The 2008 crisis and the European sinkhole

By Elisa Barwick

In the 1 February *AAS* we reported on "America: Too big to fail?", Chapter 2 of Scottish-American political scientist Mark Blyth's book, *Austerity: The History of a Dangerous Idea*. Blyth elaborated on the role of Mortgage-Backed Securities (MBS)—bundled-up and securitised mortgages, sold, resold, insured, gambled on—in detonating that crisis. Now we consider the case of European nations, operating within the self-imposed financial straitjacket of the European Union, elucidated in Blyth's Chapter 3, "Europe—Too big to bail?"

EU financial strategy, Blyth maps out, was based on the notion that monetary stability, plus strict debt and deficit controls over national governments, took priority over all else when it came to economic policy. (See "The genesis of austerity" series, Part 2 in this Almanac, for more of the background on that.) That monetarist approach has been universally adopted across the rest of the Western world, by choice. Strictures are imposed by central banks and ordered upon governments by international financial authorities. But governments can defy them if they wish. In the EU, however, it is built into the fabric of the binding economic framework. The only way out is to leave the union.

As Blyth explains in painstaking detail, before the 2008 crisis, nobody was worried about high levels of government debt in Europe. After the crisis—caused by the indiscretions of banks, *not governments*—bailouts blew out those debts. Loading nations up with debt made government bonds riskier, wrote Blyth, meaning that big European banks, teeming with them, got riskier too. "Over the decade of the introduction of the euro, very large core-country European banks bought lots of peripheral [southern European states] sovereign debt (which is now worth much less) and levered up (reduced their equity and increased their debt to make more profits) far more than their American cousins. Being levered up, in some cases forty to one or more, means that a turn of a few percentage points against their assets can leave them insolvent. As a consequence, rather than being too big to fail, European banks, when you add their liabilities together, are 'too big (for any one government) to bail', a phenomenon that the euro … only exacerbates." (Of the 29 "systemically important" banks nominated by the G20/BIS Financial Stability Board in 2011, "only eight were US banks; seventeen were European", wrote Blyth.)

By 2009, the Greek crisis had driven up yields on bonds (because they are a higher risk) of all periphery countries, including Portugal, Ireland, Spain and Italy, and they were all lumped in with the "overspending", "underworking" Greeks. But again, it was the banks, stuffed full of worthless assets—including exposed US subprime mortgage bonds—that was the initial source of the problem, not the governments. Their financial situations were far from perfect, but they were manageable, until 2008. Wrote Blyth: "The underlying crisis is, once again, one of private, not public, finance." There was no "orgy of government spending behind all this". But with EU authorities deciding to guarantee and bail out banks, private debt was transformed into public debt.

With heightened levels of debt added to government balance sheets, there was no way to bail out banks affected by the ongoing crisis without spiking the bond yields of sovereign debt securities even more. Nations were assured that austerity—budget cuts, rate rises, tax increases, wage cuts, etc.—would reassure the markets. The EU "troika", the European Commission, European Central Bank and International Monetary Fund, provided bailouts and loans, with austere conditions attached. It was an offer that nations literally couldn't refuse—locked into the EU framework, they had no option.

Public art in Berlin pointing to the culpability of banks, rather than the people, in the European debt crisis. Photo: Josh Neufeld and Martha Rosler, 2011

The implementation of austerity extended public debts further. The PIIGS countries (Portugal, Ireland, Italy, Greece and Spain) are testament to that. Blyth reported: "So PIIGS cut their budgets and as their economies shrank, their debt loads got bigger not smaller, and unsurprisingly, their interest payments shot up. Portuguese net debt-to-GDP [ratio] increased from 62 per cent in 2006 to 108 per cent in 2012…. Ireland's net debt-to-GDP ratio of 24.8 per cent in 2007 rose to 106.4 per cent in 2012…. The poster child of the Eurozone crisis and austerity policy, Greece saw its debt to GDP rise from 106 per cent in 2007 to 170 per cent in 2012 despite successive rounds of austerity cuts and bondholders taking a 75 per cent loss on their holdings in 2011."

Drawing out the deliberate deception of blaming the crisis on out-of-control government spending, which he calls "the greatest bait and switch in modern history", Blyth states: "The fiscal crisis in all these countries was the *consequence* of the financial crisis washing up on their shores, *not its cause*. … The causation is clear. Banking bubbles and busts cause sovereign debt crisis. Period. To reverse causation and blame the sovereign for the bond market crisis, as policy makers in Europe have repeatedly done to enable a policy of austerity that isn't working, begs the question, why keep doing it? …"

"To really understand why Europe has been slashing itself to insolvency, we need to embed these very real ideological and political factors within an account of how the euro as a currency enabled the development of a system of banks that is too big to bail. If the US had banks that were too big to fail, Europe has a system of banks that are collectively too big to bail. That is, no sovereign can cover the risks generated by its own banks because the banks are too big and the sovereign doesn't have a printing press. In this world there can be no bailout big enough to save the system if it starts to fail. Consequently, the system cannot be allowed to fail, which is the real reason we must all be austere." More on that to come. In the meantime, let it be known: Austerity is the price of saving the banks.