Why are Philippine Funds Being Used to Bail out Irresponsible European Banks?

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The Philippine government's decision to extend a $1 billion loan to the International Monetary Fund (IMF) to supplement the Fund's war chest of $456 billion to contain the economic crisis in Europe has been justified as assistance to countries in dire need of financial help.

It will do no such thing.

The IMF funds may be nominally earmarked for Greece, Spain, or Ireland, but they will actually flow to the big banks that made loans to these countries.

A Supply-Driven Crisis

As in the United States, the financial crisis in Europe is a supply-driven-crisis, as the big European banks sought high-profit, quick return substitutes like real estate lending and speculation in financial derivatives for industrial and agricultural investment. German and French private banks hold some 70 per cent of Greece's $400 billion debt. German banks were great buyers of the toxic subprime assets from US financial institutions, and they applied the same lack of discrimination to buying Greek government bonds. For their part, even as the financial crisis unfolded, French banks, according to the Bank of International Settlements, increased their lending to Greece by 23 per cent, to Spain by 11 per cent, and to Portugal by 26 per cent.

Indeed, in their drive to raise more and more profits from lending to governments, local banks, and real estate developers, Europe's banks poured $2.5 trillion into Ireland, Greece, Portugal, and Spain. It is said that these countries' membership in the euro deceived the banks into thinking that their loans were safe since they were implicitly backed with the economic power of the Eurozone's most powerful economies, meaning Germany and France. Not only was this a lame excuse for not looking into a debtor's financial health, which every bank is obligated to do. More likely, a country's membership in the euro provided the much-needed justification for unleashing the tremendous surplus funds the banks possessed that would create no profits by simply lying in the banks' vaults.

Rescuing the Banks

The so-called rescue funds are pretty much like the $700 billion Troubled Assets Relief Program (TARP) that injected money into the United States' top financial institutions to keep them from crashing into bankruptcy in 2008. Like TARP, the European bailout funds are public monies being used to bail out private banks that made bad bets in the global casino. TARP, however, was clearly a bailout of the banks, whereas the European rescue funds are disguising a bailout of the banks as a bailout of countries.

The European rescue program is, in this sense, also very similar to the funds assembled by the IMF during the Asian Financial Crisis in 1997. Practically all of these funds went to pay off foreign creditors and hardly anything went to ease the sufferings of people whose economies collapsed when the investors deserted them. Many creditors got a large part of their money back, but nothing was allocated to assist the estimated 20 million Indonesians and one million Thais who dropped below the poverty line as a result of the harsh stabilization programs the IMF demanded in exchange for the bailout funds.

The European bailout funds are also like the structural adjustment loans extended to the Philippines in the 1980's during the depths of the country's foreign debt crisis. They went to rescuing Citibank and other foreign creditors while Filipinos were left not only with the task of paying off the World Bank and the IMF but also undertaking the painful measures of budgetary cutbacks, trade liberalization, deregulation, and privatization that dislocated the country's economy irreversibly. One of the IMF conditions for the rescue loans for international private banks was Automatic Appropriations Law, which mandated that servicing the debt to these creditors would have priority allocation in budgetary expenditures. In the last few years, we have allocated 20-25 per cent of the national budget to debt servicing.

Banks Escape, People Pay

While the big banks will be able to get a significant part of their irresponsible investments back, as a result of the generosity of countries like the Philippines, it will be the people of Spain, Greece, Ireland, and other bankrupt European countries that will be left with the bag, just as Asians and Filipinos were the ones who had to clean up the mess that their foreign creditors and domestic economic elites left behind after the Asian financial crisis.

From our bitter experience, we can relate to the frustration of the Spanish economist who, upon hearing of the $125 billion "rescue" deal that would put the enormous burdens of repayment on Spanish taxpayers in the dreary years to come, told the New York Times, "Ultimately, those who lent to our financial system were the banks and insurance companies of Northern Europe, which should bear the consequences of these decisions." Great principle, but it won't be followed.

In order to repay the EU-IMF bailout loan, the Greek government agreed to a draconian program that increased the value-added tax to 23 percent, raised the retirement age to 65 for both men and women, made deep cuts in pensions and public sector wages, and eliminated practices promoting job security. Years of pain and stagnation are the only future Greeks can look forward to.

As for Ireland, in return for an 85 million euro loan to repay European banks, it accepted what the New York Times characterized as the "toughest austerity program in Europe," involving "the loss of about 25,000 public-sector jobs, equivalent to 10 percent of the government work force, as well as a four-year, $20 billion program of tax increases and spending cuts like sharp reductions in state

pensions and minimum wage.” The program, being essentially, as in Greece and Spain, a draconian effort to rip off resources to pay off the banks, will end up choking growth for years to come, with the IMF itself warning the program would risk a "pernicious cycle of rising unemployment, higher arrears and loan losses.”

Moral Hazard

There is a term for the consequences of bank bailout programs: “moral hazard.” By generating the expectation that they will be rescued whenever their debtors run into trouble serving their debts, bailout programs encourage irresponsible lending. The Eurozone governments-IMF rescue operations can only encourage more irresponsible lending in the future.

There are a number of other reasons others have cited why the $1 billion credit to the IMF is a bad idea. It could be better used being lent to the national government to pay off our $62.9 billion foreign debt or plugging the budgetary shortfalls for education, health, and infrastructure. It should be given only if the IMF agreed to changes in its governance structure to give countries like the Philippines larger quotas and greater voting power and a larger say in policy. But the main reason is plain, simple, and commonsensical: our government should not be in the business of bailing out irresponsible European banks.

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P.S.

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