

Recovery demands a stimulus, not Draconian fiscal austerity

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Just as the European settler economies in North America grew to eclipse the economic power of "Old" Europe during the 20th century, at least some of the BRICS – Brazil, Russia, India, China, and

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South Africa – were already on a trajectory to rise relative to both North America and Europe in economic power during the 21st century. However, a natural process that would have taken five decades or more may now be shortened to only a decade or two as the elites in charge of economic policy in the North Atlantic region seem hell-bent on committing economic suicide.

During the 20th century it was common to distinguish between the "advanced" or "more developed" economies, and the "under" or "lesser developed" economies. Soon it may become commonplace to refer to Europe, the US, and Canada as the formerly advanced economies. What follows is a brief anatomy of econocide being committed by ruling elites in a region which long dominated the global economy but soon no longer will.

Escalating Inequality

What most distinguishes more advanced from less advanced economies is the size of the middle class. During the middle third of the 20th century, political victories by progressive movements raised a significant portion of the workforce to middle class status in Europe, the U.S., and Canada as productivity gains from new technologies and expansion of education were more widely shared than ever before. Unfortunately, this trend came screeching to a halt at the end of the 1970s, and ever since we have experienced the most dramatic increase in economic inequality in world history. Not only is this terribly unfair, it has also proved to be destabilizing.

When wages rise along with increases in productivity, demand for goods and services, and the labor to make them tends to keep pace with productive capabilities. But when the top 1 percent appropriate the lion's share of productivity gains, as they have now for over 30 years, more and more income goes into purchasing assets rather than more production, creating two problems: Unemployment – which further aggravates the lack of demand for production – and asset bubbles – which eventually burst,



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destroying illusions of wealth.

Financial Deregulation

Whatever one may think about the pros and cons of markets in general, there should be no doubt that free market finance is an accident waiting to happen! Theory predicts it, and history has proved it time and time again. Whenever the financial industry is allowed to do as it pleases, it will engage in activities that increase its leverage and are highly profitable for its members, but create ever greater "systemic" risk for the rest of us. Only when the financial industry is subject to competent regulation can the risk of financial crises be reduced to socially acceptable levels.

In the aftermath of the financial crisis of 1929 which triggered the Great Depression, governments in the North Atlantic region imposed competent regulations on their financial industries which produced decades free from major financial crises in our advanced economies. But the financial industry predictably chafes under regulation since restrictions prevent them from engaging in activities they know to be highly

profitable. So the financial industry constantly searches for ways around existing regulations and relentlessly lobbies politicians to remove restrictions. The more successful they are, the more profits they have to ply the political system to further de-regulate their activities. As a result, eighty years after the crash of 1929 the financial system in the North Atlantic region was, once again, an accident waiting to happen.

However, this time there was one big difference. Instead of a massive financial crisis giving rise to successful political efforts to erect a competent regulatory system to prevent recurrence, Wall Street's influence with both major political parties was so great that it easily forestalled meaningful regulatory reform. The Dodd-Frank "Wall Street Reform and Consumer Protection Act" was neither. Instead, it was a toothless fig leaf providing cover for politicians but no real protections. Three years after the crash of 2008, systemic risk in the financial system is just as great as it was before, consumers of financial services are still without effective protection, and

taxpayers are still "on the hook," as former Treasury Secretary Hank Paulson put it when explaining to Congress in November 2008 that the big Wall Street Banks were too big for the rest of us to allow them to fail.

Ignoring Keynes at Our Peril

Paul Krugman summed it up well in his New York Times column on Dec. 29:

"Slashing government spending in a depressed economy depresses the economy further; austerity should wait until a strong recovery is well under way. Unfortunately, in late 2010 and early 2011, politicians and policy makers in much of the Western world believed that they knew better, that we should focus on deficits, not jobs, even though our economies had barely begun to recover from the slump that followed the financial crisis. And by acting on that anti-Keynesian belief, they ended up proving Keynes right all over again."

In futile attempts to reduce deficits, the Tory government in the UK and the Conservative government in Canada have subjected their own middle and lower classes to crushing fiscal austerity. Hard line fiscal conservatives in power at the European Commission and European Central Bank have visited even more Draconian austerity policies on the citizens of the so-called PIGS – Portugal, Ireland, Iceland, Greece, and Spain – in exchange for financial bailouts that have proven time and time again to be too little, too late.

Germany, sheltered from unemployment by favorable trade surpluses with the rest of the Euro Zone, steadfastly refuses to engage in fiscal stimulus. And when Obama aided his mortal Republican enemies by pivoting from an inadequate fiscal stimulus in 2009 to deficit reduction in 2010 the entire North Atlantic economic region was united in fiscal austerity. Unfortunately, what was, and still is desperately needed, is exactly the opposite – fiscal stimulus!

When consumers are tapped out, when businesses have little reason to invest in new plants and capacity since they can't find customers to buy what they are already producing, government needs to step up to the plate and provide the necessary demand for goods and services to get the economy going again. That was Keynes' great truth. Instead, ruling elites in the North Atlantic region have united to reject the advice of Keynes and instead repeat Herbert Hoover's mistake. Instead of fiscal stimulus they are giving us ever more Draconian fiscal austerity. This, more than any policy failure, has the North Atlantic region on the road to recession and mass unemployment without end. As a result, for the first time in many generations citizens of the formerly advanced economies are left to ask ourselves: "How does it feel/ To be on your own/ With no direction home/ Like a complete unknown/ Like a rolling stone?"



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