Real World Economics Blog

Letter from 100 Italian Economists

June 18, 2010 Editor Leave a comment Go to comments

A RESTRICTIVE POLICY WORSENS THE CRISIS,
ADDS FUEL TO SPECULATION AND CAN BRING TO THE
DISINTEGRATION OF THE EURO ZONE. THE DIRECTION OF
ECONOMIC POLICY NEEDS TO BE CHANGED TO PREVENT
ANOTHER BREAKDOWN OF INCOMES AND EMPLOYMENT

To the Members of Italian Government and Parliament
To the Italian representatives in the European Union Institutions
To the representatives of the political parties and the trade unions
To the Italian representatives in the European Union Institutions and the ESCB
To the President of the Republic
The extremely serious global economic crisis, and the related crisis in the euro zone, **will not be solved either by** wages, pensions, social services, education, research, culture and essential public services, or by directly or indirectly increasing taxes on employment and on the weaker social classes.In fact, there is the **grave danger that the introduction in Italy and Europe of so-called "austerity" measures will further accentuate the features of the crisis,** making insolvency, business failure and unemployment grow faster, and in all likelihood forcing some member states at some point to **withdraw from European monetary union.**

The fundamental point that must be understood is that the current instability of the monetary Union is not merely the result of slick accounting or easy spending. It is actually the outcome of a far deeper interweaving between the global financial crisis and a series of imbalances in the euro zone, deriving mainly from the unsustainable **economic liberalist nature of the Treaty of Union** and from the **restrictive economic policy of the member states which systematically show a surplus in their balance of payments.**

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The world crisis that exploded in 2007-2008 is still underway. Since no intervention was made on its structural causes, we have never actually emerged from it. As has been acknowledged from many quarters, one of the main explanations for this crisis is the **The world crisis that exploded in 2007-2008 is still underway. Since no intervention was made on its structural causes, we have never actually emerged from it. As has been acknowledged from many quarters, one of the main explanations for this crisis is the** For many years this gap was compensated by an exceptional escalation in financial speculation and in **private debt,** which, starting from the United States, acted as a stimulus for global demand.

Today there are some who are counting on a return to world growth based on a new financial boom in the United States. By unloading a huge quantity of unrecoverable private debts on the state balance sheets, it is hoped to give a new boost to finance and to the related mechanism of accumulation. We believe that **a credible world recovery on this basis is highly unlikely.** In any case, it would be tenuous and short-lived. At the same time we find it **illusory** to hope that without a profound reform of the international monetary system China would be willing to give up its commercial profits and act as the driving force for world demand.

In short, we are facing the dramatic situation of a **world economic system that lacks a primary source of demand** that, is, a "sponge" that can absorb the production.

The unsolved global crisis has been particularly felt in the European monetary Union. The evident vulnerability of the euro zone derives from profound internal structural imbalances, whose main cause lies in the economic liberalist design of the Maastricht Treaty, in the expectation that the various areas of the Union can be rebalanced purely through market mechanisms, and in the restrictive deflationary economic policy of countries with a systematic balance of payments surplus. Particularly important among these is **Germany,** which for some time has been oriented towards keeping wages down compared to productivity, demand and imports, and towards the penetration of foreign markets in order to increase German firms' share of the European market. With such policies **the 'surplus' countries do not contribute to the development of the euro area but paradoxically are pulled ahead by the weaker countries.** More specifically, Germany accumulates a considerable surplus in its balance of trade, while Greece, Portugal, Spain and even France tend to get into debt. Even Italy, despite the very low growth of its national income, finds itself buying more from Germany than it sells, thus accumulating growing debts.

The **complete mobility of capital** in the euro zone has hugely favoured the creation of credit-debit imbalances between countries. For a long time, relying on the idea of the efficiency of the market, it was believed that rising debt ratios between member states should be considered the postive sign of greater financial integration in the euro zone. But today it is quite clear that the **supposed efficiency of the financial markets finds no confirmation in practice** and the imbalances accumulated prove to be unsustainable.

It is for these reasons that **operators on the financial markets are betting on the disintegration of the euro zone.** They foresee that owing to the continuation of the crisis the revenue of the member states will decline and the earnings of a great many businesses and banks will be further reduced. In this way it will be increasingly difficult to guarantee the repayment of debts, both public and private. Various countries could therefore be **progressively pushed out** of the euro zone, or they themselves might **decide to leave** in order to escape from the deflationary spiral. The risk of generalised insolvency and of debts being reconverted into the national currency is therefore the real issue motivating the speculators. So the turbulence of the financial markets rests on a series of **real contradictions.** However, it is equally true that the speculators' expectations **add fuel to the lack of confidence** and therefore tend to be fulfilled. In fact, bearish operations on the markets push up the difference between interest rates and income growth rates, and can mean that debtors who were previously able to repay their debts are suddenly made insolvent. Financial operators, who **often act in conditions that are non-competitive and anything but symmetrical in terms of information and market power,** are therefore able not only to foresee the future but also to help determine it, following a pattern that has nothing to do with the so-called "fundamentals" of orthodox economic theory and the presumed criteria of efficiency described in its basic versions.

