

Recommendation 1961 (2011)¹

Final version

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

Parliamentary Assembly

1. There can be no good governance without sound economic governance. In their quest to bring European nations closer together, a group of states defined the rules of the Stability and Growth Pact and engaged in the euro project. However, the past 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. A dangerous vicious circle of excessive debt, large budget deficits and anaemic economic growth is now threatening the very foundations of European structures and the quality of life of European citizens.

2. The grand European undertaking originated from human tragedies and has evolved through crises. The current problems encountered by the states at the hard core of European integration should serve as an impetus for more concerted action in terms of political and economic governance. There is a strong need to repair the economic system that failed to assess risk correctly and to perform responsibly in boom years. Although too much power has shifted towards global financial markets and the private sector, the state remains the key regulator and the guarantor of the rule of law which underpins democracy, fundamental rights and the orderly functioning of the market economy.

3. The Parliamentary Assembly is concerned that short-sighted national policy decisions have eroded public trust in state institutions, fuelled speculations about the viability of the European welfare model and raised tensions between the public and private sectors. Excessive reliance on the sprawl of financial services to the detriment of other economic sectors has generated macro-economic imbalances and financial bubbles. While some bank bailouts have been justified by the necessity to preserve economic stability, overall it is not fair to transfer private sector losses to states and ultimately to all their taxpayers. This distortion in market and governance has to be fixed to avert similar crises in the future.

4. The Assembly appreciates that increased international economic interdependence has led to closer multilateral co-operation, via the G20, aimed at

improving regulation of the financial sector, strengthening the oversight of credit rating agencies and curbing tax evasion. It notes the creation of the European Financial Stability Fund in May 2010 as a temporary measure and of the European Systemic Risk Board, operational since January 2011, together with three European supervisory authorities for the banking, insurance and securities sectors. These authorities' supervisory powers should help detect and correct at an early stage emerging macro-economic imbalances and enable better structuring of the activities of credit rating agencies registered in the European Union.

5. Moreover, the Assembly notes the intention of the European Commission to propose, in summer 2011, a comprehensive legislative framework for dealing with ailing banks (that are too big, complex and interconnected to be allowed to fail) so that they could be restructured or resolved without making taxpayers carry the burden. It similarly considers that options for a partial restructuring of excessive public debt should not be taboo and that framework mechanisms for orderly restructuring should be examined.

6. The crisis was partially caused by the combination of financial deregulation and state guarantees to the financial sector. That combination has led 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.

7. The Assembly is aware that some of the Council of Europe member states have used dubious practices to minimise their short-term public deficit. These practices typically lack transparency and may have grave repercussions on future and long-term state indebtedness. Notably, derivatives can serve as a useful tool for state debt management, but also help hide more public debt if they are misused. As disclosure regarding derivative activity by sovereign borrowers is extremely scarce, monitoring by "government shareholders" (that is to say, the taxpayers) can only be weak at best. This lack of disclosure makes governments less accountable as regards the public debt situation and reduces the transparency of national statistics.

8. The Assembly therefore stresses the importance of transparency in a democracy and in the market economy. Without transparency, democracy remains incomplete because only an adequately informed population can vote advisedly and thereby exercise political rights in full knowledge of the facts. In this context, the Assembly recalls the merit of the media as a watchdog of democracy, as they enable the public to

1. Assembly debate on 11 April 2011 (11th Sitting) (see Doc. 12556, report of the Committee on Economic Affairs and Development, rapporteur: Mr Omtzigt; Doc. 12571, opinion of the Social, Health and Family Affairs Committee, rapporteur: Mr Hunko; and Doc. 12572, opinion of the Committee on the Environment, Agriculture and Local and Regional Affairs, rapporteur: Mr Meale). Text adopted by the Assembly on 11 April 2011 (11th Sitting).

react to potential abuses of political power or economic wrongdoing. As public finance management requires faultless transparency and the principle of consent to taxation is considered one of the safeguards for democracy, governments must show proof of good intentions and ensure full transparency of state accounts in order to uphold democracy.

9. In this respect, it is extremely worrying that member states have been forced to guarantee each other's sovereign debt, for instance in the cases of Iceland and Greece. State debt has thus become interstate debt. This is only acceptable in truly exceptional circumstances and should be a very temporary emergency measure. Interstate debt and guarantees increase systemic risk within Europe as the default of one state may lead to a chain reaction of debt restructuring, emergency budgets, increase in money supply and great suffering for European citizens.

10. The risk of state, and other, guarantees should not be obscured in the accounts, as they are a real risk to public finances. The crises in both Ireland and Iceland were the direct consequences of unsustainable guarantees. Those guarantees should therefore be reported in full and separately from other business to the parliaments of the member states. Countries that guarantee sovereign debt and other debt should fully report on those guarantees in an internationally consistent way. This also concerns deposit guarantee systems and loans and guarantees to the financial sector. Off-balance-sheet book keeping has been a problem in the build-up to the crisis and should thus be avoided in the state accounts. Therefore, the Assembly invites the Organisation for Economic Co-operation and Development (OECD) and Eurostat to issue methodological guidelines for states on more transparent reporting on state guarantees, no later than within six months from the adoption of this recommendation.

11. The influence of the financial markets on state governance, public interest, public conduct of economic policies and European democratic institutions is worrying. The Assembly considers that it is necessary to continue the discussions on this issue within the Council of Europe, including through the Forum for the Future of Democracy, and in member states' national parliaments. It underscores the need for closer interaction and information exchange between national parliaments, governments and the Bretton Woods institutions, in particular when the latter's assistance is sought.

12. The Assembly deplores that states have effectively nationalised private debt. Article 1 of the Protocol to the European Convention on Human Rights (ETS No. 9) explicitly prohibits the 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.

13. The Assembly recommends that the Committee of Ministers ask the governments of member states to:

13.1. ensure full transparency and accountability for state guarantees and to prepare plans for a gradual scaling down of such guarantees;

13.2. contain the erosion in living standards and citizen's socio-economic rights by making every effort to spread the effects of austerity measures fairly across the population and to spare vulnerable groups the weight of adjustments;

13.3. show realism in devising graduated strategies for public debt stabilisation and subsequent reduction through continued fiscal consolidation combined with structural reforms, sustained stimulus for growth sectors, improved tax administration and enhanced correlation between the level of welfare benefits and state revenue;

13.4. have a closer look at the integrity of economists whose advice to policy makers is as indispensable as it is dubious, or even manipulative, at times. The Assembly is convinced that the ethics and responsibility of this profession could be strengthened, for example by inviting competent bodies to draw up a global, or at least European, code of conduct, which includes disciplinary measures.