POLITICAL ECONOMY OF THE EUROZONE DEBT CRISIS: AN EVALUATION IN THE CONTEXT OF SOUTH AND NORTH EUROPEAN CAPITALISMS

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ABSTRACT

One of the most popular discussion topics in the Eurozone Debt Crisis relates to whether the policies which were implemented by the European Union (EU) to overcome the crisis could be sufficient or not. This is because countries, which are included in the EU, have different historical processes, social structures and growth strategies. Despite the existence of differences among countries, one-size-fits-all monetary policy was implemented to members of the European Monetary Union (EMU). Fiscal rules which were imposed by the EU as a supra-national institution could also be evaluated from this perspective. Hence, Southern European countries have been negatively affected by these policies because these policies did not support their demand-led growth strategies. On the other hand, Northern European countries have benefited from it by increasing their exports to Southern European countries. However, it is observed that the idea of the one-size-fits-all policy did not work for some countries with the crisis period. At this point, Varieties of Capitalism (VoC) literature provides a theoretical background to explain this process. The VoC approach emphasizes the requirement of different policies for different economies instead of one-size-fits-all policy instruments. The aim of this paper is to show that Southern European countries have been negatively affected by one-size-fits-all policies during the crisis; therefore, the implementation of varying policies by member countries of the EMU is necessary to overcome the crisis.

Keywords: Eurozone Debt Crisis, Europeanization, Varieties of Capitalism

JEL Classification: GO1, F02, P16

AVRUPA BORÇ KRİZİNİN POLİTİK EKONOMİSİ: KUZEY VE GÜNEY AVRUPA KAPİTALİZMLERİ BAĞLAMINDA BİR DEĞERLENDİRME

ÖZ

Avrupa Borç krizi sürecinde en çok tartışılan konulardan biri, içerisinde farklı ülkeleri barındıran birliğin uyguladığı politikaların krizden çıkış sürecinde yeterli olup olmadığı ile ilgilidir. Çünkü ülkelerin tarihsel süreçleri, toplumsal yapıları ve gelişme stratejileri farklıdır. Ülkeler

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arasındaki bu farklıklara rağmen, tek tip bir para politikası Avrupa Para Birliği tarafından birliğe üye ülkelere uygulanmıştır. Bu süreçte bir üst organ olarak Avrupa Birliği'nin koyduğu mali sınırlamalar da bu açıdan değerlendirilmektedir. Nitekim Güney Avrupa ülkeleri talep yönelimli gelişme stratejilerini destekleyemediğinden bu politika uygulamalarından kötü etkilenmiştir. Diğer taraftan ise Kuzey Avrupa ülkeleri Güney Avrupa'ya yaptıkları ihracatı artırdığından bu politikalardan olumlu olarak yararlanmışlardır. Ancak tek tip politika fikrinin bazı ülkelerde işe yaramadığı kriz süreci ile birlikte görülmüştür. Bu noktada Kapitalizmin Çeşitleri literatürü yaşanan sürecin açıklanmasında teorik bir temel sağlayacaktır. Kapitalizmin Çeşitleri literatürü tek tip politika yerine üye ülkelerin yapılarına göre farklılaşabilen politikaların uygulanması gerektiğini belirtmektedir. Bu çalışmada Avrupa Birliği'nin tek tip politika uygulamasının Güney Avrupa'yı ciddi bir şekilde etkilediğinin ve bu noktada bu ülkelerin farklı politika uygulamalarının kriz sürecinden çıkışa katkı sağlayacağının gösterilmesi amaçlanmıştır.

Anahtar Kelimeler: Avrupa Borç Krizi, Avrupalılaşma, Kapitalizmin Çeşitleri.