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In such a scenario we think it is **pointless trying to oppose speculation with mere loan agreements in exchange for support for restrictive policies** on the part of the indebted countries. The loans will in fact simply postpone the problems without solving them. And policies of "austerity" lower the demand even more, bringing wages down and therefore further lessening the ability to repay loans on the part of debtors, both public and private. Though significant, the change in monetary policy by the ECB, which says it is ready to buy government bonds on the secondary market, is given a new perspective by the announcement that the central bank wants to "sterilise" these operations with manoeuvres on currencies or within the banking system which would have the opposite effect.

The errors committed are undoubtedly due to the **recessive remedies of economic liberalism suggested by economists tied to the schemes of analysis in vogue in past years,** but that do not seem capable in the slightest of grasping the salient aspects of the workings of the economic system.

It is quite clear that the stubbornness with which such depressive policies are pursued is not simply the result of misunderstandings generated by economic models whose logical coherence and empirical relevance has now been strongly challenged within the academic community itself.

The fondness for so-called "austerity" is actually the expression of **consolidated social interests.** There are in fact some people who see the current crisis as a chance to accelerate the processes of dismantling social services, fragmenting employment and restructuring and centralising European capital. The underlying idea is that the capital that emerges **victorious** from the crisis will be able to trigger rapid accumulation, moreover exploiting the **lower competitivity on the markets** and a further **weakening of employment.**

It must however be understood that if such interests are backed up, not only is one acting against the workers's interests, but the conditions are also being created for an uncontrolled centralisation of capital, the **productive desertification of Southern Italy and of whole macroregions in Europe, migratory processes that are increasingly hard to control, and ultimately for gigantic debt-driven deflation, comparable only to that of the Thirties.**

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The Italian government has so far put in place a policy designed to foster this dangerous deflationary spiral. And the further budget belt-tightening announced, together with the persistent tendency to reduce the defence of employment, can only cause **further cuts to income, after the plunge already recorded in Italy in 2009.** Keep it clearly in mind that the scientific assumptions underlying the belief that such policies can improve the economic situation and the balance sheet and therefore safeguard the country from an attack of speculation are highly questionable. Instead, **in taking this road there is the risk of aggravating the crisis, multiplying insolvencies and therefore speculation.**

Nor can the opposition forces be said to have so far put forward a **clear programme of alternative economic policy.** Greater awareness is spreading about the seriousness of the crisis and the mistakes of the past, but voices have been raised from some sectors of the opposition suggesting contradictory or second-rate stances, like the proposals designed to introduce further short-term work contracts or to carry out the massive privatization of public services. Even the frequent **calls for so-called "structural reforms" are counterproductive,** when instead of being characterised by measures designed to oppose waste and the privilege of the few, they are translated into further proposals for the downsizing of social and employment rights.

As a warning for the future, it is best to remember that in 1992 Italy was subjected to a speculative attack similar to those currently underway in Europe. At the time, the Italian workers accepted an irksome programme of "austerity", based above all on the compression of the cost of labour and social security spending. At the time, like today, it was said that the sacrifices were necessary to defend the lira and the national economy from speculation. However, shortly after the programme was passed, shares in the national currency suffered fresh attacks. **In the end Italy left the European Monetary System anyway,** and the lira was sharply devalued. Workers and much of the community therefore paid twice: because of the policy of "austerity" and because of the increase in the cost of imported goods.

It should also be remembered that, with the prevailing justification of lowering public debt in relation to GDP, in past years our country has carried out a **massive programme of privatisations.** Now, the programme's effects on public debt, which were slight anyway, have largely vanished in the wake of the crisis, and the implications in terms of the country's positioning in the international division of employment, economic growth and social well-being are today considered **highly questionable** by the most reputable scientific literature.

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We therefore believe that the approach adopted up to now needs to be abandoned **before it is too late.**

It must be taken into account that for a long time it is likely that **there will not be a driving force** that can ensure a strong stable recovery for business and for world development. To prevent the crisis from getting worse and to avoid the collapse of the project of a unified Europe, what is needed therefore is a new vision and a change in the general directions of economic policy. In other words, **Europe must take an independent path to develop** its forces of production, increase its well-being, safeguard the environment and the region, and guarantee social equity.

