EU tools for economic and social recovery

Presentation by **Ann Pettifor**

Fellow: New Economics Foundation London
Co-author: The Green New Deal
Director: Advocacy International London
Blog: www.debtonation.org

18th March, 2010


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Unemployment in the EU

Eurostat estimates that **22.979 million** men and women in the EU27, of whom **15.683** million were in the euro area, were unemployed in January 2010.

Compared with January 2009, unemployment went up by **3.802** million in the EU27 and by 2.204 million in the euro area**.**

Eurostat, the statistical office of the European Union. January, 2010.

Two Major Risks:

that deprive the EU of policy tools for economic recovery

First Risk:

Misunderstanding of money/credit

= Policy errors

“**Markets** provide the money states need to finance their debts.”

“**Europe at the crossroads. Institutional Choices for Sound European Public Finance**”

Prof. Mark Hallerberg, PhD
Hertie School of Governance
Berlin, Germany

Second Risk: Ignoring the multiplier

Wrong:

"Eventually, the debt has to be repaid, either by having **higher taxes** than would otherwise have been the case or **curbing public spending.**"

"Budgetary policy tools for economic Recovery."
Iain Begg
European Institute, London School of Economics
London United Kingdom

Government spending on **public works** generates:

- employment
- new savings
- tax income
- savings on welfare benefits

Government investment in public works generates income,

pays for itself

Orthodoxy: assumption that
money or credit
- like a commodity -
is subject to **market forces**
of supply and demand.

Bank money is *not a commodity*.
There is no limit to the availability of bank money.

It is not visible/tangible
Unlike like **oil**
Or **gold**
Or **tulips**

June 2009: ECB ‘creates’ €442bn credit for **markets**

1121 banks – i.e. the market - participated in the operation, by drawing down ECB’s “enhanced credit support”.

Collateral? “the worst quality collateral they could put their hands on, subject to the constraint that a rating agency had rated it at least BBB.” * They paid 1%, and re-lent e.g for Eurozone mortgages at 3.66%.

* William Buiter “Recapitalising the banks through enhanced credit support: quasi-fiscal shenanigans in Frankfurt” Financial Times, June 28, 2009

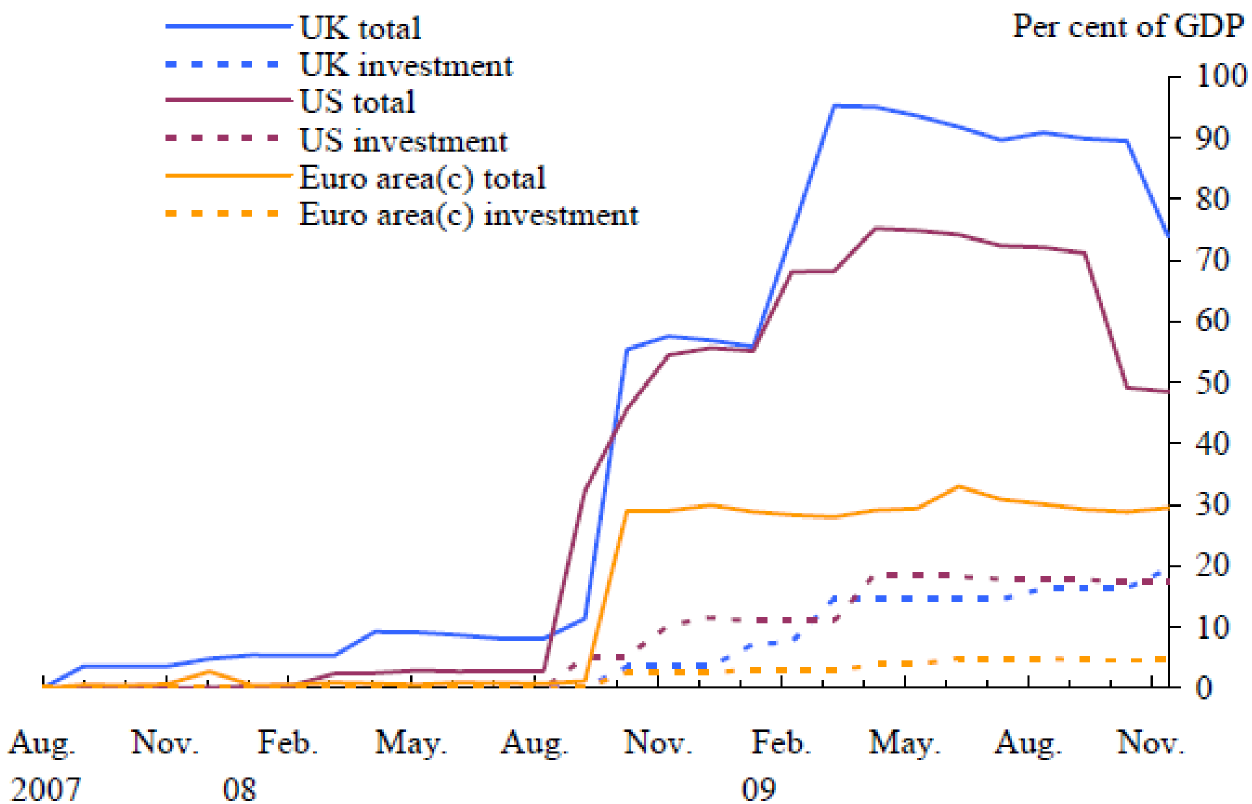
Direct ***public*** *(i.e. taxpayer backed)* support for markets has been large.

