



Sovereign debt and the crisis in the Eurozone

What this text wants¹

In our text “Financial Crisis 2008ff.” we tried to explain how a financial crisis such as that of summer 2008 results from the normal course of business and not from mistakes or mismanagement. Towards the end of the text we briefly touched on how states attempted to rescue the financial markets and that – as a result – sovereign debt itself becomes subject to the practical critique of these markets.² In the last two years these policies seem to have been successful, insofar as the financial markets have, again, started to make a profit; however, as a result of the measures taken many states have now become lodged in a debt crisis of their own, which, again, is affecting the financial industry.

In our later text “Public debt makes the state go round” we then tried to explain how modern credit money and sovereign debt are related. However, there too, questions such as how states contract debt and why, who their creditors are and why, what the relation is between the GDP (gross domestic product) and sovereign debt and what the particularities of the Eurozone are, were only very briefly touched upon or not discussed at all. In this text we attempt to fill this gap. First, we want to explain the *standard* and *common* practice of sovereign debt in general, as well as providing a critique of the most prevalent explanations for the current crisis. And secondly, we would like to consider the particularities of the crisis in the Eurozone.

Too much sovereign debt as reason for the crisis?

One way to explain the Greek problems is to remark that Greece simply took on too much debt. In fact, sometimes newspaper articles claim that Greece has the largest amount of debt in the EU. This is *de facto* wrong.³

Table 1 demonstrates rather vividly that Greece’s gross debt is comparatively small. Moreover, sovereign debt is not the exception but the rule in capitalist states. As a tendency, the more economically successful a state is, the bigger its sovereign debt (converted into Euros the US’ sovereign gross debt in 2010 amounted to about €10.000 bn.). Debt is not reduced but constantly increased. Sweden has been included in

Table 1 as an example because it actually reduced its sovereign debt for some time (similar to Finland and Denmark).

Somehow the current sovereign debt crisis is related to high amounts of debt – to clarify *how* will be the aim of this article. Pointing to huge amounts of debt does not suffice, i.e., “This could not have possibly worked out long term anyway.” The fact that almost every state in the world is in debt – and the more powerful it is the bigger the debt – first of all begs the following questions: why have these states permanently contracted debt? Why is it that most of the states in the world were able to pile up their debt over such a long time without any problems? Who are the creditors and why have they readily and increasingly accommodated loans / lent money to states? As usual it makes sense before asking why this “it” does not work to do exactly the opposite: what is this “it” anyway that does not work, and how did “it” work before?

Why sovereign debt?

If a state’s debt becomes problematic, as is currently the case in Greece, public opinion often holds that current and former politicians have failed. They have supposedly poured money down the drain, or given out nothing but presents to the people. In short, they have not managed the state for the sake of the national economy but conducted political mismanagement. This kind of explanation for the crisis is most striking for often having been arrived at only when the state’s financial difficulties already exist. It seems that the outrageous profligacy of the government, or consecutive governments, has conducted itself quietly until such a point is reached. In opposition to this way of explaining the crisis, we will provide an outline as to why the democratic state always has good reasons to draw on debt as a means of making policy. For those who are wondering who “the state” is supposed to be, perhaps the following proposition: it does not matter who is in power, be it the Tories, the Labour Party, the Liberal Democrats, ... or even the Fascists -- all politicians always refer back to sovereign debt as the adequate means of funding.⁴

Sparing tax sources, such that they are more yielding in the future

The democratic state does not organise its tasks on the basis of the means of production and workers directly at its disposal. In earlier feudal states, for comparison, this was the case: feudal lords owned serfs working for them on their land which enabled them to fund knights and castles. By contrast, the democratic state allows its own as well as foreign citizens to produce on its territory – an activity whereby they earn their money. If the democratic state wants to accomplish something it simply takes money away from its citizens via taxes and buys whatever it wants from the citizens (disregarding sovereign debt for the moment). Democratic states also own (parts of) companies, e.g., in the UK there are many private-public partnerships. In such cases, however, the state does not intend to earn money but usually keeps ploughing money into this business to keep it running in such a fashion that the products and services of this business are available for the national economy on a safe and affordable basis. If the production is viable and has the same output, the state usually privatises the business – as long as there are no concerns regarding national security. In principle a democratic state’s income shall be based on taxes rather than the state acting as an economic subject itself.

A democratic state does not have to earn its revenue but can decide it. A wage labourer is required to earn her money, and if she has run out of it before the end of the month she is forced to confine herself.⁵ A business lacking money for its next push against competitors is required to make more money or ask for credit, whereas a state has the option to simply increase taxes. To avoid a misunderstanding: the state is not free to dictate its own wealth, which is to say it is in no way the arbiter of how much wealth a society has produced; it is free only to dictate how much it will expropriate of the wealth first created by the producers in that society – the point here being that the money the state wants to collect through tax revenues must actually exist. This is in some ways analogous to how anyone makes money, insofar as she too may only earn that money which has already been earned elsewhere. But there is a difference: earning is different from expropriating.

¹This text is a translation and in some places adaptation of our text “Staatsverschuldung und die Krise im Euroraum” published in November 2011 at <http://junge-linke.org/staatsverschuldung-und-die-krise-im-euroraum-alle-teile>. This version of this text is identical to that which appeared in Kittens #3.

²Common synonyms for sovereign debt are government debt, national debt or public debt. Yet, it is not the government, the nation, or the public which is the debtor but the state. Hence, we opted for “sovereign debt” and avoided these synonyms.

³What newspapers actually mean is that Greece has the highest debt level compared to its national economic output measured in a state’s GDP, i.e., it has the highest relative debt. Nevertheless, it is often written that Greece’s sovereign debt is the largest, and people who are less knowledgeable in respect of state finances may well often hold the view that Greece indeed is indebted the most in absolute terms.

⁴By “democratic state” we simply mean successful capitalist, “Western” states such as those in the Eurozone, the UK or the USA. When we write about *the* democratic state we simply mean features that these states have in common, i.e., those features which are an integral part of them being democratic states.

⁵Of course, private persons too can apply for credit up to some limit. This limit is especially low if a loan is solely for such unproductive expenditures as food and rent.

	1999	2003	2007	2009	2010		1999	2003	2007	2009	2010
Germany	1225	1384	1579	1761	2080	UK	653	631	852	1093	1351
France	804	1003	1212	1493	1591	Greece	122	168	239	299	329
Italy	1282	1395	1602	1764	1843	Sweden	161	145	133	129	146
Euro area	4618	5218	5985	7116	7837						

Table 1: Time series of gross debt in bn. Euros – rounded. Source: Eurostat <http://bit.ly/Ac6ME>

Still, many hold the belief that taxes mean some kind of exchange. They give money to the state and expect – are entitled, even – to get something in return. Hence, if, according to this point of view, the state's actions are disagreeable, this is a scandal, since it is the tax payer who is the state's rightful client. Politicians tend to support this perspective. If they introduce a new tax they call it e.g. "green tax" whereby the claim is made that tax collection and the state's splendid use of the taxes are directly connected. Such a connection does not exist, as was perhaps most notably expressed by Winston Churchill in 1925: "Entertainments may be taxed; public houses may be taxed; racehorses may be taxed... and the yield devoted to the general revenue. But motorists are to be privileged for all time to have the whole yield of the tax on motors devoted to roads. Obviously this is all nonsense ... Such contentions are absurd, and constitute ... an outrage upon the sovereignty of Parliament and upon common sense."⁶ The taxes the state collects belong to the state — it is that simple. Accordingly, it is up to the state alone what taxes are used for. Moreover, no-one but the state itself – i.e., Parliament when deciding on the state's national budget — has the right to appropriate and direct taxes (e.g., to dedicate tobacco taxes to health care or to building roads).

