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Policy Failures, General Deficiencies, or Structural Constraints? An Alternative Explanation of the Greek Crisis

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Abstract

It is very easy to think of contemporary events as unique and isolated to our era. This is why many economists talk about the Greek crisis as unique to Greece today, or unique and isolated in space and time. That kind of framing triggers questions like "what did the Greeks do wrong?" and "who is to blame?" rather than raising questions about the internal relations in the prevailing modes of production. We live "in history" and what we have witnessed in the global economy over the last decade represents major historic transitions, culminating with Brexit this past summer when British voters narrowly opted out of the European Union's capitalist imperialism. How we think about today's challenges impact how we respond, so it is critical to consider the events in a historical context. This short essay contrasts a Marxian perspective of the Euro crisis with the more commonly documented neo-classical/neo-Keynesian and post-Keynesian explanations. In short, we consider how a Marxian explanation stacks up against the "mainstream" and the "liberal critical explanations" of the Greek crisis and the Euro zone.

A Marxist Structural Explanation of the Greek Crisis

A Marxian explanation of the Greek crisis would not surprisingly attribute the crisis to the fundamental elements in the sphere of production. Specifically, a Marxian perspective would emphasize two structural elements as they relate to capitalist crises in integrated markets. First, there are "internal" elements that contribute to crisis formation. Going back to the 2007-8 economic crises we can utilize theory of the tendency of the profit rate to fall as an explanation. Second, there are "external" elements that contribute to crisis formation, specifically broad unequal exchange within the EU, which worsened the position of Greece and aggravated the domestic crisis.
Each of these arguments, internal and external Marxian arguments are addressed below. First, the crisis is examined through the "internal" argument of falling rates of profits. Second, the external arguments are addressed where the crisis is explained based on the unequal exchange argument, which focuses on what we consider the "euro-core" and "euro-periphery" divide.

First Marxian Argument: The Falling Rate of Profit Argument

Marxian arguments hinge on the idea that social labor requires exploitation. Specifically, wage takers are not compensated for the work they do, i.e., their labor, but rather their labor power, or the minimum required to get the worker to return to work.

This surplus value represents exploitation in the Marxist models, but is also the direct source of expenses and profits when organizing production around social labor. Competition between capitalists encourages investments in capital in order to enhance labor productivity as they recognize that investments in labor reduce profits. Business crises are therefore a perpetual feature of capitalism.

Capitalists obsessively accumulate capital. At times, the accumulation of capital becomes too rapid. At such times, production increases faster than demand. When the overall rate of profit is low, smaller firms are especially vulnerable to business crises. They get taken over by larger firms. This concentrates power in the hands of fewer and fewer firms. Moreover, the middle class capitalists who sell their small firms to the big firms then become new members of the working class.

Marx showed this by demonstrating that profits are a function of surplus value (s) relative to the combined use of capital (c) and variable capital (v) – i.e., labor. If you rewrite this equation you will find the "rate of exploitation" (s/v) in the numerator and the organic composition of capital (c/v) – i.e., the use of capital relative to labor – in the denominator.

An interesting dilemma emerges. Profits will increase faster when the rate of exploitation grows faster than the organic composition of capital. However, in order for exploitation to continue to grow, an investment in capital has to be made. Hence, capital accumulation grows faster.

Second Marxist Argument: Imperialist Exploitation

In order to understand the external Marxian arguments of the Greek crisis it is critical to go back at least 40 years to put the current crisis in an appropriate perspective. The global market economy, spurred by rebuilding efforts in the wake of World War II, was in a slump in the 1970s.

The U.S. economy was hit hard in 1971 after the country's economy started running its first ever trade deficits in the late 1960s. This put tremendous pressure upon the Bretton Woods agreement, which served as the "rules of the game" between the United States and the rest of the capitalist economy participants in the post WWII era. As a result of slowing growth in the U.S., trade deficits, exceptionally high capital accumulation, and increased competition from abroad, Nixon was forced to relinquish the gold standard, and in rapid succession industrial output decreased ten percent in the Global North, banks collapsed, and Wall Street lost half its value.

The demise of the Bretton Woods system, economic decline, and *stagflation* should not have come as major revelations to economists who discern capitalism's internally destructive elements. Whereas Keynes pointed out in *The General Theory* that capitalists tend to hoard their excess capital, and that governments have to step in to make sure there is enough money in circulation, Marx insisted that it is the system itself that is at fault as individual capitalists will over-accumulate capital to the detriment of the economy itself.

Mainstream Explanations

Marxian arguments are rarely mentioned when addressing the Euro/Greek crisis. What we consider mainstream explanations instead fall into three broad categories. The first category of arguments describes the crisis as a unique Greek historical incident, or more specifically a 'Greek disease'. The second set of arguments suggests that the crisis was caused by the EMU's un-rectifiable structural deficiencies. The third category appears to represent a "middle-of-the-road" set of arguments, which suggest that the Greek disease and EMU 's deficiencies are rectifiable.

