Levy Economics Institute of Bard College

Policy Note

2012 / 1

NEO-HOOVERIAN POLICIES THREATEN TO TURN EUROPE INTO AN ECONOMIC WASTELAND

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Introduction

When the subprime mortgage crisis erupted in the United States in 2007, few people in Western Europe expected the crisis to quickly spill over into Europe, even though there were clear signs early on that the effects of the crisis were spreading across other asset markets. Moreover, Europe's financial community felt at the time that "the market would sort itself out in the end," and its policy elite expressed confidence in the belief that Euroland, in the words of European Commission (EC) President José Manuel Barroso, was "well-positioned to deal with the global credit crisis." But Europe wasn't alone. This incredulous reaction to the unfolding subprime mortgage crisis was also pervasive in the United States. At the outset of the crisis, Federal Reserve Chairman Ben S. Bernanke got the whole thing wrong. On May 17, 2007, in a speech at the Federal Reserve Bank of Chicago's 43rd Annual Conference on Bank Structure and Competition, he not only voiced his belief in the ability of "market forces . . . to rein in excesses" but also expressed his conviction that "the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system" (Bernanke 2007).

Welcome to the terrifying world of economic forecasting—and to the even more terrifying world of economic policymaking in the age of free-market dogmatism. There can be no denying

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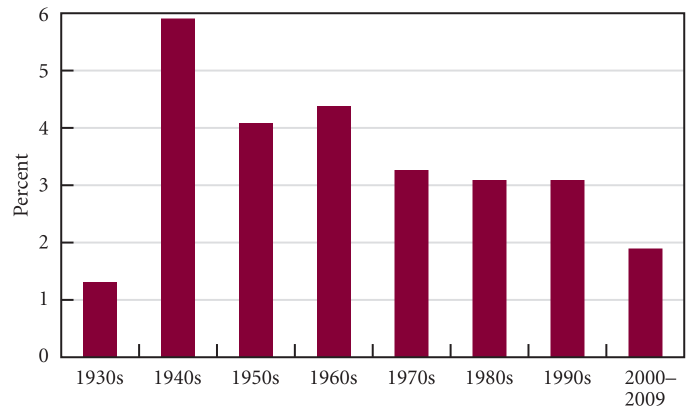
that, despite the experiences provided by the Great Depression and the numerous financial crises that have taken place since 1973, policymakers have been dismally wrong in their assessment of the 2007–08 global crisis and governments dreadfully incompetent in developing a clear strategy for addressing it appropriately.[1] The reason for this lies with an economic ideology, a conceptual framework with which government officials and bankers deal with economic reality, that is fundamentally flawed. The doctrine of free-market capitalism is a poor guide to understanding how global capitalism works. To begin with, there is no such thing as a "free market." This is one of the most pervasive myths about capitalism. All capitalist economies are essentially mixed economies and the government has always been the key to long-term development, including the formation of a global economy. Secondly, while capitalism is certainly capable of creating immense wealth, it is also capable of massive destruction. Capital accumulation is an inherently unstable process and capitalism is always prone to financial crises, especially when left unregulated in the conviction that the invisible hand of the market can provide balance between supply and demand and economic efficiency. Economists as diverse as Karl Marx, John Maynard Keynes, Joseph Schumpeter, and Hyman P. Minsky had no doubts about the inherent instability of capitalism and of financial markets, but this is a notion that tends to be obscured and neglected by contemporary economic science because of the latter's heavy emphasis on econometrics and the application of mathematical methods.

Further, in contrast to orthodox economics, rapid and constant growth is not a "natural" tendency of the capitalist system. If anything, what is more "natural" to the system, at least from a historical point of view, is its tendency to exclude people and whole regions from economic development. Also, when it comes to advanced capitalist economies, one could make the argument that, instead of constant rates of growth, the "natural" tendency is actually toward stagnation, as Figure 1 shows, using the world's most mature capitalist economy as our example.

