The crisis of the euro, a foreign currency

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Articles published in the press, especially in my weekly column in *Folha de S.Paulo,* between February 15, 2010 and June 5, 2012. In these articles I radicalized the analysis to the extent that I understand the seriousness of the crisis. The turning point for me came when, in my article of November 21, 2011, I became aware of what had been the fundamental error of the creators of the euro: they replaced their national currencies with a foreign currency

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Speculation against the EURO

Financial markets are incorrigible. Speculation now turns against the Euro or, more specifically, against Greece, and will later attack Portugal and, subsequently, Spain – the most fragile countries in the Euro Zone. The price of the *credit default swaps* aimed at protecting creditors against a possible Greek bankruptcy went from a level of 120 in October to 419 on February 9. People who buys CDs at a such high price is betting on the country's bankruptcy, which will convert this high price into a huge profit – a bet with a strong self-fulfilling ingredient. The higher the bets, the more difficult is for the country to refinance itself, and the higher the possibility of bankruptcy.

I don't believe, however, that this time speculators will win. It is true that the Euro has a weak point: the European Union lacks, on the one hand, a federal authority capable of demanding higher fiscal responsibility and higher transparency from its governments, and, on the other hand, more resources to help them when they are in need. Yet, although the European commission doesn't have those resources, European governments and their ministers of finance do.

The Greek conservative government, defeated in the last elections, was irresponsible at fiscal and exchange rate levels; it put the State and the country into debt. The public deficit rose to 12.7% and the current account deficit, to 14% of GDP. And the government lied about figures. But the new Prime Minister, George Papandreou, is a competent and cautious Keynesian economist who is already adopting a number of fiscal measures. And the European Union will certainly give Greece the necessary support.

The alternative would be for Greece to demand the IMF's support, but I don't believe that Europeans will agree on that. Greece is a country already well inserted in the Euro Zone – and the IMF's support for it would represent a support for the Euro Zone, something that the major countries of the region will not accept. This alternative was adopted for the Eastern European countries, but those are countries that have only recently joined the European Union. The huge increase in capital approved by the IMF was justified by the need to rescue those countries, whose deficits – the public deficit and particularly the current account deficit – had irresponsibly increased; in fact, it was approved in order to rescue the major Western banks that had equally irresponsibly lent money to companies in those countries with the IMF's support, because they would allegedly be "growing with foreign savings".

The European Union was severely affected by the global financial crisis, because some of its major banks have followed the wave of speculation based on "financial innovations", and partly because its countries' exports were badly affected by the crisis. The household indebtedness, however, was not so big as in the United States, and only Spain faced a real estate bubble. The Euro zone as a whole did not present the public deficits nor the current account deficits presented by the United States. During the crisis, after a brief depreciation against the dollar, the Euro appreciated again, indicating the higher equilibrium of the European economy.

For all those reasons, I am sure that the speculators will end up losing this game. But this speculative attack is another evidence of the need to strictly regulate the banks and hedge funds. To create money is an ability inherent to the financial system, because it creates credit and finances the economic development, but money is a powerful and dangerous public good that democratic societies must keep under control.

Folha de S. Paulo, February 15, 2010

The true nature of the crisis in Europe

The European financial situation remains very serious. Germany finally decided to support the Greek financial package, and therefore Greece's public sector debt is solved. There has been extensive media coverage on the subject, but it is limited to informing about the public deficit and the public debt of the Greek State, instead of informing about the fundamental problem, which is not a public

sector problem, but rather a private sector one: it is the countries' current account deficit and foreign debt.

The fiscal problem is indeed serious because the 2009 deficit was added to high levels of public debt, but the imbalance lies not only in governments; it lies in the countries as a whole and, therefore, in their current account deficit and in their foreign debt, which encompass the public sector and the private sector. If the problem was limited to the public sector, financial help and a rigid policy of fiscal adjustment would solve the issue. Since it is the country's problem, it demands an exchange rate depreciation that they cannot undertake. In fact, the European Union controls the public deficits, not the current account deficits. Newspapers do not publish data on this deficit because they do not receive it from economists. Economists do not inform the newspapers because the orthodox economic theory assumes that the private sector is balanced by the market: it is the so-called “Lawson's principle” related to Margaret Thatcher's finance minister, Nigel Lawson.

