# HOW EURO SHRINKS DEMOCRACY: INSIGHTS FROM THE GREEK CRISIS

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**Abstract**

The adoption of a single currency in Europe is a pure political project. What we have learned from Greek crisis is that being in the Eurozone means that creditors can destroy a national economy and seize public assets if the government steps out of line. To keep the European project alive, we here call for a fundamental reform on sovereign debt: switching from a goal to which policy is constrained, back to a tool to serve policy aims. In a distressed country, lenders has the power to forces the borrower to accept and to adopt restrictive spending policies that defend their interest at the expense of citizen's ones. Eventually, this leads inevitably to the loss of autonomy in borrower's decisions on fiscal policy, spending policy, public properties. If the cause for this degenerative process is the privilege on sovereign debt, then we need to find a new framework that reclassifies the public debt as functional to human development rather than individual profits. A country shall not be allowed to repay a debt that goes beyond its repayment capacity. The maximum payback capacity shall be settled before the credit is granted as a fraction of its primary balance. As such, the amount of primary balance not pledged to the repayment of the debt shall be always available to the government to undertake investments, social or security expenses and to face unexpected events. If this rule were implemented, the capital market would be automatically regulated: the debt that exceeds that threshold would be automatically written-off.***

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## 1. Eurozone's 2008/14 Crisis: Quick Guide For Non-Europeans

More than 170 publications written during the period 1989-2002 by US eminent academic economists addressed a simple question: "*Is the Economic and Monetary Union (EMU) a good or a bad thing?*" Based on an optimum currency area approach, their common conclusions were startling: potential EMU Member States were further away from a well-functioning monetary union (Jonung and Drea, 2009, pp. 33-34).

The exchange-rate fluctuation is the most effective and the promptest instrument for the adjustment of the external imbalances. By introducing a single currency within member States, alternative mechanisms would have then adjusted imbalances, to make the local production more competitive. Any differential in competitiveness would then have been transferred from the exchange rate market to the labor one.

Adopting a single currency implies giving away much more than a more or less useful mechanism for rebalancing the external accounts: the surrender of a national currency creates huge political economy problems (Bagnai and Ospina, 2014, p. 3).

A sovereign state can borrow money, which is committed to honor. Nevertheless, it can only honor it according to the sustainability of its accounts. A sovereign counterpart is not like all other private ones. It may run into financial crises that push it in dire straits, but, by definition, it has the last word. It can, for example, raise taxation, reduce or "consolidate" the debt, or print money: the mint is a vital organ of the State, such as the army or the courts.

Hence, the adoption in Europe of a single currency is a pure political project. Such a project considers crisis (predicted and unavoidable) a price to pay in order to reach more quickly the final target: the realization of a European Federal State.

The functionalist view of the European Integration Project, advanced by Jean Monnet[1], assumes that moving some policy functions to the supranational level will create pressure for more integration through both positive feedback loops (as voters realize the benefits of integrating some functions and will want to integrate more) and negative ones (as partial integration leads to inconsistences that force further integration) (Guiso et al., 2014, p. 3). In the words of Mario Monti (2004), former European Commissioner from 1995 to 2004, who espoused this theory: «*We shouldn't be surprised by Europe's need of crisis, grave crisis, to take steps ahead. Europe's steps ahead are nothing else but transfers of national sovereignty to supranational level. It is obvious that the political power and the social identification with a national community can be prepared for these cessions only when the political and psychological cost of not doing them exceeds the cost of doing them, because there is a visible, claimed crisis underway*»[2].

Well, such integration is the result of a democratic process driven by an enlightened elite's effort.

However, *«democracy, national sovereignty and global economic integration are mutually incompatible: we can combine any two of the three, but never have all three simultaneously and in full»* (Rodrik, 2011). If we want more globalization, we must either give-up some democracy or some national sovereignty. In a European perspective, each Member State shall give-up national sovereignty to a full global economic integration and a full democracy shall be exercise within an innovative Federal European State.

Yet, the European Union is even shrinking both democracy *and* national sovereignty towards a global economic integration, without any political integration within a forthcoming European Federal State! The former, by establishing institutions unlinked to polls and governments, the latter by conferring competencies and activities from Member States to supranational entities (namely: Eurogroup, European Central Bank, European Banking Authority, European Commission, etc.). In fact, according to the Treaty on the Functioning of the European Union (TFEU), when treaties confer to the Union exclusive competence in a specific area, it implies that only the Union may legislate and adopt legally binding acts.

International treaties do not automatically qualify for democratic legitimacy, even if the counterparties are democratic sovereigns. Democracy shall not be fully delegated: a well-functioning democratic polity would place severe limits on the transfer of rule-making and enforcement authority to transnational bodies. This is crucial whenever elite or its technocratic agents negotiate in secret complex agreements – such as the Transatlantic Trade and Investment Partnership (TTIP) or the Trade in Services Agreement (TiSA), currently being negotiated at supranational level without any public draft texts. Howes (2013) argues that the public and indeed even most elected representatives, in these cases face such enormous agency costs and information asymmetries which make problematic the democratic legitimacy of international economic law.

Whereas a single market within Europe might be fully achieved by regulations on free movement of capital, people and services, any further conferring of competences from Member States on EU Institutions is not functional to a free market – it is functional to a new order of sovereignty.

Following the Maastricht Treaty (formally, the Treaty on European Union or TEU), money shall no longer fit the economy of a State, but any public decision of a Member State shall fit the value of the common currency.

