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**University of Sussex**

**Beyond Immaturity and Victimisation**

The European Periphery and the Eurozone Crisis

Submitted for the degree of Doctor of Philosophy

Neil Dooley

Department of International Relations

July 2016

I hereby declare that this thesis has not been submitted, either in the same or different form to this or any other University for a degree.

Signature: .....

## Summary

### Beyond Immaturity and Victimisation: The European Periphery and the Eurozone Crisis

Neil Dooley

Submitted for the degree of Doctor of Philosophy

University of Sussex

One of the most striking aspects of the eurozone crisis is its asymmetric impact. Detrimental economic and political consequences have resonated across Europe, but peripheral countries have been most severely affected. Individual peripheral countries have followed dramatically different paths to crisis, making it difficult to speak of the crisis as a single phenomenon. Bringing literature from Comparative Political Economy (CPE) on capitalist diversity into dialogue with scholarship on Europeanisation, this thesis develops the concept of *modernisation via Europeanisation* in order to explore the much overlooked ways in which the negotiation of European integration has been generative of divergence of the European periphery.

To capture this asymmetry, I investigate the origins of the eurozone crisis across three cases – Greece, Portugal and Ireland. I study the active attempt by these countries to negotiate and adapt to a ‘one-size-fits-all’ model of European integration. This approach sheds light on how adaptation to Europe inadvertently resulted in the generation of fragile, hybrid, models of growth in each of the three countries. These findings have significant implications for how we understand the origins of the crisis. They suggest that it has been the European periphery’s attempt to ‘follow the rules’ of European Integration, rather than their failure or inability to do so, that explains their current difficulties.

This novel reading of the origins of the eurozone crisis directly challenges settled common-senses in existing literature. The eurozone crisis cannot be explained by narratives which stress the ‘immaturity’ of the countries of the European Periphery. Neither can it be explained by more critical narratives which understand the periphery as a victim of German ‘economic domination’. Instead, the relative severity of the crisis in the periphery can be explained by the EU’s obstinate promotion of a single model of convergence which has generated a variety of different European economic trajectories.

## Acknowledgements

They say if you get your mind right, you only really do two days of your PhD. The day you get in, and the day you get out. Although there have been times where I have felt the full weight of the four years in between, I have had the great fortune of having the following people help me reach that second day.

I am indebted to my two supervisors, Fabio Petito and Kevin Gray. I was implausibly young and wide-eyed back when we first met in October 2011, and it is to them that I most owe my intellectual development. I would especially like to thank Fabio for his generosity and the consistently illuminating insight he has had into my work, which has helped me develop this thesis in ways I did not think were possible. I thank Kevin for the care he has taken in guiding the direction of this project. It could not have taken the shape that it has without his invaluable advice at various critical junctures. To both, their support, kindness and guidance over the past four years have made it possible for me to produce something that I hope they can be proud of.

Here at the IR Department in Sussex I could not have asked for, nor expected, a more supportive, convivial, and stimulating environment in which to write my PhD. I would like particularly to thank Justin Rosenberg for his interest and generous engagement with my work, which has meant the world to me. My sincerest gratitude also goes to (in no particular order) Sam Knafo, Andreas Antoniadis, Kamran Matin, Beate Jahn, Ben Selwyn, Louiza Odysseus, Cynthia Weber, Rorden Wilkinson, and Anna Stavrianakis for their engagement with me and my work over the years, which has helped me grow immeasurably as a scholar. A big thank you to Jayne Paulin who has helped me survive more than one dramatic registration process, and to Kit Eves, Emilia Roycroft and all at the Global Studies School Office. A special thanks also to Annie Berry for her help over the years, and to Maria Smith and Sally Faith at the Library. Thanks also to Paul Taggart, Claire Annesley and all my new colleagues for welcoming me into my second home at the Department of Politics.

Outside of Sussex, I am indebted to the kindness of the following people who took the time to read and comment on my work: Rebecca Adler-Nissen, Niamh Hardiman, Nikolay Rostov, Umut Aydin, Kimberley Hutchings, and Lucia Quaglia. Thanks also to Andrew Baker, Susan McManus and Graham Finlay. A big thanks to all the staff at Allied Irish Bank (AIB) Dundalk - without whom it would not have been possible to fund my PhD - and to whom I truly owe more than I can ever repay.

It would not have been possible to survive the PhD without having an amazing group of friends here in Brighton. A hundred thousand thank-you's to the 'C349 crew': Sam Appleton,

Tom Bentley, Synne Laastad Dyvik, Darius A'Zami, and Felipe Antunes de Oliveira. I could not have asked for better office-mates or friends and will always look back with great fondness to those times when we were all together, sometimes making coffee with our hazardous cafetiere, sometimes streaming the West Wing, sometimes writing. To the extended 'cheers brothers', thanks to the wonderful Jade McShane, Tristan Kirby, Paul Eastman, George Moody, Helen Johnston, Ole Johannes Kaland, Lauren Greenwood, Yavuz Tuyloglu, Sahil Dutta, Yuliya Yurchenko, Evren Eken, Calvin Yan Lau, and my alt-country band-mate Roger Johnson. As we say in the old country (and increasingly in this one), you are all a 'great bunch of lads', and I genuinely don't know what I would have done without you. Bonus thanks to Sam for providing particularly insightful feedback in the final days, and to Tom and Roger (along with my parents) for proof reading. Special mention must go to my 'work-proximity associate' Darius A'Zami. More sentimental people would probably thank you for your friendship and for contributing to my intellectual development, even as (or indeed partially because) an albatross hung around our necks. Back in my hometown of Dundalk, Ireland, I am lucky to still count Joseph Edwards, Danny Meegan, Sarah Edwards, Joe Furlong, James Sheppard and Gary Brigadir among my closest friends, even if we don't see each other as often as I would like.

My greatest debt is to my parents. I thank my Dad, Tom Dooley, for giving me a fascination for political economy from an early age. There was always a 'book in the garage' on every imaginable topic from uneven and combined development to theoretical and experimental studies of slender oscillating water columns, and plenty of conversations on dialectics in the Joes' bar in Dromiskin. Heartfelt thanks to my Mom, Ann Campbell. I feel very lucky to have had your endless support and unwavering belief in me – and I could never have done this without you. You have gone above and beyond the call of duty, and this has meant more to me than I have probably ever told you outside of formal acknowledgements. I can never thank my parents for all they have done for me, materially and non-materially, and it is to them that this thesis is dedicated.

To my brother Colin, thank you for being the IMF to my Greece. Thanks also for moving to England, having you here has made the home stretch much more bearable. Special thanks to my step-Mother Kay Webster-Dooley, and to my wee brother, Enda Dooley, and sister, Rachael Dooley. I've been doing my PhD for about 50 per cent of your lives, and hanging out with you both back home has helped more than you probably realise.

To the love of my life Jenny Mc Guill, I have even less idea how to ever thank you. I will never forget your never-ending kindness, patience, love and friendship throughout writing this thesis. More than anyone, you have lived this PhD with me – an honour you could have no doubt lived without. You have always been there for me, kept me sane (no mean feat), and been

an inspiration to me. I don't think either of us can properly remember what life was like without this thesis. How exciting that we both get to exit the eurozone now, and find out together.

*For my parents*



# Beyond Immaturity and Victimisation

## The European Periphery and the Eurozone Crisis

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# Introduction

All happy countries are alike; but each unhappy country is unhappy in its own way.

Albert Jaeger, Senior Resident IMF Representative in Lisbon, 2015.

One of the most striking aspects of the eurozone crisis is its asymmetric impact. Detrimental economic and political consequences have resonated across Europe, but peripheral member states have been affected more severely than others (Hardiman and Dellepiane 2010, 473). Not only this, but individual peripheral countries have followed dramatically different paths to crisis. While the Greek state may have dangerously over-borrowed and widened its budget deficit, Ireland was among the most fiscally responsible economies in Europe. While banks fuelled a property bubble in Ireland, Portugal was in the midst of a decade long recession. As an IMF economist playfully put it, each unhappy peripheral country is ‘unhappy in its own way’ (2012).

This thesis has two main purposes. First, I aim to develop an understanding of the origins of the eurozone crisis in the European periphery by conducting case studies of Greece, Portugal and Ireland.<sup>1</sup> The embattled Greek economy makes up just two per cent of the eurozone. And yet, the shockwaves from its crisis have appeared to threaten the disintegration of the entire European project. As such, whether the eurozone crisis is understood as mostly domestic or systemic in nature, it is vital that existing literature reflects on the assumptions it makes about the crucial role of the periphery. Second, in

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<sup>1</sup> The island of Ireland technically comprises of two states: The Republic of Ireland and Northern Ireland. For the sake of convenience, throughout this thesis, I refer to the Republic of Ireland as ‘Ireland’.

order for this explanation to be persuasive, this thesis aims to account for the dramatically different paths to crisis the periphery has followed. The crisis has been and is playing out in very different ways across Europe (Bruff and Ebenau 2014, 4). This suggests an intellectual puzzle: why has the eurozone crisis appeared to manifest as a fiscal crisis in Greece, a recession in Portugal and as a banking crisis in Ireland? To examine these questions, this thesis traces the evolution of economic trajectories across these three case studies in the decades before their respective crises.

In order to examine these cases, I propose a framework based on a combination of scholarship on Europeanisation and the Comparative Political Economy (CPE) literature on ‘capitalist diversity’. This proposed framework makes it possible to draw attention to the much overlooked ways in which domestic adaptation to European integration has been generative of precarious patterns of divergence across the European periphery. I develop the concept of ‘modernisation via Europeanisation’ to argue that over the past number of decades, Greece, Portugal and Ireland have viewed their own modernisation in the mirror of a ‘one size fits all’ model of European development. As such, national and supranational efforts at promoting the convergence of member states have – paradoxically – propelled these countries towards crisis.

The issue of asymmetry is becoming increasingly acknowledged as absolutely central to research into the origins of the eurozone crisis (Bruff and Ebenau 2014, 4; Jäger and Springler 2015, 1). Yet, I argue that existing literature has yet to adequately take up the challenge of explaining it. Instead, there has been a tendency, even in otherwise sophisticated analysis, to fall back upon, and reproduce, one of two problematic narratives of why the periphery was ‘hit hardest’ by the eurozone crisis.



The first is a story about the ‘lazy Greeks’ and their fellow European ‘PIIGS’.<sup>2</sup> Much like their namesakes in the fairy tale, the PIIGS built their houses out of straw, risking the survival of the eurozone in the process (Dooley 2015a). As the story goes, Portugal, Ireland, and particularly Greece were unwilling to introduce ‘painful but necessary’ reforms in the decades before the crisis hit; content to irresponsibly reproduce patterns of fiscal profligacy, low efficiency and political immaturity (Bastasin 2012,8; Lavdas, Litsas, and Skiadas 2013, 175).

The second story offers a more critical take - casting Germany as the ‘big bad wolf’ of the tale.<sup>3</sup> While the above notions of peripheral ‘immaturity’ remain widespread and influential, somewhat surprisingly, scholars have noted that narratives expressed in Western media have increasingly focused on the problems with Germany’s, rather than the so-called ‘PIIGS’, behaviour (Cross and Ma 2015, 1066; Adler-Nissen 2015). Germany has been portrayed as iron-fisted and intransigent (Cross and Ma 2015), as irrationally committing to its ordoliberal values even when this commitment threatens the very existence of the European project (Matthijs 2015). Germany is accused of ‘beggaring its neighbour’ in the European periphery in order to reproduce its export-led model of growth, and of uniquely and perhaps deliberately benefitting from the euro at the inevitable expense of its fellow member states (Lapavitsas et al. 2012). The centrality of Germany in the origins, escalation, and intractability of the crisis has become more and more commonplace in ongoing debates. By replacing one scapegoat with another, this narrative of peripheral ‘victimisation’ aims to challenge existing assumptions by blaming the German ‘big bad wolf’ instead of the ‘PIIGS’.

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<sup>2</sup> A regrettable acronym for the so-called ‘deficit’ countries of Southern Europe and Ireland: Portugal, Ireland, Italy, Greece and Spain.

<sup>3</sup> While Germany remains central to most research in this vein, some approaches emphasise the role of ‘core Europe’ and/or of transnational capital classes.

These two narratives of the origins of the crisis in the periphery – labelled here as the ‘immaturity thesis’ and the ‘victimisation thesis’ – have remained largely undisturbed by alternative conceptions, and have strongly influenced much existing research on the eurozone crisis.<sup>4</sup> I argue that this has contributed to two major gaps in the literature. Firstly, existing accounts downplay the very different kinds of crisis the European periphery has experienced. Pointing out, as scholarship relying on assumptions of immaturity does, that every peripheral country ‘failed to converge’ tells us little about how and why these three specific kinds of ‘divergence’ emerged. Exposing the periphery’s collective victimisation by Germany or Western Europe explains less still about these multiple paths.

The second major gap relates to the agency of the periphery. While the immaturity thesis reifies and pathologises peripheral agency (rendering it immature, incomplete), the victimisation thesis neglects it entirely – peripheral agency has been stunted by the core. This problem tends to produce scholarly and political debates that are pre-occupied with assigning blame (as Hänska 2015; Papadimitriou and Zartaloudis 2014; and Ntampoudi 2014 all note). On the one hand, narratives of blame are clearly evident in the conditionality of the European Union-European Central Bank-International Monetary Fund (EU-ECB-IMF) arrangements, as well as in the emerging European institutional response to the crisis; all of which are marked by measures designed to correct the immaturities of the peripheral states. This response has been widely admonished with even the IMF issuing an extraordinary apology for not recognising the damage austerity would do to Greece (see Elliott, Inman, and Smith

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<sup>4</sup> This literature on the eurozone crisis is usually split into two levels (national and systemic level causes – see Matthijs 2015, 3), or sometimes sub-divided into different configurations of three or more (e.g. see Fouskas and Dimoulas 2013, 144 and Jones 2015). I argue that, regardless of whether a systemic or domestic level approach is adopted, literature on the eurozone crisis tends to rely on either assumptions of immaturity or victimisation when it deals with the causes of the crisis in the periphery. Because any account of the eurozone crisis will need to diagnose the crisis in the periphery, implicitly or otherwise, narratives of immaturity and victimisation are widespread. I will further develop this argument in chapter one.

2013). Related to this, some have noted how public, media and political perceptions of the periphery, particularly Greece, as immature contributed to the notorious procrastination on the part of European elites in responding to the crisis, a serious error that raised the stakes of the crisis (Bastasin 2012, 7–11). Brazys and Hardiman (2013) have even noted how the very use of ‘heuristic labels’ such as the ‘PIIGS’ acronym have actually contributed to negative market responses towards those states.

On the other hand, transposed from academic to political discourses, narratives of victimisation have contributed to the problematic rise of anti-German sentiment within Europe. Labels such as ‘Nazi oppressor and colonizer’ and ‘strict teacher’ vie for prominence against ‘immature pupil’ and ‘moral sinner’ (see Adler-Nissen 2015, 3; Dooley 2015). Roberto Orsi notes that the taboo of large scale weaponisations of war memories against Germany has been broken (Orsi 2015), and populist rhetoric from all corners has emerged that others claim form an emerging ‘intra-European neo-racism’ (Kouvélakis 2012, xix; see also Andreou 2012) – potentially feeding into disintegrative momentums for the European project.

Framed in this way, existing debates beg the question: is it possible to have understanding of the periphery as having a role in their own history without resorting to the dead end of choosing between a German and a Greek scapegoat? What would it mean to investigate the origins of the eurozone crisis without lenses of blame?

Based on in-depth case study analysis of the crises in Greece, Portugal and Ireland, I propose a different interpretation of the origins of their respective crises. These countries were ‘hit hardest’ not because of their ‘immature’ patterns of political and economic governance, nor due to their ‘victimisation’ by their more powerful European neighbours. Instead, I argue that the crisis in the European periphery is the product of supranational and national attempts to promote the *convergence* of the

European periphery with Western Europe. Greece, Portugal, and Ireland have been at the centre of the crisis because their aspirations to converge with Western Europe catalysed brand new and unexpected patterns of divergence. In other words, the countries of the European periphery got into trouble by ‘following the rules’ of European integration, not by failing to.

In developing this argument, this thesis makes important contributions to debates on the eurozone crisis. Theoretically, I develop the concept of ‘modernisation via Europeanisation’ to demonstrate how insights from the Comparative Political Economy (CPE) literature on ‘capitalist diversity’ can be fruitfully brought into dialogue with studies of ‘Europeanisation’. While the latter directs attention to the effects of ‘domestic adaptation to European regional integration’ (Vink and Graziano 2007, 7), CPE makes an important distinction between divergence (transformation) and non-convergence (persistence of national variation in the face of pressures to transform) (Hancké 2009, 9). Their combination leads to a new understanding of how domestic adaptation to European regional integration can be generative of brand new, unpredictable patterns of transformation.<sup>5</sup>

This argument implies an important distinction between convergence as a *process* and convergence as a *project*. National and EU elites alike have tended to subscribe to a common sense belief that European integration would lead to *processes* of convergence among member states. The implication of joining the Single Market and the euro is that all member states could and should use a ‘one size fits all’ formula to secure economic growth, and it was believed that competitive pressures together with

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<sup>5</sup> As I argue in chapter one, the literature on Europeanisation tends to conflate ‘divergence’ with ‘non-convergence’. Drawing on the insights of capitalist diversity, I propose that the evolving economic trajectories of the European periphery cannot simply be explained with reference to the resilience of national varieties of capitalism in the face of EU driven pressures to converge. Europeanisation led neither to convergence, nor non-convergence for the European periphery. Instead, it led to the generation of new, unanticipated, patterns of transformation, or in other words, *divergence*.

the stringent conditions imposed by the EU on member states would force structural reform and lead to institutional convergence (Hall 2012, 357). As Hall (2014) notes, an ‘element of prophecy was built into this mythology’ which remained, of course, unfulfilled. Greece, Ireland, and Portugal all participated in *projects* of convergence during their membership of the EU. I argue that these projects aimed at promoting convergence were actually significant contributors to processes of divergence in these countries. Convergence as a process is a myth, but the emergence of projects to restructure economies in the name of convergence has had real and significant effects.<sup>6</sup>

Empirically, I contribute new interpretations of the origins of the eurozone crisis in Greece, Portugal and Ireland. Existing domestic accounts have been dominated by historical narratives that are pre-occupied with identifying the various obstacles to the development of mature trajectories of development in these countries. Systemic accounts have tended to eschew a domestic focus. When they do trace national crises, they privilege the structural role of ‘external’ over domestic pressures for change. As such, parallel national histories of the origins of specific patterns of divergence – something altogether different - have tended to be neglected. In contributing to the filling of these gaps, the case studies presented here invite new thinking on the histories of economic development and crisis in these three countries.

Taken together, these contributions suggest a way for debates on the crisis in the European periphery to move beyond problematic narratives of immaturity and victimisation. Although it is vital that the domestic sources of the eurozone crisis be accounted for, a deeper understanding of these sources can be arrived at by recognising

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<sup>6</sup> For the sake of clarity, please note that throughout the thesis, the term ‘convergence’ will refer to *projects* of convergence, and does not indicate any subscription to theories that assume the likelihood of ‘convergence’ as a *process* (e.g., see Hancké 2009, 5-6 for an account of liberal convergence theorists). For this reason, it is possible to speak about a ‘project of convergence’ (e.g. adherence to EU budget rules or transposition of EU directives on banking and finance) and to note how these projects actually are generative of *divergence*.

both their immature and non-immature components. Similarly, debates surrounding the potentially ‘hegemonic’ role of Germany, hierarchy and inequality within Europe, and the architectural flaws of the European project matter. I suggest that we can enrich our understandings of these issues by leaving assumptions of ‘victimisation’ behind, and viewing them instead through the lens of peripheral agency.

## **Structure of thesis**

The argument of this thesis is developed across five chapters. Chapter one reviews existing literature on the origins of the eurozone crisis in the European periphery. I shed light on the ways in which literature ranging from domestic level to systemic level analysis has tended to fall back upon narratives of immaturity or victimisation to account for the relative severity of the crisis in the periphery. These narratives draw necessary attention to the domestic and systemic character of the eurozone crisis respectively. Yet, they are unable to adequately account for the asymmetry of the crisis or the agency of the periphery. After exposing these limitations, I propose an analytical framework that combines the study of Europeanisation with the Comparative Political Economy insights of capitalist diversity. This framework makes it possible to trace the evolving trajectories of economic development in Greece, Portugal and Ireland, while being sensitive to the possibility that Europeanisation has acted as a catalyst for the emergence of radically new hybrid structures and patterns of growth.

Chapter two analyses the case of Greece, beginning the first of three case studies. Greece has been presented in segments of the international press as ‘the new rogue element of our times’ (Lavdas, Litsas and Skiadas 2013, 175). Scholarship on the Greek crisis has similarly emphasised its ‘exceptional’ origins, typically tracing how the

emergence of ‘debt-fuelled clientelism’ in the 1980s has resisted the attempts of modernisers and reformers to supplant it in the decades before crisis struck. In contrast, I make an analytical distinction between the fiscal and competitiveness components of Greece’s crisis, and argue that although the former can be partially (but not exhaustively) explained with reference to the ‘poor reform capacity’ of the Greek state, the latter emerged as a result of implementing EU reforms relating to liberalisation, privatisation and deregulation. The Europeanisation of Greece facilitated the emergence of a ‘debt-led’ trajectory of economic growth, suggesting that Greece’s problems were caused just as much by the EU driven reforms it succeeded in introducing, as by those it failed to.

Chapter three turns to Portugal, and investigates the origins of a crisis that was characterised by the experience of ‘all of the signs of overheating... without any acceleration of GDP’ (Deutsche Bank 2010). I trace how the introduction of EC/EU facilitated ‘structural reforms’ throughout the 1980s and 1990s contributed to the development of ‘domestic demand debt-led growth’ (Lagoa et al. 2014). In the 1990s, a rejuvenated private banking sector drove the expansion of economic growth in Portugal’s non-tradable sector, damaging the country’s competitiveness and creating some of the highest levels of private debt in the EU. This trajectory of economic growth contributed to a decade of recession in the 2000s, ensuring that Portugal was particularly vulnerable to contagion from the Greek and Irish crises from 2010 onwards.

Chapter four focuses on the origins of the Irish banking crisis. I make an analytical distinction between the decline of the ‘Celtic Tiger’ export boom and the emergence of a detrimental housing bubble in the early 2000s. Challenging dominant explanations regarding the negligence of Irish governments from the late 1990s onwards, I argue that Ireland’s implementation of reforms driven by its preparations for

joining the Single Market and Economic and Monetary Union (EMU) facilitated the emergence of a highly liberalised and aggressive banking sector from as early as the late 1980s. While European integration may have been vital to Ireland's development of export-oriented growth in 1990s, it also created the conditions for a severe banking crisis a decade later.

Chapter five draws the historical narratives of the three case studies together and explains the thesis' contribution to new theories of the origins and asymmetry of the eurozone crisis. More specifically it develops the concept of *modernisation via Europeanisation* as an alternative to narratives of immaturity and victimisation. This concept comprises of two analytical steps. Firstly, it argues that the countries of the European periphery have been 'hit hardest' by the eurozone crisis because their attempts to 'catch up' with Western Europe by aspiring to converge their levels and forms of development with them were – paradoxically – generative of brand new patterns of unstable divergence. The crises in Greece, Portugal and Ireland were not caused solely by exceptional or immature national traits. Rather, they were an unintended outcome of putatively 'mature' patterns of Europeanisation.

Secondly, the damaging effects of Europeanisation are not best captured by narratives of victimisation. Germany and other 'core' member states had little to gain from this process. Rather, the European periphery actively and enthusiastically 'tailored themselves' to a 'one-size-fits-all' model of development as part of national strategies of modernisation. In addition, paying attention to agency makes it possible to identify how a common external pressure such as a 'one size fits all' model of European integration was mediated domestically, resulting in very different patterns of institutional change. Greece, Portugal and Ireland all negotiated their own Europeanisation in different forms and at different levels. Focusing only on how these



countries were ‘passively reshaped’ by Europe or Germany overlooks how the agency of each country shaped their very different respective paths to crisis. The concept of modernisation via Europeanisation implies that the eurozone crisis is a crisis of the project of convergence itself, and the integration process has not been sensitive or flexible enough to the unpredictable and divergent outcomes of the attempt to promote the economic convergence of its member states. Finally, the concluding chapter summarises the development of the overall argument, and reflects on its broader significance for academic and political debates on the eurozone crisis. I propose that the concept of ‘modernisation via Europeanisation’ can deepen understandings of the crises in the European periphery, of hierarchies and inequalities within the EU, and of the eurozone crisis more generally.

## 1

## Beyond the ‘Lazy PIIGS’ and the ‘Big Bad Wolf’: Rethinking the Asymmetry of the Eurozone Crisis

Let's be clear about the responsibility, because sometimes not only in the Irish case, I hear it's suggested the problems have been by created by the European Union or by the euro. It is exactly the opposite. The problems have been created in some countries because they did not observe the minimum prudence in terms of managing their banking or financial sector, in other countries, because they were not able to control the excessive debt. This is the case.

José Manuel Barosso, former President of the European Commission, 2013.

[The eurozone crisis] has nothing whatsoever to do with [peripheral immaturity], and even if God's angels were running the Athens government, Greece would be suffering the same destructive dynamic that we are experiencing currently

Yanis Varoufakis, former Minister for Finance of Greece, 2013.

Modernization theory can see only a failed state to be explained by 'tradition', its explanatory framework allowing only a vacuous teleology or a facile exoticism. Dependency theory is no better, seeing ... realities only as externally determined by global class forces.

Tom Young, 1999.

The aim of this first chapter is twofold. First, I scrutinise how existing literature has dealt with explaining the origins of the crisis in the European periphery. Second, in doing so, I clear the ground for an alternative framework for studying the origins of the crisis in Greece, Portugal and Ireland.

As the foregoing introductory chapter has suggested, approaches ranging from domestic to systemic-level accounts have tended to fall back upon and reproduce two

problematic narratives in order to account for the asymmetry of the eurozone crisis. In this chapter, I begin by introducing these narratives, which I label the ‘immaturity’ and ‘victimisation’ theses; and I demonstrate how they have generated problematic empirical and theoretical gaps in existing literature.

Perhaps the most influential narrative of the origins of the crisis in the periphery is the ‘immaturity thesis’. The European ‘PIIGS’ are widely understood to have built their houses out of straw. As the story goes, the causes of the eurozone crisis originate from the supposed hubris, profligacy, corruption, and general lack mature political culture in countries of the European periphery. In spite of plausible counter-narratives, the immaturity thesis continues to drive the debate on the crisis in the periphery, and to underpin policy prescriptions (Adler-Nissen 2015, 6).

Nevertheless, this narrative has been strongly challenged by approaches which view Germany as the ‘big bad wolf’ of the story; focusing on how its economic dominance of the eurozone contributed directly to the European periphery’s vulnerabilities. Such frameworks typically understand the eurozone as a region characterised by a *core-periphery* hierarchy between the ‘beggar-thy-neighbour’ style economic growth of the core, especially Germany, which has lead to precarious, ‘financialised’ growth in the periphery. ‘Core-periphery’ analysis has been rapidly gaining momentum in academic debates on the eurozone crisis (see especially Lapavitsas et al. 2012; Becker et al. 2010; Bellofiore, Garibaldo, and Halevi 2010; Bibow 2012; Stockhammer 2011; Beck 2013), and has also become very much in vogue in media circles (see Hugh 2014; Krugman 2013; 2014; Barnett 2011; Wolf 2010a; 2010b) allowing many to argue that it doesn’t matter what material the PIIGS built their houses from, the real problem is that a big bad wolf resides in the eurozone and is blowing them down.

In reviewing existing literature, I argue that scholarship which relies on notions of either peripheral immaturity *or* German dominance cannot adequately explain the difficulties of the European periphery or the origins of the eurozone crisis. Certainly, it is vital that scholarship takes the domestic sources of the eurozone crisis seriously, and in doing so, does not explain away the clear role played by ‘immature’ factors. Similarly, we cannot fully understand the eurozone crisis without engaging in debates surrounding German hegemony, current account imbalances, international capital flows, and issues around hegemony and inequality in Europe. However, while the immaturity thesis has staged a problematic ‘morality play’ between Northern ‘saints’ and Southern ‘sinners’, narratives of victimisation will be shown to lack empirical support for their positing of a ‘beggar-thy-neighbour’ relationship between core and periphery. While their challenges to notions of ‘immaturity’ are welcome, I propose that critical literature on the eurozone crisis needs to move beyond assumptions of Germany as the ‘big bad wolf’ in order to open up the space for the development a genuinely critical rethinking of the origins of the eurozone crisis. In doing so, I suggest that such perspectives can offer a more compelling explanation of the ‘systemic’ issues they are concerned with examining.

After concluding the review of existing literature, I propose an alternative framework for studying the crises in Greece, Portugal and Ireland. Combining Europeanisation studies with the Comparative Political Economy (CPE) literature on capitalist diversity, this framework proposes studying the crises in the European periphery in the following ways. First of all, by drawing upon the CPE literature on ‘capitalist diversity’ I discuss the approaches strengths (namely, the historicist study of institutional change) and limitations (namely, the problems of path dependency and methodological nationalism), and in doing so develop a key distinction between

‘divergence’ and ‘non-convergence’. Secondly, I propose drawing on this distinction to study the modernisation of the three case studies, but in a way that overcomes the linear, stadial conceptualisations of development adopted by approaches underpinned by ‘modernisation theory’ claims. Finally, by drawing on the literature on Europeanisation, I suggest a framework that can avoid the internalism of the immaturity thesis and the externalism of the victimisation thesis by studying domestic adaptation to European integration (Vink and Graziano 2007, 7). This framework provides a conceptual foundation to conduct the case studies in the following three chapters that is sensitive to asymmetry, peripheral agency, the impact of European integration, and that is also capable of providing a new kind of critical alternative to the immaturity thesis.

The chapter comprises of three main parts. Section one discusses the ‘immaturity thesis’ and its limitations through exploring two bodies of literature on the origins of the eurozone crisis – domestic level analysis and the ‘design flaws’ perspective. Section two explores the ‘victimisation thesis’, focusing mainly on ‘core-periphery’ analysis. In the third and final section, a framework for moving beyond these two narratives and rethinking the ‘asymmetry’ of the eurozone crisis is proposed.

### **Section One: The ‘lazy PIIGS’: unpacking the ‘immaturity thesis’**

In late December 2013, responding disapprovingly to a question regarding relief on Ireland’s bank debt, former European Commission President José Manuel Barroso rearticulated a familiar narrative of the crisis in the European periphery. The euro was the ‘victim’ of irresponsible economic and political governance in the periphery, rather than the other way around (Independent.ie 2013). Barroso’s answer is underpinned by the ‘immaturity thesis’; perhaps the most ubiquitous explanation of the causes of the eurozone crisis. Found across political (European Commission 2010; 2011; 2012; for an

overview see Papadimitriou and Zartaloudis 2014), media (for overviews see Antoniadis 2013; Tzogopoulos 2013) as well as scholarly discourses (mostly in the form of case studies, see below) the immaturity thesis is an explanation of the causes of the eurozone crisis which places the supposed profligacy, corruption, and general lack mature political culture in the European periphery at the heart of its analysis.

In this first section, the various ways in which the literature on the eurozone crisis draws upon and reproduces the ‘immaturity thesis’ are outlined. I begin by reviewing the widely influential country-specific ‘domestic level analyses’ of the crises in Greece, Portugal and Ireland. I then introduce the ‘design flaws’ literature which highlights the institutional and policy faults at the level of the EU and the eurozone. Finally I draw together some of the major empirical and theoretical limitations that stem from reliance on assumptions of peripheral ‘immaturity’.

### ***Domestic level analysis: ‘immaturity’ in Greece, Ireland and Portugal***

In her analysis of Ireland, Niamh Hardiman argues that although the global economic crisis has induced recession and created major shocks for all the economies of the ‘developed world’, if we wish to understand why the crisis has not had a uniformly severe effect on every country, we need to bring domestic institutions ‘back in’ to the analysis (Hardiman 2010: 71). In other words, if we wish to explain variation in experience of the global credit crunch or the eurozone crisis, the appropriate unit of analysis is the variation of practices and policies within states. Hardiman’s approach is consistent with the highly prominent ‘domestic level’ approach to the origins of the eurozone crisis. At face value, such a perspective is well positioned to account for the asymmetric impact of the eurozone crisis. Each eurozone member-country experienced the crisis as a challenge to its domestic capacity to manage its own particular ‘problem

load’ (Hardiman and Dellepiane 2010, 474). As such, this perspective explains the asymmetry of the eurozone crisis through a detailed analysis of the national-specific problems of domestic governance, economic practices and policy, arguing that these national problems have culminated to ensure the particular member state is less insulated than it should be against exogenous shock (Honohan and Leddin 2005).

Nevertheless, as I discuss in detail later, domestic-level analysis fails to deliver on this potential, because the historical specificity it purports to provide is over-determined by assumptions of ‘immaturity’. Specifically, in spite of the above strengths, it suffers from assumptions relating to unilinear modernisation theory, methodological nationalism, and has a tendency to fall back upon reified and pathologised notions of national and political cultures to explain divergence. Before these limitations are elaborated on, the different, and still dominant, domestic level accounts of Greece, Portugal and Ireland are outlined.

*‘Debt fuelled clientelism’: Greece and the immaturity thesis*

The immaturity thesis first emerged within domestic level analysis of the Greek crisis.

Jason Manolopoulos writes that:

modern Greek society and economy... is a monster... This is a systemic, cultural dimension of the Greek saga; it is not just a case of a few unconnected scandals. It is institutionalised (2011).

More than a few agree (see, for example, Katsimi and Moutos 2010; Mētsopoulos and Pelagidēs 2012). Greece has been represented as a ‘scape-goat for a systemic failure of huge proportions’, labelled by some European tabloids as a nation ‘of non-productive, lazy and unmistakably corrupt people’ (Lavdas, Litsas, and Skiadas 2013, 175). Such narratives tend to represent Greece as ‘exceptional’; as the antithesis of ‘advanced’

Northern European economies (Manolopoulos 2011, 11) and it is in these terms that the sources of the ongoing crisis can be delineated.<sup>7</sup> Notions of Greek exceptionalism underpin the argument that a country such as Greece should never have been allowed to join the euro in the first place. Greece is not only accused of being responsible for its own mess; its immaturity has risked the very survival of the European project.

How is this narrative analytically constructed? The first step is to recognise, at the most basic level, that the Greek sovereign debt crisis of 2009 was ‘mostly fiscal’: it was a crisis of Greek public finances, and of its consistently exorbitant levels of public debt and budget deficits. Greek public debt has been close to 100 per cent of GDP or more since the late 1980s, and its budget deficit, while fluctuating over the same period, has remained well over the Euro area average (Alogoskoufis 2012, 2; Featherstone 2010, 298; Pisani-Ferry, Sapir, and Marzinotto 2010, 4). Secondly, this excessive debt has its origins in the socioeconomic policies of the mid to late 1970s, but particularly of the 1980s which were aimed at expanding the public sector, social spending and raising wages through borrowing. Prime Minister Andreas Papandreou and his party the Panhellenic Socialist Movement (PASOK) are accused of pursuing political power via a highly-charged populist agenda and then consolidating this support once in power through expansionary fiscal policies and the construction of systems of clientelism.<sup>8</sup>

The third analytical step is to recognise that PASOK’s strategy of political power consolidation catalysed a particular and toxic relationship between state and society. PASOK and later New Democracy (ND) transformed the Greek state into a complex system of clientelism/patronage. Electoral support was traded for favours,

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<sup>7</sup> See also the large body of literature on Greek ‘underdog culture’, summarised in Triandafyllidou and Gropas 2013, 4–6; but see in particular Tsoukalas 1995; Diamandouros 1993; Diamandouros 2011; and for indispensable critical interventions see Tziolas 2001, 2014; Xenakis 2013.

<sup>8</sup> See various chapters in Clogg 1993; Clogg 2002, 173–209, and see the discussion on ‘Hellenic Peronism’ in Manolopoulos 2011, 1–13.



employment, and particular lifestyles. Major sections of society accordingly became bound up in a systems of clientelism, and bribery and corruption in the everyday provision of public services became a ‘national pastime’ (Manolopoulos 2011, 103–4; CNN 2011). Put very simply, the form of state developed by PASOK in the 1980s helped engender a broad ‘culture of entitlement’ across Greek society (see Triandafyllidou, Gropas, and Kouki 2013 for a summary of this argument).

The final analytical step posits the ‘end of Greek history’; the next thirty years of Greek history are, in any meaningful sense, static; the clientelistic state that had become consolidated during the 1980s proved impossible to supplant throughout 1990s and 2000s (see Diamandouros 2011).<sup>9</sup> Although exceptions are well noted, it is widely considered that no meaningful reforms succeeded during the 1990s and 2000s (see Diamandouros 2011) because the debt-fuelled clientelism had become endemic and impossible to supplant. The state’s growth, and the interests of society at large, not to mention powerful interest groups, were all too dependent on the ‘Greek’ model (see, for example, the discussion in Triandafyllidou and Gropas 2013, 1-21; Diamandouros 2011, 1994; Tsoukalas 1995).

*‘Chronic fiscal misbehaviour’: Portugal and the immaturity thesis*

With all of the (much unwanted) attention Greece receives, the Portuguese story is perhaps less familiar to many. The crisis there is understood as a story of three main factors: ‘chronic fiscal misbehaviour’ (Royo 2012), weak competitiveness (Mamede and Rodrigues 2012; Sebastián Royo 2012; Sebastián Royo 2013) and crucially, the political unwillingness to deal with either (Pereira and Wemans 2012; Magone 2004;

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<sup>9</sup> There is a large body of literature on this. For examples, see various essays in Mitsos and Mossialos 2000; and various essays in Kalyvas, Pagoulatos, and Tsoukas 2013; and for more critical contributions see Lyberaki and Tsakalotos 2002; Monastiriotis and Antoniadis 2009.

Baer and Leite 2003). Had Portuguese governments managed their public finances more prudently, and had they taken advantage of EU membership by introducing and reforming institutions and policies to improve productivity and competitiveness, it is argued to be likely that Portugal would not have found itself in the position of the country in the eurozone most vulnerable to contagion (Kalbaska and Gałkowski 2012).

It has been claimed that ‘the adoption of financially unsustainable public and private decisions over the years, together with the repeated postponement of “structural reforms”,’ lie at the roots of Portugal’s present crisis (Mamede 2012). This is nothing new for Portugal. In fact, the 2011 troika rescue package is the third time Portugal has been bailed out since its democratic revolution in 1974. Successive Portuguese governments (especially during the 2000s) are accused of failing to get a handle on their public finances, even (somewhat implausibly) temporarily introducing a government fiscal stimulus package in 2009, at the height of the eurozone crisis (Pedroso 2014). Electoral considerations and other motives, ‘often unrelated to the promotion of economic, social and environmental development... have been at the basis of fiscal practices which eventually proved to be unsustainable’ (Mamede 2012, 33).

Similar to Greece, analysis of Portugal’s misgovernment recognises the very real attempts at reform made by the country over the years. Yet, these reforms are almost always understood as insufficient or illusory (Royo 2012, 190). As Abreu notes, in the second half of the 1990s fiscal policy was expansionary. Deficit reductions necessary to join the euro owed much to high economic growth and the substantial fall in interest rates and consequently in debt servicing costs, and were not achieved through necessary structural reforms as they should have been (Abreu 2006, 2). Much like Greece, Portugal allegedly managed to participate in the euro under false pretences.

The Portuguese crisis is more widely recognised as not just a fiscal crisis, but also a crisis of competitiveness and productivity. Portugal entered recession in 2003 as GDP contracted by 0.9 percent and growth rates were lower than 2 percent from 2004 until 2006 (Pereira and Wemans 2012, 10; see also Banco de Portugal 2009, 118). It is argued that Portuguese policy makers did not do enough to improve their international competitiveness and productivity by taking advantage of the opportunities of European integration (Abreu 2006, 3). Reis (2013) notes that most literature on Portugal's crisis tends to mention various obstacles to Portugal's productivity during the 2000s; a list that typically includes low average educational attainment, low total factor productivity, an oversized government, labour market rigidities, inefficient legal system and low export competitiveness (2013; see also Mamede 2012, 33; Pereira and Wemans 2012, 4-5; see also Baer and Leite 2003, 745).

'Chronic fiscal mismanagement' together with a failure to reform and upgrade the 'cultural patterns of behaviour in Portuguese society' and politics (Magone 2004, 236) are argued to be the central causes of the Portuguese sovereign debt crisis. Together they formed a reinforcing pattern of anaemic growth and spiralling public finances. In the context of broader volatility in the eurozone from 2010 onwards, this pattern ensured that a Portuguese bailout, as Pereira and Wemans claim, was inevitable (2012).

*'We all partied': Ireland and the immaturity thesis*

If Portugal and Greece's difficulties were caused by immature political and economic governance, Ireland's crisis initially emerges as something of a puzzle. Kirby notes that Ireland was forced to apply for an €85 billion bailout after two decades of being viewed as the 'poster child of the EU, proudly mentioned as proof of the Union's policy

package’ and as a ‘showpiece of globalisation’ (Kirby 2010, 3). During the 1990s, Ireland’s high tech export sector drove economic growth at an annual average rate of over three times that of most other European countries; with some of the lowest levels of government spending and borrowing in Europe (Kirby 2010; Ó Riain 2007; 2014).

It is typically argued that over time, different decisions by Irish governments contributed to the emergence of a banking crisis. The Celtic Tiger model was ‘hijacked’ by governments in the late 1990s and 2000s, who facilitated freedoms to the banking sector, spurring a housing boom, and put in place a timid and ineffective (Honohan 2010) ‘light-touch regulatory system seeking to encourage the market rather than restrain it’ (Kirby 2010, 9; Honohan 2010; see also Hardiman 2012; Hogan, Donnelly, and O’Rourke 2010, 38; Klaus Regling, 2010). There existed close personal as well as financial links between bankers, property developers, builders and politicians, especially in the Fianna Fáil party (Dellepiane and Hardiman 2012, 92). Elaine Byrne argues that Fianna Fáil, who were in government for most of the 2000s, developed a financial reliance on the construction sector- ‘[a] list of rich political donors once read like a Who’s Who of Irish property developers’ (Byrne 2012, 205; see also McMenamin 2013, 2). Such immature governance left Ireland dangerously exposed to external shocks (Hardiman 2010, 72). As such, it doesn’t matter that Ireland temporarily ‘got it right’. When it came down to it, Ireland’s governance became just as problematic as that of its fellow PIIGS. Indeed, as early as 2001, the EU’s Economic and Financial Affairs Council (Ecofin) criticised Ireland’s fiscal over-stimulation, and Hogan, Donnelly, and O’Rourke (2010) view the failure to heed the warnings as representing a tragically missed opportunity to exploit external fiscal commitments as political cover to help overcome the political pressures to act this way (38). Ireland is understood to have

squandered its ‘mature’ economic development during the 2000s when, as the late Minister for Finance Brian Lenihan infamously put it, ‘we all partied’ (Lenihan 2010).

### *The design flaws of the eurozone*

While the above literature has focused on different aspects of national ‘irresponsibility’, another influential body of scholarship has focused on the ways in which Economic and Monetary Union (EMU) has been set up to fail from the very start (de Grauwe 2006a; 2006b Papadimitriou and Wray 2012; Lane 2012; de Grauwe 2010; Uhlig 2002; Scharpf 2011).<sup>10</sup> It argues that amongst other factors, because EMU was a monetary union without any provision for fiscal or banking management, because it removed sovereignty of monetary policy from national governments, some form of existential crisis was only ever a matter of time.

A well-known criticism of EMU is that it removed sovereignty of monetary policy from peripheral states, so that when they did get into trouble, they found that vital tools for crisis management were no longer at their disposal (Papadimitriou and Wray 2012,2-3; de Grauwe 2013, 7; Panico and Purificato 2013; Scharpf 2011). For one thing, the replacement of national central banks with the European Central Bank (ECB) meant that member states lost the lender of last resort function of their central banks (de Grauwe 2013, 8; Panico and Purificato 2013, 586-7). This meant that Greece, Portugal and Ireland could no longer issue debt in their own currencies to guarantee bank deposits. Once the crisis hit, this design flaw had a tendency to generate self-fulfilling liquidity crises and drive sovereign borrowers into default (Panico and Purificato 2013,

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<sup>10</sup> In this subsection I deal with one particular version of the ‘design flaws’ approach – namely, one which often focuses on the lack of efficacy and discipline built into the original design of the eurozone. Section two focuses on a different version of the same narrative – one that highlights how the eurozone was tailored to ‘core Europe’ at the expense of the periphery, and one that (sometimes) calls for a more meaningful fiscal *union* rather than more meaningful fiscal *discipline* (e.g. Patomäki 2013).

587). Furthermore the countries of the periphery were unable to make use of currency devaluations in the years before the crisis, which may have contributed to falling competitiveness and rising current account deficits. Worse still, EMU created perverse incentives for growth in the European periphery (Dellepiane, Hardiman, and Heras 2013). Monetary union provided a ‘one size fits all’ monetary policy across a variety of highly diverse economies. The single interest rate that the ECB imposes across all member states is too low for countries that are booming and too high for those in recession (de Grauwe 2013, 6-7). Greece, Ireland and Spain’s membership of the euro thus coincided with an interest rate shock, causing inflation and indebtedness to soar.

EMU has also been widely criticised for the sovereignty it left behind at the national level. A monetary union was designed with no parallel provision for fiscal or macroeconomic management. Peripheral countries essentially adopted a foreign currency, but retained responsibility for their own national fiscal policies (Papadimitriou and Wray 2012; de Grauwe 2013, 10). In this way, a destructive contradiction was built into the architecture of EMU. There was far too much scope available to the countries of the European periphery to sweep difficult reforms ‘under the rug’ (Bastasin 2012). This was especially true after accession to EMU. In the pre-EMU accession stage, the threat of exclusion at least acted as a hard budget constraint for countries like Greece to address fiscal imbalances. Yet from 2001 until 2008, countries such as Greece were able to violate the 3 per cent limit of budget deficits every year (Katsimi and Moutos 2010, 569).<sup>11</sup> Similarly, member states were responsible for their own banks and their regulation, contributing to, for example, Ireland’s disastrous state guarantee of its beleaguered banking sector. As Papadimitriou and Wray (2012) put it, the European

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<sup>11</sup> But of course, Greece was far from the only offender. France and Germany infamously violated SGP criteria, leading to pressure from these countries to relax the rules and to reform in 2005.

periphery became ‘the equivalent of a Louisiana, but without the benefit of an uncle Sam’ (1).

The design flaws literature points to real and important institutional defects in the architecture of EMU in a way that purely domestic level analysis may overlook. It is especially useful in identifying how the lack of adequate provisions for fiscal and macroeconomic management snowballed into a calamitous lack of mechanisms for crisis management after 2009 (Lane 2012; Papadimitriou and Wray 2012; Shambaugh, Reis, and Rey 2012). EMU had never been designed with fiscal management in mind, so when confronted with a fiscal crisis – European leaders muddled through and procrastinated in a way that almost certainly made a bad situation worse (see Bastasin 2012).<sup>12</sup> The literature also draws our attention to the ways in which the institutions and the policies of EMU exacerbated the crisis, and how a better designed monetary union could have prevented or at least mitigated the severity of the crisis. It is capable of recognising that even though the origins of the crisis may be located at the domestic or global level, EMU has greatly increased the vulnerability of certain member states to its consequences (Scharpf 2011). This is especially true for versions of the narrative that emphasise the lack of fiscal discipline at the EU level.

This leads to an important point. The above research into the ‘systemic’ design flaws of EMU can be understood as complementary to those ‘domestic level’ approaches that highlight the irresponsibility of national governments.<sup>13</sup> The argument is that the euro made it far too easy for governments and households to behave irresponsibly (Jones 2015, 3), and in this respect, the approach retains assumptions of

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<sup>12</sup> Although some authors such as Bulmer (2014) attribute such hesitation to the domestic politics of Germany and Merkel’s tendency to weigh up options in advance.

<sup>13</sup> Jones (2015, 1) points out how many competing narratives of the origins of the eurozone are reinforcing.

‘immaturity’, while adding a ‘bad parent’ to its analysis.<sup>14</sup> In this respect, design flaws matter to the extent that they failed to protect the eurozone project from the divergent economic trajectories of its member states.

None of this implies design-flaws approaches are straightforward re-articulations of the ‘immaturity thesis’. Rather, the point is that ‘systemic level’ analysis requires an implicit theory of asymmetry to be ‘cashed in’. Because even although the systemic, and indeed, global aspects of the crisis require explanation, we still need some sort of basic theory as to why some states were affected most severely and not others. A systemic level analysis cannot simply take for granted that Southern Europe and Ireland were likely to be ‘hit harder’. Accordingly, if systemic level analysis buys into the ‘immaturity thesis’, as the prevalent European policy response to the crisis has done, then fixing the design flaws of EMU is likely to require stronger discipline and other measures aimed at correcting the immaturity of peripheral states. As I argue in section two, an alternative critique of the European project highlighting the ‘victimisation’ of the periphery is likely to reach a radically different diagnosis and policy prescription. Put simply, their added value notwithstanding, once systemic level approaches attempt to deal with asymmetry, or the causes of the crisis in the periphery, they tend to fall back upon narratives of immaturity or victimisation.

### ***The pitfalls of the immaturity thesis***

Perspectives that rely on assumptions of peripheral immaturity ultimately fail to capture, and indeed, seriously misrepresent, the origins of the crisis in these countries. Worse still, as suggested in the introductory chapter, these erasures have contributed to

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<sup>14</sup> Although, as I have already mentioned, many authors conceptualise the ‘design flaws’ of the eurozone in a way that jettisons assumptions of ‘immaturity’ more clearly.



what has been widely considered to be a seriously damaging policy response to the crisis.

Three problematic assumptions can be identified at the heart of the immaturity thesis. First, such approaches tend to neglect the international dimensions of the crisis. Second, they have a theoretical inability to account for multiple models of development. Finally, they have a tendency towards reductive use of notions of political/social irresponsibility to explain peripheral agency. This literature never really explains divergence – instead it shows us the reasons why convergence failed to happen. The limits of the perspective highlight some quite serious tensions in any policy response that is underpinned by a motivation to ‘correct’ peripheral immaturity. These will now be discussed.

#### *Neglect of international dimensions*

The perspective is typically presented as a highly internalist framework that cannot take account of the international dimensions of the crisis and is unable to recognise some deeper contradictions of the eurozone itself (Dooley 2014; Becker and Jäger 2012; Fouskas and Dimoulas 2013, 147). By placing primacy of focus on domestic governance, factors such as trade imbalances, international competitiveness, the design flaws of the European Union and the power of internationally mobile capital are all relegated to being of secondary importance, if they are theorised at all (Dooley 2014). As Skaperdas puts it:

If Greece were the sole country to have run into trouble, one could argue that it was solely Greece’s problem and not the euro’s. But one country after another has shown signs of trouble. There were problems lurking in the background that

surfaced with the financial crisis and the recession that followed (Skaperdas 2011, 9).<sup>15</sup>

By focusing only on national sources of social and institutional change, such approaches suffer from the well-known problems of methodological nationalism/internalism. It is clearly both theoretically and empirically untenable to overlook the ways in which so-called ‘external factors’ contribute to social and institutional change in a given country, as I discuss below. But concretely, this internalism creates a number of blind spots for the immaturity thesis. Notably absent from the literature on the immaturity thesis are discussions of international capital flows, structural inequalities in the eurozone, ‘Neoliberalism’, the role of Germany and external threats to international competitiveness. These erasures are discussed in depth in section two, but suffice to say, downplaying these clearly important aspects of the crisis creates a very partial account of what went wrong in the European periphery (see Fouskas and Dimoulas 2013, 147).

*Modernisation theory and the problem of ‘non-convergence’*

The immaturity thesis shares its meta-theoretical assumptions with modernisation theory, a framework that is well known for its insensitivity to how development is pursued and achieved in different ways across societies (Lyberaki and Tsakalotos 2002, 93, 95; Young 1999). As I have argued in the first part of this section, there has been an implicit assumption in much of the domestic level analysis on Southern Europe and Ireland that if the correct sets of policies are followed, and the right institutions are built and effectively governed; each country could have converged along the lines of their

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<sup>15</sup> Naturally, this is a criticism that applies most clearly to domestic level accounts and not to the ‘design flaws’ literature. Yet, adding ‘design flaws’ arguments to domestic level analysis does not fully overcome this problem either. This is because both perspectives can retain assumptions of peripheral immaturity at the centre of their analysis. Had the periphery not been so irresponsible, there would be little need for more discipline. Only if analysis of design flaws leaves assumptions of peripheral immaturity behind can it fully overcome this problem of internalism.

western European neighbours. Divergence in Greece, Ireland and Portugal is quite clearly explained as the result of a failure to achieve this convergence, typically due to an ineffective and immature political and/or national culture. As a result, any variation across societies is assumed to be a ‘perversion’ of the ‘normal’ developmental trajectory. In this way, the developmental paths of particular societies are ‘othered’, and this is at the heart of the immaturity thesis’ moralisations.

