Greece, Germany and the Euro

by Keith Rankin, 3 April 2012

The financial and economic problems of the Eurozone seem to be in abeyance at the moment, at least in the New Zealand media. But the European crisis is a story that is not going away, with the European Union as a whole moving into recession - negative growth - as the demands being made by the northern Eurozone creditor countries on the southern debtor countries are suppressing demand for goods and services throughout the Union.

Radio New Zealand reported today (http://www.radionz.co.nz/news/world/102393/eurozone-unemployment-up) that the average rate of unemployment in the Eurozone has risen to 11%. (And that's only the jobless who meet the stringent international definition of unemployment.) While the southern European countries still have easily the highest unemployment rates, the overall increase is mainly due to rising unemployment in the countries that are not thought to be in crisis. In part it is due to southerners living in the north losing their jobs, or being less able to find employment there. Migration to the north is becoming less of a solution for young Greeks.

The usual explanation of the crisis is one of feckless southern Europeans - Greeks in particular - paying themselves unsustainably large borrowed incomes, avoiding taxes as if that were a national sport, and living at the expense of their generous but frustrated northern neighbours.

While all mainstream narratives contain some nuggets of truth, the bigger truth here is the 'mercantilist' business model, operated by the northern Europeans in general, and the Germans in particular. There is no shortage of Google responses to a search of "German mercantilism".

Before elaborating, I would like to recommend Neville Bennett's excellent historical perspective on the problem ("Greeks forced to kill what they love", *National Business Review*, 17 February 2012), the Media 7 TVNZ interview (http://www.youtube.com/watch?v=_L6KHdpCCZU) with Giovanni Tiso and Rod Oram (1 March 2012), and Tiso's article (http://overland.org.au/previous-issues/issue-occupy/feature-giovanni-tiso) "Europe's perfect ruins" in *Overland.*

Mercantilism is a political-business system, though it is often regarded as a defunct economic theory. The concept was originally deployed by classical and neo-classical economists (for example by Adam Smith as the "mercantile system"; by Thomas Malthus as the "commercial system") as a label for the self-defeating nationalist policy strategies of the European business classes in the nation-state and later nationalist periods, essentially from the 1490s to the 1920s.

The core belief was that economic success for a nation was to accumulate geopolitical power by running balance of payments current account surpluses; essentially by selling more than they bought, exporting more than they imported. By definition, to sell more than you buy makes you a creditor. Further, because mercantilism is, conceptually, zero-sum finance, countries can only be successful in mercantilist terms if other countries are unsuccessful. Unsuccess here means to buy more than you sell, automatically making you a debtor.

So Greece (and the other iPigs - Ireland, Portugal, Italy, Spain) can be understood as the losers of an intra-European mercantilist struggle. Conspiracy theorists argue that that's what the Eurozone was about, all along; a means through which the thrifty Bang countries (Belgium, Austria, Netherlands, Germany) can accumulate financial wealth at the expense of the iPigs. This kind of thinking resonates most of all in Greece, a country occupied by Nazi Germany in the 1940s.

The irony is that, in a mercantilist struggle (in which, globally, the winner nations are mostly in northern Europe, the Middle-East, and East Asia), the losers end up with lots of stuff (goods and services) and little money, whereas the winners end up enjoying living standards far less than their incomes entitle them to, sitting on their money rather than allowing it to circulate. To an economist, the losers, unless later punished by austerity programmes, get more stuff relative to costs incurred than do the winners.

In order for the winners to actually win in terms that an economist can appreciate – maximisation of long run consumption growth - they have to reverse their strategy every now and again. The Germans and the Dutch can stabilise the European system as a whole by spending their loot (or "treasure" as the 17th century mercantilists called it). But they don't and they won't, because they have a deeply ingrained cultural propensity towards earning more and spending less; a northern predisposition that can only be realised if it is indefinitely accommodated by the spending of others. Thus the iPigs countries, with a greater predisposition to spend, balance the Bang countries, but only so long as they are allowed to do so. Eventually, an über-crisis occurs. Then, following another Great Depression or World War or decade of inflation (or, if we are lucky, a managed default), a level playing field may once again be achieved and the game starts all over again.