A capitalist state obtains its power from its citizens' private activities and collects money from whatever income they generate. No-one knows better than the state itself that it can only take what has been produced in society, i.e., money earned by the state's residents. Hence, the more successful they are in making money, the more (financially) potent the state.

This presents a comfortable dilemma to the state: on the one hand, the more the state takes from its citizens by taxation the more it is able to accomplish, whether that be in terms of procuring advanced weaponry/technology for the military, building better infrastructure, or opening more preschools and child care facilities. On the other hand, the more taxes the state collects from its capitalists the less money they have in their pockets to be able to invest in new projects and thereby further increase society's wealth. Private business is supposed to flourish – this is, after all, what makes up the state's power. Furthermore, the more taxes the state collects from wage labourers, the more it contributes to

their impoverishment, which may also affect the economy negatively as a whole.⁷

Debt seems to offer a direct way out of this dilemma: the state obtains financial means without burdening the businesses of its citizens. These businesses are then able to invest money to increase society's wealth. It is certainly not true that citizens are not affected by sovereign debt (see the passage on inflation later). But what is true is that the dilemma of "as little taxes as possible as the basis for as much taxes as possible" functions as a founding motive for contracting sovereign debt. No surprise this option comes to politicians' minds consistently whenever it is time for preparing the next national budget.

Creating new tax sources, such that they yield in the future

The second important reason for sovereign debt is perhaps best explained by comparison with a company. If, for example, Shell wants to exploit a new oil field, then it needs to invest, say, £1 bn to build the necessary infrastructure. Now, Shell does not wait until it has earned this money from the annual profits of its already existing oil fields. Instead Shell takes out a loan and starts exploring the new oil field immediately. With that credit Shell establishes its independence from the already existing sources of revenue and even creates new ones. With these sources of revenue Shell can then pay back its loan and, on top of that, make new lasting profits – at least this is the calculation.

Politicians see it quite similarly. For them credit is not the exception to the rule; it is not a one-off which follows from an inadequate source of tax revenue in the face of necessary expenditure, or from a desire to preserve (potential) tax sources. With credit they are concerned with creating the optimal conditions under which tax sources can develop.

To facilitate economic growth throughout the country, extensive and well maintained road networks are required for the transport of workers, materials, and goods; universities are needed for technical progress and the production of specialised knowledge in the workforce; child care services are also necessary so that mum and dad can go to work etc. If successful states had waited until the already existing

companies on their territories were successful enough to allow the funding of a new university based on tax revenue alone, the development of the means of production and the GDP would be perhaps that of 100 years ago.

It is important to understand that this logic is a *logic of speculation*. Credit is used to produce future national success in competition. Whether this success shows itself or whether competing national economies are more successful, or a worldwide crisis strikes through all calculations by all states, is impossible to say a priori. So when somebody ingeniously remarks, "we lived beyond our means," then three counterpoints can be made. First, it was not "we" who took on credit but the government. Second, it was not "we" either who spent the money, but the state. And third, what about this "beyond our means"? The whole point of the investment by the state was to produce the conditions which could justify the debt and some further economic growth on top of it.

Less tax revenue and more responsibilities: crisis

There remains a third reason for the democratic state incurring debt, and this concerns its utility in an economic crisis. Revenue from tax breaks away as companies no longer turn a profit and subsequently lay off their staff; this causes massive reductions in income, commercial, and VAT tax revenue. At the same time state spending is increased because there are more welfare cases in the working class, and the economy must be subsidised to prevent the destruction of entire industries. In this sense, the banking system was indeed 'saved' during the financial crisis with extensive new loans. For this particular dilemma, credit, of course, presents itself as a veritable option for the beleaguered state capable of securing it.

We might conclude this point with the observation that *borrowing always assumes too little money*. But the question one must ask is: from what conditions and for what purposes has this lack of money arisen? We discussed three fundamental aspects of the debt of the capitalist state:

- Fall in tax revenue.
- Protection/sparing of tax revenue sources for

⁶<http://ipayroadtax.com/no-such-thing-as-road-tax/bring-back-the-road-fund/> accessed 31.12.2011

⁷The difference how its policies affect the two classes constitutes the reason why budgetary policies repeatedly and resolutely turn to social welfare whenever austerity is on the menu. Politicians call this saving and the truism that one cannot spend more than what is there to make this all plausible. This platitude holds true for every wage labourer but certainly not for the state. Since the state generates its income by enacting resolutions, its only limit is the amount of money actually available in society. Up to this limit the state may spend as much as it wants. If the state abstains from collecting income it must have its economic reasons. The reason for the cutbacks in social benefits is thus simple: the state deems money in the hands of businesses much more useful than in those of hardship cases. The latter do nothing else but spend it on consumption while the former accumulate it.

the purposes of making them stronger in the future.

- The desire to create sources of tax revenue in the first place.⁸

In each economic situation – growth, stagnation, and crisis – there are good reasons for politicians to rely on sovereign debt. It is, as such, true that sovereign debt is no exception but the constant companion of bourgeois politics. The rule is an ever-growing mountain of debt.

Greece's debt

The immense and ever-growing mountains of debt of nation states result from normal economic calculation and not from the absence of the same by spending-addicted politicians. Nothing unusual happened in Greece before the crisis; rather the country has taken out loans in order to create the conditions for better national economic growth.

This speculation has not worked out. Greece was not one of the winners of the EU common market, but a loser. Where there is competition, there are necessarily losers. The shelves in Greece are full of German and French products. It was not Greece, or Greek entrepreneurs, but Germany and France that made those gains which Greece had hoped for in joining the EC and EU. This is one reason behind the Greek sovereign debt crisis, but it is not the principal one, as shall be discussed later.

Here we want to point out that it is too easy to disregard all economic and political calculations and to say instead that Greek politicians have simply thrown money out the window. The same pattern of behaviour would be observed in any other nation faced with similar difficulties. Were Germany, to take the strongest EU economy as an example, to slide into a debt crisis, and the public would – instead of asking for reasons – call for the blood of its politicians in the same manner as has been witnessed in Greece then democracy provides enough material for those who want to find someone to blame.

First, one would find material in (almost) any budget debate. There, the government always says it has considered all aspects carefully and found the right mix of necessary expenses, savings, tax increases and cuts, plus borrowing. The opposition, on the other hand, insists that tax money would be wasted, where it does not agree with a certain decision.

It is striking, however, that in any budgetary debate the government is also accused of saving at the wrong end – i.e., where the opposition would deem measures appropriate. In every debate the opposition accuses the government of both: wasting money and saving at the wrong end.

Second, in Germany there also exists something

called the “Bundesrechnungshof,” which every year publishes a book documenting where the state has supposedly wasted money or where construction projects, for example, ran over budget (once again). Furthermore, the fact that Germany hosted a World Cup would appear about as absurd as the 2004 Olympics in Greece in light of a debt crisis.

