

# Watching the crisis of Eurozone from the European ‘periphery:’ causes and developments

John Milios and Dimitris P. Sotiropoulos

**Abstract:** Whatever the initial unwarranted optimism, the developments that followed the collapse of Lehman Brothers have struck at the heart of the euro, plunging into crisis the power strategies linked to it. The higher growth rates in the ‘peripheral’ European economies were accompanied by both a fast reduction in cost of domestic borrowing and a significant inflow of foreign investments (of various forms). This caused lasting surpluses in the financial accounts. The concomitant deficits in the current accounts mirror exactly this increase of the domestic demand and the inflow of foreign investments. While the imbalances in the financial accounts within the Eurozone and the expansion of the domestic banking systems offset the pressures imposed upon labor by the mechanism of the euro, they nevertheless shaped an unstable and vulnerable context of symbiosis which did not delay to come apart after the recent financial meltdown. In this context, fiscal consolidation and policies of recession are the only choice of the capitalist power if the neoliberal architecture of Eurozone is to be left intact.

**Keywords:** Euro, Greece, financial imbalances, crisis.

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## 1. Introduction

As has been asserted and also adequately analyzed elsewhere,<sup>1</sup> the crisis in the US housing market did not take long to be transformed into a global recession. The panic over the CDOs (collateralized debt obligations) of American banks immediately ‘contaminated’ – to use a word much favored of market analysts – a vulnerable world financial system. The problems that soon appeared, e.g. in the United Kingdom, Spain, Iceland, Ireland, Russia, Hungary, not to mention Greece, have little to do with the ‘toxicity’ of the specific American CDOs. To put it in the most general terms, capitalism internationally went into a phase of re-pricing of risk, with everything entailed by that process (that is to say into new arrangements for pricing financial instruments).

Whatever the initial unwarranted optimism, recent economic developments struck at the heart of the euro, plunging into crisis the power strategies linked to it. Above all, however, they left the Economic and Monetary Union (EMU) without a medium-term hegemonic plan in order to deal with the emerging debt problems and current account imbalances. Yet, there is something grotesque in the relevant discussions and the implemented economic policies that is worth mentioning: the medicine served is the same with the underlying cause of the crisis. And this does not only characterize the Eurozone. In a nutshell, if neoliberalism (which is accompanied by intensive labor exploitation, severe income inequalities, persistent current account imbalances and extended financial leverage) is responsible for the recent global economic recession, why do all mainstream responses insist in the same strategic course? In what follows we shall endeavor to interpret this apparent paradox focusing on the case of Eurozone.

One of the most noteworthy features of the first decade of the euro is the persistent current account imbalances: certain countries show chronic surpluses while others invariably suffer deficits. It is moreover true that these differences are linked, as has often been noted, to corresponding differences in unit labor costs and in competitiveness (the countries in surplus have kept unit labor costs down and derived advantages in terms of competitiveness). *Nevertheless*, the causality between these two ‘givens’ may not be what it is often casually asserted to be in the relevant discussions. The current account deficit, in other words, may *not be simply* the immediate result of a corresponding ‘deficit’ in competitiveness. On the contrary, it is quite probable that both will be the outcome of another deeper cause. Namely of the considerable differences in the levels of capitalist growth and of the specific mode of ‘symbiosis’ within the euro. Let us be more precise.

The symbiosis within the Eurozone of economies with different development potentialities under the same currency (and the same monetary policy) was responsible for the striking different rates of growth and profitability. The relatively fast growth of the ‘periphery’ (combined with the moderate growth in the European ‘center’) reduced remarkably the ‘developmental’ gap between European regions. At the same time, the higher growth rates in the ‘peripheral’ economies were accompanied by both a fast reduction in cost of domestic borrowing and a significant inflow of foreign savings (of various forms). This caused lasting surpluses in the financial accounts. The concomitant deficits in the current accounts, along with the

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<sup>1</sup> Lapatsioras et al. (2009).

mere deterioration of competitiveness despite the improvements in the productivity of labor, mirror exactly this increase of the domestic demand and the inflow of foreign investments.