The ball is, in 2012, in the court of the northern Bang countries: use their surpluses or lose them. Spend, or take a "haircut". The reality of this decade, however, is that those who can spend will not, and those who will spend can not. So the issue becomes the form that the financial losses will eventually take, and when the next of an escalating sequence of financial crises will occur.

We see now that the northern European countries are moving into recession, because they are losing their southern European customers. They are no longer able to sell to southern Europe on credit, as, as successful mercantilists, they were doing for many years.

The last time we had these kinds of dramas, in the 1920s, Germany was, by virtue of losing World War I, on the debtor side. The long-term lessen that Germans learned was to be a successful mercantilist nation; to never be a debtor victim again; rather, someone else should be the financial victims next time. (After the Asian financial and economic crisis of 1997-98, the Southeast Asian nations have also joined the northeast Asian countries in making that commitment to be successful mercantilists, at whatever cost to their own working classes.)

What happens when every nation makes a commitment to be successful mercantilists, and when none are willing (as New Zealand, like Greece, generally has been) to accommodate their surpluses by running current account deficits? That's when the race-to-the-bottom really gets underway; as it did in the 1920s, leaving the Great Depression as its legacy.

In the 1920s, France and the USA ran the gold standard much as Germany and the Netherlands run the Euro today. They accumulated gold because their currencies were undervalued against gold, whereas the British pound was overvalued. Britain defaulted big-time in 1931, thereby creating the necessary conditions for its own recovery. France and the USA, on the other hand, the winners of the 1920s' mercantilist struggle, suffered a decade of depression in the 1930s as their exports dried up.

Germany was in a unique situation in the 1920s. After World War 1, through the Treaty of Versailles, Germany was required to pay France and Britain directly, and the USA indirectly (given its war lending to Britain and France), a massive amount of gold. Not being a gold-producing country, Germany could only acquire this gold by running a trade surplus. (In the mid-1920s, Germany did pay, but only by borrowing from the USA; when debtors pay their creditors by borrowing from their creditors, it's known as Ponzi finance.) But France, the USA, and Britain (which in the late 1920s was undergoing an austerity programme not unlike that presently being undertaken willingly by Ireland) were all strongly resisting their requirement to buy German goods. So Germany defaulted on its reparation debts, despite its own massive austerity programme from 1929 to 1932. The Americans resisted German imports (cheap, thanks to massive deflation) by introducing its notorious Smoot-Hawley tariff in 1930.

We can be confident that, if in the 2010s, the southern European nations break out of the Eurozone by forming a Southern Euro (which would immediately depreciate), then Germany and the other northern Bang nations would impose trade barriers on those nations, effectively forcing them out of the European Union altogether. Germany, while imposing an export-led solution on Greece, is unlikely ever to allow Greece to succeed in exporting goods to Germany that Germany presently makes for itself. (The simplest way for this to happen would be for German companies to relocate to Greece and Spain, taking advantage of cheaper post-austerity wages in the south, and raising their own unemployment. But German nationalism will prohibit that.)

Can the Greeks get out of their bind simply by defaulting, leaving the Eurozone, and reintroducing the Drachma at a depreciated rate? This would be essentially the Argentine solution to its 2002 bankruptcy. Argentina had fixed its currency to the $US. In 2002 it defaulted, and allowed its peso to depreciate dramatically.

The answer for Greece is a qualified yes, but there are two provisos. First, just as those in Argentina with savings and nous had their savings in actual foreign currency - and not simply in pesos pegged to the dollar - so most wealthy Greeks will have most of their savings held outside of Greece, for example in German, Dutch or Swiss banks. Thus they'll make a speculative killing when or if Greece leaves the Eurozone, creating substantially more inequality in Greece.

The second proviso is that such a default will be seen by the markets as the first of many, creating a substantial European banking crisis.

Nevertheless, the sensible way to go would be for Spain, Italy, Portugal and Greece to secede simultaneously, creating a southern European Union that has the potential to recover much as Argentina did, and to export mainly to the anglo (English-speaking) economies, and to emerging economies, especially Latin America, in direct competition with northern Europe.

For the industrialised world as a whole, once the massive financial write-downs have taken place, and by whatever means and however much time it takes, there will be an opportunity to participate in a new economic order that specifically repudiates nationalist mercantilist strategies. At some time in the future there may be globally shared economic security and eco-prosperity; otherwise there will be globally shared insecurity and poverty.
