

UC Berkeley

Berkeley Planning Journal

Title

Restraints on European Recovery Structural and Ideological Impediments to Reviving Greece and the Eurozone After the Crisis

Permalink

<https://escholarship.org/uc/item/5qp043dk>

Journal

Berkeley Planning Journal, 23(1)

Authors

Potts, Shaina
Montero, Sergio

Publication Date

2010

DOI

10.5070/BP323111437

Copyright Information

Copyright 2010 by the author(s). All rights reserved unless otherwise indicated. Contact the author(s) for any necessary permissions. Learn more at <https://escholarship.org/terms>

Peer reviewed

Restraints on European Recovery Structural and Ideological Impediments to Reviving Greece and the Eurozone After the Crisis

By Shaina Potts and Sergio Montero

Since October 2009, the Greek sovereign debt problem has spiraled into crisis. By the end of last year, Greek national debt stood at 115% of GDP, and the deficit had been revised up from 6-8% to 13.6%. On April 27, 2010, international ratings agencies decreased Greek bonds to junk status. On May 1, Greece agreed to a series of austerity measures that convinced the previously reluctant Germany to support a bailout package for Europe but also set off massive strikes throughout Greece. An initial 110 billion euro bailout was replaced days later with a 750 billion euro (\$100 trillion) bailout of which IMF will provide 250 billion euros and EU institutions the rest. Even this news did not prevent stock market drops worldwide. Spain too lost its AAA credit rating at the end of May, further fanning fears that the crisis could spread to the rest of Europe.

Unfortunately, Greece faces two major obstacles to taking a truly proactive approach to recovering productivity. First, as a member of the Eurozone, which takes monetary policy out of national hands, Greece is unable to use monetary and fiscal measures in ways traditionally applied in such a situation. Second, this structural difficulty has been further exacerbated by the prevailing ideological approach to the European debt crisis, which has been framed in terms of restoring international creditworthiness and protecting foreign creditors, rather than in terms of ensuring employment and basic social needs for citizens.

Greece is far from the only country with budget troubles in Europe. The European Commission officially limits its member states to deficit-to-GDP ratios of 3% and debt-to-GDP ratios of 60%, but these limits have been exceeded by almost all of the 27 EU nations including Germany and France. As of late 2009 when the Greek troubles first hit headlines, Ireland and the UK were running deficits of 14.3% and 11.5% respectively and debt-to-GDP ratios of 64% and 68%. The problem has also been especially pronounced along the continent's Southern rim. Spain, Portugal, and Italy have all been facing financial difficulties, with deficits in late 2009 of 11.2%, 9.4% and 5.3% respectively and debt-to-GDP ratios of 77%, 53% and 116%. This division within Europe has actually been exacerbated by the recent success of the region's healthiest economies. In particular, Germany's strong manufacturing position has made the euro too high

for weaker economies like Greece and Portugal, and as we shall see, this shared currency has made dealing with the crisis all the more difficult.

Of course, in addition to the many systemic causes, each country has taken its own particular path to high debts and structural deficits. The Greeks have actually been on a high deficit model since the restoration of democracy in 1974, necessitated by the weak economic productivity of its private sector. After Greece joined the EU, European regional funds helped build transport, education and health infrastructure in the country and created construction and administrative jobs. In exchange, highly competitive German, British and French firms took advantage of the European single market and the low competitiveness of Greek firms to increase their presence in the appealing Greek market. During the early 2000s and with the prospect of the 2004 Athens Olympics, Greece saw its construction sector expand and house prices soar driven by both public and private demand. The introduction of the euro in 2002 and its associated low interest rates made the housing market more attractive for investment especially in Southern European countries where people were used to interest rates over 10%. The generalization of low-cost flying in Europe, facilitated by companies like Ryanair and EasyJet, also made it possible for Northern Europeans not only to fly more cheaply to Spain, Italy or Greece for a holiday, but also to actually own a second house in these countries.

