THE COFFEES OF THE SECRETARY-GENERAL
YANIS VAROUFAKIS

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THE COFFEES OF THE SECRETARY-GENERAL

Bringing New Perspectives to the OECD

Secretary General’s Speech Writing and Intelligence Outreach Unit
Programme, 1 March 2013

COFFEE BETWEEN THE SECRETARY-GENERAL AND YANIS VAROUFAKIS

Other participants: Gabriela Ramos, Chief of the Staff and OECD Sherpa; Mario Lopez-Roldan, Head of the Secretary-General’s Speech Writing and Intelligence Outreach Unit; Jorgen Elmeskov, Deputy Chief Economist; Adrian Blundell-Wignall, Deputy Director of Financial and Enterprise Affairs, Special Advisor to the Secretary-General on Financial Markets
11.30 – 13.00

PRESENTATION TO OECD STAFF

Presentation by Yanis Varoufakis to OECD Staff on “There is no such thing as a Debt Crisis: The Euro Crisis, Asia’s Woes and America’s Dilemma in a Global Context”
15.00 – 16.30
Short Bio

YANIS VAROUFAKIS

Prof. Yanis Varoufakis is a Greek-Australian political economist. He was born in Athens in 1961 where he attended the Moraitis School before leaving to study in the UK in 1978.

He obtained a Bachelor’s Degree in Mathematical Economics from the University of Essex in 1981; a Master’s Degree in Mathematical Statistics from the University of Birmingham in 1982; and a PhD in Economics from the University of Essex in 1987.

Between 1982 and 1988 he taught Economics at the University of Essex, the University of East Anglia and the University of Cambridge. Between 1988 and 2000 he moved to Sydney where he taught Economics at the University of Sydney. During this time, he was also an economics fellow at the University of Glasgow and the Université Catholique de Louvain.

Since 2000 he has been teaching Political Economics at the National and Kapodistrian University of Athens and has been chiefly responsible for setting up the University’s Doctoral Programme in Economics.

He is also a visiting Professor at the Lyndon B. Johnson Graduate School of Public Affairs at the University of Texas at Austin.

Between 2004 and 2007 Prof. Varoufakis served as economic adviser to George Papandreou, before he became Prime Minister of Greece. He is a recognised speaker and often appears as guest analyst for news media like the BBC, Sky News, Russia Today and Bloomberg TV among others. He has also published several books on economics, game theory, and the financial crisis.

Prof. Varoufakis is the co-founder (with his partner, the artist and photographer, Danae Stratou) of VitalSpace.org, a non-profit organisation aimed at promoting the role of artists in today’s society through the organisation of art projects, research programs, conferences, and publications.

In June 2012 he joined the software company Valve as the firm’s in-house economist.

Prof. Varoufakis blogs regularly on yanisvaroufakis.eu and on blogs.valvesoftware.com/economics.
PRESENTATION

“There is no such thing as a Debt Crisis: The Euro Crisis, Asia's Woes and America's Dilemma in a Global Context”

Full transcript

It is a great honour to be here at the OECD. This is an Organisation which historically had a significant role in fashioning the kind of ideas on which I will be basing my talk today. A Greek economist speaking on the theme “There is no such thing as a debt crisis” sounds a little bit like a hanged man disputing the concept of rope, but if you bear with me I will try to convince you that I am not in the business of denial; unlike the EU and my government.

I know that Greece, as well as other countries, have been twisting in the wind and hanging by the neck from the proverbial rope of debt. Nevertheless at the same time, allow me to say that I truly believe that the notion of a debt crisis is analytically unhelpful and discursively dangerous. It is detrimental to our society’s chances of recovery and of shared prosperity. When I say there is no such thing as a debt crisis I do not mean that there cannot be a debt crisis; indeed in the so called third world in the 70s, 80s and 90s there was a major debt crisis which could be uniquely and legitimately described as such. What I am saying is that in our generation’s 1929, which is of course what happened in 2008, we did not have the creation of what can be usefully termed as a debt crisis, at least in the west – in the EU, the US and in Japan. Instead, we had what I call the twin peaks crisis. We have a mountain of un-payable debts and banking losses, which is what provokes people to talk about the debt crisis. Behind that mountain there is a second peak, a mountain of idle savings of surpluses too frightened to be invested productively and in a manner that produces the income by which to repay the losses and the debts.

