

THE POLITICAL ECONOMY OF PUBLIC DEBT AND AUSTERITY IN THE EU

Edited by
Elena Papadopoulou and Gabriel Sakellaridis

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Foreword

A spectre is haunting Europe. It is the spectre of political change starting from a small country of its southern periphery. And again, all the powers of old Europe have joined forces for a holy alliance against this spectre: The governments of Germany and until recently of France, the European Commission, the International Monetary Fund, the European Central Bank, the Round Table of the Industrialists, the financial markets and the rating agencies, the mainstream-media.

The message they send to Greece and to the other peoples of Europe is straightforward: Either you accept the austerity programs, the reduction of your living standard, the carving up of the labour and social laws, the destruction of the public health and education systems, that is, the further deepening of social inequality or we will exclude you from the eurozone and the EU. Submission or expulsion. That is what their democracy looks like.

However, the June 2012 elections in Greece, with the radical Left of SYRIZA coming close to winning the government and increasing its percentage to the spectacular 27% (from the modest 4,6% in the 2009 elections), is a clear mark for political change in our continent. To this one can add the very good results of the French Front de Gauche in the French Presidential elections, where Jean-Luc Mélenchon gained 11.11% of the vote, as well as the expected march of the Socialist Party in the Netherlands. If one takes into account the big strikes taking place in Spain and Italy, but also the re-awakening of the German trade-unions, it is obvious that the peoples of Europe overwhelmingly reject austerity and search for alternative political solutions.

Following these developments, the EU is presently on a crossroads, with each road having its own logic and consequences. The first aims to restore financial stability by

sacrificing entire national economies and states on the altar of the financial markets. It leads to deprivation and suffering of the populations, without providing a way out of the crisis, while at the same time it threatens to devour democracy and destroy European integration. The second road (and logic) requires, among others, a cancellation of a large part of national debts, the socialisation of the banking and financial sector, the redistribution of income, the fight against corruption and a reconstruction of Europe's real economies according to ecological standards. Europe has to reject austerity, which will certainly deepen recession and undermine growth which could increase employment. It requires a breach with the dictatorship of the financial markets and the replacement of the current power elites in the European states and in the EU as a whole.

A realistic and radical interpretation of the crisis is one of the most important intellectual challenges with which the radical Left has to cope. Analysis, exchange of experiences and an effort to provide national and European alternatives is a prerequisite for a change in politics on a European scale. In 2008, the network of *transform! europe* –which is also the political foundation of the Party of the European Left– launched an on-going programme dealing with the political, economic and social aspects of the crisis in Europe. This programme includes conferences, seminars, workshops and the publication of numerous articles in the *transform!* magazine, as well as in our website (www.transform-network.net). A prominent activity in this programme was a big Conference on the Debt Crisis in Europe, organized in Athens on the 10-12th of March 2011, by *transform! europe*, the *Party of the European Left*, *Nicos Poulantzas Institute* and *Synaspismos*. Following this Conference, the Board of *transform!* decided to publish a book based on a selection of papers presented there and assigned the task of its editing to Elena Papadopoulou and Gabriel Sakellaris.

We hope that the book “The Political Economy of Public Debt and Austerity in the EU”, published right after the big victory of SYRIZA in Greece, will contribute to the understanding of the crisis in Europe and to the struggle for a democratic and social exit from it.

On behalf of the Management Board of *transform! europe*,

Walter Baier (coordinator of *transform!*, Austria), Elisabeth Gauthier (*Espaces Marx*, France), Haris Golemis (*Nicos Poulantzas Institute*, Greece), Ruurik Holm (*Left Forum*, Finland)

Introduction

Almost three years after its eruption, the debt crisis in Europe remains unresolved, while the economies of the European South are forced to contain their public deficits and service their debt obligations through the imposition of harsh austerity. On the political level, the recent elections mainly in Greece but also in France, as well as the fall of the government in the Netherlands, point to a growing rejection of austerity policies. On the economic level, the recent rescue of the Spanish banking system, the unviability of the Greek debt –only a few months after its restructuring–, the official request on the part of Cyprus to enter the bailout mechanism, as well as the serious problems faced by the Italian and other European economies point to a new impasse, thus making the question of the survival of the euro and the Eurozone more and more pressuring.

Given the fact that the European and Monetary Union (EMU) and the adoption of the single currency constitute the landmarks of European integration (a process unfolding for more than half a century) any development leading to a split or dissolution of the Eurozone will probably signify the beginning of a disintegration process of the EU itself.

At the same time, the neoliberal attack on the historical tradition of the so-called “European social model”, contradicts social and political features of the European societies achieved through intensive social struggles and passed on to the next generations of European citizens.

The capitalist crisis, which started in 2007 from the United States as a financial crisis, has amplified the pressures for a wholesale retrenchment of the welfare state along with the privatization of public sector enterprises, labor market flexibility, anti-inflationary policy and financial liberalization.

In this introduction we attempt a preliminary and tentative analysis on the three following general questions which, to a certain extent, permeate a large part of the contributions collected in this book:

1. What is the character of the debt crisis in Europe? Our main argument is that the latter cannot be separated from the global financial crisis, as it constitutes its expression at the European level. We trace the origins of the debt crisis in the neoliberal structure of the national political economies as well as the architecture of the Eurozone.
2. How is the crisis managed by the European political and economic elites? The point made here is that the reluctance for radical political decisions and the attachment to harsh austerity policies intensify the crisis, deepen recession, increase unemployment, deteriorate public finances and deconstruct European societies.
3. Finally, we touch upon the question of the “democratic deficit”, an important political issue accentuated in the era of the crisis.

FROM THE WORLD FINANCIAL CRISIS TO THE DEBT CRISIS IN THE EUROZONE: DISMANTLING NEOLIBERAL MYTHS

The financial debacle, which started from the US subprime loans market in 2007 and shook the foundations of the global economy after the collapse of Lehman Brothers in September 2008, signaled the crisis of neoliberalism. Finance, either in the form of public or that of private borrowing, was the very essence of the new organization of capitalist reproduction. Therefore a financial breakdown of this magnitude does not simply reflect a superficial crisis in financial markets but translates into a deep structural capitalist crisis (Duménil and Lévy, 2011).

In this section we argue that the debt crisis, which initially erupted in the peripheral countries of the Eurozone and developed into a threat for the whole of the EU, does not constitute an isolated event. On the contrary, it is strongly connected to the global crisis and more specifically it constitutes a facet of the global financial crisis in the very concrete conditions of the architecture of the Eurozone.

When the financial crisis passed the Atlantic Ocean and reached Europe, the fiscal balances of the Eurozone countries started deteriorating for two reasons:

1. The first one was that the European banking sector proved vulnerable to the

shock generated by the burst of the subprime loans bubble. Although the collapse of Lehman Brothers (September 10th, 2008) and the bankruptcy of Iceland¹ (2009) accentuated the banking crisis in many European countries, troubles with the European banks had already started in 2007, as many of them were holding toxic assets of US banks in their portfolios.

European governments stepped in to anchor the shaking banking sector of their countries by channeling huge amounts of money as a bailout for the banks. In most cases, the ownership of the banks did not change and even when the latter were nationalized they remained under public ownership only to be privatized again when they became profitable. The slogan “privatizing profits and socializing losses” or “socialism for the rich and capitalism for the poor” (Chomsky, 1997), has become more relevant than ever since the burden of banking sector bailouts is transferred to the taxpayers, while at the same time speculation continues, credit is not funneled to the real economy and banks’ executives maintain their astronomical earnings. This bailout increased public expenditures in European countries and deteriorated their fiscal status.

2. The second reason for the derailing of budget deficits was the deep recession instigated by the financial crisis. The transmission mechanism from a crisis in the financial sector to the real economy is rather evident. The operation of automatic stabilizers set in motion during a slowdown of economic activity has deepened the impact on fiscal status. As income and aggregate demand decreased, public revenues in the Eurozone fell. Tax revenues dropped slightly from 45.3% of total GDP in 2007, to 44.8% in 2009. At the same time, government spending increased sharply from 46% in 2007 to 50.1% of GDP in 2009, as welfare state provisions were activated for more and more Europeans who needed some kind of social benefit. Part of this increase in government spending reflects the bailout of the banking sector. Unemployment rose from 7.6% in 2007 to 9.6% in 2009 and to 10.1% in 2010. This means that 3.5-4 million more people became eligible for unemployment benefits.

Thus, since 2010 we came face to face with another facet of the systemic crisis, the sovereign debt crisis, which initially appeared in Greece. Although public debt was one of the most important structural problems of the Greek economy, it did not constitute a direct threat for its viability until the financial crisis. Thus, while in 2007 the debt burden of the Greek government was estimated at 107.4%, in 2008 it rose to

1. The default of Iceland created a lot of trouble for international creditors and especially for British and Dutch banks, which were heavily exposed to Icelandic debt. See Wade and Sigurgeisdottir, 2010.

113% and in 2009 it blasted off to 129.3% (European Commission, AMECO Database), leading to a crisis of confidence on the side of creditors towards the ability of the Greek government to cope with its debt obligations. This lack of confidence deteriorated even more when the newly-elected social-democratic government under George Papandreou, revised the budget deficit of that year from 6% to 12.7% in November 2009 and later to 13.6% in May 2010! The more-than-doubling upward revision of the budget deficit led to a creditors’ backlash, accentuated by the downgrading of the Greek economy by Standard & Poor’s and Moody’s in December 2009. In May 2010, S&P’s decreased the rating of Greek bonds into a “junk” status, forcing the two other major credit rating agencies –Moody’s and Fitch– to follow. This reaction made it even more difficult for Greece to refinance its debt, since the demand for Greek government bonds declined sharply, as a result of the high probabilities for the inability of Greek government to serve its obligations. Spreads of the Greek bonds compared to the German ones skyrocketed and the same held for the prices of Greek CDSs.

At this point, discussing the reasons for fiscal derailment, it is relevant to make a digression regarding the role of credit rating agencies (CRAs) in the unfolding of the current financial crisis. A lot of ink has been spilled on the notorious role of the CRAs during the subprime loans bubble in the US, when they were rating structured bonds and mortgage-backed assets with AAA+, despite the fact that these securitization products were based on very risky and insecure loans. The role of rating agencies is crucial for the organization of neoliberalism around the world. In the mainstream discourse they are presented as the institutions designed to solve the asymmetric information problems of modern finance, caused by the disintermediation of capital markets, the internationalization of finance and financial innovations. The focus on their technical character is important in order to maintain their scientific prestige, which enables them to enforce their policy recommendations and judgment in an allegedly objective manner. However, CRAs play a key role as the “gatekeepers” of neoliberal orthodoxy around the world, through the exercise of authority and power and their influence on investment, knowledge and governance (Sinclair, 2005). The downgrading of the Greek economy as well as that of nine more European countries (including France and Austria) in January 2012, evince the imperative for restricting policy options for these countries in the neoliberal straitjacket. Any divergence from mainstream prescriptions is excluded under the threat of another downgrade.

Fiscal profligacy of the Greek state was initially claimed to be the sole cause of the debt crisis. Backed-up by theoretical arguments from the school of public choice, economists, politicians and journalists –not only in Greece but around Europe–

launched an unprecedented offensive against the public sector as a whole, as well as against trade unions calumniating them as protectors of “vested interests”, having generated an economy that “consumes much more than it produces”. According to this narrative, Greece is an exceptional case of “insider” interests, which have systematically inhibited modernization and structural reforms and ultimately dragged down the whole of the EU in the vortex of the debt crisis.

However, “profligate” Greece was not the only country that had to deal with high public debts. During the last four years Spain and Ireland have more than doubled their debts due to the socialization of the costs of bank failures and property bubbles. In this sense it is not peculiar that the “Greek exceptionality” soon transformed into the “The PI(I)GS that won’t fly” (The Economist, May 18th, 2010²) and further to a general European problem bearing the possibility of a eurozone break-up (FT, December 18th 2011³). As it has been argued, the debt crisis cannot be understood outside the framework of the neoliberal project, as well as the architecture of the EU.

In this sense, the real causes of the debt crisis can be summoned in two groups: The developments within the economies and societies of the countries involved, which were shaped under the neoliberal governance, and the institutional and political framework of the Eurozone.

1. Before joining the EU, the countries in the periphery of the Eurozone exhibited a significant lag in their capitalist development vis-à-vis the rest of Europe. One of their main characteristics is that, while in the postwar period the welfare state was formed in an extremely fast pace in the rest of Europe, in these countries it was totally absent for specific historical and political reasons. Unemployment, income inequality and poverty in these countries were the largest in Europe. As a result, large sections of the population were excluded from “citizenship”, creating cracks in the social consensus, which was necessary for the neoliberal ideological hegemony. Furthermore, the benefits for capital in the form of low taxation (either through low tax rates or through legal tax exemptions), widened the class gap between capital and labor. The method adopted by these countries in order to enhance the profitability of capital on the one hand, and consolidate the neoliberal hegemony through consent of the subordinated classes on the other, was similar to the one applied in the most developed neoliberal centers: easy access to credit through the financial system.

This credit expansion took place through two trajectories depending on the social conditions formed in each country: that of the public and that of the private sector. In

2. <http://www.economist.com/node/15838029>

3. <http://www.ft.com/intl/cms/s/0/15bcafb0-296c-11e1-8b1a-00144feabdc0.htmlaxzz1gpSvd5f7>

Greece, where the financial system liberalized relatively late (in the late 1990s) and largely remained under state ownership, borrowing mainly took place through the public sector.⁴ Governments in Greece systematically borrowed large amounts from the banks. The debt was consolidated at around 100% since the beginning of 1990s. In other words, Greece followed a model of high budget deficits, mostly due to low taxation and not due to high spending. In order to finance them it turned to financial markets through public borrowing. The other countries of the region (mainly Spain and Ireland but also Portugal), followed the model of private debt, resulting in highly indebted households today. When the crisis erupted and banks were under the immediate risk of collapse, private debt was converted into public debt, since the state rushed to take over the liabilities of the overexposed banking system. Thus, in all peripheral countries, government debt exploded despite distinct paths.

2. The debt crisis is also directly related to the architecture of the Eurozone, which fomented specific national causes. The circulation of capital flows from the most developed economies of a monetary union to the least developed constitutes a rule of political economy and its empirical validation was something to be expected in the case of the Eurozone. Peripheral countries financed their deficits through the large amounts of capital they accumulated in the form of debt from the countries of the core.

THE MANAGEMENT OF THE DEBT PROBLEM IN THE EUROZONE AS A CAUSE OF THE CRISIS’ AMPLIFICATION

Despite the fact that the accumulation of public and private debt, as well as long-lasting imbalances concerns all countries participating in the EU, the European political and economic elites never considered these issues as a common problem. What was typical of the policy followed by the EU since its construction, is now clear in the management of the European crisis during the last years and characteristic of the stance of the EU leaders in the course of their attempt to contain the debt crisis through a combination of harsh austerity policies and unviable bailouts using the very debatable Special Purpose Vehicle of the European Financial Stability Facility (EFSF).

As it has often been argued, the EFSF (due to be replaced by the permanent ESM⁵

4. Tsakalotos (2010) offers an interpretation of the Greek fiscal imbalances as a way to maintain the purchasing power of households and construct consensus between the ruling and subordinated classes.

by summer 2012) constitutes a toxic mechanism of raising bailout funds. On the one hand, if a country already faces high interest rates and has to guarantee loans on behalf of another, the risk for it to be excluded from the markets increases. On the other hand, once this process is activated, the solvency of the EFSF is itself reduced. However, the structure of the EFSF guarantees two important elements: that the type of Eurobonds it issues will maintain the differentiation between the debts of the various countries that guarantee them, and that banks will continue to be bailed out with minimum political and social intervention (Varoufakis, 2011).

At the same time austerity is considered as the only way to reduce deficits and repay old and new debt. In our view, the policies of severe austerity are condemned not only to fail but to generate entirely opposite results. This has been verified in practice, since the Greek public debt jumped from 115% of GDP in 2009 to 165% of GDP in 2011 and it is expected to reach 120% in 2020, thus returning to its 2010 level.

At the time when these lines are written, a restructuring of the Greek debt has taken place, imposing a haircut on the debt of the Greek government to 106€ bn (through a Private Sector Involvement - PSI). However at the same time, the Greek government received a loan of 130€ bn from the troika, which will be exclusively funneled to the banking sector (either for servicing debt payments or for the recapitalization of banks). In other words, the European taxpayers are called in to bailout the creditors, despite the fact that the mainstream narrative maintains that the “hard-working Northern Europeans bailout the lazy Southern ones”.

Could these evolutions be expected? As many heterodox economists, including marxists, have repeatedly argued during these years, it could. On the one hand, austerity adversely affects GDP growth and erodes tax and productive bases while the operation of the multiplier in times of economic contraction creates adverse macroeconomic conditions for it to work (Varoufakis, 2011). On the other hand, lack of political incentive for cooperative solutions increases the impasse: according to the Keynesian aggregate income identity, if Greece is to repay both its public and its private debt, it must have an external surplus. In this sense, the economic policies followed by other European economies – particularly Germany – affect the viability of any recovery plan. So, as Kregel wrote in November 2011: “The bottom line is that Greece cannot repay its outstanding debt without a debt restructuring or a change in domestic policies in Germany. The solution to the euro crisis depends on German economic policy, not the character of the Greek people”. In fact, a few months later, the debt restructuring indeed occurred.

However, arguments regarding the ineffectiveness of the policy of continuous bailouts pursued in response to the Greek debt problem are not only to be found in heterodox literature. In a recent paper by the Economics Research Department of Natixis Investment Bank (January 2012) it is mentioned that the problem with Greece is not liquidity but fiscal insolvency. In order for solvency to be restored, there needs to be a reduction of its public debt far above what is conceivable. According to a recent study by the Greek Observatory of Economic and Social Developments (Argeitis, Dafermos and Nikolaidi, 2011) the 53.5% haircut on Greek bonds that was agreed at the beginning of 2012 is unlikely to bring the Greek debt to sustainable levels even by 2020, as it is claimed by the 5th Review of the IMF for Greece. This Review is based on unrealistic assumptions regarding the magnitude of the primary surplus of the Greek economy, as well as on the revenues raised by privatizations. Moreover, growth estimations are overly optimistic given the financial situation.

Why, then, is there such an insistence when markets are not “convinced” of the effectiveness of continuous bailouts to address the debt problem, “structural deficiencies” of the Greek economy are not resolved, and at the same time pressures on other European countries are accentuated? We claim that this stance should not be interpreted as an irrational obsession. Instead, it is rather successful –at least in the short-term– in servicing the interests of creditors, preventing losses by European and American banks, attacking labour and creating the conditions for a renewed accumulation regime, while adhering to the economic principle of antagonistic export-led growth through fiscal consolidation and internal devaluation.

Moreover, what should be underlined is that the management of the debt crisis in the Eurozone is not only detrimental because of its economic and social consequences on the peripheral countries, but mainly because it foreshadows the changes that will be put forward across the whole of Europe. This has become evident under the light of the “New Economic Governance of the European Union” (the so-called “six-pack”), the “European Semester” and the Fiscal Treaty. The peripheral rim of the Eurozone is currently operating as an experimental laboratory for policies to be imposed in the rest of the European countries.

Moreover, the management of the crisis does not only deploy economic, but also political tools. One of them is widening the democratic deficit in the European Union. To tackle the unprecedented impact of the above aspects of the crisis, the ruling classes and their political mouthpieces must overcome a hurdle that might ruin their plans: democracy itself.

The idea of limiting the space for democratic decision-making, stems from the tradition of the philosophy of Hayek and was considerably expanded by the school of

public choice. The idea unfolds as follows: The financial management should not be handled by politicians who are elected by the people, and therefore are prone to their demands, but by technocrats with specialized knowledge which are not tied up to citizens' interests, so they can take unpopular decisions when necessary. In this system of ideas, democracy in the sense of social control on policies and of reward or rejection of these policies by society, is treated as a variable with a negative sign. This concept has been applied for the past two decades, as the doctrine of "Central Bank independence" according to which governments cannot exercise any intervention on central bankers' decisions on monetary policy. In this way the supposed "common interests of society" are served more efficiently, since technocrats are not committed to the so-called vested interests. Lately, this tactic seems to be used more and more widely. While so far it only found application in the field of monetary policy, now it tends to spread to every sector of governance.

The cases of the two new prime ministers of Italy and Greece, Mario Monti and Lucas Papademos respectively, constitute the two most obvious examples of this diversion.

The current situation, in all its facets, is neither simple nor easy and thus predictions of how things will evolve regarding the economic, political and social situation in Europe and around the world would be overly perilous. What is for us to do at this instance is be conscious of the systemic reasons behind the crisis, contest conventional wisdom which propagates the lack of alternatives and defend social conquests. This crisis is not one that can be solely resolved at the level of the nation-state. Any viable solution that prioritizes employment, social rights and environmentally sustainable growth needs to be European and address political issues beyond the national discourse. In what concerns the Left in all its facets, fighting for international solidarity and creating the conditions for an alternative European project should be its most imperative goal.

Considering all these issues, one year ago, in March 2011, the Party of the European Left, transform! europe, the Nicos Poulantzas Institute and the Coalition of the Left of Movements and of Ecology (Synaspismos) organised a European Conference in Athens aimed at the analysis of the various aspects of the severe debt crisis that was already unfolding in Europe and which - at that point - was mainly affecting the countries of the southern European periphery and Ireland (specifically, Portugal, Greece and Spain). Contrary to the dominant view, which attributed the debt crisis to fiscal profligacy in an attempt to legitimise austerity

policies with moralistic arguments, the organisers drew attention to the crisis' systemic nature, its structural link to the global crisis of neoliberal capitalism, as well as its intrinsic roots in the architecture of the EU and the Eurozone.

A year later, most of the arguments presented in the context of this Conference look impressively sibylline. The EU stands on one of the most critical crossroads since its construction. The debt crisis has spread to the core of the eurozone (in November 2011 the sharp rise in Italian bond spreads caused international panic, while two months later, in January 2012, Standard & Poor's lowered the AAA rating of France and Austria and downgraded seven more European countries) and the prospect of recovery is all but visible.

As most would agree, urgent times require urgent action. Nevertheless, what is even more urgent –perhaps now more than ever– is to understand the issue at stake. To contest, in other words, the power of the dominant views through decoding its narrative and convincing for the validity of our own. Why did the debt crisis come about? Why do policies adopted by the EU deteriorate, rather than resolve the problem? What are the consequences of the crisis on the people of Europe and how do they affect the EU construction? What can we do to address the crisis and create the foundations for a socialist Europe based on solidarity and cooperation rather than competition and national antagonisms?

These are the issues tackled in the present collection of articles based on interventions made during the Athens Conference. Among the many interesting and insightful texts presented in the Conference, a committee consisting of the editors and members of the board of transform! europe chose a small part, being cautious to maintain a fair balance between greek and foreign authors. The full list of interventions, as well as most of the texts are available on the website of the Conference (<http://athensdebtconference.wordpress.com>).

The book is organized in five sections, each containing complementary interventions on the respective topics. The line of argument begins with the assessment of the fundamental issue of the causes of the European debt crisis. Fundamental because not a single debate regarding this crisis' effects on different countries and on different social groups, or regarding its management and the proposals for its overcoming can go forward unless we are confronted with the question of the underlying reasons behind its eruption.

Such a comprehensive analysis is not a mere academic exercise. It produces important economic and political conclusions that contest the hegemonic conventional wisdom in explaining, but most importantly in dealing with the crisis and it is, thus, the topic of the book's first section.

According to George Stathakis, the increase of public debt after 2007 was not a phenomenon contained only in Europe. In the decade that preceded the economic crisis, the world public debt was relatively stable, while private debt in many mature economies was ranging from 200-300% of GDP. The need to avoid extensive bank failures and avert the repetition of the 1929 collapse, as well as the decrease in public revenues due to the general economic downturn, caused the creation of excessive deficits and the accumulation of public debt. Further, Stathakis refers to the role of financial market speculation on public debt and the lack of a comprehensive response on the part of the EU. He concludes by stressing the inappropriateness of fiscal consolidation and the importance of resolving the Eurozone crisis in order to restore stability in the world economy.

Brigitte Unger argues that the roots of the debt crisis lie in the unequal income and wealth distribution in capitalism. The fact that the increase of sovereign debt in many countries is characterized as a “debt crisis” is a depiction of the needs of financial markets. History has shown that many levels of debt are compatible with a functioning economy, and thus the arbitrary restriction of the debt to GDP level to 60% depicts the interests of the financial markets for a low inflation rate (also inscribed as the main target of the ECB) expressed through sanctioning debt increases and making borrowing impossible.

On the same lines, Euclid Tsakalotos argues that what we are dealing with is the transformation of the financial crisis into a sovereign debt crisis. In other words, the current debt crisis is an expression of the systemic crisis rooted in income inequality and the lack of financial regulation as well as macroeconomic imbalances, accentuated by the architecture of the EU and its persistence in the neoliberal project.

The role of the EU, and more specifically that of the Eurozone and the common currency, are analysed in more detail by Dimitris Sotiropoulos. His main argument is that what is presented as a strategy against the crisis is in fact a strategy against the resistance of labour to the neoliberal organization of capitalist power in which sovereign states act as guarantors of the interests of capital. Issuing debt in a currency (the euro) which is not supported by a uniform fiscal authority can turn into a crisis with a high sovereign default risk due to the lack of a lender of last resort. What is more, financial stability can be safeguarded only through fiscal discipline.

Understanding the evolution of the crisis and its consequences both for the people of Europe and for the European construction inevitably implies an assessment of the official policies pursued by the EU authorities in the course of the crisis. This is the goal of the second section.

Marica Frangakis critically approaches the connection between the public debt

crisis and the structural problems of the EU's architecture. She shows that the transfer of large amounts of funds from the member states to their respective financial systems, as well as the lagging behind of the regulation of the financial system at the European and the global level turned a typical banking crisis into a public debt crisis. What is more, the lack of a central banker of last resort (the ECB is barred from issuing currency in order to support a member state in crisis) means there is no protection from financial-market pressures and the danger of sovereign default. Regarding the management of the debt crisis, the creation of the ESM, which will replace the EFSF by 2013, will only increase the problems confronting many Eurozone countries due to their adherence to austerity and neoliberal policies, while exacerbating the existing social and democratic deficit.

In what follows Jan Toporowski discusses the role of government debt markets in managing financial crises. As he explains, a high proportion of bonds in the capital markets, makes them less speculative because of the limited scope for capital gains. In the eurozone, however, the Stability and Growth Pact and the ECB make it more difficult to stabilize capital markets with government bonds. The lack of central bank management results to an increase in financial pressure on different countries with premiums which do not reflect the actual debt/GDP ratios but rather the markets' perception of the respective banking crises. The author concludes by proposing three prerequisites for an “optimal” government bond issue.

Riccardo Bellofiore points to the inadequate political management of the crisis. As he argues, political ineffectiveness during the last three years has exposed European countries, one after the other, to the pressures of the markets and increased the risk of default. The lack of national sovereignty over the euro and the genital inability of the ECB to either act as a lender of last resort or finance government deficits further complicate matters. In his opinion, what we need to do is not return to a Keynesian “socialism for the rich” but reconsider the issues of how, what, how much and for whom to produce.

The various consequences of the crisis are analyzed in the third section.

Maria Karamessini describes the consequences of the crisis in two levels: on the one hand for the EU as a whole –compared with other major economic regions– and on the other hand for the different EU countries. She argues that the extent of GDP contraction in the eurozone countries between 2008 and 2010 varied depending on the kind of fiscal policies implemented as a response to the initial shock of the crisis. Moreover, the management of the crisis by the EU political elites and hegemonic states and the adherence to the neoliberal project translates into a serious employment crisis and the deterioration of working conditions for the people of Europe.

A dimension of the crisis that we tend to neglect concerns its differential consequences on men and women. Giovanna Vertova contributes to this problematic using an analysis based on both class and gender considerations. She concludes that policy responses to the crisis are detrimental for gender equality as they are rooted in the already gender segregated labour markets, the gender pay gap and the domestic unpaid and migrant domestic labour.

In what follows, Elisabeth Gauthier points out the political dimensions of the crisis and especially its effect on democracy. As she mentions, the crisis in Europe is not only the result of the 2008 bank bailouts, but above all the result of thirty years of an economic, political and ideological neoliberal offensive. Its management during the last four years at the European level has undermined democratic decision-making either through “governments of experts” or through the establishment of a mode of EU governance that is increasingly authoritarian. The consequent loss of legitimacy of political leaders is expressed via massive electoral abstention, the erosion of traditional governing parties and the growing influence of an anti-systemic discourse of radical populist right-wing parties. Face to this, there is an imperative need to create more offensive resistance, build alternatives and construct new social and political dynamics.

According to the analysis of the previous sections the debt crisis in Europe is fundamentally rooted in both the systemic contradictions of neoliberal capitalism, the architecture of the Eurozone and the strategic goals of the European Union. The evolution of the crisis shows that despite national specificities most –if not all– European countries are dealing with severe debt problems face to which there is a uniform policy response: austerity. In this sense, the Greek case does not look all that unique anymore.

The fourth section consists of five country cases –Spain, Portugal, Ireland, Greece, and Hungary– that make the above point.

The crisis in Spain began as a problem of private debt. As Javier Navascués argues, the accumulation of public debt followed the eruption of the real estate bubble in 2009 through two circuits: On the one hand, there was an increase of the public deficit brought about as a result of stagnating economic activity (subsidisation of car sales, unemployment benefits and a plunge in tax earnings). On the other hand, the indebtedness of Spanish banks, backed with overpriced collateral, had to be covered by the Spanish government. The policy mix followed is by now familiar: cuts in public sector salaries, contraction of social expenditure (health and education), less public investments, labour market reform (reduced dismissal costs, flexible contracts, less collective bargaining), privatisations of savings banks, and exemption of big

corporations from income tax. Finally, Navascués outlines the basic political evolutions of recent years and the alternative perspectives for Spain and for Europe.

The analysis of the Portuguese case is presented by Mariana Mortágua, who describes the underpinnings of the debt crisis in the accumulation process of the last decades –and the financialisation period more specifically– as well as the structural effects generated as a result of the architecture of the EMU (loss of competitiveness that resulted in permanent budget deficits financed through bank loans and portfolio flows). The author attempts to deconstruct the prescribed austerity policy on the grounds of its inefficiency in meeting its proclaimed financial goals and its inability to generate growth and employment.

An ostensibly bizarre case of a country dealing with severe debt, social and political problems during the last couple of year is that of the prior “economic miracle” of Ireland. As Daniel Finn⁶ explains, between 1993 and 2000 the Irish economy was growing by an average of 9% a year and unemployment had almost disappeared. In 2008 the Irish state decided to offer unlimited guarantees to its collapsing banking system and by 2010 GDP registered one of the biggest slumps ever recorded in the country, while unemployment reached 13%. The author argues that the Irish crisis is deeply rooted in the economic model of extreme neoliberalism followed during the last decades, which generated a huge property bubble and a vulnerable financial system.

Regarding the Greek debt crisis we decided to include an article by Eric Toussaint, an economist active in the Committee for the Abolition of Third World Debt. According to his view, the case of Greece constitutes an example of a neoliberal pattern of debt compilation, and not a unique “weak link”, as it has been presented by the dominant narrative. Moreover, as he argues, the implode of public debt was due to low taxation on companies and higher incomes, the purchasing of military equipment –mainly from France and Germany– as well as the cost of organizing the Olympic Games in 2004. For all these reasons, the debt needs to be rigorously scrutinized.

The section concludes with an article on the case of Hungary. In the first instance this country does not seem to fit in the core of the “peripheral model” outlined above and to which we are used to refer as the PIGS. However, as Tamás Morva argues, there is a fundamental connection between the policy mix and its consequences described in the previous papers. Hungary has been under bail-out agreements with

6. Even though Daniel Finn did not participate in the Athens Debt Conference, we considered imperative to include an article about the Irish situation, as the latter constitutes an important part of the development of the debt crisis in Europe.

the IMF and the World Bank from 1982 to 1997. During this period it had to go through a tough consolidation program including deregulations, liberalization and privatization in order to “restore international confidence”. The result was a debt increase from 62% of GDP in 1995 to 111.5% in 2009 and the need for a new austerity intervention in the context of the current crisis.

The fifth section constitutes –and logically so– the most difficult and at the same time the most challenging part of the book. The dense economic and political evolutions driven by the urgency to contain the downward spiral in many European economies have and will continue to render proposals regarding the resolution of the debt crisis quickly outdated. However, at the time when these lines are written, the Eurozone stands in yet another critical turn after the inescapable restructuring of the Greek debt obligations by 53.5% with the participation of private sector creditors on the 9th of March 2012. In the framework of this deal, Greece had to adopt a new bail-out plan in exchange for a second Memorandum which completes the mangling of wages and pensions and the demolition of its welfare state.

In this sense, the texts of Yiannis Dragasakis, Kunibert Raffer, Pedro Páez Pérez, Nicos Chountis and Yanis Varoufakis are not only important in registering the problematic nature of the dominant strategy against the crisis. Each of them proves to be impressively sibylline vis-à-vis current developments in the EU, while outlining elements of an alternative systemic perspective.

In the introduction of his paper, Yiannis Dragasakis underlines the systemic nature of the debt crisis as an expression of the global capitalist crisis. As he mentions, the problem of indebtedness stems from the long-term unequal income distribution as well as the socialisation of costs that emerged due to the financial crisis. In the case of Greece the unsustainable accumulated public debt cannot and should not be repaid as it represents a non-existing capital both in terms of money and in terms of productive capacity. Since the debt problem has now taken a European and worldwide dimension, a progressive solution to the crisis should include: changing the role of the ECB to allow direct lending to countries, establishing a mechanism for issuing a eurobond, transforming part of the sovereign debts into a common European debt and cancel, sterilize or repurchase it, upgrading the EU budget to finance growth, employment and social development. The article concludes that the regulation of debt is not sufficient to cope with the social problem if the system that generates it is not overthrown.

Kunibert Raffer reveals the impasse of the EU policy in continuing to offer Greece and other heavily indebted countries credit that perpetuates liabilities which are impossible to be met. As he argues, what needs to be found is a solution which differs

markedly from creditor dominated lines followed so far. This solution –first presented in 1987 and currently known in bibliography as *The Raffer proposal*– attempts to introduce a framework of insolvency protection for countries, commensurate to the one used in the case of US municipal insolvency.

Pedro Páez Pérez stresses the need for coordinated action of the people in Europe in order to generate a process that block the agenda of the international financial oligarchy. His analysis focuses on the similarities between the Latin-American financial and debt crisis of the 1980s and its management through austerity policies which deeply affected the ability to restore growth due to the harsh reduction of the rate of investments with respect to GDP, and the current crisis in Europe. However, he points out that the European case needs to be carefully tackled. As he mentions, unilateral exit of a country from the euro followed by devaluation in this conjuncture is unlikely to have positive effects on the reactivation of production forces. What he proposes for the short-term is a zero interest rate lending by the ECB to finance full employment policies or an arrangement for a multilateral debt settlement according to which the maximum debt service could not exceed 5% of exports.

Nicos Chountis outlines the pillars of a Left hegemonic program for an exit from the crisis. Having described the stance of the EU towards the crisis, the decisions regarding the New Economic Governance, the European Semester and the Pact for the Euro which constitute what he calls “a poor management of the debt crisis”, he speaks about the terms under which the crisis can be an opportunity for the Left. In this sense, he refers to three interrelated levels of intervention: the ideological level, the level of reform proposals and the strategic level of economic and social organization.

Last but not least, Yanis Varoufakis, explains why the resolution of the debt crisis in Europe is more a matter of political, rather than economic decision making. In the *Modest Proposal for the Resolution of the Euro Crisis*, which he co-authored with professor Stuart Holland, he suggests that Europe should follow three levels of intervention corresponding to three main policies: the first one concerns the stabilization of the sovereign debt crisis through a tranche transfer of 60% of the sovereign debt of all member states to the ECB, the second tackles the banking sector crisis with the use of the EFSF and the third proposes the introduction of a European Recovery Programme with investments funded by the EIB.

The book concludes with two political interventions by Pierre Laurent, president of the party of the European Left (EL) and Alexis Tsipras, vice-president of the EL and president of the party of Synaspismos in Greece both stating the imperative of European-wide solutions for countering the new neoliberal offensive and putting the foundations for a new Europe. These texts were written before the last elections in

France and in Greece, thus not taking into account the very important political evolutions produced by them. However, the main strategic objectives are vigorously outlined.

We believe that all texts included in this book raise very important issues which still remain open for analytical debate, and more importantly for the reality of the people of Europe. Even though we might not be in full accordance with some of the opinions expressed, we do not cease to regard them as crucial insights that enrich our common goal. The battle of ideas in a period like this is a difficult and challenging task. With the hope that this book contributes to a critical understanding of the reality of the Great Crisis of our times, we wish you a pleasant reading.

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June, 2012

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The World Public Debt Crisis

GEORGE STATHAKIS

THE INCREASE OF PUBLIC DEBT DURING THE CRISIS

Public debt increased after 2007 with impressive rates worldwide. From 28 trillion dollars it reached the current 41 trillion, and it is projected that in a couple of years it will become 100% of world income. In the decade preceding the crisis, public debt was relatively stable and due to the prevailing low interest rates and impressive rates of growth in the world economy, it had even declined.

Prior to the crisis it was private debt, which includes financial institutions, non-financial business and households, that had reached exceptional heights. In the UK it was 300% of the GDP, in the US 230%, in Spain 250%, in Canada 180% and in Japan 260%. The mature economies had a combined debt –private and public– averaging 400% of their GDPs. Emerging economies had much smaller levels of combined debt, something in the range of 100-150% of GDP.

The general rise of private debt in the mature economies was linked to two primary causes: home loans and derivatives of all kinds, among them the CDSs. Home loans increased by around 40 trillion between 2000 and 2008. Derivatives reached the staggering sum of 60 trillion. Thus, financial institutions and households account for the impressive growth of credit. Non-financial business and corporations

did not show any particular increase in debt, with the exception of business involved in mergers and acquisitions.

This general rise of private debt must be accounted for by the impressive rates of growth that the world economy experienced in the last decade. It coincided with the absolute deregulation of the financial markets and with the neoliberal agenda that prevailed in most mature economies. Yet the signs of successive crisis were there. At first, various countries had defaulted in the Asian and Latin America crisis of the late 1990s. This was followed in 2001 by the collapse of stocks in the new technology companies, and then there was the collapse of many emerging stock exchanges. Finally, there were world-trade imbalances building up between surplus and deficit economies. In effect, there was strong evidence that the financial markets were quite incapable of directing investment and production in sustainable directions.

Yet, the credit explosion led to an impressive growth in the world economy. It sustained the increases in world demand and coincided with the explosion of production in the emerging economies, predominantly in China. It kept the world economy going despite the huge imbalances between surplus and deficit economies. At the same time it facilitated speculative growth in most mature economies. As in Japan, Sweden and many other countries in the 1990s, speculative growth was a typical real-estate bubble. All of them taken together led to the “credit crunch” and the financial crisis.

In the aftermath of the crisis private debt tends to shrink sharply. This is a common response for an extended period after any financial crisis. Just as a rapid expansion in private credit fuels the boom phase of the cycle, so does serious deleveraging exacerbate the post-crisis downturn.

This is the case in the current crisis. Wholesale inter-bank markets and foreign-exchange swap markets were disrupted. To some extent the decline of credit followed the decline of foreign trade by 20-30% within a year. In addition, the many national banks shifted their portfolios towards national products, including bonds, and their balance sheets in favour of savings. CDSs were reduced to half within a year and remained so for the coming years. Other forms of derivatives disappeared. There were large international flows of funds to the United States and Japan. US banks withdrew money from their branches abroad. Japan had been the hot spot for carry trade around the world, taking advantage of differences in interest rates. Japan started receiving repayments as financial and non-financial business shifted loans in an attempt to improve their balance sheets.

Deleveraging was harder to attain in the credit markets related to households and financial institutions. State support became necessary in order to avoid the 1929

syndrome of bank failures. Most governments responded to the crisis by bailing out banks and other financial institutions and by adopting stimulus packages to deal with the recession. In the US alone, 7 trillion dollars were spent in various instruments used to support financial institutions. In the UK, state support was also intensive. In Ireland, private debts were turned directly into public debt through the nationalisation of the banks. Iceland collapsed.

This substantially increased public expenditure, while there was a marked decline in government revenues, which have hit advanced and emerging market economies alike. In effect, public deficits increased. The increase in (inflation-adjusted) public debt that has occurred since 2007 in the five countries with systemic financial crises (Iceland, Ireland, Spain, the U.K. and the US), has been on average about 75%. These data tend to accommodate statistical research on previous deep post-war financial crises, which indicate that during the three-year period after the crisis public debt usually increases by 80-90%. Even in countries that have not experienced a major financial crisis, debt rose by an average 20% in real terms between 2007 and 2009, and this holds true for both European and developing economies around the globe.

In times of crisis the distinction between public and private debt is of little relevance, and therefore it is their combined effect that really matters. Yet the combination of fiscal deficits and “save the banks” policies were successful in stemming the downturn of the global economy. The growth of the global economy had just one negative year, 2009. Then growth returned. Considering the dimensions of the financial crisis the return to a growth path, no matter how unstable, was an achievement.

IS PUBLIC DEBT A PROBLEM?

The sharp increase in sovereign debt raised the question of fiscal sustainability, and its broader economic and financial market impact. A key issue relates to the extent to which large public debts are likely to have an adverse effect on capital accumulation, as well as productivity, and reduce economic growth. This can occur through a variety of channels including higher long-term interest rates, possibly higher future distortionary taxation, higher inflation and greater uncertainty and vulnerability to crises. If economic growth is negatively affected, fiscal sustainability issues are likely to be exacerbated as increased interest rates on public debt and decisive fiscal adjustment efforts to reduce the debts to more sustainable levels are moving the economy to deeper recession. Despite the importance of the issue, there is little

systematic evidence of the extent to which big debts are likely to reduce potential growth.

Agents are usually forward looking. This leads to the “Ricardo equivalent”, according to which it is the rise in savings that balances the rise of deficits. This may be the direct result of increased income, of savings for covering increased taxation in the future or the consequence of other factors. It may reduce the impact on interest rates. If taxes are non-distortionary and individuals are heterogeneous, debt accumulation can be consistent with a short-term rise in interest rates but may not have a pronounced impact on bond yields in the long run. Additional factors may weaken the link between debt, deficits, and interest rates. For instance, in an open economy, domestic savings may be complemented over a period of time by capital inflows leading to real exchange-rate appreciation rather than higher real interest rates in response to lower government savings.

Statistical evidence tends to support the Ricardian-equivalent approach. Most studies find that the relationship between government debt and real GDP growth is weak for debt/GDP ratios below a threshold of 90%. Above 90%, median growth rates fall by 1%, and average growth falls considerably more. It has been seen that the threshold for public debt is similar in advanced and emerging economies. Emerging economies seem to face lower thresholds for external debt (public and private), which is usually denominated in a foreign currency. What is more, there is no apparent contemporaneous link between inflation and public debt levels for the advanced countries, while the story is entirely different for emerging markets where inflation rises sharply as debt increases.

FINANCIAL MARKETS AND PUBLIC DEBT

The financial markets had been indifferent towards public debt during the boom period of 2001 and 2007. All European countries, those in the Eurozone and the new members, were receiving loans at interest rates slightly higher than the major safe economies. Even economies with very high public debt (Italy, Belgium, Greece, etc.) were refinancing their debts with very favourable interest rates.

Suddenly, during 2009, financial markets focused on public debt as the main and predominant economic problem/source of the crisis and began differentiating interest rates according to risk estimates generated by the rating agencies. This was a new phenomenon as both the rating agencies and the funding institutions had no available techniques for estimating risk on public debt. In effect, they had to adapt existing techniques of calculation being used in private asset markets and adjust them to the

case of public debt, often producing quite awkward models with little relevance to public finance.

Yet, public debt became a new area of speculative activity. Traditional markets of stocks, futures and commodities were already unstable with falling prices. Then for a short period commodities became an area of high speculation, and finally all markets were more or less stabilised at a level lower than that of the pre-crisis years. Public debt became the most important area of new speculative activity.

There are two reasons for this shift. First, there was a major shift of savings around the world in search of safe investments even with zero or negative interest rates, as the danger of financial instability was affecting money itself. Thus there was a run on safe currencies, safe bonds and gold. Second, the financial markets had to adjust to less available funds as the deleveraging process was present at all levels, with a growing demand for financing public debt both in mature and emerging economies, particularly in the former and predominantly in the US. The first factor was pushing interest rates downwards in accordance with the policies of central banks (excluding that of the EU) to lower interest rates and increase the money supply. The second factor was that the huge increase in demand for public debt financing was pushing interest rates upwards. Speculation emerged in those areas where the interface of these factors favoured unstable developments – in effect, in the EU.

Practically, the relation between financial markets and the public debt turned into a political one. The US had no problem in financing the largest peacetime public debt. There was little if any doubt that despite strong economic factors normally favouring US bonds as a safe haven, politics were also involved, as Wall Street was saved more than once through active state involvement. In the EU, however, a political conflict emerged that paralysed Europe and turned it from an economy with very strong fundamentals and relatively small public debt into the most unstable economy.

The EU has chosen from the start of the crisis not to take any action at the European level, with the exception of a small package in support of the banking system. Crisis policies were to be pursued at the national level by the respective governments opting for policy measures that could even violate existing European frameworks on competition or the Stability Pact. In effect, governments were allowed to increase public deficits and to support, through state subsidies, national industries being at risk and banks.

Yet by the end of 2009 the European economy had experienced a year with a 5% recession, but this turned out to be short lived. In most cases national policies were effective in sustaining employment levels, and by 2010 the European economy was back on a recovery path. Some economies were doing quite well. 2010 and 2011 were

years of recovery for the German, the Dutch and the French economy among others. Yet it was also a year of unprecedented crisis for the periphery of Europe.

Starting in late 2009, and within six months, Greece, Ireland, Portugal were excluded from the markets; Spain was put under enormous pressure, and it was a question of time before Italy, or even France, would become part of the picture. Without doubt, the EU under the Merkel-Sarkozy leadership proved disastrous. They were leading the way to successive responses received very badly by both the markets and respective economies, which led to a series of failures.

At first the idea was that the Greek problem of public debt could be contained through a simple mechanism of mediation between the financial markets and the indebted country. This mechanism, in practical terms, would create a buffer zone where the guarantees of Germany and France would be adequate to maintain the refinancing. The EFSF mechanism was thus established and the famous “bailout” of Greece was accomplished through fresh credit from the EFSF in exchange for an IMF-type “shock therapy” package. This package would produce a deflationary effect and an internal devaluation of wages and prices of assets, sustaining the common currency and preventing the Greek crisis from affecting the rest of Europe.

Yet Ireland and Portugal joined the EFSF in a very short period, while Spain started to have problems. The need for a permanent mechanism came to the fore. It was initially planned for 2013 and then moved to 2012. The inconsistencies in EU policies produced successive decisions by summits that lasted for just a few weeks, as markets kept pushing for more appropriate action.

The policies pursued at the European level kept pointing toward a single-issue agenda, that is, fiscal consolidation through a downward adjustment of wages, salaries, pensions and a reduced welfare state. Recession seems to be the direct effect of the policies pursued by the hegemonic political and economic elites in Europe, but it looks as if this is being undermined. The explosion of debt in the troubled economies and the addition of major economies to those under market pressure, such as Italy and even France, started putting the coherence of Euro into question.

THE CRISIS OF THE EUROZONE AND THE INSTABILITY OF THE WORLD ECONOMY

The crisis of Europe has taken on huge dimensions as both the architecture of the Euro and the prevailing policies are unable to tackle the crisis. The current fiscal consolidation is the wrong type of policy; the public debt crisis is becoming non-manageable; the banking system, despite successive injections, remains fragile; the real economy is moving into recession; the Euro is entering a phase of devaluation in

relation to the dollar and the other main currencies. The mechanisms in place such as the EFSF are unable to attract long-term loans from the financial markets. And the ECB is providing new rounds of short and medium-term finance to the banking system with increasing sums of money.

Yet, the instability of the exchange rates is a very crucial element in the world economy. During the crisis there were two major responses that managed to stabilise the system. The first involved state initiatives and the increase of public debt. The second was keeping the exchange rates among major currencies relatively stable. Both ideas came from the 1929 experience when the banking crisis and competitive devaluations led the world economy into a great depression.

Thus the crisis in Europe has become very important for the stability of the world economy. The European responses initially turned into a typical “free-ride” question. The US and China were pumping money into their domestic economies sustaining growth, and Europe as net exporter was expected to gain growth without having to take the necessary measures to sustain its own internal market. This strategy, however, came to an end due to the escalation of the debt crisis in Europe and the gradual emergence of major problems in the financing of the banking system from interbank markets. Rising interest rates constitute the threat that Europe is facing together with the collapse of one or more of the fragile banking systems in Western and Eastern Europe.

There is little doubt that we are at the centre of a world crisis which has produced a major dilemma. The Eurozone is facing a problem of unsustainable public debt in certain economies. In addition, macroeconomic imbalances are produced by the asymmetry present in trade and money flows within the EU. These factors are pushing towards a major currency crisis, which calls the Euro into question.

On the other hand, the increase of world public debt is putting pressure on world currency stability. At the same time, the world imbalances in trade and money flows raise the question of the very sustainability of the patterns established between economies with trade surplus, such as China, and debt economies, such as the US.

An international debt crisis may at any time trigger a currency crisis. Or a currency crisis may trigger the debt crisis. It depends on which area moves first. Policies to support currency stability first of all require Europe to go in a completely different direction. The deleveraging of public debt can only be achieved through common policies that turn national into European debt and use common techniques of refinancing and reduction of debt. Coordination of policies between Europe, the US and East Asia, both between central banks and governments, may manage to maintain currency stability allowing public debt to function according to the “Ricardo

equivalent” principle. In effect, the 2008 crisis has moved into a new phase where instabilities tend to threaten the fragile recovery achieved in 2010 and 2011.

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Causes of the Debt Crisis – Greek Problem or Systemic Problem?

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INTRODUCTION

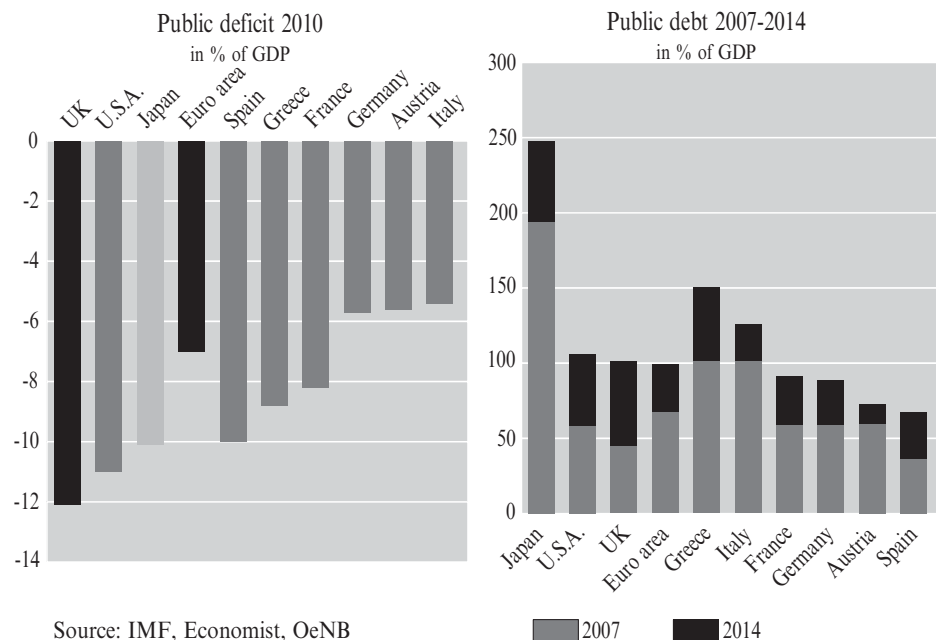
For someone coming from the Netherlands, the idea that we are living in a crisis sounds very farfetched. The majority of Dutch people seem to feel that there is no crisis, and if there was one at some point, it ended very soon and is definitely finished by now. The Netherlands is one of the countries with the largest financial markets in Europe. Therefore, big interests were involved in minimising the financial crisis of 2008. The Dutch government was one of the first to support the banking sector with massive public aid, which included nationalisation of one bank, liquidity injections and large guarantees, and amounted in total to more than 50% of the Dutch GDP. This very rapid and massive aid to the private banking sector made it seem as if there never had been a crisis. In my country of origin, Austria, things were slightly different. There, too, it was felt that the crisis was over, but fears of a replay of the hyperinflation of the 1930s emerged. Public debt was then not an issue, neither in the Netherlands nor in Austria, and so Greece’s debt problem came to both countries as a surprise.

In what follows, I would like to demonstrate first that the so-called debt crisis is a

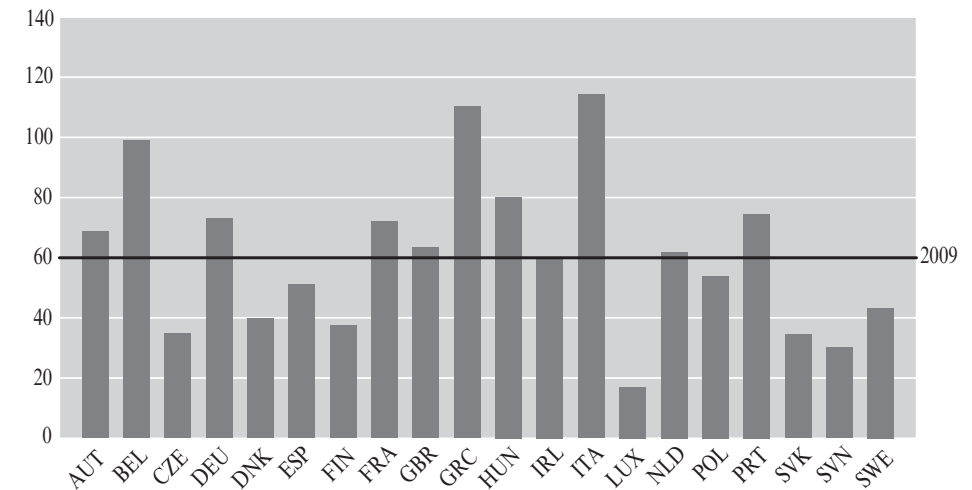
continuation and consequence of the 2008 financial crisis. Whether public debt today is too high or too low or at the right level is a matter of political perception. I will then outline the different historical perceptions of public debt. Finally, I will present my own hypothesis, namely that there is a systemic crisis which appears in different guises: as a real estate subprime mortgage crisis, as an exchange-rate crisis and as a public debt crisis. The true reason for all these crises in new disguise is the unprecedentedly unequal distribution of income and wealth worldwide. This means the next crisis will come soon.

PUBLIC DEBT AFTER THE FINANCIAL CRISIS OF 2008

Public debt has increased, especially after 2007-2008. In the first diagram, on the left, the public deficits of the UK, US, Japan and some countries of the Eurozone are shown for 2010. The Greek data have since been re-evaluated. On the right the first four columns show the EU's projection of how public debt will evolve until 2014. You can thus see that Japan, the UK and the US double their public debt, and the same goes for the Eurozone.



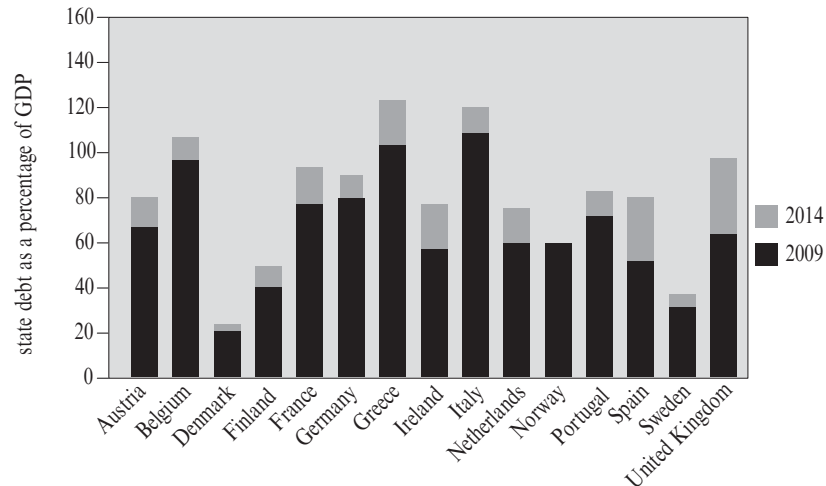
In 2009, one year after the crisis, many countries in Europe suffered from increased public debt, and many exceeded the threshold set by the Maastricht criteria for the Eurozone at that point. As the following graph shows, many countries in 2009 had a public debt exceeding the threshold of less than 60% of GDP.



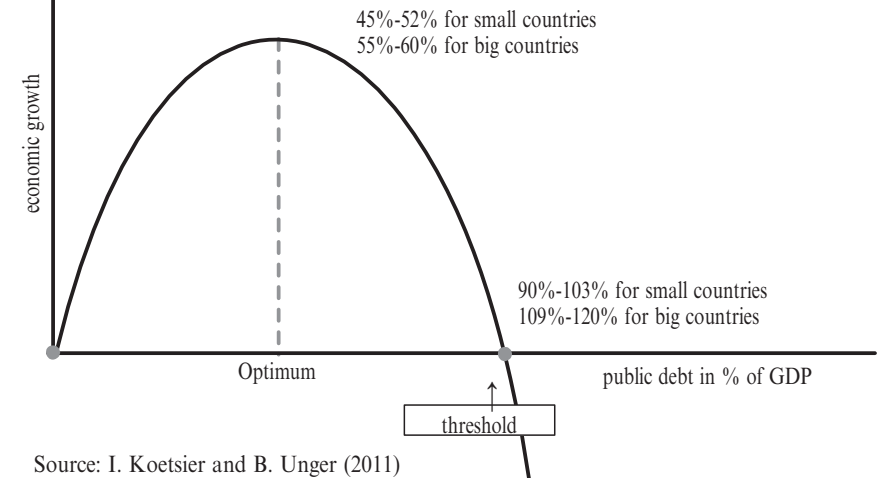
Source: IMF

By 2014 public debt will increase further, so that the EU average will be around 80% of GDP, and this will be the new official threshold of acceptable public debt. Most countries –not only Greece– will be facing the problem of increased debt. The limit of a debt/output ratio of 60% has always been too restrictive. In 1991, at the time when the threshold was established, it was the average debt in percent of GDP of the countries that participated in the EU. This magic number of 60% was then multiplied by 5% (the forecasted nominal growth rate for the coming ten years) in order to arrive at 3%, as the magic limit for budget deficits. This simple calculus –public debt as a percent of GDP times nominal growth rate equals net deficit as a percent of GDP– was the mathematical formula that has held Europe breathless since 1992. The debt/output ratio was arrived at completely arbitrarily. Had the Maastricht Committee met a short while later, the average debt in Europe would have increased, and the debt/output ratio would have been fixed at 70%, allowing a net deficit of 3.5%. Furthermore, the public debt criterion of Maastricht refers to gross debt instead of net debt. This means it does not distinguish between the case of a

country borrowing money to repay its old debt and that of a country creating new debt. In this respect, the Maastricht Treaty was absurd since its inception.



Regarding the Netherlands we (Koetsier and Unger, 2011) have tried to calculate the public debt that would be viable within a conservative framework, without even considering the question from a left point of view. In so doing we used debt overhang studies made by the IMF during the last years and have made some calculations for Europe in order to identify the margin for possible public debts that do not have a negative impact on growth rates. The debt overhang theory holds that public debt at first has positive effects on the economy, but that when it reaches a certain maximum point negative effects appear and worsen until they reach a point at which private business is crowded out. We have tried to calculate the limits of debt, using data from 1990 to 2007 and from 2001 until today. What would be an optimal and what would be a viable debt before a country experiences negative effects on growth rates? According to our calculations, the debt could be 120% of GDP for the big countries and 103% for the small countries before a negative impact is felt on economic growth. That is, even if we consider the most conservative scenario, we still can find some room for manoeuvre for public debt. For the Netherlands, Koetsier and Unger (2011) showed that the Dutch debt could double before there would be a negative impact on the economy. Greece slightly exceeds this limit, and in general all countries have a much larger room for manoeuvre of public debt than suggested by the current European debate.