JEL Sınıflandırması: G01, F02, P16

1. INTRODUCTION

The effects of the global economic crisis on Europe became even more important since the European response to the crisis was not efficient. Then, tensions between nation states and the supra-national European Union (EU) surfaced because problems of the crisis couldn't be solved at the first place. For instance, the European Central Bank (ECB) had the authority to manage monetary policy in the Eurozone; on the other hand, fiscal policy has been implemented separately by the Eurozone countries. So the members of the Eurozone practiced different fiscal policies while one-size-fits all adjustments for monetary policy were in place. There was a lack of coordination concerning monetary and fiscal policy in the Eurozone. Moreover, Northern European countries have increased their level of economic development by pursuing an export-led growth strategy which is based on technological development. They have developed their technological level and by exporting high-tech products, reached high income levels. However, Southern Europe has not reached this level because they adopted a demand-led growth strategy. Therefore, the Eurozone reached an uneasy equilibrium with the demand-led growth strategy of Southern Europe and exports and surpluses of Northern Europe. However, countries of Southern Europe have been pushed by the EU to adopt export-led growth strategies but their technological development level was not adequate like their Northern European counterparts. Therefore, they preferred to apply a low labour cost strategy. However, these low labour cost strategy reduced demand and deteriorated their economic situation. To solve this problem, they collaborated with the financial sector and started to borrow capital from other countries. In other words, they continued their consumption by borrowing from other countries; especially from Northern Europe which maintained foreign trade surpluses before the debt crisis. This strategy had positive effects on Southern Europe economies first, but then these effects turned negative. The aim of this paper is to analyse whether 'one-size- fits- all policies' could be effective in the Eurozone Debt Crisis or not. According to recent research, if Eurozone countries had implemented different policies to overcome the crisis, they would not have been affected so deeply. From this perspective, Eurozone crisis can be linked to Varieties of Capitalism (VoC) literature because of the existence of different types of capitalisms in the Eurozone. One of these types is the Coordinated Market Economies (CMEs) including Northern European countries, the other one is the Mediterranean Market Economies (MMEs) composing of Southern European countries. These different types of capitalisms have different institutions and macroeconomic growth regimes, thus different solutions are required to get over the difficulties instead of one-size-fits-all adjustments. For instance, CMEs are characterized with centralized unions and coordinated collective bargaining. In addition to these features, they have export-led macroeconomic growth regimes and their fiscal policies are stable. On the other hand, MMEs have fragmented unions instead of centralized unions. Their macroeconomic growth regimes are based on domestic demand; therefore, their fiscal policies are more activist since they tend to implement expansionary fiscal policy instruments when domestic demand is weak. Therefore, MME type members of the European Monetary Union (EMU, and also known as the currency union) did not have much option to overcome the crisis. They can only change their domestic prices and wages (internal devaluation) given that exchange and interest rates are managed by the ECB (Regan,2013).

Thus, in the following pages, firstly, 2008 global economic crisis, with its spread to Europe will be elaborated and recent issues in the European countries will be held in the second section. Afterwards, the political economy of the crisis will be discussed in terms of VoC and Europeanization approaches in the third section. And finally, some concluding remarks will be made.

2. THE GREAT RECESSION, EUROPEAN DEBT CRISIS AND RECENT PROBLEMS IN EUROPE

Since the beginning of the 1980s, there has been a tendency to implement a specific set of policies in financial, commodity and labour markets in almost all around the world. This tendency represents a change in the economic doctrine towards one which favors privatization and deregulation. The deregulated financial markets led to the emergence of the rentier capitalists causing a change in the relationship between profits and investment. Prospects for high profits no longer attracted new investments because investors preferred to invest in short term deregulated financial products which provide high profits rather than long term physical investments which contain uncertainties (Onaran, 2010: 18-21). Although this period resulted in high growth rates in the short run, the risks that came with the uncertainties were quite high. Also, due to financialization and speculative activities, capitalist system has become more fragile and volatile (Onaran, 2004: 2). Thus, in 2008, existing fragile capitalist system came out with a natural outcome, namely an economic crisis.

The story is as follows: In the beginning of the 2000s, it was really easy for households to borrow to buy houses in the USA. And millions of people began to borrow. Homeowners saw their equities increase, which justified more borrowing. Then, investors became encouraged to pump even more money into the market and even riskier borrowers were lent out. However, in 2008, the bubble burst, millions of homeowners defaulted on mortgages and their wealth evaporated as home prices dropped. In response, consumers tightened their belts and personal consumption decreased. Construction of new homes absolutely collapsed. These massive reductions in demand led firms to cut production and fire workers. Therefore, unemployment rates began to rise, the Great Recession had arrived. In 2008 and 2009, the US government provided liquidity to rescue their banks. This intervention prevented the crisis in the US from getting worse (Lapavitsas et al., 2010: 321; Stockhammer, 2012: 42). Although the recent global crisis has taken root from the USA real estate bubble, the effects of the crisis have become much bigger in Europe since the USA could implement an effective fiscal stimulus package and act actively in this period while the European Union (EU) could not (Onaran, 2010: 23). Before the Great Recession crashed, European banks had already confronted with liquidity problems, but Eurozone banks kept lending to peripheral countries[1] of Eurozone since the ECB supported EU banks by extending liquidity. However, this lending process did not continue with the collapse of Bear Stern and Lehman Brothers. In this period, EU banks reduced their lending and this caused a credit squeeze. As a result, the recession reached the Eurozone and later resulted in the European Debt Crisis (Lapavitsas et al., 2010: 324).

