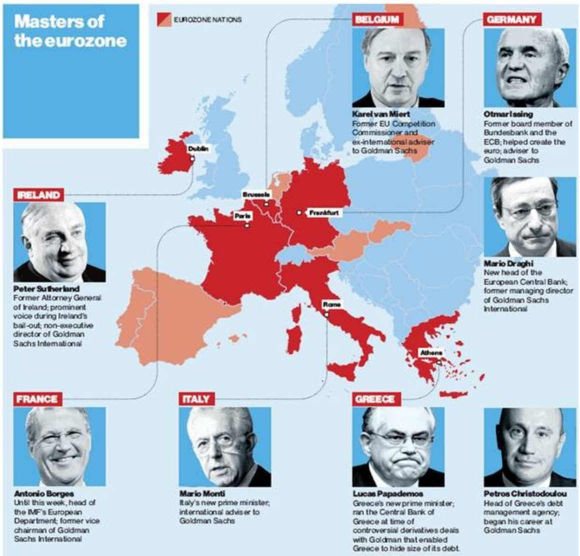
Eurozone Crisis – Banking Technocrats take over Europe to solve the wrong crisis the wrong way



Between 1999 and 2007 Greece, Portugal, Italy, Ireland and Spain did not have high government debts or deficits. They did, however, have large balance of payments deficits. As Martin Wolf, the chief economic commentator in the Financial Times put it "This is, at its bottom, a balance of payments crisis. Resolving payments crises inside a large, closed economy requires huge adjustments, on *both* sides. "

So how did a trade imbalance lead to the current crisis?

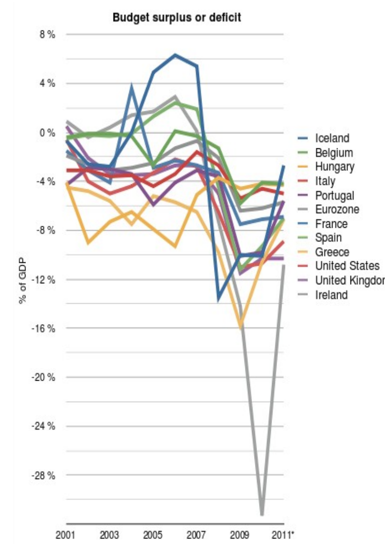
Import Surpluses are deflationary – when the 2007/8 bust came states found themselves taking on the debts

An import surplus (trade deficit) is deflationary, tending to force down income and prices. More purchasing power is being spent abroad to buy imports than foreigners are bringing in to pay for exports and their holidays.

A leakage of purchasing power out of an economy caused by imports can be offset for a time by people borrowing new bank credit money, particularly if bank credit is cheap, as it was in the first few years of the eurozone. It also helps if households or firms have savings to run down to pay for more than they are earning. After the 2007 crunch that was no longer possible. Companies and individuals saved to pay off debts instead so incomes fell as people spent less at home and abroad.

Falling incomes then created government deficits as taxes fell and welfare and unemployment benefits rose. The import surplus made state funding even more of a problem. Healthy domestic businesses from which tax revenues could be raised are less while welfare and unemployment benefits tend to rise. This added to the fact that over the last decades most countries have reduced taxes on the rich, on property and real estate and put taxes on ordinary people and labour instead.

At the same time broken banks passed their property market losses over to governments.



Source: Eurostat (2001-2010) and Global Finance magazine (2011)
* Estimates

Germany undermined its competitors –in the eurozone they could no longer devalue

Before the common currency countries that could not compete with German (and other)imports in their markets retained competitiveness because their separate currencies could be depreciated.

For example, if Italy was importing more goods from Germany than it was exporting back the lira depreciated against the deutschmark. So, for Italians to continue buying German goods meant more lira had be offered for DM and German goods became more expensive to Italian importers. By contrast Germans buying in Italy (eg on holiday) got more lira for a DM and so spent more in Italy. Imports of German goods would fall and exports to Germany would rise.

In the common currency zone this adjustment can no longer happen. The peripheral countries are probably 30% overvalued compared to Germany but cannot devalue.