Essentially, within the Eurozone, Member States are experiencing a tricky inversion of aims by tools: from economic policies targeted to social goals and public finance as a tool to raise resources to pursue those goals, to European policies that set economic goals (in terms of deficit, debt, inflation) and government engaged in finding ways to achieve them.

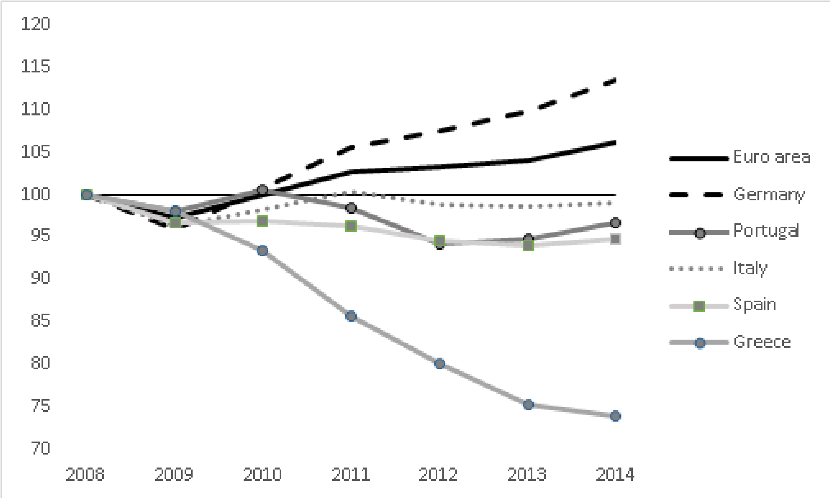
While any Member State may decide its withdrawal from the Union in accordance with its own constitutional requirements (art. 50, TEU), the question of whether a country can unilaterally leave the Eurozone without leaving the EU is controversial (Dammann, 2013). Nor a country shall be forced to leave the Eurozone.

Within this framework, in 2008 happened what was unavoidable and predicted by economists: the breakdown of unsustainable equilibria. Today the Eurozone records the lowest percentage of growth in the world; it is an island of stagnation, deflation and high unemployment rate. In fact, six years after the beginning of the crisis, most of the European countries have not yet recovered the value of GDP recorded in 2008 (figure 1).

[1] «L'Europe se fera dans les crises et elle sera la somme des solutions apportées à ces crises» [Europe will be forged in crises, and will be the sum of the solutions adopted for those crises] (Monnet, 1976).

[2] Interview in Italian available at: http://tinyurl.com/ojstk9d

**Figure 1.** Real GDP across selected EU Member States (2008=100)



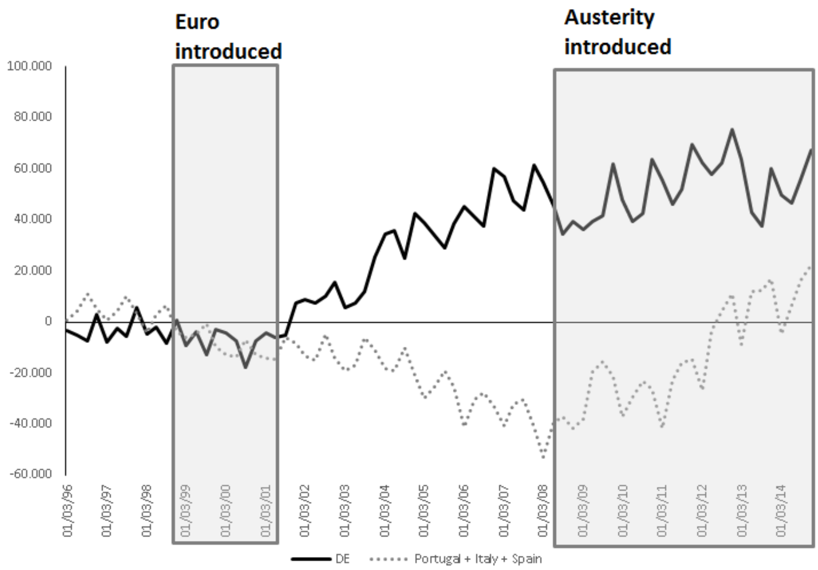

At the heart of the problem, there is a huge market failure driven by the introduction of the Euro, and its related economic policies that favored the creation of imbalances in the balance of payments.

The Brugel's final report to European Commission on the analysis of developments in EU capital flows in the global context clearly asserts: *"Persistent and excessive current account deficits, which are financed by financial account surpluses, expose countries to the risk of sudden stops and reversals in capital flows, which can lead to significant financial instability, and may lead to painful and prolonged macroeconomic adjustments"* (Darvas et al., 2013, p. 8).

In fact, the 2007/08 crisis is related to a continuous and ascending trend of accumulated deficit of the balance of payments in several economies (such as Greece, Spain, Portugal and Italy) and the correspondent accumulated surpluses in other countries (basically in Germany). These imbalances are the result of the divergences between the competitive positions of tradable products among EU Member States. The balance of the current accounts is offset by the balance of the capital account: countries facing a deficit in their current account accumulated huge debts towards countries facing a surplus, whereas the latter had financed the former, supporting their imports (vendor financing).

Figure 2 shows the quarterly current account of balance of payments in selected countries within the Eurozone. Before the introduction of the Euro data shows certain equilibrium. After that, a wide decoupling was generated by Germany, fully counterbalanced by deficits in southern countries (Portugal, Italy, and Spain). With the burst of the 2008 financial crisis, the trend is inverted, thanks to austerity policies enacted in debt countries to reduce deficit in balance of the current account and to face the capital outflow.