The imbalances in the financial accounts and the expansion of the domestic banking systems offset the pressures imposed upon labor by the mechanism of the euro mostly in the economies of the European ‘periphery.’ In other words, they heavily contributed to the organization of the social consensus, consisting also an organic element of the particular form of intra-Eurozone symbiosis. Nevertheless, they also became a condition contradictory to the architecture of the Eurozone. At the same time, they shaped an unstable and vulnerable context of symbiosis which did not delay to come apart after the recent financial meltdown.

## **2. An outline of the strategy of the euro: what was all about in the first place?**

Present-day neoliberal capitalism has proved a nightmare for the proponents of protectionism. The same is true of the architecture of the euro. To understand contemporary developments in the organization of capitalism we are therefore required to free ourselves from every ‘mercantilist’ influence so as, hopefully, to achieve a persuasive interpretation of why developed and developing social formations are attracted – despite the reality of uneven development as it impinges on them – *to a strategy of exposure to international (economic) competition.*<sup>2</sup> In other words, why does the ‘undisturbed’ linkage to the global market comprise a strategic choice for social formations with different levels of development and competitiveness? Why should a capitalist social formation with a lower level of productivity ‘seek’ to enter into an economic and monetary union with more developed social formations? The answer is complex but is to be sought in the Marxist argument according to which, for the developed capitalist countries, the strategy of exposure to international competition (promoted on a variety of bases and with various divergences, depending on the corresponding national vested interests) is the strategy *par excellence* of capital.

The basic idea is simple and perceptively summarized by K. Busch (1978, 1985) in the context of more or less the same discussion, albeit in a different historical context. The key prerequisite for unimpeded capital accumulation is that there should be favourable conditions for valorization of capital, and capitalist competition is to be included among such conditions. A country that follows the neoliberal path but it is not organically integrated into global markets and inserts between its individual capitals and the global market significant barriers and controls of different kinds will not be able to achieve both high rates of capital accumulation and the deepening of capitalist class power over the working classes. In the contemporary conditions, the adherence to protectionism ‘endangers’ the favorable conditions for the valuation of capital. In this regard, if a capitalist country has entered into the phase of developed or developing capitalism, the route of exposure to international competition is the most appropriate strategy for organizing bourgeois power (as a model for continuing reorganization of labor and elimination of non-competitive individual capitals to the benefit of overall social capital).

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<sup>2</sup> For similar argumentation see Milios and Sotiropoulos (2009; 2010).

In the above context, the ‘plan’ of euro gradually came to embody a long-term strategy for management of European capitalisms, *predicated of course on introduction of a single currency*.<sup>3</sup> Member countries accordingly relinquished the exercise of autonomous monetary policy. It is in any case well known that liberalization of capital movement in conjunction with fixed exchange rates (or alternatively abandonment of the national currency) necessarily amounts to loss of control over monetary policy.<sup>4</sup> The procedure in question represents a certain way of dealing with what has come to be called the ‘trilemma’ of economic policy and amounts to an extremely aggressive capitalist strategy. In particular, the ‘needs’ of labor are sacrificed to satisfaction of the demand for capital mobility (i.e. capitalist competition) and exchange rate stability. Indeed the celebrated or notorious Delor’s report, which takes for granted and regards as ‘natural’ the specific power plan of the single market, saw monetary union as something self-evident and inevitable. In reality the institutional framework of the EMU is interpretable as systematic organization of the specific more general way of solving the policy trilemma.

This is an economic environment that crushes traditional welfare-state policies, imposing the harshest demands of capital over labor. The increase in productivity in relation to real income of labor (the ‘terms’ of labor, as it were) is the *variable that is called upon to bear the burden of adjustment* to new capitalist conditions and in particular to the environment of the EMU. From this viewpoint too, the age of contemporary neo-liberalism resembles the period of the gold standard.<sup>5</sup> What does this mean? It means that pressures from the functioning of the EMU are focused on the core of capitalist exploitation and create the preconditions for continual restructuring of labor. The EMU puts into effect an extreme variant of the strategy of exposure to international competition which only through continual ‘adjustment’ of labor can continue to exist. It follows from this that the EMU strategy is a specific mode of organization for capitalist power.

The above argumentation does not solely fit to the European capitalisms. Its spirit describes the nature of contemporary international capitalist organization.

