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Article (Accepted version) (Refereed)

Original citation:
Duman, Özgün Sarımehmet (2017) *The political economy of the Eurozone crisis: competitiveness and financialization in PIIGS.* Journal of Balkan and Near Eastern Studies. ISSN 1944-8953

DOI: 10.1080/19448953.2018.1379752

The Political Economy of the Eurozone Crisis: Competitiveness and Financialisation in PIIGS

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ABSTRACT

This paper analyses the fundamental reasons of the current global economic crisis in the Eurozone and PIIGS – Portugal, Italy, Ireland, Greece and Spain. It evaluates the tight economic integration within the Eurozone, and scrutinises the reasons for PIIGS to be more intensely exposed to the economic crisis. It focuses on the structure of the real economy and the financial market, and outlines the levels of competitiveness and financialisation across the Eurozone and PIIGS. The paper states that the reason of the economic crisis in PIIGS was not only (i) unregulated financialisation or over-financialisation, but also (ii) the economic and trade imbalance among the Eurozone members, (iii) the falling rates of profit in the real economy, and (iv) the failure of real profits to compensate financial profits.

Keywords: competitiveness; economic crisis; Eurozone; financialisation; financial market; PIIGS; real economy

Introduction

The current global economic crisis has been widely scrutinised and published from many different scholarly perspectives. Among these, a significant share supported the view that the fundamental reason of the economic crisis is the boom in the financial market.[1] However, in stark contrast to the hegemony of this viewpoint in the academic world, the real world politics have rather experienced long discussions on the implementation of recovery policies and labour market reforms in the real economy, much earlier and more comprehensive than the regulation procedures for financial markets.

Based on this dichotomy in the academic world and the real world, this paper aims to scrutinise the fundamental reasons of the economic crisis by comparatively analysing the structure of the real economy and the financial market in the Eurozone and PIIGS. It outlines the theoretical and empirical roots of the interrelation between the real economy and the financial market. It scrutinises the rate of profit in the real economy (*real profit*) and the rate of profit in the financial market (*fictitious profit*), and probes the origins of the imbalance between the two.

The paper examines the emergence of the current global economic crisis in the United States (US) and the reasons for it to be transmitted to other regions of the world. It reveals the grounds of the Eurozone economies for being strikingly influenced by the economic crisis. For this purpose, it analyses the institutions securing tight economic integration and competitiveness within the European Union (EU), and makes an inquiry into the uniqueness of PIIGS.

The paper compares the scope of the real economy and the financial market in the Eurozone and PIIGS, and assesses the growth of capital input and labour input, labour productivity, unit labour cost, public debt, current account balance, fiscal balance and financial transactions for providing a comprehensive overview of the European market. This broad analysis aims to reveal both the economic imbalance (in terms of trade and competitiveness) and the gap between the volumes of financial account balances within the Eurozone. In order to picture this imbalance within the Eurozone, PIIGS economies are compared with the strongest economy within the Eurozone, i.e. Germany, and also with the Euro Area 16/19 where data is available.

Based on this analytical enquiry, it states that the reason of the economic crisis in PIIGS was not only (i) unregulated financialisation or over-financialisation, but also (ii) the economic and trade imbalance among the Eurozone members, (iii) the falling rates of profit in the real economy, and hence, (iv) the failure of real profits to compensate financial profits.

The Real Economy, the Financial Market and the Current Global Economic Crisis

On its way to overcome the challenges faced in the analysis of the current global economic crisis, this paper highlights the importance of scrutinising the relationship between the real economy and the financial market.[2] To do this, the first vital move is to introduce ‘a more integrated view of the relations between financial phenomena and the dynamics of production’, which provides the tools for distinguishing the fundamental reasons from the triggering effects[3] and reaching some conclusions on the endemic and epidemic nature of economic crises in the capitalist mode of production.

The Relation between the Real Economy and the Financial Market

The capitalist economy is driven by the accumulation of surplus value at an increasing rate. To achieve this, there is a perpetual struggle for boosting competitiveness of the economy and increasing rate of profit. Relocating production to low-cost markets and intensifying exploitation of labour are two main strategies for increasing the competitiveness of the economy. As the relocation of production further boosts global competitiveness among markets, the pressure to implement more comprehensive mechanisms for increasing the rate of profit also grows. This ultimate aim of the capitalist mode of production is reached through labour market reforms, which mainly include deregulation and flexibilisation policies for creating an efficient, productive and profitable labour regime. Put plainly, labour market reforms are key mechanisms in securing the increasing rates of capital accumulation in the real economy.

However, despite the presence of various mechanisms that aim for "healthy" and "steady" functioning of the capitalist economy, history of capitalism proved that the capitalist mode of production has been cursed with economic crises. In political economy literature, Turan Subasat categorically identifies three approaches to economic crisis: structural, conjunctural and policy-oriented.[4] Similarly, Stavros Mavroudeas classifies three alternative explanations to crisis: Marxist, radical and mainstream.[5] A comprehensive literature review reveals that all these approaches make a certain degree of contribution to the analysis of economic crises. The actual challenge, however, is to distinguish immediate causes of crisis and systemic underlying causes.[6]

The initial assertion of this article is that, as a central claim of Marxism, economic crisis is inherent to the capitalist mode of production.[7] Within this framework, the article perceives economic crises as a structural characteristic of the capitalist mode of production. Other approaches based on conjunctural factors and policies implemented may only play a role in explaining the triggering effects of crises. However, it is also important to highlight that there are a number of systemic explanations to economic crises in capitalism such as the tendency for the rate of profit to fall, profit squeeze, overproduction, underconsumption, disproportionality, overaccumulation and moral depreciation of capital,[8] among which the article follows the footsteps of scholars appealing to the theory of the tendency for the rate of profit to fall as an underlying explanation.[9]

The capitalist production process suffers from the tendency for the rate of profit to fall based on the interrelationship between the rate of profit, the rate of exploitation and the organic composition of capital. The law of the tendency for the rate of profit to fall assumes a certain proportion between constant capital (machinery, etc.) and variable capital (labour), i.e. the organic composition of capital. The law states that capital invests more on constant capital but cannot suppress the cost of variable capital under a certain minimum level, and hence, the ratio between constant capital and variable capital (the organic composition of capital) deteriorates. The source of surplus value is variable capital, and any increase in the organic composition of capital creates an internal contradiction in the capitalist production process. The increase in the rate of organic composition of capital exceeding the increase in the rate of surplus value decreases the rate of profit in the long run.[10] This fall in the rate of profit is not an *absolute* but a *relative* one, and labour market reforms as countervailing tendencies are impotent to completely reverse the tendency for the rate of profit to fall.[11]

However, in defiance of the criticism directed by David Harvey to some proponents of the tendency for the rate of profit to fall for overlooking the effects of financialisation (particularly in the case of the current economic crisis),[12] this article gives precise importance to the financial market, financial instruments and financialisation in the analysis of economic crisis. Financialisation is enlisted within conjunctural explanations in Subasat's categorisation and within radical explanations in Mavroudeas's categorisation of alternative explanations to crisis. Although the fluctuations in the financial market and the fictitious profit are not perceived as the underlying causes of economic crisis, these have played a crucial role in the way the current economic crisis first initiated and became effective. Based on this, there is a need to present a brief analysis of the financial market, with an insight into its relation to the real economy.