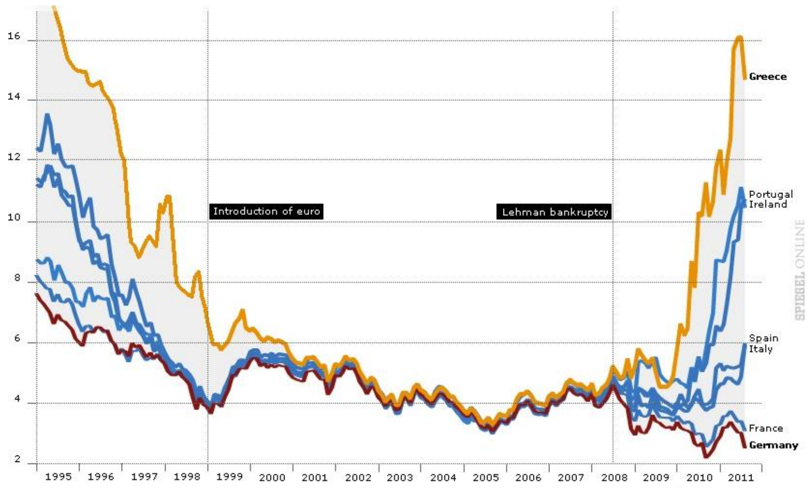
**Figure 2.** Current account, selected set of Countries (EUR, mln)



Yet, well before the crisis burst, such a growth paradigm was unsustainable, since it allowed several countries to grow well above their actual possibilities – e.g. not driven by productivity or return on investments. Those imbalances were fed and hidden by affordable credit, pumped by capital flows directed to deficit countries.

Like Odysseus saved the lives of his men blinding Polyphemus and then escaping hidden under the fleece of a sheep, so capital markets, fleeced with the euro, did not see the credit risk implicit in major differences in the fundamentals of European countries. In fact, after the convergence period, which ended with the introduction of the euro, differences in 10-year government bond yields among euro area countries were never more than 50 basis points until August 2008 (figure 3), but the institutional foundations of national economies continued to diverge. All national governments were considered by the bond market virtually the same, without taking into account each specificity, such as their level of debt, cash burning and therefore credit risk: at least until 2008 we have witnessed the greatest market failure in our history!

**Figure 3.** Interest rates on 10-year government bonds, selected set of Countries (in percent)

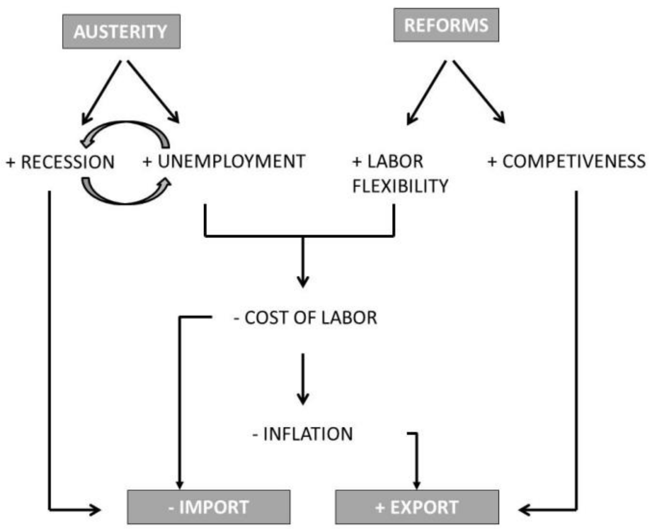



*Source:* Thomson Reuters Datastream

Following the Lehman Brothers bankruptcy, market's risk assessment awoke and risk appetite vanished. When German banks discontinued their revolving interbank credit to peripheral country banks, a huge liquidity shortage rose and the entire European economic system became very soon rickety.

Within the institutional and legal framework of the Eurozone, there are only two solutions to adjust the current account balance (figure 4): austerity (more taxes, less public expense, less available income, less aggregated demand, less imports) or structural reforms aimed to increase the export.

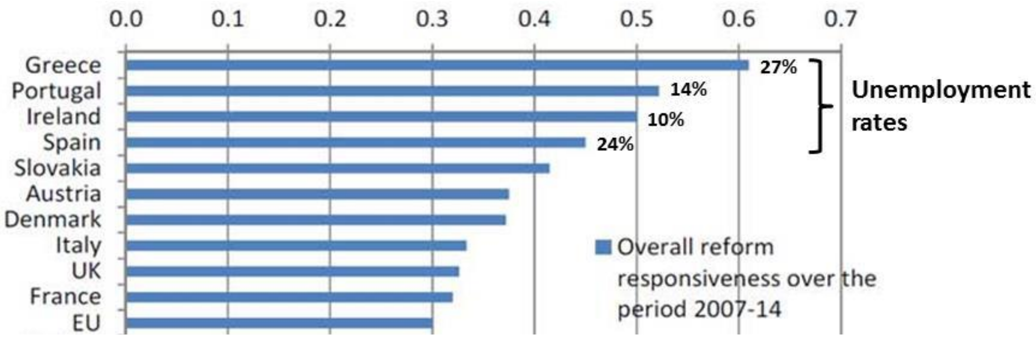
**Figure 4.** Policy actions and effects during the 2008/14 recession



This adjustment process has been borne by debtor nations only. "*In the absence of the option to devalue, the latter countries have been forced to reduce wages and prices relative to the creditor countries (an 'internal devaluation') without compensating wage and price increases in the creditor countries ('internal revaluations'). This has been achieved by intense austerity programmes in the south without compensating northern stimulus*" (De Grauwe, 2015).

