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The Breakup of the Euro?

Is Iceland's rejection of financial bullying a model for Greece and Ireland?

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Global Research, May 30, 2011
30 May 2011

Region: Europe
Theme: Global Economy

Last month Iceland voted against submitting to British and Dutch demands that it compensate their national bank insurance agencies for bailing out their own domestic Icesave depositors. This was the second vote against settlement (by a ratio of 3:2), and Icelandic support for membership in the Eurozone has fallen to just 30 percent. The feeling is that European politics are being run for the benefit of bankers, not the social democracy that Iceland imagined was the guiding philosophy – as indeed it was when the European Economic Community (Common Market) was formed in 1957.

By permitting Britain and the Netherlands to blackball Iceland to pay for the mistakes of Gordon Brown and his Dutch counterparts, Europe has made Icelandic membership conditional upon imposing financial austerity and poverty on the population – all to pay money that legally it does not owe. The problem is to find an honest court willing to enforce Europe's own banking laws placing responsibility where it legally lies.

The reason why the EU has fought so hard to make Iceland's government take responsibility for Icesave debts is what creditors call "contagion." Ireland and Greece are faced with much larger debts. Europe's creditor "troika" – the European Central Bank (ECB), European Commission and the IMF – view debt write-downs and progressive taxation to protect their domestic economies as a communicable disease.

Like Greece, Ireland asked for debt relief so that its government would not be forced to slash spending in the face of deepening recession. "The Irish press reported that EU officials 'hit the roof' when Irish negotiators talked of broader burden-sharing. The European Central Bank is afraid that any such move would cause instant contagion through the debt markets of southern Europe," wrote one journalist, warning that the cost of taking reckless public debt onto the national balance sheet threatened to bankrupt the economy.[1] Europe – in effect, German and Dutch banks – refused to let the government scale back the debts it had taken on (except to smaller and less politically influential depositors). "The comments came just as the EU authorities were ruling out investor 'haircuts' in Ireland, making this a condition for the country's €85bn (£72bn) loan package. Dublin has imposed 80 percent haircuts on the junior debt of Anglo Irish Bank but has not extended this to senior debt, viewed as sacrosanct."

At issue from Europe's vantage point – at least that of its bankers – is a broad principle: Governments should run their economies on behalf of banks and bondholders. They should bail out at least the senior creditors of banks that fail (that is, the big institutional investors and gamblers) and pay these debts and public debts by selling off enterprises, shifting the tax burden onto labor. To balance their budgets they are to cut back spending programs, lower public employment and wages, and charge more for public services, from medical care to education.

This austerity program ("financial rescue") has come to a head just one year after Greece was advanced $155 billion bailout package in May 2010. Displeased at how slowly the nation has moved to carve up its economy, the ECB has told Greece to start privatizing up to $70 billion by 2015. The sell-offs are to be headed by prime tourist real estate and the remaining government stakes in the national gambling monopoly OPAP, the Postbank, the Athens and Thessaloniki ports, the Thessaloniki Water and Sewer Company and the telephone monopoly. Jean-Claude Juncker, Luxembourg's Prime Minister and chairman of the Eurozone's group of finance ministers, warned that only if Greece agreed to start selling off assets ("consolidating its budget") would the EU agree to stretch out loan maturities for Greek debt and "save" it from default.[2]

The problem is that privatization and regressive tax shifts raise the cost of living and doing business. This makes economies less competitive, and hence even less able to pay debts that are accruing interest, leading toward a larger ultimate default.

The textbook financial response of turning the economy into a set of tollbooths to sell off is predatory. Third World countries demonstrated its destructive consequences from the 1970s onward under IMF austerity planning. Europe is now repeating the same shrinkage.

Financial power is to achieve what military conquest had done in times past. Pretending to make subject economies more "competitive," the aim is more short-run: to squeeze out enough payments so that bondholders (and indeed, voters) will not be obliged to confront the reality that many debts are unpayable except at the price of making the economy too debt-ridden, too regressively tax-ridden and too burdened with rising privatized infrastructure charges to be competitive. Spending cutbacks and a regressive tax shift dry up capital investment and productivity the long run. Such economies are run like companies taken over by debt-leveraged raiders on credit, who downsize and outsource their labor force so as to squeeze out enough revenue to pay their own creditors – who take what they can and run. The tactic attack of this financial attack is no longer overt military force as in days of yore, but something less costly because its victims submit more voluntarily.

But the intended victims of predatory finance are fighting back. And instead of the attacker losing their armies and manpower, it is their balance sheets that are threatened – and hence their own webs of solvency. When Greek labor unions (especially in the public enterprises being privatized), the ruling Socialist Party and leading minority parties rejected such sacrifices, Eurozone officials demanded that financial planning be placed above party politics, and demanded "cross-party agreement on any overhaul of the bail-out." Greece should respond to its wave of labor strikes and popular protest by suspending party politics and economic democracy. "The government and the opposition should declare jointly that they commit to the reform agreements with the EU," Mr. Juncker explained to Der Spiegel.

