The failure of the Euro

Luiz Carlos Bresser-Pereira
Folha de S. Paulo, June 5, 2011

Countries with high private debts, beginning with Spain, are caught in a trap. The only rational solution for them is to depreciate their currency, and, therefore, to leave the Euro

The European financial crisis worsens every day. Now Spain is being challenged by speculators, and the young unemployed Spaniards gather in the public squares to protest. They do not present solutions to the problem, but those offered by the European Central Bank, the European Community, the IMF, and Germany are equally unable to calm down the financial market. The only idea that made some sense for the most affected country – Greece – was the restructuring of its debt, as suggested by Germany, but ECB's and IMF's conservative bureaucracies did not accept it. Now, with the Spanish crisis, which is a private debt crisis, the point is no longer to know whether Greece or any other of the threatened countries may emerge from this crisis without imposing to the creditors of the corresponding State a substantial discount. Since it is not that simple to impose losses to private debt creditors, the point is to know whether it is possible to save the Euro.

Two were the causes of the European crisis: the expansive fiscal policy that the countries were forced to follow in view of the 2008 banking crisis, and the euro's implicit overvaluation which took place during the last ten years in Southern European countries and in Ireland, and that are today in crisis. The first cause gave rise to a huge public debt, the second one, to a huge private debt. The most serious case of public debt – the Greek one – could be solved through restructuring. Yet when the debt is private, such as in Spain, there are only two solutions: either to plunge into a profound recession which will reduce the actual wages, or to leave the euro and suffer a direct devaluation of the currency.

The solution proposed by the creditors was fiscal adjustment, recession, unemployment, decrease in wages. As a result, the implicit exchange rate would be depreciated and the current account equilibrium of the indebted countries could be restored. Since the origin of the private debt was the appreciation of the euro caused by the productivity increase in Northern European countries, without an increase in wages, whereas in the Southern countries the productivity increased less and the wages more, the solution may seem reasonable for the creditors. And the debtors will accuse it of unfair. The point, however, is not reasonableness nor justice; is economic viability. The current account imbalance and the already accumulated debt of the Southern countries are too high to be solved by a policy of austerity, unemployment and reduced wages. Countries with high private debts, beginning with Spain, are caught in a trap. The only rational solution for them is to depreciate their currency, and, therefore, to leave the Euro. Will they have the courage and determination to do it? To restore the authority of their central banks and face the risks of inflation? It is the less costly solution for them, but it takes courage. Will the euro itself survive? I believe so. But it is clear that the euro failed, despite being a strong reserve currency. It failed because it created more problems than solutions for the European Union.