BUILDING A SUSTAINABLE POLITICAL ECONOMY: SPERI RESEARCH & POLICY

CRISIS IN THE EUROZONE PERIPHERY

The Political Economies of Greece, Spain, Ireland and Portugal

Edited by OWEN PARKER
and DIMITRIS TSAROUHAS

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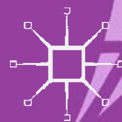

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Crisis in the Eurozone Periphery

The Political Economies of Greece, Spain, Ireland and Portugal

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CHAPTER 1

Causes and Consequences of Crisis in the Eurozone Periphery

Owen Parker and Dimitris Tsarouhas

Abstract This volume considers the political economy dynamics that both caused and were precipitated by the Eurozone crisis in four of the hardest-hit so-called periphery country cases—Ireland, Spain, Portugal and Greece. This introduction focuses on the broader structures that underpinned the Eurozone crisis, whereas the chapters that follow zoom in on domestic cases. It argues that a single currency designed in accordance with neoliberal 'efficient market' ideas was at the heart of the crisis, exacerbating dangerous economic divergences between a so-called core of creditor states and periphery of debtor states. Responses to the crisis were, it is suggested, premised on the very same neoliberal ideas and made matters worse for a struggling 'periphery'. More effective responses exist in theory, but are politically difficult in practice.

Keywords Eurozone crisis • Core–periphery • Asymmetries • Austerity • Neoliberalism

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A separation or divergence exists in the Eurozone between those member states—generally 'creditor' or 'surplus' states—that have weathered the financial and economic crisis since the late 2000s relatively well, and those states—generally 'debtor' or 'deficit' states—that have experienced the most upheaval economically, socially and politically in the context of that crisis. The imbalances between debtor and creditor states predate the crisis, as we will show in this chapter. However, the crisis has cast the relationship between the two categories of state in a new light that renders the 'core–periphery' concept increasingly pertinent.

First deployed by various post-Marxist development theorists, the concept denotes not only an imbalance but also a power relationship within global capitalism between an economically and politically dominant wealthy core—often led by a large hegemonic power—and a largely poor, dependent periphery (Wallerstein 1974, 1979). The use of the concept in relation to the European Union (EU) or Eurozone in the aftermath of the crisis can be understood as denoting a similar kind of dynamic, as we will discuss in what follows. A wealthy core led primarily by Germany has, according to such a narrative, guided the response to the crisis in ways that preserve or even exacerbate economic imbalances between a core and periphery, making the latter supplicant to the former. Such a narrative may be partially true, particularly in relation to certain periphery states that have found themselves forced into a harsh austerity politics in the course of the crisis. But it is probably to overstate the power of core states and understate the economic, political and social divisions *within* states on both sides of this divide. As we will suggest later—and as the authors elucidate in greater detail in the following chapters—important elite actors cutting across both the public–private and the core-periphery divide were collectively culpable in precipitating the crisis. And while those in the periphery countries certainly suffered the most, lower social classes in the core also encountered, and continue to encounter, significant hardship.

As the title of this book indicates, we focus here on the impact of the crisis in the 'Eurozone periphery' and, in particular, on those Eurozone states that have been most severely afflicted and received so-called bailouts of one form or another. In the chronological order in which they were first granted loans, the countries that we consider are Greece (2010), Ireland (2010), Portugal (2011) and Spain (2012). Proving that they were capable of producing even more pejorative terms than 'periphery' to denote

this group of countries in economic distress, many working in the financial markets came to refer to them collectively by the moniker 'the PIGS' in the early 2010s. Slight modifications of the acronym were used, with Italy sometimes included in this group of 'problem states'; hence, PIIGS. We will, in contrast, purposefully use the abbreviation GIPS in what follows, to denote our four country cases.

The most obvious omission from the book, according to the logic by which these four countries were selected, is not Italy but Cyprus, as it was the fifth country to receive a bailout in 2012. A much smaller member state than those considered (with a population of little over one million), it nevertheless shared certain vulnerabilities with the other four (Trimikliniotis 2013; Michaelides and Orphanides 2016). Italy, as mentioned above, is the other notable omission. Also widely regarded as part of the so-called periphery given its status as a debtor state, it has struggled significantly throughout the crisis, particularly—like GIPS—in terms of refinancing its debt in the years after 2010. Moreover, ongoing weaknesses in its political and banking systems were a pressing concern at the time of writing in 2017. That said, unlike GIPS, Italy had not received a bailout as of that date.