The construction bubble carried Greece through the early 2000s together with other European countries. Interestingly, most of the EU countries with the highest budget deficits in 2009-10 are precisely those that experienced massive construction booms and busts in the 2000s, including Spain, Ireland, Portugal, the UK, and Greece. The legacies of these construction booms have transformed urban landscapes and demographics across Southern Europe and the British Isles. During the 2000s, for instance, it became normal for Spain to build more houses than Germany and France together. In certain years, construction came to represent almost 20% of the Spanish GDP, which allowed Spain to grow at double, sometimes triple, the rate of Germany throughout the decade. This attracted a large number of low-skilled immigrants to Spain who themselves became trapped in the Spanish housing bubble by buying houses in urban areas and tourist destinations throughout the country. By 2007, the percentage of construction in total employment had risen to 13% in Spain, 12% in Ireland, 10% in Portugal, and 8% in Greece, Italy and the UK, while the percentage in Germany was 5%.¹

Greece also showed higher than average growth rates for the EU throughout 2007. But the crash hit Greece especially hard. In addition to devastating two of the country's largest industries, shipping and tourism,

1. OECD Stat Extracts, available at <http://stats.oecd.org> (accessed August 3, 2010)

rising borrowing costs around the globe made it even more difficult for Greece to finance its large debts. Systemic government corruption made the situation worse, and tax evasion deprived the state of billions of euros per year. The uproar exploded at the end of 2009 when it was discovered that the previous government had been paying Goldman Sachs and other banks large fees to hide the country's true deficit levels from its EU overseers. In 2009 the country's growth rate turned negative for the first time in over a decade.

Since early 2010, Greece and other European countries, including Spain, Ireland and Portugal, have passed a series of heavy austerity measures designed to reduce budget deficits in order to convince the EU to extend aid and the rest of the world to continue buying European bonds. Greece's \$40 billion austerity package, approximately 13% of the Greek GDP, involves raising the retirement age and slashing pensions and public sector salaries by up to 20%. Similar measures have been introduced in Spain and Portugal, and in all three countries people have responded with massive protests. On May 20, more than 20,000 Greeks marched through the streets of Athens as unions called the fourth general strike this year. Schools, government offices and tourist sites were closed, and ships were kept in port or prevented from docking. In Spain, the past few months have seen protests in over a dozen cities as unemployment has risen to over 20% with construction workers, immigrants and young people among the most affected.

As these protesters and many analysts have argued, such harsh austerity measures will most likely hinder rather than help economic recovery. Since the Great Depression, different situations have demonstrated the virtues of running a budget deficit in a moment of economic stagnation and lack of confidence of the private sector. In contrast, few successful stories have followed IMF fiscal austerity recipes and harsh budget cuts either in the developed or the developing world. As economist and Nobel prize winner Joseph Stiglitz has argued, policy makers should focus on long term national debt and not on short-term budget deficits since "[public] spending, especially in investments in education, technology and infrastructure can actually lead to lower long-term deficits."² Yet austerity measures are currently being widely touted as the only solution. IMF policies and the same voices of fiscal austerity that failed in solving the Asian financial crisis in the late 1990s have re-emerged in 2010 in Southern Europe, trying to transform the global financial crisis into a budget crisis, thus moving responsibility from financial markets to governments. This approach calls for more fiscal austerity and improved international creditworthiness as opposed to tackling unemployment or

2. Joseph Stiglitz. 2010. The Dangers of Deficit-Cut Fetishism, published at The Guardian (<http://www.guardian.co.uk/commentisfree/2010/mar/07/deficit-fetishism-government-spending>, accessed August 3, 2010)

regulating the predatory lending practices that have resulted in massive foreclosure in the US and around the world. As Paul Krugman points out, “we’re told we can’t afford to help the unemployed, that we must get budget deficits down immediately.”³ Meanwhile, Karl Otto Pöhl, former president of the German Central Bank from 1980 to 1991, suggests that the Greek bailout was designed to protect German and French banks from possible debt write offs. He notes that after the rescue package for Greece was agreed on, “shares of French banks rose by up to 24 percent.” He further argues that the bailout was really about “rescuing [French and German] banks and the rich Greeks.”⁴ Europe and the IMF actually agreed to not even discuss the possibility of restructuring Greek debt, which would have shifted some of the burden from the Greek populace to the international bankers that made the bad loans in the first place.

