



New
Direction

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THAT SINKING FEELING

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THE EURO HAS PROFOUNDLY CHANGED EUROPE

The introduction of the euro was supposed to strengthen the process of European integration. Unfortunately, although the euro has become one of the most visible symbols of the EU, the number of harmful consequences is growing.

The euro has distorted the way in which the economies of Spain, Portugal, Italy and Greece function. Moreover, the countries of southern Europe, as members of a currency union cannot use currency devaluation, the most powerful instrument for coping with a serious economic depression. Economic history teaches us that having your own currency is essential for a country facing a severe economic crisis, but appropriate reforms must follow devaluation to make a recovery sustainable.

There can be little doubt that the euro has profoundly changed Europe. A deeper reflection on the nature and consequences of the monetary union in Europe is unavoidable.

Today, more than ever before, we can see that the euro has still not improved the economic situation in the European Union. It was clearly a political rather than an economic project. The single currency, instead of accelerating Europe's prosperity, has deepened divisions between EU member states. The introduction of the euro resulted in the disappearance of exchange rates risk within the eurozone and a sudden and massive inflow of capital to southern Europe. As a consequence, wages grew much faster than productivity and southern Europe lost its international competitiveness. The problem of competitiveness is at the heart of the eurozone crisis.

The euro has affected not only eurozone countries, but also the rest of the European economy. Eastern Europe is also influenced by the economic consequences of the euro, as its largest trading partners suffer from economic growth below the potential caused by the euro and the euro-rescue policy. What is more, the euro is responsible for constant calls to transfer more powers to Brussels, and diminishing the role of the principle of subsidiarity in the European project.

With all views and analyses included in the New Direction magazine, I hope this publication will be a helpful tool in raising awareness of the economic and political ramifications of the single currency for the European Union.

Tomasz Poreba





The eurozone crisis is among the greatest challenges facing the European Union. Many eurozone countries, especially those in Southern Europe, are saddled with unemployment comparable in scale to that during worst days of the Great Depression of the 1930s. The very nature of the EU is being transformed: calls for a more centralized eurozone backed by a fiscal union feature centrally in the European political debate. The present euro-rescue policy continues to prove itself an unmitigated failure.

New Direction has invited leading economists and public intellectuals from a wide range of economic and political schools of thought—though all critical of the euro - to contribute essays assessing the eurozone crisis. It is time for an honest debate about the costs of the euro to take place in Europe, as its consequences impact non-euro countries, as well. New Direction is pleased to publish these essays, each of which combines clear, scholarly analysis with creative, courageous thinking—precisely the qualities which the European political discussion needs most.

Hans-Olaf Henkel



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THE EURO AS A **THREAT** TO EUROPEAN INTEGRATION

Stefan Kawalec¹

Europe can be proud of its achievements in the second half of the 20th century. After the terrible experience of two world wars, the creation of the European Union and the common market were remarkable political and economic successes. However, these achievements are currently being endangered by the adverse effects of the introduction of the euro.²

RESTRAINTS OF COMMON CURRENCY ARE PAINFUL IN TIMES OF CRISIS

When the euro crisis erupted in 2010, one of the main problems of the affected Eurozone southern countries was the loss of international competitiveness. It was estimated that in order to regain competitiveness and repair their trade and current account balances, Greece, Portugal, Italy and Spain needed to bring their wages down by 20-30%. If these countries had their own currencies, such substantial improvements in competitiveness could have been accomplished relatively quickly via currency devaluations, like the one implemented in Poland, which is a member of the EU but not of the Eurozone. At the peak of the world financial crisis in 2008/2009, the Polish zloty depreciated by about 30%. Thus, although wages

in Poland in the domestic currency remained unchanged, in terms of the currencies of the country's trading partners, they declined by 30%. This was probably the most important factor which enabled Poland to enjoy positive economic growth in 2009, when all other EU economies contracted. Today, Poland continues to benefit from the improved competitiveness obtained as a result of the adjustment of the exchange rate in 2008/2009.

The Eurozone countries in crisis cannot improve their competitiveness through currency depreciation. Instead, they have been trying to implement a so called 'internal devaluation,' which is in fact an ordinary deflation policy. The main tool of this policy is fiscal tightening i.e. reducing government spending and increasing taxes in order to weaken domestic demand with the hope that this will result in a decrease of domestic prices and wages.

However, as economists have known for decades, wages are inflexible downwards. When demand falls, companies reduce employment, and nominal wage cuts are rare. The internal devaluation policy resulted in a decline in GDP and employment. Compared to 2007, GDP in 2014 was 74% in Greece, 91% in Italy, 93% in Portugal, and 95% in Spain. For comparison's sake, this same ratio

was 105% in Germany, 108% in the U.S., and 124% in Poland.

Trade and current account deficits in the southern countries were mostly eliminated, but this was largely the effect of depressed domestic demand. Wages declined much less than necessary. At their present levels, current accounts can be balanced only if the southern economies do not utilize their potential, and rates of unemployment remain at elevated levels. A higher utilization of the countries' economic potential would automatically result in a reappearance of a substantial current account deficit. Therefore, southern countries have the prospect of the continuation of the 'internal devaluation' policy in the coming years.

A FRIGHTENING ANALOGY WITH THE GREAT DEPRESSION

There is a dreadful parallel between today's 'internal devaluation' policy applied in order to defend the euro, and the deflation policy applied in order to defend the gold standard in the interwar period. In Great Britain, a six-year policy of deflation (1925-1931) was unable to correct prices and wages, that were overvalued by about 10%, i.e. three times less than the overvaluation that the Eurozone southern countries are currently coping with.

1. The author is the CEO of Capital Strategy, a strategy consulting company in Poland, and a former vice-minister of finance of Poland.
2. This article draws from the following texts that also discuss other aspects of the topic:

• B. Granville, H.-O. Henkel and S. Kawalec, 'Save Europe: Split the Euro', Bloomberg View, May 15, 2013. <http://www.bloomberg.com/news/2013-05-14/save-europe-split-the-euro.html>

• B. Granville, H.-O. Henkel and S. Kawalec, 'France Must Lead Breakup of Euro', Bloomberg View, May 16, 2013. <http://www.bloomberg.com/news/2013-05-15/france-must-lead-breakup-of-euro.html>
• S. Kawalec and E. Pytlarczyk, "Controlled Dismantlement of the Eurozone: A Strategy to Save the European Union and the Single

European Market", German Economic Review, 14 (1), February 2013, p. 31-49.
• S. Kawalec and E. Pytlarczyk, "Controlled Dismantlement of the Eurozone: A Proposal for a New European Monetary System and a New Role for the European Central Bank", National Bank of Poland Working Paper No 155, Warsaw 2013. http://www.nbp.pl/publikacje/materialy_i_studia/155_en.pdf

NEITHER THE EU NOR THE COMMON MARKET REQUIRE A SINGLE CURRENCY FOR THEIR OPERATION. BOTH INSTITUTIONS HAD EXISTED AND OPERATED SUCCESSFULLY BEFORE THE EURO WAS INTRODUCED.

Ultimately, in 1931, Great Britain, plagued by a 20% unemployment rate, left the gold standard and allowed its currency to depreciate. In Germany, Chancellor Heinrich Brüning's deflation policy helped pave the rise of Hitler. Today, economists admit that clinging to the gold standard was a key factor in the deepening and spreading of the Great Depression internationally, which nearly led to the demise of democracy all over the world.

A FISCAL UNION WILL NOT SUBSTITUTE FOR THE LACK OF CURRENCY ADJUSTMENT AT THE COUNTRY LEVEL

According to a popular view, the problems with the euro are a result of the fact that the EMU architecture is not yet complete, as the single currency has not been accompanied by a fiscal union and a stronger political union.

European leaders seem to believe that more progress in the fiscal union will equip the Eurozone with effective preventive and correcting instruments, which will effectively substitute for the lack of national currencies. But this is a fallacy. A fiscal union does not provide any instruments that could substitute for an exchange rate adjustment in improving a country's competitiveness. A fiscal union could simply enable the collection of the resources necessary to finance the permanent deficits of some of the poorer or less competitive regions. This is how fiscal unions operate in federal countries such as the U.S. and Canada, where some states or provinces are permanent recipients of net fiscal transfers. U.S. states or territories such as New Mexico, Mississippi, West Virginia and

Puerto Rico annually receive net federal transfers that exceed 10% of local GDP (average for period 1990-2009).

In Europe, Germany and Italy tried to stimulate noncompetitive regions through fiscal transfers, without success. Despite spending huge amounts of taxpayer money (amounting annually to 16% of regional GDP in southern Italy and 25% of regional GDP in eastern Germany), the Italian and German economies have gained little.

In fact, an attempt to improve the competitiveness of depressed areas within a currency union through

fiscal transfers is a contradiction in itself. The inflow of funds to countries that are trying to regain competitiveness through the policy of internal devaluation only undermines this policy. While an internal devaluation policy intends to diminish domestic demand in order to decrease domestic prices and wages, incoming fiscal transfers increase domestic demand and contribute to wage and price increases, and thus make it more difficult to regain competitiveness.

So, once again, a fiscal union is not a way to resolve the problems of the non-competitiveness of some

countries/regions, but rather it is a way to permanently finance the deficits resulting from those problems.

A fiscal union may limit the risk of irresponsible budget policy, but it will not prevent problems with competitiveness from other sources. Any country in the Eurozone could at some point lose its competitiveness due to reasons which may be not easy to ex ante diagnose and eradicate. A fresh example is Finland, which until recently was regarded as one of the Eurozone's most robust northern economies, and thanks to Nokia's success was considered a symbol of a modern competitive economy. Today, it has a problem of structural non-competitiveness. In 2014, Finland's GDP was only at 95% of 2007 levels. If Finland were not in the Eurozone, its currency would depreciate, thereby facilitating an exit from economic stagnation.

CONTINUING TO DEFEND THE EURO 'AT ALL COSTS' MAY TEAR EUROPE APART

Since the famous declaration by ECB President Mario Draghi in 2012, that "... the ECB is ready to do whatever it takes to preserve the euro...", the Eurozone is well protected from market sentiments. However, the ECB is not able to insulate the Eurozone from the growing dissatisfaction of citizens of the member countries. Some Eurozone member countries are trapped in economic stagnation and suffer because they cannot improve their competitiveness through an exchange rate adjustment. Others have to take part in consecutive bail-outs, and are forced to compromise on their values of prudent financial policies. This situation boosts animosities among European nations and strengthens populist, nationalist and anti-European tendencies. The political landscape in particular countries is getting less and less predictable. Any general

election in a member country may potentially shake the Eurozone.