1 The original transcript of Yanis Varoufakis’ presentation has undergone minor editing to ensure that the text published in this brochure is presented in a reader-friendly format.
So what we have is a failure of recycling of surpluses which are flooding the private sector banks and various other instruments, incapable and too paralysed by fear to be invested in the economic activity which would generate the income from which the current debts would be repaid. I suppose we can talk about a debt crisis today, but equally, we can also talk about an accumulation of too much money – nobody of course talks about a crisis of too much money and of idle savings, it is however the other side of the same problematic coin. I prefer to state that instead of a debt crisis, we have a crisis of recycling. Economists like to assume that markets have the capacity to sort out these lumps automatically and through suitable adjustments in various prices, and to create the circumstances by which the idle savings get energised through suitable movements of interest rates, of profit rates, of wage rates and of all sorts of price signals that will cancel these two mountains out.

This has not happened, these mountains remain and the fact that one is not cancelling the other out is the real reason that wherever on the planet you scratch the surface, what you find underneath is either explicit crises or terrible angst; as in China for instance.

Why can’t markets sort out this mess? Well we never really had a reason to believe that they could. As economists – I don’t know how many of you here have been afflicted by that condition – we should be weary of the limits of our ‘science’. We should understand that since Adam Smith, we have spectacularly failed to create logically coherent models which managed to account simultaneously for complexity and for time. We can have models of great complexity of multiple sectors and in general equilibrium, but with no time. And we can have models of Robinson Crusoe-like single sector economies, or Ricardian corn models, which evolve through time. But we cannot have complexity and time in the same model. We have been trying and I will go as far as to say that it is not just a hard task, but we have not managed to do it because it is an impossible task. It is impossible to combine complexity and time in an economic model without introducing hidden assumptions that defy basic rules of logic. An anecdote comes to mind, I remember many years ago Gérard Debreu was presenting a model of general equilibrium which he had famously invented with Kenneth Arrow. He was asked by a younger economist about the relevance of the model for taxation purposes. Debreu stated “my dear fellow, you are confusing that which is interesting with that which is useful. This is merely interesting.”

The point is that whenever we talk about, and utilise in our models, Ricardian trade theory about comparative advantage, we tend as economists, because it is convenient, to ignore the fact that none of that holds in an environment where capital is mobile. Especially in areas of financialisation which has created hitherto unheard of linkages between real wage differentials, real estate bubbles, sovereign debt and exotic forms of synthesised debt. It is pure folly to imagine that these models hold.

In designing fiscal consolidation programmes after 2008 for example, the great and the good in various organisations, this one included, have assumed Ricardian equivalence. David Ricardo’s equivalence was based on the corn model, on a single commodity world. We know that a world
with many commodities does not behave like the corn model. ‘We’re damned if we know’, as Keynes might have said, whether Ricardian equivalence would hold up in such a world. We use Cobb-Douglas production functions in order to advise governments; in other words, we create a model of the world in which every country resembles an electricity generator with a well defined function linking inputs and outputs. Then we claim to be telling politicians that these pieces of advice are scientific – this is a complete and utter flight from reason, straight into the embrace of pure faith.

We should know better as economists that there are gremlins in markets that make them utterly unreliable friends. We should know that labour markets are not like the markets for tomatoes or for cabbages. A reduction in price will not necessarily lead to a clearing of excess supply. We should know that when we have oligopolistic capital goods sectors and goods markets, particularly for durable goods, in which there is a high concentration ratio, price signals will not eliminate surpluses of either trade or capital. We can actually prove this as a theorem and we have no excuses to pretend that they will.

We know that finance under capitalism is not epiphenomenal on the real economy, as our general equilibrium models assume. We know, for instance, that something tremendous happened in Britain in the 18th Century that ushered in capitalism. What happened was a sequence that took us from production to distribution and to financialisation. Back in feudal times, the peasants would work the land, when harvests were collected the sheriff would come in and claim a share for the landlord (distribution) and finally the landlord would sell part of his surplus into markets for money which he would then lend to underdeveloped financial markets. Therefore production, distribution and finance. The moment you have ex-peasants acting as entrepreneurs organising in the means of production, what you have is financialisation. This is because the entrepreneur has to borrow money, usually from the loan shark or from a landlord, in order to employ workers at given wage rates. This great reversal which constitutes the beginning of capitalism meant something very important: finance came first in the chain reaction that led to the unleashing of incredible productive capacities around the world which gave rise to the growth of the last three centuries. Finance was central to that process, it was not something that was added to the general equilibrium models assuming that it made no difference to the real economy. The role of the financier in that world, in capitalism, is instrumental because the entrepreneur uses finance as a means to stretch an arm through the timeline into the future, to grab a piece of value from the future which has not been created yet, bring it to the present and put it into work so as to produce and generate the value that will happen in the future. Therefore, capitalism involves a recycling of present and future value through finance. The more that succeeds the more value and profit is created and suddenly there is a tendency of the financier
to utilise that position of power over the rest of society in order to create a great deal of profit for himself.