First of all, the debt crisis revealed itself firstly in Greece and the Eurozone could not prevent it from spreading to other peripheral countries (Aygül, 2014: 278). After the outbreak of the crisis, public debt increased sharply in Southern Europe countries because tax revenue also decreased as a result of the recession. States started to search for funds from financial markets but banking sector was reluctant to lend to these countries; therefore, they issued state bonds which caused a rise in the supply of state bonds. This environment was quite suitable for speculation since speculators used currencies for speculation in heavily indebted countries in the EU. Nevertheless, this speculative attack was quite ineffective due to the currency union in the Eurozone so speculators canalized their interests to prices of sovereign debt. In this context, speculators concentrated on the Greek economy both because of its current account deficit problem and high public debt (Lapavitsas et al., 2010: 324-325). Eurozone crisis started with the declaration of the Greek government in the Eurozone. This declaration revealed that previous governments had given false information about the government budget. This misinformation caused lack of confidence among investors and these fears spread quickly to other Eurozone countries. In May 2010, Greek economy was provided a financial aid to avoid defaulting on

[1] It's noteworthy that there is more than one type of periphery in Europe: Southern and also Eastern peripheries (Aygül, 2014: 293). However, in this paper, Southern countries of the Eurozone (not the EU) are focused on.

its debt by the core countries and the IMF. Nevertheless, the crisis spread out to some countries such as Ireland, Spain, Portugal and Italy (Nelson et al., 2012: 2)

Actually, the crisis period is related as to which countries would take the burden of the crisis. Thus, the conflict between the member countries could be evaluated from this perspective (Hall, 2012: 367). In this point, a declaration made by Angela Merkel in March of 2011 explains the situation clearly. According to her, member countries had to work hard in order to compensate for their mistakes. However, she ignored the fact that German banks had earned high profits by giving loans to the risky southern countries[2] (Hall, 2012: 368). Moreover, Germany held countries accountable for the debt crisis and pointed out the inefficiencies in the public sector and their welfare spending. Indeed, the rescue package included structural reforms accordingly (Kutlay, 2013:172).

It is also noteworthy that there has been a conflict in the union at both national and supranational levels since Central Europe were slow to produce solutions for the problems faced by peripheral countries while recent crisis affected these countries seriously. Thus, there has been a 'tension between core and periphery countries' (Regan, 2013). Indeed, when one considers about the crisis period, it is stated that EU members have accused each other rather than dealing with the crisis or introducing rescue packages (Öniş and Kutlay, 2012).

3. POLITICAL ECONOMY OF THE CRISIS: A CONTROVERSY IN NORTHERN AND SOUTHERN EUROPE

First of all, the change that took place in 1980s in the economic doctrine also affected the EU and new institutions within the union have been established (Hall, 2012: 356). It can be observed that institutions were formed in the context of the neoliberal policy approach in the union. Nevertheless, while the EU grants the management of its currency to a central bank that is independent from political authority, it has been observed that same institutional regulations for fiscal policy could not be provided. Still, with the establishment of the EMU, some fiscal rules[3] to prevent fiscal profligacy were offered in the Maastricht Treaty. These rules contain a Stability and Growth Pact to maintain fiscal sustainability which can lead to an automatic fiscal stability (Schuknecht, 2004: 5). Stability and Growth Pact required member states to agree on the implementation of these rules. However; the problem of the pact was the implementation of these rules. That is because countries have different political economies, namely VoC[4] (Schuknecht et al., 2011: 9-11). Therefore, it is possible to claim that there has been neither common governance nor common fiscal policy in the EMU. Secondly,

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[2] Thus, not only the borrower but also the lender has the responsibility of these consequences (Hall, 2012: 362).