HOW TO SAVE THE EUROPEAN UNION AND THE COMMON MARKET?

Neither the EU nor the common market require a single currency for their operation. Both institutions had existed and operated successfully before the euro was introduced. If we do not want to witness how the euro destroys the European Union and the common market, we have to dismantle the Eurozone in a controlled manner, and we need to agree on a new currency coordination system in Europe. This task is challenging, but feasible. Nevertheless, it requires political will and leadership, which is currently lacking. However, if the task of the Eurozone dismantlement is not undertaken and fulfilled by pro-European and pro-market leaders in the EU countries, it will be done by their anti-European and anti-market successors. In the latter case, the European Union and the common market will be destroyed as well.

Dismantling the Eurozone will not solve all the problems of Europe, but will it allow it to return to a path of growth. At the same time it will free up energy and political capital which is currently engaged in defending the euro. This will enable policymakers to focus their attention on solving other problems and development challenges faced by Europe. ■



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Brigitte Granville

THE IMF AND THE EUROZONE FIREMAN ARSONIST

What has the International Monetary Fund (IMF) got itself into by accepting to rescue Eurozone (EZ) officials from their own incompetence? Not only did the founders of the single currency omit to include in their construct a crisis management mechanism to deal with liquidity problems (a true lender of last resort); in addition, the entire EZ population of experts, political authorities and civil servants were clueless in the face of the fiscal crunch that, in 2010, came to a head in one of the EZ's smallest economies – Greece.





Although several European officials and commentators at the time were against IMF involvement in a European crisis as somehow humiliating, the prevailing view especially in Germany ended up favouring the inclusion of the IMF as a “junior” partner in what became known as the Troika (the European Commission, the European Central Bank (ECB) and the IMF). On 25 March 2010, a joint programme was agreed to provide conditional bilateral loans

to Greece, and similar programmes were subsequently applied in Portugal, Ireland and Cyprus.¹

The Euro house was on fire as Greece flirted with sovereign default. This jeopardized the solvency of several major EZ banks, with the highest exposures being held by French banks. The very survival of the single currency appeared to be at stake. The head of the IMF was none other than Dominique Strauss-Kahn (DSK), who

at that time looked like the most plausible winner of the approaching presidential election in France – the very country which had initiated the entire euro project. The euro is part of the entrenched, to some extent even subconscious, beliefs and values of the French elite: as a result, any threat to the single currency is regarded as dangerous extremism. Moreover, the IMF needed to prove its relevance after the period of the global credit boom (2003-07) when it had no new customers (Blustein, 2015).² DSK therefore saw an opportunity to save both the euro and the IMF.

The IMF’s involvement with Greece meant turning a blind eye to several of the basic principles and rules governing the Fund’s operations. The result has been a

severe blow to the legitimacy and credibility of the IMF that may prove irreparable.

The various liberties taken were discussed in an article “The Economic consequences of Greece”³ that I published with a group of colleagues last year, the key points having to do with the Fund’s choice of counterparties and the scale of access to Fund resources.

The ambiguity of the Eurozone’s institutional arrangements, notably the European system of central banks, makes it doubtful that any Eurozone country’s national institutions can be counterparties with the legal accountability required by the IMF Articles of Association (Article V, Section 1).

As for the size of IMF lending to Greece, the Fund’s initial decision to allow Greece to draw down an

that the country’s public debt is sustainable.” (Blustein, 2015: 2). But that defence was contradicted not only by the fact of the restructuring of Greek public debt agreed two years later but also, and most damagingly, by a further official paper published by the IMF “Ex Post Evaluation of exceptional access under the 2010 stand-by arrangement” (May 2013),⁶ in which the Fund Staff admitted that they knew that the Greek debt was not sustainable yet had gone ahead with the programme “because of the fear that spillovers from Greece would threaten the euro area and the global economy.”

So the IMF compromised its own standards for lending and conditionality to avert the coyly expressed “threat to the Euro area” – which meant, in reality, the prospect that a write-down of Greek debt would have necessitated

SBA – as now explicitly admitted by the IMF itself – was not wholly, or even mainly, to do what was best for Greece.

The integrity of the IMF has been damaged by its failure to offer in public what would have been the most honest advice to Greece – namely, to leave the Euro as a necessary (but not sufficient) condition for a return to growth, and to secure debt relief from its private creditors while the official sector (that is, EZ governments and the IMF itself) would offer new loans to support Greece’s domestic adjustment. If Greece refused to leave the Euro, then the IMF should insist on still more radical debt forgiveness from the other EZ governments.

Five years too late, the IMF appears in the aftermath of the latest Greek convulsion to have inched towards such a position, albeit in a somewhat un-transparent way. The impression left by this sorry tale is, nonetheless, that the IMF under its French Managing Directors has prioritized supporting the strategic political goals of France and other EZ governments which, in turn, have enjoyed the decisive support of the US. This can only contribute to the feeling shared by most non-G7 IMF members that the IMF has become an instrument for supporting the geopolitical agenda of the G7. It is no wonder that emerging market countries have started to design their own multilateral financial institutions. ■

THE EURO IS PART OF THE ENTRENCHED, TO SOME EXTENT EVEN SUBCONSCIOUS, BELIEFS AND VALUES OF THE FRENCH ELITE: AS A RESULT, ANY THREAT TO THE SINGLE CURRENCY IS REGARDED AS DANGEROUS EXTREMISM.

extraordinary 600 per cent of quota over the length of the planned programme was immediately blown out of the water by the reality that the initial programme (the SBA agreed in 2010) envisaged access peaking at a stupendous 3,212 per cent (IMF, 2013: 29).⁴

Perhaps most serious of all was the IMF’s going along with the fiction in 2010 that Greece was solvent. The Fund’s defence of that position in a Staff Position Note entitled “Default in Today’s Advanced Economies: Unnecessary, Undesirable, and Unlikely”⁵ was necessary given that in 2003, the IMF board had introduced the rule that “a country receiving a large loan would have to meet a high probability

the recapitalization of French and German banks, almost certainly with national taxpayers’ funds for the most part. In so doing, the IMF was complicit in imposing economic sacrifices on Greece over and above what would have been inevitable in any case, as well as unjustly disadvantaging other Eurozone countries whose banks did not have disproportionately large exposures to Greece but now had to contribute proportionally to the official bail out of Greek debt. As remarked by Ashoka Mody (2015),⁷ a former IMF official, if the rationale for the 2010 programme was fear of contagion, surely it was a matter for the international community to share the burden not for Greece alone since the motivation for the Greek



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1. <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2014-0239+0+DOC+XML+V0//EN>

2. Blustein, P. (2015). “Over their heads: the IMF and the prelude to the euro-zone crisis.” CIGI papers 60.

3. “The economic consequences of Greece”, February 2015, Alberto Bagnai, Brigitte Granville, Peter Oppenheimer and Antoni Soy <http://www.project-syndicate.org/commentary/greece-eurozone-breakup-by-alberto-bagnai-et-al-2015-02>

4. IMF (2013). “Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-

By Arrangement.” IMF Country Report (13/156).

5. Cottarelli, C., L. Forni, J. Gottschalk and P. Mauro (2010). “Default in Today’s Advanced Economies: Unnecessary, Undesirable, and Unlikely.” IMF Staff Position Note, Fiscal Affairs Department SPN/10/12.

6. IMF (2013). “Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement.” IMF Country Report (13/156).

7. Mody, A. (2015). Professor Blanchard Writes a Greek Tragedy. Bruegel, Brussels, 13 July. <http://bruegel.org/2015/07/professor-blanchard-writes-a-greek-tragedy>



Jean-Jacques Rosa
**GIVING GREECE
A CHANCE:**

GREXIT AND THE CASE FOR COOPERATION



A Grexit will happen, sooner or later. The sooner the better, provided the creditors of Greece accept to really help an obviously bankrupt government with a major upfront debt relief, while guaranteeing its continued access to international finance during a critical transitional period.

The “bailout” that the cartel of Greece’s creditors (the « troika » of the European Commission, ECB and IMF) claims to be offering to that country amounts in reality to a cynical sinking of the Greek economy, a Greek disaster. The reason is simple: Extending loans to an insolvent debtor is a recipe for permanent depression.

I A PONZI SCHEME

Additional loans extended by the cartel, amounting in the present episode to € 86 billions over the next three years, are intended to help Athens repay interests on its previous debts, but they also add a new layer of debt to the old ones and will require additional payment of interests in the future. Increasing current debts in order to repay interest on previous ones is a well-known financial device: it is called a Ponzi scheme and leads invariably to bankruptcy because larger budget surpluses will be required to service the new “bailout” loans that in turn imply further cuts in government spending and increased taxation. Those deflationary measures will shrink tax revenues, making the search for increased budget surplus even more elusive. At the same time the contraction of output will produce still more deflation than the current one (about minus 2% a year), thus aggravating the real burden of the old debt (the value of which stays constant in nominal terms) relative to a GDP that shrinks both in real terms (recession) and in nominal terms

THE SOONER THE BETTER, PROVIDED THE CREDITORS OF GREECE ACCEPT TO REALLY HELP AN OBVIOUSLY BANKRUPT GOVERNMENT WITH A MAJOR UPFRONT DEBT RELIEF, WHILE GUARANTEEING ITS CONTINUED ACCESS TO INTERNATIONAL FINANCE DURING A CRITICAL TRANSITIONAL PERIOD.



(as a consequence of the falling price level). Given the magnitude of previously accumulated excesses of Greek products prices over those of competitors within the Eurozone, it would take ten years of deflation at that rate, or more, to restore Greek competitiveness. Long enough to raze the economy to the ground.

The destructive consequences of additional borrowing-cum-budget-austerity lock up the Greek economy in a vicious circle. But they also trap the creditors, as far as they logically lead Greece to an increasing debt/GDP ratio and pursued deflation, thus to another crisis in the coming months that will require a new bailout.

DEEP EXCHANGE RATE DISEQUILIBRIUM

The current focus on the “debt crisis” however diverts attention from the main fact: it is a collateral damage stemming from exchange rate disequilibrium. Greece cannot escape from the debt/deflation vicious circle because its fundamental problem is not addressed nor resolved. It was not, initially, a problem of excess indebtedness, although it is currently an excessive debt level that makes the country insolvent. The deep source of the economy’s predicament is to be found in the destructive, disequilibrium current and prospective real exchange rate (competitiveness) within the Eurozone that the country cannot compensate anymore by a change of the nominal parity of its own currency. The overvaluation resulting from the substitution of the euro – a DM clone – to the Drachma ruined its export competitiveness as well as its import competitiveness in the confrontation with artificially cheapened imported products. It has even induced successive governments to borrow unsustainable amounts of debt, with the active complicity of French

and German banks, in order to absorb the social and political consequences of the deflationary shocks caused by the exchange rate imbalance.