### **3. The character of the symbiosis within the Eurozone: a view from the ‘periphery’**

The exposure to international competition that was effected through integration into the single currency imposed significant restructuring to the benefit of capital while simultaneously securing for the (less competitive) countries of the ‘periphery’ satisfactory rates of growth and a rise in average productivity. The data of Table 1 are indicative enough. In general terms these countries of the ‘periphery’ have gone a significant way towards closing the gap in per capita GDP that separated them from the more advanced countries of the European ‘centre’, registering higher rates of

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<sup>3</sup> Eichengreen (1997), Wyplosz (2005).

<sup>4</sup> See Bryan and Rafferty (2006), Obstfeld et al (2005).

<sup>5</sup> Characteristic is the analysis by Bryan and Rafferty (2006), and McKinnon (1993). We need to stress that similarities with the gold standard era are more significant than those one may recognize from a first sight. One has to go so back to the economic history in order to meet a liberalized financial system which is associated with monetary policies focusing on price stability. In this respect, all the macroeconomic models claiming that price stability can guarantee macroeconomic stability, profoundly ignored the previous historical experience which had well proved that severe financial crises are likely to occur after long periods of price stability.

profit, accompanied by correspondingly higher rates of capital accumulation.<sup>6</sup> At the same time, it is quite obvious that the high growth rates in the ‘periphery’ led to higher domestic demand and inflation levels there (indicative are the cases of Greece, Spain, and Ireland).

**Table 1**  
Change [%] in GDP and domestic demand in *real* terms  
for various countries during the period 1995-2008

	Greece	Germany	Italy	Spain	Holland	Ireland
<b>GDP</b>	61,0%	19,5%	17,8%	56,0%	42,0%	124,1%
<b>private consumption</b>	55,7%	12,3%	19,6%	55,3%	33,1%	104,5%
<b>total gross fixed capital formation</b>	102,8%	18,8%	31,6%	95,2%	56,3%	130,5%
<b>public consumption</b>	51,1%	14,7%	21,5%	74,8%	41,4%	97,3%
<b>export volumes</b>	131,4%	159,0%	34,0%	115,1%	114,1%	232,3%
<b>import volumes</b>	123,1%	115,5%	56,7%	174,1%	117,8%	222,4%
<b>consumer price indices</b>	66,4%	22,2%	37,3%	47,5%	33,1%	47,2%
<b>current account balance (2008) % GDP</b>	-14,6%	+6,7%	-3,4%	-9,6%	+4,8%	-5,2%

Source: OECD (2009) [our calculations]

In particular, during the period 1995-2008 Greece experienced a *real* increase of the GDP amounting to 61.0%, Spain 56.0% and Ireland 124.1%, quite contrary to what happened to the more developed European economies. The GDP growth over the same time period was 19.5% for Germany, 17.8% for Italy and 30.8% for France. In the following analysis we will return to some of the findings of the above table. For now, it is enough to underline that the economies which experienced higher growth rates (without this explaining all the cases) ended up with noticeable current account deficits. At the same time, they run higher inflation levels; this fact, when combined with the high profitability of capital, had negative consequences to competitiveness, being associated with similar hikes in export and import prices. Finally, it is worth noting that during the same period (and contrary to what happened in Spain and Italy and in other European economies) the growth of the Greek GDP was heavily based on investment and on a high growth of employment and productivity (rather than to government consumption).<sup>7</sup>

To obtain a more comprehensive overview of these developments one must, in addition to the above comments, factor in two other basic parameters which have a further positive influence on the growth trends of the countries belonging to the European ‘periphery.’