One quarter of global GDP.

One third of GDP in the Eurozone.

In the US and UK, nearer three-quarters of GDP.

Chart 2: Public sector interventions during the financial crisis [(a)(b)]



Sources: Bank of England, BIS, Board of Governors of the Federal Reserve System, ECB, FDIC, HM Treasury, IMF *World Economic Outlook* (October 2009), US Treasury and Bank calculations.

(a) End-of-month data expressed as percentages of 2007 nominal GDP.

(b) Scale of interventions = potential size of packages when announced

(c) Original euro area 11 countries plus ECB interventions.

From Speech by A Haldane, of BoE "The Debt Hangover" 27 Jan 2010

Treasury Secretary Tim Geithner,
Testimony to Congress
23 September, 2009

Geithner: flawed analysis of financial system: **denies existence of credit**

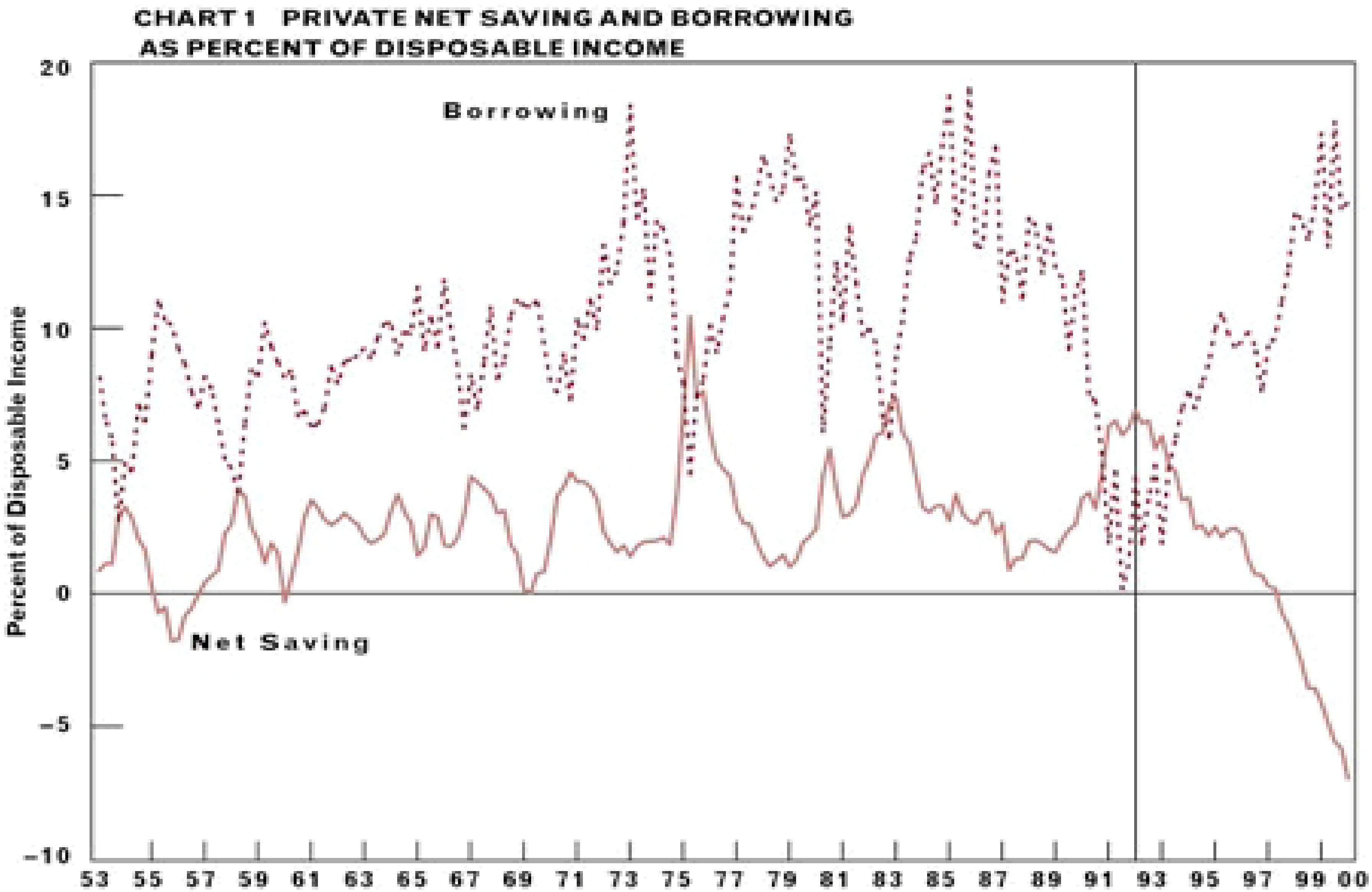
"Stripped of its complexities, the purpose of a financial system is to let those who want to ***save*** -whether for vacation, retirement or a rainy day -***save***."

Treasury Secretary Tim Geithner,
Testimony to Congress
23 September, 2009

"It is to let those who want to ***borrow*** - whether to buy a house or build a business -borrow. "

Treasury Secretary Tim Geithner,
Testimony to Congress
23 September, 2009

"And it is to use our banks and other financial institutions to bring **savers' funds** and **borrowers' needs** together and carefully manage the risks involved in **transfers** between them."



SOURCE: NIPA and Flow of Funds

Prof. Wynne Godley Jerome Levy Economics Institute. Policy Note, 2000.

The deep flaw in classical theory of economics:

That money (deposits/**savings**/credit/gold) exists only as the ***result*** of economic activity.....

Flawed orthodoxy **ignores credit**, argues that

Deposits/savings
(or vaults of gold) are
needed to
create economic activity.

Orthodoxy:

“ We can only ***afford*** what is already in the bank in the form of savings/deposits/gold.”

“What we can create,
we can afford.”

JM Keynes

“National Self-Sufficiency” The Yale Review, Vol 22, no4 (June 1933), pp.755-769

JM Keynes (and Adam Smith/John Law/Benjamin Franklin/Joseph Schumpeter/President Roosevelt/ JK Galbraith):

"Credit *creates* **savings**/ deposits"

Economic activity *generates* saving, it is not constrained by saving.

