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Over-indebtedness of states: a danger for democracy and human rights

Opinion[1]
Social, Health and Family Affairs Committee
Rapporteur: Mr Andrej HUNKO, Germany, Group of the Unified European Left (UEL)

A. Conclusions of the committee

The Social, Health and Family Affairs Committee would have appreciated more time to prepare its opinion. It believes that a new report needs to be prepared for the Parliamentary Assembly on the question of "austerity measures – a danger for democracy and social rights", and would like to be seized for report on this subject.

The committee also proposes a number of amendments to strengthen the draft recommendation tabled (in particular as concerns the protection of social rights).

B. Proposed amendments to the draft recommendation

Amendment A (to the draft recommendation)

In the draft recommendation, paragraph 1, replace the third sentence with the following sentence:

> *"However, the recent decade, in particular the last few years, has revealed a worrying inability of many European governments to pursue prudent regulatory and appropriate public debt policies."*

Amendment B (to the draft recommendation)

In the draft recommendation, paragraph 2, add after the word "Although" the word "too".

Amendment C (to the draft recommendation)

In the draft recommendation, in the second sentence of paragraph 4, replace the word "welcomes" with the word "notes".

Amendment D (to the draft recommendation)

In the draft recommendation, after paragraph 5, insert the following paragraph:

> *"The Assembly, recalling its Resolution 1673 (2009) on challenges of the financial crisis for the world economic institutions, emphasises the need to further improve regulatory mechanisms at all levels (national, European and international) in order to avert further financial and economic crises which could lead to a deepening of state debt. These regulatory mechanisms should include supervision of rating systems, banks and other financial institutions."*

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Amendment E (to the draft recommendation)

In the draft recommendation, after paragraph 5, insert the following paragraph:

> *"The crisis was partially caused by the combination of financial deregulation and state guarantees to the financial sector. That combination now leads to the nationalisation of private debt: public authorities pay the price which should have been paid by shareholders and bond holders of financial institutions. In the future, guarantees should always be combined with strict regulation to manage the public risk of those guarantees. If these guarantees are called upon, the managers of the financial institutions should pay the price and have their salaries lowered and refrain from accepting bonus payments. For if the public sector had not stepped in, their institutions might well have gone bankrupt. This should be the case as long as they continue to receive public support."*

Amendment F (to the draft recommendation)

In the draft recommendation, after paragraph 10, insert the following paragraph:

> *"The Assembly deplores that states have effectively nationalised private debt. Article 1 of the First Protocol to the European Convention on Human Rights explicitly prohibits expropriation of private property. It should also prohibit the expropriation of private debt, so that taxpayers are not called upon to pay the price of failure by private sector institutions."*

C. Explanatory memorandum by Mr Hunko, rapporteur for opinion

1. Introduction

1. Neither economic crisis nor high government debt are new phenomena. Both Italy and Belgium, for example, faced government debt far exceeding annual GDP by 125% in the 1990s[2] (before the introduction of the European Single Currency but already within the European Monetary Union) without this state debt having been called a crisis. The United States of America and Japan likewise have had deficits for decades – the United States face a double deficit in budgetary and international trade affairs alike – without disturbing the markets until recently. (So the question remains why is over-indebtedness a problem and what do we understand as being over-indebted.) We thus have to deal with the problem of what renders the current situation different to previous difficulties and what is the (potential) impact on democracy and human rights, including social rights.

2. In trying to understand and to overcome the current economic and financial crisis, which is not primarily a crisis of over-indebtedness of states, we have to acknowledge that there is no such thing as a simple answer or a "*Königsweg*" out. The reasons for increased sovereign debt differ widely from country to country as do the possible remedies to solve the problem. Put simply: Ireland saved its banks by issuing government bonds; Iceland tried to do the same but had to face the fact that its banking sector already far exceeded its national financial capabilities. When we compare the current situation with historic financial crises, we can detect parallels with the Great Depression of the 1930s, with Latin America's situation in the 1980s and the Asian crisis in the 1990s.[3] History does raise some concern over the future possible developments in Europe after the crisis. Austerity after a severe financial and economic crisis can potentially lead to nationalistic governments, or a race for better resources; not to mention violations of fundamental social rights, xenophobic

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2. Belgium had 140.7% gross financial liabilities in comparison to nominal GDP in 1993; Italy 132.6% in 1998. This only included general government. Unfunded liabilities for federal pension plans, regional county debt, liabilities of nationalised companies etc. were generally not included in those years. Belgium includes National Railway Debt in its figures since 2005.