These hypothetical considerations are meant to emphasise that it is easy to blame politicians for failing by disregarding their considerations and justifications of the specific policy measures. It is easy to blame politicians for failing, in retrospect, if one ignores that every measure of economic policy is a speculation which inherently carries the possibility of failure in it.

How the mountain of debt grows and why the tax payer does not have to settle the debt

The state borrows money by issuing bonds. For example, the British state receives £1 million and promises to pay back this amount plus interest after 5, 10 or 30 years depending on the kind of bond. Greece does the same and so does Germany.

However, when these two countries are discussed some people claim that contrary to Greece, Germany could pay back its debt – all of it. Similarly, pundits warn about the burden of sovereign debt the tax payers are confronted with because they would have to pay it back.

These statements are incorrect: in 2010 Germany had an absolute level of debt – gross debt – of around €2,080 bn. Greece had €329 bn of debt. Each year, a part of this debt is redeemed. Because there are “government bonds” – i.e., state bonds – with longer maturities (durations), not all outstanding debt has to be repaid every year. Greece's current problems lie in its inability to repay those debts which are currently due. As for the claim that Germany could pay its annual debt bill from tax revenue alone: this would be impossible, as a simple comparison shows. The total tax including all extra revenues for 2009 totalled at €260 bn in Germany. In the year 2010 Germany had to spend €276 bn just to repay its outstanding debt.

Greece, Germany, and the U.S. would all be unable to settle their debts through taxes. The burden on the taxpayers is definitely not that they have to pay back the debt. Sovereign debt only works so long as states can find new investors who will lend them money that can be used to pay off previous investors. This happens in one of two ways: either, a creditor gets his money back, plus interest, and subsequently reinvests immediately in new state bonds; or, if she does not want to reinvest new creditors in her place are needed to grant the state credit. This procedure is called “follow-up financing”.

This is not a debt trap in which states acciden-

tally step into. This relation to the financial markets is actively sought – simply because their purpose is not to be debt free, but commercially successful.

The whole process depends on the on-going repurchase of debt. Therefore, a closer look at what makes sovereign debt so attractive for the main creditors (the financial industry and other states) is in order. And to answer the question about debt crisis specifically, we must inquire as to the conditions in which sovereign debt becomes unattractive to these creditors.

Before that, one more point. So far this text has only discussed debt which was taken on in the past and how this debt is repaid. However, in almost perfect regularity the mountain of debt is growing each year, which means that new debt is added to the existing. Those debts which are contracted in addition to the follow-up financing debts are called “new net debt”. And to clear up a few common confusions that stem from fiscal jargon: if politicians talk about a balanced budget, then this only means that this year no new net debt shall be added to the existing gross debt. The state still has to take on new loans to pay off the old that are now due to be paid. When politicians say that they want to save or adopt an “austerity budget” then this sometimes only means that they want to spend less money than planned last year. This may include that they spend more money than last year and that they take on more debt than last year. Sometimes “austerity” simply means to contract less new debt than last year. The total gross debt still increases. These remarks are intended to counter the confusion that arises from the usage of terms such as “saving” in government finance. For individuals “saving” indeed implies spending less money – not so for states. Calling taking on less new debt than last year “saving” highlights with peculiar force how self-evident the course of debt is for politicians.

Who are the lenders and what makes state bonds so interesting for them?

The main lenders come from the financial industry. Banks, insurance companies and mutual funds buy the bonds of their own state or other states. The second major creditor group consists of other states or their central banks. The German state, Japan and China, for instance, have considerable holdings of U.S. Treasury bonds. Thirdly, states attempt to harness their own population to finance sovereign debt. With bonds tailored towards this clientele states encourage the people to grant the state credit for interest in return.

In the German budget debates of the '60s and '70s there were concerns that sovereign debt would lead to a “crowding-out effect”. Banks would only have limited credit available and the money they lent to the state could not be lent to companies. Sovereign debt would therefore

⁸A last fundamental reason for loans is war. For the production and security of their own political position in the world states are willing to take on large amounts of credit – just have a look at the war against terror of the United States. However, why states wage and prepare for wars is not the subject of this text.

have a negative effect on the 'supply' of cheap credit to companies. But this worry was never too severe and governments always arrived at the conclusion that they had carefully considered the extent of new net debt and that it was so modest that companies would not feel the burden.

This concern at that point was already ideological. In the following, we want to explain that when banks grant states credit, this does not displace other investments. On the contrary, state bonds spur on the business of banks so that they can grant even larger volumes of credit to companies. The thesis is that banks need state bonds so that their business can properly flourish elsewhere. This is important to understand so as not to conceive the idea that banks fucked up when they allegedly invested so carelessly in state securities. Furthermore, when states contract debt, it is always also an economic policy to support their financial sectors. This again is important to understand so as not to simply accuse politicians of mistaken policy by providing the banking industry with state bonds.

The financial industry as creditor

One reason to invest in state bonds is simply to make money. The money spent comes back in a few years, plus interest. To that extent, state bonds are compared with all other bonds, stocks and other debt obligations offered by companies. From this perspective, state bonds are attractive to the lender when they promise – compared with other investment opportunities – higher interest rates.

The second point of comparison of the many money-making opportunities lies in the relative certainty that the debt plus interest will be repaid. An absolute security does not exist, but as a rule of thumb one can say that the safer an investment the lower the interest. A loan to a small business might earn more interest than a loan to BMW but in case of the small company it may be much more uncertain the loan will be repaid. And in this regard sovereign debt has a special feature.

The state, as the monopolist on violence, is always the last solvent subject in its society: firstly, when in doubt, it may decide to raise as much taxes as required to pay the debt. Before the state defaults it could, due to its taxing authority, tax all citizens, businesses, banks, etc. in its society so that they default first. Secondly, the state itself is the issuer of that money, in which it contracted debt. The U.S. and the UK, for instance, may, in the last resort, simply issue the money they owe others. For Germany and Greece, in contrast, this is no longer as easy due to their participation in the Euro. This aspect will be relevant later on in connection with the explanation of the European sovereign debt crisis – but for now we want to leave this special case aside.

As the master over money and as the monop-

olistic on violence, the state usually enjoys the highest solvency in comparison to companies, banks, etc., in its society. With solvency we mean the relative safety of a debtor to be able to pay back its loans and interest.

State bonds offer less interest than corporate bonds but, compared to the latter, they are relatively safer. This relative safety is necessary to the banking industry as a base for its more insecure investments. Before we go into this, an interim step is required.

The trade and valuation of bonds

If an issuer of a debt instrument, i.e., an issuer of a bond or the debtor, has shown for some time that she is a reliable money-making machine by servicing debt and interest on time then these debt instruments are traded. Organised via the stock exchange or via telephone between financial institutions, debt is bought and sold prior to maturity.

Due to the possibility to be sold at any time, a debt is assigned a value. Without this possibility it would simply be like this: a bank has £1 million and gives it to the state. Now the state has that £1 million and spends it. The bank in return has a debt obligation, i.e., a promise of future payment, say, in 5 years. During these 5 years the bank does not have the £1 million any more, but just a piece of paper with a promise. After 5 years the bank gets its money back plus interest – if the state is solvent.