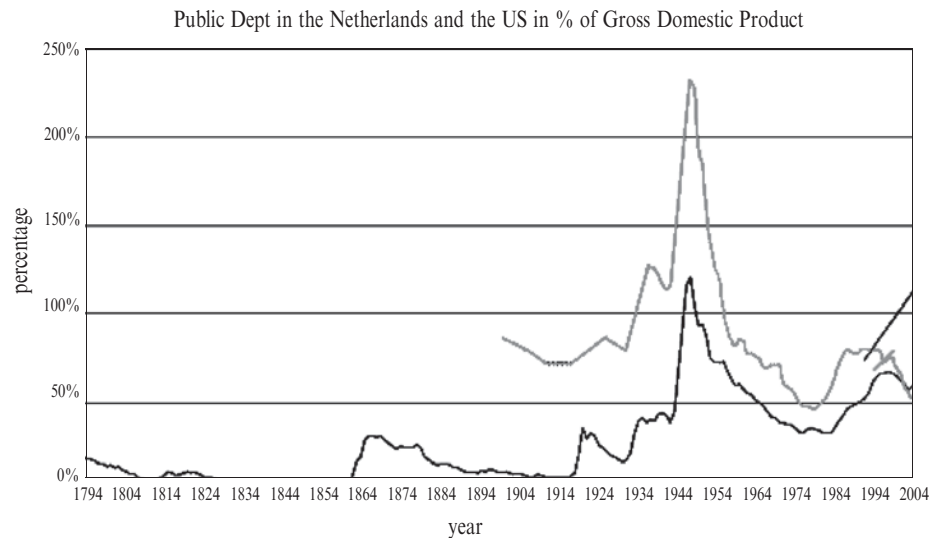


To sum up, the debt crisis is not a crisis due to high public debt. It is a problem of a perception that public debt is too high, a perception due to an anti-inflationary view of how the economy should behave, instructed by financial markets. It is financial markets which would lose money if inflation rates were high, since inflation is bad for lenders and good for borrowers, who have to pay back a lower debt in real terms. Watching inflation rates, financial markets have become more concerned about public debt as well. As the debt increases, there is sanctioning on the part of the markets. Governments start to depend on the mood of Moody's and on the poor standards of Standard & Poor's, and the financial elites have hegemony over public policy. For me, the high dependence of public policy on financial markets and the arbitrariness of rating agencies are the true problem and not the public debt as such. Public debt has gone up and down like a seesaw in history as the following section will show. Many levels of debt are compatible with a functioning economy as long as politics are still able to decide on public expenditures and income.

HISTORIC DEVELOPMENT OF PUBLIC DEBT AND DEBT PERCEPTION

In the course of history, the American debt from 1700, as well as the Dutch debt from 1900 on, had its ups and downs. As you will see, the 60% debt/output ratio was never

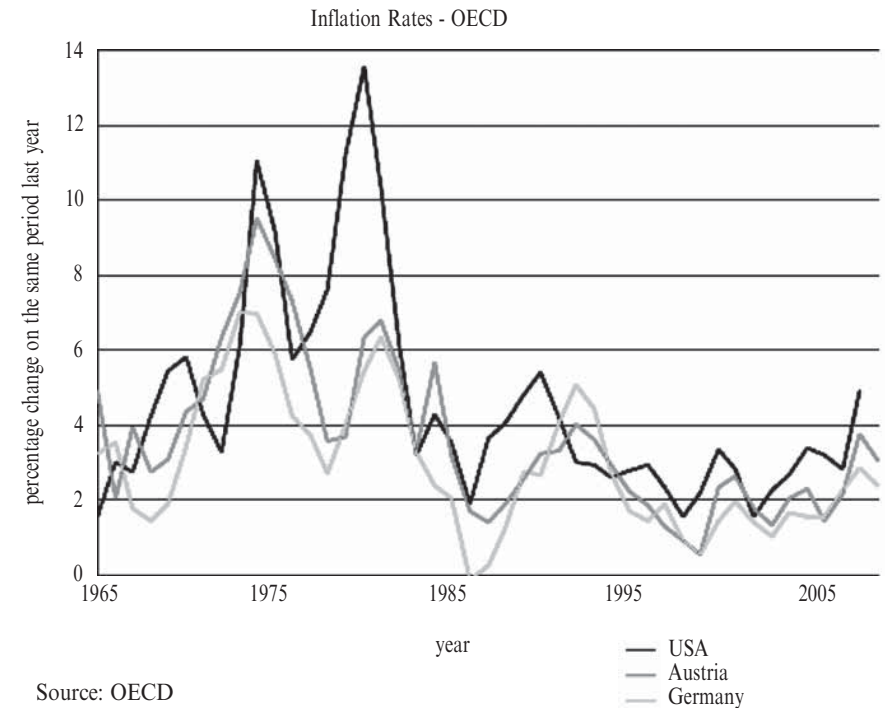
achieved in the Netherlands, except for a very brief period after the 1990s, so the Maastricht threshold in the Eurozone is far from reality.



Source: CBS and DSI Databank: OECD

Very often, especially in countries which experienced hyper-inflation, the perception of public debt goes hand in hand with the fear of inflation. As one can see in the following graph, the inflation rates that we have today are very low. When we are talking about 5% inflation, we get the impression today that this is high, but if we look at it historically, after 1965, inflation was fluctuating between 5-10%, and this was considered normal in Europe. Fear of inflation is created by financial markets which profit from low inflation rates. Fear of inflation when prices are even falling, as is the case during times of crisis, is economically exaggerated.

Let us now consider the history of public debt. Today we have the sense that it is something bad - at least in conservative circles - and we see, since the beginning of the history of economic thought that there has been a fluctuation in the perception of public debt as either good or bad. The Mercantilists considered public debt to be a treasure. The Portuguese writer Pinter wrote that public debt was a mine of gold. "A state without public debt is careless, it does either too little for the future" (by not creating enough infrastructure), or charges too much to the present generation (by making them pay for the benefits of future generation) the German author Lorenz



Source: OECD

von Stein wrote in the early nineteenth century. In the late nineteenth century, the neo-classical economists were hostile to public debt. For them, public debt represented a waste of resources, which would be used more productively by the private sector. In the twentieth century Keynes and Lerner argued that public debt is no burden and is necessary for full employment and a prosperous economy. "We owe the debt to ourselves", Lerner argued. Those who hold government bonds own the public debt and are wealthy; interest payments on public debt are charged to people and are paid to people, namely those who hold government bonds. In total, the economy is neither richer nor poorer as long as public debt is domestically held. In order not to lose interest payments on public debt to foreigners, Keynesians were in favour of domestic public debt and opposed high foreign public debt. Today public debt is seen as future taxes, as a burden on future generations, as something bad. The neo-classical economists are back in new disguise. The next turn in perception will certainly come once people are tired of the withdrawal of the public sector from the economy.

TABLE 1
Predominant View of Public Dept over Time: Its Ups and Downs

Mercantilists	Classical and Neo-classical economists	Keynesians	Ricardian Equivalence Public Choice
Public dept is a mine of gold. A state without dept is careless.	Public dept is a waste of resources.	Public dept is no burden, we owe it to ourselves. Depts are necessary for full employment.	Public debt means future taxes burdens future generations who have no free choice.
1730 Steuart	1880 Smith, Ricardo	1936 Keynes	1980 Barro, Buchanan

Source: Unger (2003)

From a Keynesian point of view, which I share, the problem of Greece, and many other European countries is the fact that control over the national debt was lost after the introduction of the Euro. Public debts are held by foreign agents who have a perception of what should happen to the economy completely different from the perception of national government bond holders. The Austrians for example, always had a domestic public debt of around 80%; now it has declined to 20%. Greece is totally dependent on international funding. With this it is also dependent on international ratings and the arbitrariness of rating agencies. Greek debt should be held by Greeks. Countries have to become more independent of financial evaluations.

Viewed from a historical perspective, we are now in a very conservative phase of public debt perception. This will change again. We will soon arrive at a turning point, where there will be a more positive attitude towards public debt and what it can mean for a country. More and more opposition to the arbitrariness of financial markets and rating agencies will grow, as they have lost a great deal of credibility and legitimacy in the last couple of years.

THE DEBT CRISIS IS A SYSTEMIC CRISIS

In my opinion, the present crisis is not one of public debt. It has the same origin as the economic crisis of 2009, rooted in the unfair distribution of income and wealth. Never

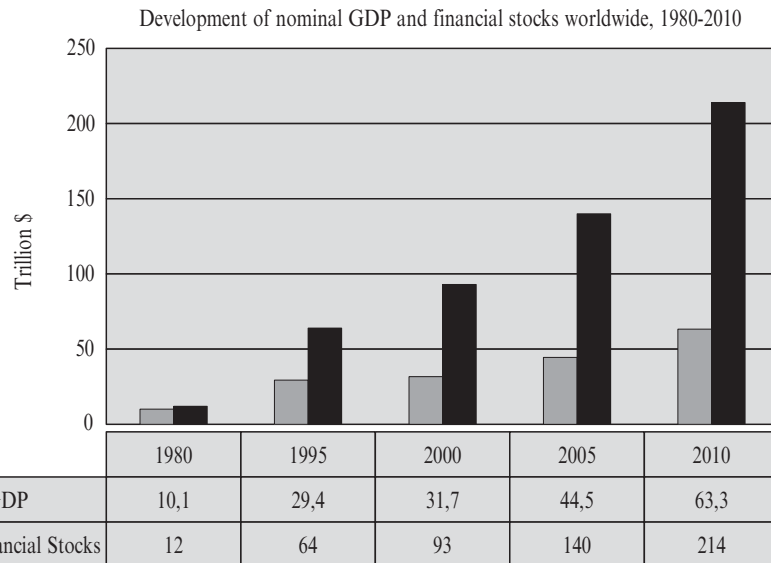
before in history have the differences between poor and rich countries and between poor and rich people been as great as they are today. When the poor do not earn sufficiently, and when the rich become so rich that they cannot spend their money on consumption and investment goods, there is a lack of demand for goods and services. Less demand for goods and services means that investors will also hesitate to invest in the real economy, since they know that they cannot sell the goods produced with the invested money. This leads to the shrinking of the real economy and the expansion of the financial sector.

Investing in financial markets rather than investing in the real economy has become so attractive that a new world with new rules has emerged. The financial sector requires low public debt and low inflation. For national governments this means austerity packages, reduction of the public sector, high unemployment and less growth. With this the debt/output ratio further increases, and eventually it all leads to a so-called debt crisis.

When one looks at the development of the real economy against the financial economy, one realises that the GDP was in a one-to-one relationship with the value of the financial markets in the early 1980s (see graph “Development of nominal GDP and financial stocks worldwide 1980-2010”). For one Euro you could buy one Euro’s worth of goods. By 2010, this relation becomes 1 to 4. Four Euros are available to buy one Euro worth of goods. So, what is then to be done with the remaining 3 Euros? You cannot eat money. It is this huge amount that is missing in the real economy. Did this odd relation change during the financial crisis? The reply is, no. The black bars in the following graph which represent the development of financial stocks worldwide, did increase further, the income and wealth of the financial sector did not suffer from the financial crisis. Nothing has changed in so far as the dynamics are concerned, and we can see that the financial sector has increased much more than the real sector, which is represented by the grey bars, measured as worldwide nominal GDP in trillion US Dollars.

Since money cannot be eaten, and since investing it in the real economy does not pay as long as other people do not have enough money to spend it on goods and services, people in the financial markets need alternative ways of investing their assets. And this is the initial reason that led to the financial crisis. Subprime mortgages, asset-backed securities, government bonds and credit default swaps, and all sorts of other derivatives, are artificially created financial products to keep financial markets going.

The financial elites make the situation more unstable, they exercise particular pressure on governments and they are interested in low inflation because otherwise they lose. The more they win, the more unbalanced the world economy is, the more



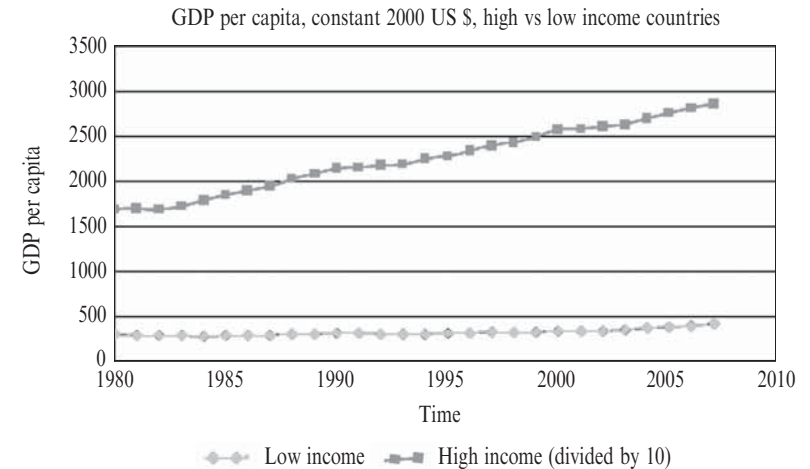
Source: OECD

fragile the whole system and the more quickly the next crisis approaches.

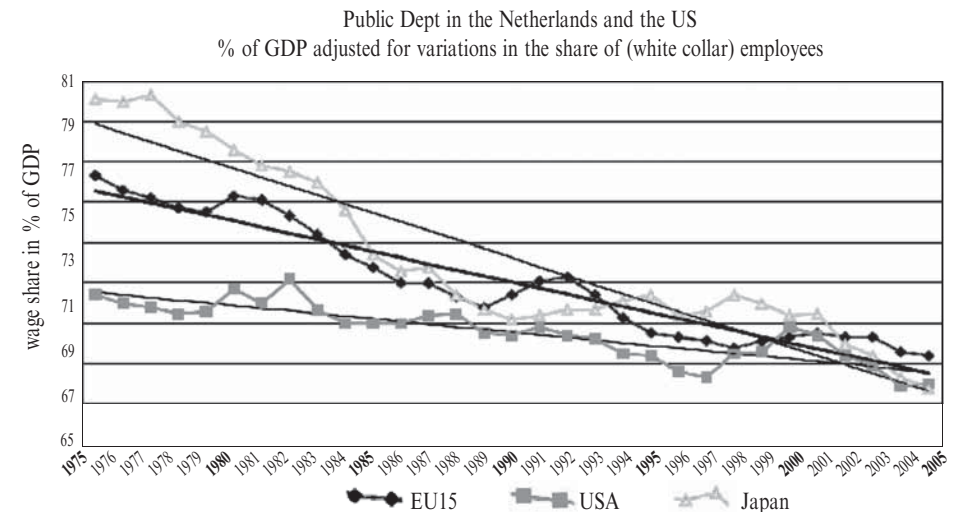
In addition to a low public debt, these elites require privatisations, low regulation, withdrawal of the public sector and free movement of untaxed capital. If we examine the reasons behind the crisis, we see that there is an income differential in the world that never existed before, at least not since we have had data to calculate. The upper line in the following graph below represents the evolution of the incomes of rich countries per capita measured against US dollars kept constant to the value of the year 2000 to correct for inflation. It moves so far away from that of poor countries that it can no longer fit in one graph. Therefore, I have divided the per capita income of rich countries by 10. The poor countries produce an average of 500 Euros GDP per capita, while the amount for rich countries is about 30.000 and this gap constantly increases. Since the 1980s and the liberalisation of capital markets, the gap has widened continuously.

There is, thus, an important group of countries, with a population amounting to millions and millions of people, that could and would like to buy goods and services but does not have the money to do so. An enormous demand potential for goods is missing on the world market because incomes in the third world are too low.

However, income differences have also become vast within rich countries. In terms



of the labour-capital relation, wages have been falling systematically since the 1960s. There is a second group of people that could buy goods and services but who do not have the same possibilities as they did in the past, and these are the working people. Since the 1960s there has been a great increase in the rates of unemployment. In essence, only the Netherlands and Austria have relatively normal unemployment rates, but that means that unemployed people are also unable to buy goods and services.



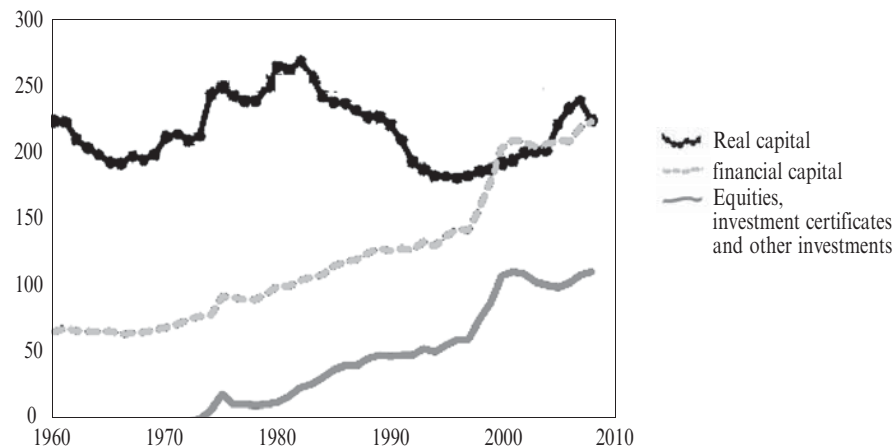
Sources: European Economy 6/2002 and 6/2004, Statistical Annex, Table 32

Moreover, there is another new type of income inequality. In the past an emperor had an income 2,000 times greater than that of his subordinates. Today, a rich person can have an income 1,000,000 times greater than a poor person. There is for example the case of the hedge fund manager John Paulson who earned in a single year 3.7 billion dollars, an amount that is equal to the income of eight countries in the world. The newspaper Forbes publishes lists of the richest people in the world. According to their figures there were 1,221 billionaires (in US dollars) worldwide. This group possesses more money than the majority of countries worldwide. Their problem is that they cannot spend it anymore. They share the sorrow of John Paulson: what to do with all that money? Since they can no longer spend it in the real world, what they must do is reinvest it in the financial sector and create the next bubble.

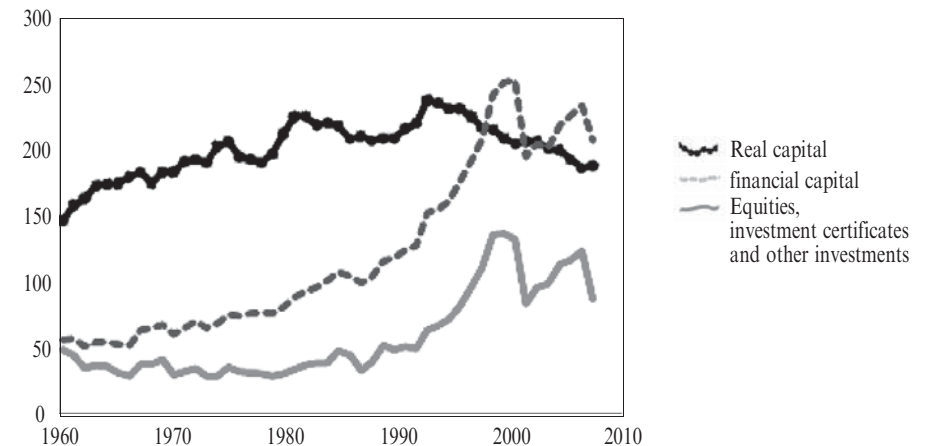
Given that the income and wealth distribution has become so unfair, we have to deal with the problem of under-consumption. This means that entrepreneurs have to face the problem that no-one will buy their products and services, due to a lack of money, and consequently they themselves will not invest in real capital. In a world of great imbalance it even does not pay for entrepreneurs to invest. In companies, it is the financial departments that have the say rather than the builders of machines or the inventors of new consumer goods.

The following graph shows the development of real capital (machinery, values of firms) as a black line, of financial capital as a light grey line and of equities, certificates and other investments as a dark grey line for the US and for Germany.

Development of real vs financial capital and other investments – US



Development of real vs financial capital and other investments – Germany



Looking at the black line, we see that real capital is declining in the US, while financial capital is increasing. As a consequence, businesses also have to invest their money in the financial sector instead of producing goods and services. This tendency also exists in Germany.

Here too the growth of real capital is declining. Thus, businesses which normally produced cars and services now invest in financial markets.

Another imbalance in the world involves current accounts. They reflect the differences between rich and poor countries, between low wage countries which experienced current account surpluses (Middle East, China, Developing Asia, but also Germany and Austria) and current account deficit countries like the US and Africa.

There is an increase in current account deviations. Many economists, Joseph Stiglitz for example, have warned about this increasing unbalance. We are, as the Swedish-American economist Axel Leijonhufvud called it, "outside the corridor". If variables such as the distribution of income are outside the corridor, then the system explodes and we cannot establish a stable route. Outside the corridor, actors don't have adequate norms and expectations that usually are associated with the continuation of the system.

CONCLUSIONS

The debt problem in general and the Greek debt problem in particular are the results of a systemic crisis.

Isolating the question of public debt from other contexts, I would recommend letting it melt away. There is a basic dynamic financing-constraint equation developed already in 1944 by Domar. This equation is a precondition for the debt not exploding. It essentially says that if we keep interest rates below growth rates and if governments do not add more deficits, the debt as a percentage of GDP will automatically stabilise. This means we do not have to worry about debt but rather about excessive interest rates and inadequate growth rates. If there is inflation, nominal GDP will increase, which means that our debt/output ratio will decrease automatically. Thus inflation is also a method by which governments could erase their debt and which historically has often been used. There are many ways in which we can reduce the debt without involving painful austerity packages. High inflation might not be a desirable way to let the debt melt away. But we should keep in mind that as long as interest rates are lower than nominal growth rates in an economy, we will never have to face a debt problem. Thus the proper macroeconomic framing can determine stable debts and not austerity packages.

However, the public debt crisis cannot be seen in isolation, but is part of a systemic crisis. If we want to overcome the very roots of the actual crises, we must restore a reasonable distribution of income and wealth. Groups of people who cannot demand goods at the moment must be supplied with enough means to establish a world balance again. Those few privileged groups who have too much income, such that they can no longer spend on goods and services, must be taxed and regulated. In order to increase the demand for goods and services, we must give more money to the third world, create more employment and transfer money to low-income groups. Then we will have more available income and wealth, and they will be able to buy goods and services that enterprises produce, the real sector will grow, taxes can then be collected, the proportion between the real and the financial sector will be one-to-one and not one-to-four, interest rates will be lower than growth rates and we will no longer have a problem of public debt.

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Crisis, Inequality and Capitalist Legitimacy

EUCLID TSAKALOTOS

During the summer of 2011, when anything like a permanent solution to the crisis in the Eurozone was as distant as ever and when the presence of new recessionary forces at the world level were unmistakable, Ben Bernanke announced that US interest rates would remain low at least until 2013. This represented the most official of recognitions that five years after the financial crisis of 2008 the world economy would still be in the doldrums. It is difficult to understand how anyone could expect any other outcome when none of the main causes of the crisis has been addressed in anything resembling a serious manner.

ANGLO-SAXON DEBATES

After bailing out financial institutions, thus transforming a crisis of finance into one of sovereign debt, it was hoped that a spell of austerity would be “all” that would be needed to bring the major economies back to the conditions that existed before 2008, in the period of the “great moderation”. To this end tired old theories, such as the expansionary effects of fiscal contraction, were exhumed. In many ways this was a simple rerun of inter-war debates. The theory had been a crucial argument of those Treasury economists in Britain in the late 1920s (the “Treasury View”) who opposed Keynes’ support for public works to reduce mass unemployment. Everything must be

done, so the theory goes, to shore up the ever fragile confidence of the private sector, which must be assured that government spending will not lead to high interest rates. The fact that, in recessionary periods, there is no empirical support for such a view has not been allowed to spoil a good story. As Larry Summers has pointed out, the paradox of the expansionary effects of fiscal contraction is just that: a paradox of no value for policy makers.

In the US and the UK we have witnessed a partial return to the old Keynesian-monetarist debates that had been all but eclipsed by the neoliberal consensus that developed after 1980. But the argument has been more about the size of the fiscal contraction than whether demand should actually be expanded. Conflict over this issue only served to highlight the underlying agreement, not to address some of the central issues that the 2008 crisis had brought to the surface. Once demand has recovered to produce something approaching full-employment, can we trust the liberalised financial system to allocate resources to the real economy? How can banks be regulated so that they refrain from undertaking activities with large private gains but little social return? Can a new phase of expansion be initiated on the basis of continuing social and regional inequalities within and between economies? These were not questions that seriously concerned ruling elites in the Anglo-Saxon world – at least not at the level of policy-making.

EUROZONE PARALYSIS

In the EU, meanwhile, even the debate on the appropriate level of fiscal contraction did not take place. Lacking even the modest democratic pressure in evidence in the US and the UK, European elites were disinclined to open up a debate on even a partial return to Keynesian economics. Neoliberal orthodoxies continued to dominate, the debt crisis being attributed more to the non-enforcement of the existing rules of the Growth and Stability Pact than to the way in which the rescue of the financial system was approached. Any debate on the serious inadequacies of the economic and financial architecture of the EU, cruelly exposed by the crisis of 2008, was kept off the agenda. Thus arguments within the Eurozone were restricted to how best to solve the debt crisis, with what doses of austerity and new finance for the struggling economies. At the time of this writing, this approach has led to a deepening of the European crisis, which has called the viability of the Euro into question.

And yet the immediate causes of the 2008 crisis are pretty well established and have even been outlined by authors with impeccably orthodox credentials. When a former chief economist of the IMF warns that the crisis is far from over and that the

problem of income inequality, the regulation of the financial system and macro-economic imbalances have not been addressed, then we begin to understand that something very serious is afoot (Rajan, 2010). The same concerns are expressed by prominent columnists such as Martin Wolf of the *Financial Times*. The criticism levelled at EU policymakers is particularly vehement, but the sense that the world's economies are going forward without meeting the key challenges of the period is widespread.

INEQUALITY AND LEGITIMACY

While left-wing accounts of the crisis have not reached consensus on its causes, there is no disagreement that inequality, financial deregulation and global imbalances constitute important pieces of the puzzle. Moreover, there is an increasing reticence to seek out *the* underlying economic cause of the crisis, as if therein lies the master key for understanding the past and developing the appropriate strategy for the future. This more eclectic and open-ended approach can be seen in Harvey's (2010) schema that draws on many supposedly conflicting Marxist accounts but all of which contribute to understanding certain phases of capitalist crises. Thus a crisis of overproduction and profitability from the late 1960s onwards led to a capitalist attempt to restore capitalist hegemony in the 1980s. The neoliberal attack on wages, working conditions and the welfare state in turn brought to the fore a latent crisis of under-consumption. In those economies with advanced financial systems this was averted through the provision of loans, eventually even to marginal social groups. The "solution" to this latent under-consumption therefore goes some way to explain the financial crisis, and the response to the financial crisis has subsequently materialised as a debt crisis.

A reticence to seek out *the* underlying *economic* cause is also motivated by a concern not to sideline the issue of politics. How a crisis develops, and how it is resolved, is always mediated through social and political conflict. A key aspect of neoliberalism was the retrenchment of democracy, a form of "governance" based on the preference for rules rather than discretion, for "independent" regulating authorities rather than deliberating institutions, and the isolation of policy-making from the influence of unions and social movements. The hidden premise of the neoliberal experiment was that the legitimacy of these new arrangements would be acquired *ex post* through economic results.

But *ex post* legitimacy was an elusive goal in the period before 2008. The neoliberal model, pursued with more rigour in the Anglo-Saxon economies, never managed that

combination of rising wages, plentiful job opportunities, and enough taxable income to support a decent welfare state which could have laid the basis for such legitimacy. Instead, the individualistic ideology that legitimised private greed led to levels of inequality not seen since the 1920s (Krugman, 2002, Tsakalotos, 2007). Crouch (2009) sees private-sector debt as having taken on the role of the state in this era of "privatised Keynesianism", thereby dealing with the problem of insufficient aggregate demand. The related financialisation of the economy, one aspect of which was the tying of the aspirations of the lower classes to the prospects of the financial system (Konings and Panitch, 2008), increasingly took the form of a Ponzi game.

But the central issue is not that of speculation, important though it is. The growth performance of the neoliberal order did not match expectations, with the result that households, firms and the public sector all took on more debt than could be repaid. The subsequent collapse of the financial system called into question not only the economic performance of the period before 2008, but also raised the issue of who was to bear the cost of the debt that could never be paid back. It has also brought into sharper focus the question of legitimisation in a world where the financial system cannot play the role of the welfare state.

The drastic increase in inequality in the more liberal economies (Piketty and Saez, 2003) becomes more pressing for ruling groups when economic performance gives little hope that the rising tide will help to lift distressed sections of society. But the issue of inequality, as many observers have pointed out, is no longer an issue only for the working class. While the promise of the Third Way, of centre-left politicians such as Clinton and Blair, was that education would protect middle-class jobs from the pressures of globalisation, this has not been the way things have turned out in practice. On the one hand, new technology has not always led to jobs with more skill content, let alone with more autonomy. On the other, middle-class jobs, ranging from computer programmers to accountants, have also been eminently transferrable to economies such as India. Indeed the phenomenon of the "city squares" in Northern Africa and Southern Europe has been fuelled by a middle-class youth that was promised an outlet through education only to find that there were no jobs available to match their enhanced educational qualifications. In short, inequality is once more also a middle-class issue.

While some economies dealt with the legitimisation deficit through financialisation, others with less sophisticated financial systems had recourse to the state (Tsakalotos, 2008). Thus, for instance, the response to the issue of legitimisation was different in the Greek case, relying less on finance and more on the mechanisms of the clientelist state. Public-sector employment, a blind eye to tax evasion, favourable tax

regimes for particular groups and much else (Stathakis, 2010) contributed to unsustainable deficits. But the direction of causality is very different from that suggested by the dominant view. The Greek economy is not weak because of clientelistic activities; rather, such activities were a necessary compliment to the chosen model which could not provide enough jobs, sufficiently steady wage increases, and taxable incomes to support welfare services. In other words, the unsustainability of the neoliberal economy has been expressed in a different form (public-sector debt rather than private-sector debt), but it can be traced to the same cause, namely the shortcomings of the neoliberal economic model.

THE CRISIS OF POLITICAL REPRESENTATION AND THE NEOLIBERAL ECONOMIC MODEL

The problems of legitimacy have become more acute after 2008, as can be seen from the problems faced by social-democratic parties, student protest movements, the phenomenon of the “city squares” and a rise in the disrepute in which politics in general is held. Neither cheap loans nor traditional clientelist mechanisms are readily available in an era when austerity programmes rule the roost. This has cut off ruling elites from many of their preferred alliances with other social groups. The crisis in politics is one of political representation, with large sections of society no longer represented within the political process. In this context, it could be the case that the preservation of the neoliberal economic model is not compatible with the form of democracy that has been dominant until recently. Without massive social mobilisation from below neoliberal governance could easily transmute over the coming years to a far more authoritarian form.

Thus a crisis of the magnitude we are facing requires that we address the economic model itself. To be sure, there is little hope of progress with the current EU economic and financial architecture. There is little prospect for southern Europe, if Germany insists on a tight fiscal and wage policy. For Germany’s surplus is the other side of the coin to the current-account deficits of the South. As Keynes argued at Bretton Woods, if there is no pressure on the surplus economy to reflate, the system as a whole becomes deflationary. Without a change of stance from the northern economies, it is difficult to see how the South will be able to grow out of its debt problem. The architecture of the EU, established during the high tide of neoliberalism, is distinctly unready to respond to the current crisis conditions. A monetary union without some form of fiscal federalism, economic solidarity, cooperation in discretionary fiscal policy and a proper central bank is simply not sustainable.

But even a different architecture may not be enough. It is not just that the neoliberal model does not seem to be compatible with greater equality of income and wealth, and the preservation of what is left of the European social model. It is that Keynes’ argument –that when we reach full employment the “classical” case holds, i.e. we can allow the market to deal with the allocation of resources– has not fared well. In a previous article in *transform!* magazine (Tsakalotos, 2009), I argued that the insights of Marx and Polanyi, that economic performance in advanced economies needs *more*, not less, cooperation and socialisation as well as the active involvement of real producers, have not lost their relevance. The productivity performance in the age of entrepreneurship since 1980, for all the talk of the knowledge economy, has been underwhelming to put it mildly. Hopes for a “new economy” based on information and communications technology were dashed by the bursting of the dot.com bubble at the turn of the century. It is in this context that the case for the Left posing the question once again of who produces what, with what technology, in what social relations and for whom, remains strong.

And it remains strong for another reason. One of the things that is most striking since 2008 is how much the capitalist state has lost its plasticity, most evidently in the EU, but almost everywhere. As we have argued, the majority of the issues raised by the crisis has not been dealt with in anything like an adequate way, while the privileges of the rich and powerful have remained sacrosanct. It is worth speculating on the underlying cause of this rigidity. One factor is the hollowing out of democracy in the previous period (Crouch, 2004). While this was part of the point of neoliberalism, and not an unfortunate by-product, the marginalisation of unions and other social movements has also cut the system off from any feedback mechanisms it previously had. In times of crisis this can be a dangerous phenomenon. The autonomy of the capitalist state is such that sometimes the short-term interests of the capitalist class, or even the longer-term interests of some section of that class, need not be met; strategic compromises with other social groups must be pursued. But the powerful presence of financial capital within the institutions of economic governance has made the capitalist state since 2008 apparently unable to allow space for such autonomy.

But this may be only part of the reason behind the reduced plasticity. Left accounts of the neoliberal era do not agree on the extent of its success before 2008. Some speak in terms of a new period of expanded capitalist accumulation on a world scale, some suggest that economic performance has been poor compared to the “golden age”, and yet others present a picture of relative stagnation. But whatever may be the case, to the extent that capitalist profitability was restored this was achieved in part through the remarkable growth of the financial sector, and the expansion of

private production into areas previously thought of as the domain of the public sector, especially education and health. The question arises of the viability of even a mildly social-democratic programme which would, say, regulate the financial system and ensure that finance returns to its core activity of mediating between savers and lenders and promote a partial de-commodification in the areas of health, education and public spaces in the inner cities and rural areas. Would such a programme, hardly radical in itself, be compatible with the profitability of capital?

We cannot be sure. But it is at least possible that it would not, in which case a shift in priorities may initiate a dynamic which ruling elites, rightly, fear. The Left needs to think strategically, and that entails the ability to portray an alternative economic model, which while not immediately implementable, can guide shorter-term aspirations and proposals. A change of direction will require a dramatic shift in the balance of political and social forces – in the first instance to block austerity and the move to more authoritarian forms of capitalism, but also to be able to exercise political leverage when, and if, there is a shift in the direction of the system.

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Thoughts on the On-going European Debt Crisis: A New Theoretical and Political Perspective¹

DIMITRIS P. SOTIROPOULOS

INTRODUCTION

During the first period after the recent financial meltdown, European officials were caught up in an unexplained optimism. Nevertheless, the developments that followed the collapse of Lehman Brothers struck at the heart of the Euro. From this point onward, we all became witnesses of the most grotesque course of events. Strong beliefs of the past totally collapsed and changed into their opposites: the economic miracles of the past suddenly became the “PIGS” of today; the financial giant companies of the European “centre” became zombie institutes that were non-existent in the absence of the ECB’s efforts and pivotal interventions; the powerful Euro became as strong as its weakest over-indebted links; the putative solidarity between different member states suddenly vanished; the bailout of the financial intermediaries entrapped public finances.

1. The following text is based on my intervention in the conference organised by the *European Left Party* in Athens on March 10-12, 2011. Due to space restrictions, I have decided to limit the scope of the paper focusing solely on the issue of the on-going sovereign debt crisis. I would like to thank Spyros Lapatsioras, John Milios and Paul Auerbach for their valuable comments on the first draft of this paper.

Ten years ago, reference to the European sovereign states as social democratic, in contrast to other parts of the capitalist world, was a trivial matter. However, nowadays it sounds like a bad joke. Austerity has become the second name of Europe, and contagion is no longer a theoretical outcome: it is happening here and now. In fact, *contagion* and *austerity* are interlinked to each other as a dangerous vortex which secures the interest of capital throughout Europe. In this paper I deal with the dynamics of this “vortex” pointing out its scope along with its vulnerabilities.

The Euro is not just a currency, it is “mechanism”. It has set up a particular form of symbiosis among different capitalist economies.² We need to comprehend the Euro in *systemic terms*: This mechanism amounts to a particular way of organising exploitation strategies and forms of capitalist power. Hence, when we refer to the Euro, we should always realise that we are above all dealing with a strategic project with its own rationalities, targets and rules. From this angle, the responses to the crisis are not “flawed”. They must be understood as policies within this general context. The social movements and the capitalist states do not share the same aims and targets: *they must always apply different answers to different questions in pursuing irreconcilable political agendas*. It is therefore meaningless to criticise the putative “irrationality” of the policies implemented by collective capitalists; but it is urgently necessary to unmask their innate logic.

In what follows, I will focus on the on-going sovereign debt crisis while trying to present the vulnerabilities of the Euro-symbiosis and the “rationality” of the European responses to the crisis. The basic idea is that these responses have as their primary preoccupation the neoliberal organisation of capitalist power; in other words, they should not be seen as strategies to combat the crisis but as *strategies against the resistance of labour*. By referring to the “European” strategies as a whole I do not mean to underestimate the secondary contradictions between the different participating social formations in the project of Euro.³ In doing so, I abstract from these secondary contradictions in an attempt to describe the main image and the nature of the strategy that so far holds the European symbiosis together.

2. For a more comprehensive view of the crisis of the European symbiosis see: John Milios and Dimitris Sotiropoulos (2010) “Crisis of Greece or Crisis of Euro? A view from the European ‘Periphery’”, *Journal of Balkan and Near Eastern Studies*, September 2010, 12(3): 223-240.

3. For those familiar with the debate on imperialism, this line of reasoning can be understood in the light of the analysis in: John Milios and Dimitris Sotiropoulos (2009) *Rethinking Imperialism: A Study of Capitalist Rule*, London and New York: Palgrave Macmillan.

FINANCIAL MARKETS AND THE NEOLIBERAL STRAITJACKET: A BRIEF COMMENT

Theoretical and political discussions of the character of contemporary capitalism are heavily populated by the idea that there exists a profound “bust-up” between the sovereign “states” and the “markets”. In my view, this is in fact an empty letter, a true distortion of capitalist reality. To make a long story short,⁴ markets aim at capturing the economic and socio-political conjuncture of a particular capitalist economy. In this sense, they unintentionally interpret the results of class struggle, coming to particular financial prices. In their everyday functioning, they attempt to “translate” the multiple economic and social events into quantified signals. This is the real content behind the complexity of the so-called pricing process. The existence of derivatives makes this representation project look *objective* to market participants. And of course the representations of the markets are not neutral; on the contrary, they define economic “fundamentals” in such a way to make it easier for neoliberal hegemony to establish and organise itself. This functioning of markets creates conditions such that capitalist economies fit safely into the neoliberal “straitjacket”. This abstract mechanism does not amount to new forms of dependency and surely it does not denote the withering of sovereign states. It indicates the embedding of a particular form of capitalist state power, undoubtedly more authoritarian and violent. From this point of view, neoliberalism can be defined as a historically specific form of the organisation of capitalist power in which “governmentality” through markets plays a crucial role. Markets do organise the conformity to the neoliberal straitjacket. Even the IMF and the WB should be seen as moments within this complex setting.

Sovereign states, for their part, are supposed to be careful and not send the wrong messages to the markets. In other words, governments are obliged to act as genuine guarantors of the core interests of capital, securing consensus for neoliberal strategies. This end can be met and reinforced under different social conditions, even under severe crises that call for the intervention of the IMF. But this is another story.⁵

HOW THE PASSION FOR NEOLIBERALISM DOWNGRADED EUROPEAN STATES TO THE CATEGORY OF EMERGING NATIONS IN THE MATTER OF THE SOVEREIGN DEBT

Many people analyse the Eurozone as if participating states just peg their national currencies to the Euro. This is a common mistake in the relevant discussions. In fact,

4. See Milios and Sotiropoulos (2009; ch. 9 and 10).

5. For instance, see Paul Krugman (2008) *The Return of Depression Economics and the Crisis of 2008*, Penguin Books.

the Euro *is* the national currency of the member states (and of course it is more than that). Nevertheless, it is a national currency of a peculiar kind. It is a currency without “traditional” central banking. And this is a major change. In what follows, I analyse the economic consequences of this unique setting, postponing the analysis of its rationale for the following section.

Let us consider for a moment this institutional innovation. In the usual nation-state setting, a single national fiscal authority stands behind a single national central bank. In plain terms, this means that “the combined fiscal-financial-monetary resources of the fiscal authority and the central bank must be sufficient to provide the central bank with the resources it requires to fulfill its role as lender of last resort and market maker of last resort and to meet its macroeconomic stability objectives”.⁶ As we know, this is not so in the case of the EMU: there is no solid and uniform fiscal authority behind the ECB. Member states issue debt in a currency which they do not control (they are not able to “print” Euros or any other type of currency). In this context, governments will not always have the necessary liquidity to pay off bondholders. Financial stability can be safeguarded only through fiscal discipline, i.e. through preserving fiscal policies within the neoliberal straitjacket.

As mentioned above, this should not be taken to be a real “sacrifice” on the part of sovereign states. On the contrary, it is considered to be a welcome condition for the organisation of neoliberal strategies: *the disintegration of the welfare state is now the only route to financial stability*. Nevertheless, this institutional arrangement came with a serious cost, a “danger” that the old discussions with regard to the Eurozone used to underestimate. The economies of the Eurozone “voluntarily put themselves into the position of ‘Emerging Markets’ issuers, and have subjected themselves to heightened default risk”.⁷

A meaningful way to recognise an “emerging” economy, in view of the vast literature on the subject, is as an economy that is unable to run meaningful counter-cyclical fiscal and monetary policies. In other words, a government that relies heavily on foreign-currency denominated debt –since it is unable to borrow the amounts needed in its own national currency without violating the neoliberal agenda– is to a significant extent deprived of the means of funding public goods and benefits. This is advantageous to the neoliberal agenda. In contemporary capitalism, the same is also true for the developed economies which can issue debt in their currencies. But the latter have more means to defend “themselves” from a sudden change in the “mood” of financial markets. Let us briefly see why.

6. Buiter, W.H. (2008), “Can Central Banks Go Broke?” *CEPR*, Policy Insight no. 24, p. 9.

7. Kopf, C. (2011), “Restoring Financial Stability in the Euro Area”, *CEPS*, Policy Brief no. 237, p. 2.

When a government with large foreign-currency denominated sovereign liabilities faces a change in the “mood” of markets (possibly expressed as a sudden freezing of the inflow of capital – a liquidity crisis, let us say), it will experience an explosion of the debt servicing costs on the foreign currency. This is bad news for debt sustainability (and financial stability). The government must immediately “tighten” fiscal policy in the midst of a recession, communicating to the markets its ability and willingness to continue servicing its foreign debt; in other words, the government must convince the markets that it can secure a social consensus for the neoliberal straitjacket. Such policies, in the midst of a recession are very likely to lead to a severe crisis. It is a vulnerable macroeconomic setting, prone to self-reinforcing and self-fulfilling sovereign debt crises. For European citizens this story is a kind of *déjà-vu*.

Things would not necessarily be this way if the economies of the Eurozone had not abandoned their national currencies.⁸ In that hypothetical case a moderate exodus from the government bond market would cause a manageable devaluation in the exchange rate without undermining the liquidity conditions of the economy. Foreign investors would get rid of the sovereign debt but they could not take with them the national currency equivalent. The latter would find its way to the national banking system and sooner or later return to the market for government debt. But even in the extreme case of financial distress, the national central bank could print money, thereby lending to the government in order to prevent sovereign default and meet the “liquidity preference” of banks.

Adopting the Euro, the participating economies have made a dangerous choice. *They have voluntarily undermined their capability of deploying meaningful welfare policies, subjecting themselves to a high degree of sovereign default risk.*⁹ This has turned out to be an adventurous trade off. A moderate exodus from the sovereign debt market now distorts the economy’s liquidity conditions and leaves the state only one option: fiscal tightening, high interest rates, recession, debt unsustainability, crisis, default. By the time these lines are published, European economies will find themselves in different points on this unfortunate path: some of them are reaching the end, some are in the middle and some just embarking on it. European states have voluntarily placed themselves into a predicament where markets can actually force them into bankruptcy, since they issue Euro-denominated debt.

8. This is not so true for the smaller economies of the European “periphery:” i.e. Greece, Portugal, and Ireland.

9. As I mentioned above, this is so because financial stability can be safeguarded only through fiscal discipline.

MORAL HAZARD AND THE MECHANISM OF THE EURO

We have seen so far how the states of the Eurozone have subjected themselves to a high degree of sovereign default risk. This was a development underestimated by the architects of the Euro. On the other hand, another –and much more discussed issue– was the restriction of public debts (funnily enough, there was not a single word about the private debt). I will not go through all the discussions that gave birth to the so-called Growth and Stability Pact, but will focus only on its central logic.

We have to stress one more time that as regards the forcing of state policies into the neoliberal straitjacket the key-issue is not the level of public debt or deficit but the way markets interpret the connection of these fiscal variables with the other crucial parameters of the debt dynamics (growth rate, interest rate, primary balance). Hence the disciplining process contains two crucial moments: the whole configuration of debt dynamics *and* the pricing of risk from markets (which, of course, is based on a particular representation of reality – see above). It was pretty obvious from the beginning that the context of the Euro could possibly “confuse” market supervision, making room for potential fiscal expansion contrary to the neoliberal spirit of the EMU. There are several reasons for this. For instance, European bank regulation put a zero capital charge on all EU sovereign debt, prefiguring the subsequent narrowing down of spreads. This means that commercial banks could borrow in the wholesale market at Euribor and then buy European sovereign debt, gaining the spread. The return on this carry trade was infinite, pushing the market to underestimate some of the risks involved in the sovereign debt market. We could mention more examples.¹⁰ But the basic issue was that markets, being aware of the financial interconnectedness within the EMU, were sure that no country would be left to default since such an event would have wider economic implications for the Eurozone. Indeed, until 2008 markets put all sovereign debt pretty much on the same footing, narrowing down the spreads.

This seems a serious limitation to the disciplining mechanism of markets. To use market language, the context of the EMU elevated the risk of moral hazard. Without some ad hoc regulation, there were not enough incentives to prevent governments from issuing too much debt or from taking the necessary measures to deal with it. This condition *could* give some space for the implementation of welfare policies (yet it did not!). Markets were unable to supervise the sovereign states “efficiently”. Therefore the solution to the “problem” was found in the invention of the Stability Pact. This Pact explicitly banned every type of bailout and deprived the ECB of the

10. See Kopf, op. cit, pp. 4-5.

right to buy sovereign debt on a regular basis. It made the Euro an international currency without the backing of a traditional central bank. Moreover, it posed an artificial ceiling on the public debt and budget: since financial stability was to be secured by fiscal tightening, and since the Euro symbiosis would not let markets properly impose fiscal disciplining, there emerged the need on the part of capitalist power to politically impose ad hoc fiscal rules. *Their key-role was to supplement markets in their oversight duty.* If markets were unable properly to “price” sovereign risk in the EMU, then explicit political regulation was to solve this problem by imposing appropriate rules. Nevertheless, when it comes to the relations between sovereign states the strict application of these rules must not be taken for granted. In any case, the Stability Pact did provide a context for the control of public finances and aside from some minor violations it succeeded in tightening them in line with the demands of the neoliberal model.

THE FEAR OF OVERCORRECTION

We have explained above why the context of European symbiosis satisfied the neoliberal objectives and made sovereign states vulnerable to fiscal crises, contagion and bankruptcy. After the outbreak of the crisis in 2008 European officials, along with the participating governments, confronted a very difficult puzzle: how to deal with the enormous economic problems and contradictions without undermining the neoliberal context of the EMU; how to create proper policy mechanisms to intervene in the mess, turning the crisis into an opportunity for further boosting the neoliberal agenda; how to set up new rules to safeguard against the vulnerabilities of the past without negating the conservative edifice of EMU; how to correct the problems while avoiding the “overcorrection” that would open a path to the implementation of social policies in the future; finally, how to use the tremendous firing power of the ECB without turning it into a “traditional” central bank.

It would be pointless to revisit the fluctuating episodes of the EU summit decisions. The European capitalist powers have jointly decided to exploit the current crisis for further boosting the neoliberal agenda. Since the EMU is not an integrated political union, *the capitalist responses to the crisis have necessarily to be complementary to the functioning of the markets.* Otherwise markets cannot play their disciplining role and the central authorities are unable to mandate the reforms. The commentators that blithely criticise European leaders misinterpret this point. Not only do European officials always have a second and a third plan under the table, but their decisions must impel the neoliberal agenda without violating the functioning of

the markets. Otherwise the crisis cannot be exploited as an opportunity for capital. In simple terms, aggressive neoliberal measures and reforms would not be implemented in the participating countries if the ECB had worked as a fiscal agent from the beginning, if its intervention in the secondary sovereign debt markets had been bigger and persistent, if the firing power of EFSF had been such as sufficiently to deal with the core needs of the sovereigns, if... *The severe character of the crisis might have been avoided but in a totally different Europe: a Europe that could not secure the interests of capital.* That kind of Eurozone would be worthless to capitalist power.

In brief, the European strategy for dealing with the crisis has as its main target the further embedding of the neoliberal agenda. It will always keep one step back from the “real” needs of the time so as to lead states into the path of conservative transformation by “exposing” them to the pressure of markets. It has its own rationality which is not so obvious at first glance. It perceives the crisis as an opportunity for a historic shift of the correlations of power to the benefit of capitalist power, subjecting European societies to the conditions of an unfettered functioning of markets and capital.

THOUGHTS ABOUT A GLOOMY FUTURE

...Nevertheless, it is a dangerous path. The above-mentioned strategy uses debt as a means. It succeeds in its priorities (embedding the neoliberal agenda), but it does exacerbate the debt problems that it provokes in order to justify itself. This deterioration creates new episodes and triggers new incomplete interventions on the part of the EU. It is a strategy with profound consequences, but it moves on slippery ground in trying to reach its end. This end has a name: Italy. If the latter passes the threshold, entering the self-fulfilling vortex described above, then we should wait for radical shifts in the workings of the EMU. These radical shifts have also a name: the ECB as fiscal agent. Even the present day interventions of the ECB in the secondary markets have become serious enough. Events are unfolding quickly and hence it is obvious that a brief paper like this one is not able to foretell all the coming developments. Maybe Italy will not pass the threshold. Maybe the EFSF and the ECB will help Spanish banks not to contaminate the public budget. Maybe the necessary funds will be found to deal with the financial panic that the forthcoming default of the Greek sovereign will cause (not to mention others). Maybe... But one thing is sure: The aggressive neoliberal strategies of the EU will increase the sustaining cost of the Eurozone for working people unless there is a change in the key attributes of the European context. Working people must expect more rules, more central mechan-

isms, more austerity and movement towards a fiscal union.

This last observation reminds us of something from the historical past of the European continent. Let us recall Polanyi's major insight.¹¹ In a historical context bearing many similarities to the present day, he argued that liberalism, when in crisis, needs a kind of "conservative interventionism" in order to reproduce itself. I believe that Polanyi's insight still holds. In our era, capitalist states do not seem so helpless, not even the European ones. They intervene in a decisive manner to restore the dynamics of the markets and to finance the building up of mechanisms and institutions to further squeeze social incomes and public benefits. The resulting situation seems to be that of a free economy under a strong government (or strong governance in the case of EU), as Polanyi might have put it. The key target of contemporary capitalist strategies is the subordination of the stability of employment and incomes to the successful functioning of financial markets. An unstable social regime seems to be the fruit of this process. However, this "authoritarian" type of intervention obviously indicates that there are many different solutions to the debt overhang.

The emerging contradictions in the Euro area are further amplified by the fact that while the governments of the EU (along with the governments of the rest of developed capitalism) dispose of policy mechanisms to easily mitigate the burden of working people, they insist on neoliberal reforms. Nevertheless, this conservative state intervention is still an "intervention", and it thus suggests that other political agendas, another kind of intervention, could be a feasible and by no means futile demand.

For a radical left no currency must be a taboo. A radical left does not have to decide between different monies which are just the mask of corresponding capitalist strategies. A radical left should not overlook the unreconciled character of the interests of capital and labour in the capitalist mode of production. The dominant bourgeois strategy in developed capitalism (and in the Eurozone, in particular) has two distinct facets. On the one hand, fiscal discipline as a means for further privatisations and tax remittal for capital; on the other, income deflation whenever and wherever domestic demand is strong enough and undermines the competitiveness of capital. And here we have to make a very important remark: a national competitive capitalist strategy that is based on seceding from the Eurozone is just another extreme form of this agenda (it is a second hidden scenario that will become dominant only when or if the current political strategies go under).

11. See Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, Boston: Beacon Press Books, 2001 (p. 231-244).

A radical left must resist austerity and seek ways of overthrowing neoliberalism. And since the anti-capitalist movement is far from taking over the capitalist state, this anti-austerity agenda must also include a crucial target that points directly at the heart of the neoliberal structure of Eurozone: the ECB and its transformation into a traditional fiscal agency ready to relieve the overstretched European societies. Not only should the ECB organise the necessary haircuts, but it should also start "printing" money and guarantee outstanding debt in an attempt to alleviate the debt burden of European economies and permit them to finance public benefits and welfare of a massive scale. If someone says that this is impossible because it requires radical institutional transformations then we should reply with a simple answer: just wait and see. Maybe the neoliberal strategies of the EU have pushed things close to this point. What we should demand is nothing particularly new: if the ECB intervenes to the benefit of the financial system, why might it not do the same for the European people as well, which is the ultimate underwriter of its structure? If the ECB secures liquidity to an injured financial system for holding sovereign debt (which is indeed an indirect form of a Euro-bond), why can it not directly buy or guarantee this debt, securing public benefits and needs?

From Banking Crisis to Austerity in the EU The Need for Solidarity

MARICA FRANGAKIS

INTRODUCTION

The banking crisis of 2007-2008 was followed by rising public debt levels both in the USA and in Europe, as historical experience would have led one to expect. The fact that the Eurozone became embroiled in a public debt crisis reflects to a large extent its faulty architecture.

The single-currency project was based on the neoliberal obsession with a low inflation rate and the notion of fiscal discipline, devoid of any mechanism for protecting it from financial speculation, or for supporting it at a time of recession. Thus there is no “government banker”, nor is there a transfer union. This exposes the Eurozone countries to the pressures of financial markets, as the case of Greece and other indebted EU countries amply demonstrated, leading them to the edge of default. Providing bailouts conditioned by austerity policies exacerbates the economic downturn and its social implications.

Furthermore, extending such policies to the EU generally perpetuates its current problems, while testing European integration to its limits. The need for a radical change in the EU policy is more urgent than ever.

“SOVEREIGN” OR “PUBLIC” DEBT CRISIS? – THEORETICAL CONSIDERATIONS

Various theoretical arguments have been put forward with regard to the dangers implicit in rising public debt levels. In particular, it is feared that high public debt ratios reduce the rate of growth through a rise in savings and through the crowding out of private investment. In the first instance, it is assumed that as people perceive that taxes are going to rise, they increase their savings, thus lowering growth. Furthermore, increasing public debt competes with private debt for the allocation of savings, thus crowding out private investment from the capital markets. If the resources employed by the state are less efficiently used in comparison to the private sector, there is going to be a loss in output.

Both the debt/tax neutrality hypothesis¹ and the crowding out effect of rising public debt ratios reflect a supply-side approach to growth, which ignores the role of fiscal policy and the policy objectives of rising public deficit and debt ratios. Such an approach is clearly inadequate in a time of recession.

Additional policy concerns refer to the risk of sovereign default, due to escalating interest rates and loss of investor confidence in a government’s creditworthiness, i.e., the sustainability of its fiscal position. However, “sovereign debt” issued in a floating, non-convertible currency, needs to be distinguished from “non-sovereign debt”, issued with a promise of conversion at a fixed exchange rate². In the first case, a sovereign government faces no insolvency risk, since it has undertaken no promise to convert its currency at a fixed exchange rate. It can thus increase the volume of its currency in the face of increased pressure from the financial markets. Although this carries the risk of inflation, it is not a principal concern at a time of recession.

On the contrary, a politically sovereign government, with a currency that is convertible at, or pegged to, a fixed exchange rate, faces the risk of default under pressure from financial markets. The Eurozone member states have surrendered their currency-issuing monopoly to a supranational institution, the European Central Bank. Thus, they can only finance their spending through taxation and borrowing on the market. This makes them vulnerable to the pressures applied by financial investors looking for high-risk/high-yield securities. As soon as such investors sense possible default, they embark on a self-fulfilling prophecy!

Overall, the risks associated with rising public debt levels need to be viewed in the particular institutional context, in which they arise. Their implications for growth are

1. Also known as the “Ricardian Equivalence Hypothesis”, as it was originally presented by David Ricardo in *The Principles of Political Economy and Taxation*.

2. Nersisyan, Y. and L. Randall Wray (2010), *Does excessive sovereign debt really hurt growth?*, Levy Economics Institute at Bard College, June.

a function of the overall policy objectives. Further, the default risk these carry needs to be examined in relation to the currency in which they are expressed. Unlike countries with a non-sovereign currency, those with a sovereign currency cannot be forced into default. Thus, concern with rising public debt levels in the EU is justified on the assumption that the Monetary Union architecture remains constant. However, such an assumption is too dangerous for the future of the European Monetary Union and indeed of the European integration project more generally.

BANKING CRISES AND PUBLIC DEBT – THE HISTORICAL EXPERIENCE

The present financial and economic crisis bears all the classic hallmarks of a banking crisis turned into a public debt crisis. Laeven and Valencia (2010) provide some insights into the historical experience of banking crises in the recent past (Table 1)³.

TABLE 1
Cost of Banking Crises

	Direct Fiscal Costs ³	Increase in Public Debt ³ Medians (% of GDP)	Output losses ³
Crises 1970-2006 ¹			
Advanced economies	3.7	36.2	32.9
Emerging economies	11.5	12.7	29.4
All	10.0	16.3	19.5
Crises 2007-2009 ²			
Advanced economies	5.9	25.1	24.8
Other economies	4.8	23.9	4.7
All	4.9	23.9	24.5

1. “Crises 1970-2006” include all systemically important banking crises over this period, viz. 42 such crises in 37 countries; 2. “Crises 2007-2009” include Austria, Belgium, Denmark, Germany, Iceland, Ireland, Latvia, Luxembourg, Mongolia, Netherlands, Ukraine, UK and USA. 3. Direct fiscal costs include fiscal outlays committed to the financial sector, mainly through recapitalisations; output losses are computed as deviations of actual GDP from its trend; the increase in public debt is measured as the change in the public debt-to-GDP ratio over 2007-2009.

Based on the above observations, Laeven and Valencia conclude that the economic cost of the 2007-2009 crises is on average much greater than that of past crises, both in

3. Laeven, L. and F. Valencia (2010), *Resolution of Banking Crisis: The Good, the Bad and the Ugly*, IMF Working Paper no. 10/146, 2010 (p. 22).

terms of output losses and of increase in public debt, although the direct fiscal costs of dealing with the crisis appear to be lower. These differences are attributed (i) to the fact that the recent crises are concentrated in high-income countries; (ii) to the increased size and interconnectedness of the financial systems in these countries; (iii) to the swift response by governments and central banks to the 2007 crisis, which limited the direct fiscal outlays⁴; (iv) to the extensive indirect support provided to the financial system through expansionary monetary and fiscal policy, the widespread use of guarantees on liabilities and direct purchases of assets that helped sustain asset prices, which however bore heavily on the size of the public debt.

Overall, past experience of banking crises points to a prolonged period of distress, both in the financial sector and in the economy more generally. In such circumstances, public debt ratios are expected to increase as a result of the automatic stabilisers coming into play, falling output, as well as bank and fiscal stimulus policies.

THE RESPONSE OF THE EU TO THE BANKING CRISIS

Since the start of the crisis, EU member states have committed large amounts of funds to their financial systems, mainly the banks. Table 2 below shows the bank support schemes by type of intervention adopted by the EU27.

TABLE 2
EU27 state aid to banks between 2007-2010

	Euro billion	% structure	% of GDP
Debt-guaranteed schemes	3,149.8	76.36	25.04
Recapitalisations	503.1	12.20	3.96
Bad assets schemes (Ireland and Germany)	430.0	10.42	3.47
Liquidity support	41.9	1.02	0.30
TOTAL	4,124.8	100.00	32.77

Source: Bank State Aid in the Financial Crisis, CEPS, October 2010 (Table 1 and calculations by the author)

We observe that the largest part of the measures European governments have taken to support their banks consists of guarantees on bank liabilities. These are best described

4. e.g., in previous crises it took policy makers about one year to implement recapitalisation measures, from the time liquidity support became extensive. This time, such measures were implemented at the same time that liquidity support became extensive.

as “contingent liabilities”, insofar as they determine an outlay only if and when they are called upon. In view of the fact that approximately one-half have been granted, it is expected that the continuation of the crisis will significantly augment the amount of funds spent by EU governments to prop up their banks.

