How the Banks Broke the Social Compact, Promoting their Own Special Interests

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Banks Weren't Meant to Be Like This. What will their future be – and what is the government's proper financial role?

The inherently symbiotic relationship between banks and governments recently has been reversed. In medieval times, wealthy bankers lent to kings and princes as their major customers. But now it is the banks that are needy, relying on governments for funding – capped by the post-2008 bailouts to save them from going bankrupt from their bad private-sector loans and gambles.

Yet the banks now browbeat governments – not by having ready cash but by threatening to go bust and drag the economy down with them if they are not given control of public tax policy, spending and planning. The process has gone furthest in the United States. Joseph Stiglitz characterizes the Obama administration's vast transfer of money and pubic debt to the banks as a "privatizing of gains and the socializing of losses. It is a 'partnership' in which one partner robs the other."2 Prof. Bill Black describes banks as becoming criminogenic and innovating "control fraud."3 High finance has corrupted regulatory agencies, falsified account-keeping by "mark to model" trickery, and financed the campaigns of its supporters to disable public oversight. The effect is to leave banks in control of how the economy's allocates its credit and resources.

If there is any silver lining to today's debt crisis, it is that the present situation and trends cannot continue. So this is not only an opportunity to restructure banking; we have little choice. The urgent issue is who will control the economy: governments, or the financial sector and monopolies with which it has made an alliance.

Fortunately, it is not necessary to re-invent the wheel. Already a century ago the outlines of a productive industrial banking system were well understood. But recent bank lobbying has been remarkably successful in distracting attention away from classical analyses of how to shape the financial and tax system to best promote economic growth – by public checks on bank privileges.

How banks broke the social compact, promoting their own special interests

People used to know what banks did. Bankers took deposits and lent them out, paying short-term depositors less than they charged for risky or less liquid loans. The risk was borne by bankers, not depositors or the government. But today, bank loans are made increasingly to speculators in recklessly large amounts for quick in-and-out trading. Financial crashes have become deeper and affect a wider swath of the population as debt pyramiding has soared and credit quality plunged into the toxic category of "liars' loans."

The first step toward today's mutual interdependence between high finance and government was for central banks to act as lenders of last resort to mitigate the liquidity crises that periodically resulted from the banks' privilege of credit creation. In due course governments also provided public deposit insurance, recognizing the need to mobilize and recycle savings into capital investment as the Industrial Revolution gained momentum. In exchange for this support, they regulated banks as public utilities.

Over time, banks have sought to disable this regulatory oversight, even to the point of decriminalizing fraud. Sponsoring an ideological attack on government, they accuse public bureaucracies of "distorting" free markets (by which they mean markets free for predatory behavior). The financial sector is now making its move to concentrate planning in its own hands.

The problem is that the financial time frame is notoriously short-term and often self-destructive. And inasmuch as the banking system's product is debt, its business plan tends to be extractive and predatory, leaving economies high-cost. This is why checks and balances are needed, along with regulatory oversight to ensure fair dealing. Dismantling public attempts to steer banking to promote economic growth (rather than merely to make bankers rich) has permitted banks to turn into something nobody anticipated. Their major customers are other financial institutions, insurance and real estate – the FIRE sector, not industrial firms. Debt leveraging by real estate and monopolies, arbitrage speculators, hedge funds and corporate raiders inflates asset prices on credit. The effect of creating "balance sheet wealth" in this way is to load down the "real" production-and-consumption economy with debt and related rentier charges, adding more to the cost of living and doing business than rising productivity reduces production costs.

Since 2008, public bailouts have taken bad loans off the banks' balance sheet at enormous taxpayer expense – some $13 trillion in the United States, and proportionally higher in Ireland and other economies now being subjected to austerity to pay for "free market" deregulation. Bankers are holding economies hostage, threatening a monetary crash if they do not get more bailouts and nearly free central bank credit, and more mortgage and other loan guarantees for their casino-like game. The resulting "too big to fail" policy means making governments too weak to fight back.