The financial market is mainly based on financial instruments and financial packages, which promise higher returns than the real economy, and hence turns the financial market into an area for speculative and risky activity.[13] Moreover, the financial market provides a fertile ground for unrestrained competition, and allows banks and other financial institutions to pursue 'whatever financial activity would bring the highest profits'.[14] Finance, in this respect, promotes extensive capital accumulation.

The penetration and extension of finance is called financialisation. It represents an attack on traditional capitalist relations not only among capital holders but also between labour and capital. Financialisation is a process by which 'various forms of capital in exchange (including financial and other assets and markets)' expands in 'extent and diversity'.[15] It increases the mobility and velocity of capital, making it not only more profitable but also more fragile.

The growth in the value of financial wealth modifies 'the relations between productive capital and financial capital'.[16] Financialisation promotes new financial products such as hedge funds, repo and mortgage credits,[17] and turns into a prolific instrument to cope with the difficulties of the capitalist accumulation process. It manipulates higher amounts of capital via borrowing and lending mechanisms, which include serious risks in terms of repayment. Banks and financial institutions aim to protect themselves against no income-no job-no asset (NINJA) borrowers, and 'securitise mortgages with financial tools that [are] traded with customers and other banks and institutions'.[18] Labour market reforms, on the other hand, contribute to the volume of the financial capital that worsening working conditions, downward pressure on wages, unemployment and reductions in public expenditure drive people into debt. These precautionary mechanisms further spread these risks throughout the financial market.[19] This, in turn, increases the size and circulation of financial products in the financial market in the form of credit.

Finance, however, is a sector where surplus value is not produced but only shared.[20] For a fully functioning and persistently enlarging stable financial market, there is a need for continual capital transfer from the real economy. Hence, due to the tight interconnectedness between the real economy and the financial market, chronic vulnerability of the productive market to economic crisis in general and the tendency of the rate of profit to fall in particular has striking consequences for the financial market. Any fall in the rate of profit affects the functioning of the financial market that it confines the amount of capital accumulation in the real economy and also downsizes the volume of capital transfer to the financial market. On the other side, any increase in the volume of capital accumulation in the financial market based on the expansion of financial products should have an equivalent in the real economy, i.e. a commensurate level of increase in the rate of profit.

In this respect, financial capital is principally *fictitious*, but the necessity for it to have an equivalent in the real economy stands *non-fictitious* (real). Financialisation and the functioning of the financial market can solely be comprehended by a scrutiny into its relationship to the real accumulation of productive capital.[21] Therefore, the economic crisis might be triggered by the incidents in the financial market, but the main reason resides in the structural characteristics of the real economy.[22] This can also be evidenced by the implementation of restructuring mechanisms towards the productive market as the major instrument for battling the economic crisis.

Based on the analysis of the relationship between capital accumulation in the real economy and the financial market, the following sections will focus on the emergence of the current global economic crisis and its reflections in the Eurozone and PIIGS. The main purpose will be re-emphasising one of the key highlights in Gökay and Whitman's argument - the current crisis is a structural one as it is both real economy and financial economy crisis,[23] but from a rather different point spotlighting the gap between the volumes of real profit in the productive market and of fictitious profit in the financial market.[24] An analysis of the economic crisis in the Eurozone and PIIGS would offer an opportunity to uncover 'the depths of the contradictions that have been at work in the entire process of capital accumulation'.[25]

The Emergence of the Current Global Economic Crisis

Changes in the structure of the real economy and of the financial market had striking repercussions on the imbalance between the real profit and the fictitious profit in a dialectical way. The financial market enlarged with tools such as credit, mortgage, social insurance funds, bonds and stock markets, and these tools brought higher returns of profit in comparison to the real economy. This speeded the flight of capital from the low-profit productive market to the high-profit financial market. Transfer of the real profit to the financial market further downsized the real economy.[26] This, in turn, resulted in capital to limit investments on constant capital, and helped to temporarily circumvent the tendency for the rate of profit to fall in the real economy. Production could not catch up with the levels of profitability in the financial market despite the implementation of comprehensive labour market reforms.[27] As the immense size of fictitious profit did not have an equivalent in real economy, the imbalance between the fictitious profit and the real profit further increased.

Figure 1 demonstrates the ratio of the growth of capital input to the growth of labour input in the period of 1995–2011 to shed light on the fluctuations in the organic composition of capital, and henceforth, in the rate of profit. According to the Figure, the ratio of the growth of capital input to the growth of labour input (the organic composition of capital) started to increase in Germany and Portugal, and remained steady in the US, the United Kingdom (UK), Ireland and Spain in 2005. It had a downward trend only in Italy. Based on this data, it would be plausible to argue that the organic composition of capital was either in rise or stable, and hence, the rate of profit was either in decline or stable before the emergence of the economic crisis. In other words, with the exception of Italy, all these economies met the current global economic crisis with relatively decreasing/stable levels of rate of profit. The relative drop in the organic composition of capital in the post–2009 period could be explained by the structural measures taken in the labour market.