So when crises occur, it is not because of outside interference. Economic slumps are internal to capitalism. When crises occur—and they do occur, and with increased frequency as the system becomes more complex and more global in context—it is absurd to expect recovery to take place on its own or, as is currently fashionable to believe, through resurrecting confidence among businesses and consumers. A do-nothing policy, or policies that seek to treat only one aspect of a crisis, will only help to prolong the slump and cause further social damage. Large-scale government intervention is an absolute must if the economy is to return to health. A political economist like Marx had no desire to rescue capitalism, but Keynes showed that the role of the government is indeed instrumental in resolving an economic crisis and in preventing future downturns. In this context, the current public policy mania of imposing fiscal tightening in the midst of a recession can only lead to catastrophic failure. This is a policy that reduces demand, increases unemployment, and leads to a prolonged economic slump. And this is precisely what has been happening in Europe during the last few years, as Eurocrats have been determined to turn back the clock and apply Hooverian policies all over the continent.

Figure 1 **Long-Term US Economic Growth**



Sources: Bureau of Economic Analysis, National Income and Product Accounts; Foster and Magdoff 2008, 2010

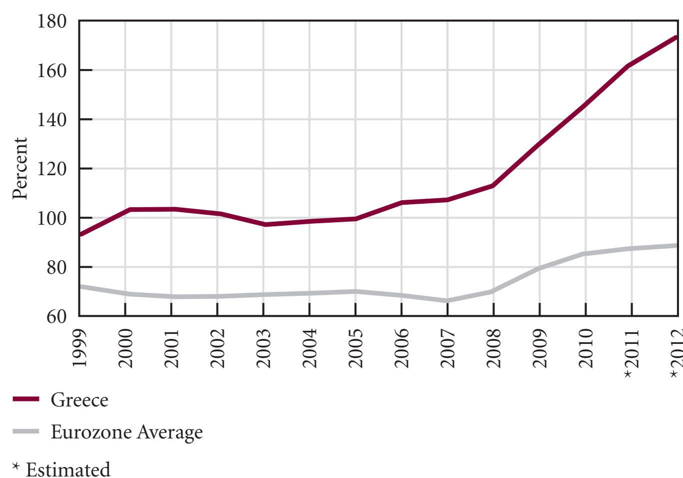
Given the severity of the 2007–08 global financial crisis and the threats it posed, the political and economic policy failures of Europe's leaders are simply extraordinary. They had three years to solve the Greek debt crisis and get the eurozone out of the woods, but what they have managed to accomplish instead is to (1) place the future of the eurozone in jeopardy, (2) convert the financial crisis into a full-fledged economic crisis, (3) create deeper divisions between northern and southern member economies, (4) sink the economies of Greece and Portugal into a state of permanent poverty, and (5) choke off a fragile global recovery. One must admit that this is truly an amazing feat, achievable only in the hands of a most incompetent political leadership.

The Impact of Austerity Measures in a Recession: The Tragedy of Greece

From an official point of view, the eurozone crisis started in late 2009 with the outbreak of Greece's debt crisis and the threat of a possible default. Future historians—free from the intellectual, political, and emotional constraints and biases imposed upon us today—should have a jolly good time when they write about the Greek debacle. A nation that, from an economic, political, and cultural standpoint, should never have been allowed to join the eurozone in the first place, borrowed massively for nearly a decade, building up one of the highest budget deficits and debt-to-GDP ratios in Europe, as Figure 2 shows. Between 2000 and 2008, Greece lost more than 20 percent of its competitiveness, squandered European Union (EU) funds designated for development projects, and even decimated its agricultural production—all while it sank ever deeper into corruption and administrative inefficiency.

The Greek debacle began essentially only a few weeks after the October 2009 national elections, when the newly sworn-in government of George Papandreou informed Ecofin that the previous administration's projected deficit of 6 percent of GDP for 2009 was based on misreporting and data manipulation, and that the actual deficit was going to be around 12.5 percent (the ultimate projection was 15.5 percent). Two days later, Fitch made its first move and downgraded Greece's credit rating. The cat was now out of the bag. Soon the whole world was aware of Greece's dismal fiscal condition. Even so, the Papandreou government not only failed to announce aggressive reform policies in order to appease the markets, especially since it had become clear that deficit data manipulation was leading to an unprecedented credibility crisis for the country; but also proceeded to grant selective wage increases. More crucially, it failed to exhibit any interest in tackling the deep-rooted problem of tax evasion as a necessary step for fiscal balance.