The process that began with central bank support thus has turned into broad government guarantees against bank insolvency. The largest banks have made so many reckless loans that they have become wards of the state. Yet they have become powerful enough to capture lawmakers to act as their facilitators. The popular media and even academic economic theorists have been mobilized to pose as experts in an attempt to convince the public that financial policy is best left to technocrats – of the banks' own choosing, as if there is no alternative policy but for governments to subsidize a financial free lunch and crown bankers as society's rulers.

The Bubble Economy and its austerity aftermath could not have occurred without the banking sector's success in weakening public regulation, capturing national treasuries and even disabling law enforcement. Must governments surrender to this power grab? If not, who should bear the losses run up by a financial system that has become dysfunctional? If taxpayers have to pay, their economy will become high-cost and uncompetitive – and a financial oligarchy will rule.

The present debt quandary

The endgame in times past was to write down bad debts. That meant losses for banks and investors. But today's debt overhead is being kept in place – shifting bad loans off bank balance sheets to become public debts owed by taxpayers to save banks and their creditors from loss. Governments have given banks newly minted bonds or central bank credit in exchange for junk mortgages and bad gambles – without re-structuring the financial system to create a more stable, less debt-ridden economy. The pretense is that these bailouts will enable banks to lend enough to revive the economy by enough to pay its debts.

Seeing the handwriting on the wall, bankers are taking as much bailout money as they can get, and running, using the money to buy as much tangible property and ownership rights as they can while their lobbyists keep the public subsidy faucet running.

The pretense is that debt-strapped economies can resume business-as-usual growth by borrowing their way out of debt. But a quarter of U.S. real estate already is in negative equity – worth less than the mortgages attached to it – and the property market is still shrinking, so banks are not lending except with public Federal Housing Administration guarantees to cover whatever losses they may suffer. In any event, it already is mathematically impossible to carry today's debt overhead without imposing austerity, debt deflation and depression.

This is not how banking was supposed to evolve. If governments are to underwrite bank loans, they may as well be doing the lending in the first place – and receiving the gains. Indeed, since 2008 the over-indebted economy's crash led governments to become the major shareholders of the largest and most troubled banks – Citibank in the United States, Anglo-Irish Bank in Ireland, and Britain's Royal Bank of Scotland. Yet rather than taking this opportunity to run these banks as public utilities and lower their charges for credit-card services – or most important of all, to stop their lending to speculators and gamblers – governments left these banks operating as part of the "casino capitalism" that has become their business plan.

There is no natural reason for matters to be like this. Relations between banks and government used to be the reverse. In 1307, France's Philip IV ("The Fair") set the tone by seizing the Knights Templars' wealth, arresting them and putting many to death – not on financial charges, but on the accusation of devil-worshipping and satanic sexual practices. In 1344 the Peruzzi bank went broke, followed by the Bardi by making unsecured loans to Edward III of England and other monarchs who died or defaulted. Many subsequent banks had to suffer losses on loans gone bad to real estate or financial speculators.

By contrast, now the U.S., British, Irish and Latvian governments have taken bad bank loans onto their national balance sheets, imposing a heavy burden on taxpayers – while letting bankers cash out with immense wealth. These "cash for trash" swaps have turned the mortgage crisis and general debt collapse into a fiscal problem. Shifting the new public bailout debts onto the non-financial economy threaten to increase the cost of living and doing business. This is the result of the economy's failure to distinguish productive from unproductive loans and debts. It helps explain why nations now are facing financial austerity and debt peonage instead of the leisure economy promised so eagerly by technological optimists a century ago.

So we are brought back to the question of what the proper role of banks should be. This issue was discussed exhaustively prior to World War I. It is even more urgent today.