We have known this since the 18th and 19th Centuries. John Maynard Keynes in his General Theory wrote: “speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes a bubble on a whirlpool of speculation.” When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill done. And since I am mentioning the General Theory, which was authored in 1936 in response to the crash of 1929 (which was that generation’s version of 2008), let me ask a very simple question. What was the lesson that we economists ought to have learnt from the experience of the 1920s and 30s? It is very simple, when you have an attempt to create a common currency—the gold standard of the time, the Euro now, or to fix exchange rates as the Bretton Woods era; unless you introduce with the fixed exchange rate regime a mechanism for recycling surpluses through a degree of political planning, the markets are not going to do it for you.

As long as there are disparities between different regions or countries in that fixed currency world; and as long as there are disparities in the degree of capital utilisation, in oligopoly power, in the development of the capital goods sector as opposed to the consumption goods sector, there will be huge flows of capital flowing from the surplus to the deficit countries. These will not be helping the deficit countries to catch up in terms of productivity enhancement. Instead, they will be driving asset prices up and creating the circumstances for a crash like that of 1929. When the crash happens, as in 1929 and 2008, the immediate repercussion is firstly the fixed exchange rate system begins to unravel as it did with Britain leaving the Gold Standard in 1931; and as the Euro zone is unravelling, despite the best efforts of Mr Draghi today. The second repercussion is Nazis in Parliament, as we now have in Greece.

The new dealers were painfully aware of these facts as the world was exiting the Second World War. This is why we had the golden era of capitalism between the late 1940s and 1971 under the Bretton Woods system, which I prefer to refer to as the ‘global plan’, because there was a lot more to it than just the Bretton Woods system. There was also the Marshall Plan, to which this Organisation owes its very existence, and various other programmes, some of them completely and utterly informal. The new dealers understood that you do need fixed exchange rates or predictable exchange rates to facilitate trade, such as the Gold Standard. But to leave it at that, without a surplus recycling mechanism, means that you are creating the circumstances for a massive depression. And they were very keen to ensure that they would recreate a Gold Standard-like fixed exchange rate regime with a surplus recycling mechanism implanted in the core. They disagreed with one another as to how this would be instituted. The British in 1944, through their representative Keynes at Bretton Woods, were proposing, as a fading power, a multilateral UN-like international clearing union that would collectively organise the surplus
recycling. The Americans, represented through Harry White, had a different view, they said “It is our surplus, we’ll recycle it anyway we like”. Therefore between 1948 and 1968 around 70% of American profits were recycled into Germany, into Europe and crucially into Japan. It was not a case of philanthropy; it was a case of pragmatism and an attempt to prevent the collapse that we had in 1929 rearing its ugly head again. The result was a period of convergence and a period during which the hegemon was losing out in relative terms if you compare and contrast the growth rates of the US to that of Japan or Germany. The US was losing but it was managing, nevertheless, through this recycling mechanism to ensure that at least for 20 years American factories were provided with the aggregate demand that was necessary in order to keep them growing after the war.

That golden era was always going to come to an end, it was predicated upon the idea of surplus recycling when the surplus was American and the recycling was orchestrated by the Americans. But by the late 1960s the Americans lost their surpluses and it was inevitable that this system could no longer continue. Something remarkable happened at that point, the best way of describing it is by quoting something a young American, said in 1971. His name may ring a bell, Paul Volker. In 1971 he was working for the National Security Advisor, Henry Kissinger, before the latter became Secretary of State. Paul Volker’s idea, which he implemented when he became Chairman of the Fed, was that if the US could not recycle its own surplus, because it did not have any, then it may as well recycle other people’s surpluses. This is precisely what happened between the late 1970s and 2008. So we had another great reversal, the first marked the transition from feudalism to capitalism; and the second marked the transition from the first phase of a post-war global capitalism to the second phase. Before that picture emerged, during the Bretton Woods, US surpluses were being recycled to Germany and to Japan so as to maintain demand for the net exports of the US in Germany, Japan, Greece, France and Italy.