In addition, bank support has taken the form of increased coverage of retail deposit insurance. This is another type of “contingent liability”, which has not fully materialised so far.

More generally, according to the above data, European governments are committed to spending a significant part of their GDP to support the banking system. On the other hand, EU and indeed global financial policy reform is lagging. As a result, the slow rate of financial policy reform both at the European and at the global level exacerbates the pressures financial markets exert on governments in need of funding, and it thus exacerbates public debt levels. In the case of the Eurozone countries, operating with a non-sovereign currency, such pressures have given rise to speculation about default.

THE PUBLIC DEBT CRISIS AND THE RESPONSE OF THE EU

Both the historical experience of past financial and banking crises and the policy measures taken to support the EU banks during the current crisis lead to the conclusion that public debt is expected to grow significantly in the aftermath of the crisis, in the Eurozone countries. Table 3 below shows the actual and forecast EU public debt as a percentage of GDP from 2006 to 2012.

TABLE 3

Gross debt, general government (% GDP)

	2006	2007	2008	2009	2010	2011	2012	Increase in debt ratio 2006-2012 (percentage points)
Eurozone	68.4	66.2	69.9	79.3	85.4	87.7	88.5	20.1
EU-27	61.5	59.0	62.3	74.4	80.2	82.3	83.3	21.8

Source: E.C. Statistical Annex of European Economy, spring 2011, Table 78

Comparing the forecast increase in the public debt ratio shown in Table 3 with that in Table 1, it is evident that the full force of the banking crisis has not yet hit public finances whether in the EU27 or in the Eurozone. On the other hand, in certain

member states, a particularly large increase in public debt is expected. Specifically, public debt is expected to rise in relation to GDP (i) in Ireland, from 24.8% in 2006 to 117.9% of GDP in 2012 (93.1% increase); (ii) in Greece, from 106.1% to 166.1% (60%); (iii) in Spain, from 39.6% to 71% (31.4%); (iv) and in Portugal, from 63.9% to 107.4% (43.5% increase).

The increasing public debt and its differentiation across EU member states has meant that sovereign credit default swap (CDS) premiums for Euro area countries have increased sharply, while certain countries have been more affected than others. In other words, financial markets are betting that default is imminent in certain countries! This has led to a rise in government bond yields relative to Germany, considered as the benchmark. For example, the graph below shows the steep climb of 10-year government bond yields since the beginning of the public debt crisis, first in Greece, in 2009 and then in other Eurozone countries. Thus, in the case of Greece the bond yield has climbed to above 20%, with the difference between the interest rates on Greek and German ten-year bonds, known as the spread, exceeding 16 percentage points.

While the sovereign debt market of Eurozone member states has come under attack from financial speculators, the need for a government banker influencing the workings of financial markets has become more pressing than ever. In particular, the ECB, armed with the monopoly of issuing currency, is by statute and by the Treaty prohibited from exercising its issuing authority in order to support a member state in crisis, as opposed to the US Federal Reserve, for example, the Bank of England and other central banks in crisis-ridden countries.

Instead, on May 9, 2010, as the Greek debt crisis was coming to a head, the ECB launched its Securities Markets Programme. This consists of interventions in the Euro area’s secondary public-debt securities markets. In moving in this direction, the ECB is partly making up for a major missing link in the Euro architecture. However, to the extent that this is a temporary measure due to extraordinary circumstances, speculation is not to be abated easily, as the continued fiscal fragility of the Eurozone shows.

THE GREEK PUBLIC DEBT SAGA

In the first half of 2010, a massive speculative attack on Greek government bonds almost led to the destabilisation of the Eurozone. It is worth noting that there were no significant signs of financial distress in the Greek banking system, e.g. significant bank runs, losses in the banking system and bank liquidations.

Greece entered the crisis with a high public debt and deficit (-5.1% and 95.7% of GDP respectively in 2007), as well as a large current account deficit in relation to GDP (-14.7% of GDP in 2007). It is these twin deficits that exposed Greece to the vagaries of the financial markets. At the same time, the hype created by the media, especially in Germany, against the “lazy” Greeks, and so on, served to conceal the fact that the real target was the Eurozone, rather than Greece. It was the missing links in the Eurozone architecture that attracted investors’ attention to the potential gains to be made from betting against it.

The EU leaders realised this fact many months after the Greek debt crisis had hit the headlines worldwide. On May 2, 2010, the finance ministers of the Eurozone countries formally launched a financial assistance mechanism, conditional on the implementation of a programme of austerity negotiated with the Greek authorities, in liaison with the ECB and the IMF. Accordingly, Greece has undertaken to reduce its public deficit from 15.4% of GDP in 2009 to below 3% by 2013 and to keep primary balances in surplus of at least 5% of GDP up to 2020. In addition, privatisation and market liberalisation are being pursued in relation to pensions, healthcare and education. A public financing gap of €110 billion has been projected for the period 2010-2013, to be covered through matching bilateral loans from Eurozone member states (€80 billion) and the IMF (€30 billion).

Already in the second year of its implementation, the austerity measures of the Greek “rescue” plan have led the economy into deflation, setting it on a downward spiral. Not only are the fiscal targets of the so-called “Economic Adjustment Plan” unattainable, but also the deepening recession is bringing the prospect of default ever closer.

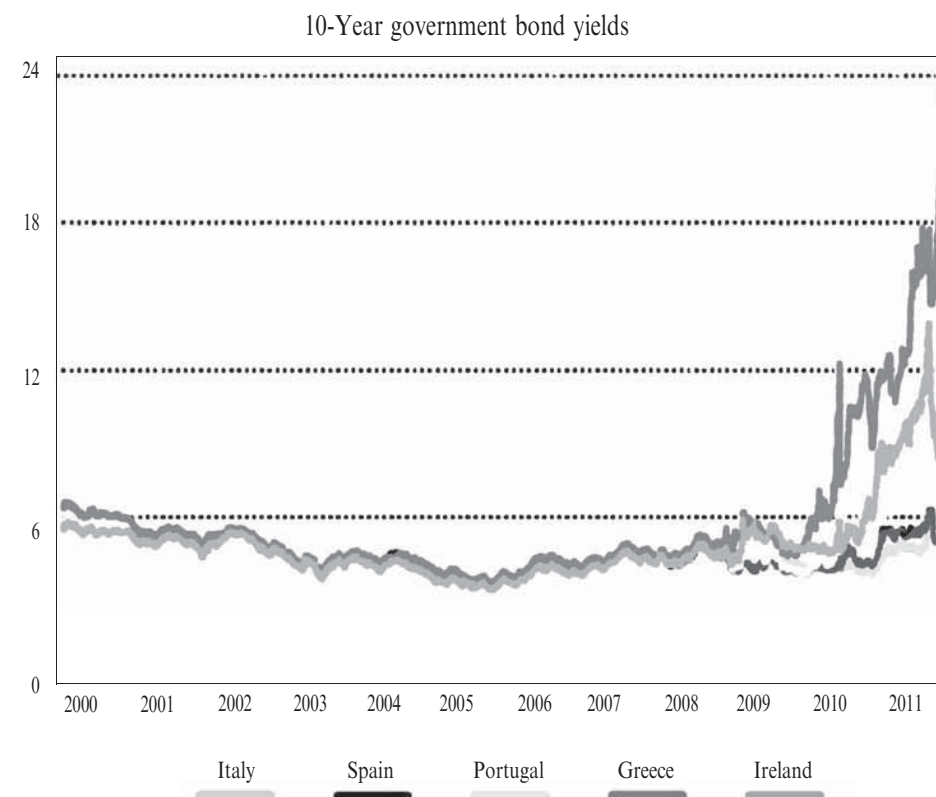
EU PUBLIC DEBT CRISIS MANAGEMENT - BAILOUTS AND AUSTERITY

The Greek rescue package was soon followed by the establishment of a Eurozone-wide financing mechanism, designed to deal with the Eurozone public debt crisis. On May 10, 2010, the European Council decided on a comprehensive package of measures, including a European Financial Stabilisation Mechanism (EFSM) and a European Financial Stability Facility (EFSF), providing a total support of €500 billion. The IMF also participates in financing arrangements providing €250 billion. The new funds are to provide bailouts to countries in difficulty in exchange for implementing austerity packages, designed to reduce their public deficit and debt drastically over a short period of time.

The new mechanism was first activated in relation to Ireland, which came under

extreme pressure in the bond market in late November 2010. The bailout to Ireland amounts to €85 billion over a period of 7.5 years, to be provided by the EFSM (€22.5B), the EFSF (€17.7B), the UK (€3.8B), Sweden (€0.6B), Denmark (€0.4B), the IMF (€22.5B) and Ireland itself (€17.5B). In exchange, Ireland is to implement a €15 billion austerity package over the next four years.

Portugal was the second Eurozone country to tap into the new mechanism, in



Source: Thomson Reuters Datastream

exchange for implementing a range of agreed austerity policies. In particular, in May 2011, a bailout of €78 billion was agreed, financed by the EFSF, the EFSM and the IMF in equal parts. Like Greece and Ireland, Portugal has undertaken to carry out public expenditure cuts, tax revenue increases and to push ahead with a broad privatisation programme and labour market reforms, while it aims for an immediate budget-neutral fiscal devaluation.

The continuing attack on Eurozone member states in financial difficulty led to the creation of a permanent crisis management mechanism, along the same lines as the EFSF and the EFSM. Thus, at the European Council meeting of December 16-17, 2010, political agreement was reached on the creation of a permanent instrument, the European Stability Mechanism (ESM), which is to replace both the EFSF and the EFSM, as of 2013.

A special feature of the ESM is that it will involve private creditors, whose claims are subordinated to those of the IMF and the ESM. In this respect, “Collective Action Clauses” (CACs) will be included in the terms and conditions of all new Euro area government bonds as of June 2013. The ESM will continue to involve the IMF.

The new provisions are to be added to Art. 136 of the Treaty on the Functioning of the European Union through intergovernmental arrangements (“simplified revision procedures”, art. 48(6) of the Treaty of the European Union). In other words, the decision will be finalised by the European institutions without involving the European citizens.

Generally, the ESM is a financial assistance mechanism to be activated under extreme circumstances (insolvency) and to be linked to severe austerity measures and neoliberal reforms. In so doing, not only does it overlook the question of social cohesion and of democratic control, but it actually exacerbates the social and the democratic deficits already inherent in the EU institutional architecture. In this sense, the ESM, as a permanent crisis management mechanism, will not solve the problems faced by the Eurozone countries.

AUSTERITY AS A POLICY PRESCRIPTION

In June 2010, the EU Council affirmed that “The EU has met the worldwide financial crisis with united resolve and has done what was necessary to safeguard the stability of the Economic and Monetary Union”.⁵ In the spirit of “business as usual”, the EU Council adopted a set of policy orientations regarding economic governance in relation to budgetary and macroeconomic surveillance, as well as the new strategy for the forthcoming decade 2010-2020, labelled “Europe 2020”. As a result, the focus of policy shifted from crisis management to fiscal consolidation, with special emphasis on further privatisation and market liberalisation, as part of the long-run EU fiscal consolidation policy.

As we can see in Table 4 below, the EU and especially the Eurozone have entered a

5. European Council, Conclusions, EUCO 13/10/17-6-2010 (p. 1).

period of stagnating real wages, high and rising unemployment, very low inflation and equally low growth. Furthermore, this is the optimistic scenario, since it refers to averages, rather than to developments in any particular country. For example, a diminution in GDP has already been recorded in countries grappling with fiscal problems, such as Greece and Portugal.

The estimates for 2011 and the forecast for 2012 presume the pursuit of austerity policies across the EU, as reflected in the falling ratio of public deficit, which however does not prevent the public debt ratio from rising. Such fiscal developments follow the historical pattern established in previous crises. Measures to change it would include financial policy reform, harnessing the financial markets and the damage caused by speculation, as well as growth-enhancing policies. But these remain outside the political agenda of the European elites.

ALTERNATIVE PROPOSALS

In this section, we shall refer to proposals made by the European Economists for an Alternative Economic policy in Europe (also known as the “EuroMemo Group”) not only in light of the current crisis, but as part of a type of thinking “alternative” to the TINA paradigm (“There Is No Alternative”), implicit in the Maastricht Treaty and the single currency.⁶ Such proposals are based on the notion of social, fiscal and monetary solidarity, the implementation of which requires a radical reassessment and deep changes in current EU policy in a number of areas. We shall refer to five such areas; namely, finance, macroeconomic policy, employment, taxation and sustainable development.⁷

Finance – The European Central Bank should be subject to greater democratic accountability and shift from its obsession with 2% inflation to focus on employment, the maintenance of purchasing power and the stability of the financial system. Control on banks should be tightened: instead of simply raising capital requirements, as in *Basel III*, banks should be subjected to stringent rules that prevent them from taking excessive risk and externalising risk to the shadow banking sector. Off-balance-sheet transactions should be banned. Public sector and cooperative banks should be promoted with at least one major public bank to ensure financing for socially and

6. The EuroMemo Group came into existence in the mid-1990s. It operates on the basis of an annual conference, as a result of which a collectively written Memorandum is produced, which is then circulated broadly and signatures of support are collected.

7. These proposals are contained in EuroMemorandum 2010/2011, “Confronting the Crisis: Austerity or Solidarity”, www.euromemorandum.eu.

ecologically desirable projects. Ratings agencies must be brought under public control. There should be a prohibition on bank lending to hedge funds, on off-shore financial centres and on over-the-counter derivatives. A financial transactions tax should be introduced to curtail harmful speculation and to finance social and ecological transformation.

Macroeconomic Policy – The discredited *Stability and Growth Pact* should be replaced by a commitment to expand macroeconomic demand to promote full employment. In the medium term this will require new institutions. Interest rates for credit-worthy borrowers are even lower than before the crisis, signalling that there is no general crisis in public finance. EU bonds guaranteed by all EU governments would signal a determination to reach a collective solution based on solidarity. Large-scale investment projects should also be based on a coordinated use of national budgets and should be led by surplus countries. Transfers are economically necessary for the survival of the monetary union, and socially necessary to ensure social cohesion. The EU should take over and guarantee a percentage of each member states' debt. The public debt incurred in rescuing the financial sector should be recuperated from the private sector through a wealth tax.

Employment – The large gap between the job vacancies and the number of unemployed indicates that employment policy should focus on creating jobs. These should be what the ILO designates “good jobs” and should promote ecological sustainability and gender equality. Public investment should create jobs especially for young people, the long-term unemployed and other vulnerable groups. A key component of employment policy is a reduction in working time, and as a first step the maximum working time in Europe should be reduced from 48 to 40 hours a week. The recent initiatives to raise the age of retirement should also be reversed.

Taxation – Tax rates in Europe should be harmonised to counter disparities. In particular, a minimum rate for personal and corporate tax should be introduced to stop the current downward spiral. Greater fairness should be introduced through making tax rates more progressive, and through taking steps to eliminate the tax avoidance industry. The marginal rate of taxation on higher incomes should be raised and flat-rate taxes should be abolished. The top rates of personal and corporate tax should converge and wealth taxes in the EU should be harmonised. Tax havens should be closed and tax arbitrage by corporations should be prevented.

Sustainable development – A concerted approach is urgently required by the EU and its member states to reduce the EU's ecological footprint. Action is required to reduce energy consumption, unnecessary transportation, and the negative international impact of the EU on developing countries. The European Investment Bank and

TABLE 4
Main economic indicators, EU-27 and Eurozone (EUZ)

	2007		2008		2009		2010		2011		2012	
	EU27	EUZ	EU27	EUZ	EU27	EUZ	EU27	EUZ	EU27	EUZ	EU27	EUZ
GDP (% annual change)	3.0	2.9	0.5	0.4	-4.2	-4.1	1.8	1.8	1.8	1.6	1.9	1.8
Unemployment (% of the labour force)	7.2	7.6	7.1	7.6	9.0	9.6	9.6	10.1	9.5	10.0	9.1	9.7
GDP deflator (% annual change)	2.7	2.4	2.5	2.0	1.2	1.0	1.2	0.8	1.6	1.4	1.8	1.7
Real wages per head (% annual change)	0.7	0.3	0.2	0.6	1.3	1.9	-0.1	0.0	-0.3	-0.3	0.9	0.6
Gen. government deficit (% GDP)	-0.9	-0.7	-2.4	-2.0	-6.8	-6.3	-6.4	-6.0	-4.7	-4.3	-3.8	-3.5
Gen. government debt (% GDP)	59.0	66.2	62.3	69.9	74.4	79.3	80.2	85.4	82.3	87.7	83.3	88.5
Current account balance (% GDP)	-0.5	0.2	-1.0	-0.8	-0.6	-0.6	-0.5	-0.4	-0.2	-0.2	0.0	-0.1

Source: E.C. Statistical Annex of European Economy, spring 2011, Tables 96 and 108

the European Bank for Reconstruction and Development should be drawn on to meet the cost of the necessary investment. Market instruments are unreliable and wasteful means of achieving ecological change. Instead there is a need for a strong public component in investing in infrastructure, public services and employment that supports local and regional sustainability. The centrepiece of the policy should be a European Plan for Sustainable Development, which seeks to mainstream economic, social, and environmental sustainability in all areas of policy in the EU and the member states.

CONCLUSIONS

The response of the EU to the public debt crisis, in addition to being slow and piecemeal, remains within the neoliberal paradigm. Any assistance given to indebted countries has been conditional on the implementation of severe austerity measures. Furthermore, fiscal consolidation and austerity are at the centre of EU economic policy, more generally. This is expected to lead to low growth and to stagnation in certain countries, to rising unemployment, inequality and poverty.

Under these conditions, public finances are going to remain problematic, giving rise to further austerity measures and thus to a vicious circle. As social discontent is

turning into social unrest, there is an urgent need for a complete turnaround in EU economic and social policy.

A number of alternative proposals have been presented here. However, it is the paradigm on which monetary and European integration are based that needs to change radically. Market competition as the cornerstone of EU policy must be replaced with the notion of economic and social solidarity. The present paradigm has reached its limits. The Left has a historical role to play in striving for a new paradigm, one based on a common vision of our European future.

Government Bonds and European Debt Markets

JAN TOPOROWSKI

“The international financial system is already in a state such, that as soon as the holes in one place start to be patched up, new ones appear in a different place”.

Michał Kalecki¹

INTRODUCTION

Most academics view financial markets as constantly moving towards equilibrium. This view is now very difficult to maintain, given recent instability in the financial markets, and the associated decline in economic activity. Academics have tried to show this as a shock in a dynamic stochastic general equilibrium, with contagion effects arising because heterogeneous agents hold as assets each other's liabilities (see, for example, Goodhart, Sunirand and Tsocomos 2004). However, the actual course of events since the appearance of the 2007 financial

1. Kalecki, M. (1932), “Czy możliwe jest ‘kapitalistyczne’ wyjście z kryzysu” (“Is a ‘capitalist’ way out of the crisis possible?”), *Przegląd Socjalistyczny* 2/10, pp. 1-2.

crisis seems to suggest that, far from a resumption of general equilibrium after the “shock” of that crisis, financial systems have succumbed to a series of shocks. Such serial disturbance suggests that something more fundamental is wrong with the capitalist system. Central to these disturbances now is the role of government debt markets. While the financial markets have been gripped by a “Ricardian funk”, demanding that the governments stand ready to repay their debts, the continuing demand for government securities, even after the downgrade of US government bonds at the beginning of August 2011 by Standard and Poor’s, indicates that the markets still need government bonds as risk-free securities.

This article discusses the role of government debt markets in managing financial crises. The first section discusses the mechanisms by which a well-managed government bond market may stabilise capital markets in nominal, or cash-flow, terms. The second section looks at the crisis in European government bond markets and suggests ways in which those markets may be converted into stabilising mechanisms for European capital markets. The conclusion outlines some implications of the analysis for an “optimal” government bond issue.

BONDS AND CAPITAL-MARKET STABILITY

Since the Modigliani-Miller studies of the late 1950s it has been widely assumed that the composition of financial instruments in capital markets is merely the aggregation of individual agents’ financing and saving preferences and has no serious implications for the functioning or liquidity of those markets. This is usually because finance theory largely omits considerations of liquidity: The standard definition of financial equilibrium, a situation in which no further arbitrage is possible implicitly assumes that market liquidity is available on demand. As recent events have demonstrated, such liquidity has a disturbing tendency to disappear when it is most urgently required (Nesvetailova, 2010).

Financial stability requires the money price of financial assets to be stable. These money values are the key parameters for ensuring that payments on banking and financial commitments can be made without default. This is for two reasons. First of all, with the exception of inflation-related derivative instruments, or index-linked bonds (see below), the cash payments that issuers of financial instruments make are related to the nominal value, and not the value of such instruments in relation to goods and services. Secondly, and perhaps even more importantly, payments on financial obligations are money commitments. They cannot be replaced by delivery of goods and services. Payments on financial obligations are usually “hedged” by

financial assets that are held to provide income from interest or capital gain. No financial or bank balance sheet has assets and liabilities whose income or repayment streams exactly match each other day by day. Typically, those assets have to be sold to raise money in order to meet those payments, or money has to be borrowed against their nominal value. In other words, financial instability is a default on money obligations, and not on real ones.

This does not mean that inflation in markets for goods and services may not threaten the stability of banking and financial markets. It may do so as part of a general debt deflation problem, or a devaluation of money contracts. But the result is a macroeconomic problem, rather than strictly a default on payment commitments arising out of the operations of banking and financial markets.

In an earlier study I argued that in a capital market with debt and equity, a high proportion of bonds in the portfolios of market participants tends to stabilise the market. This is because bonds have an “assured residual liquidity”, which anchors prices and expectations in the market for those bonds. This “assured residual liquidity” arises because bonds have written on them exactly how much will be repaid on maturity of the bonds. Financial intermediaries’ balance sheets can be constructed in such a way that future payment commitments may be matched with assured future payment receipts. By contrast, shares or common stock have no “assured residual liquidity”. Their future values cannot be reliably estimated, despite the claims of financiers and academics, whose judgement has always been warped by excessive self-confidence and credulity. This wider dispersion of possible future values makes shares or common stocks preferred vehicles for speculation, i.e. purchase for capital gain rather than income. An extended period of capital market inflation boosts equity prices (and self-confidence and credulity). As a result, the preferences of investors are distorted towards equity, encouraging equity financing without stable market values.²

A high proportion of bonds in the capital market therefore makes those markets more stable and less speculative, because of the limited scope for capital gains. In turn, such reduced variability would make for more consistent portfolio and financing choices, and a sounder basis for the expectations of market participants. The greater stability of the market should be reflected in the stability of an “average” portfolio of financial assets. However, once portfolios become heterogeneous the “average” port-

2. Toporowski 2000, pp. 23-24. Index-linked bonds, or hybrid bonds currently recommended as a source of bank capital, are clearly halfway between equities and bonds, having the appearance of bonds, but without the assured residual liquidity of equity. Index-linked bonds invite potentially destabilising speculation against future inflation, and hybrid bonds may arouse similar speculation against bank insolvency.

folio becomes less representative. Two recent trends in particular have increased the heterogeneity of portfolios. The first is the rise of specialist funds, such as private equity funds, or hedge funds, with much less diverse portfolios. The second is the absorption of large quantities of government bonds by central banks: For example, some two-thirds of US government bond issues are held as long-term investments by central banks and their associated sovereign wealth funds. This greater portfolio heterogeneity therefore makes for less stability in the market if the full variety of portfolio holders is not present in the market at any one time.

In theory, bonds issued by corporations could provide stability for the capital market. In practice however, they are less efficient stabilisers than government bonds for two reasons. First of all, corporate bonds still have some element of risk associated with them. It is therefore imprudent for central banks to guarantee the market for corporate bonds, in the same way that central banks can guarantee the market for government bonds. Secondly, most issues of equity are to repay corporate debt. This means that, in a phase of capital market inflation, corporate bond issues are more likely to be reduced, rather than increasing *pari passu* with the increased value of equity. An overinflated equity market may end up on a very thin foundation of corporate bonds.

It is true that government bonds too are not perfect stabilisers of the capital market: The government's fiscal balance tends to vary in a counter-cyclical way, while the stock market moves with the business cycle, or slightly ahead of it. The result is that the issue of government securities varies inversely with stock prices. However, this is in any case complicated by institutional factors, such as the large holdings of government securities in the portfolios of central banks and sovereign wealth funds, because of chronic international trade imbalances. Nevertheless, the capital market may still be efficiently stabilised if there is a permanent stock of outstanding government debt that can be converted into long-term bonds during the boom, taking liquidity out of an inflating capital market, and then converted into shorter-term securities to provide stable liquid assets for the banking system in the recession.

The banking system too benefits from holding large quantities of government bonds which, contrary to the view of fiscal conservatives, do not squeeze out lending to the private sector. If money consists of a limited supply of banknotes backed by government guarantee, or by some commodity, then some squeezing out may occur. But in a credit economy, credit is enhanced, rather than restricted, by the availability of larger quantities of readily realisable government bonds. The stabilising influence of government securities in bank portfolios is well illustrated in the case of US banks. In 2006 their holdings of US Treasury securities *in nominal terms* were more or less the

same as they were twenty years before. On the eve of their biggest banking crisis since the Great Depression, U.S. banks held negligible amounts of Treasury securities.

Therefore, as Minsky argued, a government bond market embracing all financial intermediaries and managed by a central bank is essential for stabilising investment portfolios (Minsky 1986, 33-37). The alternative is more extreme financial cycles and, with the build-up of debt in the economy, an eventual condition of "serial" crises preventing economic recovery. It should also be pointed out that the above remarks apply to government borrowing in its domestic currency. The fears of government default, which were so widespread in European financial markets, have a rational foundation in the case of borrowing in foreign currency. In the case of domestic currency, default does not arise because the government always has two options available to manage its internal borrowing. First of all, a government can increase taxes (for example on holders of government bonds) in order to service its debts. Secondly, the government can always refinance along the yield curve, e.g. reducing short-term interest rates and issuing short-term bills, the proceeds of which can be used to buy in long-term government bonds. Such short-term bills are usually readily held by banks because of their liquidity: on maturity, the government can usually repay the bills through a new issue of bills. Only in extreme cases, such as in conditions of hyperinflation, would such debt management be impossible.

STABILISING EUROPEAN CAPITAL MARKETS

Within the Eurozone the Stability and Growth Pact establishing the European Central Bank makes it much more difficult to stabilise capital markets with government bonds. The hostility to government bond stabilisation arises out of the view prevalent in the most powerful country of the zone, Germany, that central banks should not in principle hold government bonds in their portfolios, other than for repurchase purposes, because to do so would be to monetise government deficits. This, it is believed, is inflationary. This principle is incorporated in the rules that are supposed to make the Eurozone central banks "independent" of governments. The result of this reluctance to hold government debt is that the ECB instead monetises private debt or issues its own paper. However, such private debt issued and monetised to excess, may be just as inflationary as government debt.

The outbreak of the crisis in 2008 placed different financial pressures on different governments. Without central bank management of the government bond market, premiums emerged on bonds issued by different governments. As the table shows, these premiums are unrelated to the actual debt/GDP ratios, but are largely

influenced by the perception of banking crises in different countries. Yet in Greece, which set off the Eurozone crisis in 2010, there has (as of yet) been no bank crisis.

TABLE 1
Government debt and bond yields

	Government debt as % of GDP		Spread of 10-year government bonds over German bunds (basis points), Jan.11
	2010	2013	
Greece	130	144	880
Italy	118	120	196
Belgium	100	106	134
Ireland	94	105	625
Portugal	83	92	423
France	84	90	47
Hungary	78	80	522
UK	77	86	63
Germany	75	77	0
Austria	70	75	58
Netherlands	66	74	23
Spain	63	79	270

Source: International Monetary Fund, Financial Times (11 January 2011) and author's calculations.

Germany itself, whose government issues the benchmark bonds for the Eurozone, owes the stability of its government bond market less to the prudence of its government and more to its pension system which is obliged to hold large quantities of government bonds, with maturities matched to pension liabilities. The German pension system stabilises itself against the problems of pension fund maturity that have wrecked equity-dependent American and British funded pension schemes by holding large quantities of German government bonds. Buying in these bonds, the German pension system also helps to stabilise the market for such bonds keeping the yield on 10-year bonds at a low of 3.26%. However, in general, institutional investors' holding of government bonds cannot be an effective stabiliser for the market in such bonds. It works in Germany because the distribution of income and wealth is relatively equal, and pension funds there have a correspondingly greater influence over the capital markets. Most other countries in the Eurozone have a more unequal distribution of income and wealth. This gives their pension funds less influence over their capital markets. The institution that is, most generally, best placed to maintain a liquid market in government securities is the central bank, in particular because it has

the capacity to expand and keep its balance sheet liquid in a way that other institutions cannot.

CONCLUSION: AN "OPTIMAL" GOVERNMENT BOND ISSUE?

The above analysis suggests that three conditions must be in place to avoid serial crises of financial systems. First of all, the supply of government bonds in private portfolios should be sufficient to maintain the liquidity of private capital markets. Secondly, participants in banking and capital markets should be obliged to hold government paper in some proportion of their portfolios (as German institutions are obliged to hold government securities). Thirdly, central banks should maintain a liquid market in government securities. Only in such conditions can capital markets maintain the stable liquidity necessary to price assets in accordance with their assessment of the economic prospects of the issuer of financial paper.

Thus the determination of the "optimal" govt bond issue should not start with some arbitrary ratio of government debt to GDP, or fiscal deficit, let alone some nebulous Ricardian prospect of being able to repay all the debt in the future, as Robert Barro and some Chicago economists have suggested. In a capitalist system with sophisticated financial markets, the starting point has to be the size and value of the capital market that needs to be stabilised. This determines the issue of risk-free government paper that must be held in private portfolios. Only the government and its central bank can do this because only the government can operate along the whole yield curve all the time, and only the government can integrate such operations with monetary policy and, as recent events have shown, with the function of a lender of last resort.

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The Postman Always Rings Twice. The Euro Crisis Within the Global Crisis

RICCARDO BELLOFIORE

1. Europe is in the middle of an economic and social storm. In the meantime, the world economy is heading towards a recession that is nothing else but the continuation of the deep structural crisis of capitalism. Although the institutional scheme that gave birth to the Euro was wracked by contradictions from the start, it is the global crisis that is behind the European crisis. The European crisis is only feeding back into the international dynamic. In this context, the structure of the Euro is in danger of imploding.¹ From the weakest periphery of the continent, the Greek crisis spread first to Ireland and Portugal and then finally hit Spain. At that point, and with a speed most did not expect, the crisis struck Italy, also touching France and even Germany, which is suddenly awakening from the illusion of a partial decoupling from European demand. This illusion was the only factor used to justify its suicidal policy since 2010, from which, however, it had progressively to back down.

The "promising signs of a recovery" have withered away very quickly, and the

1. It was not very difficult to see this in advance. See Riccardo Bellofiore and Joseph Halevi: "Could Be Raining. The European Crisis After the Great Recession", *International Journal of Political Economy*, vol. 39, no. 4, Winter 2010-11, pp. 5-30.

bounce after the crisis was overestimated. China –the only country that, since the beginning of 2009 has implemented a truly active and massive Keynesian government spending policy– is at risk of derailing. Its growth relies too much on infrastructural investment; and many suspect it could fall victim to a huge real-estate bubble. The rest of the world assumes it can warn China that it cannot go on forever with the current under-consumption on the part of the masses, deluding itself that an increase in wages would be spent on imports. Latin America, for its part, is at risk of a sudden slowdown, frightened by inflation, strangled by a rise in the exchange rate, dependent not only on external demand but also on the prices of raw materials, which could turn against it. The idea that the United States could become a net exporter, with Latin America playing the role of the only buyer of last resort, is clearly unrealistic. The awaited “light at the end of the tunnel” is none other than a high-speed train heading straight towards us.

2. The *Euro* was born with an original sin. The Left chose not to see it and approved the introduction of a single currency whose very DNA included a permanent recessionary drift, increased competitive differences between countries, a wage squeeze, increasing social inequality, the dismantling of trade unions and a constant industrial restructuring. This had in fact been anticipated by Jean-Luc Gaffard (Le Monde Diplomatique, September 1992) and Paul Krugman (1993)², with arguments which still hold.

Within the structurally heterogeneous European area, in which there are radical variances both in the productive power of labour and in (material and immaterial) infrastructures, a nominal convergence cannot but give way to a progressive deepening of the real divergences. The in-built and on-going tendency to self-dissolution of the monetary union could be counteracted only through a common fiscal policy governing the resource redistribution between the regions of the Eurozone and underpinning policies intended to overcome the real divergences. Instead of this, the European Union budget (in relation to GDP) is ludicrously low: as Vittorio Valli observed a few years ago, it is equal to a tenth of what is necessary (and possible).³

How was such a fragile construction able to take off at the end of the 1990s? The answer is in the success (albeit temporary) of the “new” *made in the USA* capitalism – and in its capacity to integrate China and the rest of Asia, and to provide demand to

2. “Lessons of Massachusetts for EMU”, in Torres Francisco, Francesco Giavazzi (eds.), *The Transition to Economic and Monetary Union*, Cambridge University Press, Cambridge.

3. Vittorio Valli, “Una politica di sviluppo per l’Europa”, in *Rive Gauche. Critica della politica economica*, Sergio Cesaratto and Riccardo Realfonzo (eds.), manifestolibri, Roma 2005.

neo-mercantilist Europe, while Latin America and Russia were facing ups and downs. In the meanwhile Germany overcame the re-unification shock, and pushed forward a radical restructuring of the labour market and the labour process and was able to breathe again. With its “satellites”, Germany benefited from the brisker capitalist development in the periphery. The real-estate bubble spread throughout Europe, as a consequence of which Ireland and Spain (not to speak of England) had remarkable GDP growth: this is why their public budgets were so “virtuous”. In a world of lower and lower interest rates, the government deficits of Greece and Portugal, as well as the management of the Italian government debt, made room for ongoing financial investments for German and French banks.

The multi-speed dynamics of Europe is well known by now. Its core is the growth of Germany with its “satellites”. Net exports are the driving force, with the resulting profits invested abroad. It is a Luxemburg-Kalecki model. However, in the context of the “new capitalism” these investments have increasingly gone into “toxic” finance – and not only overseas. Indeed, in Europe the treasury-bonds of the “periphery” played a role similar to that of subprime loans in the United States.

Germany, like its “satellites” and the rest of Northern Europe, has a historical need for exporting in the rest of Europe, where it realises the largest part of its profits. Trade deficits in Southern Europe also help Germany for a second reason: they hold down the nominal revaluation of the Euro (compared to what would happen with either the Deutsche Mark or also a Euro restricted to the net exporters). The single currency also gives rise – thanks to both the increase in the productivity of labour and wage repression, which together lead to competitive deflation – to a real devaluation that benefits the stronger area. After the 1990s, even in the last decade, the net neo-mercantilist position of Europe kept on “closing” thanks to the American engine. Europe’s net exports to the United States, however, became more and more unable to offset the growing structural deficit with China, and to remedy the effects of instability in Russia and Latin America.

In that phase, trade imbalances were not a great problem. For a while, financial and trade imbalances, which grew exponentially, seemed magically to make the economies more and more resilient. There was no urgent sense of concern about government finance. Rather, in instances in which growth was not helped by real-estate bubbles, the very government deficits offset the recessionary tendency originating in Germany. Actually, the drama about the sovereign debt ought not to be staged even today, since the deficit and debt ratios of the Euro area are definitely lower than those of United States and Japan – not to mention the UK. As Krugman⁴ reminded us, if we were to list the countries where government finance was a serious problem

before the crisis the list would contain only one country: Greece.

3. In Europe, demand and (low) growth, as well as the outbreak of the crisis and the ensuing current sovereign debt crisis, were wholly determined from outside. It is not at all an endogenous replay of the 1992 collapse of the European Monetary System, as some Italian left economists fancied in 2008. As I countered at the time, if only the economic analysis of the left were free of obsolete explanations, such as the tendency of the rate of profit to fall, or under-consumption (caused by a world of low wages), it could have foreseen that it was the collapse of the “privatised Keynesianism”⁵ which would sooner or later bring Europe down. At this point a self-destructive mechanism becomes inevitable. It is not that the ECB follows its monetarist prescriptions to the letter, nor that European institutions are inactive (another legend on the left); the problem is that when they intervene in support of the economy, or they step in to protect public debt from speculation, or they eventually face the need to change some of the institutional architecture of the single currency, they do this reactively, in the wake of the crisis.

The idea that European authorities will be forced, “out of necessity”, to create an institution giving financial support to countries in crisis, or will eventually implement some kind of fiscal redistribution on a continental scale, even if minimal, is not wrong in itself. The point is that what is being done is too little and too late. The by now obvious paradox is that if Greece’s debt had been forgiven, the costs for Europe would have been negligible, as the domino effect has spread the crisis to Ireland and then Portugal. Even in this case, a simple cancellation of the debt would have been

4. <http://krugman.blogs.nytimes.com/2011/08/25/fiscalization-watch/>

5. The defining features of this ‘new’ capitalism have been put forward quite clearly already before its crisis in Riccardo Bellofiore and Joseph Halevi, “Tendenze del capitalismo contemporaneo, destrutturazione del lavoro e limiti del «keynesismo»”, in *Rive Gauche. Critica della politica economica*, Sergio Cesaratto and Riccardo Realforzo (eds.), manifestolibri, Roma 2005 (there is a German version: “Was ist neu am ‘neuen Kapitalismus’. Der Wandel von Wirtschaftspolitik und Arbeitsbeziehung aus der Perspektive von Marx und Kalecki”, in *Keynes als Alternative(r)? Argumente für eine gerechtere Wirtschaft?*, Günter Krause (ed.), Karl Dietz Verlag, Berlin, 2007; an English version is going to be published in the near future as “Deconstructing Labor. What is ‘new’ in contemporary capitalism and economic policies: a Marxian-Kaleckian perspective”, in *Employment, Growth and Development*, C. Gnos, L.P. Rochon, D. Tropeano (eds.), Elgar, Cheltenham, 2011. The picture of this financial and privatised Keynesianism is developed in all other papers of ours thereof. Our reading was, and is, opposed to the distributional/underconsumptionist vulgata which is plaguing every corner of heterodox economics, and which grounds the economics proposal of the alternative Left. Privatised Keynesianism is a notion which has been independently employed by Colin Crouch, in many papers. See “Privatised Keynesianism: an unacknowledged policy regime”, *British Journal of Politics and International Relations*, 11: 382–399.

much less destructive than the dynamics set in motion to avoid default, without rescheduling and reducing the debt to be repaid. But when the crisis hit Spain, and then Italy, the quantitative change turned into a qualitative leap. In this situation, if one does not learn to swim one drowns.

It is useless to blame markets or rating agencies. The latter are today absolutely right. They are just registering the complete absence of a political leadership which could assure some way out. It is this political ineffectiveness that pushes up interest rate spreads, and that exposes one country after another to the risk of default (according to a mechanism well described by Paul de Grauwe⁶). The economic policies of European countries, because of their deflationary nature, pull down the rate of growth, while the rest of the world either comes to a stop or slows down. It is not surprising that it is increasingly more difficult to sustain public debt. It is a sort of paradox of thrift applied to public finance (if everyone wants to increase the saved percentage no one can succeed because this collective action pulls down revenue). Further complicating matters is the ECB’s peculiar form of independence in which there is no political sovereignty over money in the single currency area, no explicit role of lender of last resort nor the will to finance government deficits.

4. The crisis in Europe is not due to Greece. Nor is it the result of the government indebtedness of a particular country (both in absolute terms and in relation to GDP). As Jan Toporowski⁷ argued, what matters is the willingness (or not) of the central bank, here the ECB, to re-finance government deficits. Even with a hypothetical Euro limited to Germany and its satellites, the sovereign debt crisis could burst. For instance, it could be Belgium, whose debt to GDP ratio is close to 100%. Excluding default, a way out could be inflation, a second growth, a third a mix of the two. Both inflation and growth increase the denominator in the deficit (or debt) to nominal GDP ratio.

Inflation is currently considered a curse. But the critics of inflation will be fewer and fewer as the crisis proceeds. For some years now, authoritative voices, such as Kenneth Rogoff’s,⁸ have supported it, even giving a percentage between 6%-8%. At present the option of inflation is not on the table. It is the Great Recession itself that blocks it. Most firms and households do not ask for credit, and loans are refused to those who request them - because banks and financial institutions are reluctant to lend to the “real” economy. We are living in a two-speed economy. Monetary stimuli make financial bubbles form again, but the latter no longer make the real economy grow.

6. “Only the ECB can halt Eurozone contagion”, *Financial Times*, August 3, 2011.

7. “Not a very Greek tragedy”, *Re-public*, June 2010, <http://www.re-public.gr/en/?p=2400>

8. “The bullets yet to be fired to stop the crisis”, *Financial Times*, August 8, 2011.

On the contrary: the bursting of the bubbles brings back recession and can make it worse. Moreover, it is easy to see what inflation means for the working classes in the absence of income indexing.

One could ask whether an exit option from the Eurozone would be desirable. One cannot exclude the possibility that the situation could lead to the dissolution of the single currency. Nonetheless, at present, this is a counsel of despair, such as that offered by the left last year with regards to Greece and then Ireland. The positive example usually put forward is Argentina in 1992. However, as again Toporowski observed, the main problem with Argentina was the banking crisis, and, second, the fact that its debt was denominated in a foreign currency. By contrast, in the Greek case the banking crisis follows the crisis of the government debt, and it is denominated in an internal currency – or better, a currency that should be internal: the fact that in practice it is not is due to a deplorable political choice. Getting out of the Euro would dramatically increase the external debt burden, as it would be accompanied by a huge devaluation. In addition, the feasibility of such a choice requires a condition that is absent in Greece, i.e. a continuous series of significant government primary surpluses. Otherwise, the concurrent impossibility of satisfying the internal debt will likely lead to the insolvency of the domestic banking system. The worsening of the structural foundations of competitiveness, which has been going on for decades, makes an improvement in the balance of trade something which may be very slow, or non-existent. A spectacular reduction in real wages should be added to the picture. It is very difficult to see all this as a left solution to the crisis.

5. Was there an alternative to the construction of the single currency in the form of the Euro? And if so on what basis? About twenty years ago, in *Les dangers d'une monnaie unique*, the economist I have already cited, Jean-Luc Gaffard, certainly no Marxist, held that one should take account of the so-called “paradox of productivity”, that is, of the need first to finance and then to realise the displacement of resources that will generate new output. The successful outcome of real investments, private or public, can only follow: and it would not be possible without that financial condition which, in turn, comprises more bank credit but also more inflation (including the change in relative prices).

From this (Wicksellian and Schumpeterian) point of view, the real convergence of the European economies would have required policies which are the opposite of those defined in the Maastricht Treaty and then put into practice: creation of money in support of private innovation; and a temporary but substantial increase in government deficits financed by new money – deficits which may be labelled “productive”. At the beginning, this policy entails higher inflation and an increase in

the debt to GDP ratio. But the price increase and the fiscal “imbalance” will be reabsorbed as long as the policy is effective.

The introduction of the Euro was not the only possible form of the monetary unification. An alternative was proposed by Suzanne de Brunhoff⁹, drawing on Keynes' plan at the Bretton Woods Conference. It involves the introduction not of a “single currency” circulating among the public but of a “common currency”, which would be merely a reserve currency used in the clearing mechanism among central banks of the member states, within a system of fixed (but adjustable) exchange rates. These latter would be changed in case of significant trade deficits of some countries, with the symmetrical commitment of net exporters to reduce their surpluses. This is what the EMS and also the Bretton Woods agreement failed to consider, inscribing deflation into their very DNA.

The clearing of the European real “imbalances” requires, yesterday as today, an intervention that concerns not only reflation on the demand side, and/or a re-coupling of wages to productivity. A strong intervention on the supply side and in the productive structure, along with financial stabilisation, is needed.

It does not seem very useful to review the various acrobatic solutions to the crisis proposed by European authorities in the last few months or the alternative proposals. The former, as Wolfgang Münchau¹⁰ rightly observed, are dead, because of this summer turmoil. The latter, missing the heart of the matter, are too weak. Even those who assert that some of the debt is illegitimate and should not be paid, or those who press for complete cancellation of the debt, are not wrong. But at present it is very unlikely that their positions, formulated so radically, can gain sufficient following.

The so-called European Financial Stability Facility (EFSF) has been introduced late and with little conviction. What was lacking is the will to cut interest rates and to reschedule the debt, such as to extend the deadlines and to make the creditors bear some losses. We are now beyond this stage: the EFSF in its current configuration cannot cope with Spain and Italy. If it tried to do so, it would seriously worsen the very fiscal balance of the states which contribute to its financing, including France and Germany. Finally, it is true that the ECB has decided to implement extensive programmes for the purchase of government securities, but only on the secondary market. It is still not a structural and permanent intervention within a coherent setting for the management of European public debt.

9. See her contribution in François Chesnais, Suzanne de Brunhoff, et al, *La mondialisation financière: genèse, coût et enjeux*, Syros, Paris 1997.

10. “Even a joint bond might not save the euro”, *Financial Times*, Aug 28, 2011.

Without a fiscal union, whose establishment is utopian in the short-run, there remains only the Eurobond solution, as a common guarantee for all the public debts of the Eurozone countries. However, apart from the formal difficulty (legal and political, not just technical) in their quick introduction (something which could be speeded up by a worsening of the crisis), the question is: Eurobonds to do what? As Yanis Varoufakis¹¹ observed, one has to see Eurobonds as something more than a credible instrument to achieve low-cost public debt financing for the countries in trouble. They have to be regarded also as the foundation for a coordinated expansion of expenditure and investments on a European scale. It amounts, in fact, to a proposal for a renewed, and innovative *New Deal* that could directly affect structural basis of growth, by improving the quality of output and by increasing the productivity of labour.

6. Some insights into a real alternative to the current mess may be found in the structural Keynesianism of those who are explicitly critical of capitalism and the Keynesianisms actually put into practice in the past. I am referring to some recent analyses by Alain Parguez,¹² and to some less recent by Hyman P. Minsky.¹³

There is no such thing as economic development not based on debt. Recent decades confirmed that *ex post* government deficits are the condition for the net creation of income in the private sector. However, as Parguez teaches us, we should not forget that there are “bad” and “good” deficits. “Bad” deficits – like those, first, of monetarism, and then of “privatised Keynesianism” – are the non-planned result of the tendency to stagnation, of shock therapies, of deflationary policies, of the unsustainability of toxic finance, and so on. By contrast, “good” deficits are planned *ex ante* deficits. Their aim is to build up, and improve, a stock of productive resources.. They are a means for the production of wealth and not of (surplus)value: a long-run investment in tangible goods (infrastructure, green conversion, alternative forms of transport, etc.) and intangible goods (health, education, research, etc.). A gender-balance and nature-friendly approach becomes inherent and crucial to this policy. Welfare itself has to be transformed from a money-supplying focus and to direct intervention on the use-value side, as part of a wider horizon of planning.

Obviously, deficit spending of this kind immediately raises the government debt to

11. See the second version of his “Modest Proposal”, with Stuart Holland:

<http://varoufakis.files.wordpress.com/2011/04/ceb1-modest-proposal-2-2-6th-april-20111.pdf>

12. “The true rules of a good management of public finance”, March 2010, mimeo.

13. See chapters 8 and 9 of his 1975 *John Maynard Keynes*, reissued in 2008 by McGraw Hill Professional. More on Minsky’s thought (and his interpretation of money-manager capitalism) in my introduction to the reprint of the Italian translation: *Keynes e l’instabilità del capitalismo*, Bollati Boringhieri, second edition, Turin 2008.

GDP ratio – but the subsequent growth in the denominator will make this increase only temporary. Such an intervention may have positive effects seen from a capitalist point of view, i.e. the effects which mesmerise Post-Keynesian economists. It would support the real economy from the demand side, it would stabilise the financial sector by providing “sound” financial assets, and it would increase the productivity of labour and of the system. This is the reason why this intervention can –and must– be part of a minimum programme of a class-oriented left. It is clear, however, that this entails not a stable model of a new capitalism, but rather an “imbalance”: an uneven terrain where the issue of overcoming capitalism in the end has to be dealt with.

7. Here some of Minsky’s conclusions in his *John Maynard Keynes* (1975) turn out to be very useful. Of course, Minsky is not a revolutionary thinker in any standard way. Nonetheless, his perspective is that of a “socialisation of investment”, coupled with a “socialisation of employment” and a “socialisation of banking”. Nothing strange, you may say. Did not Keynes himself say that capitalism needed a thorough “socialisation of investment”?

Not quite. The *General Theory*, Minsky writes, is to be read as a product of the “red” 1930s. Keynes himself underlines its conservative, not socialist, implications. Once full employment is achieved -thanks mainly to high private investments supported by economic policy (including an expansion in money supply to reduce the rate of interest) and the resulting positive expectations- there is no reason to argue against the market allocation of resources. This Keynesianism has never been adequate, and it is not adequate today. The really-existing Keynesianism of the so-called Golden Age is thoroughly criticised by Minsky. It was a system in which taxation and transfers govern consumption, monetary policy rules investments, government spending is either waste or military expenditure, rent-positions and finance are nurtured. He calls this a strategy of high profits, high investment, leading to an artificial consumption, and putting at risk the biological and social environment. “socialism for the rich”.

This is Minsky. We have to come back to square one, he insists: to 1933. We have to rethink a Keynesian *New Deal* that deals with the fundamental questions: “for whom is the game played?”; “what kind of product do we want?”. Minsky favours a society in which the real structure of consumption is determined by government investments, which are the driving force behind autonomous demand, which gives way to a different supply side. He explicitly reclaims a “socialisation of the towering heights”, consumption as a “common” dimension, capital controls, the regulation of finance, banks as public utilities, and so on. Minsky, like Parguez, asks the state “directly” to create employment.

The Great Recession, as the final crisis of neoliberalism as we knew it, and the European collapse, as the deadlock of neo-mercantilism, are putting on the agenda again the issues of how, what and how much to produce.

Global Economic Crisis and the European Union: Implications, Policies and Challenges

MARIA KARAMESSINI

INTRODUCTION

The global economic crisis which broke out in 2007/2008 – now often called the Great Recession – is a major structural crisis of capitalism still in progress, since its deep underlying causes have not yet been confronted. In advanced economies, these causes were the great increase in inequalities, the promotion of economic growth through private and public borrowing, the unregulated operation of global financial markets and enormous US trade imbalances with the other poles of the world economy. However, due to widespread state intervention to bail out banks and the “real” economy, economic collapse was avoided, recession in 2008 and 2009 was limited while recovery reappeared by the end of 2009 and was reaffirmed in 2010 in most countries of the world including in the EU. Counter-cyclical policies were implemented in the advanced economies and elsewhere, thus preventing a disinflationary spiral and proving that the historical lesson of the necessity of state intervention in the Great Depression in the 1930s had been learnt.

With the rapid spread of the crisis from the US to the rest of the world, its negative impact on production levels has manifested itself everywhere, but with significant

differences in form and intensity among countries of different levels of development as well as between and within geographical entities. Similarly, the crisis has produced worldwide regression in employment and employee rights and an increase in unemployment and loss of income for the working classes. Still, the extent of the social effects of the crisis also differs according to the vulnerability of national economies to the crisis, capital's strategies to counter it, labour-market institutions, social protection systems, state crisis-management policies, and supra-national initiatives.

In what follows there will be a discussion of:

- The effects of the crisis in the EU as a whole in international comparison;
- Different effects of the crisis within the EU;
- State intervention to counter the effects of the crisis at the national level;
- Anticipated effects from coordinated austerity policies at the EU level, with the reactivation and tightening of the Stability Pact in the framework of the new economic surveillance process.

The central argument of this paper is that, up to now, the EU economies and populations have been the greatest victim of the crisis, because of the management of the crisis by its political elites and hegemonic states, reflecting the interests of hegemonic fractions of capital and their adherence to the neoliberal project as a way out of the crisis.

HOW GLOBAL IS THE GLOBAL CRISIS? THE EU AS THE BIGGEST VICTIM BY THE POLITICAL ELITES' OWN WILL

The current crisis is not as global as suggested by the terms "global financial" or "global economic crisis" used in public debate. Originating in the US as a financial crisis, it hit mostly the advanced economies of North America, Europe and Japan as well as Russia and its peripheral countries. The unequal effects of the economic crisis on the level of output, employment and unemployment in the different parts of the globe have reinforced the pre-crisis trend of the transfer of world-output dynamics from the advanced economies to the emerging and developing economies and from North America, Europe and Japan to South and East Asia. Up to now, the emerging and developing economies of Asia and Africa have not experienced recession but only growth deceleration in 2009. Along with the newly industrialised Asian economies and the emerging and developing economies of Latin America, Eastern Europe and the Commonwealth of Independent States, they have recovered their pre-crisis dynamism since 2010 and fully absorbed the unemployment created in 2009.

The "global" economic crisis is thus a structural crisis of the advanced economies *only* and, more specifically, of North America, Europe and Japan. After a mild recession in 2009, the newly industrialised Asian economies (Hong-Kong, Singapore, South Korea and Taiwan) have shown an extremely high growth in 2010. Although growth has decelerated in 2011, these countries apparently do not share the fate peculiar to the other advanced economies. Of course, all economies in the world are interdependent. Emerging and developing economies, especially those most export-oriented, are thus affected by falls in foreign demand caused by the crisis in advanced economies. However, they are not subject to the structural crisis.

TABLE 1

Crisis effects on output - GDP growth rates (%)

	2009	2010	2011*
World Output	-0.7	5.1	4.0
Advanced Economies	-3.7	3.1	1.6
EU	-4.2	1.8	1.7
United States	-3.5	3.0	1.5
Japan	-6.3	4.0	-0.5
Canada	-3.8	3.2	2.1
Australia	1.4	2.7	1.8
Newly Industrialised Asian Economies**	-0.7	8.4	4.7
Emerging and Developing economies	2.8	7.3	6.4
Central and Eastern Europe	-3.6	4.5	4.3
Commonwealth of Independent States	-6.4	4.6	4.6
Latin America and the Caribbean	-1.7	6.1	4.5
Developing Asia	7.2	9.5	8.2
Middle East and North Africa	2.6	4.4	4.0
Sub-Saharan Africa	2.8	5.4	5.5

*Projections.

** Hong-Kong, Singapore, South Korea, Taiwan.

Source: IMF (2011).

Among the advanced economies severely hit by the crisis, the EU was the biggest victim (Table 1). It experienced the greatest recession after Japan in 2009, the slowest recovery in 2010 while growth is expected to decelerate in 2011. Although Japan's anticipated performance in 2011 is worse, this is due to the earthquake and tsunami.

The EU was also the area of the world with the biggest drop in employment and rise in unemployment after the US during the crisis (Table 2). Although recession in the US was less severe than in the EU, unemployment increased in the US much more

than in Europe because of the greater downward flexibility of employment in the US labour market. Among the emerging and developing economies, a rise in unemployment was witnessed only in 2009 and only in non-EU countries of Southern and Eastern Europe, in the Commonwealth of Independent States and in Latin America and the Caribbean. The unemployment rate remained stable or fell in all the other areas of the world in 2009.

TABLE 2
Crisis effects on employment and unemployment

Employment growth (%)			
	2008	2009	2010
EU	0.9	-1.9	-0.6
USA	-0.7	-5.0	-0.5
Japan	-0.3	-1.6	-0.6
Unemployment rate (%)			
	2007	2010	2007-2010
EU	7.2	9.6	2.4
USA	4.6	9.6	5.0
Japan	3.9	5.1	1.2

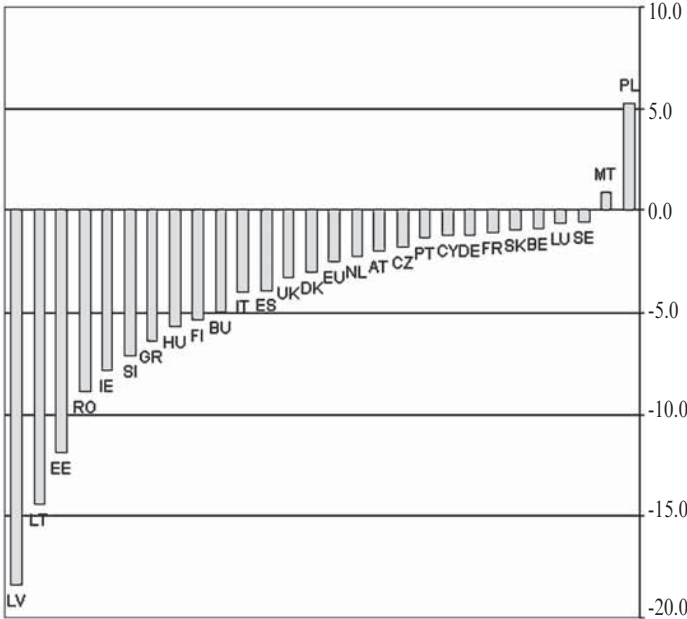
Source: European Economy, *Statistical Annex*.

As we have said, the EU today exhibits the world’s worst economic performance, but this is not only due to financialisation of its economy, pre-crisis real-estate bubbles and the great interconnection of the European with the US financial system. It is equally attributable to the EU’s having become the main stronghold of monetarist and neoliberal orthodoxy, notwithstanding the pragmatic relaxing of monetary policy to counter the sovereign debt crisis in the Eurozone since late 2009. In fact, counter-cyclical fiscal policy in 2008-2009 was less expansive in the EU as a whole relative to the rest of advanced economies (US, Canada, Australia, Japan, South Korea, Taiwan) but also relative to many emerging ones (China, India, Turkey, etc.). At present, it is feared that coordinated austerity policies in most EU member states in 2011-2013 will lead the EU not only to stagnation but also to a new recession.

DIFFERENT EFFECTS ON THE “REAL” ECONOMY AND CRISIS-MANAGEMENT
POLICIES IN THE EU

The effects of the crisis on the level of output and employment differ substantially

CHART 1
GDP change (%) 2008 - 2010



among EU member states. First of all, the virulence of the 2009 recession is the joint outcome of a series of determining factors that affected each economy in different combinations of ways and with varied intensity. These comprise the strong or weak interconnection of the national banking system with the US financial system; the size of real estate bubbles; the weight of construction in production; the importance of exports in the production system; excessive private and/or public borrowing; great financial dependence of new EU member states (e.g. Baltic countries, Bulgaria, Romania) on foreign banks and financial capital, accompanied by the lack of solidarity by the rest of EU, which led them to a credit crunch and into the arms of the IMF.

The intensity of the crisis has differed within the EU not only because of the different degrees of vulnerability of its member states to transmission mechanisms of the financial crisis, but also due to the different approaches to managing the crisis by governments and the means deployed. To prevent a disinflationary spiral and vicious recessionary circle, the governments did not only rely on the automatic stabilisers whose role is more important the more developed social protection and tax evasion are. Many of them took emergency measures to provide liquidity and capital to the

banking system and then cover the domestic demand gap in order to support production (fiscal stimulus). Others asked for IMF support due to financial collapse and adopted restrictive policies.

The emergency fiscal measures taken at the end of 2008 and in the first months of 2009 lasted until end 2010. Cyprus, Luxembourg, Sweden, Germany, Finland, Poland, Austria, France, the Czech Republic and Denmark, in decreasing order, implemented the largest *fiscal stimulus packages* (European Commission, March 2010). Spain, Portugal, the UK, the Netherlands and Belgium adopted expansionary fiscal measures of more limited extent, while Italy was the only big EU country not to implement any such measures. At the other extreme, Ireland, the Baltic countries, Hungary, Romania, Bulgaria and Malta adopted restrictive fiscal policy which aggravated the effects of the Great Recession on their economies. From the very start of 2010, Greece was the first Eurozone country to implement an extremely severe fiscal consolidation policy, after the eruption of the sovereign debt crisis and in exchange for financial aid received from the other Eurozone countries and the IMF. Spain, Portugal and Great Britain were to follow in mid-2010, putting an end to their expansionary fiscal policy under the threat of rating agencies and financial markets.