No constraint on finance

In a monetary economy, the relevant consideration is the availability of **finance** not of saving, and there is **no necessary constraint on finance**.

(Geoff Tily, Keynes and the financing of public works' August, 2009.)
http://www.heterodoxnews.com/htnf/htn87/Tily%20Keynes.pdf

Nature of finance/credit

- Nature of credit highly peculiar. Very different from the point of view of

- **an individual**

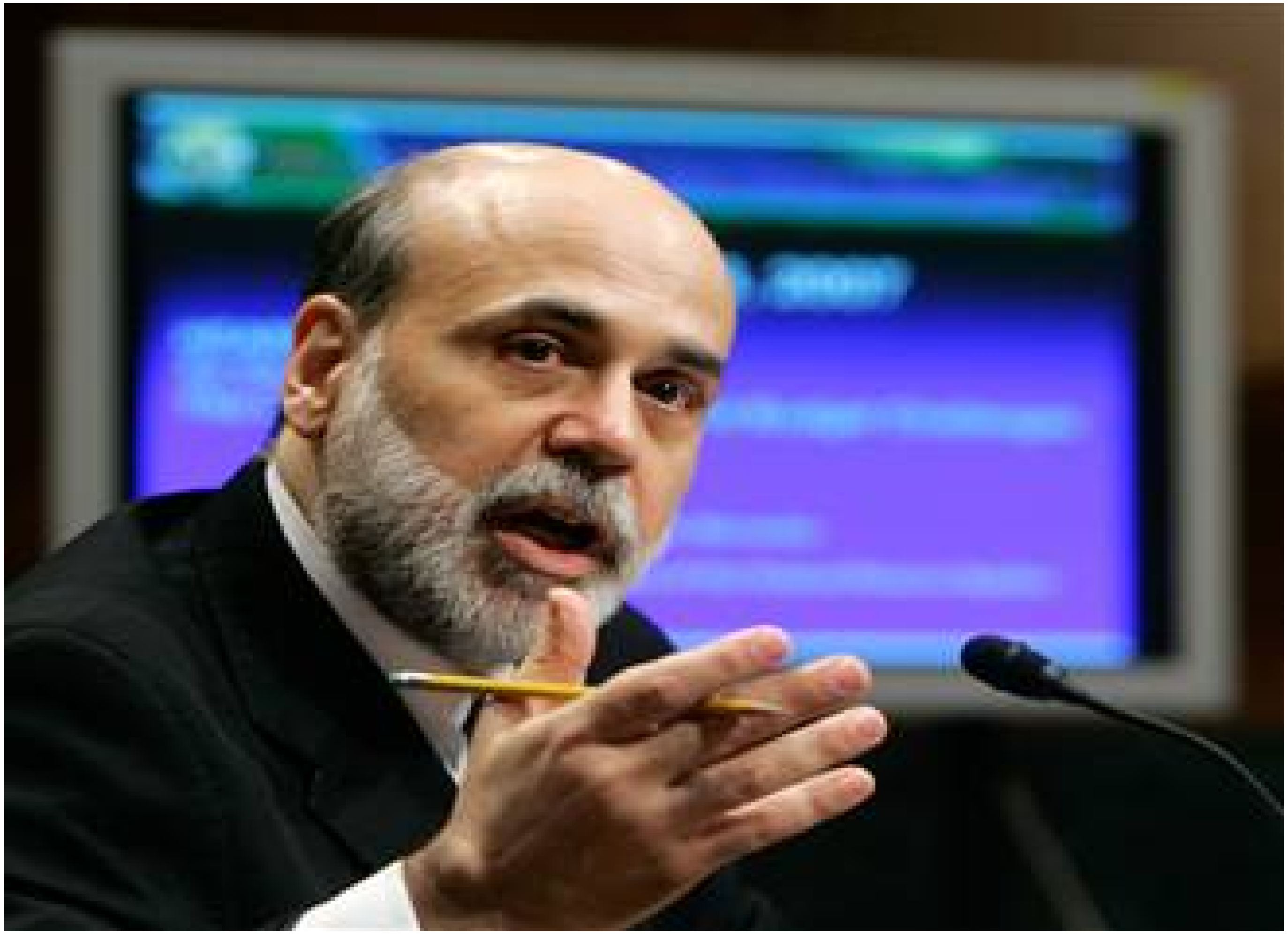
and from the point of view of

- **the system as a whole.**

Nature of finance/credit

- Individuals cannot **magic money** from nothing. But the fact is the system as a whole can magic money from nothing.

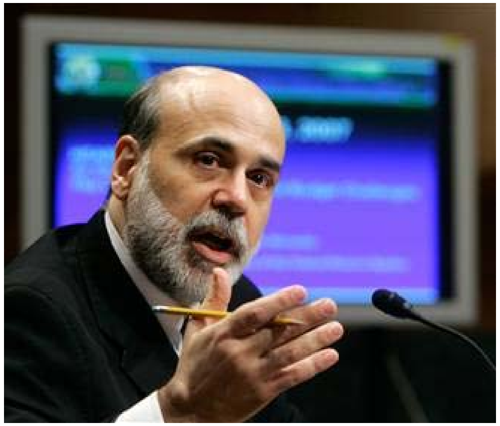
- This money can be used to bring economic activity into existence.



Governor Bernanke’s ‘magic’

Ben Bernanke, Fed Reserve Governor, interviewed on CBS. 60 Minutes Show 15 March 2009, soon after Fed had made $160 billion available to AIG. Was it tax money?

Bernanke: "It's not tax money. The banks have accounts with the Fed, much the same way that you have an account in a commercial bank."



