THE SOVEREIGN DEBT CRISIS

A TRANSDISCIPLINARY APPROACH

ABSTRACT

We have chosen to adopt an interdisciplinary approach to debt, leading to a transdisciplinary analysis of sovereign debt. Disciplinary fields as varied as logic, accounting, finance, psychology, geopolitics, economics, statistics, ethics, rhetoric and political discourse analysis are mobilized in order to reveal the prejudicial nature of an over-rigid compartmentalization of knowledge in particular that which is centered on economics alone. This approach comes in sharp contrast to mainstream economic theory, which has often refused any constructive dialogue with other disciplines. We do not praise interdisciplinarity as an end in itself. Our aim is to underline the merits of a plural scientific approach, which finds its justification in times of crisis in the very nature of the problems under scrutiny whose complexity and multidimensional character require an in-depth review of the underlying research frameworks. Finally, a textual analysis of four documents will complete and justify our argumentation.

Keywords: interdisciplinarity, transdisciplinarity, scientific dialogue, crisis, sovereign debt

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Introduction[1]

The spectacular progress of disciplines has paved the way for unprecedented levels of scientific expertise throughout the world, in particular in universities, which have consequently become gigantic knowledge factories devised to generate, almost continuously, impressive amounts of knowledge, whose intellectual codes are perfectly integrated by those involved in the world of academics. The paradox is nevertheless striking, when one takes into account that the multiple communities of actors (universities, political leaders, representatives of civil society, citizens in the broad sense, etc…) are, more than ever, in search of renewed prospects and original links between disciplines, in a quest to reorganize and clarify these self-sustained knowledge flows.

Teamwork involving several fields, scientific networking, interdisciplinary experiments in research centers, as well as increased pedagogical advances relating to multidisciplinary courses, all form a diffuse evolving knowledge paradigm, which is simultaneously the cause and the consequence of this dual reflexive and symbiotic repositioning of disciplinary fields. These approaches are resolutely modern, but are not the result of a naive belief in the virtues of heterogeneity or even of interdisciplinarity itself. On the contrary, the constant reconfiguration of epistemological and organizational limits of scientific activities is derived primarily from the very nature of the problems under study. The combined efforts of researchers thus enable a better articulation of established disciplines, so as to approach problems of a new kind.

It is possible that what may be at stake, beyond the interdisciplinarity sought after, is the concept of transdisciplinarity, which corresponds to an underlying epistemological need, and an intrinsic conviction. The first stems from the loss of what is felt as having been a former unit of knowledge. The second is the hope that transdisciplinarity will contribute to solving a shared problem, which is more than just juxtaposing disciplines, more than just placing them 'side by side[2]'.

In the face of the alarming state of the world economy since the beginning of the financial crisis in 2007, we have chosen in this article to conduct an interdisciplinary study of debt, in general, and a transdisciplinary approach to sovereign debt, in particular. Like Hayek[3] (1993) who affirmed that an economist who was only an economist, would be a bad economist, we believe that hyper-specialization is likely to be conducive to prejudicial epistemological drifts. Furthermore, Edgar Morin (1999) warned us that such an intellectual posture would distort the purpose of the single discipline, being merely perceived as an end in itself". We hence retain the assumption that the ontological nature of sovereign debt cannot be confined to economics alone[4]. We will deal with five successive disciplinary pairs: logic and accounting, finance and psychology, economics and geopolitics, statistics and ethics, rhetoric and political discourse analysis. Concerning this last binomial, a threefold textual analysis will shed light on recent controversies surrounding the American, British and Greek sovereign debt crises. Finally, in the face of the current deadlock wherein economics now finds itself, we will conclude with a few common sense recommendations.

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[1] Disclaimer: the present working paper was originally drafted in French between March and April 2010, before the crisis reached its climax in the days prior to the creation of the European Financial Stability Facility by the 27 member states of the European Union on 9 May 2010. It is both an ode to pluralism in economics and a genuine intellectual testimony. It is not meant to be read as a mere ex-post narrative of the 2010 Euro sovereign debt crisis. All errors remain mine.

[2] H. Nowotny, « Le potentiel de la transdisciplinarité », http:// www.interdisciplines.org/interdisciplinarity/papers/5

[3] Friedrich Hayek (1899 - 1992), illustrious representative of the Austrian School, but also a fervent defender of interdisciplinarity received a Doctorate in Law (1921) another in Political Science (1923) before starting his career at The London School of Economics in 1931.

[4] An obviously relevant discipline but preferably within the framework of a renewed interdisciplinary dialogue

I) Logic and Accounting

We begin our argumentation with the convergence between accounting, as defined as a tool of representation and evaluation of economic activities, and logic considered as a science of reasoning. Accounting techniques enable the listing of relevant agent-based financial information, meant to be communicated to multidimensional communities of actors (States, regulators, investors, analysts, citizens, special interest groups…), likely themselves to be apprehended through the lenses of a resolutely multi-disciplinary prism.

At the risk of stating the obvious, let us recall that accounting requires the existence of a measuring unit in which its very object is expressed. As Keynes reminds us (1930 [1971], p.3), the unit of account function takes on paramount importance in the definition of money, as a sine qua non for its existence: "[m]oney proper in the full sense of the term can only exist in relation to a money of account". To take this one step further, is not the unit of account function at the heart of all socio-economic relations, allowing the community to exist by itself (Keynes 1982, p.252)? And, moreover, is it not finally the State, when it accepts the payment of taxes in this same unit of account, (Knapp 1924, pp. vii viii; 40) that ensures and validates its unity? And does not the necessary bijection between State and money[5] result from this, as Chartalists, along with Keynes and his dictionary metaphor (1930 [1971], p.5), had predicted? In the final analysis, it appears that the essence of accounting necessitates a unit of measure, validated by a legal framework, thereby defining a unified currency area wherein debts are issued, put in circulation and repaid in interconnected and overlapping debt cycles.

What is the founding act giving rise to debt, and to which disciplinary field does it belong? One generally retains the legal concept of 'liability generating occurrence', which allows any accounting event (such as the appearance of a debt) to be recorded in a given period. Likewise, expenditure and receipts are often entered as accounting entries merely disconnected from the date of their effective realization (debt issuance sometimes occurs after the legal decision to sign the debt contract, and the ratification thereof). Once validated, any debt is then the mere legal and accounting outcome of a liability-generating occurrence, which is registered on the liability side of the economic agent's balance sheet.

Let us underline the historical dimension of accounting logic, whose evolution was determined by the necessary traceability of debts related to the expansion of the business world (with the subsequent rise of the needs for communication and transparency). Accounting has therefore entailed the development of pluridisciplinary theoretical frameworks, linking disciplines as diverse as macroeconomics, public finance or management[6], in order to analyze economic and financial activities in a more holistic fashion, through the meticulous observation of the debt phenomenon, that is, its genesis and the evolutionary dynamics thereof (Minsky, 1986).

In modern language, credits and debits appear in T accounts, which logically ensure their equality. Double-entry accounting is the basic methodological principle for recording economic and financial operations, governing the fusion of accounting and logic. Logic[7] simultaneously refers to

[5] This postulated bijection between State and currency is nullified and invalidated by The European Monetary Union which replaced the State by a supranational entity (the European Central Bank). Indeed, the Greek crisis showed the limits of a system characterized by a currency deprived of an economic government likely to solve serious dysfunctions, which do not originate from monetary policy.

[6] This diversity of methodological frameworks includes national accounting, accounting matrices of flows, cost accounting, etc…

[7] from the Greek logikê from logos (λόγος)

the philosophical categories of reason, language, and more particularly of reasoning. It consists in the study of the formal rules, which any argumentation must comply with, before it is deemed valid. Like logic, accounting rules are consistent with the double-entry system, in which each transaction simultaneously affects not one, but two accounts, thereby discarding the possibility of black holes in the economic system (Godley, 1996, p.7).

The fusion of logic and accounting thus proves very relevant within the framework of our preliminary interdisciplinary study of debt. But how does sovereign debt come in the picture? The latter appearing to us as a subset of the conceptual meta-category of debt, it consequently obeys the same principles, notwithstanding the mobilization of other disciplinary fields examined below.

II) Finance and Psychology

We outline a second disciplinary combination, between finance and psychology, with a preliminary analytical detour, by addressing the role of sovereign debt in the Capital Asset Pricing Model (CAPM).