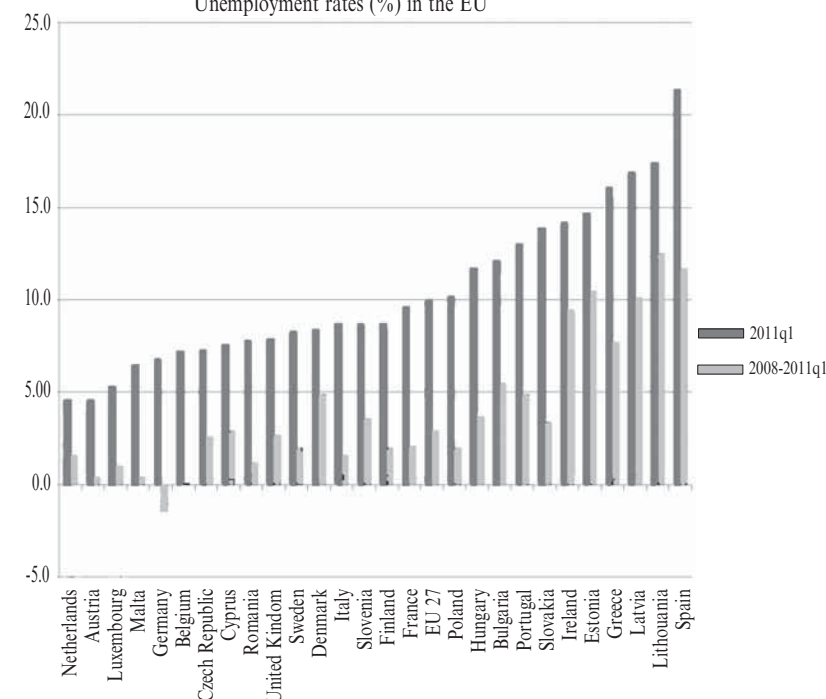
By the end of 2010, the way the Great Recession affected each national economy within the EU was very varied. With few exceptions (Finland, Slovenia), the ranking of countries according to the size of GDP contraction between 2008-2010 (Chart 1) results from the kind and extent of fiscal policies implemented as a response to the initial shock of the crisis on the “real” economies and does not reflect differences in the extent of this initial shock. This fact underlines the key role played by fiscal policy in the tempering or exacerbation of the initial effects of the crisis. It also underscores the unequal opportunities of those EU member states without public financial resources to finance the exit from the crisis and a new development model.

EMPLOYMENT CRISIS: EMPLOYMENT FLEXIBILITY AND EMPLOYMENT POLICY MATTER

For the working classes, the economic crisis is first and foremost a crisis of employment (dismissals, lack of employment opportunities, increased risk of unemployment), wage reduction and deterioration in employment and working conditions.

The deterioration of the employment situation in the EU member states since the beginning of the crisis certainly depends on the intensity and duration of the recession in each particular economy, but not only. Other determinants include the strength of

CHART 2
Unemployment rates (%) in the EU



employment protection legislation, the incidence of temporary employment as well as the measures taken by governments in 2009-2010 to maintain jobs and support incomes in order to stimulate effective demand and prevent social protest. Italy and Belgium made extensive use of temporary lay-offs, while Germany, the Netherlands, Luxembourg, Austria, Hungary, the Czech Republic, Slovakia, Slovenia and Bulgaria used subsidized short-time work schemes (European Commission 2009, ILO 2010). These measures maintain jobs at the cost of reducing pay to a larger or smaller extent. Many countries – including Greece – implemented job maintenance or employment promotion schemes based on substantial cuts or exemptions in employer social security contributions. Many of these measures expired at the end of 2010, and it is doubtful whether the remainder will survive budgetary cuts in the coming years.

The unemployment rate is the main indicator of the impact of the crisis on the working classes and the balance of power between capital and labour. Although most EU economies recovered in 2010, the unemployment rate continued to rise in the EU on average. There are substantial country differences within the EU as regards the

level of unemployment. At one extreme, the Baltic countries, Spain, Greece, Portugal, Ireland, Slovakia, Bulgaria and Hungary exhibit extremely high unemployment rates, ranging from 12 to 21% (Chart 2). At the other extreme, Austria, the Netherlands and Luxembourg have kept unemployment rates slightly below or above 5%. In the remaining countries unemployment ranges from 6 to 10%. It is expected that coordinated austerity policies from 2011 to 2013 will push the unemployment rate above 10% in many of the countries with a medium level of unemployment. Unemployment rates in the first group of countries are expected to break historical records, reinforcing trends towards social disruption and social exclusion processes.

TABLE 3

Employment crisis in EU27

	2008q1	2011q1	Difference
Unemployment rate (%)	7.1	10.0	2.9
men	6.7	10.0	3.3
women	7.6	9.9	2.3
20-24 years	13.8	20.1	6.3
25-49	6.4	9.2	2.8
50-64	5.4	7.2	1.8
minimal education	11.4	16.8	5.4
medium educational level	6.8	9.3	2.5
highly educated	3.7	5.4	1.7
EU nationals	6.8	9.4	2.6
non-EU nationals	14.1	20.5	6.3
long-term unemployed (%)	38.7	41.9	3.2
part-time rate (%)	17.8	18.9	1.1
fixed-term contracts (%)	14.0	13.5	-0.5
self-employment rate (%)	14.4	14.5	0.1

Source: Eurostat data online, *European Labour Force Survey*.

Unemployment in the EU during the crisis has involved more men than women, youth than workers over 24 years, people aged 25-49 than older workers aged 50 or more, non-EU migrants than EU nationals, workers with low educational attainment than those with high educational attainment (Table 3). With respect to job quality, this has deteriorated in several ways not always captured by official statistics: pay reductions associated (or not) with working time reductions, temporary lay-offs or conversion of full-time to part-time contracts; expansion of contract work or uninsured employment. At the same time, new hires are concentrated in part-time jobs while self-employment has resisted the crisis more than dependent employment

has. Consequently, the shares of part-timers and self-employed in total employment have both increased over the past three years. As for the share of temporary employees, it fell in the first phase of the crisis, since in dismissing employees, employers first consider temporary workers, but their share rose in the second phase of the crisis due to employers preferring to hire with limited-duration contracts.

SOVEREIGN DEBT CRISIS, ECONOMIC SURVEILLANCE AND COORDINATED AUSTERITY: EUROPEAN INTEGRATION AT THE CROSSROADS

The EU had started to discuss exit from fiscal-stimulus policies and measures in June 2009, that is, before the eruption of the sovereign debt crisis in the Eurozone at the end of 2009 and the successive recourse of Greece, Ireland and Portugal to financial aid by the rest of Eurozone countries and the IMF in the course of 2010. The sovereign debt crisis in the Eurozone intensified existing EU-level debates, in the context of *Europe 2020*, over the need for strengthening economic governance in the EU and accelerated processes for its specification and adoption (Rompuy Report 2010).

The new mechanism for macroeconomic surveillance along with the Pact for the Euro, the new Stability Pact and the new EFSF are underpinned by European Council decisions in 2010 on the implementation of coordinated austerity policies in all countries that do not comply with the criteria for public deficit and public debt, i.e. almost all countries of the Euro area and beyond. These decisions were taken even though by 2010 no country of the EU (except Poland and Malta) had recovered their 2008 level of output, the crisis was rapidly deteriorating in Greece and Ireland, was still in progress in Romania and Bulgaria, and was manifesting itself anew in Portugal and Spain.

Coordinated austerity policies are expected to lead sooner or later to recession for at least two reasons. First, although interest rates were low in the Eurozone in 2010, private investments decreased by 1% since profitability prospects are undermined by current levels and forecasts about future levels of demand. Given that we are living in a quasi liquidity trap –and the ECB has even raised its refinancing rate twice recently– fiscal policy is the only remaining powerful tool for stimulating domestic demand and investment. An alternative is export-led growth. However, Eurozone countries –which trade to a great extent among themselves– cannot all create trade surpluses at the same time, while contraction in domestic demand caused by efforts to reduce public deficits and create fiscal surpluses cannot easily be replaced by external demand.

Consequently, the EU is entering a dangerous phase in which the unresolved sovereign debt crisis in the Eurozone will be coupled with generalised stagnation and recession, in turn rendering the sovereign debt crisis even more unmanageable and systemic. At the same time, the intractable structural weaknesses of EMU put the project of European integration to a severe test, and fears for the disintegration of the Eurozone are real.

A recent IMF report extends the dangers beyond Europe to the global economy and describes the interrelated financial risks and low growth prospects as follows:

“Markets have clearly become more skeptical about the ability of many countries to stabilize their public debt. For some time, as growth prospects have dimmed, their worries have extended to more European countries and to countries beyond Europe – from Japan to the United States. Worries about sovereigns have translated into worries about the banks holding these sovereign bonds, mainly in Europe. These worries have led to a partial freeze of financial flows, with banks keeping high levels of liquidity and tightening lending. Fear of the unknown is high. Stock prices have fallen. These will adversely affect spending in the months to come. Indeed, August numbers indicate that this is already happening. Low underlying growth and fiscal and financial linkages may well feed back on each other, and this is where the risks are. Low growth makes it more difficult to achieve debt sustainability and leads markets to worry even more about fiscal stability. Low growth also leads to more non-performing loans and weakens banks. Front-loaded fiscal consolidation in turn may lead to even lower growth. Weak banks and the potential need for more capital lead to more worry about fiscal stability” (IMF 2011, p. xv-xvi).

We may finally summarise EU developments from a working class perspective in the following way. While moderate recovery of most EU countries in 2010 made apparent the great discrepancies between EU economies as far as their capacities for exiting the crisis are concerned, the fiscal consolidation and Euro Pact “straitjackets” decided at the EU level for all countries now put wages, pensions, employee rights and social spending under strain everywhere. There is an obvious need for coordinated struggles of working classes to defend the social acquis and alternatives to neoliberal Europe.

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Women on the Verge of a Nervous Breakdown: The Gender Impact of the Crisis

GIOVANNA VERTOVA

INTRODUCTION

What has begun as a subprime mortgage debacle in the United States has become the worse global crisis since the Great Depression, resulting in a widespread destruction of livelihoods and jobs. So, correctly, great attention is focused on the causes of the unfolding crisis. Many scholars from different theoretical traditions have tackled this question. Most mainstream explanations tend to concentrate on the imperfections of the financial markets, on the mistakes of monetary policy, on the phenomenon of the global saving glut. Post-Keynesian accounts run from Minsky's financial instability hypothesis to capital asset inflation. Underconsumption is the basis of the Sraffian arguments. Marxist explanations include the tendency of the rate of profit to fall, the limits of monopoly capital, the financialisation of the economy and the structural change in finance and production of this "new" capitalism. Despite this growing debate over the causes of the crisis, less attention is paid to its material impacts, and very little to gender considerations. There is very little debate about the possible gender implications of the crisis.¹ Yet the crisis and its impacts are going to be very uneven because the working class is divided into segmented labour markets; the

total labour (both paid and unpaid) is strongly gendered; localities (at the local, regional, national and international level) are spatially-hierarchically ordered.

In this work, I would like to suggest a framework for the analysis putting together class and gender dimensions. Class and gender need to be analytically intertwined because men and women are likely to be affected in different ways by the crisis, due to their different roles in society and their different position in the economic system and because the neglect of either of these two dimensions leads to very partial and bizarre explanations, although these are heavily emphasised in media coverage and public debate. "Gender-without-class" explanation leads to the awkward idea that this is a "macho" crisis due to the paucity of women occupying top positions in financial institutions and banks,² one argument being that women take less risks than men and therefore more women at influential levels in the financial industry could have avoided or lessened the crisis. Another is that men driven by an excess of testosterone were responsible for the crisis.³ A study at the University of Cambridge, demonstrating that traders with the highest levels of testosterone in their saliva realised the highest profit, provided the scientific support.⁴ Similarly, Harriet Herman, former Deputy Prime Minister and Minister for Women and Equality in Britain held this homogeneous man's culture responsible for the discrimination against women in the banking sector.⁵ The media rehearsed the old argument about biological determination. This approach has two great flaws. Firstly, it easily forgets the feminist discussion on the difference between sex and gender, thus returning to the idea that men and women have different behaviour "naturally". Secondly, it neglects the analysis of the causes of crisis rooted in the very functioning of the capitalist system, as if the laws of motion of capitalism were dominated by sex differentiation.

1. Some of the work that has been done is found in: Rania Antonopoulos (2009), *The Current Economic and Financial Crisis: A Gender Perspective*, Working Paper n. 562, The Levy Institute; Stephanie Seguino (2009), *The Global Economic Crisis, Its Gender Implications, and Policy Responses*, paper presented for *Gender Perspective on the Financial Crisis* panel at the fifty-third session of the Commission on the Status of Women, United Nations, March; Diane Elson (2010), "Gender and the global economic crisis in developing countries: a framework for analysis", *Gender & Development*, vol. 18, n. 2, pp. 201-212.

2. Sibert, A. (2010), "Sexism and the City: Irrational Behavior, Cognitive Errors and Gender in the Financial Crisis", *Open Economics Review*, vol. 21, n. 1, pp. 163-166.

3. Baxter, M. (2010), "Did men and testosterone create the crisis of our time?", *Investment and Business News*, 30 March.

4. Sullivan, K. and M. Jordan (2009), "In banking crisis, guys get the blame; more women needed in top jobs, critics say", *Washington Post*, 11 February.

5. Ruggieri, D. (2010), "Gender perspective of the financial and economic crisis", *International Journal of Green Economics*, vol. 4, n. 3, pp. 217-230.

By contrast, “class-without-gender” analysis hides the impact of the crisis on the social reproduction system, which is generally heavily dependent on women’s unpaid work, thus keeping women’s social costs invisible. Even within the explanations that take into consideration the impact on the social reproduction system, there is a tendency to ignore the deterioration of the conditions of women’s lives. So, an untiring effort must be made to keep the two dimensions together and unveil the general assumption that the capitalist system is gender neutral.

To this end, I will use an analytical framework intentionally limited to the advanced capitalist countries. I am well aware of the fact that the crisis is hitting developing as well as developed countries, but I believe that a single framework of analysis is impossible due to the strong differences between these different types of countries. Moreover, the analysis is based on some features of the current phase of capitalist accumulation common to all advanced countries despite national differences. Still, the descriptions presented must be taken *cum grano salis* because they are the results of generalisations. Despite this focus some references to the situations of developing countries will be made.

PUTTING WOMEN INTO THE ANALYSIS

Despite different approaches, the 1970s debate over domestic labour had the merit of drawing attention to two important, and today taken-for-granted, insights: (i) capitalist production is not self-sufficient but depends also on domestic labour that takes place outside capitalist relations, meaning that this labour is essential for capital because it reproduces the labour power, hence workers as bearers of labour power; (ii) men and women enter the labour market in different positions due to their unequal domestic responsibilities, meaning that the burden of domestic work hampers the participation in the labour market. More recently, a number of feminist macroeconomists have extended the classical political macroeconomic approach in order to include the social reproduction system.⁶ Placing unpaid work within a macroeconomic circular flows makes it possible to address the question of the quality and adequacy of living conditions and well-being of the working class, not as women’s responsibility but as a central and general problem of the capitalist system, thus redefining the traditional view in which the functioning of the system is reduced to

6. Benería, L. and M. Roldán (1987), *The Crossroads of Class and Gender. Industrial Homework, Subcontracting, and Household Dynamics in Mexico City*, University of Chicago Press. Picchio, A. (2003, ed.), *Unpaid Work and the Economy. A Gender Analysis of the Standards of Living*, Routledge.

monetary transactions. The point is not to reduce the work of social reproduction economically, but to find an approach that does not relegate it to the margin of the analysis of the economic structure and its dynamics.

In drawing from this literature, I assume that the way to keep class and gender together is by seeing that, in capitalism, the material conditions of life are given by the “sum” of two sub-systems:

- the production system (PS), providing goods and services through market transactions. It is grounded on wage labour commanded by capital, and it is productive of value. Yet, the labour market is gendered because labour demand and supply are very different for men and women. Therefore, the impact of the crisis on the PS has different consequences on men and women;
- the social reproduction system (SRS). I divide it into “public” and “familiar” spheres. The former has a twofold dimension: On the one hand, it provides social public goods/services through the welfare system; on the other, it is a source of female employment. The “family” SRS is represented by the domestic, unpaid and voluntary work carried out by family members within the household. Nevertheless, it should be borne in mind that in advanced capitalist economies a great part of this work is increasingly supplied by immigrant women, due to the crisis of care labour.⁷ In this case, therefore, the gender dimension must be intertwined with ethnicity.

Both the “public” and the “family” part of the SRS is affected by fiscal policy. The supply of social public goods/services and jobs are the results of public expenditure policy. An expansionary fiscal policy is likely to increase them both, though this does not always happen. It is more certain, however, that a tight one tends to reduce them both – generally, in all advanced capitalist countries a contraction in fiscal policy is carried out with cuts in social goods/services. Moreover, the burden of unpaid labour increases when the supply of social public goods and services declines, with an increase of the “family” welfare system and, consequently, of women’s unpaid work.

To be complete, the framework must include some kinds of patriarchal dimensions, which are nowadays called “gender norms”. They are “social norms that constrain the choices of men and women, and their associated social sanctions, encouraging forms of behaviour that conform to the norms, and discouraging behaviour that does not”.⁸ Gender norms are based on gender stereotypes, social and cultural beliefs.⁹ They can have a strong influence on male and female behaviour, thus

7. Himmelweit, S. (2005), “Caring: The Need for an Economic Strategy”, *Public Policy Research*, vol. 12, n. 3, pp. 168-173.

8. Elson, D. (2010), *op. cit.* p. 203.

9. Examples of gender norms can be found in the education sphere (where high professional

increasing or decreasing gender inequality. In periods of crisis, gender norms can work as backlash mechanisms. For example, it is socially and culturally acceptable that when jobs are scarce, men have more right to keep theirs because they have a family to support.¹⁰ This belief tends to bring back the traditional male breadwinner family model.

The framework I suggest, which is presented in a following table, makes it possible to consider the impact of the crisis on all aspects of human well-being and living conditions.

THE PRE-CRISIS SITUATION FROM A GENDER PERSPECTIVE

The table in the next section distils the impact of the crisis by using the theoretical framework previously suggested. As I have already said, these features represent a common trend among capitalist countries, although their national specificities must also be kept in mind, though the latter cannot be reflected in this short contribution.

Let us see, now, the gender specificities of the PS and the SRS before the crisis. As far as the PS is concerned, it is still characterised by gender inequality. Despite feminist movements and the process of feminisation going on in the labour market, women are still objects of discrimination, the most ferocious examples being:

occupational segregation, which can be of two types: *Vertical segregation* (the “glass ceiling” phenomenon) is the unseen, yet unbreachable barrier that keeps women from rising to the upper rungs of the corporate ladder, regardless of their qualifications or achievements. *Horizontal segregation* (the “sex-typing” segregation) occurs when women are relegated only to some jobs and activities. They are both the results of social and cultural stereotypes. In the former case, women are never considered to be as good as men for top positions, despite their qualifications. In the latter case, there is the idea that some jobs are just for women (e.g. secretary);

contractual segregation, in other words women have less secure, more vulnerable, informal and flexible jobs. This is a very recent phenomenon along with the great flexibility in the labour market. In all advanced capitalist countries, temporary

qualification is considered to be important only for men), in the professional one (where the workplace is not considered to be the primary place for women; therefore career and professional advancement is deemed unimportant for women), in housework (i.e. housekeeping and childcare are considered to be the primary functions of women), in the decision-making process (i.e. in conflicts men have final say – for example in the choice of living place, school for the children and buying decisions).

10. The World Value Survey shows that there is a 32.6% agreement that when jobs are scarce, men should have more right to a job than women (www.worldvaluessurvey.org, accessed on September 1, 2011).

positions as well as part-time jobs are very feminised;

a *gender pay gap*, which is the obvious outcome of the previous kinds of segregations. Women are prevented from reaching top positions, are stuck in “typical” female jobs, which are generally low paid, and have more temporary and part-time jobs. The result cannot but be less income.

As far as the “public” SRS is concerned, part of the agenda of neoliberal capitalism has been the deregulation and/or privatisation of many state-owned enterprises. Privatisation began in the 1980s in the US and UK with the neoliberal turn of Reagan and Thatcher, after which it inspired European integration, the Maastricht Treaty and its convergence criteria. On the one hand, privatisation was promoted with the idea that it would substitute inefficient state industries, and it became one of the ten ingredients of the Washington consensus. On the other hand, for some of the European countries wishing to enter the Economic and Monetary Union (EMU), privatisation became a tool of European monetary convergence, used to tackle budget deficits and meet the stringent criteria for monetary integration. The results of privatisation and deregulation were the increasing commodification of social public goods and services. More expensive or even inaccessible public goods and services means more unpaid domestic labour or, when possible, low-paid jobs for immigrant women. Commodification has been penetrating slowly and unevenly in ever more areas of daily life, such as public services, health and even education. Moreover, since the public sector is generally a source for female employment in all advanced countries, privatisation meant the lay-off of female public workers or shifting them to temporary contracts.

As far as the “family” SRS is concerned, all surveys on the use of time¹¹ show that unpaid domestic labour falls on women’s shoulders. The “family” SRS is, therefore, very gendered, although strong national disparities must be acknowledged. Moreover, immigrant women contribute to some part of it. Their work is often informal, flexible and low paid. Neoliberal capitalism has also left its mark in this case. The current restructuring in the labour market and welfare system is being translated into an increased burden of unpaid work mostly done by women within the family. Nevertheless, economic policies paid very little attention to this problem, thus leading to an intensification of unpaid work which hides a withdrawal of firms and the state from their social responsibility towards the quality of life.

11. Surveys on the use of time were presented, for the first time, in the 1995 *Human Development Report* by the United Nations. ISTAT, the Italian National Statistic Office, began to run such surveys with regularity in 1988-89, 2002-03, 2008-09, even before Eurostat did. Now, also Eurostat regularly undertakes them (*National Time Use Surveys*).

Finally, as far as gender norms are concerned, changes in social and cultural stereotypes can be seen only in the long-run. Yet, what happened in Italy during the summer can be taken as an example of the way gender norms work. Due to the crisis, Mav-Ib, a family-owned engineering firm based in Inzago, near Milan, decided to make almost half its workforce redundant, selecting only women. The union was shocked not only by this decision but also by the reasons given: "We are firing the women so they can stay at home and look after the children. In any case, what they bring in is a second income" says the company. But what is even worse is that when the FIOM¹² called a strike to protest the move, only one of the men whose jobs had been saved heeded the strike call. In this situation, the prevalence of "male breadwinner norms" led employers and even male workers to consider that men have more right to retain their jobs than women.

THE GENDER TRANSMISSION OF THE CRISIS

To understand the gender transmission of the crisis in the PS it is necessary to see which sectors are hit most and the composition of their employment. It becomes, therefore, fundamental to have disaggregated data employment and unemployment of different sectors to see where the job loss is. Nevertheless, unemployment statistics may not be good indicators of the relative impacts on women's and men's employment. Women who lose their jobs may disappear altogether from the labour-force statistics because they have given up hope of finding jobs and thus are no longer seeking them (and thus are not counted among the unemployed in labour-force statistics), or because they increasingly experience difficulty in reconciling work and family commitments. The decrease in female unemployment can just be a statistical illusion due to the phenomenon of the "discouraged worker", which is more typical for women than men.

In advance countries, the crisis has hit industrial sectors more heavily. For example, in the United States and in the UK, the crisis particularly struck the automobile and construction industries, which are typically male-dominated sectors. Women lost fewer jobs because American and British women are employed mainly in retailing and services for firms and personal care. In developing countries, the financial crisis of the North is transmitted to their production system via falling demand for exports, as a result of the crisis-induced recession in the North. This leads in turn to falling output, employment and earnings in the export sectors and very

12. FIOM is the CGIL's trade union of metal workers.

likely to the deterioration of labour rights in formal employment. In those countries, the gender implications have largely to do with these export sectors being heavily female-dominated. By contrast to the situation in advanced countries, women in developing countries are more likely to be disproportionately hit by the crisis. Moreover, another gender dimension is the inevitable reduction of micro-finance due to the international credit crunch. Also in this case, women are hit hardest because micro-finance is a typical female tool for starting small home-based economic activities.

In the "public" SRS, the effect of the crisis is related to the kind of fiscal policy adopted. During the crisis most advanced countries, in order to reduce the severity of the downturn, included a fiscal boost as part of their policy to respond to the crisis, in line with Keynesian tradition. Obviously, not all countries have done this: developing countries often had no such room for manoeuvre. Many European countries have "automatic stabilisers" in which state expenditure increased automatically in recession as more is paid out to the unemployed, while in the US such expenditures are to a greater extent treated as discretionary. The fiscal packages of advanced countries took a variety of forms and included different measures. Yet two features were common to all of them: they all used monetary policies to keep the financial sector liquid, so that enterprises could survive, and to combat the rise in unemployment. A gender audit and budget analysis of these packages concludes that male-dominated industries benefited most, due to the allocation of funds to those sectors. For examples, Alexandra Scheele¹³ points to the gender imbalance of stimulus packages in the USA, the UK and Germany, which reflects the underlying gender-political conservatism, orientated to the concept of the "male breadwinner". In these cases, the beneficiaries were male-dominated industries, such as the automotive sector and its suppliers, engineering and the construction and transportation industries. Another example is the German stimulus packages and the funds included for education. At first glance, it was assumed that this would mean new teachers and nurseries, both predominately female sectors. But in fact, the money was used for the physical restoration of educational institutions, thus boosting the male-dominated construction industry. The European Economic Recovery Plan (EERP) and the G20 Global Plan for Recovery and Reform are other examples. They do promote forms of employment but they do not include any kind of gender equality. From a gender perspective fiscal stimulus packages should have been designed in ways that also benefit women. Public

13. Scheele, A. (2009), "Hat die Wirtschaftskrise ein Geschlecht?", *Blätter für Deutsche und Internationale Politik*, n. 3.

spending on social infrastructure and services should have been maintained at pre-crisis level, preventing cuts. Moreover, since the public sector is an important source of regular female employment, governments should have avoided budget cuts. Yet, none of this happened and, as Sylvia Walby¹⁴ reports: there is no mention of the gender-specific impact of the crisis nor do these fiscal stimulus packages include gender-awareness.

In the “family” SRS the consequences of the crisis becomes a paradox: too little paid work for everybody and too much unpaid work just for women. While downsizing, firing and restructuring are all sources of jobs losses, gender-blind fiscal stimulus packages and the consequence fiscal austerity (which will be discussed in the next section) increase unpaid work. Unfortunately, unlike paid work, this cost remains invisible: it is not counted and it is not seen as a problem that needs to be addressed.

The framework for the analysis

	Pre-crisis situation	Crisis impact	Today's situation
Production System	Occupational segregation Contractual inequality Gender pay gap	Which sectors are hit hardest? What are the gender divisions in these sectors?	New occupational segregation
“Public” Social Reproduction System	Privatisation and commodification of social public goods/services	What kind of fiscal policy? Which gender considerations re in the fiscal stimulus packages?	Fiscal austerity
“Family” Social Reproduction System	Unpaid work by native women Paid work by immigrant women	Paradox: too little paid work for everybody and too much unpaid work for women	Women as shock absorbers
Gender norms	Strong specificities according to country	Risk of bringing back the “male breadwinner family model”	(Effects visible in the long run)

TODAY'S SITUATION

Today's situation in the PS depends on the job losses that occurred in the previous period. For example, in Italy the crisis hit the industrial sectors harder than agriculture and services, thus reducing more jobs for men than women. Yet female employment in industrial sectors was very low at the beginning of the crisis. So, even if

14. Walby, S. (2009), *Gender and the Financial Crisis*, paper for the UNESCO Project on “Gender and the Financial Crisis”.

women lost fewer jobs, they remain underrepresented in industrial sectors. This results in increased occupational segregation. The crisis could therefore increase or reduce occupational segregation according to the specific national situations.

The situation in the “public” social reproduction system is going to be determined by the austerity measures that all advanced countries have implemented. Enormous sums have been paid out of state funds worldwide for bank bailouts and stimulus packages, thus leading to an increase in the sovereign debt. The European debt crisis has already lent apparent plausibility to the notion that countries of the Eurozone should reduce their indebtedness drastically. Governments have two ways to reach this goal: limiting public expenditure through austerity measures and raising taxes, or a combination of both. As of this writing, the governments of the most indebted European countries have decide to cut expenditures rather than increase taxes, thus confirming the forecasts of many gender experts who warned of a “second-effect” of the financial crisis, which would affect women more than men. They expected that cuts to public spending and the increasing privatisation of public goods and services would, in turn, affect women through cuts in areas such as health, education and in social infrastructure in general. Since the austerity measures consist of reducing the public sector even more, more imbalance in gender relations can be expected, thus reversing the progress made in past years. In an open letter, the European Federation of Public Service Unions (EPSU) has asked the European Commission for more gender equality in the current crisis.¹⁵ With a female-dominated public sector, many women will be affected by these cuts. This rearrangement of the public sphere and the withdrawal of states from their responsibility for the public sphere due to deficits will lead to a worsening of women's living conditions, as women are much more dependent on public infrastructures, having few assets, less savings, lower wages and being less mobile due to family obligations. In addition, this worsening is also due to the spirit of neoliberalism, which enforces further privatisation. This will lead to the increasing influence of private capital on ever larger areas of social life, for which the state should take responsibility.

In this situation, it is obvious that the “family” SRS is going to become the only shock absorber, with women as the springs. A shifting of burdens from the visible economy (of state and market) to the invisible economy of unpaid work performed by women will occur. All this will very likely also lead to the intolerable situation of

15. EPSU (2010), “EPSU's open letter to the European Commission: cuts in public service jobs and wages – what does it mean for women?”, July 22, (www.epsu.org/a/6713, accessed on September 1, 2011).

women withdrawing from the labour market due to the increasing difficulty of reconciling work with family commitment. In Italy this is exactly what is happening.

CONCLUSIONS

The impact of the financial and economic crisis and the consequent policy responses are gendered. This gendering is linked to gender differentiated, segregated/segmented sectors of the economy with boundaries constructed by a mix of structural capacities discrimination (formal paid/informal/family worker/domestic care-work). The financial and economic crisis has detrimental consequences for gender equality. The policy responses must be assessed as to whether they are designed to protect the vulnerable, so that they include women as well as men, including public works and subsidies for unemployment.

The feminist debate on productive and reproductive work has returned in these times of crisis, emphasising the gender-segregated labour markets, the gender pay gap, and the unresolved issue of domestic unpaid work and immigrant domestic labour. Despite years of feminist work on women's invisible reproductive labour, the dominant system still does not count and value the latter. Most analyses with a gender perspective propose a reform of the financial architecture, with more democratic control; the need for a gender-economic view, which includes social reproduction as a basis for anti-crisis policies; sustainable livelihoods, decent work, gender equality and women's rights. More specific recommendations include: strengthening social insurance systems and social infrastructure investments; gender budgeting and fiscal stimulus packages to build an economic system that includes paid as well as unpaid work as a basis for policy making; and a strong public social security system.

Unfortunately, the people who caused and contributed to the crisis are still in the driving seats. Though the crisis has shaken the belief in the free market, it has not altered the theoretical, political and ideological foundations of the neoliberal agenda. So far, the only change is that the national state has temporarily re-appeared as the vehicle to allocate national tax money to bankrupt banks and firms. Yet, as I have attempted to show, burdening national budgets with these enormous debts will lead to further privatisation and the further rollback of welfare regimes, resulting in a worsening of women's conditions of life.

The only hope is that the crisis will be an opportunity for moving the unsolved question of the social reproduction problem to the centre of economic analysis.

The Rule of the Markets – Democracy in Shambles

ELISABETH GAUTHIER

In Europe, the tremors of the crisis are increasingly violent. Even if the measures adopted slow down the next explosion, not only will they not resolve the crisis but will in fact aggravate economic and social conditions.

They undermine democracy to the extent that they damage popular sovereignty. Indeed, in keeping with the neoliberal dogma there is an attempt to impose an "economic governance" allowing a kind of oligarchy to pursue the same logic which plunged Europe into an existential crisis.

If the crisis is particularly deep and explosive in Europe, it is because the very nature of its construction –as a complete neoliberal offensive– has assumed, after 25 years, the form of "pure neoliberalism", after an earlier period which had tried to go beyond the disastrous experiences of the 1930s and '40s. Today, the impasse is obvious, and the European disaster is not only bringing the EU to the brink but also the world economy. Today, due to all the asymmetries that have developed, it is within Europe that there is talk of a "centre" and a "periphery". The use of structural funds in accordance with the "Lisbon Strategy" has, it is true, permitted a certain modernisation in the peripheral countries, but it has done so without creating the bases for a sustainable development of the real economy, of the social and cultural dimensions and of ecology.

When, in 2005, the referenda in France and the Netherlands resulted in majorities

saying NO to integration under conditions of a generalised call to competition –and not to Europe as a common space– governments, parliaments and European institutions did everything not to take account of this and to pursue their logic. This warning should have been taken seriously. The lack of respect for the vote of majorities shows the extent to which democracy began to lose ground. Today, we can see how much the philosophy of the Lisbon Treaty deprives the EU and the Eurozone of economic and political instruments for intervening against the crisis. The prohibition on managing capital movements, on protecting oneself from free trade, on allocating state aid in favour of the “real economy” which “would distort free competition”, are components of neoliberal dogma. When the Commission today considers modifying the Treaty, it is in no way trying to find leeway for political action in the face of market dictates. On the contrary, it is seeking to reinforce the power of the oligarchy to the detriment of democracy at the national and European levels.

In 2011, in contrast to 2008, the “crisis” has become very concrete for millions of Europeans, in an incredible regression a little while ago in the case of Greece, and with the generalisation of austerity policies throughout Europe, which were more or less brutal and rapid depending on countries and regions.

The debt crisis crystallises the social and political issues in their complexity. This is why it is necessary to dissect it to find an effective approach for building resistance and an alternative. The way it looks today, public debt is not only the result of the 2008 bank bailouts, but above all of 30 years of an economic, political and ideological neoliberal offensive – three decades of the development of financialised capitalism. It is in the same period that the neoliberal offensive was also concretised by a new statist form strengthening political management in the direction of a “market state”, extremely distant from the social state or parliamentary democracy, and organising the distribution of wealth and power in favour of capital, to the detriment of labour. This is why a great part of the problem arises from the –politically decided– structural lack of public revenue.

Today, the sovereign debt has become a directly political problem. It is used as an ideological and political weapon to sow divisions in the heart of European societies and peoples, and to get policies of austerity and social regression accepted, which the oligarchies want to have passed, using the aggravation of the crisis as an excuse. It generates crises of political regimes. In order to vaccinate ourselves against ideological poison, in order to open up in the direction of the power of popular interpretation, it is essential to explain the confrontation between the two opposed logics, between the interest of the markets and that of the peoples, between which political powers have to

choose. Initiatives, such as public audits of the debt go in the right direction and can accompany the popular struggle against policies of austerity, economic recession and of social and democratic regression.

A SHOWDOWN BETWEEN THE RULE OF THE MARKETS AND DEMOCRACY

The October 2011 summit did not bring a solution. The next tremors have only been delayed as far as the Euro and the cohesion of the EU and the crisis of the banks and of public debt are concerned. The stranglehold exercised by a very narrow ruling group in the name of “Europe”, and in concert with the IMF, is tightening and intensifying the austerity policy and as a result the social, democratic and political crisis. European leaders are pursuing the logic that leads to disaster, without learning the slightest lessons from it to institute at least prudent rules. As in 2008, it is not a matter of preserving societies increasingly battered by the crisis but of preventing losses to property holders. On the one side, “the lack of specific economic instruments and of instruments of solidarity, able to help national economies face the pressures of recession and speculative attacks coming from the financial markets, has heightened the problems of economic and social cohesion and reinforced the inequities at the heart of the EU”;¹ on the other hand, there are intensified attempts at instituting a new “European governance” which, according to the dominant orientation, would assume a form of “authoritarian communitarianism” making “European ‘post-democracy’ emerge from the structures of authoritarian capitalism”.²

Greece and the Greeks have not been saved – quite the contrary. The decision to apply a devaluation of 50% to bonds held by banks only ratifies what already happens when Greek bonds undergo a reduction of 65% or more on the secondary market. And, finally, this decision is hardly painful for the speculators to the extent that about two-thirds of Greek bonds had by this date already left the fold of the private to land in the hands of the public. The socialisation of losses, like the privatisation of profits, continues. Greece cannot cope in this way with debts remaining high and the policies imposed by the troika only dragging the country still further down, with regression hitting the population and the real economy.

The last four years have shown that the management of the crisis at the European level has been accompanied by the establishment of a mode of “governance” that is

1. Nicos Chountis, MEP (GUE/NGL), September 2011.

2. Bischoff, J., F. Deppe, R. Detje, H.-J. Urban (2011), *Europa im Schlepptau der Finanzmärkte* [Europe in the Tow of the Financial Markets], Hamburg: VSA.

increasingly authoritarian. With the “troika” –the “Franco-German couple” revitalised for the needs of the moment– and with the emergence of an oligarchy constituted by some political and economic decision-makers, thus going beyond the traditional forms of lobbying, it is not a question of either legislative or executive bodies. The whole of the plan put in place by the last summits modifies the power structures and tends to restrict national decisions without leaving any space for the exercise of popular sovereignty. The public debate on federalism and a new economic governance seems in fact to accompany the changes adopted by masking the seriousness of the situation. In this framework, the debate on the “new governance” does not bear on the content of a common political economy –the neoliberal dogma remains at the heart of this intangible oligarchy– but aims at a “post-democratic”, authoritarian governance, keeping the ensemble of state institutions (states, European institutions) under the domination of the markets. While the ECB’s independence has always been criticised by the left, this institution –a member of the troika– has become one of the principal political protagonists participating very actively in instituting an authoritarian management mode. It is a concrete expression of the “government of experts” whose objective it is to lower the standard of living by 30% and reassure the markets.

If this logic is not called into question, we see growing threats to democracy. In a recent article, Jürgen Habermas –still very active in 2005 on behalf of the European Constitutional Treaty– has launched an appeal to save the dignity of democracy. In effect, one can only confirm that in the gigantic stranglehold –in the period of financialised capitalism– opposing economic power to that which remains of political power in the European countries, democracy has lost much terrain in the course of the last few years. Within this logic, with the state apparatuses detaching themselves from society, bonapartist regimes can profit from these opportunities.

In the face of this logic we can hypothesise that only an alternative logic, a true and proper refounding of the EU, could save the Union. Stability would thus be built on the basis of a change in logic and policy, in favour of a model of cooperation, democratisation and of social and ecological development. After having contested the Maastricht criteria, the Stability Pact, the Treaty Establishing the European Community, the Lisbon Treaty and the management of the great crisis by European leaders, the alternative left today must contest the forces of capital on the very terrain of European integration. This assumes articulating in a completely new way, and with a transformative ambition, a critique of the very nature of the European construction. It is an extremely complex challenge, as Gerassimos Moschonas points out,³ in so far as “the European system complicates in a completely new way, compared to the

political systems produced by the nation-state, the left’s modes of historic action – revolutionary as well as reformist. Whence the need for a redefinition and adaptation of the radical historical project to new historical realities... Given this framework, neither traditional reformism nor, still less, strategies for a complete break can remain unchanged when the institutional and political system has itself changed so fundamentally”.

BETWEEN REBELLIONS AND IMPOTENCE

This new “regime of authoritarian stability”⁴ creates considerable risks for democracy and for the legitimacy of leaders on the national and European levels. The signs of their loss of legitimacy are increasingly visible: massive electoral abstention, especially among the popular strata, linked to a strong sense of impotence; the erosion of the traditional governing parties, the growing influence in “anti”-systemic discourse of radical populist right-wing parties. At times this anger is expressed in a spontaneous manner as in Great Britain, with or without violence.

Recent months have seen a proliferation of protest movements taking completely new forms, with the “indignados” and initiatives of the “take the squares” type, which have made it possible to create a first on October 15: an international day of protest. When in a country like Hungary 100,000 people demonstrate and plan an event for October 15, 2012 announcing that between now and then there will be a search for an “alternative President”, we can certify that democratic energy is growing – particularly among those who had begun to be called the “lost generation” – and is trying to oppose the combination of market domination and ever more authoritarian regimes. The trade-union movement in the crisis finds itself under great pressure; at times “Krisenkorporatismus” wins the day, at times collective and solidaristic action gains the upper hand. The Athens Congress of the ETUC in the summer of 2011 as well as numerous European demonstrations in Hungary and Poland, general strikes and other mass movements as in Portugal, Italy and elsewhere show the potential for mobilisation. In a country like Greece, all the old and new forms of struggle are combined.

In France, in 2010, enormous energy was invested in exemplary struggles against the pension reform, and, a little before that, against the university reforms, but

3. Moschonas, G. (2011), “The European Union and the Dilemmas of the Radical Left”, in *Transform !* 09/2011, pp. 8-21.

4. In German “Das neue Regime autoritärer Stabilität”, Hans-Jürgen Urban, in *Europa im Schlepptau der Finanzmärkte* [Europe in the Tow of the Financial Markets], Hamburg 2011.

without winning the demands. To this were added a multitude of fierce struggles in enterprises and services, around issues of employment, wages and work conditions. A recent study⁵ indicates a break in the image of France that dominated in late 2010 and 2011: that of a “France in two speeds” (everyone is in the same boat despite increasing inequities) which has then glided toward an image of “two Frances”, one of which (those on top) is advancing while the other (consisting of those at the bottom) is receding. The rebellion grew just as resignation diminished, notably in the popular milieus (workers and employees). The growing insecurity called for a determined political intervention, notably from the most weakened strata of the population. The National Front has attempted to benefit from this situation, trying to make credible a sort of promise for the reconquest of sovereignty. In this context, the nature and ambition of the political intervention proposed by the different candidates will be at the heart of the issues in the presidential and legislative elections in spring 2012. For the critical left, what is involved is proposing a true political change that is credible from the point of view of content and of political posture.

As to the political landscape in Europe, the forces of the populist radical right are progressing, and this in countries with very different political traditions and living conditions. This right wing is adapting itself to the context of the crisis. If Islam constitutes a systematic target, Europe also serves to nourish resentments, nationalisms, withdrawal and the rejection of elites. In the crisis, this right wing is now addressing social issues, but does so while rejecting the principle of solidarity and the recognition of social and democratic rights: for right all social assistance has to be deserved and reserved for a certain community.

It seems quite realistic to characterise the present period as oscillating between anger, protest and sometimes revolt, on the one hand, and a sense of impotence, on the other. The disintegrative tendencies in societies, the divisions they are producing, including within the subaltern classes, does not favour a perception of what could be the common interest among the most impoverished, the less poor and those who still have a certain stability that is at risk of being lost. The constitution of a new social bloc that can be a force demanding political change must of necessity be a very complex project under present conditions. At the same time, the crisis process makes increasingly more visible the nature of the confrontation and the oligarchy that is in control, which could facilitate a more common vision among the different sectors of the population in opposition.

5. Mergier, A. and J. Fourquet (2011), “Le point de rupture” [The Breaking Point], Fondation Jean Jaurès, www.jean-jaures.org/Publications/Les-essais/Le-point-de-rupture.

RE-ESTABLISH WHAT “POLITICS” MEANS

The governments’ giving up the exercise of political power in the face of the growing weight of the financial markets, banks and big shareholders has discredited politics and the “political class” and caused withdrawal from the electoral sphere, especially by the popular milieus. This grants a still greater margin for manoeuvre to the oligarchy acting outside the framework of traditional legislative and executive power. Added to this is the problem that the political “alternances” in the different European countries has not made it possible to change the reigning logic, in so far as the social-democratic parties in government are equally committed to the economic “constraints”, that is, to neoliberal dogma.

In the struggle between the forces of the market and those of popular sovereignty, it is necessary to re-establish and redefine what “politics” means, what popular sovereignty, the right to choose and common interest means. The defence of what remains of social and democratic gains certainly remains the order of the day, but it is not enough. The transition to another economy is what is on the agenda today. The concept of “economic democracy” could express a new ambition. As a multi-dimensional approach it would operate all the possible levers (at the level of states, institutions, enterprises, spheres of production and of circulation...) with a view to changing the economy, relaunching the real economy and to conceiving and orienting all of this as a function of human needs. It is only thus that the development of a new social, ecological and democratic quality is conceivable.

The current grumbling anger often has difficulties in defining its target and locating exactly whom it is addressing, which is a source of anger and impotence. The lack of the power of interpretation, the lack of the power to intervene and the difficulties in uniting tend to generate resentments which are now easy to instrumentalise and manipulate in Europe on the part of the radicalised populist right wing which presents itself as the defender of certain social gains for a limited population. Militant discourses, although necessary, are not enough to push back these resentments. To do so it is indispensable to open up big public spaces to address the power of interpretation and intervention and the capacity to unite.

Numerous social movements are indeed positioned today with the political field, demanding deep changes, often beginning with demands for social rights but they are largely uninterested in appropriating the confrontation that deals with political and economic power. Considering the crisis of politics, this attitude is perfectly understandable. The idea that a new cultural hegemony has to precede the objective of a new political hegemony is certainly pertinent. However, considering the gravity of the situation, the fact that democracy as such is so abused and the weakness of the

militant trade unions and of the forces of the transformative left, it is necessary to think of new forms of social and political dynamics that can go beyond the present limits. The debate has begun. Shouldn't the very coherence of the anti-social and anti-democratic offensive lead people simultaneously to pose the social questions and those of institutional and political power? Shouldn't the reconquest of politics, of political power, of democracy in the general interest, become a common goal of the multiple forces whose motivation goes in this direction? Their energies could be combined in new forms such as fronts of struggle – at the national and European level – which, while being respectful of the different identities, would make it possible to support popular mobilisations and to tangibly modify the relations of force.

We are dealing much more with an aggravation of the systemic crisis, not to say a crisis of civilisation,⁶ than with an exit from the crisis, seeing as the contradictions underlying this crisis have not been resolved. The current period – a turning point for the EU and its countries – further intensifies the need to reflect on how to create more effective resistance, how to build alternatives and how to construct social and political dynamics capable of leading to a break with the current logic.

6. “Une crise de civilisation?”, Colloque Espaces Marx, January 28-29, 2011, *Supplement Transform!*, Paris.

Debt Crisis and Austerity Policies in Europe A Point of View from Spain

JAVIER NAVASCUES

DEBT CRISIS IN SPAIN: FROM PRIVATE TO PUBLIC DEBT

Spanish sovereign debt is being charged with a high risk premium in capital markets. Nevertheless, Spain remains one of the less indebted states in the EU. The ratio of public debt to GDP is not only lower than in Greece, Italy, Ireland or Portugal but is even lower than in Germany or Austria. How, then, has Spanish public debt come to be so badly rated?

The problem, as in many other places, began with private debt. It is well known that Spain has gone through a real-estate bubble lasting since the late 1990s to early 2007 when it began to falter even before the international financial crisis exploded. This real-estate bubble was inflated by German and other European countries' savings which were invested in bonds issued by Spanish banks who in turn lent these funds to Spanish developers and, ultimately, to home buyers. These flows have accumulated in a fantastic pile of debts which is now being recycled into public debt through two perverse circuits.

The first one, which is inevitable in the short term, is the circuit running from economic activity to public earnings. As the collapse of the real estate bubble

unfolded, economic activity stagnated and unemployment rose almost immediately to the current 21.4%. Tax collections plunged while unemployment benefits and other social expenses rose. This brought a deficit gap which replaced the previous positive balance of public accounts. Expenditures by the government in 2009 to sustain economic activity, such as subsidising (German) car sales and public works by local councils, only made the gap worse.

The second circuit through which private debt becomes public liability is less evident. The Spanish government has not yet explicitly rescued banks as other European governments have done, at least not on a significant scale. But the huge indebtedness of Spanish banks to foreign investors, large French and German banks among them, is backed by very frail collateral: hundreds of thousands of unsold flats and millions of square meters of vacant land plots and unfinished developments. Sooner or later, the Spanish government is expected to come out and meet these obligations. More than 300 billion Euros lent to developers are part of this account. How much of these will be defaulted remains to be seen because banks have unwillingly become owners of large portions of real estate valued at unrealistic prices. The Bank of Spain until recently has overlooked and even encouraged financial engineering letting banks disguise this collateral's current lack of value. But this cannot go on forever and consequently these expectations weigh heavily on the prospects of a Spanish default.

AUSTERITY POLICIES OR STRUCTURAL REFORMS?

The measures put in place by the Spanish government to cope with the crisis are similar to those adopted in other parts. Public workers payroll has been cut, expenses in health and education are being downsized, investment projects have been cancelled, and so on. The target is the 3% deficit threshold.

It is general knowledge that this response is counterproductive. Cutting off public expenditure delays recovery because the private part of the Spanish economy is too busy deleveraging. Banks are collecting cash to meet the instalments of the loans they got abroad, so currently there is no lending to the "real" economy. But even in the event banks were willing to lend, demand for credit is nil. And if economic activity does not resume tax collections will remain low and the imbalance will be much more difficult to curb. This provides the excuse for further cuts, triggering a suicidal race to the bottom.

In the meanwhile "structural reforms" are being implemented for the sake of competitiveness. First there was the labour market reform passed in September 2010,

which basically consisted of reducing dismissal costs. A second round followed in June 2011, when collective bargaining regulations were "flexibilised". In August 2011, new measures were adopted such as suspending the limitations to rollover temporary contracts and creating new kinds of "training contracts" for young people with lower wages and social security contributions.

Public pension scheme reforms were implemented in January 2011, when the retirement age was raised and benefits reduced. According to the "Aging Europe" report by the EC, the Spanish public system is supposed to be on the brink of bankruptcy... in thirty years from now! The fact is that it currently runs a surplus even as the number of contributors has diminished to almost two million.¹ No problem, if it is not bankrupt yet it soon will be: the Spanish government subsequently launched a scheme for part-time jobs exempt from Social Security contributions.

Next was the so-called "financial sector reform" or stated more clearly the privatisation of the "crown jewels", the Savings Banks. Amounting to half the retail banking market, these institutions remained in a kind of social-property status under the control of local and regional authorities. A very longed for object of desire for the Spanish private banks which have historically dreamt of getting their hands on them. Since February 2011 stronger regulations in terms of capital and solvency were imposed on Savings Banks wishing to remain within the traditional model. Consequently, their business has been transferred to new public listed companies in a way similar to what happened in Italy with the Amato Act in the 1990s.

On the other hand, the government has enthusiastically joined the race to the bottom in corporate income tax. Last spring we learned that Exxon Mobile, Vodafone, Hewlett Packard, American Express, General Mills and Eli Lilly use Spain as a tax haven. They do not pay a cent in taxes thanks to a holding company statute protected by EU regulations. At any rate, there is no risk of unfair competition for nationals: recently corporations have been allowed to depreciate freely and to deduct full depreciation from taxes.² In the meanwhile, VAT rates have been increased.

Of course this is quite similar to what is occurring elsewhere – Spain is no exception. The problem is that these measures are not only socially unfair but counterproductive because they will bring no recovery at all. In fact, we can only expect more difficulties in the future as public wealth and potentially useful

1. By July 2011 the Social Security ran a surplus of €3.2B which amounts to 5% of total expenditure.

2. In fact, the 35 companies listed in the Spanish Stock Exchange index (IBEX 35) earned 22% more net profits in 2010 than the year before. Meanwhile, GDP fell by 0.1% and unemployment rose by 8.5%.

instruments, such as the Savings Banks, are privatised. Spain's past development model is not feasible anymore, but the sacrifices we are now suffering will not bring us another growth model.

RECENT POLITICAL DEVELOPMENTS IN SPAIN: THE "INDIGNADOS", THE CONSTITUTIONAL REFORM AND THE RIGHT IN POWER

How is all this affecting Spanish politics? Up to May 2011 passivity was the norm and very little resistance was seen. In a certain sense, Spaniards seemed stunned by the crisis. There was a general sense of living through a sort of nightmare which would soon pass. The Socialist government had been assuring the country that the crisis had nothing to do with Spain, that Spanish banks were solvent, public finances were healthy and the welfare state was safe and sound. Suddenly everything fell apart by the end of 2009 and the "Keynesian" semester gave way to austerity. Unemployment benefits began to expire and the government blamed foreign speculators for the predicament while the Popular Party accused the Socialists of squandering public money and destroying "confidence". Zapatero's prestige plunged but there was nothing comparable to Greek or French mobilisations, since the unions kept backing the government for fear of an eventual right-wing takeover. Consequently, their credit sunk with Zapatero. The radical left was too weak to pose any threat. The Popular Party began to count on a probable victory.

Administrative elections took place in Spain in May 2011. Eventually the outcome was a landslide defeat of the Socialist Party which had been predicted by the polls. But what nobody expected was the eruption of the movement of the "indignados" who came on stage during the electoral campaign. By hindsight, the mobilisations by young people targeting precariousness and protests against evictions during Spring were intimations of what was to come, but the major sign of resistance, a general strike called by the unions on September 29th was more a half-hearted blaze than a sustained fire. Thus when the movement appeared, even the organisers were surprised by their success as people filled the streets and squares with demonstrations and camps. The unrest continued during the electoral campaign and, what is even more remarkable, after the elections, reaching its zenith with the huge marches against the Pact of the Euro in June.

The mobilisation was filled with criticism towards the banks, the markets and the EU but also towards the political and electoral system, including the unions and the traditional left. At a very general level it was received with sympathy by a huge majority of the Spanish people, with polls showing that more than 70% supported the

movement. On the other hand, traditional political and social actors were bewildered by the newcomers. The Popular Party blamed the Socialists for a conspiracy to spoil their well-prepared electoral victory. The Socialists, and, incidentally, many other sectors more to the left of it, were sympathetic but patronising, betting on gaining electorally from the movement and showing little awareness of the critique of the political establishment. The unions at first despised the movement though they later began to change their position but without any sign of self-criticism.

The movement itself was very pluralistic and undefined at the beginning. A general criticism of the malfunction of formal democracy and neoliberal policies was blended with naive apoliticism and the wish to behave "nicely". It was radical enough openly to defy the Electoral Courts when they banned the demonstrations the day before the elections, but some thorny questions were left out of the agenda, such as the war on Libya.³ It is also remarkable that one of the oldest and more vexing political issues in Spain, the "Basque question", remained in a world apart with the whole radical Basque movement minding its own business. Although it is difficult to speak of leadership, it was obvious that apart from some more conscientious left-inclined groups of young people, social-democratic think-tanks and certain right-wing libertarians had input into the agenda and contributed to the shaping the general mood. Even lobbies for software and network businesses were trying to influence the movement, since it relied on computer technology for organisational and communicative reasons.

In August, the debt issue entered an emergency phase when the risk premium was raised to 5%. Summoned by Sarkozy, Merkel and the ECB, Zapatero decided to amend the Constitution according to an "express" procedure for putting a ceiling on public borrowing. The Socialist and Popular leaderships supported the amendment and the procedure was used. This was extraordinary because the Constitution has been untouchable for decades. Even a secondary question such as the preference for men over women in the accession to the throne could not be changed because it risked shaking the whole establishment. Yet now the Constitution was changed in a couple of weeks.

Moderates in the left who had been hoping for some sort of front to oppose the more than probable electoral success of the right were suddenly alienated. The unions called for a referendum, which was sternly rejected by Zapatero. Rubalcaba, the Socialist candidate,⁴ was caught by surprise as the reform meant destroying the leftist

3. In contrast with the huge mobilisations against the intervention in Iraq in 2004.

4. Last summer Zapatero announced that he would not run in the next general election. The

image he was carefully trying to build for himself. The administrative elections had shown that the working class electorate which brought Rodríguez Zapatero to office had withdrawn their support out of disappointment. Now it was the turn of the unionists and intellectuals who roared in anger.

Meanwhile the Popular Party took office in almost all regions and major cities. The consequences have been immediate: pleading mismanagement by the former Socialist mayors and regional governments the newly elected Popular Party officials have launched a full-fledged attack on public education and healthcare. As the regional unbalances feed the overall deficit the pantomime goes as follows: the (Socialist) Finance Minister demands cuts in regional expenses and the (Socialist) Education and Health Ministers criticise the conservative “chainsaw”. But the constitutional reform has emptied this debate. Even a recent restoration of the wealth tax which was suppressed by Zapatero in 2007 only provokes cynical remarks among the general public.⁵

The indignados continued with a lower profile all through the summer with marches and protests against foreclosures, blocking a handful of evictions. In August there was a mobilisation against the visit of Benedict XVI whose harsh repression by the police helped to radicalise some sectors. Speakers and posts in the social networks from the indignados movement publicly opposed the constitutional reform, thus clarifying the boundaries between political positions. When, in September, the unions began to call some symbolic acts to oppose this reform some groups turned out to support the protest while keeping a certain distance. At the time of this writing it is reasonable to predict that when classes resume after the summer holidays there will be more student mobilisations.

The movement was insufficiently mature, and there were no political organisations capable of channelling its strength, so there was no possibility for an immediate electoral impact. But there already has been a palpable political effect: the constitutional reform and, more precisely, the way chosen to implement it, without providing time for debate. The reformers were well aware of how risky it would be to open a public discussion on the constitution two months after thousands of people

announcement was the cause of great relief for his comrades who no longer saw him as an electoral asset. The Socialist Party appointed Alfredo Pérez Rubalcaba as candidate. Rubalcaba is a veteran from the times of Felipe González and has been Minister in all the Socialist cabinets.

5. This tax has been partially reinstated, affecting only patrimonies over € 1,000,000, and the debate is pathetic: while the Popular Party, which will most probably benefit next year from the revenues, rejects the tax because “it penalises savings and the middle classes” the Socialists insist that the citizens affected are very few.

had marched in the streets crying “there is no democracy when markets rule!”

If one takes a closer look at the constitutional amendment that was passed one can see that what is really relevant is not the ceiling on public expenses, because this will not be enforced until 2020 and nobody can seriously imagine that the “markets” can be calmed down by a measure that will not be implemented in such a long time. The average life of a European legal rule is less than three years as the Lisbon Treaty has proved too well.

So what is the aim of the reform? The purpose is contained in a very short but deadly sentence: that interest and principal payments will have “absolute priority” over any other liability and not in 2020 but the very next day after being voted by Parliament. It is a message sent to the markets to assure them that debt payments come before all else. A government threatening default just for bargaining purposes will automatically step outside the Constitution. Spain is not Iceland. It is legitimate to think that had it not been for the indignados movement things would have been different. The interesting thing is that this first round has apparently ended well for the establishment but with substantial collateral damage. The conservative Catalan and Basque nationalists, building blocks in the constitutional consensus which would have naturally supported the reform, were left behind because there was no time for bargaining. In this sense, but also in general, the Constitution is not untouchable anymore.

At the core of the indignados movement are the sons and daughters of the working class and salaried middle classes, the children of democracy. Most of them, born in the 1980s and later, grew up under the promises of welfare, and formal democracy was their natural environment. They have had higher levels of consumption and better education in accordance with these promises. But when they became adults they discovered that the promises did not apply to them. They cannot afford to buy a home; if they find a job they are underpaid and precarious and their bosses are illiterate compared to them. For a while they were sustained by the traditional broad Spanish family networks or they betted on being entrepreneurs. It was a matter of time before they found out that none of the cherished achievements of democracy were for them. There is a sort of poetic justice in the fact that it is their threat that has stripped the 1978 Constitution of its intangibility. And they have not said their last word yet.

STRUCTURAL IMBALANCES AND THE ROLE OF SPANISH ELITES

What are the possibilities for Spain now? From a macroeconomic point of view Spain runs a structural current account deficit. And due to its peculiar position in the global economy there is little to be done in the short term about this deficit. Spain cannot compete in salaries unless they are reduced to a “Chinese” level; it cannot provide enough economies of scale so as to become an attractive location for greenfield investment, and it does not specialise in technological niches or special equipment such as Germany, Austria, Sweden or certain parts of Italy do (or used to). Now it has become commonplace to speak about the “need to change the model”, but this cannot come out of the blue. A feasible alternative requires a long-term social effort, investment, education, technological upgrading, environmental and energy reform, etc. It should be the historical task of the new generations to accomplish these changes, but there are some very serious obstacles in the way.

The major obstacle is the standpoint of the Spanish elites and ruling classes. They have shown great ability to survive successfully through all the changes that have taken place along the last 35 to 40 years. Coming out from a closed economy in which financial capital was at the top of the pyramid of Spanish vintage capitalism they have managed to survive and flourish as global champions. Not only Santander and BBVA but some major construction and civil engineering companies are among the most profitable in the world. First they got rid of their old industrial commitments and then concentrated in all kinds of public utilities and services. Strict protection of banks against foreign competition (Barclay’s, BNP, Deutsche Bank, all of them having failed in their attempts to gain a share in the Spanish market) and the privatisation of public enterprises made this possible.