However, if there is a trade of state bonds then this transaction presents itself differently in practice. A bank which gives away £1 million does not have the money but the promissory note. If this is traded the bank has the option to transfer this note into money at any time. The financial sector treats this option as an asset. The bank's balance sheet does not simply state: "We are poorer by £1 million – in 5 years this will change again" but instead it is more like "We have the promissory note now worth XXX".

This capitalisation – to turn promises of payment into an asset – of debt obligations turns these promises into "fictitious capital". Here we do not want to go into detail along which criteria these promissory notes – bonds – are evaluated, they can be found elsewhere.⁹

However, here we want to highlight three conditions for the trading of debt instruments.

First, the debtor must be known to be a money-maker. Bonds or shares of small companies are not traded because no one can size them up. Daimler Benz, on the other hand, is known to be a big, even a global player; its economic performance figures are continuously published and continuously robust. In case of states, too, it is known how potent the national economy is over which they reign.

Second, the debtor must have shown that it always pays debt plus interest on time. Not only is it necessary to prove to be a money-making ma-

chine, but also to show (potential) creditors that this machine works reliably for them. For example, in 2002 Argentina announced that it does not intend to repay its debt in full. Following this, the creditors grudgingly accepted a negotiation with Argentina over the diminished redemption of their bonds. With this step, which is now discussed under the name "haircut" for Greece, Argentina has freed itself from its debt burden. The consequence was that Argentina did not get any more credit from the financial industry. Argentina is considered an unreliable debtor since and there is no (large) trade of its bonds.

Third, the debtor must contract large quantities of debt for its bonds to be traded. This sounds paradoxical at first since the more one is in debt, one might think, the less likely it is to be able to service all debts. But if there are only a few bonds on the market then there are high fluctuations of their value. These fluctuations, however, have neither to do with the bonds' interest nor the assumed (in)security that payment of interest occurs nor with the changing assessment of the quality of the debtor. Instead changes in supply and demand have strong effects on the bonds due to the scarcity of the traded debt instrument. If the absolute amount is highly limited, a slight increase in supply might cause a big drop in price. In the business of speculation on changes in value such notes are extremely profitable, but also loss-prone. They are so risky that not many companies want to build their business based on them. This in turn has an effect on their trading volume.

Only when many bonds are bought and sold every day will a bond holder have some assurance that changes in value are based on the estimated quality of the debtor. This certainty is not only relevant to current buyers and sellers. If debt acts as an asset for the banks, then the daily changes in value even affect those banks that simply want to hold these bonds at present and do not want to sell them just now. Only when the bonds are bought and sold daily en masse, is it worthwhile for the bulk of banks to invest in them and to hold on to them. This way, trading volume is created in circles – demand for bonds is created by the demand for bonds – that makes random fluctuations due to tight supply and demand negligible. But for that the debtor must issue enough promissory notes first.

The particular significance of sovereign debt to the banking business

In order to understand sovereign debt (and thus also to grasp the crisis) it is important to comprehend the function that safe and therefore much-traded securities have in the banking business as well as their role in banks' balance sheets.

First of all, one has to give up the idea that banks would only lend their own money out. The money Barclays or HSBC lend to compa-

⁹For example, see Karl Marx's *Capital*: Volume 3, pages 594-600 of the Penguin edition. Also, our text "Gentrification" in this issue discusses capitalisation of land.

nies, invest in equities or state bonds they borrow from society themselves. Banks are characterised by the fact that they are always both borrowers and lenders. That this is the case with all banks, and hence is the norm, can be deduced from the obligation for them to hold 9% of their investments as their own property or own capital. This means that 91% of the money they lent or invested they themselves borrowed from elsewhere.¹⁰

Banks, for instance, issue bonds themselves, i.e., they go into debt with other investors in order to lend this money to others. An easy way to get money is to offer citizens to set up current accounts with them. Using this example we want to explain the important role sovereign debt plays for banks.

Every worker, every civil servant, every company has an account with some private bank. At, e.g., Barclays there is a constant flow of wages, salaries and earnings of companies into various accounts. To some extent Barclays lends out this collected money. The cost of these accounts, such as interest or administrative expenses, are lower than the interest rate Barclays may charge when lending that money out. This way they are, as they say, in business.

However, somewhat annoyingly to Barclays is the fact that customers withdraw or transfer money from time to time. For that the bank always has to keep money as a reserve that it cannot lend out, i.e., a minimum amount of money must be present at all times. Sometimes more money is withdrawn by the customers, sometimes less. In theory, Barclays would have to keep enough money for the maximum case, i.e., the amount of money all the bank's customers have in their accounts. Yet again, this would be even more annoying if subsequently only the minimum is withdrawn. In retrospect, this money would have lain idle – money the bank could have lent out to make money. Good bonds, which can be sold any time and, thus, can be converted into new money, offer an excellent solution for this distress. Hence, in practice, Barclays holds back only a minimum of money as a reserve, invests a portion in good, marketable bonds and the remaining money it lends out to companies for higher interest rates. Yet, if account holders do withdraw the maximum of money, the bank simply sells the good bonds, it is liquid immediately and, thus, it is able to pay out its customers. And in case the maximum is *not* needed (i.e., withdrawn) the money is not fallow but Barclays has lent the money out and, hence, can reap interest.

Good, i.e., at any time marketable, bonds give the above mentioned contradiction a passable form of development: banks can enter into interest-bearing transactions, thereby increase their money as capital, and at the same time

have quasi-money as a reserve in case of claims against them.

This function reinforces itself: if bonds are treated as bank capital and bought because of it, one can be more certain that one can sell at any time. Thus, the better they serve this function.

Because sovereign debt is considered to be particularly safe and traded as such, one can find it in the balance sheet of every bank. Sovereign debt is particularly compelling for banks due to the special safety of the debtor as the monopolist on violence and master of money. Sovereign debt, thus, is both investment and liquidity.

This way, the banking business is de-limited and freed through good, solid debt instruments. They are a good basis to take on extended credit and to grant credit and, thereby, to remain constantly liquid. This way the economically desirable 'supply' of companies with credit becomes looser and interest rates do not necessarily skyrocket because of a tight money supply (even though they might still do that for other reasons).

The question why states contract debt instead of simply printing the money they need derives a different answer than the usual one in this light: through its sovereign debt the state supports the national banking industry. Not in the way that it simply wants to pay for its interest, as many leftist critics of unjust redistribution assume. Instead, the state adjusts its financing to the requirements of the banking industry and this way contributes to de-limited lending by banks to businesses.

Furthermore, the state engages with the private interest of banks in quasi-cash, which also bears interest for economic reasons and supports the banks through its economic policy, when it endows its debt with another feature: the central bank always accepts sovereign debt and returns fresh, new, real money to the banks. So the banks do not have to trade the debt securities among themselves to get money. They can go directly to the central bank and receive real money for these bonds there.¹¹ This way the state supports the financial sector in its interest to lend money and to have liquidity at the same time and this way the state supports itself in its accumulation of debt. Here, too, the Euro construction has some particularities to which we will return when explaining the crisis.

