Cleaning up the Financial System –
A Prerequisite to Reducing Deficits

In times of crisis, a recurring phenomenon wants private debt to progressively fall into the public’s lap, or out otherwise, that they become debts owed by the public. The worsening of the crisis mechanically cuts into the ability of companies and households to pay back debts taken out with the banking sector. And this is where the state takes an increasing cut of the debts of its financial sector as the credit crunch intensifies. And this is why banking crises almost always precede sovereign debt crises. The escalade in private debt (of both companies and households) is cleared – in light of the crisis and using the banking transmission belt – by an explosion of public debt. To put it another way, the state resolves to call into question its own solvency by assuming the debts of the private sector. The States that have absorbed the losses and assets of financial establishments haven’t done it so much as in collusion with, or out of kindness to, the banks, but rather in order to spare the economies of the potentially devastating consequences of bankruptcies. Nonetheless, the nationalizations and the losses – a far from saving the root problem – have transformed the banking crisis into one of sovereign debt. This is because our current crisis likewise tells the story of successive rescue plans, with a permanent characteristic being that both are as Paranoiac as each other. The billions injected in 2008 into Royal Bank of Scotland, Lloyds, AIG or again into Fannie Mae and Freddie Mac, like those allowing the bailout in 2009 of establishments that were sinking in the Dubai real estate market, certainly authorized placing the financial institutions under artificial breathing. Because of all this, this deferment – or this administered electro-shock therapy – agreed to by the financial establishments was but the inflation price of state debts. In this way, and although in appearance, the drama in the peripheral European countries had been initiated by its growing difficulties in assuring its market financing, the exposure of European banks to these countries was, in reality, what detonated this crisis. It is thus undeniable that the European banking system, which was in a risky situation, to say the least, played a central role in the financial liquefaction of the peripheral states of the EU.
This undeniable interaction between public and private debts must thus be translated as an involvement of each citizen in the fight against deficits. In other words, this tendency (or this plague) of debt is characteristic of our developing countries, which have cultivated since about 30 years ago, an almost chronic tendency for cycle of booms in debt followed by implosions. Indeed, we could estimate that the private sector debts of OECD countries have advanced at an annual average rate of 4-5% during these last thirty years! The deficits have, in this way, formed an integral part in the daily lives of our populations and of our States since the start of the 1980s, knowing that a hyperbolic increase occurred when the crisis started in 2007. It is this dramatic drop in market, real estate and, in general, assets valuations, that gave the decisive impetus to this financial crisis triggered in the spring of 2007. Indeed, it is in the countries encouraging property ownership – or rather real estate speculation – with the extremely lax rules in granting mortgages that the real estate market met its greatest slump. Among these countries are the USA (with the most threatened states, such as Florida, whose market dropped 60%), Great Britain, and even “new” countries but addicted to leveraging such as Dubai. The collapse of these valuations being the object of bank loans thus froze all the loans granted to companies and individuals by the financial establishments, leading to an understandable stagnation in economic activity and a worsening of the financial crisis. This growing scarcity of credit to the real economy since 2007 is thus responsible for an economic tightening, while it was the previously and very generously granted credit (between 2001 and 2004) that was responsible for the real estate bubble. Put another way, without debt our economies cannot develop and prosper, with the knowledge that economic activity always ends up dearly paying the price for too much debt.

