

There is an Alternative to Neoliberal Monetary Austerity

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2,181 Italians pack a Sports Arena to learn Modern Monetary Theory:

The Economy doesn't Need to suffer Neoliberal Austerity

Michael Hudson

I have just returned from Rimini, Italy, where I experienced one of the most amazing spectacles of my academic life. Four of us associated with the University of Missouri at Kansas City (UMKC) were invited to lecture for three days on Modern Monetary Theory (MMT) and explain why Europe is in such monetary trouble today – and to show that there is an alternative, that the enforced austerity for the 99% and vast wealth grab by the 1% is not a force of nature.

Stephanie Kelton (incoming UMKC Economics Dept. chair and editor of its economic blog, [New Economic Perspectives](#)), criminologist and law professor Bill Black, investment banker Marshall Auerback and me (along with a French economist, Alain Parguez) stepped into the basketball auditorium on Friday night. We walked down, and down, and further down the central aisle, past a packed audience reported at over 2,100. It was like entering the Oscars as People called out our first names. Some told us they had read all of our economics blogs. Stephanie joked that now she understood how the Beatles felt. There was prolonged applause – all for an intellectual rather than a physical sporting event.

With one difference, of course: Our adversaries were not there. There was much press, but the prevailing Euro-technocrats (the bank lobbyists who determine European economic policy) hoped that the less discussion of possible alternatives to austerity, the easier it would be to force their brutal financial grab through.

All the audience members had contributed to raise the funds to fly us over from the United States (and from France for Professor Alain Parguez), and treat us to Federico Fellini's Grand Hotel on the Rimini beach. The conference was organized by reporter Paolo Barnard, who had studied MMT with Randall Wray and realized that there was plenty of demand in Italian mass culture for a discussion of what actually was determining the living conditions of Europe. His aim was to show that the emerging financial elite hopes to use this crisis as their opportunity to carve out personal fiefdoms by privatizing the public domain of the governments they have seduced, bribed or coerced into unnecessary debt. Instead of using a central bank to finance their deficits, governments are told to dump these assets under distress conditions at fire sale prices. So governments end up beholden to bondholders and Eurocrats drawn from neoliberal ranks.

Paolo and his enormous support staff of translators and interns provided us an opportunity to give an approach to monetary and tax theory and policy that until recently was almost unheard of in the United States. Just one week earlier the [Washington Post published a review of MMT](#) (followed by a [long discussion in the Financial Times](#)). But the theory remains grounded primarily at the UMKC's economics department and the Levy Institute at Bard College, with which most of us are associated.

The basic thrust of our argument is that just as commercial banks now create credit electronically on their computer keyboards (creating a bank account credit for borrowers in exchange for their signing an IOU at interest), so governments can create their own money. They can reclaim this proper function without incurring needless interest-bearing debt to private bondholders or from banks that create credit by electronic fiat. Government computer keyboards can provide nearly free credit creation to finance spending.

Once the money is created by government, the crucial difference is that governments spend it (at least in principle) to promote long-term growth and employment, invest in public infrastructure, research and development, provide health care and other basic economic functions. Banks have a more short-term time frame and narrowly self-interested motivation. Some 80% of their loans are mortgages against real estate. Banks lend against collateral in place, and the economy's largest assets are land and buildings. Although banks loans also are used to finance leveraged buyouts and corporate takeovers, most new fixed capital investment by corporations is financed out of retained earnings, not bank credit.

And contrary to popular belief, the stock market has ceased to be a source of such financing. Textbook diagrams still depict it as raising money for new capital investment. Unfortunately, it has been turned into a vehicle to buy out companies on credit (e.g., with high interest junk bonds), replacing equity with debt ("taking a company private" from its stockholders). Inasmuch as interest payments are tax-deductible – on the pretense that they are a necessary cost of doing business – corporate income-tax payments are lowered. And what the tax collector relinquishes is available to be paid out to the bankers and bondholders who get rich by loading the economy down with debt.

The upshot is that the flow of corporate earnings is not used for productive investment, but is diverted to the financial sector – not only to pay interest and penalties to banks, but for stock buybacks intended to support stock prices and hence the value of stock options that managers of today's financialized companies give themselves.