The problem is not that immature patterns of peripheral agency have nothing to do with the crisis in the periphery, as many, among them Yanis Varoufakis in this chapter’s epigraph, suggest. Very few domestic level analyses of Greece would feel comfortable denying the reality of clientelism and its role in the crisis. The real problem is that this perspective problematically assumes that *the origins of divergence are the same as the reasons for ‘non-convergence’*. The logic is simple - the periphery diverged because it didn’t converge. Yet, the three very distinctive forms of crisis encountered by Greece, Portugal and Ireland suggest that something is missing from this formulation.

Non-convergence may account for divergence at a very basic level, but we need something else to account for what caused there to be (at least) three different kinds of divergence. In other words, why did non-convergence lead to a banking crisis in one country but not the others? Why did convergence along fiscal lines still leave Ireland vulnerable? Why did falling competitiveness lead to GDP growth in Greece during the 2000s, but recession in Portugal during the same time? The immaturity thesis needs to do much more work to explain the origins of divergence. It hasn’t done this work because it has been preoccupied with explaining the origins of non-convergence (more on this in section three).

How does this problem lead to empirical gaps? For one thing, the perspective discounts the possibility that something other than an obstacle, say for example, the

transposition of EU directives on banking, could also be potential sources of divergence (see Honohan 1999). It also discounts the possibility that ‘non-liberal’ practices of governance could potentially contribute to ‘convergence’ even if they are identified as obstacles (Ó Riain 2014, 39) and vice versa. Additionally, it overlooks the fact that while there may only be one single way, in theory, to achieve ‘convergence’, there is any number of different ways to diverge, and moreover, not all of these trajectories would have necessarily led to precarious, vulnerable patterns of growth.

Furthermore, the immaturity overlooks the fact that simply because a country has ‘failed to converge’ it does not mean that ‘things have stayed the same’. Failing to modernise does not mean a simple persistence of tradition as is often assumed in the above accounts. It does not mean that these countries go ‘back to the drawing board’, almost as if a reset button has been pressed. When Greece and Portugal attempted to reform and modernise during the 1990s, their failure to do so resulted in significant and dramatic changes to their political economies, because transformation was an outcome of the attempt to reform and modernise. Narratives of immaturity overlook how failure can also be generative of political, economic and social change. Had Greece and Portugal not attempted reform, they would not have transformed in quite the same way. In addition, Ireland did appear to ‘converge’ during the same period, but this did not stop its model, made up of institutions, actors and policies, behaving in different ways in different contexts. Ultimately, a theory of ‘non-convergence’ shuts down a myriad of interesting and important questions about divergence in these countries.

*Representing peripheral agency: Distinguishing between ‘obstacles to convergence’ and ‘paths to divergence’*

Finally, in focusing on ‘obstacles to convergence’ as outlined above, a limited representation of peripheral agency is propagated. Agency is posited to peripheral state organisations and societies only to the extent that they have ‘dug in their heels’ instead of pursuing structural reforms; or to the extent that they have derailed their own development through irresponsibility, short-sightedness, corruption and low productivity. Peripheral agency is always defined in terms of what it is lacking, which leads to a number of erasures in the historical narratives that are told. Positive understandings of peripheral agency, as actively promoting political economic transformation in ways that are not reducible to reinforcing ‘non-convergence’, are absent.

In other words, when political and economic irresponsibility are the processes of agency that are taken most seriously, other kinds of agency are downplayed, explained away, or overlooked entirely. The periphery is only understood as having agency that is ‘immature’ – there is no available conception of a ‘mature’ agency for the periphery. This is a problem because it precludes analysis from considering that anything other than immature agency could be generative of divergence. Such analysis does not consider that putatively ‘mature’ patterns of agency could be just as important in explaining the origins of the crisis in a particular peripheral state. The problem can be pinpointed as one of focusing on the history of ‘obstacles to convergence’, and thereby neglecting possible counter-narratives.

The immaturity thesis is inadequate for accounting for the origins of the crisis in Portugal, Ireland and Greece due to the problematic assumptions outlined above. It accounts for the history and the agency of these countries in only a partial way, emphasising the supposed mistakes, errors, and failures which have led each country to squander its opportunity to converge with its western European neighbours. This means

that it omits any consideration of the parallel positive and creative ways in which peripheral countries have shaped their own economic destinies. We can only account for the emergence of multiple forms of economic trajectories by casting ‘obstacles to convergence’ aside, and studying the origins of ‘paths to divergence’ instead. In section three I propose that domestic-level analysis is valuable, and indeed, necessary to account for the origins of the crisis in the periphery. But it is important that such a perspective is able to rise above the more readily apparent narratives of immaturity, in order to more adequately capture the multiple paths of divergence charted by the so-called PIIGS.

## **Section Two: ‘Huffing and puffing’: unpacking the ‘victimisation thesis’**

In part as a response to the above limitations, a number of important alternatives to the immaturity thesis have emerged in recent years. In this section I focus on two literatures – ‘core-periphery analysis’ and neo-Gramscian/neo-Marxian approaches.<sup>16</sup> These approaches directly challenge assumptions of immaturity in their analyses. Both emphasise the various ways in which the eurozone has benefitted the core, or fractions of European capital, at the direct expense of the periphery. They posit a very different ‘design flaws’ narrative which makes the claim that Germany, in particular, has been acting as a hegemon (see also Bulmer and Paterson 2013; Bulmer 2014)<sup>17</sup> in a hierarchical Europe. The eurozone is not only argued to have been ‘tailored to core

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<sup>16</sup> This study cannot consider every body of literature on the origins of the eurozone crisis. For instance, numerous debates on the potential of varieties of capitalism (VoC) to contribute to an understanding of the eurozone crisis have emerged in recent years (see Hall 2012; Bruff and Horn 2012). Some of these debates are drawn on to develop the theoretical framework that I outline in section three of this chapter.

<sup>17</sup> The focus of this study is on the periphery, and not on Germany, and so the study does not fully engage in (less relevant but nonetheless important and vibrant) debates on whether or not Germany is emerging as a hegemon. Rather, this section is concerned with whether or not the periphery plays a role in Germany’s economic model (which may or not contribute to its hegemony).

Europe’ – reflecting German ordoliberal values at the expense of alternative configurations. Core-periphery analysis goes so far as to argue that the success of the German model is actually premised on the undermining of the periphery. In this section I outline the key analytical steps of this perspective. I argue that although they draw necessary attention to ‘systemic’ issues underpinning the eurozone crisis, scholarship which relies on notions of victimisation cannot adequately explain the difficulties of the European periphery or the origins of the eurozone crisis.

***Core-periphery analysis: three analytical steps***

Including Keynesian (Wolf 2010a) and post-Keynesian variants (Bellofiore 2013; Bellofiore, Garibaldi, and Halevi 2010; Cesaratto and Stirati 2010) as well as Marxian (Becker et al. 2010; Becker and Jäger 2012; Becker and Jäger 2011; Stockhammer 2011; 2012; Lapavitsas et al. 2012; Lapavitsas et al. 2010) perspectives, ‘core-periphery analysis’ reinterprets the crisis as driven by a core-periphery hierarchy driven by the ‘beggar-thy-neighbour’ style economic growth of the core, especially Germany, which has led to precarious, ‘financialised’ growth in the periphery.

Broadly speaking, core-periphery analysis involves three analytical steps. Firstly, EMU has been characterised by an institutional arrangement that has benefitted the German model of ‘export led’ growth, and in turn, has helped generate unsustainable ‘debt led’ growth (Stockhammer 2012) in the periphery. Secondly, these two models became linked by a structural ‘beggar-thy-neighbour’ pattern of growth (Lapavitsas et al. 2012, 30). Finally, large capital inflows from the core have funded current account deficits in the periphery, exacerbating their balance of payments

problems, and increasing their financialisation and indebtedness. These three steps are explored in turn.

*Step-1: Tailoring Europe to the core: export-led and debt-led growth*

The first step tends to argue that the institutions and policies of EMU have ‘taken cognisance of conditions primarily in core countries rather than assigning equal weight to all’ (Lapavitsas et al. 2012, 3, 5). The literature has focused on the ways in which German ideas, interests and ordoliberal values have contributed to the escalation of the crisis through the way in which it has been *responded* to (Dullien and Guérot 2012; Moravcsik 2012; Matthijs and Blyth 2011; Thompson 2013; Bulmer 2014; Jacoby 2015; Newman 2015; Jones 2010; Matthijs 2015, 6). But there is also an argument to be made that the ‘uploading’ of German or western European values to the European level contributed to the emergence of the eurozone crisis in the first place (Matthijs 2015, 4; see also Beck 2013; Goetz and Dyson 2003). Such approaches emphasise the institutional and policy transformations that associated the 1986 ‘re-launch’ of the European project – setting in motion plans for the Single Market and later the euro. As Matthijs (2015, 14) notes, Germany was only willing to participate in the Single Market and EMU if the rest of Europe agreed to create the euro after the Deutsche Mark’s image (see also Marsh 2011; Heipertz and Verdun 2004; de Grauwe 1996a, 1094). As Milios and Sotiropoulos note:

‘[T]he whole apparatus of the European Union in Brussels pushed the member countries to strive for a high-tech investment strategy linked to high profits and to cost-cutting financialisation under free intra-European capital mobility’ (Bellofiore et al. 2010, 131; see also (Milios and Sotiropoulos 2010).



As a result, a ‘one size fits all’ model of European integration was designed with core interests in mind.

It has been argued that this ‘tailoring to core Europe’ has contributed to the generation of current account surpluses in the core, and deficits in the periphery. Thus, European integration has contributed to the emergence of two economic models of growth in Europe, ‘export-led’ growth in the core, and ‘debt-led’ growth in the periphery (Stockhammer 2012; Becker & Jäger 2012,172; Hall 2012). For the core (Germany in particular)<sup>18</sup>, the main source of growth has been its current account surplus ‘inside the eurozone, which has resulted from downward pressure on pay and conditions rather than on superior productivity growth’ (Lapavitsas et al. 2012, 3). Different European economies have attempted to adjust to the emerging institutions and arrangements of German neomercantalism, but not all have not been successful (Lapavitsas et al. 2012, 4; Bellofiore et al. 2010, 136). The periphery was unable to emulate the core model because, ‘the scope for gains in competitiveness through pressure on workers is correspondingly less’ given that real wages were lowed and welfare states are generally less developed in the periphery to begin with (Lapavitsas et al. 2012, 4). Additional factors include the specificities of their histories and social models (Lapavitsas et al. 2012), as well as the weaknesses of their capital goods sectors (Bellofiore et al. 2010, 136). Unable to adopt a neomercantalist model itself, the periphery was forced to find other ways to develop, and typically, it lost competitiveness and generated current account deficits. Thus, the eurozone crisis is re-

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<sup>18</sup> Although I outline more serious problems, it should be noted that the categories of ‘core’ and ‘periphery’ in core-periphery analysis can lead to analytical problems, with the ‘core’ being frequently reduced to Germany alone (although see Bellofiore et al. for a more nuanced typology of European economies within the core-periphery framework (2010,136-143). ‘Debt-led’ and ‘export-led’ categorisations can be similarly blunt.

interpreted as originating from the contradictions of a project of European neomercantalism<sup>19</sup>, driven largely by Germany (Bellofiore et al. 2010, 2013).

This first step acts as a challenge to the immaturity thesis, because instead of placing the economic and political governance of the periphery at the centre of its analysis, it identifies a contradiction in the European economic project; a ‘neomercantalist fracture’ that is dividing the ‘core’ of Northern Europe and the ‘periphery’ of mostly Southern Europe (Bellofiore 2013, 498). The key theoretical point, as Lapavitsas et al. have argued, is that it was not possible for such a model to be adopted universally (2012, 5). A particular theoretical implication is important to note at this step of the argument. Firstly, although EMU and the project of European integration may have been ‘tailored to core Europe’ (Cesaratto 2013, 114), it is not analytically necessary at this stage to theorise the underdevelopment of the periphery as either *necessary to*, or *caused by* the success of the neomercantalist model of the core; what is important is that the *single* model of development fostered by EMU has been responsible for the emergence of (at least) *two* divergent economic models. Focus here is placed on how the project of EMU, and indeed, European integration more generally contributed to divergent patterns of development, but it is not analytically necessary to establish any kind of co-constitutive interaction between these divergent models.<sup>20</sup> Rather, it is enough to recognise that they are two responses to the common pressure of European integration (Stockhammer 2012). Although most writers take the ‘core-periphery’ thesis beyond this first step, I later argue that there is no imperative to do so, and as will be seen, there are alternative departures from this starting point.

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<sup>19</sup> Neomercantalism is understood as ‘the pursuit of economic policies and institutional arrangements which see net external surpluses as a crucial source of profits (Bellofiore et al. 2010, 120).

<sup>20</sup> This is important, because as steps 2 and 3 demonstrate, this co-constitutive interaction is central to most core-periphery analysis.

*Step 2: Current account imbalances*

The second step begins to theorise the interaction between the neomercantilist ‘export-led’ core and the ‘debt-led’ periphery, by more explicitly outlining how EMU has ‘facilitated the domination of the eurozone by Germany at the expense of the peripheral economies’ (Lapavitsas et al. 2012, 4). This has largely to do with analyses of current account imbalances within the eurozone. This is crucial to the supplanting of the immaturity thesis, because it recasts the crisis as a balance of payments crisis, rather than a fiscal crisis (Cesaratto 2013).

The economic success of Germany, it is argued, has been made possible due to EMU being characterised by a structural balance of payments asymmetry between the core and periphery. ‘In other words’, as Young and Semmler write in their own account of this position:

[C]ountries with current account surpluses *need* countries with current account deficits. This is particularly true in the Eurozone where there is no mechanism for tax and transfer policies to provide for regional equalization and stability as is the case in federal countries like the U.S... [t]hus the Eurozone could not function at all if all members tried to emulate Germany ([emphasis added] 2011, 9).

Thus, current account deficits in the periphery are understood to be the ‘mirror’ of Germany’s current account surpluses (Lapavitsas et al. 2012, 4). The eurozone is understood to be a hugely important trading partner for Germany - accounting for two thirds of its trade (Lapavitsas et al. 2012, 30) - leading Bellofiore to posit that ‘trade deficits in France, Italy, Spain, Portugal and Greece were crucial to Germany’s competitiveness’ (2013, 505). The Single Market, the Exchange Rate Mechanism, and later, EMU, created the conditions whereby Europe as a whole became ‘the primary market supporting Germany’s positive net exports and profits for its big

business...[and] these economic policies and industrial behaviours were the pillars of the resurrection of Germany's export-led capitalism during the 2000s' (Bellofiore 2013, 504). Within such an arrangement, the eurozone periphery fulfils a crucial role for Germany's model of growth, as Bellofiore notes that Germany has a 'historical need to export to Southern Europe, where it realised the largest part of its profits' (2013,505). This is the crux of core-periphery analysis, '[t]he worsening of the current account balance of the peripheral countries emerges *pari passu* with the improving surplus of the central countries' (Cesaratto and Stirati 2010, 59).

Thus, the first analytical two steps link together as follows. EMU has fostered a neomercantalist model of growth that Germany was, perhaps uniquely, placed to adopt, although this model of growth was conceivably a model for all to emulate (Milios and Sortiropoulos 2010). The contradiction (or obstacle for the universal adoption of this model) is that the current account surpluses of Germany are made possible by current account deficits in the periphery, exacerbating, and entrenching the division between a core and periphery in the eurozone. Thus, the success of the German model results in the underdevelopment of the peripheral model. EMU is understood to be an area for exploitation of the countries of the 'periphery' by the economic 'steam-engine' of the 'centre' (Milios and Sotiropoulos, 2010, 227). It is on this basis that Lapavitsas et al. claim that, '[t]he euro is a 'beggar-thy-neighbour' policy for Germany' (2012, 30).

### *Step 3: Capital account imbalances*

The final analytical step theorises the way in which EMU has led to enormous financial imbalances stemming from capital flows from the core to the periphery. These in turn, have been used to fund the current account deficits of the periphery. The crisis

originated in easier access for a number of peripheral states to European financial markets, due to the adoption of the euro, and the new financial and monetary institutions and innovations that accompanied such access (Cesaratto 2013, 114). Massive capital flows went from the core to the periphery, which funded credit-financed autonomous consumption growth in Spain and Ireland, and contributed to the growth of public spending in Greece (Cesaratto 2013, 114).

Germany is argued to have ‘recycled’ its current account surpluses into capital exports, ‘primarily bank lending and foreign direct investment ...the main recipient of which has been the eurozone, including the periphery’ (Lapavitsas et al. 2012, 4). This has had two important effects. Firstly, large capital inflows have resulted in capital account surpluses in the periphery, directly contributing to public and private indebtedness, precipitating the sovereign debt crisis (Lapavitsas et al. 2012, 5). Secondly, capital outflows from the core into the periphery have led to the promotion of financialised growth via investment bubbles and consumer booms. As such, the ‘export led model’ of growth in the core has directly led to the ‘debt led’ model of growth in the periphery (Stockhammer 2012). As Cesaratto notes, ‘credit that finances net imports in the [eurozone] periphery is created by local banks. This spending eventually becomes foreign saving (net exports) in core countries and normally, financial lending by core [eurozone] banks to periphery banks’ (2013, 113). Accordingly, peripheral import dependency, and persistent external imbalances becomes financed, and thereby constantly reproduced by capital inflows from the core (Bellofiore, Garibaldo, and Halevi 2010, 136-7; Becker and Jäger 2012, 183). In other words, the current account surpluses that are necessary to the success of German neomercantalism, become financed by German lending to the periphery. This not only creates new vulnerabilities and fault lines for the periphery via the worsening of their balance of payments, but it

also leads to the ‘destruction of their productive base[s]’ (Milios and Sotiropoulos 2010, 227).

*Neo-Marxian and neo-Gramscian approaches*

Neo-Marxian and neo-Gramscian accounts (see for example, van Apeldoorn 2002; 2009; van Apeldoorn, Drahokoupil, and Horn 2009; Bieler and Morton 2001; Cafruny and Ryner 2003; 2007; Holman 1996; Overbeek, van Apeldoorn, and Ryner 2003; van der Pijl, Holman, and Raviv 2011; Bieling 2003; Gill 1998; Gill 2002) also offer an explanation of the peripheral crisis by emphasising its ‘victimisation’. This literature can, in general, be understood as operating within the neo-Gramscian framework of the Amsterdam School of International Relations (but there are also non neo-Gramscian versions, see especially Fouskas and Dimoulas 2013). Much like ‘step-1’ of core-periphery analysis, this literature notes that the European project, at least since the Maastricht Treaty and the completion of the Single Market Programme and the Single European Act (SEA) has been actively devised and promoted by the interests of a ‘neoliberal transnational capitalist class’. The European project is understood to reflect and act in the interests of this class (Bieling 2003, 206). Over the years, the socio-economic structure of Europe and its member states is understood to have been in a complex process of transformation, along the lines of the interests of transnational European capital (see the concept of embedded Neoliberalism, van Alperdoorn 2009; 2000; Rodrigues and Reis 2012; and the concept ‘disciplinary neoliberalism’ or ‘new constitutionalism’ in Gill 1998; 2002). This has resulted in a move away from the Keynesian policies of the 1950s and 1960s, which have been ‘replaced step by step by a new, more aggressive configuration, which basically is neoliberal, i.e. in favour of broadened and intensified market competition and monetarist anti-inflation and austerity

measures' (Bieling 2003, 206). These approaches study the ways in which Neoliberalism, a hegemonic project promoted by, and in the interests of, a transnational neoliberal class (aided by *comprador elites* domestically, see Rodrigues and Reis 2012), has transformed the European project, and its member states, along neoliberal lines, and the ways in which the inherent contradictions of this project are ultimately responsible for the current crisis (van Alperdoorn 2009, 27). In other words, European states *in general* have increasingly come to be shaped by 'neoliberal' strategies of development. Analysis should accordingly focus on the ways in which European states and the structure of the EU have become 'more Neoliberal'. (van Alperdoorn 2009, 27). Neo-Marxian strands such as Fouskas and Dimoulas (2013) and Rodrigues and Reis (2012) take a domestic level class analysis approach which emphasises how countries such as Greece and Portugal were 'inserted', through national 'comprador' elites, into a weak position of semi-dependency with European and Global capital through European integration. This 'insertion' is argued to have 'destroyed the productive base' of peripheral economies – in favour of financialised, neoliberal, debt-led growth. However, often, when such approaches wish to explain the reasons why the periphery was 'hit hardest' by the eurozone crisis, they explicitly reproduce the 'core-periphery' narrative outlined by Lapavistas et al (Overbeek 2012; Rodrigues and Reis 2012; van Apeldoorn 2012). As such, critical approaches ranging from neo-Gramscian to post-Keynesian have adopted assumptions of victimisation in order to allow their frameworks to account for asymmetry (Bellofiore 2013; Bellofiore, Garibaldo, and Halevi 2010; Cesaratto and Stirati 2010).

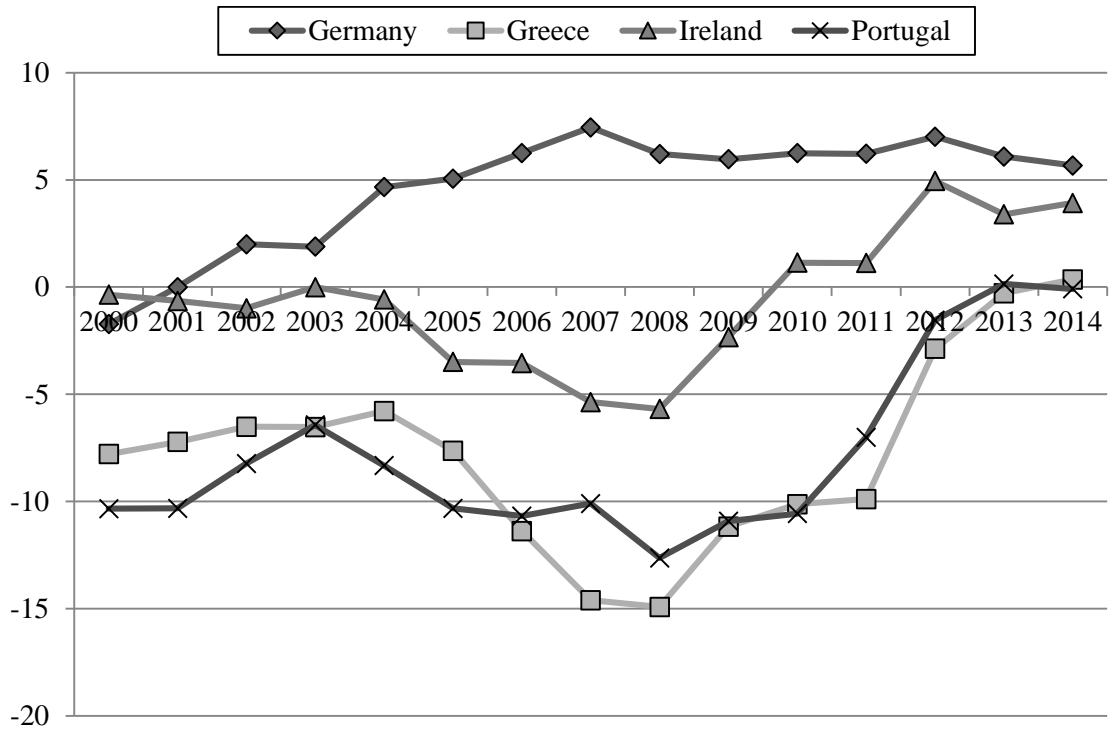
### *The limits of ‘victimisation’*

Core-periphery analysis is a highly influential critique of the immaturity thesis (Fouskas and Dimoulas 2014, 144), that allows us to recognise, as Yanis Varoufakis does, that the eurozone crisis has ‘nothing whatsoever to do with’ peripheral immaturity (Varoufakis 2013, 45). In other words, German dominance of the eurozone didn’t leave the PIIGS with any option but to ‘build their economies out of straw’. In a way that domestic-level accounts tend not to, the literature reviewed above brings issues of German hegemony, current account imbalances, capital flows, and the unequal/hierarchical nature of EMU to the fore. Nevertheless, as important as these issues are, core-periphery and neo-Gramscian/Marxian analyses do suffer from some serious empirical limitations, as I now outline.

#### *Empirical limits I: Current account imbalances*

As we have seen, claims that current account surpluses in the core are the ‘mirror’ of those in the periphery tend to rest on the assumption that most of German trade takes place within the eurozone, and moreover, that the core ‘needs’ the periphery (Young and Semmler 2011, 9) to generate its current account surpluses. This seems intuitive, as figure 1.1 shows, because the eurozone is indeed clearly characterised by current account surpluses in the core, and deficits in the periphery.





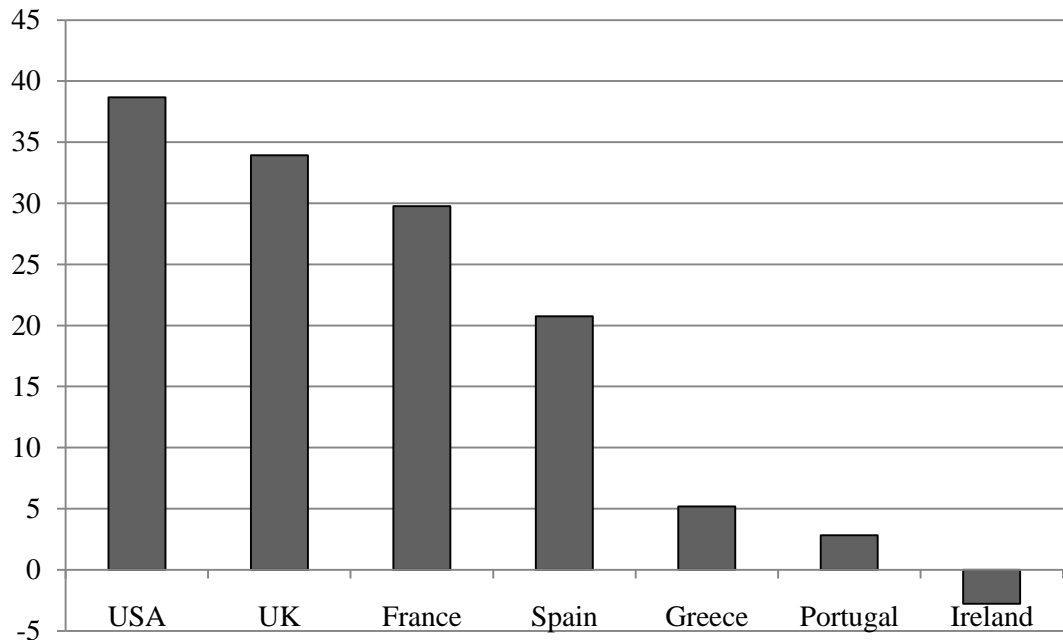
**Figure 1.1:** Current account balances for Germany, Greece, Ireland and Portugal (as a percentage of GDP)

Source: IMF Balance of Payments Statistics

However, it is one thing to be able to recognise that the eurozone is characterised by deficit countries and surplus countries, and quite another to argue that one is responsible for the other (Milios and Sotiropoulos 2010, 227; Young and Semmler 2011; Dooley 2014). In fact, it is becoming increasingly recognised that differences in competitiveness may actually emerge because of Germany's superior links to trading partners in the core and outside of Europe (such as with the USA and China), and that German exports to the eurozone periphery are in fact marginal, and are unlikely to account for the imbalances posited by Lapavitsas et al. (Milios and Sotiropoulos 2010, 234-5; Dooley 2014, 945; Bastasin 2012, 156, 157).

Indeed, the core-periphery literature tends to overlook *country specific* balances of trade. For example, if the periphery were structurally necessary to the core as a

market for its exports, we would expect that trade to peripheral economies, such as Portugal, Ireland and Greece, would be significant. However, as figure 1.2 shows, this does not appear to be the case.



**Figure 1.2:** German trade balances by country in billions of euros (average figures from 2000-2012)

*Source:* IMF Direction of trade statistics

As figure 1.2 illustrates, the peripheral eurozone countries, account for a marginal percentage of German trade since the introduction of the euro. In fact, whereas the top three destinations of German exports (France, the US and UK) account for over 100 billion euros of the German trade balance, Portugal, Ireland and Greece account for just over 5 billion euros together, and in fact, this includes a small trade *deficit* with Ireland. Germany has a considerably higher trade surplus with Spain (20.76 billion euros) than the other three peripheral countries considered here, but even accounting for this, the four peripheral economies account for less than 26 billion euros of Germany's trade surplus altogether, or just under one quarter of the contribution from core and extra-EMU trading partners. While this figure is not strictly speaking insignificant, in terms of

its visible balance of trade, it is nevertheless difficult to argue that peripheral current account deficits are the ‘structural mirror’ of core ‘surpluses’. This is intuitive when it is considered that Germany’s balance of trade did not decline from 2009 onwards, as would be expected, based on the premises of the core-periphery thesis and, given the collapse of the propensity to consume across the eurozone periphery (Milios and Sotiropoulos 2010, 235). On the contrary, German trade flourished during the crisis, precisely because its trading partners in the core of Europe, and outside the eurozone, are much more important to its current account surplus than the relatively small economies of the eurozone periphery (Reisenbichler and Morgan 2013; Beck 2013).

None of what is discussed here should be understood as denying the benefits Germany has enjoyed, perhaps uniquely, from the construction of EMU. This is beside the point. What is at stake is the ‘beggar-thy-neighbour’ thesis – and the trade balances presented here highlight the serious problems in blaming Germany for the periphery’s vulnerabilities. In addition, the case of Spain does seem to support Lapavistas et al.’s (2012) claim, even if the examples of Portugal, Ireland and Greece suggest that more nuance and complexity is needed in tracing these relationships.

### *Empirical limits II: Capital accounts*

Although the above raises significant problems for ‘Step 2’ of the core-periphery analysis, a modified version of the ‘beggar-thy-neighbour’ argument can still be made by looking at capital account imbalances.<sup>21</sup> Lapavistas et al. correctly identify that ‘Germany has been exporting capital on a large scale, while peripheral countries have been importing capital (2012, 31). Even if Germany is not generating a current account

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<sup>21</sup> As Milios and Sotiropoulos (2010) do, in spite of their critique of a ‘beggar-thy-neighbour’ core-periphery explanation.

surplus from trade with the periphery, and even if it is not ‘necessary’ for the core to direct massive capital flows to the periphery, the fact that it is doing so, could still be a proximate cause of financialised underdevelopment and indebtedness in the periphery. German credit still went to where the ‘economic climate was favourable to autonomous (credit financed) spending decisions’ (Cesaratto 2013, 113). Lapavitsas et al. demonstrate that flows from the core to periphery have actually become ‘more important in size’ than any other type of capital flows in the eurozone, at least from 2005-2009 (2012, 46, 47). However, this argument needs to be unpacked carefully. To highlight the relative importance of core-periphery capital flows, Lapavitsas et al. have grouped countries into the ‘core’ (Germany, France, Belgium and the Netherlands) and ‘periphery’ (Greece, Ireland, Italy, Portugal and Spain), and it is between these two groups of countries, rather than between specific countries that the core-periphery relationship, in terms of bank lending and capital flows, has been established (Lapavitsas et al. 2012, 46). As was the case with ‘Step-2’, the relationship is not so clear-cut if we look at specific country-to-country relations.

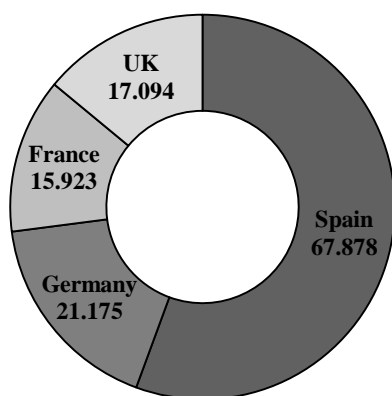
As figures 1.3, 1.4, 1.5 & 1.6 illustrate, the patterns of cross border lending within the eurozone are not clearly reducible to a core-periphery dynamic once we examine the countries on a case by case basis.<sup>22</sup> For example, in the case of Portugal (figure 1.3), we can see that although Germany is heavily exposed to the country (meaning that US\$ 21.175bn of capital flowed from Germany to Portugal); capital inflows from Spain are 3.2 times higher, at US\$67.878bn. Additionally, the amount of

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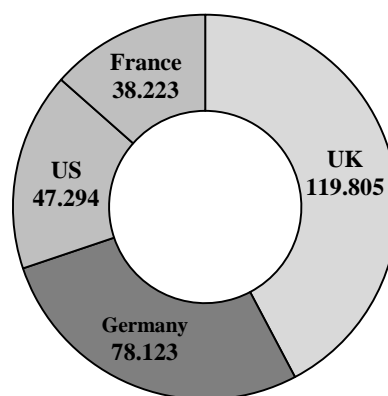
<sup>22</sup> These figures are calculated using data from the Bank of International Settlements (BIS) consolidated banking statistics. This data set provides information regarding banks’ on sheet financial claims vis-à-vis the rest of the world and provides a measure of the risk exposures of lenders’ national banking systems. This data set was chosen as Lapavitsas et al. (2012, 46-47) use BIS consolidated banking statistics to support their argument regarding the importance of core lending to the periphery. While this data provides an illustrative snapshot that complicates the relationship established by core-periphery analysis, future research could fruitfully consider the longer term historical patterns of lending between these countries.

capital inflows from France (US\$15.923bn) and the UK (US\$17.094bn) are very close to the amount from Germany. Similar patterns are identifiable for Greece and Ireland; although Germany is significantly exposed to each, in no case is it most exposed. Only in the case of Spain, does the pattern theorised by Lapavitsas et al. emerge (figure 1.6).

**Figure 1.3:** Portugal - Consolidated Foreign Claims in billions of US dollars



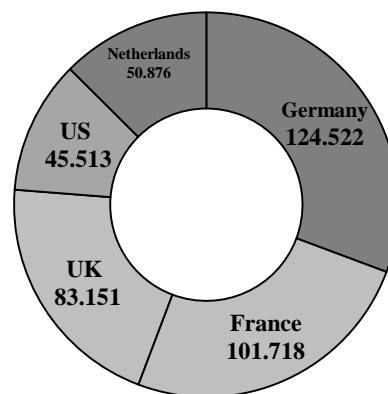
**Figure 1.4:** Ireland Consolidated Foreign Claims in Billions of US dollars



**Figure 1.5:** Greece- Consolidated Foreign Claims in Billions of US dollars



**Figure 1.6:** Spain - Consolidated Foreign Claims in Billions of US dollars



Source for figures 1.3, 1.4, 1.5 & 1.6: Bank of International Settlements Consolidated Bank Statistics end of March 2013.

Naturally, none of this should be seen as denying the significant impact of core exposure to the periphery.<sup>23</sup> However, the central point remains that analysing these flows through a ‘core-periphery’ prism can be limiting, leading to the omission of important specificities in relation to ‘peripheral’ cases, so as to occasion important blind spots in the understanding of the how crisis has originated (Dooley 2014, 945). One such blind spot is the under-appreciated salience of inter-periphery financial flows, as well as the importance of exposure to a variety of different countries as illustrated by the above figures. Financial and trade imbalances are certainly crucial to any understanding of the crisis in the European periphery, but it may be limiting if these multiple flows are contorted into a simplistic core-periphery model.

***Theoretical limitations: from immaturity to victimisation***

The above critical approaches represent an important to the immaturity thesis. Yet the empirical limitations that have been identified above suggest some theoretical problems. These can be summed up in the single observation that the asymmetry of the eurozone crisis is not reducible to German dominance alone (Dooley 2014, 945). Although the framework of core-periphery analysis has drawn attention to the importance of capital flows, imbalances, and the design flaws of European integration, it has been let down by two inter-related theoretical limitations. First of all, it has replaced the internalism of the immaturity thesis with externalism – thereby neglecting the agency of the European periphery and retaining an analysis based on assigning blame. Secondly, because of this, it has missed an opportunity to develop a theory of ‘capitalist diversity’ which could

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<sup>23</sup>The case could be made that the ultimate source of Portuguese debt, indirectly, is Germany and France via Spain. However, rather than contort these relationships further into the core-periphery model (why would Germany indirectly lend to some peripheral states while directly lending to others?), I suggest that it makes more sense to take the specificities of financialisation in each state more seriously.

have challenged the notions of ‘non-convergence’ at the heart of the immaturity thesis, thereby downplaying the diversity of peripheral economic trajectories.

Core-periphery analysis actually stands in the way of a potentially more compelling critique of the immaturity thesis. By neglecting the agency and histories of the countries of the European periphery, this perspective misses out on an opportunity to challenge the immaturity thesis on its own turf, and in doing so, overlooks its own potential to directly challenge some of its central assumptions. Core-periphery analysis has traded the problematic internalism of the immaturity thesis for its own equally problematic externalism; thus reducing the complex and multiple trajectories of political economic change in countries such as Portugal, Ireland and Greece, to a passive function of the interests of their more powerful European neighbours. Similar to the immaturity thesis, the periphery is still represented as the ‘other’ of the core, except that such frameworks adopt assumptions of *victimisation*; ‘rather than a failure to act *appropriately*, the peripheral state is represented with an inability to *act efficaciously* due to structural constraints’ (Dooley 2014, 945). Whereas the immaturity thesis explains away divergence by pathologising different forms of development (rendering them immature, incomplete); core-periphery analysis views peripheral models as ‘stunted’ modernisations. This is a problem because it relegates peripheral agency to being analytically secondary and passive, as not having a role in its own history. This is particularly disappointing, because as I elaborate on in section three, ‘Step-1’ of core-periphery analysis has the potential to rethink the origins of divergence in these countries while taking their agency and histories seriously.

Although this is not the place for an extensive account or critique of the neo-Gramscian School<sup>24</sup>, it can be argued that this literature falls into the same trap as core-periphery analysis. Namely, it generates its own version of externalism by reducing the development and transformations of a variety of European states to the interests of a transnational neoliberal capitalist class. Other strands of such analysis exaggerate the constraints of EMU and the Stability and Growth Pact (SGP) (especially the work of Gill 1998) - refusing to take seriously the so-called mainstream literature's insistence on the peripheries' non-compliances to these very constraints, see (Strange 2012) and tend to represent all major economic and political actors in the periphery as *comprador elites* (Rodrigues and Reis 2012; Fouskas and Dimoulas 2013).

This kind of functionalist externalism is a problem because as I have stressed so far, Portugal, Ireland, Greece and indeed, Spain, Italy and Cyprus have all experienced very different kinds of crisis. The paths that led them to their respective IMF-ECB-EU bailouts were far from homogenous. It is clear enough that in order to account for these different trajectories, there is a need to account for the complexities of peripheral agency. Reducing it to a function of another country's model of growth is empirically limited and an inadequate placeholder for a genuine critical rethinking. As one of the epigraphs to this chapter suggests, if the immaturity thesis has smuggled in the problems of modernisation theory to research on the eurozone crisis, critical approaches have responded by smuggling in the problematic assumptions of dependency theory (Young 1999).

As such, although these two theories of asymmetry emerge fundamentally opposed to one another, scholarship relying on assumptions of victimisation in place of

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<sup>24</sup> Not least because, when these accounts turn explicitly to accounting for the crisis in the periphery, they tend to explicitly reproduce narratives of core-periphery victimisation anyway. But see also van Apeldoorn 2009, and see Germain and Kenny 1998; and Strange 2012 for good critical accounts.



‘immaturity’ actually runs into very similar pitfalls. While the immaturity thesis can be criticised for its neglect of external factors, core-periphery analysis and neo-Marxian/Gramscian approaches respond by replacing internalism with externalism. While the immaturity thesis is inadequate to the task of accounting for the diversity of the crises in each country due to a focus on ‘obstacles to convergence’, the victimisation thesis downplays the very same diversity by explaining each crisis as a passive and/or structural result of German/European victimisation.

Furthermore, while the immaturity thesis has a narrow conceptualisation of peripheral agency due to a focus on ‘irresponsibility’, agency in the approaches discussed in this section are even more limited, being reduced to a simple passive function of external interests. In one scheme the periphery can’t act maturely, in the other, it essentially can’t act at all. Narratives of immaturity and victimisation both leave scholarship on the eurozone crisis without an adequate solution to the internalism/externalism problem, without a positive theory of peripheral agency, and without an explanation for the dramatically different forms of crisis experienced by the countries of the European periphery.

In order to take the asymmetry of the eurozone crisis seriously, we need to move beyond the safety of the ‘immaturity’ vs. ‘victimisation’ debate, itself a reanimation of the modernisation vs. dependency theory debates of decades ago – as (Gourgouris 2015) has said – ‘no matter how dressed up with new terminologies and allegedly new significations’.

### **Section Three: Theoretical framework: Comparative Political Economy and the Europeanisation of the Periphery**

Identifying the theoretical limitations underlying existing literature on the crisis in the European periphery allows the ground to be cleared for an alternative theoretical framework. This is the task of this final section.

So far, this chapter has shed light on two main gaps that have been created by literature which relies on either the immaturity or victimisation thesis. The first gap relates to how the *agency* of the periphery is accounted for. The agency and history of the periphery is represented in one narrative as immature and pathological, accounted for principally in the sense that the periphery has stubbornly refused to ‘get its house in order’ in the decades before the crisis. In the other, the agency of the periphery is neglected almost altogether by those frameworks which understand its evolving economic trajectory as the product of its victimisation by more powerful European countries.

The second, very much related issue concerns how the *diversity of the eurozone crisis* is accounted for. Greece, Ireland and Portugal have all followed very different paths to crisis, but most explanations have attempted to contort this complexity into very blunt mono-causal explanations of ‘non-convergence’ that actually neglects to account for divergence as an active process. Diversity is typically explained away, rather than brought front and centre as a phenomenon to be explained. The immaturity thesis explains it all away as ‘non-convergence’, while the victimisation thesis (typically without case-study analysis) understands it all as a function of powerful external interests. These two problems suggest that a more robust critique of the

‘immaturity thesis’ should be able to account for peripheral agency, while at the same time taking capitalist diversity seriously.

This section proposes how a framework that tackles each of these problems can be developed. I outline this in three steps. In order to capture the diversity of the eurozone crisis, I begin by drawing on the literature on Varieties of Capitalism (VoC) and Comparative Political Economy (CPE) more broadly. I pay particular attention to VoC’s problems of path dependency and methodological nationalism. Situating core-periphery analysis within CPE makes it possible to propose adopting a modified ‘step-1’ of core-periphery analysis as a more fruitful ‘post-VoC’ CPE approach.

Second, in order to trace the evolving economic trajectories of Greece, Portugal and Ireland I propose that the following three chapters focus on the *modernisation* of the European periphery. I begin by making a distinction between modernisation theory and a non-linear conceptualisation of modernisation that is sensitive to the multiple ways in which ‘modernisation’ can occur, and the consequences of modernisation beyond its simple ‘success’ or ‘failure’. This conceptualisation of modernisation ties back to CPE’s sensitivity to capitalist diversity.

Finally, I bring this CPE literature into dialogue with the literature on *Europeanisation* – or the study of a country’s ‘domestic adaptation to European integration’. By combining these two approaches it is possible to explore how Greece, Portugal, and Ireland negotiated and adapted to a ‘one size fits all’ model of European integration in different kinds of ways. Above all, the combination of these two approaches makes it possible to study the *modernisation* and the *Europeanisation* of the European periphery in a way that can capture the agency of the European periphery and the diversity of the eurozone crisis.

I bring these three sections together by proposing the following central research framework. The subsequent three chapters provide an historicist, multiple-case study research framework for exploring the evolving economic trajectories in Greece, Portugal and Ireland. In these chapters, I historically trace how processes of institutional change (modernisation) and the domestic adaptation to European integration were pivotal in driving these three countries towards their respective crises. A note on case study selection is also provided.

***Addressing the diversity of the eurozone crisis: Varieties of Capitalism and Comparative Political Economy***

In recent years, more and more scholarship has begun to direct its attention to studying ‘capitalist diversity’, comparative capitalisms (CC), or comparative political economy (CPE).<sup>25</sup> A ‘capitalist diversity’ approach to the eurozone crisis should aim to acknowledge the systemic or general nature of the crisis while ‘remaining aware of the considerable range of ways in which it has been and is playing out across different parts of the world’ (Bruff and Ebenau 2014, 4). As Bob Hancké (2009) notes, a theory of capitalist diversity is something very different from a theory of ‘non-convergence’. Whereas the latter explains diversity in terms of incomplete, externally stunted or pathological attempts at modernisation, a theory of capitalist diversity should recognise, and take seriously, the notion that modernisation is always multiple; there is no one, single model of development. As Justin Rosenberg (2006) has written in his critique of unilinear modernisation theory, ‘empirically speaking, there is not, and never has been,

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<sup>25</sup> See especially – ‘capitalist diversity’ as an emerging research agenda - Lane and Wood 2009; Bruff and Ebenau 2014; Bruff and Hartmann 2014; Bruff and Horn 2012; Bohle and Greskovits 2012; but also the varieties of capitalism (VoC) literature - see Hancké 2009, 19-22; Bruff and Horn 2012, 163, 164; and Justin Rosenberg's work on uneven and combined development (U&CD) 2006; as well as those studies on the ‘asymmetry’ of the eurozone crisis which are increasingly common, see Jäger and Springler 2015; Dooley 2014.

a single path taken by social development’ (313-4)<sup>26</sup>. The potential of a theory of divergence is that it can recognise the fact of empirical diversity, but also incorporate it into a theoretical framework that is not distorted by the *a priori* culturalist and modernisation theory assumptions of the immaturity thesis. In this way the divergence of the periphery can be studied as a positive process, rather than explained away as a straightforward ‘failure to converge’.

In this subsection I outline the potential of the literature on comparative political economy to account for the origins of the crisis in the European periphery. This will be done in two steps. I begin with an account of the Varieties of Capitalism (VoC) approach. Second, I provide an overview of how VoC and post-VoC (especially ‘step-1’ of core-periphery analysis) approaches can contribute to an understanding of the origins of the crisis in Greece, Portugal, and Ireland through their shared meta-theoretical grounding in historical institutionalism.

### *Institutions Matter: The Varieties of Capitalism Approach*

Although the comparative study of capitalisms has a long pre-history<sup>27</sup> the field has been dominated by the Varieties of Capitalism (VoC) approach since Peter Hall and David Soskice published their ground-breaking monograph in 2001 (Hall and Soskice 2001; see also Hall & Gingerich 2009; Hall & Thelen 2009; Hancké 2009; Myant &

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<sup>26</sup> It is likely that the argument proposed here could be brought together with a U&CD framework (see especially Rosenberg 2006). However, recent work that has begun to consider the applicability of a U&CD approach to the eurozone crisis and European integration has tended to run into ‘victimisation’ problems in accounting for the agency of the European periphery (for a sympathetic critique see Bruff 2010; and for a recent application of U&CD to the crisis, see Sandbeck and Schneider 2013). Future research may explore the possible bridges and tensions with my argument and U&CD.

<sup>27</sup> See Schonfield 1969; the 1970s literature on neocorporatism – Schmitter and Lehmbruch 1979; the comparative study of production regimes, Streeck 1992; and the comparative study of welfare regimes, Esping-Anderson 2013. Dependency Theory :Frank 1971; Amin 1977; Galtung 1971; and World Systems Theory: Wallerstein 2011, also are of this broad tradition.

Drahokoupil 2012; Amable 2003; Coates 2005; Becker 2009; Deeg & Jackson 2006; Allen 2004; Lane & Wood 2009). In it, the authors aim to explain national economic performance or welfare provision by reference to ‘crucial distinguishing structural conditions of each domestic system, grouping countries into relevant typologies’ (Featherstone 2008, 1).

The VoC framework is constructed around a fundamental distinction between Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs). The central conceptual innovation of VoC is that it places the firm at the centre of its analysis (Hancké 2009, 2) which as Thelen (2009, 472) notes, allows VoC scholars to trace the key difference between these two varieties of capitalisms back to the question of how employers’ co-ordinate their activities:

whether mostly through the market (as in liberal economies), or through various arrangements that allow firms to achieve joint gains through co-operation (as in the co-ordinated economies). This literature has focused special attention on the rather different institutional arrangements one finds in the CMEs that distinguish them from LMEs, including but not limited to: co-ordinated collective bargaining, arrangements for worker participation and voice at the plant level... (Thelen 2009, 472).

LMEs and CMEs are ideal types and opposing equilibria. VoC scholars typically identify how different institutions can act complementary to one another, bestowing certain comparative advantages to economies that conform closely to either ideal type. The presence of ‘correctly calibrated’ institutions determines the overall efficiency of any specific economy (Hancké 2009, 3). Institutional complementarities imply that the various institutions within an economy – ‘labour relations and corporate governance, labour relations and national training system, corporate governance and inter-firm relations – reinforce each other’ (Hancké 2009, 3-4).

There are numerous different strands to the VoC approach, but there are three important assumptions that are shared in common and worth drawing out (Clift 2014). First, different institutional configurations produce different economic capacities and problems. Second, national institutions matter. Third, these national institutions develop over long periods of time and are ‘sticky’ or path dependent (Nölke 2015, 5; Clift 2014, 199-200). These assumptions appear well suited to the research question of this project. From the beginning, the VoC approach has sought to ‘refute the idea that contemporary market pressures (broadly captured under the headings of ‘globalization’ and/or ‘deindustrialization’ will drive a convergence on a single ‘best’ or ‘most efficient’ model of capitalism’ (Thelen 2009, 472). In contrast, VoC approaches posit two possible models, and insist that these models are very durable, and exhibit strong ‘self-reinforcing tendencies’ (ibid 472). A similar study of national institutions in Greece, Portugal, and Ireland is a fruitful starting point to trace the evolution of their respective economic trajectories.

Yet while its continued influence is hard to deny, the limitations and shortcomings of the VoC approach are well documented and have been thrown into sharp relief since the beginning of the eurozone crisis.<sup>28</sup> Somewhat surprisingly VoC literature on the origins of the eurozone crisis has actually been notably thin (but see the work of Hall 2012; 2014; Hancké 2013; Hancké et al 2013). This is partially due to the key actor in VoC being the firm, which leads to a neglect of the role of the state in national political economies (see Ó Riain 2014, 23-27). This is quite deliberate, as Hancké notes ‘the VoC approach starts – axiomatically – with the firm at the centre of the analysis’ (Hancké 2009, 2). This leads to problems when accounting for Southern

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<sup>28</sup> See Hancké 2009, 5-17; Clift 2014; Jordan 2015; Bruff and Ebenau 2014; and Coates 2014 for some up to date reviews.

European or Irish ‘varieties of capitalism’, where the state has historically played a crucial role in processes of capitalist restructuring (see Featherstone 2008).<sup>29</sup>

Others have highlighted VoC’s limits in accounting for diversity and the eurozone crisis (see Jordan 2015; Jackson and Deeg 2006; 2008; Allen 2004). Clift (2014) disputes that VoC is a theory of diversity at all and claims that it actually posits a pattern of ‘dual convergence’ (206). Featherstone notes that none of the peripheral European economies fit neatly into the dominant typologies of VoC. Southern Europe and Greece in particular are typically explained away as exceptional or are simply left out of VoC scholarship (Featherstone 2008).<sup>30</sup>

Beyond these problems, VoC can be charged with more limitations relating to its understanding of path dependency and methodological nationalism which I discuss later. But before doing so, I outline the potential of existing VoC and post-VoC approaches to provide an explanation of the origins of the eurozone crisis, and situate some of the claims of ‘core-periphery analysis’ within the literature on CPE in order to contribute to the development of my research framework.

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<sup>29</sup> Yet, newer generations of VoC literature have emerged which take the state much more seriously. Featherstone (2008) offers a useful review of this second generation literature, and conducts an ‘empirical check’ to see if such a VoC approach can capture the Greek model and explain poor reform capacity as a result of the institutional make up of Greece. Featherstone concludes broadly in favour of the ‘mixed market economy’ model provided by Molina and Rhodes (2005). ‘In MMEs, unions and employers have stronger organisational structures than in LMEs (like US, UK), but they are more fragmented and have more problems in articulating their interests than in CMEs (like Germany, Sweden). They have difficulty in delivering collective goods and in sustaining autonomous coordination in collective bargaining. (Featherstone 2008 14,15).