The Global Crisis of 2008 showed that this theory is absurd at national level. Now the phenomenon repeats itself at international level. In 2009, whereas Germany, that reduced wages over the last ten years, achieved a current account surplus of 4.8% of GDP, Greece, Portugal, Spain, and Italy achieved current account deficits of 10.2, 10.5, 5.8, and 3.9% of GDP, respectively. These deficits financed medium-term investments, but the enterprises that took them became indebted on the short-term financial market. Debtors and creditors knew that the debts could not be paid overnight – that they would have to be rolled over – but, given the assumption of the permanently balanced private markets, they went ahead in the process. But suddenly this year the creditors began to raise risk premiums and to suspend the debt rollover. The problem is getting worse because they decided for the “sudden stop”, in a setting in which the countries do not have the classic adjustment mechanism for moments like these: the exchange rate devaluation, that would reduce wages and balance the current account. Each country's State can adjust its finances, but there is no solution for the private imbalance of countries that do not have their own currency to devalue.

As in the Global Crisis, there is a financial solution through the State. The government of the European Union may guarantee those four countries' foreign debt through the hastily creation of an European IMF, through the IMF itself, and through the European Central Bank. The orthodox will then say that the ECB cannot be part of this game, because, by bailing out the countries, it would be creating money; but this is precisely what the Federal Reserve Bank did in the Global Crisis without causing inflation. Now the ECB will need to create money to rescue the countries, or rather, to rescue the banks once again, because they lent the money. But a situation like this cannot continue indefinitely. It is necessary to radically rethink the problem of international finances and of the current account deficits.

As Wolfang Munchau wrote in the Financial Times, “the Greece rescue package shall not prevent the country's default. Despite all the rigorous austerity and reform measures it requires, numbers do not add up”. They do not add up because the debt belongs to Greece as a whole, and there are no available

measures for the country as a whole to make the necessary adjustment. Latin American countries had a vast experience of balance-of-payment crises such as this, but, since they were in the world's periphery, rich countries never faced this problem. In the 1980s, the primary cause of the balance-of-payment crisis was not the "populism" of the local governments, but the policy recommended by the economic orthodoxy of growth with foreign savings (current account deficits), that would be financed by short-term loans. This is what happens once again now.

The Global Crisis of 2008 was not a crisis of suspension of the foreign debt rollover, but a banking crisis. The crisis that now threatens Europe and, through Europe, the whole world, is a balance-of-payment crisis or a currency crisis. In this case, however, a rich countries' crisis. In the same Financial Times, Martin Wolf says that the help to Greece "is just the beginning" – and what is being demanded from Greece is the same thing that made of the 1980s the lost decade for Latin America. In my opinion it is worst than that, because Latin American countries were able to depreciate their currencies. The threatened countries, tied to the euro, cannot resort to that. Germany's delay in acting worsened the problem. Now, either the European Union takes decisive measures to protect its weaker members, or, as a whole, it will suffer for many years from the negative consequences of the present crisis.

Folha de S. Paulo, May 10, 2010

Greek debt: default or restructuring

There is no reason for the world to plunge once again into crisis.

After Greece, what? Hungary? Or a low growth prospect for Europe? Or the frustration with American recovery? Or, still Greece? The international financial markets are always nervous and unstable - sometimes sad, sometimes euphoric, but always in a dialectics of rationality and irrationality. Despite of our more "scientific" look, we economists make the same mistakes. In view of this situation, perplexed politicians and entrepreneurs - the agents in the real economy - ignore what to do. To invest or not to invest? To continue with the expansive fiscal policy, or is it already time to take care of each State's high public debt and of each country's sometimes high foreign debt? And they ask: is this the beginning of a W-shaped crisis?