The CAPM is a fundamental financial model, which establishes a link between the risk of a security (or a portfolio) and its expected return, thereby enabling a rational valorization of the financial assets at risk (Treynor, 1962). The CAPM allows the cartography of risks and returns, thanks to the construction of the "security market line", whose point of tangency with the efficiency frontier plots the market portfolio. The convergence of expectations (in spite of preference heterogeneity) will determine this optimal portfolio. Sharpe (1964) claims moreover that in a state of equilibrium, the market remunerates the risk that cannot be diversified away. The price of financial assets is set according to the contribution to market risk, and not total risk. The investor's remuneration is twofold: via a time and a risk component. The former implies the existence of a risk-free interest rate (RF) and the latter the remuneration of the additional risk borne by the investor by means of a beta coefficient to which a risk weighting is applied (the return of the market portfolio less the return of the risk-free asset). One of the lessons of this model is that the risk-free asset is crucial to ensure diversification in portfolio management.

Empirically, this role has traditionally been assigned to sovereign debt (primarily government bonds issued by the great economic powers). This implicit axiom of finance (sovereign debt = risk-free security in the CAPM) is yet called into question by the institutional evolution of the banking regulatory framework, from Basel I to Basel II. Whereas the States were formerly granted a risk-weighting equal to zero in the Basel I framework, they are now rated (through internal methods of risk assessment) by financial institutions themselves, taking into account a risk very largely ignored until now: sovereign default risk. This has resulted in rating agencies fixing a debt ceiling, which is acceptable for sovereign debt. This burning question in Europe from now on questions the reliability of traditional financial models in the face of the misfortunes of several Mediterranean countries, better known under the infamous PIGS acronym (Von Reppert-Bismarck, 2008) owing to their doubtful public finances.

The junction with psychology is likely to be apprehended by "behavioral finance", defined as the study of financial anomalies, at the interface between the study of human behavior and financial decision making. Mainstream postulates (i.e substantive rationality, methodological individualism, utility maximization under constraints etc…) are rejected out-of-hand. The emphasis is on uncertainty and the dynamic character of the financial environment. Economic analysis and the study of debt are thus enriched by topics such as cognitive bias, the absence of ethics in financial markets (e.g the Madoff scam) or the bounded rationality in times of bubbles, panics, crises…

The interpenetration of finance and psychology is also illustrated by the observation of mechanisms well-known to psychologists, such as the denial of reality (Laplanche & Pontalis, 1967, p.115). It is an accepted fact today that a significant number of economic agents were deliberately oblivious to the irresistible increase in risks in the five years preceding the outbreak of the financial crisis, simply to avoid the worry of the potential consequences thereof. Instead, they put their trust in the central banks and the regulatory institutions (though, with hindsight, the latter utterly failed). These risks included, inter alia, the deepening of macroeconomic imbalances (balance of payments, national debts, USA and China interdependence etc…), the increasing weight of hedge funds and other financial conglomerates feeding the over-the counter derivatives market, by resorting to unprecedented leverage effects, whilst thriving on an international macroeconomic environment characterized by low interest rates set by a complacent Federal Reserve, comforted by its successful reversal of recessionary trends, in the aftermath of 9/11 terrorist attacks (Kliesen,2003).

Economic agents have therefore neglected the meaning of this grim reality, which in theory should have been a source of worry (and therefore of caution). On the contrary, the unimaginable risk-taking practices of investors in the banking and real-estate industries between 2002 and 2007 undoubtedly mirrored the well-known issue of moral hazard that translated into the mere negation of a well perceived, albeit behaviorally neglected, reality. Agents suffering from myopia (if not, blindness) preferred an imaginary, much more reassuring and comfortable world. One particularly provocative assumption (but not explored here) would be that this fictitious universe, totally disconnected from the real economy, in which the financial community indolently bathed during the easy-money years leading to the crisis[8], turned out to be the mere validation of the market-centered dream world populated by its most fabulous incarnation namely homo oeconomicus, once imagined by neoclassical economists (and by extension, mainstream economics), tirelessly defending the self-regulation argument (and the efficient market hypothesis) since the eighteenth century, in a leap of faith going far beyond understanding. Agents were thus comforted in their denial attitudes by a (more or less conscious) alteration of their mental representations, which prevented them from deliberately placing themselves in a "crisis scenario", as long as they considered themselves to be in a euphoric situation. All in all, what is posed here is perhaps the existentialist search for the philosophical frontier between rationality and reasonableness (Kahn, 2004).

This renewed approach to the psychological determinants of finance goes so far as to highlight the illusory, and even the excessively stimulating nature of debt (akin to amphetamines). This potentially addictive nature of debt was reinforced in the run-up to the crisis by mathematical incentives, both devised and validated by the economics profession[9], thereby encouraging leverage, so as to optimize investment performance. Pathologies, such as cocaine consumption (Sharp, The Independent, 2008), have been observed, with experienced City traders, and have been the subject of in-depth clinical studies, which arguably deserve a thorough interdisciplinary examination of the debt biochemistry, inspired in particular by the recent advances made by neuro-economics, a branch of research at the interface between economics, neurosciences and cognitive psychology (Camerer and Al, 2005).

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[8] Some claim that the so-called easy-money years did not cease with the return of traders' bonuses in the more recent period, in spite of the massive bail-out plans put in operation throughout the world by the Central Banks.

[9] The leverage effect is the link connecting the rate of return on equity (financial return) to the rate of return of the capital employed (economic return), and to the cost of debt. The formula runs as follows:
RoE = ROCE + (ROCE-Cd)*D/CP; where ROCE = *Return on capital employed,* ROE = Return on equity, Cd is the cost of debt, D represents the debt and CP the firm's own equity capital.

It might appear to some that we have somewhat deviated from sovereign debt in this short interdisciplinary examination, joining up the forces of finance and psychology. Yet, it is not so. In their latest book: *"Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism",* George Akerlof and Robert Shiller (2009) basically call mainstream economics and the efficient market hypothesis into question. Keynes (1936, p.159) is somewhat rehabilitated, in the sense that he pioneered the irrationality of individual agents operating in a casino economy, capable of generating massive collective bankruptcy. The great fear of 2010, due to the explosion of national debts, may only be the reappearance of an earlier stated problem[10]. Although it was the fruit of research conducted prior to the crisis, Akerlof and Shiller's book arguably predicted the great disillusion, which currently affects economics. For these authors, the mainstream's biggest *faux pas* was to postulate pure rationality, and the omniscience of economic agents, with disregard of animal spirits (Keynes, 1936, pp.161-2). By placing psychology at the heart of human behavior - unduly occulted by neoclassical economists with their timeless and dehumanized equations - Akerlof and Shiller are challenging the axioms of orthodoxy. As Paul Krugman put it in a widely acclaimed New York Times editorial (2009), the crisis was very poorly predicted by the immense majority of professional economists worldwide. Akerlof and Shiller convincingly argue that animal spirits help explain why and how the crisis was not anticipated: "[O]ur theory of animal spirits, they say, provides an answer to a conundrum: why did most of us utterly fail to foresee the current economic crisis? How can we understand this crisis when it seems to have come out of the blue with no cause?"

Furthermore, the ideological mechanisms conducive to the weakened explanatory power of economics are relatively simple to single out: indeed, economics and political science are not disjoined and independent disciplines. The economic substrata cannot be artificially (or experimentally) isolated from the societal context, the political conflicts or the cultural, linguistic and religious diversity, which characterize human communities.

Economists have been on the wrong track for too long, and the present sovereign debt over-heating, throughout the world, is nothing else than the paroxysm of the severe crisis of a discipline, which has become indifferent to others, even autistic for some[11], as it is increasingly characterized by scientific instrumentalism, which makes no concession and merely discards interdisciplinary dialogue. This approach to the philosophy of sciences has certainly had the wind in its sails following the work of Milton Friedman (1953), who argued that the ultimate objective of science was not to provide a "true" representation of reality, but rather to serve strategic and practical stakes such as the forecast or even the effective control of economic variables such as monetary aggregates.

The burning questions, which have been asked repeatedly since the beginning of the financial crisis of 2007-2010, the last episode to date of which is that of the Euro sovereign debt crisis, are as follows:

What are the fundamental strategic and practical objectives that have been clearly achieved during the relentless reign of mainstream theory over the last decades, owing to the flagship publications of Economics departments in the world's most prestigious universities?

What predictions concerning the basic evolutions of the world economy have ultimately proved correct? Among major unforeseen evolutions, such as the subprime mortgage or the Euro

[10] See Maris (2009)

[11] See for example the "post-autistic economics network" movement (www.paecon.net/), which defends pluralism in economics.

sovereign debt crises, which ones were subjected to perfectly successful adjustments following the policy recommendations made by mainstream economists?