How classical economists hoped to modernize banks as agents of industrial capitalism

Britain was the home of the Industrial Revolution, but there was little long-term lending to finance investment in factories or other means of production. British and Dutch merchant banking was to extend short-term credit on the basis of collateral such as real property or sales contracts for merchandise shipped ("receivables"). Buoyed by this trade financing, merchant bankers were successful enough to maintain long-established short-term funding practices. This meant that James Watt and other innovators were obliged to raise investment money from their families and friends rather than from banks.

It was the French and Germans who moved banking into the industrial stage to help their nations catch up. In France, the Saint-Simonians described the need to create an industrial credit system aimed at funding means of production. In effect, the Saint-Simonians proposed to restructure banks along lines akin to a mutual fund. A start was made with the Crédit Mobilier, founded by the Péreire Brothers in 1852. Their aim was to shift the banking and financial system away from debt financing at interest toward equity lending, taking returns in the form of dividends that would rise or decline in keeping with the debtor's business fortunes. By giving businesses leeway to cut back dividends when sales and profits decline, profit-sharing agreements avoid the problem that interest must be paid willy-nilly. If an interest payment is missed, the debtor may be forced into bankruptcy and creditors can foreclose. It was to avoid this favoritism for creditors regardless of the debtor's ability to pay that prompted Mohammed to ban interest under Islamic law.

Attracting reformers ranging from socialists to investment bankers, the Saint-Simonians won government backing for their policies under France's Second Empire. Their approach inspired Marx as well as industrialists in Germany and protectionists in the United States and England. The common denominator of this broad spectrum was recognition that an efficient banking system was needed to finance the industry on which a strong national state and military power depended.

Germany develops an industrial banking system

It was above all in Germany that long-term financing found its expression in the Reichsbank and other large industrial banks as part of the "holy trinity" of banking, industry and government planning under Bismarck's "state socialism." German banks made a virtue of necessity. British banks "derived the greater part of their funds from the depositors," and steered these savings and business deposits into mercantile trade financing. This forced domestic firms to finance most new investment out of their own earnings. By contrast, Germany's "lack of capital … forced industry to turn to the banks for assistance," noted the financial historian George Edwards. "A considerable proportion of the funds of the German banks came not from the deposits of customers but from the capital subscribed by the proprietors themselves.[4] As a result, German banks "stressed investment operations and were formed not so much for receiving deposits and granting loans but rather for supplying the investment requirements of industry."

When the Great War broke out in 1914, Germany's rapid victories were widely viewed as reflecting the superior efficiency of its financial system. To some observers the war appeared as a struggle between rival forms of financial organization. At issue was not only who would rule Europe, but whether the continent would have laissez faire or a more state-socialist economy.

In 1915, shortly after fighting broke out, the Christian Socialist priest-politician Friedrich Naumann published Mitteleuropa, describing how Germany recognized more than any other nation that industrial technology needed long-term financing and government support. His book inspired Prof. H. S. Foxwell in England to draw on his arguments in two remarkable essays published in the Economic Journal in September and December 1917: “The Nature of the Industrial Struggle,” and “The Financing of Industry and Trade.” He endorsed Naumann’s contention that “the old individualistic capitalism, of what he calls the English type, is giving way to the new, more impersonal, group form; to the disciplined scientific capitalism he claims as German.”

This was necessarily a group undertaking, with the emerging tripartite integration of industry, banking and government, with finance being “undoubtedly the main cause of the success of modern German enterprise,” Foxwell concluded (p. 514). German bank staffs included industrial experts who were forging industrial policy into a science. And in America, Thorstein Veblen’s The Engineers and the Price System (1921) voiced the new industrial philosophy calling for bankers and government planners to become engineers in shaping credit markets.

Foxwell warned that British steel, automotive, capital equipment and other heavy industry was becoming obsolete largely because its bankers failed to perceive the need to promote equity investment and extend long-term credit. They based their loan decisions not on the new production and revenue their lending might create, but simply on what collateral they could liquidate in the event of default: inventories of unsold goods, real estate, and money due on bills for goods sold and awaiting payment from customers. And rather than investing in the shares of the companies that their loans supposedly were building up, they paid out most of their earnings as dividends – and urged companies to do the same. This short time horizon forced business to remain liquid rather than having leeway to pursue long-term strategy.