Other states as creditors

The reason why states buy sovereign debt of other states is similar to the above discussed interest of banks. But here the first concern is not interest. States want to hold foreign currency to hedge their own currency. Germany, Japan and China have always had an interest in Dol-

lar reserves in order to tell the world: "When in doubt, we have more than our own currency in which we can pay. If for whatever reason there is doubt on our currency, we are still able to pay in another currency." Yet, this is intended as a sort of alibi so as no one actually ever questions their currencies. Every modern currency needs its own bank hoard. Now in a second step, considerations about the rate of return come into play: "If we have to hold Dollars as a reserve then we can also take United States treasury bonds which also promise interest. Should we then need to tap the reserve, we can exchange these bonds into Dollars quickly – either on the market, or with the Federal Reserve." This way then, these states also have both: a reserve that at the same time functions as capital, i.e., for the accumulation of money.

The population as creditor

The third group of creditors for states is their own population. In Germany a special bond was specifically created for this group, the Federal Treasury note. The conditions of this note very clearly show Germany's interest with this. First, one can buy it even for small amounts of about €100. This way every wage earner is invited to invest her savings in the state. Second, "Type A Federal Treasury" note interest increases the longer one holds on to it. These notes have a maturity of six years but they can be returned early; one then, however, collects the low interest rates of the initial phase only. If one holds on to these notes until they mature then one collects the higher interest rates of the final phase. "Type B Federal Treasury" notes only earn interest at the end of their seven-year term anyway. This ought to encourage citizens – unlike the banks – to hold on to these notes until they mature. If one then, thirdly, reinvests the principal sum plus the interest back into Federal Treasury notes then the whole thing is tax-exempt. Federal Treasury bonds may, fourth, be bought by citizens and non-profit organizations only, not by banks. Fifth, they may not be traded on the stock exchange. This way these notes are excluded from the evaluation as fictitious capital.

These Federal Treasury notes hence produce proceeds for the German state which are removed from the speculations of the banking industry. This contributes to trust in sovereign debt by banks and other states as creditors.

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 –

¹⁰ On 27 October 2011 the Euro countries introduced new regulation for all European banks which raised the limit to these numbers. Before, banks only had to own 4% of the money they lent or invested – apart from a few exceptions.

¹¹ Technically, this can work in two ways. Before the introduction of the Euro private banks in Germany could sell state bonds to the German central bank (discount rate) or temporarily deposit them with it (Lombard rate). Since the introduction of the Euro, banks have only been allowed to temporarily deposit the sovereign debt to get fresh money. They must take these state bonds back after some time and return the money. But because private banks can do this over and over again, this procedure effects the same, namely, that the European Central Bank permanently holds state bonds and that the banks permanently have fresh money. In the current crisis, however, the ECB too has begun to directly buy state bonds.

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.¹² 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 upkeep 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 unavail-

able 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.¹³ 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.

¹²See also our text “Financial crisis 2008ff” available at <http://www.junge-linke.org/en/financial-crisis-2008ff>.

¹³Here 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.

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 effect on 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.¹⁴

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.

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.

¹⁴The 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.

	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

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.

The sovereign debt crisis in the Eurozone

Since late 2009, Greece has been facing a debt crisis. It has not been able to find enough investors willing to lend it money to service old debt – under the previous conditions that is. Therefore, in order to get money at all, Greece has been forced to offer higher interest rates to its creditors. The financial markets did not greet this news with joy and queue to collect higher returns, but rather as a result they became even more cautious about Greek debt. For if Greece already had problems, then how would it be able to repay even higher obligations in the future. This raised interest rates on Greek debt even further which Greece would have had to offer on new loans – if the Euro Community and the IMF had not intervened in early 2010.

Figure 1 shows interest rates that various countries of the Eurozone had to pay in the past. What is striking about it is that with the introduction of the Euro, interest rates began to align (Greece joined the Euro in 2001) and then with the financial crisis in 2007 interest rates diverge again.

Before the fixing of exchange rates of the respective currencies to the Euro (1998) and the introduction of the Euro (2002) the financial markets obviously rated the respective state bonds differently. German state bonds were rated as more secure in comparison to Italian bonds. In Europe Germany had always been the state which paid the least interest. Greece, Italy and Portugal had to promise much more in interest in order to secure their loans. This first of all expresses that German bonds were more in demand than others. Sure, one might think, Germany indeed was and is the strongest economy. However, since the departure of the Deutschmark, the Lira and the Drachma, in short with the introduction of the Euro, financial markets have treated the respective sovereign debts the same. As these countries still had different economic strengths and still developed differently, the reason for this equal treatment must then lie in the single currency. In retrospect, one can say that the different treatment must also be explained by the different currencies. The quality of their sovereign debt was apparently equal to the quality of their national currencies. With the onset of the financial crisis in 2007 this equal treatment stopped again. The financial markets treated the various countries differently, notwithstanding them having the same currency. In what follows we want to show, by analysing the Euro construction, that this “notwithstanding” is incorrect. The thesis, which is yet to be established, is that the Euro has a contradictory design, such that it allows two opposed assessments: because of the Euro all sovereign debts are equal and because of the Euro all sovereign debts are different.

First, however, the connection between the financial crisis and the sovereign debt crisis ought to be explored.

The financial industry distrusts its saviours

In 2007 the worldwide trade of a particular type of securities (securitised loans) broke down. Gradually, it turned out that pretty much all the major financial institutions worldwide were involved in one way or another in this trade and were in trouble. Already in 2007/early 2008 the first institutions started to falter and governments began to support the financial sector with extensive financial aid packages – based on credit. These funds did not stop the downward spiral. In summer / autumn 2008 one respected bank after another faced collapse and the largest financial crisis in 80 years unfolded – even more credit was now needed to rescue

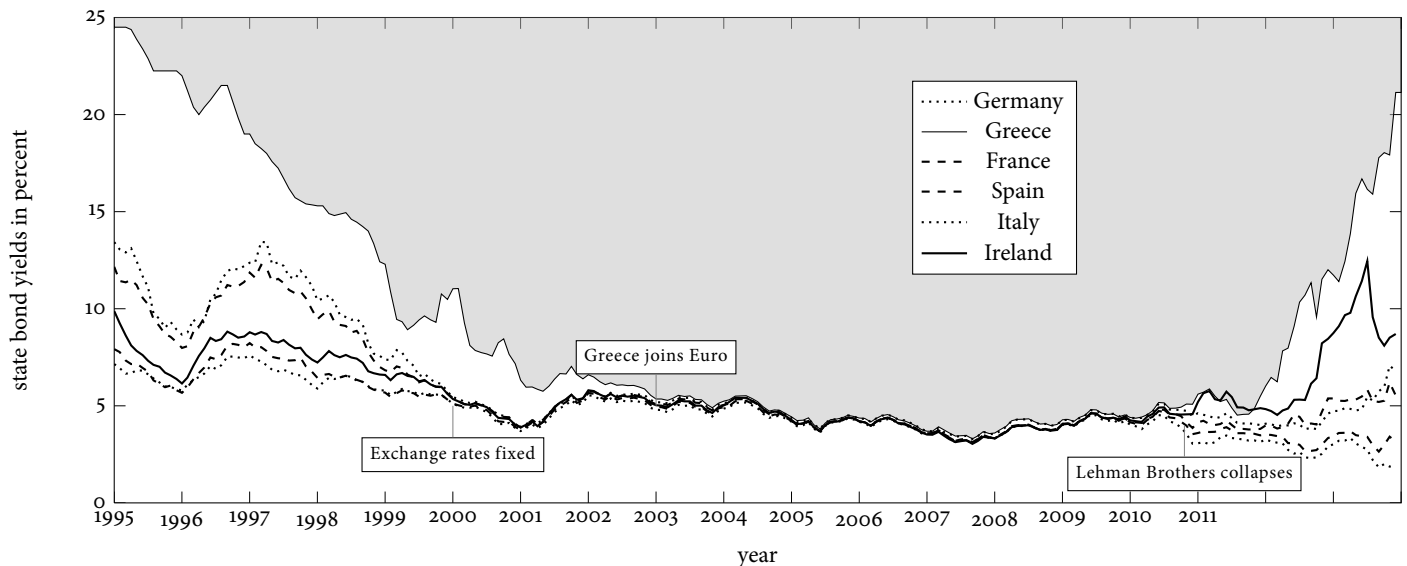


Figure 1: Yields for ten year state bonds from the Eurozone (Source: ECB Data Warehouse)