Finally, we should acknowledge that there is another periphery beyond the Eurozone itself (Bohle and Greskovits 2012; Ryner and Cafruny 2017: 137–166). Although not all members of the common currency, a number of Central and Eastern European EU member states were hard-hit by the broader global financial crisis (GFC) and associated 'credit crunch'. In particular, Hungary and the Baltic states had particularly high and rapidly increasing levels of mortgage debt that led to significant economic crises and recessions in the late 2000s and, in the cases of Hungary (2008) and Latvia (2009), to International Monetary Fund (IMF)–EU bailouts.

In offering a close analysis in this book of four important countries at the heart of the so-called periphery, we are particularly keen to explore the domestic dynamics of crisis. The chapters highlight the interconnected economic, political and social dynamics within these states that made them particularly vulnerable to crisis and that guided responses to that crisis. The chapters also document the very real social and political effects of crisis. We should certainly not understate the agency of state-level private and public actors in fostering conditions that made these states particularly

vulnerable to the crisis, even if that agency would later become constrained in important ways as a consequence of collective responses to that crisis. At the same time, in considering GIPS together as part of a 'Eurozone periphery' that stands in contradistinction to a 'core', we are also suggesting that there are important structural factors that underpinned similar developmental trajectories. In particular, these states' collective imbrication in the EU and its common currency zone on similar terms were crucial. While the chapters will focus on the domestic particularities of the individual cases in some detail, this introductory chapter will focus largely on the similarities and the broader structural context of European and, in particular, economic and monetary integration.

The chapter proceeds in five steps. In a first, we consider the underlying causes of the crisis in the periphery, highlighting the central importance of growing levels of debt within the Eurozone and the growth in imbalances between (debtor) periphery and (creditor) core. We concur with an emerging political economy literature that the emergence of a 'sovereign debt crisis' from 2010 needs to be understood against a much broader historical backdrop (see, among many others, Matthijs and Blyth 2015; Ryner and Cafruny 2017). In a second step, we consider the particular structural importance of the single currency and the design flaws in the euro that precipitated the asymmetries at the heart of the crisis. We argue that a euro modelled on neoliberal 'efficient market' principles in a broader context of so-called financialization was always destined to be vulnerable. Third, we outline the responses of the EU to the crisis, which consisted largely of the imposition of austerity on increasingly dependent periphery states. We argue that such responses failed to deal with the underlying issues enunciated in the previous sections and, indeed, exacerbated the crisis, particularly for the periphery (such consequences are considered in greater detail in the chapters that follow). Fourth, we consider possible ways forward and the political difficulties inherent in achieving the far more radical reforms that might underpin a functional single currency and overcome the divisions (and social hardship) that growing economic asymmetries have fostered. Having offered this account of the political economy of the Eurozone crisis, in a fifth step, we offer an overview of the chapters that follow. As noted, in contrast to this introduction, the chapters that follow focus on the interconnected political and economic domestic factors have been key and will continue to be key in dictating how the structures described in this chapter are mediated in GIPS.

Growing Asymmetries Between Core and Periphery

While it was widely supported, including in France and Germany, European Monetary Union (EMU) imposed a single currency on what were distinct varieties of capitalism. Crudely, coordinated market economies in the core of Europe with strong traditions of wage coordination (and, crucially, wage restraint), vocational training, research and development and high productivity had long pursued export-led growth strategies (Hall and Soskice 2001). Southern periphery mixed market economies (as well as some liberal market economies—notably, for current purposes, Ireland) with weak wage bargaining structures, and lower skilled workforces had pursued demand-led growth strategies based on, inter alia, macroeconomic stimulus policies and job creation in non-traded sectors such as service and public sectors. These countries had been prone to inflation as a consequence of such strategies and before EMU had used exchange rate policies—devaluations of the currency—to offset the effects of this inflation on trade balances (Hall 2014; Regan 2013). France has oscillated between these models and in general shows elements of both, with wage restraint—based on statist interventionism rather than social partner involvement—and at the same time a large non-traded sector (Johnston and Regan 2016: 324).

EMU worked well for the core countries, allowing them to continue export-led growth rooted in wage repression, in a context where their major trading partners could no longer devalue their currencies. In the periphery, EMU seemed like it would require a shift away from demand-led growth strategies in the absence of currency devaluation as a policy tool and of a *national* central bank able to target inflation (and *real* exchange rates). But the much lower interest rates and greater capital mobility that the euro delivered for these countries offered an apparent way out of this difficulty (Johnston and Regan 2016: 321). Surpluses from the core were borrowed in the periphery, meaning that demand remained strong even in the absence of expansionary fiscal policy. Demand-led growth became underpinned by debt.

