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# Sovereign debt and the crisis in the Eurozone - Part 3 of 4

## Credit replaces money – credit cannot be replaced by money

In almost all economically successful states the accumulated debt has reached a level where it is unthinkable for it to be repaid through taxes this would be, and has been for several decades now, impossible.

This situation has come about on the back of the financial industry's certainty that debt and interest would be serviced on time; which is to say, through credit they themselves will have granted at a future date. This propitious circle must be continuous if the symbiosis of state and financial capital is to be carried out successfully. A bank that has invested in state securities, and which is now waiting for its money, should immediately reinvest in new state securities so that it can then be paid with this (here: its own) newly invested money. In this fashion banks are able to hold on to a permanent stock of, say, British state bonds despite the maturation of given bonds after a few years. If a bank wants to reduce its holdings of state securities, then it demands payment without granting any new credit to the state. For this to work, other banks must be willing to increase their engagement in these securities.

For its own speculations on state bonds to be successful each bank depends on the speculations of its competitors. If a bank, for whatever reason, believes that other banks will reduce their commitment, it has good reason to reduce its own involvement as well. Such an action is of course likely to have a domino effect, arousing the fears of other investors and initiating a movement of divestment or withdrawal. But how do banks gauge the intentions of their competitors? Here they are reliant not only on information from their own creditors cycle but also from the economic development of the debtor the intended recipient of any potential investment. Does the national economy ruled over by the state have a positive economic outlook? And, when there is a crisis, will this economy be one of those to come out of the crisis as winners?

Hence, the circular system of credit refers to the productive sphere where money is spent and earned in a different way than in the financial cycle.[1] The national economy which is subject to the indebted states must permanently show to be a large and sustainable money-making machine. If this is the case, and the creditors have no doubt about it, then they trust that they will each want to invest over and over again in the long term. In order to gain this trust the state then makes policy. The state does not take care of economic growth so as to pay back debt, but the state provides for economic growth so that it does not have to settle the debt but can always contract new loans.

## What follows for the states? Their purpose of capitalist economic growth becomes an objective constraint

What are the responsibilities of the capitalist state in securing the availability of sovereign debt? Most importantly, past debts and interest must be paid on time. Any question of reliability here is detrimental. Should a state default on a payment to a creditor, not only is that creditor deprived of its returns and subsequently less likely to buy new state bonds in the future, but equally damaged is the capacity for those state bonds to be treated as quasi money.

The state is thus concerned both with ensuring an adequate line of credit and with the health of its domestic banking industry. Keeping the financial markets happy is central to both and so, understandably, a pressing concern for the state at all times. The credit made available to the state is used, on the one hand, to pay back old loans, and, on the other, to pay for new projects. Central to this availability, and the cheery up-keep of the financial markets, are "signals" from the state, i.e., "Here, on my territory, everyone and everything is concerned with one goal: making more money." In this way the state is fortuitously compelled to ensure optimum conditions for what it wants in any case: capitalist growth. To this end it subjects everything and everybody. To avoid a possible misunderstanding: the following points on how the state guarantees capitalist growth are valid in general and are not due to sovereign debt. However, if growth is demanded, one needs to understand how the state facilitates it – with or without compulsion from the financial markets.

Firstly, the state meets its responsibilities to general capitalist growth by upholding itself and its law (politicians, judges, police, other civil servants plus other infrastructure). This is the absolute prerequisite for private business.

Secondly, the state must make sure that the classes can play their role in capitalism. Social provisions will be necessary for the workers not so that they can live a carefree life, but so that they are merely mentally and physically fit enough to be able to offer themselves to and work for companies. The state must also have done a good deal of preparation before capital is in a position to begin investing: infrastructure, universities etc.

If all this is given the state, thirdly, considers how to accelerate economic growth. Here, some of the services and social provisions that seemed necessary in step two (e.g., labour protection laws) now become more problematic. These are necessary only to the extent that they will prevent the collapse of workers under the stress of hire and fire rules, thus rendering them unavailable to capital. But such measures can also be seen as an impediment to increased economic growth. This keeps politicians busy with the continuous experiment: how much can one do without some social services and labour protection laws?