3. One might think governments and financial institutions have learnt the lessons from history – but is that true? It has to be noted, however, that none of the former crises except the one in Latin America were caused by over-indebtedness of sovereign states. Looking back into the 20th century, the reasons for slowdowns and crises were pegged foreign exchange rates under the gold standard (1930) combined with austerity policies after the stock market crash of 1929. In 1973, the oil prices exploded, and did so again in 1979, both times putting the world economy under pressure and leading to the abandoning of the Bretton Woods system of fixed exchange rates established after the Second World War. In the 1970s, international banks were willing to lend to Latin American countries on grounds which don't seem reasonable today or are even unknown – and the receiving governments did not make good use of that money either. It took Latin America seven years to work its way out of the debt crisis which began in 1982. In the 1990s, the currency crises in the United Kingdom, in Asia and Latin America occurred when unsustainable economic policy combinations were spotted by financial market speculators who forced governments to devalue and to leave office.

populism, and other grave societal ills. However, the success of F. D. Roosevelt's "New Deal" after the Great Depression shows that good can also come of even deep economic crises if the government response is appropriate.[4]

3. But historical comparisons have their limits. The current crisis in Europe and the Western World is not a cyclical one as in former years where a crisis follows a boom and vice versa. The situation many European states face these days with limited access to financial market resources, increased sovereign debt, ailing banks, a discontented population, was triggered by a near-meltdown of the global financial sector. But the reason why this could affect national governments in the way it did has deeper roots.

4. The cause is the exposure of these countries to the global financial market: the main buyers of gilts are not private investors but international banks and financial institutions. First, these banks and financial institutions had the problem that due to the sectorial crisis in 2008 they had to curb their risk exposure. Second, they were aware that confidence in institutions and markets is the most important factor in assessing risk. So, they scrutinised the risk inherent in some of the government bonds, which brought back into focus the overall grade of indebtedness of certain countries. Ireland had to deal with ailing national banks and Spain faced a severe real estate bubble which burst due to the financial crisis. It has to be stressed that all of this would have been much less of a problem had the countries had higher saving rates of their population, like the one in Germany, for example. But unbalanced economic policies over decades made any reaction to the freeze of international money caused by now cautious investors impossible.

2. The crisis and state indebtedness

5. What is new in today's financial crisis which triggered increasing government debt is that it affected the advanced world economies when everybody thought that the Great Depression could not happen again. The Great Depression resulted in J. M. Keynes "General Theory of Employment, Interest and Money". He advised governments to spend money even to the detriment of increased budget deficits, to flood the markets with liquidity and to bring interest rates down. Keynes did not advise them to cut spending, raise taxes and increase interest rates – which were the remedies suggested by the International Monetary Fund (IMF) to countries like Argentina, Brazil, Indonesia, Mexico, Russia and Thailand, and in their 1990s economic crises. This is also the policy followed by the United Kingdom since the Tory victory in national elections in 2010 and the current popular propositions for the Mediterranean European Union member countries like Greece, Italy, Portugal and Spain. Contrary to IMF advice for less advanced economies, the United States treasury and Federal Reserve both acted in textbook manner according to Keynes when faced with the 2008 subprime crisis – although only after Lehman Brothers was left to go bust, putting the world at the brink of a complete financial meltdown.[5]

