Vérités et mensonges
sur la crise financière en Europe
(English version)

Texte révisé de l'intervention
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par la Banque Européenne d'Investissement*

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Cette intervention avait pour but d'analyser la nature extraordinaire de la crise financière en zone Euro(et en Europe), la réponse catastrophique des gouvernements, et l'existence de vraies solutions qui sauveraient l'Euro, l'Europe et l'économie mondiale.
La conférence a été prononcée en Français. Ce texte révisé est en Anglais

First a few quotations from William Greider's book "The secrets of the temple":

"*We must give to the Nation the currency that would free our citizens from the yoke of foreign bankers."* (George Washington)

"We need this administration, the Federal Reserve System to make the dollar the property of the Nation" (Woodrow Wilson)

« The public debt for a banker is gold with interest. No banker with reason is to doubt the credit of the State" (Henri Germain, founder of the French Bank Credit Lyonnais)*

All those quotations underline the hope that was enshrined by the true progressive Europeans into the creation of the Euro.*

Herein lie the explanations of the questions I intend to adress:

-Why the Euro never became the dollar of Europe?

-Why is the financial crisis in Europe both worse than in the USA and the veil of a catastrophic structural crisis?

-Why, at last, did the answer of governments was the worse of all solutions rewarding speculation by an absolute capitulation bestowing absolute power to the so-called financial market?

-What must and can be done to bail out Europe?

I. Introduction: The three crises of Europe

Crisis 1: The banking crisis, like in the USA 2008/2009. It was worse than in the USA.

Crisis 2: the first crisis was the mirror of a deep structural crisis of the European <u>Real</u> economy resulting from the violation of all stability conditions (Slide I) by systematic disastrous policy choices of governments since the late sixties of the XXth century.

Now, arrives the

Crisis 3: The crisis that could be expected by what should never have been free to accelerate:
-The collapse of the value of sovereign debt.
-The unchecked speculation on the bankrupcy of member States jeopardizing the very existence of the Euro.

Now, it is time to turn to sound economics, it could be deemed the General Theory of Monetary Capitalist Economies, the so-called General Theory of the Monetary circuit.

*en 1913 les 3/4 des titres en France sont de la dette publique

II-1 The core propositions

1- Money is the ultimate real existence condition of non-agregarian economies. An economy without money is thereby an impossibility

2- Money exists to soften or abolish the constraints on long-run expectations of <u>all agents</u> whose decisions generate the very economic process.

3- Modern money is thereby the set of liabilities issued by banks at the request of non-banking agents to be instantaneously transformed into expenditures. In a well-managed economy those expenditures are aimed at the creation of real wealth. As I explained in previous writings the creation of real wealth is tantamount to the creation of labour income.

4- Thereby banks balance sheet include on the liabilities side, money created, on the assets side the claims on agents having benefitted from credit

5- Agents must pay back their debt out of the income generated by their expenditures, sooner or later.

6- Finally, as I wrote in my last essay on the critique of usual views of monetary policy, contrary to what is emphasized by the Bank of England:

Instead of saying	one must say
Putting more money Into out economy To boots spending	Boosting spending first is the sole way to put more Money into our economy

7- In the modern economy,
Banks are private corporations targeting some growth of their net worth.
Banks net worth is: Value of their assets -Value of their liabilities

7-1- They apply this rule to <u>screen</u> requests of spending agents.

7-2- They also apply this rule to create money financing non-creating real wealth expenditures. Herein is the existence condition of both speculation and the so-called financial markets. Financing them banks hope to increase their net worth

II. 2- The State plays a leading and anchor role

1- Like corporations the State is obliged in the modern economy to finance its expenditures out of money creation by the banking system. Since the death of agrarian money-less command economies. Taxes, the State revenue are raised ex post as a levy on aggregate gross private income.

Hence the fundamental proposition:

Taxes do not finance State outlays. They destroy a share of the real money initially created by the State

2- Thereby what happens when the State runs a DEFICIT.

- It automatically increase the net savings, net wealth of the whole private sector

Why?

