

# The Political Economy of **PUBLIC DEBT** & Austerity in the EU



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# THE POLITICAL ECONOMY OF PUBLIC DEBT AND AUSTERITY IN THE EU

Edited by  
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# Greece: Symbol of Illegitimate Debt

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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

odious<sup>1</sup> 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.<sup>2</sup> 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-

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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](http://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,<sup>3</sup> 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.

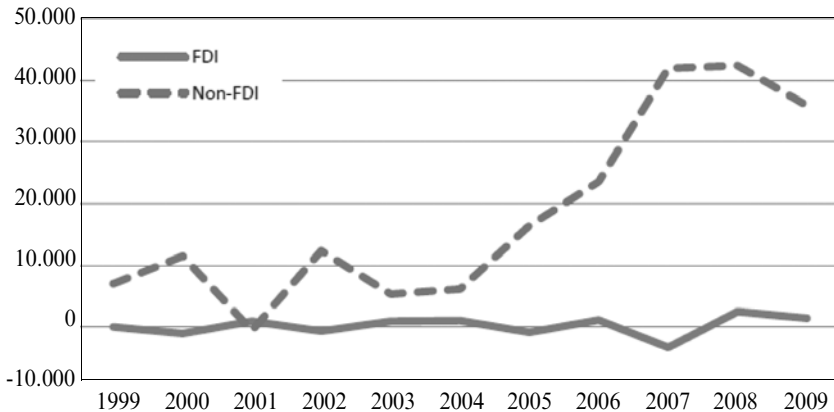
## THE RAPID RISE IN DEBT OVER THE LAST DECADE

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

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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](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: IMF<sup>4</sup>

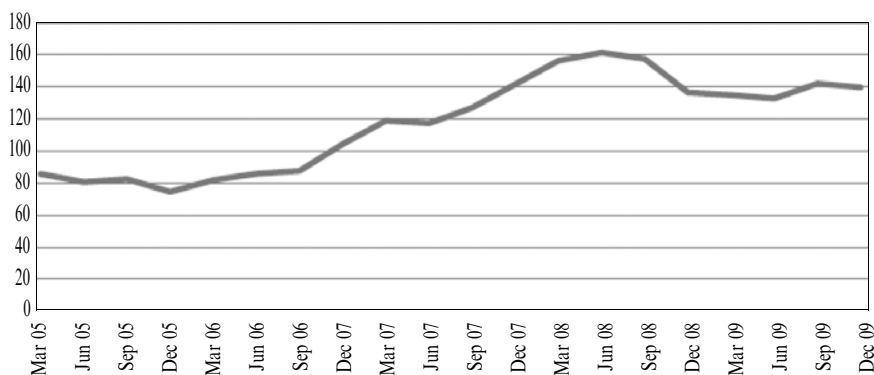
With the vast amounts of liquidity made available by the central banks in 2007-2009, the Western European banks (above all the German and French banks, but also the Belgian, Dutch, British, Luxembourg and Irish banks) lent extensively to Greece (to the private sector and to the public authorities). One 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.<sup>5</sup> Private banks are

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



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

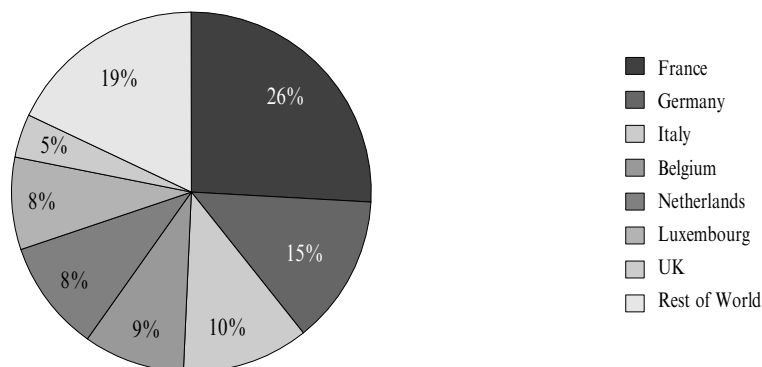
Source: BIS consolidated statistics, ultimate risk basis<sup>6</sup>

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. Lapavitsas et al., op. cit.

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



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%.<sup>8</sup> 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%.<sup>9</sup> 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](http://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.<sup>10</sup> 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

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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](http://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 ODIIOUS 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.<sup>11</sup> 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.<sup>12</sup>

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,<sup>13</sup> the

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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](http://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.<sup>14</sup> Sophia Sakorafa, who was a member of the government party PASOK until a few months ago, voted against the 2011 budget<sup>15</sup> 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,

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(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.<sup>16</sup> 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.

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16. See its website <http://www.contra-xreos.gr/>. This committee joined the CADTM international network in December 2010.