Thus, these two models were increasingly intertwined by virtue of monetary union (Regan 2013). Increasingly large capital flows from core countries—particularly Germany but also France, the Netherlands and others—moved to Eurozone periphery countries. While overall the Eurozone current account is more or less in balance—meaning that capital inflows are roughly the size of outflows with the rest of the world—Fig. 1.1

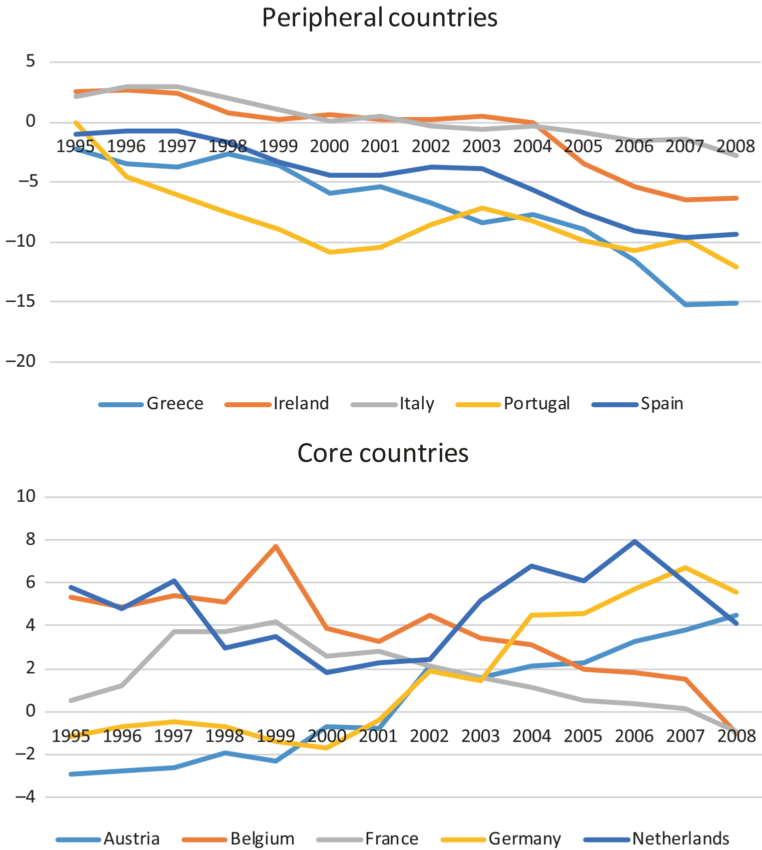

Fig. 1.1 Current accounts as percentage of GDP (Source: IMF-WO, with thanks to Luis Buendia for compiling)

shows that the divergence of flows between countries in the Eurozone is stark. Notably, all of the periphery GIPS ran substantial current account deficits, reflecting their net borrowing from those countries in the core running surpluses. We see that Spain was by far the largest net borrower and Germany the largest net lender. As noted, these capital flows reflected high rates of saving in the core and high rates of borrowing in the periphery.

Many economists did not see the emerging imbalances in the European economy as a significant issue in the early 2000s; they felt that the capital

flows were part of a broader pattern of economic convergence, whereby money pouring into the periphery would drive the economic development of poorer economies (Blanchard and Giavazzi 2002; Ryner and Cafruny 2017: 94–99). Crucially, however, against a backdrop of financial deregulation, much of the borrowed money in the periphery did not find its way into the productive economy, but into non-productive consumption and investment that did little to stimulate the export capacities of the periphery. Such intensified deregulation or financialization was a global phenomenon throughout the period, but one that was certainly facilitated by private and public actors including in domestic contexts in GIPS, as the chapters explore in greater detail.

Around the turn of the millennium, domestic demand and export competitiveness started to de-link in both the periphery and the core. In other words, money flooded into the periphery and boosted demand, but it had no impact on exports and the development of a productive economy. In fact, as the authors explore with reference to particular cases in the following chapters, this 'hot' money may even have had a negative impact on export growth to the extent that potentially productive investment was channelled into supposedly quick-win financial assets. Indeed, in many of the country cases under consideration, inflows stimulated domestic demand for both goods exported from the core and for property at home, which created financial bubbles that would eventually burst. Moreover, such hot money meant inflation—including high wages in non-tradable or non-export sectors such as service and public sectors (Johnston and Regan 2016: 324; Hopkin 2015)—in the periphery, which further undermined export competitiveness. This was particularly the case because, despite its export success, Germany kept wages and therefore its own domestic demand low. Indeed, demand and exports diverged in the opposite direction, with the former declining precipitously while the latter gradually rose.

