How Austerity Economics Turned Europe into the Hunger Games*

An interview with Servaas Storm

Lynn Parramore: What do we need to know about economists and their relationship to power?

Servaas Storm: In a brief moment after financial crisis, mainstream economists did some soul-searching and rethinking. But once the economy stabilized (somewhat) thanks to large-scale government support, most went back to "normal," rebuilding their professional status as neutral technocratic advisors and portraying macroeconomists as mere engineers solving practical problems. This is a chutzpah. Macroeconomics starts off from vision, moral values, perspectives and ideology, which color any analysis and need to be disclosed and debated. This was clear in the old days to economists as diverse as Joseph Schumpeter and Gunnar Myrdal, but not now anymore.

One example of "vision" is the unshaken belief of mainstream economics in the self-regulating and self-stabilizing powers of (financial) markets, which even Alan Greenspan admitted to be flawed.

It is exactly this "vision," or ideology as Greenspan called it, which allowed the financial system to derail and blow up our economies. But most economists refuse to debate their vision. They want to look scientific and neutral. Their refusal may also be directly linked to the fact that quite a few have undisclosed ties with financial-sector firms. But there is a far bigger reason, as explained by John Kenneth Galbraith long ago. By claiming that their economics has no content of power and politics but is neutral, mainstream economists have become "useful" as the influential and invaluable allies of the powers that be, who help to convince the public that the status quo, in Panglossian fashion, is the best of all possible worlds. They help de-democratize economic policy, which is quintessentially political and should be the subject of intense and informed democratic debate.

LP: This de-democratizing of economic policy has been playing out in the European economy, which you've compared to The Hunger Games. You note that we're watching capitalism turn into something where a parasitic few prosper at the expense of the rest, who must increasingly fight to get their most basic needs met. How did things get this bad?

SS: Crisis-struck Eurozone countries are told that they got into trouble because of wastefulness and a lack of price or cost competitiveness. The powers that be preach austerity: Cut your government expenditures (however essential these are). Deregulate — especially the labor markets in order to reduce wages and labor costs. Go sell more exports to recover, since your debt-strapped citizens at home don't have enough money to spend to keep the economy going. Do all this even if it means that wages (and living standards) get slashed by around 25-30 percent or more.

As a result of this one-size-fits-all policy prescription, all Eurozone member states (especially in Southern Europe) have been busy cutting down government spending, reducing wages and breaking down social security and labor protection provisions. The predictable, dramatic outcome has been that the crisis deepened to a near-collapse.

This frenzied race to see who can reduce labor costs the most looks like the contest forced upon 12 young people in The Hunger Games, a dystopian novel (and movie) about how a fictional dictatorship is using "Bread and Circuses" to distract and appease its oppressed and

disenfranchised population. The analogy between Europe's crisis and The Hunger Games is that it's competitive in the extreme. The contestants are the Eurozone members, each one trying to bootstrap its economy out of the throes of the most severe crisis in living memory. The audience judging each country's performance is not made up of reality TV watchers but of financial (bond) markets and credit rating agencies, whose supposedly rational views can make or break any economy.

The name of the game is boosting cost-competitiveness and exports—and its rules are carved into stone in March 2011 in a "Euro Plus Competitiveness Pact," a plan imposed by Germany and the ECB that forced the other countries to play.

LP: In your view, just about everybody is getting this story wrong. How so?

SS: Drastically cutting wages, which, mind you, shifts the huge losses of the banking-sector crisis to workers, follows naturally from mainstream economic theory. Wages, in this view, are just a cost item, and lowering them will lower prices and/or raise profit margins, and raise employment as well as net exports. Painful, say the advocates, but it will work. Plus, there is no alternative. That's why the International Monetary Fund (IMF) and the European Central Bank (ECB) urge Eurozone crisis countries to go for cutting labor costs — what economists call "internal devaluation."

Remarkably, many non-mainstream economists share this idea and blame the current troubles in Southern Europe on Germany's strategy of gaining cost competitiveness within the Eurozone by successfully squeezing its workers harder than everybody else. Germany's super-competitiveness is, in this view, just the flip side of Southern Europe's lack of competitiveness. Based on this diagnosis, the Left wants Germany to raise wages (relative to the rest) to resolve Eurozone imbalances.

