Europe’s delusional economic policies

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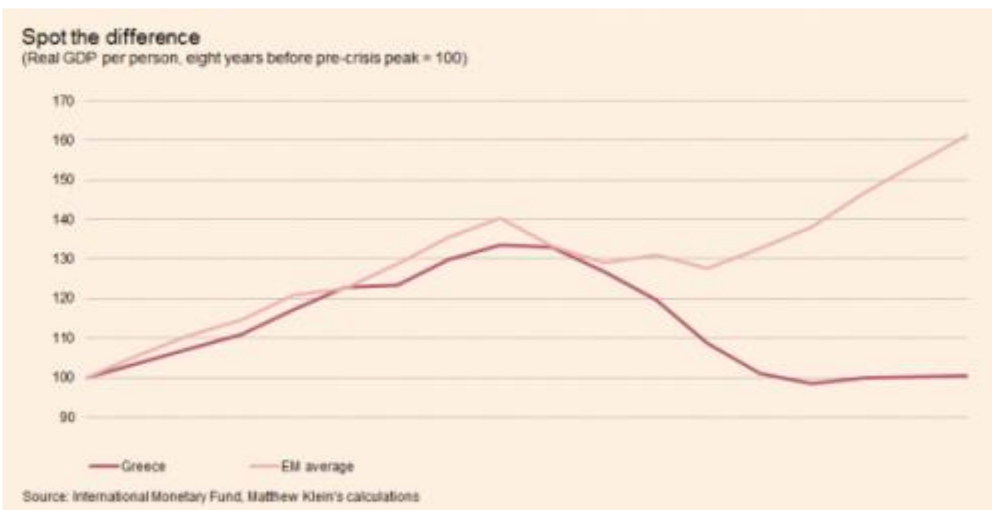
Yesterday three big things happened in three different eurozone economies that I think are interrelated. And I am going to tell you what I believe they mean for the European political economy by tying them together in this post under the somewhat provocative banner of “Europe’s delusional economic policies”. The reason for the title is that what I see happening is an anti-growth economic framework which is having political consequences by fomenting nationalism and anti-EU sentiment.

I want to start in Greece, where the numbers that came out today showed the economy contracted in Q4 2016. On Sunday night, I tweeted the following chart from Matthew Klein over at FT Alphaville:



The difference that monetary sovereignty makes in terms of economic recovery #Greece pic.twitter.com/7pNnwjlS3p

— Edward Harrison (@edwardnh) February 12, 2017

This chart encapsulates the narrative in Matt’s post – namely that Greece has underperformed other emerging market crisis countries on post-crisis growth. Here’s how

Matt put it:

Greece had a very different post-*crisis experience: it never recovered. By contrast, all the other countries were well past their pre-crisis peak after this much time had elapsed. On average, Argentina, Brazil, Indonesia, Thailand, and Turkey have outperformed Greece by more than 40 percentage points after nine years.*

The reasonable question is why. Matt answers that in the paragraph before, saying:

But unlike those countries, Greece lacked the ability to use the exchange rate as a shock absorber. So while Brazil and Greece faced the same type of downturn in dollar terms — about 45 per cent in GDP per person — Brazilian living standards only deteriorated about 2 per cent, compared to 26 per cent in Greece. The net effect is that Greece had a relatively typical crisis in dollars but an unprecedently painful one in the terms that matter most

My view is that what we are seeing, therefore, is the difference monetary sovereignty can make in post-crisis recovery because the currency does a lot of the heavy lifting. And this is true for developed economies as well. For example, we saw the UK and Sweden recover after a housing bubble and EMU turmoil in the early 1990s in part because of currency depreciations. But of course, Greece doesn't have its own currency so the currency can't depreciate.

Greece must use the internal devaluation route, which makes its labor, goods and services cheaper through a deflationary path – and that is very destructive to demand, to growth, and to credit. This, in my view, accounts for much of Greece's underperformance relative to emerging market crisis countries. In response to my tweet on Greece, Danish economist Lars Christensen pointed out to me that he had compared Greece to Turkey in 2015 and Greece came out poorly too. And his post noted that:

14 years later Turkey is still in many ways politically dysfunctional – in fact it has gotten worse in recent years – there has been rumours of plans of military coups, there has been *major corruption scandals even involving the Prime Minister (now president Erdogan) and the governing AKParty and lately the civil war in Syria has created a massive inflow of refugees and increased tensions with Turkish Kurdish population.*

Translation: it's not about reforms, people. It's about growth. **And the euro – and the policies tied to membership – is anti-growth, particularly for a country like Greece that is forced to hit an unrealistic 3.5% primary surplus indefinitely. And there will be no debt forgiveness either, as the IMF has said is necessary**.

