EU/IMF Revolt: Greece, Iceland, Latvia May Lead the Way

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Europe's small, debt-strapped countries could follow the lead of Argentina and simply walk away from their debts. That would shift the burden to the creditor countries, which could solve the problem merely by a change in accounting rules.

Total financial collapse, once a problem only for developing countries, has now come to Europe. The International Monetary Fund is imposing its "austerity measures" on the outer circle of the European Union, with Greece, Iceland and Latvia the hardest hit. But these are not your ordinary third world debtor supplicants. Historically, the Vikings of Iceland successfully invaded Britain; Latvia n tribes repulsed the Vikings; and the Greeks conquered the whole Persian empire. If anyone can stand up to the IMF, these stalwart European warriors can.

Dozens of countries have defaulted on their debts in recent decades, the most recent being Dubai, which declared a debt moratorium on November 26, 2009. If the once lavishly-rich Arab emirate can default, more desperate countries can; and when the alternative is to destroy the local economy, it is hard to argue that they shouldn't. That is particularly true when the creditors are largely responsible for the debtor's troubles, and there are good grounds for arguing the debts are not owed. Greece's troubles originated when low interest rates that were inappropriate for Greece were maintained to rescue Germany from an economic slump. And Iceland and Latvia have been saddled with responsibility for private obligations to which they were not parties. Economist Michael Hudson writes:

"The European Union and International Monetary Fund have told them to replace private debts with public obligations, and to pay by raising taxes, slashing public spending and obliging citizens to deplete their savings. Resentment is growing not only toward those who ran up these debts . . . but also toward the neoliberal foreign advisors and creditors who pressured these governments to sell off the banks and public infrastructure to insiders."

The Dysfunctional EU: Where a Common Currency Fails

Greece may be the first in the EU outer circle to revolt. According to Ambrose Evans-Pritchard in Sunday's Daily Telegraph, "Greece has become the first country on the distressed fringes of Europe's monetary union to defy Brussels and reject the Dark Age leech-cure of wage deflation." Prime Minister George Papandreou said on Friday:

"Salaried workers will not pay for this situation: we will not proceed with wage freezes or cuts. We did not come to power to tear down the social state."

Notes Evans-Pritchard:

"Mr Papandreou has good reason to throw the gauntlet at Europe's feet. Greece is being told to adopt an IMF-style austerity package, without the devaluation so central to IMF plans. The prescription is ruinous and patently self-defeating."

The currency cannot be devalued because the same Euro is used by all. That means that while the country's ability to repay is being crippled by austerity measures, there is no way to lower the cost of the debt. Evans-Pritchard concludes:

"The deeper truth that few in Euroland are willing to discuss is that EMU is inherently dysfunctional – for Greece, for Germany, for everybody."

Which is all the more reason that Iceland, which is not yet a member of the EU, might want to reconsider its position. As a condition of membership, Iceland is being required to endorse an agreement in which it would reimburse Dutch and British depositors who lost money in the collapse of IceSave, an offshore division of Iceland's leading private bank. Eva Joly, a Norwegian-French magistrate hired to investigate the Icelandic bank collapse, calls it blackmail. She warns that succumbing to the EU's demands will drain Iceland of its resources and its people, who are being forced to emigrate to find work.

Latvia is a member of the EU and is expected to adopt the Euro, but it has not yet reached that stage. Meanwhile, the EU and IMF have told the government to borrow foreign currency to stabilize the exchange rate of the local currency, in order to help borrowers pay mortgages taken out in foreign currencies from foreign banks. As a condition of IMF funding, the usual government cutbacks are also being required. Nils Muiznieks, head of the Advanced Social and Political Research Institute in Riga, Latvia, complained:

"The rest of the world is implementing stimulus packages ranging from anywhere between one percent and ten percent of GDP but at the same time, Latvia has been asked to make deep cuts in spending – a total of about 38 percent this year in the public sector – and raise taxes to meet budget shortfalls."

In November, the Latvian government adopted its harshest budget of recent years, with cuts of nearly 11%. The government had already raised taxes, slashed public spending and government wages, and shut dozens of schools and hospitals. As a result, the national bank forecasts a 17.5% decline in the economy this year, just when it needs a productive economy to get back on its feet. In Iceland, the economy contracted by 7.2% during the third quarter, the biggest fall on record. As in other countries squeezed by neo-liberal tourniquets on productivity, employment and output are being crippled, bringing these economies to their knees.