The great reversal was precisely that, the flow was reversed. Suddenly the US, which was increasingly in deficit, started operating as a huge vacuum cleaner sucking into US territory the net exports of the surplus countries such as Japan, Germany and then increasingly China. Interestingly, and there are plenty of sources to confirm this, the US was very relaxed about the increasing deficits, they did not opt for austerity to cut them down for the simple reason that the whole point was to keep recycling the surpluses of the planet which were no longer their own. But of course the main question was who was going to pay for those deficits? The answer was, the rest of the world – and they would do it utterly voluntarily. The US implemented a number of policies, including incredible interest rate hikes, under Volker, and a squeeze of US wages and energy policies that increased the competitiveness of American manufacturing relative to that of Japan and Germany. These policies ensured that the surplus nations’ profits would voluntarily gush into Wall Street to the tune of 3bn USD and 5bn USD net, every working day, and Wall Street would in turn use that in order to finance corporations and the US Treasury, as well as to provide credit to the American consumer who kept buying the net exports of the net exporters. This was recycling completely reconstituted and turned on its head. It is also the reason why, in a sub-consciously Orwellian language, Ben Bernanke referred to this period as the great moderation. This recycling mechanism succeeded in keeping interest rates and inflation rates low and growth high, while at the same time based on a fundamental imbalance which was ever-growing. Because like a shark that has to keep moving in order not to die, similarly this recycling mechanism was predicated upon increasing American deficits in order to provide the increasing amounts of demand that were necessary for growing giants like China.

The reason why I have called my book the ‘Global Minotaur’ is because it is very hard to explain these mechanisms to an audience in a pub in Australia, especially after the second pint. I had to do this and had to come up with a metaphor in order to explain it. So it occurred to me that the
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Minotaur metaphor from Greek mythology was quite apt. At a time of a Pax Cretana, a Cretan Peace of prosperity and trade overseen by the Kingdom of Crete, the myth stands that inside the guts of the Palace of the Cretan King, Minos, there lived a very sad beast, the result of incest, with a voracious appetite. The only way to satiate that appetite was by human flesh, so the subjugated Athenians had to provide tribute every year or every seven years, depending upon the version of the myth. That tribute came in the form of young men and women – this was the price that Athens had to pay for maintaining peace and prosperity in the region.

So the Global Minotaur is a modern day version of the myth, thankfully no one was sacrificed in the labyrinth, but what did happen was, the surplus nations were sending their tribute voluntarily in the form of 3-5bn USD every day to Wall Street to close the recycling loop which was necessary to keep the great moderation going. What do bankers do if you give them 3-5bn USD to play with even if it is only for 10 minutes? The answer is they find ways of making it breed for themselves – it is what we call financialisation. On the back of this tsunami of capital between the 1980s and the late 2000s, we had the creation and build-up of what Keynes referred to as “a bubble on a whirlpool of speculation.” This turbo-charged the 3-5bn USD per day by a factor between 70 or 80 by 2006. So at a time when everyone was concerned about central bank independence and monetarism and not printing too much money and keeping the money supply under a leash, the private sector banks were acting as if they had an ATM in their living rooms and printed as much money as they wanted. That was what was providing the huge liquidity which then rushed into places such as South-East Asia and the European periphery thereby creating asset bubbles which burst in Asia in the 1990s and more recently, after the collapse of Wall Street, in the west.

In 2008, the pyramids of private money minted by Wall Street, in the city of London in particular, and consumed with gusto by the German and French banks, before being sent on to the periphery to create bubbles there, burned down. And they burned down simply as a result of the same dynamic that a child piling up Lego cubes one on top of the other will soon witness them collapse. When the world’s GDP surges from 52 trillion USD to 63 trillion USD and the total value of derivatives also surge from 70 trillion USD to 730 trillion USD, you realise that at some point something will have to give and it gave in 2007-2008 with the credit crunch.
We talk a lot about global imbalances. The OECD is one of the Organisations that does so and has some very interesting things to say. I believe, however, we have got it completely wrong in terms of the diagnosis of what the matter is. The direction of causality has been completely lost to us. Global imbalances are not the cause of the problem, they are co-determined symptoms of what was going on during this great reversal, let me provide an example. In 2008-2009 the global imbalances shrunk immensely because of the recession. America stopped buying, imports fell, and this is the same reason why the Greek current account has almost been annulled, people just don’t buy. Since then however, the global imbalance has been increasing again. America has ‘achieved’ a current account deficit equal to the one in 2007 and yet we are not back to where we were in 2007. Why is that? If my argument is correct, the twin deficits of the US were playing a very significant role in the global economy. They were closing that recycling loop providing demand that was necessary for the German, the Japanese and the Chinese factories; while at the same time the profits of those factories were flowing into the US and financing the private and the public sectors in order to close that loop.