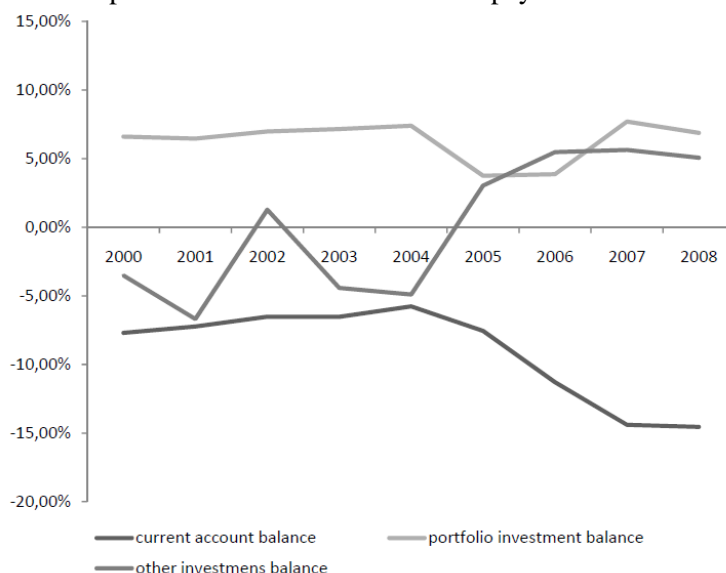
*On the one hand*, the higher rates of profit at the ‘periphery’ boosted financial yields as a whole, with the result that international investors became keener to finance

<sup>6</sup> Here Portugal is the striking exception. While the latter has accumulated over the last years one of the highest net external debts in the Euro area, the catch-up process with the rest of Europe stalled. In this sense, Portugal has been, over the last 15 years in the paradoxical situation of displaying all the signs of overheating without enjoying any acceleration in GDP. Here the deterioration in the current account did not reflect the fast growth in domestic demand (as in the case of Greece and Spain) but a steady decline in the export performance (this “singularity” of Portugal can be ascribed to a particular ill-adjusted exchange rate at the onset of EMU. For more in this connection see: Deutsche Bank (2010c).

<sup>7</sup> Alpha Bank (2010).

the high rates of growth at the ‘periphery’, particularly now that they had been granted dispensation from a number of significant risks in the environment of the euro, such as that of exchange rates, for example.<sup>8</sup> The countries of the ‘periphery’ thus recorded strong surpluses in their financial accounts. In the case of Greek economy (chart 1), the trend of the current account balance mirrors the conditions of a strong domestic demand which were further boosted by the uninterrupted inflow of portfolio investments and by the access of a powerful banking system to international liquidity.

**Chart 1**  
Basic components of the Greek balance of payments as % of GDP



Source: *Bank of Greece, Eurostat*

*On the other hand*, the member countries of the Eurozone with their different rates of growth and different rates of profit were without exception incorporated into the same monetary policy regime, that is to say the regime of uniform nominal interest rate from the European Central Bank. These interest rates were considerably lower for the countries of the ‘periphery’ than they had been prior to the introduction of the single currency. Interest rates within the Eurozone converged towards the low level of German ones. This diminishing trend met with the international cutback on the level of interest rates after the outburst of the so-called dotcom crisis in the USA stock exchange in the beginnings of the 2000s. This fact, in conjunction with the

<sup>8</sup> For instance, the immediate exposure of German banks to Greece, Spain, Portugal, but also France and Italy reaches 20-30% of German GDP (Deutsche Bank 2010a). The exposure of French Banks to the same countries amounts to 27-30% of the French GDP. One should also take into account the fact that bank loans flow between the countries of the ‘center’ while besides there are bank loans from the ‘periphery’ to the ‘center’ and from ‘periphery’ to ‘periphery’ as well. E.g. Portuguese banks have claims from the abovementioned countries that reach 24% of the Portuguese GDP. The corresponding exposure of Irish banks amounts to 34% of the Irish GDP. In other words, the intra-European boom of commerce has led to a powerful and integrated banking system, a parameter that plays a significant role in the relevant policy discussions. This intra-EU lending concerns sovereign debt as well. For example, foreign claims of European banks from ‘peripheral’ public sectors stably move around 70% of the relevant total foreign claims: Greece (73%), Portugal (84%), Spain (78%), Italy (77%) (see BIS 2010).

higher rates of inflation prevailing in these countries, translated into even lower real interest rates for the local banking sector. These are the conditions that laid the groundwork for the explosion of (private and public) borrowing and strengthened the already strong domestic demand (see Table 2). It is worth mentioning that short-term real interest rates in the 1990s averaged to around 5,4% for Greece, while after 2000 (when Greece joined the Eurozone) fell almost to 0%, and for some periods went even lower.<sup>9</sup>

In Table 2 below we see the significant increase in private debt of businesses and households in the cases of Spain, Portugal and Greece (the leverage for the last-mentioned is significantly smaller than for the other two countries). Overall private sector debt in Portugal amounted to 239% of GDP, that is to say 29 units higher than in neighboring Spain and 116 units higher than in Greece (the corresponding levels in France and Germany are 130% and 140%). Of course the basic reason for the spiraling debt in the countries of the ‘periphery’ was their participation in the euro and extraordinarily low real interest rates that were the concomitant of that participation (combined with the financial account surpluses).