Bernanke: “So, to lend to a bank, we simply use the computer to mark up the size of the account that they have with the Fed.”

Bank Money/*QE* issued by BoE – since Bank founded in 1694.

"Quantitative Easing" "Money Market Operations"

Supplying more money
how it happens

Bank of England **(indirectly through markets)** financed UK government debt in 2009

- **£200 billion QE:** mainly 'gilt' or asset purchases. *

- UK govt deficit for 2009 = **£177.6 billion.** *

* Bank of England: Quantitative Easing: Asset Purchases.
http://www.bankofengland.co.uk/monetarypolicy/qe/amount.htm

* UK Treasury: Pre-budget Report. Annex B: "The Public Finances".

ECB's "Enhanced credit support....

"constitutes the special and primarily bank-based measures ...taken to enhance the flow of credit above and beyond what could be achieved through policy interest rate reductions alone."

Jean-Claude Trichet, President of the ECB
at the University of Munich
Munich, 13 July 2009

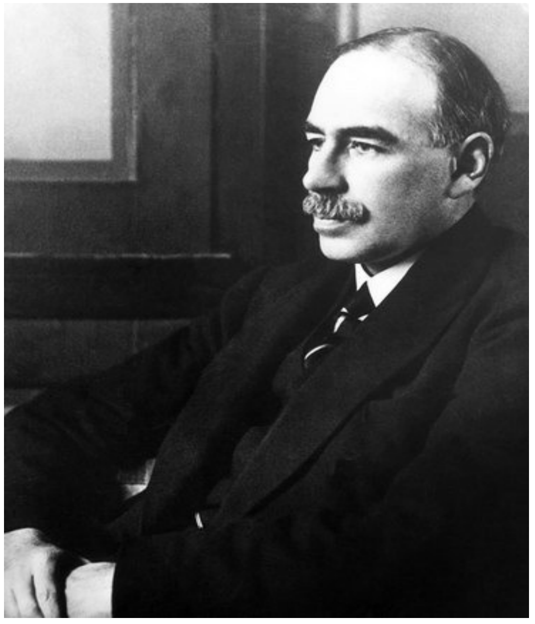
Credit/finance created by central banks: ***funding*** provided by the banks