Many of these questions unfortunately remain unanswered to date. Would economics have reached its limits with the Euro sovereign debt crisis? Our answer is affirmative without being defeatist. The objective of this article is in fact to help mobilize, as dynamically as possible, a multitude of theoretical and discursive elements within a renewed interdisciplinary perspective.

III) Geopolitics and Economics

Geopolitics, seen as the study of the interdependence between geography and political science, is an extremely rich disciplinary field in its own right, developed at the beginning of the twentieth century under the epistemological influence of heterogeneous streams of thought[12]. Geopolitics has the capacity to shed light on a wide range of contemporary economic issues, in particular those related to globalization, which has reinforced the interdependence of national economies, and the functional integration of the world economy, in spite of a persistent fragmentation that many researchers endeavor to single out (Ankerl, 2000).

Nonetheless, the stringent study of this new interdisciplinary approach goes beyond the scope of this article. To compensate, we propose to illustrate certain potential synergies through a short presentation of an article by Michael Moran published in Roubini Global Economics - Total Macro Econo Monitor dated March 11, 2010 (see appendix).

After a reminder of the weakening or indeed the obsolescence of the transatlantic relationship, which was formerly considered as unconditional (the once stalwart "trans-Atlantic relationship," the outdated misnomer for ties between Washington and its major Western European partners " (Moran, 2010)), the article underlines the rapid deterioration of diplomatic relations between Europe and the United States under the combined influence of the Iraq invasion in 2003 and the world financial crisis five years later. The following assumptions are made by the author (ibid):

- Americans would feel a scarcely undisguised sense of satisfaction with the spectacle of the PIIGS crisis, caused by the lax budget management of European States, which are considered with scorn by the American Establishment as being imprudent socialist regimes, in spite of an obvious shift of the American electorate towards the center of the political arena, following the election of Barack Obama in 2008.

- The financial contribution of Europe to the war in Afghanistan is considered by Washington to be too modest.
- The UK has had to distance itself from its long-standing ally for reasons of domestic policy.

- There remains a general feeling that president Obama did not respond to the expectations that his historical election sparked throughout the world.

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[12] We can in particular quote the contribution of the German school at the beginning of the twentieth century with for example Kjellén, Rudolf, Stormakterna (Great Powers). 1916, Staten som lifsform (the State like forms). 1920, Världspolitiken 1911-1919 (World politics 1911-1919).

- The way the United States ignored The European Union during the talks with China changed attitudes at the very disappointing Copenhagen Summit in 2009.

- The disappointment of Europeans was substantial after the announcement of banking reforms by president Obama without any prior concertation with the G20 Financial Stability Board.

- The United States responds coolly to Europe's over-reverent attitude respect towards Russia, which is endowed with enormous energy resources, which are far from being neutral in geostrategic terms.

- A growing number of bilateral litigations with the United States implicate from now on countries like Turkey, Poland and the Czech Republic.

- There is a fear that the new geopolitical vision of the Obama administration is that of a bipolar world centered on the United States and China from which Europe would be excluded.

This fear of a shift to a bipolar Sino-American world to the detriment of Europe, was evoked by Philip Stevens (2010) in The Financial Times: '[T]he postmodern view of geopolitics struggles to measure up against the rise of great national interests well ahead of wider mutual obligations".

However, Moran's article underlines the fact that the diplomatic picture is not quite so dark with the existence of solid strategic collaboration in the financial sector and joint reflection on the regulation of the derivatives market and more particularly on the controversial Credit Default Swaps, which may have exacerbated the Greek debt crisis (Gros & Mayer, 2010).

The first noteworthy observation is that, to the best of our knowledge, too few economic models have managed to apprehend the geopolitical dimension, albeit fundamental, of bilateral relations between Europe and the United States. Is this a new internal flaw within the discipline of economics or rather a failure of interdisciplinary dialogue? We opt here for the second answer.

IV) <u>Statistics and Ethics</u>

We examine in this section the connection between statistics and ethics. These two disciplinary fields are, *a priori*, perfectly distinct. Nevertheless, our sovereign debt theme provides us with a unique opportunity to associate them from an original interdisciplinary standpoint. Statistics is a formalized branch of mathematics, which provides working methods and quantitative techniques. Statisticians collect, analyze and interpret empirical data (mainly in numerical form), whilst taking care of clarity of their presentation. As for ethics[13] it is a philosophical discipline with a dual practical (recommending behavioral patterns) and normative (setting rules to be followed) dimension. Ethics thus puts forward rules of behavior, which may inspire individuals and communities within the framework of their permanent interaction, within a natural and human environment.

[13] From the Greek ηθική [επιστήμη], "moral science", ήθος, "place of life; habits; manners; character" and from the Latin *ethicus*, morals

The starting point of our interdisciplinary attempt could well be inspired by the first lines of an article by Patience Wheatcroft (2010) entitled “Time to Remove the Mask from Debt” published in The Wall Street Journal dated February 16, 2010: Greek mythology gave Hades, the god of wealth, the useful addition of a helmet that could make him invisible. Modern Greece seems to have found a financial equivalent, a piece of equipment that can make debts disappear”. The comparison between Hades’ helmet in Ancient Greece, conferring on him the gift of invisibility and the twenty-first century derivatives that knowingly enabled the dissimulation of a substantial share of the Greek national deficit from the eyes of financial markets. After drawing a parallel between the accounting Enron scandal last decade and that of the Greek sovereign debt crisis, the article continues with a reflection on accounting fraud, which renders possible for States (such as Greece but also the United Kingdom and others) to deepen their public debt, while maintaining their balance-sheet structure unchanged.

So the vocabulary oscillates between that associated with conjuring (or the art of presenting official statistics in a flattering fashion) and that of failing public ethics (by which state Machiavellism prevails, by allowing a mere accounting manipulation of deficits in order to comply *ex post* with the requirements of the Stability and Growth Pact). At times, the author sets up an almost problematic ambiguity between the need for transparency of States (the basis of which is essentially legal, and does not allow for any accurate prediction of the nature of public information made available to markets), and honesty requirements for governments (implying they have a perfect command of the contents of their official discourse, and that they know the identity of the receivers thereof*): ‘[W]hatever Eurostat finds as it delves a little more deeply into Greece's affairs, the pressure for more honesty and transparency in national accounts is now likely to mount* (Wheatcroft, 2010).

From a philosophical standpoint, it appears difficult to rely exclusively on legally binding ethics, and therefore ascertain the moral nature of the transparency of official statistics, whilst conversely, when scrutinizing the Government’s communication, in times of crisis (both internally and externally), it appears problematic to dissociate aspirations to honesty from the notion of ethics.

Sovereign debt discourse analysis, derived from policy recommendations, is often influenced by ethical considerations, in terms of measurements considered as “righteous” from the (implicit) point of view of special interest groups:
“In policy discussions about government debt, especially that of developing countries and particularly in cases when there is a crisis to overcome after a government defaults on its debt, commentators often talk about legal obligations, political necessity, and economic consequences. Implicitly or explicitly, commentators refer to what the "proper," "fair," or "just actions would be. Typically, what is claimed as fair from the perspective of one group of interests (for example, the holders of defaulted government bonds) *is regarded as unfair* by another group (for example, the people whose taxes would be raised to pay the bondholders), and vice versa” (Barry, 2007, p.5, italics added).

This is to be compared with the recent revelations of fraudulent accounting practices[14] in the weeks preceding Lehman Brothers’ bankruptcy (Story, 2010), where official statistics were put forward as a vector of information designed to justify measures involving citizens or other sectors concerned, whilst taking liberties with raw data, and even with ethics.

[14] “Since Lehman was accused of using a transaction known as Repo 105 in 2008 to hide about $50 billion in debt, analysts have said there should be a widespread inquiry of accounting on Wall Street before the financial crisis.” (Louise Story, New York Times, March 29, 2010)

In this way, the question of the use to be made by statistics illustrates, according to Barry (ibid, p.7), a recurring tendency of governments to underestimate national debt levels: "[O]fficial government debt statistics understate the fiscal condition of the government, albeit by an amount that is difficult to measure". This complex relationship between statistics, truth and ethics had already been emphasized in the 19th century by the English Prime Minister Disraeli, who stated with some humor "[T] here are three kinds of lies: lies, damned lies, and statistics".

V) Rhetoric and Political Discourse Analysis

The concept of political discourse refers at the same time to the formal process of verbalization (written or oral) in politics on major issues as regards democratic life, and to rationality used to political ends.

