



Written by [Charles Scaliger](#) on January 24, 2011

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European Dis-Union

In a November 16, 2010 speech, European Union President Herman Van Rompuy warned that the eurozone economic crisis threatened the very existence of the EU. “We’re in a survival crisis,” Van Rompuy said. “We all have to work together in order to survive with the euro zone, because if we don’t survive with the euro zone we will not survive with the European Union.”

It wasn’t supposed to turn out this way. The European Union — the triumphant culmination of a drive for European economic and political union 50 years in the making — was intended to set a new standard for transnational government, an experiment in consensual empire-building and a regional precursor for an eventual global political merger. The euro was a potent economic symbol of European unification, replacing a raft of national currencies like the peseta, lira, franc, mark, and drachma, which had endured, in name at least, for centuries.

For a brief interlude, European unification seemed irresistible. The euro soared against other currencies, including the dollar, and political milestones like a European constitution moved ineluctably forward, popular resistance in countries like Denmark and Ireland notwithstanding.

Then came the global economic meltdown, which brought the American economy to its knees. An early European casualty of the crisis was Iceland, which had managed to remake itself from a fishing economy into a center for international banking and finance. When Iceland’s three major banks failed in the fall of 2008, the EU cobbled together a hasty bailout to keep the North Atlantic republic afloat, and the world breathed a sigh of relief. Iceland’s economy was, after all, small enough for the eurozone to absorb its pain without a hiccup, or so it seemed at first.

A significant fact about the Icelandic meltdown was its magnitude: It was and remains the largest economic collapse suffered by any country in history relative to the overall size of the economy. It has left once-prosperous Iceland an economic wasteland as barren as the treeless tundra that covers the ancient Viking republic, spurring tens of thousands of Icelanders to seek emigration rather than wait for jobs that will never be revived. So severe has been the economic and political fallout from the Icelandic debacle that Icelanders are now preparing to write a brand new constitution. The economic *Ragnarok* in Iceland has utterly overturned the social and political order in that oft-overlooked country, boding ill indeed for other countries now entering into crisis.



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The next casualty of Europe's slow-motion economic disintegration was Greece. Touted as an economic miracle only a few years ago when the Greek economy was booming, the modern heir of Athens, Sparta, and Byzantium has been transformed, over a few calamitous months, into a hapless ward of the European Union, her finances and government utterly held hostage by heavy debts and burdensome conditions imposed by her creditors.

But in hindsight, investors should have anticipated the Greek collapse. Although the Greek economy grew at over four percent per annum from 2000 to 2007, Greece's socialist government had been running extraordinarily high deficits for decades. The ratio of public debt to GDP has been 100 percent or more since the early '90s, in itself evidence enough that the Greek economy rested on the shakiest of foundations. Yet Greece was welcomed into the EU and for years managed to conceal the real condition of her national balance sheets by various creative accounting tricks. In 2010, it was revealed that the Greek government had paid a number of global finance banks, including Goldman Sachs, hundreds of millions of dollars to help conceal Greece's true level of indebtedness from, among others, EU regulators, allowing the government to live far beyond its means.

When the world economy imploded, the pitiful state of Greece's finances was soon laid bare. Investors worldwide are now painfully aware that Greece's budget deficit is more than 13 percent of the GDP, one of the highest in the world, while the total national debt will likely surpass 120 percent of the GDP this year. As a result, Greece's sovereign debt was downgraded this spring to junk bond status, and a series of misnamed "austerity measures" was enacted by the Greek government.

Bunk Bailouts and "Austerity"

It is important to understand that what are being bemoaned as "austerity measures," in Greece and elsewhere, do little to truly reduce the size of hypertrophied government — the real cause for the European debacle. Greece's austerity plan, so styled, does not scale back the Greek government other than reduce the number of government-owned companies from 6,000 to 2,000. Government workers will receive modest pay cuts, but the number of public employees will not actually decline to any meaningful degree. Greek pensioners will continue to receive lavish benefits, and all of the suffocating corruption and government controls on the economy ranked the second least-free in the EU (after Poland) will remain untouched. Taxes, however, will increase sharply to pay for Greece's bloated public sector. Greek citizens will now see the enactment of a new tax on high pensions, new taxes on company profits, value-added taxes of up to 23 percent, and a 10-percent increase for luxury taxes and taxes on alcohol, cigarettes, and fuel.



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Reign of error: The European Central Bank, housed in Frankfurt, is internationalizing the inflationary errors of modern central banking and fiat currency. The EU's one-size-fits-all monetary policy has spread financial misery throughout the eurozone. (*Photo credit: Eric Chan*)

Greece was able to persuade the rest of the EU, including a skeptical Germany, to extend a bailout loan of 110 billion euros to keep the Greek economy afloat. The decision was defended as the only way of staving off a Greek default and of maintaining confidence in the euro and the economic health of the eurozone. The politicians and financiers who defended the Greek program also claimed that rescuing the foundering Greek ship of state would prevent “contagion” elsewhere in the eurozone; paying out a relatively modest sum to keep the Greek crisis under control was touted as a small price for keeping the fiscal woes of Greece from spilling over into other vulnerable European economies.

But no sooner had the Greek crisis subsided than the rest of the eurozone began to unravel. Portugal, Ireland, and Spain — the world's seventh largest economy — started coming apart at the seams, with Italy and even Great Britain coming under scrutiny for excessive public indebtedness.