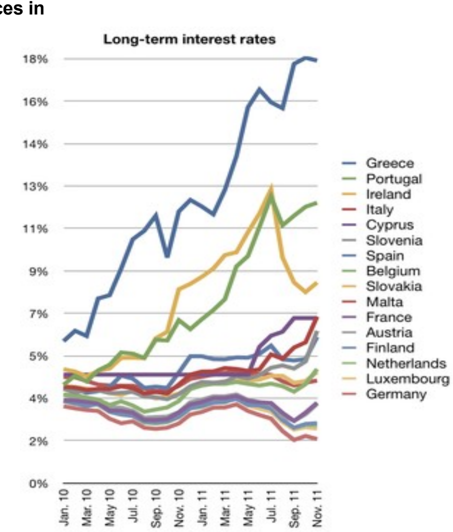
For a time the peripheral countries borrowed from eurozone banks to pay for their import surpluses. However that is a temporary solution.

The German economy is undermining the economies of its competitors who are also its customers. This had knock on effects on the property markets and then on state finances in the eurozone.

Governments also inherited the debts of broken banks

In several countries a real estate bubble developed because there was still money to be made in building houses, infrastructure and to some extent holiday homes. Migration was high and credit in the new eurozone was cheap. EU funds were available for the infrastructure. Local government often encouraged land development because their revenues were then higher. If rising land values had been taxed away this would have discouraged speculation and helped resolve the fiscal crisis but property taxes were reduced and taxes put on labour income instead.

Cheap euros borrowed from the banks pumped up real estate and land prices. When the bubble burst many banks were left with bad debts. Governments bailed out the banking system. Taxpayers were then on the hook for the debts - even though they were struggling because of their own debts...



Source: ECB

The Debt Deflation Spiral - an exercise in futility

1. Credit rating agencies downgrade countries throwing doubt over whether they will repay their debts.
2. The financial markets demand higher interest rates for more risky lending.
3. Higher interest rates have to be financed out of state budgets so lead to more tax raises on ordinary people (though not on elites), cuts in services and privatisations.
4. These austerity measures reduce income and spending as people and companies cut back more, reducing tax takes while elites take their money to Switzerland..
5. Government deficits get worse.
6. Rating agencies downgrade country debt ratings again.....
7. Riots, strikes and protests eventually means that governments fall
8. European Union imposes "technocratic" - i.e. unelected rulers - usually former bankers and their associates..
9. Bankers who have "insured debt" against default lean on politicians behind the scenes lest they have to pay out and pressure for further austerity on the people
10. People who cannot pay don't pay – so the prospect of default looms anyway.
11.Banks fear bankruptcy and a domino chain of failures as state bonds are downgraded and their assets lose value

Conclusion - The bankers must lose eventually – reform of banking is needed including the break up of the eurozone and taking away the power of the bankers to create credit money. This is better sooner rather than later...

The EU Response – Treating the wrong problem and making things worse

The Maastricht Treaty bans the European Central Bank creating euros to buy new government debt. If the ECB could create money and use it to buy government bonds (tradable IOUs) there would be no risk of governments defaulting. Governments that can print their own money do not default – but in some circumstances their currency may lose value. However, the Maastrict Treaty banned this supposedly to maintain discipline over state expenditures. The Eurozone governments now hope to borrow money for states with expensive debts at a cheaper rate through Europe-wide rescue funds but are struggling to find lenders. Meanwhile Merkel and Sarkhozy are asking governments to sign up for more austerity if governments run defcits.

But the root problem is unequal competitive strength - Germany is undermining the economies of its competitors and customers - the production systems from which peripheral states can raise tax resources. Austerity is futile. It ruins the peripheral economies and delays steps towards policies of greater priority - europe's transition to a low energy zero-carbon future. In fact *less* trade is needed. Relocalisation is needed to reduce fuel consumption in transport to cope after peak oil and because of the climate crisis. Restoring national and even local currencies would be rational in this context. 'Odious debts' by elites which should never have been taken on should be reviewed and cancelled unless the public really benefited from them – european co-operation should be re created around energy transformation eg solar energy from the south as well as wind and marine energy from the north and west.