The big companies, formerly involved in building highways and dams for the developmental state ruled by Franco, have diversified into refuse collection, street cleaning and even social care while retaining their traditional business. Their “core competency”, built up over decades, is being able to work at arms’ length with ministers and regional and local authorities. They are a good example of ‘lean management’ retaining only their intermediary role. The rest is all subcontracted. Some new entrepreneurs have joined these elites such as Amancio Ortega, from Inditex (Zara, Massimo Dutti), and Isak Andic (Mango) – industrialists without an industry, who boast large franchises all over the world, employing, without owning a single factory, hundreds of sweatshops, first in Spain and Portugal, now in Morocco, India or China.

The flip side of the coin is the role played by foreign transnational corporations in automotive manufacturing, energy and other related sectors. Since the Spanish

economy opened up in the 1960s, Spain has become a privileged destination for American TNCs. But it was during the ’80s and ’90s when Spain joined the EEC that foreign companies, both US and European, took over major Spanish manufacturing firms. These takeovers resulted in Spanish factories turned into pawns in the global game of delocalisation. The decision-making core of these companies is no longer located in Spain. Whenever there is a move in the world chess game some hundreds of Spanish workers are laid off and the trade deficit escalates by a fraction of GDP.

The power of these elites is the result of the balance of forces during the transition to democracy. The 1978 Constitution is the symbolic expression of the underlying consent. The counterpart was the expected welfare achievements of the “European model”.

EUROPE, CURE OR CURSE?

Ironically enough, the accession to the European Union, which was supposed to be the cure for Spain’s historical malaises, has turned out to be a curse. The degradation of Spain’s economic fabric has been favoured by the so-called construction of Europe in at least three ways during the last twenty-five years after Spain joined the former EEC.

The single market and competition policies have provided the legal and political background needed to prevent any sensible effort in industrial policy (except for the very remarkable case of the Basque Country). There is a long record of decisions by all sorts of European institutions penalising or directly banning public intervention in textiles, coal mining, steel mills, the automotive industry, even in public television! The downgrading of Spanish productive systems has been favoured by the neoliberal dogmas based on the ideology of free markets and comparative advantages. Recently the EU has “rediscovered” industrial policy but too late and in any case in a particularly biased way.

On the other hand, the supposed compensations for the effects of European integration, such as structural and cohesion funds, have financed the large public investment projects out of which the traditional elites have extracted their profits during the past two decades with questionable results in terms of territorial cohesion not to speak of environmental sustainability. Of course, the trickle-down effects have provided a way to make a living for many Spanish people for a number of years. But these funds are also responsible for triggering off the wave of “popular real-estate capitalism” of the last fifteen years, analogously to what happened with the flows of foreign direct investment in the 1980s, which supported what has been appropriately

termed by Armando Fernández Steinko the “financialised welfare state”.⁶

Last but not least, the single currency project has provided the rope for the noose. To begin with, it was born with an undervalued German Mark and, consequently, with an overvalued Peseta. The interest-rates policies of the ECB, aimed at easing the recovery of the German economy from its indigestion after swallowing the GDR, have proven lethal for the financial equilibrium of the Spanish economy – not to speak of the exchange rate of the Euro, which obviously damages countries whose exports exhibit high price elasticity and whose imports, on the contrary, are very sensible to income changes, so that any increase in income easily filtrates outwards. An illustration is the large number of Mercedes, BMW and Audi which have been bought with the loans provided indirectly by German banks, that is, until the crisis made evident the unsustainability of this arrangement.

Currently, the crisis continues without any sign of faltering after more than four years. Mr. Sarkozy and Frau Merkel have displaced the inane Commission at the steering wheel of the EC and keep launching pacts, initiatives and programmes – vain attempts to implement some kind of “economic governance” capable of saving the Euro. The problem, as analysed by Michel Husson,⁷ is that they face insurmountable contradictions. The first problem is the difficulty of managing class relations to the benefit of globalised capitals which no longer depend on the dynamics of internal markets. The second is dealing with past profits now turned into sovereign debt whose devaluation could pull down all major European banks.

Caught in these contradictions the European bourgeoisies are sticking to the apparently suicidal rhetoric of competitiveness, the only ground on which all of them agree because it gives them the opportunity to impose greater sacrifices and to strengthen their grip on workers. As Kalecki said, “discipline in the factories and political stability are more appreciated than profits by business leaders”.⁸ Against this iron law of bourgeois class instinct the proposals by moderate progressives are no more than wishful thinking unless there is a major shift in the balance of forces. The outcome of a step forward in any sort of Euro-federalism without such a political change will be useless. As an example let us take the position paper by the DGB “Setting a new course for Europe”.⁹ In this paper the German unions propose the following:

6. Steinko, F.A. (2010), *Izquierda y Republicanismo: el Salto a la Refundación*, Akal, Madrid.

7. Husson, M. (2011), *Une crisis sans fond*, in *Inprecor* no. 575/576, July-August-September.

8. Kalecki, M. (1990), “Political aspects of full employment”, in *Collected Works of Michal Kalecki*, Oxford University Press.

9. DGB Office of Economic, Financial and Fiscal Policy “*Setting a New Course for Europe Promoting Growth, Securing Employment, Stabilising the Euro*”. Position paper on the Eurozone crisis for

1. Sharing liabilities among all the member states extending the rescue funds and eventually issuing Eurobonds

2. Decoupling deficit financing from financial markets, which means some sort of monetisation

3. Collective control and coordination of imbalances

4. A pan-European investment programme

5. More financial regulation and wealth taxes

The point is that although well-meant these measures are not enough. Even worse, they can be counterproductive. In fact, most of these measures have already been implemented or are in the course of being implemented.¹⁰

To begin with, let us take collective control and coordination. This is the core of the infamous “European semester”. Sovereign parliaments have to make room for the supervision of a not so democratic mix of commissioners and foreign governments. The role of the European Parliament is that of the cheerleader. As for the Rescue Fund it in fact prefigures the Eurobonds which will come, one way or another; the details are what are being discussed now. The real problem is who is going to be rescued, people or banks? The consequences for the Greek or Irish people are already before us. The same goes for monetising debt. In fact when the ECB accepts all sorts of dubious assets as collateral to provide liquidity it is monetising debt in a perverse way, carry trade included. Even in the event that a sort of Marshall Plan was launched, what can be expected? The role played by structural and cohesion funds in Spain in the last decades has already been explained: they deepened territorial imbalances and made the environment even more fragile while the usual suspects filled their pockets with the proceeds and a large part of Spain’s productive structure rotted. It is difficult to see why it would be different this time, except for the fact that there is very little productive structure left.

WHAT IS TO BE DONE? FOR A DEMOCRATIC ALTERNATIVE

General elections will take place in Spain on November, 20th and it seems quite certain that the Popular Party will win the absolute majority. The United Left will probably get a better result than it previously had, which is not much, and there is the possibility that some “new left” or “third way” experiments will try to carve out a

the meeting of the DGB Federal Presidium on February 1, 2011.

10. It should be noted that “better financial regulation” is the pretext used for privatising Spanish Savings Banks.

space, probably supported by the European Greens but with little prospects. Unfortunately, we are facing a four-year term of harsh conservative rule. However, what is interesting is that the conservatives have no solutions for the situation, so social resistance can build up. Of course, the unrest can translate into extreme right-wing populism and authoritarianism, so it is the responsibility of the left to offer and work for a democratic alternative.

Hopefully the indignados movement will step in and this time the unions and other sectors will join. The left must contribute to this convergence practically but also providing alternatives. What should these be? Should we step out of the Euro as Lapavistas proposes? There are hundreds of reasons to reject the Euro, but, all things considered, one factor overrides all these reasons: in the current balance of power, stepping out of the Euro would not bring greater freedom. And there is also something worse: the possibility of being expelled from the common currency.

So we must turn to the only obvious way out; a full-fledged reform of the European framework. However, as has already been explained, the proposals coming from the moderates are also full of risks. Of course Eurofunds, a Eurobudget, central bank financing of public debt, a large investment programme focused on sustainability and environment recovery, more welfare, are all useful measures and should form part of the toolbox of a progressive and more democratic Europe. What we have learned since the beginning of this crisis is that everything that is sacred and immovable in European Treaties can be changed and moved. But something more is needed.

A new economic model based on a more sustainable employment of energy and natural resources and more centred in personal services to provide for social needs is absolutely necessary. The proposal of a “Green New Deal” runs in this direction. But the capitalists think so too. In terms of productive orientation, the proposals being made by the think-tanks of capital speak of renewable energies and environmental services. What is behind the push towards privatisation of health and care points in the same direction: “Aging Europe” is not a threat to financial sustainability; it is the perspective of a gigantic market of personal services. At any rate, exchange value needs also to be a use value. The so-called sector orientation of the new model does not make enough difference.

In my view, it is necessary to curb the concrete power of the dominant classes in the current situation. We need a step forward in socialisation that parallels the growing degree of abstraction of capital. Social needs and desires must be imposed as the key targets of economic activity. And for this we need a democratic impulse: people in movement and something capable of moving people. In Spain I would propose:

1. The right to a job for everybody. Public employment in socially useful activities under popular control for everybody who is unemployed, as in the Employer of Last Resort scheme Hyman Minsky¹¹ proposed some time ago.

2. Nationalisation of finance and housing. Sooner or later Spain (and other countries) will need to inject capital into banks, so now it is the time to nationalise them for good. In the Spanish case this will inevitably include urban land and housing as well as taking over Stock Exchange managing societies and other finance sector firms.

3. Economic democracy, starting with the public employment scheme mentioned above and citizens’ control over the stakes of the state in finance and urban land, and following this with public budgets, tax collection and control, etc. These are the lessons from the indignados movement: there is no change without participatory democracy and accountability.

The challenge is to be able to cooperate with the more moderate sectors opposing resistance, fighting for reforms in the European Union’s economic governance and struggling in the direction of sustainability, but without losing sight of the need for these stronger proposals – and to push them forward in the hope that the succession of events will show that they are necessary.

11. Randall Wray, L. (2007), “Minsky’s Approach to Employment Policy and Poverty: Employer of Last Resort and the War on Poverty”, *Levy Economics Institute*, Working Paper Series no. 515, September.

The Portuguese Debt Crisis: Deconstructing Myths

MARIANA MORTAGUA

There is a general consensus around the reasons behind the onset of the financial crisis starting in 2007. The crash in the subprime markets undermined the confidence that sustained the financial system. Without confidence, toxic financial assets spread across unknown balance sheets became worthless, lending via the Interbank Money Market (IMM) froze and liquidity crashed, rendering it impossible to sustain the existing leverage levels.

Lack of confidence and lending restrictions affected banks worldwide, restraining the amount of credit supply in the economy. Simultaneously, huge losses in stock markets contributed to transform the initial financial crisis into a severe economic crisis.

I do not intend here to look at the several causes of the crisis. Certainly, it is the product of 30 years of deregulation and financialisation that fostered income inequalities and the accumulation of international economic imbalances: in particular large current-account surpluses and correspondent deficits that generated enormous capital net flows from the peripheries to core countries or, in other words, that generated enormous amounts of debt in the peripheries.

The evolution from a private crisis to a sovereign debt crisis was relatively quick, as states rushed to bail out troubled financial institutions. The nationalisation of financial losses, together with the functioning of budget stabilisers (designed to

automatically increase expenses and reduce revenues as the economic and social situation worsens), increased public deficits and justified the pressure on public debt.

Levels of sovereign debt then became immoral, the locus of the cause and the solution to all evils, and indebted countries the “sinners” in need of redemption.

Public indebtedness in peripheral countries was used as justification for the successive downgrades by rating agencies that promoted financial speculation and raised doubts in the financial markets about the solvency of banks in those countries.

Austerity was then proposed as a way to appease the gods and solve the economic crisis. In reality, austerity represents no more than an enormous cut in direct and indirect (welfare-state) salaries, transferring to workers (and pensioners) the weight of adjustment, in order to compensate for the massive capital destruction caused by the crisis.

By now, it is fairly clear that this crisis evolved “from a private crisis whose resolution would imply a refoundation of capitalism, to a public sector crisis, the non-resolution of which would cause the collapse of the model of social protection and of the welfare-state system” (Garcia-Arias et al., 2011, p.4).

Why and how populations in European peripheral countries accepted such violent measures is one of the questions that can be addressed at this point. Two main factors were crucial here. *Authoritarianism* has emerged as a natural response from the right wing but also from social democrat and socialist governments all over Europe, in order to force people to accept these retrogressive steps with regard to their rights. *Austeritarism* is, therefore, the new face of elected governments, captured by the interests of financial markets. Public awareness of this is now leading to a generalised crisis of democratic legitimacy, which gave birth to social phenomena, like the “indignados” in Spain that spread all over Europe.

On the other hand, neoliberal discourse is still too hegemonic. The idea of an inevitable and desirable fiscal adjustment is still flourishing, based on a few myths around guilt and greed.

In what follows I will try to discuss the Portuguese situation as regards these “myths”, which I have called “crisis myths”.

GENERAL CONTEXT OF THE PORTUGUESE ECONOMY BEFORE THE CRISIS

Most of the problems we now face did not suddenly appear with the financial crisis; rather they have a structural basis. They reflect the way economic power has organised itself in Portugal for the last hundred years.

The Portuguese economy has been ruled from the 19th century on by more or less

the same industrial and financial groups. These enterprises, mostly organised within powerful old families, have represented more than one-third of Portuguese income. They have determined the accumulation process and shaped the entrepreneurial landscape of the country.

The reason behind their economic and political power is their symbiotic relation with the state, before, during and after the country's period of dictatorial rule. In one way or another, they have survived and prospered under the state's tutelage, with favourable rents and access to natural monopolies. In exchange, they have allowed for quite an impressive process of social and economic mobility – from the government to the financial and economic elite.

In other words, the way in which the bourgeoisie, and therefore capital, is organised in Portugal led to a growth model extremely concentrated in a few profitable sectors. In the first place, the financial sector, with control over a few international banks, the stock market and real-estate activity. Second, the exploitation of several natural monopolies such as electricity, energy and communication services. Finally, all kinds of private-public partnerships, which assure never-ending rents to banks and economic groups in areas such as healthcare services and road construction.

This strategy is the main cause of the anaemic economic growth over the years and is above all responsible for the excessive specialisation in non-tradable goods and financial services, at the expense of the productive sector.

As explained in *Donos de Portugal*, a history of the Portuguese ruling class in the last hundred years, “the Portuguese bourgeoisie was never able to bring democracy into the country's modernisation. It is not a matter of unwillingness or lack of capacity, but rather a rejection of social distribution, since its levels of accumulation, granted and supported by the state, have allowed it to reap the benefits of the most extreme social inequality within the European area. The outcome is a strategy, rather than a contingency; it is a huge, and perhaps disturbing, success, but not a problem for the owners of Portugal (...). The owners of Portugal are Portugal's main problem” (Costa, J. et al, 2010, p.16).

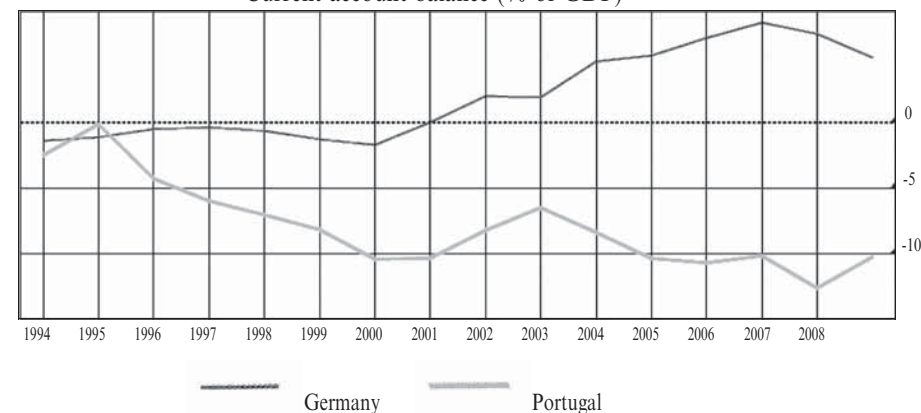
The way the Portuguese bourgeoisie has structured the accumulation process helps us understand why the economic crisis has had such an impact, but it cannot and should not be separated from a second factor - the structural problems in the Eurozone. This is, in fact, what differentiates the peripheral from the core countries in the EMU.

It is not news that the European Monetary Union was founded on unfair rules that reinforced the existing inequalities in terms of competitiveness and economic

power, and gave birth to enormous imbalances within the Union. The Maastricht criteria,¹ as well as the idea of an independent central bank obsessed with inflation and not concerned with any other type of direct intervention in the monetary system are some of the dogmas underlying the Euro-crisis.

Portuguese exports, as will be explained in what follows, suffered an immediate loss in terms of competitiveness through joining the Eurozone. This disadvantage progressively increased in relation to the core countries, and it is the cause of systematic current-account deficits, funded by bank lending from German and French Banks. One should keep in mind that deficits are a reflection of surpluses elsewhere, and German surpluses are the counterpart to deficits in Portugal (as shown in figure 1).

FIGURE 1
Current-account balance (% of GDP)



Source: Balance of Payments Statistics

Portugal's pattern of specialisation, focused on non-tradable goods, favoured imports from other EU countries, which were compensated by capital flows from core countries. In other words, to pay for imports Portugal had to rely on cheap loans,² usually from the same countries that were exporting goods to Portugal.

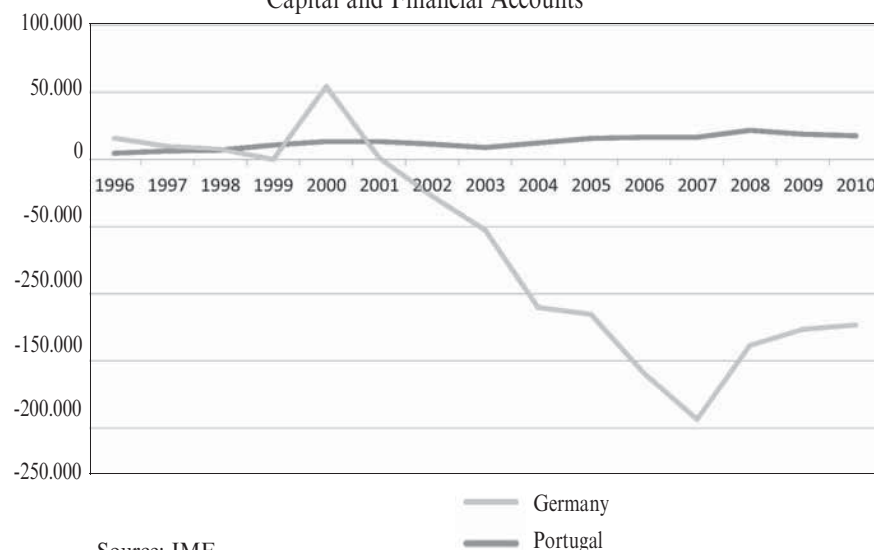
As shown in figure 2, capital and financial accounts moved in opposite directions in Portugal and Germany, as capital fled from the latter to the former. In their

1. Total public debt of no more than 60% of the GDP; and public budget deficit of no more than 3%.

2. The low nominal interest rates of the Eurozone allowed for these “cheap” loans.

analysis of the structural problems faced by the periphery in the Eurozone, Lapavitsas et al. (2010) show that, for peripheral countries, capital and financial accounts are not the result of foreign direct investment flows. Instead, “the current-account deficits have been financed through bank loans and portfolio flows from abroad (bonds)” (Lapavitsas, C. et al, 2010, p. 11).

FIGURE 2
Capital and Financial Accounts



In short, faced with a progressive loss of competitiveness vis-à-vis the core European countries (mostly Germany), the private sector in Portugal reacted by generating debt. This process has its roots in Portugal's structural problems, but it was favoured by the integration process in the EU (and EMU). Financialisation and liberalisation within the monetary area encouraged the central countries' neo-mercantile strategy and offered the private sector the “opportunity to get into debt cheaply”.

Debt is therefore the main reason behind the crisis in Portugal, but we should be worrying about private debt instead of public deficits.

By 2009 Portugal's gross external debt was about 369,155 million Euros. General government and monetary authorities were responsible for 30% of the total debt,

while the private sector held 70% of total liabilities. Within the private sector, financial institutions owed 72% of the private share of external debt. However, as the private crisis turned into a sovereign crisis, private debt has been transferred to public accounts. A good example of this operation is the IMF/EU loan, which includes a 12 billion-Euro “package” (out of 78 bn) that will serve to recapitalise private banks, increasing public debt. As a result, public debt increased, as we can see when looking at the most recent data on gross external debt. The total amount of debt is now 379,115 million, but 40% of it belongs to the public sector, instead of the previous 30%.

FROM DEBT TO AUSTERITY: THE CRISIS MYTHS

In Portugal, as in many other countries, two main arguments were used to make austerity acceptable. As in the case of other countries, however, the theories in question are weak, based as they are on moral judgments rather than on a thorough-going analysis of the real economic conditions. Thus these myths are used indiscriminately everywhere in all indebted countries, regardless of their specific characteristics.

The two arguments are: 1) Portugal lost its competitiveness because wages were growing faster than productivity; and 2) debt is the result of people (and the state) living beyond their possibilities, beyond their means, due to a) high consumption and b) an excessively generous welfare state.

Translated into more concrete terms, these arguments really mean: 1) unit labour costs are too high; 2) the whole country has been spending more than we “should” – individual consumption led to debt, just as public expenditure with the welfare state and public workers caused public debt to rise.

The solution is straightforward: for a country to recover its competitiveness and pay off its debt, both the cost of labour and the size of the state must be reduced.

These beliefs are deeply embedded in the current economic policy - austerity is seen as a strategy to achieve an export-led growth model based on (cheap) labour costs.

By the beginning of 2010 the Portuguese government faced four major problems: rising unemployment, a decreasing GDP, growing public deficits and an unsustainable cost of borrowing based on the markets' perception of the first three. In order to control the markets' perception and to reduce the public deficit (and therefore promote growth), four different austerity packages were implemented within one year. These included cuts in public-sector wages and social spending, a severe

reduction in public investment and higher taxes on consumption and work income.

Despite this, austerity proved to be inefficient. Yields on Portuguese sovereign bonds kept rising, both in primary and secondary markets, fuelled by rating-agency downgrades and by ECB behaviour³ (see Figure 14). At the same time, the combination of higher interest with slower economic growth caused public debt to increase, due to the “snowball” effect.

As a result, in June, the Portuguese government and the two major parties signed the memorandum of understanding with the IMF, the European Commission and the European Central Bank. As in Greece, this agreement implied a 75 billion-Euro loan with very harsh conditions.

In 2011, the recently elected government initiated a violent consolidation plan, which goes beyond some of the measures stipulated in the memorandum. Besides all the Draconian cuts in public spending –in social security, education, health, capital investment and public-sector wages– a new package of supply-side measures is to be implemented: examples are reforms in labour contracts, changes in unemployment allowance rules and increases in the legal daily working hours.

However, before considering the effects of the austerity measures, it might be useful to take a closer look at the myths behind it.

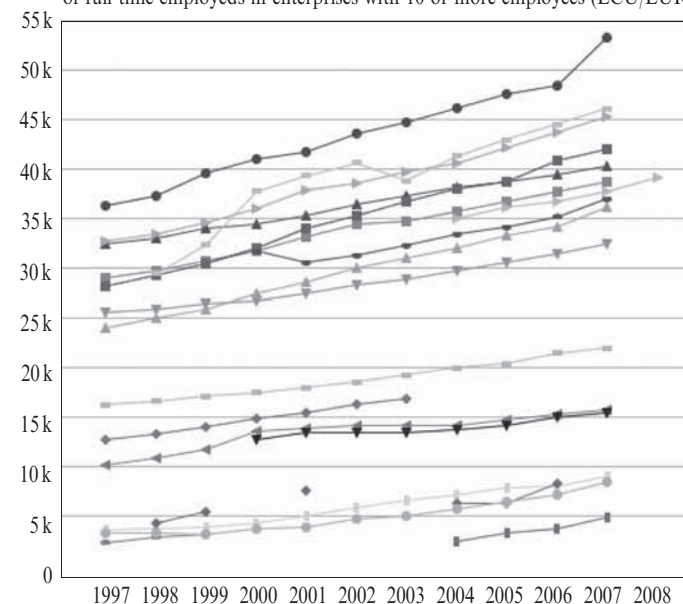
1) Portuguese wages grew faster than productivity, compromising Portuguese levels of competitiveness.

Before we begin with any analysis of relative wage evolution, let us do a simple and clarifying exercise, which consists of comparing average gross annual earnings within Europe (Figure 3).

Looking at the location of the darker blue line in the graph below, it should be difficult to conclude that the major economic problem in Portugal is high salaries. On the contrary, from 1997 to 2007, Portugal maintained its position at the bottom of Europe in terms of average gross earnings, well below every other Euro country, with the exception of some eastern European countries, such as Poland, Hungary, Romania and Lithuania.

3. During the whole period of the crisis, the ECB was lending to private banks at very low interest rates. This would not have been a problem in itself if banks had not been buying public bonds at speculative prices, which would then be used as collateral to obtain new loans from the ECB. However, when confronted with high amounts of troubled public debt in the balance-sheets of banks, the ECB began buying sovereign bonds in the secondary markets, leaving the states completely dependent on financial markets to obtain financing.

FIGURE 3
Average gross annual earnings in industry and services
of full-time employed in enterprises with 10 or more employees (ECU/EUR)



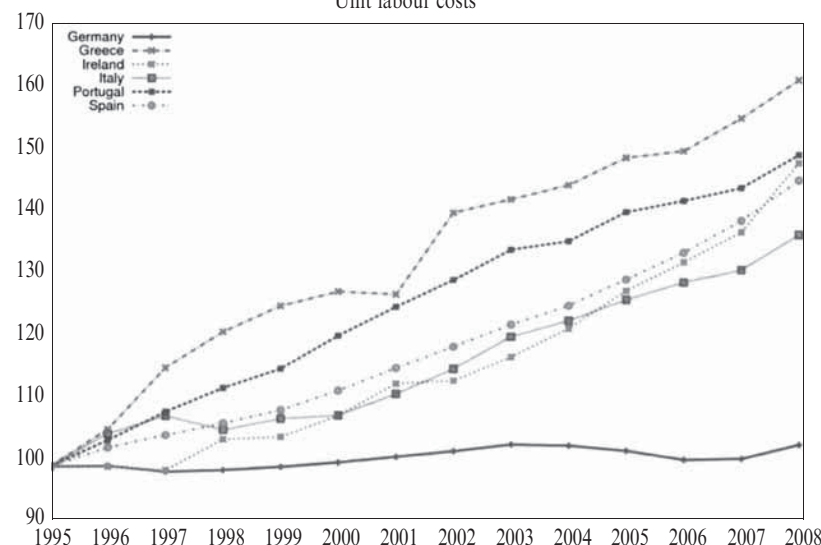
Belgium, Denmark, Germany, Greece, Spain, France, Italy, Lithuania, Luxemburg, Hungary, Malta, Netherlands, Austria, Poland, Romania, Slovenia, Slovakia, Finland, Sweden, United Kindom
Unavailable data is ignored

The standard measure used to compare competitiveness is the nominal unit labour costs (ULC), which divides nominal labour remuneration by the real output. It therefore provides some insight into the evolution of the nominal cost of labour relative to labour productivity.

Figure 4, taken from the RMF-network (Research on Money and Finance) report on the Eurozone crisis, shows the evolution of ULC comparing several countries in Europe, using 1995 as the base year:

The flatness of unit labour costs in Germany seems to confirm the idea that German nominal wages followed changes in productivity. On the other hand, nominal wages in peripheral countries evolved faster than productivity, causing the unit labour costs to increase sharply in the last 15 years.

FIGURE 4
Unit labour costs



Source: Research on Money and Finance Report, "Beggars themselves and their neighbours".

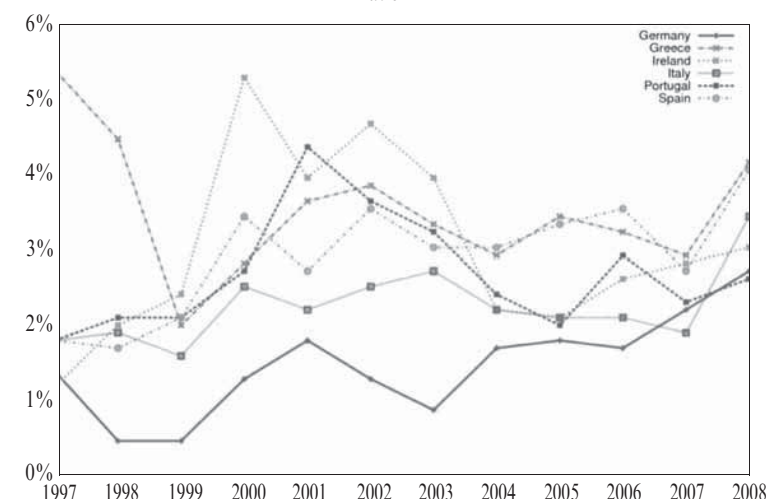
However, because it divides a nominal variable by a real variable, unit labour costs do not convey the effect of inflation on wages. As in many other countries, nominal wages in Portugal tend to catch up to changes in price levels. Therefore, differences in inflation explain, partially, why unit labour costs evolved differently in the periphery compared to Germany.

If we look at the real compensation of labour, instead of unit labour costs, the overall picture changes. In fact, real compensation of labour was growing as fast in Portugal as in Germany, which, in itself, should be enough to question the "myth" of wages. Nevertheless, it remains true that real compensation of labour grew faster in most peripheral countries than in Germany, which was compressing its internal wages and gaining competitiveness.

However, as stated by Lapavistas et al. (2010) in their Report, this might be a true but misleading way to approach the problem:

For the real problem has not been excessive compensation for peripheral workers but negligible increases for German workers, particularly after the introduction of the

FIGURE 5
Inflation



Source: Research on Money and Finance Report, "Beggars themselves and their neighbours".

Euro. Even in Greece, in which nominal and real compensation have increased the most, the rise in real compensation has been of the order of 20% during the period of 2000-8, and that from a low base compared to Germany (Lapavistas et al., 2010, p. 24).

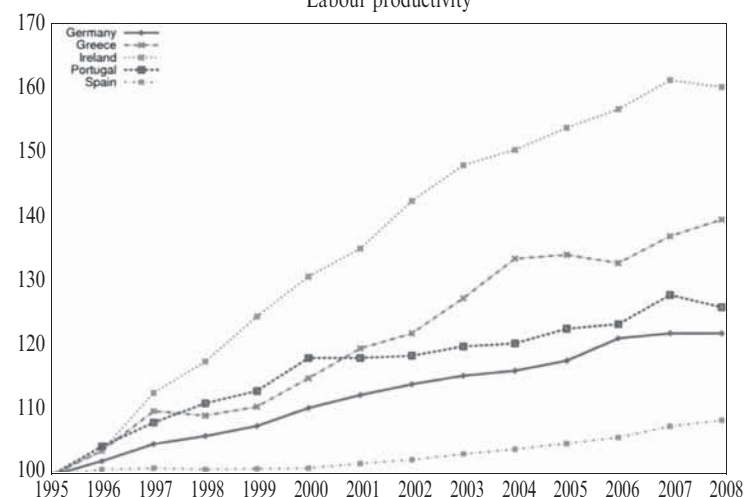
In fact, when looking at the evolution of labour productivity alone (Figure 6), two conclusions can be drawn. The first is that productivity was actually growing faster than wages in the periphery since 1995. Again, this fact contradicts our "myth". Second, Germany performance in terms of productivity was anything but successful.

It should be clear by now that wages in Portugal did not grow faster than productivity, despite the positive evolution in real compensation of labour. If anything, the rise in German competitiveness in relation to peripheral countries is related to the pressure on German wages during the last decade (of course we should keep in mind that Germany started from a higher position in terms of competitiveness).

This constant pressure on wages in Europe is the result of the Stability Growth Pact (SPG) criteria imposed by the Maastricht treaty, in the context of a single monetary policy.

Without control over monetary and foreign-exchange policy, national govern-

FIGURE 6
Labour productivity



Source: Research on Money and Finance Report, "Beggars themselves and their neighbours".

ments were left with national welfare systems, public-sector and labour markets under the pressure of competitive international markets, which had to be managed in order to meet debt and deficit requirements. Thus, the SGP logic of permanent discipline over public economic choices imposed austerity as the ultimate policy and promoted a competitiveness model based on low wages.

Germany, also because of its situation (investment, technologies, welfare state, etc.) before adopting the SGP logic, has been far more successful in compressing its internal wages and gaining competitiveness relative to the periphery. This strategy resulted in the accumulation of enormous surpluses in Germany's current account, mirrored by equally enormous deficits in Portugal.

But other factors have contributed to the Portuguese "disaster" as a competitive force within the Monetary Union, besides the wage compression strategies in the core relative to the periphery.

It is commonly accepted by Portuguese economists that the country entered the Euro at high rates of exchange as compared to Germany. This imposition, aimed at controlling inflation and sustaining a strong Euro capable of competing with the dollar, undermined Portuguese export competitiveness. According to a recent study

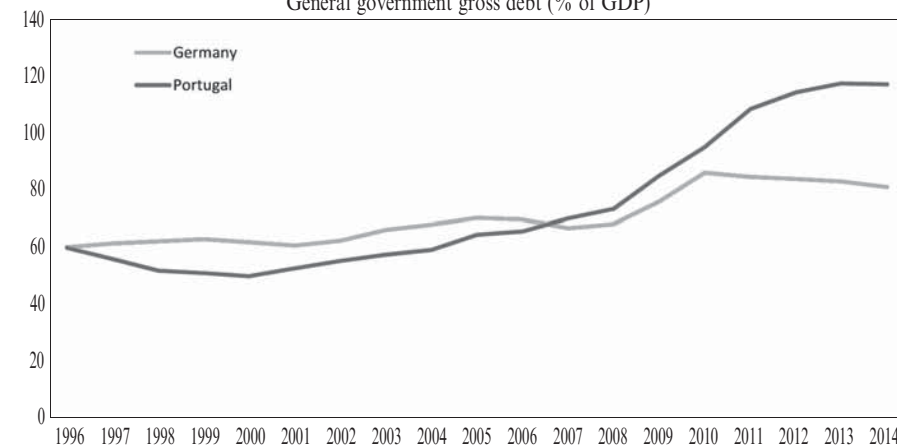
by Ferreira do Amaral, Portugal lost about 17.3% of its competitive strength in 2006 as compared to 1991. The high exchange rate between the Escudo and the Euro accounted for 60% of the 17.3% lost. Structural factors within the Portuguese economy, such as our extreme specialisation in non-tradable goods and services, is responsible for the remaining 40%. On the other hand, the study reveals that labour costs had no impact on Portuguese competitiveness.

In short, the reality of European asymmetrical integration tells us that the main causes of the differences within Europe in terms of competitiveness are far more complex than a simple comparison based on nominal unit labour costs shows. In fact, such analysis seems to be completely incorrect and misleading in terms of economic policy.

PEOPLE LIVED BEYOND THEIR MEANS AND THIS IS THE CAUSE OF PUBLIC DEBT.

The idea that peripheries in general and Portugal in particular were running consistent structural public deficits has no basis in reality. Portuguese public debt was below the 60% demanded by the Maastricht criteria until 2005. Figure 7 also shows that government gross debt, as a percentage of GDP, was lower in Portugal than in Germany until 2007. The sharp increase in public debt occurred after 2008, as a consequence of automatic budget stabilisers, the bailing out of financial institutions and, later on, the IMF/UE loan.

FIGURE 7
General government gross debt (% of GDP)



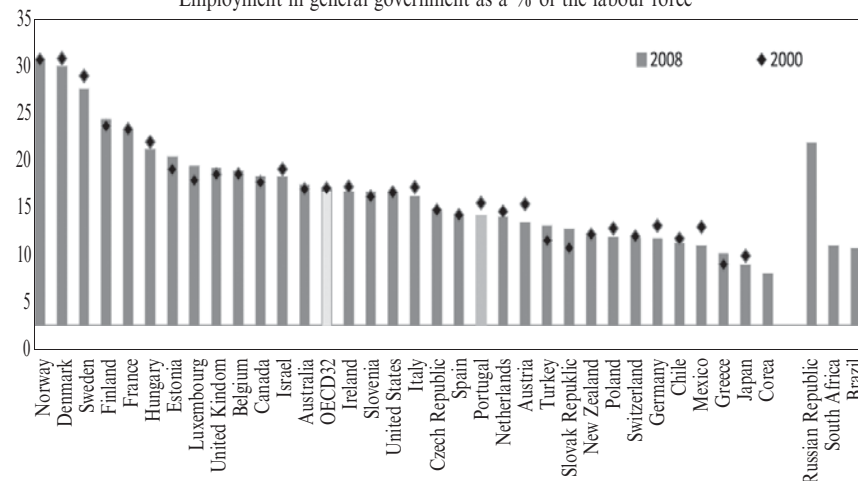
Source: IMF

In a similar way, available data on public spending and the number of state workers seems completely to contradict the idea of an inefficient and spendthrift public sector in Portugal.

The percentage of public workers in the total active population is below the OECD average and very different from countries like Denmark, France or Sweden. (Figure 8)

FIGURE 8

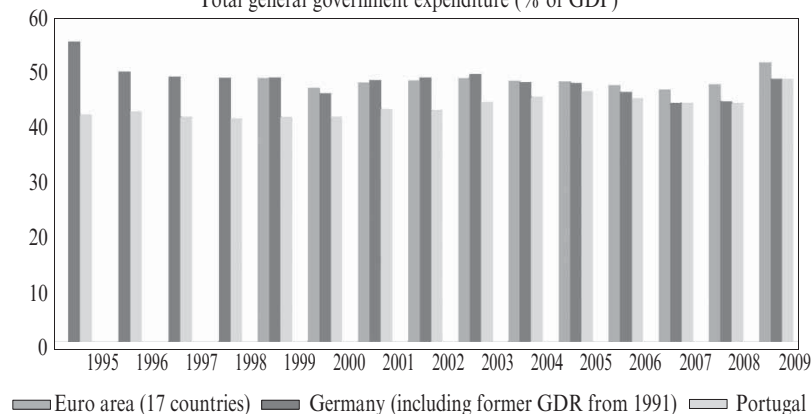
Employment in general government as a % of the labour force



Source: OECD, Government at a Glance, 2011

FIGURE 9

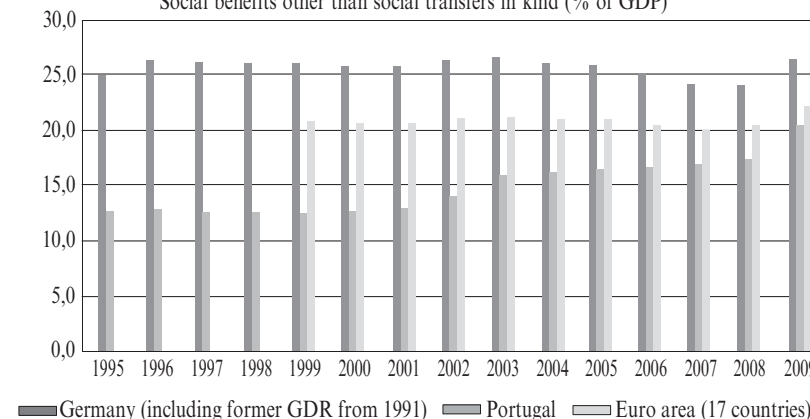
Total general government expenditure (% of GDP)



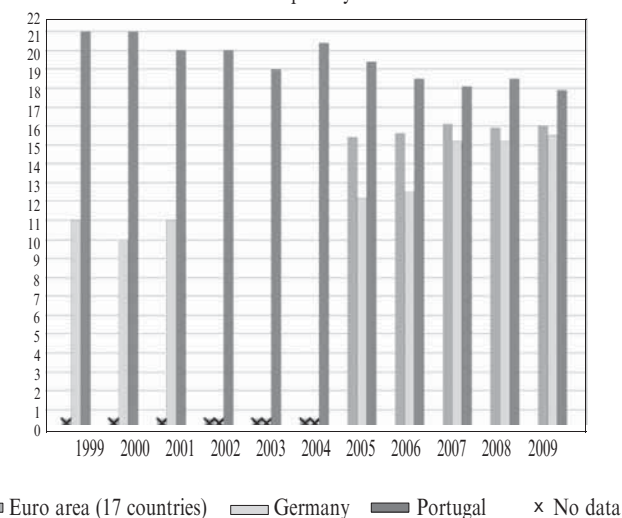
Source: Eurostat

FIGURE 10

Social benefits other than social transfers in kind (% of GDP)

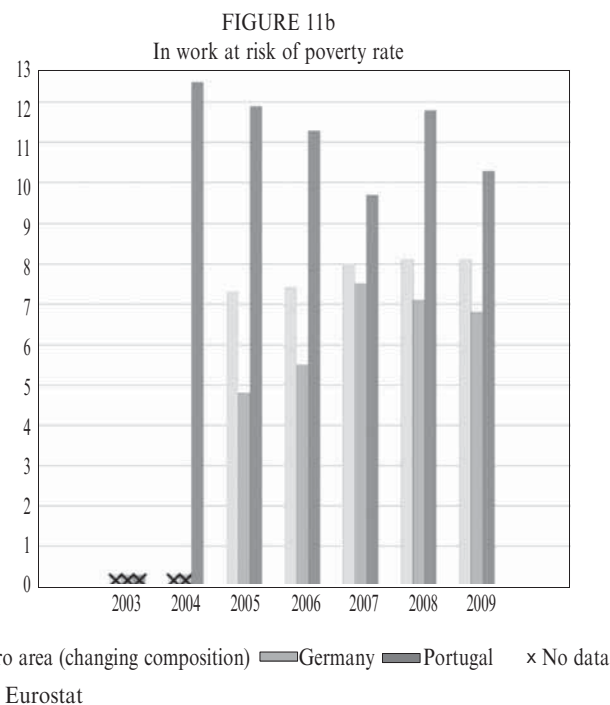


Source: Eurostat

FIGURE 11a
At risk of poverty rate

Source: Eurostat

The same argument applies in terms of general government expenditures. Total government expenditure as a percentage of GDP in Portugal was never above German levels, or even above the Eurozone average (Figure 9). By the same token, if one looks at social benefits expenditures in terms of percentage of GDP, it is quite



difficult to maintain that there was a “too generous” welfare state in Portugal. If anything, Portugal was simply catching up in terms of social protection (Figure 10).

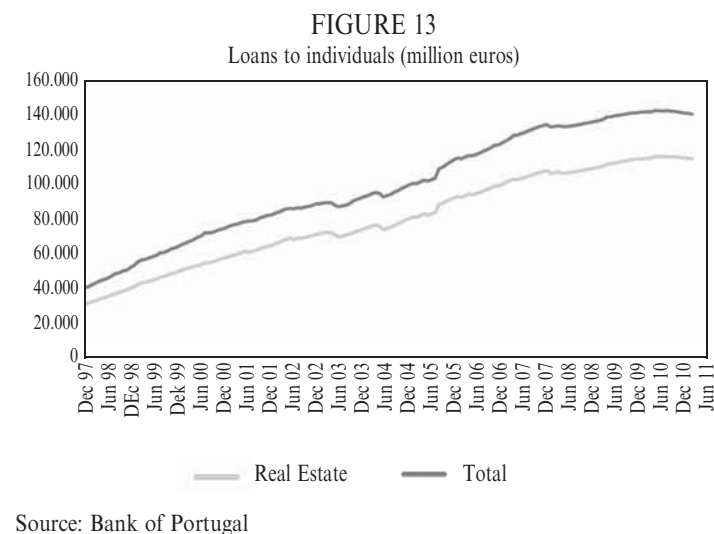
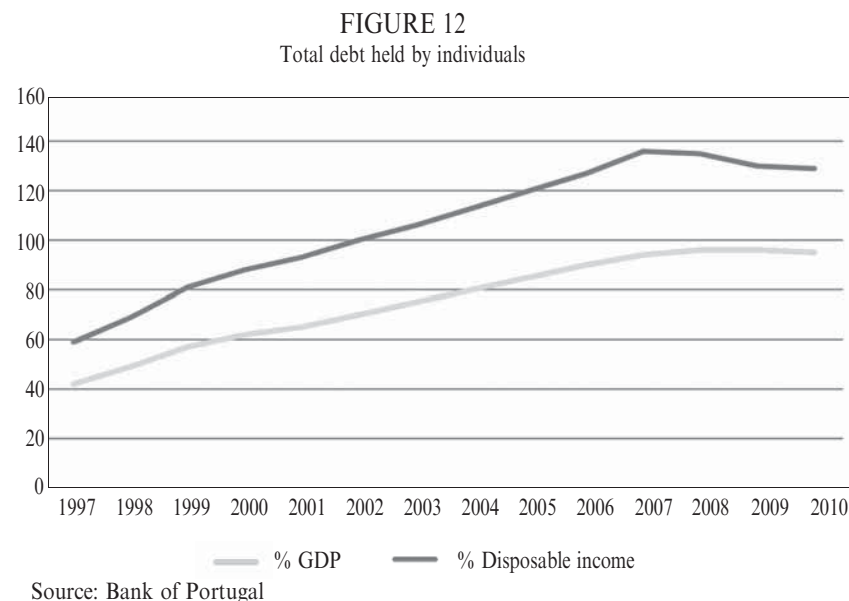
In fact, low wages, combined with insufficient protection, help explain why poverty rates in Portugal are well above the European levels. The in-work poverty rates confirm the idea of low salaries in Portugal: for more than 10% of the working population, their wages are not enough to keep them above the poverty line.

The reality of these data destroys the “common-sense” arguments, and one should thus question what it really means to “live beyond our means, beyond our possibilities”.

Portugal has shown modest public deficits (and gross debt) over one decade, as a consequence of the SGP criteria - fiscal conservatism is not a new concept that governments have learned after the crisis; it was being implemented much before then. Thus, it is not credible that public debt is the real cause of the sovereign crisis, or that excessive social and public expenditures were the cause of rising public indebtedness.

There is no doubt that individual debt grew to unsustainable levels during the past decade (from around 60% to 130% of the available income in 2008) (see Figure 12). But that fact, by itself, does not mean that the workers were living beyond their

means. Instead, it is more reasonable to conclude that (private) debt occurred as a consequence of diminishing “possibilities” for workers. The relative collapse in wages and decreased consumption power were compensated by an increase in families’ indebtedness.



Therefore, this increase in individual private debt was not the result of increasing levels of luxury consumption, but was mainly channelled, as in many other countries, to real estate. The boom in real-estate market reflects the wrong public housing policies - it is a direct product of the liberal campaign during the 1990s and 2000s to create property owners and sustain the speculation levels in real-estate markets. This was largely favoured by the financialisation process and deregulation in European markets.

FROM AUSTERITY TO ECONOMIC COLLAPSE: WHY IT IS NOT WORKING

Austerity is being presented to the peripheral countries of the Eurozone as the inevitable economic solution to the crisis. However, it would be a mistake to believe that only the countries in the periphery, or within the monetary union, are facing all sorts of Draconian measures; the recent measures implemented in the UK are enough to prove the contrary.

Austerity is expected to be the answer to both problems faced by the Portuguese economy. It is supposed, in the first place, to increase competitiveness through lower wages, more flexible labour markets and by privatising a large share of the strategic sectors in the economy. In the second place, it is supposed to reduce the state debt, by cutting the number of public workers, contracting social expenditure and public investment and increasing income taxes. Such “reforms” are supposed to be enough to tranquilise the markets, bring down the yields on sovereign bonds and, simultaneously:

- enable exports and promote an export-led growth model capable of leading the way out of the crisis;
- reduce public deficits by more than what is required by the SGP.

However, once again reality proves that the chosen strategy is not working. Austerity is the wrong medicine for a poorly diagnosed disease, and it should not be difficult to understand the reasons why.

1) Austerity is not able to tranquilise the markets.

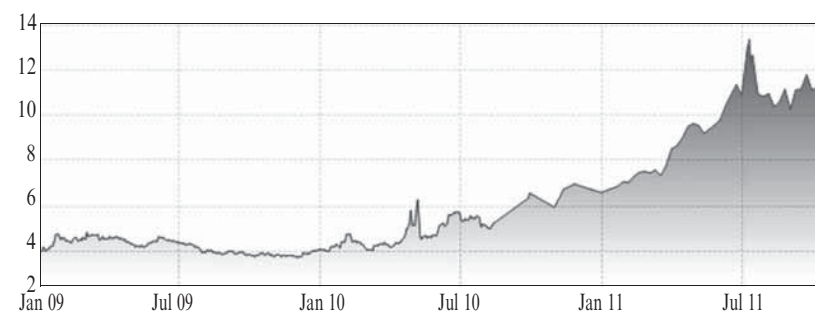
Simple statistics should be enough to show that there is no negative correlation between the “austerity packages” and the premium risk on sovereign bonds. Rather, austerity reinforces speculation.

First and foremost because speculation in financial markets assumes the characteristics of a self-fulfilling prophecy, making it almost impossible for a country to resist its effects in a liberalised economic environment. In the second place because, if anything, austerity worsens the country’s economic situation. The impact

of such Draconian cuts in public expenditure, while increasing the tax burden, is seriously compromising consumption and investment. Without consumption and investment, the economy will not grow and debt will expand in relation to GDP.

Figure 14 shows the evolution of the implied yield on 10-year bonds since 2009, with the red arrows representing the several austerity packages implemented in order to control the escalation in the implied yields (the last arrow on the right-hand side is the IMF/UE/BCE agreement). It is obvious that the austerity measures failed as a strategy to control speculation in financial markets.

FIGURE 14
Portugal Government Bond 10Y



Source: TradingEconomics.com; IGCP

2) Reducing unit labour costs will not increase our competitiveness.

We have already seen why this is a misleading idea. First because unit labour costs tend to introduce a bias into the discussion. Second, because the evolution of wages in Portugal should not be analysed independently from other factors, such as the Euro integration process or the German economic strategy concerning their own wages. There are two main reasons why one should reject the idea of lowering wages to increase competitiveness.

First, because high wages are not the main problem of Portugal’s lack of competitiveness. A strategy based on a cheap labour force, which will not in any case succeed against China or some Eastern European countries, is not the way to promote exports.

Second, because a contraction in wages, like the one that is being implemented now, will have several consequences on the economy. Consumption will drop sharply, affecting business sales and compromising employment levels. Unemployment causes

social expenditure to rise and lowers consumption even more, which will affect sales and investment levels. It is a dangerous spiral of negative effects that will most probably end in a severe recession.

3) And, even if lower wages were in fact to increase Portugal's competitiveness, is the export sector capable of promoting enough economic growth?

Exports represented, in 2009, about 30% of the Portuguese GDP, against 70% of private consumption, 22% of public consumption and 20% of private investment.⁴ Thus, even with diminishing imports exports remain a small part of economic activity when compared to consumption (private and public). The main question therefore is how much exports would need to increase in order to offset the negative impact of austerity in private and public consumption and investment, and whether it is realistic to hope for such increase.

The latest macroeconomic forecasts published by the government point out that the contribution of exports to GDP growth will be of 4.7%. However, internal demand will have a (minus) 5.5% effect on GDP growth, dissolving any positive effect arising from exports. Moreover, one should take into consideration that Portugal's main trading partners are following the same strategy of compressing wages and improving their commercial balance account. Portugal should not rely excessively on external demand in the near future.

4) Austerity is not reducing public debt.

Because it undermines economic growth, austerity automatically increases the debt-to-GDP ratio. However, total amounts of public debt are also increasing, not only as a consequence of the bailout of financial institutions, but mostly because of the impact of interest in the servicing of debt. In fact, interest payments account for almost three-quarters of the expected rise in total debt in 2012. Total amount of interests in 2016 will be 5.1% of the GDP (9,841 million Euros), which means that in order to meet the deficit target of -1.8%, the government will have to show a primary surplus of 3.3% of the GDP.

Furthermore, deficit adjustment is even more complicated to achieve in a context of contracting fiscal policies. The economic slowdown caused by a reduction in consumption and investment decreases tax revenues, which tend to be compensated by increasing the tax burden and by cuts in wages and social expenditure. However, the pro-cyclical impact of such measures causes a new reduction in tax revenues and increases the necessity of new social expenditures. Therefore, the decreasing marginal

4. It should be noted that the sum is more than 100% due to the effect of imports, which were not subtracted from this calculations and represented 37% of the GDP in 2009.

gains of raising the tax burden and cutting expenditures will probably compromise the fiscal adjustment targets.

Austerity leaves the country trapped in the well-known fallacy of composition: it might be beneficial if one debtor stops spending in order to pay off his or her debts in a certain moment, but it will turn into an economic collapse if every agent in the economy decides to do the same at the same time. And that is exactly what is happening.

With a lack of control over monetary policy, a counter-cyclical fiscal policy is crucial in order to promote economic dynamism. Without bank lending or direct access to the wholesale markets, the private sector relies mostly on public spending to inject money into the economy. However, governments are doing the opposite in taking money out of the system and fuelling the crisis. Until now, the direct consequences of such strategy in Portugal have been translated into higher unemployment and a deep recession, with growing public debt. At the same time, supply-side measures aimed at bringing flexibility to the labour market facilitate this quick adjustment through unemployment and lower wages which, combined with cuts in welfare state, have been augmenting poverty and inequalities to unprecedented levels.

TABLE 1

	2010	2011	2012 (f)
GDP	1.4	-1.9	-2.9
Unemployment	10.8	12.5	13.4
Government debt to GDP	93.3	101.9	110.5
Variation (% of GDP)	10.3	8.6	8.6
Primary balance effect	6.8	1.6	-0.7
Snowball effect (GDP and interest)	1	5.1	6.4
interest	3	4.3	5.2
GDP growth	-2	0.8	1.2
Others	2.6	1.9	2.9
(out of which, bank recapitalisation mechanisms)	-	1.6	4.7

Source: National Budget, 2012

Within the straitjacket of fiscal conservatism there is no space for public policies to promote growth or employment. We are left with a slow and painful process of labour devaluation that will destroy part of the economy in order to start growing again, leaving the structural causes of the crisis untouched. Thus, believing that austerity can solve Portugal's debt problems, restore its competitiveness in global markets and promote growth is simply a matter of blind faith.

Instead, employment should replace debt as the centre of economic concerns. To assure workers a reasonable and stable income is the most efficient way to promote dynamism and growth, on the one hand, and to reduce public social expenditures, on the other. It is not a simple task. However, in order to do so, countries should: 1) protect public employment in those sectors which are suffering from workforce shortages - education and healthcare services; 2) fight precarious work and promote long-term contracts in the private sector; and 3) guarantee that private enterprises can access financial resources to fuel their activity. One of the most efficient ways to channel credit into specific value-added sectors is through a state-owned bank, capable of internalising the social benefits arising from its activity.

Notwithstanding their shape, public policies will fail to succeed as growth strategies as long as countries' resources keep being absorbed by debt service, and austerity remains the only, inevitable strategy. Therefore, public debt must be restructured, and deficit targets postponed. Not only because, from an accounting point of view, this debt is not payable but also because part of it (that which results from speculation, rating agencies' abuse of a dominant market position or illegal contracts between the state and private enterprises) should not be paid, from a moral perspective. In this sense, an independent audit on Portuguese public debt would be a crucial instrument for clarifying why debt was incurred, the terms on which it was contracted and the uses to which funds were put.

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A Model in Meltdown

DANIEL FINN

For much of the past two decades, the Republic of Ireland found itself hailed as a crowning glory of neoliberalism. Between 1993 and 2000, Irish GNP grew by an average of 9% a year; unemployment – which reached a peak of 17% in the 1980s – had almost disappeared by the close of the century. A nation that had stood ignominiously on the economic sidelines during the *trente glorieuses* of its larger and richer neighbours suddenly vaulted past them all, even reaching the psychologically vital milestone of a per capita income higher than Great Britain's. Foreign journalists rushed to praise the Irish economic miracle, which could handily be attributed to its willingness to don the golden straitjacket and embrace the logic of global capitalism. Neoliberal pundits from Thomas Friedman to George Osborne urged the rest of Europe to "follow the leapin' leprechaun" down the road of low taxes, light regulation and flexible labour markets.¹ After witnessing the transformation of Ireland from basket-case to economic paragon, who could possibly deny the validity of the formula?

The EU-IMF package of December 2010 hammered the final nail in that particular coffin. With unemployment standing at 13% and GDP having registered

1. Friedman, "Following the leapin' leprechaun", *New York Times*, July 1, 2005; Osborne, "Look and learn from across the Irish Sea", *The Times* February 23, 2006.

the largest dips ever recorded –7% in 2009 alone– the Republic was then saddled with a punitive interest rate of 5.8% on a multi-billion Euro loan that will be immediately used to repay German, French and British banks. This burden stems from the Irish government's decision in September 2008 to offer an unlimited guarantee of the liabilities accumulated by its putrid banking system – and the refusal of the major European states to consider imposing a loss on “senior bondholders”, i.e. the said banks.

The terms of the deal cast an ironic light on one of the major themes of Irish political debate throughout the Celtic Tiger years. It was articulated most famously by Mary Harney –leader of the Thatcherite Progressive Democrats and veteran of the Fianna Fáil-led coalition which held office between 1997 and 2011– when she asserted that Ireland was “closer to Boston than Berlin”: more in tune with the Anglo-American economic model than with the welfarist leanings of continental Europe. Harney's trite slogan was adopted by the Irish commentariat, with the value sign reversed by those on the liberal left who assumed that the EU would represent a more humane and progressive form of capitalism. Now Boston and Berlin have come to town, marching in step, and there is little to choose between them. Indeed, the IMF has shown itself to be somewhat more enlightened than the EU, if only because it does not consider it imperative to defend the interests of European banking giants. It is a measure of the trauma that even the conservative *Irish Times* felt compelled to distance itself in sub-Yeatsian style from the country's new financial masters:

“It may seem strange to some that the *Irish Times* would ask whether this is what the men of 1916 died for: a bailout from the German chancellor with a few shillings of sympathy from the British chancellor on the side... Having obtained our political independence from Britain to be the masters of our own affairs, we have now surrendered our sovereignty to the European Commission, the European Central Bank and the International Monetary Fund”.²

ROOTS OF THE CRISIS

Explanations of this debacle can begin with the distinction between two phases of the “Celtic Tiger”. The first was driven by an unprecedented flow of investment from US multinationals into key manufacturing sectors, with exports as the main spur to economic growth. The second phase began after the US recession of 2001, with a new emphasis on construction and finance generating a property bubble with few parallels

2. “Was it for this?”, *Irish Times*, November 18, 2010.

in modern economic history. The early decades of the Republic –as of the Free State which preceded it– had been characterised by import-substitution policies, which had reached the limit of their potential by the 1950s. With Seán Lemass as Taoiseach (1959–66), the dominant Fianna Fáil party removed tariff barriers and offered enticing tax breaks to foreign capital. Accession to the European Economic Community in 1973 helped lay the foundations for the subsequent boom. Ireland became the recipient of growing waves of structural funding in the 1980s, while its big farmers reaped the benefits of the Common Agricultural Policy.

For American companies seeking profitable sites for investment in the early 1990s, the Republic could offer two key advantages: membership of the EC, which gave companies on its territory access to the new Single Market, and a special 10% rate of tax on manufacturing profits (eventually replaced by a flat corporation tax rate of 12.5%).³ The impact of this generous tax regime on the public finances was partially offset by €10 billion of EU structural funding received between 1989 and 1999, which added almost 2% to Irish GDP during the take-off decade.⁴ The US share of industrial investment in the local economy rose from 32% in 1990 to 68% in 1997. FDI was concentrated in a handful of sectors, particularly computers, pharmaceuticals and electronic engineering. Dell built its largest European factory on Irish soil, and was joined by a gaggle of IT giants. Between 1995 and 1999, multinational corporations were directly responsible for 85% of total economic growth.⁵ One result of this dependence on foreign-owned companies to power the Irish economy was a growing divergence between the figures for GDP and GNP: by the end of the decade, GNP was almost 20% lower.

The role of multinationals in the 1990s boom naturally left Ireland's economic health perilously exposed to a shift in the conditions that had made it such an attractive location for investment. There was little hope of indigenous industry picking up the slack: while multinationals exported almost 90% of their output in 2001, Irish-owned firms sold less than 40% of what they produced abroad. Unlike the original Asian Tigers, the Celtic model did not produce its own industrial champions to drive the economy forward.

3. The effective tax rate paid by companies such as Google and Microsoft on the profits of their Irish subsidiaries has often been less than 1%, reflecting the widespread exploitation of Ireland's tax regime for transfer pricing by TNCs.

4. Hegarty, D. (2003), “Framework for the evaluation of the Structural Funds in Ireland”, National Development Plan/Community Support Framework Evaluation Unit, Dublin.