"Political discourse is the formal exchange of reasoned views as to which of several alternative courses of action should be taken to solve a societal problem. It is intended to involve all citizens in the decision-making process, persuade others (through valid information and logic), and clarify what course of action would be most effective in solving the societal problem". (Johnson et al, 2000)

"Political discourse is a method of decision making in a democracy. A decision implies that some agreement prevails as to which of several courses of action is most desirable for achieving a goal (…). Making a decision is just one step in the more general problem-solving process of goal-directed groups. After defining a problem or issue, thinking over alternative courses of action, and weighing the advantages and disadvantages of each, a decision is made as to which course is the most desirable for them to implement (Johnson & Johnson, 2000)".

Even if since Aristotle[15] and Plato, the links between the art of sophism and true knowledge have been the subject of very rich philosophical debates, rhetoric is not always regarded a disciplinary field in its own right, but rather as a theory of efficient speech related to oratory. The aim of rhetoric is thus to persuade an audience and, by extension, anyone who receives a complex message (the readers of a newspaper, the audience in a theatre, students in a lecture room etc…).

The preceding section highlighted the close links between public announcements of statistical data to political ends, which can sometimes deviate from a certain conception of ethics. We continue our interdisciplinary reflection with a threefold textual analysis of the complex political discourse and rhetoric nexus. In support, we refer to three recent articles (see appendices) devoted to the American, British and Greek sovereign debt crises, the latter posing the problem of the IMF intervention in the euro zone countries.

[15] Aristotle defines rhetoric as a "means of arguing, using common concepts and rational elements of evidence, in order to an audience convince an audience with his ideas"

A) Weisbrot, Mark. 24 February 2010. « America's Public Debt : The Least of Our Worries ». Center for Economic and Policy Research.

The tone of this opinion article is that of the lampoon, and has no claim at all to objectivity concerning American public debt. Its aim is rather to describe, even denounce, the perception of sovereign debt in the American media through a deforming prism, voluntarily maintained by vested interests to the detriment of others. The use of controversial terms such as "demagogues" or "Wall Street interests" illustrates our discursive reflection on the ethical standards of the debates on sovereign debt according to the desired objective.

The author plays on the reader's sensibility by recalling that the wealth of the United States renders the current employment situation even more unacceptable.
"The difference between 10 percent unemployment and 5.2 percent is more than 7 million people without jobs. And that doesn't count the increase in millions of people involuntarily working part time, or millions who leave the labor force because they can't find work".

"unacceptable in any civilized society; but even more outrageous in the world's richest country."

By means of a statistical way of reasoning, daring to say the least, putting on the same level the size of the American economic stimulus plan and the number of jobs saved since the beginning of the crisis, the author deduces that, contrary to dominant opinion, the sovereign debt of the United States is not excessive but on the contrary insufficient: "[B]ottom line: we need more stimulus, not less; this is not the time to be worrying about deficits or national debt".

At the risk of amplifying the controversy and losing sight of the initial message on the best way for the United States to ensure growth and full employment, the author voluntarily engages on the slippery ground of the sudden increase in military expenditure, which has not been frozen by the Administration for historical and ideological reasons:

" But thanks to the power of what President Eisenhower famously named the "military industrial complex," President Obama has exempted the military from any spending freeze".

Continuing in vigorous rhetoric, the author does not hesitate either to recall a particularly painful episode in the subconscious collective American thought: the budgetary turn adopted by the United States after the attacks of September 11, 2001:

"On an annual basis, we spent 5.0 percent of GDP on just the Defense Department budget last year. Before 9/11, the CBO had projected just 2.4 percent for 2009."
The sarcastic tone is even used for this same purpose in order to show that the burning question of American health system reform (whose fiscal implications are extraordinarily important) remain particularly dependent on the political positioning of powerful interest groups in Washington:

"Thanks to the two most powerful lobbies in Congress -- insurance and pharmaceutical -- getting health care costs under control is still a distant dream".

The polemical tone of the author's rhetorical discourse takes on an almost acid tone (and consequently becomes extremely subjective) with the following sentence:

“The people who make the nation's major economic decisions and actually brought us this mess - Goldman Sachs and their Wall Street friends: they want to put Social Security on the hopping block to pay for their crimes (and bonuses)”.

Lastly, a well-known rhetorical device, namely that of complicity between the journalist and his readers[16], makes it possible to thus conclude the article:

“[A]nybody see a pattern here? It's not the debt that threatens our future.”

B) Wren-Lewis, Simon. 26 February 2010. « Cutting now or later: Making sense of the debate on UK government debt ». <vox.eu>

This article devoted to sovereign debt in the United Kingdom is much more normalized and serene than the previous one. It is extracted from the academic platform of economic debates VoxEu and begins with a reminder of a prickly question, which haunts the majority of Heads State in 2010:

“[C]ut the government‟ s budget deficit now or cut it later?”

From the outset, there is an obvious intention to reach a measure of agreement in spite of the existence of persistent dissensions within the community of economists:
“Economists disagree, again! However, behind the headlines highlighting differences, there is a good deal of agreement. Furthermore, there is a growing consensus among economists in favor of an institutional change that could help resolve disagreements on this issue”.

The author’s argumentation rests on statistical elements and rigorous economic criteria coming in support of his thesis of the immediate non-reduction of debt.

“Standard smoothing arguments apply to this inter-temporal trade-off, suggesting that we are better off leaving debt where it is rather than bringing it down. This is the random-walk steady-state debt result, and it applies in the same way if we use cuts in spending rather than higher taxes to reduce debt”.
The author recalls that the United Kingdom is not directly threatened by an imminent risk of default, based on purely economic criteria (considering the moderate spreads on British Treasury bonds) and at the same time on a renewal of the sovereign default issue from the multi-disciplinary point of view (i.e economics and political science):

First, markets at the moment do not think there is any serious possibility that the UK will default. No significant premium is imposed on the UK Government’s borrowing costs. Second, the possibility of default depends mainly on politics, not economics.

In spite of its calmer tone, the text is not free from critical comments concerning the free market economy’s limited perspicacity as far as risk assessment is concerned: “You cannot trust markets to get risk assessments right, as we all found out to our cost in the credit crunch.” There is much

[16] “Complicity between the journalist and his reader: a time for exchange between linguistic sciences and communication” is moreover a chapter of the book “Linguistic analysis media discourse, under the direction of Marcel Burger, Notabene, 2008.

uncertainty about the desire of market operators to invest in the British bonds in the future. A change of mood in the market is always possible and the probability of the loss of confidence in the market in the short and medium term therefore remains a topical question.

The trade-off between fiscal and monetary policy is faced with the problem of governments' limited room for manoeuver in a period of recession:
"in a severe downturn, we want to be able to use fiscal policy to support demand but in a boom we are happy to leave demand to monetary policy […] arguably, both in the UK and the US, more could have been done to mitigate the recession using fiscal policy if we had not started with structural deficits."

This rhetorical argument echoes the well-known saying: "mend the roof before it rains".

The author also raises the problem of long-term crowding out effect:

("high government debt may crowd out investment in capital, reducing UK prosperity") even if it supports that the low level of interest rates currently reduces this risk. He makes a cutting remark here against to his potential detractors:

"[A]nyone who tells you that government borrowing is currently crowding out private investment needs to rethink their macroeconomics".

The political problem of "deficit bias" is also underlined insofar as it has imposed itself in an indisputable way in the United Kingdom during last decades, independently of the evolution of the business cycle but also of the political cycle.

Even if these questions are not dealt with by the author (which tends to somewhat weaken his argumentation), the uninterrupted deepening of the British deficit raises some difficult questions it would be appropriate to deal with in order to better understand political bias in favor of deficits, which transcends the political community, from the Labour Party to the Conservatives.

With regard to tax revenues, we can recall the importance of tax base optimization, economic incentives to take up a new remunerated activity in the event of unemployment, the fight against tax evasion (and therefore tax havens), outsourcing etc… Concerning expenditure, it is necessary to point out the considerable increase in expenditure related to the generalization of the Welfare State, to the concomitant redistribution of wealth among the underprivileged, to the financing of the social security system, to the public companies and finally to the increase in state subsidies to strategic industrial and agricultural sectors.

C) Matthes, Juergen. 27 February 2010. « Why the IMF should be involved in solving imminent fiscal debt crises in Eurozone countries ». <vox.eu>

Even if the emphasis is on the Greek crisis in this article, the tone is resolutely European with an overview, which puts the debate in perspective in a historical context. The Euro had already been the subject of much controversy before its introduction. Perhaps it causes even more ‟ today but it is worthwhile associating these debates by trying to articulate them in an intelligent way: "[t]he escalation of the fiscal situation in Greece has highlighted the problems of the Eurozone to deal with such crises". It would have been desirable to specify here the chronology of the historical criticism of the Euro.