[3] These rules are as follows: "the prohibition of monetary financing of government deficits via central banks"; "the prohibition of privileged access to financial institutions by the public sector"; "the no-bailout principle'', which preclude the sharing of liability for government debt across member states (Schuknecht et al., 2011: 8).

[4] Hence, countries in the Eurozone were ill-prepared to the outbreak of the financial crisis in the summer of 2007. That is why the period between 1999 (the year the euro was introduced) and 2007 is called "wasted good times"(Schuknecht et al., 2011: 9-11).

according to the new economic approach, economic growth was tied to the structural reforms carried out at the supply side of the economy. This fact caused indifference towards demand-side policies. Moreover, the same policies aiming to improve the competitive structure of the economy were applied to all member countries. In this direction, the competitive discourse which was set as 'single market' and 'single currency' forced countries to apply structural reforms accordingly and a reform process began in all of the member countries. That reform process has brought along an adaptation process at the institutional level in the Eurozone (Hall, 2012: 356-357). In this context, adaptation discourse within the EU coincides with the *Europeanization* emphasis. However, it has been viewed that there are also differences between the countries. These differences are stated as *VoC*[5] in the relative literature. Therefore, Europeanization and VoC approaches are held as contraries to each other. That is because while Europeanization emphasizes adaptation and harmonization, VoC underlines ongoing differences. On the other hand, these two approaches are employed to analyse the process in the Eurozone. Thus, while VoC approach helps to explain the resistance of the member countries to the adaptation process, Europeanization approach has a crucial role to introduce the external effects which member and candidate countries are subjected to (Featherstone, 2008: 32- 34).

On the other hand, before the crisis, Europe had entered a new historical path and convergence occurred between the different varieties of capitalism. While, the Europeanization discourse continued before the Eurozone Debt Crisis, the crisis process caused this this discourse to be questioned (Lallement, 2011: 630). Thus, a controversy in Northern-Southern Europe can be analysed in this context. Therefore, the differentiations of the countries within the union lead us to focus on different forms of capitalism. In this regard, two types of capitalism emerge in the Eurozone. The first one is Northern European countries consisting of Germany, Netherlands, Austria and Finland; and the other one is Southern European countries consisting of Spain, Italy, Greece, Portugal and Cyprus**.**[6] (Regan, 2013: 2-3). For instance, because of the Northern countries' export-led strategy, economic growth depends on the competitive products developed by national firms to be able to compete at the international level. Thus, in order to achieve this goal, countries have aimed to improve the quality of their products and the efficiency of labour by either keeping cost of labour low or producing high value added products or substituting capital over labour. On the other hand, it is noteworthy that

[5] In the characterization of VoC, countries such as Germany, France, Finland, Norway, Denmark, Holland, Belgium and Austria in which an organized labour, less firm dependence on financial markets, and a system more inclined towards incremental innovations, are characterized as the CMEs, whereas Italy, Spain, Portugal and Greece can be classified as Mediterranean Market Economies (MMEs) (Hall and Soskice, 2004). Hall (2014) states MMEs's properties such that trade unions are rather strong but divided among themselves, making coordination in an economy-wide sphere more difficult than northern CMEs. Also, as the author notes, northern CMEs possess institutionalized vocational training systems making labour more skilled than southern MMEs (Hall, 2014). Lallement (2011) also mentions MMEs, counting southern economies such as Greece and Spain among others. These MMEs have rather weak systems of education thus face difficulty in climbing up in the global value-chain (Lallement, 2011).

[6] Brenner et al. state that *"…a neoliberalized Europe would represent neither fish nor fowl; it was considered an analytical impossibility in a bipolar regulatory world*." (Brenner et al., 2010: 186).

Southern countries which have adopted a demand-led development process lack institutional structures that can improve export-led performance. In short, while on one side there are Northern countries which pursue the export-led strategy and institutional structures accordingly, on the other side, there are Southern countries which are institutionally unprepared to compete and have no capacity to manage their monetary policy in the monetary union[7] (Hall, 2012: 358-359).