<sup>30</sup> Yet, it is important to recognise that VoC is not attempting to argue that there are only two types of capitalism from an analytical standpoint. What the first generation claims is that there are, in ideal typical form, two (or more, but at least two – Hancké 2009, 2) institutional equilibria: the LMEs and CMEs. Naturally, there are models that are intermediate, or fall somewhere in the middle of the continuum (and second generation approaches are allowing for the possibility of at least hybrids, potentially different kinds of models outside the spectrum). But the real implication is that there are only two models of capitalism that work. As Goodin notes, ‘[t]he implication is that the middle ground between LME and CME is ultimately economically untenable, in a fiercely competitive international environment. Countries in that region must, if they are to remain internationally competitive for finance capital, move wholly in one direction or wholly in the other... On the logic of ‘institutional complementarities’, it is only to be expected that intermediate cases should be expected to pay a hermaphrodites penalty’ (Goodin 2003, 206).



*Back to 'step-1': CPE analysis of the eurozone crisis and core-periphery analysis as a post-VoC approach*

First generation VoC (see Jordan 2015 for a detailed review) has indeed been limited to the study of western, advanced, industrial economies, but the concept of Mixed Market Economies (MMEs) have been applied to study the European Periphery (Molina and Rhodes 2007; Featherstone 2008; Hall 2014). Hancké (2009, 14-16) notes the emergence of market based, state centred and associational modes of economic governance in the work of Schmidt (2002) and Amable (2003), and of finer grained distinctions still which include family-based Mediterranean Market Economies (another 'MME', see Whitley 1999). Naturally there is a trade-off between empirical coverage and analytical sharpness implied in the expansion of typologies, 'ultimately one could claim that every capitalist country has produced its own variety' (Hancké 2009, 15). The attempt of Molina and Rhodes (2007) to retain the parsimonious spirit of first generation VoC while including the Mediterranean economies within a third category of Mixed Market Economy has been a reasonably popular solution, taken up by Featherstone (2008) and Hall (2014).

Moreover, as already mentioned, VoC has been applied to explain the origins of the eurozone crisis. Hall (2014) has attempted to show how the lack of institutional complementarities on show in Mixed Market Economies partially accounts for the emergence of fragile economic performance in Greece, Portugal, Spain, Italy, and Ireland:

To stylize slightly, on one side is a set of coordinated market economies in 'northern' Europe, operating export-led growth models... [and a]nother set of countries in 'southern' Europe might be described as *mixed market economies* where, apart from periodic 'social pacts', wage bargaining is difficult to coordinate because trade unions are relatively strong but view with one another

for the allegiance of the workforce and the right to negotiate wage bargains (Hall 2014, 5,6 italics added).

Hall's VoC approach focuses on the *absence* of the kinds of institutional complementarities that allow LMEs and CMEs to act as relatively more sustainable models of capitalism in Southern Europe. In doing so VoC seems to offer little more than the non-VoC domestic level analysis reviewed in section one; providing a theory of non-convergence, rather than divergence. To be fair, the modest departure Hall's VoC does make is important. By paying attention to the long, path dependent institutional development of these national political economies, Hall is able to recognise that it would have been very difficult for these economies to introduce painful but necessary reforms during the 1990s and 2000s. Given the reality of an EMU made up of CMEs, LMEs and MMEs, the eurozone and single market themselves should have reformed in order to be more sensitive to this variation, rather than the other way around.

Nevertheless, arguably, post-VoC approaches to study of the eurozone crisis are taking over in prominence from the analyses of Hall and Hancké due in part to the limitations mentioned (as argued by Ebenau, Bruff and May 2015, 1). Although they modify or reject VoC assumptions, many of these newer approaches still build on the historical institutionalism of the VoC approach.<sup>31</sup> As Hall (2014) argues, VoCs focus on how institutions gradually develop over time and how they are relatively durable provides a useful starting point for explaining the key difference between the 'core' and 'periphery' in Europe. The strength of this institutionalist foundation is on clear display within step-1 of core-periphery analysis which makes claims about how nationally distinct capitalisms within EMU have responded very differently to the external

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<sup>31</sup> Although others draw instead from more heterodox sources, including Keynesian and Kaleckian political economy, as well as dependency theory and uneven and combined development (see discussion in Bruff and Ebenau 2014).

pressure of European integration. It is useful to situate core-periphery analysis within this CPE literature, in order to draw out how the claims of ‘step-1’ can contribute to the theoretical framework of this thesis.

Nölke (2015, 6) characterises many of the works containing broadly core-periphery analysis claims as *Critical Comparative Capitalisms* (CCC) (see Stockhammer, 2011; Becker and Jäger, 2013; Becker, 2014; Jessop, 2014; Stockhammer et al., 2014, all cited in Nölke 2015). He argues that although CCC approaches do not tend to speak of CMEs, LMEs or MMEs, they do contrast export-led or profit-led *growth regimes* (or models) in the core of Europe with demand-/consumption-/debt-/wage-led growth regimes/models in the periphery of Europe. These export- and debt-led models do not need to be viewed as homogenous, as, for example, ‘demonstrated in a juxtaposition of recent developments within the one-sidedly export-led German economy and the more balanced export and consumption-led Swedish economy, both usually classified as CMEs’ (Baccaro and Pontusson, 2015 cited in Nölke 2015, 6).

Working within this CCC, or post-VoC approach, the core-periphery analysis of Lapavistas (et al 2012) and others recognises that the economies of Germany and Southern Europe display dramatically different histories of institutional development. Here I return to the potential of ‘step-1’ of that argument. While steps 2 and 3 of core-periphery analysis have relied on notions of German economic dominance, the first step is distinct from the others because it contains an implicit theory of capitalist diversity; namely the idea that *there is something about the European project that has led to the emergence of different models of economic development in Europe*. By participating in the project of European Integration, peripheral countries often had to adapt to western European norms and practices (Featherstone 2003, 6-7). As I argued earlier, the

‘beggar-thy-neighbour’ relationship between ‘debt-led’ and ‘export-led’ models is not analytically necessary to account for their emergence in the first place. They were simply multiple responses to the common pressure of a particular ‘one-size-fits-all’ project of European integration that not all countries were well suited to emulate/adapt to.

Nölke (2015) provides a useful overview of how such a CPE approach can account for these different institutional histories, and of how the common pressure of a ‘one size fits all’ model of European integration affected the core and the periphery differently. He focuses on wage bargaining systems, differences in competitiveness systems, and the relationship between the state as a central coordination mechanism and rising indebtedness (Nölke 2015).

First, in the core, institutions were developed over time that facilitated comprehensive wage restraint (especially in Germany) and accordingly, price competitiveness. A very different history of institution building in Southern Europe meant that the workforces in Greece, Portugal, Spain and Italy were not able to repeat this fate, in particular due to a lack of a wage coordination tool, and due to the strength of (certain) labour unions (Nölke 2015, 7-8). Given the ‘stickiness’ of wage bargaining systems which have been ‘established over many decades, with coordinated wage systems being particularly difficult to emulate - Höpner and Lutter (2014, p. 19) call the German case a ‘relic of a historical stroke of luck’ (cited in Nölke 2015, 9; see also Hall 2012: 359).

Second, according to CPE approaches (especially VoC), different national institutional contexts create different comparative advantages between core and peripheral economies. CMEs or export-oriented economies such as Germany have an

advantage in building up incremental innovations in high-quality manufacturing, ‘based on a sophisticated system of skill formation, in particular through vocational training’ but also through relative job security and traditions in long term investment practices (Nölke 2015, 10). Peripheral economies typically have more of an advantage in the production of low to medium quality goods which rest on a more uneven system of skill formation. This has a number of consequences, not least of which are the relative price sensitivity of peripheral-type goods, and their vulnerability to competition from emerging economies outside of the EU single market (Nölke 2015, 10). Moreover, as Chen et al., (2012) and Baccaro and Pontusson (2015, 28 cited in Nölke 2015) note, extra EU demand for EU goods is typically stronger for advanced German products, and much lower for the low-medium goods produced by peripheral economies. All of these implications help to explain why the countries of the European periphery have lost export competitiveness over the decades, and have accumulated trade deficits vis-à-vis the rest of the Eurozone, as well as huge extra-EU deficits.

Thirdly and finally, Nölke reviews CPE scholarship that focuses on the role of the state in the European periphery and on increasing public and private indebtedness. A CPE approach can allow us to recognise that financial and capital flows will interact differently with different types of capitalism (Lapavistas and Powell, 2013 cited in (Nölke 2015, 13), leading to different growth regimes, with export oriented growth in Germany and credit/demand-led growth regime in Southern Europe, the USA and the UK (Stockhammer, 2011 cited in Nölke 2015, 13). LMEs such as the UK and CMEs such as Germany were able to adapt successfully to increasing capital flows following the introduction of the euro. This external pressure reinforced already existing institutional complementarities. The periphery on the other hand were in a much weaker position, and were lacking in the institutions that the USA and the UK had built up over

the course of three decades which focused their economies on the provision of innovative financial services, (Nölke 2015, 14). Instead, the periphery developed a dependency on foreign capital,

but with a strong tendency towards deindustrialisation. Due to long standing trends towards deindustrialisation already in place in the periphery, economic activity moved towards finance, real estate and construction, and often from production for export to the management of imports (Nölke 2015, 14).

Nölke's review demonstrates the applicability of CPE approaches, grounded in the meta-theoretical historical institutionalism of VoC, to the study of the eurozone crisis in the periphery. Studying the historical evolution and 'stickiness' of peripheral institutions helps flesh out the claim of 'step-1' of core periphery analysis that the European project was tailored to core Europe, and not to the European periphery (Lapavitsas et al. 2012). Yet in spite of its value, this CPE approach leaves a number of questions unanswered, as I now discuss.

***Beyond non-convergence: the problems of path dependency and methodological nationalism***

A broadly CPE approach to the study of the crisis in European periphery makes two central claims which can help orient the research framework of the next three case study chapters. First, the political economies of the European periphery are 'shaped' clearly by national institutional contexts. Second, these institutions develop historically, are 'sticky', and set the periphery apart from the core. In other words, CPE can approach the study of differential capitalist restructuring of European economies by recognising the institutionally embedded differences, and the path dependency of these differences, in national political economies.

Yet, historical institutionalist path dependency *cannot* tell us the whole story. Focusing on the resilience of path-dependent institutions can certainly help us explain ‘non-convergence’, but is far less helpful in explaining institutional change (Streeck 2009; Streeck and Thelen 2005; Jackson and Deeg 2008; Thelen 2009). The key strength of VoC, post-VoC, and CPE more generally is also its greatest limitation. That is its meta-theoretical foundations in historical institutionalism, approaches which, as Thelen notes (2009, 473) have quite poor records in explaining institutional change. CPE has tended to involve the analysis of ‘comparative statics, in which institutions are invoked as an independent or intervening variable to explain some other outcome – for example, policy differences or divergent patterns of social or political stratification’ (Thelen 2009, 473).

This makes a lot of sense if we consider the origins of the approach. It first emerged as a critique of the hyper-globalist thesis and makes the argument that national models of capitalism can resist transformation in the face of external pressure for convergence (Featherstone 2008). ‘To this day, scholars are still generally more apt to ask what institutions do than how they evolve and change over time’ (Thelen 2009, 473). Because institutions are ‘sticky’, these approaches have a strong tendency to emphasize continuity through time in the basic structure and logic of models of political economy (Thelen 2009, 473). VoC scholars have very little to say about institutional change over time – because the ‘idea of persistence is virtually built into the definition of an institution, it should perhaps not be a surprise that the question of change is a weak spot in the literature as a whole, and indeed across all varieties of institutionalism’ (Thelen 2009, 473). As such, like domestic level analysis, it emphasises obstacles to convergence, path dependency, and non-convergence.

As was the case with domestic level analysis, reproduction of the problem of non-convergence leads to a number of empirical blind spots. Focusing only on ‘sticky’ institutions which act as ‘obstacles to convergence’ shuts down the possibility that something other than these obstacles has acted as a catalyst for divergence. It generates a research framework that cannot recognise that simply because a country has ‘failed to converge’, doesn’t mean that an economy has not transformed. Fundamentally, it is not well suited to exploring the important *institutional change* that has taken place in Greece, Portugal, and Ireland in the decades before their respective crises. Historically ‘sticky’ institutions matter, but there is also an important and neglected story of institutional change that VoC has been unable to tell.

#### *Methodological Nationalism*

Mainstream CPE and VoC in particular have also been widely critiqued for their methodological nationalism (Jordan 2015, Bruff et al. 2015, 33; Jessop 2011). As Bruff et al. note, VoC scholarship has an ‘overwhelming tendency to neglect both intra-national and transnationally relational character of capitalism’ (2015, 33). While institutions matter, little appreciation is given to the international constitution of national institutions (cf Rosenberg 2006). Jordan (2015) notes that while the VoC approaches of Hall and Hancké pay due attention to the importance of current account imbalances and the design flaws of the eurozone, nevertheless, ‘the boundaries erected by an approach underpinned by methodological nationalism mean that there is no ability to *explain* this important political economy development in relation to anything but national factors and how these change’ (Jordan 2015, 14). In other words, the methodological nationalism which underpins much of CPE reproduces the internalism



of domestic level analysis. In spite of its ability to distinguish between divergence and non-convergence, and to reject simplistic modernisation theory assumptions, VoC analysis tends not to move beyond ‘step 1’ (in terms of core-periphery analysis) in its own analysis (see Hall 2012, 357 – 361), and this is a result of its inability to account for the international constituents of ‘internal’ development. While core-periphery analysis has a problematic conception of the international dimensions of the peripheral economic development, the VoC literature does not provide one at all.

***Modernisation in the European periphery: Beyond linear conceptions of development***

How can a CPE approach be utilised to account for the origins of the crisis in the European periphery in a way that captures their multiple paths to crisis? How can a CPE approach overcome the three gaps identified in this chapter: the problems of agency, diversity and the internal external problem? In the remainder of this section I propose that a CPE approach can be used to orient the following three chapters by adopting, first, a *non-linear* conceptualisation of *modernisation*, and second, by focusing of the effects of *Europeanisation* in these three countries.

A CPE approach can trace historically specific economic trajectories in the European periphery by tracing different national strategies of *modernisation*. Unlike much of Western Europe, the countries of the European periphery were ‘economic latecomers’ – all members of the ‘cohesion countries’. Countries such as Ireland, Portugal and Greece all attempted strategies of ‘catching up’ with their industrialised European neighbours at different junctures in the decades before the crisis. Historically, these countries of the European periphery have had much in common; they were all agrarian dominated economies characterised by little to no industrialisation, high levels

of emigration, high unemployment, balance of payments problems, and very low levels of GDP per capita. Crucially, they all attempted to modernise, ‘catch up’ and to converge with Western Europe (Featherstone 1998; 2005).

Yet, it is important to make a distinction between the study of ‘modernisation’ and ‘modernisation theory’. Modernisation theory typically portrays economic development as a ladder, where, as Selwyn (2014) explains, ‘once on the bottom rung, poor countries have the possibility of climbing further up and, by doing so, accelerating the human development of their population’ (1). As Lyberaki and Tsakolotos quote, this macroeconomic orthodoxy claims to ‘Spread the truth – the laws of economics are like the laws of engineering. One set of laws works everywhere’ (quoted in Lyberaki and Tsakolotos 2002, 96). Modernisation is conceptualised as evolutionary, linear and occurring in stages (Rostow 1990; see discussion in Leys 1996, 9-11; Payne and Phillips 2010, 61-72; Selwyn 2014). Modernisation is conceived of as a process of change that is both transformative and progressive (Payne and Phillips 2010, 66) and occurs when countries ‘get the policies right’; when they adopt norms, structures and behaviours that together will produce economic development (Leys 1996, 9-11). The assumption is that all economies are basically going in the same direction and that the central aim of policy makers should be to dismantle obstacles to that process of convergence (ibid 96). On the other hand, as Anthony Giddens puts it, the sources of underdevelopment

don’t come from the global economy itself, or from the self-seeking behaviour on the part of the richer nations. They lie mainly in the societies themselves – in authoritarian government, corruption, conflict, over-regulation and the low level of emancipation of women (2000, 120 cited in Selwyn 2014, 1).

It is not hard to find these assumptions at work in the literature on the eurozone crisis. As mentioned in section one, modernisation theory acts as a meta-theoretical assumption underpinning much of the claims of the ‘immaturity thesis’. For example, Jason Manopoulos characterises Greece as having a peculiar impunity for the ruling classes, their corruption, and Oligarchical business structures. Greece is understood as distinct from ‘advanced’ ‘strong real’ economies, and contrasts are drawn between the USA and Northern Europe (mature economies) and Russia, Turkey and Greece (2011, 9; see Antoniadis 2013 for an account of the pervasiveness of this view). Unsurprisingly, modernisation theory assumptions are also clearly evident in the economic analysis and policy prescriptions of the European Commission, ECB and the IMF, centred as they are on the ‘correction’ of peripheral immaturity. If Greece, Portugal and Ireland got into trouble by failing to remove obstacles to modernisation, pushing through painful but necessary reforms now is nothing if not long overdue. Transposed from Cold War era analyses of underdevelopment in the ‘developing world’ to the analyses of the crisis in the European ‘PIIGS’, approaches underpinned by modernisation theory bring with them the same built in tendency towards moralist representations of agency in the periphery as ‘immature’ (Payne and Phillips 2010, 62; see Young 1999).

The major limitations of this linear conception of development have already been discussed in section one. Domestic level analysis of the crisis in the European periphery has tended to smuggle in Rostowian stadial determinism, leading to a preoccupation with the identification of obstacles to development. Greece, Ireland and Portugal encountered crisis because of a failure to introduce ‘painful but necessary reforms’ in the decades before the crisis hit. Yet, a failure to modernise is not the same thing as a straightforward continuity of ‘tradition’. Focusing on so-called ‘obstacles to

convergence' discounts the possibility that there are other, potentially important sources of economic divergence. Modernisation theory can only account for the path not taken, it cannot explain the institutional change that has actually taken place.

Nevertheless, in order to explore the origins of the crisis in the European periphery, I propose historically tracing processes of modernisation across Greece, Ireland, and Portugal in the following chapters. This implies the adoption of an alternative conception of modernisation; one that goes beyond the stadial and linear assumptions of modernisation theory. This alternative conception comprehends the possibilities of 'economic latecomer' economies pursuing 'catch up development', recognising at a basic level that Greece, Portugal, and Ireland would not follow any linear pattern of development such as Rostow's (1990) five-stage modernisation trajectory (Selwyn 2014, 79-81; see also Rosenberg 2006; Gerschenkron 1962).

Unilinear conceptions of development are ill-suited to understanding the evolving economic trajectory of the European periphery because conscious projects to 'catch-up' are evaluated in terms of success and failure, whether the development project in the third world or 'convergence' in the countries of the European periphery. When they encounter crisis, such as these three countries did, failure becomes the dominant theme. Yet, in framing such projects in terms of 'success' and 'failure', existing approaches have overlooked the important ways in which failed attempts at modernisation can actually be generative of social and political transformation. Through analysing the origins of the eurozone crisis it is possible to show how in no case did 'failure' result in mere persistence of existing institutions or a return to the 'drawing board', as existing narratives frequently imply. Indeed, that very conception results in the erasure of significant change. Failed, but nevertheless active attempts to converge on a vision of modernity propelled the trajectories of both Greece, Ireland and Portugal in

new and unexpected directions. Studying the ‘modernisation’ of the European periphery, but moving beyond unilinear understandings of modernisations highlights how existing narratives of ‘success and failure’ within the literature have led to important and longstanding blind spots that could be overcome by recognising how ‘failure’ is just as generative of change as ‘success.’

A CPE approach can therefore study the transformative effects of attempts made by these ‘economic latercomers’ to modernise, rather than measure convergence or non-convergence against an arbitrary yardstick of ‘modernisation’ as a presumed stage of development. Studying modernisation in this way has the potential to provide a history of divergence, rather than non-convergence.

### ***Europeanisation and capitalist diversity***

As I argued in section two, critical perspectives that highlight the deleterious effect European integration has had on the periphery already exist. In spite of their strengths, such as those illustrated by ‘step-1’ or core-periphery analysis, they tend to reproduce many of the problems associated with the problem of victimisation. On the other hand, domestic level analysis, including much CPE (and especially VoC) has a problem with methodological nationalism.

A notion of capitalist diversity can overcome the internalism/externalism of such approaches by emphasising the international dimensions of domestic change through bringing it into dialogue with the literature on *Europeanisation*.<sup>32</sup> Scholars of

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<sup>32</sup> In a certain respect, this framework takes up the invitation of Bache, Bulmer and Gunay (2011) who have called for Europeanisation studies to engage with critical political economy. They argue that Europeanisation studies has not done enough to interrogate its own metatheoretical foundations, and that by taking on board some of the insights of, inter alia, critical political economy, Europeanisation literature could ‘catch up’ with the eurozone crisis in a way that it has yet to do (Bache, Bulmer, and Gunay 2011, 18).

‘Europeanisation’ study a country’s ‘*domestic adaptation to European regional integration*’ (Graziano and Vink 2007). In this respect, there is clear potential here to account for the domestic level agency of the European periphery in a way that is sensitive to international (or at least European) dimensions of that agency. Scholars in this field have developed a well established research agenda which asks question about what happens ‘when Europe hits home’ (Börzel and Risse 2002). As Radaelli notes, Europeanisation as such is not a theory, but ‘rather a phenomenon that needs to be explained’ (Graziano and Vink 2007, 12).

Europeanisation and CPE (especially VoC) approaches are typically seen as opposites, according to Featherstone (2008, 32). If we baldly claim that the first asserts the likelihood of increasing convergence, while the latter anticipates persistent non-convergence, it is easy to see why.

In addition, the VoC approach has a very weak conception of the international. External pressure will not lead to domestic change, it will only shed light on and confirm existing national specificities. All meaningful change comes from within. ‘Thus the approach would support hypotheses of path dependency in relation to external pressure and would stress the resilience of the particular market model in interpreting such pressures’ (Featherstone 2008, 32). Europeanisation on the other hand takes the possibility of domestic transformation as a result of adaptation to European regional integration as its starting point. Yet, in the case of southern Europe, as Featherstone notes enthusiastically in his 2008 article on VoC and the Greek crisis, Europeanisation literature often assumes a great deal of path dependency – precisely for the reasons VoC would suggest. This is why, as Featherstone notes, the approaches are ‘two sides of the same coin’.

Unsurprisingly, Europeanisation studies has generated a lot of case study research, but also a number of works explicitly concerned with developing its theoretical parameters (Exadaktylos and Radaelli 2012; Graziano and Vink 2007). Due to its focus on domestic adaptation to European integration, or in other words, the ‘bottom up’ dynamics of European integration (Radaelli 2004), there is a clear benefit to positioning the research question of this project in relation to the literature on Europeanisation.<sup>33</sup> But how useful is it in accounting for the divergence we are concerned with?

Promisingly, the Europeanisation literature has recognised that domestic adaptation to European Integration is very unlikely to lead to convergence. ‘Diversity of domestic responses – across countries, institutions, and policy domains – has become a key theme in Europeanization research’ (see Radaelli 2004, 3; Bulmer 2007, 52; Börzel and Risse 2003; (Knill 2001; Heritier et al. 2001; Knill, Tosun, and Bauer 2009). ‘In fact, it has become something of an article of faith that Europeanization is not associated with convergence’ (Wessels et al. 2003) (quoted in Goetz 2007, 76). Some literature has focused on the ‘differential impact of European integration’ (Wessels et al. 2003, xv; Héritier and Knill 2001; Vink and Graziano 2007, 9; see also Radaelli 2003, 33). Existing specific domestic contexts may lead to differential results from the process of Europeanisation (Vink and Graziano 2007, 9). Laffan (2007) sees a persistence of diversity across national executives rather than convergence towards a particular model. Although European directives are aimed at harmonising national policies, in reality,

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<sup>33</sup> Yet, Europeanisation studies has sometimes been accused of being overly structural– see especially (Woll and Jacquot 2010; Héritier and Knill 2001, 2). Because Europeanisation studies often emphasises the ‘impact’ of European integration on member states, a passive conception of agency often results instead of one that focuses on the ways in which European integration can be positively and creatively ‘used’ by member states to pursue domestic goals. My framework emphasises creative ‘usages’ of European integration rather than ‘impact’ through focusing on how ‘Europe’ was used to advance national modernisation strategies (see also Radaelli 2004, 4-5).

they leave much room for continued national diversity (Vink and Graziano 2007, 10-11; Wessels et al. 2003, xv).

A particular strength of the Europeanisation literature is its domestic focus which allows for a recognition of the constitutive role of the international (European level) in transformation of politics, policy and polities, and indeed, many have suggested that ‘the new research agenda of Europeanization has provided the study of European integration with a ‘Second Image Reversed’ theory (Vink and Graziano 2007, 16; Raedelli 2003, 35; see Gourevitch 1978), along with its recognition that Europeanisation is unlikely to lead to convergence. Studying ‘when Europe hits home’, clearly moves us beyond the internalism of the immaturity thesis. Its ‘domestic level’ focus also facilitates the (potential) avoidance of the externalism of the victimisation thesis (Radaelli 2004). As Radaelli and Pasquier (2007) note, it is useful to make a distinction between Europeanisation, which is a process, and convergence and divergences, which are outcomes, ‘[t]here is now substantial evidence that EU politics provides different opportunities to different actors in terms of creative usages of Europe – the implication being that there is more differential impact than convergence’ (Radaelli and Pasquier, 2007, 39; see also Woll and Jacquolt (2010) and Héritier and Knill (2001).

However, digging a little deeper, it is possible to see that the discussion of ‘divergence’ within such debates is actually quite limited. Europeanisation of policies, politics or polities can either lead to convergence (and thus, transformation) or a persistence of diversity (effectively a continuity with the past, and in a theoretically meaningful sense, a lack of transformation). This leads back to the problem of immaturity, because there is little discussion of how divergence is a form of transformation in and of itself, and how a state can diverge while marking a significant



discontinuity with its past. Scholars of Europeanisation have been sensitive to the non-uniform effects of European integration on nation states (Graziano and Vink 2007, 8). Yet, the different variants of Europeanisation tend to be explained as ‘non-convergence’ rather than ‘divergence, or in other words, how nation states can account for the timing, extent and terms of their adaptation to European integration. Radaelli notes that Europeanisation is sometimes measured in four ways (specifically in this case, Radaelli (2000) looks at European nations states adaptation to EMU – but the four criteria are widely used).<sup>34</sup> The first is accommodation, which indicates a pre-existing closeness of fit (i.e. Germany). The second is transformation, indicating lack of fit, but leading to fundamental challenges to existing domestic structures. Third is inertia, indicating a lack of change due to lack of fit and deeply entrenched domestic institutional veto players. Finally there is retrenchment, which indicates a paradox of negative Europeanisation.<sup>35</sup>

Studying ‘transformation’ as a result of Europeanisation is the most fruitful direction to take from the above. Yet, most research on Europeanisation and the European periphery tends to focus on inertia. This is perhaps because as of yet, not enough attention has been paid to how transformation due to ‘lack of fit’ is much more likely to lead to divergence, rather than convergence. When convergence fails to occur, researchers tend to focus on obstacles to that convergence – leading them to identify cultural and political obstacles (the problem of immaturity identified in section two). Indeed, in cautioning against using the concept of Europeanisation as ‘yet another way to refer to convergence and homogeneity in Europe’, Radaelli and Pasquier (2007)

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<sup>34</sup> The above is paraphrased from Dyson 2000, 12, and see also Radaelli and Pasquier 2007; 40, Heritier et al 2001; Bulmer 2007, 55. See also Börzel and Risse (2003) for a ‘slightly different threefold classification: absorption, accommodation and transformation’ (quoted in Bulmer 2007, 55).

<sup>35</sup> A pattern that is arguable occurring in *Syriza*-led Greece since 2015, and has been observed in Italy also (see Dehousse 2013).

recommend that ‘the prediction to test is about *lack of convergence*, not its presence’ (39, italics added). Other studies question whether the EU has really determined domestic institutional arrangements in member states beyond very narrow requirements to meet EU stipulations (Bulmer 2007, 53). Much recent scholarship on Europeanisation therefore emerges as a critique of earlier studies in the field which tended to expect convergence as a result of domestic adaptation to European integration. Framing their positions in this way has led them to emphasise the resilience/persistence (non-convergence) of national differences (as Wessells et al 2003 and Héritier and Knill 2001 do).

However, the multiple forms of divergence encountered by Portugal, Ireland and Greece suggest something much more significant than mere resilience of existing national differences. Yet it is also certainly true that Europeanisation has not led to convergence, harmonisation or homogeneity across political economies. At this point we can bring in the insights of capitalist diversity to provide a third option: the possibility that domestic adaptation to European integration can lead to *divergence*, or in other words, the fundamental transformation of existing domestic structures. It is possible to conceive of Europeanisation leading to the emergence of radically new hybrid domestic structures and patterns of growth. Divergence is more than the resilience of national differences. It is the possibility of the emergence of *entirely new* kinds of national differences. The transformations that occurred in the developmental trajectories of the European periphery cannot be easily located within existing trajectories. Therefore, the dramatic transformations of the 1990s and 2000s are not mere ‘persistence’ or continuations of existing trajectories. Rather, ‘when Europe hit home’, it could potentially have led the countries of the European periphery in multiple different directions. Recognising the possibility of Europeanisation being generative of

divergence (as opposed to non-convergence) addresses both the limitations of the VoC approach – as it allows for the possibility of institutional change, and recognises the international (in this case European) constituents of domestic institutional development. As the next three chapters show, in no case did the periphery fail to transform or ‘converge’ as a result of adapting to European Integration. Instead, something much more radical occurred. The European periphery went in new and unexpected directions.

### *Europeanisation and the agency of the European Periphery*

This conceptualisation of Europeanisation also has implications for how I conceptualise peripheral agency in this project. The problematic conceptions of agency have already been well established. Approaches underpinned by immaturity thesis assumptions portray the history of the European periphery as one of neglect. These countries neglected to ‘get the policies right’, they neglected to introduce painful but necessary ‘structural reforms’ and above all they failed to modernise. As mentioned in section one, when political and economic irresponsibility are the processes of agency that are privileged, other forms of agency are neglected or entirely absent from analysis.

On the other hand, CPE approaches emphasising path dependency leave us with limited analytical scope to capture peripheral agency. The dominant theme in this instance is the inability to act. For Hall (2012), the European periphery could not reasonably have been expected to pursue different economic policies, because the institutions which shape the structure of their economies are built up slowly over time and are very difficult to change.

I propose studying processes of modernisation and Europeanisation in a way that is more sensitive to the agency of the European periphery in two ways. First of all,

while I accept that path dependency matters, parallel to this, I allow space to focus on how institutional change was happening in Greece, Portugal and Ireland, and how peripheral agency has an important part to play in that story. ‘Sticky’ differences in national institutional configurations will, in part, explain the different kinds of crisis experienced by the Greece, Portugal, and Ireland. However, institutional and political economic change clearly did take place in these countries and in order to capture that change, it is important to trace how domestic actors negotiated path dependency as they consciously pursued strategies of ‘catching up’. Similarly, Europeanisation is a common external pressure, but the periphery will have some say in how it responds and how it negotiates it. It is likely that each case negotiated European integration in a different way, and that this played a role in the different paths to crisis. As Menz (2003) puts it, while the external pressure of Europeanisation was constant, the actual impact of Europeanisation is conditioned by domestic actors (545-7). Greece, Ireland, and Portugal may have emphasised certain aspects of Europeanisation and showed less success in adapting to others. A ‘one size fits all’ model of European integration may have nevertheless provided different kinds of opportunities and constraints for different actors (Radelli and Pasquier 2007). Focusing on peripheral agency can help draw out the different experiences and results of Europeanisation in Greece, Portugal and Ireland.

Second, related to the above, ‘agency’ in this project is conceived of as addressing the problematic conceptions of agency which dominate existing accounts. The following case study chapters will allow space to consider the role of putatively ‘mature’ processes of agency in catalysing divergent economic trajectories. This addresses the problem of focusing only on ‘obstacles to convergence’, and recognising that there are neglected counter-narratives that can be illuminated. In other words, this project utilises a conceptualisation of agency that moves beyond narratives of blame

(immaturity/victimisation) and allows Greece, Portugal, and Ireland an active role in their own evolving economic trajectories.

***Modernisation, Europeanisation and historicist approaches: proposed framework for studying the cases of Greece, Portugal, and Ireland***

Drawing all of this together, a clear guide to research is provided. I argue that a focus on previously overlooked ‘non-immature’ sources of divergence (as opposed to immature sources of ‘non-convergence’) implies a multiple-case study, historicist framework which focuses on *Modernisation* and *Europeanisation*.

The above dialogue between Europeanisation and Comparative Political Economy guides the research framework of this thesis in the following three ways. First of all, I adopt a *multiple-case study* approach which explores, in turn, the evolving *economic trajectories* of Greece, Portugal and Ireland in the decades before the eurozone crisis. Instead of a comparative methodology, I have opted for this historicist multiple-case study approach that examines the historical specificity of institutional change in Ireland, in Greece, and in Portugal. This approach is more useful as it allows for an inductive, theory generating research framework. While it is a truism that each economy can be treated as a *sui generis* and as not representative as cases of a broader category (Schonfield 1969, Goodin 2003, 203), if we are to gain a deeper understanding of the very different paths to crisis followed by Greece, Portugal, and Ireland – it is important to keep the historical specificity of these political economies front and centre in the analysis. The aim of the analysis is to reveal how very different political economies experienced Europeanisation differently.

This methodology certainly does not dispute the role of path dependency articulated by VoC, ‘step-1’ core periphery analysis and the CPE analyses of differences between wage levels, competitiveness, and financial systems outlined by Nölke and others. Rather, a *historicist* case study approach avoids the ‘use and abuse’ of ideal types, and the dangers of forcing the ‘square peg of empirical reality into the round hole of the conceptual ideal type’ (Clift 2014, 209). Institutional ‘stickiness’ is important, but it is not the whole story, and a historicist multiple case study approach will allow light to be shed on the histories of institutional change that the path dependency of the VoC approach has caused to be neglected. This project is conceived much more as a critical historicist analysis that seeks to illuminate how institutions and (especially) institutional change produced an evolving political economic trajectory in these three countries *specifically*. While not necessarily generating generalizable claims, such an approach can potentially tell us something new about the origins of the Eurozone crisis. In other words, I propose a historical multi-case study methodology in order to provide a complementary yet neglected history of institutional change in the European periphery. In this respect, the intention is to offer a critical contribution to the CPE accounts Nölke (2015) reviews, rather than a straightforward rejection.

By bringing CPE and Europeanisation together it is possible to study the evolution of modernisation across my three case study chapters. Most importantly, rather than tracing convergence or non-convergence, I ask whether or not active attempts at ‘adapting the European integration’ generated brand new patterns of economic development in the European periphery? What, if any, impact did ‘Europeanisation’ have on the periphery’s modernisation? By situating the European periphery’s adaptation to European integration within their histories of modernisation, I pose the following question - did the periphery’s adaptation to a ‘one size fits all’

project of European integration have any significant impact on their evolving economic trajectories? Studying the impact of European integration in this way allows me to consider the ways in which putatively ‘mature’ processes of Europeanisation may have been generative of divergence.

This approach has potential to deepen existing critical debates on the origins of the eurozone crisis. Studying modernisation in this way implies taking domestic-level analysis more seriously, and in this way the agency of the periphery can be better accounted for. This makes it possible, across a multiple-case study analysis, to also account for the specific paths to crisis followed by the periphery. In addition, by bringing the insights of CPE together with those of Europeanisation, issues highlighted by narratives of victimisation can be dealt with in a way that existing domestic-level approaches tend to avoid. Studying ‘domestic adaptation’ to European integration makes it possible to consider the role of the latter in catalysing peripheral divergence in a way that does not posit the periphery as being ‘passively reshaped’.

Finally, a note on case selection. The countries that were worst hit by the crisis were chosen, and these were deemed to be those countries that faced pressure to agree to IMF-ECB-EU bailout agreements. Of course, this relates to five countries, Greece, Ireland, Portugal, Spain and Cyprus (and there is certainly a strong case to include Italy on this list also). For reasons of space, three countries were chosen, and in the interests of maximising the diversity that needed to be accounted for, Cyprus and Spain were left out because - important differences notwithstanding – Spain and Cyprus’ crises were very similar to the Irish case in that they both stemmed from banking crises due to housing bubbles (not to mention that Cyprus was heavily exposed to the Greek crisis). Portugal, Ireland and Greece on the other hand represent well the different kinds of

crisis which occurred across the European periphery, i.e., stagnation and recession, banking crisis and a public debt and fiscal crisis respectively.

## **Conclusion**

In this chapter I offered a critical overview of the literature on the eurozone crisis that purports to account for the origins of the crisis in the periphery. In doing so I paid particular attention to the assumptions existing debates make about the *asymmetry* of the crisis. Why have the countries of the European periphery been hit hardest? I outlined two opposing answers.

The ‘immaturity thesis’ is used to argue that the periphery is responsible for its own problems, because it failed to introduce difficult but necessary reforms at the appropriate times. This ‘failure to converge’ meant that Portugal, Ireland and Greece did not become modern, mature, European economies, and pre-existing political and economic pathologies persisted, meaning it was ‘only a matter of time’ before they got into trouble. The ‘victimisation thesis’ is used to argue that the periphery was ‘victimsed’ by the core of Europe. The modernisation of the periphery was stunted and contorted in order to ensure the interests of its more powerful European neighbours.

Framed in this way, the debate asks us to choose between one of two scapegoats – the ‘lazy PIIGS’ or the German ‘big bad wolf’. This framing has stood in the way of a genuine critical rethinking of the eurozone crisis. So far it has not provided an explanation of the divergence of the European periphery that can take seriously the diversity of individual paths to crisis or the periphery’s own agency, leading to a number of important blind spots.



The theoretical framework proposed in the final section of this chapter allows the next three case studies to investigate how the economic trajectories of the European periphery evolved and diverged in the decades before the crisis. It also allows these chapters to question just what effect putatively ‘mature’ patterns of political agency, such as adaptation to European Integration, had on these changing economic trajectories through looking at three different histories of national modernisation strategies. Studying peripheral divergence in this way makes it possible to overcome the limits of immaturity and victimisation because it places the agency of the periphery and the diversity of their respective crises front and centre. It also has the potential to study the impact of a ‘one size fits all’ model of European integration on the periphery’s economic trajectory in a way that is not limited by assumptions of convergence/non-convergence.

## 2

## It's Mostly Fiscal? The European Dimensions of the Greek Crisis

Greece must ...adopt a European policy that breaks away from its 'traditional' attitude of seeking exemptions and defending the self-defeating notion of its own exceptionalism. It is in every country's interest not to be seen as a perpetual exception—a 'problem' that never goes away.

Costas Simitis, former Prime Minister of Greece, 2015.

For Greece ...accession [to the EC] meant an enormous reorganisation of its economic structures, which were the most significant ones in the recent history of the country.

Tassos Giannitsis, economic advisor to Costas Simitis, 1997.

This chapter begins the first of three case studies. Greece is the epicentre of the eurozone crisis and 'patient zero' for the immaturity thesis. The country is often, as Tsakalotos (2014) has observed, conceived of as 'exceptional' to a purported European norm of fiscal responsibility, and thereby cast as the principal architect of its own downfall. Antoniadis (2013) has noted that Greece has been portrayed in popular media as the 'corrupted other of European modernity'. Although widespread, this narrative is unpopular, and in response to such claims, many critical approaches, especially from the discipline of IPE, have unpersuasively attempted to ignore or downplay the causal role of Greek public debt and fiscal deficits in Greece's contemporary difficulties (see

especially Lapavitsas et al. 2012). Yet at the same time, Greece's crisis has never been purely fiscal, and scholarship that has over-relied on notions of immaturity in the guise of 'Greek exceptionalism' has proved inadequate to the task of accounting for the deeper structural problems facing the Greek economy (see discussion in Triandafyllidou, Gropas, and Kouki 2013). In this chapter I argue that a convincing understanding of the Greek crisis must accordingly begin with the recognition that it has two components - it is both a fiscal and a competitiveness crisis – and these dimensions should be analysed separately.

As the first of three case studies, this chapter adopts the analytical framework outlined in chapter one to draw attention Greece's experience of Europeanisation, and to the ways in which 'non-exceptional' dynamics played a key causal role in Greece's crisis by tracing the evolution of the country's economic trajectory since 1974. In doing so I show that, rather than Greek fiscal irresponsibility, the most important factor in the origins of the contemporary crisis may be found precisely in the process of Greece's integration with Europe.

This argument is developed over four sections. Section one engages with the 'exceptionalism' thesis, the Greek version of the 'immaturity thesis', examining those perspectives which emphasise how particular 'exceptional' national and political traits are primarily responsible for the country's fiscal crisis. I take some of these insights on board by focusing on how long-standing problems relating to tax collection, welfare provision, and poor reform capacity do indeed have an important role in the crisis. Yet, I also outline two important limitations. First, perspectives in this vein have misleadingly explained the origins of these problems as stemming mainly from processes of corruption and irresponsibility. Second, they have problematically conflated the fiscal crisis with the causes of the competitiveness crisis.

Section two lays the groundwork for an alternative narrative of the Greek crisis by focusing on modernisation strategies during the 1980s. It argues that public debt accumulation should be understood as bound up in a process of state directed investment in a project of industrialisation, with a specific focus on the high-tech sector. This strategy was undoubtedly a failure, but it is important to understand that this failure is indicative of the challenges faced by a small peripheral ‘latecomer’ economy attempting to realise a rather typical modern vision of development.

Section three focuses on the emergence of ‘debt-led’ growth in Greece. It was during this decade that the Greek economy started to grow for the first time in decades. Greece underwent important changes during the 1990s as a result of joining the European Single Market and as a result of its preparations for the euro. A puzzle emerges: just as Greece got its inflation and exchange rates under control, experienced above average GDP growth, and introduced liberalisation, privatisation and deregulation, its economy became increasingly inward looking and less competitive. This suggests a linkage between ‘Europeanisation’ during the 1990s, growth, and falling competitiveness in Greece.

The final section considers the ways in which euro membership catalysed existing vulnerabilities in the run up to the sovereign debt crisis in two main respects. First of all, the trajectory of debt-led growth which had already emerged in the 1990s expanded rapidly as a result of increased capital flows following deepening financial integration. Secondly, EMU contributed to new and unsustainable dynamics of public debt management.

Shedding light on the ‘non-exceptional’ causes of the Greek crisis reveals the crucial role played by Europeanisation in the country’s divergence. It is no coincidence

that Greece's economic trajectory transformed most dramatically during the 1990s and 2000s, following the emergence of the 'one market, one money' project of European integration (Emerson, Gros, and Italianer 1992). The economic trajectory that led Greece to its 2010 sovereign debt crisis was catalysed by 'non-exceptional' processes of Greek agency, and especially by its attempt to catch up with its Western European neighbours. Preparing for the Single Market and EMU presented Greek elites who were concerned with modernisation with a clear vision for what it means to be both 'modern' and 'European', and clear guidelines (in the form of EU targets, directives and legislature) on how to reshape Greece in order to emulate this vision. This suggests an intriguing challenge to the immaturity thesis and notions of Greek exceptionalism. While the country's failure to follow specific rules of European integration appears to account for its fiscal crisis, it is precisely its success in following other rules of European integration which accounts for its competitiveness crisis.

### **Section One: Contesting the 'exceptionalism' of the Greek crisis**

Greece is often represented in mainstream scholarly, political and media narratives as 'exceptional' and as the antithesis of 'advanced' Northern European economies. As the previous chapter has suggested - existing 'domestic-level' approaches tend to emphasise the ways in which Greece failed to 'play by the rules' befitting a modern, mature member of the European project. On the other hand, critical and 'systemic' literature on the Greek sovereign debt crisis has had difficulty in 'explaining away' Greek immaturity, as Kevin Featherstone's response during a debate with Costas Lapavistas demonstrates:

[you say that it] has "nothing to do with state profligacy." Sorry, I had understood that the debt to GDP ratio since 1993 has been consistently around

100% of Gross Domestic Product. How could a state sustain those levels of debt and not be vulnerable? (in Lapavitsas 2010).

It is clear that clientelism, corruption and tax evasion have played important roles in Greece's crisis. However, in this chapter I argue that these well documented, supposedly 'exceptional' aspects of Greece's political economy do not tell the whole story. This section sketches the most important claims of the exceptionalism thesis,<sup>36</sup> before identifying some important limitations. Crucially, I argue that while notions of exceptionalism may capture important aspects of the historical character of Greece's fiscal crisis, they are inadequate in accounting for the origins of Greece's competitiveness crisis.

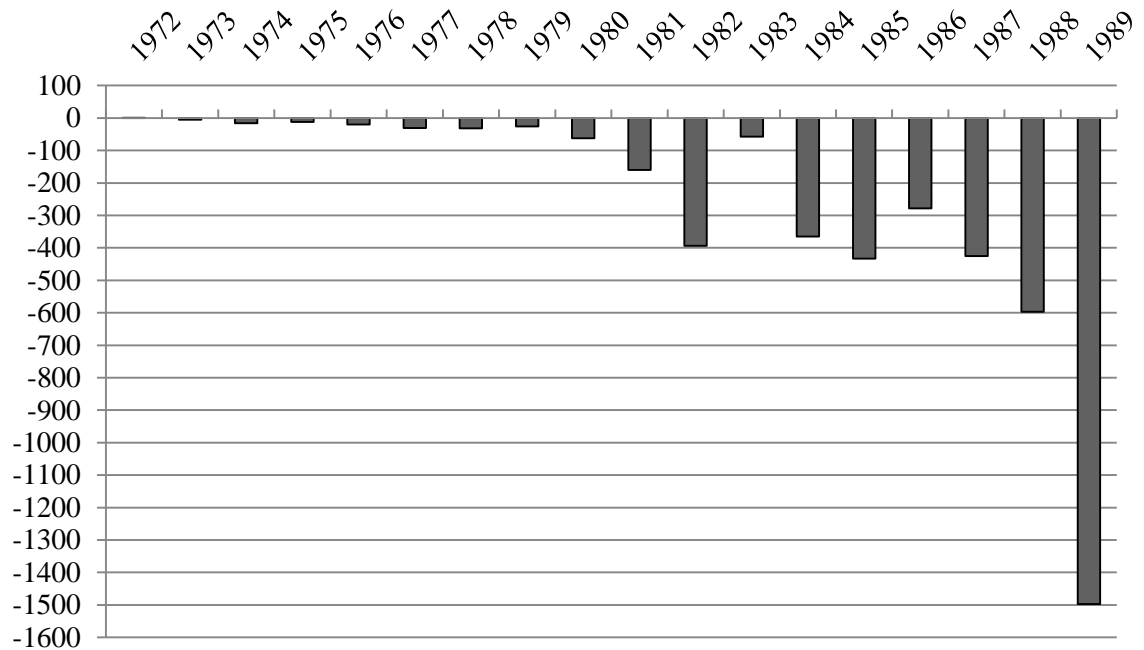
### ***Debt-fuelled clientelism: the 'exceptional' origins of the Greek crisis***

The story of Greece's crisis typically begins with the foundation of a new party, the Panhellenic Socialist Movement (PASOK) in 1974 under the leadership of Andreas Papandreou. PASOK secured an overall majority in the 1981 elections at the expense of New Democracy (ND). As figures 2.1 and 2.2 show, public deficits and debt rose significantly from the late 1970s, and particularly from 1981-1989. Most of the debt was accrued by PASOK governments in the 1980s, through socioeconomic policies aiming to expand the public sector and increase social spending and raising wages through borrowing. For many, the electoral success of Papandreou and PASOK can be explained through skill, party organisation and ingenuity on the one hand, and personal charisma and the inherent emotive appeal of populist rhetoric on the other. In this

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<sup>36</sup> In the case of Greece, notions of 'exceptionalism' can be seen as synonymous with notions of 'immaturity'. It is precisely the various aspects of political and social life wherein Greece is viewed as 'immature' that account for its 'exceptionalism'. As such, in this chapter, I use the 'immaturity thesis' and the 'exceptionalism' thesis interchangeably.

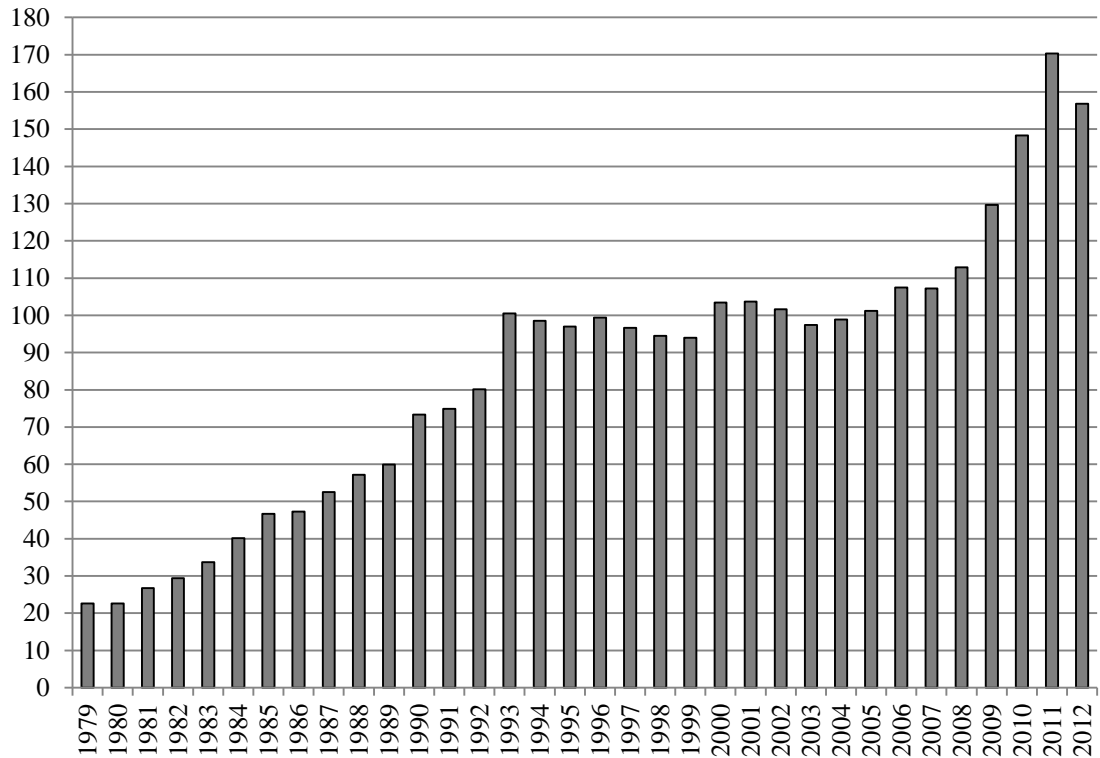
narrative, Papandreou and PASOK effectively ‘seduced’ the masses, and then consolidated this support once in power through patronage, at the expense of Greek public finances and macroeconomic sustainability.



**Figure 2.1:** Greek government deficit/surplus in millions of national currency (drachma).

*Source:* International Monetary Fund, Government Finance Statistics

According to this perspective, the public debt of the 1980s is the primarily the result of reckless short term political power consolidation by PASOK and their supporters (see various chapters in (Clogg 1993; Clogg 2002, 173–209; see discussion on ‘Hellenic Peronism’ in (Manolopoulos 2011, 1-13).



**Figure 2.2:** Greek Public debt as percentage of GDP, 1979-2012

*Source:* International Monetary Fund, Historical Public Debt Database

PASOK's strategy of political power consolidation in the 1980s is understood to have catalysed a 'Greek Tragedy of the Commons', or in other words, in tandem with rising deficits and debt, PASOK transformed the Greek state into a complex system of clientelism/patronage, the upshot being that major sections of society became dependent upon the state for favours, employment, and a particular lifestyle, in return for electoral support. The absence of the state governance in this regard was just important, as tax evasion became a common and widely practiced phenomenon. Bribery and corruption in the everyday provision of public services became a 'national pastime' (Manolopoulos 2011, 103–4). Put very simply, Greek society became bound up and complicit in the debt fuelled clientelism of PASOK's state during the 1980s; as PASOK's power became



consolidated, so did a widespread ‘culture of entitlement’(see Triandafyllidou, Gropas, and Kouki 2013 for a summary of this argument).

Thereafter, in spite of wide ranging reform efforts, this system of debt-fuelled clientelism proved impossible to supplant. In such analysis, the 1980s emerges as a ‘big bang’ moment for Greece – giving rise – in a once and for all fashion - to static and immovable political and economic pathologies that would, in due course, lead Greece to inevitable fiscal and sovereign debt crisis (Diamandouros 2011). Although this literature has produced important scholarship which recognises, evaluates and takes seriously the emergence of modernising forces in Greek politics and civil society from as early as the 1980s (but mainly in the 1990s and 2000s), the battle between ‘modernity’ and ‘tradition’ in Greece is analysed as a losing one for modernisation.

