Book review

Finance and Society
2017, 3(1): 99-101

10.2218/finsoc.v3i1.1942

Monetary policy as economic warfare

David Hollanders
University of Amsterdam, Netherlands

Yannis Varoufakis, *Adults in the Room: My Battle With Europe's Deep Establishment*, London, Bodley Head, 2017, 550 pp., £14.99 (pbk), ISBN 978-1-847-92446-9

At least since the publication of 'Rules rather than discretion' by Nobel Prize winners Kydland and Prescott (1977), an undisputed principle in monetary economics is that central bankers should be politically independent. Politicians have an electoral incentive to jack-up the money supply to finance programmes the electorate favours, ignoring the inflation this will result in. Monetary policy is therefore best separated from fiscal policy, leaving the latter to politicians, while entrusting the former to central bankers, whose sole calling is to ensure moderate inflation and financial stability by determining the conditions (i.e., interest rate and collateral) under which private banks can borrow from the central bank. Although central banks' independence might be undemocratic, it is nonetheless in the long-run interest of the citizenry.

Of course, many political economists insist that what is here called 'independence' simply amounts to central bankers being unelected and unaccountable. Far from being detached from worldly affairs, central bankers are recruited from and cater to private banks, with former Goldman Sachs-banker turned European Central Bank (ECB) President Mario Draghi providing a well-known example. The functional divide between fiscal and monetary policy is not only undemocratic, but also fundamentally anti-democratic, taking one of the most important political-economic domains ('the printing press') away from the influence of the demos and handing it over to the financial sector.

It is hard to establish if, when, and how central banks are anti-democratic (as opposed to merely undemocratic), as minutes of meetings are undisclosed. One way to read the first-hand account by former Greek Minister of Finance Varoufakis is to establish the anti-democratic tendencies of the ECB, which is arguably the most 'independent' central bank of the world. Such a reading of *Adults in the Room* is pertinent, as the book paints a picture of the ECB, together with the International Monetary Fund (IMF) and the European Commission, working against democratic institutions. If so, democratising the European Monetary Union (EMU) by, for example implementing a euro-parliament will turn out to be dead on arrival. But before evaluating the merits and consequences of Varoufakis' account, let's turn to the account itself.

Corresponding author:
David Hollanders, University of Amsterdam, P.O. Box 19268, 1000 GG Amsterdam, Netherlands.
Email: d.a.hollanders@uva.nl

The account starts with the ‘bailouts’ of the insolvent Greek state in 2010 and 2012, which were really bailouts of its creditors, primarily French and German banks. Instead of haircutting its debt or outright defaulting, Greece had to borrow from EMU-countries (and later from the ECB, the IMF, and other the ad hoc institutions like the European Financial Stability Facility and the European Stability Mechanism) to repay bondholders in full. The second bailout in particular inaugurated a state Varoufakis dubs ‘Bailoutistan’. The regime of Bailoutistan consisted of three new institutions that sidelined the Greek parliament. First, a new fund, the Hellenic Financial Stability Fund (HFSF) was created, into which 50 billion euro was channelled. The HFSF is a rescue-fund for Greek banks. Although the HFSF was and is formally owned by the Greek state, the members of HFSF's board of directors are appointed by or have to be approved by the Troika. Second, the head of the Greek Tax Department needs approval by the Troika. Third, privatisations are now overseen by a new authority, the chairperson of which needs, again, Troika approval. The result, Varoufakis argues, is that the Greek people are caught in a “debtor’s prison”, and their best chance of escape from this lies in what he calls “constructive disobedience” (p. 60).

The main opponent is the ECB, which after all controls the printing press that Greek banks and the Greek state need for liquidity support. The ECB makes its first move already in June 2014, announcing that from March 2015 onwards, it will no longer accept bank-issued bonds which are guaranteed by the Greek state. With elections taking place in early 2015, the timing is obviously anti-Syriza – or so Varoufakis tells Tsipras. The second move comes in February 2015. Varoufakis describes his first visit to the ECB:

> Draghi began his reply with a brief speech on the ECB's independence and his determination to play no role in the politics of the negotiations between my government and other eurozone states, emphasizing the prohibition that prevents the ECB from 'monetary financing' via the commercial banks. ‘And I must tell you that recent developments in Greece are putting us in a difficult position’. (p. 201)