Deutsche Bank

SOCIETE GENERALE

Banco Santander

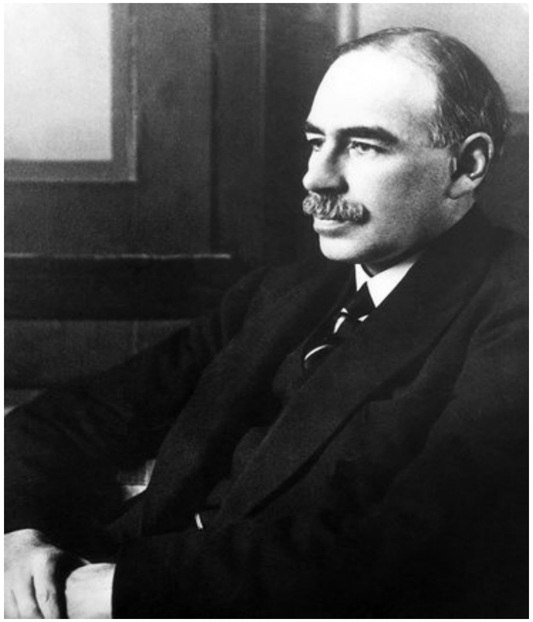
BARCLAYS



Keynes, Treatise on Money, 1930.

"Why then...if banks can create credit, should they refuse any reasonable request for it?

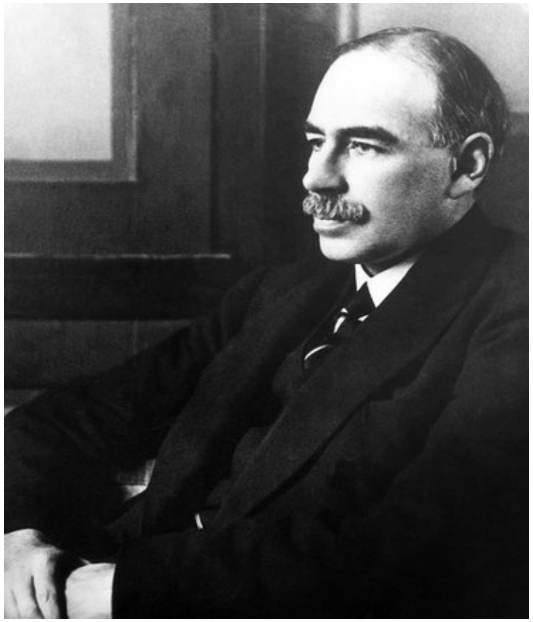
" And why should they charge a fee for what costs them little or nothing?"



Keynesian monetary tools for recovery:

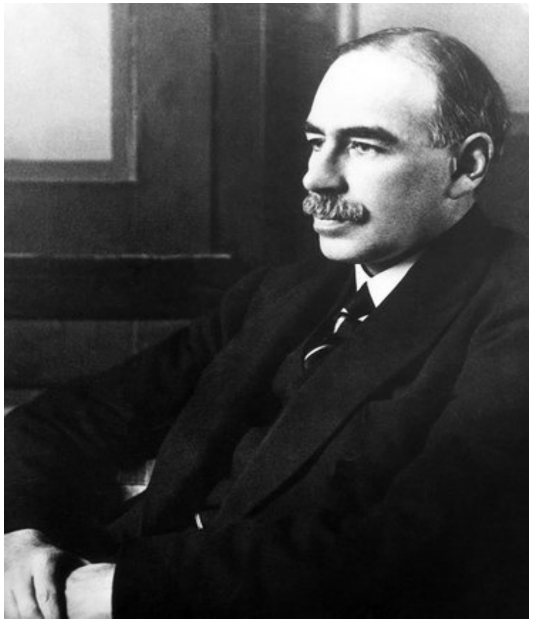
- QE + Fiscal stimulus – to compensate for 9.6% collapse in investment across EU in 2009. (ECB: Ec and Financial data)