German banks, by contrast, paid out dividends (and expected such dividends from their clients) at only half the rate of British banks, choosing to retain earnings as capital reserves and invest them largely in the stocks of their industrial clients. Viewing these companies as allies rather than merely as customers from whom to make as large a profit as quickly as possible, German bank officials sat on their boards, and helped expand their business by extending loans to foreign governments on condition that their clients be named the chief suppliers in major public investments. Germany viewed the laws of history as favoring national planning to organize the financing of heavy industry, and gave its bankers a voice in formulating international diplomacy, making them “the principal instrument in the extension of her foreign trade and political power.”

A similar contrast existed in the stock market. British brokers were no more up to the task of financing manufacturing in its early stages than were its banks. The nation had taken an early lead by forming Crown corporations such as the East India Company, the Bank of England and even the South Sea Company. Despite the collapse of the South Sea Bubble in 1720, the run-up of share prices from 1715 to 1720 in these joint-stock monopolies established London’s stock market as a popular investment vehicle, for Dutch and other foreigners as well as for British investors. But the market was dominated by railroads, canals and large public utilities. Industrial firms were not major issuers of stock.

In any case, after earning their commissions on one issue, British stockbrokers were notorious for moving on to the next without much concern for what happened to the investors who had bought the earlier securities. “As soon as he has contrived to get his issue quoted at a premium and his underwriters have unloaded at a profit,” complained Foxwell, “his enterprise ceases. ‘To him,’ as the Times says, ‘a successful flotation is of more importance than a sound venture.’”

Much the same was true in the United States. Its merchant heroes were individualistic traders and political insiders often operating on the edge of the law to gain their fortunes by stock-market manipulation, railroad politicking for land giveaways, and insurance companies, mining and natural resource extraction. America’s wealth-seeking spirit found its epitome in Thomas Edison’s hit-or-miss method of invention, coupled with a high degree of litigiousness to obtain patent and monopoly rights.

In sum, neither British nor American banking or stock markets planned for the future. Their time frame was short, and they preferred rent-extracting projects to industrial innovation. Most banks favored large real estate borrowers, railroads and public utilities whose income streams easily could be forecast. Only after manufacturing companies grew fairly large did they obtain significant bank and stock market credit.

What is remarkable is that this is the tradition of banking and high finance that has emerged victorious throughout the world. The explanation is primarily the military victory of the United States, Britain and their Allies in the Great War and a generation later, in World War II.

The regression toward burdensome unproductive debts after World War I

The development of industrial credit led economists to distinguish between productive and unproductive lending. A productive loan provides borrowers with resources to trade or invest at a profit sufficient to pay back the loan and its interest charge. An unproductive loan must be paid out of income earned elsewhere. Governments must pay war loans out of tax revenues. Consumers must pay loans out of income they earn at a job – or by selling assets. These debt payments divert revenue away from being spent on consumption and investment, so the economy shrinks. This traditionally has led to crises that wipe out debts, above all those that are unproductive.

In the aftermath of World War I the economies of Europe’s victorious and defeated nations alike were dominated by postwar arms and reparations debts. These inter-governmental debts were to pay for weapons (by the Allies when the United States unexpectedly demanded that they pay for the arms they had bought before America’s entry into the war), and for the destruction of property (by the Central Powers), not new means of production. Yet to the extent that they were inter-governmental, these debts were more intractable than debts to private bankers and bondholders. Despite the fact that governments in principle are sovereign and hence can annul debts owed to private creditors, the defeated Central Power governments were in no position to do this.