Indeed, since the Greek economy used traditionally to be more inflationary than the other members of the Eurozone, the suppression of any possibility of devaluation that the entry in the zone implied rapidly eroded the competitiveness of Greek products in foreign (Eurozone) markets, as well as in the domestic market. And this depressing effect increased as the national inflation rates divergence grew over time. It brought a progressive deterioration of national growth while the government was left with the sole budget policy to compensate for the falling incomes of firms and households.

CLASSICAL IMF SOLUTION PLUS MARSHALL PLAN

This was all the more tempting since, given the relatively high Greek inflation, the moderate nominal ECB interest rates were transformed into negative real rates for Greek borrowers. As a borrower, the government was then rewarded by a positive return to float larger amounts of debt.

By the “virtue” of the euro entry, the vicious circle of production was thus complemented by a vicious circle of financial policy. Without an exit from the euro and its vicious circle of non-competitiveness no solution to the current depression is possible.

This is not a radically new situation, unknown of. The IMF has been confronted, in the past, to similar cases in several countries. The classical, standard, solution is well known: a simultaneous use of the three instruments of massive debt relief, substantial devaluation of the currency, and financial

THIS IS NOT A RADICALLY NEW SITUATION, UNKNOWN OF. THE IMF HAS BEEN CONFRONTED, IN THE PAST, TO SIMILAR CASES IN SEVERAL COUNTRIES.



help during the readjustment period since the government's access to international capital markets is jeopardized by default and devaluation. That's what the Greek economy requires to return to competitiveness and solvency: massive debt relief plus exit from the euro.

THE GROWING COST OF NON-EXIT

Even though Greece is a small country within the European Union and the Eurozone, whose national product amounts to no more than 2% of the Union GDP, a unilateral exit from the euro could prove costly for Greece but also for the Eurozone.

Were Greece forced to a confrontational Grexit, without agreement or help from other Eurozone members, the necessary devaluation of a new Drachma would maximize the burden

of foreign debt in euros, which proves already unbearable today. A devaluation of 30% vis-à-vis the euro for instance would instantly increase by 30% the amount in drachmas that the Greek government would have to raise to pay interest on that debt, and there would be no possibility whatsoever to borrow in international capital markets, making a unilateral debt default unavoidable. Bankruptcies would follow as well as a deepening of the current depression. And the default on debts would lead to costly litigation with European creditors undermining any return to confidence in the Greek economy.

That perspective could explain why the public opinion in Greece still favors staying in the euro in spite of the fact that the euro itself is the main cause of the problem and precludes any return to growth. On the other hand, Eurozone politicians fear that a Grexit would lead to contagion and refusal

of austerity in other southern countries currently trapped in austerity-cum-depression.

And given the close association between big banks and big governments, a shrinking Eurozone resulting from one or several exits would constitute a serious drawback for private and public interest groups that political leaders do not want to displease.

In spite of periodic announcements of an imminent return to prosperity in the south, austerity policies have clearly failed to restore growth there. The only perspective for the southern part of the Eurozone is one of a continuing stagnation. The Greek case is even worse since the Ponzi scheme of bailouts must lead to recurrent crises, and ultimately to bankruptcy and euro exit. It follows that a contagion effect is unavoidable in southern Europe. International investors are progressively learning that and

the confidence in the euro must be eroding in the near future.

It follows that in spite of the opposition to a Grexit both in Greece and in the rest of the Eurozone, the shrinking of the Euro area will prove impossible to avoid. The choice for its leaders is thus not one of "shrinking versus not shrinking" of the euro, but of a managed shrinking intended to avoid major disruption of southern economies and to limit the costs to the northern Eurozone citizens, versus saving the current euro membership "whatever it takes", implying larger losses to both Greeks and other Eurozone citizens.

BIG BILLS LEFT LYING ON THE SIDEWALK

The earliest exit is the best solution, first and foremost for the Greek citizens themselves of course, because a return to growth under conditions of a deep disequilibrium

in the exchange rate is impossible. But also for the taxpayers of creditor countries because the Maastricht treaty forbids monetization of a governmental debts, so that bailout "aid" has to be financed by national taxes, difficult to increase for governments that are already struggling to reduce their own budget deficits. And these contributions will be lost when the final bankruptcy will occur.

The conclusion is that the costs of a Grexit to Eurozone institutions, in terms of contagion effects on other southern countries (including France) and reduced credibility of the euro in international financial markets, cannot be avoided and won't be avoided, while the losses to Eurozone taxpayers will increase with the passage of time and further delay in exiting. The losses to Greek citizens will also increase due to continuing economic contraction. Thus the costs of exit will materialize in all cases, while

the costs of non-exit will keep growing. The balance of costs and benefits will increasingly favor exit. It follows that of all the options at the table an assisted Grexit now, augmented by a Marshall Plan to help Greece modernize, would be the best one .

Shortsighted politicians that keep neglecting this best option do let the equivalent of "big bills lying on the sidewalk". We should pick them up and reap the benefits. ■



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EUROPEAN MONETARY DISUNION

Zdzisław Krasnodębski

Today the opinion that monetary union was a failure is widely shared by a majority of economists. How could this error - now so seemingly evident - have happened? Frits Bolkestein, former EU Commissioner for the Internal Market, argued at a Warsaw conference in May this year that the “euro” was a “romantic act”, the work of politicians, not of economists.

However, when the project of monetary union was created, the vast majority of economists did not see any threats in it, and a few critical voices, mostly from the US, were effectively suppressed.

European financial circles supported the project of the common European currency with enthusiasm, hoping for reduced transaction costs, new profits and a new dynamic for the economy. It is not so, that on the one

side there were reckless, romantic politicians and on the other sober, rational economists who were familiar with “the inevitable laws of economics” and knew from the beginning that the euro could not be a success.

Monetary union was the work of elites - political, economic and academic, including economists - who believed that the more “unity”, the better also for economic development, that “more Europe” is always better than “less Europe”, that integration can move only forward towards ever closer union, and that there is “no alternative”. And where there is no alternative, there is also no politics - we know this not only from Hannah Arendt.

Therefore one can say that it was not politics, but - on the contrary - its absence, which led to the creation of the euro. The consequence of the absence of politics was a weakness

of democracy. Indeed, if at that time public debate had really been carried out and the tools of direct democracy had been used, the euro would never have been implemented, because the majority of EU citizens, especially in Germany, were against it.

The euro turned out to be a trap. Instead of unifying Europe economically, and as a consequence politically, it dramatically increased the economic gap between the European centre and the periphery, undermining the entire “European project”. The argument that Greece is a special case does not stand the test of facts - Spain, Portugal, and Italy are still fighting with enormous debts and high unemployment, while economic growth in these countries is still too low.¹

Currently, the crisis also threatens countries that have not committed sins of excessive debt like the Greeks - for example, Finland and the

Netherlands. It is therefore wrong to maintain that other countries - in contrast to Greece - in spite of belonging to the euro zone were able to reform and overcome the difficulties. Antonio Soy convincingly demonstrated that with the example of Spain.

The chances that another recovery program will improve the situation, are minimal. Even the two main protagonists of recent events - Greek prime minister Alexis Tsipras and German Finance Minister Wolfgang Schäuble, like most economists, remain sceptical.² The previous "reforms" have seen a 25% reduction in Greek GDP since 2008, an unemployment rate of 25%, and among young people more than 50%. There is no indication that this could fundamentally change in the future. The International Monetary Fund openly stated the need to redeem some of the Greek debt.

During the last performance of the "Greek tragedy" another taboo has fallen. German Finance Minister Wolfgang Schäuble proposed a temporary Grexit. So far, no one officially and at such a high-level dared to propose an exit scenario. It is interesting that prior to this dramatic U-turn, those who had argued for a Grexit as the only path to a real Greek recovery in the German political debate were presented as populists. The aim of Schäuble's proposal was above all to exert political pressure on Greece and was one of the examples of the new power dynamics in Europe.

Monetary union has strong political implications. The Euro has changed the European Union but not in the way that was expected. Instead of

integrating it, it has caused inner tensions and economic rifts, which disintegrates Europe.

Most visible are the political consequences: Greece has become a protectorate, managed by financial institutions and the Commission. The new status of Greece contradicts the declared democratic principles of the European Union. As Jürgen Habermas argued in The Guardian: „the de facto relegation of a Member State to the status of a protectorate openly contradicts the democratic principles of the European Union" (The Guardian, 16 July 2015).

The fate of Greece is, however, only one of the symptoms, even if a dramatic one, of a profound change of political configuration in Europe. One can speak of a new political geography.³ In this new political geography the difference between centre and periphery became more politically visible, because the dream of caching up thanks to European integration turned out to be illusory. This time the most troubled periphery is not the post-communist countries of Central and Eastern Europe - with the exception of rebellious Hungary - but the countries of southern Europe.

In that transformed constellation Poland has gained in reputation and become an object of excessive praise - a rare success story. It is no coincidence Donald Tusk was awarded the position of President of the European Council. This success story would be impossible, if Poland had given up its national currency. Fortunately Donald

Tusk's announcement that in 2012 Poland would enter the eurozone turned out to be empty words. While in the near, European periphery within the Union, economic problems contribute to political tensions, in the more distant periphery out of the Union - its neighbourhood in the East and South - domestic wars and conflicts, the emerging Islamic State and an expansive Russia pose a military threat to the Union.

In the new political geography Germany has risen to power and has become the centre of Europe.⁴ The monetary union has strengthened a united Germany. France became a junior partner in the "directorate", and is becoming more and more frustrated.

One can, however doubt, if Germany is able effectively, and as a consequence to play the role of

"liberal hegemon."⁵ Until now one has to agree with Hans Kundnani that "Germany has not created stability ...but instability."⁶

In that new role Germany should be no longer only a "Zahlmeister", cashier of Europe, but a "Zuchtmeister", its disciplinarian. It has not only to pay, but also to discipline the other.⁷ As "superpower in the middle" it must patiently but sternly integrate Europe, taking care of the centre.⁸ The leader taking hard, but necessary decisions, must reckon with the fact that it will be the subject of dislike, or even hatred. In fact, one can observe growing anti-German sentiment in Europe. It is not an easy psychological situation for Germans themselves, who are not accustomed to such a role.⁹ The inconsequent, chaotic policy concerning refugees shows that this psychological burden is too big.

