

APPENDIX 4

WHY DID THE “BAIL-OUT” STATES NEED IT?

Contents

Macroeconomic context leading up to the financial crisis	1
High GDP growth and unbalanced development	4
The impact of the Single Market.....	5
The impact of the euro	5
Credit-fuelled expansion.....	5
Sovereign-debt crises.....	6
Poverty and social exclusion	6
The value of the AROPE measure in capturing the full impact on poverty of austerity programmes ...	7

Macroeconomic context leading up to the financial crisis

The financial crisis was evident in most of Europe by the first quarter of 2008. In the “Great Recession” of 2008-2009, of EU states only Poland avoided a slump in GDP of 3-6%. Ireland and Romania suffered a bigger contraction than the EU average that year, but two “bail-out” countries, Greece and Portugal, did not. The UK and Spain also had lower growth contraction than the EU average.

From 2010 many states recovered to positive and even robust growth. For example, Germany recovered from an above average contraction to strong positive growth in GDP. Portugal and the UK did recover in 2010, at close to the EU-27 average rate, but at only half the German rate. The other four of our Task Force group’s states (Greece, Ireland, Romania and Spain) failed to recover in 2010.

EU recovery faltered in 2012 and overall the EU was in recession. The EU-27 (-0.4%) and the Eurozone (-0.6%) moved into recession in quarter three of 2012 compared to the same quarter in 2011. The November 2012 data from Eurostat¹ showed that compared to one year earlier, GDP by volume had fallen by -7.2% in Greece; -0.5% in Ireland (although over 2012 alone Ireland showed a slight increase of 0.5%); -3.4% in Portugal; -0.8% in Romania and -1.6% in Spain. The UK showed zero growth though like Ireland, over 2012 alone it showed a very slight upturn of 0.1%.

Table 1 below shows the evolution of GDP by volume from 2006 to 2011 for our Task Force states and for comparison, Germany, the Eurozone and the EU-27. Table 1 might suggest that the Troika countries may have needed a “bail-out” because of what happened after the financial crisis rather than its initial impact, including financial markets’ refusal to refinance certain governments’ bonds without ever higher risk premiums above Germany’s borrowing rate. But it involves also the nature of governments’ response to the crisis, including initial deflation and then from 2010 the impact of austerity programmes versus the effectiveness of counter-cyclical spending mechanisms such as the

¹ Eurostat (2012) Growth rates of GDP by volume, *2012 news release euroindicators 159/2012*, November. The figures are seasonally adjusted and compare the third quarter of 2012 with the same quarter in 2011, except Ireland (quarter 2).

“automatic stabilisers” of rising welfare spending and falling tax revenue in recession. EAPN’s crisis report of 2011 discussed some of these issues.²

TABLE 1:
REAL GDP GROWTH RATE BY VOLUME: PERCENTAGE CHANGE ON PREVIOUS YEAR
(F=forecast; P=provisional)

Country	2006	2007	2008	2009	2010	2011	2012
Greece	5.5	3.5	-0.2 ^p	-3.1 ^p	-4.9 ^p	-7.1 ^p	-6.0 ^f
Ireland	5.4	5.4	-2.1	-5.5	-0.8	1.4	0.4 ^f
Portugal	1.4	2.4	0.0	-2.9	1.9	-1.6 ^p	-3.0 ^f
Romania	7.9	6.3	7.3	-6.6	-1.1	2.2	0.8 ^f
Spain	4.1	3.5	0.9	-3.7	-0.3	0.4	-1.4 ^f
United Kingdom	2.6	3.6	-1.0	-4.0	1.8	0.9	-0.3 ^f
Germany	3.7	3.3	1.1	-5.1	4.2	3.0	0.8 ^f
EU (27 countries)	3.3	3.2	0.3	-4.3	2.1	1.5	-0.3 ^f
Euro area (changing composition)	3.2	2.9	0.4	-4.4	2.0	1.4	-0.4 ^f
Euro area (17 countries)	3.2	3.0	0.4	-4.4	2.0	1.4	-0.4 ^f
Euro area (16 countries)	3.2	3.0	0.4	-4.4	2.0	1.4	-0.4 ^f

Source Eurostat (2012), code tec00115, accessed at http://epp.eurostat.ec.europa.eu/portal/page/portal/national_accounts/data/main_tables