And among the Allies, Britain led the capitulation to U.S. arms billing, captive to the creditor ideology that “a debt is a debt” and must be paid regardless of what this entails in practice or even whether the debt in fact can be paid. Confronted with America’s demand for payment, the Allies turned to Germany to make them whole. After taking its liquid assets and major natural resources, they insisted that it squeeze out payments by taxing its economy. No attempt was made to calculate just how Germany was to do this – or most important, how it was to convert this domestic revenue (the "budgetary problem") into hard currency or gold. Despite the fact that banking had focused on international credit and currency transfers since the 12th century, there was a broad denial of what John Maynard Keynes identified as a foreign exchange transfer problem.

Never before had there been an obligation of such enormous magnitude. Nevertheless, all of Germany's political parties and government agencies sought to devise ways to tax the economy to raise the sums being demanded. Taxes, however, are levied in a nation's own currency. The only way to pay the Allies was for the Reichsbank to take this fiscal revenue and throw it onto the foreign exchange markets to obtain the sterling and other hard currency to pay. Britain, France and the other recipients then paid this money on their Inter-Ally debts to the United States.

Adam Smith pointed out that no government ever had paid down its public debt. But creditors always have been reluctant to acknowledge that debtors are unable to pay. Ever since David Ricardo's lobbying for their perspective in Britain's Bullion debates, creditors have found it their self-interest to promote a doctrinaire blind spot, insisting that debts of any magnitude could be paid. They resist acknowledging a distinction between raising funds domestically (by running a budget surplus) and obtaining the foreign exchange to pay foreign-currency debt. Furthermore, despite the evident fact that austerity cutbacks on consumption and investment can only be extractive, creditor-oriented economists refused to recognize that debts cannot be paid by shrinking the economy.5 Or that foreign debts and other international payments cannot be paid in domestic currency without lowering the exchange rate.

The more domestic currency Germany sought to convert, the further its exchange rate was driven down against the dollar and other gold-based currencies. This obliged Germans to pay much more for imports. The collapse of the exchange rate was the source of hyperinflation, not an increase in domestic money creation as today's creditor-sponsored monetarist economists insist. In vain Keynes pointed to the specific structure of Germany's balance of payments and asked creditors to specify just how many German exports they were willing to take, and to explain how domestic currency could be converted into foreign exchange without collapsing the exchange rate and causing price inflation.

Tragically, Ricardian tunnel vision won Allied government backing. Bertil Ohlin and Jacques Rueff claimed that economies receiving German payments would recycle their inflows to Germany and other debt-paying countries by buying their imports. If income adjustments did not keep exchange rates and prices stable, then Germany's falling exchange rate would make its exports sufficiently more attractive to enable it to earn the revenue to pay.

This is the logic that the International Monetary Fund followed half a century later in insisting that Third World countries remit foreign earnings and even permit flight capital as well as pay their foreign debts. It is the neoliberal stance now demanding austerity for Greece, Ireland, Italy and other Eurozone economies.

Bank lobbyists claim that the European Central Bank will risk spurring domestic wage and price inflation of it does what central banks were founded to do: finance budget deficits. Europe's financial institutions are given a monopoly right to perform this electronic task – and to receive interest for what a real central bank could create on its own computer keyboard.

But why it is less inflationary for commercial banks to finance budget deficits than for central banks to do this? The bank lending that has inflated a global financial bubble since the 1980s has left as its legacy a debt overhead that can no more be supported today than Germany was able to carry its reparations debt in the 1920s. Would government credit have so recklessly inflated asset prices?

How debt creation has fueled asset-price inflation since the 1980s

Banking in recent decades has not followed the productive lines that early economic futurists expected. As noted above, instead of financing tangible investment to expand production and innovation, most loans are made against collateral, with interest to be paid out of what borrowers can make elsewhere. Despite being unproductive in the classical sense, it was remunerative for debtors from 1980 until 2008 – not by investing the loan proceeds to expand economic activity, but by riding the wave of asset-price inflation. Mortgage credit enabled borrowers to bid up property prices, drawing speculators and new customers into the market in the expectation that prices would continue to rise. But hothouse credit infusions meant additional debt service, which ended up shrinking the market for goods and services.