Yet the problem is not only if Germany is able to play the new role and in what way. The problem is, if the role of the "Zuchtmeister" can really be reconciled with the idea of Europe? For many European nations, Poland included, it is not acceptable. It is also rejected by both the European right and European left. For example Habermas argues in the above-mentioned interview that when finance minister Schäuble threatened with the prospect of a Greek exit from the euro, he revealed himself as Europe's chief disciplinarian.

The German government thereby made for the first time a manifest claim for German hegemony in Europe - this, at any rate, is how things are perceived in the rest of Europe, and this perception defines the reality that counts. I fear that the German government, including its social democratic

faction, have gambled away in one night all the political capital that a better Germany had accumulated in half a century - and by "better" I mean a Germany characterised by greater political sensitivity and a "post-national mentality". The conservatives in Europe would not expect a "post-national mentality" from Germany, but respect for interests, sensitivities and sovereignty of other European nations.

Taking all this into account one can expect that in the future the political disputes in Europe will become fiercer. Political polarization will become stronger. Some member states will seek to strengthen their sovereignty and will form different blocks within the Union. This tendency will be accompanied by a centrifugal pressure from the centre to respond to the crisis with greater centralization, by building a political and economic union according to the opinion that only further integration, and the introduction of a common fiscal and economic policy can solve the problems.

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"AUSTERIANS" VS. "APPEALIANS" THE TWO SIDES OF THE AUSTERITY TALE

Alberto Bagnai

According to the Merriam-Webster dictionary, austerity is "the quality or state of being austere"; austere, in turn, means "stern and cold in appearance, ascetic". The very first question we should ask ourselves when discussing austerity is why on Earth we are describing a policy tool (basically, expenditure cuts) by using a word which carries with itself a positive value judgment. Austerity, in principle, is a virtue, or at least one of its antonyms, luxuriousness, is usually considered to be a vice.

The choice of words matters. Every time a word carrying a positive connotation is used in a debate where rationality should prevail, manipulation is at work and disaster is looming large. The European "dream", and "austerity", are two good cases in point (the latter being largely a consequence of the former). The morality tale suggested by the word "austerity" is simple: the crisis we have been living in for the past seven years has been caused by the profligacy of the wicked state. The bitter medicine of austerity, to be administered by virtuous technocrats, is the only remedy to past excesses. Needless to say, this tale has looked plausible to what Keynes has called "the ordinary uninstructed person". Everybody is asked to pay taxes, and most respond by considering the state an enemy. A tale where your enemy is the villain is indeed tempting. Yet, it does not need to be true.

Since the beginning of the crisis a few economists pointed out that the austerity tale did not square with the facts: most crisis countries have had stable or declining public debts. In each and every case what had risen was private external debt, i.e., the debt of domestic firms and households with foreign creditors. Hence, we have not been witnessing a "sovereign" debt crisis, but a balance-of-payments

crisis (what a bitter irony – or a clever manipulation! We call "sovereign" the debt of states which are increasingly deprived of economic sovereignty by the selective application of European rules). The crisis was not caused by government profligacy, but rather by the fact that the euro, being too weak for Northern countries and too strong for Southern countries, had favored the build-up of huge external imbalances: Northern countries' exports were favored by a relatively weak currency, as were Southern countries' imports by a relatively strong one. Moreover, the euro had favored the reckless financing of those imbalances. Indeed, this is what the euro was all about: favoring financial integration, i.e., the ability of a

question (how to consolidate public finance?) was wrong, because government debt was not an issue. But the answer was right, because by "destroying domestic demand" (in Mario Monti's words), austerity settled the intra-Eurozone external imbalances, which were the real issue. The fall in income in Southern countries reduced their imports; moreover, the fall in labour income (which from the point of view of the firm is labour cost), favored by skyrocketing unemployment, was expected to propel their exports.

Just to make an example, the external balance of Italy expressed as a percentage of GDP improved by more than 5 points from 2010 to 2014. But this came at a cost: public debt as a percentage of a

THE VERY FIRST QUESTION WE SHOULD ASK OURSELVES WHEN DISCUSSING AUSTERITY IS WHY ON EARTH WE ARE DESCRIBING A POLICY TOOL (BASICALLY, EXPENDITURE CUTS) BY USING A WORD WHICH CARRIES WITH ITSELF A POSITIVE VALUE JUDGMENT. AUSTERITY, IN PRINCIPLE, IS A VIRTUE, OR AT LEAST ONE OF ITS ANTONYMS, LUXURIOUSNESS, IS USUALLY CONSIDERED TO BE A VICE.

country's agent to get indebted with another country's agent.

At the height of the Eurozone crisis (back in 2011), nobody heard us. Then, on May 23rd 2013 the vice-president of the ECB, Vitor Constâncio, confirmed in a speech held at the Bank of Greece public debt was not the cause of the crisis. Two more years later, on September 7th 2015, Francesco Giavazzi, the high-priest of the "austerians", arrived at the same conclusion on Voxeu.org. Does this mean that austerity was the wrong policy response? No matter how paradoxical this may seem, austerity proved to be the (temporarily) right answer to the wrong question. The

GDP increased by 17 points, and the cumulated GDP loss reached -2.6%. Why was austerity deteriorating, rather than consolidating, public finances? Well, because unsurprisingly enough the deliberate "destruction of demand" carried with itself a huge demand crisis, and hence deflation. While the real burden of public debt was increasing, tax earnings were falling, and the debt-to-GDP ratio exploded. Suddenly, the wrong question became the right one! Public debt is becoming an issue almost everywhere in the Eurozone. But on top of all this, the strategy of responding to external shocks by destroying domestic demand

annihilates the main advantage of forming an economic union, which is precisely the opportunity to sustain the member countries' growth through the demand expressed by a big single market (as another "austrian", Alesina, had wisely pointed out in 1997).

Is there an alternative strategy available? Of course there is: every textbook will tell you that it is nominal exchange rate flexibility. And yes, you got it: in the Eurozone this implies the end of the euro. This is something the believers of euro religion cannot admit. Their reaction is to propose another morality tale: the wicked austerity imposed by despicable technocrats

was the villain. But now valiant politics will fight austerity, and good will prevail. I call these colleagues "the appealians", because of their nagging habit of writing long appeals. For whatever reason those colleagues seem not to understand that a unilateral expansionary policy in Southern countries would destroy both their balance of payments and (after the austerity) their public finances. They also refuse to understand that a coordinated expansionary policy at the Eurozone level is politically unfeasible. Of course one may advocate it, and write a nice appeal for it, but Greece is a telling example of what will happen afterwards.

Summing up this discussion: with the "austerians", and their late conversions, the economic science has lost its credibility. With the "appealians" it is losing its dignity. Every undergraduate textbook will explain unless you restore some degree of exchange rate flexibility, an excess of imports must be addressed by curtailing incomes (thereby leading the whole system to collapse). The refusal to reckon with this simple fact of life is likely to reopen in Europe the bleak times of religious wars: the only difference being that this time the whole story began when European politicians decided that "Brussels was well worth a single currency". ■

**IS THERE AN
ALTERNATIVE STRATEGY
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THE EURO AND THE CURRENT NON-DEMOCRATIC SHIFT

Jacques Sapir

We have witnessed a dramatic shift toward a non-democratic form of governance this summer in Europe. Many observers carefully noted that. But, this shift has actually been under way for many years. The current Greek crisis revealed but not created it.

In retrospect one can say that the decisive turning point has been, in Europe, the implementation of the Euro (or, in other words, the Economic and Monetary Union). This is not just a governance problem.

Actually institutions have been deeply modified in that non-democratic direction. The change is a major one and affecting all institutions, from economic ones to political ones.



A MAJOR INSTITUTIONAL CHANGE

The economic institutions of the countries which adopted the Euro have been progressively modified. What we are calling today “austerity” is merely the result of this institutional change. Austerity is the legitimate daughter of the Euro; since 2010 it has become its darling favourite. After having attempted to finagle around it between 1999 to 2007, countries like France, Spain or Italy, Portugal and Greece have been forced, according to rhythms and under conditions, which were specific in each case, to squeeze into the straightjacket of austerity. The domination of the austere thematic over the political life of these countries is concomitant with the Euro.

Economic and Monetary Union has also induced, and one can suppose that this was indeed the true aim of those who put in place the Euro, important changes in the forms and methods of political governance. The shifting towards a world of systematic denial of democracy is the result of this. We must be aware of the fact that the single currency is not only an instrument of financialization. It has progressively become autonomous itself, and it has become a way of government with ever-greater consequences, day by day, on the political functioning of the countries. National Parliaments have been progressively deprived of their sovereign prerogatives, particularly – but not only – by the TSCG which was ratified in September 2012. This dispossession

of popular sovereignty and of democracy operates for the profit of one single country, Germany. It has deep political consequences both on the representation of the people, and on the political mechanisms within the various countries, as well as between them. This is one of the main factors promoting anti-democratic behaviour in the European countries.