A fourth necessary provision of the state is a diplomatic team so that capital's interests may be represented, and that it is able to invest, abroad. Furthermore, it needs the whole war machinery so that this diplomatic staff can negotiate properly with other foreign sovereigns; that is, such that other countries pay the appropriate respect.

All of the above costs money. And, of course, in the effort to establish and promote economic growth as just described, but also in the attempt to make its creditors feel secure, the state is in need of more credit. The state wants to facilitate the logic of capital, and for that it goes into debt.

If it is indebted and permanently dependent on credit, the state has in fact created an objective constraint which merely compels it towards what it had initially wanted. Perhaps this difference of "want to" and "need to" is indistinct when everything goes well, but the opposition between the two asserts itself in an economic crisis. No one wants it, no one works towards the crisis, neither the state, the banks, companies, nor wage earners; but every few years "it" happens, and everybody knows it.2 In this phase, the state, as shown above, has to rely on credit even more. In this phase the state wants national economic growth, but it does not have the means to bring this to pass. But the claims against the state in the form of sovereign debt are in the world and require positive evidence.

With this in mind, one can distinguish between two types of austerity programmes. The first type is implemented when a state suspects that financial markets are not quite convinced of its quality as a money-making machine. In these cases, less money is spent on social programmes, but more is spent for the support of certain industries. For these stimulus programmes even additional loans are taken out and tax cuts for businesses are introduced to attract additional capital. The signal is: “Look, we have cut everything that is economically superfluous and we also have given impetus to increased economic growth.”

The second type of austerity can be seen in Greece. The EU and the IMF make their ‘support’ dependent on broad tax increases and austerity measures. The Greek government is forbidden to contract more credit, and thus it is unable to provide new impetus. In this way the recession is exacerbated and there is no trace of development a signal which is understood accordingly on the financial markets: a state that actually scales back all its expenses is a project in liquidation and is certainly undeserving of trust.

| Year | 1980 | 1995 | 2005 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| Interest in bn | 7.1 | 25.4 | 37.4 | 38.1 | 33.1 | 35.3 |
| New net debt in bn | 13.9 | 25.6 | 31.2 | 34.1 | 48.4 | 48.4 |

Table 2: Time series of interest payments and new net borrowing in the federal budget, FRG. Source: German Federal Ministry of Finance.

# The ideology of objective constraints

The objective constraint of economic growth, imposed by sovereign debt, is real and not an ideology. How this fact is presented in political debates, however, is often ideological and provides the basis for more nonsense.

When a politician claims that social benefits and wages had to be cut to satisfy the financial markets, the claim comes couched in the appeasing tones of sympathy and regret: he would indeed like to see better provisions for wage labourers, but, unfortunately, at this point, hands are tied, and needs must, etc. Any such argument fails to acknowledge that the state in fact approached the financial sector, and made itself dependent on it precisely in order to foster national economic growth. The state makes the life of wage earners dependent on profit and this also applies if special measures are required because of sovereign debt. The state is not compelled by a matter with which it would otherwise have no involvement but by an effect which follows from its national project of capitalist growth.

Unfortunately, this argument is not only popular among politicians but is widespread in the general public as well. During a more successful phase of the national economy, there is already enough evidence to put to question capabilities of capitalism to provide for material needs. In this regard, a crisis provides an even clearer demonstration of this. However, many people do not take this as a reason to question capitalism but as a reason to hope for or demand its better functioning: for that, many are willing to accept cruel policies. However, in the logic that the state now has to be cruel because of the financial markets, the public goes one step further: it is thought to be because of the financial markets, as opposed to the state's project of national economic growth – which the people themselves want – that these austerity measures are now needed. This difference in emphasis is what politicians are after when they speak of economic constraints; it is not the own project that causes inconvenience but it is the financial markets.

A good part of the protest which recently spread across Europe and the U.S. is based on this idea. It targets the financial sector as the culprit and calls for its regulation or sometimes even nationalisation. Governments fuel these kinds of explanations for the crisis by complaining the banking industry has 'forgotten' its supposed purpose as a servant of the whole economy.

This way, the contradiction which is contained in capital as an economic principle is distributed across different actors. In railing against some of the actors (the banks) other actors are longed for (strong politicians who dare to take on the banking industry), and so the whole mess keeps going on.