The "No-bailout" clause (Article 103, section 1) of the Treaty of Maastricht lays down the rule of the game as regards institutional prohibition of the financial rescue of member-states:

"The Community shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project."

However, Article 100, section 2 states the "exceptional circumstances" which may provoke a meeting of the Council of Europe at the initiative of the European Commission:

"Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, acting by a qualified majority on a proposal from the Commission, may grant, under certain conditions, Community financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken".
The contradiction between the two articles is obvious. There is no point in seeking a purely economic criterion in order to make a decision in the event of a critical, even litigious situation (the Greek case). Only the interdisciplinary combination of economics, the law of European institutions, international relations and political science, can put us on a coherent track in attempting to determine the best institutional architecture likely to validate (or not) the "no bail out" clause.

It is also necessary to add to the problem of institutional inconsistency, which characterizes the treaty of Maastricht, that of time inconsistency. This problem arises in the "rules versus discretion" debate. In the acute phase of the Greek debt crisis, any policy announcement by the public authorities designed to influence the expectations of private operators will run up against the rational calculation of these same operators who will assess the probability of a policy change. In this respect, it is very likely that any announcement may be considered with skepticism from the onset. We find here, in a concomitant way, the theme of political discourse and rhetoric. What should one attach more importance to, in case of a crucial, political announcement (in the example of the Greek crisis, this could be the announcement of a coordinated rescue plan)? Should one put the accent on the current situation, on market expectations, on the future evolution of macroeconomic conditions? Whatever the case, the problem of time inconsistency tends to discredit the idea that an economic policy decision will preserve its optimal character in the future, even if state of knowledge and environment remain unchanged.
The central question of moral hazard is closely related to that of political discourse and its force of persuasion. The article underlines, and rightly so, the limited reaction to the IMF interventions in Hungary, Latvia and Romania (outside the Euro zone) compared to the Greek case (where the intervention of the IMF is moreover no more than one hypothesis among many others). And in this respect, the possible creation of a European Monetary Fund (EMF), which would have money-printing rights, loans or guarantee facilities, in exchange for a strict conditionality, rehabilitates the previously mentioned debate on rules versus discretion. Indeed, the EMF hypothesis (not discussed in the article) could be a particularly effective weapon in the fight against moral hazard and, by extension, against the default risk of the Member States of the Euro zone.

The article also raises the relevant problem of the vulnerability of the Euro zone, which is due to its dual political and cultural fragmentation. The democratic deficit of Brussels reinforces the image of a Europe that promotes individualism (through an implicit cost-benefit analysis of membership) to the detriment of a unified sense of belonging. The problem of Greece thus threatens the cohesion of long-term Europe by widening the political and cultural gap between Mediterranean and Northern European countries.

The author then goes on to identify the current assets of the IMF (specialization in crisis-resolution mechanisms, strong external credibility, tools for fighting moral hazard allowing for a repositioning around the fundamentals of the Stability and Growth Pact, future financial opportunities for joint financial supervision with the European Union etc…). Finally, the main rhetoric device of the article is undoubtedly to have reformulated the Greek debate, in a subtle way, in terms of a merely degraded image (and not of damaged external credibility) of the Euro zone, which remains infinitely more desirable, according to the author, than an internal solution to the crisis, which would affect the integration of an already very culturally split and politically divided Europe. The final recommendation in favor of an intervention by the IMF is thus made. Without being consensual for all the actors involved, it nevertheless will have made it possible to judiciously combine the fields of rhetoric, political discourse, economics and the Law of European Institutions.

Conclusion

Among all the disciplines suffering from potential intellectual isolation, we have put forward the idea that it is most notably mainstream economics, which was conducive to the most disastrous consequences, in particular in terms of the discredit following, on the one hand, the failed predictions of the worst economic and financial crisis since the 1930's and, on the other hand, the implicit legitimization of a former economic reality upon which the (socio-economic) seeds of evil had be sown. Paul Krugman's diagnosis (2009) in this respect was lucid and made very little concession. It denounced the state of a discipline showing an evident incapacity to bring concrete solutions to the major problems of our time in spite of an undeniable scientific and institutional influence thanks in particular to the mathematical elegance of its tools.

Our initial approach to debt conceived through the dual prism of logic and accounting claimed to be inspired to a certain degree by interdisciplinarity. This approach then led, in a more ambitious way, to a trans-disciplinary sovereign debt framework using four other combinations that all shared an essential federating principle: transcending the institutional, ideological and methodological boundaries, resulting in a refusal to contemplate the world through the lenses of a rigid compartmentalization of existing disciplines.

Diversity of points of view, of disciplinary backgrounds, of socio-cultural origins, and of collaborative research methods: such therefore seem to be the ingredients of the success of future research endeavors, which will have a vocation to overcome the obstacles inherent in group thinking, self-sufficient paradigms, narrow visions of the world, and scientific approaches that are hermetic to alternative ways of thinking.

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Appendices

Document 1 — Choppy Waters Rock the Trans-Atlantic Relationship

Michael Moran — Mar 11, 2010

EXECUTIVE SUMMARY

Each day in recent weeks has brought new evidence of troubles in the once stalwart "trans-Atlantic relationship," the outdated misnomer for ties between Washington and its major Western European partners: Britain, France, Germany and more recently, the European Union. Disputes and slights – some real, some imagined – have led to speculation about a drift in a relationship that dominated (and indeed founded) most of the global institutions of the second half of the 20th century. While few see any evidence of an actual rivalry between the two sides, it's possible that the combined damage to the relationship caused by the 2003 Iraq War and then the global financial crisis in 2008 has altered the way the major players view each other. In particular, hopes that maturing EU institutions could simplify this relationship so far remain unfulfilled. Ties between various individual European states and Washington vary greatly, with Poland and the Baltic states on the warm end and an increasingly disgruntled Turkey and bellicose Russia on the other.

The core of the relationship, of course, continues to reside in the power capitals – Paris and Berlin, London and Washington. Given the diverging economic, demographic and geostrategic outlooks involved, however, can the trans-Atlantic relationship still be reliably described with that comfortable old phrase, or has it evolved into a series of complex bilateral and multilateral conversations fated to wax and wane between partnership and rivalry?

Friendly Fire

More than a year into the Obama administration, nothing like the disdain that characterized Bush-era ties with Europe is present. Yet a host of disputes, resentments and misunderstandings have made both sides uneasy:

- A suspicion in Europe that the U.S. administration, in spite of its own center-left sympathies, is happy to see the EU's business model come under strain due to the improvidence of some of its more socialist members (i.e., the "PIIGS"). Treasury Secretary Tim Geithner on March 11 issued the clearest signal yet that Washington does not agree with EU calls for curbs on hedge funds and private equity firms, which critics blame for exacerbating the EU's sovereign debt crisis;
- Anger in Washington about Europe's relatively small contribution to the Afghan war;
- The neutralization of Britain as a "bridge" between Europe and America, largely because British Prime Minister Gordon Brown, an "Atlanticist" himself, has felt compelled for domestic political reasons to distance himself from U.S. policy or risk renewed charges that Labour has been Washington's "lapdog";
- A sense of disappointment in Europe that President Obama has not brought the sea change in global affairs and U.S.-European ties that many there had expected;
- Anger in Brussels at Obama's decision to cut the EU out of last minute dealings with China and other major players so that a minimalist deal on climate change could be salvaged at the otherwise moribund Copenhagen summit last December;
- Similar feelings when Obama unilaterally announced a series of banking regulatory reform proposals without coordinating with the G-20's Financial Stability Board;
- Unhappiness in Washington at the tendency of Europe's largest continental powers, Germany and France, to be deferential to Russia – in large part due to Moscow's demonstrated willingness to use its energy resources for leverage. The sale of several large French warships

to Russia earlier this year drove home poignantly the differing perspectives of Russia prevalent on the two sides of the Atlantic;

- A number of bilateral disputes involving individual countries, including Turkish fury over a U.S. congressional resolution on the Armenian genocide to Polish and Czech disappointment that the risky decisions to invite U.S. missile bases onto their territory have been for naught now that Obama has canceled those programs in deference to Russia;
- In general, European anxiety that China has displaced the EU as the focus of American global policymaking and that a "G-2" world is emerging with a diminished voice for Europe.