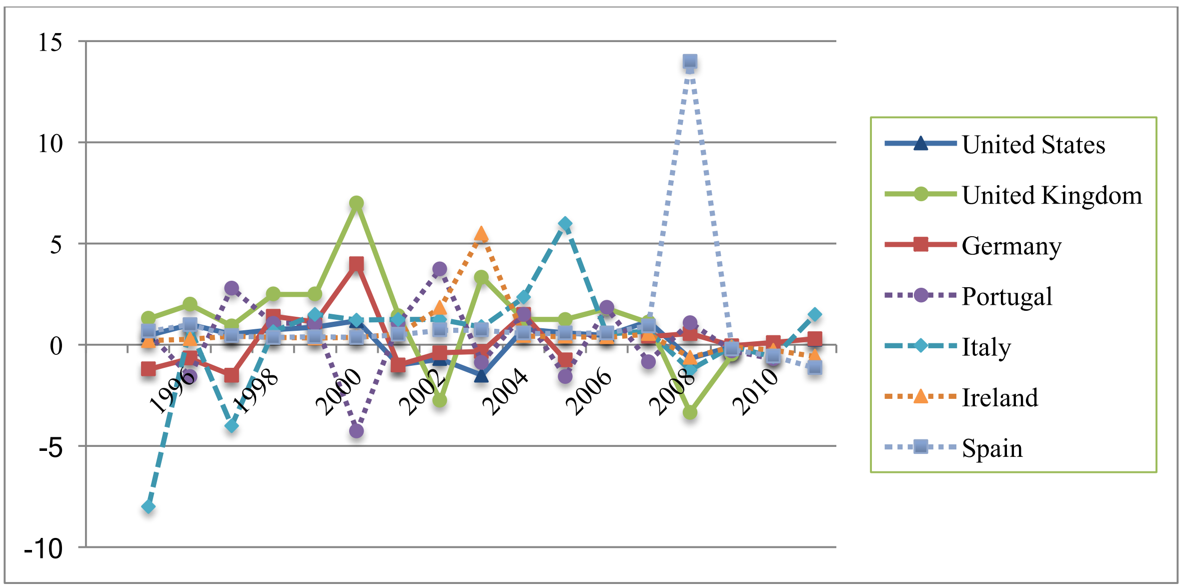

Figure 1 Growth of Capital Input/Growth of Labour Input (Organic composition of capital)

Source: OECD, 'Growth of Capital Input/Growth of Labour Input (Organic composition of capital)', 2013 <www.oecd.org/industry/oecd-compendium-of-productivity-indicators.htm> (accessed 10 October 2016).

A comparison between the organic composition of capital in year 1995 and in year 2010 also demonstrates that the rate of profit in the mid–1990s was even higher than the rate of profit in the post–2009 period. Notwithstanding, it is crucial to note that this represents not an absolute but a relative decrease in real profits in the economy.

Whereas the rate of real profit decreased, the rate of fictitious profit continued to increase in developed capitalist economies. The rate of the financial sector profits to total profits escalated from 25 per cent in the 1980s to 40 per cent before the global economic crisis.[28] The rise in the volume of financial capital not only exceeded real profits but also expanded the investment opportunities at the productive market.[29] Financial capital holders aimed to lend more to receive higher returns, but productive capital holders did not have a corresponding need for investment.[30] This also created an imbalance in terms of the supply and demand relationship in the financial market and the real economy. Overaccumulation of fictitious capital further inflated the financial market.

The fictitious profits accumulated in the financial market could not be fully served to the service of the real economy for more investment on constant capital, but they were presented to the use of households, whose working and living conditions were worsened by labour market reform policies.[31] Fictitious profits were sold as commodities in the financial market. The need to put the excessive fictitious capital into use resulted in the broadening of lending mechanisms from credit-worthy workers qualified for prime mortgages to less credit-worthy workers qualified for subprime mortgages.[32] Household debt (as a percentage of disposable personal income) increased from 59 per cent in 1982 to 77.5 per cent in 1990, 91.1 per cent in 2000 and 128.8 per cent in 2007 in the US.[33] Trustworthiness of borrowers decreased, and this radically threatened the safety of the financial market.

The increase in housing prices and mortgage rates encouraged borrowers to buy new mortgages to pay the old ones, but start of the fall in housing prices threatened the lending regime that borrowers turned insolvent.[34] Mortgage sector was bankrupted, and this created a domino effect in the world financial market. Tighter integration of national financial markets, higher velocity of financial capital and inflow/outflow of fictitious profits led to the endemic and epidemic crises in national markets consecutively.

Therefore, the tight interconnectedness between the financial market and the real economy, and the imbalance between the real profit and the fictitious profit evidenced that the crisis began in the financial system, but was not generated there.[35] The financial boom *triggered* the crisis,[36] but its *fundamental reason* resided in the tendency for the rate of profit to fall in the real economy.[37]

Following the first signs of the economic crisis, the capitalist system responded efficiently. In the financial market, recovery policies included the rescue of 'a large number of systemically significant global financial institutions'.[38] Capitalist states expropriated national banks, introduced credit and liquidity measures to the market, presented guarantees to household investments, and announced production incentives and tax exemptions. Besides the measures taken in the financial markets, very comprehensive labour market reforms were introduced aiming further deregulation and flexibilisation.[39] This also demonstrated that the so-called financial crisis is not solely financial, but has roots in the crisis-prone nature of the capitalist mode of production.

The current global economic crisis has also posed a severe challenge for the EU, the member states and the Eurozone. Following the financial boom in the US, the Eurozone economies proved to be under threat, and implemented equally comprehensive recovery policies and austerity measures in the real economy and the financial market. The next section analyses the uniqueness of the Eurozone and the economies most intensely exposed to the crisis (PIIGS) by referring to tight economic integration, competitiveness and trade imbalance in the Eurozone.

The Eurozone Crisis: Structural Deficiencies, Imbalances and Asymmetries

The emergence of the US-originated economic crisis in the Eurozone has posed a major question. The increased global economic interdependence 'accelerated transmission of economic disturbances from the US to other countries of the world', and the European member states were the first ones under influence.[40] A 'collapse in the market of securities' followed the financial shock, and caused 'lower financial market capitalisation, a decline in financial liquidity, high losses of financial institutions'.[41] Credit squeeze initiated in the US market influenced the global market, and resulted in an absolute fall in GDP in the Eurozone economies.[42] To put it plainly, the current global economic crisis first emerged in a highly credit-based economy, i.e. the US, and then spread to the Eurozone and revealed its structural deficiencies, imbalances and asymmetries.

Vulnerability of the Eurozone economies to the current global economic crisis was vastly related with its tight economic integration entrenched by the SEM and the EMU, which 'acted as the cornerstones of the institutionalization of neoliberalism in the EU'.[43] The SEM mainly involved the removal of physical, technical and fiscal barriers to trade within the EU, reinforced market competition, which consecutively boosted the pressure on labour,[44] and influenced the competitive capacity of the European market in general. On the other hand, the harmonisation of national markets and better competition *within* the European market posed a threat for member states with different labour market structures,[45] and also fostered the competition *among* the

European and global markets, which necessitated a further decrease in production costs and increase in productivity.