Greece's problem actually posed the threat of a strong recurrence of the crisis. Germany's delay contributed to worsen the problem. However, in the end, Germany and the European Central Bank (ECB) did what was expected from them: they guaranteed Greece's debt and, more broadly, the debt of the other countries of the euro and, although this did not solve everything, the crisis eased off. Everyone knows that, structurally, Greece's problem is not solved because, even if it carries out its program of fiscal adjustment to the letter and its GDP

falls around 3% to 4% in the next two years, at the end of this period its public debt/GDP ratio would still be 150%.

Given such a setting, the question arises again as to whether would Greece withdraw from the euro system, but this is very unlikely. The advantage of having a currency that would begin its history already depreciated as compared to the euro does not counterbalance the risks of remaining outside the protection of the euro system. There is, however, the possibility of restructuring the public debt within the euro system. This would be the best course of action for Greece, given its insolvency, because even if the interest rate on its securities goes back to a reasonable level and stabilizes at that level, Greece will not be able to honour its financial engagements and to grow again.

But a reader might ask: are you then proposing "default"? No, my friend, I am suggesting that Greece should "restructure" at a discount. Which is the same as a default and something entirely different. It is the same thing, because the outcome is identical for the creditor: he receives only part of his credit. It is entirely different, because the word default has a derogatory tone to it that suggests an irresponsible debtor. Yet restructuring has a more lenient meaning, not only because it divides the guilt between the debtor and the creditors, but mostly because in the end all or the vast majority understand that it was the only rational solution for the problem, given the insolvency of the Greek State.

When a sovereign debt crisis is settled by a "default", it is usually an unsatisfactory solution because it means that there was no insolvency, or that the financial markets have not accepted the diagnosis of insolvency of the debtor country, and consider that it acted in bad faith. Yet restructuring, although it is basically unilateral or almost unilateral, is a better solution for the problem, because, in the end, it sanctions the creditors' loss that reasonably efficient financial markets must have already foreseen by pricing the credits at a discount.

The governments of countries whose State became insolvent are afraid of restructuring because they fear that this would be seen as a default. I understand this fear. The financial markets, the governments of rich countries, and the International Monetary Fund always do what is expected from the "establishment": they put pressure on the country to make the adjustment instead of restructuring the debt. And they always warn that the action will be considered as a default and that, ultimately, the country will be forced to yield, given the power of the creditors or the power of international law. If the situation is not of insolvency, but of liquidity - a mere imbalance between maturity dates and revenues - these threats may be enforced. However, in a situation of clear insolvency, as is the case of Greece today, these threats are rather rhetoric than real. The financial markets already know that restructuring is necessary. They know it because their economists and traders are aware of the figures, and know what they mean. They also know it because economists such as Martin Wolf, and economic publications they respect, such as, for instance, "The Economist", have already said that this will probably be the most appropriate solution for the Greek crisis. Those economists and publications represent a sort of financial "public opinion". Which, as any public opinion, may

be wrong, but this is not important - the important thing is that actions performed according to it become promptly legitimate.

There is no reason for the world to plunge once again into crisis. The crisis still costs rich countries a lot of money, but their governments knew how to deal with it, and their economies are on the way to recovery. Meanwhile, crises such as the Greek one may occur, but if its government has the courage and the determination to do what must be done, the other governments and the financial market itself will understand, and this source of crisis will soon be neutralized, instead of festering for a long time.

Valor Econômico, June 18, 2010

The failure of the Euro

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.

Folha de S. Paulo, June 5, 2011

Negotiated restructuring for the Greek crisis

The European Union is a wonderful and successful work of political engineering, but this judgment does not apply to the creation of the Euro, let alone to the way Europe is behaving when the Greek insolvency led it to its first major crisis. Instead of deciding to solve the problem, it is trying to postpone it and, as a result, the problem worsens day by day. The Greek crisis had four causes: the former Greek government, that was unable to manage its accounts; Germany, that increased productivity without increasing wages and thus unbalanced the economies of the weaker countries, which became indebted; the banks, that happily lent money to Greece and other countries; and the orthodox economic theory, that advocates growth with “foreign savings”, that is, to try to grow at the expense of current account deficits, forgetting that they are usually associated with public deficits.