Actually, the expected results of the structural reforms were particularly modest. Paradoxically, the countries that registered a more vigorous implementation of the reforms (namely Greece, Portugal, Ireland, and Spain) were actually the ones that relied mostly on austerity generating abnormal unemployment rates (figure 5).

**Figure 5.** OECD Going for Growth reform responsiveness score, selected set of Countries (average 2007-2014)




*Source: OECD, Eurostat*

In the above-mentioned scenario of asymmetrical adjustments, the majority of the Eurozone countries were caught in a trap which implied recession, job losses, decrease of the wage percentage in the national income, reduction of the welfare State; stuck in a misleading equilibrium of low growth and high unemployment rates. According to an Oxfam research (Cavero, 2015), in Europe, poverty and inequality have reached a shocking level (between 2009 and 2013, the number of Europeans living without enough money to heat their homes or cope with unforeseen expenses, rose by 7.5 million to 50 million), driven by austerity alongside unfair and regressive tax systems.

Moreover, in those countries such a condition fostered a vicious circle: the debt/GDP ratio or the public deficit/GDP ratio jumped out of the line due to the dramatic fall in GDP, lower tax revenues and higher financial cash burning.

Actually, now the pertinent question in the Eurozone should be: what institutions must we have (or disestablish) to take back democracy (Bagnai, 2014, p. 374)?

## 2. Insights from the Greek Crisis

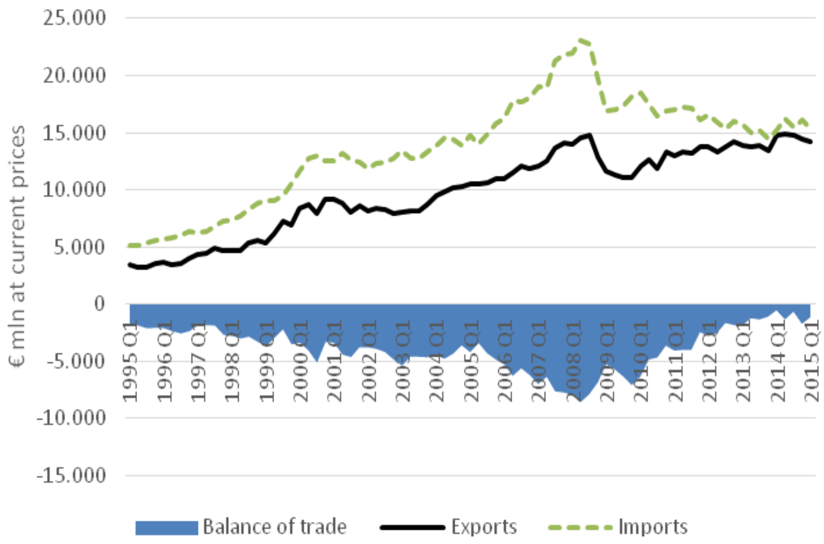
The case study offered by the Hellenic Republic in the management of the default of its public debt is not so much paradigmatic of the causes of the crisis, just described above, as of the solutions adopted, which does not recognize the causes and proposes solutions even aggravating.

*Lesson 1: Fixed exchange rate or not Greece has a structural dependence on capital inflows to finance its external deficits in the balance of trade*

At least since 1995 (e.g. six years before its adoption of euro) Greece reports regular trade deficits due to higher volume of imports of goods and services (figure 6, lower shadow area).[3] With the beginning of the 2008 crisis, the balance of trade has reversed its negative trend (actually unsustainable), but this has happened mainly through the destruction of domestic demand for imports (figure 6, dotted line). Greece cannot rely on exports as long as its trade goods are not demanded at any competitive level.

[3] Main imports are mineral fuels (34 percent of the total imports); machinery and transport equipment (14 percent) and chemicals (13 percent).

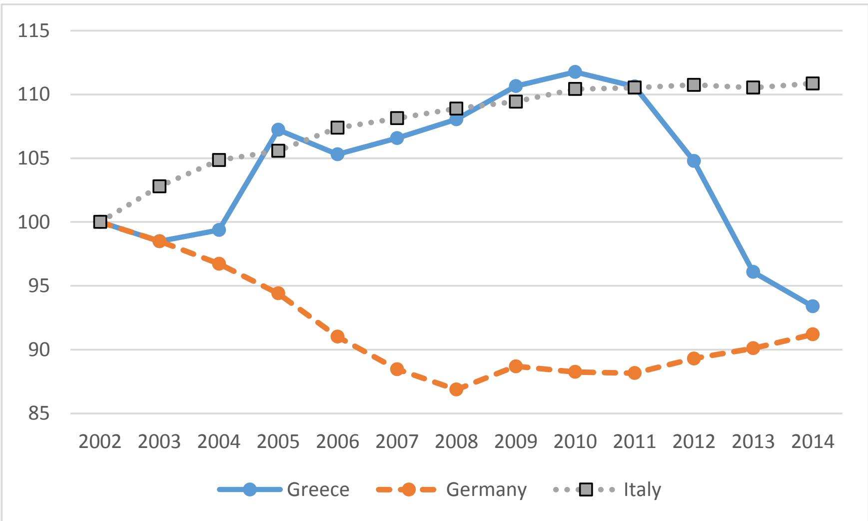
**Figure 6.** Greek balance of goods and services (quarterly seasonally adjusted figures)




*Source: Hellenic Statistic Authority*

The relative unit labour cost (ULC) series measures the trading position of an individual country relative to its partners in the euro area and as such offers an indication about changes in its competitive position. ULC takes into account variations in relative price levels based on the unit labour cost and therefore can be used as indicators of competitiveness. A decrease in the relative ULC index is regarded as an improvement of a country's competitive position relative to their trading partners in the euro area.