The EMU targeted 'management of the single EU currency and euro-zone affairs' in general[46] and 'an open market economy with free competition [and] ... price stability … [as] the primary aim of monetary policy' in particular.[47] At the initial stage of joining the EMU, the least competitive peripheral countries, that are PIIGS, fixed the exchange rate at a higher value[48] whereas Germany 'joined the EMU enjoying a devaluation of its exchange rate'.[49] The Maastricht Agreements introduced certain criteria on inflation rate, government finance, exchange rate and interest rate, 'institutionalise[d] a new currency and mandate[d] strict fiscal discipline', and hence, put the national markets under discipline.[50] It substituted national currencies with a European currency, and worsened the asymmetries between the core and the periphery.[51]

The EMU turned the European Central Bank (ECB) into the only monetary policy making authority. The centralisation of control by the ECB on national markets terminated the role of exchange rate devaluation mechanism in 'adjust[ing] productivity growth to globally competitive levels'.[52] The Maastricht criteria embodied impulses to 'channel income and investment opportunities to capital', to 'cut state spending', and 'to privatise public assets'.[53] Moreover, the ECB has 'supported financialization in Europe mostly by protecting the interests of financial capital' that 'restrictions on financial operations have been abolished' and the European financial capital has gained benefits 'in competition with US and other global banks'.[54]

The introduction of the EMU put a threshold on budget deficits and inflation rates, and deprived the member states of monetary policy mechanisms for boosting competitiveness. Eurozone economies resigned from their own monetary policy 'as an instrument of macroeconomic stabilisation',[55] and became subject to the European monetary policy. In other words, the EMU inactivated the strategy of regaining competitiveness through exchange rate regulations.[56] Adjustment to the increasingly competitive economy of the Eurozone would only 'come through a change in the real exchange rate – that is, changes in wages and prices'.[57]

The institutionalisation of the 'neo-liberal economic paradigm' at the European level expedited the implementation of labour market reform policies by strict monetary and fiscal policies.[58] As tighter integration through single European currency ruled out the possibilities for adjusting national economies with exchange rate regulations, labour market reforms remained as the only mechanism for adjusting to higher levels of competitiveness. Under the 'no national currency mechanism to moderate the differences in competitiveness', the peripheral countries were put in a position to 'impose drastic restructuring of labour'.[59]

In that sense, the SEM and the EMU served to secure the flexibility and deregulation of labour regimes and to liberalise labour markets by guaranteeing decrease in costs and increase in demand, competition, productivity and growth. The European Employment Strategy (EES) and the Lisbon Strategy also encouraged greater labour flexibility.[60] Common currency policies and finance-led regime of accumulation in the Eurozone further increased the significance of labour market reforms as the only tools of increasing the rate of profit. Therefore, growth and competitiveness further relied on conditions of work and the performance of the labour market,[61] i.e. labour market flexibility,[62] which turned out to be the main tool for macroeconomic adjustment in member states.[63] The 'finance-led regime of accumulation' also necessitated 'an agenda of deregulation, liberalisation and labour flexibility' with stagnation of real wages and productivity growth.[64]

Labour market reform policies mainly targeted 'flexibility of wages by adjusting labour prices to supply-demand relationship and improving competitiveness of enterprises by reducing wages, thus improving macroeconomic effectiveness and increasing production and employment'.[65] Hence, 'higher labour productivity, wage restraint and "neoliberal" welfare reforms' played a key role in increasing the level of competitiveness in the EU.[66] The EMU functioned as 'the strategy par excellence of capital'.[67]

Despite having a similar point of departure - the influence of the SEM and the EMU on boosting competitiveness in Europe, discussions reveal two challenging arguments on the effects of competitiveness on the core and peripheral countries of Europe. On the one side, Lapavitsas et al. argues that peripheral countries have lost competitiveness against core countries in the Eurozone.[68] The increasing pressure for competitiveness in a "no exchange rate mechanism" market restrained peripheral economies with three alternatives during the economic crisis: to adopt austerity, to reform the Eurozone, or to exit from the Eurozone.[69] On the other side, Milios and Sotiropoulos state that exposure of individual capitals to international competition led peripheral economies to higher growth and accumulation rates.[70] Based on this argument, they claim that international competition within the Eurozone was actually to the benefit of capital in the periphery.[71]

In this respect, these two perspectives by Lapavitsas et. al., on the one hand, and Milios and Sotiropoulos, on the other hand, on levels of competitiveness in core and peripheral countries of the Eurozone makes divergent interpretations of how the introduction of the SEM and the EMU has influenced the European market in terms of economic (im)balances. Contrary to Lapavitsas et. al., Milios and Sotiropoulos reject the core-periphery divide as a simplistic way of explaining the emergence of the economic crisis in the Eurozone.[72] Despite agreeing Milios and Sotiropoulos's contributions on the crucial role played by mechanisms for the adjustment of labour for higher levels of competitiveness under the conditions of international competition, this article affirms that the core-periphery divide is a plausible one in the context of a single currency market where economies have started a race for higher levels of competitiveness from very disparate stops.

Accordingly, it is argued that the single market policies and the monetary requirements within the Eurozone cause important economic imbalances between core and peripheral countries. Tight economic integration policies resulted in the 'intra-euro area current account balances of euro area countries' to diverge significantly.[73] There existed economic and trade imbalances among the Eurozone countries in terms of competitiveness, productivity and efficiency, which resulted in the emergence of two groups within the Union: importers and exporters. Strong economies with higher competitiveness (exporters) and weak economies with lower competitiveness (importers) marked the trade relations within the Eurozone. As an interrelated and structural phenomenon, a balance of payments crisis characterised the fact that 'someone's surplus [was] someone else's deficit'.[74] In the bilateral trade between Germany and PIIGS, for example, German exports became PIIGS imports and vice-versa.[75]

A Comparative Analysis of the Pre- and Post-Crisis Situation in PIIGS: Competitiveness and Financialisation

Tighter integration of the European market for products and services had a strikingly negative impact on national labour markets in terms of wages, working conditions and social security rights.[76] The EMU put extreme pressure for capitalist exploitation and restructuring of labour, and set 'the strategy of exposure to international competition which only through continual "adjustment" of labour can continue to exist'.[77] This structural set-up in the Eurozone furthered the class struggle and institutionalised the relation of exploitation by intensive labour market policies. An analysis of labour productivity, unit labour cost, public debt, current account balance, financial account balance and financial transactions in the Euro Area 16/19, Germany and PIIGS would unveil the structural deficiencies, imbalances and asymmetries within the Eurozone on the way to the economic crisis.