If we compare the demand that would have been created by the American deficits (had the 2008 crash not happened), to the level that is being created today; we will see that there is almost a 30% shortfall in the amount of demand that the current American deficit is producing for the net exporters. Similarly, within Europe this shortfall in demand created by the United States for the surplus countries like Germany, is even worse than it is for the periphery. This explains, to a large extent, the conundrum that Germany and China are facing to net exporters which rely on each other, or at least have each other in their sights, as a source of aggregate demand, something which is utterly incoherent given that they are both net exporters. But this is what concerns the US and is important, non-American residents continue to finance the Federal deficit. So one of the two deficits of the United States has bounced back to almost where it was in 2008. But look at the situation regarding the private sector, foreigners shift from a position of massive net lenders of US corporations to net borrowers. So whereas profits from the rest of the world were financing American corporations, this no longer happens. American demand does not create sufficient pool for the net exports of net exporters. Non-US residents have reduced their holdings of American assets by more than one-half. The surplus recycling mechanism that kept the global economy going therefore – unbalanced irrationally and with great inequalities, but nevertheless going and growing – has now broken down. This is the reason why Europe, America and the BRICS are in a constant angst ridden state. Some with explicit crises and some with implicit slow-burning crises within their midst.
This brings me to Europe. Europe is the laboratory of our collective global future for a number of reasons. The first being, it is the largest economic bloc at a time when the world is in this state of imbalance and in a major recession. A deeper recession than the current is certain to happen should the Euro zone break-up. This would be detrimental to the prospects of, not only Europe, not just the US, but Africa, which has started growing after a very long time, and the Asian hardworking countries. Europe in the past 100 years has twice dragged the rest of the world with it into mire – we are perfectly capable of doing this again. The problem with the Euro zone is that it constitutes a kind of Gold Standard, a monetary union designed to remove internal shock absorbers while at the same time guaranteeing that when the inevitable shock happens, as it did, both its probability and its magnitude are enhanced.

During the era of the great moderation, or the Global Minotaur era as I call it, the imbalances in the Euro zone, as we all know, were growing. In Europe between 2000 and 2008 we had the budget deficit countries with savings which amounted to less than investment, because investment funds were flowing from the financial centre the German and French banks into the periphery. Similarly, the surplus countries were also in budget deficit but possessed savings well in excess of investment and a current account surplus. Throughout that period, the divergence between these two groups was being enhanced, while the Maastricht Treaty’s 3% limit meant that there was a political constraint not to fall behind a certain level. This, in turn, meant that given the divergence in terms of trade deficits and trade surpluses, to maintain that process, there had to be a steady flow of capital running from the core to the periphery. That flow of capital, just like in the 1920s, did not enhance the productivity of the deficit countries, it enhanced the bubbles in real estate markets and in various other areas such as the public sector; additionally, competitiveness was diverging.
When 2008 came and the credit crunch ensured that the liquidity being provided disappeared, budget deficits increased, but because of the austerity policies which immediately came hand-in-hand with the crisis, imports collapsed and as a result current account deficits shrank. At the same time, the surpluses of surplus countries fell and their budgets also went deeper into the red. The tragedy here is that in the construction of the Euro zone we have the principle of perfectly separable debts while we do not have a central bank that can stand behind insolvent banks and insolvent states. We also have a drive towards universal austerity and fiscal consolidation. What we are effectively asking our economies to do is something that makes sense under a specific set of circumstances that does not hold. The principle of the greatest austerity to the economies suffering the greatest recession would be quaint if it were not the wind that blows into the sails of misanthropy, and in the case of some countries, Nazism.

At this point I want to talk to you again as a theoretical economist, because we economists bear a very significant burden of debt to society for having misled society. How come policy-makers the world over fell for, what I consider to be logical incoherence? My answer is very simple, we as economists extracted immense social power from our models. That social power had nothing to do with the truth stages of our theories but instead it reflected the extent to which we could solve our models and close them. But to close those models we had to introduce hidden axioms which guaranteed that they would be irrelevant vis-à-vis capitalism. So the more irrelevant our models were, the greater our discursive power, within the corridors of power. It would take indeed a heroic disposition for an economist working in the IMF, the World Bank, or the OECD to confess that his or her models have absolutely nothing to say, as Gérard Debreu would. It is much easier to convince oneself that although one’s models do not have time or they cannot combine complexity and dynamics, they must nevertheless have some relevance, especially when a great deal of political utility is attached to an ideological support for economic policies which are in search of such pseudo-scientific ideological support.