Notably, while in the early 2000s, many were pointing to economic achievements in countries with high debt-led growth—there was, for instance, talk of 'a Spanish miracle' and Ireland was dubbed the 'Celtic tiger' (Ryner and Cafruny 2017: 92)—Germany was described as the 'sick man of Europe'. However, while speculative domestic demand and economic bubbles drove rapid growth in periphery countries such as Spain, apparently anaemic growth in Germany was driven by exports in a context of very weak domestic demand. Thus, even in the early years of the common currency, major structural imbalances were exacerbated by

the growing asymmetry between core and periphery. The underlying European growth model was comprised then of both debt-led growth in the periphery economies that permitted excessive spending—though, as the chapters will describe, without in most cases significantly addressing underlying inequalities or substantially developing social models—and low-wage export-led growth in the core, the proceeds of which were saved rather than spent.

In practice, then, capital movements into the periphery did little to address overall balance of payments imbalances as the aforementioned optimistic prognoses of the early 2000s had suggested they would. On the contrary, the asymmetries grew larger in the run up to the crisis. The Eurozone was characterized by a combination of a wage-cutting low-inflation core that actively enhanced its competitiveness and a periphery where demand was boosted by cheap money. As noted, this asymmetry was facilitated by financialization. In other words, by a transnational banking sector—and increasingly liberalized capital market—that fed core surpluses and savings to the periphery via increasingly deregulated and highly leveraged banks in both the core and periphery (Baldwin and Giavazzi 2015). In the crisis context, a broader neoliberal financialization model linked banks in the core to those in the periphery, with important implications for the response to the crisis. In turn, the economic fate of sovereign governments was fatally linked to this highly leveraged and indebted financial sector in both core and periphery as the crisis would reveal and as we discuss below.

Politically, both core and periphery states were content to overlook these imbalances as long as there was growth in the Eurozone. As we have suggested, Germany's dominant manufacturers essentially pursued a neo-mercantilist strategy based on wage repression that enabled the country to support and develop its export sectors. Such a strategy is perhaps unsurprising given the broader context of the costs of German reunification in the 1990s and ongoing efforts in the 2000s to reinvigorate export-led growth. Governments in the periphery states were content before the crisis hit, as long as debt-led economic growth continued to sustain (often weak) social compacts and the various asset prices upon which the tax-take became increasingly reliant. However, the imbalances ultimately proved unsustainable and, when crisis hit, irresolvable.

The underlying causes of such imbalances were, as noted, in large part, the processes of neoliberal financialization (Stokhammer 2016): a deregulation of finance and an associated shifting of capital into financial

speculation (at the expense of productive sectors). Such processes had been underway in Europe as in other developed parts of the world (and led by the USA) since at least the 1980s and intensified, first with the preparations for, and later with the realization of, EMU (Ryner and Cafruny 2017: 91–92; Jones 2015). Debt levels that we can associate with financialization ballooned in the period between the start of the single currency and the crisis. In the context of the GFC that started in 2007, such financialization was a direct cause. US mortgage defaults took place in a context of the 'securitization' (a form of financialization) of 'sub-prime' mortgage assets, which led to systemic banking failure in large global banks and prompted a global credit squeeze (the infamous 'credit crunch') and recession. In the context of the Eurozone crisis, the proximate cause appeared to be sovereign debt, but due to the aforementioned interlinked fate of financial institutions (banks) and sovereigns, we would argue that the underlying cause was, as in the USA, this broader financialization and associated indebtedness. Such indebtedness was itself dependent upon wage shares falling from the 1970s as part of a broader neoliberal turn (Bengtsson and Ryner 2015).

Regarding the first trigger for the Eurozone crisis, it was indeed the revelation in 2009 by the incoming Greek government that its predecessors had been concealing the true size of the country's budget deficit. As Chaps. 5 and 9 recount, cronyism and systems of public sector patronage were important factors in the particular Greek case that had seen a long-term increase in public debt and deficits. In light of these revelations, widespread concerns that its public debt might become unsustainable led the financial (specifically, sovereign bond) markets to offload Greek government debt and substantially push up Greece's borrowing costs, ultimately to unsustainable levels. Despite some reluctance and following substantial procrastination, Eurozone states and, crucially, Germany ultimately decided that the potential systemic effects to the euro of allowing a default were too great and stepped in with substantial financial support in 2010. This was not enough, however, to allay the fears of bond markets. Cutting a much longer story short, the spread on Greek government bonds (the cost of refinancing its debts) continued to rise, and the contagion effects meant that other states, particularly the most vulnerable ones in the Eurozone chain, began to feel the effects.

