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Debt crisis

# In the eye of the storm: the debt crisis in the European Union

- Features -

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**In July-September 2011 the stock markets were again shaken at international level. The crisis has become deeper in the EU, particularly with respect to debts. The Committee for the Abolition of Third World Debt (CADTM) interviewed Eric Toussaint about various facets of this new stage in the crisis in a seven-part interview published initially on their website.**

## First part: Greece

**CADTM:** Is it true that Greece has to commit to paying about 15% interest rates to be allowed to contract ten year loans?

**Eric Toussaint:** Yes, it is; markets are only ready to buy the ten-year bonds Greece wishes to issue on condition it commits to paying such extravagant rates.

**CADTM:** Will Greece contract ten-year loans on such conditions?

**Eric Toussaint:** No, Greece cannot afford to pay such high interest rates. It would cost the country far too much. Yet almost every day we can read in both mainstream and alternative media (the latter being essential to develop a critical opinion) that Greece must borrow at 15% or more.

In fact, since the crisis broke out in spring 2010, Greece has borrowed on the markets for 3 months, 6 months or 1 year, no more, at interest rates ranging between 4 and 5%. [1] Note that before speculative attacks against Greece started, it could borrow at very low rates since bankers and institutional investors (pension funds, insurance companies) were eager to lend.

For instance, on 13 October 2009, it issued three month Treasury bonds, also called T-Bills, with a very low yield of 0.35%. On the same day it issued six month bonds at a 0.59% rate. Seven days later, on 20 October 2009, it issued one year bonds at 0.94%. [2] This was less than six months before the Greek crisis broke out. Rating agencies had given a very high rating to Greece and the banks that were granting one loan after another. Ten months later, it had to issue six month bonds at a 4.65% yield - in other words, 8 times more. This denotes a fundamental change in circumstances.

Another significant fact points to the banks' responsibility: in 2008 banks demanded a higher yield from Greece than in 2009. For instance in June-July-August 2008, before the crash produced by the Lehman Brothers bankruptcy, rates were four times higher than in October 2009. They were at their lowest (below 1%) in the fourth term of 2009. [3] This may seem irrational, since a private bank is certainly not supposed to lower its interest rates in a context of major international crisis, least of all with a country such as Greece, which is prompt to borrow; but it was perfectly logical from the point of view of bankers out to maximize profits while relying on public rescue in case of trouble. After the Lehman Brothers bankruptcy, the governments of the US and European countries poured huge amounts of cash to bail out banks, restore confidence and boost economic recovery. Banks used this money to lend to countries such as Greece, Portugal, Spain and Italy, convinced as they (rightly) were that if there were any problem, the ECB and the European Commission would help them out.

**CADTM:** You mean that private banks deliberately pushed Greece into the trap of an unsustainable debt by offering low interest rates, then demanded much higher rates that made it impossible for Greece to borrow beyond a one year term?

**Eric Toussaint:** Yes, exactly. I don't mean that there was some sort of plot but it is obvious that banks literally threw capital into the arms of countries such as Greece (notably by lowering the interest rates they demanded) since they considered that the money they so generously received from public authorities had to be turned into loans to Eurozone countries. We have to bear in mind that only three years ago States appeared to be the more reliable actors while the capacity of private companies to repay their debts was questionable.

To go back to the concrete example mentioned above, on 20 October 2009 the Greek government sold its three-month T-Bills with a 0.35% yield in an attempt to raise EUR 1,500 million. Bankers and other institutional investors proposed about five times this amount, i.e. 7,040 million. Eventually the government decided to borrow 2,400 million. It is no exaggeration to claim that bankers literally threw money at Greece.

Let us also go back to the time sequences in the increase of loans granted by West European banks to Greece between 2005 and 2009. Bankers of Western European countries increased their loans to Greece (to both public and private sectors) in several stages. Between December 2005 and March 2007, the amount of loans increased by 50%, from just under USD 80 billion to 120 billion. Although the subprime crisis had broken out in the US, loans increased again, this time by 33%, between June 2007 and summer 2008 (from 120 to 160 billion), then they stayed at a very high level (about 120 billion). This means that Western European private banks used the money they received at very low rates from the ECB, the Bank of England, the US Federal Reserve and the US money market funds (see below) in order to increase their loans to countries such as Greece . [\[4\]](#) without taking risk into consideration. Private banks thus bear a heavy responsibility for the crushing debts of Greece. Greek private banks also loaned huge amounts to public authorities and to the private sector. They too have a significant responsibility in the present situation. Consequently the debts claimed from Greece by foreign and Greek banks as a result of their irresponsible policy should be considered illegitimate.

## Part 2: The great Greek bond bazaar

**CADTM:** You say that since the crisis broke out in May 2010 Greece has stopped issuing 10-year bonds. Why then do markets demand a yield of 15% or more on Greece's 10-year bonds? [\[5\]](#)

**Eric Toussaint:** This has an influence on the sale price of older Greek debt bonds exchanged on the secondary market or on the OTC market.

There is another much more important consequence, namely that it forces Greece to make a choice between two alternatives:

a) either depend even further on the Troika (IMF, ECB, EC) to get long-term loans (10-15-30 years) and submit to their conditions;

b) or refuse the diktats of markets and of the Troika and suspend payment while starting an audit in order to repudiate the illegitimate part of its debt.

**CADTM:** Before we look at these alternatives, can you explain what the secondary market is?

**Eric Toussaint:** As it the case for used cars, there is a second-hand market for debts. Institutional investors and hedge funds buy or sell used bonds on the secondary market or on the OTC (over the counter) market. Institutional investors are by far the main actors.

The last time Greece issued ten-year bonds was on 11 March 2010, before speculative attacks started and the Troika intervened. In March 2010, to get 5 billion euros, it committed itself to an interest rate of 6.25% every year until 2020. By that date it will have to repay the borrowed capital. Since then, as we have seen, it no longer borrows for ten years because rates blew up. When we read that the ten-year interest rate is 14.86% (on 8 August 2011 when the 10-year Greek rate, which had been as high as 18%, was again below 15% after the ECB's intervention), this indicates the price at which ten-year bonds are exchanged on the secondary or OTC markets.