It will not work. Why? A country is not competitive because its workers are paid less than those in other countries. It's the country's high-tech or lower-tech production and what kinds of exports it specializes in that drive economic success. The imbalances between countries in the Eurozone were actually driven by capital flows from Europe's core (Germany and France) to the periphery (Greece, Portugal, etc), which increased by a lot following the creation of the euro. Most of it was bank debt (not equity) and it was happily lent (directly or indirectly) to project developers and construction firms in Spain, fueling Spain's property bubble, and to Greece's already indebted government (which was considered almost as creditworthy as the German one just until the crisis broke).

So imbalances, in our explanation, were driven by the inflow of cheap foreign credit. These foreign loans were used to finance extra spending, a major part of which was on imports — basically machines and luxury cars manufactured in Germany. The surge in imports created deficits on the trade balances of the Southern European economies, but these imbalances had nothing to with rising relative unit labor costs or "excessive" wage growth in the periphery. By blaming the European crisis on wages and the cost of labor and ignoring the role of credit flows within the monetary union, economists are letting Big Banks off the hook, absolving them from any responsibility, leave alone blame – and unjustifiably so.

LP: You note a social Darwinist view of how Germany came out of the financial crisis as the economic powerhouse of Europe by squeezing workers and so on. How does your view differ from this dominant narrative?

Germany was once called "the sick man of Europe" because its economy was stagnant and lots of people were unemployed. The dominant narrative holds that the so-called Hartz Reforms of 2003-2005 turned things around when they deregulated labor markets, formalized "mini-jobs" (with lower than normal-tax and-social-security contributions), and made receiving benefits conditional upon the willingness of a person out of work to accept

any job offered to her. Many people claim that these reforms gave Germany a competitive edge to expand export market shares and grow. Mainstream commentators praise Germany as the only European Monetary Union (EMU) country that got it all right and they set it up as the example to be followed. This view has become codified in policy in the Euro Plus Pact (adopted by the European Council in March 2011).

This story is wrong on two accounts. First, Germany's superior export performance has nothing to do with labor cost competitiveness. Demand for Germany's exports has not been sensitive to changes in the cost of labor, as we show and as other studies (including ones by IMF, World Bank and ECB economists) confirm. German firms do not compete on "costs" but on factors other than price: things like product design, quality, high-tech content, and reliability.

They also compete because they cater to the fastest growing export markets like China and Russia, so German firms could benefit from the fiscal stimulus happening in those countries and hook into feebly recovering global demand.

Also, the German welfare state had things in place, like unemployment benefits, which steady the economy during rough patches, plus two stimulus and bailout programs. This robust stimulus restored basic confidence and protected jobs in export-oriented manufacturing, Germany's core-sector. The government enhanced the effects of these stabilizers by helping firms bridge the slump by funding part-time support for core-sector workers and avoiding layoffs until the recession is over. As a result, employers could adjust by changing the hours worked per employee, rather than layoffs. These co-ordinated and partly publicly funded short-time provisions helped stabilize German consumer spending, since short-time workers have more disposable and safer income than the unemployed. Germany recovered from the crisis despite, and not thanks to, the Hartz Reforms.

LP: Many argue that the old German economic model of "cooperative capitalism" has been happily replaced by something more like the American model, where companies focus on short-term profits, workers are restrained and benefits like unemployment insurance are reduced. You call that an economic myth. Why?

SS: It's a myth because it did not happen. At least it did not happen in Germany's core sector – export-oriented manufacturing – which is responsible for the country's export growth. Germany did not shift toward the American model, but in contrast continued to encourage long-term thinking in manufacturing activities and doing things to make products attractive through design and quality and so on rather than price.

This long-termism was based on a system of cooperative capitalism, with checks and balances on the behavior of firms, banks, and unions. This system creates commitment, both of employees (who think as they work) and of long-term bank finance, which is fundamental to innovation, technical change and continuous improvement. The German government protects core-sector jobs by supporting firms' research and development efforts, technological learning, and workforce training, and also by providing long-term committed finance through its national investment bank KfW (Kreditanstalt für Wiederaufbau) and Germany's public banks (Deutsche Sparkassen).

