

Can Greece defy the Troika?

March 3, 2015



The agreement signed between Greece and the EU after three weeks of negotiations is widely lamented on the left as a setback, if not a defeat, for Syriza. The two sides emerged from the agreement, if that is an accurate description, with different interpretations of the memorandum, signifying perhaps that no real deal was made after all. Greece obtained brief reprieve. Its banks will remain liquid for the next few months. The next phase will not be about what can be extracted from the troika, as much as what Greece can do despite and in defiance of the troika. That is what will be discussed here.

The immediate political problem for Syriza and Varoufakis is to create "fiscal space" to generate a countercyclical momentum. They have to increase government spending to more than offset the declines in the nongovernment sectors. But the Greeks are caught in a straightjacket. By agreeing to join the Eurozone, Greece, like all other member states, effectively ceded their fiscal sovereignty. They no longer have a unified central bank and treasury to call upon to support their spending decisions. So if there is to be fiscal expansion, within the confines of the EU's rules, Greece has to find ways to increase state spending without adding to its cumulative debt. It can tax idle savings. But this is only going to take them so far. And that distance is not far enough. In any case, these personal savings have probably been long squirreled away in Switzerland, where they are not touchable anyway. It can, as well, levy a draconian wealth tax, but the well goes dry after these funds are spent.

So the Greek Finance Minister needs to find work-arounds that allow increased state spending without technically adding to the Greek state's debt. This requires changing the current debt structure by swapping out existing debt for other forms of obligations. Varoufakis is proposing two things: the first is a GDP-linked bond (growth bonds). This is a perpetual bond that comes attached with a variable interest payment obligation pegged to the growth in the economy. This holds the possibility for a modest inflation premium for the Greek state. What is crucial is that Varoufakis is aiming to craft a debt swap by means that no longer oblige the Greek state to repay principal. Because there is no obligation to repay the principal, such bonds do not add to the debt. Greece can, by this artifice, remain in technical compliance with EU rules, while vigorously financing an economic turnaround. Willingness on behalf of EU bankers to put skin in the game would signal a common class commitment to a Greek recovery.

The second type of bond is technically called "consols." It was created by the British government in the 18th Century and used to pay off the Napoleonic war debt. It too is a perpetual interest bond, paying, in contrast to the growth bonds, a fixed rate of interest, again with no principal repayment. Again, because of the last provision, it doesn't enlarge the Greek deficit, and therefore does not add to the debt..

What we have seen in the last week is that Greece's creditors are unwilling to go for this. A perpetual period is a long commitment to carry credit risk on banking balance sheets. There is no obligation to repay principal even if Greek socialists eventually turn the economy around. So this is a

permanent concession. If forced to service interest payments or pay for health care down the line, socialists are going to opt for the latter (we hope), which is precisely what bankers fear. So in case of failure, bankers get neither principal nor interest. And if the Syriza government is wildly successful in its negotiations and the troika (the European Commission, the European Central Bank (ECB), and the IMF) funds these perpetual bonds, the banking system may be forced to accept returns below the market rate of interest.

And not just here. For if dispensations can be made to Greece, why not Italy, Portugal and Spain? Why not France? What credibility would Merkel have with German workers who have complacently accepted job rationing in lieu of wage growth for fear of imperiling German industrial competitiveness?

Syriza was swept to power on a wave of democratic discontent. The future of the government critically hinges on its success in terminating the austerity regime imposed by the troika. But Syriza and the troika are not merely approaching the same problem by differing class methods.

If European elites were actually interested in jumpstarting Eurozone capitalism in a reactionary way, they could have taken a page out of Obama's playbook. The massive TARP recapitalization of Wall Street calmed panicky elites and softened their opposition to a modest \$800 billion 3-year fiscal stimulus bill. This was far less than what was called for, but sufficient to put a floor under the economic collapse. Flagging capitalist sectors, most notably the automobile industry, were then subsidized and placed into temporary receivership. Union contracts were rewritten; public union contracts shredded. Social welfare provisions were slashed. Corporations and cash-strapped state and local governments were encouraged to ransack pension funds, while the government's pension fund insurer was deliberately short-changed. What was left of the underperforming pensions was turned over to hedge fund managers with the desperate hope that risky betting could eliminate shortfalls. The Fed obliged this end by stimulating a stock market boom by means of quantitative easing. Toxic housing assets were removed from balance sheets, stimulating a financial asset bubble, which, in turn, prompted an upsurge in consumer spending.