# The problem is not injustice in distribution but capital's end in itself

A common critique of sovereign debt is its alleged redistributive effecton incomes; some would collect interest on sovereign debt, while others would have to guarantee it via the taxes they pay. Since tax laws have been changed in recent years so that, for example, now two-thirds of the taxes in Germany are paid by wage earners, it is clear for many: through sovereign debt some get richer and others poorer.

This critique of sovereign debt, firstly, is wrong and, secondly, it is far too harmless. For the principal sum we have already discussed that it is usually repaid through follow-up financing on the financial markets instead of taxes. The focus on the relationships that arise solely from dealing with old debts was meant to emphasise that the necessities of sovereign debt are more far reaching than interest payments. But not only is it wrong to assume the the principle sum of sovereign debt to be paid by taxes. Even the idea that at least the interest from that debt is paid by 'the people' in form of taxes is doubtful.

Every year interest payments are due for the total debt. These are listed in the German federal budget as a separate item. In the years 2005 and 2009 the new net debt (i.e., debt that is added in addition to the old) was slightly lower than the interest that was due in those years (cf. Table 2). Here it was indeed the case that at least part of the obligations growing out of sovereign debt were met by taxes but not the predominant part. As shown in the table, in the other years, new net borrowing was higher than the interest owed. Regarding this, it may be said that the federal government not only paid its debts with new debts but also the interest. Hence, the taxpayers are not or only slightly burdened with debt. The lenders have earned money through sovereign debt, but this is only by virtue of the fact that they have credited not only the old debt but also the interest. That the gap between rich and poor would be widened due to the redistribution of taxes into interest payments is only correct to a minor degree, or not at all, depending on the fiscal year. 3

The attack on the living conditions of workers resulting from sovereign debt is to be found elsewhere and it is much more extensive. In order that the state permanently does not have to meet its debt obligations from its economic performance alone but is always able to take out new loans, the whole of society must be aligned without exception as a money-making machine. This signal to the financial markets includes measures such as establishing a low-wage sector, cuts in social welfare, promotion of already successful businesses, etc. The normal functioning of capitalism then provides the dazzling juxtaposition of poverty and wealth.

In relation to those who earn from sovereign debt we need to make one more point regarding their 'greed': their wealth exists and proliferates only so long as their private consumption, which may well turn out to be lavish, remains a sideshow of their money-making. Their wealth sustains and reproduces itself only when they reinvest their earned money again and again. If they do not – and this happens now during the sovereign debt crisis – their wealth vanishes. Banks must write off their wealth in large quantities. The immiseration of workers does not result from wine and cheese for bank shareholders but for the recurring reinvestment of profits for more profits. This end in itself of capital produces misery, and even more so during a period of crisis when this end in itself is not being realised.

| | 1999 | 2003 | 2007 | 2009 | 2010 | | 1999 | 2003 | 2007 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Germany | 60.9% | 63.9% | 64.9% | 73.5% | 83.2% | UK | 43.7% | 39.0% | 44.5% | 69.6% | 79.9% |
| France | 58.9% | 62.9% | 63.9% | 78.3% | 81.7% | Greece | 94.0% | 97.4% | 105.4% | 127.1% | 142.8% |
| Italy | 113.7% | 104.4% | 103.6% | 116.1% | 119.0% | Spain | 62.3% | 48.7% | 36.1% | 53.3% | 60.1% |
| Euro area | 71.6% | 69.0% | 66.2% | 79.3% | 85.1% | | | | | | |

Table 3: Time series of gross debt as % of GDP. Source: Eurostat

## Sovereign debt and economic performance

At the beginning of this text we offered a critique of the idea that the European sovereign debt crisis had its basis in too much debt. However, what is mainly referred to in explanations of the crisis is the ratio of gross domestic product (GDP) and gross debt. Here people do not simply talk about too much but about a ratio an excess of debt in relation to economic performance.

The usual explanation of crisis then goes something like this: “Greece has fallen into the debt crisis because it has contracted too much debt in relation to its economic performance. While Germany had a ratio of about 73% at the beginning of the crisis in late 2009, Greece was at a ratio of 127%. Greece lived beyond its means.”