In Table 2 below (for 2006 and 2011), it is evident that there is not a single proximate cause for the troika ‘bail out’ states’ situation. Indeed the major sources of imbalance and their timing vary in all six of our Task Force member states.³

² Dr. Katherine Duffy for EAPN, [Re-engaging Hope and Expectations. Getting out the Crisis Together – Alternative approaches for an inclusive recovery](http://www.eapn.eu/images/stories/docs/EAPN-position-papers-and-reports/2012-crisis-report-katherine-duffy.pdf). EAPN’s analysis of the crisis, 2012, available at: <http://www.eapn.eu/images/stories/docs/EAPN-position-papers-and-reports/2012-crisis-report-katherine-duffy.pdf>.

³European Commission (2012) *Macroeconomic imbalances procedure scoreboard Headline indicators*, 1 November 2012 statistical information accessed at http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/MIP_NOV_2012/EN/MIP_NOV_2012-EN.PDF. See also Eurostat (2012) *Macroeconomic imbalance scoreboard* accessed at http://epp.eurostat.ec.europa.eu/portal/page/portal/excessive_imbalance_procedure/imbalance_scoreboard

TABLE 2:**SOME INDICATORS OF TASK FORCE STATES' ECONOMIC POSITION PRE-FINANCIAL CRISIS (2006) AND MOST RECENT DATA (2011), WITH GERMANY INCLUDED FOR COMPARISON**

	A1 2006 Govt debt as % GDP	A2 2011 Govt debt as % GDP	B1 2006 Current account balance as % GDP	B2 2011 Current account balance as % GDP	C1 2006 Private debt as % GDP	C2 2011 Private debt as % GDP	D1 2006 House price increase relative to final household consumption	D2 2011 House price increase relative to final household consumption
Greece	107.5	170.6	-7.2	-4.3	98.0	125.0	9.3	-5.1
Ireland	24.6	106.4	-2.5	0.0	217.1	309.5	12.2	-15.2
Portugal	69.4	108.1	-9.8	-9.1	209.2	249.4	-1.0	-3.6
Romania	12.4	33.4	-9.1	-4.3	67.7	71.8	Na	-18.9
Spain	39.7	69.3	-0.2	-1.6	200.4	217.9	11.8	-10.0
UK	43.3	85.0	-2.7	-2.2	206.3	204.6	3.5	-5.4
Germany	68.0	80.5	5.3	5.9	124.3	127.8	-1.4	1.4

*Source: Adapted from Eurostat MIP Scoreboard Headline Indicators
1 November 2012, tables 1,6,8,9,*

Almost to the point of forgetting the global banking crash of 2007-8, government profligacy has been much blamed in the narrative of the crisis. But this explanation does not stand up in most of our Task Force states.

Across Europe, government debt has tended to be a much lower percentage of GDP in former central and Eastern Europe especially in the Balkan and Baltic States. This is partly due to the influence of almost two decades of World-Bank/ IMF led structural adjustment programmes in the post-communist / socialist era. Government debt has been much higher as a percentage of GDP in western and north European countries (except Luxembourg). But this percentage had been falling for a decade or more in Scandinavia and much of northern Europe, but rising in southern Europe.

Nevertheless, Table 2 above (columns A) shows that of our Task Force member states, only Greece and perhaps Portugal had a potentially problematic level of government debt prior to the crisis. Greece's high public debt levels of around 100% or more (like Italy's), are longstanding, going back to at least the mid-1990s. Ireland had very low government debt by western European standards; the post-crisis figure reflects the government's decision (instigated by the European Commission) to take over responsibility for the whole loan book of private bank debt; one third of current government debt is attributable to that. Post-crisis, all of our Task Force states except Romania have potentially problematic levels of government debt, yet they are three or four years into cuts programmes of almost unprecedented scale, depth and duration.

Prior to the crisis, growth of private debt (Columns C) was the more serious problem in some of our Task Force states - Ireland, Portugal, Spain and the UK, but not Greece and Romania, which had amongst the lowest levels of private sector debt in the EU. On the other hand Denmark, Netherlands and Luxembourg all had private debt above 200% of GDP in 2006. It is tempting to suggest that in our Task Force states as in much of Europe, either the public sector or the private sector had taken up debt to sustain the expected standard of living of European peoples.