THE MESSAGE OF THE JULY 13TH CAPITULATION

The message, which the europeist circles in Brussels and elsewhere will be trying to foist upon the media is clearly that it could be no alternative to austerity and non-democratic domination by people from the Eurogroup. And, with no loss of irony, it will be the politicians pretending to be from the “left” who will make the greatest use of it, from François Hollande to Pierre Laurent (head of the French Communist Party), over Pierre Moscovici. But this in no way corresponds to the truth. The existence of the « plan B » drafted by former Greece minister of finance, Mr Varoufakis being one proof that another kind of policy was possible. However, we must understand that this other policy implies, at one time or another, a break-up with the Euro and – may be - with the European Union. What the Greek crisis, which from all evidence is far from over, is teaching us, is that there is no other policy possible within the framework of the Euro. This evidence has come to hit hard those who, to the left, and in all

honesty, were holding up a « pro-Euro » as well as an anti-austerity discourse. These two discourses are incompatible, as we can see today. Either one accepts austerity, with the possibility to negotiate some titbits of it, like the weight of the chains and the duration of slavery, or then one can keep the Euro, or else one refuses austerity but this then implies an exit from the Euro.¹

THE EURO AND DEMOCRACY

The Euro has become an obstacle to democracy (as we have seen in Greece) as well as to policies favouring labour and opposed to finance. However, these questions by no means exhaust the subject. The Euro has, in reality accentuated and generalized the process of financialization of the economies, which we have known for close to 15 years.² It is because of the Euro that the great European banks have gone looking for subprimes in the United States with the consequences we know since the crisis of 2008. So that, not only has the Eurozone dragged part of Europe into very weak growth,³ but also neither did it protect it, contrarily to what politicians are very imprudently claiming, from the financial crisis of 2007-2009. Thus, the result is clear. If policies nefarious to economies can be implemented outside of the Euro, the latter implies nefarious policies. In fact, no other economic policy is possible as long as one is inside the Euro. This is indeed one of the lessons of the Greek crisis. So the dismantling of the Eurozone appears indeed to be a priority task. Because of the Greek crisis we have had an important clarification of the debate, be it in Greece or in Europe and in France in particular. One must note, on the question of the Euro, an important evolution within the forces of the left, including in France, looking at evolution of the “Left Party” of

J-L. Mélenchon and especially of Eric Coquerel.⁴ This is also what an article published in The Guardian on July 14th, that is, one day after the capitulation of Tsipras, called for an « exit of the left » or a « lexit ».⁵ It was also the meaning of the article by Oskar Lafontaine, former leader of the SPD and a founding member of Die Linke, who, in 2013, called for the dissolution of the Euro.⁶ This is, implicitly, the meaning of the appeal of Stefano Fassina, who was one of the leaders of the Democratic Party in Italy (and former vice-minister of economy in the Letta government), an appeal, which was, picked up on the blog of Yanis Varoufakis.⁷ Fassina actually called for a large union of all democratic forces, be they from the left or from the right, against the Euro. The true question which one must ask therefore is of knowing whether one must make the dismantling of the Euro a priority. And, on this point, Fassina as well as Oskar Lafontaine and many others are answering affirmatively.

And it is both symbolic and important that a man such a Romano Prodi, who was President of the European Commission and Prime Minister of Italy, is talking on this subject as of a « German Blitz ».⁸ The Greek crisis has shaken the wobbly foundations of the European construct to its core. ■



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THE EURO HAS BECOME AN OBSTACLE TO DEMOCRACY (AS WE HAVE SEEN IN GREECE) AS WELL AS TO POLICIES FAVOURING LABOUR AND OPPOSED TO FINANCE. HOWEVER, THESE QUESTIONS BY NO MEANS EXHAUST THE SUBJECT.

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Joachim Starbatty

HAS GERMANY BENEFITTED FROM THE EURO?

When the Bundestag voted on a third rescue package for Greece on August 19th, the entire political spectrum represented in Germany's legislative institution agreed: Germany has benefitted immensely from the common currency. The deputies referred to a competitive German economy, a strong exporting sector and low

unemployment. In their view, it was in the country's best interest to avoid a Grexit at all costs. But it is remarkable, that 86 members of the CDU/CSU group did not follow chancellor Angela Merkel and voted against the package. Apparently, her power base is undermined.

When it comes to evaluating the economic impact of the

common currency on Germany, an economist's perspective must go to the roots. Politicians deliberately ignore the negative consequences of the Euro. Positive developments like the decrease in unemployment during last decade and the success of German exporters had other driving forces such as structural reforms and a stellar economic growth in emerging markets. If

labour markets become more flexible (as happened in Germany with the so-called Hartz-Reform at the beginning of the 2000s), unemployment shrinks. If firms in China build factories, demand for German machinery rises. Whereas positive developments are incorrectly attributed to the single currency, negative aspects were not even considered in the Bundestag.

A first negative consequence of the Euro for Germany relates directly to exports. German politicians are short-sighted: the common currency has helped the export sector. In fact it has worked as a subsidy to firms selling their products outside the Eurozone because the Euro is undervalued for Germany. After the introduction of the Euro, less prudent member states could

not offset comparatively small wage increases in Germany by devaluating their currencies anymore. Consequently, they lost their competitiveness. The often proclaimed German advantage is just the Keynesian "beggar-thy-neighbour-policy", which imposes a huge cost on the European periphery and has led to a large increase in TARGET-balances. But this "advantage"



has a downside, too: subsidies encourage complacency. If German exporters get used to full order books because of a subsidized exchange rate, incentives decrease to cut costs and increase productivity. In the long run, German firms run the risk of becoming dependent on a cheap subsidised currency. If exporters gain from a cheap currency, importers lose. Germans have seen their relative purchasing power decrease, since the social dividend (Karl Schiller) of regular currency appreciation has not materialized any more. The purchasing power of every German could be 30% higher. Therefore we have also negative wealth development. Due to the weak exchange rate, holidays in Non-Eurozone countries like Denmark, Sweden, the UK and Switzerland have become prohibitively expensive for middle income German families. According to a recent study from the economic think tank DIW (Deutsches Institut für Wirtschaftsforschung), average German wealth has declined by 15 percent in the last decade. Until the introduction of the Euro, the German Bundesbank ensured with its monetary policy that investments paid a decent yield. It was able to do so because it adapted benchmark interest rates suitable for the current state of

the German economy. In contrast, the ECB, is not able to focus on German needs because it has to take into account the situation of other Eurozone members, some of which require loose monetary policy to overcome persistent economic crisis. Ultra-loose monetary policy may help to cushion recessions but it bears significant risks: if applied too long, central banks produce asset price bubbles. Even though, there is no clear evidence of such bubbles in Germany yet, exponential house price developments in major cities like Munich and Frankfurt suggest speculative activity has picked up dramatically recently.

A third negative consequence of the single currency for Germany is the disastrous economic situation in Southern Europe,

THE COMMON CURRENCY HAS HELPED THE EXPORT SECTOR. IN FACT IT HAS WORKED AS A SUBSIDY TO FIRMS SELLING THEIR PRODUCTS OUTSIDE THE EUROZONE BECAUSE THE EURO IS UNDERVALUED FOR GERMANY.

which has negative effects on the German economy and on the country's standing within Europe. Strong European neighbours are a blessing for Germany because they buy German products and visit the country, recession plagued crisis countries drag down its economy. As an external devaluation offers the best hope of swift recovery in Southern Europe, it is from an economic perspective to be welcomed by Germans. The supposed irreversibility of the Euro rules out the fastest way to recovery and inevitably leads to a banking and transfer union. Hard-saving Germans will consequently be liable with their deposits and pensions for less disciplined

periphery governments and social safety nets.

Ever since the end of the Second World War, Germans have aspired to be good Europeans and deepen the European integration. Especially after reunification in 1990, Germans were eager to overcome Europe's past and build a peaceful and prosperous European Union which included the former socialist countries of Central and Eastern Europe. Germans were well-liked in Europe, especially in Greece, where Germany was voted the most popular country numerous times. That has changed dramatically, since austerity policy in Southern Europe has caused severe economic pain and is widely seen to be enforced by Germany. Many Germans feel that resentment against their perceived



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Jean-Pierre Vesperini

THE EURO'S IMPACT ON FRANCE

The euro has been a disaster for all countries that have adopted it, with the exception of Germany and countries strongly linked to German economy, such as Austria and, to a lesser extent, the Netherlands.

The euro has been especially catastrophic for France, because it dramatically reduced the competitiveness of the French economy through two processes.



First, France has lost its monetary sovereignty. The euro fixed the exchange rate between the franc and the mark, all the while wage policies in France and Germany remained completely divergent. France has pursued lax policies (especially with the adoption of 35 hours week) while those in Germany have been strict. So, since the creation of the euro in 1999, unit labour costs have grown twice as fast in France as they have in Germany (+31.5% against 14.8%). This loss of competitiveness in France relative to Germany, which could no longer be offset by changes in the exchange rate between the franc and the mark, was particularly serious because of direct competition between German and French companies. The resultant loss of competitiveness is particularly evident in observing the evolution of the trade balance between France and Germany. Whereas that balance was almost equilibrated in 1998, just before the introduction of the euro (import-export ratio or coverage of import by export of 97.3%), it is now heavily in deficit with a ratio of 73%.

Second, the optimal exchange rates for the French and German economies are different. This is because labour costs are higher in France than in Germany, and, because of elasticity: the price of French exports is higher than those of German exports due to differences in composition. Under these conditions, the optimal exchange rate of the French economy is around € 1 = \$ 1.10, while for the German economy it is about 1 € = \$ 1.35. But throughout the period in which Mr. Trichet was the president, from 2003 to 2011, the European Central Bank followed an exchange rate policy close to the optimum exchange rate of Germany, and at the same time

far away from the French one. Indeed, during this entire period, the exchange rate of the euro was on average € 1 = \$ 1.332, so nearly equal to the optimal exchange rate for Germany, and more than 20% above that for France. German politicians who negotiated the creation of the euro have hence proved far more skilful than their French counterparts (Mitterrand, Delors) since they won the headquarters for the ECB in Frankfurt, which is headed by a Frenchman, but led a policy favourable to the interests of Germany and inimical to French economic interests. The consequences of the exchange rate policy of the ECB during the presidency of Jean-Claude Trichet were extremely serious. Indeed, the overvalued exchange

market shares plummeted 20.8% since the creation of the euro from 4.8% to 3.8% of world trade, while those of Germany remained roughly stable only dropping by 2.7%, from 7.5% to 7.3% of world trade.

The euro has reduced the growth of exports of France and as a consequence has greatly reduced production, particularly industrial production. By reducing growth, the euro has prevented attempts at reducing unemployment which was the same in 2014 as it was in 1998 (10.3% of the workforce) while during the same period Germany managed to reduce its by half (9.4% to 5%).

The reduction in output growth also slowed the growth of tax

THE EURO HAS REDUCED THE GROWTH OF EXPORTS OF FRANCE AND AS A CONSEQUENCE HAS GREATLY REDUCED PRODUCTION, PARTICULARLY INDUSTRIAL PRODUCTION.

rate policy has led French companies, either to lose market share if they maintained their margins or to sacrifice their margins to avoid losing too much market share. But in sacrificing their margins, they were forced to reduce investments, which resulted in a weakening of their competitiveness, which in turn erodes their market shares.

These two factors, first, the fixed exchange rate between France and Germany combined with divergent wage policies and, second, the long period of overvaluation of the euro for the French economy has been devastating. Dramatically reducing the competitiveness of the French economy, the euro drove down the market share of France. In France the

revenues, which explains why public debt has grown much faster in France than in Germany. While the debts of both countries were about the same level in 1998 (about 60% of GDP), French public debt was equal to 95% of GDP in 2014, while in Germany it was just 74.7%.