Under normal conditions the effect would have been for rents to decline, with property prices following suit, leading to mortgage defaults. But banks postponed the collapse into negative equity by lowering their lending standards, providing enough new credit to keep on inflating prices. This averted a collapse of their speculative mortgage and stock market lending. It was inflationary – but it was inflating asset prices, not commodity prices or wages. Two decades of asset price inflation enabled speculators, homeowners and commercial investors to borrow the interest falling due and still make a capital gain.

This hope for a price gain made winning bidders willing to pay lenders all the current income – making banks the ultimate and major rentier income recipients. The process of inflating asset prices by easing credit terms and lowering the interest rate was self-feeding. But it also was self-terminating, because raising the multiple by which a given real estate rent or business income can be "capitalized" into bank loans increased the economy's debt overhead.

Securities markets became part of this problem. Rising stock and bond prices made pension funds pay more to purchase a retirement income – so "pension fund capitalism" was coming undone. So was the industrial economy itself. Instead of raising new equity financing for companies, the stock market became a vehicle for corporate buyouts. Raiders borrowed to buy out stockholders, loading down companies with debt. The most successful looters left them bankrupt shells. And when creditors turned their economic gains from this process into political power to shift the tax burden onto wage earners and industry, this raised the cost of living and doing business – by more than technology was able to lower prices.

The EU rejects central bank money creation, leaving deficit financing to the banks

Article 123 of the Lisbon Treaty forbids the ECB or other central banks to lend to government. But central banks were created specifically – to finance government deficits. The EU has rolled back history to the way things were three hundred years ago, before the Bank of England was created. Reserving the task of credit creation for commercial banks, it leaves governments without a central bank to finance the public spending needed to avert depression and widespread financial collapse.

So the plan has backfired. When “hard money” policy makers limited central bank power, they assumed that public debts would be risk-free. Obliging budget deficits to be financed by private creditors seemed to offer a bonanza: being able to collect interest for creating electronic credit that governments can create themselves. But now, European governments need credit to balance their budget or face default. So banks now want a central bank to create the money to bail them out for the bad loans they have made.

For starters, the ECB’s €489 billion in three-year loans at 1% interest gives banks a free lunch arbitrage opportunity (the “carry trade”) to buy Greek and Spanish bonds yielding a higher rate. The policy of buying government bonds in the open market – after banks first have bought them at a lower issue price – gives the banks a quick and easy trading gain.

How are these giveaways less inflationary than for central banks to directly finance budget deficits and roll over government debts? Is the aim of giving banks easy gains simply to provide them with resources to resume the Bubble Economy lending that led to today’s debt overhead in the first place?

Conclusion

Governments can create new credit electronically on their own computer keyboards as easily as commercial banks can. And unlike banks, their spending is expected to serve a broad social purpose, to be determined democratically. When commercial banks gain policy control over governments and central banks, they tend to support their own remunerative policy of creating asset-inflationary credit – leaving the clean-up costs to be solved by a post-bubble austerity. This makes the debt overhead even harder to pay – indeed, impossible.

So we are brought back to the policy issue of how public money creation to finance budget deficits differs from issuing government bonds for banks to buy. Is not the latter option a convoluted way to finance such deficits – at a needless interest charge? When governments monetize their budget deficits, they do not have to pay bondholders.

I have heard bankers argue that governments need an honest broker to decide whether a loan or public spending policy is responsible. To date their advice has not promoted productive credit. Yet they now are attempting to compensate for the financial crisis by telling debtor governments to sell off property in their public domain. This “solution” relies on the myth that privatization is more efficient and will lower the cost of basic infrastructure services. Yet it involves paying interest to the buyers of rent-extraction rights, higher executive salaries, stock options and other financial fees.

Most cost savings are achieved by shifting to non-unionized labor, and typically end up being paid to the privatizers, their bankers and bondholders, not passed on to the public. And bankers back price deregulation, enabling privatizers to raise access charges. This makes the economy higher cost and hence less competitive – just the opposite of what is promised.