Labour productivity and unit labour cost indicators allow to reach some conclusions on the asymmetries in the levels of competitiveness within the Eurozone. According to the data provided by OECD on labour productivity in total economy (measured in accordance with the annual growth rate), average labour productivity was 2.2 in Germany, 1.2 in Portugal, 0.6 in Italy, 1.5 in Ireland, 3.4 in Greece and 0.5 in Spain in the period of 2000-2007.[78] Similarly, OECD data on unit labour cost in total economy (measured in accordance with the annual growth rate) demonstrates that average unit labour cost was -0.6 in Germany, 2.6 in Portugal, 2.2 in Italy, 5.0 in Ireland, 2.3 in Greece and 3.1 in Spain for the same period.[79] This comparison between Germany and PIIGS state that Germany has the second highest rate of labour productivity and the lowest rate of unit labour cost that it is one of the most competitive economies. PIIGS economies, on the other hand, have lower rates of labour productivity and higher rates of unit labour cost.

Figure 2 on labour productivity in the Euro Area (EA) 19, Germany and PIIGS indicates that labour productivity fluctuated in the late 1990s and the first years of the 2000s. An analysis of labour productivity in Germany and PIIGS on an individual basis shows that labour productivity was in decline from 2006/2007 to 2008/2009, with the only exception of Spain. That is to say, labour productivity decreased in EA–19, Germany, Portugal, Italy, Ireland and Greece in the period just before the emergence of the current global economic crisis. The measures taken for increasing labour profitability started boosting it from 2009 onwards, but it has kept fluctuating. When the year 2012 is taken as an indicator, the percentage change in labour productivity over the previous period was -2.5 in Italy, -1.1 in Greece, -0.7 in Germany, -0.4 in the EA-19, 0.1 in Portugal, 0.7 in Ireland and 1.5 in Spain.

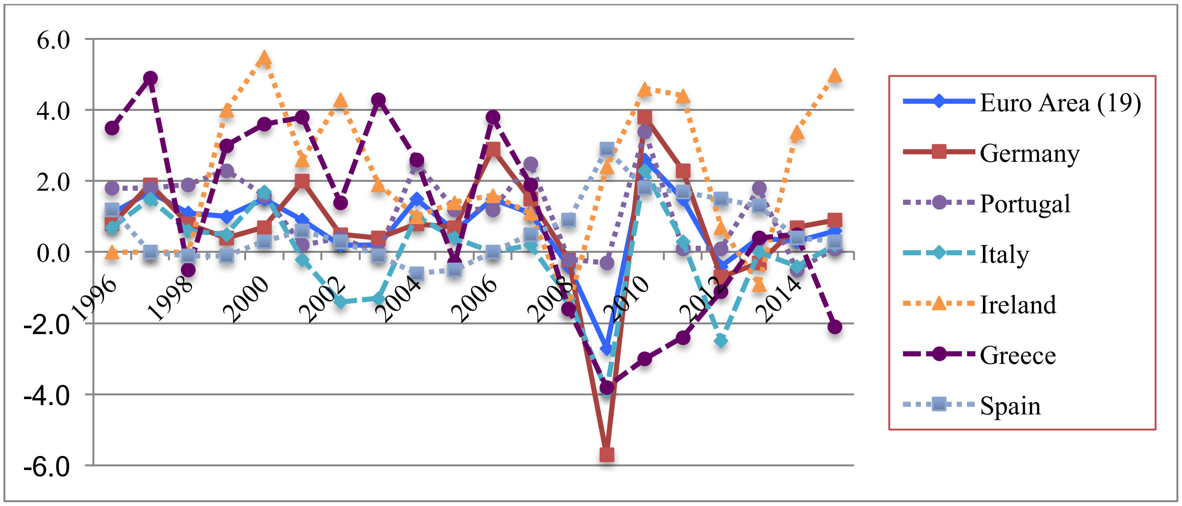

Figure 2 Labour Productivity (percentage change over previous period), 1996–2015

Source: Eurostat, 'Labour Productivity (percentage change over previous period), 1996-2015', 2016a, <http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_lp_ulc&lang=en2016a> (accessed 30 June 2016).

Figure 3 shows the quarterly change on the same quarter of the previous year in unit labour cost for the period of 1996–2015 in the EA–19, Germany and PIIGS. It had fluctuated in all of these economies in the decade before the emergence of the current global economic crisis. According to the research conducted by Perez-Cladentey and Vernengo, unit labour cost averagely increased by 7 per cent in Germany, France and Austria, and by 24 per cent in PIIGS in the period of 2000–2007.[80] In the period preceding the emergence of the crisis, from 2006 to mid-2008, unit labour cost had a sharp increase in the EA–19, Germany and PIIGS. Unit labour costs indicated that the peripheral economies lost competitiveness relative to Germany in the Eurozone.[81] Hence, these economies met the economic crisis with relatively lower levels of competitiveness and decreasing rates of profit.

The pressures of single market and single currency policies in the Eurozone, and also the post-crisis labour market policies in the Eurozone forced a convergence in unit labour cost in member states. The unit labour cost reached its lowest level in the EA–19, Germany and PIIGS in 2010. In this respect, the economic crisis was actually instrumentalised to decrease unit labour cost for achieving higher levels of competitiveness in the Eurozone.