Draghi then threatens to remove the waiver – that is, to stop liquidity support for Greek banks. This was, Varoufakis writes, “a calculated act of aggression” (p. 201), and given that the ECB *raised* “the credit card limit” in 2012 for the incoming Samaras-government and had stress-tested the Greek banks a few months earlier, it is indeed difficult to see it any other way. At the first Eurogroup meeting, chairman Dijsselbloem repeats the threat: “If there is no agreed communiqué tonight … the ECB will be forced, on 28 February, to pull the plug … Accept this communiqué now or the train will leave the station” (p. 241). The train did not leave the station, as the ECB extended the waiver, only to remove it the week prior to the referendum in July. The pressure unleashed by the ECB was then enough to subjugate the Tsipras-government into signing up to the Troika programme they had contested for years. According to Varoufakis, the ECB had “plan-Z” (p. 512) ready to eject Greece from the Eurozone, in case Tsipras would not budge.

All this is not to say that the ECB was the only one acting against the Syriza government and/or Varoufakis. Varoufakis describes constant pressure from fellow ministers in the Eurogroup, whose first weapon of choice is leaking to the press that Varoufakis is a self-satisfied amateur with no plans to speak of. The exact opposite, according to Varoufakis, is true. He tirelessly presents debt-restructuring plans in the Eurogroup, but Schäuble refuses to accept official (paper) versions, as that obliges him to discuss them in the German parliament. The German government, or so Tsipras has been told, pressures China to back off and not to invest in Greece. And Varoufakis points out that in December 2014, the then Greek Prime Minister Samaras requested a two-month extension of the Troika programme (instead of the six-month extension on offer), putting immediate pressure on Tsipras, who would likely succeed him in February 2015, as indeed he did. By then Tsipras had already asked Varoufakis, at that moment an engaged economics professor, to serve as his finance minister.

Varoufakis turns out to be a good writer as well. *Adults in the Room* is eloquent, including many well-placed literary references and allusions. So, the least one can say is that even if untrue, the book makes for a good read. But of course, the pertinent question is whether the account is plausible. Parts of the book can, and perhaps should, be read as self-justifying and/or ex-post ordering of contingent events into a coherent story line. Varoufakis makes much of his plan to force the Eurogroup into accepting debt-restructuring – the plan being that in the absence of debt-restructuring, Greece would default on SMP-bonds held by the ECB, which would trigger an immediate clash between the ECB and the Bundesverfassungsgericht (as the latter had approved the ECB-Securities Market Programme on the condition that all state-bonds purchased by the ECB would be repaid). Whatever the merits of this plan, it is not obvious if and how well worked out that plan was, including contingency planning for Grexit in the event that the Eurogroup would stick to its guns. In any case, Tsipras changed his mind when the Eurogroup and the ECB stuck to the Troika programme. In passing, let it be noted that Varoufakis' plan was unknown to many Syriza members and Greek voters alike, which is problematic from a democratic perspective.

However, Varoufakis' account is internally consistent and correct when stating the bare facts about ECB policies. Varoufakis clearly knows his way around in monetary economics. When, how, and why the ECB and other institutions made threats shall remain a mystery, but the fact that unelected central bankers are in a position to make such threats in the first place is arguably bad enough. All the same, if the ECB had wanted to sabotage Syriza, the way it operated would be pretty much the way to go about it. To what extent the ECB acted against Syriza silently or added threats to ensure Syriza knew what it was up against, does not matter materially. For this much is clear from *Adults in the Room*: Varoufakis knew what he was up against, and so did the cabinet. And as if it was needed, he was warned by other economists like Willem Buiter ("don't let the bastards grind you down!", p. 257) and Jeffrey Sachs ("these people lie. Don't trust them", p. 419).

In effect, Varoufakis's account shows how the world's most independent central bank, in cahoots with the Greek central bank, the IMF and the Eurogroup, actively undermined both the Greek economy and the Greek government. The capitulation of Syriza was the aim and the result. Varoufakis describes how he tried to convince Tsipras until the referendum to enact the original plan. Tsipras was pressured to choose otherwise. If Varoufakis made a mistake, it was to underestimate the sabotage, the intimidation, and the blackmail that the Troika would unleash after the victory of Syriza in January 2015. With the benefit of hindsight, the Syriza government should have defaulted immediately on its public debt, as it had indeed called for itself in 2012 in its Thessaloniki programme. As the default-decision is part and parcel of fiscal policy, mainstream economists should in theory have no objection to it. Of course, it might also be that central bankers and monetary economists in their heart of hearts would like to remove fiscal policy from the democratic domain as well.

References

Kydland, F.E. and Prescott, E.C. (1977) Rules rather than discretion: The inconsistency of optimal plans. *Journal of Political Economy*, 85(3): 473-91.