In Table 2 above (Columns D), positive values show that house prices rose faster than general consumer prices and vice versa. The table shows that in 2006 Greece, Ireland, Spain and the UK experienced house price inflation above that of general consumer prices. Housing “bubbles” and cheap and easy credit may have stimulated households’ perception of their wealth and therefore their propensity to borrow. In Greece, Ireland and Spain the relative rate of house price inflation dropped sharply after 2006 but in the UK it continued to rise to 8.2 in 2007 before beginning to fall back. In Portugal there was no house price explosion relative to general consumer prices. The rate was low and negative from 2006-2008 and positive between 2008 and 2010. There are no data available before 2009 for Romania, but house price inflation was severely negative in later years.

The current account balance indicates a country’s external trading position. In the Eurozone, the trade balance is neutral; essentially, what the south owes the north has. In Table 2 above (Columns B), the negative figures for 2006 show that all of our Task Force states imported more than they exported to the rest of the world. The imbalances were at their worst in 2008. By 2011, figures show Ireland posted an import-export balance, and the current account balance had improved in most of our Task Force states, but their trading positions were still very weak compared to the large trading surplus enjoyed by Germany. The trading positions of the emergency assistance countries are expected to continue to improve and some were expected to show a surplus in 2013. The cuts programmes are certainly effective in helping balance of payments positions. But most of the improvement is the result of a decline in imports due to lower domestic demand, and not due to a much greater ability to sell exports, although there has been some improvement in Ireland and Spain.⁴

Just eight EU countries ran surpluses in 2006 and only seven in 2011 (Belgium went into balance of payments deficit). It was mainly the same EU countries in surplus, but during this period each of the Baltic states showed remarkable Balance of Payments turnaround following incredibly tough fiscal squeeze; overall domestic wealth is lower than it used to be and many people are poorer than they used to be. While our Task Force member states may have a competitiveness problem it should be noted that it is not only they who have the problem. Most countries in the world are in balance of payments deficit and the majority of the worlds’ surplus is held by China, Germany and some Arab oil states.

High GDP growth and unbalanced development

The relatively high public or private debt in our Task Force states can be explained by their highly leveraged high growth rates in years preceding the financial crisis. For Greece, Ireland (the “Celtic Tiger”), Portugal and Spain, entry to the single market stimulated growth. Romanian growth averaged around 6.5% between 2003 and 2008 when it was preparing for accession to the EU (Romanian fiche p 5). The UK Labour government presided over ten straight years of growth before the crisis and Chancellor Brown suggested that he had abolished the business cycle: “no more boom and bust”.

The Task Force states experienced unbalanced development exacerbated by de-industrialisation of traditional employment with few new manufacturing growth areas. Some states had particular “bubble” sectors especially real estate and construction in Spain, Ireland, UK and Greece. All of the states represented in the Task Force had expanded their public sectors including large employers such as education and health, which increased the size of the high-skill high-pay workforce.

⁴ IAGS (2012) *Independent annual growth survey: first report* iAGS 2013, November, p14

The impact of the Single Market

De-industrialisation accelerated in most of the sub-group's states after entry to the EU Single Market, in which they were not competitive as their labour costs grew. Current account deficits doubled in Greece and Spain between 2001 and 2008. On the other hand Romania's growth export performance was strong between 2002 and 2008, when it went into reverse following the financial crash, leading to a rising trade deficit.

The impact of the euro

Greece in particular entered the euro at an overvalued exchange rate.⁵ Greece, Portugal and Spain faced further de-industrialisation on entry to the single currency, losing the last vestige of protection for domestic industrial development. The lack of an EU industrial policy meant that these states did not gain from giving up scope for domestic strategy.

Credit-fuelled expansion

The Single Market and European Monetary Union were designed respecting the requirements of northern, industrial, developed wealthy states. Or at least, it was designed for their businesses. While German export businesses gained from the Eurozone, German wages and economic growth stagnated. Between 1998 and 2011 German exports grew 115%. In the same period the German average annual growth rate was 1.4%; this was below the EU average of 1.7%, or the 2% in the UK and 2.7% in Sweden. Real German personal disposable income grew by 7% over the period compared to 13% for Spain and 18% for the UK, France and the USA. The money received by German exporters goes through the ECB Target2 system as paper claims in the Bundesbank, which are credited to the bank accounts of the exporters and can then be recycled to allow foreign (often southern European) buyers to continue fund purchases of German exports. But the money does not circulate in the German economy where anyway stagnant German wages held back domestic demand for goods and services.⁶