Public deficits are therefore what result from this decrease, the immediate translation of which is the decrease in the State’s tax revenue and the increase in unemployment compensation payments and other social security provisions, directly linked to the difficult economic situation. It is also in this way that at least half of the public deficits of the peripheral EU countries in 2012 are due to the fall in tax collections and the unbearable increase in their debt interest. It is useless and counterproductive to reduce public spending in such a situation because these represent less than 10% of their deficits. When will we finally realize that the deterioration of public deficits is due only to the increase in unemployment? These days, our politicians are at a crossroads and must fight – and show a real obsession – by the “passive” deficit, which is mechanically created, because the increased unemployment prevents the state from offsetting its spending. The key priority being employment, those who are unemployed evidently will not be put back to work due to
reductions in public spending or the increase in taxes. The state on the other hand must consider the “active” side of deficits that consists in creating new employment and ensuring all welfare payments for its citizens. The only solution to reduce the public deficits brought about by unemployment is, obviously, to eradicate the unemployment. Passive deficits must be transformed into active deficits, that is, into deficits that are of use to the public which take over a depressed financial system to finance and re-establish all economic sectors. To put it another way, the path that will allow public deficits to be decreased is the one that will settle the financial crisis because the role of the state is evidently not to finance the economy forever. This reconstruction of the banking system must necessarily be carried out based on new rules. After having ridding the banks’ balance sheets of the toxic assets and having cleaned up their accounts, enforcement personnel must necessarily monitor the practices, supervise the payments and rethink in depth the training of bankers. At the same time, a restructuring of private debts must occur which, through a rationalization, or indeed wiping out, of a portion of their debts, shall re-establish their consumption and saving capacity. Public deficits must thus cease to be examined with fear by both politicians and central banks because to this day, they remain the only lever to recreate employment. Provided that the deficits are advisedly utilized, that is as passive one, they shall become active. In the absence of private financing, unemployment can only be reduced by public deficits in the knowledge that the private and banking sector must again fulfill their duty as liquidity providers whilst the financial crisis fades out.

Moreover, one after the other, all the arguments – or pretexts? – in favor of austerity fall like nine pins. Would deficits be an extra charge to be borne by future generations? Those who claim so have not always understood that increasing the debt today is not in any way an inter-generational transfer, but an intra-generational one. Since it is the debtors – tomorrow – who should in fact reimburse tomorrow’s creditors. Do deficits harm investment? So in times of a depressed private sector, the state must specifically step in rapidly to pour cash into its economy. Would these deficits lead to soaring interest rates? Indeed, to the contrary, in any case in heavily indebted countries, which nevertheless have their own “sovereign” currency, namely the United States and Japan… In short, the state should instead take on more debt and bigger deficits in order to restore full employment, even if our current leaders flatly refuse to use debt to stimulate economic activity. Their single and only objective – or obsession? – thus being to balance their budget. Is tax consolidation a policy? While the ambition of our leaders (men and women) should instead be to stimulate investment and reduce inequalities! How can they continue to defend austerity – and therefore the acceleration of unemployment – when they can use tax as a leverage wisely and fairly
at the same time, while putting pressure on the European Central Bank, which is completely uninterested in growth. Public spending is drastically revised downwards while efforts and energies should be focused on increasing the taxation of the wealthier classes, and the active contribution of the ECB to growth recovery. Unless the fallacious argument behind which lurk the proponents of orthodoxy which are being used to divert attention from their real motivation. Who would have the state take a step backward time and time again, exactly as the current British model and the admission of the Prime Minister who just stigmatized the poor and unemployed, according to him, had “made a choice lifestyle”… It is therefore in the name of “structural reforms” and “there is no other alternative to stringency” that we blithely saber social spending, and we oppose any veto contemptuous of any job creation that would call for state stimulus. Like the President of MEDEF professed, as “life is fragile, love is precarious, why would work not be insecure?” Thus, the ardent defenders of finance and healthy accounts require that the employment level be dependent on only the degree of confidence prevailing in the business community. While it has been repeatedly documented in the last twenty years that the stock market and financial speculation was the main reason for the deterioration of economic conditions. Under the guise of an economic argument, this diehard obstinacy which fights fiercely against the doctrine of full employment yet masks less and less its true political, even ideological, motives. Narrowing public spending strictly to income earned by the state is in fact nothing more than a moral tale told by those who set themselves up as lecturers in liability 101. Behind their storytelling which abuse ordinary people who are made to believe it is necessary to manage the budget of a state in the same way as the purse strings of a household, these destroyers of deficits preserve very prosaically the interests of the dominant class. The very one who, seeing everything through the prism of material accumulation and enrichment, saw itself described by Keynes as “semi criminal” and “semi pathological”… All the while supportive of the dominance of annuitants on our economies, this dictate of austerity also reveals a ruling intellectual class that definitely fails to address the economic fundamentals from the right angle. Why not indeed integrate this debt equation into parameters as compelling as the level of interest rates and inflation? And why continue to insist that a healthy economy must necessarily be balanced (budgetary and accounting) when an economic activity – by essence dynamic, i.e. unstable – occasionally requires the soothing injection of public funds? It is therefore important not to confuse economy with morality, for those who need support have committed no sin. Before – well before – the state seeks to balance its books, its only concern should be getting its citizens back to work.