**Figure 7.** The relative unit labour cost, selected set of Countries (2002=100)




*Source: Eurostat*

Well, in Greece, despite the internal devaluation of labour (figure 7), the decrease of the cost of oil and the depreciation of the euro, exports were reported to the pre-crisis level in 2015 only (figure 6, solid line). This suggests that in the current situation, the Greek economy does not seem to be characterized by the elasticity of foreign trade.

If Greece quits the Eurozone, then it would cope anyway with an external constraint, due to its inability to finance its external deficit. In fact, today it can at least rely on the TARGET2 system. Out of the eurosystem Greece should instead earn every single dracma or dollar on exports in order to buy its imports from abroad. In case of insolvency in front of either the International Monetary Fund (IMF), the

European Central Bank (ECB) or the European Stability Mechanism (ESM) there would not be any possible financial support from lenders of last resource.

Once again, money serves the sovereign, not vice versa. In an effective (federal) state, the mint would print (devalued) currency, or *whatever it takes*, to serve the obligations of the sovereign. Here, we grudgingly face not a sovereign to serve, just a single private insolvent debtor. A failed debtor who need to stay within the Eurosystem safety network.

*Lesson 2: the country needs debt relief*

The IMF (2015), the United States' government, many other governments around the globe, and most independent economists believe (along with us) that the Hellenic republic needs debt relief. This conclusion derives first and foremost by morale (Pogge, 2002) - well before simple algebra.

Public debt should be seen from a perspective where it is functional for human development. The general principle of credit protection shall be reconciled with the higher principle of dignity protection of a person, his liberty, and the outlook of overcoming its economic problems.

Moreover, the legal relations with sovereign states should not be governed by private law, or even up to the bankruptcy law. In private law the parties are set by *synallagma* on the same level of rights and obligations. In bankruptcy law the insolvent loses rights on his assets in favor of the creditors. But the sovereignty of a country can be neither at the level of a single private creditor nor lost, but by the surrender and submission to another's foreign authority. Of course, a sovereign state shall be bound to repay its debts, as much as it can, but not at all costs. Here comes the key factor to unveil before discussing debt sustainability: the primary balance of a nation.

Primary balance is defined by ECB as government net borrowing or net lending, excluding interest payments on consolidated government liabilities. In plain English, it is the cash in hand to payback debt, interest and capital. After interests payments the budget might be in deficit or surplus. Table 1 shows time series data on primary budget across selected European countries.

Debt sustainability assessment is based on primary balance and its realistic projections. In fact, a state might maintain a fixed value of the outstanding debt (by issuing new debt when the former falls due and pay interests on the outstanding debt) or deleveraging to reduce future cash burden for interest payments (by paying back debt). The primary balance is the source of cash either for the former strategy (to pay interest on outstanding debt) and for the latter (to pay interests and the principal).

Here comes basic algebra. As of 31 December 2014, the nominal value of the outstanding debt issued by Hellenic Republic worth 317.094 million euros, that is 169 times its primary balance recorded in that year. Or, to say, other things been equal, it is needed a period of 85 years to payback the 50% of the outstanding debt on an interests-free basis. Please note that the primary balance in Greece was negative until 2012.

**Table 1.** Primary balance, selected set of Countries

| | Germany | | Greece | | Italy | | EMU 18 | |
|---|---|---|---|---|---|---|---|---|
| **Year** | € mln | % GDP | € mln | % GDP | € mln | % GDP | € mln | % GDP |
| **2014** | 69.512 | 2,394 | 1.872* | 0,590 | 26.126 | 1.617 | n.a. | n.a. |
| **2013** | 60.499 | 2,153 | 667* | 0,209 | 30.487 | 1,894 | -9.854 | -0,099 |
| **2012** | 65.769 | 2,392 | -7.128 | -3,670 | 35.776 | 2,215 | -61.489 | -0,626 |
| **2011** | 43.870 | 1,625 | -6.154 | -2,962 | 19.262 | 1,175 | -111.893 | -1,145 |
| **2010** | -41.509 | -1,611 | -11.883 | -5,253 | 715 | 0,045 | -322.379 | -3,389 |
| **2009** | -9.680 | -0,394 | -24.383 | -10,270 | -13.424 | -0,853 | -314.180 | -3,394 |
| **2008** | 67.963 | 2,657 | -12.051 | -4,978 | 36.525 | 2,237 | 79.591 | 0,576 |
| **2007** | 74.942 | 2,986 | -5.021 | -2,156 | 52.089 | 3,235 | 211.242 | 2,254 |
| **2006** | 28.155 | 1,178 | -3.553 | -1,631 | 13.320 | 0,597 | 121.394 | 1,367 |
| **2005** | -11.335 | -0,493 | | | 5.003 | 0,233 | 32.147 | 0,265 |
| **2004** | -19.492 | -0,860 | | | 15.061 | 1,039 | 9.720 | 0,083 |
| **2003** | -25.434 | -1,147 | | | 21.671 | 1,558 | 7.445 | 0,095 |
| **2002** | -20.670 | -0,937 | | | 32.062 | 2,381 | 56.418 | 0,516 |
| **2001** | -1.019 | -0,047 | | | 34.971 | 2,691 | 123.695 | 1,684 |
| **2000** | 87.132 | 4,123 | | | 59.560 | 4,804 | 250.658 | 3,571 |
| **1999** | 31.043 | 1,506 | | | 53.809 | 4,590 | 166.160 | 2,494 |
| **1998** | 17.788 | 0,613 | | | 55.057 | 4,847 | 134.411 | 2,099 |
| **1997** | 10.000 | 0,354 | | | 67.055 | 6,150 | 114.430 | 1,869 |
| **1996** | 529 | 0,027 | | | 46.201 | 4,428 | 65.093 | 1,107 |
| **1995** | -111.927 | -5,897 | | | 38.337 | 3,891 | -109.379 | -1,926 |