6. Keynes was one of the first (or even the first) economist who stressed the importance of expectations in financial markets and of confidence which financial players have to restore. If one wants to have a single and simple answer for governments regarding what to do in times of heavy public debt, it is to restore confidence within the financial market that the country will be able to pay back its debt entirely. But confidence is not a commodity that is evenly spread among national economies. Financial actors may be confident that Ireland will be able to solve its banking problem but they might not have confidence in Greece to ever pay high wages, high pensions, *and* interest on public debt. Unfortunately, the global financial market is not a fair place. Rich economies can much more easily restore faith in their economic policy, especially if they have a long and consistent stability track record than weak governments or less advanced countries.[6]

7. Governments that have never shown this zeal have to convince their population and national companies that everybody will be better off after the crisis is resolved. If these governments do not have the necessary credibility even to convince their own people, they need to be able to borrow this credibility from other states and or institutions which might act as mediators. It cannot be the correct way forward for the poor to have to carry the burden of restoring financial sanity (as could be argued is the case now in the United Kingdom and Greece) while the rich are left untouched. Economic policy measures have to be balanced:

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4. The "New Deal" was a series of economic programmes implemented in the United States in the 1930s as a response to the Great Depression, focusing on relief (for the unemployed and the poor), recovery (of the economy) and reform (of the financial system to prevent a repeat depression).
5. Personally, I have doubts that it was indeed necessary to save the banks – but this is not the subject of this opinion, so I will not go into more detail here.
6. However, the government bonds issued during the current crisis are not bought exclusively by private investors – for example, the European Central Bank (ECB) invests heavily in these bonds (the ECB even had to be recapitalised as a consequence).

capital controls can help to avoid capital flight by the rich; corruption and cronyism have to be curbed; and investors (including banks)[7] need to bear at least part of the losses when loans go bad. Governments have to be transparent on how they support corporates indirectly, how they distribute public contracts, what the next measures will be, when newly introduced taxes in order to pay public debt will be abolished again, and so on.

3. Indebtedness and austerity measures – potentially undemocratic and violating human rights

8. If we consider that many European states are over-indebted – and I regret the lack of data on non-European Union and non-OECD member countries –, we can consider that this over-indebtedness is problematic from an economic point of view (as explained above). However, this alone would not make it a problem the Council of Europe should deal with. What makes over-indebtedness of states a matter for the Council of Europe is its potential to pose a threat to democracy and human rights.

9. It is the role and the duty of governments to govern. This means setting down the rules and regulations within which the economy can then develop freely. One of the main problems which led to the current financial and economic crisis was the comparative lack of global regulation of the international financial system – in particular, of democratic regulation.[8] As the rapporteur, Mr Omtzigt, clearly states in his report, this regulation is still lacking. I consider that this is an unacceptable situation, and that the Council of Europe should insist on such regulation being adopted and implemented without further delay. Our citizens – to speak with Icelandic President Ólafur Ragnar Grimsson – should not have to "choose between democracy and the financial markets", as he considered the Icelanders had to.[9] Over-indebtedness of states is a problem when it comes to the democratic regulation of the markets, as it weakens states' negotiating position.

10. Over-indebtedness of states can theoretically also be a threat to human rights, in particular fundamental social rights such as those guaranteed by the Council of Europe's (revised) Social Charter, if states are unable to continue to finance their welfare systems – the cost of debt-service, in particular at the higher interest rates imposed on some states by the financial markets, has ballooned in recent years. However, the more immediate threat to these rights is, in fact, not posed by the over-indebtedness of states themselves, but rather to short-sighted "austerity" packages, which are in reality simply budgetary cuts in the social and welfare sector. There are numerous examples of such cuts which negatively affect the social rights of the whole population of the countries implementing such packages, including the most vulnerable groups of the population: from lowering the minimum wage (to a "minimum" which no longer covers "minimum" needs and thus no longer allows for decent living) to cutting child and/or unemployment or other benefits, to no longer paying for breast-cancer screening. The list is practically endless, and as morally reprehensible as it is unacceptable from a human rights point of view.