the financial system. A general economic crisis, especially in the automotive sector was added to the mix which in turn again required more sovereign debt as an intervention.

As in the US, Japan and Great Britain, countries in the Euro area took on massive amounts of new debt to rescue the banks. This was meant to prevent a “meltdown”. For some time this meltdown was indeed stopped. Back then, rating agencies were attacked by governments for rating what in retrospect turned out to be bad assets as fairly safe. They were accused of not properly assessing the risks attached to debt investments, whilst banks were accused of engaging in risky speculation without assessing the safety of their investments properly. To encourage them to be more cautious, new laws were passed (e.g., Basel III).

In the aftermath the financial industry and the rating agencies indeed reconsidered the safety of businesses which were previously considered risk-free and found some problematic ones: sovereign debt itself.

From the point of view of investors, states deserve trust when they use their debts to promote economic growth. In this respect the bailout of the banks by European states was a big minus. The ratio of gross debt to GDP in the Eurozone was increased from 66% in 2007 to 85% in 2010. That might have been acceptable if all the money had been used for the development of the respective national economies. However, the bank bailout was only an attempt to maintain the status quo, not to further economic growth. Hence, banks became more cautious towards all sovereign debt. Rating agencies also learned their lesson and took a harder look at sovereign debt. This is half the explanation why currently almost all successful capitalist nations

are confronted with or threatened by a debt crisis.

However, in the Eurozone this crisis took on a special form. The first suspicion was directed mainly against Greece, and later against Spain, Italy and Portugal. In October 2011, France was already under pressure. Hence, the question on the table is why the financial markets came to such different conclusions when they re-assessed sovereign debt in the Eurozone and why they continue to do so. This is due to the nature of the Euro.

The Euro: a common currency of rivals

The Euro Stability and Growth Pact imposes the rule on member states of the Euro that their gross debt must not rise above 60% of their gross domestic product. Additionally, their new net borrowing, i.e., those debts which are added each year, must not exceed 3% of the gross domestic product. To monitor these rules member states are required to write reports on how they are going to comply with them in the current as well as the next few years. If a state exceeds these requirements it receives a blue letter and if things still do not change penalty fares are due – this is what the member states agreed on.¹⁵

This agreement expresses both a common purpose and mutual mistrust. The member states knew that the Euro was a good basis for each country to take on debt. Indeed, this was the plan for each country, to borrow as cheap and easily as Germany could when it had the Deutschmark. Thus, in the first step, going into debt is permitted. However, in the second step, the freedom to borrow is limited. An unlimited use of the freedom to take on debt, it is assumed,

would damage the new joint currency.

How is this potential damage to be understood? As discussed above, states support the quasi-money quality of their bonds by offering banks the right to exchange state bonds at any time for real money via their central bank. This also applies to the Euro. The fiscal policy of the European Central Bank (ECB) declares that it accepts bonds with a top-rating by rating agencies and offers fresh money in return. These top rated bonds include above all sovereign debts of Eurozone member states. In this way the Euro Community declares its sovereign debt to be the same as the Euro (sovereign debt = Euro). Conversely, they declare that the Euro is equal to their debt (Euro = sovereign debt). The quality of the Euro now depends on how well this debt contributes to capitalist economic growth.

The extent to which sovereign debt does not facilitate capitalist growth in the Euro area can be observed in the inflation of the Euro.¹⁶ Inflation refers to the situation in which money devalues itself and prices rise; everything brings in more money than before, but everything is more expensive. Companies and banks earn more money but realise that this brings no benefit because everything is more expensive.

Strong inflation shakes up a national economy. A capitalist invests money, gets more money back and then has to worry whether he can afford all the raw materials needed for further production, because they are now more expensive. But inflation is especially crucial for the banking industry. A loan which earns 3% interest is an actual loss if, during the same time, money was devalued by 4%. Therefore, states have an interest in avoiding excessive inflation, because it prompts financial capital to invest somewhere else in equities, state bonds, corpo-

¹⁵From the beginning almost no country obeyed these rules, not even Germany. Despite agreeing on the rules the incentives for member states to take on more debt than agreed did not go away. Furthermore, until the bank bailout the financial markets did not seem to mind this.

¹⁶The fact that sovereign debt has an inflationary effect on the currency is recognised in bourgeois economics and politicians are aware of it, too. However, we explain this relationship quite differently than bourgeois theories. That said, we have not understood the issue of inflation well enough so far to be able to present it here clearly. We still have open questions. Therefore, here we simply content ourselves with citing inflation as one reason for the mutual distrust amongst the Euro states.

rate bonds, etc. On the other hand, no state wants to completely avoid inflation. Every state knows that inflation is a necessary side effect of their sovereign debt. Thus, the ECB sets the self-imposed goal of 2% inflation.

By mutually restricting each other's debt the Eurozone member states collectively worry about the quality of their money. Above all, they want to prevent the respective other states from harming the shared currency.

They have a common money, but the nation states still compete against each other as before, when they pursue economic growth in their respective domestic contexts. The power of Germany, Italy or Greece still depends on the strength of their respective national economies. And it remains the duty of the respective states to seek to achieve that success through national economic policy. The extensive use of debt by one country might not only damage the Euro but also allow this country a competitive advantage at the expense of other nations. If Greece could have taken on much more debt and thereby set up superior infrastructure, perhaps then capital would have flown to Greece. Then maybe supermarkets in Germany would be full of Greek products and not the other way around as it is now: German producers are superior to Greek producers, defeat them through competition and do not allow them to develop. Now, Germany profits from the fact that supermarkets in Greece are full of German products.

The justice that the Euro countries have agreed on is that whoever is successful is right. With the freedom to take on 60% debt relative to its GDP Germany may – with a GDP of around €2,500 bn (2011 estimate) – take on €1,500 bn in debt. Greece with a GDP of around €226 bn may only take on €135 bn. On the one hand, this means that successful countries such as Germany and France dictate to the other states the conditions of their community. On the other hand, this condition has an internal rationality; if the adverse effect of sovereign debt on the quality of money can be balanced out by capitalist growth, then it is logical that states can contract more debt if capitalist growth accumulates more on their territory. If they contribute less in this respect, then they should also borrow less. This is a signal to financial markets which says: look, the entire economic output of all Euro countries underwrites the Euro. We only take on debt in accordance with a fixed relation to economic performance. Therefore, you can trust us as the Euro Community.