The Obama recovery took shape, in short, as a painfully protracted economic uptick with weak job growth, stagnating wages, lax labor markets, and burgeoning profits and gains concentrated almost exclusively at the top. Absent a ripple effect in the form of induced private sector investment the Obama recovery remains fragile. But it is nonetheless a recognizable economic stabilization.

Even this overwhelmingly class-biased recovery has proven to have little attraction for the troika. If for no other reason, Varoufakis was successful in calling them out and exposing the troika for what it actually wants. They are patently uninterested in jumpstarting a recovery, even a reactionary recovery. Rather, they are hell-bent on perpetuating the restructuring of the Eurozone initiated by the Great Recession. They see the social welfare state as a looming hindrance to competition with the US and China that must be decisively removed. Since that cannot be eradicated through the democratic process, it must be imposed on that process by an unelected and unaccountable elite.

The ECB is a very peculiar institution. A properly functioning central bank spends money into the economy to support financial decisions made by the government it serves. Eurozone governments are, in starkest contrast, subordinate to the ECB. The latter, like any other central bank, has an endless supply of money and is not constrained by the Eurozone's tax base. Private banks lend money into existence against collateral, both tangible and financial and make money on the spread between what they may need to borrow, in the last resort from the central bank to maintain required reserves, and the interest they get back in return. The private banking system under capitalism is, in either case, always problematic. They are backstopped by the nations' central banks, which must insure adequate business liquidity, but they are answerable to their shareholders. Without

government oversight, private banks are simply—no, literally—given a blank check to engage in whatever reckless behavior they can get away with in full knowledge that the central bank has no alternative but to recapitalize them if they fail.

The ECB and the Eurozone captures all these frailties. What it is purposely designed not to do, in contrast, is to support the spending decisions of the constituent democracies. These decisions must be made good from taxes and from loans issued by private banks secured against the nation's public assets. Constituent states must, first of all, demonstrate adequate constraint against inflation lest bank profits be threatened. They must agree to operate in a context in which there is a scandalously inadequate surplus-recycling mechanism. Revenue sharing in the US, for instance runs to 10% of GDP. So, if the South in effect runs a balance of trade deficit with the North, the federal government returns a larger portion of the nation's taxes to the South in compensation for that which is drained through trade. The European Social Fund and the Common Agricultural Policy recycle, in comparison, about 1% of Eurozone GDP to the entire periphery. The entire Eurozone framework is a prior constraint against democracy and the public interest, both because it effectively will not recycle surpluses (from Germany and the Eurozone north to the "PIIGS"—Portugal, Ireland, Italy, Greece and Spain) except through unsustainable lending arrangements (and foreign investment) because it withholds support for needed public spending decisions, including countercyclical emergency decisions.

It is therefore entirely wrong to attribute a "debt" problem to Greece. It does not have a debt problem. It has a liquidity problem. It cannot finance the spending decisions needed to put the unemployed to work, to pay pensions, to maintain a public health system, to fix its infrastructure, to offset its current account imbalance and to offset spending cuts in the private sector resulting from the global recession. It has an austerity problem, because it has a liquidity problem.

It is the banks that lent money to Greece that have a debt problem, as a result of Greece's illiquidity. Their asset base consisting of sovereign debt is worthless. But because they are fully insulated against failure by the ECB, this debt problem presents a mere technicality, a mere technicality with an immense human price tag. For the ECB could, in principle, simply recapitalize the banks directly, including Greece's central bank, such as it is. The Greek central bank could, in turn, support the spending decisions of the Greek government up to the inflation barrier of full capacity employment.

Instead, Greece has been used as a dummy corporation for the laundering of funds to the banks, and the various private and national central banks have been forced to accept a "haircut" as a penalty for their reckless past support for democratic decisions. For its service as a holding corporation, the ECB has "generously" agreed to pay Greece a small service fee sufficient to operate a bare bones government; further payment of which being contingent on Greece surrendering untold public assets and beating its workers into penury.

Again, it is not the debt that presents a problem. The ECB can always internalize the debt and place toxic assets on its balance sheets in exchange for Euros through quantitative easing. And this is exactly what the ECB is now doing—but not for Greece. It may or may not otherwise be in Greece's interest to renege on its "debt" and exit the Eurozone, but this so-called nuclear option is, in any case, a hollow threat and provides Syriza with absolutely no negotiating leverage. Any negative economic consequence of default can be readily mopped up—if hasn't already been—and neutralized by the ECB, before becoming a contagion. The only threat of bank run insolvency in the event of a Grexit, will be against Greek banks.