Welcome to the post-industrial economy, financial style. Industrial capitalism has passed through a series of stages of finance capitalism, from Pension-Fund capitalism via Globalized Dollarization and the Bubble Economy to the Negative Equity stage, foreclosure time, debt deflation, and austerity – and now what looks like debt peonage in Europe, above all for the PIIGS: Portugal, Ireland, Italy, Greece and Spain. (The Baltic countries of Latvia, Estonia and Lithuania have been plunged so deeply into debt that their populations are emigrating to find work and flee debt-burdened real estate. The same has plagued Iceland since its bank rip-offs collapsed in 2008.)

Why aren't economists describing these phenomena? The answer is a combination of political ideology and analytic blinders. As soon as the Rimini conference ended on Sunday evening, for instance, Paul Krugman's Monday, February 27 New York Times column, "What Ails Europe?" blamed the euro's problems simply on the inability of countries to devalue

their currencies. He rightly criticized the Republican Party line that blames social welfare spending for the Eurozone's problems, and also criticized putting the blame on budget deficits.

<http://www.nytimes.com/2012/02/27/opinion/krugman-what-ails-europe.html?hp>

But he left out of account the straitjacket of the European Central Bank (ECB) inability to monetize the deficits by issuing currency or more typically, simply writing checks on the central bank's own account. This prohibition is a result of the junk economic theology written into the EU constitution. Krugman's rejection of MMT leads him to ignore this option:

"If the peripheral nations still had their own currencies, they could and would use devaluation to quickly restore competitiveness. But they don't, which means that they are in for a long period of mass unemployment and slow, grinding deflation. Their debt crises are mainly a byproduct of this sad prospect, because depressed economies lead to budget deficits and deflation magnifies the burden of debt."

There are two problems with this neoclassical trade analysis. First, currency depreciation lowers the price of labor, while raising the price of imports. The burden of debts denominated in foreign currencies increases in keeping with the devaluation. This creates problems unless governments pass a law re-denominating all debts in their own domestic currency. This will satisfy the Prime Directive of international financing: always denominate debts in your own currency, as the United States does.

Fortunately, sovereign nations can do this ex post facto. In 1933, for instance, Franklin Roosevelt nullified the Gold Clause in U.S. loan contracts, enabling banks and other creditors to be paid in the equivalent gold value. But any sovereign government can rule how debts are to be paid (or not paid, for that matter). In his usual neoclassical fashion, Mr. Krugman ignores this debt issue:

"The afflicted nations [the PIIGs], in particular, have nothing but bad choices: either they suffer the pains of deflation or they take the drastic step of leaving the euro, which won't be politically feasible until or unless all else fails (a point Greece seems to be approaching). Germany could help by reversing its own austerity policies and accepting higher inflation, but it won't."

So the existing system could work, he contends, if only Germany would inflate its economy and more German tourists spend more in Greece – assuming that the Greek government would tax enough of this spending to balance its budget. If Germany does not bail out the failed and dysfunctional economic structure, Greece will have to withdraw – but devaluation will restore equilibrium.

This is typical neoclassical over-simplification. Leaving the euro is not sufficient to avert austerity, foreclosure and debt deflation if Greece and other countries that withdraw retain the neoliberal anti-government, post-industrial policy that plagues the Eurozone. If the post-euro economy has a central bank that still refuses to finance public budget deficits, forcing the government to borrow from commercial banks and bondholders. What if the government still believes that it should balance the budget rather than provide the economy with spending power to increase its growth? In this case the post-euro government will tie itself in the same policy straitjacket that the Eurozone now imposes.

Suppose further that the Greek government slashes public welfare spending, and bails out banks for their losses, or takes losing bank gambles onto the public balance sheet, as Ireland has done. For that matter, what if the governments do what the neoliberal Obama Administration in the United States has done, and refrain from writing down real estate mortgages and other debts to the debtors' ability to pay, as Iceland and Latvia have failed to do? The result will be debt deflation, forfeiture of property, rising unemployment – and a rising tide of emigration as the domestic economy and employment opportunities shrink. The budget deficit and balance-of-payments deficit both will worsen, not improve.