The cynical view is that that may have been the intent. Instead of helping post-Soviet nations develop self-reliant economies, writes Marshall Auerback, "the West has viewed them as economic oysters to be broken up to indebt them in order to extract interest charges and capital gains, leaving them empty shells."

But the people are not submitting quietly to all this. In Latvia last week, while the Parliament debated what to do about the nation's debt, thousands of demonstrating students and teachers filled the streets, protesting the closing of a hundred schools and reductions in teacher salaries of up to 60%. Demonstrators held signs saying, "They have sold their souls to the devil" and "We are against poverty." In the Iceland Parliament, the IceSave debate had been going on for over 140 hours at last report, a new record; and a growing portion of the population opposes underwriting a debt they believe the government does not owe.

In a December 3 article in The Daily Mail titled "What Iceland Can Teach the Tories," Mary Ellen Synon wrote that ever since the Icelandic economy collapsed last year, "the empire builders of Brussels have been confident that the bankrupt and frightened Icelanders must finally be ready to exchange their independence for the 'stability' of EU membership." But last month, an opinion poll showed that 54 percent of all Icelanders oppose membership, with just 29 percent in favor. Synon wrote:

"The Icelanders may have been scared out of their wits last year, but they are now climbing out from under the ruins of their prosperity and have decided that the most valuable thing they have left is their independence. They are not willing to trade it, not even for the possibility of a bail-out by the European Central Bank."

Iceland, Latvia and Greece are all in a position to call the bluff of the IMF and EU. In an October 1 article called "Latvia – the Insanity Continues," Marshall Auerback maintained that Latvia's debt problem could be fixed over a weekend, by a list of measures including (1) not answering the phone when foreign creditors call the government; (2) declaring the banks insolvent, converting their external debt to equity, and having them reopen with full deposit insurance guaranteed in local currency; and (3) offering "a local currency minimum wage job that includes healthcare to anyone willing and able to work as was done in Argentina after the Kirchner regime repudiated the IMF's toxic package of debt repayment."

Evans-Pritchard suggested a similar remedy for Greece, which he said could break out of its death loop by following the lead of Argentina. It could "restore its currency, devalue, pass a law switching internal euro debt into [the local currency], and 'restructure' foreign contracts."

The Road Less Traveled: Saying No to the IMF

Standing up to the IMF is not a well-worn path, but Argentina forged the trail. In the face of dire predictions that the economy would collapse without foreign credit, in 2001 it defied its creditors and simply walked away from its debts. By the fall of 2004, three years after a record default on a debt of more than $100 billion, the country was well on the road to recovery; and it achieved this feat without foreign help. The economy grew by 8 percent for 2 consecutive years. Exports increased, the currency was stable, investors were returning, and unemployment had eased. "This is a remarkable historical event, one that challenges 25 years of failed policies," said economist Mark Weisbrot in a 2004 interview quoted in The New York Times. "While other countries are just limping along, Argentina is experiencing very healthy growth with no sign that it is unsustainable, and they've done it without having to make any concessions to get foreign capital inflows."

Weisbrot is co-director of a Washington-based think tank called the Center for Economic and Policy Research, which put out a study in October 2009 of 41 IMF debtor countries. The study found that the austere policies imposed by the IMF, including cutting spending and tightening monetary policy, were more likely to damage than help those economies.

That was also the conclusion of a study released last February by Yonca Özdemir from the Middle East Technical University in Ankara, comparing IMF assistance in Argentina and Turkey. Both emerging markets faced severe economic crises in 2001, preceded by chronic fiscal deficits, insufficient export growth, high indebtedness, political instability, and wealth inequality.

Where Argentina broke ranks with the IMF, however, Turkey followed its advice at every turn. The end result was that Argentina bounced back, while Turkey is still in financial crisis. Turkey's reliance on foreign investment has made it highly susceptible to the global economic downturn. Argentina chose instead to direct its investment inward, developing its domestic economy.

To find the money for this development, Argentina did not need foreign investors. It issued its own money and credit through its own central bank. Earlier, when the national currency collapsed completely in 1995 and again after 2000, Argentine local governments issued local bonds that traded as currency. Provinces paid their employees with paper receipts called "Debt-Cancelling Bonds" that were in currency units equivalent to the Argentine Peso. The bonds canceled the provinces' debts to their employees and could be spent in the community. The provinces had actually "monetized" their debts, turning their bonds into legal tender.

Argentina is a large country with more resources than Iceland, Latvia or Greece, but new technologies are now available that could make even small countries self-sufficient. See David Blume, Alcohol Can Be a Gas.