Banking has moved so far away from funding industrial growth and economic development that it now benefits primarily at the economy’s expense in a predator and extractive way, not by making productive loans. This is now the great problem confronting our time. Banks now lend mainly to other financial institutions, hedge funds, corporate raiders, insurance companies and real estate, and engage in their own speculation in foreign currency, interest-rate arbitrage, and computer-driven trading programs. Industrial firms bypass the banking system by financing new capital investment out of their own retained earnings, and meet their liquidity needs by issuing their own commercial paper directly. Yet to keep the bank casino winning, global bankers now want governments not only to bail them out but to enable them to renew their failed business plan – and to keep the present debts in place so that creditors will not have to take a loss.

This wish means that society should lose, and even suffer depression. We are dealing here not only with greed, but with outright antisocial behavior and hostility.

Europe thus has reached a critical point in having to decide whose interest to put first: that of banks, or the "real" economy. History provides a wealth of examples illustrating the dangers of capitulating to bankers, and also for how to restructure banking along more productive lines. The underlying questions are clear enough:

* Have banks outlived their historical role, or can they be restructured to finance productive capital investment rather than simply inflate asset prices?

* Would a public option provide less costly and better directed credit?

* Why not promote economic recovery by writing down debts to reflect the ability to pay, rather than relinquishing more wealth to an increasingly aggressive creditor class?

Solving the Eurozone's financial problem can be made much easier by the tax reforms that classical economists advocated to complement their financial reforms. To free consumers and employers from taxation, they proposed to levy the burden on the "unearned increment" of land and natural resource rent, monopoly rent and financial privilege. The guiding principle was that property rights in the earth, monopolies and other ownership privileges have no direct cost of production, and hence can be taxed without reducing their supply or raising their price, which is set in the market. Removing the tax deductibility for interest is the other key reform that is needed.

A rent tax holds down housing prices and those of basic infrastructure services, whose untaxed revenue tends to be capitalized into bank loans and paid out in the form of interest charges. Additionally, land and natural resource rents – along with interest – are the easiest to tax, because they are highly visible and their value is easy to assess.

Pressure to narrow existing budget deficits offers a timely opportunity to rationalize the tax systems of Greece and other PIIGS countries in which the wealthy avoid paying their fair share of taxes. The political problem blocking this classical fiscal policy is that it "interferes" with the rent-extracting free lunches that banks seek to lend against. So they act as lobbyists for untaxing real estate and monopolies (and themselves as well). Despite the financial sector's desire to see governments remain sufficiently solvent to pay bondholders, it has subsidized an enormous public relations apparatus and academic junk economics to oppose the tax policies that can close the fiscal gap in the fairest way.

It is too early to forecast whether banks or governments will emerge victorious from today's crisis. As economies polarize between debtors and creditors, planning is shifting out of public hands into those of bankers. The easiest way for them to keep this power is to block a true central bank or strong public sector from interfering with their monopoly of credit creation. The counter is for central banks and governments to act as they were intended to, by providing a public option for credit creation.

Notes

2 Joseph E. Stiglitz, “Obama’s Ersatz Capitalism,” The New York Times, April 1, 2009 http://www.nytimes.com/2009/04/01/opinion/01stiglitz.html.

3 http://neweconomicperspectives.blogspot.com , and The Best Way to Rob a Bank is to Own One (2005).

4 George W. Edwards, The Evolution of Finance Capitalism (New York: 1938):68.

5 review the literature from the 1920s, its Ricardian pedigree and subsequent revival by the IMF and other creditor institutions in Trade, Development and Foreign Debt: A History of Theories of Polarization v. Convergence in the World Economy (1992; new ed. ISLET 2010). I provide the political background in Super Imperialism: The Economic Strategy of American Empire (New York: Holt, Rinehart and Winston, 1972; 2nd ed., London: Pluto Press, 2002),