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The Conscience of a Liberal

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Origins of the Euro Crisis

Kash Mansori has an excellent post about the origins of the euro crisis. He documents the fact — which the Germans cannot bring themselves to acknowledge — that fiscal irresponsibility had very little to do with it. And he shows that what really predicts who found themselves in crisis was capital inflows:

| Fiscal balance | | CA balance | |
|----------------|-------------|-------------|-------------|
| Country | 2000-07 ave | Country | 2000-07 ave |
| Greece | -5.4% | Portugal | -9.4% |
| Portugal | -3.7% | Greece | -8.4% |
| Italy | -2.9% | Spain | -5.8% |
| France | -2.7% | Ireland | -1.8% |
| Germany | -2.2% | Italy | -1.3% |
| Austria | -1.6% | France | 0.4% |
| Netherlands | -0.6% | Austria | 1.6% |
| Belgium | -0.4% | Belgium | 3.0% |
| Spain | 0.3% | Germany | 3.2% |
| Ireland | 1.5% | Netherlands | 5.4% |
| Luxembourg | 2.3% | Finland | 5.9% |
| Finland | 4.1% | Luxembourg | 10.6% |

The key point here is that countries within the euro zone have no policy tools with which to manage their balance of payments, so that this was hardly a case of policy sin.

I'd add that it is very difficult in real time to convince people that capital inflows pose a threat, no matter how obvious the numbers seem. Somewhere in the years just before the crisis I was at a meeting in Barcelona where Olivier Blanchard tried to tell the Spaniards how dangerous the situation was getting; he got trashed and ridiculed for his pains, just like those who warned about the US housing bubble.