The crisis appeared a year ago, and soon it became clear that this was an insolvency crisis of the Greek State. In those situations, the solution is to “restructure” the debt, that is, the country engages to pay only a portion of it. The alternative of additional loans combined with austerity measures which cause recession and reduce wages is ineffective, because the debt is too huge to be paid. And, in the Greek case, it is even more inadequate, because the country cannot combine austerity with the devaluation of its currency, which would lead to a decrease in wages without much pain and would restore the balance of foreign accounts.

Instead of understanding Greece's real interests and starting to discuss with the other European countries how to achieve a negotiated restructuring, Prime Minister George Papandreou opted for the easier path of subordinating to the international bureaucracies involved: the European Central Bank, the European

Community and the IMF. These always conservative bureaucracies have decided to kick the can down the road instead of solving the problem. Only Germany acted consistently: it proposed a negotiated restructuring, which would force the creditors to assume part of the losses. But two weeks ago president Nicolas Sarkozy persuaded Prime Minister Angela Merkel to continue to postpone the problem's solution. Initially, a year ago, this was a reasonable policy, because the creditor banks needed time to protect themselves from the inevitable loss. But to repeat it now is simply to worsen the problem.

The two arguments usually advanced against restructuring are that it will force Greece to leave the Euro and that it will have a domino effect on the other fragile European countries. The first consequence is definitely not true. As for the second one, we must consider that the situation of the other countries is substantially better. On the other hand, it is not by postponing the solution to a problem that we will avoid its deterioration and the risk to the others. Now is the time to solve the crisis – and this is not being done, to the detriment of Greece and the whole Europe.

Folha de S. Paulo, July 3, 2011

An uncontrolled European crisis?

There is no guarantee that the crisis will be peacefully overcome, because the risk of contagion will always exist.

The speculative attack against Italy this week makes it clear that the real problem that Europe faces today is no longer to avoid the crisis – it is there already – but to go through it under reasonable control. The primary obstacles to a suitable solution are the international bureaucrats from the European Central Bank and from the IMF, who reject the managed restructuring of the debt, and the Institute of International Finance that wants to reduce the cost of the restructuring for the major banks which represents more than it is already being reduced.

Greece is today in a position of insolvency. The IIF's document acknowledges this fact. In view of the situation, the only reasonable solution to the problem is default and debt restructuring – the reduction in the total amount to be paid and the extension of the payment term – made in a negotiated and orderly way. Germany put forward this solution, which would share the losses between the states and the banks. The banks rejected the proposal with the support of the European Central Bank, of the IMF, and of the European Commission, and, three weeks ago, the German proposal was discarded for an alternative according to which the major banks would participate in the total support of €115 billion, by replacing their €30 billion short-term credits with long-term credits at a discount. The IIF now gives its answer. It wants to annul or reduce part of Greece's €350 billion public debt. It agrees, therefore, with the restructuring it

had refused, but it wants the public sector to pay the loss sustained by the banks when they lent money to Greece.

The opponents of restructuring argued that the contagion of Greek restructuring would affect other countries. But this is already happening, and is reflected in the high interests that the other affected European countries are being forced to pay. Now, with the leak of IIF's document, Italy is the new target. Due to the public debt overhang, the interest rates on its securities increased dangerously. It seems that IIF went too far. This weekend, faced with the worsening of the crisis, European Finance ministers are reconsidering the restructuring proposal, now called "selective default", which will force the creditor banks to accept the discount. And the IMF finally indicates that it favors this solution.

The restructuring of the Greek debt controlled by the European Union, the BCE and the IMF is no guarantee that the crisis will be peacefully overcome, because the risk of contagion will always exist, and because the solution will be a partial one. It solves the problem of Greece's public debt, not of its private debt. Nor does it solve the problem of excessive production costs in the other debtor countries, because the increase in wages in those countries was higher than the increase in productivity, whereas the opposite was taking place in the European creditor countries, which resulted in the implicit overvaluation of their exchange rate. The solution merely provides an organized solution to part of the problem. Let's hope that the other part – the necessary depreciation – will be gradually settled through the adoption of austerity plans by the governments, and through productivity increase in the enterprises. The essential thing is to keep the European economy under control.

