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WITHOUT MAJOR RESTRUCTURING, THE EURO IS DOOMED,
NEW STUDY FROM LEVY ECONOMICS INSTITUTE SAYS

EU/IMF Rescue Plan Does Little to Help Troubled European Economies
like Greece, Italy, Ireland, Portugal and Spain in the Long Term

ANNANDALE-ON-HUDSON, N.Y.— This past spring, the growing debt crisis in Europe prompted the European Union (EU) and International Monetary Fund (IMF) to enact a 750-billion-euro rescue plan to help struggling EU countries, like Greece, avoid defaulting on their massive debts. A new study from the Levy Economics Institute of Bard College argues that, while helping the European banks holding these debts, the bailout does little to address the problem at the core of the debt crisis: that countries with very different economies are yoked to the same currency. Lacking a sovereign currency and unable to devalue their way out of trouble, they are left with few viable options—and voters in Germany and France will soon tire of paying the bill. Furthermore, the Levy study contends that the strict austerity measures attached to the rescue plan will reduce income and consumption in Greece and other struggling EU countries, undermining their growth and helping to create a deflationary environment across all of Europe.

In their new Public Policy Brief, End Game for the Euro? Without Major Restructuring, the Eurozone Is Doomed, Levy President Dimitri B. Papadimitriou, Senior Scholar L. Randall Wray, and Yeva Nersisyan suggest that the austerity measures will ultimately reduce government revenues in Greece and other countries. “Austerity means stagnant or even falling wages; under the current plan, public sector paychecks will shrink 10 percent, pensions will be cut, and the retirement age raised. Private sector wages and pension reform will soon follow,” they write. “All of this cost cutting will reduce consumption and retail sales, and hence government revenues. There will also be spillover effects to nations

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that export to Greece. To be sure, Greece is a tiny economy within Euroland, representing a mere 2.6 percent of the area’s GDP; but its fiscal problems are by no means unique. As the bigger troubled economies like Spain and Italy also adopt austerity measures, the entire continent could find government revenues collapsing. Worse, exports to neighbors will be hurt by a reduction in demand… What is most remarkable is that the EU’s largest net exporter, Germany, does not appear to recognize that its insistence on fiscal austerity for all of its neighbors will cook its own golden egg—laying goose.”

Papadimitriou, Wray, and Nersisyan maintain that the rescue plan “rests on the assumption that, with more time, the eurozone’s ‘problem children’ can get their fiscal houses in order. But Greece and some of the other major European debtors are seriously uncompetitive in comparison with countries that are either more productive or have lower production costs,” they write, stressing that, without other measures, “the same factors that necessitated the bailout of Greece will probably force similar rescues of Portugal, Spain, Ireland, and Italy, at the expense of the same resentful taxpayers in Germany, France, and the other solvent eurozone nations. Costly as these bailouts may be, none will provide more than palliative care for nations too indebted to dig their way out on their own.”

Without a major restructuring, the Levy scholars see the EU headed toward an “amicable divorce” that, though having some benefit to rich and poor countries alike, would increase economic inequality between European countries and provide a major blow to the idea of Europe mounting a challenge to American power. To avoid the demise of the EU, they recommend both short- and long-term fiscal stimulus plans: first, the distribution, on a per capita basis, of one trillion euros in relief that each eurozone nation could use at it sees fit, and second, a permanent fiscal arrangement through which central eurozone authorities could distribute funds to member nations. The latter would replicate, in some ways, the U.S. Treasury’s relationship with U.S. states, but with greater fiscal transfers and more control by European states. “What’s needed is a way of redirecting demand to the trade-deficit nations—for example, by having surplus nations spend euros on direct investment. Germany did this with the former East Germany following reunification. Such a mechanism could be set up very quickly under the aegis of the European Investment Bank. Effective incentives to ‘recycle’ current account surpluses via foreign direct investment, equity flows, foreign aid, or imports could be easily crafted. If successful, this would enable Greece and the other trade-deficit nations to become competitive enough to secure their future through higher exports.”

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