Institutional investors who bought those bonds in March 2010 are trying to sell them off on the debt secondary market because they have become high risk bonds, given the possibility that Greece may not be able to refund their value when they reach maturity.

**CADTM:** Can you explain how the second-hand price of the ten-year bonds issued by Greece is determined?

**Eric Toussaint:** The following table should help us understand what is meant by saying that the Greek rate for ten years amounts to 14.86%. Let us take an example: a bank bought Greek bonds in March 2010 for EUR 500 million, with each bond representing 1,000 euros. The bank will cash EUR 62.5 each year (i.e. 6.25% of EUR1,000) for each bond. In security market lingo, a bond will yield a EUR 62.5 coupon. In 2011 those bonds are regarded as risky since it is by no means certain that by 2020 Greece will be able to repay the borrowed capital. So the banks that have many Greek bonds, such as BNP Paribas (that still had EUR 5 billion in July 2011), Dexia (3.5 billion), Commerzbank (3 billion), Generali (3 billion), Société Générale (2.7 billion), Royal Bank of Scotland, Allianz or Greek banks, now sell their bonds on the secondary market because they have junk or toxic bonds in their balance sheets. In order to reassure their shareholders (and to prevent them from selling their shares), their clients (and to prevent them from withdrawing their savings) and European authorities, they must get rid of as many Greek bonds as they can, after having gobbled them up until March 2010. What price can they sell them for? This is where the 14.86% rate plays a part. Hedge funds and other vulture funds that are ready to buy Greek bonds issued in March 2010 want a yield of 14.86%. If they buy bonds that yield EUR 62.5, this amount must represent 14.86% of the purchasing price, so the bonds are sold for only EUR 420.50.

### Example

**Nominal value of a 10-year bond issued by Greece on 11 March 2010:** EUR 1,000

**Interest rate on 11 March 2010:** 6.25%

**Value of the coupon paid each year to the owner of a EUR1,000 bond:** EUR 62.5

**Price of the bond on the secondary market on 8 August 2011:** EUR 420.50

**Actual yield on 8 August 2011 if the buyer bought a EUR 1,000 bond for EUR 420.50:** 14.86%

To sum up: buyers will not pay more than EUR 420.50 for a EUR 1,000 bond if they want to receive an actual interest rate of 14.86%. As you can imagine, bankers are not too willing to sell at such a loss.

**CADTM:** You say that institutional investors sell Greek bonds. Do you have any idea on what scale?

**Eric Toussaint:** As they tried to minimize the risks they took, French banks reduced their Greek exposure by 44% (from USD 27 billion to USD 15 billion) in 2010. German banks proceeded similarly: their direct exposure decreased by 37,5% between May 2010 and February 2011 (from EUR 16 to EUR 10 billion). In 2011 this withdrawal movement has become even more noticeable.

**CADTM:** What does the ECB do in this respect?

**Eric Toussaint:** The ECB is entirely devoted to serving the bankers' interests.

**CADTM:** But how?

**Eric Toussaint:** Through buying Greek bonds itself on the secondary market. The ECB buys from the private banks that wish to get rid of securities backed on the Greek debt with a valuation haircut of about 20%. It pays approximately EUR 800 for a bond whose value was EUR 1,000 when issued. Now, as appears from the table above, these bonds are valued at much less on the secondary market or on the OTC market. You can easily imagine why the banks appreciate being paid EUR 800 by the ECB rather than the market price. This being said, it is another example of the huge gap between the actual practices of private bankers and European leaders on the one hand and their discourse on the need to allow market forces to determine prices on the other.

## Part 3: The ECB, ever loyal to private interests

**CADTM:** On 8 August 2011 the ECB started buying bonds issued by European States that had run into trouble. What do you think of this?

**Eric Toussaint:** A first important point to remember: the media announced that the ECB would start buying bonds without specifying that this would only occur, as usual, on the secondary market.

The ECB does not buy bonds on the Greek debt directly from the Greek government but from banks on the secondary market. This is why banks were pleased on 8 August 2011.

Indeed, between March 2011 and 8 August 2011 the ECB claims that it did not buy any bonds on the secondary market. This was a source of aggravation for the banks since, as they wanted to get rid of the Greek bonds and the bonds of other States experiencing difficulties, they had had to sell them at knock-down prices on the secondary market. Most of them only sold a few because prices were really too low. [\[6\]](#) This is why they insisted that the ECB start buying again.

**CADTM:** The ECB's return to the secondary market raises the price of Greek bonds, is that it?

**Eric Toussaint:** Yes, but only for a while, and what matters is that the ECB buys in huge quantities and at a higher value than the market price. Between May 2010 and March 2011 it bought Greek bonds from bankers and other institutional investors for EUR 66 billion. Between 8 and 12 August, i.e. within five days, it bought Greek, Irish, Portuguese, Spanish and Italian bonds for EUR 22 billion. Over the following week it bought another 14 billions'

worth. We do not know the proportion of Greek bonds but we can see that the purchase was massive. What is clear is that the ECB's practice of buying bonds makes it possible for institutional investors to speculate and make juicy profits.

Indeed, banks can buy bonds at cut prices on the secondary market or much more unobtrusively on the OTC market that is outside any regulation (42.5% of their face value in the days following 8 August 2011 and even lower a few weeks later) and sell them to the ECB at 80%. The volume of this kind of transaction may be marginal, it is difficult to know exactly. But they certainly are most profitable and I cannot see how the ECB or market authorities could prevent this, even if they wanted to.

We have to remember that transactions on the secondary market are barely regulated, and that next to the secondary market there is the OTC market that is not regulated at all by the public authorities. On a regular basis, debt bonds are sold and bought as 'short sales', i.e. a buyer, for instance a bank, can buy bonds for dozens of millions without having to pay for them when receiving them. Buyers promise they will pay, they get the bonds, sell them on, and pay what was owed with the proceeds of the resale. This proves that the purchase was never intended to be used for its own yield, but was bought to be sold on immediately to maximize profit (speculation).

