NDS: You've pretty much followed what's been happening in Europe in the past years, haven't you?

Galbraith: I have been.

NDS: You've seen what's been going on in Germany? I've sent you some stuff that may or may not have enhanced what you know.

Galbraith: Thanks to you I have some familiarity.

NDS: Germany, about ten years ago – when was it, that the call came out for a larger-sized low-wage sector?

NDS: Ten years ago it became dramatic, but in the Kohl era it started here in Germany, and I think if you look at the euro crisis, the financial crisis, and the reaction from German policy-- because Germany's power – became the European answer to the Euro crisis. Do you think that if we look at inequality, is inequality rising due to this reaction, like the austerity policy, like the constitutional debt brake, which now comes in future and …

NDS: …the Stability Pact...

Galbraith: Well, what you're seeing already is divergence across Europe, and that's the basic mechanism of rising inequality – and again, what played out in the United States in the form of credit booms to sectors, and in some cases in housing to various parts of the country – that boom followed by a bust played out in Europe as credit booms to countries, so you see the rise and the fall of Ireland and Spain and so forth, and it's that divergence which is truly the major, the largest single stress in the euro zone right now. Obviously what you describe going on inside Germany is also important, but the German national community is still bound together with a great many stabilizing institutions that still exist, although they are – as in the United States...

NDS: ...very much weakened...

Galbraith: …they're weakened, but they are still strong compared to what happens across national lines. So you expect things to fracture along the weakest links, and that's clearly the national boundaries in Europe. What will happen as a result of that is that you'll have a re-management of populations. It's clear that anybody with a professional qualification and the ability to do so will exit Greece to large expatriate communities already in the United States and in Australia. People will go – and Europe has a long history of people emigrating from Portugal and Spain – and if pressed, they will do that again. So you're going to see that the failure to stabilize national economies in Europe is simply going to lead, in the long run, to the redistribution of its populations.

NDS: I know you did compare inequality in Europe with the United States in your book. Do you think it's really legitimate to compare Europe, though, to the United States? In general you don't move from one country to another very often, because learning a language, of course, you're not going to learn a language and then move somewhere else two years later.

Galbraith: But I assure you, people do in fact, and they will. But it doesn't matter – in any event,for a valid measure of inequality, it is not necessary that people physically move. The important thing is that Europe is a unified economic whole from the standpoint of, let's say, an enterprise making investment decisions or an investor making portfolio decisions. The absence of barriers to capital mobility is just as decisive in creating a unified entity as fluidity of labor movement. But the other thing is one should not exaggerate the extent to which people inside the United States move permanently from one part of the country to another – it's very common for professionals, but a very large part of the population lives where it started from.

NDS: I don't know if you'd just call it a strategy, or if it's just more of an ideology of competitiveness between countries – Germany even goes so far as to want to have competition between the states for investment.

Galbraith: One consequence of European integration, which was clearly foreseen from the beginning and is characteristic of all industrial systems as they move to larger scale is that activity concentrates in the most competitive spot, and it's not just industrial, it's also agricultural. You've actually had concentration of certain agricultural activities in north Europe, which would hardly be thought to be ideal for that, but it happens. And it was foreseen that this would require compensating investments in the European periphery, but those investments haven't been close to being of an adequate scale. The same exact thing was true in the United States. You had, as the country developed on a continental level, industrial activity concentrated the North, Northeast and the Midwest. What ultimately happened to offset that was the New Deal. And the New Deal distributed economic activity – massive infrastructure projects in the South. We had, of course, the advantage of having a single country from the standpoint of distributing military expenditures, which is very important in the State of Texas, very important in other parts of the South. And we had a continental-level Social Security system that was established, which basically means that your base retirement is done at the national standard, not the local standard. So if you have a working life in Alabama, you're still getting at least the federal minimum Social Security payment. This has an enormous equalizing effect. People talk about the ways in which the United States is a very unequal country, but over the last 80 years, it has become radically less unequal geographically than it was before. It was a huge difference between the North and the South, which is no longer the case. Even forty years ago, when I was a kid, nobody, let's say, very few academics would consider making a move from New England to Texas. Because it was a one-way trip, you took a big cut in pay and you would never be able to come back. Now it's routine. The whole place has become substantially integrated, at least to a certain level. Now there are lots of inequalities and growing inequalities at the local level in the U.S., which is what people observe, but at the national level. It's much, much less than it used to be.

NDS: So do you think that a modern version of the Roosevelt New Deal would be the right answer for the euro crisis?