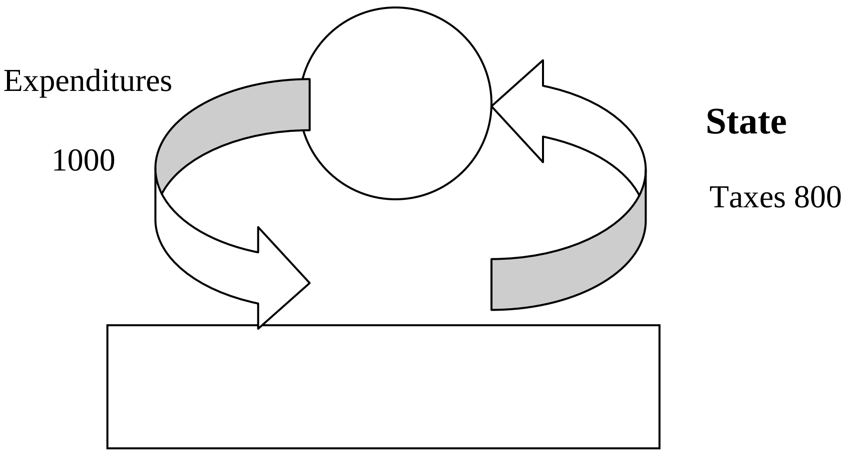
- The deficit accounts for the <u>net</u> expenditures of the State. Their counterpart is an equal increase in the surplus or net wealth of the private sector.

Let us abtract from the foreign sector.The core proposition implies that the sum of deficits of the State and the private sector is Zero. It is a basic accounting rule.

So

State deficit $\equiv$ Private surplus or negative private deficit

A small graph illustrates this



Private sector (Corporations+household)

State deficit $\equiv$ 200
Private surplus $\equiv$ 200 shared between household net savings and corporations net savings or net profits.

It is the well-known accounting identity of Kalecki, Steindl, Eisner, Parguez <u>etc</u>

3- Now, if there is a trade deficit, it is accounted as the <u>creation</u> of foreign net savings.

Ultimately we have:

State deficit $\equiv$ Private rise in net wealth + Foreign rise in net wealth

4- What about the so famous public debt?

1- Why does it exist at all in a well-managed system?

-In banks balance –sheet the counterpart of the deficit materializes in their liabilities side as the net rise in saving deposits of the private domestic sector and the foreign sector.

-In the assets side, it is balanced by an equal accumulation of claims on the State in pure liquidity or reserves.

-The Treasury issue bonds bearing interest bought by banks spending their reserves

-Net private and foreign savers may desire to spend their saving deposits by acquiring a share of those bonds yielding a permanent income.

-Finally, corporations and household being financed by private banks. The State should finance its expenditures through the central bank

-Thereby, the central bank accumulate public bonds as a conventional net credit to the treasury . After it can sell bonds to private banks and private savers.

2- Why is a well-managed economy the public debt is never excessive nor a burden?

-A crucial question is to understand that one must carefully distinguish between good and bad deficits:

Good deficits or planned deficits reflect the State net aggregate investment I_G including tangible capital: bridges, ports, airports, railways, roads, protection of environment etc Hospitals and research centers and non tangible capital including payment of salaries in activities where what matters is the creation of human capital : education research...
This investment is a bet on the long-run , the very future existence of society, it cannot and never has been made by the private sector, now less than EVER

Bad non planned deficits do not reflect the creation of real capital and are the result of disastrous policy choices the so-called shock therapy policies. A shock therapy like the electro-shock imposed on Greece leads to a collapse of the economy out of the collapse of private net wealth
-Tax revenue collapses
-Just to maintain a minimum social order. The government is obliged to pay quasi-misery incomes to unemployed people.

It is a law of history; in an economy already afflicted by a crisis, a shock-therapy is to maintain or increase the deficit. It is not a useful deficit: it has a negative impact on all private expectations, as everybody bets on more deflation

-Good deficits do not raise any problem. The rise in the stock of debt is backed by the real accumulation of capital. Together with the accumulation of net private wealth, it has a very strong multiplier impact.
The debt, repayment and interest is self financing . The State includes repayment and interest in its expenditures. The ratio of debt to GDP could fall through the strong impact on growth.

-As for bad deficits to get rid of them one must renounce forever to shock-therapy and commit to a long –run policy of planned deficit to reconstruct society.

-First, the deficit is to rise the ratio of debt to GDP is to rise
-Growth reappears out of ultra-positive expectations, the ration of debt to GDP drops.
-Government is free to remove former bad debts

III- Had those principles been applied, the Euro crisis should never have happened and Greece and now the whole euro-zone would not be obliged to capitulate before "speculators".
What has been decided –as a bail-out plan-is an economic Waterloo, Sedan, a capitulation and total defeat.

III-1 First, because of the rules of the monetary union public finance have been fully privatized which means that the debt of "sovereign States" is dealt with as if it were issued by a pure private corporation.

1/Governments are obliged to undertake their expenditures out of credits granted by private banks without any intervention of central banks

2/ The State ability to spend entirely depends on the good will of private banks to accumulate State bonds. It is led by their bets on the capacity of the State to be always able to pay back its debt and pay interest. Government debt is dealt with in a worse way than corporate debt. Why? Because of the economic ideology in Europa, all deficits of the States are postulated to be <u>bad</u> (In this ideology State management=poor management).

