THE CROSSROADS WORKSHOP

1 | EMERGING MARKETS AND DECADENCE OF THE EUROPEAN MODEL, SWITZERLAND 3000

MMT and the Euro

- 1996 Bretton Woods Conference
- 1998 Currencies irrevocably locked
- The deed is done!

The Treaty of Maastricht

- Member nations retained their national debts
- 3% annual deficit limits
- Bank deposits insured by the member nations
- No ECB support for the member nations

The Treaty of Maastricht

- The new member nations were to be revenue constrained
- Only the ECB would not be revenue constrained

1996 Bretton Woods Conference

- Deposit insurance not credible
- Member nation interest rates subject to market forces
- Member nation fiscal policy procyclical

1996 Bretton Woods Conference

- Only the ECB can act counter cyclically
- Only the ECB can provide credible bank deposit insurance
- The entity that insures the bank deposits must also regulate the banks

1996 Bretton Woods Conference

- Why was it set up like this?

  Only to achieve political consensus
- A fully functional structure could not command political consensus

  Establish a treaty that would be ratified
- Let circumstances drive subsequent adjustment

The New Euro

- It worked reasonably well on the way up, supported by private sector credit expansion
- It all went bad with the 2008 crisis as the private sector retreated
- Circumstances forced change, precisely as discussed in 1996 at the Bretton Woods conference

MFI Loans to Households Annual Growth

Post 2008 Trauma

- Lack of credible deposit insurance triggered the bank liquidity crisis
- Market forces drove up member nations interest rates
- Member nation were forced to act procyclically with austerity policies

Post 2008 Trauma

The EU had two problems:

1. Solvency- interest rates escalated with some members unable to access funding at any rate
2. The output gap- unemployment and an economy in retreat