Wages in Germany's core sectors have actually increased relative to Eurozone wages, while employment protection and social protection for core-sector jobs have remained intact. The problem is that the core is not creating but shedding jobs, contributing to high unemployment. The aim of the Hartz Reforms was to bring down unemployment by protecting those core jobs while abolishing cooperative capitalism in services sectors like the restaurant industry or cleaning. Those industries had to absorb "excess" manufacturing workers, who got very low pay and at very flexible working conditions ("mini-jobs").

Now Germany has a two-tiered labor market. You've got high-paid productive workers in the protected and regulated core versus low-paid, flexible, and unprotected workers in McDonaldized services.

LP: You observe that this two-tiered labor market is an "inconvenient truth" about Germany's economy. What do you see happening if this trend continues in Germany and elsewhere?

Given that the future will bring even more robotization and automation, the labor-shedding by the productive core-sector will only accelerate. Because of this, you will see more conflicts over inequality, for starters. The fights will be over how to share (productive) employment and incomes but also over social protection (who gets what and who has to pay and how much). It will be harder for the core-sector to grow if most of the population has no money to spend on goods and services. Leaving it up to the market to fix this will just lead to still more inequality — Piketty on steroids, as it were. I think we can do better. But for that we need to fundamentally rethink the maxims of free-market economics. I guess that is the major aim of INET's Political Economy of Distribution Working Group.

LP: The real game in Europe, you suggest, is a battle of ideas. What ideas would you like to see prevail?

SS: We need to understand the benefits of economic co-ordination that doesn't rely solely on the market. As Germany's successful response to crisis shows, a co-ordinated ("co-operative") fiscal stimulus by Eurozone member countries would have stopped the economic downfall sooner and generated far superior outcomes than the current "Hunger Games" response in which each member country is forced to fend for itself, basically by unilaterally cutting its wages and thereby hoping to gain export market share at the expense of the others.

This strategy has had, and is still having, huge and avoidable social costs. (Yes, this is a damning indictment of the way European policymakers handled the crisis.) The same holds true for the monetary policy response of the ECB which is still based on conditionality: to get help from Frankfurt, governments have to impose structural reforms, a euphemism for labor market deregulation and breaking down social protection.

To illustrate, the ECB sent a letter to the Spanish government in August 2011 asking for wage cuts and the creation of "mini-jobs" to address the issue of youth unemployment in exchange for buying Spanish government bonds in the secondary market. These "mini-jobs" would pay salaries below the Spanish minimum wage. How to square this with the aim to turn Spain into a more competitive economy? I don't know, unless one wants Spain to directly compete with China.

The Eurozone crisis is a banking-sector crisis, and not a sovereign-debt crisis or a crisis of labor cost-competitiveness. Banks, especially the big ones, were all too eager to lend to firms, households and governments in the Eurozone periphery, in their euphoria creating a "credit glut" which they knew they could get away with if things went wrong. European integration has been primarily a process of financial integration – with credit flows between countries growing much faster than anything else. Eurozone banks are even bigger than U.S. banks. They got rescued, and still get pampered, while the population got stuck for the damage of their miscalculations (or misbehavior).

We should debate the role played by banks and financial markets and how we can make them pay for the crisis. We need ask questions about how socially efficient the deregulated financial sector actually is, if it can be improved, and whether or not we really need Big Banks.

It’s time to get rid of the myth that market competition is the overwhelming source of innovation (and competitive advantage). The truth is that the government plays a huge role as the ultimate risk-taker and financier and through social co-ordination (between firms and workers, firms and banks, and firms and the state). The strength of Germany’s core sector is testimony of the enduring power of co-operative and regulated capitalism.

Europe needs a hand-on industrial policy with government investment in innovations like renewable energy systems, public transport and education and health. Countries like Greece in the periphery need help in the task of industrial restructuring and upgrading. Resources should be going from countries like Germany to them instead of the other way around.

If the Eurozone continues the path of market mythology, imbalances and inequality will get worse. And if that happens, well, Yeats said it best: “Things fall apart; the center cannot hold/Mere anarchy is loosed upon the world.”

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