All Eurozone states were, following the effects of the GFC, running government budget deficits. But it was notably the sovereign bonds of peripheral states that had borrowed substantially from abroad (those with

the large *current account* deficits described above, namely, GIPS plus Italy) that were rapidly offloaded, pushing their borrowing costs to unsustainable levels. The market fears in all cases related to the sustainability of public financing, either because of high public debt levels or because of the fragility of domestic financial institutions that were likely to require government support. As discussed in greater detail in the individual chapters on GIPS, each of these countries would ultimately receive bailouts from a combination of the IMF, EU and European Central Bank (ECB)—the 'troika'—with significant strings attached and big political implications and effects.

Ultimately, the bailouts were not enough to allay concerns that the possibility of sovereign default was (despite a clause in the Maastricht treaty explicitly proscribing it) becoming ever more real. The second Greek bailout in 2011 included a write-down of debt by private investors that turned a fear of losses into actual losses and caused further market panic. In early 2012 both France and Belgium—notably, countries whose broader current accounts (see Fig. 1.1) saw them moving from surplus to deficit (or from core to periphery by that measure) in the late 2000s—began to experience the contagion effects when a Franco-Belgian bank, Dexia, was nationalized by the Belgian authorities. And in the same period Cyprus—whose banking sector was heavily tied to Greece—requested a bailout. It was interventions by the ECB that ultimately afforded some breathing space and, in particular, President Mario Draghi's now infamous declaration in July 2012 that, 'the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough'. Markets did indeed believe Draghi and sovereign bond yields in the Eurozone saw a significant convergence. The role of the ECB as an active policy entrepreneur, in the face of apparent reluctance by other major EU actors, was thus confirmed.

The Euro

The most obvious common thread connecting the periphery countries under consideration is their participation in EMU. The designers of EMU had chosen not to focus on the aforementioned differences in the varieties of capitalism in the Eurozone that underpinned the asymmetries that predated the single currency. Against the aforementioned backdrop of increasingly unregulated finance and liberalized capital markets, the design arguably exacerbated the imbalances that lay at the heart of the crisis and

meant that periphery countries were particularly hard-hit. It was EMU that locked-in German competitive advantages vis-à-vis the periphery, established an environment that made borrowing and growing indebtedness easier in the periphery, and (as noted above) facilitated the intensification of an already liberalized capital mobility from core to periphery.

The design of EMU was based on the prevailing economic ideas of the 1990s. These broadly neoliberal ideas were unsympathetic to active fiscal policy (demand management), promoted a monetary policy focused on controlling inflation (sound money) and pushed supply-side economics—wage cuts, flexibilization of labour markets and promotion of human capital—as the appropriate tool for increasing competitiveness and investment (McNamara 1998, 2006; Ryner and Cafruny 2017: 94–99). In accordance with these ideas, the key plank of EMU was a ECB whose mandate was solely devoted to sound money and a system of economic governance based on maintaining debt and deficit levels within certain limits (the Stability and Growth Pact). It was anticipated that states within the Eurozone would converge economically via the pursuit of broadly supply-side economic policies or so-called structural reforms, an approach that the later Lisbon agenda (2000) would broadly endorse. Indeed, for some, monetary union would 'discipline' states into making such reforms (for a critique of such ambitions, see Gill 1998). Such features of economic governance would, so it was thought, provide the credibility upon which the aforementioned liberalized and heavily diversified financial markets would efficiently allocate capital to the areas where it might accrue the greatest returns (Ryner and Cafruny 2017: 95–96). However, as noted above, capital in fact poured in to highly speculative rather than productive ventures in the periphery; indeed, a broader misallocation of investments by a finance sector with problematically short-term time horizons lay at the heart of the global crisis.

Certainly in hindsight, it seems clear that there should have been some serious doubts about these neoliberal ideas. In the event of growing divergences and asymmetries—and in particular sudden 'asymmetric shocks' (a boom or bust in different parts of a currency area)—it is politically inconceivable that difficult and socially deleterious supply-side policies could underpin economic adjustments. But in the context of a single currency and the absence of control of national exchange rate policy—currency devaluation is no longer an option—there is no alternative to turn to for national governments. EMU was politically popular for GIPS countries (and others) even though participation in the single currency