5. O'Hearn, D. (2003), “Macroeconomic policy in the Celtic Tiger: a critical reassessment”, in Colin Coulter and Steve Coleman (eds.), *The End of Irish History? Critical Reflections on the Celtic Tiger*, Manchester.

The dreaded climatic shift began with the collapse of the American IT bubble. Irish manufacturing employment had grown every year from 1995 to 2001 but then started to decline, falling from 251,000 to 223,400 by 2007.⁶ Annual growth in exports, which had averaged over 17% between 1995 and 2000, struggled to reach 5% over the next five years.⁷ The expansion of the European Union eroded Ireland's tax advantage, with new member-states in the East offering more lucrative deals and much lower wages. Dell decided to close its flagship plant in Limerick and shift production to Lodz in 2008. There was no sudden end to the boom, however, despite the attrition of Ireland's manufacturing base. The banking sector now overtook industry as a provider of jobs, with 14% of the workforce in finance by 2008.

Much of this expansion was centred around the International Financial Services Centre, a satellite of the City of London in Dublin's docklands with a farcically inadequate regulatory regime, prompting British politicians to speak of "Liechtenstein on the Liffey". The banks funnelled as much capital as they could into the other pillar of the Tiger's second phase: a wildly overheated construction sector which accounted for almost 23% of GNP by 2007. The average price of a new house rose from €67,000 in 1991 to €334,000 in 2007, by which time there were 21 new units of housing being built per thousand citizens (even Spain only managed 15). Construction also became the main source of new private-sector jobs, with employment in the industry rising by 59% between 2000 and 2008.⁸

The whole set-up might have been calibrated to produce a meltdown in the event of a global crisis: Irish banks had borrowed vast sums on the international markets so they could keep on lending to property developers and allowed their capital ratios to reach unprecedented troughs. When Lehman Brothers hit the wall in September 2008, the storm broke. Brian Cowen's panicked –and deeply compromised– government offered to guarantee the full liabilities of Irish-owned financial institutions, exposing its citizens to a potential wallop several times larger than the nation's annual GDP. Soon afterwards, the Fianna Fáil-led administration moved to nationalise Anglo Irish, the third-largest bank in the state, and shore up its two main competitors with huge cash injections. Anglo Irish specialised in massive loans to a small body of customers: fifteen accumulated debts to the bank of at least €500m each. Its losses of over €12 billion for 2009 were the largest in Irish corporate history.

6. Allen, K. (2003), *Ireland's Economic Crash*, Dublin, p.162.

7. Kirby, P. (2010), *Celtic Tiger in Collapse: Explaining the Weaknesses of the Irish Model*, Basingstoke, p.35.

8. See Allen, *Ireland's Economic Crash*, p.44; Kirby, *Celtic Tiger in Collapse*, p.41. Employment in financial services rose by 43% over the same period, while industrial employment contracted by 9%.

THE WORLD'S CHEAPEST BAILOUT

Once the bank guarantee was put in place, the overriding goal of Cowen's government was to shore up the private financial system at any cost. Finance Minister Brian Lenihan initially bragged that Ireland had instituted the "cheapest bailout in the world". As the rotten foundations of Irish banking gradually came into public view, the anticipated cost of the guarantee rose exponentially: realistic estimates at present lie somewhere between €50 and €70 billion (Irish GDP in 2010 was less than €150 billion). Cowen and Lenihan spurned opportunities to terminate the 2008 guarantee, despite the fact that they had the legal option to do so on the grounds that three of the banks had withheld material information about their solvency, in direct breach of the 1971 Central Bank Act. But, as the economist Morgan Kelly noted, that would have entailed an "unpleasant showdown with the European Central Bank". Instead, "the German and French banks whose solvency is the overriding concern of the ECB get their money back", while "the senior management of the banks that caused this crisis continue to enjoy their richly earned rewards. The only difficulty is that the Government's open-ended commitment to cover the bank losses far exceeds the fiscal capacity of the Irish State".⁹

This unlimited subsidy to Irish banks and European bondholders has come at the expense of any government schemes to create or sustain employment. While economists in other countries wonder what will happen when the various financial stimuli expire, their Irish counterparts have no such worries: there never was a stimulus package to begin with. In the first two years of the crisis, €15 billion was extracted from the economy by the Fianna Fáil-led government in a series of regressive austerity budgets. The assault on the social wage has been accompanied by a shrill orthodoxy which maintains that such cuts need not bring dire consequences for those who rely on public services: there is plenty of room for trimming as Ireland was unduly lavish in its outlay during the boom years.

This consensus shows little regard for the tiresome business of gathering evidence. Even at the peak of the boom, the Republic of Ireland had little reason to boast about its social performance. It ranked second-to-bottom in the OECD league tables for poverty and inequality; only the US fared worse. Inequality increased during the period of highest economic growth, with the number of households earning below 50% of the average income rising from 18% in 1994 to 24% in 2001. Other benchmarks shifted in the opposite direction: government expenditure on social

9. Kelly, M., "If you thought the bank bailout was bad, wait until the mortgage defaults hit home", *Irish Times*, November 8, 2010.

protection as a proportion of GDP stood at 20% in 1993, but had fallen to 14% by 2000 – barely half the EU's average.¹⁰

Even the reliably orthodox OECD could not find much fat on this particular bone when it was delegated to scrutinise the Irish public service in 2008: "Ireland's real average annual growth rate in public expenditure between 1995 and 2005 was 5%, significantly slower than real GDP growth of 7.5%". Fianna Fáil policies had already decreased the total number of public-sector employees as a percentage of the labour force and the overall public-sector wage bill as a percentage of GDP.¹¹ This is the "bloated" public sector now earmarked for an indefinite period of austerity, as media outlets contrive a synthetic backlash against those employed in the public service (displaying a monomania worthy of a better cause, one columnist could think of no more wounding barb for Catholic bishops who protected child abusers than to compare their actions to "the worst sort of public-service union thinking"¹²). The vilification has been so egregious that the government's own economic advisor, Alan Ahearne, felt impelled to protest:

"Much of the rhetoric in the media about public-sector pay and reform is an attempt by some of the least well-informed commentators to distract attention from the main source of our economic woes. The mess in which the Irish economy finds itself largely stems from the house-price bubble, not from problems in the public sector. It is probably not a coincidence that some of the most vocal critics of the public sector today were among the most conspicuous cheerleaders for the housing boom".¹³

This onslaught has been renewed in the wake of the EU-IMF deal. It would be wrong to think that the new managers of the Irish economy have pushed the Dublin government down a path it would rather not tread: their suggestions have been accepted with something that closely resembles glee. Another €15 billion is to be taken out of the economy over the next three years, with €6 billion of cuts concentrated in Lenihan's December 2010 budget. The latter package, the last delivered by Lenihan while in office, comfortably exceeded the mean-spirited benchmark set by his previous offerings. At present, Lenihan's successor Michael Noonan is being urged by a range of establishment figures to exceed the ECB-IMF targets for austerity when he delivers

10. Kirby, P. (2004), "Globalization, the Celtic Tiger and Social Outcomes: is Ireland a Model or a Mirage?", *Globalizations*, December, p.216.

11. OECD Public Management Reviews, *Ireland: Towards an Integrated Public Service*, Paris 2008, pp.15-16.

12. O'Hanlon, E., "Man of cloth recast as just a jobsworth", *Sunday Independent*, March 21, 2010.

13. Quoted in Fintan O'Toole, "Popular thinking on crisis swept aside", *Irish Times*, April 13, 2010.

his 2012 package. A boom disfigured by gross inequality has given way to a slump marked by Victorian standards of social reaction. If David Cameron and Nick Clegg want a model to emulate, they will not have to look very far.

RESISTANCE OR RESIGNATION?

At the beginning of 2009, three months into the financial crisis, Brian Lenihan felt assured enough to boast: "The steps taken have impressed our partners in Europe, who are amazed at our capacity to take pain. In France, you would have riots if you tried to do this".¹⁴ The same assessment of the Irish character was made –with a rather different value judgement– by the Greek demonstrators who chanted "We are not Ireland, we will resist".¹⁵ The subsequent actions of Lenihan's government might fairly be seen as an attempt to test his claim to destruction. Yet civil unrest has thus far been minimal, and certainly insufficient to compel a shift in government policy.

The inherited frailties of the Irish left have contributed to this muted response. Ireland has never elected a left-wing government; indeed, its main social-democratic force has traditionally been smaller than many European communist parties. Although many of the factors that induced this weakness have now passed into history, it remains a debilitating legacy: there are no traditions of struggle comparable to those of Greece and Portugal to be drawn upon. The combativity of the trade-union movement has been sapped by two decades of corporatism known as "social partnership". Business leaders saw the partnership system as a convenient way of limiting wage increases at a time when unemployment was too low to supply the necessary blackmail. More valuable still was the anaesthetizing effect it had on organised labour, as the unions discarded any sense of themselves as a social movement with a distinctive and radical vision that clashed with the dominant forces in Irish society. The price paid in return was remarkably small: the Republic lacks even a weak union-recognition act and the years of "partnership" saw a steady erosion of union density in the private sector.

Now that the dole queues are doing a better job of disciplining the labour force than any national agreement could, Irish capitalism has decided to launch a frontal assault on the trade-union movement in its remaining bastions. The union hierarchy has largely resisted acknowledging this and its stop-start mobilisations, intended to

14. Lucey, A., "Europe 'amazed' at steps taken in budget: Lenihan", *Irish Times*, April 27, 2009.

15. Smith, H., "Athens protest: 'We are at war with them, as they are with us'", *Guardian*, February 10, 2010.

secure a return to the bargaining table, have been ignored by the government. Every time a march has been called, there has been a very healthy turn-out, followed by months of inactivity. The radical left, which would dearly like to organise a more sustained campaign of protest, enjoys a very limited social footprint and has proved incapable of mobilising large numbers without the support of the official trade-union leadership.

Fianna Fáil was pulverised in the 2011 general election, tumbling from 77 seats in 2007 to 20 (and from 19 to one in the nation's capital). Yet the main victors proved to be the equally conservative Fine Gael party, which went on to form a coalition with Ireland's tame social democrats that boasts a huge majority of seats and a staunch commitment to austerity. There was a discernible shift to the left in the election: Fianna Fáil's share of the first-preference vote fell by almost 25%, yet Fine Gael's increased by less than 9%. For the main opposition party – the only party other than Fianna Fáil to have ever led an Irish government – facing a decayed incumbent in the midst of the worst economic crisis in the state's history, this was a good deal less than miraculous. The rest of the missing FF votes went to Labour, Sinn Féin and others on the left, with the two conservative parties receiving their lowest ever combined share, 53.5% (in 1981 it was 82%; four years ago 68).

Had Labour been keen to break the conservative mould of Irish politics, it could have put itself at the head of a left-wing opposition bloc with over 40% of the vote and a very good chance of winning an overall majority at the next election. But its leaders preferred to take their place at the cabinet table in a government firmly anchored to the right. They face the largest ever group of TDs to Labour's left, including Sinn Féin, the United Left Alliance and left-wing independents. That parliamentary bloc will be impotent against the governing majority, however; an end to the passivity which evoked Brian Lenihan's smug benediction will be required if the crisis of Fianna Fáil is to become a crisis of conservative politics in general.

While Labour and Fine Gael attacked the terms of the agreement concluded by Fianna Fáil with Ireland's foreign creditors while on the campaign trail, the new government soon declared itself powerless to change those terms. That being so, another crisis is inevitable. The EU-IMF agreement cannot work, even on its own terms. Quite apart from the social suffering it will impose on a broad swathe of the population, its probable outcome will be to break the Irish economy altogether. The growth projections underpinning government plans lack even a semblance of plausibility. As the think-tank TASC argued in its analysis of Lenihan's December 2010 budget:

"The Department of Finance is forecasting that GDP will increase by 1.7% in 2011

and by an average of 3% per annum over the period 2012-2014. These growth numbers are predicated on exports increasing by an average of 4.6% per annum, at a time when our major trade partners are forecast to experience growth rates of less than half that amount. Given the massive debt overhang, the uncertainty in the banking sector and absence of credit that will continue to constrain the domestic economy, it is unclear on what grounds Ireland is expected to outperform other advanced economies ...If lower growth than that projected by the Department of Finance occurs, the general government deficit will still be greater than the nominal growth level in 2014, and the debt ratio will still be moving in an unsustainable direction".¹⁶

If the losses incurred by private banks were excluded from the national debt, Ireland would have a chance of stabilising its finances over the next few years. Until this step is taken, the prospects of recovery are negligible. Had they been fortunate enough to possess a modicum of courage and insight, the power-holders in Dublin would have beaten a path to Lisbon, Athens and Madrid, urging their fellow PIGS to form a bloc within the EU that could challenge the ruinous appeasement of bondholders. Instead, they have spent their time assuring their citizens that "Ireland is not Greece" – until the point was reached when the Greek prime minister felt obliged to state that "Greece is not Ireland". It is getting very late in the day for such alliances to be formed. But in their absence, the list of those hanging separately will surely extend far beyond the periphery of the Eurozone.

16. TASC, *Response to Budget 2011*, Dublin 2010, pp.3-4.

Greece: Symbol of Illegitimate Debt

ERIC TOUSSAINT

The Greek public debt made the headlines when the country's leaders accepted the austerity measures demanded by the IMF and the European Union, sparking very significant social struggles throughout 2010. But where does this Greek debt come from? As regards the debt incurred by the *private sector*, the increase has been recent: the first surge came about with the integration of Greece into the Eurozone in 2001. A second debt explosion was triggered in 2007 when financial aid granted to banks by the US Federal Reserve, European governments and the European Central Bank was recycled by bankers towards Greece and other countries like Spain and Portugal. As far as *public debt* is concerned, the increase stretches over a longer period. Borrowing since the 1990s has served to fill the void created in public finances by lower taxation on companies and high incomes. Furthermore, for decades, many loans have financed the purchasing of military equipment, mainly from France, Germany and the United States. And we should not forget the colossal debt incurred by the public authorities for the organisation of the Olympic Games in 2004. The spiralling of public debt was further fuelled by bribes from major transnationals to obtain contracts, Siemens being an emblematic example.

This is why the legitimacy and legality of Greece's debts should be the subject of rigorous scrutiny, following the example of Ecuador's comprehensive audit commission of public debts in 2007-2008. Debts defined as illegitimate, illegal or

odious¹ would be declared null and void and Greece could refuse to repay, while demanding that those who contracted these debts be brought to justice. Some encouraging signs from Greece indicate that the re-challenging of debt has become a central issue and the demand for an audit commission is gaining ground.

FACTORS PROVING THE ILLEGITIMACY OF GREECE'S PUBLIC DEBT

Greek public debt has been steadily high since the 1980's. However, we could locate certain important time periods that contributed to its amplification. Firstly, we have the Olympic Games scandal of 2004. According to Dave Zirin, when the government proudly announced to Greek citizens in 1997 that Greece would have the honour of hosting the Olympic Games seven years hence, the authorities of Athens and the International Olympic Committee planned on spending 1.3 billion dollars. A few years later, the cost had increased fourfold to 5.3 billion dollars. Just after the Games, the official cost had reached 14.2 billion dollars.² Today, according to different sources, the real cost is over 20 billion dollars.

Many contracts signed between the Greek authorities and major private foreign companies have been the subject of scandal for several years in Greece. These contracts have led to an increase in debt. Here are some examples which have made the main news in Greece:

- Several contracts were signed with the German transnational Siemens, accused - both by the German as well as the Greek courts - of having paid commissions and other bribes to various political, military and administrative Greek officials amounting to almost one billion Euros. The top executive of the firm Siemens-

1. According to Alexander Sack, who theorised the doctrine of odious debt, "If a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress the population that fights against it, etc, this debt is odious to the population of all the State. This debt is not an obligation for the nation; it is a regime's debt, a personal debt of the power that has incurred it, consequently it falls with the fall of this power" (Sack, 1927). For a concise overview, see (in French) "La dette odieuse ou la nullité de la dette", a contribution to the second seminar on International Law and Debt organised by CADTM in Amsterdam in December 2002, <http://www.cadtm.org/La-dette-odieuse-ou-la-nullite-de>. See also "Topicality of the odious debt doctrine", <http://www.cadtm.org/Topicality-of-the-odious-debt,3515> and <http://www.cadtm.org/Topicality-of-the-odious-debt>

2. Dave Zirin, "The Great Olympics Scam, Cities Should Just Say No", www.counterpunch.org/zirin07052005.html : "But for those with shorter memories, one need only look to the 2004 Summer Games in Athens, which gutted the Greek economy. In 1997 when Athens "won" the games, city leaders and the International Olympic Committee estimated a cost of 1.3 billion. When the actual detailed planning was done, the price jumped to \$5.3 billion. By the time the Games were over, Greece had spent some \$14.2 billion, pushing the country's budget deficit to record levels".

Hellas,³ who admitted to having “financed” the two main Greek political parties, fled in 2010 to Germany and the German courts rejected Greece’s demand for extradition. The scandalous contracts include the sales, made by Siemens and their international associates, of *Patriot* antimissile systems (1999, 10 million Euros in bribes), the digitalisation of the OTE - the Hellenic Telecommunications Organization - telephone centres (bribes of 100 million Euros), the “C41” security system bought on the occasion of the 2004 Olympics and which never worked, sales of equipment to the Greek railway (SEK), of the Hermes telecommunications system to the Greek army and of very expensive equipment sold to Greek hospitals.

- The scandal of German submarines (produced by HDW, later taken over by Thyssen) for a total value of 5 billion Euros, submarines which from the beginning had the defect of listing to the left (!) and which were equipped with faulty electronics. A judicial enquiry on possible charges (of corruption) against the former defence ministers is currently under way.

It is absolutely reasonable to presume that the debts incurred to clinch these deals are founded in illegitimacy, if not illegality. They must be cancelled.

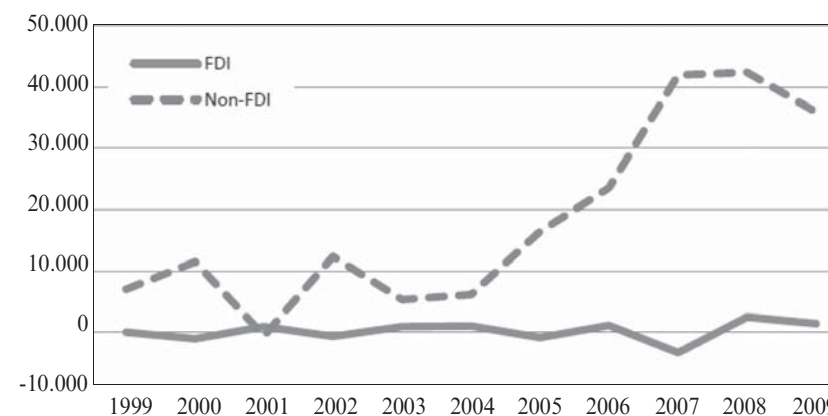
Beside the above-mentioned cases, one should also consider the recent evolution of the Greek debt.

THE RAPID RISE IN DEBT OVER THE LAST DECADE

Debt in the private sector has largely developed over the decade of the 1990s. Households, to whom the banks and the whole private commercial sector (mass distribution, the automobile and construction industries, etc.) offered very tempting conditions, went massively into debt, as did the non-financial companies and the banks which could borrow at low cost (low interest rates and higher inflation than for the most industrialised countries of the European Union like Germany, France, the Benelux countries and Great Britain). This private debt was the driving force of the Greek economy. The Greek banks (and the Greek branches of foreign banks), thanks to a strong Euro, could expand their international activities and cheaply finance their

3. See a detailed summary of the Siemens-Hellas scandal at <http://www.scribd.com/doc/14433472/Siemens-Scandal-Siemens-Hellas>. The charges made by the German courts against Siemens were so undeniable that in order to avoid a sentence in due form, the company agreed to pay a fine of 201 million Euros to the German authorities in October 2007. The scandal has tarnished Siemens’s image to such an extent that, in an attempt to redress the situation, the transnational company has conspicuously announced on its web page that it has contributed 100 million Euros to an anti-corruption fund. See: http://www.siemens.com/sustainability/en/compliance/collective_action/integrity_initiative.php

national activities. They took out loans by the dozens. The chart below shows that Greece’s accession to the Eurozone in 2001 has boosted an inflow of financial capital, which can be in the form of loans or portfolio investments (Non-FDI in the chart, i.e. inflows which do not correspond to long term investments) while the long term investments (FDI- Foreign Direct Investment) have remained stagnant.



In \$ million.
Source: IMF⁴

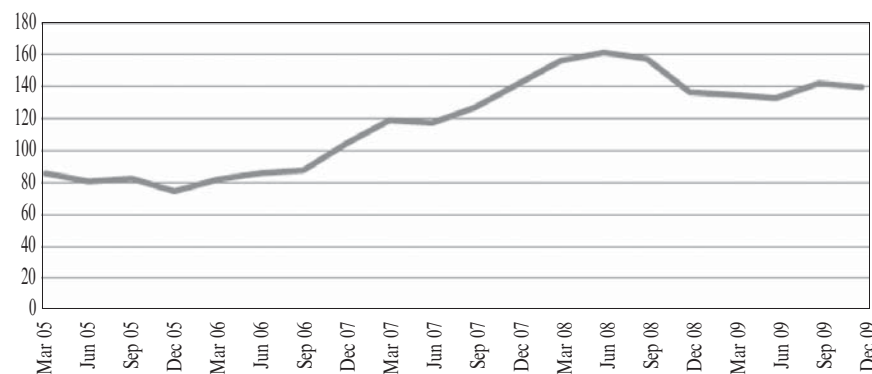
With the vast amounts of liquidity made available by the central banks in 2007-2009, the Western European banks (above all the German and French banks, but also the Belgian, Dutch, British, Luxembourg and Irish banks) lent extensively to Greece (to the private sector and to the public authorities). One must also take into account that the accession of Greece to the Euro bolstered the faith of Western European bankers who thought that the big European countries would come to their aid in case of a problem. They did not worry about Greece’s ability to repay the capital lent in the medium term. The bankers felt that they could take very high risks in Greece. History seemed to prove them right up to that point. The European Commission and,

4. Taken from C. Lapavistas, A. Kaltenbrunner, G. Lambrinidis, D. Lindo, J. Meadway, J. Michell, J.P. Paineira, E. Pires, J. Powell, A. Stenfors, N. Teles: “The eurozone between austerity and default”, September 2010. <http://www.researchonmoneyandfinance.org/media/reports/RMF-Eurozone-Austerity-and-Default.pdf>.

in particular, the French and German governments have given their unfailing support to the private banks of Western Europe. In doing so, the European governments have put their own public finances in a parlous state.

In the chart below we see that the countries of Western Europe first increased their loans to Greece between December 2005 and March 2007 (during this period, the volume of loans grew by 50%, from less than 80 billion to 120 billion dollars). After the subprime crisis started in the United States, the loans increased dramatically once again (+33%) between June 2007 and the summer of 2008 (from 120 to 160 billion dollars). Then they stayed at a very high level (about 120 billion dollars). This means that the private banks of Western Europe used the money which was lent in vast quantities and at low cost by the European Central Bank and the US Federal Reserve in order to increase their own loans to countries such as Greece.⁵ Private banks are

Evolution of Western European banks' exposure to Greece
(in billion dollars)



therefore in large part responsible for Greece's excessive debt.

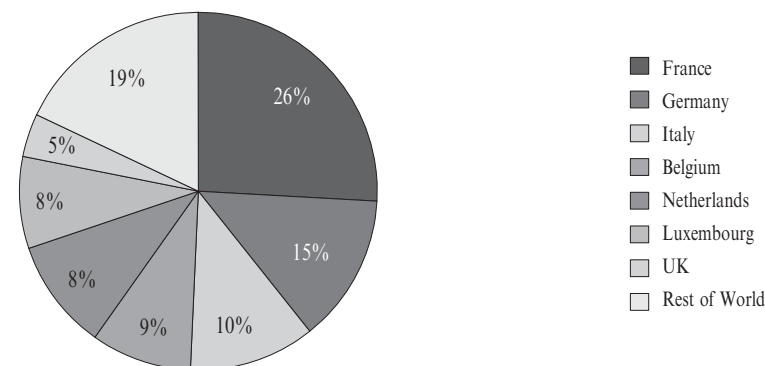
Source: BIS consolidated statistics, ultimate risk basis⁶

As shown in the chart below, Greek debts till recently were overwhelmingly held by European banks, mostly French, German, Italian, Belgian, Dutch, Luxembourg and British banks.

5. The same occurred at that time for Portugal, Spain, and countries of Central and Eastern Europe.

6. Taken from C. Lapavistas et al., op. cit.

Foreign holders (almost exclusively foreign banks and other financial companies) of Greek debt securities (end of 2008)⁷



Greek citizens have every right to expect the debt burden to be radically reduced, which means that the bankers must be forced to write off debts from their ledgers.

Now, almost every day we can read in both mainstream and alternative media (the latter being essential to develop a critical opinion) that Greece must borrow at 15% or more.

In fact, since the crisis broke out in spring 2010, Greece has borrowed on the markets for 3 months, 6 months or 1 year, no more, at interest rates ranging between 4 and 5%.⁸ Note that before speculative attacks against Greece started, it could borrow at very low rates since bankers and institutional investors (pension funds, insurance companies) were eager to lend.

For instance, on October 13, 2009, it issued three-month Treasury Bonds also called T-Bills with a very low yield of 0.35%. On the same day it issued six-month bonds at a 0.59% rate. Seven days later, on October 20, 2009, it issued one year bonds at 0.94%.⁹ This was less than six months before the Greek crisis broke out. Rating agencies had given a very high rating to Greece and the banks that were granting loans on loans. Ten months later, it had to issue six-month bonds at a 4.65% yield, i.e. at 8 times more. This denotes a fundamental change in circumstances.

Another significant element points to the banks' responsibility: In 2008 banks demanded a higher yield from Greece than in 2009. For instance, in June-July-August

7. Taken from C. Lapavistas et al., op. cit. According to the BIS in December 2009, the French banks owned 31 billion dollars of the Greek public debt, the German banks 23 billion dollars.

8. Hellenic Republic Public Debt Bulletin, n. 62, June 2011. Available at www.bankofgreece.gr

9. Hellenic Republic Public Debt Bulletin, n. 56, December 2009.

2008, before the crash produced by the Lehman Brothers bankruptcy, rates were four times higher than in October 2009. They were at their lowest (under 1%) in the fourth term of 2009.¹⁰ This may seem irrational, for a private bank is certainly not supposed to lower its interest rates in a context of major international crisis, least of all with a country such as Greece, which is prompt to borrow; but it was perfectly logical from the point of view of bankers out to maximise profits while relying on public rescue in case of trouble. After the Lehman Brothers bankruptcy, the governments of the US and European countries poured huge amounts of cash to bail out banks, restore confidence and boost economic recovery. Banks used this money to lend to countries such as Greece, Portugal, Spain and Italy, convinced as they (rightly) were that if there were any problem, the ECB and the European Commission would help them out.

It is obvious that banks literally threw capital into the arms of countries such as Greece (notably by lowering the interest rates they demanded) since they felt that the money they so generously received from public authorities had to be turned into loans to Eurozone countries. We have to bear in mind that only three years ago states appeared to be the more reliable actors while the capacity of private companies to repay their debts was questionable.

To use the concrete example mentioned above, on October 20, 2009 the Greek government sold its three-month *T-Bills* with a 0.35% yield in an attempt to raise EUR 1,500 million. Bankers and other institutional investors proposed about five times this amount, i.e. 7,040 million. Eventually the government decided to borrow 2,400 million. It is no exaggeration to say that bankers threw money at Greece.

Private banks thus bear a heavy responsibility for the crushing debts of Greece. Greek private banks also loaned huge amounts to public authorities and to the private sector. They too have a significant responsibility in the present situation. Consequently, the debts claimed from Greece by foreign and Greek banks as a result of their irresponsible policy should be considered illegitimate.

THE SECOND-HAND PRICE OF THE TEN-YEAR BONDS ISSUED BY GREECE

The following table should help us understand what is meant by saying that the Greek rate for ten years amounts to 14.86%. Let us take an example: A bank bought Greek bonds in March 2010 for € 500 million, with each bond representing 1,000 Euros. The

10. Bank of Greece, Economic Research Department –Secretariat, Statistics Department–Secretariat, Bulletin of Conjunctural Indicators, Number 124, October 2009. Available at www.bankof-greece.gr.

bank will cash € 62.5 each year (i.e. 6.25% of €1,000) for each bond. In security-market lingo, a bond will yield a € 62.5 coupon. In 2011 those bonds are regarded as risky since it is by no means certain that by 2020 Greece will be able to repay the borrowed capital. So the banks that have many Greek bonds, such as BNP Paribas (that still had € 5 billion in July 2011), Dexia (3.5 billion), Commerzbank (3 billion), Generali (3 billion), Société Générale (2.7 billion), Royal Bank of Scotland, Allianz or Greek banks, now sell their bonds on the secondary market because they have junk or toxic bonds in their balance sheets. In order to reassure their shareholders (and to prevent them from selling their shares), their clients (and to prevent them from withdrawing their savings) and European authorities, they must get rid of as many Greek bonds as they can, after having gobbled them up until March 2010. What price can they sell them for? This is where the 14.86% rate plays a part. Hedge funds and other vulture funds that are ready to buy Greek bonds issued in March 2010 want a yield of 14.86%. If they buy bonds that yield € 62.5, this amount must represent 14.86% of the purchasing price, so the bonds are sold for only € 420.50.

	Nominal value of a 10-year bond issued by Greece on March 11, 2010	Interest rate on March 11, 2010	Value of the coupon paid each year to the owner of a €1,000 bond	Price of the bond on the secondary market on August 8, 2011	Actual yield on August 8, 2011 if the buyer bought a € 1,000 bond for € 420.50
Example	€ 1,000	6,25%	€ 62,5	€ 420,50	14,86%

To sum up: buyers will not pay more than EUR 420.50 for a EUR 1,000 bond if they want to receive an actual interest rate of 14.86%. As you can imagine, bankers are not too willing to sell at such a loss.

As they tried to minimise the risks they took, French banks reduced their Greek exposure by 44% (from USD 27 billion to USD 15 billion) in 2010. German banks proceeded similarly: Their direct exposure decreased by 60% between May 2010 and February 2011 (from € 16 to € 10 billion). In 2011 this withdrawal movement has become even more noticeable.

THE ODIUS ATTITUDE OF THE EUROPEAN COMMISSION

After the crisis broke, the military-industrial lobby supported by the German and French governments and the European Commission saw to it that hardly a dent was made in the defence budget, while at the same time the PASOK (Socialist Party) government set about trimming social spending (see the box on austerity measures

below). Yet at the beginning of 2010, at the height of the Greek crisis, Recep Tayyip Erdoğan, Prime Minister of Turkey, a country which has a tense relationship with its Greek neighbour, visited Athens and proposed a 20% cut in the military budget of both countries. The Greek government failed to grab the line thrown to them. They were under pressure from the French and German authorities who were anxious to safeguard their weapons exports. In proportion to the size of its economy, Greece spends far more on armaments than the other EU countries. Greek military spending represents 4% of its GDP, as compared to 2.4% for France, 2.7% for the United Kingdom, 2.0% for Portugal, 1.4% for Germany, 1.3% for Spain, and 1.1% for Belgium.¹¹ In 2010, Greece bought six frigates (2.5 billion Euros) and armed helicopters (400 million Euros) from France. From Germany it bought six submarines for 5 billion Euros. Between 2005 and 2009, Greece was one of Europe's five largest weapons importers. The purchase of fighter aircraft alone accounted for 38% of its import volume, with, for instance, the purchase of sixteen F-16 (from the United States) and twenty-five Mirage 2000 (from France) – the latter contract amounting to 1.6 billion Euros. The list of French equipment sold to Greece goes on: armoured vehicles (70 VBL), NH90 helicopters, MICA, Exocet and Scalp missiles as well as Sperwer drones. Greece's purchases have made it the third biggest client of the French military industry over the past decade.¹²

From 2010, increasingly high interest rates charged by bankers and other players in the financial markets, supported by the European Commission and the IMF, have triggered the usual "snowball effect": The Greek debt has followed an upward trend as the country's authorities take out loans in order to repay interest (and part of the previously borrowed capital). The loans granted starting in 2010 to Greece by EU member countries and the IMF will not serve the interests of the Greek people - quite the opposite. The austerity measures implemented entail numerous infringements of the population's social rights. On these grounds,¹³ the

11. 2009 figures. Among the NATO members, only the United States spends more than Greece (4.7%) in proportion to its GDP.

12. Some of the data cited is taken from François Chesnais, "Répudiation des dettes publiques européennes!" in *Revue Contretemps* n. 7, 2010, which is itself based on the data of the Stockholm International Peace Research Institute (SIPRI), www.sipri.org/yearbook.

13. At least one argument can be added for declaring this new debt illegitimate or void, and it goes as follows: for a contract between two parties to be valid, according to Common Law, the principle of contractual autonomy, of the voluntary consent of both parties, must be fully respected, meaning that each party to the contract must be in a position to say no or refuse any clauses of the contract which go against its interests. When in March-April 2010 the financial markets started to blackmail Greece and when then the European Commission and the IMF united to impose draconian conditions on Greece

notion of "odious debt" should be applied and its repayment contested.

What the members of the Troika are doing can be compared to the odious behaviour of someone who, while claiming to help a person in a difficult predicament, actually worsens that condition and benefits from it. We can also see that it has been a criminal act planned collectively by the IMF, the ECB, the EC, and the governments that are supporting their action. Associating in order to plan and carry out a criminal act increases the responsibility of the aggressors.

There is more: The economic policies enforced by the Troika will not allow the affected countries to improve their situation. For three decades this kind of damaging policy has been implemented on behalf of large private companies, the IMF and the governments of industrialised countries, in indebted countries of the South and in a number of countries of the former Soviet bloc. The countries that complied most cooperatively have had to face terrible times. Those that refused the diktats of international bodies and their neoliberal doctrines have fared much better. This has to be recalled and insisted on, for we have to make it known that the results of the policies demanded by the Troika and institutional investors were foreseen. Neither today nor tomorrow will they ever have the right to claim they did not know what their policies would result in. We can already see what is happening in Greece.

THE DEMAND FOR AN AUDIT IS GATHERING MOMENTUM

In December 2010, the creation of a Parliamentary Commission was proposed in order to audit the Greek public debt. This proposal attracted a great deal of attention.¹⁴ Sophia Sakorafa, who was a member of the government party PASOK until a few months ago, voted against the 2011 budget¹⁵ partly because of the heavy debt repayments. When justifying her brave position, she extensively referred to the audit carried out in Ecuador in 2007-2008 which resulted in a significant reduction of the country's debt. She proposed that Greece should follow the Ecuadorian example and asserted that there was an alternative to submitting to creditors, whether IMF or bankers. In making her case she emphasised the "odious debt" that should not be repaid. Her stance was widely covered by the media. Again in the Greek parliament, the leader of Synaspismos (one of the radical left parties) Alexis Tsipras also asked for an audit commission to be set up "so that we know which part of the debt is odious,

(very harsh austerity measures that infringe on social and economic rights), we can see that Greece was not really in a position to exert its autonomy and refuse them.

14. See <http://tvxs.gr/node/73861/450287>.

15. <http://www.hri.org/news/greek/eraen/last/10-12-22.eraen.html>.

INFRINGEMENT OF SOCIAL RIGHTS AND NEOLIBERAL MEASURES IMPLEMENTED IN GREECE SINCE 2010

Reduction of public sector wages by 20 to 30 %; cuts in nominal wages that could reach 20%; 13th- and 14th-month salaries replaced by an annual lump sum, the amount of which varies according to wages; a freeze on wages over the next 3 years; in the public sector, 4 out of 5 workers who retire will not be replaced; in the private sector, massive wage cuts up to 25%.

Unemployment benefits have been cut, and a poverty support scheme implemented in 2009 has been suspended; drastic cuts in benefits for large families.

Plans to end collective bargaining and impose individualised contracts instead; the existing practice of extended very low-paid or even unpaid internships has been legalised; resorting to temporary workers is now permitted in the public sector.

EMPLOYMENT

Drastic cuts in subsidies to municipalities, leading to mass lay-offs of workers; sacking of 10,000 workers under fixed term contracts in the public sector; public companies showing a loss to be closed down.

TAXES

Increase in indirect taxation (VAT raised from 19% to 23% and special taxes on fuels, alcohol and tobacco introduced); increase from 11% to 13% of the lower VAT rate (this concerns staple goods, electricity, water, etc.); increased income tax for the middle brackets, but reduced corporate tax.

PRIVATISATIONS

Intention to privatise the ports, airports, railways, water and electricity supply, the financial sector and the lands owned by the state.

PENSION SCHEMES

Pensions are to be cut and then frozen; the legal retirement age has been increased, the number of years of contributions required in order to be entitled to full pension benefits will be set at 40 in 2015, up from 37, and the pension amount will be calculated on the average wages of the total working years and no longer on the last pay; for retired workers in the private sectors, the 13th- and 14th-month pension payments have been abolished. Spending related to pension has been capped to a maximum level of 2.5% of GDP.

PUBLIC TRANSPORT FARES

Price of all public transport fares increased by 30%.

illegitimate and illegal". Greek public opinion is changing and the media are watching.

On December 5, 2010, a leading Greek daily published an op-ed by the Greek economist Costas Lapavistas entitled: "International Audit Commission on the Greek Debt: an Imperative Request". In his conclusion, the author writes: "The international commission will have a privileged scope of activity in our country. You only need to think about the debt agreements made with Goldman Sachs's mediation or intended to finance the purchase of weapons to see how badly an independent audit is needed. If they are proved to be odious or illegal, these debts will thus be declared null and our country could refuse to repay them, while taking the people who incurred them to court".

On March 3, 2011, economists, activists, academics and parliamentarians from across the world supported a call to audit Greece's public debts. The call demands the establishment of a public commission to examine the legality and legitimacy of debts with a view to dealing with them as well holding those responsible for unjust debts to account. There is widespread anger in Greece because debt has ballooned since the crisis of 2007-9. There is also a belief that the debt is unsustainable and that austerity measures are forcing the poorest in society to pay for the economic problems caused by the crisis. The Greek campaign for a public audit has obvious significance for Ireland, Portugal, and Spain, and could lead to broader European action against debt. Trade unions, several political parties and many intellectuals support this proposal as a means of finding a solution to debt through cancellation on the one hand, and penalisation of companies and people responsible for this illegitimate debt, on the other. It should be noted that a Greek anti-debt committee was set up in 2010.¹⁶ These elements are encouraging. 2011 could mark the start of a welcome change in terms of the Left's ability to devise solutions to resist the diktat of creditors.

16. See its website <http://www.contra-xreos.gr/>. This committee joined the CADTM international network in December 2010.

Foreign Debt and the Role of the IMF and the EU The case of Hungary

TAMAS MORVA

There is a close relationship between the IMF, World Bank and EU membership of Hungary and the history of the country's indebtedness during the last thirty years, including the transition from a socialist to a capitalist country. This connection emerged at the end of the 1970s and in the 1980s following the second oil price shock that doubled oil prices in 1979-1980. Due to its great energy dependence and previous indebtedness, the Hungarian economy approached the brink in 1981. To avoid bankruptcy the idea of joining the World Bank and IMF was raised at the highest decision-making level.

Before the decision, János Kádár, First Secretary of the Hungarian Socialist Workers' Party, sought the opinion of responsible Soviet authorities. At the time, the Soviet Union was no longer in a situation to help with cheaper oil or hard currency, but it did not agree with our plan, although its officials made it clear that the decision rested with the Hungarian government. They explained that the Soviet Union is not a member of the IMF, which they did not join on fundamental principles as well as for practical reasons. Despite this advice, under the pressure of circumstances reform economists convinced Kádár that the best solution would be to join, which is what happened in May 1982. Hungary received a warm verbal welcome, and a period of

grace was initiated, during which the country received IMF stand-by arrangements and a number of helpful WB loans that kept the country afloat.

The main IMF arrangements and WB loans of the period from 1982 to 1998 are enumerated in Table 1 (next page). As the table shows, in 1982 and 1984 Hungary received strong support from the IMF and –not included in the list– a number of WB loans that fitted with our national plans. During this period the WB was the country's main negotiating partner. This assistance helped Hungary overcome economic difficulties for a while. However, due to the evolution of old and new economic problems and to mistakes in planning, financing difficulties returned on a higher level in 1987. The IMF used this occasion to raise political and tough economic conditions as a precondition of further financing. The government of the time yielded to the demand and with a number of organisational measures started the direct transformation of the socialist planned economy into a capitalist market economy. The IMF and WB pushed for the system change supported by new arrangements and WB Structural Adjustment Loans characteristic of those ten years.

IMF and World Bank recommended policies amounted essentially to an adoption of neoliberal theory: governments were to cease direct state economic intervention and open the way for private markets to distribute economic resources efficiently. This way dynamic economic growth would commence, from which all people in society would gain. In the spirit of the "Washington Consensus" the IMF and World Bank recommended measures of decentralisation, deregulation, liberalisation and privatisation.

In Hungary *decentralisation* started by removing credit and commercial bank functions from the Hungarian National Bank and establishing a state-owned two-level banking system. Later, this change opened the way for the privatisation of credit and commercial banks. Taxation was another field of systemic change by introducing the categories of gross and net wages and income taxes to be paid also by workers and employees. State-owned enterprises in industry were reorganised as independent share companies and supervising industrial ministries were closed down.

Deregulation mainly meant the abolition of the national planning system and elaboration and stepwise introduction of a juridical regulation of the market economy. Central planning has been substituted by forecasting; the National Planning Office was closed by the end of 1989.

Privatisation of state property was implemented in three waves; the first (1988) made it possible to establish private enterprises and opened the phase of the so-called spontaneous privatisation that opened the way for high level managers of state enterprises to become owners. The second (1991) was initiated by the establishment of

TABLE 1

List of IMF and World Bank agreements	
May 1982	To keep solvent Hungary joins the IMF and World Bank
December 1982	IMF stand-by arrangement SDR 475 million
1983	The first World Bank loan (corn programme, USD 130.4 million)
January 1984	IMF stand-by arrangement SDR 425 million
May 1988	IMF stand-by arrangement SDR 265 million
July 1988	World Bank: Industrial Structural Adjustment Loan, (ISAL) (USD 200 million)
March 1990	IMF stand-by arrangement SDR 159 million
June 1990	World Bank: Structural Adjustment Loan (SAL) (USD 200 million)
February 1991	IMF extended arrangement SDR 1114 million
April 1991	World Bank: Human Resources Development Program (USD 150 million)
July 1991	World Bank: Second Structural Adjustment Loan (SAL II.) (USD 250 million)
April 1992	World Bank: Enterprise Reform Loan (ERL) (USD 200 million)
September 1993	IMF stand-by arrangement SDR 340 million
1994	IMF suspends the call in of outstanding tranches of the arrangement
March 1995	Stabilisation package (see Table 3.)
1996	IMF stand-by arrangement; Hungary doesn't call in the loan World Bank: Enterprise and Financial Sector Adjustment Loan (EFSAL) (USD 225 million)
January 1998	World Bank: Public Sector Reform Loan (PSAL) (USD 150 million)
March 1998	World Bank: Higher Education Reform Program (DEM 263.6 million)
Finally, the country received 40 World Bank loans in a total value of 3.4 billion USD.	

Source: Structural Adjustment Participatory Review Initiative (SAPRI), Hungarian National Steering Committee, April 2001.

the State Property Agency that better organised the process. Large industrial enterprises were sold individually mainly to foreign companies, while retail shops and restaurants were auctioned off and bought mainly by the former managers. The final stage (1995) was the selling off of credit and investment banks and insurance companies with a view to increasing hard currency income and improve the current account.

The economic logic would assume that *liberalisation* would remain after domestic changes helped new organisations, leaders and workers learn new rules and accommodate to the new conditions. However, it is the opposite that occurred. One of the first and strongest demands was to open the economy to foreign products and capital, a demand that was satisfied simultaneously with privatisation in the period of 1989-1993.

Rapid and forced privatisation and liberalisation ruined the food industry first;

foreign capital bought factories, laid off workers and then shut the gates. Large traditional steel and engineering companies (such as the Ganz factories) met a similar fate. In traditional heavy industrial centres in the northern part of the country production ceased. Production in some other enterprises (like Tungsram that became a subsidiary of General Electric, and some chemical and pharmaceutical enterprises) continued and innovations were adopted, but the number of the workforce decreased. The bus industry that produced more than 10 thousand units per year lost its main markets (the Soviet Union and the GDR) and after a few years had to close. The textile industry has been wholly eliminated.

In agriculture, a system of indemnification of previous landowners or their children took place, and its cost was paid by a state fund. The high-level state farms and nearly all production cooperatives ceased to exist. A large part of their wealth, cattle and machinery was carried away, buildings taken over or ruined.

In these years of transition accumulated national property was sold against income and a large part simply given over to destruction. The total loss of national wealth can be compared only with figures from the Second World War.

However, relationships with the IMF were not unclouded. At the end of 1993 and the beginning of 1994, the IMF was not satisfied with the speed of execution of agreed-on measures and suspended the call in of outstanding tranches of the 1993 stand-by arrangement; a break in relations nearly occurred. In the national elections of that year the Socialist Party won and a socialist-liberal government substituted the conservatives. The new government after a few months of hesitation responded positively to the demand of the IMF and elaborated and implemented a radical restrictive programme.

The 1995 Stabilisation Package is typical of neoliberal measures taken in order to restore international confidence (see box "The Stabilisation Package of 1995"). The energetic implementation of the programme achieved its objective, re-established the relations with the IMF and improved the country's image with financial markets, but caused the deterioration of the government's domestic prestige. The Socialist and mainly the Liberal Party's support fell and they lost the elections. In 1997 the need for IMF assistance and direct contacts stopped, while the financial assistance of the World Bank decreased. There was a general belief that Hungary would not need IMF contributions in the future. However, the IMF returned to Hungary in 2008 again. At the same time, preparation for entry into the European Union accelerated.

THE STABILISATION PACKAGE OF 1995

In response to the deterioration of the current account, the finance minister elaborated a strict stabilisation programme in the spirit of IMF requirements. The package was presented at the government's March 12, 1995 meeting; two Socialist ministers resigned, but the government adopted the programme. The Ministry of Finance predicted that these measures would reduce the budget deficit by 170 billion forints.

The government decision subordinated all policies (fiscal, monetary, trade and social policy) to the aim of re-establishing short-term equilibrium.

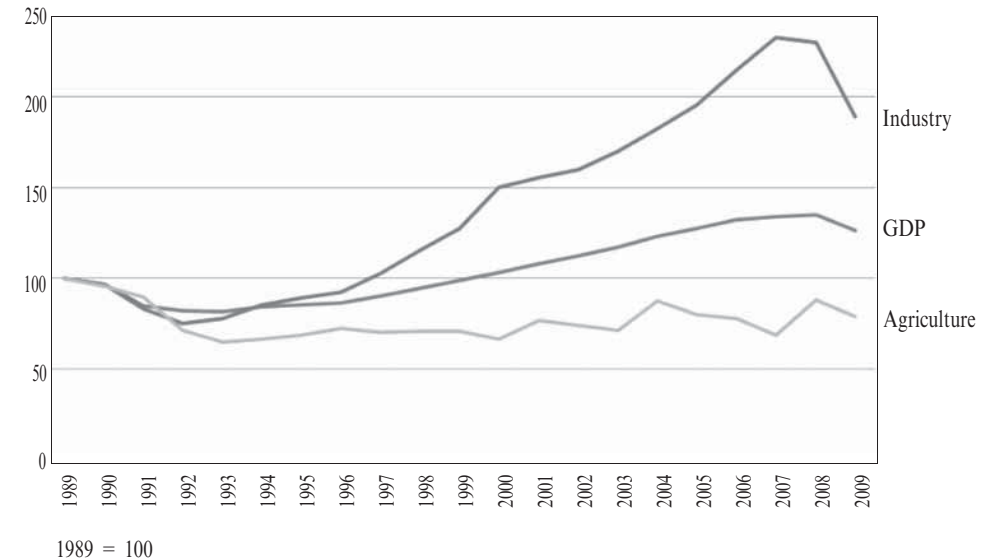
- The currency (forint) was devaluated by 9% and a system of crawling devaluation was introduced.
- As a temporary measure (valid until 1997) an 8% surplus import duty was imposed on all products except energy.
- Salaries were frozen in state enterprises and budget institutions and the payment of a large proportion of sick pay was displaced on to employers.
- Zero rates of PIT and VAT ceased, and tax allowances of families with two or more children were abolished.
- Tuition fees were introduced in higher education.
- The system of social provisions was transformed; the general right to family allowances, child care benefit and child support and pregnancy assistance was made dependent on the social situation of families.

Source: Structural Adjustment Participatory Review Initiative (SAPRI), Hungarian National Steering Committee, April 2001.

IMPACT ON ECONOMIC GROWTH

At first, the impact of the system change on the economic development was a big drop in output and income figures. The annual change of GDP, industrial and agricultural output and its tendencies during the last two decades are shown in Figure 1. Real growth in the industry improved in 1996 and 1997 as foreign investments grew and some large green field investments were initiated; industry gradually became the engine of growth again. Within industry the main sector is actually the car industry, which is all foreign owned (Audi, General Motors, Suzuki, recently Mercedes), and strongly dependent on foreign managing, investments and markets.

FIGURE 1



Source of data: Central Statistical Office, Yearbooks.

In the period from 1990 to 1994 the number of employed declined by nearly 30%, from 5.3 to 3.8 million and rose only in 2006 to 3.93 million; after this, the crisis caused a further decline that pushed the figures below 3.8 million.

Agriculture contributed to the decline of GDP and the low level of employment too. Agriculture was hit by the system change to a greater extent and in a more lasting way than industry. At the lowest point, in 1993, agricultural output was 35% lower than before and could never return to its previous level. One important reason for this bad performance was the breaking down of the traditional balance between plant cultivation and animal husbandry; livestock and output fell to one third of its previous level. After entering the EU, the Common Agricultural Policy (CAP) contributed to maintaining the gap and was effective only in increasing crops. In Hungary, which was the agricultural and food supplier and store of the Austro-Hungarian Monarchy, domestic production cannot now meet the total demand for meat and milk and must import some of these staples.

Beside industry and agriculture, an upswing of commerce, the financial sector and other services (that are not shown in the graph) explain the development of GDP during the twenty years. In 2008 the GDP was 35% higher than in 1989, but under the shock of the crisis fell to 27%. If we take the average annual growth rate of the twenty

years, it is only 1.2% against the 5.2% of the 1960s and 5.1 percent during the 1970s. Also relevant to the performance of the transitional and market-economy period is the fact that the country's indebtedness did not decline; on the contrary, it increased to a great extent.

INCREASE OF FOREIGN DEBT: 1990 - 2009

The first part of this paper has demonstrated the very important economic and political role played by indebtedness in joining the IMF and WB. Thus it is relevant to ask the question of whether it was worth enacting these changes in order to solve the debt problem. The answer is contained in Table 2.

TABLE 2

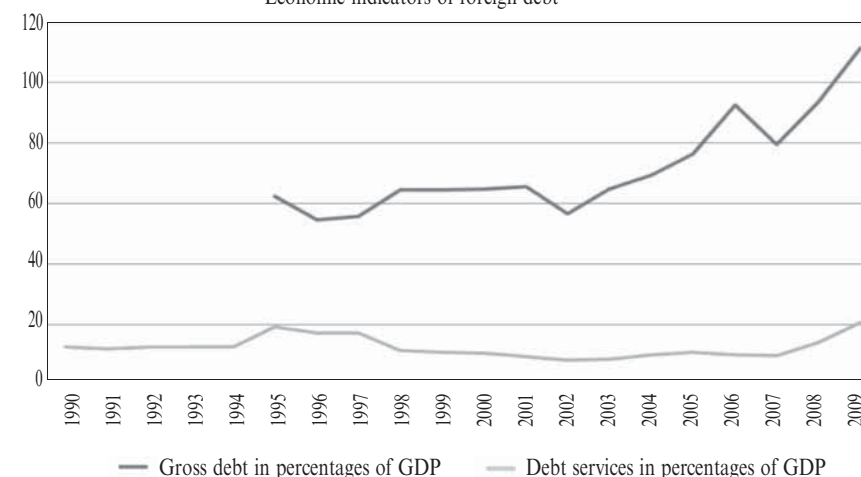
	1990	1995	2000	2007	2009
Gross foreign debt USD million 1990 = 100	21270	31449 147.9			
Gross foreign debt € million 1995 = 100		37934 86.6	32868	10016 264.1	
Changed methodology 2007 = 100 1995 = 100				80380 128.7 339.9	103409 128.7 339.9

Source of data: Central Statistical Office, Yearbooks.

Some technical remarks are needed to explain the table's structure. Current account and debt figures were accounted and published in US dollar figures until 1996. Later, the debt was converted and recalculated in Euros beginning with 1990 as a base year. The recalculation depends on two different factors: on the currency composition of the Hungarian debt figures and also on changes in the €/USD exchange rate. Therefore, the further we go back into the past, the farther we move away from the original accountancy figures. I choose the 1995 data to switch to the Euro data series in order to have the best and longest possible time series for demonstration purposes.

The data also include another statistical problem that is clear from the break in the data in 2007, when annual statistics originally published the data based on one construction, and starting in the next year switched to another methodology, and for this transition we have two figures for the debt of 2007. An explanation is given in the box "The concept of state debt". At any rate, the tendency to a large increase is clear, as demonstrated in Figure 2, which presents two qualitative indices.

FIGURE 2
Economic indicators of foreign debt



Source of data: Central Statistical Office, Yearbooks.

The line on top in Figure 2 is an index of the interrelationship between economic growth as expressed by GDP and the change of foreign debt; the index signals the sustainability of growth in the future. According to the Maastricht criteria foreign debt can reach up to 60% of GDP but not beyond that, for purposes of stability of the Euro. Therefore, it consists an object of steady examination and possible intervention by the EU. An overrun might cause the imposition of austerity measures and in some cases of financial punishment. Its evolution is also carefully examined when a member state enters the Eurozone and replaces the national currency with the Euro. In the case of Hungary the index number was within the limit only between 1996-1997 and 2002 while from 2002 on we witness a rapid increase. The explanation for the break in 2007 was a new austerity package, but during the following years the trend continued and the index reached a value of 111.5% in 2009.

The lower line in Figure 2 expresses the percentage of GDP that is paid for the service of debt in a given year. This part of the GDP cannot be used for investments and consumption. The heritage of the past was already 12.7%. Only in four years (2001-2003 and 2007), of the twenty years considered here, was the value below 10 %, and in 2009 it was already 20.8%, while the danger for a further increase due to ever newer needs for credit remains. One fifth of GDP would be a rather good rate of accumulation, but this amount does not belong to the country any more and thus it

THE CONCEPT OF STATE DEBT

State debt is not a clear concept; ambiguities crop up when there is a shift from a socialist to a capitalist state as in the case of Hungary. Under socialism, as basic means of production are nationalised and the state controls all foreign financial activities it is clear that an annual state debt covers all foreign debts. The concept is supported also by taking the whole financial system as a totality, crediting by a national bank and state budget are harmonised and foreign currency management is centralised in the national bank. Privatisation broke down this unified regulation not only through the creation of private firms having the right to deal on foreign markets and in foreign currencies directly, but also by separating the activities of the national bank and the state budget, to which the EU added a prohibition on direct bank financing of the state budget and the subordination of national banks to the ECB.

Actually, the Central Statistical Office of Hungary uses the term foreign debt (meaning total national debt) and subdivides it into two parts: state and private, but the latter covers only those items for which the state has a certain responsibility. A study by two staff members¹ of the National Bank published in 2006 calls attention to the fact that depending on the concept used very important differences arise in the figures. An undisputable basis is the debt of the central and local government budgets and social funds (e.g. pension fund, health fund). An open question is whether the debt of big state-owned enterprises, such as Hungarian Television and Hungarian Radio, or, to go further, of state enterprises such as the Hungarian State Railways or Metropolitan Transport of Budapest, has to be included and, if so, which part of their debts? There are also state obligations in large investments – is this debt a part of the state debt? The authors also refer to the time dimension of the problem, for in preparing projections of debt services known but not yet fixed or numerically defined items are usually omitted.

These problems cause statistical difficulties. However, the primary aspect is the uncertainty of the figures that are important subjects of decision-making on a national level and in negotiations with the EU and the IMF.

represents a high level of foreign exploitation. It indicates credit slavery without any perspective for emancipation by legal means.

Entering the EU in 2004 did not change the long-term trend of high-level

1. Czeti Tamás-Hoffmann Mihály, *Dynamic of the Hungarian State Debt: Analyses and Simulations*, January, 2006. Publication series of the Hungarian National Bank, n. 50.

indebtedness, and the world crisis dragged the country into previously unknown depths.

THE ROLE OF THE EU AND THE RETURN TO THE IMF

Long preparatory years preceding the 2004 entry into the EU were needed for harmonising laws and rules. That was a period of upswing in industrial output. The contribution of EU accession to better growth was marginal, because the Hungarian economy was already integrated into the EU during and after the system change. The economy has exhibited some bad signs in 2006 and domestic and foreign investment contracted. The world and EU economic crisis hit the Hungarian economy much more strongly than in the developed member states.

In November 2008 the financial situation again turned critical, and the government asked support from the EU. The EU leadership, in first place Germany, rejected the country's demand. At the moment, the German position was that each country should solve on its own the problems brought by the crisis. However, German government and EU leaders assisted in finding a financial solution elaborated by the IMF, a new package of short term financing against further cuts in the national budget. So the country had to return to the well-known measures demanded by the IMF.

The Hungarian government's declaration of intent defined the following aims: to reduce the budget deficit mainly by cutting expenditures, to recapitalise the banks and maintain liquidity on domestic financial markets, and to strengthen the confidence of foreign financial agents. The country got a stand-by arrangement from the IMF of 12.3 billion Euros for 17 months, which was supplemented with 6 billion Euros from the EU and 1 billion from the World Bank. The credit could be drawn in six parts; the use of the money has been controlled by IMF at regular intervals. The government implemented the promised measures, decreased government spending, which meant cuts in central and local administration, health and education and generally in social expenditures. It put a stop on wage increases, eliminated the 13th month of wages and salaries and increased water, electricity and gas prices. After the fifth instalment of the credit line, the IMF supervisors expressed a positive evaluation, and the government's view was that there was no need to use the final instalment.

In April 2010 the national elections, and later in October the local elections, were held under such circumstances. The population expressed its deep discontent with the Socialists, and the Liberal Party dissolved itself; participation was low, a national-conservative party named Young Democrats, FIDESZ, supported by its close ally KDNP (a Christian-conservative party), won the elections winning more than two-

thirds of the seats in parliament, which by Hungarian law automatically entitled the parliament even to change the constitution. The head of FIDESZ, the new prime minister, made unrestrained use of all the possibilities that opened up. The first major step was to get full control over the media. Then began the preparation of a new constitution that pulls back the country into the Middle Ages. The ideological leading principle is Christianity, with historical churches, first of all of the Catholic Church, receiving big financial support and their role in education hugely increased. The constitution declares families' responsibility for children and the elderly, which means in the practice that the government intends to eliminate the existing social system and drastically decrease social expenditures. Work is declared to be a duty and unemployment is regarded as a defect of the unemployed. Work camps are being organised as a task of the Ministry of Interior, and the unemployed have to accept work in or away from their home village under threat of losing all social support. The administration of social problems will be shifted from the local to a higher level, making it more difficult to deliver services precisely for those who need them. All social expenses are to be controlled by a newly established office in the future. The new constitution received much criticism; the European Parliament has already dealt twice with the case of the Hungarian government, since many of its new concepts, instruments and rules are in full contradiction with European law, but there was no positive reaction from the Hungarian government. The parliament approved the constitution in April 2011.

Concerning the debt problem the FIDESZ government first had the position of keeping EU rules while ceasing future contact with the IMF, but this initiative was rejected by the EU which insisted that the solution of debt problems is possible only in cooperation with the IMF. Later the government declared its intention to keep budget deficit in 2010 below the 3.8% level set and in 2011 below 3.0% (the Maastricht criterion). To keep the annual limit the government followed its strongly criticised predecessor's policy and made further cuts in budget expenditures. However, factual data show a 4.1% deficit in the annual budget of 2010. Further steps within the austerity policy are envisaged in the government's stabilisation programme and beyond this.