First Mainstream Explanation: It's a Greek Disease

The initial explanations, as communicated through the 1st Memorandum of Understanding – or the first bailout package, focused on the public sector and the fiscal deficits. The next versions of the adjustment programs added a focus on the private sector and the falling competitiveness of Greek industry. These explanations identify two major Greek deficiencies that contributed to the crisis: (a) large and persistent fiscal deficits financed through borrowing, which created large external debts and (b) falling international competitiveness.

This is the type of explanation expressed by the EU, the European Central Bank, and most neo-classical commentators, and are assumed to be caused by nationally-specific policy errors, thereby making it a Greek "disease". Structural deficiencies are simply assumed to be consequence of these errors.

In plain language, these arguments assume that the crisis is caused by low productivity, relatively high wages and a big public sector. As a result, fiscal deficits are accumulated, which had to be financed through loans, which again resulted in a widening external debt, and eventually was expressed in a deteriorating current account.

The Greek 'disease' hypothesis appeared to lose some of its appeal when other EMU countries required bailouts. As a response, contagion from Greece was attributed to the expansion of the problem.

Additionally, the "EMU Outcasts" were labeled as prone to fiscal and banking profligacy. As a result, the term "Greek" was replaced with "South" when referring to the "disease". Either way, the explanation hinges upon the *Twin Deficits Hypothesis***,** which contends that there is a strong link between the fiscal deficit and the current account deficit. I have yet to identify any empirical studies that have verified this hypothesis.

Second Mainstream Explanation: The EMU is NOT an Optimal Currency Area

The second mainstream explanation is that the EMU is not an Optimal Currency Area (OCA) – an OCA is a geographical region in which it would maximize economic efficiency to have the entire region share a single currency - and is therefore more likely to experience asymmetric shocks that generate national "diseases". American and British neoliberal and neo-Keynesian commentators continue to express these types of sentiments and generally imply that the EMU is inherently faulty.

This explanation does not state that the Greeks are without blame, but it allows neoliberals particularly to bash the EMU by stating, "It can't happen, it's a bad idea, and it can't last". Milton Friedman was particularly critical of the EMU.

These arguments rest on two underlying assumptions. 1) There are geopolitical issues that will lead to increased conflicts within Europe and between Europe and the United States. 2) Europe's failures can be explained by the theory of Optimal Currency Area, which is the closest thing mainstream economics have to the Marxist thesis of uneven development.

This explanation recognizes a rather weak structural cause. It is mainly concerned with the sphere of circulation, or how the common currency is related to diverse national economies and has not much to do with the sphere of production.

Third Mainstream Explanation: A combination problem

A third mainstream explanation of the crisis suggests that national policy errors such as high fiscal deficits and debt coupled with problems created by an incomplete economic unification of the EMU. This explanation suggests that a deepening of the economic and political unification of the EU, i.e., a fiscal and banking union with the political union, would solve the problems.

This argument also appears to provide a weak structural explanation. It basically agrees with the second argument, but suggests that a more unified EU, economically and politically, could overcome the problems.

Critical Explanations

The more critical explanations, i.e., explanations that are critical to neoliberalism but not capitalism itself, typically emphasize two inter-related elements. First, they emphasize the crisis-prone nature of capitalism, thus focusing on its world structure and the 2007/2008 crises. Second, they criticize EMU's neoliberal architecture and argue either for its dissolution or for its radical overhauling.

In short, these explanations recognize in a rather implicit or disguised manner the general deficiencies of the capitalist system. However, they do not appear to suggest that the immediate problem is capitalism but rather its forms of management or "financialization" of capitalism.

The "financialization" theory argues that we have witnessed a return to the pre-capitalist modes of operation. Banking in feudalism was after all based on unequal exchange. Hence, these types of theories argue that we are not witnessing an a-la-Marx crisis but a financial crisis, or a crisis of financialized capitalism.

An example of these type of arguments come from Lapavitsas who argues that the Greek crisis is a debt crisis, which is in agreement with the mainstream arguments, but that its roots can be found in financialized capitalism, which was triggered by the 2007-8 crisis. These arguments imply that the rate of profit has no role in it.

This is actually the mainstream argument in reverse. In other words, the lazy South did not cause the crisis. Rather, it was caused by the over-prudent "North". The Eurozone was polarized in a North with trade surpluses and a "South" with debts. The North gave loans to the South in order for the latter to buy its products.

