Unpacking Austerity in Europe

Keith Rankin, 13 June 2015

A respondent to my last week's posting said:

> How's the Greek challenge to austerity working out again? I do believe they are being told to pull their heads in and get on with austerity.

Very true. But so far the Greek new new-left Syriza government is holding its nerve. Even if it ends up failing in its mission to end catastrophe politics in Europe, it does represent a beacon of hope for new left-wing politics. That's why the European political establishment is fighting so hard to keep Europe on its present slow suicide track by not making concessions to Greece's government led by Alexis Tsipras.

The Economic Unreality

One of the big ironies is that Europe is behaving so much like it did in the late 1920s, except that then it was Germany playing the role now played by Greece. Germany's debts then were those imposed by the Treaty of Versailles in 1919. These debts could only be paid if Germany's vengeful post-treaty creditors (the victorious powers after World War 1) allowed Germany to run a trade surplus. Trade was the only way that Germany could earn the 'gold standard hard currency' required to pay those debts. Yet Germany's creditors were themselves trying to run trade surpluses. They were indulging in 'vendor finance' which is just a fancy way of saying they were trying their very best to lend to Germany, not to be repaid.

I simplify. The creditor powers were trying to get their private sectors to lend to Germany's private sector, with the expectation that the German government would tax its private sector heavily, and pay its reparations to the governments of France, United Kingdom and United States. The unintended aim was to make Germany's private sector the biggest debtor in the global economy, with the private sectors of France, UK and USA becoming the biggest creditors in the global capitalist economy.

It's the same in Europe today. The southern governments are being required to repay northern-based institutional creditors in 'hard currency' (Euros in this case). The only way this can possibly happen, given the determination of northern European and other creditor economies to run trade surpluses, is through huge lending to the southern private sector, enabling a boom in debt-fuelled spending in the south which would in turn enable the southern governments to collect more taxes.

It's a fantasy of course, like the subprime housing loans of the mid-2000s. The Greek private sector today is in no better shape to acquire gazillions of Euros worth of imports on credit than the German private sector was able to owe gold marks in 1928.

The Economic Theory (it's quite simple really)

Because the Eurozone is a fixed currency zone (as was greater Europe under the gold standard). It means that trade imbalances need to be reconciled through a process of internal devaluation ***and*** revaluation. This is another way of saying that northern European countries must, through higher inflation, run substantial trade deficits so that southern European countries can run the trade surpluses that enable them as countries (public and private sectors) to service their debts to the north.

The Euro problem results from a one-way flow of goods from the north to the south in the 2000s' decade. The solution is a decade-long rebalancing one-way flow of goods from the south to the north. If interest is to be paid, the latter south to north flow must exceed the former north to south flow.

The basic theory of internal devaluations and revaluations says that the creditor bloc should have higher than normal inflation and the debtor bloc should have lower than normal inflation. That is understood (and has been understood ever since David Hume enunciated the 'price-specie-flow-mechanism' in the 1750s) as the normal means to achieve a one-way trade flow. Hume (and Ricardian economists subsequently) believed that this process was self-regulating. The drain of money from debtor countries like Greece would automatically create deflation. And the flow of money into creditor countries like

Germany would automatically induce the required inflation. For this to work in Europe today we would probably need the inflation rate in Germany to be 10 percentage points higher than in Greece; eg 7% inflation in Germany and 3% deflation in Greece. Pigs will fly before the Germans will accept 7% annual inflation as part of the cure.

An Alternative Mechanism
Policymakers in dominant economies cannot create inflation when inflation is needed and is known to be needed. So an alternative to Hume's mechanism is needed. Japan has tried valiantly to create inflation, but cannot.

In Germany's case the authorities wouldn't create inflation, even if they could. Germany is at core a mercantilist nation – a mercantilism aggravated by a semi-mythological national trauma over inflation – that understands economic success as the indefinite accumulation of trade surpluses. To be good world economic citizen, Germany needs to become like modern Japan, only more so. Japan today does run trade deficits, and does have the highest public debt to GDP ratio in the world, and has had zero interest rates for two decades.

There are other ways the objective of trade rebalancing could be achieved. One would involve protectionism, which, by the way, was not the cause of the Great Depression and was part of its cure.

A better approach would be to adopt Social Credit style national dividends in the northern European creditor nations, funded by quantitative easing rather than by taxes, combined with the introduction in those northern countries of a 25 hour work week. That would turn the northerners into net consumers rather than net producers. (The word 'net' is important here; this is a green solution.) The already highly indebted northern governments would be taking on the deficits that the northern private sectors would not consider taking on. Northern Europe needs public debt at Japanese levels in order to balance the huge private surpluses endemic in the rich world.

The Politics
The real austerity agenda is one of privatisation. In a superficial sense, Greece's government can pay a chunk of its debt if it sells all its assets to northern private interests. But, in making Greek resources plunder for foreign capitalists, the underlying trade imbalances would be accentuated by even greater imbalances in financial income – interest and profit outflows – that would add to the unspent private cash reserves in the north and have to be recycled as even more debt.

The other part of the political agenda is that the northern financial interests want compliant governments in the other southern countries. Compliant left-wing governments – the one's that prioritise the reduction of government debt while confining their leftishness to identity politics – are just fine to these interests. They are desperate that Syriza-style anti-austerity live-with-debt politics does not spread to the likes of Spain and Italy and France. That kind of effective political economy would reveal the nakedness of the austerity Empress.

New Zealand's Labour Party is still, in the main, of the compliant deficit-phobic left rather than of the brave and intellectually edgy new new-Left. New Zealand has one of the most indebted private sectors and one of the less indebted government sectors. Yet so much of what Labour is about is that we cannot afford this and we cannot afford that. Even the Governor of the Reserve Bank knows that we need more debt, not less. That's why interest rates were cut on Thursday and will be cut again; to reduce the price of debt so that we get money moving again.

The Economic Reality
Your debt represents my employment. My spending represents your income. Your austerity represents my unemployment. My forced austerity represents your insolvency.

Greek government deficits (the ***additions*** to the debt) averaged over 10% of GDP since austerity was imposed. In the 10 years before the financial crisis they averaged 5% of GDP. Spain had public debt of only 36% in 2008, much less than Germany's 64%. Since austerity Spain has reached 98%. Austerity, supposedly about compromising living standards in order to repay debt, has both shattered living standards and substantially increased the rate of accumulation of public debt. Counter-austerity, on the other hand, can raise Greek living standards making it possible for Greeks to pay more taxes, and can raise the GDP denominator, making the debt more serviceable.

The economic argument about European debt is simple, when looked at in a systemic way. Syriza addresses the systemic issues, and wins the argument. In a significant act of defiance, Greece reopened its public television network this week, two years after it was shut down as a failed public economy measure. Let public enterprise blossom.