*Source:* ECB Statistical Data Warehouse. *: Hellenic Republic, Ministry of Finance

Of course, the primary balance might grow by means of higher revenues (taxes) or lower expenditures (public services), or both. In theory, the former might grow constantly every year, but cost cutting has a minimum threshold below which a state ceases to function.

Well, Eurozone is an island of stagnation and deflation (figure 1). Among European Union member states, over the period 2010/2014, Lithuania recorded the highest compounded average growth rate in GDP: +4,29%. However Greece cannot exploit exports to push its GDP (and indirectly its primary balance via taxation) nor to cut further its services provided to citizens. Optimistically, Greece might stands halfway, between Lithuania and the average stagnation. Eventually, it might sell all assets it holds: public, tradable and commons. The government of Greece has officially promised to raise euro 50 billion (about 16% of total debt) through sales of public assets. Privatization can overcome liquidity problems. If the problem is solvency, such as the one experienced in Greece, privatization will only make difficulties worse, especially if assets are sold at distressed prices (Manasse, 2011; Gros, 2011). Would it be still a sovereign state the one who holds nothing to manage for its citizens? Individual creditors shall not seize public goods and commons.

Consiglio and Zenios (2014) proposed a scenario analysis for debt sustainability and integrate it with scenario optimization for risk management in restructuring sovereign debt. An application to the case of Greece confirms that its debt is highly unsustainable, but sustainability can be restored either with an upfront nominal value haircut of 50%, or interest rate concessions of 70%, or maturity extension by about 10 years (Consiglio and Zenios, 2015). Their findings are in line with the IMF (2015) conclusions, and provide additional robustness since they hold true with high probability. Based on a slightly more complex algebra, their conclusion is clear-cut and consistent with ours: "*No matter how misguided the negotiating tactics of the Greek government might have been, debt was unsustainable before they came to power*".

What we have learned from Greece debt negotiations is that being a member of the Eurozone means that creditors can destroy a national economy and seize public assets if the government steps out of line: "*it is as true as ever that imposing harsh austerity without debt relief is a doomed policy no matter how willing the country is to accept suffering*" (Krugman, 2015).

*Lesson 3: #ThisIsACoup*

Let's go back to the Dani Rodrik's political trilemma of the world economy. Given three policy targets, namely "international economic integration", the "nation-state", and "mass politics", we can pick any two out of three: "*If we want true international economic integration, we have to go either with the nation-state, in which case the domain of national politics will have to be significantly restricted, or else with mass politics, in which case we will have to give up the nation-state in favor of global federalism. If we want highly participatory political regimes, we have to choose between the nation-state and international economic integration. If we want to keep the nation-state, we have to choose between mass politics and international economic integration*" (Rodrik, 2000, p. 180).

Greece, as a member state of the European Union, is headed in the direction of aligning jurisdictions within the internal market and of removing "border" effects. In the Rodrik's trilemma framework, EU would be in the "global federalism" case, by giving up single nation-states. In this case, national governments would not necessarily disappear, but their power would be severely constrained by supranational legislative, executive, and judicial authorities. A global government would take care of the fully integrated market. By contrast, in a pure global federalism case, politics need not, and would not, shrink: it would relocate to the global level, where political institutions are responsive to mobilized groups of electors. However, EU is far away from a federal system at present, as long as its fundamental authorities are excluded from the electoral scrutiny.

Eventually, European Union is even giving up a second node of the Rodrik's trilemma: mass politics – democracy. The case of the couple "nation-state" & "international economic integration" in the trilemma is what Thomas Friedman (1999) labeled as the "Golden Straitjacket":

*As your country puts on the Golden Straitjacket, two things tend to happen: your economy grows and your politics shrinks.... [The] Golden Straitjacket narrows the political and economic policy choices of those in power to relatively tight parameters. That is why it is increasingly difficult these days to find any real differences between ruling and opposition parties in those countries that have put on the Golden Straitjacket. Once your country puts on the Golden Straitjacket, its political choices get reduced to Pepsi or Coke - to slight nuances of tastes, slight nuances of policy, slight alterations in design to account for local traditions, some loosening here or there, but never any major deviation from the core golden rules"* (Friedman, 1999, p. 87).

According to Rodrik (2000), in a world where national markets are fully integrated, the shrinkage of "mass politics" would get reflected in the insulation of economic policy-making bodies from political participation and debate, the disappearance (or privatization) of the welfare state, and the replacement of development and social goals with the prerequisite to maintain market confidence. Once the requirements for a sound and fully integrated global economy are set, the ability of parties or popular groups to access and influence national economic policy-making has to be restricted.

Now, in light of this framework, fully outlined ten years before the Greek crisis (curiously right in the year when Greece adopted the euro), we can step ahead in our analysis.