The financial industry had trust in the Euro construction ...

At first, the financial sector had confidence in this construction, when, since the introduction of the Euro, it did not discriminate between state bonds of different Euro countries. They were all equally good because they could all be exchanged, if in doubt, for fresh Euros at the ECB. That these countries maintained their joint money as competitors the financial markets also did not take as an argument against the quality of the Euro. After all, all countries gain an advantage from the Euro, hence, they have a common concern for their currency. Indeed, because they are competitors they monitor each other more vigilantly with respect to their debt policies than they would do on their own. Behind the Euro stands an economic power which is the sum of the individual national economies – another argument in favour of the currency. The Euro also managed to replace the Deutschmark adequately as foreign exchange hoard outside the Eurozone. Central banks around the globe are interested in holding the Euro alongside the Dollar as a currency reserve. As discussed above, this does not take the form of suitcases full of Euro banknotes but rather the form of state bonds. The best hoard is one which increases itself.

... and wonders now, whether this was justified

In light of the bank bailout the financial markets see this somewhat differently now. Due to the large amounts of new debt taken on merely for the preservation of the status quo, there are good reasons to be wary with respect to any European state. But suspicion is not just suspicion, because this wariness engenders a hypothetical question which reinforces the suspicion: if the financial markets actually were less happy to accept a specific state bond, making that state's follow-up financing come under pressure, what options would such a state have at its disposal? If a state has options, this may be enough to calm the markets such that they do not even test out whether these options would work.¹⁷ The hypothetical answer to this question differs from one Euro state to another. Also, with respect to this question the Euro construction itself proves to be a disadvantage.

Before the start of the Greek crisis in late 2009 the situation was like this: in the event that a Euro country had issues with refinancing its sovereign debt on the capital markets, that it had to pay higher interest rates because of this, and therefore that its chances of getting fresh credit were reduced further, it was not intended

that the other Euro countries would intervene to help the troubled nation out. On the contrary, the Euro states explicitly agreed on a "non-assistance clause" (Article 125 of the Treaty on the Functioning of the European Union). If then rating agencies downgraded the state bonds in question, then the ECB, in accordance with its own rules, should not accept these bonds any more in exchange for fresh money.

A sovereign state, as the sole master of its money, always has the option of exchanging its bonds for fresh money. This might cause inflation (which alleviates sovereign debt) which can lead to a devaluation of its currency so that domestic companies can export more (but imports become more expensive). This way the national economy may regain momentum. These are by no means certain but still possible ways to get out of the dilemma. However, a single Euro country cannot decide the monetary policy of the ECB alone. Why should the competition agree to a Eurozone wide inflationary programme that would harm their own national economies? According to the regulations, until 2009 a single country in a debt crisis could rely only on its own national economic strength and was in just as bad a situation as a country that had contracted debt in a foreign currency.¹⁸

The test of financial markets and the response of the Euro Community

The financial markets picked Greece as the weakest link in the chain of the Eurozone and became more cautious. Therewith they presented the following questions to the rest of the Euro countries.

Firstly, will you really allow Greece to default in accordance with your treaty, or will you leave it to the IMF to take care of it? If so, then we made a mistake in the past when we speculated that the strength of the Euro stands behind Greece. We then need to rethink our involvement in all other Eurozone countries. That is, we will have to exercise more caution in the future for all countries except perhaps Germany.

Or secondly, does the Euro or the Euro Community now support Greece in violation of the treaty? If so, then we would refrain from treating Greece only as Greece since the Euro would still stand behind Greek sovereign debt and it would be as good as any other debt. But that does now mean that the Euro and the rest of the sovereign debt are a little bit as bad as Greek sovereign debt is itself. Similar to the bank bailout, new credit was contracted for an unprofitable piece of land: not to develop it but simply to preserve it in its miserable condition. The Euro would then be burdened by an unprofitable area and bad debts. Thus a more cautious

¹⁷When in this text or in newspapers one reads that the financial markets "test out", "cherry pick" or "put pressure", then one should not imagine that the heads of major financial institutions meet and devise a common strategy. Financial institutions are competitors, they usually do not coordinate. But they are dependent on each other with regard to the development of the value of their assets, and, hence, they pay attention to each other. If an institution is becoming more cautious about the purchase of Greek bonds, then it may be appropriate for competing institutions to become more cautious as well. The result is a uniform investment strategy that is inappropriately called "herd instinct" not only in newspapers but also in bourgeois economics.

¹⁸Third World countries, in which the financial markets have little trust economically, hardly get any credit in their own currency. They need to offer state bonds denoted in Dollars to the financial markets. They receive Dollars but must also repay the debt and the interest in Dollars. If there is inflation in their own currency, then the lenders do not lose money – as long as the state pays, which, ultimately, the IMF ought to guarantee.

approach would be in order with respect to the Euro and the sovereign debt of all countries – including Germany.

Along these two alternative lines, each carrying bad consequences, a dispute broke out within the Eurozone. Germany wanted to answer the first question with “yes”: no help for the sovereign debt problems of individual countries. The Euro Community shall not become a “transfer union”. If a country has a fiscal problem it is its own problem. Germany insisted that its own national achievements are not to be used to make up for the failures of other states.

France, however, did answer the second question with “yes”: we have to help other Euro countries, otherwise there will be an unpredictable chain reaction and the whole Euro will collapse.

This argument ultimately made sense to Germany. After all, its successes depend on the Euro and the Eurozone. This does not mean however that the first argument is off the table. Hence, Germany has a conflicting interest: because of its national interest it does not want to stand by and assist other countries and because of its national interest it must stand by other countries.

With a little resistance from Germany, the Eurozone member states and the ECB agreed on option number two. In April 2010 the Eurozone countries agreed on an initial bailout for Greece. It would run for three years and the IMF would be involved. In an emergency Greece could access assistance totalling €45 bn in the first year.

As with the bank bailouts, the Euro states mobilised large sums of money, such that the Greek state had the necessary funds to pay back its due debt. If Greece had to access these funds on the capital markets, according to the valuation of its bonds on these markets, it would have had to pay 20% interest rate for its state bonds¹⁹ – a rate that makes funding in the future so unlikely that no investor would grant the Greek state credit. Now it gets this credit from the rescue funds, which ‘only’ demand an interest rate of 5%, or since July 2011 of 3.5%.

For these funds, the Euro countries themselves borrow on the credit market and thereby further increase their sovereign debt. This money is then invested in new Greek state bonds, the quality of which of course is not much better than the old ones.

That did not impress the financial markets. The Euro states responded with increasingly higher masses of money to support those countries that are under pressure. Already in May 2010, the package for Greece was raised to €110 bn. At the same time the EU and IMF agreed on a res-

cue fund for the whole Euro area – the EFSF (European Financial Stability Facility). Additional €750 bn were mobilised to assist those Eurozone countries having problems contracting credit on the credit market to pay back old loans. For this the ECB also decided to temporarily accept poorly rated bonds in exchange for fresh Euros. This “temporary” still holds true today (November 2011). This, unsurprisingly, did not impress the financial markets.

First, this is because these rescue measures carry the above-mentioned disadvantage in them – that more debt is issued just for the preservation of the current state and not for capitalist development. The larger the rescue packages, the more claims on accumulation of money are collected relative to a non-development.