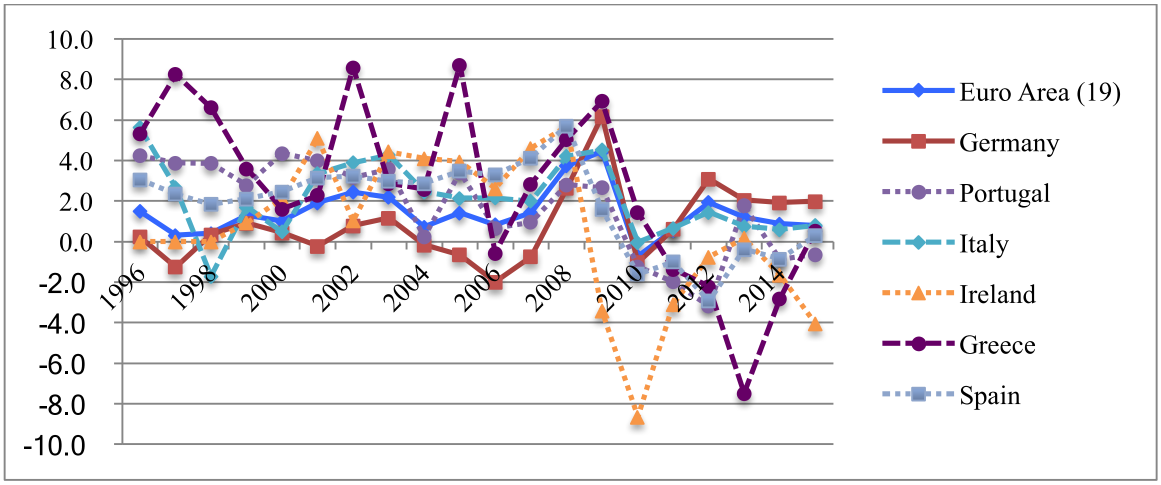

Figure 3 Unit Labour Cost (quarterly change on the same quarter of the previous year)

Source: OECD, op. cit.

Within the straitjacket structure of the Eurozone, the working class has been under systematic attack of the capitalist class both at the centre and the periphery.[82] However, as the figures on labour productivity and unit labour cost do also verify, this attack has put different levels of pressure on the working class depending on unique domestic politics of Eurozone countries. All Eurozone countries have started the race of competitiveness from very different points that core countries have had 'high real wages and strong social policies' whereas peripheral countries have had 'low real wages and weak welfare states'.[83] Middling levels of technology in the periphery, with the exception of Ireland, has also been key to the gap between the levels of competitiveness in the Eurozone.[84] Therefore, the Eurozone system set the ground for *unfair* competition among central and peripheral economies with the same currency but different structural characteristics and levels of strength. The establishment of euro 'contributed to the perpetuation of asymmetries in the current account balances and divergences in the unit costs of labour'.[85]

According to the Global Competitiveness Report 2010-2011, Portugal was the 46th, Italy was the 48th, Ireland was the 29th, Greece was the 83rd and Spain was the 42nd among 133 countries.[86] The most powerful economy of the Eurozone, Germany, ranked the 5th. Moreover, in the period of 1999-2006, competitiveness of the economy declined by 27 per cent in Italy, 12 per cent in Spain and 10 per cent in Greece in comparison to the other Eurozone economies, and this pattern also followed in Portugal and Ireland.[87]

In the Eurozone and PIIGS, public debt also increased in the period of 1998-2009. Labour market reforms diminished the purchasing power of workers and the least advantaged groups in societies, and 'unstable income earners need[ed] help from credit and financing'.[88] Hence, the 'demand for financing for consumption developed',[89] and credit became crucial for sustainability of consumption in Europe. Throughout the years, the lending boom financed a large expansion of consumption that 'wide availability of credit generated in PIIGS a large debt-financed increase in consumption (both public and private) with growing imports and large trade deficits as a consequence'.[90]

However, with the burst of the financial boom in the US and then the Eurozone, credit squeeze created devastating effects on debt-financed economies. The scarcity of capital was followed by the economic growth slowdown, which further increased budget deficits and public debt. As it is shown in Table 1, public debt increased in EA–16, Portugal, Italy, Ireland and Greece, and decreased only in Spain in the period of 1998–2009. From 2007 to 2009, the beginning of the current economic crisis, public debt increased by 19 per cent in EA–16, 21 per cent in Portugal, 12 per cent in Italy, 160 per cent in Ireland, 20 per cent in Greece and 47 per cent in Spain.

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Euro Area (EA-16)	69.2	68.2	68	69.1	69.5	70.1	68.5	66.2	69.8	79.2
Portugal	50.5	52.9	55.6	56.9	58.3	63.6	63.9	62.7	65.3	76.1
Italy	109.2	108.8	105.7	104.4	103.8	105.8	106.6	103.6	106.3	116
Ireland	37.8	35.6	32.2	31	29.7	27.4	24.8	25	44.3	65.5
Greece	103.4	103.7	101.7	97.4	98.6	100	106.1	105	110.3	126.8
Spain	59.3	55.5	52.5	48.7	46.2	43	39.6	36.1	39.8	53.2

Table 1 Public debt in the Euro area in the period of 1998-2009 percentage of GDP)

Source: Eurostat, compiled by Bukowski, op. cit., p. 281.

Growing public debt led to 'a higher risk of investment in treasury bonds', which meant 'higher profitability of bonds in the financial market'.[91] Greek, Irish and Portuguese government bond yields started to increase in 2009, and this was followed by an increase of credit default swaps.[92] The rise in risk increased the interest rates to encourage investors to purchase bonds, and this in turn led to 'higher government debt and further difficulties in debt repayment'.[93] In this regard, countries with high share of fixed costs and high public debt (to GDP) became more vulnerable to the crisis.[94] Moreover, the greater the debt held abroad, the greater the probability of receiving a speculative attack.[95] The Eurozone crisis also indicated how ‘all private debt could potentially be public debt’.[96]

Although labour market reforms had been implemented for almost two decades in PIIGS, the levels of flexibility, deregulation, wage compression, productivity and competitiveness did not reach at the levels of strong economies in the EU. Hence, the rate of real profit accumulated in the real economy could not compensate the levels of fictitious profit accumulated in the financial market. Larger capital inflows also increased the balance of payments imbalances in the European periphery.[97] The following data on current account balance in Germany (as one of the strongest economies in the Eurozone) and PIIGS aims to demonstrate this imbalance within the Eurozone. It will also show that the economic crisis rooted not only in ‘sovereign debt and bank financials’ but also in ‘the real economy with structural problems’.[98]