Of course if they cannot sell these bonds on at a good price or at all, they cannot foot the bill. This can lead to a crash, since hundreds of institutional investors play the same game and the amounts at stake are astronomical. Transactions on securities backed on the public debt of States facing problems amount to tens or hundreds of billions of euros on a liberalized market.

**CADTM:** Why doesn't the ECB buy directly from the States that issue the bonds instead of buying on secondary markets?

**Eric Toussaint:** Because the governments concerned wanted to preserve the monopoly of the private sector on providing credit to public bodies. Direct lending to member States is prohibited by the ECB's own statutes as well as by the Lisbon Treaty, and this also applies to central banks in the EU. The ECB therefore lends to private banks which in turn lend to States with other institutional investors.

As mentioned above, French, German and other banks sold Greek bonds massively in 2010 and in the first term of 2011. The ECB has so far been their first buyer and it buys above the secondary market price. [\[7\]](#)

As you can see, this makes for all sorts of manipulations by the banks and other institutional investors, since bonds are warranted to the holders and the markets are liberalized. Clearly the private banks put pressure on the ECB for it to buy bonds at a higher price, claiming that they needed to get rid of them to clean up their balance sheets and so prevent another large-scale financial crisis.

July and August were good months for such blackmail, as the stock markets went through a fall of 15% to 25% in their indexes between 8 July and 18 August 2011. Share prices of those banks that lent money to Greece, French banks in particular, literally plummeted. Panic-stricken, the ECB gave in to the bankers' and institutional investors' pressure and started buying bonds again. The ECB's intervention saved the day (at least for a while) for a number of major banks, particularly French ones. Once again public institutions helped out the private sector. But there is an even more outrageous aspect to the ECB's behaviour.

**CADTM:** Can you explain?

**Eric Toussaint:** It's very easy. It lends money at a very low rate to private banks, 1% from May 2009 to April 2011, 1.5% today, merely asking banks that receive the loans to provide a financial guarantee. Now what the banks provide as guarantee are the very bonds (called 'collaterals') on which they receive, if they are Greek, Portuguese or Irish bonds, interest rates ranging from 3.75 to 5% if they were issued for less than a year (see above), and more if they are bonds maturing after 3, 5 or 10 years.

**CADTM:** Why do you call this outrageous?

**Eric Toussaint:** Here is why. Banks borrow at 1% or 1.5% from the ECB to grant loans to some States at 3.75% at least. Once they have bought the bonds and cashed their interest, they win twice over: they leave these bonds as collateral to borrow again at low rates from the ECB and loan this money to States at high interest rates. The ECB makes it possible for them to make even more juicy profits.

Moreover, from 2009-10 the ECB has changed its safety and security criteria and agreed to banks using high-risk bonds as collateral, which obviously encourages those banks to make inconsiderate loans since they are sure to be able either to sell the bonds to the ECB or to use them as guarantee.<sup>5</sup> It seems logical to consider that the ECB should behave differently and lend directly to States at 1 or 1.5%, without lavishing gifts to bankers as it does.

**CADTM:** But does it have a choice since this is prohibited by its statutes and the Lisbon Treaty?

**Eric Toussaint:** A number of dispositions in the Treaty are not adhered to anyway (the debt/GDP ratio that should not be over 60%, the government deficit/GDP ratio that should not be over 3 %), so considering the circumstances we can forget about that one too.

For the next stage we need to be aware that various EU treaties have to be abrogated, that the ECB statutes have to be radically changed, and that the EU has to be founded on other premises.<sup>6</sup> Yet to achieve this, the balance of power has first to be changed through massive street mobilizations.

## Part 4: A European Brady deal: austerity for life

**CADTM:** After the European summit of 21 July 2011 it was announced that the Greek debt was to be reduced by calling upon bankers. Was this a good move?

**Eric Toussaint:** Not at all. Those decisions do not provide countries facing financial problems with a favourable solution. The decisions taken on 21 July, supposing they are ratified by the parliaments of the member States in September-October 2011, will only slightly loosen the noose that strangles those countries and particularly their populations.

Moreover, in the case of Greece (soon followed by other countries), European governments have relied on bankers, who are largely responsible for the disaster, to devise a policy tailored to their own needs. They set up an ad hoc cartel of the major creditor banks under the grand but misleading name of Institute of International Finance (IIF), which has drafted a menu with various options offering four possible scenarios. [\[8\]](#)

As recalled by Cr dit Agricole, one of the main French banks (it owns a bank in Greece, 'Emporiki,' [\[9\]](#) stuffed full

of Greek bonds), the IIF clearly found its inspiration in the Brady Plan that was implemented in the 1980s-90s to face the debt crisis in 18 emerging countries (see below). Heads of State, the EC and bankers, relayed by the media, announced that this would reduce the debt by 21%, which is wrong. Actually, at best, the Greek debt would be reduced by EUR 13.5 billion, i.e. 4% of the current principal, which amounts to EUR 350 billion (which will further increase in the coming years). The 21% figure is the haircut bankers are ready to apply to the value of the Greek bonds they hold. It is just a bookkeeping operation. Indeed it does not affect at all what the Greek government has to pay. Bankers are so pleased that their proposal should have been accepted by the Heads of State and the ECB that several of them announced as early as late July-early August that they provisioned 21% losses on Greek bonds maturing in 2020. For instance, BNP Paribas provisioned EUR 534 million, and Dexia 377 million. [10]

By doing that, banks that play a leading part in the IIF hope to get parliaments in the EU countries to ratify the agreements made with the Heads of State and the ECB. Besides, such expected loss provisioning can be offset from their profits to reduce taxation. So far, however, there is one trouble-maker among the bankers, namely the Royal Bank of Scotland (RBS), which withdrew from the IIF and announced that it would apply a 50% haircut instead of 21% and provision losses for GBP 733 million, which shows that the 21% cut is far from sufficient. Moreover, according to the Financial Times and the Belgian financial daily *L'Echo* [11] the International Accounting Standards Board (IASB) sent a letter to the European Securities and Markets Authority which regulates the European financial markets, calling into question banks that apply a 21% cut on their Greek bonds when the market to market value is less than 50%.