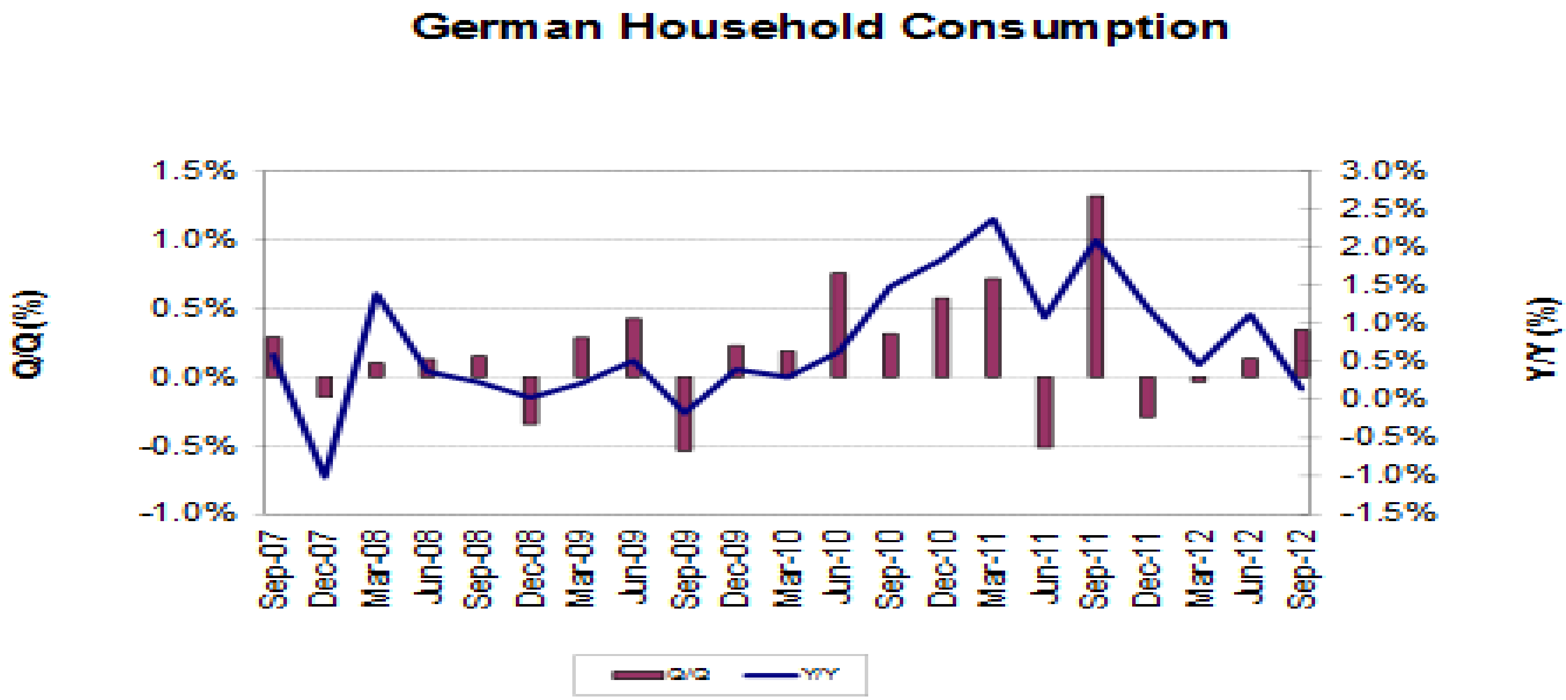
Solvency

- Circumstance forced the ECB to act beyond the spirit of Maastricht
- The ECB provided unlimited bank liquidity, expanding the notion of ‘acceptable collateral’
- The ECB allowed nations to recapitalize their banks with new issues of their own debt
- The ECB is now ‘doing what it takes’ to ensure member nations can fund themselves

Conditionality

- The ECB addressed the solvency issue
- The austerity requirement for ECB support continues to widen the output gap

How Well is Germany Doing?



Restoring Employment and Output

- With tax hikes and spending cuts every forecaster paid to be right lowers his GDP and employment forecast
- With tax cuts and spending hikes the same forecasters raise those forecasts
- The ECB has fixed the solvency issue.
- SO WHAT'S THE PROBLEM?

Obstacles to Recovery

- There is widespread agreement that deficits remain too large
- Even Beppe Grillo states debt must be lower, proposing debt reduction by repudiation

The Problem

- Unemployment is the evidence that deficit spending is too low
- The ECB/EU is demanding austerity in exchange for funding
- The economy continues to deteriorate as social unrest increases

The Problem

The ECB sees its current financing role as temporary, when in fact:

- The ECB is now acting as all CBs necessarily do
- They all necessarily backstop bank liabilities
- They all necessarily fund counter cyclical fiscal policy
- TINA! There is no other way!

The Problem

- Everyone agrees the problem is public debt is too high
- Unfortunately the economies are failing because deficits are too low

MMT

- ***The currency itself is a simple public monopoly***
- The funds to pay taxes and net save ultimately come only from government spending or lending
- If government spending isn't enough to provide the funds to pay taxes and net save as desired, the evidence is unemployment

The Answer

- Unemployment is necessarily a monetary phenomenon
- For a given size government, mass unemployment is the evidence that the economy is being grossly over taxed
- The answer is always to cut taxes or increase spending, depending on one's politics

Turning Litter into Money

- Taxing functions to create unemployment
- Gov. spending employs the unemployed its taxation created

Deficits, Savings, Unemployment

- Deficit spending is the source of all net savings
- Demand leakages create savings desires
- If gov't spending is insufficient to satisfy the desire to pay taxes and net save, the evidence is unemployment

The Silver Bullet

- The ECB explicitly guarantees deposit insurance and assumes bank regulation
- The ECB makes the 0% rate policy permanent
- The ECB guarantees member nation debt
- The EU relaxes deficit limits to 8% of GDP with enhanced enforcement policy
- The EP sources its public goods and services in regions of highest unemployment

What Actually Happens?

- Austerity continues and expands to the financial sector with transactions taxes and various PSI iterations
- There is no political support for higher public debt
- There is no political support for leaving the euro

What Actually Happens?

- Wealth destruction via austerity continues
- Unemployment and wealth destruction increase social unrest
- Voters support Grillo type candidates who ultimately fail to reverse the economic decline
- Really bad things happen????
- Tax on bank deposits in Cyprus?

Additional Discussion Topics

- Foreign trade
- Fiscal transfers
- Inflation
- An employed labor buffer stock price anchor

Foreign Trade

- Exports are real costs
- Imports are real benefits
- Optimizing real terms of trade

Fiscal Transfers

- All successful currency unions include fiscal transfers
- Directing the production of public goods and services to regions of high unemployment impose a real cost on that region, while benefiting the rest of the regions.

Inflation

- The price level is necessarily a function of prices paid by govt. when it spends, and/or collateral demanded when it lends
- CPI can increase from costs or from demand

Inflation

- Inflation is often 'confused' with one time price adjustments
- 'Inflation' is not a function of interest rates
- 'Inflation' not caused by excess demand is not 'cured' by unemployment

Conclusion

- The European 'slow motion train wreck' will continue until there's a recognition that deficits need to be larger.
- The continuing efforts at deficit reduction will continue to make it all worse.

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