3/ Henceforth, the price of debts denominated in euros may be different, amid States member of the euro-zone;

<u>III-2 The Greek and soon Portuguese, Spanish ...conundrum</u>

<u>The final crisis</u>

It was the final impact of the collapse of expectations or bets on the future. Banks and other private institutions which bought to banks Greek bonds reversed their bets. At a sudden, they believed, that the Greek-Corporation was near bankrupcy. The price of Greek bonds collapsed, rates charged on bonds rose to the stars, the Greek-Corporation was threatened of being screened as such a bad borrower by private banks, that it could not spend. By its very nature and ideology it could not rely on the central bank of Greece, part of the European Central Banks System.
Soon a speculative move spread all over the Euro-zone, and the very existence of Euro was in jeopardy

III-3 One had forgotten that:

-First Greek deficits had not been purely bad. There has been a huge amount of capital creation in Greece.

-Second whatever their nature they had a counterpart:

*The accumulation of net wealth by private corporations, domestic and foreign including private banks.

*The more the Greek government could run a deficit, the more it was a cornucopia for the private european sector.

Herein is the proof that private banks managers fully forgot the difference between the State and a private corporation.
Euro core governments, France and Germany, were fully responsible of this interpretation; they never stopped to spread the idea that themselves were near bankruptcy.

III 4 Thereby, what should and could be done

The creation of a European agency recycling all the net financial wealth created by the accumulated deficits. It could issue bonds (with ECB Guarantee) sold to all those who had accumulated net saving deposits thanks to Greece, Portugal deficits. Proceeds would be spent in lending euros to the most “threatened” banks. Those loans would be used to retire excess depreciated bonds and to new loans to Greece (and others).
Such a truly quasi federal plan would have “closed” the circuit by giving back to Greece (and others) –in someway the wealth it had bestowed (or lended) to the private sector. It is tantamount to the proposition that when a Government runs a debt to provide net wealth to the private domestic sector and to the foreign sector it is as though it became their creditor. As I shall prove in a forthcoming paper, it also explains that in pure economic terms it is not the USA which are indebted to China, it is the inverse . Thereby it is absurd to believe that the chinese finance the US deficit.

III-5 It explains the absurdity of the just decreed salvation plan of the euro

First “the richest core States” issue bonds sold to the private financial institutions with the “States guarantee”

So there is a rise
In the Frenceh and
German debt
While those gov
at the same time
want to cut their
own debt

Banks buying
those bonds create
money for the
German and French
Treasuries
Neither Germany nor France
is lending another thing that the
proceeds of its own borrowing

Mystery

What means State
Guarantee exactly
For States declaring
Themselves over-indebted?
That core gov promise
To repay in full, how?

Those bonds -might be-could be
resold to the ECB
Since they are
not funding
Expenditures?

Then governments lend the proceeds to threatened governments which spend it by repaying their debt to the same banks which bought the second bonds

Finally it is a dare balance –sheet operation solving nothing.Threatened banks issue euros to extinguish their bad debts.

There is worse :

To save the euro ideology, governments which are bailed out are obliged to swear to impose to their own people a lethal shock-therapy deflation program. The outcome is to be a collapse of their economy, a destruction of society, the destruction of any collateral to their own debt.

According to history,

-Either out of a collapse of the economy, deficits appear again and they are bad, hence more deflation

-Or the economy vanish.
It is as though to save a corporation, creditors oblige its managers to close their factories, sack their workers, swear to abstain from investment!

Thereby more debts should be issued by core governments. Core governments to save their credit-wortheners are obliged to impose limits on their new indebtness.

Hence Europe calls for the IMF!
It is indeed the best proof of the failure of all hopes embodied into the euro.

What is lending the IMF?: US Dollars

-At last, it is not enough, all governments as soon as they rose their debt to save banks (which saved themselves) imposed on their people the most horrendeous shock therapy ever implemented. The worse case is France just to save its credit wortheners.

Finally, all the rules of good governance have been rejected. Net wealth is to collapse everywhere in Europe, unemployment is to rise beyond sustainability; to save the euro governments destroyed its very foundation

Conclusion

1/ If core governments do not change their minds. I must say from a pure scientific perspective that euro is very much in jeopardy. By playing the game of giving speculators what they wanted, they trigger more speculation. Such an absolute capitulation (meeting secret hopes of the ruling elite) is something New.

