Published on *Adam Smith Institute* (http://www.adamsmith.org)

What?s a Grecian urn? Not much, thanks to the euro [1]

Written by **Sam Bowman** [2] | Tuesday 30 March 2010

Angela Merkel?s victory in blocking an automatic bailout for Greece may be good news for the eurozone in the short term, but may ultimately prove to be a sticking plaster on a tumour. The immediate problem is well known: the Greek government?s profligate spending, combined with a government unwilling to cut spending, has become hugely indebted to avoid making difficult decisions. What is less well known is the euro?s role in getting Greece to this point in the first place.

Whatever happens to Greece now, the crisis reveals one of the underlying problems with the euro: that it was always a politically-driven project constructed by people with little regard for the economic well-being of the countries involved.

The euro?s shortcomings during the bust are obvious: it locks countries into price systems across the continent, and makes the entire eurozone vulnerable to shocks in one or two countries. What is less clear, but equally important, is that the euro drove the boom that many small eurozone economies experienced in the 2000s, and that this was a major reason for the severity of the busts in those countries.

The low interest rates set by the European Central Bank to stimulate the sluggish French and German economies caused the economies of the fast-growing peripheral countries ? like Ireland and Spain ? to overheat. This led to malinvestment in roundabout projects like housing. Cheap credit meant that house prices spiked, appearing to cause a surge in demand that was actually caused by borrowers outbidding each other with money that they didn?t have. No informed observer of the Irish or Spanish economies could deny that the housing bubbles in these countries were one of the main reasons for their collapse.

By setting interest rates to an artificially low level, fast-growing economies overheated and saw speculative bubbles emerge. The size and scope of these bubbles meant that economic catastrophe was inevitable after they had burst. And the cheap borrowing also made it easy for governments to spend their way into power, as in Greece: Most destructively of all, the eurozone?s low interest rates allowed free and easy borrowing by the most irresponsible spender of all: the government.

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