Essentially, the weaker Eurozone Member States experienced zero risk premiums from lenders with confidence in the single currency. Northern European financial entities (as well as those from outside the EU), looked for a profitable home for surplus funds. Credit-fuelled consumer booms in housing and commercial property development were especially evident in Greece, Ireland, UK and Spain. Real estate is one of the few industrial sectors in which employment cannot be "off-shored". Credit expansion in the UK was enabled by its position as a world financial centre and laxity in the long boom. In the Eurozone, expansion was consequent on access to cheap borrowing at "German"-level low interest rates. Debt in all the Task Force Member States was legitimised to differing extents through a combination of an increasingly globalised consumer culture and confidence in the right to "catch-up" with core Eurozone living standards, plus faith that the economic model had permanently shifted gear and global capitalist individualism would deliver ever higher living standards for the many: the "end of history".

This was always unsustainable and the banking crisis exposed it. Recently the German government has allowed some small upward pressure on domestic wages, but businesses are now looking more to non-EU markets to reduce dependence on austerity-constrained European buyers.

⁵ IAGS (2012) *Independent annual growth survey: first report IAGS 2013*, November, PUT PAGE REF

⁶ Beck, G (2012) In reality, Germany is shackled to a corpse, *The Guardian*, 8 January, p28

Sovereign-debt crises

Public debt rose in almost all states as governments responded to the financial crash by fiscal stimulus to prevent a slump induced by a credit freeze. The financial crisis became a sovereign debt crisis in some EU states when financial actors realised that some states could go bankrupt and began charging high risk premiums for refinancing government debt. Interest rates on government bonds in the exposed countries were close to 7% against less than 2% for Germany and debt became unfinanceable for Greece, Ireland and Portugal. They suffered severe recession. Irish state revenue fell from €47b in 2007 to €31.5b in 2010 and the budget deficit reached 13.1% of GDP in 2011 (9.4% excluding bank financing) and debt reached 108%.

In Ireland and the UK sovereign debt burdens rose because of bailing out their reckless, bankrupt banks.⁷ Irish public debt quadrupled, UK public debt doubled. Iceland, like Ireland and the UK had a banking sector with paper assets much bigger than its economy and clear evidence of reckless and fraudulent activity. But rather than take the Irish course insisted on by the European Commission where the Irish taxpayer took over the whole burden, Iceland audited bank debt and refused to cover the most egregious part of it, including bank debt owed to UK local municipal investors.⁸

In none of the Task Force group had the tax base or tax rates extended adequately alongside public expenditure. Greece and Romania had the additional problem of very significant tax evasion and avoidance or lack of transparency and poor tax-gathering procedures. But all of the Task Force participants recognised something like the “crony capitalism” of Irish builders and politicians or the “business breakfasts” and “revolving door” between British politics and finance which inhibited proper oversight of their over-heating economies.

There has been much negative public discussion about the governance and strategic failings of the southern and eastern periphery states – although they are not the only European countries with problematic debt and deficit, or indeed problematic governance including governance of banks in a number of north European states, including UK and Germany.

UNCTAD pointed out that the fiscal stimulus post-crash was “justified by the gravity of the situation”. Public finances are worse in the UK, the USA and Japan than in the Eurozone and the current threat to the global economy is the “counterproductive” “fiscal austerity” from 2010 that has become “the golden rule throughout the Eurozone”, “especially draconian fiscal retrenchment in the Southern European member States”.⁹ We have been here before in the 1930s; we seem to have learnt nothing and forgotten nothing.¹⁰

Poverty and social exclusion

While actual real incomes and levels of living are very different in the Task Force Member States they have in common an experience of rising levels of absolute poverty on a fixed standard, due to falling real incomes consequent on the crisis and austerity response to it. The increase in food insecurity is evident in the rapid rise of food-banks in the UK, Spain, Portugal and Greece.