**Table 2**  
Private sector debt as % of GDP

	<b>Households</b>		<b>Businesses</b>	
	<b>1995</b>	<b>2008</b>	<b>1995</b>	<b>2008</b>
<b>Greece</b>	13%	61%	38%	62%
<b>Portugal</b>	42%	105%	53%	134%
<b>Spain</b>	42%	88%	47%	122%

Source: Eurostat and Deutsche Bank Global Markets Research<sup>10</sup>

In many cases access to cheap loans contributed to a revival in the housing market.<sup>11</sup> Between 1999 and 2005 house prices in the Eurozone increased at around the same rate as the corresponding figures for the USA (moving around levels approximately 40% higher than the corresponding average for the last 30 years), while in specific areas such as e.g. Ireland and Spain, price inflation was higher than the corresponding figure for the USA (we should note also that in these countries the proportional contribution of house building to the GDP was higher than in the USA). Indeed in 2005 and 2006, when the runaway increases in house prices reached their peak in the USA, the corresponding increases not only in Spain and Ireland but also in Spain and Belgium were even higher.

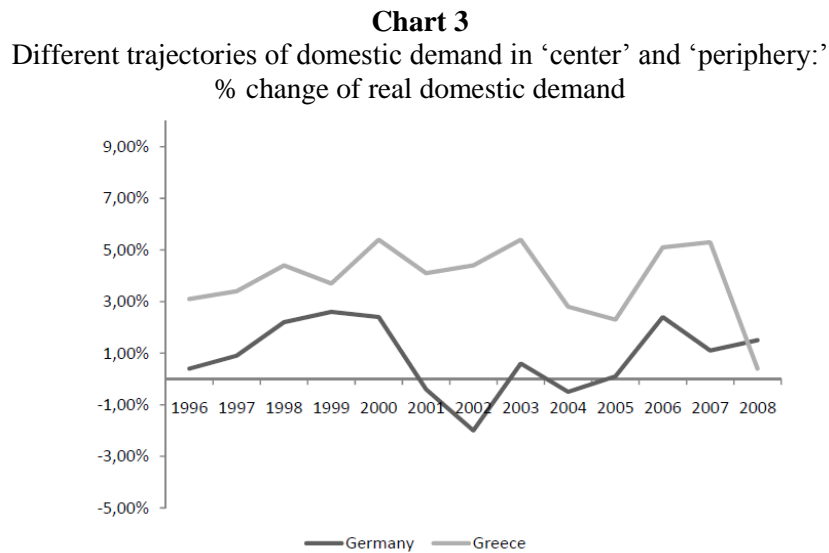
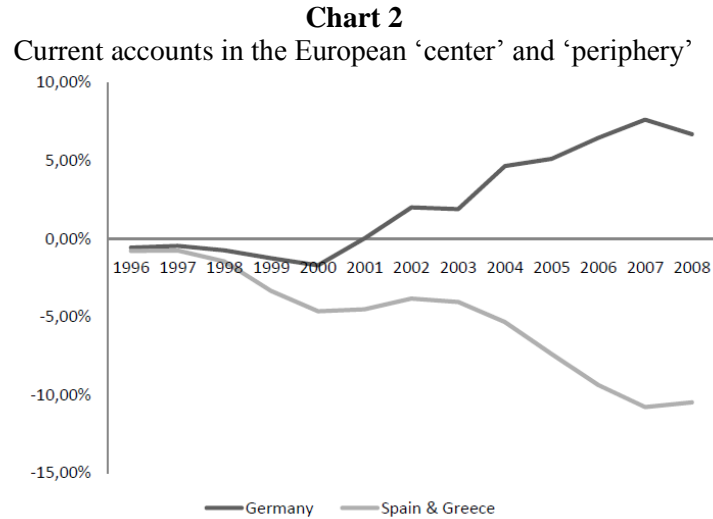
The above two factors strengthened domestic borrowing, contributed to the further warming up of the economies of the ‘periphery,’ and directed production to the needs of a strong domestic demand. The later had negative implications to the competitiveness of exports (due to inflation, increases in the labor cost, and high and ‘inelastic’ profits) surging accordingly the demand for imports. In the case of Greece, we have to mention that for a relatively small economy – albeit open to international competition (the sector of internationally tradable products and services exceeds 60%