So, that's the first story. But then, while I was driving, I was listening to Bloomberg radio and heard an interview that EC President Pierre Moscovici gave Guy Johnson and I thought the exchange was incredible. The part I found very telling comes is on France and it comes about 4 minutes into the clip when Johnson asks Moscovici about austerity in France affecting the election in April and May. Moscovici's response struck me as completely tone deaf because he says first that France hasn't even had any austerity to begin with. And then second, he goes on to say in effect that the rules are the rules – and that it's a question of credibility economically and politically.

Let me be clear about what Moscovici was saying here. He is saying that in the EU – because countries are currency users without monetary sovereignty – debt sustainability is a key consideration. And the EC has to hold big countries' feet to the fire on debt because not doing so would weaken the Eurozone's credibility economically and politically. Think about this in the context of Greece. The corollary of what Moscovici is saying about France applies to Greece – in that the EC has to hold Greece's feet to the fire for exactly the same reasons – irrespective of the negative impact on growth. So what Moscovici is saying about the need for credibility in France in the context of austerity strengthening Le Pen's hand is true for the contentious negotiation with Greece too.

The last event I want to tie in here was in the Netherlands. The Dutch evening news program Nieuwsuur is doing an 8-part election series and the first instalment aired last night. But let me describe what was presented. Nieuwsuur talks to a number of ordinary Dutch people they seem to have met through a food bank, a place they go because they or their families are struggling to get by years after the Dutch housing and economic crisis has ended. **And what these people say is a lot like what people in the rust belt in the US were saying last year: for them the crisis isn't over.**

The twist here, though, **is that they see a lot of refugees coming to the Netherlands and getting clothing, housing and a bunch of other services from the Dutch government. And to a person they ask: why can't we get more help from the government if the government is willing to feed, clothe and house these refugees?** The [result is this] that I have translated from Dutch:

Arie and Harma Kempinga and their three children literally count every penny. The family from Oldambt in East Groningen has been in debt fort ten years, with no end in sight.

Arie and Harma have eighty euros a week left over, just enough groceries for half a week. To be able to eat in the other days, they go to the Food Bank. Like nine other families in Oldambt. Many of them feel abandoned by politicians. They will vote for the PVV.

Q from Niuewsuur: How is the Netherlands doing?

Arie: "Not so good. I think the world and the Netherlands are being torn apart, thanks to the government. All the rules that are coming and we have already — The Netherlands is being destroyed…"

Harma: "I totally agree. The crisis is over, they say, but not for us. And not for many Dutch people. I think it will all get worse. People with lots of money lining their pockets and those who have less, get…. even less."

[…]

Q from Nieuwsuur: Who are you going to vote for?

Harma: "The CDA definitely won't be getting my vote. The PvdA neither The VVD neither. I am still debating it. On the one hand, I think that Geert Wilders says very good things. But sometimes he goes too far, about foreigners. We also have neighbors from Syria and they are hard workers. That does give me pause. But with some things he's right."

"He wants to do more for people who work, like us, and not touch the child allowance and help the elderly. I do not know if he will make it better, but maybe a tiny bit easier."

Arie: "I will not vote, I'm fed up with politics. It will be a blank ballot. I have no confidence in politics – for years now"

Q from Nieuwsuur: Do you feel that the government has abandoned its citizens?

Arie: "Absolutely, they can send millions to Greece or a country at war, but if I ask for a stipend for my daughter's studies for later, they say they can't help. There's no money for that."

So, there you go. You can help refugees and bail out Greece, but you can't give us money to help with my daughter's future education. The tie to the Greek situation is crystal clear**. Greece is not getting any forgiveness because voters in the Netherlands and Germany, who go to the ballot box this year, don't want this. It's as simple as that.**

I don't know how you solve this politically. What I do know is that none of this is good for growth. **To me, Europe's economic policies are delusional. It's clear they are anti-growth.** But everyone feels boxed in politically because the lack of monetary sovereignty for eurozone governments mandates that governments restrict spending to maintain fiscal sustainability. This causes electorates to turn inward and circle the wagons – as we see in the Dutch reactions.

Eventually there will be a change. But it won't come before a political and economic crisis force it. **I find it hard to think of European equities as an overweight in that environment, despite relative valuation. And periphery government bonds have**

incalculable default risk as a result of the political uncertainty.

Wilders' PVV is polling first in the Netherlands. I believe they will get the most seats. But that doesn't mean Wilders will become Prime Minister. Present PM Mark Rutte's VVD could try and form a PVV-less coalition government. But the more stealth PVV voters there are, the harder that gets. And many of those votes will come from Eurogroup head Jeroen Dijsselbloem's PvdA party, making it harder to form a PVV-less coalition. And if Dijsselbloem is out of the Eurogroup, who replaces him? Does the PVV have a role in the Eurogroup? I ask because it goes to Greece, Grexit, and debt relief.

Wilders – who is anti-EU – and the Netherlands should be the focus of those questioning a breakup of the eurozone and the EU, not Le Pen. And this vote is next month.