As a result, much of the debate concerns discussions of the causes and dynamics of ‘poor reform capacity’ in Greece.<sup>37</sup> The upshot of this argument is that no meaningful reforms were made during the 1990s and 2000s (see Diamandouros 2011) because debt-fuelled clientelism had become endemic and impossible to supplant; the state’s growth, and the interests of society at large, not to mention powerful interest groups, were all too dependent on the ‘Greek’ model.<sup>38</sup>

### ***The limits of emphasising Greek exceptionalism***

This approach has key strengths in terms of its ability to account for a number of central causes of Greece’s fiscal and public debt crisis. For instance, tax evasion in Greece is

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<sup>37</sup> For contributions to the literature on Greece’s ‘poor reform capacity’, see Featherstone and Papadimitriou 2008 and various essays in Mitsos and Mossialos 2000. See also various essays in Kalyvas, Pagoulatos, and Tsoukas 2013, and for more critical contributions see Lyberaki and Tsakalotos 2002; Monastiriotis and Antoniadis 2009.

<sup>38</sup> For literature on the persistence of clientelism through the decades, the discussion in Triandafyllidou, Gropas, and Kouki 2013. See also Manolopoulos 2011, 1-13 & 81-109; Diamandouros 2011, 1994; Tsoukalas 1995.

pervasive and a practice that has significant effects on its economy. For example, relative to GDP, Greece spends four times as much collecting income tax as does the United States. It has been suggested that as much as 64 per cent of eligible taxpayers in Greece did not pay any tax in 2009 (Oltheten et al. 2013, 332).<sup>39</sup> In addition, Greece has one of the largest ‘shadow economies’ in Europe, amounting to about 30 per cent of GDP – implying an annual loss in taxes of about 8 – 10 billion euros (Oltheten et al. 2013, 332). Moreover, as Featherstone and others have argued (Featherstone and Papadimitriou 2008; Featherstone 2008), problems of state efficiency cannot be ignored – even if Greece’s fiscal difficulties are more to do with revenue shortfalls than overspending (contrary to common misconceptions). State spending on social provision compares favourably with other EU states, but the coverage is relatively limited. For example, unemployment benefit is relatively low and limited in scope and duration, while that spent on pensions is notoriously high. The weakness of the welfare state and social provision in turn contributes to widespread tax evasion (Featherstone 2008, 24).

In spite of these important contributions to our understanding of the historical character of the Greek political economy, there are two key limitations to the ability of accounts which emphasise Greek exceptionalism to explain the contemporary problematique. First, they tend to neglect of the ways in which Greece’s economic trajectory dramatically transformed over the course of the 1990s and 2000s. In clarifying his own position on this debate, Nikos Diamandouros neatly outlines this manoeuvre,

Let me immediately clarify that my argument is not that the dominant paradigm has remained entirely unchanged or frozen in time for more than a century. Such an assertion would be clearly untenable, both theoretically and empirically. It is,

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<sup>39</sup> Although there is good reason to be sceptical of these widely reported figures. A recent article in BBC News notes that although Greece has a ‘massive’ tax collection problem, such exorbitant figures are likely a product of accounting anomalies (BBC News 2015).

rather, that, notwithstanding significant evolution, notable improvements, important modifications, and occasionally substantive reforms, the *fundamental logic* underpinning and informing the dominant paradigm has, in fact, retained its integrity throughout this period ([authors own italics], (2011, 2).

Emphasising the stubborn persistence of particular exceptional national traits posits an unbroken continuity in how the Greek economic trajectory is conceptualised from the 1980s onwards. In doing so, it provides a framework that is not well suited to accounting for the important changes that took place during the 1990s and 2000s that I argue in sections three and four contribute to the emergence of brand new and unanticipated trajectory of Greek economic development.

A second limitation is the disproportionate focus on the fiscal dimension of Greece's crisis, which is by now, widely recognised as simply one part of the twin crisis facing the country, comprising also of a competitiveness dimension (Wihlborg, Willett, and Zhang 2010; Fouskas and Dimoulas 2013; Lapavitsas 2010).

This is not simply a problem of emphasis; the causes of the fiscal crisis have actually been used to also account for the competitiveness crisis. As Oltheten et al. (2013) argue, the reason that Greece has underperformed and lost competitiveness in past decades is because 'the education system is ineffective, the government is incompetent, the tax system is corrupt, and the system of justice is dysfunctional' (330). All of this supposedly culminates to make Greece a deeply unattractive small country in which to do business. 'The private sector, normally a source of entrepreneurship and growth is so weighted down that it can no longer overcome the burden of its own government' (Oltheten et al. 2013, 330-1). Featherstone similarly writes about corruption as a cultural phenomenon and claims that it is 'anti-competitive: it imposes

costs and distorts the market, whilst offering privileged contact via enclosed networks. It is evident at all levels and across sectors' (Featherstone 2008, 19).

Eliding the causes of these twin crises appears somewhat misleading because, as I argued in chapter one, there is a crucial distinction that should be made between an explanation of non-convergence and one of divergence. Even if Greece had tackled the above 'exceptional' traits via structural reforms aimed at convergence, its failure to do so does not automatically explain the particular path of debt-led growth Greece diverged onto. In fact, as I argue in the following sections, beginning with the period of PASOK's first governments, precisely that period in which Greece is conventionally considered to have diverged most signally from modern European norms – Greece's road to crisis was paved with good, non-exceptional intentions.

## **Section Two: The limits to Greek modernisation: 1974-1989**

Greece's exorbitant public debt, persistent public deficits, and pervasive corruption and clientelism can all be traced back to the late 1970s and 1980s. During this critical period, Greek policy aimed at 'modernising' the economy. However, this agenda was shaped by both the pathological features identified by the 'exceptionalism' thesis, and a number of further factors which are conventionally understood as non-exceptional – the importance of which has hitherto tended to be overlooked by literature on the contemporary Greek crisis. As I show in this section, Greek policymaking in the 1980s was aimed at modernising the economy – but this agenda was operationalised within the parameters set by political, economic, and at times, geopolitical imperatives. In doing so, I claim that Greece's, in many important respects, 'non-exceptional' attempt to modernise during the 1980s was just as important as its embrace of corruption and

clientelism in sowing the seeds for its eventual crisis. Accordingly, without denying the role of the well documented emerging ‘dysfunctions’ of this period, I argue that running parallel were dynamic and complex patterns of policy making that contained a distinctly ‘modern’ vision for Greece, that were in turn subject to and limited by various constraints, challenges and imperatives. In this section, I provide a revisionist historical narrative of the origins of the Greek crisis in the 1980s which reveals the ways in which distinctly ‘non-exceptional’ patterns of Greek agency may be seen to have been equally as generative of divergence as those which may be identified as exceptional.

***The era of ‘Metapolitefsi’: Challenges to Greek modernisation, 1974-1989***

Like so many other peripheral European countries, Greece in the 1970s and 1980s was clearly an ‘economic latecomer’, attempting to modernise and ‘catch up’ with its Western European neighbours. Greece attempted national development strategies in the face of a number of urgent challenges during this period. Following the Turkish invasion of Cyprus, the first oil crash and mounting social unrest, the seven year right-wing authoritarian Regime of the Colonels collapsed in 1974, beginning the period of *Metapolitefsi*<sup>40</sup> in Greece (see Clogg 2002; Fouskas and Dimoulas 2013, 109-134). In 1974 Constantine Karamanlis and his party *New Democracy* (ND) formed a conservative government which began the process of ‘de-juntafication’ which carried on throughout the 1980s, in a context of the international economic crisis, and where, as Clogg (2002) argues, the overriding priority of this new government was to defuse risk of war with Turkey’ (166). Hence, the newly established ‘Third Hellenic Republic’ began a process of modernisation in the middle of unprecedented and severe international economic and geopolitical crises.

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<sup>40</sup> Democratisation; for the purposes of this chapter, this refers to the period from 1974-1989.

By 1980 per capita GDP was only 68 per cent of the EU average, higher only than fellow peripheral country Ireland's (Oltheten et al. 2013, 319). Greece remained predominately agricultural, and de-industrialisation had generated serious economic difficulty for the country from as early as 1973 (see Louri and Minoglou 2002, Sapelli 1995; Fouskas and Dimoulas 2012, 2013; Markantonatou 2012) and these difficulties were accelerated by the oil shocks of that decade. Although it had witnessed some industrialisation in the post war period (the so-called 'Golden era' - see Mavroudeas 2010, 5), by the 1970s this had already begun to decline; and as Louri and Minoglou put it, Greece 'never fully completed the transition from a backward mercantile/agricultural economy to an advanced capitalist economy' (2002, 324, 337). Even at its peak, industrial employment in Greece was 30% as opposed to roughly 47% for other Western economies. The trend was set to continue; by 1994 the share of manufacturing output in GDP was 15 per cent, down from 19.8 per cent in 1951 (these figures are provided by Louri and Minoglou 2002, 338). Foreign Direct Investment (FDI) also fell sharply and technology intensive sectors stopped increasing and remained basically static from the mid-1970s onwards. Following the second oil crisis and EEC membership, Greece became increasingly exposed to import penetration and declining export competitiveness into the 1980s.

In addition to the above economic crisis, the processes of *Metapolitefsi* and 'dejuntafication' required a new urgency on the part of the Greek state to respond to the demands of those who had been excluded under, not just the authoritarian regime of Colonels, but via the various repressive tendencies of the post-war Greek state since the post-war period.<sup>41</sup> Concretely, various imperatives aligned during the 1970s and 1980s

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<sup>41</sup> For more on this see Clogg 2002; Fouskas and Dimoulas 2013, 80-109; Draenos 2009; Gerakis and Wald 1964; Botsiou 2009; Michaelides, Papageorgiou, and Vouldis 2013, 811; Kornetis 2010; Michael-Matsas 2010.

which meant that the (comparatively late, especially compared to Britain and Western Europe) necessity to begin the establishment of a welfare state. This is crucially important to note: Greece found itself in a position of having to respond to an unprecedented economic crisis, while also having to begin the construction of a welfare state. Modernisation, stabilisation, and the establishment of the welfare state were pursued *all at once* (Markantonatou 2012, 422).

Adding insult to injury, the (seemingly legitimate) prospect of a war with Turkey made Greece one of the world's highest per capita military spenders' during this period and right up until the present day (Pappas 2013, 34). Precipitated by the 1974 Cyprus emergency, tensions between Greece and Turkey continued from 1974-1990 and beyond. Massive expenditures on military hardware meant that 'infrastructural reforms, e.g. in education and health care, that demanded urgent attention received a low priority' (Clogg 2002, 173), something that fell to the 1980s PASOK governments to rectify. Although there is not the space to provide a more detailed account, suffice to say, tensions regarding Turkey continued to be significant from 1974-2009, and this translated into persistently high defence spending for Greece – something that had a clear and direct effect on debt (see Clogg 2002).

As such, Greek governments in the 1980s found themselves compelled to tackle a triple challenge; an economic crisis, a welfare crisis, and a potential geopolitical crisis. This triple crisis contributed to a particular strategy of modernisation – one that attempted to meet the welfare and economic crisis together through fostering economic modernisation. Conventional accounts that highlight corruption and clientelism tend to downplay this aspect of 1980s Greece. It was the goal of economic 'stabilisation through development' (Tsakalotos 1991, 179) that best explains the transformation of the Greek political economy at this time, to which I turn in the following section.

***Stabilisation through development: Greek modernisation strategy in the 1980s***

‘Stabilisation through development’ refers to PASOK’s attempt to meet this triple challenge through an early programme for modernisation. It aimed to manage the economic crisis while at the same time attempting to restructure the public sector, modernise the banking system, and harness the private sector for developmental purposes (Lavdas 1997, 149). Specifically PASOK made use of an inherited post-war *dirigiste* strategy of development which hinged on publically financing a national project of industrialisation. It was a strategy that suffered from serious limitations and ended in outright failure by the end of the decade. Specifically, it contributed detrimentally to the accumulation of public debt and deficits, rising inflation, and had little success in modernising the Greek economy in the way it intended. I argue that this strategy failed because, aside from being constrained by the political, economic and social imperatives outlined above, the strategy was caught between a particular vision of Greece’s future, and a particular institutional framework inherited from Greece’s past that was to prove no longer effective.<sup>42</sup> Nevertheless, in this respect, we can re-interpret the dysfunctions of the 1980s as a product not simply of the exceptionalism noted in section one, but as a product of the limitations of an ambitious project of modernisation, that nevertheless could not escape the imperatives that shaped its attempted implementation.

Turning to the strategy itself, Euclid Tsakalotos argues that PASOK’s strategy was based on its structural analysis of the problems facing the Greek economy at the time. In particular, PASOK wished to reverse deindustrialisation in Greece through coordinated national development plans and public investment (Tsakalotos 1991, 136). It was widely perceived by PASOK elites at the time that existing state investment was

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<sup>42</sup> See Pagoulatos 2003 for a detailed version of this argument.



ad-hoc and that no previous government had ever effectively integrated the ‘financial sector into any specific strategy for development’ (Tsakalotos 1991, 137) and furthermore, the deteriorating economic performance of the Greek economy by 1981 represented the failure of the private sector to invest in industry (Tsakalotos 1991, 152). PASOK’s national development plan, in contrast, assigned a clear role for a reformed public sector along with various supervisory councils to direct the financial sector towards national development goals.

A key element of PASOK’s new development agenda, particularly in its first term (1981-1985) involved a policy of ‘sectoral targeting’. Law 1262/1982 was introduced (Lavdas 1997, 152; see also Tsakalotos 1991, 154) to explicitly target ‘high end’ ‘export’ manufacturing sectors – and so public investment was concentrated in what were perceived as dynamic areas (electronics, IT related branches, biotechnology and precision instruments’ (Lavdas 1997, 152). This strategy is widely agreed to have had limited success, partly to do with poor implementation and planning, but also because the sector targeting policies failed to take into account that some of traditional sectors in Greece (cement, food and beverages, textiles, clothing etc.) were more likely to be areas where Greece had a comparative advantage, while the manufacturing sectors were declining (Lavdas 1997, 152). It was also aggravated by Greece’s entry into the EEC in 1981 which led to an increase in import penetration and poor export performance (Tsakalotos 1991, 154). Eventually, this policy provided assistance to a majority from the traditional sectors.

This strategy was also expected to tackle the much prolonged issue of welfare provision. As Markantonatou (2012) notes, during the post-War period, an authoritarian state ‘undertook an active ideological role in the perpetuation of the division between the losers and the winners of the [Civil] war, by offering jobs and state subsidies to the

latter, repudiating and purging the former, long after the end of the hostilities' (418). A particular form of economy emerged during this period, one that was characterised, *inter alia*, by low wages and little to no welfare state (418, 419). The 1980s represented an attempt to rectify this in various ways. Papandreou introduced a number of reforms, including the establishment of a National Health Service, the building of hospitals and clinics, the raising of salaries in the public sector, and other measures (see Clogg 2002 181-186). Yet, as Clogg argues, any hope of creating a modern welfare state 'hinged critically on putting the economy on a sounder footing and in particular, on improving productivity' (2002, 181). The limited success achieved by this strategy by the end of the 1980s meant that Greece never really ended up with a modern welfare state, which was to have consequences for tax evasion and fiscal policy going into the 1990s and 2000s.

In spite of its failure, it is important to note that the PASOK governments' pursuit of 'high tech' industrialised growth was a distinctly 'modern' vision for Greece that should be understood as a not unusual example of a 'late developing' economy catch up or converge with its Western neighbours. Indeed, in aspiring towards a 'smart' and high-tech' economy, it anticipated many aspects of the Single Market and Lisbon Agenda that emerged years later<sup>43</sup>, as Lavdas notes:

In business circles, the perception of the PASOK strategy was that the Papandreou government wished to achieve a dominant role for the public sector supported by clusters of 'smart' SMEs in areas that were new or almost new for Greece (Lavdas 1997, 152).

This is true, even if the means by which this vision were pursued were somewhat out of step with the abandonment of domestic demand led growth strategies in most European countries at the time. Because the PASOK strategy resulted in nationalisations and

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<sup>43</sup> This will be further discussed in chapter five.

enormous public spending and investment, it goes without saying that the pursuit of this modernisation strategy was to be politically and economically costly for Greece. Numerous advisory bodies were also set up to function as ‘channels for the flow of information and proposals between public and private agencies’ (153). The infamous OAE (Organisation for Business Reconstruction) was set up during this period also to deal with ailing firms problems, to restructure them in line with this modernising vision. The OAE was set up as Law 1386/1983 to take over bankrupt or overburdened firms in order to reduce unemployment (Lavdas 1997 162). It was justified as being in the public interests with reference to unacceptable levels of employment (*ibid* 162). By 1985 the OAE had obtained control of 41 industrial firms with a total debt of Dr350bn (Lavdas 1997 162). Of course, the restructuring of these firms proved ineffective, and many of these problematic companies remained on the public balance sheet for years to come.

If ‘high tech’ modernisation was a vision of Greece’s future, it was to be implemented using an institutional framework inherited from Greece’s recent past. The dirigiste model was an inheritance from the so-called golden years of Greek economic growth, which took place in a context where the US was imposing and directly dictating policy in Greece (Clogg 1993, Fouskas and Dimoulas 2013, 80-109; Draenos 2009; Kaplan 2010; Gerakis and Wald 1964; Botsiou 2009). Accordingly, the 1980s in Greece do not represent an ‘abrupt discontinuity’ (Louri and Pepelasis Minoglou 2002, 323; see also (Alogoskoufis 2000) with the post-war model, but an appropriation of it to continue a project of modernisation (Pagoulatos 2003). The first PASOK government’s economic plan made use of this existing state-bank-industrial investment infrastructure to tackle the economic and employment crisis that had emerged since the 1970s, but also to restructure the Greek economy away from traditional towards advanced and semi-advanced industrial production – partially stimulated by domestic demand.

However, it was becoming clear that a dirigiste industrial model was no longer appropriate for Greece post 1974. For one thing, the repressive political mechanisms of the post-war Greek state were no longer available. Previously marginalised groups, especially labour, were now able to demand and receive economic benefits previously denied to them. These demands, however, partially translated into an attempt to protect the ‘industrial model’ as a way of maintaining employment over the course of the 1970s and 80s which explains why the industrial sector continued to receive state support during the period (Pagoulatos 2003, 88-89). As such, Greek democratisation took place using the tools available from the pre-existing pre-1974 ‘developmentalist’ or dirigisme model. Pagoulatos describes such measures as ‘[the] last ditch effort of what remained of a developmental state seeking to prop up industrial growth amidst a highly adverse economic environment’ (2003). Indeed, joining the EC can be actually be seen as an initial post 1974 attempt to rescue, *not* dismantle the pre-1974 model, and the Karamanlis government attempted to prop up the Greek manufacturing sector through exports and direct investment towards heavy industry (Pagoulatos 2003, 88).

These attempts by PASOK governments to ‘catch up’ by pursuing a ‘modern’ developmental agenda during the 1980s while continuing to utilise the pre-existing infrastructure of the post-war dirigiste model generated a number of key contradictions in the Greek economy which have had major significance for the contemporary conjuncture.<sup>44</sup> Firstly this bank-based institutional model contributed heavily to the accrual of public debt in Greece during the period. Secondly, the expansion of the public sector and the raising of salaries can be seen as an attempt to develop a form of welfare provision.

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<sup>44</sup> See Tsakolotos 1991 for a comparison between the PASOK strategy and the contemporaneous model of the French Socialists under Mitterrand before the ‘U Turn’ (43-50).

It is important to recognise that using this model was a necessary and immediate decision of both ND in the 1970s and PASOK in the 1980s – there wasn't another model that was readily available or 'waiting in the wings'. Crucially, PASOK's policy agenda during its second term in office was shaped by the evident failures of its first term, and represented something of a radical shift in policy. PASOK knew that it needed to control inflation, tackle the deficit, and confront the problem of falling private investments, whose decline since 1979 (two years before PASOK took office) had reached a record low in 1985 (Lavdas 1997 174-5). Indeed, as the next section shows, from as early as 1985, the project of Greek modernisation resulted in the gradual supplanting of the old dirigisme model.

To conclude this discussion of the first 'turning point' in Greece's economic trajectory, it is certainly impossible to ignore the unprecedented growth of public debt and budget deficits that emerged during this period and it would be unwise to downplay their impact in Greece's current crisis. It would also be unwise to fully discount the importance of new modes of corruption and clientelism that emerged during this period, and their constitutive role in Greek debt and deficits. However, the 1980s, as I have shown, cannot be understood *solely* as an abandonment of a sound project of modernisation in favour of a nefarious project of political power consolidation.

Rather, the problems of the 1980s are better understood as stemming from the imperatives of modernising, within the context of an international economic crisis, geopolitical turbulence in the Aegean, achieving legitimate democratisation, and the desire to transform into an industrialised modern economy using the inherited dirigisme institutional structures of the post-war period, all at the same time as trying to develop a welfare state.

These were the real imperatives which Greek modernisers had to negotiate. PASOK governments of the 1980s faced nothing less than the complex problematique of a late developing peripheral European state attempting to catch up with its Western European neighbours.

As the next section shows, dealing with legacy of this ‘failed modernisation’ was to become central to the emergence of a new modernisation strategy for Greece – one that was much more clearly defined by a vision of ‘European modernity’, and unlike the strategies of the 1980s, this vision was to be explicitly underpinned by the attempted construction of European institutional frameworks.

### **Section Three: Greece adapts to Europe: ‘debt-led’ growth as a result of Europeanisation**

If the 1980s were characterised by early, failed, attempts by the newly formed Greek democracy to mark a rupture with its past, the 1990s saw subsequent Greek governments succeed in doing just that. Yet, transformation was not achieved through enhanced export competitiveness or ‘high tech’ industrialisation as was hoped. Rather, the second ‘turning point’ in Greece’s economic trajectory relates to its transformation during the 1990s into what scholars have identified as an economy driven by ‘debt-led’ growth (Lapavitsas et al. 2012).

This section draws attention to the ways in which Greece’s debt-led growth was driven by the country’s adaptation to European integration. Successive Greek governments began to develop a new strategy of modernisation during the 1990s. This new agenda was synonymous with Greece’s successful participation in the Single Market and admission to the eurozone, which were understood by Greek governments

as representing both a useful external imperative for necessary yet unpopular reforms, as well as an historic opportunity for development. The dramatic institutional and policy changes that took place during Greece's efforts at joining the euro led directly, yet unintentionally, to the country's transformation into a 'debt-led' economy.

In this section I illustrate that while Greek 'exceptionalism' or resistance to European-style convergence may account to a limited extent for Greece's fiscal problems, *at the same time*, successful adaptation to Europe during the 1990s resulted in the transformation of the Greek economy into a fragile and non-competitive model of growth. The narrative of Greek exceptionalism is not well suited to explaining the specificities of Greek divergence in the 1990s. In fact, quite the contrary; many of the areas where Greece most successfully adapted to the European agenda were constitutive of its subsequent debt-led trajectory of economic growth.

### ***Preparing for the euro: the emergence of a new modernisation agenda in 1990s Greece***

The 1990s witnessed the emergence of a very different strategy of modernisation for Greece from what had come before. PASOK's second term in office coincided with the 1985 're-launch' of the European project by the first Delors Commission, which set out a dramatic new agenda for enhancing the international competitiveness and growth prospects of the EU, starting with the completion of the Single Market by the end of 1992, and culminating in the single currency in 1999. As that PASOK government slowly resigned amid scandal<sup>45</sup> and economic disarray in the late 1980s, it is hardly

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<sup>45</sup> PASOK finished its second term in controversy due to the Koskotos/Bank of Crete scandal in 1989. This was a financial scandal which implicated Papandreou and many PASOK officials in charges of embezzlement. The personal life of Papandreou also contributed to the PASOK crisis at this time. Electoral instability followed in the years after, leading to a mandate for 'catharsis' regarding corruption

surprising that Greece's rejuvenated 'modernisation agenda' in the 1990s was to be shaped very heavily by a desire to leave the experience of the 1980s behind. But crucially, as Kevin Featherstone argues, this new agenda was also to be defined 'within the frame of 'Europe': it had little meaning without reference to the need to adapt to the EU; the latter defined and legitimised their project' (2005, 227). Adjusting to the Single Market and preparing for EMU was to provide the new 'blueprint' for Greek modernisation.

Greece's modernisation in the 1990s is most closely associated with the emergence of Costas Simitis as leader of PASOK in 1996. Simitis had long been associated with the 'modernising wing' of the PASOK party, and brought a clear modernising agenda to Greek politics in the 1990s; and with the death of Papandreou in 1996 and of Karamanlis in 1998, many commentators heralded the 'end of the era of the dinosaurs' in Greek politics (Clogg 2002, 88). Specifically, Simitis and others aimed at overcoming the limits of the dirigiste strategies of the 1980s, and indeed, 'modernisation' was typically defined against the corruption and economic misgovernment of the earlier era. By the 1990s both the Greek public and policy-makers realised that the strategies of the 1980s had 'not only failed to deliver steady economic growth and to secure high employment. On the contrary, they had produced high inflation, a stagnant economy, high unemployment and growing fiscal deficits' (Herz and Kotios 2000, 170). It was clear that the old strategy needed to be abandoned in favour of something new.

Policy makers found their new agenda in the specific reforms and adjustments required of Greece in order to join EMU and the Single Market. European integration

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in Greek politics that was to inform the changing political environment of the 1990s. See Clogg (2002) for a full account.



thus translated into a strategy of modernisation for Greece in two ways – through adapting to constraints and through anticipating new opportunities. It is clear enough that preparing to join the Single Market and particularly, EMU created pressures and constraints for Greek governments to liberalise, privatise and deregulate. Greek governments during this period introduced a number of convergence programmes over the course of the 1990s – a requirement of Article 116 (2a) of the Treaty on European Community (Herz and Kotios 2000, 171). Specifically, these were the three-year Medium Term Adjustment Programme (MTAP) of 1991-93; the Convergence Programme (CP) of 1993-98; the Revised Convergence Programme (RCP) of 1994-99, and the Updated Revised Convergence Programme (URCP) following that (Arghyrou 2000,158). As part of these plans, Greece committed itself to an ambitious macroeconomic stabilisation policy in order to reduce inflation, restrict budget deficits and reduce public debt (Herz and Kotios 2000, 171). Greece also fulfilled a number of EMU requirements such as joining the Exchange Rate Mechanism (ERM) in 1998 and granting independence to the Greek central bank (Herz and Kotios 2000, 171).

The pursuit of an extensive privatisation agenda by successive Greek governments was also associated with EU pressure concerning Greece's obligation to meet the five 'Maastricht criteria' in order to join EMU. Because the Greek state was obligated to lower its ratio of public debt to GDP to 60 per cent, and its budget deficit to 3 per cent of GDP – privatisation became incentivised as a strategy for meeting the conditions of joining EMU. It allowed the government to raise public revenue without having to increase tax receipts while at the same time, relieving the state budget from subsidising various expensive loans (Pagoulatos 2005, 360) as was the case with the overmanned 'problematic' OAE companies nationalised during 1970s and 1980s (Featherstone 2005, 235; Clogg 2002; Pagoulatos 2005, 360).

Greece was also expected to make reforms relating to the banking and financial sectors as part of its accession to the EC and in particular due to its participation in the Single Market project (Christodoulakis 2013; Pagoulatos 2005; Pagoulatos and Triantopoulos 2009; Featherstone 2005; Pasiouras 2012). Capital movements were liberalised and the financial sector was deregulated and strengthened through various reforms, legislature and directives associated with deepening European integration from the late 1980s onwards (Deeg 2012; Bakker 1996). As I elaborate on, since the mid 1990s, the Greek banking and financial system has operated as the engine of the national economy, developing rapidly since the 1990s as a result of the liberalisation and modernisation that took place under the Simitis reforms, and in the context of the EU Single Market programme (Pagoulatos and Triantopoulos 2009; see also Pasiouras 2012; Pagoulatos 2005, 360; Christodoulakis 2013, 94-95; OECD 1994).

As significant as these reforms were, we should not understand Greek modernisation during the 1990s and 2000s as either simply passive or reactive in relation to EU pressure. For one thing, as I implied in section one, it is quite clear that Greece resisted and failed to implement highly important aspects of the European blueprint. As Featherstone has pointed out, official reports from the EU consistently call out Greece as having the ‘worst records in terms of the infringement procedures instigated against it, in the transposition of single market legislation, and in adoption of the provisions of the Lisbon Programme of 2000 on socio-economic structural reform’ (2014, 8). Greece emphasised particular aspects of ‘Europe’ to adapt to – privatisation, deregulation and liberalization in particular - with far less success in areas such labour market reform, tax collection, and the pension system reform (Featherstone 2014, 7). The upshot of this ‘poor reform capacity’ is that many of the problematic legacies of the 1980s persisted throughout the 1990s, into the 2000s. The exceptionalism thesis is

correct to argue in this sense that the trajectory of fiscal crisis first set in motion during the 1980s, was not adequately overcome during subsequent decades. However, taking this insight on board does not necessarily require a wholesale subscription to the ‘exceptionalism thesis’, for two reasons. First, as section two has argued, many of these fiscal and public debt problems can be understood as having ‘non-exceptional’ as well as ‘exceptional’ roots. Second, as I go on to argue, recognising the persistence of fiscal problems is not enough to explain the separate emergence of the competitiveness crisis.

In addition to poor reform capacity, indirect pressures from Europe were often just as important as direct pressures, and created plenty of scope for Greek agency. For instance, although Single Market legislation does require the liberalisation of state monopolies in certain sectors, ‘it does not require a change in the ownership structure of those enterprises’ (Featherstone 2005, 232; see also Clogg 2002). Nevertheless, Greek political elites who identified themselves as pro-EU modernisers supported a vigorous privatisation agenda – one that was fraught with opposition, setbacks and reversals – including the infamous attempted privatisation of the Athens Bus Company which was renationalised by PASOK in 1994 (Pagoulatos 2003, 234). Dyson and Featherstone’s concept of a *vincolo esterno* (1996) is well known in the literature of European political science, and it can be helpful in explaining how the EU was frequently evoked as an external imperative by Simitis and other modernisers, who wished to introduce particular and often unpopular reforms.<sup>46</sup>

What is important to draw out here is that ‘adjusting to Europe’ was just as much an active vision of Greek modernisation by Greek elites, as it was a reaction to EU constraints. This is clear from much of the political discourse associated with

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<sup>46</sup> See Featherstone (2005, 232); although Featherstone, Kazamias, and Papadimitriou (2001) note that Greek reformers had limited success in their attempts at using Europe in this way.

Simitis and PASOK at the time.<sup>47</sup> Simitis clearly expressed deepening integration as a historic opportunity (Featherstone 2005, 228) for Greece to transform into a 'competitive and dynamic' European economy by claiming that:

[t]he globalisation of the economy and the development of technology create opportunities and capacities to those that are able to adjust and those who have the will and creativity to take advantage of them...They give to smaller countries like Greece the ability to participate further and more dynamically in international markets (Simitis 2000, quoted in (Antoniades 2010, 72).

In this way, privatisation, on the one hand part of the toolkit of fiscal consolidation, was on the other also expected to help induce a brand new environment of competition and efficiency for the Greek economy (Pagoulatos 2005, 361). In addition, increased access to domestic and international capital through public listing and participation in the Single Market and EMU was expected to allow Greek firms to raise funds to aid their technological investment and modernisation (Pagoulatos 2005, 361). Such incentives, together with the immanent pressure of Greek firms competing in a highly competitive open Single European Market, was expected to create positive pressures that would encourage the modernisation of the Greek private sector.

Greece's participation in the integration process was, as Simitis put it, the 'strongest lever for our exit from a reality of economic and social retardation' (quoted in Featherstone and Papadimitriou 2008, 190). Many observers, such as Jason Manolopoulos have been sceptical that Greece's meeting of the targets of nominal convergence meant that the country was genuinely modernising and reforming during this period; 'you can hit numbers without having convergence, while maintaining the different structures of the economies. You can put someone in a corset, but it doesn't necessarily make them thin' (2011, 54). The large body of literature on 'poor reform

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<sup>47</sup> See Antoniades 2010 for an important study of discourse, globalisation and the 'modernising' Greek governments during the 1990s and 2000s).

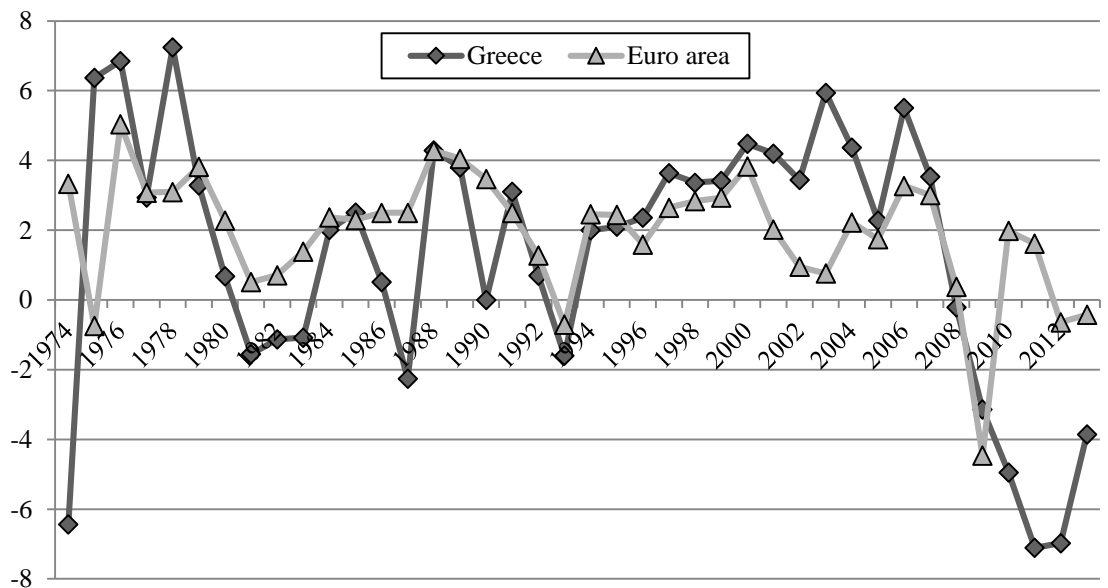
capacity’ and ‘reform fatigue’ mentioned in section one, along with the 2009 Greek crisis has seemed like a clear vindication to many of such claims. Yet, what Manolopoulos and so many others in the literature cited above overlook is that the EU ‘corset’ didn’t simply maintain the different structures. It contorted and reshaped these structures in brand new ways. In this way, Greece’s successful admission to EMU did not represent culmination of its drive for modernisation. Instead, it helped drive Greece down a path of unanticipated and historically specific divergence.

***Rethinking the origins of the Greek ‘debt-led’ model: Modernisation and European Integration***

While the legacies of the fiscal crisis persisted from the 1980s, the 1990s sowed the seeds for a parallel crisis of competitiveness. The EU/Simitis reforms of the 1990s contributed to the transformation of Greece’s economic trajectory, from the declining pre-1974 semi-industrial model to one based strongly on domestic consumer demand and import penetration. Greece’s attempts to modernise/Europeanise, at their most successful, resulted in the transformation of its economy into a consumer driven one, with negative consequences for its current account and its competitiveness. It was the growth that was achieved during this period, premised so strongly on the negotiation of EU convergence and ‘typical’ visions of European modernity that, to a large extent, made Greek ‘divergence’ possible during this period (see figure 2.3).

As I have already argued, the Greek model had been de-industrialising since the post-war period, with the share of the tradable sector declining from about 23 per cent of GDP in the late 1970s, to less than one seventh of output by 1999 (Christodoulakis 2000, 98). Yet in spite of the declining of Greece’s industrial base, there was an

unprecedented upsurge in Greek GDP (3.7 per cent on average, one of the highest rates in the EU) from the mid-1990s onwards, as figure 2.3 shows, which is in stark contrast to the growth levels recorded during the 1980s (Markantonatou 2012, 423). The reforms introduced as part of the accession process to EMU as well as the Single Market contributed to the expansion of the non-tradable sector. This was partially a result of the dramatic fall in interest rates as a result of ERM and EMU (Christodoulakos 2000, 108).



**Figure 2.3:** Annual percentage growth rate of GDP in Greece and euro-area at market prices based on constant local currency. Aggregates are based on constant 2005 U.S. dollars.

*Source:* World Bank national accounts data, and OECD National Accounts data files.

Markantonatou (2012) argues that such growth was generated by privatisation, credit liberalisation and investments in public infrastructure , ‘a rising stock market and a finance-led economy, a booming real estate market, tourism, services and shipping,

contracting-out of public services to private firms and privatizations of banks and public companies' (423) – all phenomena associated with the EU/modernisation agenda of Simitis. As the OECD put it in 1994:

Reforms undertaken since 1986 in the area of financial liberalisation have considerably changed the structure of financial markets and contributed to their fast development...[f]oreign investors directly benefitted from the liberalisation of exchange controls...[and] the attraction of foreign capital...has been identified as an important aspect of development policy (OECD 1994, 7).

Optimism due to its preparations to join the euro, coupled with newly strengthened financial and banking sectors and the expansion of the stock market due to privatisations, led to increasing inward investment into Greece during the 1990s. This, together with the declining fortunes of manufacturing and industrial sectors, resulted in economic activity shifting conclusively to domestic consumption and other non-tradable activities (Markantonatou 2012, 423). The sectors of the Greek economy that began to grow during this period contributed to the transformation of Greece into a less competitive and fragile economy. The upshot of all this being that the growth registered in Greece from the mid 1990s until the crisis became increasingly debt driven (Fouskas 2012, 35).

Based on the discussion in section one, the 'changing economic structure of Greece' that Fouskas and Dimoulas and others identify (Fouskas 2012; Fouskas and Dimoulas 2013; Fouskas and Dimoulas 2012) discuss is to be expected – the 'industrial model', such as it was, had been in decline since the 1970s, and exhaled its last gasp in the 1980s. The 1990s represent the period where the state, along with private capital, attempted to move beyond and adapt to the evident decline of the old model, leading to

the eventual, but not necessarily preconceived or ‘planned’, emergence of something new (cf. Fouskas and Dimoulas 2012, 8).<sup>48</sup>

The 1990s represented Greece more firmly supplanting the dirigisme-industrial (failed) project of modernisation that had existed in many different guises in the post-war period. The reforms of the 1990s, centred on the objectives of transforming the banking sector, reducing inflation, reducing budget deficits and public debt and restructuring the supply side of the economy (Featherstone 2003; Pagoulatos 2005; Lavdas 2005). In direct and indirect ways, this was achieved through EU facilitated privatisations, liberalisation and deregulation. These measures consolidated the changing model of the Greek economy, from the pre-1974 semi-industrial model to one based strongly on domestic consumer demand and import penetration. Declining interest rates and levels of inflation attracted significant international investment into Greece. However, with no opportunity for industrial development, and an increasing culture of ‘short-termism’ on behalf of international investors (Deeg 2012, 77), this investment tended to flow towards the non-tradable sector, rather than the tradable sector (Nicos Christodoulakis 2000, 98) which damaged Greek competitiveness and widened its current account deficit.

To sum up this second ‘turning point’ in Greece’s economic trajectory since 1974, the 1990s reveal a transformation in the Greek model – evidenced by the GDP growth that began to emerge, and the emergence of growth in brand new sectors. The project of Greek modernisation in the 1990s was driven by the imperatives of a) rectifying the economic problems of the 1980s and b) meeting the criteria for

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<sup>48</sup> Neo-Marxian approaches such as Fouskas and Dimoulas (2012) tend to understand the emergence of ‘debt-led’ growth as causing the destruction of Greece’s productive base. The narrative I present challenges this argument – Greece’s productive base was already in marked decline – debt-led growth should be seen as a response to this changing reality and not a cause of it.



completing the Single Market and joining EMU. These imperatives reshaped Greece's project of modernisation. Above all, the 1990s transformations represented Greece's attempt to *follow* the prevailing model of European modernisation – and the various targets and accession criteria set by the EU as part of the Single Market project and EMU provided a very clear blueprint for Greece to follow that model.

By the end of the 1990s Greece was thus on track to enter EMU, but in a very fragile position. In sections one and two, I noted that the 1980s had left Greece a legacy of exorbitant levels of public debt and budget deficits. While important steps were taken to mitigate this legacy during the 1990s, improvements were often temporary and insufficient (Simitis and Stournaras 2012; Featherstone 2008). In this respect, my argument so far converges – to a certain extent - with the literature on Greece's 'poor reform capacity' (Christodoulakis 2013; Featherstone and Papadimitriou 2008). What I have argued in this section is that, during the 1990s, new sources of tension emerged for Greece's political economy that were analytically separate to the fiscal dimensions of Greece's crisis. As sections one and two noted, Greece's fiscal difficulties emerged in the 1980s, and persist to the present day. However, in this section, I argued that the 1990s witnessed the emergence of new, parallel fragilities, as EU driven reforms catalysed a competitiveness crisis through creating a trajectory of debt-led growth. By the turn of the century, Greece's fiscal problems were accompanied by an embryonic crisis of competitiveness. As I now argue, Greece's political economy was not robust enough to take the strains of EMU membership, which led to important and damaging developments for its fiscal sustainability, as well as its competitiveness. This is now discussed.

## **Section Four: Greek modernisation in Crisis: the impact of European financial integration in the 2000s**

Over the course of the 1990s, Greece had already developed debt-led patterns of economic growth. Against this background, membership of EMU in 2001 led to the rapid destabilising of its newly emerging economic model, in a number of ways. First of all, the structure of the economy continued to transform, locking in patterns of non-competitive debt-led domestic demand level growth. Secondly, although public debt did not rise, at least initially, as a percentage of GDP (see figure 2.5), there is a radical shift in the structure of public debt; during the 1990s it was mostly domestically held, but from the 2000s onwards it became mostly external. Thirdly and in relation to this, Greece, along with many other eurozone member states, begins to make use of new financial technologies available for public debt management. All of these factors undermined Greece's debt-led growth, contributing the country's relative vulnerability to external shock circa 2009.

### ***EMU membership: catalysing the Greek competitiveness crisis***

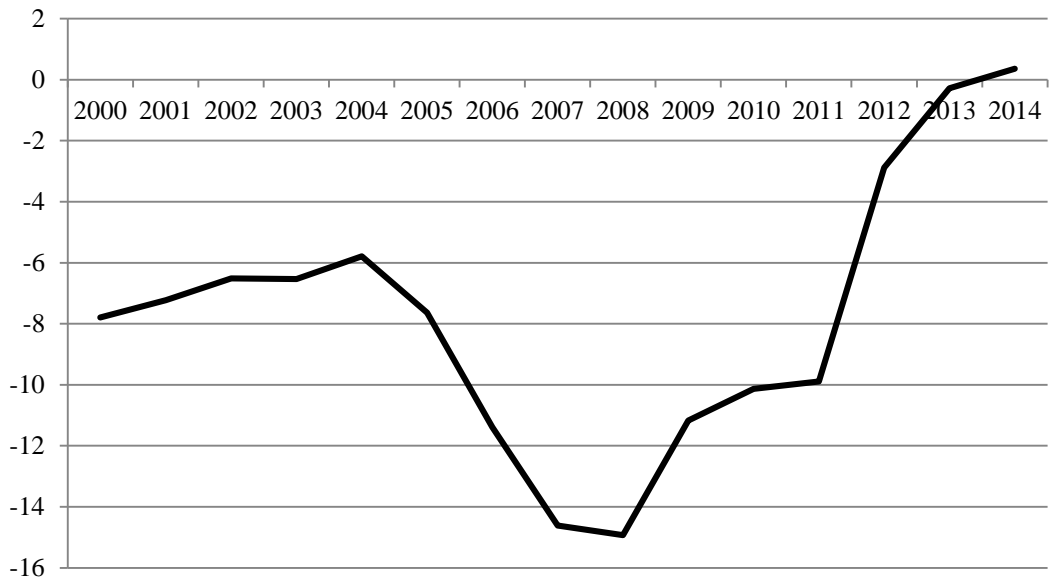
Greece's debt-led growth throughout the 1990s had already generated current account deficits and damaged economic competitiveness. But nothing approached the scale of the country's current account deficits following euro membership. Cheap borrowing costs, extensive financial integration and capital availability stirred consumer demand to an unprecedented extent (Polychroniou 2013, 3). Greece's annual average growth rate of above 3.5 per cent since joining the euro was second only to Ireland but as it grew, its current account deficit also doubled (Pagoulatos and Quaglia 2013, 188). This consumer

demand was financed by an annual average credit growth rate that Pagoulatos and Quaglia note was among the highest in the eurozone, (2013, 188-189).

EMU entailed a significant drop in interest rates for peripheral economies such as Greece. A big rise in consumer borrowing drove Greek growth as individuals began to take advantage of significantly falling interest rates. As Matthew Lynn notes, the overall indebtedness of the country rose by the equivalent of 55 per cent between 2002 and 2005 (2010, 115). However, it is worth noting, at this point, that Greece has one of the lowest levels of private and household debt in the eurozone (see Pagoulatos and Triantopoulos 2009; Pasiouras 2012). Pagoulatos and Quaglia note that although there was a surge in rates of credit growth, Greek household debt as percentage of gross disposable household income remained consistently below the eurozone average. In fact, household leverage ratios in Greece rose from 35 to 70 per cent in 2003–9, compared with the 80–90 per cent for the eurozone (Pagoulatos and Quaglia 2013, 188-198). Unlike Ireland and Spain – Greece was quite clearly *not* a banking crisis.

Nevertheless, household debt became an important force driving the Greek economy during the 2000s. As argued in section two, after the stagnation and recession of the 1970s and 1980s, from the 1990s onwards Greece was one of the fastest-growing economies in Europe. Its annual real GDP grew at a rate of 3.92 per cent from 1996-2007 (Pasiouras 2012, 15). According to various annual reports of the Bank of Greece, the high GDP growth rates between this period were ‘mainly driven by an increase in domestic demand and production capacity’ (Pasiouras 2012, 15). Such a situation was aided by the ‘deregulation of the financial system in the 1990s and the entry of Greece into the euro area’ which resulted in a ‘decline in borrowing costs, high credit expansion, a rise in consumption, and both private and public investments’, or in other words, the changing economic structures of the 1990s, catalysed by increased

availability of cheap capital following EMU (Pasiouras 2012, 15, 16). Greece's current account deficit effectively doubled during EMU membership from 7.3 percent of GDP in 2001, to 14.1 per cent in 2007 (Manolopoulos 2011; see figure 2.4).



**Figure 2.4:** Current account balance of Greece (percentage of GDP)

*Source:* IMF Balance of Payments Statistics

Yet, current account deficit expansion was not simply demand led. EMU brought with it deepening financial integration among member states, and increasing capital availability meant that there was a big demand for investment opportunities. Greece, as a debt led model with high rates of GDP, attracted over €180 billion in lending from 2000 to 2010 (Manolopoulos 2011, 168). By the 2000s, Greece was registering one of the highest average GDP growth rates, while the core of Europe was stagnating, partially as a result of the dot.com crash (see Perez 2009). Between 1995 and 2008 Greece experienced a real increase of GDP amounting to 61 percent, whereas Germany only recorded a 19.5 percent increase for the same period (Milios and Sotiropoulos 2012). Higher inflation

and low interest in countries like Greece, a situation brought about mainly by the euro, led to increased investment in the country (Milios and Sotiropoulos 2012, 8). As such, the rapidly expanding periphery represented a relatively more attractive location for investment than the stagnating core of the eurozone for much of the 2000s. Greece slotted into this broader context as an investment opportunity for European capital. As such, Greece's enormous current account deficit during the 2000s should be understood as the joint result of the country's transformation into a debt-led trajectory of growth in the 1990s, and of the dangers of participating in the financially integrated eurozone with such an economy.

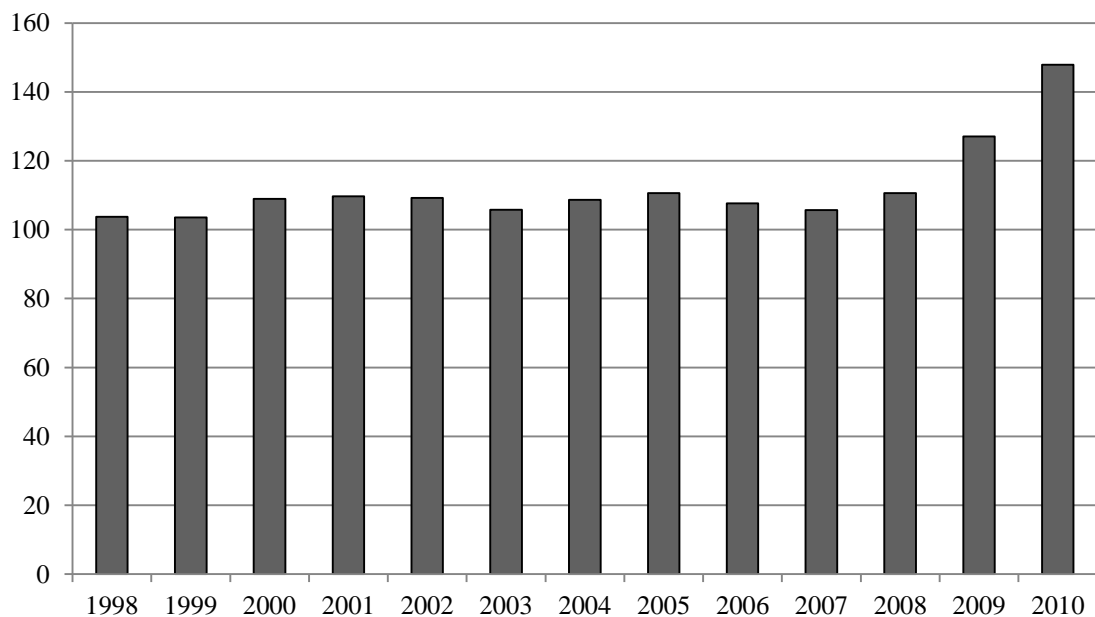
### ***The changing dynamics of Greek debt: financialisation and externalisation***

In addition to consolidating a dangerous pattern of debt-led growth, EMU membership also had consequences for Greece's fiscal stability. As should be clear by now, Greece certainly has had a long history of public finance problems. However, as Manolopoulos (2011) notes, 'the crisis would not have taken on the scale that it did without huge volumes of investment funds being ploughed into eurozone government bonds' during the 2000s '(165).<sup>49</sup> It is worth emphasising, as figure 2.5 shows, joining the euro did not result in an 'explosion of debt' for Greece – in fact, as a percentage of GDP it exhibited a slight downward trend. What did change as a result of the euro was that Greece's public debt became mostly held by external lenders. For example, in 2009, Italy only

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<sup>49</sup> Greek public debt rose from about 20 per cent of GDP in the early 1980s to almost 100 per cent of GDP in the 1990s. Yet, in 2000, public debt stabilized at around 100 per cent, and displayed a weak downward trend until 2007. Greek public debt exploded in the aftermath of the 2008 crisis. From 2008 until 2011 it rose to more than 150 per cent of GDP. In the aftermath of the 2008 crisis, the average fiscal deficit in the euro area rose from just 0.7 per cent of GDP to 6.3 per cent of GDP in 2009. Public debt also rose, from 66.2 per cent in 2007, to 88.5 per cent in 2012. Greece made significant adjustment during the 1990s and 2000s – e.g., the general government deficit declined from 7.5 per cent of GDP in 2004 to 3.6 per cent in 2006 – but the situation deteriorated again in 2007. In 2009, the deficit exploded to 13.6 per cent (these figures are all taken from Alogoskoufis 2012, 5, 17, 26–27).

had 50% of its public debt held abroad, contrary to 80% of Greece' (Pagoulatos and Quaglia 2013, 190-191). During the 1990s, the vast majority of public debt in Greece was domestic, held by the Greek banking system – most of which was state controlled (see Manolopoulos 2011, 137). Manolopoulos notes that in 1994, 85 per cent of Greek government debt was held by domestic financial institutions, and by 2007 this had been practically inverted with 75 per cent held by foreign investors (Pagoulatos and Quaglia 2013, 190-191; see Manolopoulos 2011, 137). Membership of the euro had transformed Greece as a source of risk to international bond holders – and this externalisation of debt, in addition to its high level, can be argued to be fundamental to understanding the 2009 crisis.