Folha de S. Paulo, July 16, 2011.

Greece, take the initiative!

The Greek government should declare default, demand a large discount on its public debt, leave the Euro and devalue its money.

Many analysts criticize European leaders, particularly Germany's Prime Minister, for the timidity and hesitation that have characterized their actions. I agree with this evaluation, but I have never seen a creditor take the initiative in forgiving part of the debtor's debt. Therefore, my main criticism is directed to the Greek Prime Minister, George Papandreou. When I see his image in the media, I cannot help feeling a sense of solidarity with him, given the size of the crisis he is facing. But I also cannot help comparing him with Argentinian president Fernando de la Rúa, a politician as correct and well-intentioned as Papandreou, who in 2001, in view of Argentina's extremely serious crisis, turned out to be weak, paralyzed, lacking the courage to take exceptional measures to cope with an exceptional situation. And I cannot help remembering that it was necessary that a new president, Eduardo Duhalde, take hold of the government and call Roberto

Lavagna as Economy minister, for the crisis to be tackled with determination and finally overcome.

Now, whereas Papandreou limits itself to ask for help and to promise what he cannot fulfill, European leaders are asked to decide in favor of a huge support to Greece and to the other countries in crisis, involving the restructuring and monetization of their debts and the creation of Eurobonds. This is the only possible solution, it is a condition for the European Union to save the euro and protect its banks. Because the major crisis lies with the major European banks, given their high exposure in the already insolvent countries or in those that are heading to insolvency. The European Stabilization Fund was a good step towards the solution of the crisis, but we know that it did not soothe the financial market because it is not enough. It will have to be a much bigger fund, and for that, European citizens must become aware of its necessity.

Right now, it is the Greek government that should be taking the initiative, that should be taking care of its own affairs. It should be in charge of devising a heroic plan, involving the declaration of default, the demand of a large discount on its public debt, and Greece's willingness to leave the Euro and devalue its money. Is this a risky policy? Yes, but I do not believe that the cost involved would be higher than what is being demanded of Greece. What is being demanded is a huge fiscal cut associated with a highly recessive policy that would reduce wages through unemployment. With the Greek plan, there would be a higher discount and a lower fiscal cut, and the equilibrium of the country's current account would be restored through the depreciation of the domestic currency rather than through unemployment.

Faced with this Greek initiative, the European leaders will have two alternatives. Either they will be angry - but this will not solve the problem of their banks and their Europe - or their constituents will be more aware of what is at stake – which is not only Greece but the whole Europe and their banks. As a result, their governments will achieve the political legitimacy that they lack today to take the necessary measures to keep Greece in the Euro zone and to promote the restructuring of its debt in an organized way.

Folha de S. Paulo, October 10, 2011

Europe's abnormal times

The best solution to Greece and to the Eurozone is a negociated and orderly withdrawal of the country from the Euro.

Could the call of a referendum made by the Greek Prime minister, Georges Papandreou, be successful? We will never know, because the Greek Prime Minister confirmed his weakness and retreated quickly before the violent reaction of the Eurozone leaders. What would "be successful" mean in this case? It would mean to find a decent solution for such a serious crisis. The fifty percent

discount on the public debt that was decided last week was an improvement, but it does not solve the major problem, which is the imbalance of Greece's current account, that is, the implicit overvaluation of the Greek Euro.

European leaders also offered a “solution” to this problem. It is the austerity plan, the measures to cut expenses, whose result is to provoke unemployment and to reduce wages and prices, and thus to depreciate Greece's implicit exchange rate. But this solution is very costly for the country. Greece is already eighteen months into recession, and no one knows how long it will still take for the country to correct its prices in relation to Germany's and the Netherlands' prices.

By proposing the referendum, Papandreou was paving the way for Greece's withdrawal from the Euro, and for the depreciation of its currency. This way, wages would also be reduced, but in one fell swoop, and without resorting to more unemployment. For Greece this is the best solution. It does not leave the European Union, but only the Euro, and it returns to its own currency, depreciated as compared to the Euro. There are risks in this move for Greek banks and regarding a possible inflation in the new currency. But both risks are probably smaller than the cost of remaining in the Euro and trying to implement an austerity plan that is too big and has no popular support.