2/ Hope there is following the plan I proposed but it requires a genuine cultural revolution leading to some federal Europe animated by the spirits of the founding fathers of the USA.

ANNEXE I

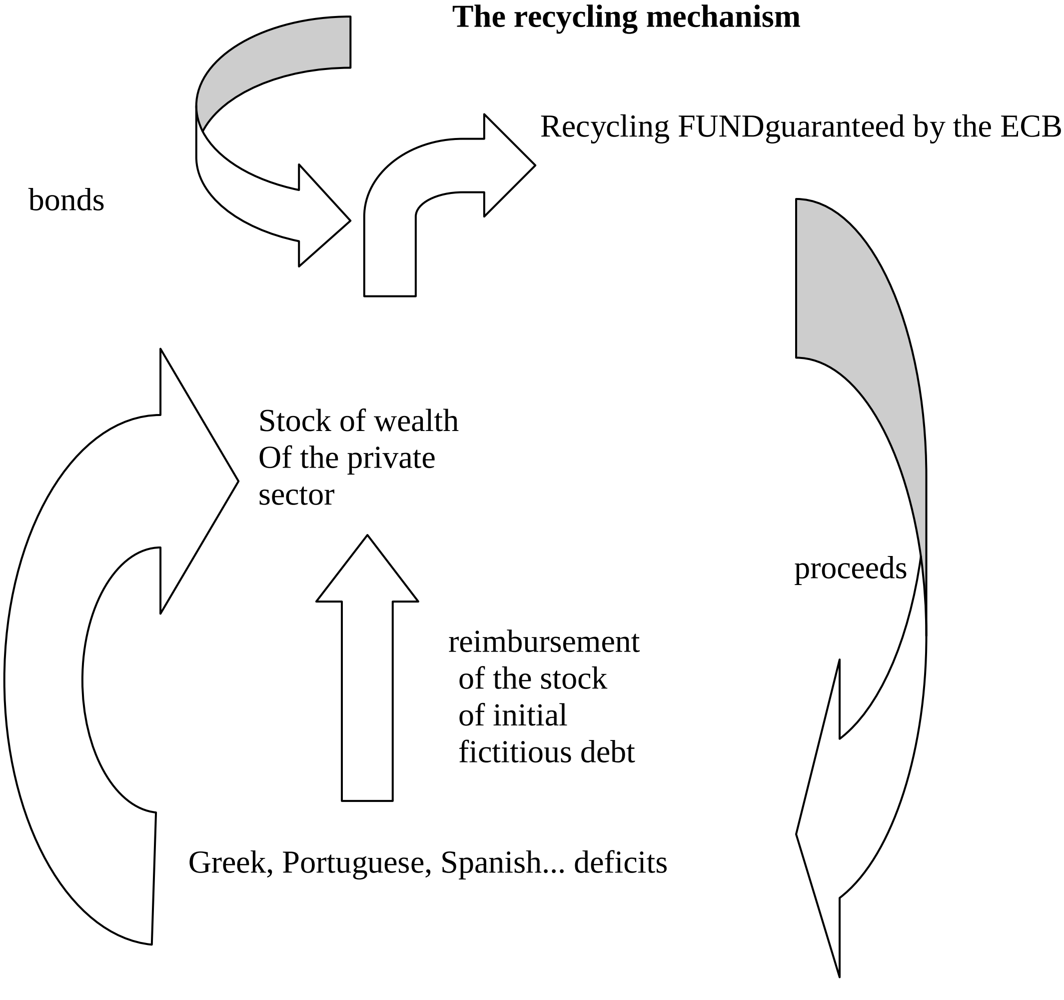
Emergency plan

For the same reason, the Greek government (and the Portuguese , Spanish one etc), in pure economic terms should be dealt with as the creditors of the European private sector for the stock of net wealth it bestowed on it.
Thereby, the recycling mechanism I emphasized above should give back to Greece the enormous amount of capital it generated for the European private sector! In Keynesian terms the Greek, Spanish, Portuguese (French, German) governments were a permanent source of windfall gains for the private sector. It is exactly as though the private sector had borrowed to governments this stock of capital at zero interest, without any effort of its part.

The final identity is thereby

Stock of outstanding Government debt in Europa	≡	Stock of net wealth of the European private sector earned within Europa
	causality relationship	

The recycling mechanism



ANNEXE III
Long-term salvation

Government debts-as long as they commit to planned deficits targeting full employment out of public accumulation of capital are not to be sold to private institutions. They are to be acquired by the European Central Bank
Thereby, the dictatorship and blackmails or "financial markets" would be over.

Existence condition: core governments must themselves renounce their obsession of deflation.