Despite Obama’s pitch at the June 2010 G-20 meeting in Toronto calling for continued stimulus measures to prevent a new global economic downturn, most Western European leaders have announced steep deficit reductions by 2013. Conservatives around the world, with the support of their preferred media, have seized this opportunity to attack the very idea of the welfare state, arguing that this crisis is proof that what has long been seen as the European social model cannot be sustained. It is the possibility that such arguments will gain more traction that may well be the most dangerous legacy of the European debt crisis. For instance, in February 2010, after several apocalyptic editorials and articles about Spain’s budget deficit in British international media, Spanish Economy Minister Elena Salgado flew to London to meet with executives of the *Financial Times*, *The Economist* and other opinion leaders of the City of London to defend Spain’s economic policy and, literally, promise that the Spanish deficit will be lowered to 3%.

Unfortunately, in addition to the imposition of fiscal austerity as ideological recipe for stagnant European countries, there are further structural reasons why Greece—and other Eurozone countries—will endure more pain than would, for example, either the US or the UK in the same situation. Both those nations can manipulate their own currencies and coordinate fiscal and monetary decisions in a way that Greece cannot. For those within the Eurozone, the euro is essentially a fixed currency whose production is controlled by the European Central Bank (ECB), and participating states are thus deprived of several methods for alleviating financial crises. Greece cannot print its own currency to inject money into the system as the US did after the financial collapse. Neither can it use inflation to reduce the real value of its euro-denominated debt.

3. Paul Krugman. 2009. *The Return of Depression Economics and the Crisis of 2008*. New York: W.W. Norton & Company

4. Spiegel Magazine <http://www.spiegel.de/international/germany/0,1518,695245,00.html> (accessed Oct 5, 2010)

In fact, austerity measures will probably make debt repayment even harder by slowing the Greek economy and causing deflation. Greece also cannot use currency devaluation to make its export economies more competitive, a classic crisis response though at best an ambiguous one when a significant amount of debt is held abroad.

This inability to control monetary policy is just part of a more general problem of the separation of fiscal and monetary powers in the Eurozone - a separation that has been based on a broad acceptance of the monetarist tenets of economists like Milton Friedman and his followers, who see money as a neutral force that can be treated as separate from the "real" economy. In fact, a government's fiscal and monetary policies are normally deeply interconnected. The creation of the Eurozone, however, has had "the effect of further severing the fiscal and monetary connections in the 'social relations of production' of the euro and of subordinating the fiscal to the monetary."⁵ The use of a single currency for 16 countries means that one monetary policy is essentially applied to multiple countries that actually have very different needs. As noted above, Germany's current economic strength has caused major problems for weaker economies in the EU recovering from the burst of the housing bubble. And this shared currency has meant that countries like Greece cannot use monetary policies in conjunction with their fiscal programs to help mitigate crises. Simultaneously, because the ECB has no political sovereignty, it cannot impose real fiscal guidelines on member states. The location of the ECB headquarters in Frankfurt only exacerbates a situation in which EU monetary policies are geared more towards German economic cycles than to those of peripheral Mediterranean countries.

The challenges to EU coherence, which the Greek debt crisis has made visible, are institutional and political but also ideological. With accusations of Greek indolence and corruption flying, national rivalries within the EU have made it difficult to coordinate any response to the crisis. How the EU will deal with the split between monetary and fiscal powers that the euro necessitates is far from clear. Many believe that either the euro must fall or the EU must learn to share further political powers. But perhaps the more fundamental question for citizens in Greece and all over the world is whether the conversation can be turned away from protecting international creditors and back to ensuring productivity, employment and social services for all.

5. Ingham, Geoffrey. *The Nature of Money*. Polity Press, 2004: 190.