EAPN’s Crisis report noted that the first sufferers from the financial crash were low income workers whose employment, hours and wages were immediately affected. The poorest people, whose incomes are primarily from cash welfare benefits, have been more affected by the post 2010

⁷ We cannot say we were not warned. See for example Lewis, M (2006) *Liar's poker*, London, Hodder

⁸ Lewis, M (2011) *Boomerang: the meltdown tour*, London, Allen Lane

⁹ UNCTAD (2012) Policies for inclusive and balanced growth, *Trade and Development Report 2012*, Geneva, UN, piii, accessed at http://unctad.org/en/PublicationsLibrary/tdr2012_en.pdf

¹⁰ Ahamed, L (2009) *Lords of finance: the bankers who broke the world*, London, William Heinemann

austerity policy which has cut state spending on cash benefits and services. As well, benefits and services are now delivered by fewer and less well-paid staff and often from fewer local points, despite increased need.

Unemployment rates rose in all the Task Force states during the Great Recession and continued to rise in the bail-out countries and in Spain, due to induced recession from austerity programmes. Youth unemployment is higher than adult unemployment and long-term unemployment has continued to rise, increasing the numbers outside the main unemployment insurance benefits.

All of the Task Force participants had doubts about the interpretation of their level of unemployment compared to past measurements. First, the veracity of the figures in counting the gap between jobs available, especially full-time jobs and those who want employment. For example, the Romanian figures are unlikely to reach to all the unemployed, few of whom are eligible for support and on whom less than 0.03% of 2010 GDP was spent on active labour market policies – a tenth of average EU spending (Romanian fiche p8). The Irish figures do not count as unemployed those working very few hours. Part-time and/ or atypical employment has increased in Ireland, Spain and the UK and poorer migrants are most at risk of exploitation.

Task Force participants also thought migration flows could have a significant effect on registered unemployment rates and flows and the size and skill composition of the labour force. Although many of the Task Force states, for example Ireland, Romania, Greece and Portugal, have been significant sources of emigrants to other countries, during their boom years some of them had experienced very significant in-migration from other parts of Europe, especially central and eastern Europe, as well as migration, legal and undocumented, from other part of the world. But emigration has recommenced from the states in difficulties. This includes emigration of educated young people from Greece, Ireland and Romania as well as emigration of ethnic groups likely to be poor and discriminated against.

The value of the AROPE measure in capturing the full impact on poverty of austerity programmes

The AROPE measure does not directly capture the impact of the fall in the “social wage” due to re-commodification of services. Higher inflation for the poor and commodification of services may show up indirectly in numbers at risk of material and severe material deprivation (which are rising) as households reallocate incomes in this context. But it will not capture until the long term, the impact on poverty of the medicines and school materials not purchased, and the sickness and educational failure endured or the resort to migration from home and family. It is perhaps because of the extended (certainly longer than the electoral cycle) evidence and impact of much that is happening now, that the poverty and exclusion risks are hardly being addressed in public debate.

Across the rich world the wage share is the lowest it has been for at least sixty years. The 2012 UNCTAD report is quite clear about the impact on reduced demand, higher unemployment, lower profits, lower investment and reduced productive capacity.¹¹ Yet the MOUs in the “Troika” states do not refer to the impact of increasing income inequality and there is very little more than lip-service paid to protecting even the most vulnerable. The content of the Troika programmes is very similar to that already imposed in Latin America, Indonesia and central and eastern Europe in return for loans and development assistance from the IMF and World Bank.

The capacity of states implementing “austerity” expenditure cuts to combat poverty is much reduced. It is further reduced by weakened tax-raising capacity of Member States. Tax competition, problems in tax collection, distrust of the state and neo-liberal ideology have led some central and eastern European states to adopt income “flat” taxes in which the same percentage rate is charged

¹¹ UNCTAD (2012) Policies for inclusive and balanced growth, *Trade and Development Report 2012*, Geneva, UN, Overview, accessed at http://unctad.org/en/PublicationsLibrary/tdr2012_en.pdf

to all people regardless of income. The rate is 13% in Russia, so tax competition in much of Europe has a long way to go but the direction of travel is clear as most states resist obvious income tax rises (as opposed to narrowing income bands and lack of updating) and rely more on regressive taxes such as VAT. There is also a decline in the tax share borne by businesses vis-a-vis employees. Add more privatisation and the capacity of the state, practically and strategically, to combat inequality and poverty is much reduced.

None of this is an accident. Core to the EU fiscal strategy is budget readjustment to prevent the risk of fiscal transfers in a closer Union; but also it is a response to globalisation and the capture of policy by finance industry, multinationals and the super-rich.