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A GREAT NATION DESERVES THE TRUTH

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There are three Europe stories — the Republican story, the German story, and the truth

By Gaius Publius on 2/28/2012 09:15:00 AM

In his latest column and a related blog post, Paul Krugman revisits the Europe problem, which turns out to be two problems.

The first problem is, How do the struggling European economies — the GIPSIs, meaning Greece, Ireland, Portugal, Spain, and Italy — right themselves economically?

The second problem is, How (and why) do people persistently misstate and misunderstand the first problem?

Krugman looks at the second problem first. He sees three stories (explanations) of what went wrong in Europe. From theblog post (my emphases):

> There are basically three stories about the euro crisis in wide circulation: the Republican story, the German story, and the truth.
>
> The Republican story is that it's all about excessive welfare states ... [and] the German story is that it's about fiscal profligacy, running excessive deficits.

Why is the first the "Republican" story (more about those quotes in a second)? Because they love to tell that story, says the Professor in his column:

> This story is, by the way, a perennial right-wing favorite: back in 1991, when Sweden was suffering from a banking crisis brought on by deregulation (sound familiar?), the Cato Institute published a triumphant report on how this proved the failure of the whole welfare state model.

The story is false, as this chart shows (click to open in a new tab). The **red** bars are the GIPSI states, the rest are in **blue**. Tall bars mean higher "welfare state" spending. Note that of the GIPSIs, only Italy is in the top six of welfare spenders, behind four rather healthy economies.

So much for "Republicans." What about the German story?

> [T]he German story ... is that it's all about fiscal irresponsibility. This story seems to fit Greece, **but nobody else**. Italy ran deficits in the years before the crisis, but they were only slightly larger than Germany's (Italy's large debt is a legacy from irresponsible policies many years ago). Portugal's deficits were significantly smaller, while **Spain and Ireland actually ran surpluses**.

And the truth?

> [T]he creation of the euro fostered a false sense of security among private investors, unleashing huge, unsustainable flows of capital into nations all around Europe's periphery. As a consequence of these inflows, costs and prices rose, manufacturing became uncompetitive, and nations that had roughly balanced trade in 1999 began running large trade deficits instead. Then the music stopped.

Where did the GIPSIs (and the U.S.) go wrong?

The best way to think about that last quote is as a simple supply and demand situation (phrases like "capital inflows" make the non-economist's brain hurt). When there's too much cash chasing not enough goods and services, prices simply go up. How can they not?

"Capital inflows" is economist-speak for "cash coming into a country." Investors dumped a lot of eager money into the peripheral countries, more money than the countries could absorb.

The eagerness of investors created a sellers' market for suppliers of goods and services (like manufacturing and labor). Sellers charged what the market would bear (why shouldn't they?) and the peripheral economies experience a bubble-like boom. The money flowed like wine (so to speak).

The same thing happened in the U.S. with the housing market. Take, for example, the temporary boom in towns like Hemet, California. In the days when "no one could lose money on housing," little Hemet was being build up as fast as money could be found to do it.

Why? Hemet was considered "driving close" (under an hour and a half) to the city of Riverside, a place with actual jobs, and houses in Hemet were cheap compared to those in Riverside. Buyers traded driving time for home prices, on the assumption that housing would never go down (and that gas would not go very far up).

Investors were eager to build in Hemet because buyers were eager to buy. Add in the illusion of safety, and the economy of sleepy little Hemet exploded — till it crashed.

The "illusion of safety" that did so much to wreck the U.S. economy also wrecked the peripheral economies of Europe. In the U.S., that illusion was supplied by the supposedly bullet-proof housing market — and by the ratings agencies that "blessed" with AAA ratings all of the mortgage-based derivative products the banks were buying and selling.

In Europe, the euro supplied the illusion. The common currency made everything magically safe. As long as France and Germany were strong, the euro would be strong everywhere. Investment in Portugal, Spain, and other peripherals was "blessed" by German strength, and investors in the GIPSI countries lined up at the door.

"Then the music stopped"

What happened next in Europe is the same as what happened here. After the crash, the elites (Our Betters) had only one bottom line. Make sure no banker loses money. Which explains Krugman's "Republican" and German stories perfectly.

▪ "Republican" story — If it's the people's fault (for being lazy and spendy), then it's right to punish them by taking away their welfare benefits (and give it to the banks to make good their derivative-based losses).

▪ German story — If it's the GIPSI's fault (for being "fiscally irresponsible"), then it's right to take the losses out of *their* hide (and give it to the banks to cover their now-vulnerable investments).

What's the answer to the first question above — "How do the GIPSIs right themselves?" They don't. They wait until the crisis is so great that leaving the euro won't make it worse, then they leave the euro, one by one. From the blog post (the article says roughly the same thing):

> [I]f you’re running a peripheral nation, and the troika [European Commission, IMF, World Bank] demands austerity, you have no choice except the nuclear option of leaving the euro, coming soon to a Balkan nation near you.

Count on it.

Why the scare quotes around "Republican"?

Those quotes are mine alone. Krugman calls his anti-welfare story Republican (no quotes) because the state of the Krugman is Dem-friendly in these articles.

Yes, the Republicans hate welfare, but they're not alone. The fact is that **all of Our Betters**, including the NeoLiberals, the Obamas and the Clintons, the Leahys and the Schumers, think like the so-called "Republicans."

It's not a Republican story, it's a Village story, an elite story, the DC cocktail story they all are telling.

Bill Clinton got caught here agreeing with Paul Ryan about the safety net.

By "paralysis" Clinton means "failure to cut the safety net." He might lie to you (remember all those NAFTA jobs?) but not to Paul Ryan. Village-on-Village violence is beyond the pale.

This is, unfortunately, the one time you can trust Bill Clinton. (Does the phrase "Tea Party the Democrats" suggest anything to you now?)

GP