Replacing Trichet with Mario Draghi has been accompanied by a radical change in the exchange rate policy of the ECB. Henceforth, the exchange rate of the euro, without yet being particularly favourable to French exports, is more suitable for its economy. However, 10 years of overvaluation (eight years under the Trichet presidency, plus the two years it took Draghi to succeed in reversing the orientation of



exchange rate policy) has proved destructive for the French production base. In particular, employment in the industrial sector, which had remained stable between 1999 and 2002, began to decline from 2003, namely when the policy of the strong euro was inaugurated by Mr Trichet. Industrial employment in France would not cease to decline annually from 2003 to 2014. Over that period, industrial employment fell by 24% in France, while it barely changed in Germany.

Admittedly, since 2011, unit labour costs rose slightly faster in Germany than in France. However, this recent development, which may not endure, does not offset the huge

competitive gap that emerged between Germany and France in the period from 1999-2011.

Both the adverse effects of the divergence in costs between France and Germany and those of the overvaluation of the euro, even as they have attenuated, will continue to impede the growth of the French economy.

The euro has handicapped the growth of the French economy in other ways, too. By constraining France from exercising budgetary sovereignty and submitting itself to supervision by the European Commission, the euro prevented France from adopting a fiscal policy enabling it to combat the crisis of 2008, as the US and Britain were able to do.



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Having lost its monetary and fiscal sovereignty, France no longer has the ability to define a policy appropriate to its situation. So long as France does not regain monetary and fiscal sovereignty, it will not return to strong growth. ■



Antoni Soy

THE ILLUSION OF THE SPANISH RECOVERY

Since 2008 the Spanish economy has suffered a major crisis, with a sharp drop in its GDP and per capita GDP and a big increase in its unemployment rate. It is its deepest crisis since the 1936-39 civil war with a fall in per capita GDP of more than 7% in seven years. It can be compared to the impact of the Great Depression of the 1930s.

In 2005-07 the economy presented a public sector surplus. With the crisis the public deficit grew rapidly at 11% of GDP in 2009. The deficit remained high, finishing 2014 at 5.6% of GDP. As a result, Spain's public debt has increased rapidly and it stood at more than 98% of GDP. Private debt has increased significantly and rapidly since 1999 reaching 231% of GDP in 2010.

The causes of the crisis have been neither the public sector deficit nor the failure of "structural reforms". Both, rising private debt levels and the lack of prudence and efficiency of the creditors that caused this situation, are at the root of the crisis.

Since the third quarter of 2013 the Spanish economy

has not been in recession. The unemployed and the unemployment rate have started to fall. However, unemployment stands at more than 5 million people and the unemployment rate at more than 22%.

Undoubtedly, some external shocks have helped what seems to be an economic recovery. But, an

important part has been achieved thanks to a very severe "reform" of the labour market, with cuts in wages, a reduction in unit labour costs, a reduction in firing costs, a decrease in unemployment benefits, and a greater flexibility for companies in all collective bargaining procedures. During the crisis period, wages and nominal unit labour costs have been the

lowest of the major countries of the euro zone and they have shown the most moderate growth.

The internal devaluation in Spain has been very intense. The burden of the adjustments to improve the imbalances in the euro zone between creditor and debtor states has been highly asymmetric, with the peripheral countries being

the ones to suffer them almost exclusively. With the EMU and the euro the adjustment process has been as asymmetric as in the other fixed exchange rate regimes.

Theoretically, the austerity policies has been characterised also by the cuts in public spending, with the consequent reduction in public deficit. Many public services have had to accept major cuts; however, public deficit has withstood these attempts at reduction and the public debt to GDP ratio has increased constantly. So, besides the labour market reform, an important element for the recent so-called recovery is the sizeable public deficit of the Spanish economy in recent years.

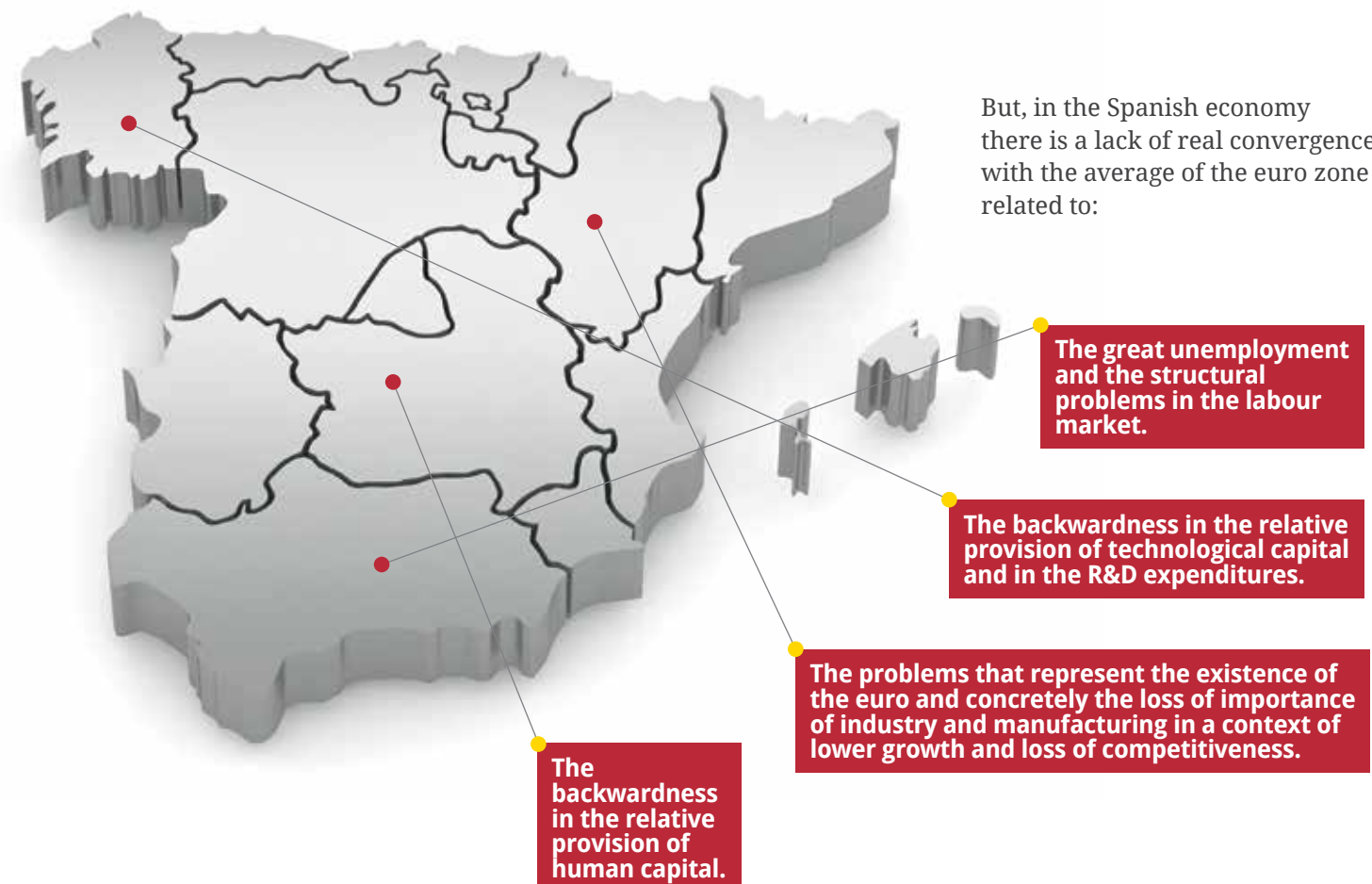
It experienced a dramatic moment of crisis in 2011-12 with a big rise in unemployment, a sovereign

debt crisis and a profound crisis of the banking system. The danger of a bankruptcy and the need of a bailout as the Greek economy came to be very close, with a very important difference: the Spanish economy is much larger than Greece, and the consequences on the whole euro zone would have been much more severe. So, the troika has allowed Spain to maintain a relatively expansionary fiscal policy.

The current account deficit became larger and larger in the period of economic growth, due to high import growth and increasing private sector indebtedness which were financed primarily with funds from abroad, with a historic current account deficit of almost -10% of its GDP in 2007. With the “internal devaluation” Spain began to cut its imports significantly

together with some reduction in private sector borrowing abroad. Consequently, the current account balance gradually recovered and in 2013 it became a surplus. However, the first signs of a possible recovery have caused imports to rise and in 2014 the current account balance was back in deficit.

Based on these figures, the Spanish government, the EU and the IMF, have spoken of the success of the policies they have promoted and implemented: competitiveness can be restored within the euro zone, and it can start to grow again, based on increased exports, implementing policies of “internal devaluation”. The Spanish economy is being held up as an example of what other economies, particularly Italy and France, should do.



THE INTERNAL DEVALUATION IN SPAIN HAS BEEN VERY INTENSE.



Antoni Soy, Professor of the University of Barcelona, Former Deputy Minister of Industry and Business in the Government of Catalonia

The unemployment rate is the second highest in the EU and the euro zone (more than twice) after Greece. Youth unemployment represents another important issue (over 50%). There is a temporary employment rate much higher than in the other countries of the euro area. In fact, the recent increase in employment is mainly in temporary jobs and with precarious conditions. Between 1994 and 2013 in Spain the employment increased by more than 40% but the unemployment did it by more than 75%.

This structural unemployment, so high and persistent, seems related to: the type of specialization too much focused on sectors relatively unproductive and not technologically advanced; an education system unable to respond adequately to the needs of businesses, with an excess of people who only have primary education (with a major school failure) and a lack of people with secondary education, specifically

on job training; third, a significant delay in the technology and innovation system.

One of the main problems of the Spanish economy is its technological slowdown, with respect to the EU, the euro area and the OECD. The technological capital, the R&D expenditure in relation to GDP and the number of researchers in % of the labour force are below the average of these areas and decreased clearly from the crisis.

Another important backwardness is that human capital in relation to the working age population is 5% below the euro area average and its relative improvement is stagnant since 2005. Public expenditure on education relative to the working age population is a 22% below the euro area average and prone to decrease since 2009.

During the period of expansion, there were growth rates higher before (1986-1999) than after the implementation of the euro (2000-

But, in the Spanish economy there is a lack of real convergence with the average of the euro zone related to:

2007). Moreover, there is a loss of weight of both the industrial and the manufacturing production especially after the outbreak of the crisis. Finally, the evolution of competitiveness (measured by the Real Effective Exchange Rate) has been negative in relation to the euro zone since 1999.