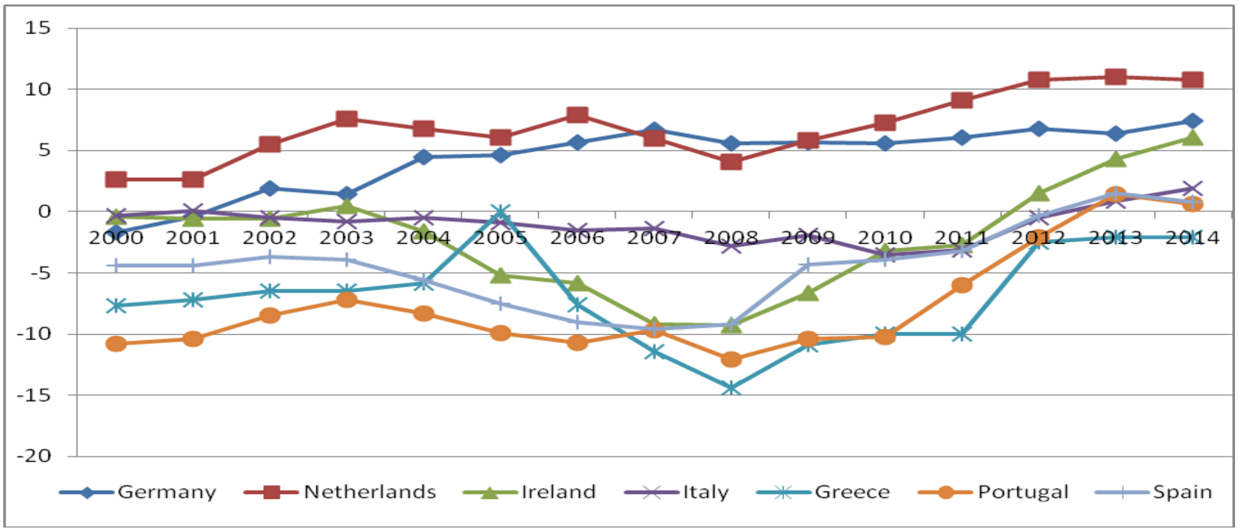
In this process, the establishment of a monetary union with a single currency facilitated the exchange of money between countries within the union. Moreover, having a single central bank, namely the ECB, took from countries their autonomy to implement their own national monetary policies. Thus, the risk of the debt crisis had spread within the union (Jessop, 2012b; Regan, 2013: 3). At this point, although monetarists predicted that monetary union would lead both to an economic and a political union in Europe (Regan, 2013:6) this was not an easy case as claimed. That is because all of the member countries of the EMU have neither standard neo-classical criteria nor institutional arrangements that will support long-term development. Indeed, in the related literature, there has been a debate that the debt crisis has proved the inefficiency of the union (Jessop, 2012a: 15). At this point, for example, current account surpluses of Northern Europe facilitated by exports were transferred to southern companies and also southern governments via northern banks. That is because Northern Europe which had an export-led strategy needed the demand from southern countries. These transfers have encouraged demand-led development in southern countries but on the other hand, indebtedness has made their economies fragile. The crucial effects of the Great Recession on Europe, especially on Southern European countries, and the background of the collapse of the southern economies are based on these facts[8]. This, in fact, is crucial as it reveals that southern economies have lost their competitiveness within the union (Hall, 2012: 360; Regan, 2013: 3-5).

Figure 1 shows both the current account surpluses and deficits in various Eurozone members from 2000 to 2014. For instance, Northern European countries such as Germany and Netherlands have had current account surpluses. On the other hand, Southern European countries including Italy, Greece, Portugal, Ireland and Spain had current account deficits. After 2012, Southern European countries have started to give current account surpluses except for Greece. These current account imbalances might be related to different growth regimes in Northern and Southern European economies. For instance, countries with a deficit needing financial sources borrow capital from surplus countries. The money flows from export led economies to demand led ones (Regan, 2013: 6).

[7] Although it is emphasized that monetary union may be unfavourable to periphery countries, it prevents the risk created by devaluating domestic currency. The risk may be an increase in interest rates or inflation rates. Therefore, dismantling the monetary union would mean the loss of an important device in blocking strong inflationary pressures and an increase in interest rates (Deutschmann, 2014: 353).

[8] Credit growth played a role in the growth period of Greece after 1990 as domestic saving rates declined from 1996/2000 to 2001/2005. Despite its prominence as a global merchandise carrier (%40 of EU merchandise trade is done via Greek fleet) the growth fuelled by credit growth brought together increases in the country's current account deficit (Schmidt, 2011: 81).