I will come to my conclusion so that we can have a discussion. I know that I was exceptionally provocative, and that was my intention. The title of my presentation today was “There is no such thing as a debt crisis”, at least in the post 2008 era. It is an analytically unhelpful term that softens us up and prepares us to accept a creditors’ agenda at a time of a debt deflationary crisis which is, in the end, bad for the creditors themselves – as we know from the Latin and Central American crises not that long ago. Our generation was cursed to have to have lived through a 1929 or 2008 moment. What we must understand is that today’s reality cannot be made sense of in terms of pre-2008 narratives, especially economic ones. We cannot
understand the reasons why the recession and the global uncertainty refuse to be lifted until we understand that there is a problem of a broken down recycling mechanism. We have had two mechanisms since the Second World War, they are both gone, and we do not have a clue today as to how to replace them. Until and unless we do, there will be a hefty human cost involved throughout the breadth and width of our planet. What we need is a gestalt shift.

Let me recount a story since we are at the OECD. In the late 1930s at Harvard University, three Rockefeller Fellows formed a study group. They were: John Kenneth Galbraith (who would become Roosevelt’s ‘price czar’, effectively running the war economy), Robert Marjolin (who was the First Secretary of this Organisation before it changed its name to the OECD) and Paul Samuelson – they were all studying John Maynard Keynes’ General Theory. The two who played significant policy roles, Marjolin and Galbraith, were technically advanced enough to understand the limitations of the economic models that they spent their lives studying. When they came to policy related matters, they used judgement without trying to reduce it to calculation and they were not impressed by models of Robinson Crusoe that pretended to be models of a complex macroeconomic capitalist economy.

Today we need more of that spirit in the OECD, in the IMF, in the World Bank and in our governments. We also need a little bit of Paul Volker, crude as he was, he was nevertheless exceptionally astute in understanding the epochal shift that came in 1971 and the need for an alternative surplus recycling mechanism. We also need an element of the Occupy Wall Street movement to inject a radicalism that has completely disappeared and we need to understand that development is very different to growth and that societies have an increasing need for the quality of life and productivity enhancing green energies and green concepts. These can only be built on genuine recovery as opposed to continuing disintegration.

What we do not need is politicians whose cosy relationship with bankrupt bankers comes above the imperatives of shared prosperity. Speaking as an economist we certainly do not need economists who have traded their critical faculties for the career rewards that solving toxic models bestow upon them. We do not need economists who, as Alan Kirman once famously said – and I mention him because I believe he was here recently – “we do not need economists who do not care about the sea worthiness of their theoretical vessels”.

Thank you.
QUESTION AND ANSWER SESSION

Question 1:
Where would you place Ireland and Spain in the problem countries? They are not in the same position, they are not running a deficit yet they still end up in the same group of countries facing problems in Europe.

Yanis Varoufakis:
I would put them in exactly the same position as the others. Let me explain. It is quite right that Spain and Ireland had a lower debt-to-GDP ratio than Germany, let alone Greece and Italy. And indeed they were running surpluses. So in terms of the fiscal pact, they were the blue-eyed boys and girls of the Euro zone, of the IMF, of the universe. But they are part of the same problematic monetary union. Let us compare and contrast Ireland and Greece. In Ireland there was a torrent of capital primarily from German banks and some from British banks into Irish banks such as the Anglo-Irish Bank and the Irish Nationwide Building Society. These banks then passed the capital on to estate developers who, in cahoots with politicians, created a real estate bubble. This bubble fuelled consumption because of the asset effect. People were told that their home values had trebled and were far more ready to take out credit card and personal loans to finance their consumption.

In Greece exactly the same thing happened with the difference that it went through the State. The State borrowed from German and French banks to provide capital to the real estate developers. When 2008 came and liquidity disappeared, in Ireland real estate prices fell, real estate developers collapsed as they could not repay their loans to the banks. In turn, banks went
under and the tax payer suddenly inherited a Greek like debt-to-GDP ratio. In Greece the State had borrowed therefore the State went bankrupt.

The difference between the two is just the question of the direction of that trajectory, but the essence is the same. There was a flow of surplus capital from the centre to the periphery that does not enhance competitiveness. It did enhance it more in Ireland, but let us not forget that Ireland has a very low marginal tax rate corporation regime which effectively brings in a lot more empty shell companies which produce elsewhere and portray their output as part of Ireland’s GDP. In the end the situation remains exactly the same. I am actually surprised by peoples’ surprise that Greece and Ireland were sitting on the main dock of bankrupt EFSF Member States.

Question 2:
I am struck by the title of your presentation. It is important to distinguish between public and private debt. Looking at corporate debt trends and the tax system over the last 10 years, we see increasing scope for multinationals to avoid tax on returns; to double and triple on interest deductions; and to find very efficient ways of raising capital, in particular debt finance. So we see, through the tax lens, tax playing a big factor in leveraging up firms which argue that their increased leverage has not been a problem of late in creating instabilities in the market to deal with the crises.