Figure 2 **Greek Debt Relative to the Eurozone Average**



Source: Eurostat

Clearly, the Papandreou government lacked the political will to reform the economy and to undertake the measures necessary to address the ills of the nation's political culture. (Perhaps that's why it invited the International Monetary Fund [IMF] to do the dirty work.) Within the next two months, Greece's credit ranking was downgraded twice and, by early to mid January 2010, the spreads for Greek sovereign bonds began their meteoric rise, with the yield spread between 10-year Greek government bonds and German Bunds spiking to as much as 365 basis points by early February, and eventually rising as high as 1,000 points above the Bund by late April. The rest, as they say, is history. A national fiscal crisis was turned in no time into a severe debt crisis, thanks largely to the incompetence of the Papandreou regime, which was surrounded, by all accounts, by third-rate technocrats.

Greek political leadership has been notoriously ineffective. This is one of the nation's contemporary curses. However, Europe's political leadership has fared no better in handling Greece's crisis. German Chancellor Angela Merkel went on the record early on, saying that "what happens in one member state affects all others" (cited in Smee 2009). But as of late February, the EU was moving in snail-like fashion, having no idea how to respond to the Greek crisis. Indicative of the indecision that seems to have paralyzed the EU chiefs, Merkel even denied talk of a Greek bailout plan, stating on public television that "we have a (European) treaty under which there is no possibility of paying to bail out states in difficulty" (quoted in *Economic Policy Journal* 2010).

In the end, the strategy adopted toward Greece had nothing to do with either Greece's economic reality (the country was already in the midst of a recession) or the eurozone's own problems (a flawed currency and the emergence of a two-speed Europe). The 110 billion euro bailout package of May 2010, which was put together with the assistance of the IMF, came attached with the strings of fiscal tightening and severe austerity measures that were as much designed to punish the Greeks for having strayed from the official EU fiscal guidelines as to

protect European banks, which were highly exposed to Greek debt. The austerity measures (and the list kept growing almost on a monthly basis throughout 2010 and 2011) included pension cuts; salary reductions for public employees; a sales tax boost; excise taxes on fuel, cigarettes, and luxury goods; blanket privatizations; and an increase in the mandatory retirement age to 65 by 2015.

If ever there was any doubt, Greece puts the austerity myth to rest. As Figure 3 shows, the nation's GDP began a sharp decline once the first round of austerity measures went into effect. In 2009, with Greece already in a recession, the GDP had contracted by 2 percent, but it declined 4.8 percent in 2010 and 6.9 percent in 2011. As for 2012, with a new bailout agreement in effect that demands even more austerity measures, the EC predicts a 4.4 percent contraction in Greece's GDP (EUbusiness.com 2012).

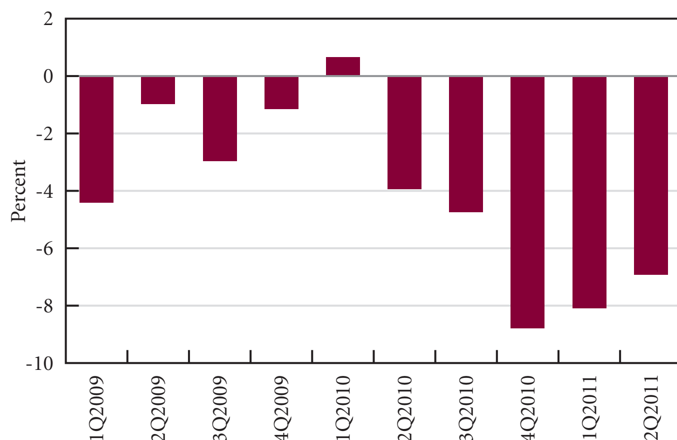
The Greek economy has been devastated not so much by the global recession as by the IMF/EU-imposed austerity measures. Note that when Argentina defaulted on its debt in December 2001, its GDP shrank "by about 5 percent in the first quarter of 2002. However, recovery began after that one quarter of contraction, and continued until the world economic slowdown and recession of 2008–2009" (Weisbrot et al. 2011).

Fiscal consolidation and austerity are having catastrophic effects on Greek unemployment, as Figure 4 shows. In 2010, the unemployment rate ranged from 12.5 percent (in May) to 13.9 percent (in November), but by December 2011 it had soared to 20.9 percent. Youth unemployment is a staggering 48 percent. The National Confederation of Hellenic Commerce estimated in its 2011 report that more than 60,000 businesses shut down between 2009 and 2011, and it forecasts that just as many will do so in 2012 (cited in *Eleftherotypia* 2011). Thus, the unemployment rate in Greece will continue its upward trajectory in the years ahead as the conditions of the new bailout agreement sink the economy deeper into a 1930s-style depression.