This last element – Europe's fear of being marginalized in world affairs – has been fueled by a series of American decisions that, deliberately or not, feed a uniquely European gloom about the coming decades. Having adjusted their philosophical approach to the world to emphasize soft power, European policymakers must realize that in a world where their economic throw-weight diminishes, the soft approach risks eventual irrelevance.

"European elites are paralyzed by sight of a future they fear has been claimed by the U.S. and China," wrote Phillip Stevens in his Financial Times column recently. "The postmodern view of geopolitics struggles to measure up against the rise of great powers in Asia, which put narrow national interests well ahead of wider mutual obligations."

The inability of the U.S. and EU to forge a common approach in Copenhagen set the tone, but three far less serious tiffs have supercharged Europe's suspicion that Washington has a waning interest in European opinion.

The first of these perceived slights was Obama's announcement that he would forego the annual U.S.-EU summit scheduled for Madrid this May. While the decision might seem completely rational to anyone who has read the final communiqué of past such gatherings, feelings are fraught in Brussels, and the White House announcement touched off a spate of eulogies for the trans-Atlantic relations in European media. The U.S. has since backtracked somewhat, pledging a summit level meeting in the autumn.

Another spat, this time between the U.S. and Britain, involves the Falkland Islands – Las Malvinas in Argentine eyes. Argentina's troubled government has been loudly complaining about British oil exploration in the island's territorial waters lately, stirring memories of the 1982 war fought by the two nations. A furor erupted in Britain earlier this week when, answering a question from a British reporter, the State Department spokesman described the U.S. position on the centuries-old territorial dispute with a term British conservatives equate with treason: "neutrality."

"Our position remains one of neutrality," the spokesman said. "The U.S. recognizes de facto UK administration of the islands but takes no position on the sovereignty claims of either party." A typical response in the British media, fond of references to the cultural and historical "Special Relationship" forged by Winston Churchill, came from the right-leaning military analyst Nile Gardiner in The Telegraph: "Thousands of British soldiers are laying their lives on the line alongside their American allies on the battlefields of Afghanistan. Yet the president of the United States is either unwilling or too timid to offer a single word of support for the British people, who face a mounting confrontation with a corrupt, populist Argentine government that is threatening a blockade of British territory."

Still another dispute has arisen as result of the convoluted nature of Pentagon procurement policies. After years of political wrangling, corruption and bid-rigging in the U.S., a European-American consortium (comprised of Northrop Grumman and Airbus-parent EADS) finally decided to drop out of a US$40 billion contract for airborne refueling tankers, conceding the ground to Boeing. The March 9 decision quickly brought claims of protectionism from the EU, with the European Commission saying it feared the "terms of tender were such as to inhibit open competition for the contract." Airbus' Chairman Thomas Enders made the same point somewhat less diplomatically.

Not All Bad

By and large, of course, U.S.-European ties remain exceptionally strong, particularly when measured in economic terms. The world's largest economy and the world's largest integrated trade bloc have suffered massively in the recent downturn, but the interconnected nature of U.S. and European corporate sectors, markets and transportation networks ensures no breach cuts too deep.

Analyses which dwell on "rifts," meanwhile, will tend to overlook the positive developments – like the continued cooperation over Iranian nuclear proliferation and the developing joint U.S.-EU position on credit default swap regulation – and focus on the negatives.

It is also true that old definitions of the "trans-Atlantic relationship" fail to take into account the EU's newer members, most of whom view the United States favorably (and many of whom put a good deal more faith in U.S. promises of "mutual defense" than anything emanating from the chancelleries of Paris, Berlin or London). In Central and Eastern Europe (CEE), the fear of an unpredictable Russia is directly proportionate to the devotion in Brussels to "soft power."

Still, even here, some doubts have arisen. Russia's war with Georgia in 2008 exposed the very limited recourse open to the U.S. or its allies in the former Soviet space. In seeking a "reset" of U.S.-Russian ties, largely to win Moscow's aid in curbing Iran's nuclear ambitions, Bush-era plans for a robust missile defense system in Poland and the Czech Republic were scrapped. So far, the concession has brought little in the way of support in international negotiations on Iran, yet has reinforced the insecurity of some EU/NATO nations – particularly the Baltic states.

Brussels Sprout

American policymakers, particularly those in the Democratic Party, have cheered moves to strengthen EU foreign policy and military institutions, arguing this would help reduce the cacophony of national opinions which make coordination on major policy issues difficult. (Republicans, to the contrary, have tended to view EU institutions with suspicion as rivals to NATO and captive instruments of the French foreign ministry). By and large, the rollout late last year of the new EU High Representative for Foreign Affairs and Security Policy, Britain's Catherine Ashton, has been deeply disappointing in this regard. Since taking office, Ashton has found little appetite in the foreign ministries of the EU's major powers for ceding ground to the center. She has struggled against conflicting bureaucratic and national demands to make the 5,000-strong European diplomatic service a reality and has been criticized by member states for everything from inexperience to being upstaged by U.S. Secretary of State Hillary Clinton on Haiti relief. Her involvement in perhaps the most sensitive issue of all between the U.S. and Europe – the mission in Afghanistan – is minimal since the mission there is run by NATO.

Ashton has argued that EU member states need to put aside squabbling and help her coordinate the trade bloc's international message or face dwindling influence in the world. On March 10, speaking to the European Parliament, Ashton said that India, China and other rising powers would not wait for Europe to get its act together in foreign affairs. "If we pull together we can safeguard our interests," she said. "If not, others will make the decisions for us. It's that simple."

That Island Nation

Taken on the whole, even with the list of grievances growing weekly between them, it could be argued that ties between the U.S. and Europe's major continental powers – Germany, France and Italy – are less agitated today than at any time in recent memory. Afghanistan aside, efforts to coordinate responses to global flashpoints – the quakes in Haiti and Chile, Niger's recent coup, the summer's unrest in China's Muslim region of Xinjiang – all were notable for the consensus across the Atlantic.

Britain, however, stands out as an exception. Harder hit economically by the downturn and in the throes of a general election year, the Labour government has been loath to play to role in geopolitics that British leaders since Margaret Thatcher have sought: Europe's agent to America, and America's translator for the continent. In part, the reluctance stems from the spectacular failure – in the eyes of most British voters – of Tony Blair's efforts to put that dynamic to work ahead of the Iraq War in 2003. Brown's government faces a Conservative opponent with a lead in the polls who ceaselessly hammers home the consequences of such "kow-towing" to Washington.

The so-called "Special Relationship" enjoyed a late-life surge in the U.S. during the early days of the Iraq War but has since dropped once more from American usage. In fact, U.S.-British ties have been deeply strained over a range of issues – the Falkland Islands spat being only the silliest. Under severe political pressure, the Brown government has railed against U.S. treatment of terrorist suspects, inaction (and pro-Israeli favoritism) in the Middle East peace process, drone missile attacks and resulting civilian casualties in Pakistan and, in Washington, a lingering anger that Britain's Financial Services Authority prevented a last-minute rescue of Lehman Bros. by Barclays in 2008 (however poorly organized the idea was by U.S. officials).

The Conservatives, once the standard-bearers of this relationship, show no interest in picking up that flag if they defeat Labour in upcoming elections. Douglas Hague, the senior Tory official on foreign affairs, said on March 11 Labour had been slow to recognize the sea change in global geopolitics. He said Britain had to "acknowledge that a vast proportion of the world's economic activity, followed inevitably by its political weight, has moved in recent decades beyond the confines of Europe and North America.

This tension has real-world implications. Britain's storied talent for applying diplomatic putty to the cracks in U.S.-European affairs has been exhausted, its politics making such efforts painful to its government, and the rest of the EU a good deal less susceptible to its charms than in the days when the Anglo-American model was all the rage. U.S.-British ties will continue to drift at least until the next government is seated, and while politics may be dictating what both sides say about Washington at the moment, there is not much in current British political discourse to suggest London is ready to resume its role as trans-Atlantic interlocutor.

Toil and Trouble

The mutual interests that encourage high-level policy coordination between Europe and the U.S. (as well as Japan, Canada, New Zealand, Australia and any number of other like-minded states) are at no risk of disappearing. At any given time over the past five decades, one or another of the bilateral relationships that exist under the "trans-Atlantic" umbrella were dysfunctional – U.S. disagreements with France and Germany in the run up to the Iraq War in 2003 stand out as a prominent recent example. By and large, the broader strategic value of what used to be called the North Atlantic Community remains great, though its primacy is waning. Economically, politically and even culturally, Europe and North America writ large continue to judge the occasional diplomatic annoyances and tiffs at the margins to be well worth bearing.