When you speak of idle savings, do you mean savings that are absorbed by the public sector, or that are employed by the private sector and therefore enhance our productivity? Where are these idle savings?

Yanis Varoufakis:
There are two separate issues here. One concerns the shenanigans of corporate capital to avoid tax payments and the second concerns the idle savings.

Regarding the first issue, I would like to reply in the means of a question. Isn’t it true that at least during the last 25 years the corporate sector is increasingly investing in innovative ways of avoiding tax? This is done through transfer pricing and perhaps through the employment of exceptionally intelligent accountants. I do not see how this would change during a crisis. To me the ethos of tax immunity began sometime in the 1970s. It was part of a more general agenda whereby there was a substitution in the same way that wages in the US were falling and have been falling since 1973 to this day. They were being substituted by the means of credit cards, this was the financialisation drive by which to replace demand funded through wages, with demand funded through finance. As part of the same project you have governments that were increasingly seeking to be financed by the profits of the financial sector; taxing financial capital and leaving corporations effectively free to seek these tax immunities. I do not think the crisis of 2008 made much of a difference in this.

Regarding your second question, if you look at a database of EU and the US data on bank savings and bank lending, you will see a scissors diagram. There is a vast divergence between the amount of money saved in banks and the amount of money lent for investment purposes by banks to firms. These two trajectories used to be quite close together until 2008. After this time they completely diverged. Since you have experience with corporations here in Europe, you will find that large corporation have actually exited the banking system themselves and are hoarding capital. Banks are also doing this, even though they are bankrupt, they park hundreds of billions of Euros at the ECB overnight – maybe less so over the past months, after the introduction of the OMT – rather than lend it to one another. That is the locus where the idle savings are parked.
Question 3:
Do you notice a significant change in the profession of economics after this crisis?
What would you suggest to an economist that has been educated in a top academic institution and now wants to update his or her knowledge because many of the theories taught have been discredited by reality?

Yanis Varoufakis:
The economics profession resembles, at least in my eyes, a driver that has been caught by the police doing 120 miles per hour in a 70 mile zone. He pays the fine drives carefully for half an hour and then goes back to 120mph. In other words, after 2008 economists realised they better shut up for a while because they were being absolutely ludicrous. They had infected the world with rational expectations and efficient markets hypotheses and various formulae such as value at risk. For a while kept a low profile and made noises as to how it is important for the economics profession to re-assess its practices and its curricula. And now, just like the driver, we are back to where we were before, there is zero intellectual thinking going on in economics departments. There is a great deal of technical modelling, a lot of it has great aesthetic beauty. I love some of those models, just like I like the Ptolemaic astronomic model which had earth at its heart but happened to be completely wrong.

Regarding economists who have second thoughts, who maintain some intellectual life in their head and who are genuinely interested in questioning the true value of their models – what would I say to them? The answer is nothing because if they have that intellectual curiosity they do not need me to point that out. My problem is that they do not.

Question 4:
I am not a macroeconomist, I work in health economics, so this may be more of an Australian pub question rather than an OECD roundtable question. We are always thinking of flows and of how to get back to growth and if we achieve that then the future would be better than the present.
But at the end of the day we are highly dependent on stocks such as fossil fuels which are running out. I do not want to be over-dramatic but when you read in the newspaper that we are squeezing oil out of rock, or fracking to get the last bits, all our hope for growth is based on future scientific discoveries which.

What do you think about the next 20 years for our countries in the OECD and all over the world if that fundamental assumption of economics: that scientists will come up with a solution, does not really come at such a high speed as we actually need it?

Yanis Varoufakis:
Thank you for this question; it gives me the opportunity to make amends for a major absence in my speech today. The world is facing a twin crisis, it is an economic crisis and an existentialist crisis, that of the environment. Up to 2008 there was some progress being made in creating awareness for this. Today, especially in the US, there is all this merriment about fracking and horizontal drilling as if that were the problem, and as if the problem never was climate change. I am sure there will be increasing pressure in Europe to introduce fracking, certainly there is in Australia. One of the repercussions of the implosion of awareness about the causes of the crisis is that we simply have lost focus regarding these life changing experiences. Economists have played a major role in undermining the scientific projects that would produce the technologies which could help our future. While we speak, the state of development of green techs is very low; unless we have something like a Manhattan project, where the best scientists meet to produce better forms of energy, we know the market will not do that, and we know that the multinationals
The Coffees of the Secretary-General: Yanis Varoufakis

will only benefit from this once it is undertaken by the public sector – just like they benefited by the internet once the public sector created it.