The problem remains: an unaccountable ECB monopoly over the creation and mobilization of money that allows it to dictate a social program antithetical to the needs and interests of Europe's workers.

What Varoufakis and his ministry have tried to do is to raise the service fees by changing the bond structures. They tried to create wiggle room through negotiations. Having failed, Syriza must find other ways, if Greece is to remain in the Eurozone, to break the stranglehold of the troika and gain fiscal space. In either case, it needs to demonstrate to the workers of Greece and Europe that defiance is not a losing strategy.

It has become patently obvious that the only measure Greece could carry out and command the full respect and attention of the ECB would be to dissolve itself as a country and reconstitute itself as a bank, declaring its citizenry co-equal shareholders and the former nation's businesses to be bank assets.

In the nonparallel universe where Greece actually resides however, there are still some limited stopgap measures and work-arounds that may buy Syriza some time. They have committed themselves to ramping up the intensity and efficiency of tax collection. This is probably the only place where Syriza and the troika agree. When the necessary institutional changes are implemented, the Greek government can begin to generate a parallel currency for internal transactions by securitizing future taxes and issuing scrip based on revenue anticipation. This scrip can be an electronic entry into accounts, personnel and corporate, with which the government has business. Or it can be issued in small denomination bills intended for day-to-day purchases. It is denominated, in either case, in Euros with an exchange rate of parity. Euros will remain the unit of account, but scrip can be introduced as an additional means of payment. This parallel currency should be acceptable for settlement of private sector tax liabilities and must be transferrable within the nation and to foreigners who have business or pay taxes in Greece. It is precisely scrip's acceptability to extinguish tax liabilities that assures its ability to circulate. It is in effect a short-term loan granted by the citizenry to the government. And because it is perpetual without a defined maturity date requiring repayment of principal, it would not increase the public debt-to-GDP ratio.

Numerous state governments in the US and elsewhere around the globe have employed this mechanism. It is a form of short-term credit cheaper than that offered by financial markets. The maintenance of parity with the Euro means that it comes with a built-in safeguard against inflation in compliance with EU guidelines.

Socialist economist Michael Burke has pointed out that Greek business claims the highest share of national income of the entire OECD at 56%. Of this, only 11.3% of the national income is actually invested. There is no reason why the remainder cannot provide a firm platform to securitize taxes for countercyclical activity. With adequate capital controls, Syriza is in a position to present business with a Hobson's choice: either invest this savings now or it will be confiscated and spent by the state later. In the meantime, these savings will be securitized as scrip for immediate relief.

Scrip can pay civil servants and support the expansion of public services. With it, Syriza can fund infrastructural improvements and R & D needed to earn additional Euros for Greece through improved trade and import substitution. And, at the same time, it frees Euros for the large-scale import purchases of food, medicine and fuel.

But neither is this a sufficient plan B. Even if the fiscal restraint imposed by the Eurozone limiting primary deficits to 3% of GDP were not in effect, the Greek economic recovery would still be restrained by its tax base. The advantages to this parallel currency is that it permits a path through which the tax base, once securitized, can pump a self-expanding loop through the system generating additional incomes to tax. Nevertheless, the type of robust recovery needed is still unlikely given these dual limitations. According to one estimate, Greece needs to run a primary deficit of 10% to return it to a full recovery growth path.

With a socialized European central bank, as has been argued previously, Greece and the other member nations would not be so constrained. A socialized ECB could disregard the deficit position of the collective national treasuries and directly support the spending decisions of the constituent governments up to full economic capacity. And it could do away with government “borrowing” as an unnecessary subsidy to private investors.

What such stopgap measures can do is to transform the Eurozone from a monetary union to a looser monetary federation. It can chip away at the power of the troika and provide hope and encouragement to similarly-minded insurgencies such as Podemos, and trade union militants eager to break with or move existing mass workers’ parties to the left. By stoking the anti-austerity brushfire, any success by Syriza, no matter how modest, would mobilize an emboldened left to ask larger questions about the structure, design and necessity of this Bankers’ Federation.

More immediately, it can provide Syriza with the space to properly deliberate over the risks and prospects that await Greece were it to opt out of the Eurozone.