**CADTM:** The 21 July 2011 agreement is also said to mean that the Troika's loans to Greece, Ireland and Portugal would be extended over a longer period with lower interest rates. Is this the case?

**Eric Toussaint:** European governments did announce that they intended to reduce the interest rates they charge Greece, Ireland and Portugal by 2 or 3 points. [12]

Announcing a reduction of 3.5% in interest rates for 15 or even 30 year loans amounts to acknowledging that the rates they had demanded so far were prohibitive. The move is motivated by the obvious disaster they have contributed to bring down on those countries and by the risk of the crisis spreading to other countries. The measures announced by European governments on 21 July 2011 are a clear acknowledgement of the 'unjust enrichment' they are responsible for and of the fraudulent nature of their policies.

**CADTM:** What is unjust enrichment?

**Eric Toussaint:** Unjust enrichment is abusive enrichment, profit gained through unlawful means. It corresponds to a general principle in international law defined in article 38 of the statutes of the International Court of Justice.

[13]

States such as Germany, France and Austria borrow at 2% on the markets and lend the same money to Greece at 5% or 5.5%, to Ireland at 6%. Similarly the IMF borrows from its members at low interest rates and lends to Greece, Ireland and Portugal at much higher rates.

**CADTM:** What is the fraudulent nature of the Troika's policies?

**Eric Toussaint:** Fraud [14] is an important notion in international law. It refers to an intentional deception made to damage another individual. If a State were led to contract a loan through the fraudulent behaviour of another State or an international organization that is party to the negotiation, it may invoke fraud as grounds for declaring the contract void, since it was agreed to through deceit. Now the Troika uses the plight of Greece, Ireland and Portugal to enforce measures that go against citizens' social and economic rights, challenge collective conventions, contravene the country's sovereignty and in some cases also its constitution. Thanks to some Italian newspapers, we know that in early August 2011 the ECB benefited from speculative attacks against Italy forcing its government to implement the

same kind of antisocial measures as Greece, Ireland and Portugal. If the Italian government did not comply, the ECB said it might not help Italy at all.

What the members of the Troika are doing can be compared to the odious behaviour of someone who, while claiming to help a person in a difficult predicament, would actually make it worse and benefit from it. We can also consider that it is a criminal act planned collectively by the IMF, the ECB, the EC, and the governments that are supporting their action. Associating in order to plan and carry out a criminal act increases the responsibility of the aggressors.

There is more: the economic policies enforced by the Troika will not allow the affected countries to improve their situation. For three decades this kind of damaging policy has been implemented on behalf of large private companies, the IMF and the governments of industrialized countries, in indebted countries of the South and in a number of countries of the former Soviet bloc. The countries that complied most diligently have had to face terrible times. Those that refused the diktats of international bodies and their neoliberal doxa have fared much better. This has to be recalled for we have to make it known that the results of the policies demanded by the Troika and institutional investors are a foregone conclusion. Neither today nor tomorrow will they ever have the right to claim they did not know what their policies would result in. We can already see what is happening in Greece.

**CADTM:** For over a year now, the **CADTM** has been warning against a debt reduction led by creditors, namely the Troika, bankers and other institutional investors. Is this justified?

**Eric Toussaint:** Of course. The current operation is led by creditors and geared to their own interests. As indicated above, the current plan is a European version of the Brady plan. [\[15\]](#) Let us remember the context in which this plan was implemented at the end of the 1980s.

In the early years of the crisis that broke out in 1982, the IMF and the governments of the US, the UK and other major powers helped private bankers in the North that had taken huge risks as they granted loan after loan to countries of the South, particularly in Latin America (as was to happen later with subprime mortgages and loans to countries such as Greece, Eastern European countries, Ireland, Portugal and Spain). When developing countries, starting with Mexico, were close to defaulting, the IMF and countries of the Paris Club agreed to lend them capital, provided they further repay private banks of the North and implement austerity plans (the notorious structural adjustment policies). Next, as the debt of the South was snowballing, they set up the Brady Plan (after the name of the US Treasury Secretary of the time) that involved a restructuring of the debt of the main indebted countries with bond exchanges. The participating countries were Argentina, Brazil, Bulgaria, Costa Rica, Côte d'Ivoire, the Dominican Republic, Ecuador, Jordan, Mexico, Nigeria, Panama, Peru, the Philippines, Poland, Russia, Uruguay, Venezuela and Vietnam. At the time, Nicolas Brady announced that the amount of the debt would be reduced by 30% (actually, when there was a reduction it was much less than that, and in several major cases the debt even increased, see below) and the new bonds (the Brady bonds) guaranteed a fixed interest rate of about 6%, which was very favourable to bankers. It also ensured that austerity policies would continue under the supervision of the IMF and the World Bank. Today, under other latitudes, the same logic produces the same disasters.

It is most interesting to look at *a posteriori* assessments by two well-known US neoliberal economists, Kenneth Rogoff, former chief economist with the IMF, and Carmen Reinhart, university professor and advisor to the IMF and the WB. Here is what they wrote in 2009 about the Brady bond. They first assert: "Conspicuously absent from the large debt reversal episodes were the well-known Brady restructuring deals of the 1990s."