After much deliberation by the EU chiefs, Greece was provided on February 20, 2012, with a new bailout package that is almost identical to the first one in terms of its overall objectives. The package extends to the Greek government a new loan worth 130 billion euros (with 30 billion euros as "sweeteners" for the Greek banks), imposes a "voluntary" bond swap with private bondholders (which, in contrast to EU claims, will most likely trigger a credit default swap), and demands additional austerity measures—including massive layoffs from the public sector, a reduction in monthly unemployment benefits from 460 to 360 euros, a 15–20 percent reduction in pension payments, a slashing of private sector wages by 20 percent, and a lowering of monthly minimum wages by 20 percent. This is a scorched-earth economic policy, an awe-inspiring pillage that incidentally, the (nonelected) Greek government accepted triumphantly and presented to the nation as a "historic achievement."

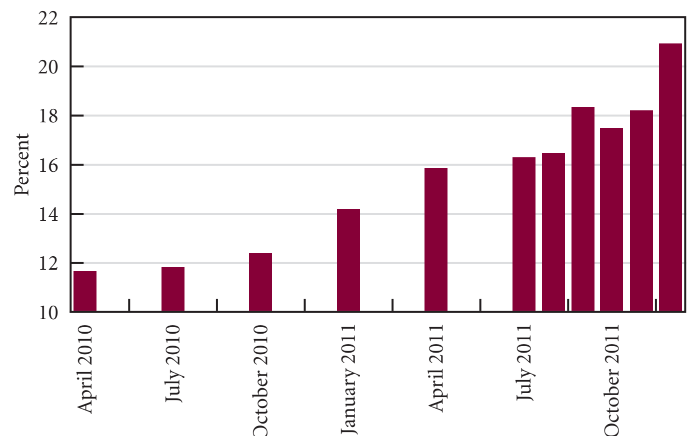
Finally, the new bailout does not solve Greece's debt crisis and simply postpones an official default. EU officials had initially projected that the deal would reduce Greece's debt ratio to 124 percent of GDP by 2020 (its level when the crisis broke out

Figure 3 **Greece: Real GDP Growth (in constant euros, year over year; not seasonally adjusted)**



Source: National Statistical Service of Greece

Figure 4 **Greece: Unemployment Rate**



Sources: National Statistical Service of Greece; www.tradingeconomics.com

in 2009), but the gloomy reality of the Greek economy is already forcing the authorities to revise their estimates, with the head of the Eurogroup of eurozone finance ministers already indicating that a third bailout cannot be ruled out. In the meantime, some EU officials have already gone on record saying that further cuts in private sector wages are needed.

In sum, the Greek tragedy is hardly over. As a matter of fact, it still has a long way to go, with the country's future in the eurozone remaining very much up in the air; and the EU's woes are far from over—particularly since the fundamental flaws of the eurozone remain intact and Europe's economic problems go deeper than those of its weakest link.

The Incredible Shrinking of and Social Misery in Europe's Economy: Some Selected Examples

Greece is a dying patient, but an assessment of the rest of Europe's economies points to a bleak future. Aside from being a very economically uneven region (so much for the convergence myth that was behind much of the drive for the creation of a monetary union), virtually all of Europe's economies, including that of Germany, are facing either anemic growth or are already in a recession. Industrial output in Europe is on the decline, unemployment is at economically unacceptable and politically dangerous levels, and the "social safety net" is being shredded by massive cuts in an attempt to impose neoliberal doctrine. From the look of things, one would have to say that capitalist Europe has a miserable future.

The austerity measures demanded by Germany's current leadership have spread like a plague over Euroland, and they threaten not only to plunge Europe into a recession but also to transform the region into an economic wasteland. In Portugal, the bailout scheme has also failed miserably, and the country is being subjected to a brutal fiscal adjustment that has done nothing to appease bond markets. As in the case of Greece, the only tangible outcome is immense human suffering. Portugal has done everything demanded by the EU and the IMF (i.e., reducing public and private sector wages, slashing social programs, cutting down pension payments), yet its debt ratio has increased since the bailout and the country needs to run surpluses of 10 percent of GDP over the next several years in order to make the sovereign debt ratio sustainable. Overall, Portugal's GDP shrank 2.7 percent in the fourth quarter on an annual basis, and the government forecasts a contraction of 3 percent for 2012. And as for the unemployment rate, it rose above 14 percent at the end of last year—a record—and is expected to grow further in 2012.