CLOSING REMARKS

After the system change a dual economy developed in Hungary with a small and weak domestic sector and a strong, broad foreign-owned or mixed sector. Large and modernised industrial corporations, commercial and investment banking, insurance

institutions and the dominant part of commerce form the dynamic foreign and mixed sector with high export and labour productivity and low employment level. A large number of small and medium-size private enterprises were established after the system change, but their number is gradually decreasing and –though support for them is often declared in political programmes and speeches– most of them have to fight for survival on a daily basis.

The IMF and the World Bank – with the partial exception of the first two to three years – helped only in eliminating socialist institutions and opening the market for foreign products and capital. On the ruins of the socialist sector of the economy a capital inflow into the country began, which after a few years began to pay for the owners. A large part of produced profits flows out of the country either in an open way or as an internal turnover between the mother corporations and their Hungarian affiliated firms. The strongly undervalued foreign exchange rate (more than 55% over the currencies' domestic purchasing power) is also a large source of the loss of produced national income. These factors add to the burden of the country's working people though in a less visible form than the official debt service.

The story of Hungary is typical for most countries in Eastern Europe, though with significant national differences in each case. Increasing indebtedness and the related problems of Greece, Portugal and Spain show many similarities, and since the crisis the economic difficulties of developed countries have grown too; unemployment, wage and social cuts are spreading throughout all Europe. Austerity policies are often interpreted as the only solutions for debt problems, and defending the interests of banks and currencies as being the path to well-being for everybody. The case of Hungary contradicts this conception. A better knowledge of historical experiences and consideration of existing inter-regional and national differences are necessary for developing cooperation and solidarity between all kinds of movements that are fighting for another solution throughout Europe.

A Radical Solution Only Through a Common Left European Strategy

YIANNIS DRAGASAKIS

In the Europe of financial capitalism and neoliberalism, a new Pact is now being discussed that would police wages and leave the insatiable markets uncontrolled.

Instead of a credible and humane exit from the crisis, European leaders are laying the ground work for even harsher crises in the future.

In Greece, where the Memorandum policies' bankruptcy is total and non-negotiable, the cry for a change of direction has become universal.

A SYSTEMIC CHOICE

In this conjuncture, dense as it is in developments, it becomes increasingly evident that the problem of public and private indebtedness is not an isolated phenomenon, but an expression of the current capitalist crisis. Despite the cross-country differences, private and public debt emerges gradually and more intensively as a world issue. In most of the advanced economies, including Greece, this is a major social, economic, but primarily political, problem. It is the outcome of very concrete policies rooted in long-term unequal income distribution and in the structural problems of the real economy. The limitless recourse of nations, banks and households to borrowing

represented a conscious choice within the prevailing neoliberal framework, which aimed at ensuring easy profits –mainly, but not only– for the banks, temporarily camouflaging social inequalities and amplifying the cyclical capitalist crises, through a credit-led growth model, which resulted to the accumulation of incremental debts. The current predicament can thus not be blamed on a mistake; rather it is the result of a systemic choice.

This is so especially in Greece, where for years total borrowing was increasing at much higher rates than those of GDP growth, while the Greek governments were borrowing and the banks were persistently providing credit. As Mr Junker, the President of EuroGroup admitted, the driving engine for this credit recycling was the large profits yielded for foreign and domestic interests, especially those relying on domestic consumption and the respective imports. While Junker recognised that the EU authorities were aware of this situation, Greek officials were attempting to implicate the workers in order to conceal their own responsibilities.

Public debt is not only a political problem but also has a profound class character, clearly evident in the socialisation, through the state, of the cost of the crisis and the losses of the business sector. Ireland is the most blatant example: there public debt did not exceed 25% of GDP before the crisis, but now Ireland is threatened by bankruptcy due to the state's absorption of the banks' losses. The same transformation of private into public debt can be seen in Portugal, Spain and elsewhere.

In Greece, this socialisation of losses was initiated, during previous crises. Greek public debt was created mainly during the 1980s and the beginning of the 1990s, when from 22% in 1980 it reached 98% in 1993 and today, after the recession caused by the Memorandum policies, it has skyrocketed.

The problem of public debt in Greece is intensified by other, more country-specific causes. Based on studies by Greek economists and reports by the Economic Chamber of Greece and other scientific institutions, we may identify the three most important ones:

1. The blatant inequalities and inefficiency of the tax system: tax exemptions for the powerful and rich, widespread tax evasion, tax receipts hysteresis in comparison to the rest of the Eurozone. It has been estimated that if the tax revenues in Greece (as a % of GDP) had been at the average levels of the Eurozone, Greek public debt would have been similar to that of Germany.

2. High military and armaments expenditures were responsible for almost one-third of the public debt before the crisis.

3. The absence of any monitoring and evaluation system for the social efficiency of public expenditures, and the transformation of the public sector into a free zone for

private interest, especially after the advent of neoliberalism, which resulted in the further domination of the state by private-sector interests and profit-seeking behaviour and practices. The maintenance of an extravagant and clientalistic bipartisan political system, in combination with clientalism and corruption, intensified the problem of the low –if not negative– social efficiency of public expenditures.

However, the evolution of the Greek public debt problem –which, as we have mentioned, already existed but was manageable until 2009– into a severe crisis and Greece's exclusion from international bond markets did not have only an endogenous cause. Despite the responsibilities of the government of PASOK, it was an outcome, on the one hand, of the world capitalist crisis and, on the other hand, of the neoliberal architecture of the monetary union, the internal contradictions of the common currency, the absence of a mechanism for common borrowing and defence against speculative attacks and the omnipotence of financial markets. Nowadays, almost everyone is talking about these issues. Even top EU officials admit that the magnitude and the cost of the Greek crisis was inflated on account of these problems and due to the deliberate delay on the part of the German Chancellor Mrs Merkel and the European authorities

ACCUMULATED DEBTS NEITHER CAN NOR SHOULD BE REPAYED

From this brief analysis two conclusions can be drawn.

1: The accumulated public debt, which the government has estimated in 2011 at 350 billion Euros, represents a no-longer existing capital, either in terms of money or in terms of productive capacity. It is capital of which a great part has been consumed, spent in equipment not producing value added, in profits and tax evasion that were not invested productively, but have largely fled abroad.

Thus, this is a “notional” capital, a consumed capital that can neither be reproduced nor generate additional income, and therefore it cannot be serviced and repaid. This is so for two main reasons:

First, in order to service the accumulated debt, but even to conform to the respective interest payments (which are expected to exceed 8-10% of GDP in 2014-2015), high primary surpluses are required, something that is unfeasible under such a recession.

Second, the domestic causes for indebtedness must be confronted, and the fiscal primary deficits must also be eliminated. However, even if the Greek economy could create surpluses, if these were used exclusively for servicing the debt, there would then be no resources for financing growth.

Indebtedness will be perpetuated and society will be condemned to long-run stagnation and withering, mass poverty and social immiseration. Hence, the accumulated public debt neither can nor should be repaid, at least not in its totality.

Similar predicaments can occur in other European countries as well, if there is no common and radical solution.

2. The only way to service one part of this consumed capital, namely the old debt, is through growth, whose achievement, however, requires new sources. In a theoretical framework, this debt could be serviced –and in the long-run be totally repaid– even if its level were higher, as was the case after the Second World War with the debt of the US and other countries – through constant and sustained growth. However, such a perspective is not visible today and maybe not even feasible, due to the limits to growth posed by social and environmental factors. In any case, such growth would require a radical shift of the dominant European policy, a European development plan and a massive transfer of no-loan funds, as happened after the Second World War with the Marshall Plan. What is needed is a combination of measures and policies that would decrease the burden of the accumulated debt and would ensure conditions for the repayment of the rest.

The public debt crisis must be approached politically and not as a mere accounting issue. Those who make the distinction between “virtuous” and “vicious” debts are right. Virtuous debt indicates the borrowing necessary for growth, while “vicious” debt is the debt incurred in the past, which must be absorbed by a European mechanism through which it will gradually be eliminated in the long run. Perhaps those who have been supporting the absorption of a portion of the sovereign debts by the ECB in order to neutralise them have been proved right. The common idea is that the old debt is a “dead debt” and it must not suffocate living capital and through this the economy and society.

A PROGRESSIVE EXIT FROM THE CRISIS

These are some findings. However, the conclusion derived from these findings is that we can arrive at a progressive solution of the debt crisis. However, this solution requires a negotiation focused on two crucial issues: the first one is a drastic decrease of the accumulated debt and the servicing cost to viable levels that will not prohibit the carrying out of social and development policy. As it has become obvious, this is not what happened during the recent restructuring of the Greek debt (March 2012). The second is the financing of recovery, reconstruction and new growth, although much needs to be clarified in this respect. For instance, some beneficiaries, such as

Greek and European pension funds or the small savers should have been exempted from paying the cost or should be compensated. Within the current conditions of recession and high unemployment there could also be a stipulation achieved through the freezing of the debt service.

It is important to elaborate further on the idea of a common and complete solution of the debt problem, but also of the inequalities and asymmetries characterising the evolution of the EU and the Eurozone, in a direction of reconstructing Europe on the basis of solidarity and not of destructive competition. The alternative option is to let problems continue forever through relentless bipartite and fragmentary negotiations, pressure, blackmail and recurrent crises.

I advocate choosing the first direction.

Is it, however, possible to achieve such a perspective? I would like to point out that such a solution is similar to the one that Germany was able to reach in 1953 regarding its own debt. Therefore it is not an unrealistic one.

We can also recognise that today, in comparison to one year ago, the problem of public debt has taken on a European and worldwide dimension. It has gradually been understood that the root of the problem is not public debt but recession, private debt, the banking sector debt and the continuation of policies generating indebtedness. This means that the same problem may appear even in countries without a public debt emergency today. There has been a broad discussion initiated within the left and even beyond, reaching even the fringes of social democracy, which include, in addition to the European Left Party, the EuroMemo Group, ATTAC, and a number of social and research organisations, which have generated progressive European responses to the problem of debt. Although the debate continues with converging and diverging views, the basic points of such a policy must be:

1. The role of ECB must change and allow direct lending to nations, exactly as it does for private banks. Moreover, a joint mechanism for issuing Eurobonds must be established, which under specific preconditions could restrain the potential of financial capital to destabilise the markets by speculating with interest rate spreads.

2. Part of the sovereign debts must be transformed into a common European debt and either be canceled or repurchased through resources collected by a financial transaction tax or a tax on large-scale assets.

3. A boost on growth must be ensured on a European level, focused on employment, social development and solidarity, through an upgraded EU budget and new transparent and democratic institutions.

There are, therefore, solutions that could offer an immediate exit from the crisis and at the same time contribute to the struggle against wage, tax and social dumping,

while strengthening solidarity. The deeper reason blocking the adoption of such a policy mix is not the existence of institutional and technical obstacles, but that it would shake neoliberal hegemony and the consensus based on it, which is shared by European Conservatives and a large part of Social Democrats. It is this kind of consensus and balance that must be overturned in order to pave the way to more progressive solutions – and not only for the solution of the debt problem.

LEGAL AND MORAL DIMENSIONS OF DEBT

So far, I have referred to the political and economic character of the debt problem and have argued for the necessity of cancelling a significant part of the accumulated debt, which follows from a political-economic approach to the issue. However, the legal and moral dimensions are significant as well. And I wonder if anyone can assure us that the loan agreements of the Greek State are beyond reproach after all the disclosures on the Siemens scandal - and others as well. In this regard, initiatives developed by citizens, by political parties and MPs may have a positive contribution to make in bringing such issues to the attention of the public opinion.

I also referred to the need for a negotiating policy, and this is exactly where political subjects come into the picture. For example, can the Greek government confront the very policies and interests that it has served up to now with such obedience – or, more importantly, does it want to?

Obviously, it is up to the Greek people to produce a government possessing the will and the power, based on the people themselves, to struggle to liberate society from the threat of long-term immiseration. But, in any case, this process of «bargaining» must be understood as intertwined with the active presence of the popular factor – trade unions, social movements, progressive scientists – both in Greece and Europe. A combination of political and social action within institutions and outside of them is needed. We must not underestimate the ability of financial capitalism not only to concentrate wealth but also to spread the risk and spread fear in society. There is therefore a need for resistance, accompanied by comprehensive quality information. We thus need well-organised coordination, information-exchange networks and mobilisation.

DEBT REGULATION: NECESSARY BUT NOT SUFFICIENT IF THE DEBT-GENERATING SYSTEM IS NOT OVERTURNED

Public debt is not merely an existing problem, but is also used to enforce dependency, pressure, blackmail and terrorise society. Hence, it is necessary for the Left to put forward proposals for a just and viable solution to the debt problem and to fight for this solution, instead of pushing the problem in the indefinite future. However, such a proposal will not be enough, since public debt is not an autonomous issue.

In the first volume of *Capital*, Marx devotes several pages to the very important role of public debt for the primitive accumulation of capital and the development of capitalism, referring to it as a source of illusions. Indeed, debt is often regarded as the sole culprit for all problems. But this gives rise to a second illusion, making people believe that addressing the problem of debt will mean the end of all problems for workers and society.

Regulating the debt itself, even if done under the most favourable conditions, is not sufficient to cope with the social problem, if the system that generates the debt is not replaced. In this connection, the Left should be primarily interested in the causes, the roots of the problem, and not only its symptoms. As I tried to show, the debt, especially in the Eurozone countries, is currently a systemic debt, organically linked to the neoliberal model and the crisis of capitalism, which differs in some respects from third-world debt as we knew it up to now. Thus, we need to draw on existing experiences in a creative way, not mechanically, and we need to generate new experiences through our ideas and actions.

What is certain is that liberation from the debt trap will not be a one-act play but the result of a profound systemic change in the productive model, the financial model of the economy and in the distribution and redistribution of income. This means that the radical transformation of the state, economy and society, the enduring vigilance and struggle for democracy and human rights, the equitable distribution and redistribution of income and wealth, the social control of the banking system and the implementation of a strategy for social development, focusing on increasing employment and the upgrading of labour constitutes the framework within which a just and lasting regulation of accumulated debt has the potential to really offer relief to the populations.

The coexistence of an economic and an ecological crisis renders such a framework even more challenging, since the exit from the crisis must take place not through faster growth but through different patterns of growth as regards its ecological and social aspects.

Insolvency Protection and Fairness for Greece: Implementing the Raffer Proposal

KUNIBERT RAFFER

Recalling Greek tragedies, misguided EU-decisions have produced catastrophe. Already crushed by her debt burden, Greece has been forced to borrow more since the crisis broke. The foreseeable result is more debts and less chances of recovery. In open violation of the Lisbon Treaty –whose Art. 125 clearly stipulates that no member state nor the EU shall be liable for or assume the commitments of another member state– and economic reason, EU-bureaucrats and politicians have wreaked unnecessary damage on the Eurozone and particularly on Greece. Member states are expressly prohibited from assuming Greek debts both openly or under whichever flimsy disguise, e.g., pretending that these are mere loans on which the “lenders” are going to make profits, as purported by Austria’s politicians. Exerting pressure on members wishing to act lawfully and respecting the Treaty by not joining in breaching Article 125, is illegal. The EU did so. Few politicians dared defend the Rule of Law and economic sense, by preventing their country from participating in this illegal activity, as Slovakia courageously and correctly did.

Obviously, some of the bailout money will never be recovered. Official acknowledgment that Greece would need additional cash after terms were softened shortly after the bailout had started, acknowledgment of the need to “reprofile” debts,

rumours of Greece leaving the Eurozone, S&P's downgrading by two notches, the "voluntary" participation of the private sector – all this corroborates the obvious that was assiduously denied by official EU-sources for so long: the impossibility of full repayment of Greece's debts.

When Argentina defaulted in 2001, her debt/GDP ratio was near the Maastricht target, 63%. In July 2001, when IMF employees considered a debt reduction of 15-40% necessary, it was roughly 50%. Germany's debts were roughly halved in 1953. A debt service ratio of 3.35%, and a debt-exports-ratio of 85% (1952) were considered absolutely unsustainable. Greece and Ireland were among those forgiving German debts. A national of the debtor country, a German banker, was allowed to tell creditors how much Germany could afford to pay. No one even dreams of asking a Greek nowadays to tell creditors how much they are to lose. In addition, Article 5 of the 1953 London Accord exempted some claims totally. Art. 5.2 postponed the settlement of claims of victim countries originating from WWII forced loans and occupation costs these countries had to finance until the final settlement of the question of reparations. Gladly accepting relief when Germany needed it, the German government has meanwhile strongly opposed any relief on the high moral grounds that all debts must be honoured, becoming the sternest creditor of its own former benefactors.

Official lending is prolonging and worsening the crisis, postponing and increasing eventually unavoidable haircuts. In quite a few jurisdictions penal law sanctions delaying insolvency proceedings, precisely because it makes things worse. The illegal and economically absurd bailout of "investors" rather than Greece may eventually threaten the solvency of would-be savers themselves. A quick haircut, already proposed early on, would have contained losses (not least of the budgets of those bailing-out speculators) and spared the Greek people unnecessary hardships. Already in February 2010 the proposal to halve Greece's debts came from the banking community. Gros and Mayer (2010; for comments see Raffer 2010a), the latter, the chief economist of the Deutsche Bank, proposed a solution whose main elements seem to be eventually realised now, unfortunately with some unhealthy extras added by politicians changing things for the worse and after worsening the situation dramatically, most notably a higher stock of debts and a shrinking Greek economy.

Gros and Mayer proposed the establishment of "a European Monetary Fund", which, in the event of a default, could step in and offer all holders of debt issued by the defaulting country an exchange against new bonds it issues. The EMF would require creditors to take a uniform "haircut", or loss, on their existing debt in order to protect taxpayers", as they wrote in the *Economist* (February 18, 2010). They called the

proposed "haircut" of 50% "only a *modest* (my emphasis KR) loss rate for those who bought up the debt more recently" (Gros and Mayer 2010, p.4). In exchange for a fee of 50% investors would have bought guarantees by EU member states (by economically strong members really, as the authors contend), exchanging bad debt for good titles. Compared with the EU's strategy that followed, this is an excellent, virtually unselfish proposal. With hindsight (one obviously hesitates to write "benefit of" under the circumstances) and after what EU functionaries and our governments did, I have to admit that I (Raffer 2010a) did not do full justice to the Gros-Mayer proposal, focussing too strongly on elements in the interest of the banking sector. Trading off losses for guarantees is economically acceptable. 50% seems a fair and honest proposal. The unlawful 100% bailout dressed up as "solidarity with Greece" that followed was incomparably worse. More recently, Mayer was quoted in the *Wall Street Journal*, observing: "Taxpayers will end up buying out the private sector" – right after the *WSJ* had pointed out that Greek "debt will consist increasingly of emergency loans and ever less of bonds held by private investors".

Repeatedly, voices from the banking sector proposed a haircut, an opinion endorsed by many academics, even private investors including Mohamed El-Erian, CEO of PIMCO, one of the biggest investors worldwide with over one trillion dollars in assets. El-Erian said Greece was in a "debt trap", drawing attention to the increase in debts through the rescue. Debts would have to be reduced to below 90% of GDP and the burden would have to be equally shared and could not just go to the taxpayer. Such opinions were ignored. Against the law and economic reason the EU decided to bailout the financial sector fully. Meanwhile, reality seems to dawn on official creditors. They softened terms and pursue optimistic ideas such as voluntary participation of private creditors. The very expression "bailing-in" private creditors is absurd. They were already "in" before public authorities broke the law to bail them out, protecting lenders from the results of their own lending decisions.

The *Telegraph* headlined it this way: "Vulture funds stand to make a fortune from second Greek bailout" (Aldrick 2011). Busily buying Greek debt, hedge funds see the Greek crisis (in the words of one leading manager) as "certainly a great chance to make money". Without the official bailout this would not be so. German banks reduced their claims substantially as well in the meantime. Economically, this means that many original investors have already realised losses. Taxpayers' money increasingly benefits venturous speculators.

The official bailout caused an increase in Greek debts since the crisis broke. It fuelled the crisis by encouraging speculation against other Euro-countries. It signalled to speculators that they would be bailed out at taxpayers' cost and could go on

speculating. Naturally, the crisis spread. This invitation to engage in risk-free speculation was gratefully accepted. The bailout cannot avoid but only postpones the unavoidable haircut. EU politics made things worse for everyone except some bureaucrats and politicians parading themselves as trouble shooters, and so-called vulture funds. In quite a few jurisdictions such lending, only prolonging crises, is called abusive credit, entitling *bona fide* creditors to damage compensation. Juan Pablo Bohoslavsky (2010) tries to transform the concept of the responsibility for abusive granting of credit into a general principle of international law. He argues that claims of lenders postponing the insolvent lender's crash by granting economically unjustifiable credits, thereby increasing other creditors' losses, should be subordinated to those not classified as abusive. The EU already has already been thinking about a ladder of preference unjustly privileging and protecting abusive claims of the official sector including their own against *bona fide* creditors.

Meanwhile, these disastrous, so-called "rescue operations" have even tainted institutions traditionally seen as bulwarks of stability. The German Bundesbank, for example, has amassed net claims against "the Euro-system". These increased enormously in the recent past. So-called Target liabilities of crisis countries amounted to over €300bn in March 2011. These are hidden claims within the Euro system, financing current-account deficits. Eurostat counts the creation of Target claims against other countries' central banks via the ECB as a capital flow between the national central banks. These "balances come close to short-term eurobonds. Moreover, their size dwarfs the parliament-approved bailouts extended to Greece, Ireland and Portugal." (Sinn 2011). One cannot but concur with Sinn: it is a "normal payment mechanism [that] became a bailout mechanism". The European Central Bank (ECB) has violated its ironclad taboo by buying up the bonds of countries in distress. It is now sitting on assets of doubtful quality, becoming an EBB (European Bad Bank) – as some cynics joke. What is officially touted as "solidarity with Greece" is solidarity with the ECB and speculators rather than with the Greeks. For the Greeks it is not solidarity but the chronicle of a catastrophe foretold.

THE RAFFER PROPOSAL - INSOLVENCY PROTECTION FOR STATES AND THEIR POPULATIONS

All domestic legal systems have introduced insolvency as the only economically efficient and fair solution. Its record and the fact that no one wants to abolish it, strongly suggest emulating national insolvency mechanisms for countries, as already advised by Adam Smith and proposed early on after the 1982 Southern debt crisis. A

solution to an overhang of sovereign debts is needed that differs markedly from any debt relief granted by creditors so far that usually prolonged and deepened crises. The need to deal satisfactorily with sovereignty was used as a powerful argument against the first generation of proposals advocating the emulation of US corporate insolvency (Chapter 11) in the 1980s until the IMF itself proposed emulating corporate insolvency out of the blue in 2001.

Nevertheless, the point that states differ substantially from corporations and that this must be taken into account by any meaningful insolvency framework has great merit. In 1987 I therefore presented a proposal countering the arguments against adapting Chapter 11 for countries by proposing a mechanism adapted to and practical for sovereigns: applying the essential features of US municipal insolvency (Chapter 9, Title 11 USC) to countries. This proposal, kindly dubbed the Raffer Proposal by professors Galbraith and Streeten and Fair Transparent Arbitration Procedure (FTAP) by many NGOs, has been propagated globally, in particular by the Jubilee Movement. It is the only appropriate procedure and the best solution for a sovereign debt overhang. It upholds the Rule of Law, respect for human rights, the most fundamental legal principles vocally touted by anyone, and economic efficiency. As my proposal has been presented repeatedly (e.g., Raffer 1990, 2005, 2010b), this paper only recalls its main features briefly. Specific features making it fundamentally different from creditor dominated "solutions" or the present "handling" of Greek debts are:

- Impartial decision-making and respect for the Rule of Law;
- Debtor protection;
- Right to be heard (which may be seen as part of debtor protection);
- Treating the problem of sovereignty;
- Fair and equal treatment of all creditors;
- Improved sustainability.

The basic function of any insolvency procedure is the resolution of a conflict between two fundamental legal principles: the right of *bona fide* creditors (which excludes EU bailout lending) to interest and repayment versus the generally recognised principle, limited not just to lending, that no one should be forced to fulfil a contract if this causes inhumane distress, endangers one's life or health, or violates human dignity. Debtors should not be forced to starve themselves or their children to be able to pay.

IMPARTIAL DECISIONS

A proper mechanism to solve the problem of a sovereign debt overhang must comply with minimal economic, legal and humane requirements and be fair to all involved. Impartial decision-making and debtor protection are the two essential features of insolvency, both denied to debtor states nowadays. Ideas such as a “Berlin Club” (called “Institutionalized Disempowerment” by Spiegel-online) with sequestration of the debtor by creditors demonstrate open contempt for the rule of law. It means stepping back beyond the 19th century, even though on the whole debtors usually had more rights then. One has to agree with the Bruegel proposal of a European mechanism for sovereign debt crisis resolution (Gianviti et al 2010): that an institution that is neutral, not a creditor, is needed to supervise debt reduction as a court would do domestically, and that putting a government under receivership is inconceivable because this would contradict the nature of democracy. However, the authors’ prime choice, the Court of Justice of the EU seems highly problematic. It is debatable whether this EU institution would be neutral. Their alternative, an entirely new institution, makes more sense.

My proposal upholds the very foundation of the rule of law. As national courts in debtor or creditor countries might not be totally beyond political influence, I have proposed arbitration. Following established international law practice, each side (creditors - debtor) nominates one or two persons who in turn elect one more person to achieve an odd number. While institutionalised, neutral entities are technically feasible, *ad hoc* panels are preferable, not least because they can be established at once. No long negotiations are necessary to draft a treaty, nor is ratification needed. The panel should proceed on the basis of the essential, internationally relevant features of Chapter 9 and recognise or void individual claims. Naturally, it must reject the debtor’s demand if unfounded, denying this debtor any advantage resulting from initiating the procedure. This is no different from intra-US Chapter 9. The plan filed by the municipality of Harbour Heights was rightly denied approval because the district had assets greatly exceeding its liabilities and “there was no sufficient reason why the District’s tax rate should not have increased sufficiently to meet the District’s obligations” (§943, note 3, 11 USCA, as quoted in Raffer 1990, p.303).

Arbitrators would mediate between debtors and creditors, chair and support negotiations with advice and provide adequate possibilities to exercise the right to be heard, and, if necessary, decide. Ideally, the panel would just confirm agreements reached between creditors and the debtor. As all facts would be presented by both parties and the representatives of the people during a transparent procedure, decisions would be unlikely to affect substantial sums of money; rather they would resolve deadlocks.

Before the 1970s, arbitration was the usual means of solving disagreements between creditors and sovereign debtors. This was also the case in outstanding, historic examples: loans by the League of Nations before WWII usually contained arbitration clauses, e.g. Austria’s when she received a structural adjustment type loan from the League of Nations. In this case the League grafted a controlling High Commissioner based in Vienna upon Austria. Though resulting from the dictate of the victors after WWI, both the Dawes and the Young loans to Germany contained arbitration clauses (Waibel 2011, p.160). The London Accord established arbitration for disagreements with creditors; debt relief was so generous, though, that it was never invoked. Recently, arbitration on debts has become increasingly popular with creditors who seek it at the ICSID (International Centre for Settlement of Investment Disputes) or under bilateral investment treaties. While supported if perceived as in the interest of creditors, our governments shun arbitration as a fair and general principle whenever they see the danger of justice or fairness to debtor nations.

RESPECTING SOVEREIGNTY

Chapter 9 protects governmental powers. It is therefore immediately applicable to sovereigns. In the US the court’s jurisdiction depends on the municipality’s volition, beyond which it cannot be extended, similar to the jurisdiction of international arbitrators. US municipalities cannot go into receivership, and change of «management» (i.e. removing elected officials) by courts or creditors is not possible - nor should this be possible in the case of sovereigns. Only voters should have the power to remove elected politicians from office. Obviously, similar guarantees are for obvious reasons absent from Chapter 11. Ideas such as a European Ministry of Finance overruling national parliaments go in the opposite direction, in an anti-democratic direction.

The concept of sovereignty does not contain anything more than what §904 protects in the case of US municipalities. Headed “Limitation on Jurisdiction and Powers of Court”, it states with outmost clarity:

“Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with:

- (1) any of the political and governmental powers of the debtor
- (2) any of the property or revenues of the debtor; or
- (3) the debtor’s use or enjoyment of any income-producing property.”

While this may be seen as giving the debtor too strong a legal position, the

economic necessity to settle the problem and to re-gain normal access to capital markets counterbalance this strong position. Furthermore, a public interest in keeping the debtor functioning exists. Thus, when some creditors refused to agree to the plan, insisting on higher payments (financed by tax increases) by the City of Asbury Park in the 1930s, the US Supreme Court (quoted from Malagardis 1990, p. 68) prevented this: “The notion that a city has unlimited power of taxation is, of course, an illusion. A city cannot be taken over and operated for the benefit of its creditors, nor can its creditors take over its power of taxation.” In short, Chapter 9 is particularly appropriate for sovereign debtors. What is happening to Greece now could not happen to a municipality.

PROTECTING DEBTORS AND DEMOCRACY

Debtors - unless they are countries in distress - cannot be forced to starve their children in order to be able to pay more. Human rights and human dignity enjoy unconditional priority, even though insolvency only deals with claims based on solid and proper legal foundations.

A US municipality must be allowed to go on functioning and to provide essential services to its inhabitants. Resources necessary to assure this are exempt. This principle must also be applied to sovereign countries. Resources necessary to finance minimum standards of basic health, primary education, etc. must be exempt. Private creditors have always been aware that some money simply cannot be collected for what they often call “political” reasons, meaning public resistance against social expenditure cuts. Eventually, anti-poverty measures under HIPC II (Enhanced Highly Indebted Poor Countries Initiative) have recognised this principle, at least verbally. The SDRM (Sovereign Debt Restructuring Mechanism), by contrast, fell behind this minimum standard, not mentioning any kind of debtor protection at all. This does not mean that there is no reduction in government expenditures. Of course, no insolvent debtor can just go on as before; saving and economising are unavoidable. The question is solely whether any, and which, services are exempt, even though reduced in scale.

Exempting resources necessary to finance minimum standards of basic health services, primary education etc. can only be justified if that money is demonstrably used for its declared purpose. The solution is quite simple – a transparently managed fund financed by the debtor in domestic currency. The money going into that fund would not be phantom debts (i.e. debts existing on paper but uncollectable in reality) but money that could actually be recouped if no debtor protection existed, as is

presently the case. The management of this fund could be monitored by an international board or advisory council. Members could be nominated by NGOs and governments (including the debtor government). As this fund is a legal entity of its own, checks and discussions of its expenditures would not concern the government’s budget, which is an important part of a country’s sovereignty.

Creditors have, of course, the right to demand selling some of the debtor’s assets to reduce their losses. This is part and parcel of any insolvency case and is fair and justified. Quick fire sales under enormous pressure as presently and loudly requested from Greece are not. They are likely to yield unfairly low prices, damaging both *bona fide* creditors and the debtor, though allowing a lucky (allegedly well connected) few to get these assets on the cheap.

Participation of the municipality’s inhabitants is guaranteed in two ways:

- 1) The affected population has a right to be heard;
- 2) If electoral approval is necessary under non-bankruptcy law in order to carry out provisions of the plan it must be obtained before confirmation of the plan pursuant to §943(b)(6).

In strict analogy to domestic Chapter 9, the population affected by the solution must have the right to be heard, exercised, of course, by representation in the case of countries. Domestic Chapter 9 foresees both exercising this right individually or by representation. Trade unions, entrepreneurial associations and religious or non-religious NGOs could exercise this right to be heard, representing the affected population and presenting arguments and data before the panel. Affected people would thus have the right to defend their interests, to present estimates and arguments, to show why or whether certain basic services are necessary. The openness and transparency usual within the US should become the norm of sovereign insolvency. In short, I propose to apply the same legal and economic standards to all debtors, to guarantee equal treatment of indebted people everywhere, irrespective of nationality or colour of one’s skin. There is no logical reason why someone living in an insolvent municipality must be treated in a more humane way than people living in another public debtor that is a country, such as Greece.

Rejected as utopian when first proposed (Raffer 1990, p.305), participation officially became part of the HIPC II. Civil society is to participate in designing poverty reduction strategies. Obviously, participation is possible. In fact, it already goes beyond what I initially thought possible when I proposed this in 1987. Furthermore, one cannot keep people from expressing their views. In Argentina, for instance, civil society “participated” in the streets by banging on pots. In Greece, violent demonstrations and street fights have expressed the affected population’s

discontent and disagreement. Formal representation would seem a better way of voicing opinions.

Further participation by parliaments or the electorate could easily be integrated. The debtor government can choose to leave the task of nominating panel members either to the parliament or the people. Voters could, for instance, elect arbitrators from a roster. Experts reaching a minimum of supporting signatures by voters would have to be on this roster. One arbitrator might be chosen by parliament, the other by voters. The parliament might establish a special committee to handle insolvency, including members of the cabinet, as proposed in a bill drafted on the initiative of Argentine Congressman Mario Cafiero. This bill would have established a Comisión Representativa del Estado Nacional. Consisting of members from both houses and the executive power, it was to nominate panel members and represent Argentina during the proceedings. Solutions to sovereign debt problems need not destroy democracy – as presently planned in the EU.

FAIR AND EQUAL TREATMENT OF ALL CREDITORS

Insolvency laws usually allow preferential treatment of certain types of claims. Ladders of priority are plain vanilla. Treating all creditors equally is not a procedural necessity, but in my model all creditors are to be so treated. Except creditors lending during the procedure to keep the country afloat, all private and public creditors must get the same haircut. This avoids unfair burden sharing. Demanding that those official creditors that have aggravated the situation by illegal lending must not enjoy preference is extremely justified and indispensable. Especially in the Greek case, official creditors worsening the situation must not be rewarded financially. Rather, they should be taken to account.

Basel regulatory norms practically pushed banks into Eurozone government papers summarily anointed AAA by the big rating agencies. Thus, Greek

instruments had capital weights of zero. To use Soros' words, banks "obliged to hold riskless assets to meet their liquidity requirements were induced to load up on the sovereign debt of the weaker countries to earn a few extra basis points". This regulatory original sin, a brilliant example of policy-encouraged crashes, renders any preference ladder privileging public money all the more unfair. Attempts at establishing new preferences for EU actors, such as a ladder IMF-EU/(ESM) claims-other creditors would involve greater and unfair losses for *bona fide* private creditors and penalise banks for lawfully playing by the rules established in Basel. It would further encourage the public sector responsible for these rules to muddle

through at least as badly in the next crisis as in Greece now. Legally, the IMF is not a preferred creditor (see Raffer 2010b, pp.225ff) but is already being given unlawful *de facto* preference. A solution is needed that is fair to anyone involved.

Equal haircuts, arguably subordination of abusive public credit, is therefore an important feature of my sovereign insolvency model, which is based on specific economic, legal, and ethical grounds: on the necessity to establish the equivalent of national liability and tort laws, and on fairness to *bona fide* creditors, who like debtors would have to pick up part of the bill of failures by official lenders.

IMPROVED SUSTAINABILITY

A sustainable solution could emerge from the facts presented and discussed openly and by all affected. As the population concerned would have the opportunity to present their arguments in a transparent procedure, one can either expect agreement on one specific solution or differences between positions that are quite small. Ideally arbitrators would just have to rubberstamp the plan agreed on by the parties, the creditors and the debtor.

CONCLUSION

Unfortunately, muddling through seems the most likely "strategy", although haircuts are meanwhile accepted as inevitable and the same evolution towards losses as in Latin America after 1982 is clearly discernible. But lessons were not learned. When over-exposed Wall Street banks demanded a bailout, the US Treasury refused to use tax money. Instead, banks first had to go on lending (so-called "forced lending"). Admittedly, the Bretton Woods Institutions also increased their lending, which was some form of bailout. Once banks were able to digest haircuts they had to grant them ("Brady Initiative"). Officially, of course, banks did all this "voluntarily". Reducing debts to the amount that can be serviced is unavoidable. It should be done in a civilised, humane, fair, and efficient way: extending the time-tested mechanism of insolvency to the last debtor still denied insolvency protection. My proposal safeguards the debtor's sovereignty, and gives the affected a voice, which is normal use within the US. Quite a few essential points made in the 1980s have since then become accepted (for example, debtor protection in HIPC's, transparency by including NGOs, even reducing multilateral claims, although still with undue and illegal preference), but the cornerstone of the rule of law –that one must not be the judge in one's own cause– continues to be violated openly. As long as creditors

remain judges, experts, and bailiff, arbitrariness substitutes arbitration. Debt management will reflect the errors and injustice of the last decades. Greece will continue to suffer under EU receivership. What largely goes unnoticed is the huge advantage that most of the current debt is subject to domestic law, an advantage that must not be traded away.

Eurobonds are no alternative to proper and sufficient debt reduction. Debtor countries would save interest costs, marginal, though, compared with the relief needed. Lower interest would attenuate the problem but definitely not solve it. Somewhat lower interest service would not greatly affect Greece's debt burden, even assuming that investors do not see Eurobonds as another opportunity to charge relatively high interest because "economically sound" Euro-countries guarantee claims. The EFSF's first bond issue carried such a high interest rate that it was hugely oversubscribed, nearly nine times. The German newspaper *Frankfurter Allgemeine Zeitung* (January 29, 2011) rightly entitled an article "Saving Europe and Profiting from It". So far, official guarantees and money have not reduced spreads for crisis countries. On the contrary, spreads increased and more and more Euro-countries have been targeted by speculators. Why should speculators let another offer to make profit with EU-guarantee slip by, not charging relatively high interest although "economically sound" Euro-countries remove risk? High risk premiums without risk are a speculator's dream and a taxpayer's nightmare. The market mechanism forcing lenders to check country risks and to take the losses debtors routinely pay for in advance via higher spreads would be removed in favour of speculator welfare.

In contrast to possibly small relief, the political implications are extremely dangerous. Understandably, those countries guaranteeing debts would also want to control the lending and expenditures of those benefitting from such sureties. Whether one uses Eurobonds or another form of international subsidy, those guaranteeing will want control over those using these guarantees. Quite logically Trichet demanded a European Finance Ministry, a group of unelected bureaucrats taking away from democratically elected parliaments their most important right: voting on the budget. Thoughts such as a fiscal union or a European economic government, perfectly understandable from the economic point of view of guarantors putting their money on the line, are being aired. Greece, the cradle of democracy, might thus also become its grave.

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A Latin-American Perspective on Austerity Policies, Debt and the New Financial Architecture

PEDRO PAEZ PEREZ

GLOBAL AWAKENINGS, GLOBAL STRUGGLES

The times we live in are very difficult, and coordinated action is needed in order to awaken the people of all countries, make their rebellion possible and generate a process that will permit us to block the agenda of the international financial oligarchy and the political and cultural breakdown it implies.

I will try here briefly to present some of the characteristics of the crisis of recent decades in Latin-America, which are relevant, but not identical, to your experience. I find it incredible that what is now imposed on Europe is a turnaround of history: the austerity policies, the creation of a permanent debt trap – all these things are presented as solutions to what is a self-created problem. And what is even more incredible is that the identical tactics are being used of blaming the people for problem.

The last time I visited Europe, one year ago, I was astonished to see that the discourse Europeans were engaged in here was the same that we had in Latin-America decades ago: “now you have to pay the bill for what you have squandered, you have to discipline yourselves, you have to stop being irresponsible and lazy, you have to

produce and be competitive”. It is exactly the same scenario used with us thirty years ago, sometimes assisted by Latin America’s most brutal dictatorships, and every time with the excuse of external debt, with the excuse of fiscal deficit, with the excuse of these “harsh but necessary measures”.

This is a fundamental element that we have to take into account when we discuss our political action, a coordinated action of the progressive forces that will serve our democratic and humanistic vision.

We need this coordinated action in order to defeat the fascist forces that, during the previous structural crisis of capitalism, ushered in a period known as “the golden era” of capital: a balance of power that led to a period of promises to construct a system of nation-states based on the principles of citizenship and of social rights.

EXTERNAL DEBT AND FINANCIAL CRISIS: THE BASES FOR POLITICAL SUBMISSION

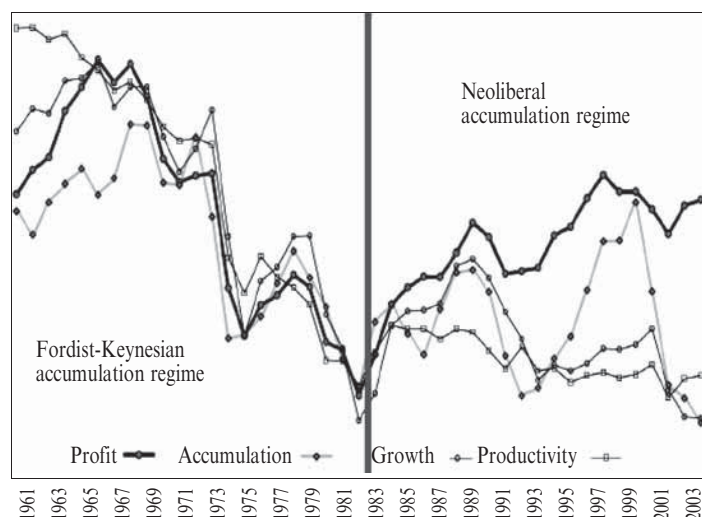
I would briefly like to explain the role of external debt, the role of public debt in the South, by looking at the reconstitution and recomposition of the neo-colonial powers for which neoliberalism constitutes an important tool. During this “golden era” the powers of the capitalist system were obliged to maintain a balance between capital and labour that protected the profitability of capital in the countries of the North. In Figure 1 the thick black line indicates one of the measures of the rate of profit in the most important OECD countries. This decline could only be restored by applying neoliberal policies and by shifting the balance of power between classes, resulting in a radical conversion of the terms of distribution of production.

Two strategies played a fundamental role during this shift of the balance of power in favour of capital. The first one was financialisation – the black line in Figure 2 represents the evolution of the real economy, the global GDP which, during the last fifty years was increasingly volatile and decreasing. By contrast, one of the most characteristic measures of fictitious capital –financial derivatives– increased exponentially. Today, financial derivatives account for more than twenty times the value of the global GDP. We are therefore talking about a problem of structural insolvency, which cannot be resolved with liquidity injections.

The second important strategy for the restoration of capital profitability is associated with the process of industrial delocalisation in search of lower wages. The resulting system of global imbalances is directly linked to these self-referencing mechanisms of financial transactions. Figure 3 indicates the volume of global transactions by geographical area. What we can observe here, for example, is that, through international financial flows, the surplus of the Chinese economy helps

FIGURE 1

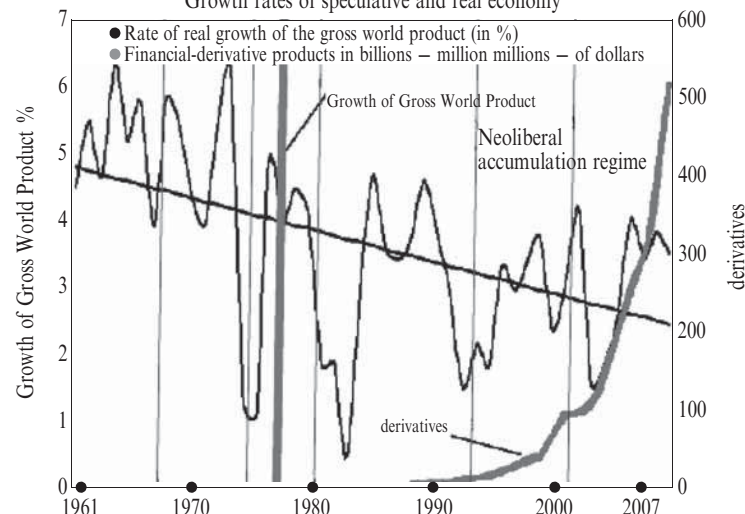
Basic macroeconomic indicators for industrialised countries



Weighted averages according to the GDPs of the G6 (USA, Japan, Germany, France, UK, Italy)
Source: OECD, Economic Perspectives, 2003

FIGURE 2

Growth rates of speculative and real economy

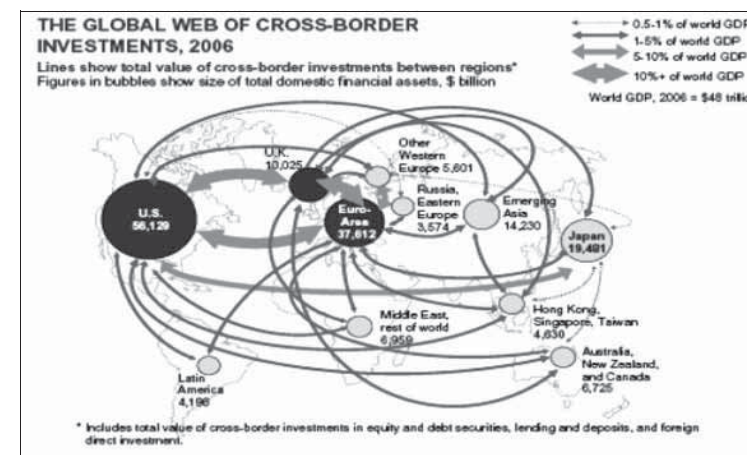


Source: World Bank and Basel Committee on Banking Supervision
Taken from: Beinstein, 2008

finance an indebted US. You can see that the bulk of financial transactions occurs within the United States, within Europe, within the City of London and between these fundamental poles at the heart of the system.

FIGURE 3

Global financial flows



Unequal exchange and financial dependency — the keys to neoliberal recovery

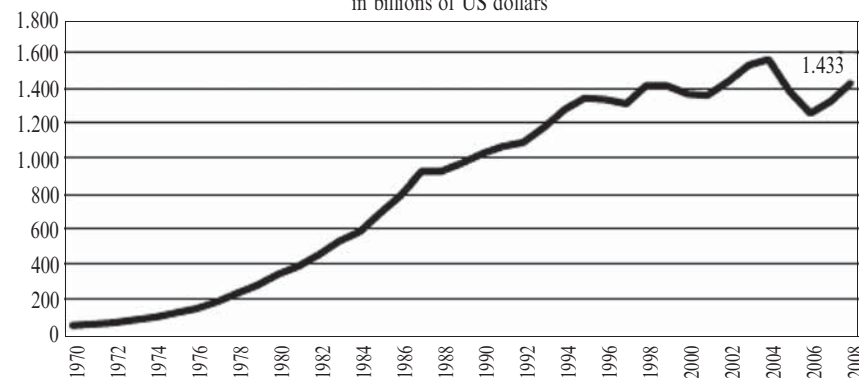
Source: Rey, 2008

This dislocation of financial flows and the way in which fictitious capital is reproduced vis-à-vis the real economy reveals the seriousness of the structural crisis of the system we live in. With this artificial profitability of investments, the dynamic increase of public debt is transformed into a power shift from labour and citizens towards a financial oligarchy. Figure 4 shows the increase of indebtedness in Third World countries during the period of restored profitability in the North. As we can clearly see, until the end of the 1970s the levels of debt were manageable. The current unsustainability was not due to the irresponsible indebtedness of the South. It was due to the unilateral increase of interest rates on the part of the US and the consequent appreciation of the dollar, the currency in which the debt was created. That resulted in a desperate and continuous effort on the part of the South to make its products cheaper and race to the bottom as it struggled to maintain its market shares.

Since then, and after the debt crisis of the 1980s, there has been a dynamic of continuous indebtedness in order to pay for old debts. This is why a distinction ought

FIGURE 4

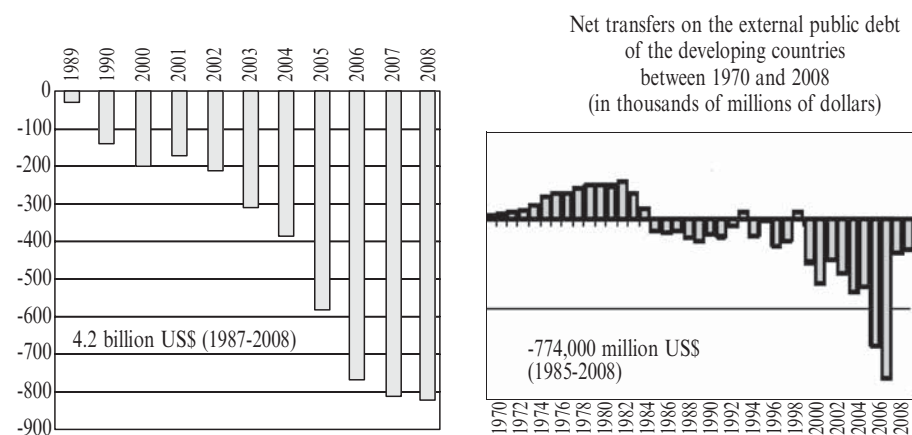
Evolution of external debt in the global South
Developing countries outstanding public external debt
in billions of US dollars



Source: World Bank

FIGURE 5

Weight of external debt in the extraction of surplus from the South



Source: World Bank

to be made between the onerous debt and the new loans that should be directed towards real investment in infrastructures and finance the generation of employment. Figure 5 illustrates these net transfers from the South to the North during the whole period from the 1980s – during which the neoliberal regimes were imposed. On the left hand side we can see the net transfers through foreign direct and portfolio

investments and trade flows, while on the right hand side we can see the net transfers for the payment of interest on external debt.

The relevance of this figure for the assessing the current political conjuncture is obvious. One does not have to be on the Left to realise what Keynes already observed decades ago: “If I owe the bank ten thousand [Euros], I am doomed, but if I owe the bank ten billion [Euros], then the bank is doomed”.

This is precisely what we have to understand: in this instance we owe fortunes to the banks ironically due to the “rescue processes” underway, as well as to the current and future nationalisation of private debt. Thus, it is we who have the advantage in the current balance of power. And it is essential to engage in political action and coordinate the progressive forces on a global level on that basis. Failing to prepare ourselves for a struggle under these conditions can condemn us to decades of failures – to those same failures that prevailed in Latin America through austerity policies.

DEBT AND AUSTERITY IN LATIN AMERICA

With the threat of the external debt, the forces behind the imposition of the IMF provided for a generalisation of austerity policies, which obviously resulted in the inability to restore growth due to drastic reductions in the rate of investments with respect to GDP. In the period of industrialisation through import substitution –from the 1950s through the 1980s– the share of national income devoted to generating new productive capacities was between 25 and 30%. After the application of the so-called “market model”, the model of efficiency that would attract investments, this share fell to a level of 15-18%, as is seen in the figures provided by the UN Economic Commission for Latin America (CEPAL).

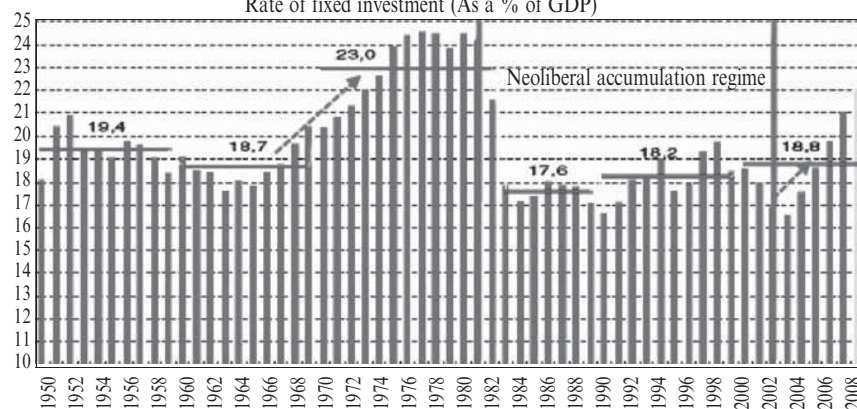
The effect of this reduction in the rate of investment is part of a war strategy of capital against labour because it weakens demand for wage labour, which in turn reduces wages as a percentage of GDP in a radical way and in a very short time.

As seen in Figure 7, the falling share of wages in the GDP –which does not necessarily reflect the fundamentals of distribution due to the conditions of structural heterogeneity in Latin America– will have multiplier effects on other parts of the non-wage-earning working classes, which will signify an increase in absolute and relative terms, both of destitution and of poverty, a trend that was only mitigated by the compromise of progressive governments in the last decade.

Unlike the declining number of poor during the accumulation regime of industrialisation through import substitution –with its oligopolistic tendencies– the austerity of neoliberal adjustment policies involves a continuous sharp rise in the

FIGURE 6

Evolution of fixed investment in Latin America
Rate of fixed investment (As a % of GDP)



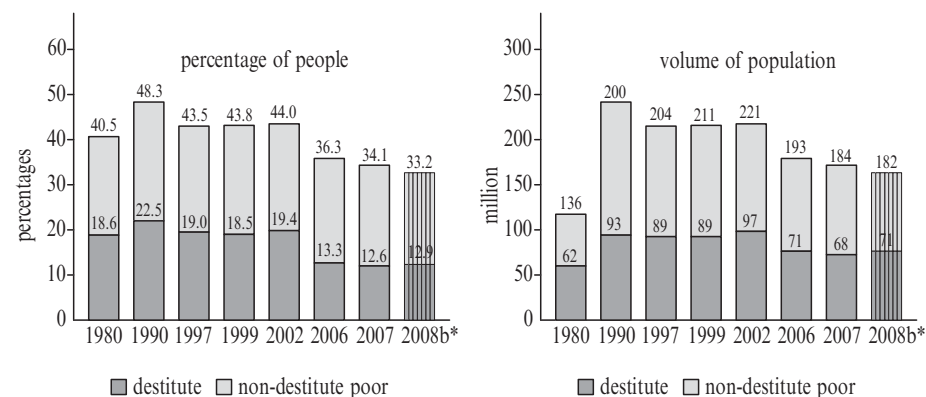
Accumulation regime based on import-substitution industrialisation

2008 > = projected

Source: CEPAL (2008)

FIGURE 7

Evolution of absolute and relative poverty and indigence in Latin America 1980 = 2008



Source: CEPAL (2008)

2008b = projections

number of the destitute. This civilisational degradation does not only have negative effects on the social sphere. Even in terms of its own criteria, the austerity policies of neoliberal adjustment are a failure. If investment is reduced and markets suffocate, GDP growth is going to shrink. During the period of import substitution, growth was

not as weak and volatile as it was during the neoliberal period. The same can be said of the performance of the external sector reflected in the blue line, although it was certainly not sustainable during the period of import substitution because of dependence on machine technology and consumer goods. This is also true of the import of luxury goods for high-income sectors. This external vulnerability is reflected in an endogenous element of the vicious circle of debt increase. The desperate devaluations, in search of a continuous surplus of foreign currency in order to pay the debt, only render these imports more costly and unaffordable.

At the fiscal level, the austerity policies create a series of deficits, which run year after year and increase public debt to the point that it is unpayable. This is why I argue that the austerity program imposed by the Troika is unsustainable. Fiscal vulnerability is itself another factor of debt generation, which has been endogenised to create the permanent need for more government deficit.

All this in the context of greater reliance on exogenous factors in Latin America over the last decade, which deceptively exhibits an unusual improvement in the terms of trade, an improvement without parallel in the last 110 years of the history of Latin American trade.

In this context, I would like to present one of the options we have for changing the balance of power that has imprisoned us for over thirty years: the experience of Ecuador in the foreign-debt auditing.

DEBT AUDITS AND MORATORIA IN ECUADOR

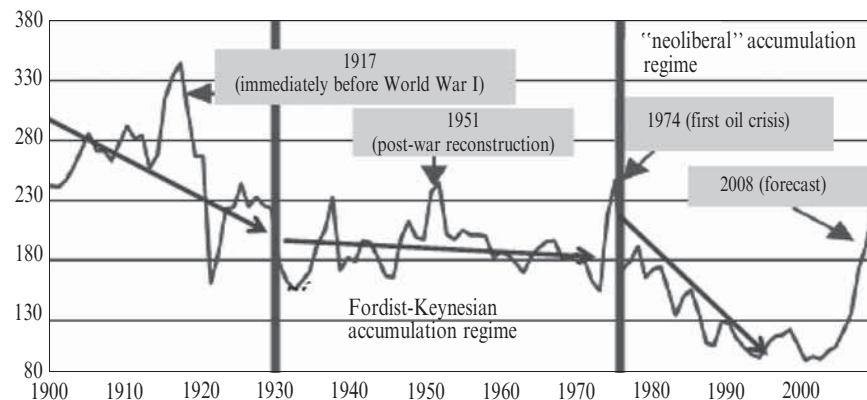
After many episodes of involuntary cessation of payments and the restructuring following the US's problematic Brady Plan and the recognition that the inherent unsustainability of the exponential growth of debt was caused by the neoliberal policies, the civil-society struggle for the audit of the debt finally produced results in terms of government action.

At the moment when the government of Rafael Correa announced that foreign-debt agreements were going to be made transparent, the secondary markets suffered a significant decline in the price of the foreign debt of Ecuador. The "financial markets" knew they had irregularities, because they themselves had produced them!

Later, when the government of Ecuador presented the results of the audit, prices in the secondary market rose by up to 15% for every dollar of the nominal value of the debt. This opened the door to a process of debt repurchase which substantially reduced the debt stock and debt service and made it possible to liberate resources for social and productive investments.

FIGURE 8

Evolution of Latin American terms of trade
Index of real prices of basic goods unrelated to energy (1977-1979 = 100)



Source: World Bank (2009)

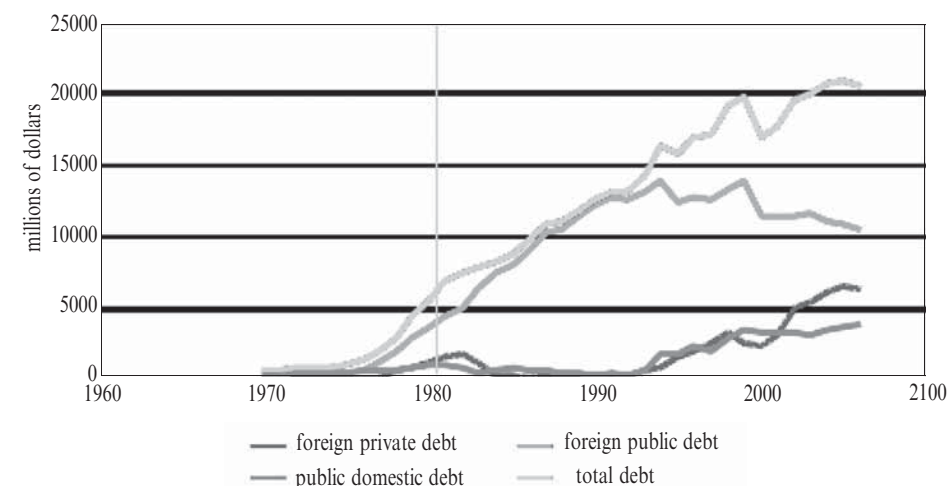
This is not only an issue for progressive governments. In Latin America we have the experience of the centre-right government of Paraguay. We also have the cases of debt audit in Argentina and Brazil driven by civil society and the parliament. The results of these audits and examinations of the public debt reveal the involvement of the same actors in the same circumstances and more or less with the same financial instruments. The names that appear in these audits are quite familiar to you: Goldman Sachs, Merrill Lynch, Bank of America, CitiGroup, JP Morgan Chase...and they are on both sides of the negotiating table! They negotiate on the part of the creditors and at the same time they are supposedly helping the debtor countries to restructure their debts.

Ecuador's foreign debt during the 1970s, as shown in Figure 9, was at manageable levels. The sharp increase at the end of the decade was due to a unilateral increase in interest rates by US Federal Reserve. Since then there was a sharp increase in the bulk of the debt – a debt to pay the debt. Only 14% of the new debt accumulated between 1969 and 2006 was allocated to investment projects. This means that in a very short time, 75% of the national budget was devoted to servicing foreign debt. This is the breakdown of civilisation suffered by a South that is now on the verge of striking back against the North.

Neoliberal policies, whether they appear with the “bad face” of trying to change the balance of power or with the “good face” of the Brady Plan, are doomed to fail. After

FIGURE 9

Evolution of Ecuador's external debt

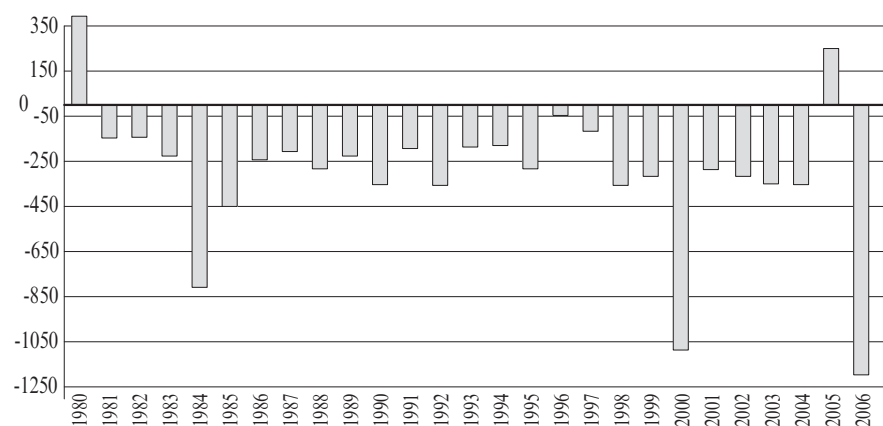


submitting to neoliberal policies or following the “progressive” economists that established them, all countries in Latin America experienced repeated default episodes. In the case of Ecuador there were three defaults which are represented by the vertical bars of Figure 10. Two of them –1984 and 2000– are shown here, and they involve a debt restructuring of gigantic size.

