Socialism for the bankers, capitalism for the rest of us – so it goes

On 21 July, the European Central Bank decided to raise interest rates for the first time since 2011 and unveiled a new tool aimed at protecting eurozone states from rising borrowing costs. Responding to the decision, **Bob Hancké** *argues the ECB's response to inflation essentially boils down to a massive transfer of funds to banks, almost certainly without any positive effects for the population at large and especially for those who most feel the negative effects of inflation on essentials like energy and food.*

About a decade ago, the billionaire Warren Buffett stated, with thinly veiled sarcasm, 'there's been class warfare for the last 20 years, and my class has won'. The recent decision by the ECB on 21 July to raise interest rates reminded me of this. Not only is there a lot of confusion among central bankers about what is going on in the advanced capitalist economies today (a topic for a post later this summer); the simultaneous rate rises and the central bank's aim to contain bond spreads among EMU member states will also likely lead to a significant transfer of wealth to the bankers.

Enter ECB interest rates

The basics first. The inflation that looked temporary in 2021 – following on from the supply bottlenecks after the shutdown of the global economy in 2020 and much of 2021 – lasted longer, in fact significantly longer, than many (including me) thought. High inflation (still) has little to do with too much money sloshing around in the system, despite what you will read almost everywhere. The main causes are still in the real world: the remaining uncertainty around Covid-19, confusion about fiscal responses to the necessary support packages for households and business, Putin's war in Ukraine and its repercussions, and the stagnation (or decline?) of China's export-led growth model have created the perfect storm.

Food and energy prices have rocketed, hurting all, but those with smaller incomes considerably more, as they spend a larger share on these essentials. In fact, core inflation, stripping out volatile items such as food and energy, is much lower: Paul Krugman pointed out a few weeks ago that it was, at about 4.5%, roughly where Paul Volcker declared victory forty-odd years ago. Ignore for a moment the issue of what a small rate rise will do when inflation is running at close to 10% (as I said, a topic for another blog) or the question of how exactly a wage-price spiral will develop when real wages are falling almost everywhere (another blog post). With inflation rising, the ECB needs to do something, and to be seen to do something.

One money, many government bonds

The snag is that the ECB, like all other central banks, has only one tool to handle inflationary pressures: interest rates. Higher rates dampen demand (but remember that current inflation resulted from a supply shock…), and increase returns on savings, especially bonds.

Yet in EMU that has a nasty side effect: bond spreads between countries (the differential in the borrowing costs of governments) rise as well. In 'normal' times, the bond yields on the 19 euro members' debt moves more or less in tandem, with only small differences. But times of crisis upset that synchronicity, and EMU members that are deemed weaker by financial markets are punished with a higher risk premium – they pay a higher interest rate (in large part because their growth prospects are lower now, which means tax revenues fall).

Enter ECB cash

So, since it wants to counter that centripetal force, the ECB needs to think of ways to reduce the risk for lower-quality bonds, such as Italy. For that, it also only has essentially one tool: buying up the bonds, directly or indirectly (by subsidising banks), of the weaker member states to push their actual interest rate down (the interest rate falls when demand for the bonds rises).

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We have had a long flavour of that policy since 2012 under the guise of quantitative easing, and we are about to witness another incarnation. We now know where all that extra cash went – not in investment, as hoped, predicted or desired, which is at its lowest level for two decades, according to Martin Sandbu in the FT a few days ago. So where did the money go? To the banks, and especially the bankers, whose bonuses are broadly back where they were 15 years ago. So it goes.

In essence, therefore, we are entering Alice's Wonderland (again). The ECB's reaction to the cost-of-living crisis for the bottom half of the income distribution is a rate increase to manufacture slower growth – and a recession with high unemployment (which was probably on the books anyway, courtesy of Putin). In other words, if you were screwed then, you'll be even more screwed after the ECB has its way with the European economy. So it goes.

To those who have, shall be given

But very few observers mention that the QE-type policy the ECB is engineering today has the opposite effect at the top (trust me: I scan the FT pages for those insights and have yet to find them). Banks will receive more cash to buy Italian bonds. Part of that will go to the bankers in the shape of increased income. Now, since even banks cannot pay several hundreds of billions to their employees without blushing these days, they look for alternative opportunities to use that cash.

In a world entering a recession or at least a period of very, very low growth the main, if not sole condition for investment is absent, and only one avenue makes sense: save the money. How do banks save, you might ask? They park the money at the ECB. It's called a *central* bank for a reason. And here the perverse policy comes full circle, because the higher interest rate that the ECB has just imposed on the economy ends up being a nice present to the banks. The free money from the ECB has been turned into more money, paid for by the ECB. We pay twice, the banks only gain, and the lower 75% of the income distribution loses their jobs or see their standards of living fall. So it goes.

Echoes of Kalecki

It is impossible to tell if this is simply incompetence by the ECB's governing board, an almost criminal bottom-up redistribution of life chances, or a Kaleckian institutional class struggle that has moved from individual capitalists to the only government arm that cannot be politically influenced.

The FT's Martin Wolf lamented, early in the financial crisis, that socialism for the bankers and capitalism for everyone else was not a viable growth model – but that's where we are headed again: the ECB as a giant welfare system for the banks. At least Buffett suggested that he had to work for his money – capitalism applied for everyone in that sense; his point was that taxes were increasingly regressive.

One of the old Marxist tropes talked of the state as the executive committee of the bourgeoisie, safeguarding the collective interests of the capitalist class. The advent of social-democratic parties in government took, at least for some, the bite out of that argument. But the fact that central banks everywhere, including the ECB, are now raising rates just when labour markets seem to be structurally tightening for the first time in fifty years, reopens that can of worms.

If you ever wondered who the principal is in the conservative monetary policy set-up that we have lived with for over three decades in the OECD, stop wondering. It is not the population at large. It is not the European Parliament, the Commission, or the Council either. It seems to be the financial sector: it's called a central *bank*, after all. So it goes.

Note: This article gives the views of the author, not the position of EUROPP – European Politics and Policy or the London School of Economics. Featured image credit: Adrian Petty/ECB (CC BY-NC-ND 2.0)