Ireland is the third EU country to have received a bailout as a result of its housing bubble collapse in 2008, and is portrayed as the lone success story among the bailed-out nation-states of the eurozone. Some quick data should quickly dispel this myth. First, Ireland's GDP contracted 1.9 percent in the third quarter of 2011, making it "the worst performing economy in the euro zone in the third quarter apart from Greece" (Halpin 2011). Its unemployment rate currently stands above 14 percent and more than 70,000 people emigrated between late 2009 and the end of 2011 because of a lack of jobs, making today's Irish exodus worse than that in the 1980s (O'Carroll 2011).

While the peripheral countries are the ones that get all the attention in discussions of Europe's economic woes, the fact is that the European economy on the whole faces deep problems. First, EU growth in 2011 was anemic at best. GDP data are not yet available for the fourth quarter of 2011 (most analysts thought that an economic contraction was unavoidable; see O'Donnell 2011). But according to analyst John Ross (2012), for the third quarter "EU GDP was still 1.7 per cent below its peak in the previous business cycle and Eurozone GDP 1.9 per cent below." Ross goes on to underline, "With EU GDP likely to have turned down in the 4th quarter of 2011, Europe is suffering a strictly defined 'double dip' recession—i.e. a fall in output before the previous peak level of GDP has been regained." As further evidence of the deepening crisis in Europe, a recently released EC report predicts that the eurozone economy will shrink by 0.3 percent in 2012 (Castle 2012).

Let's look at some economic data for the core eurozone member-states. Recent data for "Europe's powerhouse" shows that German industrial production fell 2.9 percent in December, while the country's exports dropped by 4.3 percent (Elliott 2012). Likewise, industrial production in "Europe's second powerhouse," France, contracted in December by 1.4 percent (Parussini 2012).

The unemployment rate is perhaps the best indicator of an economy's health. Unemployment rates for Europe reveal a region in deep recession. In France, truly a stronghold of industrial capitalism, unemployment approached 10 percent in 2011, while youth unemployment (ages 15–24) rose above 21 percent. In Spain, the overall and youth unemployment rates are 22.9 and 48.7 percent, respectively; in Greece, 20 and 47.2 percent;

and in Lithuania, 15.3 and 32 percent. Taken as a whole, the euro area unemployment rate stood at 10.4 percent by the end of 2011, with the figure registering a slight increase over that of the previous year. The lowest youth unemployment rates are to be found in the core eurozone countries: Germany (7.8 percent), Austria (8.2 percent) and the Netherlands (8.6 percent) (Eurostat 2012).

When all is said and done, there is enough disturbing economic evidence in the eurozone for one to make the claim that the region could soon begin to resemble the late 1920s in the United States, especially since additional austerity is certain to make the euro crisis worse (see Andini and Cabral 2012). The Neo-Hooverian policies adopted by Germany and the EU are shrinking Europe's economies and are producing social misery as a result of massive unemployment levels.

Conclusion

Ever since the start of the Greek debacle, German and EU leadership have proven quite incompetent at addressing the eurozone crisis. All measures taken have been temporary. Much of the blame for this lies with the economic dogma of fiscal consolidation and austerity that has gripped the imagination of Europe's political and economic elite. The harsh austerity measures demanded by all member-states have turned the financial crisis into largely an employment crisis, with the result that Europe finds itself in the midst of an economic recession that will only get worse if current policies continue to be enforced. Contractionary fiscal policies and austerity measures are turning Europe slowly but gradually into an economic wasteland, as evidenced by widespread unemployment and growing poverty throughout the region. Europe needs a political and economic revolution. What it needs is an immediate return to Keynesian measures and a new institutional architecture for the eurozone. It needs to move toward a United States of Europe. But I am not optimistic. Indeed, in an indication of where Europe may be headed politically, the EU's budget was slashed by four billion euros in 2010, with some governments arguing that the EU budget, in the words of British Prime Minister David Cameron, should be progressively "reduced rather than increased" (quoted in EUbusiness 2010)—and this appears to be the definite trend in Euroland.

What manner of union is this?

Note

1. The same dismal picture emerges when looking at the IMF's projections for growth and recovery. The fund's forecasting errors are so many and so gross that it would take volumes to record and analyze.

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