The fear of being threatened by the banks if a firm stance is adopted toward them, all the fears of the recessional effects of a scheduled default, can be easily confronted when one looks at the statistics demonstrating that good relations with the financial markets during the period 1980-2006 meant a net transfer of resources to the financial oligarchy. When, in 2008, Ecuador suspended its debt payments in order to handle the restructuring of its liabilities there was a reduction of the debt of nearly one third with immediate results at the political level. After several decades of indebtedness the priority begins with the audit and the scheduled debt default. There is no doubt that the transition is tricky and we have to plan the situation responsibly and in strictly legal terms, as we did in Ecuador. Moreover, there has to be a change of macroeconomic and development policy.

FIGURE 10

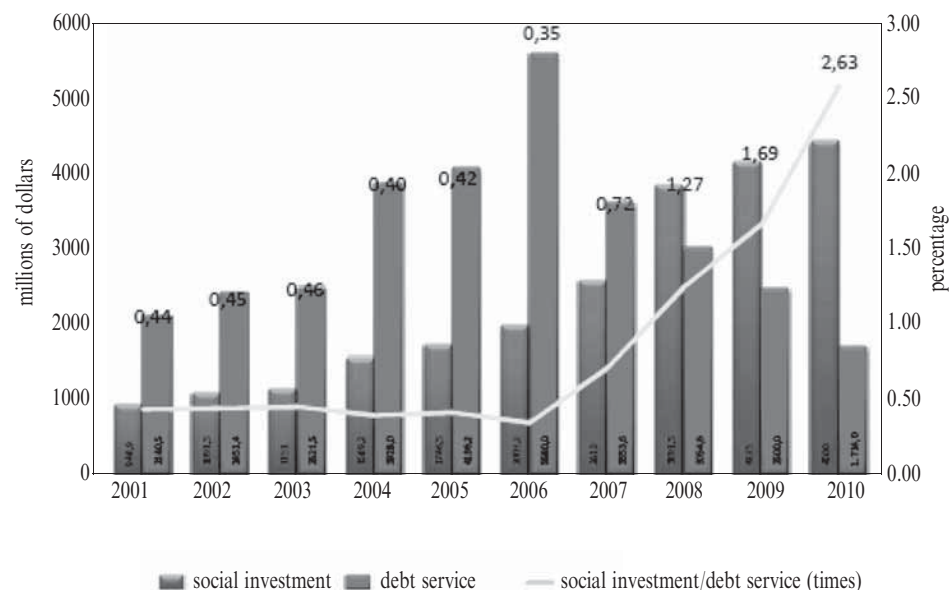
Net transfers of the external debt of Ecuador



Source: Final Report of the Commission for a Comprehensive Audit of Public Credit

FIGURE 11

Debt service and social investment in Ecuador



EUROPEAN ALTERNATIVES: UNITY IN THE FIGHT FOR A DEMOCRATIC EUROPE

Specific conditions cannot be extrapolated from their historical conjuncture. The situation in Greece and in Europe has to be seen from a European perspective through the concrete analysis of the concrete situation. Nevertheless, the development of the crisis goes far beyond what can be learned by merely monitoring the growth of GDP and by other financial indicators. It has to do with the decline of fundamental mechanisms for the operation of markets, the deepening of insolvency and the increase of global imbalances which have led to the dismantling of the self-correcting mechanisms of the markets, the generalised misalignment of exchange rates and the sharp increase in the prices of energy, precious metals and food with respect to their production cost.

In this sense, an exit from the Euro followed by a devaluation according to the example of Argentina or an adjustment of relative prices in this conjuncture is unlikely to have positive effects on the reactivation of the production forces if we realise that key relative prices are structurally distorted vis-à-vis their production costs. If the debt were expressed in foreign currency at this point, it would be even worse than it is.

After spending billions of dollars to bail out speculative bubbles, what is the exchange rate, the price of oil, the food prices, on the basis of which a country, a company or a region can decide what its specialisation is or can make decisions on long-term investments? It is absolutely useless to do calculations that supposedly permit one to correct structural imbalances – doing so would mean that based on these “right prices” one decides to destroy the productive capacity of one’s economies as was done during the recent decades of neoliberalism in Southern Europe.

In that sense, I think that the case of Europe is characterised by some important conditions that differentiate it from Latin America, as far as exiting the crisis is concerned. It can start from zero-interest-rate loans by the ECB to finance full-employment policies, or an arrangement for a multilateral debt settlement along the lines followed by Germany in the 1953 Treaty of London, according to which the maximum debt service could not exceed 5% of exports, resulting in a significant reduction of the stock of debt accumulated since the 1920s, with no contingency clauses for the non-service of the debt during recession periods. There would also be automatic payment conditions which prevent retaliation on the part of the “financial markets”.

These elements could constitute a significant alternative in the short term not only to prevent these restructurings and negotiations from becoming an additional mechanism for the submission of people, but also to strengthen the process of

building a multi-polar world with regional integration and commitment to peace and development.

THE NEW FINANCIAL ARCHITECTURE: TOWARDS A MULTI-POLAR AND DEMOCRATIC WORLD

In the case of Latin America, these processes are being reinforced by the initiative of the New Financial Architecture (NAF) that aims to establish a sovereign system of credit that would replace the debt slavery that is the structural condition of dictatorship of the transnational and domestic financial oligarchy over countries making impossible the improvement and relaunching of their productive capacities.

In that sense, with the NAF we are working on the construction of a new type of development bank, of a new type of central bank and of a new type of currency. It is very analogous to European proposals for a new role of the ECB in financing full-employment projects carried out by the governments, a proposal coordinated with that made by Francis Wurtz regarding the Fund for Economic and Social Development. It is the possibility of establishing a sovereign credit system that promotes different economic principles not based on short-term speculation and the incredibly high profitability demands that block very many productive projects. Those are the elements that would underlie the relaunching of the project to construct a social Europe.

It is also fundamental to understand the dominant role that currency plays in finance, as far as the capacity for action of the financial oligarchy is concerned. We need to rethink the role of currency, from being a vehicle of speculation, of spoliation, of exclusion, to becoming the element that makes exchange between peoples viable, that gives value to the work of people, including the type of work that is made invisible by the actually existing markets, like women's work and that of whole families in the South. In that sense, the systems of compensation payments can provide a solution.

In Latin America we are trying to establish the Bank of the South and the Alba Bank as a first pillar of the transformation of the development bank. Additionally, we are pushing for a regional alternative to the International Monetary Fund as the heart of a new financing, via a network, of the central banks of the region recuperating the national capacities and providing a new space of continental decision making. Finally, complementing those basic pillars, we have already moved forward with the establishment of a regional currency that, unlike the neoliberal restrictions that were self imposed for the Euro, is planned as a complementing currency designed to coexist

not only with the national currencies but also with popular currencies.

These three pillars are a necessary, but not sufficient, condition for further transformations. They are designed to achieve tactical and strategic goals, and they are meant to strike at the structural roots of external debt slavery.

The Debt Crisis and the Alternative Strategies of the Left

NICOS CHOUNTIS

INTRODUCTION

In order to discuss alternative strategies of the Left, we must, first of all, examine the characteristics of this multifaceted European and global crisis. After the evolutions of last summer (2011), nobody can risk predicting how it will end, since signs of a new recession and instability are coming strongly to the fore. Within the last month, international stock markets have experienced considerable losses, the US economy was downgraded for the first time in its history by the rating agency S&Ps and the Eurozone was on the verge of collapse with the Italian and the Spanish borrowing costs peaking a few weeks after the decision of the European Council of July 21 which –theoretically– “saved the Euro”.

However, we must also examine the way in which the dominant forces themselves face the crisis, what the policies are they adopt to overcome it, and what changes they promote in order to prevent future crises. These future crises may soon again test the efficiency and sustainability of the dominant neoliberal capitalist model, which, in my view, is irreparably shaken.

THE CRISIS IN EUROPE

1. European leaders appeared startled by the crisis and its dimensions, having believed neoliberalism was immune to crises or that, should they occur, crises would be short-lived and easily addressed. Nevertheless, the explanations given for the current crisis- at least for its European dimension- are limited to the non-implementation of the requirements of the Maastricht Treaty and the Stability Pact, tolerance towards indiscipline, obstacles to market freedom and the insufficient control of the financial sector.

2. They see the crisis as an opportunity for the refoundation of the dogmas of neoliberalism and thus for a harsher attack on social policies and state intervention as well as the barriers of:

- the welfare state, social, working and social-security rights and collective action;
- the policies which promote a Europe of solidarity, economic and social cohesion and actual convergence.

Their strategy includes the continuous reinforcement of capital in economic, social and political terms and at the expense of the forces of labour, and, since they cannot eliminate class struggle they try to block it as much as possible. For this reason, they are using the debt crisis –which does not only embrace the periphery of the Eurozone, but its core as well– in order to promote even more neoliberal policies. Thus, the resolution of the debt crisis, and the confrontation of the economic crisis in general is the main field for class struggles at the global, European and national level today.

THE ECONOMIC CRISIS CHANGES THE EUROPEAN UNION

In addition to revealing the limits of the neoliberal model, the current economic crisis also revealed the limits –the historical limits according to some people– of the EU itself and of the common currency. The truth is that the European experiment incorporates a variety of economic, social and national controversies in a single international structure. Since the 1990s, the left has pointed out the weaknesses –political and technical– of the common market (which reinforced entrepreneurship at the expense of society and the forces of labour), and the Euro itself (which was not backed by a sufficient community budget in order to compensate for the loss of the ability, on behalf of the member states, to exercise an independent monetary policy).

The economic crisis started from the financial sector in the US and the UK, it soon evolved into a debt crisis of the Eurozone and it has led the European construction to its worst ever crisis. Two things should be pointed out at this point: First, we are not only dealing with a crisis of the neoliberal model, but with a structural crisis of

developed western capitalism. It is a crisis which, despite its different characteristics in each country incorporates certain common elements such as the meagre economic recovery and persistent unemployment. The recent data concerning the US and the German economy are not accidental. The former faces, record-high unemployment rates despite the huge “liquidity injections” made by the Fed, while the latter has returned to a recessionary track after a year of impressive exports performance. Thus, we are indeed dealing with a structural crisis of the capitalist system in its current neoliberal form which not only affects economic structures, but political systems, social formations and the geopolitical arena as well.

The second point concerns the conflicts and contradictions of the European Union which –magnified by the crisis– have led it to a political deadlock. On the one hand, European leaders are imposing an authoritarian process of community integration in their effort to manage the recessionary effects of the crisis and the speculative attacks of the financial markets. On the other hand, they realise that this type of integration exacerbates the economic, social and national conflicts and augments instabilities within the Union. So far, the ruling political forces have not been able to provide a convincing explanation of their inability to achieve economic and political balance in the EU. On the contrary, they insist on the dogmas of neoliberalism, obliging all member states to follow the same model of economic and political management of the crisis – the German model of labour-wage downgrading.

The dominant thought and the political elites of Europe interpret the economic crisis and the crisis of the EU as the result of an incorrect application of neoliberalism’s financial recipes and the labour movement’s refusal to modify their demands. Thus, for them, the origins of the huge deficits and consequent skyrocketing of the costs of borrowing of such countries like Greece, Ireland, Portugal, Spain etc. is not due to fiscal competition which reduced the tax burdens of capital at the expense of labour, nor is it due to the liquidity injections administered to the banking sector, or to the socialisation of private losses. It is not even due to the statistical alchemies of the Commission, Eurostat and Goldman Sachs and the behaviour of the rating agencies. On the contrary, in their opinion, the debt crisis is rooted in the “lack of competitiveness”, the inflexible labour markets, the “oversized” social state, inflexible investment programs, the “closed professions”, agricultural subsidies and so on and so forth.

Besides, this is the reason why the reaction of the ruling elites towards the economic crisis takes the form of the intensification of the neoliberal model of economic growth and in particular the institutional framework of the EMU and the Eurozone. The reply of the EU to the aggravation of the debt crisis was structured on

two levels: 1) the “rescue” of “undisciplined” countries like Greece, Ireland and Portugal through the EFSF (the ESM in Summer 2012) which lends to member states on the verge of bankruptcy in cooperation with the IMF and in exchange for applying tough austerity programmes; 2) the tightening of the Stability Pact and the exercise of public policy by the member states in accordance with it, on the grounds that the enhancement of European integration and the application of common policies by the member states is the only remedy to the crisis of the Eurozone. This is achieved through the European Semester, economic governance and the Euro Plus Pact.

In particular, the European Semester –the first measure undertaken by the EU in order to face the debt crisis– obliges member states to submit their national budgets to the Commission for approval six months before their ratification by the national parliaments. It therefore infringes on sovereign rights beyond the limits of the current neoliberal pacts. Economic governance does not only oblige member states to pay exorbitant amounts in interest-bearing deposits and fines to the EU beyond the boundaries of the 3% deficit and 60% debt, but it also imposes penalties for a range of macroeconomic indicators which go beyond “normal” limits, such as labour costs, trade balances, productivity, etc. Finally, the Euro Plus Pact formerly referred to as the Competitiveness Pact introduces the basis for the political framework on which to build the new EMU by committing governments to engage in policy intervention to reduce wages, eliminate collective bargaining, to establish flexicurity and the legal commitment –constitutional or otherwise– to the deficit limits set by the Stability Pact.

European management of the debt crisis yielded very poor results. Not only has it failed to convince the international markets that the Euro is a stable variable, not only has it not managed to stop the recession in a number of countries with big deficits, but we could reasonably claim that since 2010 the decision of the EU leaders has contributed to the instability of the system and led Greece, Ireland and then Portugal to the verge of bankruptcy. In 2010, ten out of seventeen of the Eurozone countries had a modest growth rate (below 2%) and in some cases a negative one, while since the summer of 2011 the German economy entered a recessionary track.

However, the big loser in this process is democracy itself, in that there has been an utter defeat of a policy against the sovereignty of the market. In Greece, as well as in other European countries and the European institutions themselves, there is underway an unprecedented effort to impose neoliberal policies and subvert democracy and its institutions. Both in the Greek and the European Parliaments, we are witnessing ever more institutional and constitutional “coups” defended as necessary to deal with special circumstances and in order to “progress”. It is obvious

that the limits of such an authoritarian policy are not determined at the level of the democratic legitimacy of government policies and the EU. On the contrary, the recent example of the repression of the “square movement” shows that the cases of police and state violence are exacerbated in the process of enforcing neoliberal policies.

THE ECONOMIC CRISIS AS AN OPPORTUNITY FOR THE LEFT

So far we have seen how the economic crisis, this structural crisis of capitalism, has radically shaken social formations and international cohesion and created an explosive social and political mix. In a conjuncture in which the coexistence of capitalist contradictions is prominent, the left, and in particular the European Left, is struggling to find a common strategy that will lead to the socialism of the 21st century.

Nevertheless, if we want this strategy to be fruitful, we are obliged to analyse the European construction and its crisis isolated from the prejudice of the past, while taking into account the limits of the so-called Left Europeanism. As was made clear by the previous analysis, the EU and the EMU are reaching their limits. And it is at this moment that the European Left can finally claim that its criticism regarding the problematic architecture of the Euro and the Eurozone was vindicated. However, we cannot overlook the fact that the economic crisis and the crisis of the EU are two sides of the same coin.

Thus, the strategy of the left, a hegemonic programme for the establishment of socialism in the 21st century, must not only focus on the fundamental social relationship between capital and labour, but also the secondary economic and social contradictions which arose due to the 30-year-long application of the neoliberal growth model. In other words, a modern and at the same time radical programme of the European Left must incorporate reforms needed to counter the debt problem and the structural weaknesses of the EMU and the Euro, and at the same time it must introduce essential political and social changes at the national and European levels, which challenge the logic of capital at its core.

The European Left should not make the mistake to limit itself to an ideology (Keynesianism) that is not part of its tradition and thus forget its historical roots. It should not focus its criticism and demands on the problematic architecture of the common currency that today serves a specific sector of capital. On the contrary, it should bring these contradictions to the fore and contest the policies which make up the core of the economic union and which—in the name of free competition—degrade labour, deregulate pension systems, privatise education, transportation systems, energy, water, and so on.

Proposing such a programme is not an easy task. However, the European Left can use its programmatic proposals regarding the overcoming of the debt crisis in the Eurozone—ranging from the introduction of Eurobonds and investment bonds to the complete revaluation of the framework of the ECB in the direction of more democratic control, the restructuring of the debt and increasing the Community’s budget. The list of such proposals is long. Nevertheless, their application depends on a balance of power that for the time being is not favourable for the Left. This is the hardest, and perhaps the most important element of left strategy in this conjuncture: how are we going to find a common language in communicating with society? How are we going to regain the trust of working people and our lost credibility?

I consider the ideological and political struggle, as well as the unity of all left forces in a common hegemonic program based on democracy, social justice and the transformation of the economic reality in order to meet social needs, to be an appropriate starting point. Our participation in social movements is not only necessary; it is indispensable if the left wishes to consolidate social explosions and turn them into political changes.

In conclusion, we may outline the strategy of the left as an intervention on three interrelated levels:

- 1) Ideological and political struggles aiming at deconstructing the dogmas of neoliberalism and the logic of “eternal capitalism”. This is the best moment to do it, since the crisis of 2007-2008 has already shaken the credibility of capitalism.
- 2) Reform proposals that confront the acute problem of the debt and help countries escape their recessionary trajectories in a direction that benefits labour.
- 3) Contesting the core of neoliberal economic policy as it is applied by the EU, the European Pacts and the Regulations in such a way as to propose a fundamental restructuring of the Greek and the European productive model, replacing it with new methods of production and processes of distribution in which the worker will have a central role, say and power.

A Modest Proposal for Overcoming the Euro Crisis

YANIS VAROUFAKIS¹

INTRODUCTION

In seeking to placate credit rating agencies,² the governments of the Eurozone are undermining Europe's credibility with electorates, markets and, ironically,... the credit rating agencies themselves! Instead of closing what was already recognized as a democratic deficit, they deepen it and, in the process, reinforce the Eurozone's unfolding predicament. Eager to please the markets, Europe's leaders ignore Treaty commitments to economic and social cohesion and, indeed, undermine them with a series of decisions (or lack thereof) which attach a major legitimization crisis onto an already vicious economic crisis. Thus, not only the

1. This proposal was co-authored with Stuart Holland from the Department of Economics, University of Coimbra, Portugal. It was first tabled in November 2010. Since then, it has been updated on a number of occasions in response to developments within the Eurozone and comments sent to the authors by a large number of readers. The authors wish to thank them for playing an active part in seeking to effect a Gestalt shift by which a fresh perception of what is feasible may gain ground.

2. The very agencies whose triple-A ratings of the bank-generated toxic debt drove the financial sector into insolvency.

EU's economic future but that of European democracy is endangered as well.

Not all governments or ministers have been equally compliant. There have been several calls for new institutions for European governance. They fall in two categories: Proposals that require greater federalism on the lines of common fiscal policies and fiscal transfers. Such proposals are blocked by a general consensus that federalism is either utopian or undesirable. Then there is the second category of proposals, which have been kept off the official agenda. Meanwhile, the mixture of policies adopted, by which to face down the crisis, comprises new expensive loans (to already insolvent member-states), more austerity (which guarantees a reduction in their national income) and, possibly, the prospect of some debt buy-outs.

In the present perplexing situation, one thing is crystal clear: That the combination of policies adopted, based on the triptych loans, austerity and debt buy-outs, is failing both economically and politically. On the 14th of March, and then again on the 25th of March 2011, the EU's leadership failed to agree on how to increase the EFSF bailout fund, deferring their decisions (with the fall of the government in Portugal, following that in Ireland) until June. The surplus countries (Germany, Finland, Austria and the Netherlands) are objecting to open-ended, unlimited liability lending to the fiscally challenged periphery. Germany and Finland resist the fiscal transfers necessary under the EFSF.

Our main point is that none of this is even necessary. As argued below, the euro crisis can be dealt with *without any fiscal transfers*, with *no taxpayer-funded bond buy-backs* and *without changing existing Treaties*. What Europe needs is today is:

- i. A commitment to stabilise the current debt crisis by transferring a share of national debt to Europe which (at less than one per cent of GDP) has next to none (and until May last year had none at all).
- ii. To hold the transferred debt as Eurobonds and offer net issues of such bonds which would create a highly liquid market in European paper, attract capital from the Central Banks of surplus economies and Sovereign Wealth Funds. This new, highly liquid, market for Eurobonds will, in itself, lessen volatility in the remaining bonds of member states as well as attract funds to the "centre" with which to co-finance recovery and turn the Eurozone's current weakness into a major strength.
- iii. To utilise this inward flow of capital, in conjunction with the funds raised by the European Investment Bank (EIB) from its own bonds issues, to finance the European Economic Recovery Programme to which the Union has been committed since 2008 but which is currently blocked by deflationary policies that risk a double dip recession not only in Europe but also in the US.
- iv. To achieve such a Eurobond funded recovery (by shifting excess savings into

investments, rather than printing money) by drawing on the precedent of the US New Deal; a singular attempt by the Roosevelt Administration to build up a fresh confidence in the ability of governments to govern at a time of crisis (rather than be serial victims of a vicious circle which leaves neither states nor markets in charge).

v. To thereby contribute to a more balanced recovery of the global economy (which is one of the main stated aspirations of the G20) and do so by recycling global surpluses into productive, socially useful and environmentally sustainable investments.

A key to this is not fiscal transfers but a *tranche transfer*: transferring a share of national debt and borrowing to Eurobonds held and issued by the European Central Bank (ECB). One of us (Stuart Holland) recommended a new institution to issue such Eurobonds in a report to Jacques Delors in 1993. The Bruegel Institute more recently has done the same. The EIB has declined to issue the bonds, which is sensible since there is a difference between bonds as instruments of debt stabilisation and bonds for investment in recovery.

But the scale of the current debt crisis is such that we do not need a new permanent institution (such as the European Stability Mechanism, ESM, intended for summer 2012), nor a temporary institution such as the European Financial Stability Fund (EFSF), but one which is sufficiently established both to command the respect of financial markets (including global bond markets) and to deter short-term speculation.

If such a *tranche transfer* of debt were up to 60% of GDP (as Policy 1 recommends), it would reduce the default risk for the most exposed member states by lowering their debt servicing costs, and signal to bond markets that governments have a proactive response to the crisis, rather than are victims of unelected credit rating agencies.

Importantly, the *tranche transfer* would not be a debt write-off. The member states whose bonds are transferred to the ECB would be responsible for paying the interest on them, but at much lower rates. This also would strengthen rather than hazard the Stability and Growth Pact (SGP).

At present the SGP lacks credibility not only because France and Germany weakened it in 2005 but because the macroeconomics of debt reduction do not add up. When rating agencies are serially downgrading member states' sovereign debt, and causing them to refinance at rates of from 7 to 10 per cent, this is unsustainable and the edge of the cliff of default.

In contrast, a *tranche transfer* would ensure that the remaining debt held by most member states (except Greece, which is the outlier here) would be within national

SGP limits (60% of GDP). For countries like Greece, it would be over this but with a manageable excess next year of 27% rather than 87%. Policies 1&2 of the Modest Proposal address this further.

Yet debt stabilization alone cannot be the complete answer to Europe's political crisis. The Eurozone needs to reinvigorate its 2008 commitment to a European Economic Recovery Programme by learning up from Roosevelt's New Deal, whose success gave Truman the confidence to fund the Marshall Plan from which Germany herself was a principal beneficiary and which she gained on the basis of debt restructuring and grants (rather than repayable, expensive loan finance).

The key to the New Deal, it must be remembered, was not cutting investments nor raising taxes but borrowing to invest through US Treasury bonds. These do not count on the debt of US states such as California or Delaware. In parallel, there is no need for the Eurobonds (which can match those issued on its own account by the European Investment Bank (EIB) –see Policy 3– to count on the debt of EU member states.

Net issues of ECB Eurobonds neither imply fiscal transfers nor a buying out of national debt, nor national guarantees. The EIB –already double the size of the World Bank– has issued bonds for fifty years without such guarantees. Moreover eurobonds issued by the ECB would attract surpluses from the Central Banks of the emerging economies and from Sovereign Wealth Funds eager to achieve a more plural and more secure global reserve currency system.

Both the US and the trade surplus economies (China above all) would gain if this was part of a European Recovery Programme, whereas contraction of the European economy (as an outcome of debt stabilisation without such a programme) would reduce their exports risking a double-dip global recession.

Our proposal therefore is radical but modest since it does not need new institutions. Several commentators have claimed that a monetary union without a common fiscal policy is doomed to failure. But EU bond finance for a European New Deal would not need the equivalent of a US Treasury, nor common fiscal policies, nor finance from German or other taxpayers, nor a revision of the terms of reference of the European Central Bank, nor a new European Economic Government.

The institutional framework is already in place. Within existing Treaty provisions, since Maastricht, the heads of state and government in the European Council can decide “broad economic guidelines” for “general economic policies” which the ECB has been obliged not only “to note” or “to respect” but “to support”. This wording was in fact lifted directly from the constitution of the Bundesbank. Article 282 of the Lisbon Treaty simplified this to: “The primary objective of the European System of Central Banks (and the ECB) shall be to maintain price stability” but that: “without

prejudice to that objective, it shall support the general economic policies of the Union in order to contribute to the achievement of the latter's objectives".

Some European economies are currently undergoing inflationary pressures. But these are not due to excess demand. They are caused by rising commodity and food prices with high growth in the emerging economies, by some structural factors and, last but not least, by speculation. The speculation, in particular, should be addressed, as Nicolas Sarkozy has acknowledged. Arguably more food should be available for consumption rather than for conversion into biofuels. But neither of these will be redressed by more European austerity, while with a European Recovery Programme more firms could assure themselves of sustained cash flows from revenues (rather than from raising prices to compensate for the lower cash flow in recession).

To preempt claims that new terms of reference will be needed for the EIB, let us be clear: They are not needed! Since 1997, on the initiative of then Portuguese Prime Minister António Guterres, and recommended to him by one of us (Stuart Holland) the EIB gained a "cohesion and convergence remit" from the European Council to invest in health, education, urban regeneration, environmental technology and small and medium firms.

Since then the EIB has quadrupled its annual lending to over €80bn, or two thirds of the "own resources" of the European Commission, and could quadruple this again by 2020, making a reality of the European Economic Recovery Programme. In this sense, a New Deal for today's Europe is much more tangible than Europe's leaders think.

The EIB as the investment arm of a European Recovery Programme therefore already has macroeconomic potential. This is especially the case when investment multipliers are taken into account. As illustrated later, these multipliers can be as high as 3 (i.e. for every euro invested, €3 of additional GDP is generated). Thus an addition to EU investment of one per cent of GDP by the EIB registers up to treble this in terms of an investment-led recovery. It generates related investments and sustains rather than drains the private sector.

Finally, the macroeconomic recovery foreshadowed here, to which the EU has been formally committed since 2008, does not need to be monitored or surveyed either by the European Commission or the ECB. The criteria have already been established by the European Council decisions since 1997. Nor need there be a question of where the demand can come from. The very nature of the current crisis is the co-existence of insufficient effective demand (yielding low growth) with massive latent demand for investments in precisely the social and environmental areas which have been remitted to the EIB since 1997.

THE NATURE OF THE CRISIS

Each response by the Eurozone to the sovereign debt crisis has been consistently underwhelming. This includes the joint European Union (EU) - International Monetary Fund operation to "rescue" Greece and the European Financial Stability Facility or EFSF intended to support the rest of the fiscally challenged Eurozone members (e.g. Ireland, Portugal, Spain). More recently, European leaders announced their provisional agreement to create a permanent mechanism to replace the EFSF (called the European Stability Mechanism, or ESM) as well as a series of measures aiming to stabilise the crisis. Yet the crisis intensified.

The reason is that the crisis is systemic and multiple including:

- a sovereign debt crisis, a banking sector crisis and an under-investment crisis.
- The reason the EU's current policies are failing financially, economically and politically is that they seek to address one of its three manifestations, the sovereign debt crisis, while displacing the banking sector crisis and deepening unemployment and recession in all save its core economies.

This exclusive focus on sovereign debt is counter-productive: instead of reducing the debt-to-GDP ratio of the stricken member-states, it makes it worse. The debt burdens of the fiscally stricken nations are confronted by:

- huge, expensive loans to, effectively, insolvent states;
- new institutions which lack credibility on financial markets, not least since governments as yet have not been able to agree on their criteria (e.g. the EFSF);
- the negative effects of raising the funds to be loaned by utilising toxic financial instruments which contain a vicious default dynamic (that increases the likelihood of contagion within the Eurozone) and
- massive austerity drives that reduce employment, income and revenues for the member states burdened with these new loans.

But the immediate effect is a worsening of the other two crises: the banking sector and under-investment crises.

Europe's private sector banks are over-laden with worthless paper assets (both private and public). They are black holes into which the ECB is pumping oceans of liquidity that only occasion a trickle of extra loans to business since the banks are using the money to recapitalise without writing down toxic debt.

Meanwhile, the EU's policy mix in response to the sovereign debt crisis, founded primarily on austerity drives (as a condition for the new loans) –including the aim to halve fiscal deficits by 2013– constrains economic activity further and fuels the expectation of future sovereign defaults.

The mechanism designed to raise funds for Ireland, Greece and now Portugal

neither assures them of avoiding default, nor alienates the risk for other member states such as Portugal. So the crisis is reproducing itself rather than being resolved.

The problem with loans and bond buy-back schemes is that they do nothing to address either (a) the banking sector crisis or (b) the under-investment crisis, and (c) have minimal effects on the debt crisis.

We therefore propose four main principles for a more Comprehensive Solution.

Principle 1: The triple debt, banking, and under-investment crises must be tackled together. National debt stabilisation needs to be matched by a restructuring of the banks. Recession of national economies needs to be offset by realising the formal commitment of the Union to the European Economic Recovery Programme and respect for Treaty commitments to economic and social cohesion, both of which are undermined by a strategy focusing only on national debt and deficit reduction.

Principle 2: Shareholders rather than depositors in the banks which caused the financial crisis should share in the pain. Depositors and precautionary holdings in banks by individuals and pension funds should be protected. Speculative holdings relying on ECB bail outs should not. Determining these will take time. But commitment to the principle should be made from now. Both bank losses and portions of sovereign debts should be restructured in a transparent and socially equitable manner, rather than making electorates alone responsible for the banks' errors.

Principle 3: The crisis needs structural proactive change, not reactive responses to exposed sovereign debt. German, Dutch, Finnish and Austrian taxpayers should not be asked to shoulder new loans for insolvent countries. Fiscal transfers should be within the agreed framework of the Structural Funds through the Commission's "own resources", rather than a response to the sovereign debt crisis. The structural change should be one by which a major share of national debt is transferred to the Union to be held by the ECB as Eurobonds.

Principle 4: Such a *tranche transfer* to ECB Eurobonds should not count on the national debt or member states nor need be guaranteed by them anymore than are EIB bonds. A key parallel, as in the recommendation by one of us of Union Bonds to Jacques Delors, which he included in his White Paper of December 1993, is that US Treasury bonds do not count against the debt of the states of the American Union such as New York State or Vermont, nor are guaranteed by them. Therefore EU Eurobonds need not and should not count on the debt of EU member states, nor be guaranteed by them.

THE PROPOSAL'S THREE MAIN POLICIES

Policy 1 - Stabilising the sovereign debt crisis

Institution: The ECB (European Central Bank)

1.1 Tranche transfer to the ECB

The ECB takes on its books a tranche of the sovereign debt of *all* member states equal in face value to up to 60% of GDP.

1.2 ECB bonds

The transferred tranche is held as ECB bonds (€-bonds hereafter) that are the ECB's own liability.

1.3 Fiscal neutrality (i.e. no fiscal transfer)

Member states continue to service their share of hitherto sovereign debt now held by the ECB. To do so, each participating member-state holds a debit account with the ECB which it services long term at the lower interest rates attainable by the ECB as the central bank of the Union. Formerly sovereign national debt transferred to the ECB reduces the debt servicingburden of the most exposed member states without increasing the debt burden of any of the remaining member-states.

1.4 National debt reduction

The transfer of debt of up to 60% of GDP to the ECB means that most European member states then are Maastricht compliant on their remaining national debt and do not need to reduce it within the terms of reference of the SGP. Greece would need to do so but at some 27% of GDP in 2012 rather than 87% such reduction would be feasible especially if the deflationary effects of current policies are offset by its share of EIB financed cohesion and convergence investments.

1.5 The SGP and the Tranche Transfer

The national SGP limits therefore become credible with the *tranche transfer* to the ECB. For such a member state as Greece, whose remaining national debt exceeds 60% of GDP, the transfer should be conditional on an agreed schedule for its reduction.

Policy 2 - Tackling the banking sector crisis

Institution: The European Financial Stability Fund

2.1 Rigorous Stress Tests

Rigorous stress tests to be conducted centrally (as opposed to by national watchdog authorities) that assume an average haircut of 30% for sovereign bonds of member-states with debt-to-GDP ratio exceeding 70% and a 90% haircut for toxic paper found in the banks' books. The degree of recapitalisation necessary for each Eurozone bank should be computed on the basis of these tests.

2.2 Banks seeking long term liquidity from the ECB

Funded by net issues of Eurobonds subscribed by the central banks of surplus economies and sovereign wealth funds, the ECB can make medium term large liquidity provisions to the private banks conditional on haircuts on the existing sovereign bonds in their portfolio.

2.3 Recapitalisation

Re-capitalisation of banks should be short-term, once off and undertaken by the EFSF rather than a future ESM. It also should be in exchange for equity. If a bank cannot raise the necessary capital to meet the re-capitalisation target computed above, then the EFSF (and later the ESM) should require a swap of capital for public equity in the bank. The finance for this could be from bonds issued by the EFSF/ESM rather than national taxation. The return on the bonds should come from the dividends on the equity paid to the EFSF.

Summary: The purpose of Policy 2 is to cleanse the banks of questionable public and private paper assets so as to allow them to turn liquidity that comes their way in the future into loans to enterprises and households. The problem, currently, is that if banks are submitted to rigorous stress tests, several may be found to be bankrupt. Thus, Europe needs to simultaneously lean on them to come clean but also to help them do so without insolvency.

Policy 3 - European Recovery Programme

Institutions: The EIB (European Investment Bank), the ECB (European Central Bank) and national governments

3.1 Co-financing the EIB commitment to cohesion and convergence investments

As indicated earlier, since 1997 the EIB has been remitted to contribute to both cohesion and convergence through investments in health, education, urban renewal and environment, green technology and new high tech start ups.

But while it has done so with success, quadrupling its own borrowing and investments since then, its investments in many cases (as with the TENs) have been constrained by the national debt and deficit limits of the SGP.

There is a strong case for maintaining that national co-finance for EIB investments should not count on national debt and that this should be allowed within the 2005 revised terms of the Stability and Growth Pact (see below).

But just as EIB borrowing for investment through its own bonds is not counted against national debt by any of the major Eurozone countries, nor need be so by others, ECB bonds which could co-finance EIB investments –by the analogy with US Treasury bonds– should not do so either.

The analogy with US Treasury bonds, which do not count on the debt of member states of the American Union, should be seized upon. It would take the brake off the TENs and especially the high speed rail networks which, in several member states, are still being postponed because national co-finance counts within the current interpretations of the SGP.

These in themselves could constitute €1 trillion of investments in the decade to 2020. Also, while their environmental impact in the case of motorways is open to challenge, priority could be given to rail networks which are both less directly polluting and, in the case of shifting freight from road to rail, and for medium distances from air to rail, indirectly so.

3.2 Extension of the role of the European Investment Fund

The original design by one of us (Stuart Holland) for the EIF was that it should issue Union Bonds. But a parallel recommendation to Delors for the EIF, and which influenced his gaining consent from the Essen 1994 European Council to establish it, was that it should offer public venture capital for small and medium firms rather than only equity guarantees. The Council declined this at the time, but Ecofin, which constitutes the governing body of the EIB/EIF Group, could remit it to do so.

A similar constraint on EIF finance for small and medium firms and new high-tech start ups was that it initially would not consider an application for equity guarantees of less than 15 mecu and then declined direct applications for such guarantees rather than offering them through private sector banks or other financial intermediaries.

This was compromised both by the concern of private banks to gain loan finance as counterpart packaging of such equity guarantees and denied the original design for the EIF which was to enable SMEs to avoid the need for interest repayments during the initial years of a new high tech start-up in which revenue was either nil or negligible.

Ecofin, therefore, should determine that the EIF, co-financed by both EIB and ECB bonds issues, should offer equity rather than only equity guarantees and do so through “one stop shops” in each of the national capitals of the EU member states to which SMEs, currently starved of finance from the concern of banks to recapitalise, can readily have access.

Summary: Policies 1&2 will reduce but not eliminate the Eurozone’s sovereign debt and private banking sector burdens. Only development and real recovery will do the trick. Thus, the Eurozone (especially the periphery that has been in the doldrums for years) requires a productive investment drive. This is a task well suited to an existing institution: the EIB.

The EIB has a formal commitment to contribute to both cohesion and convergence, where key cohesion areas include health, education, urban renewal and the environment. However, at the moment, EIB investment projects are co-financed on a 50-50 split between the EIB and the member-state in question. The EIB's 50% does not count against national debt but the 50% of the member-state's contribution, if borrowed, does.

At a time of fiscal squeeze amongst many member-states, these co-financing rules severely circumscribe the utilisation of the EIB's investment capabilities. Once, however, member-states have debit accounts with the ECB (see 1.3 above), there is no reason why the member-state's 50% co-financing of a worthy (from a pure banking perspective) investment project should not be funded from that debit account (i.e. against the ECB's Eurobonds).

Thus, while the ECB is the guardian of stability, the EIB is the safeguard of recovery through investments funded by its own bonds and from transfers to it of net issues of Eurobonds by the ECB. It already has been remitted by the European Council to invest not only infrastructure but also areas of social cohesion including health, education, urban renewal, environment, green technologies and support for SMEs – all of which are in the joint EIB-EIF criteria since Lisbon 2000 (the EIF is now part of the EIB Group). Moreover, as recommended above, the EIF (European Investment Fund) should offer equity capital to new high tech start ups rather than only venture capital guarantees.

REGIONAL AND GLOBAL IMPLICATIONS

Our *Modest Proposal* outlines a three-pronged *Comprehensive Solution* to the Eurozone crisis that respects three principles: (1) Addressing the three main dimensions of the current crisis rather than only that of sovereign debt; (2) Restructuring both a share of sovereign debt and that of banks; and (3) No fiscal transfer of taxpayers' money. Additionally, it requires no moves toward federation, no fiscal union and no transfer union. It is in this sense that it deserves the epithet *modest*. Three existing European institutions are involved.

- First, the *tranche transfer* to the ECB stabilises the debt crisis.
- Second, the EFSF is relieved of the role of dealing with the member-states' sovereign debt and, instead, acquires the role of recapitalising stress tested banks (in exchange for equity).
- Third, the EIB is given the role of effecting a New Deal for Europe drawing upon a mix of its own bonds and the new Eurobonds.

In effect the EIB graduates into a European *Surplus Recycling Mechanism*; a mechanism without which no currency union can survive for long. But this also has global implications.

There are major structural asymmetries not only within the European Union but also between different regions of the global economy. Some of these range wider than the terms of reference of this *Proposal*. For example, consider the Ricardian hypothesis that the pursuit of comparative advantage will maximise welfare for all economies. This hypothesis relies (as Ricarco demonstrated himself) on the assumption of perfect capital immobility. But in our world nothing is as mobile as capital! Think of the combination of foreign direct investment and technology transfers from West to East, and especially the combination in China of transferred capital and technologies with a literate but low cost labour force (not to mention world class communications and infrastructure). Such developments have realised the conditions for Adam Smith's absolute advantage in a manner that cannot readily be offset only by exchange rate changes.

In turn, this makes the recycling of global surpluses more imperative if the G20 is to achieve the more balanced recovery of the world economy to which it aspires and which even a continental economy such as China needs, given that a major share of its GDP is export-dependent.

Such a recycling of global surpluses to co-finance economic recovery can ensure that Europe sustains global trade while this does not put it as a Union at risk in view of the fact that, unlike the US, it is broadly in balance with the rest of the world. But this also is relevant to a reversal of the beggar-my-neighbour deflation of mutual spending and demand implicit in current EU responses to the sovereign debt crisis. For Europe now constitutes a third of the global economy. If it combines contraction of its own global demand with a serial default of its most indebted member states, it would risk the disintegration of the Eurozone which would, in turn, bring about a terrible confidence crisis not only in the EU's economic governance, but also on markets. Then the risk of a double dip recession may well exceed that of 2008, spill over to the US and restrain the growth and development of emerging economies such as China, L. America, India etc.

Lastly, issues of sustainable development, rather than simply GDP growth, are central to an agenda for avoiding the second trough of a double dip recession, as are issues of economic and social inclusion for not only Europe and the US but also the emerging and less developed economies. But these should be on the agenda of the G20 with Europe able to show that it can assure its own economic governance rather than be 'mastered' by the credit rating agencies and the whims of speculative finance.

People Should Not Pay for the Crisis of Capitalism

PIERRE LAURENT

The European Union has never known such a crisis. It is at risk of breakdown if its leaders insist on serving the insatiable markets and ravenous capital. For three years, the only response of capitalist leaders was bailout plans for the banks and the financial markets, as well as a series of austerity plans. The only thing they achieved was the impoverishment of the populations and plunging member states into a morass of debt.

Today, the crises of the banking and financial systems continues unabated. Negotiations are underway for a new recapitalisation of the banks. President Barroso has just revealed the actual numbers: the states - and thus the people of Europe - have already borne the cost of a bank bailout amounting to 4.6 trillion Euros in aid funds and guarantees. This is evidence of how ineffective these measures are.

What did José Manuel Barroso propose in his intervention on the state of the Union addressed to the European Parliament? To continue in the same way. As he explains: "The causes of the crisis are known by now: Europe has not responded to the challenges of competitiveness. Some countries have lived beyond their means. The financial markets have been inadmissibly irresponsible. We have allowed for imbalances between member-states to widen, particularly inside the Eurozone". The

informal European summit has launched a new plan of extreme austerity, a new type of war against society. They call it a "Competitiveness Pact". The truth is that this is a pact of capitalist power against the forces of labour, a reinforced Treaty of Lisbon.

To draw some conclusions: the "response" to the crisis lies in the contraction of wages, the expansion of precarity and the undermining of the rights of wage earners and pensioners. Therefore, they had to amplify the measures they had already taken with the Euro-Plus Pact. But what does Barroso propose for the young people affected by unemployment? "Internships and opportunities to learn!" In his words, what we must do is "discipline" the "black sheep" of the Union by imposing new austerity measures on them. Moreover, since there are imbalances among the states, the EU should a priori control member states' budgets and macroeconomic choices. Faced with this dictatorship of the markets, we have the responsibility to defend the rights of the people of Europe.

Decline of wages, retirement at the age of 67, higher taxes on consumption and more leeway for capital, dismantling of collective agreements and the generalisation of precarious labour, drastic reduction in jobs and public spending... These will be the new standards for Europe.

As they claim, we have to abolish collective agreements, lower salaries and get rid of their cost on final prices because: "important and sustained increases can erode competitiveness"! In the public as well as the private sector the states must guarantee "wage moderation". In order to "encourage employment", they say, we must promote flexicurity, remove obstacles to free and undistorted competition and steer taxation from labour to consumption, in other words increase unjust indirect taxes. Finally, we have to adjust the retirement age to life expectancy and eliminate early retirement schemes. If we let them carry out all of these changes, the consequences of the Pact will be catastrophic.

Angela Merkel and Nicolas Sarkozy, as good defenders of the financial markets, explain that these austerity measures are only intended to cleanse the economy of the "bad students" who constitute a threat to the common currency and the economies of other EU member states. In Greece, European leaders are testing the recipes they want to apply to all countries. Banks launch their speculative attacks against the sovereign debts of the European economies. The EU and the IMF have experimented with their austerity policies against the will of the people and with the complicity of the government of George Papandreou. Their dramatic consequences on everyday life are evident, and, unfortunately, the worst is still to come in the next months.

We must send a warning to these sorcerer's apprentices who are creating scapegoats and trying to pit the people of Europe against each other in order not to

touch those really responsible for the crisis: in Europe we already have the historical experience of divisions which can emerge among people in times of crisis, and we know the potential dangers that such an approach can produce.

In reality, according to the elites, all people will be affected by the application of more or less brutal adjustment programs whose impact has already appeared. Today, Europe not only pays for the crisis of certain irresponsible countries. It pays for the crisis of financial markets, the crisis of a system that broke down in its effort to accumulate profits at the expense of labour by creating excessive competition, as well as fiscal and social dumping.

However, the European crisis concerns not just the issue of social justice but essentially the right of people to self-determination. During all these years it was the markets –in other words, banks, rating agencies, hedge funds and big multi-nationals– that ran the world. Now, we are witnessing the rise of fully visible authoritarian capitalism that intends to subordinate our entire existence. Its policy is rooted in economic wars, currency wars and perhaps, unfortunately, a new real war.

Europe is regressing as never before since the World Wars, and it is our duty now to renew our oath against such a barbaric future.

THE HOPES RAISED BY SOCIAL MOBILISATION

Anger is mounting among Europeans. Following the great emancipation movements which toppled –supposedly unshakable– dictatorships on the southern shores of the Mediterranean, new hope has risen with the hundreds of thousands of young –and old– people occupying public squares around Europe last spring. Social mobilisation has been growing across Europe for months. Although it certainly has not won for the moment, the number of those who are reacting and whose consciousness is being raised is steadily increasing in Europe.

Now more than ever it is time to unite our forces and our struggles. These are the struggles and the people who, by uniting, can change things. It is finally up to us to give meaning to the motto of the European Union “United in diversity”! This motto means nothing if it does not refer to the union of the people.

This is the moment of truth for Europe and for the Europeans. We either let our Europe and our countries sink into the cruellest austerity and authoritarianism, with –sooner or later– the same consequences as in Greece, or we unite against the dictatorship of financial markets.

For the European Left (EL), participating and helping these movements of popular resistance –both in our countries and at the European level– is the first

priority. The second priority is to contribute –with them and with all other available forces– to the formulation of alternative proposals against the crisis. Thus, the time has come for a political counter-offensive against the European-wide extension of austerity policies. It must not be the people of Europe who pay the price of the global financial crisis of capitalism.

THE SOLUTION LIES ON THE LEFT

The solution lies in the creation and redistribution of wealth in favour of workers: in wage increases, in fair taxation and in a policy of social stimulus which will not be funded by borrowing in financial markets. The EL proposes to replace the stabilisation fund by a fund for social development and solidarity. In contrast to the European Stability Fund, it would distribute funds for public service projects on the basis of social and environmental criteria. The money could be easily be found through the ECB, part of the EU budget and the taxation of financial transactions and income, and that would liberate public investment from financial markets and disarm speculators.

Our priority is not the annulment of debt at any cost. It is the development of social and industrial activities for human progress and the future of the environment. It is the resumption of control on the banking and financial sector in Europe in order to bypass the financial markets. We oppose solving the debt problem through social bleeding, by killing the patient to satisfy the vampires of finance. If we want France, Greece, Spain, etc. to start again on new foundations, we need to finance investments useful for the social and ecological transition and for industrial innovation.

When we propose that the citizens, the elected officials and the depositors take control of the direction of banks at the regional, national and European level, we are not just proposing a better social management, a better distribution of wealth and of the fruits of labour, we are proposing a revolution in the economic order that allows us to organise labour and production according to new development goals that can ensure the survival and development of the human species and its environment.

When we propose relocating entire sections of industrial activity, we are certainly defending the workers of our country and of Europe, but at the same time we are defending all of humanity because producing parts of the same product in ten different countries, with all the costs of pollution, is a crime against future generations.

A lot has already been done, and solid convergences exist in how we proceed together: audits, cancellation of illegitimate sovereign debt, public control of banks,

tax justice, redirection of the ECB's tasks, withdrawal of the Euro Plus Pact and revision of the Treaties on a new basis, harmonised European rights and increased wages and revival of industrial employment with new modes of production.

What we ask for is popular intervention and substantive debate. We want to revolutionise the political system, invent new practices, change the electoral system, move towards a democracy that is as direct as possible, and do away with overlapping of mandates and corruption across Europe. And we call for the abolition of a model where people are stripped of their powers!

We do not want to manage the crisis, we want to overcome it!

We will always defend the sovereignty of people. We do not want the "economic governance" and authoritarian federalism of the elites. At the EL, we are not Euro-blissful. Whether we are members of the Euro area or not, whether we reject the EU or we are fighting for change, our destinies and struggles are linked. Let us be united –workers, unemployed, precarious, women, immigrants– against the market. Let us work together. Our enemy is one and the same: exploitation and capitalist domination.

The Debt Crisis as a Social Crisis A European Solution for a European Problem

ALEXIS TSIPRAS

What has been occurring in Europe for the last two years is not a matter of coincidences. Rather it is a combination of symptoms of a deep systemic crisis challenging the global economy's neoliberal architecture.

This crisis emerged in 2008 as a crisis of the markets and the banking sector. The markets speculated on the impoverishment of social classes, through massive loans – and of course at a certain point the bubble had to burst. Thereafter the banks demanded and got support from state budgets, which meant that the crisis turned into a crisis of state budgets.

Now we are in phase three, in which the states and the markets are transferring the costs onto the populations. And they are doing this with the crudest and most violent agenda: the demolition of the social state, the eradication of labour rights, and the privatisation of social goods.

GREECE AND THE DEBT CRISIS

For the past two years a huge social crisis has appeared primarily in Greece. Europe's attitude towards the crisis –which was fully supported by Greece's "socialist"

government— was to blame the lazy Greeks who lack the sense of responsibility shown by their European neighbours.

However, the policy of harsh austerity measures and recession implemented by both the European Union and the International Monetary Fund has failed miserably. Despite Greece's social devastation, the prospect of solving the debt problem is receding.

The Greek ruling class and government tried to manage the debate on the causes of the debt crisis in such a way as to incriminate the Greek society. They tried to blame the problem on the supposedly high salaries of the public sector and the wasteful welfare state. In order to convince the public of this they injected the dominant media with spectacular individual examples of wastefulness and corruption in the public sector. Arguing that the lack of transparency and corruption—which the two dominant parties have maintained for decades in Greece— was pervasive, they propagated the notion that all people are to blame for the crisis.

They tried in this way keep the blatant cases of government corruption of recent years out of public discussion – the interweaving of political and economic power with the media, the huge profits made by major private companies from public-sector contracts, as well as Greece's scandalous tax immunity for capital and concentrated wealth.

This spin operation had a specific goal: to create the ground on which the "structural reforms" could be built, "structural reforms" being the polite term to describe the pillaging of low incomes, the gutting of the social-security system, the abolition of any legislated workplace protection and the demolition of the welfare state. Of course, these measures are not new. They were inscribed into the Lisbon agenda with great clarity. However, before the crisis it was not possible for the elites to enact these measures without igniting massive social resistance.

Therefore, the debt crisis offered an opportunity for tearing up the existing social contract. Greece, whose position makes it impossible for it to borrow, became the guinea pig for a project now being promoted throughout Europe.

THE ANSWER OF THE LEFT TO THE GREEK DEBT CRISIS

Faced with this situation, the Left has advanced its proposals for an alternative exit from the debt crisis. These propositions were projected to society as a whole and at the same time constituted a base for bringing the left and progressive forces together in a common front. The basic goals that we put forward are the following:

1) The organisation of universal resistance against the current attack on social

rights, work, and the welfare state, concentrating our social struggles on social solidarity, the defence of labour rights and full employment and the expansion of social goods.

2) The fair redistribution of wealth. The taxation of capital and accumulated wealth, as well as taxation of stock transactions.

3) Preventing the privatisation of public assets. The productive reconstruction of public administration, aiming at transparency and social efficiency.

4) A full audit, control and identification of the debt in order to clarify the precise state of the debt, the borrowing conditions, the needs that prompted each individual loan as well as the effectiveness of each loan.

5) A rescheduling of the debt with the purpose of cancelling a large part of it, improving its repayment terms and reducing the service costs to sustainable levels. Such a negotiation must and can be made among all countries facing problems with their lenders. And if there will be coordination and solidarity among the European countries, the result can be a fruitful one.

6) The issuance by the ECB of low-interest post-obit bonds and the issuance of Eurobonds for the needs of productive reconstruction. Today the ECB lends the private banks at a 1% interest rate, while it lends states at five times this rate.

7) A banking system under public control to serve social needs. In Greece, during the last three years, we have given the banks more money in cash and guarantees than the amount the government borrowed from the troika within the framework of the Memorandum. If this public aid was given to common and not preferred shares, today the Greek state would be in control of all big banks.

Demanding the socialisation of the banking system, with the first step being a public pillar, is not extreme. It is fair and necessary in order to pass to a banking system under public control which will defend and put forward the public interest and not that of some invisible shareholders.

8) The settlement of the domestic debt, especially of indebted households.

9) Emancipation from the control of the markets. A settlement of the debt cannot by itself guarantee that we will not find ourselves again in debt. Therefore we need a different development model based on the redistribution and reallocation of resources in order to promote public investments, full employment and environmental protection, as well as a new role of the EBC and the Eurozone that will finance this development on favourable terms.

10) The defence of democracy during this crisis and resistance to authoritarianism and the violation of social rights. The current neoliberal and authoritarian management of this crisis, as well as the attempt to control all types of social

resistance, prepare the way for a constantly growing authoritarianism and conservatism. It is no coincidence that the developments in Greece have led to a government that has no democratic legitimacy and even includes the participation of the extreme right. The obedience to the markets' wishes openly goes hand in hand with a constantly growing authoritarianism in dealing with protest movements, but even with an ultra conservative shift in issues like the one of immigration.

AN ALTERNATIVE PATH FOR DEVELOPMENT

Along this direction an alternative path for development can be opened. The route passes through rejecting the implementation of the harsh measures being imposed today by Europe and the IMF, and includes a radical redistribution of wealth.

Obviously, in order to deal with the debt we need to create primary surpluses. However, in order to get there we need to tax the rich and not deprive the weak of any resources. We need to increase the taxation of big enterprises and of great wealth and to abolish their scandalous tax havens once and for all. We must proceed to courageous taxation of all stocks transactions. We need to tax church property. We must move to the creation of an obligatory system for all Greeks that will keep track of their movable and immovable property, of all types, in Greece as well as abroad, so that everyone contributes according to their true capacities. We need to make those who have money –those who according to investigations have deposits of more than 600 billion Euros in Switzerland– pay for this crisis.

It is equally important to redesign development by placing social needs at the centre of our plans rather than the profits of the powerful. We need to fund the economy's target productive sectors with great potential which need to be reconstructed. We need to constitute a national strategy for the development of the agricultural and livestock economy, so that we ensure Greece's future food sufficiency and opportunity for export development. We need to socialise and exploit the important wealth resources of our country, strengthening the relevant industries at the same time. We need to develop the applications of new technologies building on the potential of Greek Universities, which are currently facing the prospect of complete inactivation due to drastic funding cuts in research.

We must make use of our country's high-level and geographically based potential for renewable energy sources, promoting the economy's productive reconstruction and the creation of social profit, not profit for a few multinational companies.

Finally, we must proceed immediately to a solidarity social shield in order to protect those most affected by the current crisis. We need to establish a minimum

guaranteed income as well as guaranteed access to public goods and basic services. We must combat unemployment creating jobs to meet urgent needs in the public sector. And of course we need to ensure the viability of social security funds, and the right to decent pensions.

THE DEBT CRISIS SPREADS ALL OVER EUROPE

Eventually, in only a few months time, the debt issue was transformed from a Greek abnormality to a danger for the whole of Europe.

Today, the debt crisis has struck a number of countries, affecting even the very core of the Eurozone. Not because of the laziness of Greeks, Portuguese, Irish, Italians, Spanish and German workers, of course, but because the European growth model cannot handle the attack launched by the markets.

Today it is clear that the left's criticism of the neoliberal architecture of the Euro has been vindicated.

With the consent of the European right-wing and social democracy, the single currency was built to serve the markets and capital, instead of real social needs. This was a logic that made the European perspective one of austerity, unemployment and regional disparities. This is precisely the logic underlying the current crisis.

It is more than obvious that those who are currently determining European policy have neither the will nor the capacity to make even the slightest structural change that would compromise the interests of the capital. Instead, they prefer to entrap the peoples of Europe in false dilemmas: Euro or chaos, ultra-austerity or chaos.

But these arguments come up against reality, day by day. The single currency, by its very nature, and the persistence in austerity and recession policies is the shortest and surest road to chaos. As became clear after the June and the October summit meetings, each project developed in order to control the situation collapses under the weight of new developments only a few days after its announcement. The decisions The October 26 decisions are already de facto cancelled, since the crisis has touched all European countries without exception. These new conditions are creating an extremely explosive situation.

Much could have been avoided had the authorities listened to the proposals of the European Left for common European lending, but also for the transformation of the European Central Bank into a lender of last resort. In this case, the crisis could, even still today, be brought under control.

But as we know from previous crises, the dominant elites would rather sink with the ship than make the slightest concession involving the relation of forces. Thus, the

current political leaderships, dragged along by the markets and banks, are once again following a dead-end and suicidal plan. Their first priority is the deconstruction of social contracts, thus risking a blow-up of the whole system. The recent interference of Brussels in the internal affairs of Greece, in order to prevent holding extraordinary elections at all costs, shows that they have reached a point which, not long ago, was unimaginable: that of undermining the democratic *acquis* in Europe.

Today the EU decision-making actors are in a state of panic. Disagreements and conflicts are openly expressed in the public sphere, and it is extremely difficult for anyone to predict the course of things.

The only thing we can take for granted is that all existing scenarios that are being discussed by European bureaucrats share a common concept, which is the exercise of extreme pressure on society and the termination of any social rights conquered in the last decades.

A LEFT ALTERNATIVE FOR EUROPE

It is now the time for the European Left to demystify the blackmail. The peoples of Europe do not have to choose between social degradation and complete disaster. The real choice is whether it will be societies or the markets to be saved from the crisis.

The only way to exit the crisis is the re-establishment of Europe on the basis of true democracy, full employment, social justice, dignity and equal cooperation.

Those who try to tackle the crisis with plans based on the certainty that societies, people and the world of work and education will continue to be the weaker link, should not be so sure of themselves. People have begun to revolt. The social struggle across Europe will alter the current balance of forces.

Faced with the supranational plans of the capital, the answer that we give is not the return to ethnocentric approaches of competition between people and workers. Each struggle in Greece is also a struggle for life and dignity for all the peoples of Europe. Each struggle in Europe is a struggle for life and dignity in Greece.

Today, the Left in Europe is facing a historic duty: to prevent these changes and create a coalition with all active social forces, in order to change the course of things and to exit this crisis, which, as it becomes deeper calls forth ever more aggressive measures by the ruling class and the capital. This is the only way for a new development based not on market profit, but on social needs, solidarity, environmental protection and enlargement of the sphere of common goods and public services.

In this sense, it is important to realise that we carry out this struggle on both the

national and international level. There are no purely national solutions to the problem, nor are there solutions that will fall from the sky, without our having to fight for social and political change in each country separately.

Class conflicts occur mainly at the national level. They are hard and therefore demand all our forces. On the other hand, we cannot ignore the fact that capital and the markets have internationalised their functions. We cannot ignore the global nature of the crisis, and therefore the answers that we give should also be based on international cooperation and action.

Our basic aim is to make left alternative proposals hegemonic inside a massive popular movement. Without energising popular protagonists we cannot change the balance of power and these proposals will remain behind the closed doors of our congresses, far from our societies. No proposal can be elaborated without a political subject to demand it or without a popular movement and without massive parties, capable of achieving political alliances and majorities. Our answer is to promote the common struggle and solidarity among all the peoples of Europe. The Europe of capital, of the markets and speculators is dying. It is time for the Europe of the Left to open up a new path for the future of our continent.

The future is a democratic and social Europe!

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