**Figure 2.5:** Total Greek central government debt percentage of GDP, 1998 - 2010

*Source:* OECD

The public debt conversion from domestic to foreign was accelerated into the 2000s. The euro made it much easier for Greece to push its debt servicing burden to the

future while becoming highly exposed to global debt market fluctuations' (Pagoualtos and Quaglia 2013, 190-191; see also Simitis and Stournaras 2012). Once Greece adopted the euro in 2001, it experienced a sharp reduction in interest rates. The nominal interest rate on 10-year Greek government bonds declined from 20 per cent to 3.5 percent by 2005 (Kouretas and Vlamis 2010, 391-393). Low inflation and low interest rates led to an increase in private investment and robust real growth rates of 3.9 per cent per year over the period 2001-2008 (Kouretas and Vlamis 2010, 391-393). 'Greece's adoption of the euro in 2001 provided sharply-reduced interest rates. Nominal interest rates declined from about 20% in 1994, at the time when Greece announced its intention to join the eurozone, to less than 3.5% in early 2005' (Panageotou 2011). For the Greek government itself, debt repayments had been consuming 12 percent of government revenues in 1994, but by 2006 this figure had dropped to just 4 percent of revenues (Lynn 2011, 115). Joining the euro entailed a significant change in the dynamics of Greek public debt, in that the low interest rates lowered the costs of servicing public sector debt (Kouretas and Vlamis 2010, 391-393; see also Hardiman and Dellepiane 2010, 15).

This section brings to a close this chapter's narrative of the origins of the Greek crisis. In 2010, following reports of severe recession and that the figures for Greek budget deficits were considerably higher than originally reported, credit ratings agencies downgraded Greek debt to junk status, effectively locking the country out of international financial markets. Greece, and the eurozone itself, has been in jeopardy ever since. In this section, I have demonstrated how long-standing fiscal and competitiveness issues came to a head following Greece's participation in the eurozone. This suggests two important points. First, as sections one and two demonstrated, Greece's fiscal problems have their lineages in the 1980s. They were a product of the

well documented ‘dysfunctions’ of a clientelistic state with a poor reform capacity, but also manifestations of the difficulties faced by a late-developing peripheral economy attempting to modernise and catch up with its Western neighbours. Throughout the 1990s, Greece managed to get its public spending and borrowing under control, but levels of each remained comparatively high by European standards. In the 2000s EMU membership negatively affected Greece’s high budget deficits and levels of borrowing in two ways. First of all, low interest rates and high international demand of EU sovereign bonds made Greek debt easier to service, and contributed to an expansion of borrowing. Secondly, and in relation to this, the profile of Greece’s sovereign debt became increasingly internationalised, changing the risk dynamics involved.

Second, as section three argued, Greece’s crisis was never purely fiscal. On the eve of EMU membership, Greece’s already high GDP levels were sustained by a model of growth reliant on domestic consumption and imports – signalling the poverty of Greece’s new model of ‘modernisation via Europeanisation’ that first emerged in the 1990s. In this section I argued that EMU membership helped translate this already non-competitive debt-led trajectory of economic growth into a crisis of competitiveness. International demand for investment opportunities in an increasingly financially integrated Europe led to a surge of investment into non-productive sectors in Greece, ultimately doubling its current account deficit.

## **Conclusion**

As the first eurozone member country to encounter a sovereign debt crisis, Greece has borne the brunt of the charges of the immaturity thesis – it has been understood as responsible, not only for its own difficulties, but for triggering a crisis of systemic



proportions, threatening the supposedly ‘mature’ economies who were not ‘living beyond their means’. This chapter has offered an explanation as to why Greece was relatively vulnerable to a sovereign debt crisis in 2009 in a way that challenges both the immaturity and victimisation theses that I outlined in the first chapter. The Greek immaturity or ‘exceptionalism’ thesis traces the origins of the country’s sovereign debt crisis back to 1981, when the fiscally expansionary socio-economic policies of the PASOK governments created a corrupt and clientelistic state, heavily reliant upon debt to fund an overstaffed and inefficient public sector. This debt-fuelled clientelism is understood to have persisted throughout the 1990s and 2000s, apparently immune to the efforts of the ‘modernisers’. Greece, in this analysis, is ‘exceptional’, and the 2009 crisis was ‘predictable... [and] a long time coming, one that was to expected from a country that did not quite modernize’ (Triandafyllidou, Gropas, and Kouki 2013, 1–2).

In response to this, I have provided an alternative narrative of the crisis. By locating it in the longer history of the Greek economy and in the context of critical international dynamics associated with European integration, I have sought to uncover the various ways in which ‘non-exceptional’ processes of Greek agency contributed to its fiscal, and particularly, its competitiveness crises. The modern Greek Republic has been attempting to modernise since the 1970s, and has introduced ambitious projects of modernisation in order to catch up with Europe, overcome various economic crises, and aimed to move beyond its historic economic role as an agrarian, ‘relatively backward’ economy. However, it was only during the 1990s that Greece began to follow a relatively clear blueprint of ‘European style’ modernisation – in order to ensure its participation in the EU, the Single Market and EMU. Adapting to European integration – in spite of clear instances of ‘poor reform capacity’, nevertheless dramatically transformed Greece’s economy into one characterised by domestic demand debt-led

growth. By neglecting these processes, in favour of the more readily apparent pathological features of the Greek political economy, conventional accounts do not adequately capture the limits to the capacity of Greek policymakers to transcend the parameters within which they operated, which were, as I have shown, bequeathed by, *inter alia*, a long and complex history of indebtedness and geopolitical competition. Contrary to this, I argue that Greek attempts to modernise according to the European blueprint are the key causal factor in the genesis of the political economic features which the ‘immaturity thesis’ has identified as exceptional and backward. Integration with Europe has, as I have shown, played a critical role in catalysing the crisis of 2009.

This chapter can also be read as a challenge to the victimisation thesis by emphasising the agency of Greek governments in their own evolving economic trajectory. Greece was not passively transformed by European integration or by its more powerful European neighbours. Rather, Greek governments, especially during the 1990s, actively ‘used’ Europe (Woll and Jacquot 2010) as part of their own strategies of modernisation. As this chapter argued, drawing upon the literature on Greece’s ‘poor reform capacity’, Greece emphasised particular aspects of ‘Europe’ in its modernisation strategies, and quite clearly jettisoned others. Greece’s current difficulties are certainly the product of its negotiation of a European vision of modernity, but the analysis must allow scope to account for the agency of Greek governments in how exactly this vision was negotiated.

As such, Greece’s vulnerability cannot be solely reduced to the exceptional character of its political or national culture. After all, the clientelistic model persisted through numerous and very distinct periods of significant economic transformation in Greece. As such, negotiating a European-style project of modernisation *within* a more general project of European integration can be seen as a cause of the Greek crisis;

Greece's problem was not that it did not modernise *enough*, it was that it modernised in the way that it did. As such, Greece's weaknesses cannot be solely explained with reference to its exceptional national and political traits – because just as crucial were the 'non-exceptional' patterns of Greek agency that were generative of its divergence.

Paying attention to the putatively 'mature' causes of the Greek crisis has highlighted the important role played by European integration in that country's ongoing crisis. The next chapter will turn to Portugal, to investigate the extent to which its trajectory resembles that of Greece.

## 3

## Overheating Without Accelerating: The Portuguese Recession and Crisis

Portugal has been, over the last 15 years in the paradoxical situation of displaying all the signs of overheating without enjoying any acceleration in GDP.

Deutsche Bank report, 2010.

To Portugal, acceding to the EEC means making a fundamental choice for a progressive and modern future. But let no one believe that it is a choice made for the sake of convenience. It will make heavy demands on the Portuguese, while at the same time opening up completely new prospects for development to them.

Mário Soares, 1986.

This second case study chapter traces the evolution of Portugal's economic trajectory in the decades before its crisis in order to shed light on its contemporary difficulties. I claim that the origins of the Portuguese crisis can be traced by examining the impact of its 'Europeanisation' over the course of the mid-1980s to the 1990s. As was the case with Greece in the previous chapter, Portugal's adaptation to the European project during this period resulted in the dramatic transformation of its economic trajectory. It

was as a result of Portugal's Europeanisation that the country transformed into a 'debt-led domestic demand' driven model of growth.

In April 2011, Portugal requested a bailout of €78 billion from the EU and IMF. This bailout occurred in the midst of severe instability in Europe. The eurozone had never seemed so likely to break apart as it did during late 2010 - 2011. Ireland followed Greece in officially applying for bailout funds in November 2010, causing bond yields to soar across Greece, Spain, Italy and Portugal. European leaders continued to muddle through in their responses to the Greek crisis, leading to countless debacles and escalations. Particularly destabilising were the repeated rumours regarding private sector involvement culminating in the infamous Deauville Agreement on October 18<sup>th</sup> of 2010, sending financial markets into repeated panics in the months to come.<sup>50</sup> The 'PIIGS' acronym, referring to Portugal, Ireland, Italy, Greece and Spain, had come to be widely used by international media, capturing an apparent shared economic vulnerability across the European periphery, and contributing – in a kind of self fulfilling prophecy – to market anxiety (Brazys and Hardiman 2013, 8-10). Fears of exit, sovereign default, banking insolvency and break-up propelled Europe from one emergency summit to another.

It was within this broader tumultuous context that the Portuguese bailout occurred. Following the Greek crisis, successive Portuguese governments had introduced numerous austerity programmes to reduce the countries budget deficit and public borrowing and also to send positive signals to the international community. But such measures were unable to alleviate the entrenched international nervousness of the

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<sup>50</sup> This was a surprise agreement between Angela Merkel and Nicolas Sarkozy which stated that in future, sovereign bailouts would require that losses be imposed on private creditors. This agreement was blamed for widening sovereign spreads in late 2010 and early 2011. The proposal was subsequently watered down and effectively abandoned (Mody 2014).

time (Fishman 2011; Mody 2014; Brazys and Hardiman 2013). By 2010, risk premiums on Portuguese bonds hit record highs as credit ratings agencies downgraded the country's sovereign bond rating and Portugal had little choice but to seek help.

For many, the Portuguese crisis is a simple case of contagion (Fishman 2011; Arghyrou and Kontonikas 2012; Kalbaska and Gątkowski 2012), while for others, the country's 'chronic fiscal misbehaviour' and long standing productivity problems (Pereira and Wemans 2012; Royo 2012; Soares 2012; Royo 2013; OECD 2013; Blanchard 2007) echo the Greek crisis. Yet for many others, the Portuguese crisis is more complex (Blanchard 2007; Rodrigues and Reis 2012; Krugman 2011; Serra 2014; Reis 2013). On the eve of its bailout, Paul Krugman suggested that the 'difficult' Portuguese macro story is harder to tell than those of Greece, Spain and Ireland:

Greece was excessive government borrowing; Ireland and Spain, housing bubbles. Portugal, by contrast, wasn't all that bad fiscally — debt/GDP on the eve of the crisis roughly comparable to Germany. But it also didn't have surging house prices. There was a lot of private-sector borrowing, but it's not that easy to explain exactly why (Krugman 2011).

More puzzling still, while Greece and Ireland were booming post-euro membership, Portugal was in the midst of a decade long recession. As a 2010 Deutsche Bank report (quoted in the epigraph to this chapter) put it, Portugal exhibited all of the signs of overheating, but without the growth. It quickly becomes clear that we are dealing with a very different crisis to that afflicting Greece. Portugal is not just out of sync with core Europe; it is out of sync with the rest of the periphery (Lourtie 2011, 5).

I examine this 'difficult story' over three chronological sections. In section one I argue that, much like Greece, the story of Portugal's difficulties begins with a democratic revolution in 1974. After a period of tremendous economic and political volatility, the centre right modernising Social Democratic Party (PSD) governments of

the 1980s and 1990s looked towards European Integration for stability and as a strategic framework for the country's modernisation (Serra 2014, 42). I discuss how the nascent Portuguese democracy sought to sublimate the conflictive experience of the revolution (Maxwell 1995) by introducing a number of 'structural reforms', which were made, and legitimised with specific reference to joining the European Community by 1986.

Section two explores the consequences of these reforms during the 1990s. Portugal went through a remarkable improvement in its economic conditions during this period, registering some of the highest rates of growth in Europe. The country was even held up by the European Community institutions as a model for Central and Eastern European (CEEC) candidate countries, due to the apparent success achieved during the 1990s (Soares 2012, 121). This growth occurred as Portugal incorporated the *acquis communautaire* into its domestic law, opened its frontiers to the Single Market, and completed the process of nominal convergence, successfully participating in the euro in 1999 (Soares 2012, 121). Yet, this growth was also indicative of the transformation of the Portuguese economy into one driven by 'debt led domestic demand' growth (Lagoa et al. 2014). In other words, the 'Europeanisation' of Portugal's economic trajectory during the 1990s catalysed a divergent and fragile trajectory of growth.

Section three discusses how these new patterns of growth were to cause considerable difficulties in the 2000s. Rising levels of private indebtedness together with declining export competitiveness contributed to a severe recession at the turn of the century. This recession has typically been understood as an outcome of chronic fiscal misbehaviour and unwillingness by the state to encourage productivity. On the contrary, I argue that the recession is a direct legacy of the form of economic growth that emerged in the 1990s. This was the context that led to Portugal being viewed as a weak link after 2010.

Accordingly, echoing Greece, the story of Portugal's economic transformation since 1974 is one of it largely following the rules of European Integration. Portugal's participation in the European project led to the emergence of a new, precarious, model of growth. Even though there are many respects in which Portugal's trajectory was very different to that of Greece, I show that the important turning points occurred as Portugal began to view adapting to Europe as a strategy of modernisation.

### **Section One: Revolution and structural reform - Portugal 1974-1990s**

The contemporary Portuguese economy emerged in the 1980s and 1990s during a period of revolutionary turbulence. On the 25<sup>th</sup> April 1974, the 'Carnation Revolution' overthrew the forty year old dictatorship of Olivier Salazar's *Estado Novo*.<sup>51</sup> The revolution began as a bloodless military coup but quickly turned into a full-scale revolution, leading to years of political uncertainty and revolutionary change. In this section I illuminate the ways in which successive Portuguese governments set about moving beyond the instability of the revolutionary period and towards European integration via the introduction of a number of 'structural reforms'.<sup>52</sup> I trace the ways in which the contentious politics of the revolutionary years set the scene for Portugal's embrace of European integration in the 1980s. I then briefly discuss the structural reforms which were introduced during the 1980s and 1990s, with a focus on privatisation, deregulation and liberalisation. These agendas were very much in line with the EU's Single Market programme as well as preparations for the euro. The

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<sup>51</sup> Although Salazar had resigned in August 1968 due to health problems, and it was his successor Marcelo Caetano who was to be the last Prime Minister of the Estado Nova regime.

<sup>52</sup> The 'structural reforms' refer to the reforms introduced by the centre-right Social Democratic Party (PSD) from the mid-1980s onwards. I discuss these reforms in detail later in this section. They aimed to dismantle the more socialist elements of Portuguese state following the revolution. But they also were defined positively in relation to Portugal's adaptation to European integration.



structural reforms took Portugal on a path which aspired towards European style modernity, but as I argue in sections two and three, actually began the process of Portugal's development into a debt-led, non-competitive peripheral economy.

***Revolutionary instability: Portugal in the 1970s***

The revolutionary period (typically understood as from 1974-1979, see Morrison 1981) was characterised by 'political turmoil, social upheaval and military factionalism' (Maxwell 1995), 157). Tensions between socialists, communists, peasants and the Military were deeply destabilising. Conflicts over the militarization of the politics, and between the Socialists (PS) and Communists (PCP), as well as between the landowning classes of north and central Portugal and the PCP were particularly destabilising throughout the 1970s and 1980s (Morrison 1981, 19, 20; Maxwell 1995, 135–137). The institutional structure that was emerging during this time leaned towards the radical left, and included such policies as the constitutionally 'irreversible' nationalisations of banking and industry (Macedo 1990, 311). Yet, institutional construction during this period was a highly fluid, highly unstable process, and the socialist vision ultimately failed to take root. The authority of the state during the revolutionary period was frequently in question, with successive short lived and unstable governments 'barely having enough time to introduce their programs and nominate their ministers' (Maxwell 1995, 163; 170). Manuel Braga Da Cruz (1998) describes the fragile political settlement in the years immediately following the revolution:

'In party political terms, ...[a] conflict was waged between the forces that defended an electoral legitimacy and those that affirmed a revolutionary legitimacy. This period was also marked by strong governmental and party instability, which favoured high levels of presidential interventionism in governments established by presidential initiative. The period also witnessed a

confrontation between a presidential majority and a governmental majority' (113).

This political crisis was to be punctuated by severe economic instability. By the spring of 1975, an economic crisis emerged that had so far been postponed by the \$2.8 billion of gold and foreign-currency reserves left behind by the Salazar dictatorship (Maxwell 1995, 139). Governments since 1974 had pursued large scale borrowing, nationalisations and expansionary fiscal policies aimed at redistribution. These policies quickly dried up the *Estado Nova* reserves by as early as 1975. As a consequence, Portugal had accumulated massive debts, balance of payments deficits, and inflation was out of control (Macedo 1990, 324). This economic crisis was to prove decisive for the institutional fate of the Third Portuguese Republic. Socialist governments led by Mário Soares were pressured into imposing austerity - measures which were likely to result in increasing unemployment, and which the Communists labelled a 'capitalist offensive' (Morrison 1981, 60-61). As a result of the gravity of the economic problems during these years, Portugal faced pressure to apply for a loan from a consortium of industrialised western economies. In 1977, the European council of ministers agreed that the consortium would lend Portugal \$750 million, with the catch that Portugal would also need to qualify for a \$50 million standby credit line from the IMF, which came with strict conditions (Morrison 1981, 75). As Morrison argues, the consequences of this first IMF loan were significant.<sup>53</sup> The Socialists had accepted a highly unpopular agreement that would force Portugal to reduce its rate of growth and increase its rate of unemployment. Imports would cost more, and there would be higher taxes and prices on domestic consumption (Morrison 1981, 77-78). The Socialists identification with this

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<sup>53</sup> A second IMF bailout agreement was made in 1983.

agenda of 'revolutionary austerity' ultimately undermined their political base and led to their dismissal by the electorate in the late 1970s (Maxwell 1995, 164).

Accordingly, an opportunity arose for the centre right to reshape the constitutional settlement and remove the Marxist overtones of the revolutionary period (Maxwell 1996, 166). From the 1980s onwards, Social Democratic Party (PSD) governments began to introduce a new institutional infrastructure which was to be defined against the turmoil of the 1970s, and made possible through deepening European integration. In these years, the more radical elements of the 1974 revolutionary state were dismantled. Although the Socialists continued to be an important political party, their more radical leftist tendencies were to become subsumed within the emerging institutional structure of an alternative vision for Portugal (see Stoleroff 1992).

The real turning point came in 1985 when, under the leadership of Aníbal Cavaco Silva, a new minority government of the PSD was formed with the support of the newly created PRD (Democratic Renewal Party). The economic situation began to improve shortly afterwards, bolstered by pre-accession EC aid (Magone 1997, 32). Accession to the EC in 1986 rapidly restored international confidence in the Portuguese market. Cavaco Silva and the PSD consolidated this popularity with a programme for economic and political stability in 1987, when they formed the Third Republic's first majority government (Magone 1997, 32, 33). This government saw Portugal into the EC, and the accession coincided with the adoption of the Single European Act and progress towards the Single Market (Magone 1997, 34). It was these governments that implemented the structural reforms which were to characterise the Portuguese new economic trajectory in the following decades.

The popularity and success of the PSD structural reforms was helped by the fact that they appeared to be working well. By 1986, all indications suggested that Portugal was on the road to recovery. Rising GDP, increasing domestic demand, falling unemployment and a positive balance of payments all served as evidence of the apparent success of the PSD's policies. Collective bargaining agreements were also introduced during this period which managed to secure popular pay rise agreements, and eventually, certain stability in industrial relations (Stoleroff 1992, 122). In this context, the 'expedient' - as opposed to revolutionary - political solution of the PSD proved highly attractive, and 'the PSD, as the incumbent minority government since 1985, was able to reap the profits of the positive economic situation of 1986, the latent optimism associated with joining the EC as well as the fatigue accumulated during two years of austerity and perceived political instability' (Stoleroff 1992, 124).<sup>54</sup>

### *The 'European option' and structural reforms*

Democratic consolidation and moving beyond the turbulence of the revolutionary period may certainly have acted as a motivation for an alternative vision of Portuguese modernity. But it was also defined positively in relation to Europe. Corkill (1999, 64-70) noted that from the 1980s onwards 'it is clear that the motivating force behind...policy shifts was the accession to the European community'. EC membership was expected to promote the modernisation and economic development of the country by introducing structural reforms which would modernise and improve the

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<sup>54</sup> It is important to note that the implementation of structural reforms was not without (significant) conflict. For example, in 1986 alone, 'the Ministry of Employment and Social Security (MESS) registered a total of 363 strikes, involving 231,535 workers and 381,917 working days lost (see Stoleroff 1992, 138).

competitiveness of the economy (Corkill 1999).<sup>55</sup> Since the revolution, there has been a wide consensus among Portuguese political parties regarding European integration (Teixeira 2012, 13).<sup>56</sup> In 1992 Portugal held the presidency of the EU and during this time deepening European integration was defined as a ‘new national goal’. This goal was strongly motivated by a view of the integration process as ‘the only way to keep a peripheral country at the heart of the EU’s decision making process’ (Teixeira 2012, 18, 19).<sup>57</sup> As a strategy, Portugal swiftly adopted legislative changes that were outlined in various EU treaties, earning the country the nickname of the ‘good student’ of European integration (Teixeira 2012, 18-19).<sup>58</sup>

Crucially, Portugal’s accession to the EC took place at precisely the moment the European project was undergoing its ‘re-launch’ with the Single European Act (SEA) (Teixeira 2012, 25). As such, Portugal’s experience of European integration involved adaptation to a very specific blueprint for modernisation from the very beginning. This was to lead to a decade and a half of accelerated modernisation which was to have a clear transformative impact on the structure of its economy (Teixeira 2012, 25). Through the introduction of various EC/EU reforms after 1986, Portugal’s economy set out on ‘a process of structural reformulation, with the goal of achieving macroeconomic stability and increased competitiveness which became one of the key consequences of

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<sup>55</sup> Some authors have noted that deepening European integration may also have represented a solution to a peculiarly Portuguese identity crisis. As Magone (2004) put it, the ‘traumatic loss the huge colonial empire with feet of clay and the misfortunate decolonization process...’ played a role as an ‘important escapist route for democratic political elites’ (Magone 2004, 16-17).

<sup>56</sup> Illustrated by the slogan of the Socialist Party – ‘Europe is with us’ (Seabra 2003, 355).

<sup>57</sup> Although Seabra (2003, 355) notes that during the 1980s, Portuguese governments had a low-profile pro-European policy, due to deep concerns over the impact of integration for the country. Nevertheless, all major parties, save for the PCP, were pro-European, and in spite of concerns, adapting to the post-SEA European project was an expedient and pragmatic choice for PSD governments.

<sup>58</sup> However, for Coppolaro and Lains (2013) EEC/EU membership for Portugal did not represent a breaking point, but simply a continuation of an economic policy that had already been pursued since 1947 (79). While they draw attention to the important to the long-term historical lineages of Portugal’s integration with Europe, they underestimate the significance and transformative effects of deepening integration since 1986.

accession’ (Teixeira 2012, 25). The most important reforms during this process were introduced by the PSD and related to privatisation, deregulation and liberalisation (as is discussed in more detail in section two). Privatisation transformed the domestic economy by reversing the extensive nationalisations of the revolutionary period. An intense cycle of privatisation from 1993 - 2003 averaged at about 23 per cent of GDP (at 2000 prices) (Rodrigues and Reis 2012, 196-197). Liberalisation and deregulation of banking and finance had particularly important effects. As (Leão, et al. 2013) note, the development of the Portuguese financial system occurred relatively late when compared with the other EU countries, mainly due to the nationalisation of the banking system in the aftermath of revolution (2013, 6). In order to join the EC, the Single Market and later EMU, Portugal was required to begin the gradual dismantling of constraints on its financial system during this period, ‘particularly regarding State ownership of banks and insurance companies’ (Leão, et al. 2013), 6). By the end of the 1980s, a new set of liberalising measures were adopted. These included the progressive elimination of administrative limits to interest rates, to credit growth and to the number and location of banks’ branches in the country, amongst many other measures (Leao, Barradas, Mamede, Lagoa 2013, 6). The response of the re-privatized financial sector has been ‘very vigorous’ as Patrick Honohan has argued:

The past decade has seen this regulated regime almost entirely replaced by one which approximates that in most other EU member states in respect to openness and deregulation, and where the state’s ownership share declined rapidly from more than 90 per cent to around one-quarter by 1997 (1999, 28).

As I elaborate on in the following section, these structural reforms were to have dramatic consequences for the Portuguese economy.

During the 1980s and 1990s Portugal began to experience economic recovery and even growth, and this change in fortunes was to be closely associated with the structural reforms of the PSD and with European integration (Stoleroff 1992, 137). In this section I have highlighted how the introduction of these structural reforms in the 1980s and 1990s were defined in a positive and a negative sense. They were negatively defined against the political and economic volatility of the revolutionary period, and overcoming this turbulence was a strong motivation for their introduction. They were defined positively in relation to European integration. This positive aspect is particularly important because it provided a clear blueprint for reform and modernisation for the country, as I now discuss.

## **Section Two: Structural reform and ‘debt-led’ growth: Portugal 1990-2000**

By the mid 1990s, a mere twenty years after the revolution, Portugal had consolidated a socio-economic vision for the country that could claim legitimacy, which was no mean feat considering the relatively recent turbulence of the late 1970s. Political and economic instabilities no longer constituted existential threats. In fact, the economy was actually growing, leading to a short but substantial boom in the 1990s. However, as I argue in this section, this economic growth was unstable as it represented the growing importance of new economic sectors in Portugal, mainly the financial and non-tradable sectors.

I explore two important aspects of the evolving Portuguese economic trajectory during the 1990s in this section. First, as a result of EU reforms relating to banking and finance, private indebtedness rose dramatically during the 1990s, paving the way for a

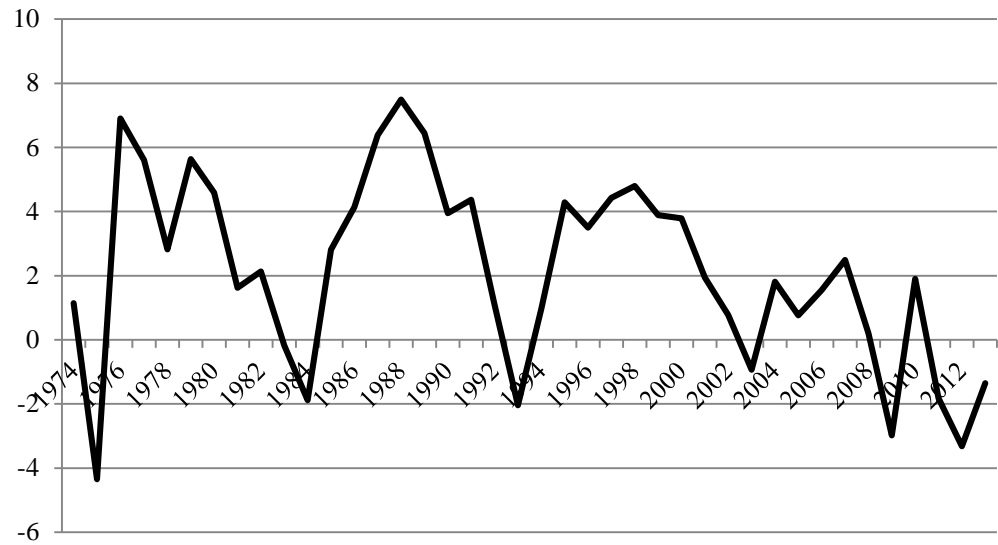
recession in the early 2000s. Second, investment was redirected to the domestic, non-tradable sector of Portugal, damaging the country's competitiveness and generating a pattern of growth for the country that had not existed before.

***Structural reforms and the growth of private indebtedness***

As I suggested in the first section, Portugal's experience of European Integration involved adaptation to a very specific blueprint for modernisation from the outset. This was to lead to a decade of accelerated modernisation which was to have a clear transformative impact on the structure of its economy (Teixeira 2012, 25). The re-launched project of European Integration was to present enormous challenges and opportunities to Portugal as it prepared to participate in the Single Market and Economic and Monetary Union (Serra 2014, 42).

Between 1986 and 2000 the Portuguese economy experienced the third fastest growth rate among the EU15 countries, falling behind only Ireland and Luxemburg, with GDP increasing at an average annual rate of 4.1% (Lagoa et al. 2014, 6; IMF 2002). Unemployment fell to a record low of 4 percent in 2000, and inflation was brought down to just over 2 percent in 1999 (Royo 2012, 187; Cardoso 2005).





**Figure 3.1:** Percentage GDP Growth: Portugal

*Source:* World Bank - World Development Indicators

As Lagoa et al. (2014; see also Lourtie 2011; Orsi 2010; Leão, et al. 2013) and some critical political economists (Rodrigues and Reis 2012; Lapavitsas et al. 2012) have noted, Portugal achieved these impressive growth rates through ‘debt-led domestic demand growth’. Although I agree that the ‘debt-led domestic demand growth’ label is appropriate, I do not posit the origins of debt-led growth as stemming from Portugal’s ‘insertion’ into a pattern of dependency characterised by ‘core-periphery’ dynamics (Lapavitsas et al. 2012) or as an unequal partner in the strategy of a powerful transnational and influential ‘neoliberal thought collective’ (Rodrigues and Reis 2013, 190). Rather, as I outlined in the previous section, Portuguese governments actively introduced various EC/EU reforms for a number of reasons, not least of which were the sublimation of the conflictive experience of the revolutionary period, and the desire to catch up with Western Europe (Maxwell 1995). In other words, Portugal’s active

attempt to become European and modern as a result of ‘adjusting to Europe’ suggests that Portugal set its own transformation in motion – although it was following a plan that was established with ‘core-Europe’ in mind. The key claim is that Portugal became a debt led model through the active negotiation of European integration, or as Mário Soares put it, as part of its attempt to narrow ‘the gap which still separates us from the more developed European countries, by creating for the Portuguese people genuinely European patterns of life and welfare’ (Soares 2012). Yet, much like Greece, Portugal’s economic growth during the 1990s was not driven by export competitiveness or by the type of modernisation that was hoped for.

One of the most important factors that contributed to this performance were the ‘structural reforms’ that I discussed in section one, and in particular, the transformation of the financial sector (Royo 2012, 187; Cardoso 2005, 2). A 1998 IMF report noted that the Portuguese banking system of the late 1990s:

differed profoundly from that of yesteryear: a system tightly controlled by the state between the mid-1970s and the end of the last decade has, after wide-ranging reforms associated with Portugal’s accession to the European Union (EU) in 1986, given place to a fully liberalized and modern system (Decressin and Mauro 1998)

These structural reforms were in turn driven by Portugal’s adaptation to European integration. The Portuguese banking sector was rejuvenated as a result of various EU reforms relating to banking and finance, and the restructuring of the financial sector produced a ‘very competitive and innovative market highly suitable for absorbing the rapid increase in credit demand and for sustaining its dynamism’ (European Commission Directorate-General for Economic and Financial Affairs 2004, 11; Banco de Portugal 2009, xxi). In anticipation of joining the Single Market and EMU, reforms

took place in terms of liberalisation of regulatory frameworks, privatisation and the freeing of international capital movements (Decressin and Mauro 1998, 5; Leao et al. 2013, 6). These reforms represented a dramatic turning point. As I discussed in section one, following the revolution, the Portuguese banking system was characterised by pervasive public intervention and control. All interest rates were fixed and subsidised rates existed for eligible projects in agriculture, housing and exports. From 1983 onwards, key reforms were implemented that reversed this; and the banking system was opened to private, foreign and domestic entry and authorised commercial banks to engage in medium-term operations (e.g. housing credit), blurring a previous distinction between commercial and investment banks. Following EC accession, there was a wide-ranging overhaul of the financial system (see Decressin and Mauro 1998, 7 for a detailed summary of these measures), propelled by various EU banking directives and other measures. The upshot of many of these reforms was the raising of banks' opportunities to take on more risk, to provide new products, and to access new sources of financing. Interest rates were deregulated, credit ceilings were abolished and open-market operations. All restrictions in consumer credit were abolished in 1995 (albeit this was comparatively late) following the completion of the Single Market. Privatisations also played an important role in this changing landscape (see Decressin and Mauro 1998, 10 for a list of selloffs). By the 1990s, as a result of adhering to the requirements from the EC/EU, the financial system in Portugal had completely transformed (Honahan 1999: 3).<sup>59</sup>

These reforms ensured that the profile of economic growth had a powerful engine for change in the country's fledgling financial sector (Royo 2012, 187). By 1996, it was clear that Portugal was successfully fulfilling the nominal convergence

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<sup>59</sup> The discussion of this paragraph draws on the detailed account of Decressin and Mauro (1998, see pages 5-10 especially).

criteria and that it would likely join the euro straight away, in 1999. The prospect of joining the eurozone had a dramatic impact on the expectations of households and enterprises (see European Commission Directorate-General for Economic and Financial Affairs 2004, 11; Cardoso 2005, 2). According to research by the European Commission, more than anywhere else in the EU, there was a marked increase in consumer confidence and share price indicators in Portugal around 2007 (European Commission Directorate General for Economic and Financial Affairs 2004, 11). Rising incomes and employment bolstered this momentum, with unemployment rates declining to 4 per cent in 2000 (Cardoso 2005, 2).

Credit fuelled consumer spending became a significant driver of economic growth during the 1990s (see table 3.1). Over the 1990s, household savings decreased and household indebtedness tripled to just over 120 per cent of disposable income between 1994 and 2004, which as Cardoso (2005) notes was well above the euro area average of 80 per cent (2). Lagoa et al. note, that private consumption was responsible for 70 per cent of GDP growth in the period, gross fixed capital formation (GFCG) for 36 per cent, and public consumption for 21 per cent (2014, 7). Portugal experienced a surge of investment during the 1990s and this would not have been possible without the wide availability of credit made possible by deepening European integration (Lagoa et al. 2014, 9), and the concomitant liberalisation and deregulation of the banking sector during this period. Credit expansion was dramatic during the 1990s, and as Lourtie notes, a consequence of this was that '[n]on-tradable, uncompetitive rent seeking sectors surged, diverting investment from tradable sectors and thus contributing to low productivity growth' (Lourtie 2011, 5).

1995-2000				
GDP Growth	Contribution of:			
	Private Consumption	Public Consumption	Gross Fixed Capital Formation	Net Exports
3.6%	2.4%	0.7%	1.8%	-0.9%

**Table 3.1:** GDP growth and contributions of the main demand components in 1995-2000 (annual average, at 2005 prices)

*Source:* reproduced from Lagoa et al. (2014, 9).

Furthermore, the effective absence of exchange risk as part of deepening European monetary integration, leading up to and including EMU, meant that Portuguese banks had access to European inter-banking markets and could issue euro bonds<sup>60</sup>, resulting in a greater supply of cheap credit to sustain the demand of Portuguese consumers (European Commission Directorate-General for Economic and Financial Affairs 2004). Interest rates plummeted as Portugal prepared to join the euro, and this together with improved perceptions of future income levels contributed to demand for credit by Portuguese consumers (Lagoa et al. 2014, 9; Lourtie 2011, 5). Nominal interest rates dropped from 16 percent in 1992 to 4 percent in 2001, and over the same period, real interest rates dropped from 6 percent towards roughly 0 per cent. This, along with positive expectations regarding Portugal's growth after joining the euro, led to increased confidence and growth in consumption and investment (Blanchard 2007, 3).

<sup>60</sup> 'Euro bond' in this context, refers to European sovereign and other bond markets, and should not be confused with contemporary debates around the issuing of 'eurobonds'.

Additionally, in order to meet the Maastricht criteria, Portugal engaged in an intense cycle of privatisation between 1993-2003, averaging at about 23 percent of GDP at 2000 prices (Rodrigues and Reis 2012, 196). As Rodrigues and Reis put it, these privatisations ‘reconstructed corporate groups which had been enfeebled by the nationalization process following...1974’ (ibid, 196). Privatisation and financial liberalisation promoted the ‘emergence of Portuguese private banks and assur[ed], also through a very favourable system of taxation, the enormous expansion of their activity (ibid 197).

All of this meant that household spending and household indebtedness rose dramatically during the 1990s. A 2004 European Commission report noted that the indebtedness of the household sector and non-financial sector more than doubled between 1995 and 2002 (European Commission Directorate General for Economic and Financial Affairs 2004, 12; Banco de Portugal 2009, xxi). Lagoa et al. similarly note that outstanding loans to the above sectors increased from 50% to 93% of GDP, and that almost three fifths of this growth was directed at households, three quarters of which were mortgage loans (Lagoa et al. 2014, 10). As I discuss further in section three, the upshot is that Portugal experienced a relatively early pattern of indebtedness during the 1990s and the reverse experience during the 2000s. Lagoa et al. note the peculiar timing of Portuguese private indebtedness:

[W]hile in other countries the levels of indebtedness grew slowly until the turn of the century, accelerating only after 2000, in the Portuguese case the reverse happened – private sector debt in percentage of GDP grew most rapidly in the second half of the 1990s, growing slowly thereafter (Lagoa et al. 2014, 11).

The evolution in real rates of credit growth in Portugal during the 1990s was remarkable. It accelerated from close to 0% in 1990 to above 25% in 1998, before, as I

discuss in section three, decelerating sharply in the 2000s. The result of this dramatic growth in credit was that by 2002, household debt approached 71 per cent of GDP in 2002 – up from just 15 per cent in 1990 (European Commission Directorate General for Economic and Financial Affairs 2004, 57; see also Lagoa et al. 2014, 17). Lagoa et al. note how by 2000, this resulted in the gross debt-to-income ratio of Portuguese households reaching 84 per cent – above the euro area average of 75 per cent, and clearly above the average of countries such as Spain (69 per cent) or Italy (34 per cent) (Lagoa et al. 2014, 17).

Credit fuelled consumer spending drove the Portuguese economy during the 1990s. The favourable conditions associated with the prospect of joining the euro encouraged households to increase their borrowing at such high rates – namely disinflation, lower nominal and real interest rates, and rapidly rising income levels (European Commission Directorate-General for Economic and Financial Affairs 2004, 57). Similarly, the structural reforms relating to the banking sector ensured that there was a wide supply of credit to meet consumer demand, and the liberalisation of the credit market helped foster a strongly competitive environment where banks were eager to meet the growing borrowing demands (European Commission Directorate-General for Economic and Financial Affairs 2004, 58). Decressin and Mauro (1998) note how European integration (through deregulation and privatisation) significantly raised competition in the 1990s, triggering a large drop in financial margins for banks. The upshot of an accelerated consolidation process was the emergence of five major banking groups accounting for 80 per cent of market share. To compensate for declining financial margins, these banks ramped up, *inter alia*, housing and consumer lending as sources of new income (Decressin and Mauro 1998, 5). As such, in these different ways, the EU/PSD reforms are strongly implicated in the transformation of Portugal

into a ‘debt-led domestic demand’ model of economic growth during the 1990s (Lagoa et al. 2014, 16).

### ***The expansion of the non-tradable sector***

In addition to increasing indebtedness, this trajectory of credit-fuelled economic growth contributed to the expansion of particular sectors of the Portuguese economy. The incentives provided by the structural reforms geared investment and capital inflows to the newly profitable non-tradable sectors, including construction, retail and privatised utilities, which were less exposed to foreign competition (Rodrigues and Reis 2012, 197). These sectors were in turn financed through the pivotal role of the newly invigorated, liberalised and privatised banking sector. As Leão, et al. (2013, 12) note, the financial sector itself began to grow as a result of this capital inflow.

David Corkill writes how Portugal became gripped by ‘construction fever’ during the 1990s as a result of credit being directed to the sector (1999, 44-46).<sup>61</sup> Lower interest rates and greater supply of credit created a situation where the construction industry was growing at four times the rate of the economy as a whole (Corkill 1999, 43). A 2012 IMF report notes how a liberalised financial sector combined with increased bank competition to direct a surge in capital flows into the non-tradable sector which contributed to growing macroeconomic imbalances (IMF 2013, 8). The Portuguese economy, following EU membership, tended to favour domestic demand over exports – especially in sectors such as construction, real estate, and wholesale/retail trade – all sectors where, as the IMF notes, productivity was lagging (IMF 2013, 8).

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<sup>61</sup> Although it should be noted that this property boom was relatively modest when compared to other countries, and is not comparable to the scale of property booms in Ireland and Spain over the 2000s. In fact, between 1995 and 2001, supply of property was very much in line with demand, and real estate process accelerated by a modest annual average of 1.6 per cent (Cadoso 2005, 4).



As I discuss in more detail in section three, the poor performance of the manufacturing sector in Portugal, concentrated mainly in ‘traditional sectors’ such as clothing, textiles and footwear, also contributed to the emergence of the debt-led model in the 1990s. Leão, et al. (2013, 18) argue that in the period from 1993-2007, it is clear that the newly liberalised and privatised banking system has given far more credit to construction, real estate and other non-tradable activities than to manufacturing, and that this difficulty for the latter in obtaining credit is partially due to the reality that banks assess manufacturing as a higher risk sector, ‘exposed to competitive pressures from abroad’ (see table 3, below) (Decressin and Mauro 1998). During the 1990s, but especially during the 2000s, there was clear competitive pressure from abroad which threatened the Portuguese manufacturing-for-export sector. Because this sector suffered from low productivity and due to (warranted, as it turned out) fears about its future growth prospects, economic activity during the 1990s and 2000s redirected towards the non-tradable sector.

Over the course of the 1990s, the Portuguese economy transformed significantly into an economy driven by domestic consumption, seeing the growth of the financial and non-tradable sectors, and the expansion of their activity. It was the EU/PSD reforms which created the conditions for a new type of economic growth. As such, similarly to Greece, Portugal’s participation in the project of European integration since the 1980s set in motion a new form of economic growth. This new model of economic growth emerged directly as a result of Portugal’s adjustment to the Single Market and its preparations for the euro. Yet, as I show in the next section, unlike Greece, Portugal’s similar model of debt led growth was to head in a very different direction over the 2000s.

### **Section Three: Recession and crisis – Portugal in the 2000s**

The fortunes of the Portuguese economy turned in the early 2000s when the country entered a prolonged recession. In this section I discuss the link between the debt-led model of growth that emerged during the 1990s, and the sovereign debt crisis of 2011 by discussing the causes and consequences of the 2000s recession. I first briefly introduce the dominant understanding of the Portuguese recession and subsequent crisis, which focuses on Portugal's failure to improve its own productivity and get its public finances in order. I then challenge this narrative by arguing that the causes of the Portuguese recession are better understood as stemming from the unintended consequences of the 1990s nominal convergence process combined with problems stemming from its membership of the eurozone. I also discuss Portugal's declining export competitiveness during the 2000s, arguing that it contributed to the downturn. I re-interpret the 2000s recession as having been caused by the transformations generated by the EU/PSD structural reforms in the 1980s and 1990s. Accordingly, Portugal's current difficulties are the product of the emergence of patterns of debt-led economic growth during the 1980s and 1990s.

#### ***Obstacles to productivity: Portugal and the immaturity thesis***

From 1998 onwards, the performance of the Portuguese economy began to deteriorate. Inflation began to rise and the trade deficit began to widen, from 5.4 per cent of GDP in 1997 to 6.6 per cent in 1999 (Royo 2012, 189). In stark contrast to the impressive and above average growth rates of the 1990s, between 2000 and 2013 economic growth stagnated to an average rate of 0.1% of GDP, the second lowest in the entire EU (only Italy was lower) (Lagoa et al. 2014, 6) (see figure 3.1). The causes of the 2000s

recession are crucial to understanding the difficulties that Portugal found itself in on the eve of its troika bailout. It was during this period that rising public and private indebtedness coincided with dramatically low prospects of GDP growth. All of these factors led to falling investor confidence in Portugal after the 2008 crisis.

Reis (2013) notes that most literature on Portugal's crisis tends to mention various obstacles to Portugal's productivity during the 2000s; a list that typically includes low average educational attainment, low total factor productivity, an oversized government, labour market rigidities, inefficient legal system, low export competitiveness (for examples of this approach, see also Selassie 2012, 12; IMF 2013; Abreu 2006; Blanchard 2007; Amador and Coimbra 2007; Pereira and Wemans 2012; and see discussion in Chapter One for more on this). Perspectives that rely on this variant of the immaturity thesis imagine that a country like Portugal could be a modern, productive and competitive economy, if only it could clear all of the obstacles and impediments caused by its fiscal mismanagement out of its way.<sup>62</sup>

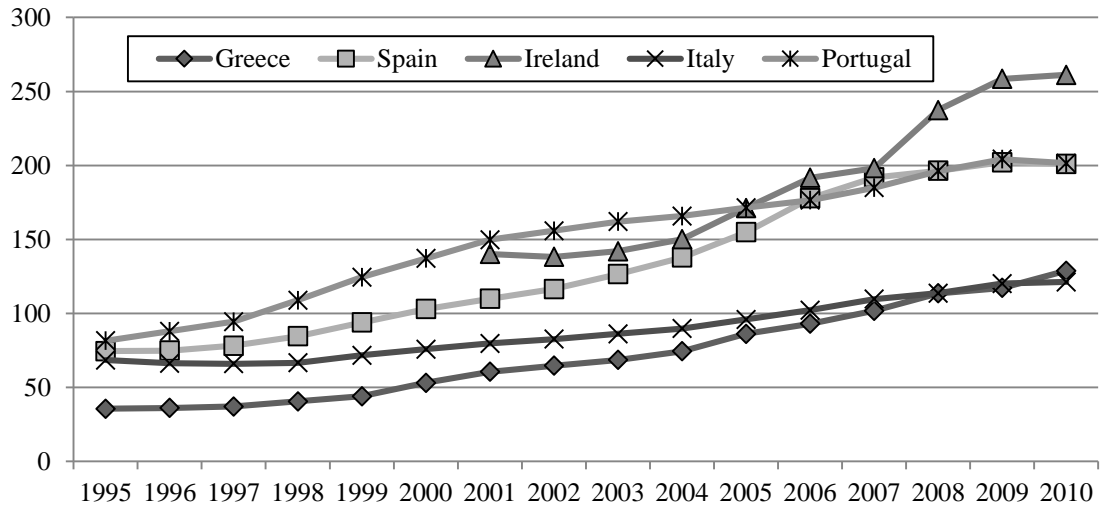
Yet, the story I have told so far presents a number of important challenges to the Portuguese immaturity thesis. As Reis (2013) notes, all of the facts listed above are not an answer for what caused Portugal to 'stop growing after 2000, instead of in some other year when all of these same hindrances to growth were also present' (148). Moreover, the puzzle of Portuguese stagnation in a context of Irish and Greek overheating cannot be explained with reference to 'obstacles to convergence' – after all, Ireland and Greece had any number of well documented 'obstacles to productivity' in place during the 2000s, yet still experienced above average growth. The puzzle is less why Portugal didn't experience a virtuous pattern of growth, and much more why it didn't even experience a non-virtuous pattern of growth. Accounting for the 'non-

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<sup>62</sup> See the literature on 'total factor productivity' as a particularly strong example of this kind of modernisation theory approach (Amador and Coimbra 2007; see also Lains 2003; Reis 2013, 148).

convergence' of Portugal can tell us little about the causes of its specific divergent trajectory.

Lagoa et al. (2014) argue, as I noted in section two, that we can explain Portugal's downturn, relative to the experience of Greece and Ireland, as the result of timing. During the 1990s, the banking sector in Portugal appears to have been relatively more vigorous in fuelling credit led growth than it was in Ireland and Greece at the same time (see figure 3.2). The upshot being - Portugal was heavily indebted by 2000, to an extent that was not the case for Greece or Ireland. By the end of the 1990s consumers 're-assessed their income expectations amid high indebtedness and a rebound of interest rates, as well as a gloomier outlook with the Portuguese economy' leading to a dramatic fall in consumption (Cardoso 2005). Similarly, a 2013 IMF country report notes that Portuguese companies tended to favour debt over equity financing in the run up to euro membership, partially due to the availability of cheap capital flows (IMF 2013, 9), leading to high corporate leverage. This further damaged Portuguese growth by the 2000s. As the IMF notes, 'excess leverage may ...have had a negative impact on investment, as over-indebted firms tend to pass up on new investment opportunities, particularly those with limited short-term benefits but higher long-term productivity gains' (IMF 2013, 9). Indeed, investment growth in Portugal peaked in 1997 and then gradually declined to turn negative, in line with increasing leverage (IMF 2013, 9). In other words, debt was so great in the corporate sector that it served as a barrier to accessing further debt, stalling productivity (Selassie 2012, 5–7). Portugal's experience from the mid-1980s to the 2010s is the reverse of Greece and Ireland. It already had private indebtedness levels that were too high by the turn of the century, whereas Greece and Ireland only really began to accelerate their levels of debt after the 2000s (Lagoa et al. 2014, 6).



**Figure 3.2:** Private sector debt, consolidated - percentage of GDP

*Source:* Eurostat

This was to prove a difficulty for Portugal when, in response to signs of overheating in the eurozone, the ECB increased the main reference interest rate from 2.5% in early 1999 to 4.75% in late 2000 (Lagoa et al. 2014, 12). This had a significant impact on levels of available income, and accordingly, domestic demand in Portugal – to an extent that it didn't in Greece and Ireland where there were not such high levels of private indebtedness around that time. It also had a negative impact on the Portuguese public deficit and debt levels, which became more expensive to service, leading to Portugal's breach of the Excessive Deficit Procedure in 2001. As a result, the country was obliged to follow a pro-cyclical, contractionary fiscal policy, which further contributed to falling GDP (Lagoa et al. 2014, 12). As a consequence, economic policy during the 2000s was characterised by attempts at fiscal consolidation and improving competitiveness and productivity (see Abreu 2006; Lourtie 2011, Royo 2012), which further dampened demand and economic growth.

Rather than a failure to converge, it can thus be argued that the recession of the 2000s has clear origins in the model of ‘debt-led domestic demand growth’ that emerged in the 1990s. As the European Commission Directorate-General for Economic and Financial Affairs reported, ‘Since 2001, private agents and public authorities alike have started to readjust their balance sheets, bringing spending more in line with incomes/revenues’ (2004, 7). Accordingly, we can understand the role of European financial liberalisation and integration as a catalyst of slowdown in the 2000s (Banco de Portugal 2009, 66). Portugal’s nominal ‘convergence’ with Europe since the 1980s had been premised on the inflation of domestic demand. Once this dropped, the economy accordingly stagnated.

Falling consumption during the 2000s is clearly evident when looking at the construction sector, which significantly, saw its share in value added as a percentage of GDP fall from 7.6 percent to 6.6 percent, in stark contrast with Ireland and Spain (Reis 2013, 156). In fact, Portugal was the only European country to register an annual decline in investment in construction every single year since 2002 until 2011 (Lourtie 2011, 6). In terms of employment, it was wholesale, retail and in education, health care and social work where large increases were witnessed during this period (Reis 2013, 156). The relative prices of these sectors also rose, and construction contracted prominently during this period (Reis 2013, 161). So, unlike Greece and Ireland, and in spite of large capital inflows and long term interest rates that modestly raised real wages and the real exchange rate, the economic activity that was promoted in Portugal was not in sectors that were likely to result in significant growth, and less still, speculative bubbles. There are many different ways to have economic activity driven by the non-tradable sector – and in the case of Portugal, ‘adjusting to Europe’ created reliance on wholesale, retail trade and community and other services. By the 2000s, these sectors

were still prominent in terms of gross value added and employment, but they were not delivering growth.

***Declining export competitiveness: the rise of China and the CEECs***

A second cause of Portugal's downturn relates to its export sector, which suffered a decline around the same time as the decline of its debt-led sector. Portugal's unemployment rate began to rise from 5.1 percent in 2000 to 9.2 per cent in 2009, and to a peak of 17.5 per cent in 2011. Aside from the steep rise after 2009, much of this unemployment can be attributed to declining export competitiveness and difficulties faced by the manufacturing sector. Between 2000 and 2007 Portugal lost jobs in manufacturing at an average annual rate of 2%, 'one of the fastest rates of deindustrialisation in the EU' (Lagoa et al. 2014, 13). Additionally, the increased indebtedness of non-financial corporations led to declining investment in Portuguese enterprises, because it may have increased the difficulty of their getting additional funding (Lagoa et al. 2014, 47).