They then base their negative assessment on the following elements: "*In fact, in Argentina and Peru, three years after the Brady deal, the ratio of debt to GDP was higher than it had been in the year prior to the restructuring!*"

*By the year 2000, seven of the seventeen countries that had undertaken a Brady-type restructuring (Argentina, Brazil, Ecuador, Peru, the Philippines, Poland and Uruguay) had ratios of external debt to GDP that were higher than those they had experienced three years after the restructuring, and by the end of 2000, four of those countries (Argentina, Brazil, Ecuador and Peru) had debt ratios that were higher than those recorded before the deal.*

*By 2003, four members of the Brady bunch (Argentina, CÃ´te d'Ivoire, Ecuador and Uruguay) had once again defaulted on or rescheduled their external debt.*

*By 2008, less than twenty years after the deal, Ecuador had defaulted twice. A few other members of the Brady group may follow suit." [16]*

The European version is true to the original Brady Plan down to its finest details. In the context of the plan, participating states had to buy US treasury zero coupon bonds [17] as guarantee in case of defaulting. The European plan devised by the banks, the EC and the ECB (with the full support of the IMF) proposes four options. In the first three, Greece, through the European Financial Stability Facility (EFSF), buys zero coupon euro bonds as a guarantee that it will repay the principal on thirty-year bonds. [18]

**CADTM:** What do you think of this plan?

**Eric Toussaint:** It will not help Greece to clear its debts for two essential reasons. Firstly, the debt reduction is completely insufficient; and secondly, the economic and social policies implemented by Greece to meet the Troika's demands will further weaken the country. As a consequence the new loans granted to Greece in the context of this plan as well as the former, now restructured, debts can be defined as odious. [19]

**CADTM:** The ECB is said to be against a strong haircut of the Greek debt.

**Eric Toussaint:** Correct. The ECB is trapped by its own policy: as it bought lots of Greek bonds on the secondary market and agreed to banks, including Greek banks, depositing Greek bonds as guarantee on the loans it grants, the assets in its balance sheet consist of huge amounts of Greek bonds (plus Irish, Portuguese, Italian and Spanish bonds). If a 50 or 60% haircut were to be applied to Greek bonds, its balance sheet would be unbalanced. That being said, it is still quite feasible since this is merely a matter of book-keeping.

The ECB's opposition to a strong haircut coincides once again with the interests of private bankers who do not agree to their assets being devalued either. The ECB has put pressure on EU Heads of State and on the EC for them to strengthen the European Financial Stability Facility so that it can buy high risk bonds. It wants to get this over with as soon as possible.

## Part 5: CDS and rating agencies: factor(ie)s of risk and destabilization

**CADTM:** You haven't talked about *Credit Default Swaps* (CDSs) yet.

**Eric Toussaint:** CDSs are a derivative financial product which is not submitted to any form of public control. They were created in the first half of the 1990s in the middle of the era of deregulation. Credit Default Swap literally means permutation of unpaid debts. Normally, it should allow the holder of a loan to obtain compensation from the CDS seller in the case of default by the bond-issuer, whether a government or a private company. I use the conditional for two main reasons. Firstly, a CDS can be bought as protection against the risk of non repayment of a bond that the

buyer **does not have**. This is the same as taking out insurance for the house next door, hoping that it will catch fire so that one can get the money. Secondly, CDS sellers do not begin by banking enough funds to indemnify victims of defaults. If a whole lot of private companies having issued bonds should go bankrupt, or if a major lender State should default on payments, it is quite certain that CDS sellers would be incapable of indemnifying as promised. In 2008, the collapse of the North-American company AIG, the biggest international insurance company (which was actually nationalized by Bush to avoid the consequences of bankruptcy) and that of Lehman Brothers were directly linked to the CDS market. AIG and Lehman had both been very active in this sector.

The CDS enables all sorts of manipulations. I had the opportunity to observe closely an attempt at manipulation when I was a member of the audit commission for the internal and external debts set up by the government of Ecuador in 2007, which delivered its report in September 2008. While we were auditing the Ecuadorian debt and President Rafael Correa was threatening to stop paying the illegitimate part of the debt to the international money markets, a private North-American company contacted the Ecuadorian government with a most edifying proposal. The company suggested that President Correa should let it be known that he was going to suspend payments just before the next due-date three weeks later. This would enable the company to sell CDSs for a value they had calculated at USD 300 million. The final outcome was supposed to be as follows: in reality, Ecuador would pay what it owed as usual. This would mean that the company would not need to indemnify the CDS holders and it would give half the proceeds to the Ecuadorian government. The company claimed that this operation was completely free of any risk of prosecution as it would be an over-the-counter transaction outside US government control. It claimed to have already carried out similar transactions on several occasions. In the end, the Ecuadorian government refused the offer, opting for another strategy which produced good results. The point about this true-life story is that it illustrates that issuers and buyers of CDSs can carry out all sorts of manipulations. Let us not forget that right up until the AIG disaster and the collapse of Lehman Brothers, the IMF, the US Federal Reserve and the ECB repeatedly claimed that CDSs were a new product that offered excellent guarantees against risks (see the box on CDSs). Since then, their discourse has changed, but nothing, absolutely nothing, has been done to regulate the CDS market. Meanwhile, in view of the size of the phenomenon, CDSs constitute a huge time-bomb hanging over the international finance system. The fact is that CDS should be outlawed.

**CADTM:** How much responsibility do rating agencies bear for the crisis?

**Eric Toussaint:** The North-American Standard & Poor's and Moody's and the Franco-American Fitch are the three private agencies which rule the roost regarding credit ratings and the credibility of bond issuers, whether they be State or corporate. [20] They have existed for almost a century but it was not until the 1970s-1980s, with the financialization of the economy, that their business took a sudden leap. However they are constantly in a situation of conflict of interests. Until the 1970s, it was the prospective buyers of bonds issued by the State and by companies who paid rating agencies for their advice on the quality of the issuers. Since then, the situation has been completely reversed: now it is the issuers of bonds who pay the agencies to rate them. What motivates the government and the companies is of course to get good ratings so that they can pay the lowest possible interest rates to those who buy their bonds. Let us recall that until the eve of the collapse of Enron in 2001, highly paid rating agencies attributed top marks to the power supplier. Again, in 2008, it was the same story with the investment banks, Merrill Lynch and Lehman Brothers. And again with Greece in 2009-early 2010. These are ample demonstrations of the harm they do. They should be sued for the damage caused by the results of the ratings they hand out. Risk assessment is a task which should only be entrusted to public bodies.