Other critical arguments suggest that it was not the loss of competitiveness that gave rise to high indebtedness, but the other way around. The EMU, bringing together countries with very different rates of growth and profitability, gives rise to high levels of borrowing for the euro-periphery because it has higher profit rates which attract euro-core capital. This was facilitated by euro's low interest rates. Foreign loans boosted euro-periphery's domestic demand, therefore giving rise to increasing inflation and the deterioration of competitiveness.

Problems with the Mainstream and Critical Arguments

In summary, the mainstream explanations identify two sets of causes. First, high public expenditure, weak tax collecting mechanism, corruption and clientelism, over-regulated labor and product markets, high wages, a non-market friendly institutional environment, and deteriorating competitiveness (internal explanations). Second, they hinge upon EMU's deficiencies and repercussions of the 2007-8 crisis (external explanations).

There are several problems with these arguments when examining the crisis through a Marxian lens. First, Greek wages have been suggested as the factor triggering both the fiscal and the current account deficits. This argument rests upon the assumption that Greek nominal unit labor costs (ULC) - a measure of labor costs relative to labor productivity - increased faster than those of the other European countries. Thus they worsened both the budget deficit and the current account deficit. This is difficult to accept for a number of reasons.

First, as Lapavitsas has argued, nominal ULC is not a convincing measure of competitiveness as it is only to a very limited extent dependent on the wage level. Second, the Kaldor paradox (frequently used by macro economists) argues that competitiveness depends not only on low wages, costs competitiveness, but also on qualitative factors, i.e., structural competitiveness. Third, wages have been constantly lagging behind productivity in Greece (which increased faster than that of Germany). Thus, real ULC (i.e. the wage) have been falling continuously for several decades. Fourth, a decrease in wages aiming to restore competitiveness presupposes that rival economies will maintain their wages stable or, at least, will reduce them less.

These explanations also appear to underestimate the role of the 2007-8 capitalist crisis. This is considered as a mere financial crisis without origins and causes in the sphere of real accumulation. However, if this crisis is so significant and lengthy as it appears to be, it becomes difficult to neglect the notion that it must have some basis on the main sphere of economic activities, i.e., the sphere of production. More alarmingly, many of the mainstream explanations consider the Greek crisis as independent of the 2007/2008 crises. Collectively these explanations fail to appreciate the fundamental structural dimensions of the problem and relegate it either to policy errors and/or to weak structural origins.

The more "critical arguments" for the crisis appear to suffer from the general weaknesses of the "financialization" thesis. They do not appear to make any reference to the production structure of the Greek and other EMU economies. In fact they are also unable to recognize the existence of relations of economic imperialist exploitation between the North and the South within the EMU economies. The arguments uncritically accept the mainstream arguments about the Greek's relatively "high wages" being the cause of Greece's deteriorating competitiveness.
These types of arguments also appear to introduce problematic policy suggestions: If this is a debt crisis, it could be solved not by the exiting EMU but making it a full OCA. However, what would happen if the crisis runs deeper, i.e., grounded in the sphere of production? Then exiting the EMU and remaining within the Common Market would not suffice. A full exit from the EU would be required.

A Marxian Take on the Greek/Euro Crisis

From a Marxian perspective, history does in deed appear to repeat itself. As mentioned in the introduction, thinking about these problems as unique in time and place makes us vulnerable and ignorant. Similar to today's mainstream and critical argument; capitalist policy makers in the 1970s were not being willing to curb capitalism or at least recognize it's destructive powers. Keynes and "workers' laziness" became natural targets. Workers in the Global North had to work harder, expect less, and the government should get out of the way of free enterprise. Paul Volcker, Chairman of the U.S. Federal Reserve, even announced in 1979 that the Great Boom had ended and that "the American standard of living must decline." These arguments are very similar to those being made about Greece by advocates of austerity measures.

The idea that the poor will benefit from the rich getting richer gained general acceptance in the 1970s and 1980s and were supported by economists such as Friedrick Hayek and Milton Friedman, who believed that the solution to economic stagnation hinges on free trade, deregulations, privatization, and limited government control. Social programs were cut, wages were reduced, and a war was launched against unions and organized labor, while tax cuts were extended to the wealthy in order to spur economic growth. Volcker delivered a monetary shock (known as the *Volcker shock*) in order to break the inflationary cycles. The result was a three-year global slump, which allowed Reagan to launch his war on unions and install fear in workers.

The neoliberal agenda that swept the world in the late 1970s and early 1980s resulted in massive global economic growth. The world economy tripled between 1982 and 2007. It was, however, workers around the globe who paid the price for the growth. The trickle-down effect did not work. While incomes for the top 1% in the United States rose by 100% and the income for the top 0.1% increased by more than 200%, organized labor was defeated and real income dropped nine percent for the bottom 90% of wage earners in the United States between 1973 and 2002.