But this rested largely on the logic of a world whose agenda was shaped predominantly by the G-7. Now, it is clear both sides have started to recalibrate the value of the old trans-Atlantic link in light of a very different world. For Europe, a debate is beginning over its future role and influence in the world, with some suggesting the EU should carve out a larger version of the "bridging" role Britain played for years, harnessing America's power for Europe's interests; most appear to prefer to stay the "soft power" course, steering clear of the big policy fights (with Russia over Georgia, China over Taiwan, Cuba over human rights) that Washington still pursues.

For the United States, Europe will likely remain a valued diplomatic partner, even if its diplomatic relevance is increasingly based on the UN Security Council vetoes apportioned out to it in the U.S.-

designed international architecture of 1945. Even with those cards, Europe's word in Washington does not carry the weight it did as recently as the late 1990s, and the irresistible temptation to downgrade relations in favor of Asia will get more rather than less obvious. The U.S. calculation in this regard appears to be simple: In the 21st Century as it is currently unfolding, Europe needs us more than we need Europe. So let Europe adjust.

Document 2

America's Public Debt: The Least of Our Worries 26 February 2010

by: Mark Weisbrot | The Center for Economic and Policy Research

Various political demagogues and Wall Street interests have mounted a campaign to convince Americans that despite persistent massive unemployment for the foreseeable future, more than 15 million people underwater on their home mortgages, and two unnecessary wars, what we really should be worried about is America's national debt.

It doesn't help that most of the media pretends not to understand the basic economics, accounting, or arithmetic of the issue. Let's start with the economics: the Obama administration forecasts unemployment of 10.0, 9.2, and 8.2 percent, respectively, for 2010-2012. The rate does not fall to the 5.2 percent rate it considers full employment until 2018.

The difference between 10 percent unemployment and 5.2 percent is more than 7 million people without jobs. And that doesn't count the increase in millions of people involuntarily working part time, or millions who leave the labor force because they can't find work.

This is unacceptable in any civilized society; but even more outrageous in the world's richest country. It means millions of ruined lives and permanent scars that will persist for years and possibly decades -- in the form of increased poverty, lower educational levels, mental illness, suicide, crime, and other social ills.

This means that our government's stimulus package was too small, which fits with the data: in 2009, taking into account the spending cuts and tax increases of state and local governments, it was less than one percent of GDP. That is why the stimulus is estimated as having saved about 1.6 to 2 million jobs, whereas we are down about 8.5 million jobs since the recession began.

Bottom line: we need more stimulus, not less; this is not the time to be worrying about deficits or national debt.

It is clear that there is no short-term problem with running large deficits in a weak economy: investors are buying up even long-term U.S. Treasury bonds at remarkably low real interest rates. Clearly the markets do not perceive that our government is heading into risky territory with its debt. Interest payments on the debt are currently just 1.4 percent of GDP.

For the long term, as the CBO has emphasized, the vast majority of the deficit and debt problem is just rapidly-rising health care costs. Of course, we could be like other developed countries and have universal health care, and pay about half of what we are now paying per person. That is the average for the other high-income countries. This would take care of our long-term federal debt problems.

Another significant contributor to our long-term debt is the military. On an annual basis, we spent 5.0 percent of GDP on just the Defense Department budget last year. Before 9/11, the CBO had projected just 2.4 percent for 2009. The difference is more than twice the long-term shortfall in our Social Security system, and it is based on an understatement of military spending. Maybe we need to focus on protecting our airports from already existing terrorists rather than recruiting more by occupying foreign countries. Maybe we don't need hundreds of military bases all over the world.

But thanks to the power of what President Eisenhower famously named the "military industrial complex," President Obama has exempted the military from any spending freeze. Thanks to the two most powerful lobbies in Congress -- insurance and pharmaceutical -- getting health care costs under control is still a distant dream. And then there's the people who make the nation's major economic decisions and actually brought us this mess - Goldman Sachs and their Wall Street friends: they want to put Social Security on the chopping block to pay for their crimes (and bonuses).

Anybody see a pattern here? It's not the debt that threatens our future.

Document 3

Cutting now or later: Making sense of the debate on UK government debt

Simon Wren-Lewis 26February 2010

How fast and how soon should UK government debt be cut? This column argues that recent debate on this issue contains as much agreement as disagreement. Many economists now believe that fiscal councils could provide an institutional solution to fiscal policy difficulties.

Cut the government's budget deficit now or cut it later? Economists disagree, again! However, behind the headlines highlighting differences, there is a good deal of agreement. Furthermore, there is a growing consensus among economists in favour of an institutional change that could help resolve disagreements on this issue, or at least allow them to take place at a deeper level than the letters pages of national newspapers.

There is almost universal agreement that UK government debt should not stay at current or projected levels for too long. It should come down. The disagreement is when and how quickly it should come down. Understanding these disagreements requires understanding why UK government debt needs to come down.

The dangers of debt

One intuitive reason is that higher government debt requires higher taxes to pay the interest on that debt, and higher taxes are damaging because they are distortionary. However, we also have to take account of the fact that taxes will have to rise to bring debt down. Indeed, any given reduction in debt requires tax rises that are far greater than are required to pay interest on it, although obviously such large tax increases will be temporary and not permanent. Standard smoothing arguments apply to this intertemporal trade-off, suggesting that we are better off leaving debt where it is rather than bringing it down. This is the random-walk steady-state debt result, and it applies in the same way if we use cuts in spending rather than higher taxes to reduce debt. (See Kirsanova **et al.** 2009 for further discussion.) We might want to modify this principle for intergenerational equity reasons, but this analysis does illustrate the costs of reducing debt rapidly, and why debt should be regarded as a useful buffer and not a rigid target.

The reason most often given today for reducing UK government debt is the danger that those buying the debt will start requiring a significant interest rate risk premium, because of worries that the UK might default. This is what is happening to Greece and other small Eurozone economies. There are three important points to make about this concern. First, markets at the moment do not think there is any serious possibility that the UK will default. The UK government is not paying a significant premium on its borrowing. Second, the possibility of default depends mainly on politics, not economics. There is plenty of scope for higher taxes or lower spending in the UK – the key issue is whether politics will allow either. In this respect, the UK has a system of government that looks much more decisive than, say, the US, and an electorate that is much less resistant to government austerity than in, say, Greece. But third, you cannot trust markets to get risk assessments right, as we all found out to our cost in the credit crunch.

This means that even those arguing for cuts later rather than cuts now should not discount the possibility that the markets could suddenly grow reluctant to buy UK government debt. The key question is whether we can deal with this problem if and when it happens or whether we should try and minimise the chances it will happen by acting now. This discussion should include consideration of measures that would help bring down debt without immediately hitting demand, such as announcing a future increase in VAT.

A second reason debt should come down is that, in the longer term, high government debt may crowd out investment in capital, reducing UK prosperity. Unfortunately, macroeconomists have no idea how big this effect is. But what we do know is that this effect works through higher interest rates, so at the moment it is not a problem. Anyone who tells you that government borrowing is currently crowding out private investment needs to rethink their macroeconomics.

A final reason debt should come down is a lesson we should draw from the last two years. The zero lower bound for nominal interest rates generates an asymmetry for countercyclical fiscal policy. In a severe downturn, we want to be able to use fiscal policy to support demand, but in a boom we are happy to leave demand management to monetary policy. As a result, we want debt low enough to give us the capacity to use fiscal policy to combat a sharp negative shock, without having to be limited by issues involving default. Arguably, both in the UK and the US, more could have been done to mitigate the recession using fiscal policy if we had not started with significant structural deficits.

The merits of waiting vs the problem of deficit bias

All these problems could be solved by a credible medium-term programme to reduce debt. All our letter writers agree on this. And all should agree that cutting spending now will reduce UK output at a time when the UK recovery has hardly begun. So why not wait until the recovery is well under way before starting to reduce government debt?

For some, I suspect worries over debt represent a political opportunity to reduce the size of the state. But for others, the problem may be a concern that once the recovery starts and budget deficits begin to decline because tax receipts rise, the political momentum to reduce deficits further will be lost. And these fears are not without foundation. Even before this recession, the last few decades have seen government debt in the OECD area roughly double, without any justifiable economic cause. This is the problem of deficit bias. Politicians appear to believe they get more credit for cutting taxes or increase spending than the reverse.

