; second, public infrastructure to extract rent as access fees; and third, any other enterprises or assets in the public domain.

In this new financialized warfare, governments are being directed to act as enforcement agents on behalf of the financial conquerors against their own domestic populations. This is not new, to be sure. We have seen the IMF and World Bank impose austerity on Latin American dictatorships, African military chiefdoms and other client oligarchies from the 1960s through the 1980s. Ireland and Greece, Spain and Portugal are now to be subjected to similar asset stripping as public policy making is shifted into the hands of supra-governmental financial agencies acting on behalf of bankers – and thereby for the top 1% of the population.

When debts cannot be paid or rolled over, foreclosure time arrives. For governments, this means privatization selloffs to pay creditors. In addition to being a property grab, privatization aims at replacing public sector labor with a non-union work force having fewer pension rights, health care or voice in working conditions. The old class war is thus back in business – with a financial twist. By shrinking the economy, debt deflation helps break the power of labor to resist.

It also gives creditors control of fiscal policy. In the absence of a pan-European Parliament empowered to set tax rules, fiscal policy passes to the ECB. Acting on behalf of banks, the ECB seems to favor reversing the 20th century's drive for progressive taxation. And as U.S. financial lobbyists have made clear, the creditor demand is for governments to re-classify public social obligations as "user fees," to be financed by wage withholding turned over to banks to manage (or mismanage, as the case may be). Shifting the tax burden off real estate and finance onto labor and the "real" economy thus threatens to become a fiscal grab coming on top of the privatization grab.

This is self-destructive short-termism. The irony is that the PIIGS budget deficits stem largely from un-taxing property, and a further tax shift will worsen rather than help stabilize government budgets. But bankers are looking only at what they can take in the short run. They know that whatever revenue the tax collector relinquishes from real estate and business is "free" for buyers

to pledge to the banks as interest. So Greece and other oligarchic economies are told to "pay their way" by slashing government social spending (but not military spending for the purchase of German and French arms) and shifting taxes onto labor and industry, and onto consumers in the form of higher user fees for public services not yet privatized.

In Britain, Prime Minister Cameron claims that scaling back government even more along Thatcherite-Blairite lines will leave more labor and resources available for private business to hire. Fiscal cutbacks will indeed throw labor out of work, or at least oblige it to find lower-paid jobs with fewer rights. But cutting back public spending will shrink the business sector as well, worsening the fiscal and debt problems by pushing economies deeper into recession.

If governments cut back their spending to reduce the size of their budget deficits – or if they raise taxes on the economy at large, to run a surplus – then these surpluses will suck money out of the economy, leaving less to be spent on goods and services. The result can only be unemployment, further debt defaults and bankruptcies. We may look to Iceland and Latvia as canaries in this financial coalmine. Their recent experience shows that debt deflation leads to emigration, shorter life spans, lower birth rates, marriages and family formation – but provides great opportunities for vulture funds to suck wealth upward to the top of the financial pyramid.

Today's economic crisis is a matter of policy choice, not necessity. As President Obama's chief of staff Rahm Emanuel quipped: "A crisis is too good an opportunity to let go to waste." In such cases the most logical explanation is that some special interest must be benefiting. Depressions increase unemployment, helping to break the power of unionized as well as non-union labor. The United States is seeing a state and local budget squeeze (as bankruptcies begin to be announced), with the first cutbacks coming in the sphere of pension defaults. High finance is being paid – by not paying the working population for savings and promises made as part of labor contracts and employee retirement plans. Big fish are eating little fish.

This seems to be the financial sector's idea of good economic planning. But it is worse than a zero-sum plan, in which one party's gain is another's loss. Economies as a whole will shrink – and change their shape, polarizing between creditors and debtors. Economic democracy will give way to financial oligarchy, reversing the trend of the past few centuries.

Is Europe really ready to take this step? Do its voters recognize that stripping the government of the public option of money creation will hand the privilege over to banks as a monopoly? How many observers have traced the almost inevitable result: shifting economic planning and credit allocation to the banks?