<sup>9</sup> See Deutsche Bank (2010b).

<sup>10</sup> Cited in Deutsche Bank (2010c).

<sup>11</sup> See Eichengreen (2009).

of GDP, with no limits to the movement of capital) – every increase of domestic demand benefits mostly the ‘protected’ sectors and the imports.<sup>12</sup> In other words, the deterioration of the current account balance of the counties of the European ‘periphery’ mirrors a strong growth, characterized by the above described features, within the Eurozone. The following Charts 2 and 3 are quite indicative of this reasoning.



<sup>12</sup> The reduction of the domestic demand that necessarily follows the economic recession primarily affects imports and non-competitive sectors. The improvement of the competitiveness in the sector of international tradable commodities tends to increase their production, boosting exports and substituting imports. Hence, the fall in the domestic demand affects primarily imports and only to a lesser extent domestic production.



We understand, therefore, that current account deficits in the ‘peripheral’ economies are not the straightforward outcome of an analogous ‘deficit’ of competitiveness. On the contrary, they both are consequences of a deeper cause. Namely: of the striking differences in the levels of capitalist growth within the particular form of symbiosis in the Eurozone.

Countries like Greece, Spain, and Ireland experienced higher accumulation and profitability rates (catching up the more developed countries of the center). Domestic demand was further boosted by the credit expansion in an environment of historical low interest rates and also by the uninterrupted inflow of foreign savings (a great deal of them coming from the surpluses of the ‘center’). Current account deficits are but the immediate outcome of these factors and mirror the corresponding surpluses in the financial account.

#### **4. The financial account imbalances and the strategic dilemma of the euro**

The plan for the single currency very obviously generates strategic ‘benefits’ for the collective capitalists of all the countries that participate in it. We have already presented the picture in its essential outline.

For a less competitive country, access to international markets can indeed be a way for implementing the strategy of exposure to international competition and for translating this potentially into high levels of growth (and an increase in productivity), but it is a rather ‘ambitious’ strategy. Let us see why. In the case of the Eurozone, given that member countries cannot adopt a policy of ‘mild’ protectionism and given that there is no national currency mechanism to moderate (through devaluation) the differences in competitiveness, *then* the less competitive countries (of the ‘periphery’) must be in a position *immediately* to impose (without significant deviations) drastic restructuring of labor. Otherwise there exists the danger of non-competitive capitalist enterprises being downgraded in a first phase (and significant sections of the workforce displaced from them) without any new parallel constitution of other more ‘efficient’ individual capitals.

Nevertheless, the restructuring of labor and the consolidation of new antagonistic forms of exploitation is inevitably a process fraught with delays and resistances. And as it has already been stressed above, the ‘cost’ of participation in euro for the labor at the ‘peripheral’ economies *was offset to some extent* by the expansion of domestic banking leverage and by the inflow of foreign savings (not so much in the form of FDI but mostly in the form of portfolio investments, loans, deposits and repos), that is to say by factors that reinforce the already significant increase in the domestic demand.

The strong domestic demand and the extension of private debt have offset the powerful pressures for continual restructuring of labor in the countries of the ‘periphery’. At the same time, this boosted domestic demand re-oriented production towards domestic uses and arrested the improvement of competitiveness. Two are the main reasons for this. On the one hand, despite the deterioration in the terms of labor, households are able to maintain their consumption level through the channel of borrowing. From a different perspective, the consensus to the neoliberal paradigm is based on the access to cheap loans that are destined to the financing of consumption, accommodation and other expenses, in order to raise enough household income to substitute the withdrawal of the state from supporting insurance, retirement, health,

education and other social benefits. This remark is rather general, but it also characterized the case of Greek economy. At the same time, the significant expansion of domestic demand – on the basis of an economic growth that hinges upon production restructuring as well as upon inflow of foreign savings – creates a protection zone around the less competitive enterprises (especially in the sectors of non-tradable goods and services) offsetting to some extent the pressures from the international competition and allowing for slight recovery of employment.