Local Currency for Local Development

Issuing and lending currency is the sovereign right of governments, and it is a right that Iceland and Latvia will lose if they join the EU, which forbids member nations to borrow from their own central banks. Latvia and Iceland both have natural resources that could be developed if they had the credit to do it; and with sovereign control over their local currencies, they could get that credit simply by creating it on the books of their own publicly-owned banks.

In fact, there is nothing extraordinary in that proposal. All private banks get the credit they lend simply by creating it on their books. Contrary to popular belief, banks do not lend their own money or their depositors' money. As the U.S. Federal Reserve attests, banks lend new money, created by double-entry bookkeeping as a deposit of the borrower on one side of the bank's books and as an asset of the bank on the other.

Besides thawing frozen credit pipes, credit created by governments has the advantage that it can be issued interest-free. Eliminating the cost of interest can cut production costs dramatically.

Government-issued money to fund public projects has a long and successful history, going back at least to the early eighteenth century, when the American colony of Pennsylvania issued money that was both lent and spent by the local government into the economy. The result was an unprecedented period of prosperity, achieved without producing price inflation and without taxing the people.

The island state of Guernsey, located in the Channel Islands between England and France, has funded infrastructure with government-issued money for over 200 years, without price inflation and without government debt.

During the First World War, when private banks were demanding 6 percent interest, Australia's publicly-owned Commonwealth Bank financed the Australian government's war effort at an interest rate of a fraction of 1 percent, saving Australians some $12 million in bank charges. After the First World War, the bank's governor used the bank's credit power to save Australians from the depression conditions prevailing in other countries, by financing production and home-building and lending funds to local governments for the construction of roads, tramways, harbors, gasworks, and electric power plants. The bank's profits were paid back to the national government.

A successful infrastructure program funded with interest-free national credit was also instituted in New Zealand after it elected its first Labor government in the 1930s. Credit issued by its nationalized central bank allowed New Zealand to thrive at a time when the rest of the world was struggling with poverty and lack of productivity.

The argument against governments issuing and lending money for infrastructure is that it would be inflationary, but this need not be the case. Price inflation results when "demand" (money) increases faster than "supply" (goods and services). When the national currency is expanded to fund productive projects, supply goes up along with demand, leaving consumer prices unaffected.

In any case, as noted above, private banks themselves create the money they lend. The process by which banks create money is inherently inflationary, because they lend only the principal, not the interest necessary to pay their loans off. To come up with the interest, new loans must be taken out, continually inflating the money supply with new loan-money. And since the money is going to the creditors rather than into producing new goods and services, demand (money) increases without increasing supply, producing price inflation. If credit were extended for public infrastructure projects interest-free, inflation could actually be reduced, by reducing the need to continually take out new loans to find the elusive interest to service old loans.

The key is to use the newly-created money or credit for productive projects that increase goods and services, rather than for speculation or to pay off national debt in foreign currencies (the trap that Zimbabwe fell into). The national currency can be protected from speculators by imposing exchange controls, as Malaysia did in 1998; imposing capital controls, as Brazil and Taiwan are doing now; banning derivatives; and imposing a "Tobin tax," a small tax on trade in financial products.

Making the Creditors Whole

If the creditors are really interested in having their debts repaid, they will see the wisdom of letting the debtor nation build up its producing economy to give it something to pay with. If the creditors are not really interested in repayment but are using the debt as a tool to exploit the debtor country and strip it of its assets, the creditors' bluff needs to be called.

When the debtor nation refuses to pay, the burden shifts to the creditors to make themselves whole. British economist Michael Rowbotham suggests that in the modern world of electronic money, this can be accomplished by creative banking regulators simply with a change in accounting rules. "Debt" today is created with accounting entries, and it can be reversed with accounting entries. Rowbotham outlines two ways the rules might be changed to liquidate impossible-to-repay debt:

"The first option is to remove the obligation on banks to maintain parity between assets and liabilities . . . . Thus, if a commercial bank held $10 billion worth of developing country debt bonds, after cancellation it would be permitted in perpetuity to have a $10 billion dollar deficit in its assets. This is a simple matter of record-keeping.

"The second option . . . is to cancel the debt bonds, yet permit banks to retain them for purposes of accountancy. The debts would be cancelled so far as the developing nations were concerned, but still valid for the purposes of a bank's accounts. The bonds would then be held as permanent, non-negotiable assets, at face value."

If the banks were allowed either to carry unrepayable loans on their books or to accept payment in local currency, their assets and their solvency would be preserved. Everyone could shake hands and get back to work.

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