Eventually, to sum up, in this context the recovery of the Spanish economy does not seem to have a very solid base. The permanence of the structural problems of the economy (high structural unemployment; mismatch in the labour market; backwardness in the technological capital and the human capital adversely affecting productivity; the problems of growth and competitiveness posed by the existence of the euro) as well as that there has been no change in the predominant type of sectors in the economy, it does not permit much optimism regarding the possibility of achieving a strong and powerful economic growth without the problems and the limitations of the past. ■



Peter M. Oppenheimer

IMPACT OF THE EURO THE VIEW FROM BRITAIN

The euro in its present form is a negative-sum game. Not merely for members of the eurozone, but for the global economy as a whole. It makes the world community worse off – in other words, with outputs and incomes lower – than it otherwise would be.

This happens because the euro within its sphere of operation signifies renunciation of a key economic adjustment mechanism, namely movement of exchange rates between currencies. Countries deprived of this mechanism come under pressure to lower or to raise their internal money wage levels, according as they are in incipient deficit or surplus on their balance of external payments. In practice, surplus countries – which in the eurozone means chiefly Germany – resist pressure to inflate. This is partly because their businessmen do not like to sacrifice competitiveness. So the deficit countries (in the eurozone, mostly in southern Europe) undergo intensified deflationary pressure. This means depression of their output, employment and, of course, aggregate domestic demand. That includes their demand for imports, which in turn spreads the depressive impact both to other members of the eurozone (ironically offsetting some of the stimulus enjoyed by German producers from their over-competitive cost level) and to third countries around the world.

Depression in the deficit countries may be to some extent postponed or relieved by borrowing. But this means accumulation of shaky debts on the part of either private or public bodies. The creditors too are partly banks or private non-bank lenders in other countries, and partly (mostly!) official lenders. These comprise national governments and international institutions, notably the European Central Bank and the International Monetary Fund (IMF).

The total volume of such debts has been swollen by periodic surges in market interest rates facing debtor countries in response to their loan demands. It should be added that the IMF has, constitutionally speaking, no business lending to sub-units of a single-currency area such as the eurozone, without a guarantee of repayment from the monetary authorities of the zone as a whole. The Fund's disregard for this principle reflects its eagerness to earn income in order to pay its staff, as well as the fact that its Managing Director is traditionally a European, and latterly from a eurozone country (France).

All this was not unpredictable or unpredicted. Indeed, virtually no respectable economist outside official circles defended creation of the single currency. Rather, the

and institutional diversity, and partly from the nature of modern labour markets. National diversity alone was in the 19th century consistent with an exchange-rate union extending not merely across, but far beyond Europe. This was the classical gold standard.

With industrial technologies comparatively primitive, and in the absence of strong trade unions or state-funded income support, money wages were sufficiently responsive to market forces to maintain equilibrium in international payments. The process was also assisted by large-scale migration of labour from European countries to other parts of the world (especially the Americas), together with simultaneous exports of capital through the London bond market.

**DEPRESSION IN THE DEFICIT COUNTRIES
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euro's advocates and designers – from Pierre Werner in the early 1970s to Jacques Delors in the 1990s – turned a blind eye to its implications and sought to justify it in economic terms by proclaiming that a single European market requires a single European currency to eliminate foreign-exchange transaction costs. This was like seeking to eliminate transport costs by outlawing distance. Their real motive was of course political – to set up a rival currency to the US dollar, and nowadays also one covering the same domestic expanse as the Chinese renminbi or the Indian rupee.

The dysfunctionality of a single currency for the bulk of Europe stems partly from Europe's cultural

Furthermore, much of the output of food and raw materials generated by these resource flows to new countries was absorbed as imports by the United Kingdom. Total British imports in 1913 amounted to about 40% of the rest of the world's exports.

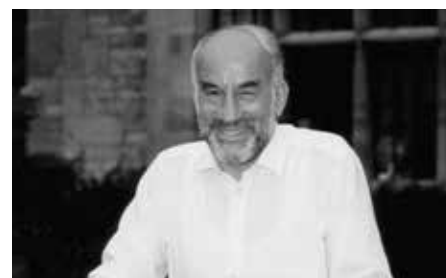
By then, however, this remarkably self-regulating system was already fading. With new industrial technologies, more powerful trade unions and the beginnings of the welfare state, money wages lost their flexibility. The First World War massively disrupted demographics, commerce, and international finance. The sequel was twenty years of market instability, economic slump and erratic struggle for new weapons

of economic policy. Leaving aside full-blooded socialist planning, the two most important new weapons were, in chronological order, exchange rates and fiscal or budgetary management. The second especially was associated with the rising ratio of government expenditure and taxation in market (or “mixed”) economies.

Britain in the 1920s and again in the 1960s, and France in the 1930s, damaged their economies by maintaining an over-valued currency for confused motives of prestige, morality or nostalgia. Such attitudes appeared after 1970 to have vanished – until the Maastricht Treaty and the creation of the euro at the end of the century.

across much of the North Atlantic area after the year 2000. The need, from 2007 onwards, to rescue failed banks, along with a big jump in UK unemployment from 5 to 8% of the labour force, put further strain on Britain’s public finances.

A coalition of Conservatives and Liberal Democrats took over government after the general election of 2010. It pursued a far more balanced policy of gradual fiscal consolidation without extreme deflation. At the same time, Britain now benefited briefly from non-involvement in the financial travails of the eurozone, not least the massive expansion of national government debts within the zone. The second half of 2013



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recovery – which were rashly permitted by the UK authorities to induce a 15% appreciation of sterling against the euro. Admittedly, Britain has slowly been rebalancing its external trade in goods and services away from the EU. Since 2000 continental Europe’s share of Britain’s exports and imports has fallen, roughly speaking, from 55 percent to 45. But even this lower figure represents some 13.5 of Britain’s GDP; and in any case appreciation of sterling handicaps Britain’s trade not merely within Europe but world-wide.

The pound’s appreciation vis-a-vis the euro is entirely defensible in relation to the depressed or stagnant economies of southern Europe. In relation to Germany, however – with that country’s massive trade surplus and near-50% share of exports in GDP – it is beyond belief, and underlines the iniquity of the single currency. David Cameron needs to have this in mind when embarking on his quest for the reform of EU institutions. Preserving the sovereignty of national Parliaments and re-thinking EU policies on labour migration are clearly key issues. But at least equally vital for the harmony and prosperity of Europe – and infinitely more important for Britain than the parochial interests of the City of London – is to restore a rational basis to currency arrangements. ■

Oxford, September 2015.



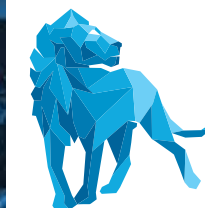
Gordon Brown

Gordon Brown, Chancellor of the Exchequer in the Labour Government after 1997, kept Britain out of the euro. This created an opportunity to enhance Britain’s competitive position by depreciating sterling against the euro, and thereby prevent a fresh widening of the country’s trade deficit (previously narrowed since 1992).

Regrettably, Brown then threw away his own opportunity by pursuing a grossly over-expansionary and irresponsible fiscal policy. This was accompanied, moreover, by Britain’s participation in the wave of imprudent banking policies and poor financial regulation that swept

saw a clear upturn in the British economy, at a rate of 2 - 2.5 % per annum. This was a modest figure beside the 7% drop in Britain’s GDP since 2008. Parallel gains in employment, though welcome in themselves, pointed also to poor productivity performance, connected obviously to the alarming shrinkage of Britain’s manufacturing sector, which currently constitutes little more than 10% of GDP.

In any case the upturn has not maintained its momentum. It tapered off in the course of 2015. This was largely due to higher capital inflows – induced partly by premature confidence in Britain’s



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THE EURO-RESCUE POLICY AND

BRITXIT

Hans-Olaf Henkel

The eurozone crisis has had profound implications for the functioning of the European Union. The Greek drama is certainly its most illustrious example. After seven years of depression, the situation in Athens is now a humanitarian crisis. Yet the Greek establishment shows a strong commitment to continued membership in the

Eurozone, even while a Grexit combined with a debt write-off constitute a sine qua non of recovery. EU institutions and some European governments present the crisis as a justification to push towards more economic integration and a fiscal union. Yet the scale of the tragedy is such that it now has consequences far beyond Greek, and even beyond Italian, Portuguese and Spanish

borders. The eurozone tragedy is now bleeding into Shakespeare's homeland, where the euro-rescue policy is slowly pushing Britain out of the EU.

At the heart of the eurozone crisis lies the euro itself. The single currency has long been too weak for Germany and too strong for Southern Europe, including France. Moreover,

the one-size-fits all monetary policy suits nobody. According to conventional wisdom in Brussels, the eurozone needs to be backed by a transfer union in order to make the European economy work again. Any historically informed reflection on the Italian experience and the miserable effects of attempts at fiscal transfers intended to improve competitiveness of

regions suffering for a strongly overvalued currency, should restrain enthusiasm about this idea. But this historical consideration does not seem to figure in the mainstream European public debate. A call for a more centralized European political union with a common treasury has no economic grounds. Even more, it is against the economic

interests of European economies and undermines democracy in Europe, which work the best at national level. The only viable solution for Southern Europe's economies to return to the path of real economic growth is a sharp currency devaluation, which in some cases ought to be combined with debt restructuring. Obviously, a sound economic policy must follow.

THE POLITICAL ROMANTICISM OF EUROPEAN ELITES HAS EXACTED THE PRICE OF MAJOR ECONOMIC MISERY, WHICH UNDERMINES THE SOCIAL FABRIC OF MANY EUROPEAN SOCIETIES, AND ENDANGERS THE VERY EU ITSELF, BREATHING LIFE INTO RADICAL POPULIST PARTIES QUESTIONING ANY AND ALL BENEFITS OF EUROPEAN INTEGRATION.



THE EUROZONE IS NOT AN OPTIMAL CURRENCY UNION. THEREFORE, ANY SOLUTIONS WHICH ARE SUPPOSED TO FIX THE CRISIS BUT FAIL TO ADDRESS THE ROOT OF THE PROBLEM, THE EURO ITSELF, CAN MAKE THE SITUATION WORSE.



The vision of 'ever closer union' embodied by the single currency has turned out to be a trap for Southern Europe. The political romanticism of European elites has exacted the price of major economic misery, which undermines the social fabric of many European societies, and endangers the very EU itself, breathing life into radical populist parties questioning any and all benefits of European integration. There is, however, an alternative vision of the European Union, which has at its heart the principles of subsidiarity, self-governance and strengthening the Single Market. This very vision embodied by the Great Britain represents the best strategy for a prosperous and strong Europe. Tragically, the faith in

'more Europe' as a solution to the eurozone's woes is seriously diminishing the attractiveness of the European Union in the eyes of the British public. However, we should not be surprised with this development.