Galbraith: I think that a functional union requires measures that redistribute income and activity effectively across large areas. Otherwise things collapse to the center. The European Union has done it on a very large scale in the structural funds to governments, which leads to infrastructure projects. You get a lot of paving – Portugal has become like California – a very dubious strategy of economic development, but there it is. What you don't have at the European level is distributive mechanisms to individuals. There's no equivalent of a continental social security system. And you don't have the same level of, let's say, redistribution of operations and maintenance, which we do with the military budget in the U.S. The Greek military is paid for out of the Greek tax base, and so...

NDS: ...and they have a large military...

Galbraith: ...and they have a large military, which is a heavy burden on the Greek economy...

NDS: ...and Portugal and Greece are the ones that import the most weapons – statistically recently published – they spend the most on the military in Europe.

Galbraith: This, of course, is a legacy of the politics of these two countries in particular.

NDS: It's hard to imagine why they would need so much, I mean, Greece looks at Turkey and says, “you're dangerous”...

Galbraith: It has nothing to do with that, it has to do with the legacy of '74 and the deal made with the Greek military to keep them content with being in the background of politics, and it has to do with, of course, the intra-European arrangements, because these are German tanks and French submarines that they're buying. They don't seem to be easily sacrificed as part of austerity packages.

NDS: Well, it's one of the things that the German government wasn't so interested in sacrificing.

Galbraith: I can't imagine why not, with all this talk about austerity...

NDS: German submarines, too...

Galbraith: German submarines...

NDS: But do you think that the idea of trying to promote competition between countries is a good one? This is kind of what the EU is doing, wanting the countries to compete against each other.

Galbraith: Well, the idea that a country like Greece can effectively compete against Germany – n what, exactly?

NDS: Olive oil...

Galbraith: Yeah, that's right... There is a real problem of the difference between increasing and diminishing return sectors here.

NDS: We have to almost ask the question of what Greece can do – particularly in a currency union – because Greece is not going to be exporting like Germany does. It's not going to be able to.

Galbraith: Of course it's not, which is why one has to have a permanent policy of stabilizing income flows. Otherwise the country is simply being squeezed until its population leaves, which, of course, it will do. Nobody in the United States says that Florida should be competing, with, let's say, Ohio, for the assembly of Hondas. That isn't what Florida is there for.

NDS: Florida is there to be a retirement center, basically.

Galbraith: That's right, and in fact, the eastern part of the Gulf of Mexico has been largely kept free of oil and gas development for precisely that reason, so as not to have the kinds of potential disasters such as that which we saw in the Mississippi Canyon last year.

NDS: Germany – and not just Germany – has been pretty much against the idea of having that kind of flow of money, flow of income into any of the countries, into the south. They don't want a transfer union.

Galbraith: It is a contradiction of one of the basic principles of a functioning economic union.

NDS: On the subject of Greece – do you think there's any way out for them? What do you think is going to happen there? I can imagine now that, of all things, they're cutting wages – not just in the public sector – they're cutting wages, which, of course, is not going to help the tax situation, it's not going to help their debt situation – supposedly in order to make them more competitive, you know, internal devaluation. I can see what's going to happen: People aren't going to be able to pay their rents, people who own the houses are going to go bankrupt, there's going to be another credit crunch, do you see that kind of a cycle?

Galbraith: It's very difficult to escape taxes levied on, let's say, the ordinary working population in Greece, because they're taxing property and they're running the tax through the electric bill, so unless you are in a position to move off-grid – which requires a certain capital investment – you are going to be stuck paying those taxes so long as you want electrical service. So this is a downward spiral. The cuts in public services in Greece, which are cuts in a very under-performing public health system and an under-performing educational system in a very already inefficient and stressed transportation system are of the type that will make it much less attractive for foreign investment. So the idea that there is some route through internal devaluation to restore competitiveness is a transparent falsehood. It's a transparent falsehood. So what do we have to ask? What is being done here? I think it's not very difficult to understand that in order to recycle funds to the French and German banks and to create conditions in which private creditors could escape from the losses that they would suffer when the Greek debt was ultimately written down, which it has now been, the pretense had to be given to the German electorate that this was assistance to Greece in return for Greek sacrifices. The only thing that was real about that was the sacrifices. Those were palpable, they provided a justification for the policy, but there was no assistance to Greece associated with this.

NDS: This is where my German criticism comes up – there is a certain mentality, I think, that sacrifice is a good thing in and of itself.

NDS: Yeah, absolutely.

NDS: I think it's a very dominant mentality.