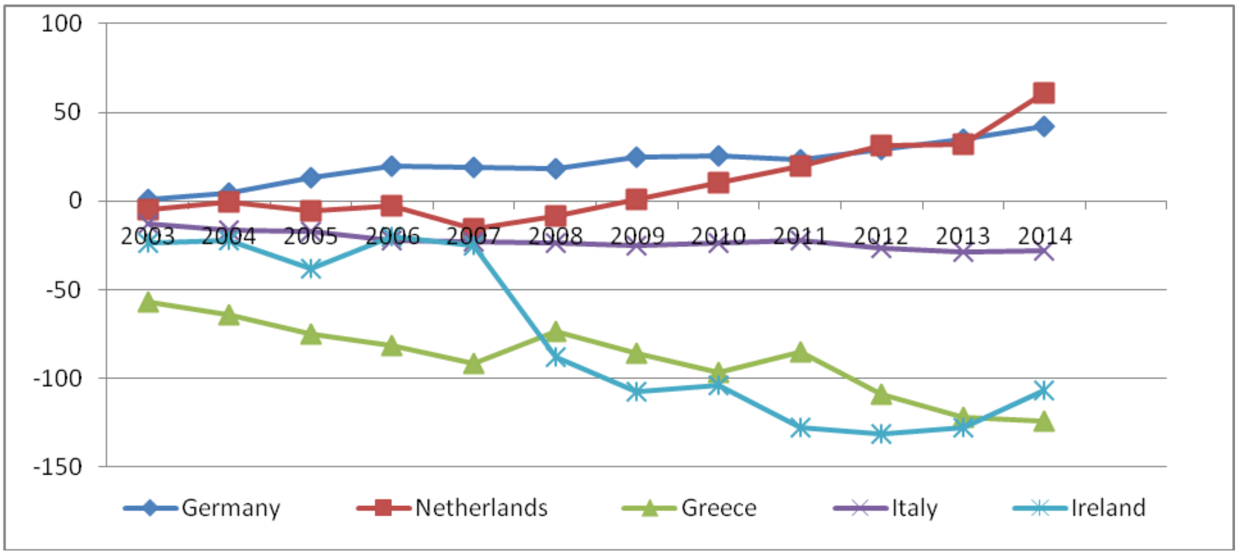
Figure 1: Current Account (% of GDP)



Source: OECD, 2015; Eurostat, 2015

Net international investment positions can be seen from figure 2. Net international investment data which is the difference between financial assets and liabilities in an economy gives information about the financial position of a country compared to the rest of the world. This data gives the opportunity to make an analysis for the external position of the country (Eurostat, 2015). Figure 2 illustrates that net international investment position of Germany and Netherlands is positive which could mean that these countries have acquired assets from other countries such as Ireland, Greece, Italy, among others. Furthermore, net international investment of Greece, Italy and Ireland is negative. It is understood that their liabilities are much more higher then their assets. For instance, foreign claims of German and French banks from countries such as Greece, Ireland, Italy, Portugal and Spain rose from %15 in 2005 to around %20 - %25 of their total foreign claims through the end of the decade. The amount of foreign claims of German and French banks from these southern European countries and Ireland rose from 500 billion dollars in 2005 to around 900 billion dollars in 2008 (Forster et al.,2011:14-15).

Figure 2: Net International Investment Position (% of GDP)



Source: Eurostat, 2015

According to discussions in the related literature, it is emphasized that what has been happening in the Eurozone is not a liquidity problem nor national states going bankrupt; it is about the wrong set of economic structures and problems of competitiveness in southern countries. These problems have shown themselves in many areas such as productivity, labour costs, trade imbalances and competitive structures (Jessop, 2013: 18).

Here, the point of emphasis is on the different political economies of the countries which are members of the currency union. Moreover, the arguments that the debt crisis can be overcome by structural reforms in goods, labour and capital markets ignore these differences between the countries in terms of political economy perspectives. Indeed, in this point of view, especially the Southern European governments could not implement their own national policies and this is one of the reasons that the debt crisis got even deeper (Hall, 2012: 357-358). Thus, it can be claimed that the political differences between nation states in the union and the reactions of the countries to the adopted policies are crucial to consider. Here, different cultures, different varieties of capitalism and different state-society relations are important factors in analysing the situation (Aspinwall and Schneider, 2000: 20). Therefore, one-size-fits-all policies are quite ineffective regarding export-led and restricted domestic demand model of the Northern economies vis a vis import-led and demand oriented model of the Southern economies. Moreover, in addition to economic issues, an analysis of the differences experienced by member countries highlights the 'state-society relations' (Kutlay, 2013: 180).