11. I am not saying that over-indebted states should not curb their budget deficits, even if they have ballooned mainly due to the bailing out of banks: I am advocating a balancing of the budget which is respectful of citizen's democratic and human rights. Citizens should have a say in how and when the state debt should be cut – governments should thus not be dictated to by financial institutions (or other states)[10] in this area, in particular since it even makes good economic sense to make budgetary cuts in boom years rather than just following the greatest crisis and recession of this century. But countries should also remember their international commitments and obligations, and governments' decisions on where to cut should thus be fully in line with them. Other budget cutting alternatives, which do not directly threaten social rights and the European welfare state, do exist: for instance in states' military budgets, in reducing tax breaks for the wealthy, and so on.

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7. It is not acceptable that some banks (whether or not they were "saved" by states) have been able to offload risks almost completely onto tax payers, and have gone back (within the space of two years) to making a tidy profit.

8. It is doubtful whether the ECB can be called a democratic body – and it should not be one. The same applies to the European Systemic Risk Board.

9. Author's translation. See http://www.focus.de/finanzen/news/referendum-in-island-nein-zu-milliarden-ueberweisung-nach-crash_aid_487365.html, 7 March 2011.

10. A slogan during a demonstration in Portugal read "I did not elect Merkel" (author's translation). (www.jornaldenegocios.pt/home.php?template=SHOWNEWS_V2&id=472989).

4. Recommendations

12. Democratic economic institutions have to be strengthened in all Council of Europe member states: there has to be a proper supervision of banks and other financial institutions, as called for in Resolution 1673 (2009) on challenges of the financial crisis for the world economic institutions. Financial institutions from countries that have not ratified the Basel Accord Requirements should not be allowed to deal in the currencies and assets of those countries who ratified and accepted the minimum requirements.[11]

13. I agree with Mr Omtzigt's analysis of the failures of the rating agencies. The European countries should set up their own public multinational rating agency supervised by parliaments, preferably under OECD responsibility, but should this not be possible, under European Union or Council of Europe responsibility, since sound financial markets and open economies are a precondition for democracy and human rights.

14. Member states should self-restrict their borrowing from foreign capital markets. Japan can sustain a 200% of GDP deficit because this is mainly financed by Japanese private investors – and those parts that are not are covered by exports. So Japan is an example of a self-sufficient economy which guarantees a certain shock-resistance plus independence from speculative investors. It is obvious that this cannot be achieved within a few years in Europe. But governments should be aware of the fact that heavy international indebtedness brings with it risks of “foreign” interference – be it by financial markets, institutions, or states.

15. Council of Europe member states should be aware of the fact that sound statistical measures and policy are vital for transparency and financial engagement of international institutions and other countries. It could be advisable to set up a multinational statistics agency for Council of Europe member countries which either helps less advanced countries in their statistical work or even takes over national statistical duties. It is clear that this is not an easy task, especially as there are always several ways to dress up statistical figures.[12] But the ways to gather data, to define the data needed, to calculate and to measure growth can be unified in order to show where there is need for development aid, interest rate subsidies, etc.

16. I have agreed with Mr Omtzigt not to propose a number of amendments which would follow from the above now, and to suggest that the Social, Health and Family Affairs Committee be seized for report on a new report instead, which would deal with “austerity measures – a danger for democracy and social rights”.

17. The aim of Amendment A is to streamline the text. Amendment Bseeks to point out that too much power has shifted towards global financial markets and the private sector (a judgment I think I share with Mr Omtzigt). Amendment Cremoves an unnecessary value judgment.In Amendment D, reference is made to the Assembly's past Resolution 1673 (2009) on challenges of the financial crisis for the world economic institutions and the recommendations made therein. Amendments E and Fseek to prohibit the nationalisation of private debt.

11. It is fair to say that the subprime crisis would not have been possible had the US Administration ratified the Basel II accord on minimum capitalisation of banks.

12. Germany has had its own experience: until unification, economists believed East German statistics indicating a per capita income of 80% of West Germany. After reunification, they found out that the level looked pretty much like what it was, the Third World.