## Part 6: Has the crisis peaked yet

**CADTM:** Has the crisis peaked yet?

**Eric Toussaint:** The crisis is far from over. Even if we only consider the financial aspects, we must be aware that private banks have continued to play an extremely dangerous game which profits them as long as nothing goes wrong, but which is prejudicial to the majority of the population. The amount of bad assets on their balance-sheets is enormous. If we look at only the top 90 European banks, the fact is that over the coming two years, they will have to refinance debts to the tune of an astronomical EUR 5,400 billion. That represents 45% of the wealth produced annually in the EU. The risks are colossal and the policies adopted by the ECB, the EC and the member States of the EU will not solve anything – indeed quite the contrary.

A central aspect of the risks taken by the European banks needs to be emphasized. They finance a significant part of their operations by making short-term loans in dollars from the North-American lenders known as "US money market funds" at a lower rate than the ECB's. Furthermore, to return to the case of Greece, how could the European banks possibly settle for 0.35% over 3 months if they had to borrow from the ECB at 1%? They have always financed their loans to European States and companies using loans they themselves took out from the US money market funds – and they continue to do so. Now those money market funds were scared by what was happening in Europe and also by the dispute over the US public debt between Republicans and Democrats. So by June 2011, that source of low-interest finance had just about dried up, which has hurt major French banks most. This was what precipitated the tumble they took on the Stock Exchange and led to the increase of pressure on the ECB to buy back their bonds and thus provide them with new money. In short, this demonstrates the extent of the knock-on effect between the economies of the USA and the EU. It further explains the continual contact between Barack Obama, Angela Merkel, Nicolas Sarkozy, the ECB, the IMF ... and the major banks from Goldman Sachs to BNP Paribas and the Deutsche Bank. A breakdown in the flow of dollar-loans to European banks could cause a very serious crisis in the Old World, just as difficulties encountered by European banks in repaying their US lenders could trigger off a new crisis on Wall Street.

Since 2007-2008, banks and other institutional investors have displaced their speculation activities from the property market (where they had created a bubble which burst in nearly a dozen countries, including the USA) to the public debt market, the currency market (where the equivalent of USD 4,000 billion changes hands every day, 99% purely for speculative purposes) and the primary resources market (petroleum, gas, minerals, food commodities). These new bubbles can burst at any moment. A possible trigger could be if the US Federal Reserve decided to raise interest rates (followed by the ECB, the Bank of England, etc.). In this respect, in August 2011 the Fed announced its intention to maintain its base rate near zero until 2013. However other events could trigger off a new bank crisis or a crash on the Stock Exchange. The events of July-August 2011 show us it is time to muster our energy in order to prevent the private financial institutions from doing any further damage.

The extent of the crisis is also determined by the volume of the US public debt and the way it is financed in Europe. European bankers hold more than 80% of the total debt of an array of European Union countries in difficulty such as Greece, Ireland, Portugal, the Eastern European countries, Spain and Italy. In volume, Italian public debt paper amounts to EUR 1,500 billion, more than twice the combined public debt of Greece, Ireland and Portugal. Spain's public debt comes up to EUR 700 billion, i.e. about half of Italy's. The arithmetic is simple: the public debts of Spain and Italy added together represent three times the sum of those of Greece, Ireland and Portugal. As we saw in July-August 2011, while each country continued to pay off its debts, several banks almost collapsed. The ECB had to intervene to save the day. The financial scaffolding of the European banks is so fragile that an attack through the Stock Exchange is enough to bring them down... Not to mention what would happen if the Stock Exchange crashed, which cannot be ruled out.

So far, with the exception of Greece, Ireland and Portugal, the States have managed to refinance their debts by taking out new loans as and when the borrowed capital fell due. The situation has worsened significantly over the last few months. By July/early August 2011, the interest rates demanded by the institutional investors to enable Italy and Spain to refinance their public debt as it fell due with 10-year loans had literally exploded to reach 6%. Once again, the ECB had to intervene, buying up massive amounts of Spanish and Italian debt paper to satisfy the bankers and

other institutional investors and bring down interest rates. For how long, though? Italy will have to borrow about EUR 300 billion between August 2011 and July 2012 as that is how much they will require to honour bonds that fall due over that short period. Spain's needs will be considerably lower, at about EUR 80 billion, but that is still a hefty sum. How will the institutional investors behave over the coming twelve months and what will happen if their borrowing conditions on the North-American money market funds become stiffer? Many other events could aggravate the international crisis. One thing is certain: the present policies of the EC, the ECB and the IMF cannot result in a favourable outcome.

**CADTM:** On several occasions you have written that the private debt was far greater than the public debt. So far you've been talking about public debt.

**Eric Toussaint:** There is not a shadow of a doubt that the private debts are much higher than the public debts. According to the last report by the McKinsey Global Institute, the sum total of private debt worldwide comes to USD 17,000 billion, i.e. about three times the sum of all public debts, which is USD 41,000 billion. There is a great risk that private companies, including banks along with the other institutional investors, will not be able to repay their debts.

Bankers, chief executives of other companies, the traditional media and governments only discuss public debt and use its increase as a pretext to justify new attacks on the social and economic rights of the majority of the population. Austerity and the reduction of public deficits by axing social budgets and civil service jobs have become the only way of raising funds, along with privatizations and more consumer taxes. For appearances' sake in Europe, some governments have added a tiny tax for the rich and talk of taxing financial transactions.

Obviously the increase of public debt is the direct result of 30 years of neoliberal policies. They have used loans to finance fiscal reforms in favour of the wealthy and of large private companies. They have rescued banks and large companies by getting the State budget to take on part of their debt or other losses. Due to the recession, there have been new falls in tax revenues and an increase in some public spending to help victims of the crisis. The combined effect of these different factors has been to increase the public debt. It all comes down to deliberately unjust social policies which aim systematically to favour one social class only. A few crumbs are tossed to the middle classes to keep them quiet. On the other hand, the great majority of the population have been hit by these policies and seen their rights trampled underfoot. That is why the public debt has to be seen as globally illegitimate. And that is why I have been focusing on the public debt in this interview, because we absolutely must find a positive solution to this problem.