Criticizing Prime Minister George Papandreou's delay at even to start selling state assets, European financial leaders proposed a national privatization agency to act as an intermediary to transfer revenue from these assets to foreign creditors and retire public debt – and to pledge its public assets as collateral to be forfeited in case of default in payments to government bondholders. Suggesting that the government "set up an agency to privatize state assets" along the lines of the German Treuhandanstalt that sold off East German enterprises in the 1990s," Mr. Juncker thought that "Greece could gain more from privatizations than the €50 billion ($71 billion) it has estimated."[3]

European bankers had their eye on the sale as much as $400 billion of Greek assets – enough to pay off all the government debt. Failing payment, the ECB threatened not to accept Greek government bonds as collateral. This would prevent Greek banks from doing business, wrecking its financial system and paralyzing the economy. This threat was supposed to make privatization "democratically" approved – followed by breaking union power and lowering wages ("internal devaluation"). "Jan Kees de Jager, Dutch finance minister, has proposed that any more loans to Greece should come with collateral arrangements, in which European state lenders would take over Greek assets in the event of a sovereign default."[4]

The problem is that ultimate default is inevitable, given the debt corner into which governments have recklessly deregulated the banks and cut property taxes and progressive income taxes. Default will become pressing whenever the ECB may choose to pull the plug.

The ECB makes governments unable to finance their spending by central banks of their own

Introduction of the euro in 1999 explicitly prevented the ECB or any national central bank from financing government deficits. This means that no nation has a central bank able to do what those of Britain and the United States were created to do: monetize credit to domestic banks. The public sector has been made dependent on commercial banks and bondholders. This is a bonanza for them, rolling back three centuries of attempts to create a mixed economy financially and industrially, by privatizing the credit creation monopoly as well as capital investment in public infrastructure monopolies now being pushed onto the sales block for bidders – on credit, with the winner being the one who promises to pay out the most interest to bankers to absorb the access fees ("economic rent") that can be extracted.
Politics is being financialized while economies are being privatized. The financial strategy was to remove economic planning from democratically elected representatives, centralizing it in the hands of financial managers. What Benito Mussolini called "corporatism" in the 1920s (to give it its polite name) is now being achieved by Europe's large banks and financial institutions – ironically (but I suppose inevitably) under the euphemism of "free market economics."

Language is adopting itself to reflect the economic and political transformation (surrender?) now underway. Central bank "independence" was euphemized as the "hallmark of democracy," not the victory of financial oligarchy. The task of rhetoric is to divert attention from the fact that the financial sector aims not to "free" markets, but to place control in the hands of financial managers – whose logic is to subject economies to austerity and even depression, sell off public land and enterprises, suffer emigration and reduce living standards in the face of a sharply increasing concentration of wealth at the top of the economic pyramid. The idea is to slash government employment, lowering public-sector salaries to lead private sector wages downward, while cutting back social services.

The internal contradiction (as Marxists would say) is that the existing mass of interest-bearing debt must grow, as it receives interest – which is re-invested to earn yet more interest. This is the "magic" or "miracle" of compound interest. The problem is that paying interest diverts revenue away from the circular flow between production and consumption. Say's Law says that payments by producers (to employees and to producers of capital goods) must be spent, in the aggregate, on buying the products that labor and tangible capital produces. Otherwise there is a market glut and business shrinks – with the financial sector's network of debt claims bearing the brunt.

The financial system intrudes into this circular flow. Income spent to pay creditors is not spent on goods and services; it is re-invested in new loans, or on stocks and bonds (assets in the form of financial and property claims on the economy), or increasingly on "gambling" (the "casino capitalism" of derivatives, the international carry trade (that is, exchange-rate and interest-rate arbitrage) and other financial claims that are independent of the production-and-consumption economy. So as financial assets accrue interest – bolstered by new credit creation on computer keyboards by commercial banks and central banks – the financial rake-off from the "real" economy increases.

The idea of paying debts regardless of social cost is backed by mathematical models as complex as those used by physicists designing atomic reactors. But they have a basic flaw simple enough for a grade-school math student to understand: They assume that economies can pay debts growing exponentially at a higher rate than production or exports are growing. Only by ignoring the ability to pay – by creating an economic surplus over break-even levels – can one believe that debt leveraging can produce enough financial "balance sheet" gains to pay banks, pension funds and other financial institutions that recycle their interest into new loans. Financial engineering is expected to usher in a postindustrial society that make money from money (or rather, from credit) via rising asset prices for real estate, stocks and bonds.