The economic ruin of Spain, still very much a work in progress, followed a trajectory very similar to what the United States has experienced. Like America, Spain was buoyed for years by a monster real estate bubble. Since the 1970s, the Spanish government has encouraged Spanish citizens to own their own homes, creating a strong cultural demand for affordable mortgages. From 1995 to 2007, the price of real estate in Spain grew by more than 200 percent, and the Spanish economy grew with it — such, at least, was the popular perception. But when the world economy went bust in late 2007, the Spanish real estate bubble burst alongside that of the United States. Unemployment in Spain soared to Great Depression-esque levels of nearly 20 percent — the highest unemployment in Spanish history and in the eurozone. The Spanish government, facing drastic declines in revenue and international skepticism concerning the viability of its sovereign debt, was suddenly staring at the very real possibility of having to default on some of its debt obligations.

In December 2010, the beleaguered Spanish government approved austerity measures of its own which, although more market-oriented than Greece's, still fall far short of the mark. Spain has decided to partly privatize major airports, cut taxes for small businesses while hiking the tobacco tax, sell off a 30-percent stake in the national lottery, and cut back on government-funded jobless benefits. Moreover,



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Spain has cut wages for civil servants and frozen retirement pensions — without, we hasten to add, actually cutting the size of the existing socialist government with its many-splendored bureaucracies.

Spain's Iberian neighbor, Portugal, is in even more acute danger, because electoral squabbles are complicating Prime Minister José Socrates' attempt to negotiate an austerity package for his country. One possible outcome is that Portugal may fail to pass a budget at all, leading to dissolution of the government. In such a case, said Portuguese political commentator Viriato Soromenho Marques, "We wouldn't have a proper government and it wouldn't have the political ability to discuss a bailout with the EU and IMF. This would turn the Portuguese situation worse than the Greek one, which is really frightening."

Regardless of the outcome, most investors are betting that Portugal will soon follow Greece and Ireland down the bailout road. In the meantime, Portugal is faced with unemployment well over 10 percent, a swooning standard of living, and the prospect of tax hikes (the Portuguese government's predictable take on "austerity") to sustain the rotten government that brought about the crisis in the first place.

The recent and well-publicized collapse of the economy of Ireland — once known as the "Celtic tiger" for her spectacular economic growth over the last 20 years — has shown the world that the European crisis is not limited to the countries of "Club Med." Ireland appears to have been the first European country in the ongoing crisis to enter recession — the first on the Emerald Isle since the 1980s. Prior to the collapse, Ireland's stock exchange was soaring, with the ISE breaching 10,000 points in 2007; subsequent to the collapse, it fell below 2,000. Unemployment in Ireland rose above 300,000 by early 2009, the highest level ever recorded in that country. Like the United States and Spain, Ireland entertained a years-long real estate bubble, which brought down several huge Irish banks when it burst. The Irish government moved aggressively to bail out the banking behemoths — only to incur enormous new debts that made Ireland the world's second most indebted country, after Luxembourg. (Ireland owed a whopping 1,305 percent of her GDP, amounting to more than \$500,000 per person.)

Predictably, the EU and IMF cobbled together a bailout package for Ireland. Despite anger among many Irish for the inevitable conditions that will be attached to the Irish bailout loans by her creditors, the \$114 billion bailout appears to be a done deal. Given that Ireland still is saddled with unpayable debts, the Irish bailout is unlikely to accomplish more than postpone the evil day.

Fiscal Demons Continue Havoc

Nor has the crisis left the continent's bigger economic powers untouched. Great Britain's public finances are in tatters, prompting Ed Balls, a senior Minister and confidant of former British Prime Minister Gordon Brown, to proclaim this the worst economic crisis for Britain in a century, with the potential to surpass the Great Depression both in duration and impact. "The economy is going to define our politics ... in Britain in the next year, the next five years, the next 10 and even the next 15 years," Balls told a Labour Party gathering in Yorkshire last year. "These are seismic events that are going to change the political landscape. I think this is a financial crisis more extreme and more serious than that of the 1930s, and we all remember how the politics of that era were shaped by the economy."



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The face of austerity: Iceland, the first European economic domino to fall, has endured the worst collapse, relative to size, in recorded economic history. The North Atlantic nation will probably never fully regain its financial swagger following the failure of its entire banking system and bailout loans that will never be repaid. (*Photo credit: AP Images*)

Britain's new Conservative government, led by Prime Minister David Cameron, has been making a serious effort to head off economic Armageddon, though it remains to be seen whether the British Parliament will allow significant belt-tightening. At the present, Britain's public debt is on track to reach 100 percent of the GDP in a few years, prompting *Newsweek* to proclaim the last gasp of Britain's status as a "pocket superpower" and its transition into a "lesser Britain" overshadowed by new global powers like India, China, and Brazil.

Elsewhere in Europe, the beat is the same; from the Baltic states of Latvia, Lithuania, and Estonia, to Italy, Belgium, and the Balkans, public debt is sinking European economies faster than the *Titanic* after it collided with the iceberg. Continent-wide, once-grand illusions of indissoluble union and permanent prosperity have been punctured as the pitiless laws of economics make their exactions.

The root causes of the crisis are political as much as economic. In hindsight, the folly of unequally yoking together disparate economies and political cultures under a single financial authority has become obvious. The creation of the euro and the European Central Bank have denied individual countries the ability to engage in their own fiscal policies, which in some cases at least would have been more restrained than the easy-money policies of the eurozone.

But the root problem is the failure, yet again, of modern Keynesian economics, of which the creation of fiat money to offset alleged economic contractionary tendencies is a central article of faith. Both Great Britain and the United States have independent central banks and cling to their respective national currencies, yet their economies are in the same condition as those of the eurozone.

The European crisis is likely to lead to the financial collapse of the European Union and its international currency, the euro, as the debt pigeons continue to return to roost over the coming months. But the only solution to the problem — and the one politicians and bankers are likely to dismiss — is to rid the world of fiat currency, return to sound money, and drastically reduce the size and cost of government. If events in Europe force such an outcome, then the current tribulations will not be altogether fruitless.



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