On the other hand, the argument that high social spending thus the unsustainable welfare state had caused the debt crisis is falsified by the performance of Ireland and Sweden. Indeed, while Ireland as a competitive state had been affected deeply by the crisis, Sweden as an unsustainable(!) welfare state got through the crisis period. And this caused the neoliberal paradigm to be criticized.

Therefore, it can be claimed that the debt crisis was not caused by social spending of the welfare states but by pressures of the financial sector on budgets (Bayram, 2013: 144-146). Indeed, the crisis and failures of the banks had a significant burden on public finance. It can be stated that European countries which have had problems in public finance are not welfare states for almost thirty years. On the contrary, welfare states like Sweden took no serious damage from the debt crisis (Bayram, 2013: 162-164). Furthermore, the emphasis of German politicians on financial inefficiencies of the countries is actually a weak portrayal (Hall, 2012: 367). Indeed, it can be exemplified that Ireland needed a high level rescue package (85 billion €, that is more than half of Ireland's GDP) while before the crisis the country had a budget surplus (Stockhammer, 2012: 45). It is said that both austerity and labour market reforms emerged as obligations set by the core Europe to the periphery countries. Thus, it can be highlighted that these obligatory policies of the core can be seen as economically useless and/or even harmful for others (Meardi, 2012: 12-13).

4. CONCLUSION

While monetary union in the Eurozone has been accomplished together with the use of the Euro in this area and granting the full authority of the monetary policy to a supranational institution, there has been no union in terms of fiscal authority and nation states have continued to implement their own fiscal policies. Thus, there have been significant differences in terms of public finance, tax regulations and labour markets among member states (Kutlay, 2013: 177). At this point, achieving a fiscal union would have a crucial role for the acceptance of the Euro as an international reserve money. However, in this context, it is possible to say that there is no common fiscal discipline within the union (Lapavistas et al., 2010: 5-6).

Nevertheless, the concern over the possible dissolution of the EU due to the debt crisis has forced countries to take responsibility (Kutlay, 2013: 177). As a consequence, rich European countries have loaned billions of Euros to other countries in the union in order to overcome the crisis. In addition, with the establishment of the short term European Financial Stability Facility, five hundred billion Euros were transferred to European Stability Mechanism. As a return for this financial support, southern countries were asked to apply structural reforms and programs. However, in spite of these reforms and programs, high unemployment rates and declines in levels of income were experienced (Hall, 2012: 363). On the other hand, although this financial support which was also backed by IMF could not provide stability, they prevented the collapse of southern economies. Furthermore, expansionary monetary policy of the EMU and purchasing toxic assets in secondary markets were also among the measures taken. However, all these interventions prevented only further deterioration and therefore, the economic recovery does not seem possible for now (Deutschmann, 2014: 344) since expected effects of the expansionary monetary policy of the EMU could not be obtained due to differences in institutional structures of the member states (Regan, 2013:9) and also varieties of capitalism. Therefore, the current financial crisis resulted in prominence of the nation states rather than the integration of Europe (Regan, 2013: 10). In this respect, one can claim that nation states have continued their political sovereignty while there has been an attempt for economic integration in the EU (Öniş and Kutlay, 2012: 8). The differences within the union have led member countries to react differently to certain actions; therefore, expecting the same results from the implementation of uniform policies to the member countries would not make much sense.

In conclusion, while there has been a monetary union, a fiscal union could not be implemented within the EU. However, after the crisis, it has been witnessed that core countries urged peripheral countries to implement fiscal austerity policies still in accordance with the neoliberal paradigm. And because of the differences among member states mentioned above, the effects of these policies were not satisfying. Thus, in this context, it is possible to claim that differences among member states have come forward rather than a unified European Union after the debt crisis period. In other words, VoC approach has overcome the Europeanization concept. Additionally, the global crisis has triggered not only an economic crisis but also a political fragmentation within the EU.

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