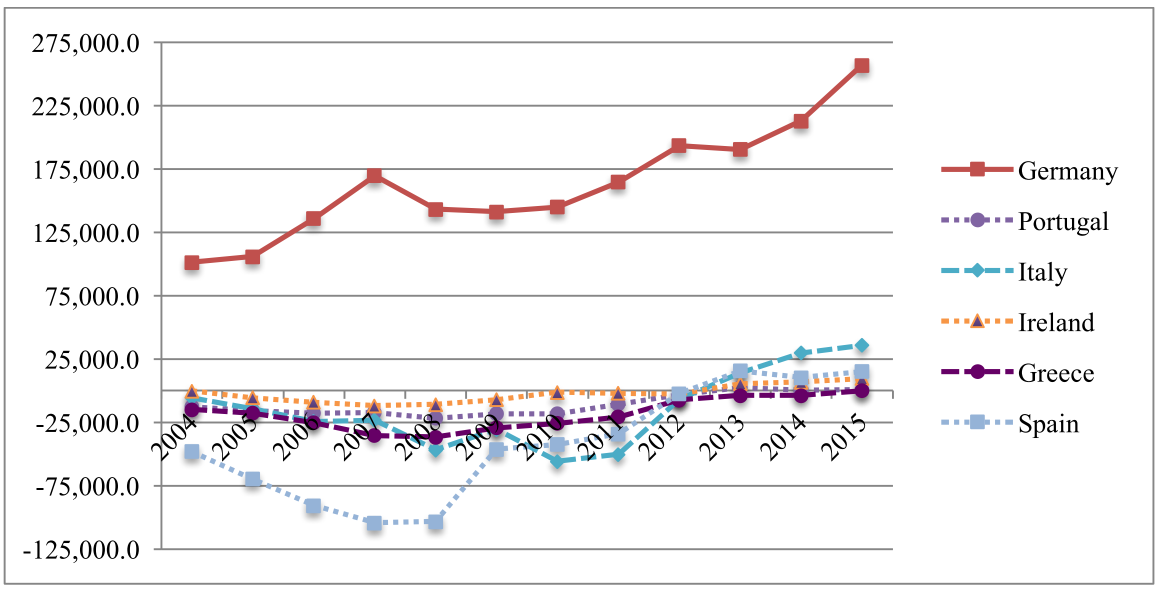

Figure 4 Current account (EUR 1000 million)

Source: Eurostat, ‘Current account (EUR 1000 million)’, 2016b <http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do> (accessed 30 June 2016).

Figure 4 shows current account balance in Germany and PIIGS for the period of 2004–2015. The upward trend in current account surplus in Germany had a rupture in the period of 2007–2008, but then the increase continued at an increasing rate. On the contrary, current account deficit had an upward trend in all PIIGS economies until 2008. It had reached very striking levels in Spain, which was followed by Italy, Greece, Portugal and Ireland. Current account balance started to recover from 2007 onwards, and Spain could get closer to the levels in Portugal, Italy, Ireland and Greece in 2012. All PIIGS economies perpetuated large current account deficits until 2013. It turned into current account surplus in Portugal, Italy, Ireland and Spain, the only exception being Greece, in the same year. However, the gap between the levels of current account surplus in Germany and PIIGS broadened after the emergence of the current economic crisis.

In a nutshell, Figure 4 clearly demonstrates that current account balances developed quite uneven, and the asymmetries and imbalanced trade were even further consolidated within the Eurozone after the emergence of the current economic crisis. All PIIGS economies suffered from trade imbalance within the Union that Germany experienced rising current account surplus whereas PIIGS perpetuated large current account deficits.[99] Asymmetries within the Eurozone and diverging levels of productivity and competitiveness brought imbalanced trade among the member states. Therefore, current account balances developed quite uneven as a result of the unequal rates of surplus value within the Eurozone.

The deeper financial integration in Europe and the structural characteristics of the Eurozone also enhanced the fragility of the peripheral economies. The peripheral countries seemingly gained credibility, which increased the capital inflow, and eventually 'enabled greater consumption and investment in the non-tradable sector and the domestically oriented sectors of the economy'.[100] Under the elimination of the risk of exchange rate differences, the financial flows within the Eurozone 'increased the foreign liabilities of Southern Europe by almost 70 per cent between 1999 and 2009'.[101] The capital flows caused real interest rates to decline, which supported the credit boom in the period of 2003-2007.[102] The growth of housing sector and of capital inflow extended 'credit growth, government spending, debt accumulation and current account deficits'.[103] Excessive lending caused banks to have debts and governments to burden large fiscal deficit.[104]

Figure 5 shows financial account in PIIGS in the period of 2004–2015. Strikingly, this figure is pretty similar to that of current account. The continuous increase in financial account surplus in Germany had a downward trend in the period of 2007–2008, but then turned upward and started to increase at an increasing rate until 2014. Quite the reverse, all PIIGS economies had financial account deficit in the first years of the 2000s, and deficit further increased in the period of 2007–2008. Similar to the case of current account deficit, financial account deficit was also the largest in Spain, and this was followed by Italy, Greece, Portugal and Ireland. It turned into financial account surplus in all PIIGS economies in 2013. It is also crucial to underline that the volume of financial account surplus in PIIGS is incomparable to the volume of financial account surplus in Germany that the total of financial account surplus in PIIGS (102,689 million Euro) was less than half of the volume of financial account surplus in Germany (232,197 million Euro).

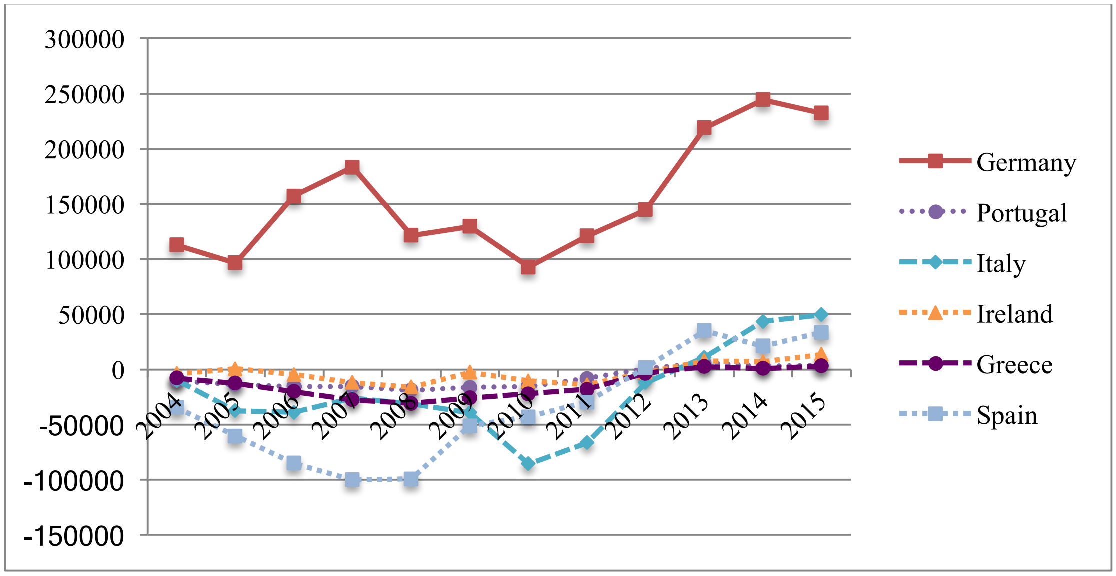

Figure 5 Financial account, 2004–2015 (million Euro)

Source: OECD, ‘Financial account, 2004-2015 (million Euro)’, 2016b <http://stats.oecd.org/#> (accessed 30 June 2016).

