

Classical Economics and the Greek Credit Crisis

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The credit crisis in the Eurozone has sent tremors throughout the global economy, and the world is anxiously waiting to see if these tremors precede a coming earthquake. Greece has come under particular scrutiny as the probability of a government default threatens the stability of the entire European Union and, by extension, the rest of the world. However, common metrics of economic health and stability indicate many pivotal nations are in equally—if not more—dire straits.

These modern economic metrics have progressed far beyond the conception of the fathers of modern economics. This does not, however, preclude these foundational ideas from furnishing potential insights into the origins and appropriate responses to the crises. In particular, I claim that the works of Adam Smith, Karl Marx, and Max Weber each provide some substantive insights concerning the crisis, though each also carries stark limitations.

Strangled by the Invisible Hand

In his seminal work, *The Wealth of Nations*, Adam Smith espoused the belief that the maximally efficient economy was one in which the economy was permitted to effectively self-regulate. The composite interests of all of the rational constituents of an economy yield the optimal economic outcomes. For this fundamental tenet of Smithian economics, we can surmise some causal characteristics of the Greek credit crisis. In particular, if we accept that the crisis is a suboptimal outcome, then we can conclude that the overbearing intervention of the government has caused the crisis.

There is some compelling support for this argument. Since the Greek government adopted the Euro as its currency in 2002, it has expanded its deficit spending substantially. The free exchange of a locally-universal currency streamlined the process of intergovernmental

lending. Greece took full advantage of this opportunity, rocketing its national debt to 10.5% of GDP in 2010. The probability of a default has prompted the government to make significant cuts to its employment and services. These cuts have led to mass protests and riots in Greece in the recent months.

While the rule of free-market capitalism and rationality has become a mantra of modern economic liberalism, the world in which Smith first addressed his problem of explaining economic organization is far removed from the world today. Smith conceived of the government as a distinct economic entity from individuals and other economic actors. Smith viewed the world as a collection of discrete country-economies. The world in which we live is far more complex. Instead of an assortment of discrete markets which are solitary to the nation-state in which they exist, we experience single a global economy in which governments are better represented as firms with unique abilities, than institutions with absolute power and a moral obligation not to exercise such capabilities. However, if we disregard the fundamental nationality of Smithian theory and conceive of an international market which mirrors Smith's conception of a national market, then we can derive some small amount of substantive traction. While Smith's theory lacked the structural mechanisms to capture lending between governments, Smith did describe public debt and thereby foresee related crises:

The necessities of the state render government upon most occasions willing to borrow upon terms extremely advantageous to the lender. The security which it grants to the original creditor is made transferable to any other creditor, and, from the universal confidence in the justice of the state, generally sells in the market for more than was originally paid for it.

The government [...] is very apt to repose itself upon this ability and willingness of its subjects to lend it their money on extraordinary occasions. It foresees the facility of borrowing, and therefore dispenses itself from the duty of saving. (V.3.7-8)

[...] The progress of the enormous debts which at present oppress, and will in the long-run probably ruin, all the great nations of Europe has been pretty uniform. Nations, like private men, have generally begun to borrow upon what may be called personal credit, without assigning or mortgaging any particular fund for the payment of the debt; and when this resource has failed them, they have gone on to borrow upon assignments or mortgages of particular funds. (V.3.10)

Smith fails to explain the means by which governments will be ruined by debt, but it's only a small step beyond the content he did generate to assert that uncontrolled debt leads to probable default. This is a sensible, tenable conclusion—one which we are seeing played out in Greece, and to a lesser extent in a variety of other European nations. However, by failing to describe the mechanisms in any resolution, Smith denies us any ability to prescribe activity based on his theory. In short, we know the causal factor, if not the mechanisms by which this mess emerged, but we do not know how to emerge from it in the short term.

A longer-term prescription to avoid this kind of crisis would be to more closely align to the functions of government Smith suggested. Namely, the government should be responsible for functions which rationally self-interested actors cannot adequately generate profit: maintaining infrastructure and educating the populus. A stripped-down government of this variety should be more capable of confining itself to the allocated budget, instead of spilling from revenues into deficit and thereby, debt. In this, Smith betrays his thinking with a

fundamental flaw. For Smith, economic optimality is achieved by all actors behaving in rationally self-interested ways *except for the governments*. The assumed rationality of governments has become a fundamental tenet of political science in the last 50 years (Levi 2007). Ignoring this, Smith consigns his theory to dusty shelf of history to be revered as groundbreaking, but long since supplanted by superior approaches to the study of politics.

You Have Nothing to Lose but your Sovereign Debt

Karl Marx, being more an activist in his outlook, would likely take an entirely different tack. The credit crisis emerged because the bourgeoisie has exploited the proletariat to the point that the current conditions are no longer sustainable. Marxian theory is less descriptive in this regard than prescriptive. The credit crisis should alert the proletariat of Europe to his/her plight. In this social dimension, Marx hits the mark much more closely than Smith. Marx predicts that an aware, angry proletariat class should rise up against the institutions of bourgeoisie and install a more socialist system of governance in which wealth is distributed more equitably. In short, this should mark the tipping point between the stages of economic development.

The current protests in Greece are indicative of this wealth disparity. The bourgeoisie in the Greek government are maintaining their own income streams by cutting government spending, forcing thousands of proletariat government employees into unemployment. The proletariat are actively responding with protests resulting in violence (Economic Times 10-19-2011). Having nothing to lose but the government which embroiled them in this crisis, the Greek working class should resort to violence to attain their socialist utopia. This closely reflects Marx's observation that the revolts in France during his lifetime indicated the same sort of social change.

