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Economic Crisis

Toxic Aid: on the European Bill of Fare

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In May 2010 the European Commission created the European Financial Stability Facility (EFSF), financed with several hundred billion euros [To make sure that institutional investors still get their return and that the ECB can buy as a last resort]. Aid was intended for three years, but it is already clear that this limit will be overstepped. It is conditional on the concerned countries implementing austerity policies that are supposed to restore them to solvency.

The EFSF is part of a broader aid programme, which also includes IMF financing for several hundreds billion euros under the same conditions, in keeping with the IMF Structural Adjustment Policies that have been imposed to developing countries and to countries that used to belong to the Soviet bloc since the 1980s. On the other hand the ECB decided to buy debt securities issued by countries that are meeting hard times but, and this is crucial, it does so with private banks on the secondary market. Instead of directly lending to Eurozone member states, the ECB thus lends capital at a 1.25% rate to private banks which then, with this money, buy securities from States in difficulty at two or three times the rate for short term borrowing (if they are 10-year bonds the rates can reach 10 to 13% in the cases of Greece, Ireland or Portugal).

Next the ECB buys the securities issued by States [To make sure that institutional investors still get their return and that the ECB can buy as a last resort.] it had refused to grant direct loans to, from the same private banks! It seems entirely logical to think the ECB should lend the needed amounts directly at 1.25% interest instead of lending it to banks that make juicy profits and take unconscionable risks in their lending policies, which States will eventually have to cover up in case of bankruptcy. But we shouldn't just demand that the ECB lend directly to States, we must first and foremost have the illegitimate part of the public debt cancelled and the remainder significantly reduced. [See Eric Toussaint, Eight key proposals for another Europe, proposal 1, <http://www.cadtm.org/Eight-key-proposals-for-another>] If we do not give priority to this demand, the noose of the debt will hardly be loosened and these countries' people will have to pay for the crisis for decades.

Several provisions in the treaties governing the EU, the Eurozone and the ECB must be repealed, for instance, articles 63 and 125 of the Lisbon Treaty that prohibit all restrictions on movements of capital and any help to member states meeting difficult times. We must also move out of the Stability and Growth Pact. Moreover, the current treaties must be replaced by new ones in a truly democratic constituent process, concluding with a solidarity pact among peoples to promote employment and protect the environment. We must thoroughly revise the current monetary policy as well as the status and practice of the European Central Bank.

Issuing Eurobonds

Faced with the depth of the crisis, European leaders decided to create and issue European bonds (Eurobonds) to partly finance the Fund established to provide loans to the most indebted countries. This new mechanism makes it possible for countries with AAA rating (as was the case for France and Germany in 2010) to borrow on the capital markets in the most favourable conditions. Again the process involves borrowing on the markets, i.e. with private banks or other investment bodies instead of directly financing the needs of public bodies with money from the ECB or the member states' central banks.

Prospect of a Brady plan for the most indebted European countries

During 2010 European leaders realized that Greece, Ireland, Portugal and probably other countries as well would have to face even more difficult times in the coming years since a snowball effect has been triggered. While these governments repay their debts, their amounts steadily increase because of interest costs and weak economic growth. The debt repayment burden will soon become unbearable for some of them. This is why at the end of 2010 European leaders announced that from 2013 onward, new rules would be applied for issuing debt securities so as to make it possible to restructure the debt and reduce its amount. From June 2013 all securities issued by European member states will include a “collective action clause” mentioning that if a defaulting country cannot repay its debt, all investors will have to come together and indicate how debts can be restructured and possibly reduced. This kind of mechanism had already been discussed within the IMF in the early 2000s, in the wake of Russia and Argentina suspending their repayments in 1998 and 2001.

In short, in the years following 2013 private creditors must expect a restructuring of the debts of debtor countries, which means a reduction of their amounts after imposed negotiations. But we are not too concerned about the dividends of major shareholders in creditor private institutions: meanwhile, creditors will have received considerable amounts while reducing their exposure to countries at risk, because the IMF, the ECB and the European Commission are taking over. Patrick Artus, chief economist at Natixis, has the same analysis: At the beginning of the coming decade virtually all the debt owed to private creditors will have been repaid while virtually all the public debt owed by countries at risk will be to public creditors (European Financial Stability Facility (EFSF), European Union, IMF...) (Flash Economie, 24 March 2011, <http://gesd.free.fr/flas1218.pdf>, our translation).

This actually recalls the management of the debt crisis in developing countries in the 1980s with the Brady Plan [See Éric Toussaint, *The World Bank: a Critical Primer* (2008), Pluto, London, chapter 15.] Indeed at the beginning of the 1982 crisis the IMF and the governments of the United States, the UK, and other major powers bailed out private bankers in the North that had taken huge risks when lending without restraint to countries of the South, particularly in Latin America (in a somewhat similar way to what happened with subprime mortgages or with countries such as Greece, Eastern European countries, Ireland, Portugal, Spain). When developing countries, starting with Mexico, were on the brink of defaulting, the IMF and member countries of the Paris Club granted them loans on condition that they carry out repaying private banks and that they implement austerity plans (the notorious Structural Adjustment Policies).

Next, as the South was getting more and more into debt through a snowball effect, they set up the Brady Plan (Brady was the US Treasury Secretary at the time) that involved restructuring the debt of major indebted countries through an exchange of securities. In some cases the amount of the debt was reduced by 30% and the new securities (Brady bonds) guaranteed a fixed interest rate of about 6%, which was quite favourable to bankers. This also insured that the same austerity policies would be carried out under control of the IMF and the WB. Today, under different latitudes, the same logic results in the same disasters.

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