An analysis of the financial transactions in Germany and PIIGS highlights the uneven development of the financial market and financial account balances. Figure 6 shows the net acquisition of financial assets in Germany and PIIGS for the period of 2001–2009. It indicates that financial transactions in Germany were larger than PIIGS economies. Among PIIGS, financial transactions were very limited in Portugal and Greece, comparatively larger in Italy, and very extensive in Ireland and Spain.

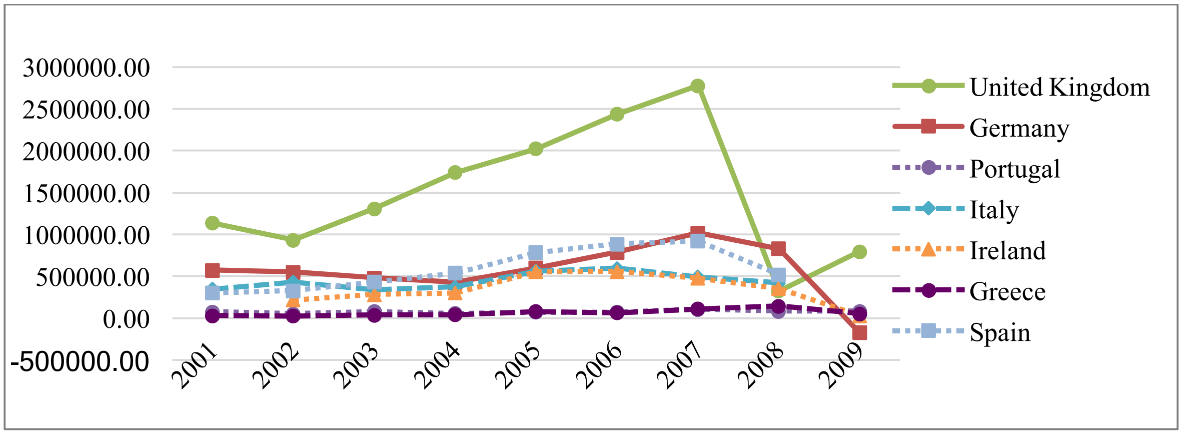

Figure 6 Financial transactions, 2001–2009 (millions of Euro)

Source: Eurostat, *Eurostat Yearbook 2010,* 2010 <http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-CD-10-220/EN/KS-CD-10-220-EN.PDF> (accessed 15 August 2014).

An overall analysis of PIIGS economies in terms of the size of financial transactions demonstrates that the economies mostly influenced by the crisis were not necessarily the ones with the highest levels of financialisation in the EU. Nevertheless, these were the economies that did not have the equivalent of their financial assets in the real economy. Current account balance and financial account balance were already negative before the emergence of the crisis. During the crisis, the economic indicators worsened that the objective of deficit reduction made the situation inferior.[105] The size of the financial market and financialisation was not extensive in PIIGS, but profitability, productivity and competitiveness was rather limited. Therefore, the emergence of the economic crisis in PIIGS was a result of both the imbalance in the real economy and the imbalance in the financial market within the Eurozone.

Consequently, both current account balance and financial account balance are highly related with productivity and competitiveness. The greater part of debt was held inside the Eurozone, and the strong economies of the EU has helped PIIGS further reducing the default probability in order to 'protect the financial stability of the Euro area and the balance sheets of their banks'.[106] Therefore, the whole process of structural adjustment and austerity focused on 'further fiscal consolidation, labour market "reforms", and supply-side measures supposedly to promote growth by "large price and cost adjustments" in the weaker economies'.[107] Bailout packages involved austerity measures and structural labour market reforms, which aimed to increase the deregulation and flexibility of labour markets by the institutionalisation of atypical forms of work and to decrease social expenditures by social security and pension reforms. PIIGS economies typically demonstrated the importance of the implementation of labour market reforms, and hence, increasing the competitiveness of the real economy, during the current global economic crisis.

Conclusion

The current global economic crisis posed a serious challenge to the EU, the Eurozone and the member states. Among other Eurozone economies, PIIGS were strikingly influenced by the crisis that the bailout packages and the structural reforms intended to rescue the economies from a total collapse. However, despite the tendency to define the emergence of the economic crisis in the Eurozone and PIIGS as the result of the financial boom, the austerity measures mainly included the implementation of labour market reforms, the key purpose of which was to restructure the real economy.

The paper aimed to grasp the fundamental reasons of the economic crisis in PIIGS. It analysed the structure of the real economy in comparison with the structure of the financial market, also paying particular attention to the tight interconnectedness between the two markets. It examined the growth of capital input and of labour input to evidence the tendency for the rate of profit to fall, and reviewed the data on labour productivity, unit labour cost, public debt and current account balance to outline the different levels of competitiveness within the Eurozone. The paper also scrutinised the financial account balance in a comparative perspective. It reached at the conclusion that the Eurozone economies had different levels of economic competitiveness but the same currency, which led to an economic and trade imbalance among the members. Furthermore, the volume of financial account balance strikingly differed in the Eurozone.

As a result of this analytical enquiry, the paper stated that the fundamental reason of the economic crisis in PIIGS was not only (i) the deficiency or malfunction of the financial market such as unregulated financialisation or over-financialisation. It was also (ii) the economic and trade imbalance among the Eurozone members, (iii) the falling rates of profit in the real economy, and hence, (iv) the failure of real profits to compensate financial profits. The paper also underlined that the implementation of labour market reforms as remedies to the crisis aim to increase the rate of real profit, to turn these economies into more profitable and competitive ones, and to compensate fictitious profit with increasing rates of real profit.

Acknowledgements

I would like to thank Vassilis K. Fouskas and the anonymous reviewers of the *Journal of Balkan and Near Eastern Studies* for their invaluable comments and suggestions. An earlier version of this paper was presented at Sheffield Political Economy Research Institute (SPERI) 2016 Conference in Sheffield. I would also like to thank all the participants at the conference for their questions and comments.

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