Inequalities continued to grow throughout the neoliberal era. Whereas the top 1% owned 38.7% of all corporate wealth in 1991, it increased to 57.5% in the early 2000s. European unemployment rates soared from about 2% in the early 1970s to well above 10% in the mid 1980s. Moreover, class power was restored in affluent societies. The share of national income of the top 0.1% of the United States population, a number that had decreased significantly since the beginning of the twentieth century, increased quickly and by the 1990s the numbers rivaled those of the early 1930s.

Global inequalities also escalated as a result of neoliberal policies. Whereas the ratio of income received by the 20% richest countries to the 20% poorest countries was 30:1 in 1960, the ratio was 74:1 in 1996. These ratios do not take into consideration that *within* country differences were increasing as noted above. Accordingly, the real difference between the rich in rich countries and the poor in poor countries were growing astronomically.

The *financialization* of the global economy that took place in the 1990s was the direct result of capitalists having to develop a new role for money in response to over-accumulation and lower profits. Hedge funds and derivatives were developed to protect investors from market risks, and monetary means allowed for an aggressive war against government intervention, and a general undermining of workers as economic bubbles were combated with the help of rising prices on commodity products. With no governmental control of the free flowing money, the economy turned highly speculative, consumers were urged to borrow, and the mortgage industry proliferated as the finance industry generated a variety of exotic tools for investors to earn return on surplus capital and for ordinary workers to finance their deficit spending, while the majority of them witnessed their real income continue to decline.

The neoliberal expansion, aided by a financialization of the global economy, started to tumble in 1997 during the East Asia meltdown. The climax appeared to be the 2008 crisis, which media referred to as a *financial crisis*. Marx argued in the third volume of Capital that the end of capitalism would present itself in that manner: “At first glance… the entire crisis presents itself as simply a credit and monetary crisis”.

Investors are not “betting” on future profits based on sales of products and services when they buy stocks and other assets. They are participating in purely speculative trading as they hope that the price of the stock itself will rise. This cannot continue indefinitely, as the events of 1929 should have taught us. As factors of production over-accumulate and investors chase fictitious capital, the capitalistic economy marches toward its own demise. Recessions and depressions may eventually end, but we may want to remind ourselves that the Great Depression only ended as a result of war and colossal human suffering.

Human suffering, like what we see in Greece, is how capitalism rids itself of crises. As a more progressive economist stated in 2009, we are experiencing “a statistical recovery, but a human recession”. This may be correct, but a California schoolteacher put it even more succinct: there is “statistical recovery because of a human recession.”

The truth is that capitalism is facing one of its most severe crises, and that the neoliberal phase and the associated financialization of the world economy, including the Greek economy, allowed capitalism to sustain itself to the benefit of the rich and to the detriment of the masses. The problem is not neoliberalism, which can be compared to a capitalist “caffeine surge”. The real problem is capitalism. When corporations and capitalists fail, the debts, bad investments, and excess capital do not go away. The state has to step in and cover the losses, which is what the Germans and the EU asked the Greeks to do over and over again, but the bill has to be paid by someone and is therefore passed on to the proletarians, or you and me or our fellow workers in Greece.

The capitalist forces play some crazy games with us to distract us from the underlying structural issues inherent in capitalism. On the one hand, they dangle carrots in font of us by appealing to our deep ingrained work ethics. We are told that if we just apply ourselves we can succeed and that capitalism is the “little guy’s” opportunity to compete with the big corporations.

On the other hand they scare us by appealing to our insecurities in hopes of becoming good consumers who contribute to economic growth. If the market tanks we are told that we have become greedy, lazy, complacent, and that we expect too much.

The crises we see in the southern regions of Europe today is not all that different from what happened in the United States in 2008. However, we tend to have relatively short memories and we don't typically associate with fellow workers abroad. Instead, banks and corporations that created the crises in 2008 were bailed out.

Poor racial minorities were conned into taking on mortgages in order to support the rapid increase in deficit spending. Further, the governor of the largest state, Arnold Schwarzenegger, cut billions from social spending. More than $100 billion were cut from California programs that directly supported the most disadvantaged, including rural migrant clinics, temporary assistance to the poor, health insurance to 900,000 children, and services provided to victims of domestic violence and maternal and child health. Similarly, Greek teachers and public employees became the scapegoats when they argued that they have the right to decent pensions after a lifetime of service.

What we can learn from the Marxian arguments and the history of global capitalism over the last four decades is that the "financialization" is actually a consequence and not a cause as the critical perspectives on the capitalist crisis suggest. Further, more capitalism is not the solution as argued by the mainstream economists. The key Marxian insights remain the focus on the internal contradictions of production and the need for imperial expansion. The ideas may seem dated, but history does in deed seem to repeat itself.