## Part 7: Alternative ways out of crisis

**CADTM:** During this talk, you have claimed that Greece is forced to choose between two options:

- either to eat humble pie, resigning itself to turning to the Troika;
  
- or to refuse the dictates of the markets and the Troika by suspending repayment and calling an audit in order to be able to repudiate the illegitimate part of the debt.

You have described the first option. Could you now explain the second in more detail?

**Eric Toussaint:** We talked about the case of Greece. It is important to mention that other countries are now being confronted with the same choices – Ireland, Portugal, not forgetting Hungary, Bulgaria, Romania, or even Latvia – to

mention ones in the European Union. There is every reason to believe that tomorrow it will be the turn of Italy and Spain. And we should not be surprised to see yet other EU countries in a similar predicament the day after tomorrow, because the crisis is accelerating rapidly. Outside the EU, Iceland is another high risk case.

The best thing would be for these countries, subject to blackmail by speculators, the IMF and other organizations such as the European Commission, to resort to a unilateral moratorium on public debt payments. Commitment to such a unilateral sovereign act would completely transform the balance of power to the detriment of the creditors. Whether they are banks, insurance companies or pension funds, they would be in such haste to sell off their bonds that interest rates would plummet to almost nothing. As for the Troika, it would be obliged to seek to negotiate concessions. Russia in 1998, Argentina in 2001 and Ecuador in 2008 all declared unilateral moratoria on their debt payments, and they all came out of it very well.

[21]

It is important to take stock of these recent experiences and to see how to apply the best strategy so that the population can see improvements in their living conditions and make a tangible break with the capitalist system.

**CADTM:** What other immediate measures are needed alongside a unilateral suspension (moratorium) of debt payments?

**Eric Toussaint:** A unilateral moratorium should be combined with an audit of public loans (with the participation of civil society). The audit must allow the necessary proofs and arguments to be brought before the government and popular opinion to justify the cancellation/repudiation of the part of the debt identified as illegitimate. International law and each country's domestic laws offer a legal basis for the sovereign unilateral act of cancellation/repudiation.

[22] A ratio of the following type might be defined: the sum allocated to debt repayment may not exceed 5% of State revenues. A legal framework is also required to avoid a repetition of the crisis that started in 2007-2008: socializing private debts should be prohibited; a permanent audit of public debt policy with citizens' participation should be mandatory; there should be no prescription for offences linked to illegitimate indebtedness; illegitimate debts should be ruled null and void... and so on.

**CADTM:** Debts can be cancelled, but what could be done about the rest?

**Eric Toussaint:** A whole panoply of further measures are needed. Austerity programmes must be stopped; banks should be transferred to the public sector; radical tax reforms are required; sectors privatized during the neoliberal era should be socialized there must be a radical reduction of working hours. All these measures have to be implemented, as debt cancellation, however necessary, will not suffice if the logic of the system remains intact.

*Translated by Christine Pagnouille and Vicki Briault in collaboration with Judith Harris for the [CADTM](#).*

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[1] Hellenic Republic Public Debt Bulletin, n° 62, June 2011. Available at [www.bankofgreece.gr](http://www.bankofgreece.gr)

[2] Hellenic Republic Public Debt Bulletin, n° 56, December 2009.

[3] Bank of Greece, Economic Research Department – Secretariat, Statistics Department – Secretariat, Bulletin of Conjunctural Indicators, Number 124, October 2009. Available at [www.bankofgreece.gr](http://www.bankofgreece.gr).

[4] The same can be observed in the same period with Portugal, Spain, and CEE countries.

[5] On 25 August 2011 the Greek rate for 10 years reached 18.55%, on the day before, 17.9%. The rate for 2 years was a staggering 45.9%.

<http://www.lemonde.fr/europe/articl...> (accessed 26 August 2011)

[6] In the *Hellenic Republic Public Debt Bulletin*, n° 62, June 2011, p. 4, we clearly see that the secondary market literally dried up from May 2010 when the ECB started buying bonds.

[7] By the end of 2009 before the Greek crisis broke out, French financial institutions (mainly banks) held 26% of Greek bonds sold abroad, German banks held 15%, 10% for Italy, 9% for Belgium, 8% in the Netherlands, 8% in Luxembourg, 5% in Britain. In short, financial institutions, especially banks, of seven EU countries held no less than 81% of Greek bonds sold abroad.

[8] They are summed up in an article in *The Financial Times* on 26 July 2011, p. 23, and in the *Crédit Agricole's* bulletin *Perspectives Hebdo* 18-22 July 2011.

[9] <http://www.lesechos.fr/entreprises-...> (accessed 26 August 2011).

[10] *Financial Times*, 6-7 August 2011

[11] *L'Echo*, 31 August 2011. See also TF1 "[La BNP a-t-elle sous-estimé son risque grec?](#)".

[12] See the [official declaration of the EU Council:->[www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/123978.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf)].

[13] It is also mentioned in several national civil codes, for instance in those of Spain (articles 1895ff) and France (articles 1376ff).

[14] Article 49 of the Vienna Convention of 1969 and of the Treaty of Vienna of 1986.

[15] See Éric Toussaint, *The World Bank : the never-ending coup d'État*, Mumbai: Vikas Adhyayan Kendra; (2007), chapter 15.

[16] Carmen M. Reinhart, Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009, pp. 84-85. Accessed online as googlebook.

[17] These are bonds that do not give a right to periodic interest payments or coupons, hence their name. They are bought at a discount price from their face value, which is paid when the bond reaches maturity. Zero-coupon bonds are usually inflation indexed.

[18] See *Crédit Agricole, Perspectives Hebdo* 18 - 22 July 2011, p. 3.