In fact, the one here discussed is a unique shocking case study on how democracy shall be shrunk to serve a stodgy “Golden Straitjacket & (still in progress) Global Federalism” double sandwich.

On 26 January 2015 Alexis Tsipras, leader of the Syriza anti-austerity party, was sworn in as prime minister of Greece at the presidential palace in Athens. During the ceremony, he said he would have given his all “to protect the interests of the Greek people” and “an era of national humiliation is over”. Together, Syriza and Independent Greeks jointly control 162 seats in Greece’s 300-seat legislature. Syriza staked its election campaign on repudiating the steep budget cuts and tax increases that Greece agreed to in exchange for a financial rescue. He has promised, first, to deliver a spending package aimed at Greece’s struggling poor, and then to use money earmarked for debt payments on social programs in Greece (Bouras and Granitsas, 2015).

At the end of June 2015 the negotiations with creditors stalled. Consequently Alexis Tsipras called a snap referendum to ask the Greek people whether or not the government is willing to surrender to measures demanded by the Juncker Commission, the IMF and the ECB (jointly, the so called “Troika”) during the Eurogroup (an entity not disciplined by any Treaties) meeting on 25 June, which are conflicting with the electoral program.

The question of how to vote in Greece’s referendum has split Nobel economists. Paul Krugman and Joseph Stiglitz came out on the No-side, while Christopher Pissarides on the opposite one, even if they jointly called for debt relief earlier.

As a result of the 5 July referendum, the bailout conditions were rejected by a majority of over 61% to 39% approving, with the “No” vote winning in all of Greece’s regions.

Just a week later, Greece surrendered to Troika and its democracy vanished.

On 12 July 2015, the Euro Summit[4] (2015) welcomed the commitments of the Greek authorities to legislate without delay a first set of measures which include, among others: higher taxes, a comprehensive pension reform programme, quasi-automatic spending cuts in case of deviations from ambitious primary surplus targets, a significantly scaled up privatisation programme with improved governance[5].

Of course, in a parliamentary government such measures ought to be discussed and voted freely by Members of Parliament. In this dramatic case study, all of them were decided and written *before* a discussion within the deliberative body. The Greek Parliaments had only to ratify norms decided elsewhere by external authorities – unlinked to polls nor mandates.

Such a result is fully suitable to the Rodrik and Friedman’s Golden Straitjacket: *once your country puts on the Golden Straitjacket, its political choices get reduced to Pepsi or Coke* – no referendum for Ubutu cola or else!

Here comes the bitter lesson learned: any resurgence of democracy or popular “bottom-up” choices shall be sedated. The election results from *referendum* or elected government who attempt to remove the straitjacket shall be quickly dismissed.

Neoliberalism running integrated economies does not govern with the tanks and the colonels. It requires that nation-states approve in full its diktats about economics orthodoxy. It requires that nation-states internalize and disseminate the role of play among the people and next-door countries. It entails that debtors feel guilty if they fail to repay a debt and kneel to expiate such sins.

*Lesson 4: Greek banks: illiquidity or insolvency?*

While at government level the matter is one of solvency (e.g. value of outstanding debt higher than the value of assets), at bank level is it the case of insolvency or liquidity? Can banks survive the bankrupt of the State?

As a result of the credit multiplier, no bank in the world could face the willingness of all creditors to withdraw their deposit. Indeed a modern banking system is based on trust: trust that money deposited in a bank exits - even if it is not so. If all creditors run to a bank to withdraw, a bank fails.

Given the end of trust among depositors, without the ECB liquidity provision Greek banks are unable to convert their assets into the cash that their depositors are willing to withdraw. However, the Emergency Liquidity Assistance (ELA), supplied by the European Central Bank, can only be provided against sufficient collateral. Hence, the financial situation of the Hellenic Republic has an impact on Greek banks since the collateral they use in ELA relies to a significant extent on government-linked assets.

If ELA were to be terminated (in case of no deal on debt restructuring) the banks would effectively run

[4] The Euro Summit is composed by the heads of state or government of the euro area countries, the Euro Summit President and the President of the European Commission. It provides policy guidance to ensure the smooth functioning of the Economic and Monetary Union. This helps to coordinate all the relevant policy areas between the euro area member states.

[5] Valuable Greek assets will be transferred to an independent fund that will monetize the assets through privatisations and other means. The monetization of the assets will be one source to make the scheduled repayment of loans for a targeted total of euro 50 billion.

out of cash and collapse. A significant part of their assets currently pledged as collateral for the ELA would be seized, as the banks would have no cash left to repay the ELA funds. At that point, the banks would need to be heavily recapitalized. A default of the Greek government would negatively affect banks not only via liquidity shortage (ELA termination), but sooner via insolvency too.

In fact, as of May 2015, the four larger Greek banks hold government bonds for 3% to 5% of their total assets (Merler, 2015). A sovereign default would further negatively affect the Greek economy, which recorded arrears by the Greek finance ministry during the first six months of 2015, and this would in turn affect banks non-performing loans figures.

According to Merler (2015) the ESM tool for direct recapitalization would require a very significant bail-in of 8% of total liabilities, that is, given the structure of Greek banks' liabilities, it would require a 100% haircut on junior and senior (non-government-guarantee) bonds plus very high haircut on uninsured deposits (ranging between 12% and 39%).

The lesson learned here is that it is crucial to separate banks' troubles from those of the sovereign and ensure that the banks can be kept alive even if the sovereign is dead.

The ESM, even if it is never used as of today, seems to be a step backward of one's desired. Harshly limiting banks holding in government bonds on a going concern is what seems to solve the problem at its root.