http://www.ecb.int/stats/keyind/html/sdds.en.html#foot-2



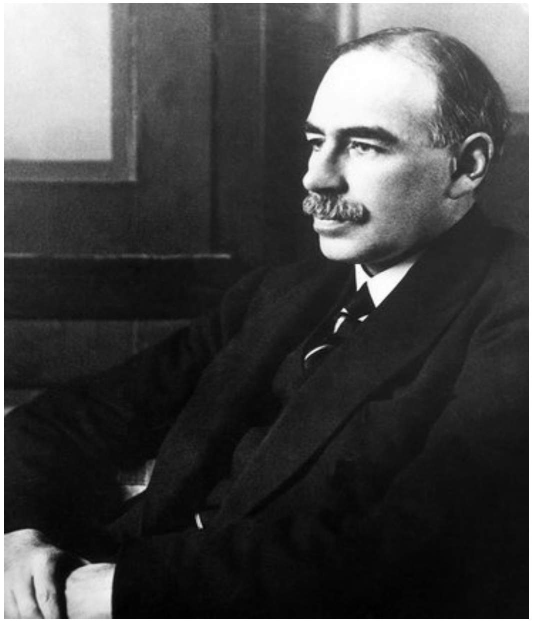
Keynesian monetary tools for recovery:

- Low Interest rates – **across** the financial architecture: for safe, risky, short & long-term loans. Not just base rates.



Keynesian fiscal tools for recovery:

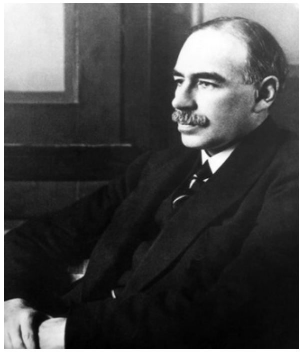
- Public investment
- Employment creation
- Multiplier creates income
- Tax income pays the debt



QE + Fiscal stimulus:

Bank balance sheets can only artificially and temporarily be bolstered by creating more debt.

Asset values can only recover when income recovers.



Public expenditure - unlike private expenditure - generates tax income.

Public expenditure will pay for itself.

The public debt will only fall with public works expenditures.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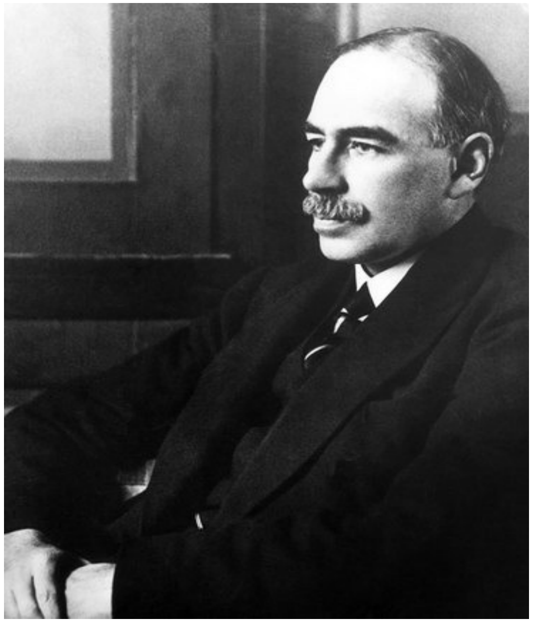


Keynes:

"Look after the unemployment and the budget will look after itself"

(Keynes, January 1933, CW XXI, p. 150)

UK Public Sector Debt: % of GDP

Source: HM Treasury; public finances databank, Table A10
http://www.hm-treasury.gov.uk/d/public_finances_databank.xls