Do we have to risk the recovery to avoid this happening in the UK? Ironically, the UK political party pushing early cuts is also the party that has proposed an institutional solution to this problem of deficit bias. Many economists now believe that fiscal councils, which are government-funded-but-independent watchdogs that would monitor and advise on the state of public finances, are the way forward in preventing this trend rise in public debt (see most recently Besley and Scott 2010, but also Kirsanova **et al** 2007 for a detailed proposal for the UK.) Fiscal councils have recently been established in a number of countries including Sweden, and the Conservative's Office of Budget Responsibility could be the UK's Fiscal Council.

The details of exactly how a UK Fiscal Council might operate remain open, and examples from other countries differ substantially. However, it would be odd, given the level of expertise that such a council would have to develop, if it did not form a view about the issues discussed above. It is also vital that the council should be seen as politically independent. This raises an interesting question. If the Conservative Party does win the election, will its Office of Budget Responsibility be independent enough to give its own advice in the cut now or cut later debate, advice that could differ from the current party line?

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Document 4

Why the IMF should be involved in solving imminent fiscal debt crises in Eurozone countries

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The escalation of the fiscal situation in Greece has highlighted the problems of the Eurozone to deal with such crises. The reaction of EU countries up to date has appeared erratic and urgently needs clear, sustainable and credible direction (Baldwin and Wyplosz 2010, Cavallo and Cottani 2010).

Interest rate spreads on Greek government bonds have risen considerably (Attinasi et al. 2010), and rating agencies have downgraded Greece. However, judging from economic fundamentals, there appears to be no imminent danger of a sovereign default. Notwithstanding the rapid rise in the fiscal deficit and total government debt, interest rates and interest payments in relation to total fiscal revenues are still relatively low compared to the early 1990s. Still, there is the danger that financial markets get more nervous and that a self-fulfilling spiral is set in motion with continually increasing spreads, rising debt burdens, higher risk perceptions and again higher interest rates.

Beside these pressing concerns, we uncover the more fundamental policy problems in a new research paper (Busch et al. 2010).

Dysfunctional institutional framework for dealing with fiscal crises

To put it bluntly, the institutional architecture of the Eurozone for crisis prevention and crisis intervention appears dysfunctional. The first pillar to avoid moral hazard in fiscal affairs in the Eurozone countries, the Stability and Growth Pact, has been weakened in 2005 (Deutsche Bundesbank 2005) and was unable to prevent the fiscal profligacy of Greece. The second pillar, the "no-bailout clause" of Article 125 of the Treaty on the Functioning of the European Union (formerly Article 103 EC-Treaty), has lacked credibility from the outset. Both suffer from the problem of time inconsistency. No matter how often you have told your friend to learn swimming and to rely on his own in case of danger, if he is drowning, you will run to help him.

A Greek sovereign default is, politically, unimaginable. Moreover, this would entail severe collateral damages. Contagion could spread to Portugal, Spain, Italy, and Ireland, countries that, like Greece, suffer from a combination of fiscal strains as well as losses of international competitiveness (Matthes 2009). And no less important, the balance sheets of European banks and insurers would suffer considerable losses on government bonds of the respective countries– which could significantly aggravate the distress in financial markets again. Thus, any affirmation not to help Greece in case of need is simply not credible.

The no-bailout clause was called into question all the more by the vague announcements of possible assistance schemes for countries in danger of default. These were initially made in February 2009 by the then German finance minister and some prominent EU representatives in the wake of rapidly rising interest rate spreads on government bonds of some the Eurozone countries. They have been re-iterated in recent weeks by EU governments without spelling out the details of a resolution plan. Before this renewal, however, European officials had appeared to retreat from these promises and had put into question the availability of the protective shield – often by referring to the alleged relevance of the no-bailout clause (Financial Times 2010). These see-saw changes together with the vagueness of the possible assistance scheme clearly demonstrate that the Eurozone lacks an institutional mechanism to deal with an imminent fiscal crisis in a member state.

Many reform proposals suffer from the same time inconsistency problems

This stand-off urgently requires ground-breaking reforms. In fact, many proposals have already been tabled (e. g. Johnson 2009, Mayer 2009, and The Economist 2009), among them strengthening the Stability and Growth Pact, interfering with the sovereignty of a country in crisis, a bailout with ex post conditions or based on ex ante conditions, and the foundation of a European Monetary Fund. All of these suggestions, however, which rely on the Eurozone to solve its problems internally, will eventually suffer from the same time-inconsistency problems as the no-bailout clause and the sanction threat of the Stability and Growth Pact.

Political vulnerability of European integration is the root of the problem

The basic reason for the time inconsistency problem lies in the political and cultural vulnerability of European integration. The historical geopolitical motivation for EU integration to secure peace among formerly war-torn countries has gradually receded over time. It has made way for a more egocentric approach of many Europeans who tend to focus on their own economic advantages from EU-integration. Furthermore, due to the ever increasing scope of EU regulations, the image of Brussels has suffered over time.

Under these preconditions, the envisaged strict enforcement of fiscal austerity in Greece by the European Commission brings with it the danger of pulling the rug under the feet of the bureaucrats in Brussels. In other words, strong political resistance could arise against the European Commission - and may be also against Germany where traditionally the hawks of European economic stability and the guardians of fiscal austerity are said to reside. The strikes in Greece and other countries against deep but necessary reforms do not bode well in this respect. Moreover, strictly disciplining Greece (and possibly other Mediterranean countries) would potentially deepen the political and economic cleavage between northern and southern the Eurozone-countries and could eventually even incite cultural animosities. Together these potential effects pose a considerable threat to the spirit of European integration.

A dilemma arises in the face of foreseeable political resistance in Greece. Either the EU risks EU coherence or – facing such an imminent threat - EU-institutions retreat from strictly enforcing fiscal adjustment in Greece, so that the issue of moral hazard would re-emerge with full force.

The IMF as a scapegoat and credible disciplining force

As a result, an external solution appears more appropriate. The IMF is in an appropriate position to take on this task – in the short term with regard to Greece, but also more formally as a general institutional reform that would require the Eurozone countries to rely on the Fund in case of imminent default. This suggestion, which initially was put forward by the Cologne Institute for Economic Research already in March 2009 (Huether 2009), can be supported by several arguments:

- The IMF is well specialised in crisis resolution and fiscal stabilisation.
- The Fund is used to and institutionally strong enough to play the role of an external scapegoat. There would be no lack of credibility because the IMF is required by its statutes to impose and enforce reform conditions (conditionality).
- The threat of an eventual intervention by the IMF with a strict adjustment regime will reduce the moral hazard problem in fiscal affairs. Thus, this institutional innovation could become a substitute for and preserve the spirit of the no-bailout clause. Moreover, it is likely that the fear of the IMF can effectively strengthen the Stability and Growth Pact which is still badly needed to provide a framework for fiscal surveillance.
- Politically, drawing upon the IMF can even promote European integration, because the EU and the Eurozone countries could play a constructive role in providing co-financing.

Several arguments, which have been raised against calling in the IMF, can be qualified:

- It is sometimes said that the IMF can only help a country with a currency of its own. However, the Fund has already provided financial assistance for countries in other currency unions (Hagen 2009).
- Some observers see the problem that the IMF's usual conditions concerning monetary policy would interfere with the ECB's independence. Yet, in the case of Greece, monetary policy prescriptions appear to be dispensable. There is no need to stabilise an independent currency by raising interest rates. Furthermore, the required reforms concern other policy areas such as fiscal policy but also wage policy and deregulation issues. Limiting wage increases would also contain potential inflationary pressures which are, however, unlikely to become strong in the short to medium term due to the manifold adjustment needs in Greece.
- EU treaties, it is said, would not allow the IMF to bailout a Eurozone country because the Fund uses financial means from central banks of Eurozone countries. However, this use is only indirect and - different from direct financing government expenses by a Eurozone central bank – the IMF's financial assistance is conditioned on reforms. In addition, the part of the IMF's finances originating from the Eurozone central banks is only limited.
- Calling in the IMF is considered as a severe political weakness of the Eurozone which insists on solving its problems by itself, as has most recently been suggested at G7 summit in Canada. To a certain degree this is surely true. However, having been strongly criticised particularly from the US, the self-confidence of the Eurozone may be too low despite the fact that the first ten years of the euro were rather successful. Moreover, hardly any critical voices were heard when the IMF intervened to help Hungary, Latvia, and Romania.

Weighing the political arguments, the slight damage to the image of the Eurozone appears much less grave than the dangers for European integration which would arise if the Eurozone tried to sort out the problems on its own. Therefore, it appears reasonable to formally involve the IMF in the resolution of potential fiscal crises in the Eurozone countries.

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