Galbraith: Of course it is, so one cannot be entirely critical of Chancellor Merkel for insisting on this, because all she is doing is meeting the conditions for the political acceptability of the policy.

NDS: Most people support her in that.

Galbraith: Right. So this is a Greek tragedy in the classic sense in which people are doing what the conditions of their politics require that they do, and what is being sacrificed here is a small country of 11 million people.

NDS: You read in the papers here about every month that economists are surprised that Greece has not been able to improve its situation, and we sit back and say, “right, why are these people surprised?”. What I think is that even maybe we're being too optimistic, because if you think about it in an economy where people can't pay their rent, I mean, they're just getting by and all of a sudden they have to decide between paying the electric bill and paying rent. That, of course, is going to ripple on to the landlord or the electric company, that it's going to expand as more of a chain reaction. Do you see that happening, do you see that as a likely thing to come?

Galbraith: Well, I was in Greece in October, and I gave a talk for a major company, and so it was an occasion where you had the chance to chat with prominent business leaders, and what they said to me was that they saw no hope – let alone what ordinary people are experiencing. There was no sense anywhere in the country that the policies, that the situation that the country was in, had a turning point ahead. There was some sense of this – at least this was what people in government said in the first year or so of Papandreou's government – that they were at least willing to express the official line that if the reforms were pursued effectively that this would yield a return of confidence to the credit markets. I had a conversation about this directly with Papandreou's first finance minister, Papaconstantinou, in the summer of 2010. The reforms were pursued energetically in that government, and some of them, I'm sure, were very valid things to do. You're looking at a government that was never a paragon of efficiency, to say the least.

NDS: Not all the criticism of Greece is misplaced...

Galbraith: A great many useful things were attempted by Papandreou's government. The element of illusion crept in in a belief, or an expressed belief – it's hard to tell if people took it seriously – that if they did the reforms effectively that this would be rewarded by the credit markets.

NDS: The confidence fairy...

Galbraith: ...the confidence fairy, and that the confidence fairy was a benign figure who surveils how well you are working and gives you improved access to the credit market on the strength of your performance. Once you realize that what you have here is a European, not only a European, but a global credit crisis, and you realize that the effect of events anywhere in the world is going to be felt equally by all of the weak borrowers, whether you're talking about Greece, Portugal, Spain, Ireland...

NDS: Essentially everybody needs to deleverage. Well, not everybody...

Galbraith: ...but in a flight to safety, and this is putting it even more straightforwardly, a flight to safety, all of the weak ones are going to be sold off. So there is nothing that a government can do, no matter how virtuous it is, to transform itself from a weak to a strong borrower. People are still going to classify it as one of the weak ones, and they're still going to dump them – not only when bad events happen, but even there is a simple speculative movement in, say, the market for CDS. So it was just from the very beginning illusory to think there was some path back into the credit markets.

NDS: Do you think products like CDS are even worthwhile having, or do you think they're more a danger?

Galbraith: They're obviously a very dangerous development. What is interesting to me is whether there is any effective way that one can now control them. Having been invented – this is a little the aspect of the nuclear bomb: once it was realized that it could be made, it was going to be made and it cannot be unmade.

NDS: You can't put the genie back in the bottle.

Galbraith: A credit default swap is just a contract between two private parties on an over-the-counter basis that says that if event x happens, then I will make payment y in return for a stream of payments z in advance. We can call them credit default swaps, but I don't see how one can make such a contract *ultra vires*, how one can remove it from legality.

NDS: You can make regulation, like in Germany it's forbidden that I take out a life insurance on someone else's life.

NDS: It is in the United States, too, generally.

Galbraith: Well, that's true, but can you stop a subsidiary of company x and a subsidiary of company y from making the same contract in Singapore? Good luck!

NDS: True. Can you prevent major financial institutions from making those contracts so that it doesn't get to be a systemic risk?

Galbraith: I don't know the answer to that. I think that the answer is probably not straightforward.

NDS: Back a little bit to European austerity: Do you think that those who are demanding austerity – Merkel and Schäuble are the two main culprits here – do you think they really believe that this is going to help?

Galbraith: I do not know Chancellor Merkel, I do not know Herr Schäuble. All I can tell you is that political leaders should not be suspected of believing things that they say.

NDS: I mean, it should be sort *of* obvious that this is not going to work. Our speculation is more along the lines of this being a crisis that's too good to waste in order to get rid of social programs, to cut government down – much like the Republicans in the United States are doing.

Galbraith: It is a hypothesis with a certain amount of explanatory power.