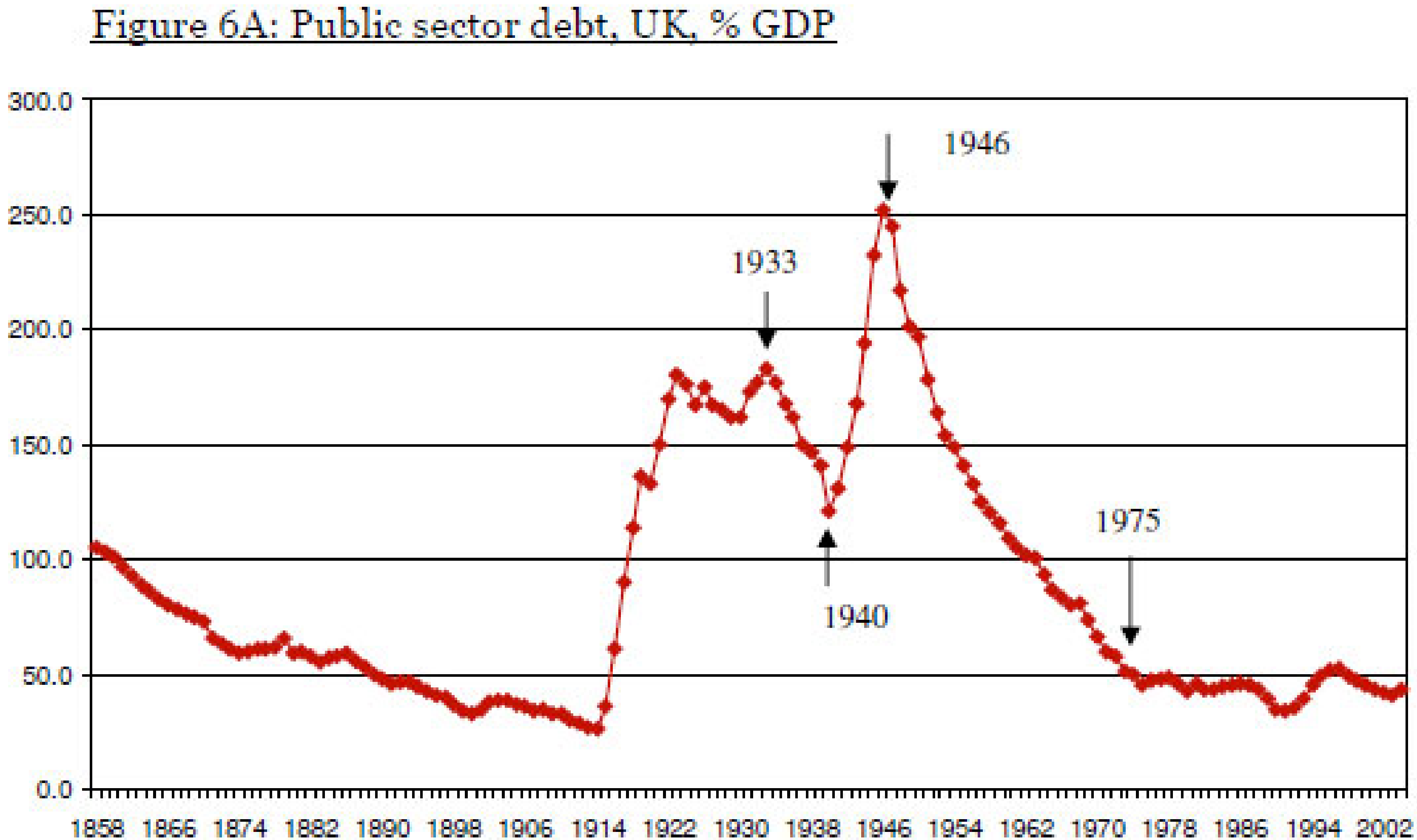
1946: Labour Govt Spending

NHS

Public Housing

Butler Education Act 1944

UK Public Sector Debt: % of GDP



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