Question 5:
What advice would you give the current and future Greek administrations on the policies they should follow to exit the crisis? Do you think the problem of competitiveness in Greece has to do with high wages?

Yanis Varoufakis:
For the past three years I have been stating that after the Euro zone shifted in the way that I described today, the Greek state became insolvent, the debt overhang became impossible to service within a currency union by a government that lacked both access to the markets and access to a lender of last resort in the form of central bank. When you become insolvent, you embrace it, you do not pretend it is not there, that would be the equivalent of having a mortgage which you cannot pay and getting a credit card with which to repay it, it is pure madness.

What we should do is what Mexico and other Latin American countries did, you just go for a quick and savage restructure, you take the pain and start again. Unlike Mexico and Argentina, Greece was a Euro zone member and could not devalue, but it could certainly default. The fact that Mrs Merkel said the triple ‘nein’- no to default, no to interest rate relief and no to a bailout, was simply an invitation to the Greek government at the time, a government which had the moral and political duty to its citizens and to the rest of Europe, to say ‘well we are defaulting anyway’. There is absolutely no argument against a default when you have reached a level of unsustainable debt dynamics. My advice then was, first restructure and then borrow. My advice was not heard, we did it exactly the opposite way which was catastrophic for Greece and for the Euro zone.

The reason why Spain is in trouble today; why Ireland and Portugal fell; and why Italy is ungovernable, is that the EU, with all its wisdom, based its policy, vis-à-vis those countries, on the Greek model. Sometimes saying no to your partner is good for your partner. That would be the advice that I would offer today even though we have lost a quarter of our GDP, we have a social economy which is in deep depression and we have no banking system left standing. Even now there has to be a veto by the Athens government that would make it possible within the Euro zone to have rational conversation which has been banned during the past three years.

As for the future of Greece in the Euro Zone, it depends whether the Euro zone is reformed. The Euro zone is a design from hell. The people who designed it were not intellectually inferior; people like Francois Mitterrand and Helmut Kohl understood that the EU they were putting together was not capable of withstanding a major earthquake like that of 2008. But their hope was that when such an earthquake would come, the EU would get rid of its principle of perfectly separable debts, it would create new institutions quickly to allow for surplus recycling within the EU and would move towards a direction of a proper banking union. None of these have been done and so not only Greece cannot survive in the Euro zone but the Euro zone itself cannot survive the way we are handling matters at present. Let’s not forget that if Greece in 1999-2000 had not entered the Euro zone we would not be having this conversation today. There would have been a substantial devaluation in 2008 and Greece would be where Iceland is today. It would not on be the front pages of the world’s newspapers for the past three years. This indicates that there is nothing wrong with Greece but something very wrong with the Euro zone, if a small country like Greece can occupy the international press in that way.
Regarding competitiveness and real wages, I believe that your question is motivated by the agenda set by the European Commission and the IMF and their idea of an internal devaluation given that there cannot be an external devaluation. This is the epitome of macroeconomic illiteracy. If you look at it as a static algebraic problem, it really does not make much difference if my income is reduced by 20% of all prices are reduced by 20%; and then there is an internal devaluation that increases my competitiveness vis-à-vis my neighbours. But that is a static picture which ignores the dynamics. The dynamics are very simple, to get from those prices to the new lower prices and to the new lower wages, you have to go through a process. That process guarantees that prices will not decline as fast as wages, because during a recession as the number of competitors in every sector is reduced, the concentration ratio and degree of monopoly power rises, and therefore prices do not fall as fast as wages. So that kind of symmetric non-deflationary internal devaluation is simply impossible. Secondly, during this kind of freefall, especially in view of the fact that you have a credit system that is not working, what you have is a fiscal pact which is imposing stringent cuts in the public sector and a private sector which is deleveraging very fast. As a result the sum of those two is a shrinking in real GDP; and the additional problem of all deflationary eras: who wants to buy something today for 10 when you can buy it for 8 tomorrow?

Question 6: What do you think are the prospects for Asia creating its own recycling mechanism?

Yanis Varoufakis:
That is a great prospect and I hope it happens. But I do not think it can in the current phase of global development. What is certainly happening is China is spreading its wings not just in its own region but also in Africa and in Latin America and very gradually, but importantly, there will be a Renminbi denominated trade. Nevertheless, it is a truth of simple arithmetic that net exporters brought together cannot recycle surpluses unless there is someone else to absorb them. In this case this someone is the west, which is in a self-inflicted recession at this time. This recession is caused by two things, firstly by pro-cyclical austerity and secondly by an unwillingness of politicians to address the banking malaise.

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