First of all, for a debate of such importance to mature in the various countries involved and in the political institutions, **space must be given to the democratic process.** In other words, there must be **time available.** That is why as a preliminary step, we propose the **immediate introduction of a check on speculation.** To this end, initiatives at a national but also at a coordinated European level are underway, but the measures being introduced still seem weak and **inadequate.** Putting an end to speculation is undoubtedly possible, but uncertainty and political ambiguity need to be got rid of. The ECB must therefore commit itself fully to buying the stocks under attack, and stop "sterilising" its interventions. Adequate taxes need to be imposed designed to discourage short term financial transactions, along with effective administrative controls on the movement of capital. If the conditions for taking concerted action were not found, it would be far **better to intervene at once on a national level,** with the methods available, than to delay acting or to do nothing at all. It is only through such initiatives that decisions can be taken **in the time required by democratic institutions,** without the latter being subjected to the constant threat of a speculative attack.

The experience of the past teaches us that to effectively counteract deflation a **wage floor** needs to be imposed, through minimum wages, constraints on firing and new general rules to protect employment and unionising processes. Above all at the present stage, the idea of entrusting the process of destruction and creation of jobs to market forces alone is analytically senseless, as well as politically irresponsible.

In coordination with monetary policy, we need to encourage the countries with a balance of payments surplus, especially Germany, to take appropriate measures to **expand the demand** so as to trigger a process of virtuous rebalancing of European Monentary Union member states' balance of payments. **The leading 'surplus' countries have a great responsibility,** on this point. The rescue or the destruction of the Union will depend largely on their decisions.

We need **a system of progressive taxation** coordinated at a European level, which can help to reverse the trend towards income disparity that contributed to the outbreak of the crisis. We need a shift of the fiscal load from employment to capital profits and to rents, from incomes to wealth, from PAYE taxpayers to tax evaders, from the poor areas of the Union to the rich ones.

There should be a significant expansion of the Union's federal budget and the possibility of issuing European bonds. There should be the attempt to coordinate fiscal policy and European monetary policy for the purpose of drawing up a **development plan** designed to achieve full employment and the regional rebalancing not only of buying power but also of the productive capacities in Europe. The plan should follow a different logic from the often inefficient and aid-oriented mentality that governed the European development funds. It should be based first of all on the **public production of collective goods** ranging from the funding of state research facilities to fight the monopoly on intellectual property, to the safeguarding of the environment, to regional planning, to sustainable labour mobility, to the care of individuals. These are goods that inevitably generate market failures and are not understood by the limited logic of the private capitalistic firm, but at the same time are indispensable in strengthening the forces of production and in guaranteeing equity and social and civil progress.

We need to regulate and restrict the access of small savers and pension funds to the financial market. We need to restore the **principle of separation** between banks offering ordinary short-term credit, and finance companies that work on the medium to long term.

To counter any strategies of dumping and of "exporting the recession" by non-EMU countries, we should consider **a system of conditional opening of markets,** of capital and goods. This opening can be complete only if coordinated wage and development policies are put in place.

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We are well aware of the distance existing between our recommendations and the current **fearful decline** in the state of European economic policy.

We believe however that the present direction of economic policy may soon prove to be **unsustainable.** If the conditions do not exist for the realisation of a development plan based on the objectives outlined, there will be an extemely high risk of debt-driven deflation and the consequent disintegration of the euro zone. This is because some countries could be sucked into a vicious spiral, caused by short-sighted national "austerity" policies and the resulting pressure of speculation. **At a certain point these countries could be forced out of the monetary union or could deliberately decide to leave it in order to try to create their own economic**

policies in defence of internal markets, incomes and employment. If things actually went in that direction, it is obvious they would not necessarily be seen as the main culprits for the crisis of the European union.

Such eventualities make us think that the conditions no longer exist for reviving the European spirit by appealing only to our shared ideals. The truth is that **what is underway is the most violent and determined attack** on Europe as a political player and on the last bastions of social security in Europe. Now more than ever, then, **in order to survive and be revitalised, Europeanism needs to embody a meaning** and real opportunities for coordinated economic, social and civil development.

Essentially what is needed is to **start a broad and open debate on the reasons and responsibilities for the dire mistakes** being made in economic policy, on the consequent risks of a worsening of the crisis and of a disintegration of the euro zone, on the urgent need for a change in the direction of European economic policy.

If the hoped for change in European economic policy should not eventuate, unemployment will increase and **the crisis of the euro zone will worsen. In this case, national authorities could be forced to take autonomous economic policy decisions in order to sustain internal markets, incomes and employment.**

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