We thus end up confronted with what could be called *the strategic dilemma of the euro*.

The persistent imbalances (in the financial account) within the Eurozone region along with a surging private debt comprise an effective contradiction of the architectonics of Eurozone. On the one hand, they contributed to the organization of the social consensus to the particular exploitation strategy of capital. On the other hand, they turn into a symbiosis quite vulnerable to unpredictable economic events, becoming at the same time an impediment to the strategy of EMU.

This contradiction of the EMU is thus deeper than it seems from a first sight. Given the neoliberal orientation of the Eurozone, it will be attempted to deal with the abovementioned imbalances with the pursuit of wage deflation. It is an extremely aggressive strategy, but also dangerous for the organization of social consensus. Nevertheless, it is the only plan which can turn the dynamics of the ‘peripheral’ European capitalisms into competitive gains, *without undermining the neoliberal character of Eurozone*. The recent crisis is seen as a positive ‘opportunity’ to correct the contradictions emerged so far. Hence, what we experience (and we should expect in the future) from European governments is a tough and unprecedented attack against labor in the name of ‘public consolidation’.

In this context, the EU as a whole will have to shift to a position of corresponding current account surpluses with the rest of the world, an option which will strengthen the hegemonic position of the USA in the global imperialist chain.<sup>13</sup> Moreover, improvement in the current account balance at the ‘periphery’ means overall reorientation of domestic economies, which can be consolidated only through recession and income deflation. What is therefore to be expected on the part of capitalist power is an attack on labor of unprecedented harshness, which will be carried out in the name of fiscal consolidation and ‘rationalization.’

It is however well-known that policies of recession imposed in a high-debt environment considerably prolong the time required for dealing with the latter. From

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<sup>13</sup> We lacked the time and space in the context of the present study to deal with this subject. Briefly (and more or less indicatively) we might mention the following. If the EU is added to the multitude of regions of the planet that sustain their development through an emphasis on exports, we may expect a world with more net savings at the national level (current account surpluses). The United States does not have any particular reason to pursue such a strategy. They will continue to extract other nations’ surplus savings for their own benefit, seeing current account surpluses elsewhere being converted into an accumulation of currency reserves in dollars. The dollar will be reinforced in the international financial markets, where it will be deemed the undisputed international currency. The real dilemma for the USA will be having to choose between a high public or private debt. Nevertheless, the point about the USA is that it possesses a developed and dynamic financial sector which plays a central role in organization of the international financial system and will continue to some extent to “recycle” the international supply of cheap savings as high-yield portfolio investments abroad. It is worth noting that despite its markedly negative investment position, the United States retains significant net investment income.

the moment that there is no possibility of currency devaluation, the recovery of competitiveness in the current account balance can come only through corresponding price devaluation. To the extent that the labor market is not ‘flexible’ enough to allow of such measures, *competitiveness can be regained only through drastic reduction in incomes, recession, unemployment and a more general offensive against labor for the purpose of securing the celebrated restructuring*. This is the a-b-c of present-day macro-economics, not so clearly formulated. For a country such as Greece this means inability to deal with the high rate of indebtedness (particularly when financial risks are repriced), something very rapidly anticipated by the ‘markets’ and it has led to the developments with which we are all more or less familiar.

Let us reformulate our main insight: the fiscal consolidation policies whose implementation is under way, but also those to be imposed in future, are not aimed at dealing with debt but (in the final analysis) with the recovering of competitiveness and the reducing of the current account imbalances through recession. And for precisely that reason they are not able to confront debt directly and effectively. The crisis in Greece, the international financial markets, the EU, the European Financial Stability Facility (EFSF) and the IMF unswervingly serve the harsh options of capital, essentially comprising components of a single mechanism (not without contradictions). What is never predictable, of course, are the unforeseen turns in the class struggle and the degree of social consent to be extended to such nakedly class-based policies.

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