A ratio of 100% would mean that the economic performance of a country, as measured in a year’s GDP, would be as high as the absolute level of debt. If Germany has a ratio of 73% then the GDP in Germany is greater than the gross debt. Greece, however, in 2009 had more debt than its GDP in that year.

So, does this ratio offer a cause for the crisis? When financial capital is looking for positive evidence in the national economy to decide whether a loan is worth it, then one could say that the economic performance indeed plays a role. This is true but not in the rigid sense implied here.

First of all, every contraction of credit is an attempt to become independent of current economic performance “living beyond your means” is invariably the starting point. States want to take on credit to develop their own national economy. Hence, it is clear that, when borrowing the ratio of debt to economic performance increases. However, another question is whether the economy then develops in such a way that it proves itself worthy of the sovereign debt. If debt was a contribution to faster capitalist growth then the relationship between debt and economic performance would fall again. But why should a state only contract debt temporarily and then wait to see whether this works out? At any time there are opportunities and ideas on how to develop the national economy. Therefore increased economic output might ensue, but at the same time the start of the next “period of development on credit” may be heralded – in this case, the ratio does not decrease. Table 3 lists the temporal development of the ratio of absolute debt and gross domestic product of some countries and the whole Euro area.

None of the numbers by themselves indicate that a state has overdone it. A country like Germany which had 60% in 1999 is dependent on follow-up financing via the financial market just like Greece. The 60% could express stagnation and may indicate to the financial markets that Germany deserved no confidence. Spain is currently one of the main loose candidates in the Eurozone at 60%. The 113% of Italy in 1999 could have meant that Italy has taken on a lot of credit for its development. For this reason the number itself could be interpreted as absolutely ‘healthy’. Germany’s ratio has continuously increased until 2007 to nearly 65%. This could be interpreted against Germany’s favour, so as to say that the economic development was positive, but not as positive as it might first appear, owing to the growth of its debts at the same time. But why should 65% not express that Germany got to work on accomplishing more, and that success will be seen in the future? When Italy’s ratio decreased to 103.6% by 2007, this might have been seen as an expression of the successful outcome of Italy’s ‘calculation’ – i.e., the high debt pays off gradually. But the financial markets could then also have asked whether Italy has not become uninspired after its successful period of development: does it not have any more future-oriented projects for which an expansion of sovereign debt would be justified? Is Italy not, therefore, yet again a questionable candidate for investment? One can see that the ways of finance capital are not unfathomable, but nor are they definite. This is not the fault of financial capital but is due to the nature of capital.

Whether it is in the case of states or companies, there is an effort to become independent from traditional sources of revenue (taxes or profits). They constantly live beyond their means: contracting credit and thereby trying to create new sources of revenue. Credit is a claim against them, it stipulates that they will have to pay an increased amount of money at a later date; and insofar as this is the case, credit is in principle an entitlement to the economic future. When and if this economic future becomes the present cannot be properly identified. As such, the banking industry has the thankless task of deciding when a borrower has become so heavily indebted that the economic future no longer meets the growing demands. This is the political-economic basis for the hatred which confronts the financial sector in crisis. Because they trigger the crisis with their verdict, they are held responsible for the crisis. Here we emphasise that the crisis is anticipated from the beginning. The normal credit relation contains the possibility of crisis from the very outset.

1See also our text "Financial crisis 2008ff" available at http://www.junge-linke.org/en/financial-crisis-2008ff.

2Here we do not want to pursue the issue of economic crisis further. But from the fact that it appears in all regularity, one can conclude that it is somehow related to the normal pursuit of success of everybody involved. Especially when there is a worldwide economic crisis, one cannot even specify which state had done something wrong now. All countries had their national efforts to promote economic growth, all companies have tried to generate tidy profits, the result is a period in which there is no gain to be accounted for across the board. A crisis does not "come" from heaven, and not because of failure of the actors, but because everybody did everything "right" according to the logic of capitalism. To explain how this works exactly is beyond the scope here.

3The British campaign "Move your Money" http://www.moveyourmoney.org.uk/ makes a similarly erroneous assertion when it claims "UK taxpayers have given up to 500 bn to the banks in the form of bailout and guarantee schemes." (http://www.moveyourmoney.org.uk/the-problem-with-the-banks, accessed 18.2.2012) This money was not collected through taxes but borrowed from the financial markets.