The two prices of the Euro

Luiz Carlos Bresser-Pereira

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The G20 left unresolved the key issue that divided its rich members. Europe advocated fiscal adjustment, whereas the United States argued that the demand crisis is still unsettled, and that, therefore, it is necessary to maintain a policy of fiscal expansion or public deficits. In addition, the United States proposed that Germany should adopt an expansive policy and, thus, export more, whereas Germany reaffirmed its decision of deepening its fiscal adjustment.

Who is right in this debate? I suggest that the Europeans, Germany excepted, must carry out the fiscal adjustment. The idea of some fellow Keynesians that it is too soon to start the adjustment makes sense for the United States, Great Britain, and Germany; not for the rest of Europe. As for Germany, there is a clear reason for this distinction. As soon as the problems of its reunification were solved, Germany adopted a policy of wage reduction to face foreign competition. Thus, while productivity increased, wages remained stagnant. Big trade surpluses, even as compared to the other European countries, resulted from this policy – that led Greece to the crisis and several other European countries to a situation of high financial vulnerability. Therefore, Germans can and should do more. Their big trade surpluses have no economic logic for Germany itself.

The other European countries are forced to carry out a strong fiscal adjustment. Their foreign creditors promote speculative attacks against their government bonds. To guarantee them, the support offered by the European Union is not enough. It is also necessary for them to reduce their public deficit and particularly their public debt, which is over 100% of GDP. This adjustment will not contribute to a strong resumption of European growth, but it is inevitable.

Yet the United States and Great Britain are not compelled to the same austerity. Not because they have big surpluses, but because they have their own domestic currency, which enables them to do two things: first, to depreciate it – which already happened with the dollar and the pound; second, to print it, through the financing of each country's treasury by its Central Bank (the so-called "quantitative easing"). As *The Economist* (June 26) puts it, the countries that are part of the Euro Zone "renounced devaluation and money printing". Something that the United States and Great Britain did not. In a situation of insufficient demand, their treasury can go into debt with the corresponding Central Bank in order to finance the expansion of their expenditure, without this implying an increase in their net public debt and without paying the price of inflation, because the demand is cooled down. Besides creating liquidity to rescue their banks (something that the Europeans also did), those two countries have quietly and moderately adopted the policy of issuing money to finance their expenditure. European countries cannot do the same thing, and they are compelled to fiscal austerity. They have the euro but they pay two prices: they cannot devalue it and they cannot issue money.