## 3. From lessons learned to policy actions

In a previous article, we questioned whom among Euro or Democracy will surrender first (Lanzavecchia and Pavarani, 2015). After Greek capitulation, the only possible democratic outcome in Europe is now the collapse of the political project, and its fundamentals institutions, designed to serve capital against people: like it or not, all else is slow-burning tyranny. Many observers are now sharing the conclusion that "*Neoliberalism is inherently incompatible with democracy. Something has to give, and it must be the people. This is the true road to serfdom: disinvesting democracy on behalf of the elite*" (Monbiot, 2015).

Electors feel frustrated when they realize the impossibility to change the Eurozone's self-destructive economic policy through elections or referendum - that is the most basic rules and instruments of democracy. In spring 2017, the European Commission will make specific proposals on how to pool sovereignty further. We fear that by that date there would be no more sovereignty to pool.

To keep the European project alive, we here call for a fundamental reform on sovereign debt: switching from a goal to which policy is constrained, back to a tool to serve policy aims.

Let's start our arguments from the "international resource and borrowing privileges" (Pogge, 2002), which allow a third entity effective power in a country to sell its assets and resources or to borrow in its name.

Under existing international rules, a government may authorize a person or a group holding to sell the country's resources and to dispose of the proceeds of such sales; to borrow from investors and thereby to impose debt service obligations upon it; to sign treaties on people's behalf and thus to bind its present and future population.

According to Pogge (2002), international resource and borrowing privileges cause there main dysfunctional results.

First, this mechanism finances and sustains countries where governments are either not democratically elected or even unpopular by electors.

Second, international resource and borrowing privileges allow privatizing the wealth of a country, because the new borrowing equals the discounted cash value of future wealth otherwise not yet transferable.

Third, any future democratically elected government would face the burden of the enormous debt piled up by predecessors that shrinks its capacity to implement social policy.

In all of these scenarios, people are overwhelmed by capital (and its tyranny).

The refinancing process of a distressed country pushes the creditor to lend more funds in order to facilitate the repayment of past debt. The net capital employed in the refinancing process is ultimately low.

In a distressed country, lenders has the power to forces the borrower to accept and to adopt restrictive spending policies that defend their interest at the expense of citizen's ones. Eventually, this leads inevitably to the loss of autonomy in borrower's decisions on fiscal policy, spending policy, public properties. The result is a national sovereignty loss.

"We have been indebted for fifty, sixty years and even more. That means we have been led to compromise our people for fifty years and more. Under its current form, that is imperialism controlled, debt is a cleverly managed reconquest of Africa, aiming at subjugating its growth and development through foreign rules. Thus, each one of us becomes the financial slave, which is to say a true slave, of those who had been treacherous enough to put money in our countries with obligations for us to repay. (...) Debt cannot be repaid, first because if we don't repay, lenders will not die. That is fore sure. But if we repay, we are going to die". (Thomas Sankara, former president of Burkina Faso, on 29 July 1987 at the OUA in Addis Ababa).

If the cause for this degenerative process is the privilege on sovereign debt, then we need to find a new framework that reclassifies the public debt as functional to human development rather than individual profits. The private law on bond provisions shall be limited by human rights: capital shall be limited by human dignity and the right to liberty and life without slavery or servitude.

Hence, we urge to break up this mechanism.

To break this loop, a country shall not be allowed to repay a debt that goes beyond its repayment capacity. The maximum payback capacity shall be settled before the credit is granted, in the loan's prospectus, as a fraction of its primary balance. As such, the amount of primary balance not pledged to the repayment of the debt shall be always available to the government to undertake investments, social or security expenses and to face unexpected events – e.g. the exercise of its sovereignty.

The primary balance pledged to the repayment of public debt shall not include capital disposals of strategic assets (architectural heritage, infrastructures and commons) or commons.

Under this rule, the maximum cash flow to international creditors would be flexible, varying every year depending on the primary budget.

If this rule were implemented, the capital market would be automatically regulated: the debt that exceeds that threshold (e.g. a debt unsustainable without hurting present and future generations) would be automatically written-off.

It is important to prevent a government to payback more than what it is coherent to the needs of the same country for an internal balanced equilibrium. Likewise, international financial institutions have to evaluate the cash flow a country need to repay its current debts and what is the sustainable amount, under the penalty of automatic write-off. If the loans granted are higher that the repayment capacity, an automatic haircut mechanism would balance out the distortion and put it back to a stability condition.

A limit to the repayment of the external debt could provoke a weakening of the borrowing capacity and this might be considered by someone as a harmful effect to the economic freedom of a country. But the rule aforementioned is finalized to realize an exchange between (less) freedom ex-ante and (more) freedom in case the repayment capacity would turn for the worst. Furthermore, the solution here described would be coherent with the need to curb the incentive to take on excessive debt for some countries and to restore market monitoring, nowadays hidden behind misleading automatisms.

If this rule were applied to the public debt of Greece (or Italy's), today the nominal value of the issued debt would not be reimbursable under conditions of equilibrium and full sovereignty (not even privatising all public goods). Today international lenders would not grant any more credit, borrowers would benefit automatic write-off on the outstanding debt, but the country would continue its normal activity having its residual primary surplus intact and it would not be forced to dispose assets owned by the people, present and future, to satisfy private creditors.

Until a mechanism able to discourage further lending to an entity that is not in the condition the repay it in the future is in place, we will always face a "loan shark" that takes advantage of the state of need of the borrowers. This usurer would first take all its proprieties, and the ones of the related parties, and eventually the life of people.

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