Second, perhaps a common announcement would have impressed the financial markets a little bit – an announcement that the Euro area would absolutely and unquestionably stand behind sovereign debts and was ready to step in no matter what size of credit was required would have impressed the financial markets a little bit. However, the German point of view is also present the whole time: to grudgingly accept rescue packages but always to jam on the brakes. Rescue packages, at a pinch, but limited please. The financial markets take note of this and this is an argument against these rescue attempts.

Third, imperialist competition thrives in times of crisis. The weakness of the other states is the best opportunity to extort political concessions from them. In this way, Germany strong-armed all the other states into surrendering their national fiscal sovereignty. What one can observe in Greece shall be extended step by step to other states. In addition to the Parliament, an international troika is now also allowed to intervene with a government’s budget. To wring such concessions – that is the nature of extortion – Germany must threaten over and over again to not agree to the rescue packages. The German chancellor Angela Merkel has accomplished this repeatedly in the last two years. She has over and over again risked everything in order to extort the next concession from other countries. All this jeopardising, of course, is not a calming influence on the financial markets.

Fourth, in this way more and more countries get into trouble. The trend is that fewer and fewer states are using their credit to support a growing number of states. If Spain or Italy would have to be supported as a large debtor, then France and Germany could no longer manage this.

However, in order to give the impression that this could work and that the financial markets would therefore not need to test it, it was

decided that the rescue package would be increased to €2,000 bn in October 2011.²⁰

However, the Euro states note that their previous rescue principle, by which no European debtor could admit that it was unable to meet its payment obligations, hit a dead end for the reasons given above. Therefore, what has long been discussed as insanity is now proposed as a new solution.

Greece’s creditors should take a “haircut”. This would mean all creditors, namely financial institutions, states and the rescue fund of the Euro states itself should give up around 50% of their claims. In this way, not only would Greece lose a bit of its burden, but the rescue fund itself would also be relieved. It does not have to spend as much additional money when only 50% of Greek debt has to be re-financed. This however begs the question again whether the banks could withstand this haircut and what chain reactions this could cause, if, for example, credit default swaps (CDS) – basically insurance against default – which also still exist, are due. If the haircut is voluntary then these CDS might not be due. Then all of the institutions which hold these derivatives must depreciate these assets which they list in their balance sheets. This way the game returns to its starting point: the banks must be rescued by state loans. To that effect the EFSF rescue fund is allowed to grant credit to member states to support their banks.

Austerity and mass impoverishment – for what?

As of November 2011, the logic of the rescue packages was as follows: more and larger masses of debt would be mobilised to ensure that no state bond ruptured. Each state bond should, at the end of its term, fulfil its promise: to return the principal sum plus the promised interest rate. In countries facing a sovereign debt crisis the program accompanying these rescue attempts has been austerity and government policies which reduce the salaries of state employees or dismiss them directly; in addition, pensions and social benefits have been cut. This, first of all, ought to reduce government spending. Second, the state’s revenue ought to be increased independently of credit by increasing or more thoroughly collecting taxes and by privatising state property. Third, economic growth ought to be boosted, pensions reduced and “barriers to competition” removed, i.e., wages cut.

To think of these measures those countries do not need guidance, they come up with them on their own. The Euro Community’s role is to encourage them to try even harder. Greece, how-

¹⁹When a state issues a bond of €1 million at 5% interest, then it promises that it will pay €1.05 million when the bond ‘matures’. On the stock market these bonds are bought and sold daily. If suspicion develops and more and more institutions want to sell but less want to buy then the price on the stock exchange falls – say to €900,000. Now, if the debtor can ultimately pay, then the yield for the buyer has risen. For €900,000 he has the right to €1,050,000. This would be a gain of €150,000 and therefore a return of 11.67%. A state that now issues new bonds must offer the financial markets at least 11.67% interest rate, otherwise nobody would buy them as there is a better deal to be had on the stock exchange. Greece’s state bonds have fallen so much that it would theoretically have to offer 20% or more of interest to attract investors.

²⁰It works like this: before, the money from the bailout fund was used simply to pay off old creditors. The states that have given money to the bailout fund in turn received new promises of payment from Greece. With €500 bn one can buy €500 bn worth of state bonds. Now, the money will be used differently, that is, as insurance. Potential investors in Italian state bonds are promised that they get up to, for example, 30% from the bailout fund, if Italy would actually default. This is supposed to animate investors to grant Italy new credit so that it can use it to pay off old debt. Thus, with €500 bn one could hedge state bonds worth €1,666 bn up to 30% ($500 \cdot \frac{10}{3} \approx 1,666$). However, should it actually come to a default, which would mean that Italy negotiated to pay only 70% of its debt, those €500 bn from the bailout would simply be gone. In the old variant the bailout fund would still have claims against Italy worth €350 bn (i.e., 70% of €500 bn).

ever, which was the first nation in need of support from the Euro Community, has been forced to commit itself to these measures.

These measures are a radical programme of impoverishment. This can be illustrated briefly in Greece. A state employee earns on average €1,000 per month. A worker in the private sector earns on average €800. While the unemployment rate in Greece was at 10% before the crisis, it has now reached 19%. In addition, in Greece a salary must usually suffice for an entire family. This family often includes youths old enough to work but who, with a youth unemployment rate of over 40%, cannot cut the cord from the family and cannot contribute anything to its income.

All this occurs, with food prices that are on average not lower than in the UK or Germany. That it is necessary for survival under such conditions to evade the tax claims of the state is obvious. Against this widespread behaviour the Greek state now acts fanciful and collects taxes with electricity. Anyone who does not pay taxes gets their power shut off. If the state is the largest economic player in a country because it has nothing to offer but tourism, shipyards,

fields and banks, then an austerity program does not end an economic crisis but exacerbates it. Because people are made dependent on capital's success, this results also in accelerated impoverishment. In the 21st century people are turning their backs on cities and returning to the land. They are learning agriculture, not to make money but to survive somehow by this kind of subsistence economy.

This dazzling new poverty is due to a specific cause: the doubt that is produced by the Euro construction and still present in the rescue efforts, is fought against by extending the financial control of the Euro Community over the national budgets. Ideally, and to some extent actually, Greece degenerates to a basket case which has had taken from it a core aspect of its sovereignty, namely its fiscal policy. Greece has become a piece of trash that shall continue to exist in such a way that the Euro is not doubted. All debts are settled, this the Euro guarantees. The vital needs of the people are irrelevant, for those no new loans are taken on. The harshness with which this happens is at the same time a demonstration intended to boost the financial markets' confidence in the Euro. The message is this: although the new loans are not being used for the

development of capitalist progress, but only to save the status quo, no money is wasted on the mere necessities of the people.

As a tendency it can be said: the larger the size of the rescue package, the less financial markets see it as a solution; so, the more countries gradually come under pressure, the more radical and cruel become the impoverishment programmes. What force is behind this development can perhaps be shown by the example of a strike of air traffic controllers in Spain in December 2010. The government declared a state of emergency, sent the military out and threatened strikers to put them in front of military courts for insubordination which would have resulted in prison sentences of several years. Tourism is an important economic sector in Spain, and it is too important for the government to take any risk. That also was a signal to the financial markets.

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