As with Greece, it is important to distinguish between the decline of Portugal's export-led growth, and the emergence of its debt-led growth. The emergence of the latter is not necessarily responsible for the destruction of the former, as authors such as Rodrigues and Reis (2012) have suggested. Just like Greece, the Portuguese export sector faced a number of serious challenges that suggested its demise in any event. In fact, an already existing trend of declining export competitiveness in traditional sectors during the 1990s (but especially during 2000s) contributed to the recession and made it increasingly likely that investment was encouraged in the non-tradable and financial sectors during this period.

Portugal's exports have historically been concentrated in 'traditional sectors', especially in textiles, clothing and footwear. This industry has been contracting across Europe since the 1970s in the face of fierce competition from low-cost manufacturers in East Asia, North Africa, Eastern Europe and other areas (Corkill 1999, 158; Lains 2007). Portugal was threatened also, but due to its own low wages and integration into Europe, by 1999, textile and clothing was still a major industry, accounting for one third of manufacturing employment and some 20 per cent of the value of manufacturing output. It comprised some 30 per cent of total exports, 22 per cent of which were destined for the EU (Corkill 1999, 158, 159). Corkill, writing in 1999, estimated that one million people depended on the Textile and Clothing industry (159). The industry has typically been characterised by a large number of small and medium sized firms – 'only a little over 10 per cent of cotton textile plants have more than 500 workers' (Corkill 1999, 159). During the 1990s boom, the sector accumulated problems of low productivity and a lack of capital investment. This was to become more problematic in the 2000s.

Portugal's international competitiveness became threatened by China's entry into the WTO, the ending of the Multi-Fibre Arrangement in 2005<sup>63</sup>, and the prospect of EU enlargements to Central and Eastern Europe (CEEC) (Serra 2014, 43). Due to this decline, economic growth became more and more dependent on domestic demand (ibid 2014: 43). As a result of participation in the Single Market, but also to more general processes of trade liberalisation happening on a global level, Portugal became affected by its traditional productive sectors being exposed to 'wider and more aggressive foreign competition' (Serra 2014, 43). Portugal encountered difficulties in world trade markets, because of its specialisation in low-wage and low-value-added goods, which

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<sup>63</sup> The Multi-Fibre Arrangement was an international trade agreement on textile and clothing which imposed quotas on the amount that developing countries could export to developed countries.



were especially hurt by competition from Central and Eastern Europe (CEEC) and China (Reis 2013, 148; NSRF 2013, 18; Lane 2013, 10; Mamede 2012; Sebastián Royo 2012, 205–213). The accession of the latter to the WTO in 2001 introduced a fierce competitor for Portuguese exports, one that, like Portugal, specialised in exploiting its low wages relative to the richer EU countries (Reis 2013, 154). In 1993, a Uruguay round agreement established, as Leão and Palacio-Vera note:

a progressive elimination of export quotas of textiles, clothing and footwear from less developed countries over a 10-year period (1995-2005). As a result the market share of China in the EU15 increased sharply at the expense of several southern European countries, mainly Portugal and Italy. In 2000-08, Portuguese exports of textiles, clothing and footwear suffered steep declines, average annual declines of 6.1, 21.2, and 4.5 percent, respectively... [c]onsequently, the share of these three goods in total goods exports fell from 25 percent in 1999 (40 percent in 1993) to only 14 percent in 2008 (Leão and Palacio-Vera 2011, 12).

The ending of the Multi Fibre Arrangement in 2005 ended restrictions on the quantities of textiles and clothing that could be exported from developing countries to developed countries, further damaging Portuguese competitiveness, especially as so much of its exports went to Europe.

Additionally, nascent attempts at developing a more advanced export sector in medium-tech manufacturing (including some emblematic projects such as a large car plant – see European Commission Directorate-General for Economic and Financial Affairs 2004, 24) were stunted by the prospect of European enlargement and competition from the CEECs. As such, in the second half of the 1990s, inflows of FDI into Portugal fell below the EU weighted average. In addition, Portugal's preparation for monetary integration entailed the appreciation of the escudo during the 1990s, which further damaged export competitiveness, and promoted the redirection of economic activity to domestic demand. Portuguese exports of medium-to-high tech products like

vehicles and electrical machines also lost market share over the 2000s, mainly to the CEECs, which have benefitted from a combination of lower wages and a more skilled labour force (Leão and Palacio-Vera 2011, 12). Anticipating the EU's eastern enlargement in 2004, a number of MNCs in automotive and related industries de-located their productive capacity from Portugal to the new member states (Mamede 2012). As a result, over the last decade the CEECs have attracted large flows of FDI into medium-to-high tech sectors, which formerly had headed towards southern Europe, including Portugal (Leão and Palacio-Vera 2011, 12). The consequences for the Portuguese manufacturing sector in terms of gross national product were significant (Serra 2014, 43). Because the composition of Portuguese exports is almost twice as high in terms of 'low-tech' goods as compared to the rest of the eurozone countries, it seems obvious that their exports are likely to be more directly associated with competition from China and East Asia (Leão and Palacio-Vera 2011, 7). As Lourtie (2011, 5-6) notes, the textile sector represented 33 percent of total Portuguese exports in 1990. It accounted for only 13 percent in 2006. In addition, the market share of Portuguese exports in the EU15, the main destination for Portuguese exports (having accounted for 71% of total in 2008), declined by 33 percent between 2003 and 2009, mainly in favour of China and of the CEECs. This led to more imports in the Portuguese market, and the skewing of the economic model towards services and non-tradables (Leão and Palacio-Vera 2011, 11).

This changing international economic environment contributed to consolidating the redirection of economic activity in Portugal. Economic growth became increasingly inward looking (Serra 2014, 43), contributing to the continued widening of Portugal's current account deficit. The competitiveness of China and other East Asian economies meant that the Portuguese economy was unable, under these conditions, to attract

significant amounts of capital to its manufacturing and export sectors. Instead, investment tended to become redirected to non-tradable sectors. The most important effect of the rise of China was how Portugal adapted – rather than how much it lost in trade<sup>64</sup>. In other words, the impact of falling revenue from exports is of secondary importance to what Portugal did *instead* of manufacturing for export (Reis 2013).

The consequence of the emergence of ‘new players in world trade and the erosion of comparative advantage’ in Portugal (Royo 2012, 205) was that ‘many economic groups adopted defensive growth strategies based on investments in non-tradable sectors’ (Royo 2012, 206). These new strategies were made possible by the new institutional environment created by the EU/PSD structural reforms. Reis argues that the weakness of the Portuguese economy can be explained by the ‘misallocation of financial flows’, leading to an expansion in the country’s relatively unproductive non-tradable sector (2013, 146). The Portuguese production system was transformed as a result of the shocks discussed above, and crucially, investment tended to flow towards the non-tradable sector (Serra 2014, 43).

Portugal did indeed transform into a ‘debt-led’ model of growth during the 1990s. However, as this section has suggested and as was also the case with Greece, the emergence of debt-led growth should not be understood as having the effect of *undermining* the productive base of the Portuguese economy. It is worth pointing out here that it is extra-EU economies, and fellow ‘peripheral’ European economies (the CEECs) that represented a threat to Portuguese international competitiveness, not the core (German, France, the UK, etc.), as Lapavitsas et al. (2012) and others working within the core-periphery perspective often suggest. The productive base of the Portuguese economy was undermined for reasons largely unrelated to the emergence of

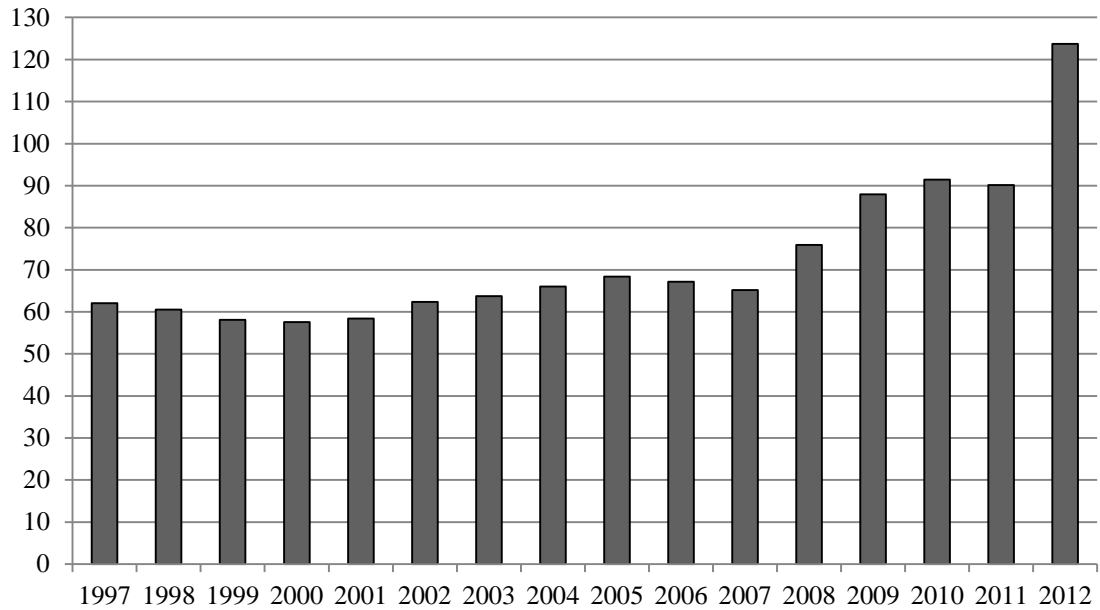
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<sup>64</sup> See Reis (2013) for a critique of a ‘trade based’ explanation of Portuguese decline.

its debt-led model. The causality is reversed; the debt-led model, rather than being a cause of this undermining, was actually consolidated by declining export competitiveness.

### ***Rethinking the Portuguese crisis***

Portugal followed a unique economic trajectory during its membership of the euro. Unemployment and public and private indebtedness increased as GDP growth stagnated. Portugal's budget deficits and net public debt as a percentage of GDP rose during membership of the euro, but they were nowhere close to Greece's levels at the time and in fact, its public debt did not exceed 60 per cent of GDP until 2007 (see figure 3.3) (Baer, Dias and Duarter 2012, 3). Germany's government debt exceeded 60 per cent this year also, and in fact, Portugal's public debt was lower than Germany's from 1996 until 2007. It was not until after the eruption of the eurozone crisis that Portugal's longer term structural fault lines began to mark it as a target for international financial market anxiety.



**Figure 3.3:** Portugal's central government debt, total (percentage of GDP) for Portugal, Annual, 1997-2012, Not Seasonally Adjusted

*Source:* World Bank, retrieved from FRED, Federal Reserve Bank of St. Louis

From 2009 the deficit increased dramatically as it did in most European economies during this time, to 9.3 per cent of GDP from 2.7 percent in 2008 (Lourtie 2011, 14). Portuguese governments responded to international market pressure following the Greek and Irish bailouts by introducing new austerity programmes (Lourtie 2011, 20). Nevertheless, as the eurozone continued to drift from crisis summit to crisis summit during 2010, Portuguese borrowing costs soared. As Lourtie notes, for Portugal in 2010 and 2011:

“Even the agreement reached late in the evening of Friday, 29 October, between the Portuguese government and the main opposition party (PSD) on the strong austerity 2011 budget, after very difficult and tense negotiations, had no positive effect on bond prices. It was clear by then that good news at national level could always be trumped by bad ones at European level” (Lourtie 2011, 20).

Although Portugal was, to an important extent, a victim of contagion during this time, this contagion fed off the longer term structural vulnerabilities of the Portuguese economic trajectory. This chapter has traced the emergence of these vulnerabilities since 1974, and argued that it was Portugal's transformation into a 'debt-led domestic demand' model of growth as a result of adapting to European Integration during the mid 1980s and 1990s that can account for its active divergence. As such, Portugal was not hit relatively hard by the crisis because it failed to converge. Rather, it was hit relatively hard because its attempts to converge led, unsurprisingly, to unintended consequences. As such, following the rules of European modernity, rather than failing to, is what accounts for the origins of the crisis in the case of Portugal.

## **Conclusion**

This case study provides an account of Portugal's evolving economic trajectory since 1974 in order to understand why it suffered relatively severely as a result of the eurozone crisis. The 'difficult' Portuguese crisis can be understood as follows. During the 1980s a process of structural reforms, facilitated by the EU, created a new institutional structure that allowed the expansion of economic growth in the non-tradable sector via the financial sector. The growth of these sectors was not the aim of the reforms but rather an unintended consequence of measures taken to stabilise the political and economic volatility of the two decades following the 1974 revolution. Secondly, the limits of this new model became evident in the early 2000s when declining export competitiveness was not counterbalanced by domestic demand led growth – because of over-indebtedness. This led to a prolonged recession, placing

Portugal in a particularly vulnerable position in the context of the Greek and Irish crises in 2011.

Much like Greece, tracing the transformation of the Portuguese economic trajectory has highlighted the importance of European integration. Two economic crises bookended the narrative offered here. Following the instability of the revolutionary period, the PSD governments of the 1980s and 1990s turned towards Europe, and implemented reforms necessary to join the Single Market and EMU. Implementing these reforms transformed the Portuguese economy during the 1990s into an inward looking, debt driven patterns of growth. It was this transformation that led to Portugal's current difficulties. This leads to a remarkable conclusion. Although its trajectory was markedly different to Greece, Portugal's economic crisis was also set in motion by deepening European integration. This is an important correction to the narrative of the immaturity thesis. This chapter has also challenged narratives of victimisation. Portugal was not passively exploited by a neoliberal European project – rather Portugal actively participated and negotiated its own European integration in an effort to consolidate its democracy and advance its own modernisation. In addition, Portugal's declining competitiveness was not the result of any core-periphery dynamic – in fact, the countries of Central and Eastern Europe, as well as East Asia, represented the biggest threats to Portugal's export led growth. Furthermore, debt-led growth did not undermine the productive base of the Portuguese economy – it is better understood as a response to a situation where export-led growth was already in marked decline.

Portugal, like Greece, illustrates the damage caused by a small, peripheral European economy's attempt to pursue an agenda of modernisation via an attempt to adapt to a 'one size fits all' model of European integration. So far, the experience of these two countries builds towards a fundamental critique of the project of European

integration since the late 1980s. Namely, we can see that the European project – through the promotion of convergence, has in fact been generative of specific patterns of divergence in these two cases. In the next chapter I will depart from Southern Europe to the North Atlantic to explore the origins of this thesis' final case study, the Irish financial crisis. Ireland followed an equally distinct path to its own crisis. I will nevertheless examine whether a similarly problematic experience of Europeanisation can be identified.



## 4

## The Decline of the Celtic Tiger and the Origins of the Irish Banking Crisis

What really makes Ireland attractive to corporate America is the kind of economy we have created here. When Americans come here they find a country that believes in the incentive power of low taxation. They find a country that believes in economic liberalisation, they find a country that believes in essential regulation, but not over regulation.

Mary Harney, former Tánaiste of Ireland, 2000.<sup>65</sup>

How did Ireland get into its current bind? By being just like us, only more so.

Paul Krugman, 2009.

This chapter examines the origins of the Irish banking crisis. In the two decades before the eurozone crisis, Ireland was the poster child of European integration and a ‘showpiece of Globalisation’ (Kirby 2010, 3). From the mid-1990s onwards, its economy grew at a rate of three times the European average and within four years its

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<sup>65</sup> Quoted in Laffan and O’Mahony (2008, 234).

unemployment rate more than halved. Stunningly, this growth was export-led and driven by a high profile, high-tech manufacturing sector, not to mention achieved with some of the lowest levels of public debt and spending in the continent. Fast forward to 2008 and Ireland was in the midst of a banking crisis that the IMF claimed to be among ‘the most severe in world economic history’ (quoted in Ó Riain 2014, 240).

Irish public debt soared from 25 per cent to 110 per cent as a consequence of the state issuing a blanket guarantee of bank liabilities in 2008 to the tune of €440 billion (Cooper 2012; Hendrikse 2013, 192). Over the next three years, bond yields on Irish sovereign debt reached unsustainable levels. Unemployment levels approached 15 per cent in 2012 and an unprecedented fiscal crisis developed as Ireland had become overly reliant on property related taxes which had collapsed following the end of the property boom (Dellepiane and Hardiman 2012, 95-96). On November 29<sup>th</sup> 2010, just over fifteen years after a Morgan Stanley report drew world attention to Ireland’s miracle ‘Celtic Tiger’ economy (O’Hearn 1998, 1) the Irish government found itself responding to the most severe economic crisis the country had faced since gaining independence. It was forced to negotiate a financial assistance package with the ECB, EU and the IMF totalling €85 billion.

This final case study is a story of the replacement of Ireland’s ‘miraculous’ export led growth of the 1990s with unsustainable debt-led growth in the 2000s. I explore this shift, as I did in the previous case studies, by situating the Irish banking crisis within a longer history of Ireland’s evolving economic trajectory.

In section one I begin by briefly framing the argument in relation to two important explanations of Ireland’s Celtic Tiger and financial crisis. The first and arguably most dominant perspective argues that we should make an analytical

distinction between the Celtic Tiger of the 1990s and the property bubble of the 2000s. The former was hijacked, squandered and supplanted by immature political and economic governance from the late 1990s onwards.

The second perspective emerges as a critique of this analysis, as well as in an earlier iteration, a critique of the self-congratulatory readings of Ireland's growth during the 1990s (O'Hearn 1998). It claims that the lightly-regulated, low tax regime that was so successful at attracting Foreign Direct Investment (FDI), during the 1990s, contained the seeds of the property boom and banking crisis during the 2000s. The property boom, in other words, is the other side of the Celtic Tiger coin.

Challenging each of these perspectives, I argue that an analytical split should indeed be made between Ireland's export boom and debt-led boom, but I also suggest that authors such as Ó Riain (2014), Hardiman (2012) and others (Honohan 2010; Nyberg 2011; Regling and Watson 2010; Whelan 2013; Lane 2011; Drudy and Collins 2011, 342–244) have not paid enough attention to the international, European, and pre-2000 origins of the Irish property boom.

In sections two and three I provide evidence for the claim that the property boom emerged in a context of Ireland's deepening European Integration. Section two discusses the rise and fall of Ireland's export led model of growth. In the 1990s Ireland's Celtic Tiger economy was growing at a rate that was three times higher than the any other EU state, yet from 2000 onwards, this growth became undermined by the dot-com crash, registering a significant decline in growth and falling investment between 2001-2003. Although it recovered after this period, new forms of economic growth sidelined the export-led growth for most of the 2000s. This downturn reveals the limitations of Ireland's Celtic Tiger, in that it was always highly vulnerable to

international shocks and, in particular, the performance of the US economy. I argue, however, that it is misleading to locate the origins of the property boom, specifically, in the institutions and policies that made the export boom possible.

Section three discusses the (much overlooked) parallel emergence of the conditions for the property and banking crisis during the 1980s and 1990s. Ireland's banking and financial sectors transformed since the late 1980s as a result of preparing for the Single Market and EMU. This boom could not have occurred without the changes to the Irish banking and financial sector following the liberalisation and deregulation associated with the re-launched European project in the late 1980s. The story of Ireland's debt-led development, and the institutions that underpinned it since the late 1980s, needs to be taken more seriously.

The experience of Ireland presents an intriguing conclusion. 'Following the rules' of modernisation and European Integration, as Ireland was widely considered to have done, does not necessarily lead to sustainable economic growth. In fact, doing so actually threatened sustainable economic growth in Ireland. As Paul Krugman notes, Ireland got into its current bind '[b]y being just like us, only more so' (2009).

## **Section One: The Celtic Tiger: Contesting the link between export and debt-led growth**

Was the Irish banking crisis a departure from the export led growth of the 1990s, or an unintended outcome of it? Scholarly opinion is divided. Most narratives of the Irish property boom and bust begin with the election of the 1997 Fianna Fáil-Progressive

Democrat coalition government.<sup>66</sup> This is typically cited as the moment where the export-led growth of the 1990s began to be undermined by a decade of expansionary, short-sighted misgovernment during the 2000s.<sup>67</sup> As the argument goes, Irish politicians helped generate the bubble through changes in national and investment politics. The 1997 coalition government combined the populist ‘growth machine’ approach of the centre-right Fianna Fáil party with the liberalising economic policies of the conservative-liberal Progressive Democrats (PDs). As early as 1998 this government had slashed capital gains tax in half, with the explicit intention of injecting untapped capital into the economy. They more than succeeded in this goal and capital flowed into property and construction; signalling a newly emerging dynamic in Irish investment politics (Ó Riain 2012, 506).

Irish governments during this period are often accused of actively encouraging, rather than restraining credit fuelled property development during this period (Kirby 2010, 9). Hardiman notes that Irish politics has consistently had a tendency to use taxation to garner political support. This continued into the 2000s when the former Irish Minister for Finance Charlie McCreevy – now infamous for his ‘when I have it I spend it, when I don’t I don’t’ aphorism on fiscal policy – pursued politically driven reductions in income tax, damaging the profile of exchequer returns and contributing to inflationary spending (Dellepiane and Hardiman 2012, 95).

In addition, as I noted in chapter one, Fianna Fáil led governments are noted to have had close personal as well as financial links between bankers, property developers, builders and politicians (Dellepiane and Hardiman 2012), 92; see also Byrne 2012). The

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<sup>66</sup> For overviews, see the following accounts: Honohan and Walsh 2002; Whelan 2013; Lane 2011; Ahearne, Schmitz, and von Hagen 2011; Hardiman 2012; Hardiman and Dellepiane 2010; Hardiman 2010; Honohan and Leddin 2005; see Ó Riain 2014, 36-38 and Kinsella 2012.

<sup>67</sup> This is widely influential assessment. See Honohan 2010; O’Toole 2010; Ross 2010; Byrne 2012; Carswell 2012; Cooper 2012; Hardiman 2012; Ó Riain 2012; Ó Riain 2014.

accusation, which is ubiquitous in the popular consciousness in Ireland, is that bankers and property developers exercised undue influence on Irish politicians (see for example O'Toole 2010; Ross 2010; Carswell 2012; Cooper 2012).

The theoretical explanation that is implied within this narrative (the Irish version of the immaturity thesis) is that the property boom of the 2000s represents a discontinuity with the export boom of the 1990s, and moreover, it represents the overwhelming of the productive, sustainable growth Ireland had worked hard to achieve in the 1990s (Ó Riain 2012). In a manner of speaking, there is no contradiction between Ireland's status as the 'poster child' for European Integration in the 1990s, and its membership of the PIIGS in 2010. Immature patterns of governance hijacked and reversed the mature growth of the 1990s. Ireland's Celtic Tiger was squandered, it was sunk by 'stupidity and corruption' (O'Toole 2010).

However, this reading of the Irish crisis has been widely challenged. It is an explanation that is grounded in an earlier and still influential literature on the origins of the Celtic Tiger export boom. Honohan and Walsh (2002) and others (see Whelan 2010; Lane 2011; Ahearne et al. 2011; see Ó Riain 2014, 36-38 and Kinsella 2012 for overviews) understand the unprecedented growth of the Celtic Tiger era as a case of 'delayed convergence'. Since the late 1950s, the institutions and policies set up as part of the 'great switch' (as I discuss in section two) should have led to convergence with Western Europe, but in the 1960s and 1970s, successive Irish government's 'got the policies wrong' – they followed fiscal expansion as a response to the oil crisis which caused inflation, raised wages thereby damaging competitiveness and discouraging productive growth (see Ó Riain 2014, 36).

In 1987, when the newly elected Fianna Fáil government finally ‘got the policies right’, expansionary fiscal contraction took place (Kinsella 2012; Barry 2003), and convergence flowed rapidly, as if it had been water building up behind a dam that had just been demolished. As Ó Riain (2014) notes, this is in many respects the standard account of Ireland’s Celtic Tiger, and remains a key reference point for accounts of the crisis, when after the 2000s, policymakers ‘got the policies wrong’ once again. (36).

The ‘delayed convergence’ reading explains economic transformation as having been achieved through market liberalisation. This has been strongly and frequently contested by a literature that focuses instead on the crucial role played by the state in generating Ireland’s convergence. Scholars have correctly pointed out that Ireland’s success cannot be reduced simply to the liberalisation of markets (Murphy and Kirby 2007). Critical political economists such as O’Hearn (1998; 2001) and others (Wickham 1980; Crotty 1987; Mac Laughlin 1994) stress the central role played by the state in reshaping the Irish economy. They often argue that Ireland has gone through a pattern of ‘dependent export oriented development’ (Kirby 2010, 95) where indigenous industry is neglected by the state in favour of attracting FDI through opening up and free trade. Irish governments have attempted to attract multinational corporations to invest in Ireland by offering low taxes and a ‘hands off’ government attitude towards business (O’Hearn 1998). O’Hearn notes that Irish governments have fostered a liberal environment for US MNCs to accumulate substantial wealth, but in spite of its high profile, these sectors have never created substantial numbers of jobs (O’Hearn 1998, 165). Moreover, in reshaping the Irish state in order to be as attractive as possible to US MNCs, successive Irish governments have pitted economic growth against social prosperity (O’Hearn 1998, 165).

These approaches also typically shed light on the inequality that has accompanied the Celtic Tiger boom, and point out the various ways in which GDP growth has been illusory, oftentimes an artefact of corporate accounting and a conflation of ‘growth’ with ‘development’ (Kirby 2010, 92). One author within this literature recalls how such analysis was received as ‘begrudgery’ during the boom years (O’Hearn 1998), and notes that refrains about how such arguments were akin to ‘talking down the economy’ became a common accusation during the 2000s. Former Taoiseach of Ireland, Bertie Ahern who was very much at the helm during the property boom infamously remarked when addressing an Irish Congress of Trade Unions (ICTU) conference in Belfast that:

sitting on the sidelines, cribbing and moaning is a lost opportunity. I don't know how people who engage in that don't commit suicide because frankly the only thing that motivates me is being able to actively change something (RTÉ News 2007).

In the wake of the crisis, this critique of the Celtic Tiger period has led authors such as Kirby (2010; 2002; Kirby 2004; Kirby and Murphy 2011; Murphy and Kirby 2007) to emphasise the continuity between the Celtic Tiger export model and the speculative property bubble. As this argument goes, the property bubble should not be understood as a departure from the patterns of the 1990s. Free market principles, deliberately weak regulation and low levels of taxation and expenditure may have underpinned the export-led growth of the 1990s, but these policies and institutions also left Ireland particularly vulnerable to financial crisis in 2008 (Ó Riain 2014, 37; Kirby and Murphy 2011; Kitchin et al. 2012). Kirby sums up this argument:

The reliance on stimulating an unsustainable construction boom to replace the growth model based on FDI and the role of the very lightly regulated banks in facilitating this, was the proximate cause, but the vulnerabilities this has exposed in the capacity and resilience of the Irish state derive from the low-tax regime



that was seen as the central policy mechanism for attracting foreign investment. Behind these lie the role of the state and the ways in which it understood the opportunities of globalisation. *What has collapsed therefore is Ireland's dependent low-tax model of state led development* (Kirby 2010, 9 [italics added]).

Kirby's work on the Celtic Tiger highlights the limitations and contradictions in a model of growth that was overly-reliant on FDI; less a 'Celtic Tiger' and more a 'U.S. Tiger caged in a Celtic Zoo' (Kirby 2010, 149); as well as illuminating a number of social and welfare failures that accompanied the Irish 'competition state' (Kirby 2010, Kirby and Murphy 2011). Yet, Ó Riain (2004; 2014) criticises Kirby for having no positive account of the causes of change in the Celtic Tiger. Although he welcomes Kirby's critique of the cheerleading for the Celtic Tiger, he criticises the overall thrust of the argument for failing to take seriously the extensive change that has occurred in Ireland, whether or not the character of it should be taken to task (Ó Riain 2004, 9). This critical approach is successful in highlighting some of the reasons why export-led growth did not continue during the 2000s. Yet, it is less convincing in explaining the origins of the debt-led boom that replaced it – often assuming that the demand led growth and low tax regime that accompanied the Celtic Tiger, would inevitably lead to a housing bubble (which was not straightforwardly the case in either Greece or Portugal following similar demand led growth in the 1990s).

As Kirby himself recognises criticising the dependency theory approach of O'Hearn (1998), the notion that multinationals are simply 'draining capital' from the Irish national economy is difficult to support. In fact, far from a relationship of dependence, Ireland has received substantial net economic and financial gains to its economy (Kirby 2010, 95). It is clear that dismissing the Celtic Tiger boom as simply illusory, or as preamble before the speculative boom is limiting. As I argue in section

two, brand new patterns of economic activity emerged across Ireland during this period, and as the empirical thrust of Kirby's (2010) analysis concedes, we still require some sort of proximate explanation for the dramatic shift that this model went through circa 2000.

These competing perspectives leave us with a puzzle for explaining the link between the Celtic Tiger and the banking crisis.<sup>68</sup> The existing debate has left us with a choice between problematically conflating these two very distinctive patterns of growth, and falling back upon the narrow internalist assumptions of the immaturity thesis to account for an analytical distinction. As a way out of this puzzle, I argue in section two that during the 1990s, the Irish economy did indeed undergo a significant transformation – which the challenges of Kirby (2002, 2010) and O'Hearn (1998; 2001) downplay by reinterpreting the decline of the Celtic Tiger as bound up in the 'logics' of its initial, illusory, success. While I go on to argue in section three that Ó Riain and others have in turn neglected the impact of European integration on this transformation, I first focus on how Ireland managed to succeed in achieving genuine, albeit vulnerable, export-led growth that should be understood as distinct from the property boom. This distinction is important to make because, as I later argue, it clears the ground for an alternative explanation of the origins of Ireland's property boom. As was the case with Greece and Portugal, in doing so, I draw out the key role played by Ireland's adaptation to European integration.

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<sup>68</sup> See Kirby (2010, 71-217) for a close to exhaustive account of the different perspectives.

## **Section Two: Export led growth: Ireland's Celtic Tiger - 1987-2001**

A 1980s advertisement by the Industrial Development Authority (IDA)<sup>69</sup> aimed to attract US businesses to invest in Ireland – ‘we’re the young Europeans’, it ventured (New York Times 1984). By 1994, the young Europeans were overtaking the old as their ‘Celtic Tiger’ model of export-led growth gained Ireland international acclaim that it was quite unaccustomed to. As Kitchin et al. note:

[p]oliticians, policy makers, economists, academics, practitioners, think-tank gurus, and journalists from around the world flocked to Ireland to be inducted in the art of best practice in fast-track growth, and former Irish leaders have gone on global lecture tours espousing the so-called benefits of the ‘Irish model’ of neoliberal economic reform for countries wishing to fast-track modernisation (2012, 1302-3).

In this section I trace the rise and decline of Ireland’s export-led pattern of growth during the period of 1987-2001. I briefly account for some ‘pre-history’ – tracing the institutional innovations of the ‘Great Switch’ in 1959 that marked the beginning of Ireland’s attempts to develop export-led strategies of modernisation. I then offer an account of the unprecedented growth of the Celtic Tiger era from 1987-2001, when Ireland began to experience growth rates and falling unemployment that set it very much apart from its Southern European, and at times, its Western European neighbours. I subsequently highlight some of the limitations of this pattern of growth, drawing particular attention to its vulnerability to changing international economic circumstances. Finally, I emphasise the distinction between the Celtic Tiger, and the banking crisis that was to follow.

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<sup>69</sup> Renamed the Industrial Development Agency (Ireland), or IDA Ireland, in 1994.

***The ‘Great Switch’: From economic nationalism to export-led growth***

As late as 1990, Irish historian Joe Lee declared Ireland to be the ‘economic laggard of Europe’ (1990). The OECD similarly notes how economists tended to label Ireland as the ‘Sick Man of Europe’ throughout the 1980s (OECD 2009). Breznitz notes that even as late as 1995, ‘observers considered Ireland’s economic performance one of continuous failure’ (Guimard, 1995 quoted in Breznitz 2012, 87). The legacy of Ireland’s colonial past had weighed heavily on its fledgling projects of modernisation. At effective independence<sup>70</sup> in 1922, Ireland found itself with underdeveloped capitalist and working classes, little to no industry, and a relatively impoverished population (O’Hearn, 1998, 35). Agriculture accounted for almost half of the Irish economy, and 98 per cent of exports went to Britain. Ireland had little control over its monetary policy as the new Irish currency, the punt, was tied to the sterling. Non-agricultural activity in the economy was characterised by small shop-owners, small professional elites, artisans, and transport and services workers (O’Hearn 1998; Kirby 2010; Crotty 1987; Lynn 2010, 64–74).

By the mid-1950s various projects of economic nationalism aimed at modernising and industrialising Ireland had little success, creating political and economic crises for the new state. The first Fianna Fáil government of 1932, led by Éamon de Valera, instigated economic programmes that promised economic self-sufficiency (O’Hearn 1998, 36). An extensive regime of protection of infant industrial industries was pursued by de Valera, with the average tariff level rising from 9 per cent in 1931, to 45 per cent in 1945 (Kirby 2010, 17). Despite initial success, the developmental nationalism project was in chaos by the 1950s. As O’Hearn notes, by

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<sup>70</sup> ‘The Irish Free State’, a self governing ‘Dominion’, was created in 1922 following the ending of the War of Independence and the signing of the Anglo-Irish Treaty. Ireland only officially became an independent Republic in 1949.

1955 industrial production had fallen by 3 per cent, agricultural production by 7 per cent and GNP by 1.3 per cent. Employment fell by almost 10 per cent between 1951 and 1956, and census results revealed that Ireland's population had declined by 2.11 per cent over the same period (O' Hearn 1998, 38).<sup>71</sup> The Irish state was facing mounting pressure to address this economic situation. This led ultimately to the 'great switch' of 1959, the period when Ireland began to actively follow a project of export-led growth, facilitated through the successful attraction of FDI, coming primarily from the US. This was channelled into high-tech sectors that were new to Ireland, namely in computing, pharmaceuticals, chemicals, metals and engineering (Kirby 2010).

A young generation of Irish politicians pioneered a radical strategy of modernisation during the 1950s and 1960s that favoured export-orientation and the promotion of free trade. Éamon de Valera retired as Taoiseach in 1959 and was replaced by Seán Lemass. This marked a new era for Ireland's political economy, which was signalled by the publication of the *First Programme for Economic Expansion*, covering the period 1959-63 (Kirby 2010, 19). Lemass and his secretary of the Department of Finance, T.K. Whitaker, are largely credited with setting in motion the three elements that characterise the liberal export-led model of Irish growth which kicked off the Celtic Tiger decades later; the use of grants and tax concessions to encourage the development of an export-oriented sector, the attraction of FDI (especially in manufacturing) and the dismantling of protection in order to gain greater access to international markets (Kirby 2010, 20). Ireland unilaterally reduced tariffs by ten per cent on two occasions during the 1960s, and also negotiated the Anglo-Irish free trade agreement which came into effect in 1966. EEC accession in 1973 provided a five year window for Ireland to establish free trade with all EEC member states (Kirby 2010, 20). The Irish state also

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<sup>71</sup> Fears about the 'vanishing Irish' were common, see (O'Brien 1953).

offered grants and, crucially, tax concessions to manufacturing and later financial services companies – in a number of predecessor arrangements to Ireland’s well-known 12.5 per cent corporation tax rate. The Industrial Development Authority (IDA) became a key (semi-state) agency, with similarities to the agencies of East Asian Tigers, and played a ‘hunter-gatherer’ role in attracting foreign firms (Kirby 2010, 20; O’Hearn 1998; Ó Riain 2004, 2014). Crucially, the IDA identified electronics as a key sector in 1974, and focused on attracting investment from the US in that sector, meaning that investment in post-1973 Ireland was decidedly ‘modern’ (O’Hearn 1998, 40).

Kirby notes that initially, this programme was expected to make indigenous industry more attractive, and few foresaw the pivotal role that FDI would ultimately play (2010, 20). In 1983 there were almost a thousand foreign firms in Ireland and they had invested over I£4 billion in the economy (Kirby 2010, 20).<sup>72</sup> The shift to US investment came during a period of rapid world-wide investment in high-tech sectors such as electronics. Ireland’s membership of the EEC, where free imports of intermediate goods into Ireland, and re-exports of final products to the rest of Europe from there, proved to be a powerful attraction for American-based firms (O’Hearn 1998, 41). Yet, this export-oriented strategy, while somewhat successful, did not lead anywhere close to the kind of growth levels that would eventually characterise the Celtic Tiger. By the 1970s and 1980s ‘Ireland was in kind of a funk’ (O’Hearn 1998, 55). Initial optimism over EC membership quickly subsided as industrial growth appeared to be short term. Also, while some (mostly larger) farmers experienced a rise in incomes, in the early decades Ireland’s export-orientation strategy ‘turned into a nightmare of emigration and unemployment’ (O’Hearn 1998, 55).

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<sup>72</sup> I£ refers to the Irish punt.

### ***The Celtic Tiger – 1987-2001***

Few could have predicted the turnaround of the 1990s. The country found itself in a position to use the institutions and policies of the Great Switch to take advantage of a booming US economy, together with the new opportunities and increased attractiveness of Ireland as a destination for FDI due its membership of the recently ‘completed’ European Single Market (Cahill and O’Donnell 2010).

Existing literature tends to split Ireland’s export-led boom into three phases (Ó Riain 2014, 2008; Kirby 2010, 32). The first phase begins with ‘1987 and all that’ (Ó Riain 2014, 50) the typical start date of Ireland’s Celtic Tiger. The newly elected Fianna Fáil government led by the charismatic and divisive Charles J. Haughey (Joyce and Murtagh 1983) introduced a number of significant new policies and institutions, including Social Partnership, ‘one of the longest historical unbroken series of corporatist national social pacts’ (Ó Riain 2014, 177); as well as an ambitious project of fiscal consolidation, representing ‘the moment Ireland got its house in order’ (Kinsella 2012, 233). Ireland succeeded in reducing its public debt levels from 112 per cent of GDP in 1986 to 25 per cent in 2007 (Kinsella 2012, 233).

Yet, as Kirby notes, at first recovery was quite modest with growth averaging at about 3.6 per cent of GNP between 1987 and 1993 and by the latter year 294,000 people remained unemployed (Kirby 2010, 32). While it is true that Ireland began to exit a long history of recession, growing unemployment and structural emigration during this period, progress consisted largely of ‘jobless growth’. The radical increases in the employment rate and the reversal of emigration did not take place until after 1994 (Ó Riain 2014, 53). Overall, the recovery of this first period was a mixed affair, even seeing an upturn in unemployment towards the middle of the 1990s – with the international recession of 1991 and the departure of computer manufacturing companies

in that same year especially. The recovery of these years was certainly welcome, but it was difficult to anticipate the growth that was to follow (Ó Riain 2014, 54).

The second phase of the Celtic Tiger is best represented by the GNP<sup>73</sup> growth, and the dramatic decline in unemployment, of 1994-2000. In the 1990s, GNP growth ran at over 10 per cent per annum and unemployment fell from 15 per cent in 1994 to 4 per cent in 2000. From 1980 – 2000 Ireland attracted 40 per cent of US electronics FDI that went to Europe. Firms were undoubtedly attracted by corporate tax rates of zero to 12.5 per cent at different time periods, pools of skilled labour, a highly supportive state, and increasingly improved technological and innovation capacities (Ó Riain 2014, 52; Lynn 2011 67). Even as Ireland lost some manufacturing employment during this period, FDI attraction became more sophisticated, and various evidence has suggested that labour cost competitiveness was only one factor of many considered by investors (and it was to become less and less important as years went on, see Brazys and Regan 2015). Skilled and educated labour, according to Ó Riain, were crucial to increased inward investment during this period– and government policy had gone some way to target and encourage education in science, technology and engineering (Ó Riain 2014, 50; 2004). The population grew and there was very significant return migration from about 1996 onwards (Ó Riain 2014, 54). Average incomes rose by 34 per cent between 1994 and 2001 (Kirby 2010, 32). Remarkably, throughout all of this, wage pressure and inflation remained relatively subdued, and government finances continued to be consolidated (Ó Riain 2014, 54). As Ó Riain notes, in 1999, 40 per cent of public spending went on redeeming securities and loan repayments as government receipts increased, with an additional 4 per cent directed to the repayment of interest on national

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<sup>73</sup> GNP is a better measure than GDP due to the key role of FDI in Ireland's economy.



debt. In other words, Irish governments took advantage of high growth rates to overcome their debt crisis during this period (Ó Riain 2014, 55).

Ó Riain refers to this period as Ireland's 'developmentalist phase' (Ó Riain 2014, 184-86). Ireland became the second richest country in the EU (after Luxembourg), moving from a position of about 60 per cent of EU per capita income (a position it had held since EEC accession in 1973) to 145.4 per cent in 2006 (Kirby 2010, 32-33). Unlike Greece and Portugal during the 1990s, Irish growth was driven by a boom in exports, facilitated largely by US FDI in high-tech sectors (Ó Riain 2014, 55). Ireland was certainly in the right place at the right time, but the institutional and policy legacy of the 'Great Switch' made such growth possible during the 1990s. As such, its 1990s boom should be set apart from that of the other cases in this study. All three countries experienced unprecedented GDP growth during the 1990s, but Ireland was the only one that appeared to be doing so via sustainable export-led development.<sup>74</sup>

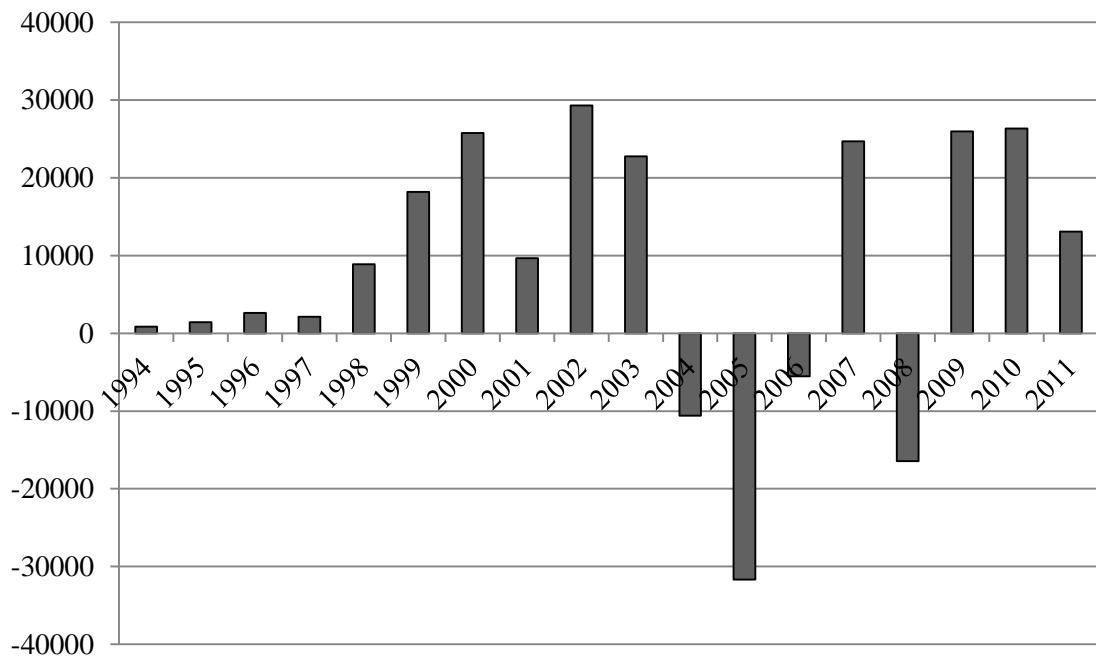
### ***The decline of Ireland's export-led growth***

The massive influence and importance of US FDI for economic growth in Ireland is unquestionable. This meant that the profile of Irish growth during the 1990s was incredibly vulnerable to fluctuations in the US economy and to changing levels of FDI. Denis O'Hearn (1998) has noted that perhaps the most startling thing about Ireland's increased dependence on MNCs is not simply their share of GDP but their domination of economic growth. He notes that MNCs were responsible for 45 per cent of GDP growth during from 1990-95, and were indirectly responsible for an unknown additional amount of growth (O' Hearn 1998: 72, 73).

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<sup>74</sup> But naturally, as I show in section three, Ireland's export-led growth is not the only story to be told about this period.

Ireland's vulnerability was made apparent during the third period of the Celtic Tiger, 2001-2003, when export growth actually began to decline. This was in large part due to Ireland's particular exposure to those sectors affected by the dot-com crash (see figure 4.1). US investment was also negatively affected by 9/11, from an annual average of 17.6 per cent between 1995 and 2000 to an average of 4.9 per cent annually between 2001 and 2006 (Kirby 2008, 16). After a decade of sustained growth, Ireland was losing the inflows that had characterised, and arguably defined the economic success of the Celtic Tiger era, as figure 4.1 shows.

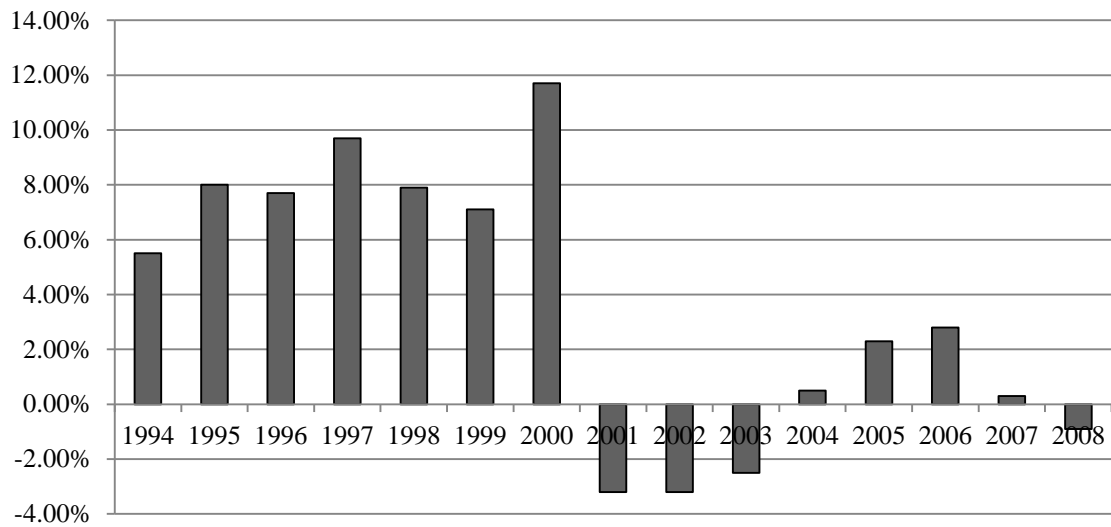


**Figure 4.1** Amount of FDI Inflows (in US Dollars) from the US to Ireland

*Source:* UNCTAD

A 2002 IDA Annual Report reveals also that the year 2001 marked the first time since 1993 that employment dropped in IDA supported companies, never to come close to recovering the same percentage employment (IDA Ireland 2002) (see figure 4.2). In the year 2000, employment in IDA supported companies increased from the previous year by 11.7 per cent. In 2001 it fell by 3.2 per cent, and again by 3.2 per cent in 2002 and by

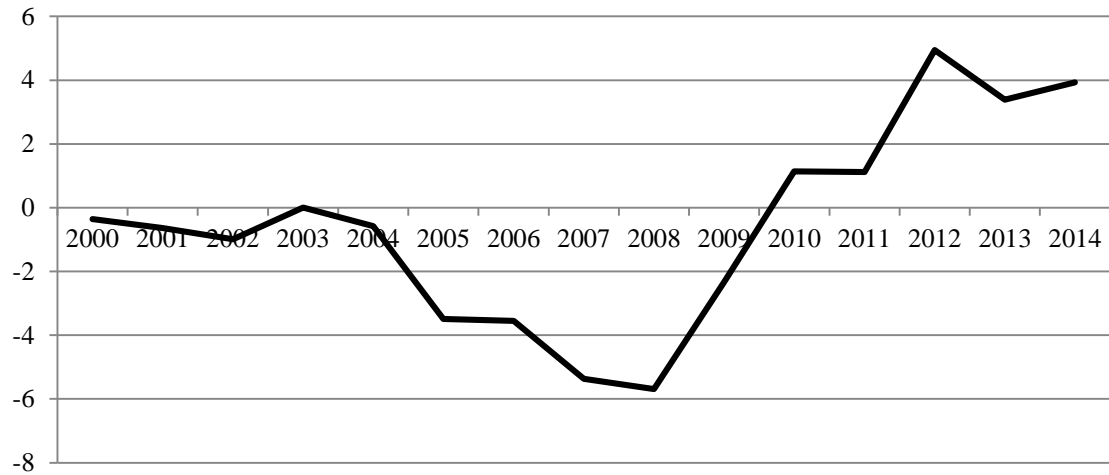
2.5 per cent in 2003. Percentage change in full time employment averaged at 1 per cent from 2001 until 2008. This is contrast to the period from 1994 – 2000, where it averaged at 8.2 per cent.



**Figure 4.2:** Percentage change in net employment in IDA supported companies.

*Source:* IDA Annual Reports

In addition to falling investment and employment, the value of Ireland's merchandise exports in 2006 was less than it was in 2002 and crucially, for an 'export-led country', Ireland's balance of payments moved from a position of balance in 2003 to a deficit of 3.3 per cent of GDP in 2006 (Kirby 2010, 35; see figure 4.3).



**Figure 4.3:** Ireland's Current account balance (percentage of GDP)

*Source:* IMF Balance of Payments Statistics

Kirby quotes Tansey (2007) – ‘the Celtic Tiger economy met its end in 2001’ (in Kirby 2010, 35). Export-led growth was to pick up again, and is arguably underpinning Ireland’s recovery in 2015 (Brazys and Regan 2015). But at the time, vulnerability to falling FDI contributed to a massive shift away from Ireland’s ‘developmentalist phase’, and the economy has seen nothing like the Celtic Tiger since 2001. Yet, even accepting all of this, as I now discuss, the limitations of Ireland’s export-led growth should not be understood as the same as the causes of its debt-led growth.

***A boom without a bubble: towards a new account of Ireland’s debt-led growth***

It was during this period of uncertainty and downturn (2001-2003) that the Irish property bubble began to kick off. As I suggested in section one, Kirby and others have argued that the origins of the speculative property boom are to be found in the weaknesses of the Celtic Tiger export-led model of the 1990s. There are a number of

problems with this argument. Firstly, it tends to under-specify the linkages between the Celtic Tiger's institutional set up and the origins of the property bubble. Secondly, in conflating the Celtic Tiger and the property boom into a singular, non-interrupted trajectory, the genuine promise of the Celtic Tiger that authors such as (Ó Riain 2004; Ó Riain 2014) recognise is denied. This is a particular problem, because it misses out on a fundamental critique of Ireland's relationship with European integration. As I argue in section three, such analysis overlooks the possibility that there are other, potentially discrete causes of Ireland's debt-led growth. Crucially, certain aspects of Ireland's European integration contributed to the undermining and damaging of a peripheral economy that actually had effectively 'done everything right'.

The links between the various market and non-market state-led strategies of attracting inward investment and credit-fuelled property development are not usually clearly defined by critical analysis of Ireland's crisis (see Kirby 2010, 156-160 especially). Neoliberalism is often evoked as a 'black box' to account for the increasing prevalence of market logics across both the Celtic Tiger period and the 2000s (Kirby 2010, 164). Yet, authors such as Kirby fail to trace, historically the concrete linkages between 'a particular type of market economy...highly dependent on high levels of FDI and ever attentive to the needs of these foreign corporations' (Kirby 2010, 164) and the property boom; instead, the linkage is taken for granted.

In fact, such analysis tends to need to rely on assumptions of the immaturity thesis to bridge their critique of the Celtic Tiger with their analysis of the origins of the property bubble. Kirby and others tend to over-emphasise the significance of certain 'market forms' of FDI attraction when discussing the Celtic Tiger period. Light touch regulation is a clear linkage between both periods and was an important strategy for the attraction of the financial services sector, but less so for other sectors such as

manufacturing and software. In fact, a strong and reliable regulatory infrastructure has been argued to be a central reason why Ireland managed to hang on to its pharmaceutical sector in the wake of the EU's enlargement to the CEECs (Barry 2004, 844). Similarly, although low corporation tax is more clearly important across sectors, the link between Ireland as a 'low tax regime' in this respect, and the damaging of Ireland's fiscal profile in the 2000s does not stack up well with the reality that when the export-boom was at its height, the tax base was not skewed towards unsustainable revenues, and fiscal consolidation was being strongly pursued.

Additionally, as Brazys and Regan (2015) argue, 'non-market' forms of FDI attraction were just as important as the well-known 'market forms'. Of key significance is the long standing institutional commitment by public sector agencies to attract inward investment from global firms in high-technology sectors (Brazys and Regan 2015, 6). The authors emphasise the 'non-market forms' of coordination that have been instrumental in attracting large global firms to Ireland, including:

informal networking, hard political bargaining and the active marketing of Ireland's low corporate tax regime, and their willingness to partner in a readymade business model (Brazys and Regan 2015, 6).