Mr. Krugman's second error of omission is his assumption that government budgets need to be balanced. He misses the MMT point that governments can finance deficits rather than relying on bondholders. The monetary effect is identical: credit-financed spending. The difference – and it is essential – is that the government is not constrained by having to tax the economy to finance its operations, and it does not go further in debt to banks and bondholders. But despite his counter-cyclical Keynesianism, Mr. Krugman shares in principle the neoliberal mythology that demonizes the public option for credit creation, while approving private sector debt financing (even in foreign currencies!). The upshot is to make economies behave as if they still were on the gold standard, needing to borrow savings (in "hard" assets), when in fact the banks have simply sold the illusion that their electronic balance-sheet entries are "as good as gold." That world ended in 1971 when the United States went off gold. Since then, all currencies are state currencies – often backed by U.S. Treasury IOUs rather than their own money, to be sure.

So what then is the key? It is to have a central bank that does what central banks were founded to do: monetize government budget deficits so as to spend money into the economy, in a way best intended to promote economic growth and full employment.

This is the MMT message that the five of us were invited to explain to the audience in Rimini. Some attendees came up and explained that they had come all the way from Spain, others from France and cities across Italy. And although we gave many press, radio and TV interviews, we were told that the major media were directed to ignore us as not politically correct.

Such is the censorial spirit of neoliberal monetary austerity. Its motto is TINA: There Is No Alternative, and it wants to keep matters this way. As long as it can suppress discussion of how many better alternatives there are, the hope is that the public will remain quiescent as their living standards shrink and wealth is sucked up to the top of the economic pyramid to the 1%.

The audience was vocally against remaining in the eurozone – to the extent that continued adherence to it meant submission to neoliberal pro-financial policies. (The proceedings were videotaped and will be transcribed and placed on the web. Pacifica KPFA broadcaster Bonnie Faulkner attended and is compiling a series of programs and will re-interview the speakers for her "Guns and Butter" program.) They had no naivety that withdrawal by itself would cure the problems that they originally hoped EU membership would solve: Italian political corruption, tax evasion by the rich, insider dealings, and most of all, the power of banks to siphon off the surplus and control the government, the mass media and even the universities in an attempt to brainwash the population to believe that financial control of resource allocation, tax policy and wealth distribution was all for the best to make the economy more efficient.

The audience requested above all more monetary and fiscal theory from Stephanie Kelton, who gave the clearest lecture on economics I have ever heard – a Euclidean presentation of MMT logic.

The size of the audience filling the sports stadium to hear our economic explanation of how a real central bank should operate to avoid austerity and promote rather than discourage employment showed that the government's attempt to brainwash the population was not working. (For a visual of the magnitude, see <http://www.youtube.com/watch?v=XP60tpwu5cs> .)

The attempt to force TINA logic on the population is not working any better than it did in Harvard's Economics 101 class, from which students recently walked out in protest against the unrealistic parallel universe thinking. Its appeal is mainly to intelligent but ungrounded individuals (not yet post-autistic). They are selected as useful idiots and trained to draw pictures of the economy that exclude analysis of the debt overhead, rentier free lunches and financial parasitism. One needs to be very clever, after all, to imagine a system that "saves the appearances" of an unrealistic Ptolemaic system. Any positive role for government and a real central bank not oppressed under the thumb of private-sector bankers and financial engineers seeking to suck the economic surplus out of nations much as military conquerors did in past centuries.

There is a growing sense that Western civilization itself is at a critical juncture. It must choose between needless austerity and progress – but progress is blocked by the reluctance to write down the debt overhead. So as Prof. Kelton noted, economies face two different types of growth policy. Neoliberal policy promises to help the body politic grow by draining the blood from the body, ostensibly to help it grow more healthy and restore its balance (with all power to the wealthy 1%). The MMT policy is feed the body to help it grow healthy. This requires liberating the brain – the government and policy makers that implement an economic philosophy – from the financial sector's control.

Epilogue

Now that summary videos have begun to be placed on the web, a Norwegian economist wrote to me

I do not understand what is new about this:

governments can create money ... to promote long-term growth ...

What IS new is that somebody finally listens.

There seems to be a hunger out there for somebody (with the "right background") to tell people plain simple common sense.

What MMT teaches today is indeed long-established knowledge and practice. The degree to which its logic and message have been excluded from the academic curriculum is testament to the neoliberal version of free markets: their policy only appears to work if they can exclude discussion of any alternatives – and indeed, exclude economic history itself.

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