This approach, however, is a gross oversimplification. As can be seen in Table 1, Greece's income inequality is on par with the rest of the Eurozone (CIA 2011). If Marx's theory held uniformly, all the nations of Europe should be experiencing the kinds of protests that Greece is seeing presently. Moreover, if the crisis were precipitated purely by the debt and its secondary effects on the working masses, then there should be a correlation between the probability of default and the relative size of the public debt. In 2010, Greek debt constituted 10.5% of the nation's GDP. While this is admittedly a very bad valuation (199 worst in the world), Greece is in good company: The UK's debt is estimated at 10.2%, and Ireland's is a staggering 32.4% (CIA 2011). And yet there is little credible talk of revolt in the British Isles. Perhaps more surprisingly, Intrade predicts (as of October 25, 2011) that the probability of Greek default is 36%, where Ireland's is a meager 4%. So the probability of default is likely not proportional to the relative size of the debt, nor is it represented by the latent relative income inequality.

	Gini Coefficient	Debt (% of GDP)	Pr(Default)
Greece	.34	10.5	.36
United Kingdom	.29	10.2	-
Ireland	.34	32.4	.04

Table 1: Inequality, Debt, and Probability of Bankruptcy in Europe
(2007 Estimate, CIA 2011, Intrade 2011)

As we can see, there is no way to operationalize Marx's predictions in a way which is both sensible and defensible. Thus Marx's calls for the working class to overthrow the stifling institution of bourgeois government seem less credible than Smith's assessment that the debt crisis *should* emerge under the circumstances.

The Orthodox Ethic and the Spirit of Failure

Unlike Smith and Marx, Max Weber addressed the question of socio-economic organization by proposing a single variable instead of a grand theory. Namely, Weber suggested that the protestant work ethic gave rise to economic competition and thereby modern capitalism. He demonstrated his hypothesis by pitting majority protestant cultures (Germany, Britain) against Catholic ones (France, Spain). He fails, however, to expand his worldview beyond these two categorizations.

For the purpose of argument, we can fixate (as Weber does) on the nature of Protestantism. Unlike Weber, however, we can pit this spirit against the rest of the varieties of Christianity and other world religions to apply the theory to the Greek case, instead of assuming a diametrically opposed, Protestant versus Catholic, world. In other words, where Weber compared Protestant with Catholic, we will compare Protestant and non-Protestant so as to include Greek culture, which is predominantly Greek Orthodox.

With this assumption in mind, the Greek lack of Protestantism caused cultural non-competitiveness which stifled economic viability in the modern world. We might even further look for support in the other countries suspected by prediction markets of facing default: Ireland, Spain, Italy, and Portugal (Intrade 2011), all of which are predominately Catholic nations.

While at first glance, this theory seems to hold water (and do so rather better, comparatively, than the others), Weber's approach leads to some important self-contradictions. Namely, Weber uses the relative success of individual Protestants in the fields of government and industry as indicators of the protestant work ethic. However, no nation in Europe is exclusively non-protestant. If Protestant leaders tend to emerge because of some inherent quality of Protestant worldview, Protestant leaders should emerge in non-Protestant societies. As such

the decision processes of government leaders should yield similar national trends, even in cases of religiously distinct societies. Claims otherwise (namely, that Protestants shouldn't be leaders in Catholic societies) hinge upon the assumption that culture affects decision processes in some conditions (for working individuals) but not for others (for state leaders). This logical inconsistency is entirely unaddressed by Weber.

This approach of looking at the leader as the appropriate unit-of-analysis is emerging as a significant paradigm in the field of International Relations (Wolford 2007). Whether the same should hold true in comparative studies is open for debate, but I contend that Weber fails equally as his forbears, both in predicting the crisis (largely because it is far out of the scope of his research intent) and in prescribing the solution.

Were we to take *The Protestant Ethic* at face value, we should conclude that the economic distortions which have embroiled Greece are caused by the non-Protestantism of the Greek people. Thus the Weberian solution to a crisis of this sort is to institute Protestantism world-wide. Religious beliefs notwithstanding, this is an unbelievable pursuit. Whether or not Weber would argue that this would be ideal is not imminently clear, as Weber does not advocate a convergence on a particular, uniform system of economic or social governance in the manner that both Marx and Smith advocate.

Too Big to Fail, Too Precarious to Sustain

The varied approaches to the comparative study of politics can each be traced back to one of the foundational thinkers of socio-economic theory. Each can provide some insight to the causes of the current conditions in Greece. Even so, devoid of newer approaches, none can provide a truly cohesive and comprehensive assessment of the crisis. More importantly, none can

prescribe a viable route out of the impending disaster. As such, we must venture outside the realms of classical economic theory in order to generate any adequate assessment of plausible solutions.

The global system has proven that Smith's world outlook carries more weight than Marx's, as grand theory goes. This may be in no small part attributable to Smith's far more accurate portrayal of humans as rationally self-interested, instead of Marx's conception of the noble worker willing to sacrifice the well-being of the one for the benefit of the many. It is interesting that Weberian theory can hold its own in this case, despite being far more limited in scope.

The most viable prescription comes from a modification of Smith's approach to social theory. It is in the best interest (i.e. rational) of the European Union to save the Greek government, thereby averting a cataclysmic economic downturn. However, the gross costs thereof have made that process a halting one. I would predict that the European leaders with enough financial capital to save this too-big-to-fail firm will pull through, though not without further painful concessions on the part of the Greek government. This is not a clean solution: the Irish, Spanish, and Portugese governments are facing similar (though less developed) crises, and saving Greece will signal that a safety net exists for those governments. This is, however, the state of things. Whether or not this grim scenario will save us from the far grimmer scenario of a complete, unbridled collapse, only time may tell.

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