Viewing the property boom as caused by the Celtic Tiger belies an important distinction that ought to be made between Ireland's export-led growth and its latter-day debt-led growth (see Kinsella 2012, 572). Certainly, Kirby et al. are correct to highlight some of the social and economic limitations of the Celtic Tiger model of growth. Yet the elision of Ireland's debt-led and export-led growth does a disservice to some of the more positive aspects of the modernisation that was achieved during the 1990s. For Ó Riain, the Celtic Tiger growth of the 1990s represented a legitimate transformation in Ireland's economy - Ireland can be viewed as a 'developmental network state' and as

having contained a genuine promise of a more sustainable, socially progressive developmentalist trajectory of modernisation – even if this promise went unfulfilled (2004, 2014). Neglecting this distinction is a problem, because, as mentioned, it serves to downplay just how significant a discontinuity the property bubble was in the context of Ireland's recent economic trajectory.

In this section I traced Ireland's transformation from a beleaguered peripheral European economy to an international success story (Lynn 2011). In spite of its limitations – especially with respect to its vulnerability to the fortunes of the US economy, the Celtic Tiger was a symbol of Ireland's hard won modernisation, a model that generated high-tech export oriented growth through liberalisation, economic integration, and free and open trade. This section sought to sever the analytical link between Ireland's export-led model of growth and the debt-led property boom, in order to clear the ground for an alternative account of the origins of the latter. The third and final section provides this alternative account. I argue that Ireland's adaptation to European financial integration contributed greatly to the protracted derailment of a peripheral country's successful (at least temporarily) development of export-oriented growth.

### **Section Three: Rethinking the origins of the Irish banking crisis: 1986-2008**

While section two discussed the evolution of Ireland's export-led model of growth and its place in the narrative of Ireland's crisis, this section traces the parallel emergence of Ireland's debt-fuelled property bubble. Although Ó Riain (2014) and others are correct to make a distinction between the Celtic Tiger and the property boom, such accounts

have nevertheless overlooked the important international and European dimensions of Ireland's banking crisis, many of which predate the expansionary fiscal policies of the late 1990s and 2000s.

Some background to the property boom and banking crisis is first provided, before going on to trace the longer-term, neglected origins of the Irish property boom. The narrative presented in this chapter provides an alternative reading of the Irish crisis as developing *alongside* the Celtic Tiger rather than because of it, due to Ireland's commitment to participation in the euro and the European Single Market.

### ***The Irish Property boom: historical background***

From about 2003-2008, domestic demand replaced export led demand as the main driver of Ireland's economic growth.<sup>75</sup> Aggressive lending by the Irish banking system propelled a property boom during this period, which began to overwhelm all other sectors of the economy (Lane 2012, 2). Following the international recession of 2001 and because of Ireland's particular exposure to the dot-com sector, there were expectations that Ireland would return to 'a more 'normal' European growth path (Lane 2012, 6). Instead, a drastic transformation was occurred.

White (2010) notes that capital stock in Ireland soared by 157% in real terms between 2000 and 2008, and that housing accounted for almost two-thirds of this (1). House prices began to break the link with demand in ways they had not done during the 1990s, as vacancies in private dwellings and office space increased in tandem with construction. Ó Riain notes that 89 per cent of all ghost estates in 2010 were granted planning permission in the period from 2002 - 2008 (2014, 87). Houses and offices

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<sup>75</sup> For overviews, see Ó Riain 2014, 61; Kirby 2010; Lane 2011; Regling and Watson 2010; Cooper 2012; Drudy and Collins 2011; European Commission 2012; Whelan 2013; Rae and van den Noord 2006.



were being built at a level that maintained and increased vacancy levels (Ó Riain 2014, 90). A 2006 census, carried out at the height of the boom, found that there were 250,000 empty houses in the country, an astonishing figure for a country with a population of just over four million (Lynn 2011, 65). In 1994, the average residential mortgage had been just one-and-half times the average industrial wage, but by 2004 that figure had risen to five-and-a-half times the average (Lynn 2011, 65). By 2009, the IMF was reporting that Ireland ‘was perhaps the most overheated of all economies’ (IMF 2009, 5 quoted in Kirby 2010).

The property bubble was the proximate cause of Ireland’s banking and fiscal crisis (Hardiman 2012; Whelan 2013). Following the global credit crunch and falling house prices circa 2008, the banking system collapsed, leading the Dáil (Irish Parliament) to pass a blanket bank guarantee, effectively converting private bank debt into sovereign debt. In 2007 Ireland’s gross debt to GDP ratio was 25 per cent. By 2012 that had risen to 120 per cent of GDP (Whelan 2013). The Irish state had taken on a contingent liability of €440 billion, a sum so large that it would have bankrupted the economy many times over if ever called upon (Cooper 2011, 161). The notorious bank guarantee has resonated through the popular Irish imagination as ‘economic treason’<sup>76</sup> (O’Halloran 2011) and it played a key role in making Ireland’s debt appear unsustainable to international markets (Whelan 2013, 1, 18); effectively ensuring the arrival of the troika to Dublin in November 2011.

The property bubble also contributed to a fiscal crisis (Dellepiane and Hardiman 2012, 91). Over the course of the late 1990s and 2000s, the Irish tax base became skewed towards construction related taxes, as governments from 1997 onwards reduced

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<sup>76</sup> A charge first levelled by Eamon Gilmore, former leader of the Irish Labour Party and Tánaiste (deputy Prime Minister) from 2011-2014, at the Fianna Fáil/Green Party coalition government responsible for the bill; although the guarantee is not without its defenders, see Donovan and Murphy (2013).

income taxes and promoted the inflation of the construction sector in various ways (Regling and Watson 2010, 5). Taxes on economic activities related to the construction boom; namely stamp duty, capital gains tax (although this was cut in half in 1997) and VAT began to dominate the tax base, all of which fell dramatically after the property crash, no longer becoming effective sources of revenue (Dellepiane and Hardiman 2012, 95-96). This left the exchequer in serious trouble once the property bubble burst and those receipts stopped flowing. As Whelan argues (2013, 18) even though bank debts contributed hugely to this figure– Ireland’s debt to GDP ratio was likely to be well over 80 per cent of GDP by 2013. This was due to the gap between government receipts and expenditure, not to mention declining GDP.

As such, Ireland’s second ‘great switch’ to debt-led growth in the 2000s damaged the competitiveness and sound public finances that had characterised the export led growth of the Celtic Tiger era. In this section I provide a revisionist historical account of the origins of this property bubble. I challenge a settled commonplace assumption that the boom originated due to pro-cyclical and expansionary fiscal policy in the 2000s, by arguing that such accounts neglect to mention that the conditions for the banking crisis were set in Ireland as early as 1986. It was from that year on that Ireland began to introduce dramatic new reforms relating to the liberalisation and deregulation of banking and finance. This not only expanded banking activity, provided access to deep international sources of capital, but also contributed to the emergence of new patterns of banking activity.

***The neglected origins of the Irish banking crisis: Ireland's adaptation to Europe***

As I mentioned in section one, scholarship on the Irish crisis (Whelan 2013; Lane 2011; Ahearne, Schmitz, and von Hagen 2011; Hardiman 2012; Hardiman and Dellepiane 2010; Hardiman 2010; see Ó Riain 2014, 36-38 and Kinsella 2012 for overviews), media coverage (for instance, The Economist 2011; English 2013; The Belfast Telegraph 2012; Sheahan 2010) and an ongoing Oireachtas banking inquiry (Regling and Watson 2010; Nyberg 2011) tends to situate the origins of the banking crisis in the four to five year period from 2003-2008 (Ó Riain 2014, 61). As the story goes, increased, pro-cyclical government spending contributed to overheating, as did rising wages across the public and private sectors, and timid, ineffectual regulation failed to put the brakes on reckless bank lending. After 2000, euro membership resulted in an interest rate shock, adding fuel to an already blazing fire through unprecedented access to cheap capital.

This narrative establishes a clear analytical distinction between the Celtic Tiger and the property boom. While this distinction is important and correct, Ó Riain and other have nevertheless neglected the longer historical origins of the Irish banking crisis. In fact, we can trace the origins of the banking crisis back to the late 1980s, as Ireland began to make dramatic reforms to its banking and financial sector. Perhaps due to the extensive body of research on the strengths and weaknesses of Ireland's export led growth during the 1990s, comparable attention has not been paid on the parallel history of Irish financialisation. This sub-section draws on the work of Sinéad Kelly (2014), John Kelly and Mary Everett (2004), as well as the Central Bank of Ireland (2013) to fill this gap.

It is not often remembered that, until the mid-1980s, the Irish banking system was one of the most heavily regulated systems in Europe. During the 1970s and 1980s,

Irish governments issued credit controls and many other restrictions which were reinforced to varying extents throughout the 1980s.<sup>77</sup> Following EEC accession in 1973, Irish banks were advised not to increase private-sector credit to non-productive sectors, including financial, property companies and property sectors (Ferriter 2012, 465-473). This was in part a response to the debt and inflation crisis Ireland found itself in the 1970s. Governments were concerned that increased levels of private spending and borrowing were damaging Ireland's competitiveness and widening its current account deficit. T.K. Whitaker was concerned that 'for all the new opportunities, ill-judged and reckless policies could lead to a return to the dark days that had propelled his original foray into Irish economic policy formulation' (Ferriter 2012, 467). In 1974, credit restrictions on banks were reinforced by provisions for special deposits at non-commercial rates of interests, and banks were required to have a special 50 per cent deposit requirement on capital outflows during these years (Central Bank of Ireland 2013). Stricter guidelines on loans to non-productive lending were enforced in October 1978 and after briefly being discontinued, these guidelines were re-imposed in 1982.

In anticipation of Ireland's signing of the Single European Act these formal guidelines were ended in 1984. This began a process of dramatic financial liberalisation, driven by Ireland's adaptation to European Integration. In 1988 there was a major relaxation of credit controls, and Ireland began to liberalise and deregulate the entire financial sector in accordance with preparation for the completion of the Single Market in 1993 (Kelly and Everett 2004, 95-98; see also Central Bank of Ireland 2013). Just like Greece and Portugal, Ireland's participation in the 're-launch' of Europe from the 1980s onwards signalled considerable changes for the terms and conditions for capital movements, domestic banking and stock-market trading. Restrictions on credit-growth

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<sup>77</sup> See O'Sullivan and Kennedy 2009; Kelly 2014; and also Kelly and Everett 2004, 91 for how little attention has been paid to this.

and interest-rate rules were progressively dismantled by 1992, capital controls were removed, and banks' reserve requirements were reduced from 10 per cent to 6 per cent in 1992, falling further to 2 per cent in 1999 (Kelly 2014, 42). Additionally, as was happening across the EU as a result of Single Market reforms, Irish banks expanded their operations overseas and widened their deposit bases (Kelly 2014, 43). Irish banks such as Anglo, AIB and BoI opened branches in the UK and elsewhere, contributing to massive flows of lending from the UK into Ireland (Kelly 2014, 43; Dooley 2014, 945). In other words, the seeds of Ireland's notorious 'light touch regulation' and highly liberalised banking sector were sown from as early as this period; and crucially, this transformation was driven by changes at the EU level.

In addition to the dismantling of controls, adaptation to European integration during this period drove the development of a more competitive banking environment in Ireland – which increased the availability of credit and reduced its cost. Deregulation and EU policies including, but not limited to, the Single Passport for banking<sup>78</sup> enabled new entrants to the Irish market. Halifax Bank of Scotland (HBOS), Rabobank, Northern rock, Royal Bank of Scotland (RBS) (trading as Ulster Bank) and Danske Bank (trading as National Irish Bank), were all operating in Ireland by 2003. This transformed the landscape of Irish retail banking, creating imperatives for growing competition (Kelly 2014, 44). This new competition drove a transformation of banking practice, leading to expanding balance sheets 'regardless of risk' (Kelly 2014, 44). For instance, the introduction by HBOS of a 3.99 per cent mortgage rate in 2001 had dramatic knock-on effects (Kelly 2014; see also Ross 2010) as other banks reduced their own mortgage rates in line. Banks also began to compete with new innovations, offering longer term loans and higher loan-to-value ratios (Kelly 2014, 45). 90 per cent

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<sup>78</sup> The 'Single Passport' is part of the EU's Second Banking Directive. It allows any bank that is licensed to do business in one EU country to do business in another EU country.

mortgages were offered by all the major banks by 2005, and First Active, a building society acquired by RBS in 2004, pioneered the notorious 100 per cent mortgage soon after (Kelly 2014, 45; Cooper 2012, 239). Equity release loans became more common, and vetting of customer's ability to repay became laxer (Kelly 2014, 45). Domestic and these new foreign banks operating in Ireland were now free to compete in terms of the interest rates they could charge. All of this had a considerable impact on Ireland's mortgage markets (Kelly and Everett 2004, 97).

Of particular importance, as Kelly (2014) notes, was the entrance of Royal Bank of Scotland (RBS) into the Irish residential mortgage market in August 1999, trading as Ulster Bank, which resulted in a significant reduction in mortgage interest rates (Kelly and Everett 2004, 97; Cooper 2012, 239-241). With the increasing presence of foreign banks in Ireland, Irish financial institutions faced more pressure to be competitive and this promoted the practice of short term lending, and a culture of bonus payments to financial managers who could successfully meet or exceed targets through short-term lending (Kelly 2014, 37). This promoted the kind of reckless lending practices that were to characterise the transformation of Ireland from an export-led model of growth to a debt-led model in the 2000s with the property boom.

Such reckless lending was further propelled by the increasing availability of cheap foreign capital following waves of capital market liberalisation in Europe, which subsequently exploded following the introduction of the euro. Irish banks found themselves having much greater freedom to set their own liquidity-management and interest rate policies since the Single Market (Kelly 2014, 42). Borrowing decisions also began to become affected from 1998 onwards when it was announced that Ireland would join EMU. Against the background of capital liberalisation and structural change in the financial sector, Irish banks were able to respond quickly when demand for credit

strengthened (Kelly and Everett 2004, 98). Even before EMU membership provided Irish banks with significant sources of cheap foreign capital, the provisions of the Single Market meant that Irish banks were becoming increasingly internationalised.

In addition to the domestic banking sector that was most clearly implicated in fuelling the property bubble (mainly through banks such as Anglo Irish Bank, Bank of Ireland and Allied Irish Bank), a brand new transnational banking sector emerged in Ireland from the mid 1980s and 1990s onwards. Much as Irish state agencies had identified the high-tech sector as an emerging sector that could be attracted to Ireland, the financial services industry began to be courted to set up firms in Ireland (Hendrikse 2013; Ó Riain 2014; Kelly 2014, 42). This was most emblematic in the International Financial Services Centre (IFSC) which was established in Dublin's docklands area in the late-1980s. Financial companies such as Citibank, Mellon Investment, Merrill Lynch, Chase Manhattan and Deutsche Bank set up in the IFSC, bringing with them knowledge of new technologies of financial innovation as well as new and lucrative channels of access to international financial markets (Kelly, 2014, 42). Hendrikse writes about how the attraction of financial services enterprises was an explicit developmental strategy for Ireland, as Ó Riain (2014; 2012, 508) has also noted. The presence of these enterprises and the Irish government's desire to continue to develop the financial services sector created incentives for light touch regulation, as well as favourable tax incentives to the banking and financial sector – a regime that extended much beyond the 'City of London' style offshore IFSC (Hendrikse 2013). Hendrikse argues that the Irish property bubble grew in the shadows of the IFSC:

as much as the Irish regulator did not police transnational finance in Dublin, it equally failed to detect the huge risks built up in its domestic banks. In other words, national and transnational financial institutions made use of the same institutional setting' (2013, 191).

Accordingly, public bodies that were responsible for the regulation of the banking sector became heavily committed to the promotion of increased competition and liberalisation (Kelly 2014, 42). This dual role resulted in the timidity and complacency that Irish regulatory bodies have been accused of by the former Governor of the Irish Central Bank in the course of an ongoing Irish banking inquiry into the causes of the crisis (Honohan 2010; Nyberg 2011). The Irish Financial Services Regulatory Authority (IFSRA), established in 2003 had an explicit goal to ‘foster an internationally competitive and successful financial services industry’ within the context of its regulatory practice (Kelly 2014, 43). There has, unsurprisingly, been clear evidence of regulatory capture (McGrath 2010).

***Ireland’s debt-led growth as an outcome of European integration***

The above narrative suggests that we cannot understand the property bubble of the 1990s without accounting for the EC/EU encouraged deregulation and liberalisation of the banking sector in Ireland from the late 1980s onwards. Ireland’s participation in the EU’s ‘one market, one money’ project since 1986 has had a dramatic transformative effect on its economy. While the role of credit in Ireland’s export led boom is disputed (Everett and Kelly 2004; Honohan 2006) – the EU reforms discussed above were setting the scene for a parallel pattern of growth that was to become fully activated following the EMU interest rate shock of the 2000s and the separate decline of the export led growth following the dot-com crash 2001-2003. We cannot understand the unprecedented property bubble during this period without accounting for the EU reforms of the 1980s and 1990s. This suggests that existing explanations that focus only on pro-cyclical government policy during the 2000s are incomplete. While this undoubtedly contributed to the boom, former Central Bank governor John Hurley is



correct when he claimed in the banking inquiry on May 21<sup>st</sup> 2015 that he didn't believe that 'regulation could have prevented the crash and said international factors played a crucial role' (Irish Times 2015). Irish governments in the early 2000s may indeed have tragically missed an opportunity to put the brakes on this boom. Yet, it is crucial to recognise that, in the decade before; European integration had already helped create an aggressive banking sector capable of driving debt-led growth. Irish governments may have failed to halt the bubble, but European financial integration helped it to emerge in the first place (Dooley 2015b).

Thus, just like Greece and Portugal, Ireland's crisis is intimately bound up in its adaptation to the project of European Integration. This conclusion makes it possible to recognise that European integration can have a distinctly paradoxical impact on a small peripheral economy such as Ireland. As I suggested in section two, the Single Market and EMU are widely considered to have, at the very least, facilitated Ireland's export led boom during the 1990s, and were certainly a significant factor in increasing overall US FDI to Europe from the late 1980s onwards (Cahill and O'Donnell 2010). It is reasonable to assume that Ireland would not have emerged as the prominent destination for US FDI into Europe without this deepening of European integration. Yet, as I have argued in this section; pursuing export led growth via the specific blueprint of the Single Market and EMU also led to unintended transformations in the Irish economy. The specific reforms, policies and institutions that were involved in Ireland's adaptation to Europe from the late 1980s onwards did far more than simply complement its export-led development strategy. They also set the scene for a banking crisis so severe that Ireland found itself returning to the periphery of Europe. Ireland thus owes a great deal of its success, but also its crisis, to European integration.

## Conclusion

In this final case study, I traced Ireland's remarkable economic trajectory from the 'sick man of Europe' in its first 50-60 years of independence, to its status as the 'poster-child' of European Integration in the 1990s, to an apparent full circle return as one of the worst hit economies of the European PIIGS in the 2000s. I make two important claims to account for this trajectory. First of all, Ireland's Celtic Tiger boom should be analytically separated from the property bubble of the 2000s. Since the 1950s, the Irish state, through a variety of institutional and policy innovations, consolidated a model of export-led development that allowed Ireland to take advantage of the 1990s US boom and the completion of the Single Market between 1994 and 2001.

This narrative represents a challenge to the 'victimisation thesis'. Since the late 1950s Ireland managed to negotiate its European integration to generate a high-tech, export-oriented model of modernisation. Ireland's relationship with Europe has thus never been straightforwardly negative. Nevertheless, as a small, open liberalised economy, Ireland was clearly exposed to any potential downturn in the US economy, and the Celtic Tiger model suffered a major crisis in the early years of the 2000s. It has since shown signs of recovery, but the country is unlikely to see the same levels of unprecedented growth that it witnessed during the 1990s any time soon.

The second important claim that I make is that the origins of a parallel pattern of debt-fuelled property speculation have their origins in the capital market liberalisation, deregulation and financial integration associated with Ireland's adaptation to the re-launched European project since the 1980s. Ireland's participation in the 'one market, one money' project was taken for granted, as it was viewed as a vital aspect of the Celtic Tiger export led growth. Yet, somewhat ironically, the specific reforms that were

introduced as part of this project set the scene for Ireland's banking crisis. Existing accounts that limit their analysis to domestic policy errors in the 2000s have tended to overlook this longer history, and in doing so, fail to recognise how new and more aggressive lending strategies by banks emerged quite directly as a result of these transformations in the late 1980s and 1990s.

This suggests an intriguing conclusion. In spite of Ireland's mature, 'core European' style export-led growth in the 1990s, it was not invulnerable to the deleterious effects of 'following the rules' of European integration during this period. Ireland certainly benefitted in the earlier decades from European Integration, and the success of its export led model was almost certainly unthinkable outside of the EC/EU and indeed outside of the euro and the Single Market. Yet, financial integration in Europe led to unintended consequences in Ireland, catalysing parallel patterns of growth from the late 1980s onwards. Just like Greece and Portugal, adhering to a one-size-fits-all model of integration led to unexpected, and detrimental patterns of divergence in Ireland. Contrary to the claims of the 'immaturity thesis', Ireland's difficulties do not stem from its 'getting the policies wrong' in the 2000s. They stem from its following of those EU driven policies deemed to be 'right' since the late 1980s. Far from a 'poster child' for European integration, Ireland tells a cautionary tale (Dooley 2015b).

## 5

# Bad Things Can Happen to ‘Good Pupils’: ‘Modernisation via Europeanisation’ and the Eurozone Crisis

But, and forgive me for saying this, Portugal is a good pupil.

Jacques Delors, 2013.

The globalisation of the economy and the development of technology create opportunities and capacities to those that are able to adjust and those who have the will and creativity to take advantage of them...They give to smaller countries like Greece the ability to participate further and more dynamically in international markets.

Costas Simitis, former Prime Minister of Greece, 2000.<sup>79</sup>

[T]he process of transformation that [Ireland] began over four decades ago has become a model for the millions of new citizens of the European Union...Thanks to Ireland’s economic success, to which you devoted your life, we can be confident that economic reform works.

Jean-Claude Trichet, former President of the ECB, 2004.

In the foregoing three chapters, I traced the diverging trajectories of economic development in Greece, Ireland and Portugal in the decades before their respective IMF-

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<sup>79</sup> Quoted in Antoniadou (2010, 69-70).

ECB-EU bailouts. Having done so, it is now possible to suggest that these countries suffered relatively severe levels of crisis not because of their ‘immature’ patterns of political and economic governance, nor due to their ‘victimisation’ by their more powerful European neighbours. Rather, their respective economies transformed into increasingly fragile and precarious patterns of development as a result of their adaptation to a particular project of European integration.

Drawing the three narratives together, it is possible to argue that Greece, Ireland and Portugal have been at the centre of the eurozone crisis, because their *attempts to converge* with their Western European neighbours were generative of brand new patterns of divergence. The EU has obstinately promoted a single model of development across a variety of different European economic trajectories. Projects of convergence towards this ‘one size fits all’ model of development have actually been a catalyst of divergence for the European periphery. Recognising this leads to the central claim of this thesis: it was the periphery’s attempt to ‘follow the rules’ of European Integration, rather than their failure to, that explains their current difficulties.

I outline this rethinking of the crisis in the European periphery over two main sections. In the first section, I discuss how processes of Europeanisation have acted as catalysts for divergence in Greece, Portugal and Ireland. Since the 1957 Treaty of Rome, European integration had always exerted pressures on its member states, but the ‘one market, one money’ strategy (Emerson, Gros, and Italianer 1992; Delors 1989) of the late 1980s onwards created a specific ‘blueprint’ which created relatively extensive and explicit imperatives for change. EU driven reforms, especially those relating to banking and finance, were identified as pivotal to the generation of ‘debt-led’ growth in each of the cases that were studied. This insight represents an intriguing challenge to narratives of peripheral ‘immaturity’, because it emphasises the ways in which

putatively ‘mature’ processes of Europeanisation were responsible for the crises in the periphery. *Projects* of convergence did not lead to *processes* of convergence for Greece, Portugal and Ireland. Instead, these very projects were generative of processes of *divergence*.

In section two I further draw out the ways in which the three case studies contribute to understandings of the asymmetry of the eurozone crisis by developing the concept of *Modernisation via Europeanisation*. This is done in two main ways. First, European integration may have promoted a specific model of modernisation for all (Milios and Sotiropoulos 2010), but in reality, when peripheral countries followed this model, it led to the emergence of multiple hybrid trajectories of economic development. The multiple case study analysis suggests that there is more than one way to become ‘debt-led’ just as there is more than one way to negotiate and adapt to Europe.

Second, I emphasise the agency of the countries of the European periphery in positively appropriating aspects of European integration in order to facilitate national strategies of modernisation. Greece, Portugal and Ireland did not passively participate in a project of European integration that was ‘tailored to core Europe’ simply because it was in the interests of the more powerful core for them to do so. Rather, as I have shown across the three case studies, the European periphery began to view the success of their own modernisation strategies as being tightly bound up in ‘tailoring themselves’ to core-Europe. This implies that, contrary to the claims of dominant critical perspectives, the periphery was never simply a passive victim. By showing that Greece, Portugal and Ireland have had some kind of an active role in their own paths to crisis – this argument has the potential to enrich these same critical accounts by opening up space to consider new and intriguing questions about what it may be possible for these countries to do next (Adler-Nissen 2015).

Emphasising the agency of the periphery also leads to a deeper understanding of the *different paths to crisis* followed by Greece, Portugal and Ireland. No single country adapted to or negotiated their Europeanisation in the same way. Although Greece succeeded in adopting various EU directives relating to banking and finance, no other country had quite as poor a record in adapting to EU expectations on pension reform, tax collection, public debt or fiscal consolidation. Portugal embraced the same principals relating to banking and finance as the other countries, but much earlier, and with different consequences for household and firm indebtedness. Ireland's experience of Europeanisation was similarly distinct, creating the conditions for a successful export-oriented modernisation strategy and a disastrous bank-fuelled property boom almost simultaneously. European integration certainly promoted a 'one size fits all' project of convergence, but individual peripheral states had a degree of scope and agency to negotiate this common external pressure in their own way. This is an important part of the explanation for why the three cases followed such dramatically different paths to crisis.

This thesis stresses the need for existing debates on the origins and asymmetry of the eurozone crisis to move beyond the limiting assumptions of 'immaturity' and 'victimisation'. Preoccupied over whether blame should be laid at the feet of the 'lazy PIIGS' or the German 'big bad wolf', existing narratives of asymmetry have been unable to adequately account for peripheral agency, or for the very different paths that led to crisis. In this chapter I reflect on the findings of the case studies of Greece, Portugal and Ireland to propose a way for these same accounts to move beyond unhelpful analyses of blame, stressing instead the centrality of both supranational and

national aspirations of *convergence*<sup>80</sup> in the origins of the crisis. This critique should not be interpreted as a wholesale rejection of either thesis. The domestic sources of the crisis in the periphery, both ‘exceptional’ and ‘non-exceptional’ are central to any understanding of the eurozone crisis. Debates surrounding the inequalities and hierarchy of the European project matter. The concept of modernisation via Europeanisation has the potential to deepen these important debates, already started by narratives of immaturity and victimisation, by overcoming some of their more serious limitations.

### **Section One: the eurozone crisis as a product of Europeanisation**

The notion that the eurozone crisis was caused by the failure of governments in the European periphery to introduce ‘painful but necessary’ reforms in the decades leading up to their respective bailouts continues to resonate strongly throughout scholarly (e.g. Featherstone 2011; Dellepiane and Hardiman 2012; Pereira and Wemans 2012), political (European Commission 2010; 2011; 2012), and media debates on the eurozone crisis (see Antoniadis 2012; Tzogopoulos 2013). It has been noisily reanimated since the beginning of 2015 when the Greek electorate first provided left-wing party *Syriza* with a mandate to renegotiate the terms and conditions of the embattled country’s agreements with its creditors (Gourgouris 2015).<sup>81</sup> Months of breakneck disagreements followed over the extent of political and economic reforms Greece should be required to impose. Commentators frequently point to Ireland (Kinsella 2012) and to a lesser extent Portugal (Richter 2015) at such times, noting how they have exited their bailout programmes and returned to growth because they successfully ‘got their houses in

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<sup>80</sup> This discussion retains the distinction between convergence as a ‘project’ and convergence as a ‘process’ introduced in the introduction chapter. Throughout this chapter, convergence will be understood as a project, not a process, that in no way implies any country is actually on the road to convergence.

<sup>81</sup> *Syriza* were re-elected on September 20<sup>th</sup> 2015.



order’ (Brazys and Regan 2015). Their assumed repentant maturity is regularly contrasted with Greece’s supposed petulance. As Ray Kinsella, former IMF and Central Bank of Ireland economist, wrote at the time:

[t]he tenor of the euro zone’s criticism of the government of Alexis Tsipras has shifted from the patronising to the denunciatory, from faux long-suffering indulgence with a brash upstart to near visceral condemnation. The message is that the grown-ups are “exasperated” and “running out of patience” with Greece’ (Kinsella 2015).

If the countries of the European periphery, including Ireland and Portugal, are responsible for their own turmoil, then it is the very essence of immaturity for Greece to expect the rest of Europe to bend to it. As I argued in the introductory chapter, this narrative has underpinned a stubborn policy response to the crisis in the periphery that even the IMF has admitted on more than one occasion is ‘unsustainable’ (Nardelli 2015) and ‘damaging’ (Elliott, Inman, and Smith 2013).

The preceding case studies have presented a challenge to this narrative. Informed by the assumptions of modernisation theory, narratives of immaturity have not fully allowed for the possibility that anything other than immature or ‘exceptional’ actions by the periphery could have been generative of divergence. In contrast, I have drawn on Comparative Political Economy (CPE) notions of capitalist diversity (Bruff and Ebenau 2014; Lane and Wood 2009) to shed light on how actions by the periphery that would not typically be considered as ‘immature’ have been absolutely central to their various paths to crisis (see Ó Riain 2014, 3–10). By returning to the analytical distinction made between ‘divergence’ and ‘non-convergence’ in chapter one, I draw out the key role of *Europeanisation* as a common catalyst of divergence across all three cases. This argument is situated in relation to a brief discussion on key EU level

developments in banking and financial integration as part of the ‘one market, one money’ re-launched project of integration. I conclude that Greece, Portugal and Ireland’s adaptation to this project has been generative of brand new patterns of unanticipated, unsustainable economic growth. In other words, the European periphery diverged and encountered crisis precisely because they ‘followed the rules’ of European integration, not simply because they failed to.

***Beyond non-convergence: Europeanisation as a catalyst of divergence***

Drawing on the insights of the Comparative Political Economy literature on ‘capitalist diversity’ (Lane and Wood 2009; Bruff and Ebenau 2014; Bruff and Hartmann 2014; Bruff and Horn 2012; Bohle and Greskovits 2012 Hancké 2009, 19-22; and see also Rosenberg 2006; 2013a; 2013b) chapter one introduced a crucial distinction between a theory of divergence and one of ‘non-convergence’. I subsequently drew on this distinction to orient the study of changing economic trajectories of Greece, Portugal, and Ireland. This made it possible to examine the ‘non-immature’ origins of peripheral divergence, and in doing so, highlight the central role of European integration.

Bringing the analytical framework of Europeanisation studies (especially those concerned with the differential character of Europeanisation – e.g. Radaelli 2004, 3; Knill 2001; Heritier et al. 2001; Wessels 2003) together with the insights of CPE, I questioned whether existing accounts of the eurozone crisis have overlooked important sources of transformation by primarily paying attention to ‘obstacles’ to an assumed ‘quasi-automatic’ process of convergence. Crucially, much existing accounts of the eurozone crisis have not yet considered that presumed ‘mature’ political and economic developments could have been generative of non-virtuous patterns of divergence. In

assuming that ‘immaturity’ begets divergence and ‘maturity’ begets convergence (i.e. failure or success in implementing ‘painful but necessary’ reforms respectively) this perspective has answered too many questions in advance. Accordingly, the three case studies presented here have investigated how these approaches could be enriched by considering the ways in which putatively ‘mature’ developments in the European periphery could have set the scene for crisis.

In each of the three cases, I found that the periphery’s adaptation to European integration (their *Europeanisation*) was generative of precarious patterns of divergence. The transformations that occurred in the developmental trajectories of the European periphery cannot be easily located within existing trajectories – and therefore the dramatic transformations of the 1990s and 2000s are not mere ‘persistence’ or continuations of existing varieties of capitalism (i.e., non-convergence – failure to introduce structural reforms), as is often been claimed. Rather, ‘when Europe hit home’ (Börzel and Risse 2002), it led to countries of the European periphery in multiple different directions. In no case did the periphery ‘not transform’ or ‘converge’ as a result of its Europeanisation. Instead, something much more radical occurred; the European periphery went in new and unexpected directions.

As such, focusing primarily on the structural reforms that the periphery failed to implement misses out on an important parallel history. Although this should not be seen as denying the role of path dependency, ‘exceptional’ or ‘immature’ patterns of divergence entirely, accounting for this parallel history invites existing domestic-level analysis to rethink the consequences of their arguments. EU reforms drove a transformation of banking and finance across the periphery, catalysing the emergence of different patterns of debt-led growth. The upshot of this is that avoiding the eurozone

crisis would have required much more than simply encouraging the periphery to overcome ‘obstacles to convergence’.

***Building ‘the most competitive and dynamic economy in the world’: European financial integration and the Single Market for banking***

Each case study has emphasised the key role played by the ‘re-launched’ project of European integration since the late 1980s. European integration had placed pressures on member states to adapt before this period. But the mid-1980s ‘one market, one money’ project – comprising the Single Market and preparations for EMU (Emerson, Gros, and Italianer 1992) - provided Greece, Portugal and Ireland with a relatively explicit and extensive ‘blueprint’ for their adaptation to Europe.<sup>82</sup> Preparations to join both acted as relatively strong imperatives for reform in the countries of the European periphery during the 1980s and 1990s (Featherstone, Kazamias, and Papadimitriou 2001, 462). As I have argued in the case study chapters, it was the attempt to adjust to these imperatives that acted as an important catalyst of divergence in the European periphery. These imperatives constitute a project of convergence which the periphery participated in. But it did not lead to the processes of convergence that may have been hoped for.

Europe was ‘re-launched’ with the Single European Act (SEA) and the first Delors Commission’s plan to ‘complete the Single Market’, create the European Union (EU) and introduce Economic and Monetary Union (EMU) soon after (Giordano and Persaud 1998, 8). ‘One market, one money’ (Emerson, Gros, and Italianer 1992); an integrated Single Market that was free from all barriers to the free movement of trade,

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<sup>82</sup> As such, I argue in the case studies something more concrete than that the periphery was simply emulating a dominant ‘vision’ of European modernity (Triandafyllidou, Gropas, and Kouki 2013), although there is certainly scope for important constructivist or discursive analysis (such as Giurlando 2012; Adler-Nissen 2015) that would enrich the discussion presented here.

capital and labour, and a single currency for that market were seen as the cornerstones of a new vision for a European economy that could gain a competitive edge in global export markets, and adapt to the perceived challenges of globalisation; namely rival economies and internationally mobile capital (see Laffan 1998, 235-6; Wigger 2015; Buch-Hansen and Wigger 2010; Buch-Hansen and Wigger 2011). Although competitiveness agendas have been essential aspects of the European project from the outset, they only acquired heightened agenda status with the acceleration of the Single Market project following the signing of the Single European Act (Wigger 2015, 119; Deeg 2012, 79).

By the 1980s, economic integration in Europe was considered to have failed to reach its potential. Accordingly, the project to 'complete' the Single Market by 1992 was expected to unleash the untapped potential of the Treaty of Rome, better preparing Europe for the challenges of globalisation by providing it with a competitive edge in the global economy (Dinan 2004, 205; Laffan 1998, 240-1). The Single Market was intended as the beginning of a Grand Strategy of ensuring the competitiveness of the EU against the USA and the various rising powers that came to increasingly challenge it in the coming decades (Laffan 1998, 241; Cahill and O'Donnell 2010, 20). It was to be achieved through a number of reforms intended to stimulate trade, increase competition, and promote European-wide economies of scale by dismantling a variety of nontariff trade barriers, which included national differences in taxes, regulations, and health and safety standards (Fligstein and Mara-Drita 1996, 9; these intentions are seen by many as a 'neoliberal turn' in Europe, see Beiling and Jager 2009, 92; Gill 1998; van Alperdoorn 2002). During the period from 1986-1992, the EU adopted approximately 280 pieces of legislation. In many areas, twelve sets of national regulations from the then twelve Member States were replaced by one common European law (European Commission

2012). Every member state was required to transpose European directives relating to everything from harmonisation of manufacturing standards to banking and capital market liberalisation. The Single Market was successfully ‘completed’ on the 1<sup>st</sup> of January 1993.<sup>83</sup>

Each case study has emphasised the particular significance of EU developments relating to banking and finance in stimulating ‘debt-led’ patterns of growth in the European periphery from the late 1980s onwards. Completing the Single Market resulted in a dramatic shifting of the landscape of European banking and finance (Deeg 2012, 79; Abdelal 2007; Bieling 2003, 208). A Single Market for Banking, together with European financial integration were viewed by their proponents as the backbone of the strategy of transforming Europe into, as it was later put in the Lisbon Agenda, the ‘most dynamic and competitive knowledge based economy in the world’ (Bieling 2003, 213). Specific EU directives on the dismantling of barriers, capital standards and deposit protection were issued in 1989, 1992 and 1994 (N. B. Murphy 2000). The idea was that if European banks could conduct business anywhere in the EU, increased economies of scale, competition and capital availability would result in benefits to businesses and consumers (Murphy 2000, 2). As the Presidency Conclusions to the Lisbon European Council put it:

[e]fficient and transparent financial markets foster growth and employment by better allocation of capital and reducing its cost. They therefore play an essential role in fuelling new ideas, supporting entrepreneurial culture and promoting access to and use of new technologies. It is essential to exploit the potential of the euro to push forward the integration of EU financial markets. Furthermore, efficient risk capital markets play a major role in innovative high-growth SMEs and the creation of new and sustainable jobs (European Parliament 2000).

New developments in European banking and finance proceeded in various ways.

Minimum standards for banking conduct are set out in various EU directives. The

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<sup>83</sup> Although as some noted upon its 20 year anniversary, in many respects, the Single Market remains ‘incomplete’ (Egan 2012; de Bois 2014).

cornerstone of the EU's policy at the time was the *Second Banking Directive* which was adopted in 1989 and by 1992 all member states were required to have in place laws and regulations consistent with it. Murphy (2000, 3) outlines the basic principles of the directive. The first was the highly important principle of *mutual recognition*. This entailed that a host nation must allow any foreign bank to do whatever is permitted in that bank's domestic environment. This implies that foreign banks may initially have different powers and capabilities over domestic banks. Mutual recognition, accordingly, has the potential to provide foreign banks with a competitive edge over domestic banks, driving the adjustment and transformation of the latter if they are to compete with foreign entrants (Murphy 2000, 3). Secondly, banking activities were explicitly defined by the EU, and all member states were required to address any differences in existing practices so that they were in line with the principle of 'universal banking' by 1993. Concretely this entailed, *inter alia*, a considerable degree of dismantling of regulations, interest rate and capital controls, and the harmonisation of solvency ratios. The third principle was the 'single passport' for banking in Europe. This authorised any bank licensed in an EU country to do business in any other EU nation as well, free from any barriers to such action (Murphy 2000, 4). As has been seen in previous chapters, each of these principles had dramatic effects on domestic banking across the periphery and beyond (see Murphy 2000, Deeg 2012, 79; Bieling 2003, 209; Cockfield 1994; Pérez-Caldentey and Vernengo 2012, 10, 11). They introduced new competitive pressures, new forms of banking activity, and greater inflows of cheaper capital to these countries in ways that had never been the case before.

Beyond the Single Market, financial integration was pursued clearly and extensively during the 1990s and 2000s, both through the Lisbon Agenda and the introduction of the euro. Yet, following EMU membership, the hard edge of these EU

pressures was absent, and adaptation to Europe through such mechanisms as the Lisbon Agenda's 'Open Method of Coordination' attempted to achieve transformation through more voluntary or persuasive means (Smith 2012; Vink and Graziano 2007, 10; Umbach and Wessels 2008, 63-66). As such, the 'harder' pressure of banking reforms during the 1990s were identified as relatively more important drivers of transformation for each of the case studies. Nevertheless, the 2000s entailed dramatic changes in providing the Single Market for Banking with a deep, easily accessible, source of capital. Developments such as the 1999 Financial Services Action Plan (FSAP) represented a programmatic and operative platform for financial market integration in Europe (Bieling 2003, 211, 212). The headline goal of the Lisbon Agenda was to achieve investment in R&D across Europe, and in order to do this, financiers needed to be encouraged to invest in more risk-oriented capital in order to finance innovation projects (Deeg 2012, 74). Yet, Deeg notes that this development was associated with the 'shareholder value' ideology in financial markets – which has led to an increased focus on short term profitability (Deeg 2012, 75) – so while cheap capital became readily available, it did not tend to flow to so-called 'productive sectors'. As is well known, the euro itself led to a deepening of financial market integration and liberalisation (Papadimitriou and Wray 2012, 2; Noeth and Sengupta 2012, 466; Bieling 2003, 211). With the removal of exchange rate risk, cross-border banking activity became much easier and liquidity became more abundant as domestic banks had easier access to interbank loans from banks in other euro-area countries. The introduction of the euro also brought with it a historic reduction in interest rates, because the ECB effectively adopted the Deutschemark interest rate levels, countries such as Portugal, Ireland and Greece witnessed their own interest rates fall sharply (Koo 2011, 1; de Grauwe 2013, 6-7).



Specifically in relation to banking and finance, the ‘blueprint’ of the ‘one market, one money’ strategy provided the European periphery with very specific pressures to adapt from the late 1980s onwards. From the brief historical background provided here, we can note that since the 1980s, the European project has become a supranational internal market and monetary union that aims to promote policies of market efficiencies, capital market liberalisation, competitiveness and convergence (van Apeldoorn, Drahokoupil, and Horn 2009). Financial market liberalisation, monetary integration and national competitiveness strategies based on ‘knowledge based’ innovation and ‘sound finance’ have underpinned the European project since the 1980s (see Featherstone 1998, 23-24; Bieling 2003, 207; see also van Apeldoorn, Drahokoupil, and Horn 2009). The ‘one market, one money’ project was expected to unleash ‘unprecedented potential for accelerated growth and enhanced competitiveness across Europe’ (Pellegrin 2001, 1). Leaving aside its more or less evident failure in achieving these aims (Pisani-Ferry and Sapir 2006; Jessop 2006; Copeland and Papadimitriou 2012), it presented a clear vision of the type of modernisation that should be aspired to and, more than this, provided concrete mechanisms for member states to reshape themselves. It is of great significance that each of the countries considered in this study successfully adapted to the various directives discussed above; which is often overlooked by focusing on the more readily apparent ways in which the periphery failed to introduce other structural reforms. In fact, existing case study literature has overlooked and neglected the transformative effects of Europeanisation as a catalyst for *divergence* – precisely because it has been pre-occupied with identifying ‘obstacles’ to an assumed trajectory of ‘convergence’. As I discuss in more detail in the following section, domestic adaptation to these EU driven reforms helped catalyse patterns of

domestic demand and debt-led growth in Greece and Portugal during the 1990s, and helped set the scene for a credit-fuelled property boom in Ireland during the 2000s.

The significance of recognising debt-led growth as an outcome of Europeanisation in this way is that it can take a domestic-level approach while telling a very different story to that of the ‘immaturity thesis’. By paying attention to the consequences of domestic adaptation to European integration, it is possible to overcome the internalism of existing domestic-level analyses without resorting to the externalism of the victimisation thesis.<sup>84</sup> Similarly, by taking on board the insights of the CPE literature on capitalist diversity, the case studies have shed light on how supposedly ‘non-immature’ practices of Europeanisation have been generative of divergence, while outlining the role of European developments in banking and finance in particular. Attempting to participate in a EU *project* of convergence contributed to *processes* of divergence in each country. In this way, the three case studies have deflated the central premise of the immaturity thesis – because they posit a narrative wherein non-exceptional processes are recognised as the problem, rather than purely considering the ‘exceptional’ character of the Greek, Portuguese and Irish crises.

In this respect, the eurozone crisis has never simply been about the failure of the periphery to introduced ‘painful but necessary’ reforms, because many of the reforms they successfully adopted were shown to have been responsible for the emergence of crisis. Significantly, the case studies contribute a theory of the origins of the eurozone crisis that understands it as an outcome of Europeanisation. In the following section I

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<sup>84</sup> Europeanisation studies provides a ‘second image reversed’ analysis that is sensitive to the international constituents of domestic development (see Featherstone 2003, 7; Vink and Graziano 2007, 16; Raedelli 2003, 35). In this respect, it has the potential to avoid the methodological nationalism of some of the domestic-level analysis reviewed here, while also challenging externalist accounts in much the same way advocated by theories such as uneven and combined development (U&CD); which focus on how domestic development always involves international constituents – and how there is no thing as purely ‘domestic’ development (Rosenberg 2006).

expand on this argument, while also drawing out the ways in which it can overcome the limitations of narratives of peripheral ‘victimisation’.

## **Section Two: ‘Modernisation via Europeanisation’: rethinking the asymmetry of the eurozone crisis**

In chapter one, I identified two major gaps in existing debates on the crisis in the European periphery. First, by relying on assumptions of immaturity or victimisation, existing approaches have been inadequate to the task of accounting for the very different kinds of the crisis the European periphery has experienced. Highlighting the various ways in which peripheral economies failed to introduce ‘painful but necessary’ reforms might explain the absence of advanced, export-oriented trajectories of growth in the periphery, but it tells us far less about how and why a banking crisis developed in Ireland, a prolonged recession in Portugal, and a competitiveness-cum-sovereign debt crisis in Greece. Pointing out that Germany has ‘beggared-thy-neighbour’ in the European periphery, on its own, explains even less about these distinctive forms of divergence.

The second gap relates to how the agency of the European periphery has been represented in existing debates. Perspectives relying on assumptions of immaturity have been unable to fully account for the possibility that any actions besides error, irresponsibility and other such ‘exceptional’ national and political traits could have been generative of divergence. Section one has already outlined the ways in which this has caused such perspectives to miss out on identifying how ‘non-exceptional’ processes of Europeanisation played a role in peripheral debt crises. Perspectives relying on assumptions of victimisation on the other hand have effectively neglected peripheral

agency entirely, viewing it as a function of ‘core’ economic domination. They discount the possibility that although the periphery may have faced a common, and compelling, external pressure – they still had a degree of agency with which to negotiate and adapt to European projects of convergence.

In this section I outline the ways in which the narratives provided by the three case studies address the above limitations. I begin by developing the concept of *modernisation via Europeanisation* in order to illuminate the ways in which Greece, Portugal and Ireland began to view the success of their own modernisation strategies as being tightly bound up in ‘tailoring themselves’ to core-Europe. This concept stresses that the emergence of debt-led growth is not best viewed as a process of victimisation, but rather as an instance of the limitations of ‘latecomer economies’ actively aspiring towards a ‘one size fits all’ developmental strategy in order to ‘catch up’ with Western Europe.

Subsequently, I build on the discussion in section one in order to trace the ways in which Europeanisation was generative of multiple and discrete patterns of divergence across the periphery. Paying attention to peripheral agency can help explain how although European integration may have created common imperatives, as Knafo (2010) has noted, ‘this does not mean that there is only one way to react to these imperatives’ (504). It provided the rules of the game, but did not fully determine how the periphery played it (ibid 504). Greece, Portugal and Ireland had the requisite agency to negotiate a ‘one size fits all’ model of European integration in different ways, and they emphasised different aspects of these rules. Moreover, similar pressures led to different outcomes in each case – the ‘one size fits all’ model did not have a consistent nor homogenous effect on the European periphery. On the contrary, the *attempt* by these countries to converge was, in fact, generative of multiple and different forms of modernisation. Narratives

underpinned by assumptions of victimisation tend to downplay this scope for agency, and accordingly miss out on an important part of the explanation for the very different paths to crisis followed by the European periphery.

Re-prioritising the centrality of the asymmetric paths to the eurozone crisis, together with the role of peripheral agency contributes an intriguing reinterpretation of the origins of the eurozone crisis. The real strengths of core-periphery analysis and other critical IPE perspectives have been to emphasise the ways in which the inequalities and hierarchies that have been built into the architecture of EMU have unevenly affected member states. The argument presented here seeks to deepen these debates by viewing them through lenses that leave notions of victimisation and ‘beggar-thy-neighbour’ dynamics behind. What is at stake is an understanding of how the European project negatively affected the periphery, in a way that takes the agency of the periphery seriously, and is also sensitive to complex patterns of asymmetry and unintended consequences.

To this end I argue that the crisis in the periphery is the outcome of a project of European integration that has been underpinned by the extensive pursuit –at supranational and domestic levels - of *convergence*. The specific paths to divergence across the European periphery were set in motion by aspirations for the periphery to ‘tailor themselves’ to Western Europe. The experience of Greece, Portugal and Ireland suggests that the future of the eurozone may need to interrogate whether such the project can proceed based on the promotion of convergence, or whether as Adler-Nissen has suggested, a better chance for stability may lie in the development of an ‘ever looser union’ (2014, 174-190).

***Beyond victimisation: modernisation via Europeanisation in the European periphery***

So far, the argument of this thesis appears to have much in common with the claims of core-periphery analysis and other critical ‘design flaws’ perspectives. The adverse impact of European integration on the European periphery that I posited in section one is not something that such approaches would dispute. Furthermore, as I have noted in chapter one, many relevant analyses have traced the ways in which Economic and Monetary Union has been converted into an area of exploitation of the countries of the European periphery by the ‘steam engine’ of the core. Germany and other ‘core’ European economies are understood to have uniquely benefitted from the European project, forcing the less-competitive economies of the periphery to ‘underdevelopment’ and causing the destruction of their ‘productive bases’ (Milios and Sotiropoulos 2010, 227). This narrative of ‘victimisation’ has been pioneered by core-periphery analysis (Lapavitsas et al. 2012; Lapavitsas et al. 2010b) and has subsequently dominated ‘critical’ scholarship on the crisis, having been taken up by post-Keynesian (Bellofiore 2013; Bellofiore, Garibaldo, and Halevi 2010; Cesaratto and Stirati 2010) neo-Gramscian (Overbeek 2012; van Apeldoorn 2012) and even by more mainstream scholarship (Wolf 2010b; Wolf 2014). It remains an influential and the predominant challenge to the immaturity thesis, allowing analysis to supplant moralisations regarding the ‘lazy PIIGS’ by shifting blame towards the German big bad wolf.

The limits of these narratives have already been substantially outlined in this thesis. Country specific balances of trade between Germany and the European periphery reveal little empirical evidence for claims that peripheral import dependency is the ‘structural mirror’ of German export success. Disaggregating capital flows between the countries of the European periphery similarly revealed that in no case was Germany the

most important lender to Greece, Portugal or Ireland. These empirical limitations suggest that the asymmetry of the eurozone crisis cannot be explained by reference to German or 'core' dominance alone.

Milios and Sotiropoulos (2010) have rebuked core-periphery analysis for failing 'entirely...to explain the dynamics of the eurozone and of the countries that coexist within it' (227). The Single Market and the euro would never have obtained support from Germany if the latter had been merely thinking about ways to 'beggar they neighbour'. This is because it would not have had a vested interest in promoting the convergence, improved competitiveness and low debt and inflation policies that were cornerstones of the accession process (ibid 235). In fact, the central logic of deepening integration since 1986, as exemplified in the Maastricht 'convergence criteria', was predicated on '*[g]reater convergence of economic performance*' (Delors 1989, 11 italics author's own). European integration since the 1980s has never been deliberately driven to generate a fracture between the core and periphery, precisely due to fears (*especially* German fears) about the possibility of such a divide leading to the kind of instability that has emerged since 2008. As such, a tighter coordination of economic policy-making was deemed necessary for both the Single Market, but especially EMU to succeed. The 'one Market, one Money' strategy contained a number of mechanisms aimed at promoting economic convergence across its member states. In the Delors report, it is mentioned that the Single Market was expected to link national economies much more closely together and 'significantly increase the degree of economic integration within the community' (Delors 1989). Greater economic interdependence was expected to:

reduce the room for independent policy manoeuvre and amplify the cross-border effects of developments originating in each member country...Community

polices [that are] in support of a broadly balanced development [among member states] are an indispensable complement to a single market (Delors 1989).

The rolling out of the Single Market coincided with adjustment periods for the so-called cohesion countries (see Bakker 1996) along with the provision of significant structural funds, many argue, as side payment for the support of the peripheral countries (Moravcsik 1991, 25).