The eurozone is not an optimal currency union. Therefore, any solutions which are supposed to fix the crisis but fail to address the root of the problem, the euro itself, can make the situation worse. Many aspects of the new European financial legislation and the Banking Union undermine vital British interests and transfer more power to Brussels. Moreover, the eurozone is prone to constant crisis, because any currency in a suboptimal currency area will

not be subject to a rule-based regime, so promises made to the British government will be broken. Economic reality will always come with vengeance, which has become clear during recent years and the seemingly endless sequence of emergency crisis summits that demand the attention of European leaders. The most recent act of the still-unfolding Greek drama proved this point strongly, when in July 2015, EU leaders decided to use the European Financial Stabilisation Mechanism to grant a bridge loan to Greece, despite a previous promise made to the British government that it would not be used to bailout the eurozone countries. Given this, how can anyone expect the British public to have

AT THE HEART OF THE EUROZONE CRISIS LIES THE EURO ITSELF.

faith in the credibility of the European Union? The continuous mismanagement of the eurozone crisis creates a picture of the European project as a failure, and this for sure is not an argument for staying in the EU.

The euro-rescue policy, based on a blind commitment to saving the euro 'at all costs', largely explains why, contrary to the United States and the United Kingdom, the eurozone has not experienced the long awaited economic recovery. European leaders have

sacrificed the well-being of many millions of Europeans at the altar of the euro. Calls for more harmonization, centralization and debt socialization cannot solve the situation. This can only be accomplished by a controlled dismantling of the eurozone. Exchange rates realignment is a must for economic recovery in Europe. The failed philosophy of 'ever closer union' must be rejected to revive the European project. One of the great paradoxes of the euro-rescue policy is that it pushes Britain out of the EU, when it is precisely the British vision of integration, which represents the best strategy for securing the future success of European project. As a result, the British call for a reformed EU deserves support, but the British

elites must understand that the euro is also their problem. Not being a part of the eurozone does not make Britain immune to the consequences of its crisis. ■



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Roland Vaubel

BANKING UNION A BREACH OF FAITH

The project of the European “banking union” covers legislation at the EU level and at the eurozone level. I shall focus on the EU level regulation and especially the European Banking Authority (EBA).

The EBA regulation was the first piece of EU legislation imposing EU regulatory control on the City of London. It was initiated and promoted by EU Commissioner Michel Barnier. When Barnier was appointed Commissioner for the Internal Market, Nicolas Sarkozy, the President of France, exclaimed

in a speech: “Do you know what it means for me to see for the first time in 50 years a French European Commissioner in charge of the internal market, including financial services, including the City (of London). I want to see the victory of the European model, which has nothing to do with the excesses of financial capitalism” (The Times, London, 2 December 2009). Christine Lagarde, French Minister of Finance at the time, declared: “We need a City that plays by different rules” (Financial Times, London, 4 December 2009). A few months later, when

on vacation in France, I read the following statement by Jean- Paul Gauzès, French rapporteur for financial market regulation in the European Parliament and member of Sarkozy’s party UMP, in Le Figaro: “Dans un pays comme la France, il y a une vraie tradition de surveillance des institutions financières. L’avantage d’une supervision européenne serait d’étendre les mêmes règles partout” (7 July 2010). In other words, the idea was to impose the regulations of the more restrictive majority, including France, on the less restrictive minority.



In the political economy literature, this is called “the strategy of raising rivals’ costs”. It has become common practice in the EU – also in the field of labour market regulation and the taxation of the art market (by the so-called “droit de suite”, a levy on art sales first introduced in France).

The strategy of raising rivals’ costs requires voting by simple or qualified majority. Commission, Council and Parliament based the EBA legislation on Art. 114 TFEU, the so-called internal market article, which had been introduced unanimously (as Art. 100a TEC) in the Single European Act in 1987. It permits qualified majority decisions. The Single

in national financial regulation is perfectly compatible with the free movement of capital because these regulations are process regulations, not product regulations. Thus, the EBA regulation could not have been based on the Single European Act.

However, in 1989, two years after the Single European Act, the European Court of Justice fundamentally changed the meaning of the term “internal market”. In its “Titaniodide decision” (C-300/89), it declared that “by virtue of Articles 2 and 3 of the Treaty, a precondition for such a market [i.e., an internal market] is the existence of conditions of competition which are not distorted” (nr. 4).

THE LESSON IN CLEAR: WITHOUT A FUNDAMENTAL REFORM OF THE COURT, THE RULE OF LAW CANNOT BE RESTORED AT THE EU LEVEL. THE JUDGES SHOULD NOT BE CHOSEN BY THE GOVERNMENTS BUT BE DELEGATED BY THE HIGHEST NATIONAL COURTS, AND THEY SHOULD BE REQUIRED TO HAVE JUDICIAL EXPERIENCE (WHICH MOST OF THEM DO NOT HAVE).

European Act had been signed by Margaret Thatcher. So did Margret Thatcher open the floodgates for Brussels legislating the regulation of the City?

Art. 114 TFEU requires that the regulations “have as their object the establishment and functioning of the internal market”, and it explicitly refers to Art. 26 TFEU which defines the internal market as “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured.” As Fahey (2011) and others pointed out at the time, diversity

Since any difference between national regulations may be claimed to distort competition, the Court opened the whole field of government regulation for qualified majority voting in the EU Council. This was a blatant breach of the Treaty, and a breach of faith. The internal market article refers to the definition of the internal market, not to Art. 2 or 3 which, at the time, did not even contain the term “internal market. The Court reasserted its position in several decisions. The UK challenged the use of Art. 114 TFEU several times before the Court but in vain (see Fahey 2011

and the ESMA case, i.e., C-270/12). The only way to restore the original meaning of Art. 114 would have been legislative override by treaty amendment. However, in the Treaty of Lisbon, Gordon Brown agreed to a “Protocol on the Internal Market and Competition” which legalized what the Court had done. According to the protocol, “the internal market as set out in Article 3 of the Treaty on European Union includes a system ensuring that competition is not distorted”.

The lesson in clear: without a fundamental reform of the Court, the rule of law cannot be restored at the EU level. The judges should not be chosen by the governments but be delegated by the highest national courts, and they should be required to have judicial experience (which most of them do not have). This reform and the interpretation of Art. 114 TFEU ought to be central issues in David Cameron’s renegotiation. ■



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A TALE OF TWO LEFTS AND THE EURO

David Liebers

A widening chasm separates the American left and its European counterpart on the question of the eurozone. To mainstream observers on the left and centre-left in the United States, it is increasingly obvious that the European single currency is a problem. Astonishingly, the European left rejects this notion, and even more shockingly, it has served as an architect of the continent's most severe austerity policies. Consider the observations of three of the most influential economic thought leaders on the American left.

Nobel laureate and New York Times columnist **Paul Krugman** has seen straight through the two most common and puerile arguments defending the single currency, **(a)** that it is a “political rather than purely monetary project,” and **(b)** that the main problem with Greece is the lack of structural reforms. His apt comparison with Poland illustrates his point that barriers to productivity cannot explain Greek unemployment:

“Poland, like Greece...is closely linked to the rest of the European economy ... [with] lower productivity than Greece by standard international measures... But Poland has not had a Greek-style crisis, or indeed any crisis. Instead, it has powered through the turmoil of recent years. What’s the difference? The main answer, surely, is the euro.” ¹

Similarly, Vox co-founder and economic journalist **Matthew Yglesias** offered the following analysis:

“Europe is currently mired in a depression whose initial cause was the single currency, and mainstream European leaders have no solutions to offer. The eurozone is fundamentally a political project rather than an economic one, but to succeed politically it needs to work economically.” ²

Last, Nobel laureate economist **Joseph Stiglitz**:

“We know the structure of the eurozone encourages divergence, not convergence...the euro was supposed to strengthen [European Solidarity]. Instead, it has had the opposite effect... Although the single currency was supposed to bring unprecedented prosperity, it is difficult to detect a significant positive effect for the eurozone as a whole in the period before the crisis. In the period since, the adverse effects have been enormous.” ³



The simple message from America's most influential leftist economic minds is clear: the euro is the critical variable causing Europe's economic (and unemployment) woes. This argument is unwelcome in polite conversation among moderate politicians in Brussels, despite levels of unemployment and economic despondency in Greece and Spain not seen since the Great Depression.

The disconnect between the American left and European left is in part due to the American left's aversion to draconian austerity measures. But perhaps distance from the European Project allows opinion-makers in the United States to understand something that is rarely acknowledged in Europe: the EU and the eurozone are separate (though related) enterprises. Almost universally, the American observers that have taken aim at the single currency are strongly in favour of a healthy European Union, and view partnership with a strong EU as a geopolitical imperative.

European leaders that lump anyone who criticizes the euro currency together with extremist populists, have rendered untenable any form of serious pro-EU, anti-Euro politics. The inflexibility on this point is so great that the President of the European Parliament, and leader of the largest left-wing party in the parliament, Martin Schulz, has threatened to throw Greece out of the EU if it leaves the eurozone - the only real solution that has been tabled for returning to competitiveness.⁴ Worse, the imprecision of the moniker "Eurosceptic," squeezes out moderate, pro-EU, anti-Euro voices.

The Obama administration has been largely quiet on these matters. Where the White House has intervened, its pro-forma statements (for example, admonishing the Greeks to "get their house in order" during the most recent debt repayment crisis

in June 2015) sound engineered to echo the received wisdom in Brussels—this perhaps an attempt by the Obama Administration to cosy up to European politicians still bristling over NSA spy revelations. But this is a political chess move, and disparate from the views of his progressive supporters, and academic opinion leaders.

It should not surprise Europe if the United States begins taking far greater interest in a speedy resolution of the euro-generated financial crisis. It is no secret that economic turbulence buoys extremist politics. The current catastrophe has breathed life into anti-NATO, anti-American, pro-Putin political parties across the political spectrum. Yet nothing will get done if the dominant discourse continues to link the dismantlement of the euro to the end of the EU. As Yglesias puts it, it is the "the professional consensus" that the eurozone does not represent an optimal currency zone.

It is time for moderate European politicians to display political courage and creativity and acknowledge this. The European left should remind itself that the values at the heart of left-wing policies, such as protecting human dignity and securing the social well being of citizens, have been the central victims of the euro. Reconnecting with the American left on the euro question would be a most sensible beginning. ■



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EUROPE'S FASTEST GROWING POLITICAL MOVEMENT



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