Even if governments provide a "public option," creating their own money to finance their budget deficits and supplying the economy with productive credit to rebuild infrastructure, a serious problem remains: how to dispose of the existing debt overhead now acting as a deadweight on the economy. Bankers and the politicians they back are refusing to write down debts to reflect the ability to pay. Lawmakers have not prepared society with a legal procedure for debt write-downs – except for New York State's Fraudulent Conveyance Law, calling for debts to be annulled if lenders made loans without first assuring themselves of the debtor's ability to pay.

Bankers do not want to take responsibility for bad loans. This poses the financial problem of just what policy-makers should do when banks have been so irresponsible in allocating credit. But somebody has to take a loss. Should it be society at large, or the bankers?

It is not a problem that bankers are prepared to solve. They want to turn the problem over to governments – and define the problem as how governments can "make them whole." What they call a "solution" to the bad-debt problem is for the government to give them good bonds for bad loans ("cash for trash") – to be paid in full by taxpayers. Having engineered an enormous increase in wealth for themselves, bankers now want to take the money and run – leaving economies debt ridden. The revenue that debtors cannot pay will now be spread over the entire economy to pay – vastly increasing everyone's cost of living and doing business.

Why should they be "made whole," at the cost of shrinking the rest of the economy? The bankers' answer is that debts are owed to labor's pension funds, to consumers with bank deposits, and the whole system will come crashing down if governments miss a bond payment. When pressed, bankers admit that they have taken out risk insurance – collateralized debt obligations and other risk swaps. But the insurers are largely U.S. banks, and the U.S. Government is pressuring Europe not to default and thereby hurt the U.S. banking system. So the debt tangle has become politicized internationally.

So for bankers, the line of least resistance is to foster an illusion that there is no need for them to accept defaults on the unpayably high debts they have encouraged. Creditors always insist that the debt overhead can be maintained – if governments simply will reduce other expenditures, while raising taxes on individuals and non-financial business.

The reason why this won't work is that trying to collect today's magnitude of debt will injure the underlying "real" economy, making it even less able to pay its debts. What started as a financial problem (bad debts) will now be turned into a fiscal problem (bad taxes). Taxes are a cost of doing business just as paying debt service is a cost. Both costs must be reflected in product prices. When taxpayers are saddled with taxes and debts, they have less revenue free to spend on consumption. So markets shrink, putting further pressure on the profitability of domestic enterprises. The combination makes any country following such policy a high-cost producer and hence less competitive in global markets.

This kind of financial planning – and its parallel fiscal tax shift – leads toward de-industrialization. Creating ECB or IMF inter-government fiat money leaves the debts in place, while preserving wealth and economic control in the hands of the financial sector. Banks can receive debt payments on overly mortgaged properties only if debtors are relieved of some real estate taxes. Debt-strapped industrial companies can pay their debts only by scaling back pension obligations, health care and wages to their employees – or tax payments to the government. In practice, "honoring debts" turns out to mean debt deflation and general economic shrinkage.

This is the financiers' business plan. But to leave tax policy and centralized planning in the hands of bankers turns out to be the opposite of what the past few centuries of free market economics have been all about. The classical objective was to minimize the debt overhead, to tax land and natural resource rents, and to keep monopoly prices in line with actual costs of

production ("value"). Bankers have lent increasingly against the same revenues that free market economists believed should be the natural tax base.

So something has to give. Will it be the past few centuries of liberal free-market economic philosophy, relinquishing planning the economic surplus to bankers? Or will society re-assert classical economic philosophy and Progressive Era principles, and re-assert social shaping of financial markets to promote long-term growth with minimum costs of living and doing business?

At least in the most badly indebted countries, European voters are waking up to an oligarchic coup in which taxation and government budgetary planning and control is passing into the hands of executives nominated by the international bankers' cartel. This result is the opposite of what the past few centuries of free market economics has been all about.