Of course, the problems facing the Maastricht or ‘convergence’ criteria were infamous even before the crisis hit. Debates during the 1990s challenged the economic rationale and the efficacy of these criteria for generating convergence, while others questioned whether these were the right criteria at all (e.g. de Grauwe 1996a; 1996b; Gunther Schnabl 2004; Gros 2000; Holzmann, Hervé, and Demmel 1996). Two decades later, the ‘design flaws’ literature on the eurozone crisis echoed these same debates (Papadimitriou and Wray 2012,2-3; de Grauwe 2013, 7; Panico and Purificato 2013; Scharpf 2011). Depending on the perspective, the Maastricht criteria were toothless and unable to fulfil the very necessary function of fiscal discipline (Katsimi and Moutos 2010, 569), they were a wholly inadequate substitute for a genuine fiscal union (Patomäki 2013) or were the mechanisms of a transnational strategy of neoliberalism that aimed at promoting the interests of certain sectors of European capital, against the interests of European workers and welfare states (Holman 1996). Put simply, very few have claimed to be under any illusion that the ‘convergence criteria’ were generating convergence.

Nevertheless, for candidate states during the 1990s, membership of EMU entailed, *inter alia*, the adherence to five convergence criteria. In order to qualify for euro membership, all prospective member states needed to meet strict criteria relating to



low inflation rates (which must not exceed a certain ratio), government budget deficits (must not exceed 3 per cent of GDP), government debt to GDP ratio (must not exceed 60 per cent), participation in the second European Exchange Rate Mechanism (ERM II) in order to guarantee exchange rate stability, and finally, governments were required to meet limits on long term interest rates on sovereign bonds. Across all member states, a number of convergence plans were implemented in order to meet these five criteria.

As such, and in spite of its clear failures, a central aspect of the ‘one money, one market’ project was to narrow the precise divide between ‘core Europe’ and the so-called ‘cohesion countries’ (Barry 2003; Bradley 2006; Leonardi 2006; Martin and Tyler 2006; Tumpel-Gugerell and Mooslechner 2003) in order to transform an integrated European economy into the most ‘competitive and dynamic economy in the world’. As the critique of core-periphery analysis had made clear, the important point is that Germany had little interest in perpetuating a ‘structural’ divide between core and periphery. On the contrary, the convergence criteria were a crucial aspect of ensuring German participation in EMU. In joining, Germany committed to the abandonment of its Bundesbank and the Deutsche Mark (DM), two highly symbolic institutions of stability and growth. The argument goes that the only way Germany could have agreed to join the euro is if it was modelled very heavily on the DM. As Paul de Grauwe notes, ‘Germany will want to control the entry into the union, so that only those countries with the same preferences join the union’ (de Grauwe 1996a). Candidate member countries were supposed to show that they ‘care about low inflation rates in the same way that Germany does. This they do, by bringing down their inflation rate to the German level’ (de Grauwe 1996a).

Such ‘self-imposed suffering’ (such as rising unemployment as a result of low inflation policies) were supposed to provide added evidence for Germany that countries

such as Greece, Ireland and Portugal were ‘serious about fighting inflation. Once the proof is given, these countries can be let in safely’ (de Grauwe 1996a). Debates over their efficacy, logic and rationale aside, all candidate countries for EMU were expected to meet the Maastricht criteria during the 1990s, and these five criteria became key mechanisms in the ‘one market, one money’ strategy. It is unlikely that Germany would have participated in EMU without such firm commitments to the promotion of convergence across member states. For this reason, along with those outlined in chapter one, narratives of peripheral ‘victimisation’ are lacking in support.

And yet, as I have argued so far in this chapter, whatever its intended design may have been, there is clearly something about the project of European integration since its 1980s relaunch that has been calamitous for peripheral member states. Convergence may have been promoted for all, but it has certainly benefitted those it was ‘tailored to’ over those who found themselves having to adjust to it. Critiques of the victimisation thesis should not entail the shutting down of debates regarding the ongoing role of Germany, hierarchies, and inequalities in contributing to the contemporary crisis. Rather, I propose a different interpretation of these same factors.

Chapter one developed an analytical framework that was capable of recognising the detrimental impact of European integration on the periphery but that did not rely on ‘beggar-thy-neighbour’ assumptions. By drawing on the literature on Europeanisation, I proposed that the multiple case studies would explore the consequences of domestic adaptation to European integration. As already discussed, bringing this literature into dialogue with CPE’s insights of capitalist diversity allowed these case studies to illuminate the ways in which supposedly ‘mature’ processes of Europeanisation were generative of debt-led growth.

Adopting this framework, the case studies have shown that the periphery did not passively participate in a project of European integration that was ‘tailored to core Europe’ simply because it was in the interests of the more powerful core for them to do so. Rather, they actively and enthusiastically participated because they believed that ‘tailoring’ *themselves* to core Europe would lead to their own modernisation. In fact, the countries that really stood to gain from membership were the periphery themselves.

The three case studies have emphasised how, from the late 1980s onwards, Greece, Ireland and Portugal all began to view their ongoing strategies of modernisation in the mirror of the European ‘one-size-fits-all’ project. Existing literature has also noted how due to their considerably lower levels and, more importantly, diverse forms of economic development than ‘core-Europe’, countries of the European periphery tended to view EU membership as a chance to allow external forces to re-shape them as modern, mature European economies (Triandafyllidou, Gropas, and Kouki 2013; Giurlando 2012; Dyson and Featherstone 1996).

Naturally, the commitment by the EU to significantly increase flows of structural funds to the poorer member states and regions of the European Union was widely welcomed by Portugal, Ireland and Greece (Laffan and O’Mahony 2008, 14; Teixeira 2012, 16). Similarly, the prospect of remaining outside of the Single Market and the euro was largely unthinkable – as a 1961 Irish department of finance memorandum anticipating EEC membership put it - ‘[w]e might find ourselves a political, as well as an economic, anachronism in the midst of the world’s largest political and economic entity’ (see Geary 2013).

Yet in addition, all three countries were motivated by a shared perception of the failures of earlier strategies of development, as well as the opportunity to utilise

European integration as a developmental strategy. As I argued in the first section of this chapter, the ‘one market one money’ project has helped explicitly define what ‘levels’ and ‘forms’ of economic development represent both the ‘accomplishment of modernity and the formal confirmation of ‘being’ European’ (Triandafyllidou, Gropas, and Kouki 2013, 16) for countries attempting to ‘catch up’. As such, the ‘one market, one money’ project created a clear vision and blueprint for the periphery to pursue their own *modernisation via Europeanisation*.

As I argued in chapter two, emerging agendas of modernisation in 1990s Greece were shaped strongly by the economic turbulence of the 1980s. As Greek PM Costas Simitis put it in 2005, Greece’s participation in the integration process was the ‘strongest lever for our exit from a reality of economic and social retardation’ (quoted in Featherstone and Papadimitriou 2008, 190). Participation in the Single Market and, especially, preparation for joining the euro, allowed the Simitis government (and the Mitsotakis government before him) to push for a number of measures aimed at ‘reform’ (in spite of many supposed missed opportunities and resilient obstacles (Featherstone and Papadimitriou 2008)). The modernisation agenda was explicitly framed in relation to Europe and, as Featherstone and Papadimitriou note, ‘it had little meaning without reference to the need to adapt to the EU’ (2008, 14). Portugal joined the EC in 1986, the same year as the introduction of the Single European Act. As I argued in chapter three, the introduction of a series of structural reforms during the 1980s and early 1990s were ‘marked by a self conscious escape from the legacy of [the revolutionary] period’ (Maxwell 1995, 1). As such, the mitigation of political and economic instability was sought through the adoption of, or emulation of certain aspects of the European model of modernity. For Ireland, participating in the Single Market and EMU emerged as ‘a new zone of consensus’ (Antoniades 2010, 146) which had much to do with Ireland’s

export-oriented strategy of modernisation – which would have been unthinkable outside of the Single Market and Monetary Union (Ahern 2004).

The EU tended to be viewed by the periphery as providing tools to overcome the problems caused by the instability of recent attempts at modernisation, but also as a ‘challenge for development’ (Antoniades 2010, 69) wherein Greece, Ireland and Portugal could each leave their ‘peripheral’ pasts behind, and converge with their Western European neighbours. Deepening European integration represented an opportunity for the European periphery to ‘make the journey from autarchy to interdependence’ and to embrace international liberalisation and economic growth to carry with it ‘the seeds of deep societal change and challenge’ (Laffan and O’Mahony 2008, 14). As former Prime Minister and President of Portugal Mário Soares put it in a 1985 interview with *Le Monde* ‘No if we did not want to miss out on the end-of-the-century technological revolution, we absolutely had to join Europe. Now is the time!’ (Clerc 1985). For Ireland, Europe appeared to ensure that Ireland would have an ‘industrial rather than a pastoral future’ (Laffan and O’Mahony 2008, 16). As one of the epigraphs to this chapter has noted, Costas Simitis, Prime Minister and leader of PASOK and its ‘modernizing wing’ from 1996-2004 understood European integration as opportunity for countries such as Greece to transform into ‘competitive and dynamic’ knowledge based economies (quoted in Antoniades 2010, 72). Participation in the ‘one market, one money’ project entailed that Portugal, Ireland and Greece each attempted to adopt a ‘one-size-fits-all’ development strategy in order to modernise their economies and catch up with Western Europe. As Kevin Featherstone recognises, for the periphery, modernisation became Europeanisation (Featherstone 2005; 1998, 24).

Viewing strategies of modernisation as intimately bound up in Europeanisation, as the three case studies have done, allows us to move beyond the limits of immaturity

and victimisation. Greece, Ireland, and Portugal were at the centre of the eurozone crisis because they actively and voluntarily followed the rules of the ‘one market, one money’ project in order to modernise. Their participation was never of clear instrumental value to core-Europe. Rather, it was the countries of the European periphery that appeared as if they had the most to gain.

Nevertheless, as I have argued, the periphery’s attempt to modernise via an attempt to converge with Europe did not lead to economic stability, enhanced competitiveness and convergence. Instead it led to the generation of multiple and fragile hybrid forms of development. There is no ‘one-size-fits-all’ model for development (Rosenberg 2006), and the attempt by the European periphery to reshape themselves in order to adapt to the one promoted by the EU, has had disastrous consequences.

This argument has the potential to enrich critical approaches to the origins of the eurozone crisis. In the first chapter I noted that ‘step-1’ of core-periphery analysis had unrealised potential to account for the asymmetry of the eurozone crisis by recognising that a beggar-thy-neighbour relationship between core and periphery is not necessary to recognise that a model of European integration that was ostensibly tailored to ‘core Europe’ was likely to have adverse effects on the European periphery. Yet, the narratives provided by the three case studies have gone further than this. They have shed light on the ways in which the attempt by the periphery to adapt to a homogenous strategy of modernisation was actually generative of multiple and qualitatively different patterns of divergence. Core-periphery analysis and other perspectives that claim to study the asymmetry or unevenness of the eurozone crisis (e.g. see collected essays in Jäger and Springler 2015; Rodrigues and Reis 2012) have been more successful in paying attention to the differences between the core and the periphery, but considerably less so in accounting for variation amongst the periphery itself. I now return to the

discussion in section one, in order to emphasise the ways in which Europeanisation was generative of multiple, discrete trajectories of divergence.

***Peripheral Agency and the multiple outcomes of ‘convergence’: accounting for the asymmetry of the crisis in the periphery***

Modernisation via Europeanisation resulted in a variety of hybrid trajectories of development. By paying attention to the agency of the European periphery it was possible to draw out the ways in which a ‘one size fits all’ model of European integration was negotiated differently by the different countries. This in turn helps explain why Greece, Ireland, and Portugal followed very different paths to crisis. Explanations which focus on the passive restructuring of the European periphery neglect to pay sufficient attention to the differential impact of external pressures such as membership of the euro and single market. As Radaelli and Pasquier (2007) note the weight of evidence in EU politics leans towards the notion that external pressures will provide different actors with different opportunities and the scope for ‘creative uses of Europe’ (39). When Europe ‘hits home’, it has to negotiated and adapted to by domestic agents, and the implication of this is that it will have a differential impact (ibid, 39). In this section I draw out the important differences between the case studies and emphasise the way these differences reflect different levels or forms of agency across the three cases.

As I outlined in chapter two, the modernising reforms of Costas Simitis were defined in relation to preparing for the Single Market and EMU. While Greece may have been considerably less successful than other countries in tackling structural problems relating to pension reform, tax collection and public debt and fiscal consolidation (Featherstone 2014, 8; Featherstone and Papadimitriou 2008), it nevertheless succeeded in adopting the various principles relating to banking and

finance set out by the Single Market project. In the process, the Greek economy set off on a course of transformation from the pre-1974 semi-industrial model to one based strongly on domestic consumer demand and import penetration. The transformed Greek banking and financial sector has operated as the engine of the national economy from the 1990s as it developed rapidly in response to EU reforms. Declining interest rates and levels of inflation attracted significant international investment into Greece, and this investment tended to flow towards the non-tradable sector, rather than the tradable sector (Nicos Christodoulakis 2000, 98) which damaged Greek competitiveness and widened its current account deficit. Following EMU membership, this overheating continued, severely damaging the country's competitiveness, widening its current account deficit, and consolidating brand new patterns of economic activity.

However, the impact of European integration on Greece has not been entirely consistent. (Featherstone and Papadimitriou 2008; Featherstone 2008) and others (see various essays in Mitsos and Mossialos 2000; and various essays in Kalyvas, Pagoulatos, and Tsoukas 2013) have noted Greece's poor record in implementing reforms relating to pension provision, tax collection and privatisation. Greece's poor reform capacity in this regard contributed to its fiscal and sovereign debt crisis in 2009. As such, Greece's crisis can be understood as stemming from a combination of adopting certain EU driven changes, while resisting others. Furthermore, although economic growth in Greece became driven by credit fuelled domestic demand, as was the case in Ireland and Portugal, Greece ended up with one of the lowest levels of private and household debt in the eurozone and, unlike Ireland, Greece was quite clearly not a banking crisis (see Pagoulatos and Triantopoulos 2009; Pasiouras 2012). Indeed, Greece's poor reform capacity may actually have worked in its favour, as Pagoulatos and Triantopoulos (2009) note. Post-EMU accession, reform zeal subsided in Greece.



The performance of the Greek banking sector was actually relatively lacking when compared with other EU member states. It exhibited relatively conservative credit policy stances and a limited integration of the Greek banking system with international financial markets. ‘This relative ‘underdevelopment’ including the lack of exposure of Greek banks to ‘toxic’ products, proved beneficial during the current financial crisis’ (37). As Pagoulatos and Triantopoulos (2009) put it, Greece was actually fortunate, at least in this particular respect, not to have belonged to the club of the more ‘developed and sophisticated’ European financial systems (51).

As Chapter Three has shown, Portugal also adapted to the ‘one market, one money’ strategy from 1986 onwards after joining the European Community. A number of structural reforms were introduced which resulted in the establishment of a newly liberalised and privatised banking system. These reforms radically changed patterns of economic growth in Portugal during the 1990s – as banks fuelled the inflation of the non-tradable sector and generated some of the highest levels of private indebtedness in Europe for the country by the end of the 1990s (Royo 2012, 205). This inflated the construction sector in Portugal during the 1990s, but not to the same extent as Ireland or neighbouring Spain. In fact, in terms of increasing employment, wholesale, retail, education, health care and social work saw the largest increases (Reis 2013, 156), and construction contracted sharply after 2000. This suggests that phenomena such as capital market liberalisation and interest rate shocks do not automatically result in the generation of speculative bubbles. As Portugal’s export competitiveness declined in the early 2000s, this new pattern of growth witnessed a downturn as over-indebtedness dampened consumer demand and as acted as an obstacle to investment (Royo 2012, 206). Together, the structural reforms and falling international competitiveness contributed to the transformation of the Portuguese model into an import dependent,

consumer driven, ultimately stagnant (particularly from the 2000s onwards) economy with a persistent tendency to run current account and public deficits. This experience sets Portugal apart from Greece and Ireland. Portugal's adoption of EU reforms relating to banking and finance led to a relatively early pattern of private indebtedness during the 1990s. This suggests that, unlike the other cases, Portugal did not experience the interest rate shock of EMU with an increase in domestic demand or an acceleration of GDP. Portugal exhausted its domestic demand-led growth at a much earlier stage than Ireland and Greece (Lagoa et al. 2014, 66).

In anticipation of joining the European Single Market and preparing for EMU, Ireland began to dismantle its heavily regulated banking sector. With the increasing presence of foreign banks in Ireland partially as a result of the EU's 'Single Passport' directive, Irish financial institutions faced more pressure to be competitive and this promoted the practice of lending funds and 'a culture of bonus payments to financial managers on the basis of short-term success in meeting or exceeding lending targets' (Kelly 2014, 37). Ireland also set itself apart from Greece and Portugal by explicitly attracting a transnational financial sector to set up in Dublin's docklands from the 1980s onwards, as part of a broader developmental strategy of FDI attraction (Ó Riain 2012, 508). Each of these factors promoted the kind of reckless lending practices that were to characterise the transformation of Ireland from an export-led model of growth to a debt-led model in the 2000s with the property boom. The scene was set for the Irish property boom in the fifteen years before it began. Ireland may have eagerly participated in the Single Market and EMU to promote its export-oriented modernisation strategy, but in doing so, unintentionally created the conditions for a property boom and a banking crisis.

However, as Chapter four has argued, Ireland's experience of the 'one market, one money' project was initially highly positive, and especially so during the 1990s. It was during this period that Greece and Portugal were beginning to find their economies dominated by debt-led domestic demand growth; while in contrast, Ireland was experiencing an unprecedented export boom. Ireland's export-oriented strategy of modernisation is also intimately bound up in the country's experience of European integration. Ireland's Celtic Tiger was made possible by long standing state-led innovations in FDI attraction, but only fully activated once Ireland joined the Single Market, thus becoming a uniquely attractive location for inward investment from the USA. It was only when this export-oriented growth declined in the early 2000s that Ireland found its economy overwhelmed by debt-led activity (Cahill and O'Donnell 2010). It is reasonable to assume that Ireland would not have emerged as the prominent destination for US FDI into Europe without the Single Market and EMU. As such, the historical reality of Ireland's integration has been more complex and contradictory than was perhaps realised at the time. Europe was seen (not without warrant) as a necessary and indispensable part of Ireland's modern and vibrant export-led growth, and yet, at the same time, Ireland's eagerness to adapt to the European model created the conditions for a severe banking crisis a decade later.

These differences reflect the different ways in which the 'one size fits all' model of European integration was negotiated domestically in Greece, Portugal and Ireland. Paying attention to domestic agency in this way is important because it makes it possible to explain sources of economic divergence, in a way that approaches emphasising passive external restructuring are ill-equipped to recognise. This is a major distinction between my argument and those underpinned by assumptions of 'victimisation'. The periphery certainly experienced disastrous consequences from its

attempt to adapt to the ‘one market, one money’ project. But these consequences played out in very different ways and took on very different, not at all consistent, forms. We cannot trace the specific sources of divergence, and the multiple paths to crisis followed by the European periphery without jettisoning an externalist framework and recognising how domestic agency allowed that project to be negotiated in different ways.

### ***Rethinking the ‘design flaws’ of the European project***

The case studies of Greece, Portugal and Ireland have revealed that their respective paths to crisis were catalysed by their attempts to adapt to a ‘one size fits all’ project of European integration. In an important respect, the findings of this study have much to contribute to literature that focuses on the ‘design flaws’ of the European project (e.g. de Grauwe 2006a; Papadimitriou and Wray 2012; Lane 2012; de Grauwe 2010; Uhlig 2002; Scharpf 2011). However, rather than focusing on the ways in which EMU lacked the necessary ‘discipline’ to manage economic imbalances or on the ways in which monetary union was disastrously incomplete without a fiscal, political or federal union, I argue that the real design flaw was the promotion of a project of integration with *convergence*.

The notion that the European project did not promote convergence efficaciously enough resonates throughout numerous (and often otherwise fundamentally incompatible) strands of opinion on the eurozone crisis. The publications of critical political economists (e.g., Varoufakis and Holland 2011) and the European Commission alike (see, for example, the provisions on the promotion of competitiveness in line with EU ‘best practice’ in Greece’s latest bailout agreement - European Commission 2015) have been united by a shared vision of the importance of deeper and more genuine

convergence amongst EU member states in the wake of the crisis (even if their visions of how to achieve such convergence differ radically). But the experiences of Greece, Portugal and Ireland as it has been traced here suggest a competing interpretation. Existing attempts at the promotion of convergence *at their most successful* have been generative of multiple and unanticipated patterns of divergence. This heralds that future developments in European integration require a tremendous degree of caution in their promotion of convergence. Countries of the European periphery have long understood EU membership as a chance to facilitate their re-shaping into modern, mature European economies. As I argued in section one of this chapter, since the 1980s relaunch of the European project, a Single Market for banking, capital market liberalisation, a European level competitiveness agenda, and ‘convergence criteria’, together, have defined, concretely, what it means for the European periphery to ‘catch up with Europe’. The existence of this project has helped explicitly define what ‘levels’ and ‘forms’ of economic development represent both the ‘accomplishment of modernity and the formal confirmation of ‘being’ European’ (Triandafyllidou, Gropas, and Kouki 2013, 16). As such, the ‘one market, one money’ project created a clear vision and blueprint for the periphery to pursue their own modernisation *via* Europeanisation.

The obstinate promotion of projects of convergence since 1986 has created three precarious patterns of divergence for peripheral countries. As such, implementing a ‘one size fits all’ model of development across uneven levels and types of economies was always unlikely to produce homogeneity of models (Smith 2012). This is a critique of the integration process that goes beyond the claims of the design flaws literature regarding the dangers in integrating diverse ‘varieties of capitalism’ into a single monetary union (e.g., de Grauwe 2013). Certainly, the existence of very different kinds of economies was likely to result in tensions. But what this thesis has argued is that the

attempt to mitigate these differences through various measures aimed at convergence actually contributed to the emergence of brand new and perilous patterns of divergence.

This reading of the origins of the eurozone crisis has important consequences for how existing political responses to the eurozone crisis should be evaluated. The official EU response has been marked by measures designed to correct the immaturities of the peripheral states; to drive convergence more extensively and systematically – to prevent the periphery from endangering the rest of the eurozone through its ‘failure to converge’. Yet, if adaptation to new developments at the level of the EU is understood as central to emergence of crisis-prone trajectories of economic development, it suggests that a lack of convergence is not the main problem facing the eurozone. In fact, quite the opposite is true. The relative severity of the crisis in the periphery can be explained by the EU’s commitment to the promotion of a single model of convergence across a variety of different European economic trajectories. This ‘one-size-fits-all’ model of integration promoted patterns of debt-led growth across Portugal and Greece, and even contributed to the derailment of Ireland’s development of export-oriented growth during from the late 1950s onwards. The crisis in the eurozone is therefore not best understood as one of peripheral profligacy, misgovernment or exceptionalism. Rather, it is a crisis of a project of European integration that has been underpinned by projects aimed at promoting convergence. This has important consequences for even the more critical proposed solutions to the crisis. Even if Political Union (Bastasin 2012) or a ‘European New Deal’ (see Laciata and Vallentino 2014; Patomäki 2013) are somehow pursued, as with any conceivable project of European regional integration, they will produce similar tensions unless it is recognised that any project of European integration is likely to produce multiple models of development. The challenge is not to heedlessly

push for future convergence, but to envision ways in which virtuous patterns of divergence can be cultivated within a project of integration.

## Conclusion

Tracing the economic trajectories of Portugal, Ireland and Greece has shown that the divergence of peripheral economic models should neither be understood as an incomplete modernisation (immaturity thesis) or as a stunted/repressed modernisation (victimisation thesis), but as one of many multiple ‘modernisations’ that emerged and were transformed via participation in the project of European integration. Since the 1980s, the European project, tacitly or otherwise, provided a single model of modernity for all to follow. In spite of numerous, wide ranging and highly extensive projects of convergence, this model of modernity led to the emergence of multiple hybrid models of development. In fact, domestic adaptation to this project was *generative* of divergence; adapting to the euro and the Single Market contributed to the declining competitiveness and financialisation of all three countries. This is at the heart of the causes of the eurozone crisis.

Reinterpreting its origins in this way presents a new challenge to the immaturity thesis. It does not matter that Portugal, Ireland and Greece did not follow ‘all the rules’ of European integration. The rules that they were compelled to follow led to wholesale, and damaging, transformations. Similarly, the argument presented here challenges notions of peripheral ‘victimisation’. The periphery actively Europeanised in order to further national projects of modernisation. The real design flaw of the European project is not that such a process ‘underdeveloped’ the periphery to the benefit of the core, but that the periphery were following a blueprint that was to lead to unpredictable patterns

of divergence. Greece, Ireland and Portugal, as Alexandre Afonso puts it, were pupils that got ‘good grades for learning bad lessons’ (2013).

The concept of ‘modernisation via Europeanisation’ can be interpreted as a way of enriching domestic level and systemic level approaches in different ways. Although narratives of immaturity are disputed, my argument has been developed by paying attention to the domestic sources of the periphery’s crisis. The importance of path dependency, ‘immature’ or ‘exceptional’ causes has not been altogether dismissed. Rather, I have claimed that these processes cannot tell the full story. By recognising the ‘non-immature’ sources of the periphery’s crisis, domestic-level approaches can deepen their understandings of the crisis in the countries they study. Yet, this does mean that these perspectives should move beyond their emphasis of the more readily apparent ‘pathological’ origins of the crisis, towards a deeper engagement with the systemic, European level causes of the crisis which I have identified as pivotal.

This argument, accordingly, seeks to contribute to critical debates on the role of European integration in catalysing the crisis. Core-periphery analysis, design flaws perspectives, and other accounts from critical IPE have emphasised the adverse effect of EMU and the integration process on peripheral economies. I have sought to deepen the arguments of these approaches by emphasising the ways in which the periphery positioned themselves into a European hierarchy. This does not necessarily imply that the periphery were fully free from patterns of victimisation<sup>85</sup>, but it does propose an analysis that is better able to account for agency, complexity, unintended consequences, and asymmetry.

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<sup>85</sup> Although it does suggest that we re-think what is meant by ‘victimisation’. The periphery clearly lost out as members of the re-launched European project. Europe was clearly tailored to a vision of development that suited core member states more than the periphery. But notions of dependency do not adequately capture the ways in which the periphery was adversely affected by their participation in this project, as I have argued throughout this chapter.



To sum up, the three case studies, together with this chapter, have implied a potentially far-reaching rethinking of the origins of the eurozone crisis in the European periphery. Ultimately, the crisis relates to the ways in which Portugal, Ireland and Greece navigated their projects of modernisation through the project of European integration, and how participation in the latter, shaped those projects for the worse. The origins of the very different kinds of crisis in Portugal, Ireland and Greece thus have a common catalyst; they are the multiple outcomes of attempts to converge towards a ‘one size fits all’ model of European development. By taking the history of economic divergence seriously in each case, the constitutive role of the EU’s ‘one market, one money’ project in the divergence of the European periphery has been established. As such, the periphery was not hit relatively hard by the crisis because it failed to converge. Rather, it was hit relatively hard because its attempts to converge led, unsurprisingly, to unintended consequences.

As such, following the rules of European modernity, rather than failing to, is what accounts for the origins of the crisis in the European periphery. This explains why a beleaguered peripheral economy such as Portugal may indeed be, as described in 2013 by Jacques Delors, the ‘good pupil’ of the eurozone (Delors 2013). Even the most studious emulation of European modernity can still produce a fragile, divergent model of growth.

## Conclusion

In this thesis, I argued that national and supranational projects aimed at fostering the economic convergence of the member states of the European Union have, counter-intuitively, propelled the periphery down divergent paths; paths which ultimately led them to their respective crises. The origins of the eurozone crisis were investigated across three of the worst-hit countries; Greece, Portugal, and Ireland. By bringing literature on Europeanisation studies into dialogue with the insights of capitalist diversity, the concept of ‘modernisation via Europeanisation’ was contributed. This made it possible to examine how domestic adaptation to a ‘one size fits all’ model of European integration has inadvertently resulted in the generation of fragile trajectories of economic development in each country. Contrary to much conventional wisdom, I argue that the European periphery got into trouble by ‘following the rules’ of European integration, rather than failing or being unable to.

This rethinking of the origins of the crisis in the European periphery has potentially far reaching consequences for existing academic and political debates. The eurozone crisis cannot be fully explained by narratives which stress the ‘immaturity’ of the countries of the European periphery. Neither can it be explained by more critical narratives which understand the periphery as a victim of German ‘economic domination’. Instead, I explain the relative severity of the crisis in the periphery as a

product of these countries' attempt to modernise by tailoring themselves to a 'one size fits all' model of European development. In this concluding chapter, I reflect on how this argument has been developed across the previous chapters, and bring the thesis to a close by drawing out the broader significance of my argument for important debates on the origins - and future development - of the eurozone crisis.

## **Development of argument**

I began this thesis by recognising that existing literature on the eurozone crisis has been unable to account for its asymmetric impact. The eurozone crisis has had a detrimental impact across Europe, but the countries of the European periphery have been affected more severely than others (Hardiman and Dellepiane 2010, 473). Moreover, the individual countries of the European periphery have followed considerably different paths to crisis, making it more difficult than might be expected to speak of the eurozone crisis as a single phenomenon. If there have been multiple paths to the eurozone crisis, it follows that any policy response will need to take this asymmetry into account. Yet, existing debates have tended to downplay, or explain away this asymmetry.

Chapter one uncovered a previously overlooked tendency, common to both mainstream and more critical accounts of the eurozone crisis, to fall back upon and reproduce one of two problematic narratives on the asymmetry of the eurozone crisis. These were labelled the *immaturity* and *victimisation* theses. The 'immaturity thesis' accounts for the relative severity of the crisis in the 'PIIGS' by stressing the central roles of fiscal profligacy, corruption, and pathological patterns of national and political culture. Had the periphery introduced 'painful but necessary' structural reforms in the decades before the crisis, the sovereign debt crisis could perhaps have been avoided.

Such assumptions continue to generate reams of commentary on Greece, but José M. Magone's analysis of Portugal exemplifies this argument as well anything else:

[t]here is a social psychological explanation for ... [the low productivity of the Portuguese economy]...related to the lack of transformation of the values of Portuguese society, which tend to go counter with a competitive ethos and emphasize a lack of ambition in pushing through major objectives (2004, 223).

The second perspective challenges the immaturity thesis by re-interpreting the eurozone as a region characterised by a 'beggar-thy-neighbour' hierarchy between the economic growth of the core, which leads to precarious, 'financialised' growth in the periphery. Germany's economic strategy is centred on low domestic demand, export-led growth and a firm commitment to ordoliberal values. Germany has reputedly used the euro to advance this strategy at the direct expense of the European periphery. Proponents of this approach have seemingly been vindicated, time and again, by Germany's intransigent response to the crisis. It makes perfect sense that Germany should be so inflexible in its negotiations with Greece; it has directly profited from the very unfairness that Syriza and others want so desperately to change (Dooley 2015a). In fact, without a narrative of victimisation, Germany's response seems difficult to comprehend (as Matthijs 2015 notes).<sup>86</sup>

I have argued that each of these underlying theories of asymmetry have acted as obstacles to our understandings of the asymmetry of the eurozone crisis, primarily due to their problematic conceptions of peripheral agency, and their inability to account for the very different kinds of crisis experienced by countries such as Greece, Portugal and

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<sup>86</sup> And yet, of course, this thesis strongly challenges the claims of core-periphery analysis. This has significance for scholars working on Germany and the eurozone crisis, and could contribute to debates on German hegemony (Bulmer and Paterson 2013; Bulmer 2014; Paterson 2011). Future research that jettisons 'beggar-thy-neighbour' assumptions could potentially ask intriguing new questions about Germany's relationship with Europe and the periphery, as forthcoming work by Adler-Nissen (2015) also demonstrates.

Ireland. Perspectives underpinned by assumptions of peripheral ‘immaturity’ were often unable to take the international dimensions of the crisis seriously. Moreover, by sharing meta-theoretical assumptions with modernisation theory, they have propagated analysis that is insensitive to the ways in which development is pursued and achieved in different ways across societies (Lyberaki and Tsakalotos 2002, 93, 95; Eisenstadt 2000; Rosenberg 2006) – thereby merely offering explanations as to why the periphery failed to generate export-oriented patterns of growth, rather than accounting for the three dramatically different forms of divergence that emerged. On the other hand, core-periphery analysis was found to have overstated the ‘structural role’ of the periphery for Germany in its generation of trade surpluses and as a destination for capital outflows. The empirical case for a ‘beggar-thy-neighbour’ relationship between Germany and the periphery was exposed as seriously limited. Moreover, while the immaturity thesis conflates a ‘failure to converge’ with an explanation of divergence (Hancké 2009) narratives of victimisation account for all divergence as a passive function of German economic domination. And while the immaturity thesis provides no conception of the periphery as capable of acting maturely; core-periphery analysis provides little conception of peripheral agency at all. In order to adequately understand the asymmetry of the eurozone crisis, I claimed that we need to move beyond the limiting ‘immaturity’ vs. ‘victimisation’ debate.

To this end, I proposed an analytical framework which combined Europeanisation studies focus on the ‘domestic adaptation to European regional integration’ (Vink and Graziano 2007) with Comparative Political Economy’s (CPE) focus on capitalist diversity and its distinction between divergence and ‘non-convergence’. While Europeanisation and CPE have both long been sensitive to the differential impact of Europeanisation, each literature has tended to account for this

difference with reference to the ‘persistence’ of national diversity. In other words, asymmetry is explained as continuity with the past, and in a theoretically meaningful sense, a lack of transformation in the face of the pressures of European integration. Taking cue from core-periphery analysis’s recognition that the institutions and policies of EMU have ‘taken cognisance of conditions primarily in core countries rather than assigning equal weight to all’ (Lapavitsas et al. 2012, 3, 5), I proposed an analytical framework that would investigate whether or not Europeanisation has been generative of divergence in the European periphery. Combining these two literatures proved very productive, as it made it possible to study the ways in which domestic adaptation to European integration could have lead to *divergence* – the fundamental transformation of existing domestic structures – and to the emergence of radically new hybrid domestic structures and patterns of growth.

This approach allowed me to build on the respective strengths of the immaturity and victimisation theses, while overcoming some of their limitations. Domestic level analysis of the crisis is vital, as is an awareness of deep patterns of inequality and hierarchy between EU member-states that core-periphery analysis and others recognise. The approach I propose makes it possible to examine these important aspects, while also bringing the agency of the periphery, and the asymmetry of the crisis, front and centre.

I then proceeded to trace the evolving economic trajectories of Greece, Portugal and Ireland in the decades leading up to the eurozone crisis, while being sensitive to the possibility that domestic adaptation to European integration could have contributed to that evolution. Three new narratives of the crisis in the European periphery were accordingly contributed. Across each case, the attempt to achieve national goals of modernisation through adaptation to a ‘one size fits all’ model of European integration

was emphasised. The Europeanisation of Greece, Portugal and Ireland, in this respect, was revealed to have acted as a catalyst for the emergence of multiple patterns of precarious, non-competitive debt-led growth.

Beginning with the supposed epicentre of the eurozone crisis, chapter two investigated the case of the Greece. Much existing literature tends to emphasise the ‘exceptional’ character of the Greek crisis, setting it apart from not just Western Europe, but also at times, from its fellow peripheral states. Jason Manolopoulos has perhaps been less equivocal than many when outlining a nevertheless familiar sentiment - ‘Greece is not a Western country’ (Manolopoulos 2011, 61). In contrast, this thesis has emphasised how the crisis in Greece is better understood as having both ‘exceptional’ and ‘non-exceptional’ roots. While it would be misguided to downplay Greece’s poor record in reforming, *inter alia*, its public sector, welfare system, tax collection and pension provision, it was argued that these putatively ‘immature’ processes only tell part of the story. Recognising that Greece’s current difficulties have a fiscal and a competitiveness component, it was argued that we can best trace the origins of the latter by studying the impact of Europeanisation during the 1990s. As a result of implementing reforms relating to liberalisation, privatisation and deregulation, a rejuvenated banking sector became the engine of a new type of Greek economy from the 1990s onwards (Pagoulatos and Triantopoulos 2009). Following the introduction of the euro, this new ‘debt-led’ trajectory was accelerated, inflating the non-tradable sector, import penetration, and significantly widening its current account deficit. As such, Greece’s problems - somewhat incongruously – were caused just as much by the EU driven reforms it succeeded in introducing, as by those it failed to. This suggests that, although the fiscal and debt crisis may have been greatly mitigated, there is little

guarantee that the introduction of ‘painful but necessary reforms’ from the 1980s onwards would have ensured the good economic health of Greece today.

The thesis next turned to the ‘difficult story’ of Portugal (Krugman 2011). The narrative begins in the 1980s, when responding to severe political and economic stability in the aftermath of the 1974 Carnation Revolution, centre-right governments led by the Social Democratic Party (PSD) introduced a number of important ‘structural reforms’. These reforms were facilitated by the EC/EU, and contributed to the development of a new institutional structure that allowed the expansion of the economic growth in the non-tradable sector, fuelled by a newly invigorated banking sector. During the 1990s, Portugal accumulated some of the highest levels of private debt in Europe, creating a situation of household and enterprise over-indebtedness by the turn of the century. Combined with falling international competitiveness resulting from the rise of East Asia and the EU’s Central and Eastern enlargements, this private over-indebtedness contributed to a decade long recession beginning in the early 2000s. Existing approaches have attempted to explain this recession as the result of state failures to improve the productivity of the Portuguese economy during the ‘good times’. In contrast, this thesis has argued that Portugal’s difficulties were a direct result of the pattern of debt led domestic demand’ growth (Lagoa et al. 2014) that emerged as a result of the ‘structural reforms’ of the 1980s and 1990s. In other words, like Greece, the Europeanisation of Portugal’s economic trajectory during the 1990s catalysed a divergent and fragile trajectory of growth. Implementing the reforms necessary to take part in the Single Market and EMU helped transform Portugal’s economy into one that was increasingly inward looking and debt-driven; and fated to burn out rapidly.

The final case study departed Southern Europe for the North Atlantic. It traced the decline of Ireland’s export-led ‘Celtic Tiger’ boom of the 1990s, and the emergence



of credit-fuelled property boom in the 2000s. An analytical distinction was made between the Celtic Tiger and the banking crisis, in contrast with much Irish IPE literature that understands both as two sides of a neoliberal coin (Kirby 2010). Nevertheless, it criticised those perspectives that mostly understand the former as having been hijacked, squandered and supplanted by immature political and economic governance from the late 1990s onwards. The Irish crisis was not, as the late Brian Lenihan, former Minister for Finance put it in a memorable interview, caused when ‘we all partied’ during the 2000s (RTÉ 2010).

Instead, chapter four charted the parallel history of how Ireland’s adaptation to the Single Market and EMU facilitated the emergence of a highly liberalised and increasingly aggressive banking sector, a process beginning as early as the late 1980s. Until the mid 1980s, the Irish banking system was among the most heavily regulated in Europe. New developments in European integration changed all of this. EU driven reforms in banking and finance helped develop Ireland’s notorious system of ‘light touch regulation’, and the various reforms required by the 1989 Second Banking Directive allowed for the entrance of foreign banks, such as Royal Bank of Scotland and others, into the domestic market. These EU driven changes dramatically transformed the mortgage lending landscape as mortgage interest rates were reduced, and domestic banks began to respond to increasing competition by increasingly promoting short term lending with little regard to risk. The scene was already set for Ireland’s disastrous property boom in the decade before waves of capital market liberalisation fully activated it following EMU membership.

Ireland’s crisis is particularly interesting as a former ‘poster child’ for European integration (a moniker that has recently been re-applied to the country in honour of its commitment to recovery via austerity (Dooley 2015b)). While the Celtic Tiger boom

may almost certainly have been unthinkable (Ahern 2004) without a strong commitment to European integration, the very same commitment also contributed to Ireland's banking crisis a decade later. The Irish case suggests that the consolidation of sustainable, putatively mature trajectories of export-led growth were little defence against the emergence of EU facilitated, precarious patterns of debt-led growth.

These three case studies were finally drawn together to develop the concept of 'modernisation via Europeanisation'. Two important implications of this concept were drawn out. First, it was possible to conclude that Greece, Ireland and Portugal have been at the centre of the eurozone crisis, precisely because their attempts to converge with core-Europe were generative of new patterns of precarious divergence. 'Bad things can happen to good pupils' – in each case, the countries of the European periphery got into trouble by following the rules of European integration, not simply by failing to. This has implications for narratives of immaturity, because in each case studied, political and economic processes that were, on face value, 'mature', propelled the periphery towards crisis. While this does not dismiss that 'immature' processes also played a role, it does imply that domestic level analysis could deepen its understanding of the crisis by recognising that 'non-convergence' is far from the whole story.

Second, the agency of Greece, Portugal and Ireland was emphasised in actively pursuing their own convergence with a 'one size fits all' model of European integration in order to facilitate national strategies of modernisation. These countries were not passive victims of core-Europe. Rather, they actively 'tailored themselves' to Europe because they believed it would set them off on a particular trajectory of development. Of course, the attempt to converge was far more unpredictable than anticipated, and propelled the periphery in multiple, yet similarly perilous, directions. This means that

the promotion of convergence among member states – long central to the development of the European project – has been fatally misguided.

Recognising the analytical significance of agency in Greece, Portugal, and Ireland made it possible to gain a deeper understanding of the multiple paths to crisis followed by each country. Tailoring themselves to a ‘one size fits all’ model of European integration had disastrous consequences for all three peripheral countries. The ‘one market, one money’ project of convergence faced all three as a common external pressure to restructure their economies. Yet, contra to narratives of victimisation, I showed how in each of the three case studies domestic negotiation of Europeanisation mattered. Europeanisation was interpreted, negotiated, and adapted to in different forms and at different levels in Greece, Portugal, and Ireland. This implies that the common pressure of Europeanisation, mediated through Greek, Portuguese, and Irish domestic agency, resulted in anything but common patterns of divergence.

A deeper understanding of Greece’s crisis will recognise the importance of adapting to EU directives relating to banking and finance in catalysing a competitiveness crisis, but also highlight the damaging effects of Greece electing not to emphasise structural reforms relating to its public sector, its revenue system, and EU budget rules. In Portugal, a trajectory of domestic demand and debt driven growth emerged as household indebtedness grew at a much faster rate during the 1990s than in any of the other cases. Portuguese firms similarly favoured credit over equity financing, leading to a recession in the early 2000s as a result of relatively severe overleveraging. Ireland experienced particularly contradictory effects of Europeanisation, as the Irish state and development institutions developed a long term export-oriented modernisation strategy through their embrace of EU driven institutional change. Yet these very same processes set the scene for Ireland’s banking crisis a decade later.

This argument has the potential to strengthen critical approaches to the eurozone crisis that have, so far, relied on narratives of victimisation. Inequalities and hierarchies within the European project matter. But these cannot be explained simply through a core-periphery dynamic, or on the other hand, solely by pointing out the skewed architecture of EMU. Rather, I have established the periphery's complicity in their own positioning within a European hierarchy, through their aspirations to become both 'modern' and 'European'.<sup>87</sup> This should not suggest that the periphery was completely free from 'victimisation' – it is clear that the European project was tailored to, and worked in the favour of countries other than the periphery. What it does suggest is that the production of hierarchy, and its outcomes, is far more complex than core-periphery analysis posits.<sup>88</sup>

## Significance

The argument of this thesis has clear significance for scholars working on the origins of the eurozone crisis. Above all it has stressed the need for existing literature to take the asymmetry of the eurozone crisis more seriously, and to move beyond the problematic and limiting paradigm of 'immaturity' vs. 'victimisation'. Neither approach was capable of adequately accounting for the many different paths to crisis taken by the countries of the European periphery. Nor were they capable of developing a conception of peripheral agency where ostensibly 'mature' actions counted in any theoretically meaningful way.

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<sup>87</sup> Adler-Nissen's forthcoming work on the discursive production of hierarchies within Europe develops a similar line of argument (2015).

<sup>88</sup> Future research could certainly build on the argument of this thesis to develop a systemic-level account of inequality and hierarchy within the contemporary European project. Indeed, doing so would deepen the critical edge of existing critical IPE approaches that have so far relied on narratives of victimisation.

The significance of ‘modernisation via Europeanisation’ for narratives of immaturity and victimisation can be interpreted as follows. First, while overcoming the important limitations of each narrative, I do not suggest that Greece, Portugal and Ireland are fully absolved from responsibility for their own crises. Second, neither do I propose that the absence of ‘beggar-thy-neighbour’ dynamics between core and periphery should shut down important debates about inequality and hierarchy within the EU and the eurozone, or regarding Germany’s possibly (re-)emergent role as a hegemon, reluctant or otherwise (Bulmer and Paterson 2013).

Rather, in overcoming some of their limitations, my argument aims to enrich these existing debates in two main ways. First, although I have stressed the hitherto overlooked ‘non-exceptional’ catalysts of divergence in Greece, Portugal and Ireland, to ignore parallel ‘exceptional’ catalysts of divergence would be to simply invert the problem. For instance, it would be misleading to ignore the role of ‘poor reform capacity’ in driving Greece’s fiscal crisis, just as it would be equally limiting to downplay the role of Europeanisation in driving its competitiveness crisis. The argument presented can potentially act as a complement to domestic-level approaches by inviting them to broaden their analytical scope to consider more than simply the readily apparent ‘exceptional’ causes of peripheral crises. Such an approach can offer a deeper understanding of the crises in Greece, Portugal and Ireland that a straightforward rejection of the ‘immaturity thesis’ would miss out on.<sup>89</sup>

Second, although I have challenged narratives of victimisation, the concept of modernisation via Europeanisation speaks to important debates surrounding the role of Germany, the design flaws of the EU, and the production of hierarchies within Europe.

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<sup>89</sup> In other words, as already argued, I tackle the immaturity thesis ‘on its own turf’, rather than resorting to the externalism of core-periphery analysis and other perspectives.

‘Beggar-thy-neighbour’ dynamics between core and periphery have been theoretically and empirically challenged, but this does not mean that Germany has not still, perhaps uniquely, benefitted from the institutional character of the euro. As I made clear in chapter one, the European project has certainly been tailored to a specific, one-size-fits-all model of development in mind. We do not need beggar-thy-neighbour assumptions to recognise that this model may reflect the interests and work to the benefit of certain member states while disadvantaging others.

Indeed, as outlined in Chapter one, my argument draws on ‘step one’ of core-periphery analysis, and as such, can be argued to contribute to debates about ‘German Europe’ and ‘Modell Deutschland’ (e.g., Jessop 2014; Beck 2013a Bulmer 2014; Cesaratto and Stirati 2010; Dullien and Guérot 2012; Dustmann et al. 2014). My argument has the potential to deepen these existing debates and hierarchy in Europe by inviting critical scholars to jettison empirically limited assumptions of ‘dependency’. While I argue that the periphery were not passively reshaped, but actively aspired towards ‘European style modernity, it is nevertheless vital to remember that the countries of Western Europe have long been synonymous with being both ‘modern’ and ‘European’. The countries of the European periphery were thus situated at the bottom of a foundational inequality, because they were seeking to confirm their ‘Europeanness’ and modernity by reforming and converging with or towards a model of development that has been defined by ‘core’ Europe. The burden of adjustment and convergence was thus on these peripheral states and not the core (an inequality well-articulated in this way by Triandafyllidou, Gropas, and Kouki 2013). As such, the concept of ‘modernisation via Europeanisation’ has the potential to enhance existing debates on hierarchy, the role of Germany, and the unequal position of the periphery in a more

dynamic way is better able to recognise diversity, unintended consequences, and in a way that does not forfeit the agency of the periphery in the process.

If the eurozone crisis is neither a crisis of Greece nor Germany, the argument presented here could be brought fruitfully in relation to literature on the ‘design flaws’ of the eurozone. In various ways, these approaches emphasise that the eurozone crisis was an institutional one, stressing that we need to understand the crisis in the periphery in that context. The argument presented here invites ‘design flaws’ perspectives to interrogate the notions of asymmetry that underpin their own arguments. While these approaches focus on how EMU lacked the requisite discipline or how it did not promote a ‘genuine’ union involving banking, fiscal and perhaps federal union, I have argued that the real institutional flaw in the European project was not that it lacked *enough* convergence. It is that the very promotion of convergence has generated multiple and unexpected patterns of divergence. Hence the distinction made in the introduction between convergence as a *process* and convergence as a *project*. National and supranational projects of convergence were prophesied to create pressures towards a process of convergence of the periphery with the core (Hall 2014). I argue instead that these very projects of convergence set in motion real processes of *divergence*.

This argument also speaks to contemporary debates on the policy response to the eurozone crisis. The ongoing official response to the crisis in the periphery has centred on the correction of peripheral ‘immaturity’. The ‘PIIGS’ got into difficulty because of their failure to modernise in the decades before the crisis, risking their own stability and the very survival of the eurozone. If this diagnosis is accepted, it is easy to sympathise with the scathing and exasperated analysis of Francesco Giavazzi; without economic and social reforms such as those prescribed by the troika, Greece will remain a relatively poor country. So if the Greeks chose poverty, ‘let them have their way’

(Giavazzi 2015). By illuminating the central and adverse role of Europeanisation in catalysing non-productive, debt-led patterns of growth across three peripheral countries, this thesis adds to the already long list of reasons why such a response is gravely misguided. Addressing only the ‘exceptional’ origins of the crisis fails to tackle the ‘non-exceptional’ causes. And if Greece, Portugal and Ireland’s crises were, to an important extent, an outcome of a flawed project of convergence, obviously attempting to impose that same project is unlikely to ensure that all will be well for the eurozone.

This argument also echoes the invitation first extended by Bache, Bulmer and Gunay (2011) which calls for Europeanisation studies and International (or, in this case, Comparative) Political Economy to engage more closely with one another (see also Featherstone 2008). The authors note that Europeanisation literature has portrayed itself as an analytical framework or as a valuable ‘attention-directing device’ rather than a theory in its own right. This framing has led to the neglect of meta-theoretical reflection (although see recent important exceptions from Exadaktylos and Radaelli 2012; Graziano and Vink 2007). This insight echoes the points made in this thesis – in that it has tended to smuggle in unilinear conceptions of development into its debates regarding divergence and convergence. By shedding light on how Europeanisation has been generative of brand new trajectories of economic divergence, rather than simply leaving ‘non-convergence’ behind, it has shown the real potential of Europeanisation studies to inform Comparative Political Economy theories of capitalist diversity. Moreover, the ‘second image reversed’ framework of Europeanisation has much to add to IPE approaches on the eurozone crisis that have tended to conflate ‘externalism’ with a theory of the international (see Keohane 2009; Rosenberg 2006; Bruff 2010). Bache, Bulmer and Gunay note that Europeanisation literature has ‘not yet caught up with the Eurozone crisis’; however, to place it within the limitations of a conventional



understanding ‘would be a very incomplete account’ (2011, 18). This thesis suggests that it may be just as important for IPE and CPE literature on the eurozone crisis to catch up with the study of Europeanisation, and to once and for all leave behind moribund debates on modernisation vs. dependency theory. The concept of ‘modernisation via Europeanisation’ clearly shows the potential of an interdisciplinary dialogue between these two literatures to do just that.

Similarly, this thesis speaks to ongoing debates within IPE and CPE regarding capitalist diversity. As I argued in chapter one, scholars working within critical political economy (Bruff and Ebenau 2014), *Varieties of Capitalism* (Hall 2012) and *Uneven and Combined Development* (Sandbeck and Schneider 2013) have all attempted to understand the eurozone crisis by bringing their respective sensitivity to the diversity of economic development to existing debates. Similarly, Bruff (2010) notes the need for IPE to reconcile the role of the ‘international’ in accounting for distinctive national trajectories of development. Yet, the persistence of narratives of immaturity and victimisation in existing accounts suggests that the modernisation vs. dependency theory debate hasn’t fully gone away, at least for analysis of the eurozone crisis. While debates on capitalist diversity suggest intriguing alternatives to this debate, Bruff and Ebenau (2014, 4) recognise that, as of yet, there has been a general lack of reflection within debates on capitalist diversity on the implications of the eurozone crisis for their respective frameworks. Although it remains for future research to investigate more fully, the concept of modernisation via Europeanisation, together with the case studies of Greece, Portugal and Ireland, provide a useful starting point for deeper reflection on issues of diversity and the role of the international in contemporary IPE. There is potential for the empirical contributions offered here to enrich these kinds of debates on

the eurozone crisis, but potentially, to also enrich theoretical debates on capitalist diversity within IPE more generally.

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