[19] On the odious and consequently void nature of debts claimed by the Troika from Greece, Ireland and Portugal (to which we can add debts claimed by the IMF from Romania, Latvia, Bulgaria and Hungary, i.e. countries that are all members of the EU) see Renaud Vivien and Éric Toussaint, [Greece, Ireland and Portugal: why agreements with the Troika are odious](#).

[20] There are others, such as the Chinese Dagong, but they have little influence.

[21] See Damien Millet, Éric Toussaint (eds), [La dette ou la vie](#), Aden-CADTM, 2011, chapter 19. On 19 July 2011, the *Financial Times* (p.7) devoted a whole page to the relative success Argentina had had after refusing to repay a substantial part of her debt. Referring to Argentina and Russia, Joseph Stiglitz, winner of the Bank of Sweden's prize for economics in memory of Alfred Nobel in 2001, who presided President Bill Clinton's council of economists from 1995-1997 and was Chief Economist and Vice-President of the World Bank from 1997 to 2000, argues strongly in favour of suspending repayment of public debt. In a collection of essays published in 2010 by Oxford University Press (Barry Herman, José Antonio Ocampo, Shari Spiegel, *Overcoming Developing Country Debt Crises*, OUP Oxford), he claims Russia in 1998 and Argentina in the 2000s demonstrated that unilateral suspension of debt payment could be beneficial for countries who decide to take that course of action. "*Both theory and practice suggest that the threat to turn off the credit tap has probably been exaggerated*" (p.48). In an article published in the *Journal of Development Economics* entitled "*The elusive costs of sovereign defaults*", Eduardo Levy Yeyati and Ugo Panizza, two economists who have worked for the InterAmerican Development Bank, present the results of their meticulous research into cases of default of payment in about forty

countries. One of their main conclusions was: "*Periods of default of payment mark the end of economic recovery*" (in *Journal of Development Economics* 94, 2011, p. 95-105). For more on Russia and Argentina, see also: C. Lapavistas, A. Kaltenbrunner, G. Lambrinidis, D. Lindo, J. Meadway, J. Michell, J.P. Paineira, E. Pires, J. Powell, A. Stenfors, N. Teles: "[The Eurozone between Austerity and Default](#)", September 2010. About lessons for Greece from Argentina, see Claudio Katz: "[Lecciones de Argentina para Grecia](#)".

[22] See Damien Millet, Éric Toussaint (eds.), [La dette ou la vie](#)

For countries who resort to suspension of payments, there needs to be a moratorium without delay interest on the part not paid.

In other countries, such as France, Belgium, Great Britain, it is not necessarily imperative to decree a unilateral moratorium while the audit is made. The audit is required to determine the extent of cancellation/repudiation to be effected. Should the international conjuncture deteriorate, suspension of payments could become a necessity, even for countries that claim to be safe from the blackmail of private creditors.

**CADTM:** And how can civil society participate?

**Eric Toussaint:** The participation of civil society is imperative to guarantee that the audit is carried out both efficiently and transparently. The audit commission should be composed of, for example, different bodies of the State concerned, so that they can report on its work. In any case, it is the participation of the social movements, of grassroots civil society, that will be the key to the audit's success. Social movements can designate their own experts in public finance auditing, economists, jurists and constitutionalists. Obviously the different social movements affected by the debt crisis must also be represented. The audit ought to help determine the different responsibilities in the indebtedness process and demand that those responsible, nationally and internationally, be brought to justice.

**CADTM:** In most cases, the ruling class has no interest in seeing an authentic audit carried out under the auspices of civil society. In other cases, it may resign itself to the idea in order to circumvent the problem.

**Eric Toussaint:** That is quite true. The case I mentioned earlier corresponds to a situation where strong popular mobilization brings left-wing forces into government who will adopt policies in the interests of the people or go even further. I am reminded of something Arthur Scargill, one of the main leaders of the Miners' Strike in Britain in the mid-eighties, said. Basically he said that they needed a government as true to the interests of the workers as Margaret Thatcher was to the interests of the capitalist class. In the present situation in Europe, we are still far from achieving that. We are confronted with governments who are hostile to the idea of an audit and unwilling to call debt repayment into question. That is why we need to constitute proper citizens' audit commissions without government participation.

**CADTM:** Who will have to foot the bill of debt cancellation?

**Eric Toussaint:** Whatever happens, it is only right and proper that the private institutions and high-earning individuals who hold the debt paper should bear the brunt of cancelling illegitimate sovereign debt since they are largely responsible for the crisis, and furthermore, they have largely profited from it. Making them bear the cost of cancellation is only fair, if there is to be a return to greater social justice.

**CADTM:** Will small stock-holders or salaried workers who hold public debt paper through pension savings also have to pay up?

**Eric Toussaint:** A proper survey of debt-stock holders needs to be drawn up so that citizens of modest or middling means among them can be indemnified.

**CADTM:** What will happen to those responsible for illegitimate or odious debt?

**Eric Toussaint:** If the audit proves the existence of offences linked to illegitimate indebtedness, the offenders will be severely condemned to make reparation and should not escape prison sentences in accordance with the seriousness of their felony. As for government authorities that have instigated illegitimate borrowing, they must be held accountable.

**CADTM:** What about the part of the debt that cannot be declared illegitimate, illegal and/or odious?

**Eric Toussaint:** For debts that are not deemed illegitimate, creditors should be made to contribute through reduction of stock and interest rates, as well as by rescheduling payments over a longer period. Here too, positive discrimination should be adopted in favour of small public debt holders, allowing them to be repaid on normal terms. Moreover, the amount of funds in the State budget earmarked for debt repayment should be limited as befits the state of the economy, the government's capacity to repay and the incompressible nature of social spending. Such practices will emulate what was done for Germany after the Second World War. The 1953 London Agreement on the German debt, which consisted, for example, of reducing the debt stock by 62%, stipulated that the ratio of debt service to export revenues should not exceed 5%. [[See Éric Toussaint, *The World Bank : the Never-ending coup d'état*, Mumbai: Vikas Adhyayan Kendra; (2007), Chapter 4.