It all seems much easier than earning profit from tangible investment to produce and market goods and services, because banks can fuel asset-price inflation simply by creating credit electronically on their computer keyboards. Until 2008 many families throughout the world saw the price of their home rise by more than they earned in an entire year. This cuts out the troublesome M-C-M' cycle (using capital to produce commodities to sell at a profit), by M-M' (buying real estate or assets already in place, or stocks and bonds already issued, and waiting for the central bank to inflate their prices by lowering interest rates and untaxing wealth so that high income investors can increase their demand for property and financial securities).

The problem is that credit is debt, and debt must be paid – with interest. And when an economy pays interest, less revenue is left over to spend on goods and services. So markets shrink, sales decline, profits fall, and there is less cash flow to pay interest and dividends.

Unemployment spreads, rents fall, mortgage-holders default, and real estate is thrown onto the market at falling prices.

When asset prices crash, these debts remain in place. As the Bubble Economy turns into a nightmare, politicians are taking private (and often fraudulent) bank losses onto the public balance sheet. This is dividing European politics and even threatening to break up the Eurozone.

Breakup of the Eurozone?

Third World countries from the 1960s through 1990s were told to devalue in order to reduce labor's purchasing power and hence imports of food, fuel and other consumer goods. But Eurozone members are locked into the euro. This leaves only the option of "internal devaluation" – lowering wage rates as an alternative to scaling back payments to creditors atop Europe's economic pyramid.

Latvia is cited as the model success story. Its government slashed employment and public sector wages fell by 30 percent in 2009-10. Private-sector wages followed the decline. This was applauded as a "success story" and "accepting reality." So now, the government has put forth a "balanced budget amendment," to go with its flat tax on labor (some 59 percent, with only a 1 percent tax on real estate). Former U.S. neoliberal presidential candidate Steve Forbes would find it an economic paradise.

"Saving the euro" is a euphemism for governments saving the financial class – and with it a debt dynamic that is nearing its end regardless of what they do. The aim is for euro-debts to Germany, the Netherlands, France and financial institutions (now joined by vulture funds) are to preserve their value. (No haircuts for them). The price is to be paid by labor and industry.

Government authority is to lose most of all. Just as the public domain is to be carved up and sold to pay creditors, economic policy is being taken out of the hands of democratically elected representatives and placed in the hands of the ECB, European Commission and IMF.

Spain's unemployment rate of 20%, much as in the Baltics, with nearly twice as high an unemployment rate among recent school graduates. But as William Nassau Senior is reported to have said when told that a million Irishmen had died in the potato famine: "It is not enough!"

Can anything be enough – anything that works for more than the short run? What "helping Greece remain solvent" means in practice is to help it avoid taxing wealth (the rich aren't paying) and help it roll back wages while obliging labor to pay more in taxes while the government (i.e. "taxpayers," a.k.a. workers) sells off public land and enterprises to bail out foreign banks and bondholders while slashing its social spending, industrial subsidies and public infrastructure investment.

One Greek friend in my age bracket has said that his private pension (from a computing company) was slashed by the government. When his son went to collect his unemployment check, it was cut in half, on the ground that his parents allegedly had the money to support them. The price of the house they bought a few years ago has plunged. They tell me that they are no more eager to remain part of the Eurozone than the Icelandic voters showed themselves last month.

The strikes continue. Anger is rising. When incoming IMF head Christine Lagarde was French trade minister, she suggested that: "France had to revamp its labor code. Labor unions and fellow ministers balke3d, and Ms. Lagarde backtracked, saying she had expressed a personal opinion."[5] This opinion is about to become official policy – from the IMF that was acting as "good cop" to the ECB's "bad cop."

I suppose that all that really is needed is for people to understand just what dynamics are at work that make these attempts to pay in vain. The creditors know that the game is up. All they can do is take as much as they can, as long as they can, pay themselves bonuses that are "free" from recapture by public prosecutors, and run to their offshore banking centers.

This article is an excerpt from Prof. Hudson's work in progress, "Debts that Can't be Paid, Won't Be," to be published later this year.

Notes

[1] Ambrose Evans-Pritchard, "Iceland offers risky temptation for Ireland as recession ends," The Telegraph, December 8, 2010.
[2] Bernd Radowitz and Geoffrey T. Smith, "Juncker Calls for Greek Privatization Agency," Wall Street Journal, May 23, 2011, based on Juncker's earlier interview in Der Spiegel magazine.
[3] Ibid.
[4] Peter Spiegel, "Greek assets could go to 'fund of experts'," Financial Times, May 24, 2011, Dimitris Kontogiannis, Kerin Hope and Joshua Chaffin, "Greece to sell stakes in state-owned groups," Financial Times, May 24, 2011, and Alkman Granitsas, "Greece Speeds Up Plans to Sell Off State-Held Assets," Wall Street Journal, May 24, 2011.
[5] Alessandra Galloni and David Gauthier-Villars, "France's Lagarde Seeks IMF's Top Job," Wall Street Journal, May 26, 2011.