In order to decrease those risks it is important that the withdrawal from the Eurozone is agreed upon, as the restructuring of its public debt is already being agreed upon. For the Eurozone it will be good that a country that became structurally unbalanced no longer be part of it. The imbalance is considerable, not only the fiscal one but also the exchange rate one. And it is better to think about a negociated and orderly withdrawal from the Euro.

Instead, Papandreou capitulated, and Europe went back to the restructuring alternative, plus the austerity, plus the increase in the European Financial Stability Facility. If the financial agents were calmer and more confident, if they were not so concerned with the high indebtedness of the countries of the Eurozone, this could really be the way, provided that the European Central Bank added to it a more active action in support of its members. But Europe is going through abnormal times, the fear of new crises makes financial markets even more unstable than they already are, and in abnormal times abnormal solutions are required. Such as the Real Plan in Brazil. Such as the action of the Federal Reserve Bank in the United States after the 2008 crisis. Such as Eurozone policies and the policy of its Central Bank should be, among them the withdrawal of some of their members.

Folha de S. Paulo, November 7, 2011

European, or foreign currency?

The euro's fundamental mistake is to be a foreign currency – a currency that the Eurozone

countries do not have the sovereign power to issue

Can the euro still be saved? The question makes sense because there are many analysts eager to announce that the euro failed and is condemned to disappear. Today it is clear that the euro was a risky idea, that eventually presented more problems than solutions, but it is too early to say that it failed. The whole issue in these abnormal times that trouble the Eurozone lies in knowing whether the Europeans will continue to have a "foreign currency", as it is currently the euro, or will transform it into a national European currency.

The euro's fundamental mistake is to be a foreign currency – a currency that the Eurozone countries do not have the sovereign power to issue. By adopting the euro, the countries renounced their sovereignty, because one of its basic requirements has always been the ability of the nation-State to issue money when it has no alternative to pay its debts. The exercise of this power implies a risk of inflation, but in the case of the euro this is a small risk. It is certainly smaller than the cost that European countries are incurring with this crisis.

Last week, at an international conference, the title of my presentation was "No foreign finance, please", because I know that nothing was worst for a country than to run into debt in foreign currency. Instead of promoting investment and development, indebtedness promotes exchange rate appreciation, increased consumption, financial fragility, and a balance-of-payment crisis. The developing countries went into debt in foreign currency due to exchange rate populism and because they mistakenly believed that they should "grow with foreign savings". Yet European countries went voluntarily into debt in foreign currency – a currency over whose issuance the country lacks sovereignty. A perfect paradox based on the markets' presumed self-regulation.

But the Europeans still can make the euro a national European currency. For this, the European Central Bank must do what the central banks of the United States and of the United Kingdom are doing, and issue money to buy securities of the member countries. In the case of the Eurozone, it must buy them until its interest rate reaches a normal level – and then the crisis will be over. As a trade-off, this will imply a substantial decrease in the country's autonomy to incur fiscal deficits, and a strict monitoring of private indebtedness, which is expressed by the negative current account of the debtor countries within the Eurozone.

The Germans oppose this monetization of debt; they are afraid of promoting fiscal irresponsibility. But five illustrious German economists wrote a document in support of this solution: they proposed that the ECB buy the debt of the countries exceeding 60% of GDP, because they know what will be the cost of the

collapse of the euro for their country: nearly two-thirds of German exports are destined for the Eurozone. For the moment, Northern Europe took advantage of the euro to export and invest, whereas Southern Europe used it to import and consume. This perverse syndrome will either be corrected by the collapse of the euro and the devaluation of the debtor countries's currency, or be solved by making the euro a true national European currency, of the European multinational State in formation.

Folha de S. Paulo, November 21, 2011

Neither security nor sovereignty

While the prospect increases of a collapse of the euro, given Germany's insensitivity in transforming the euro into a national European currency, the United States and Great Britain, which were the champions of deregulation and neoliberal financerization, are in a more comfortable situation, because they kept their national currency, and, faced with the crisis, they were able to doubly exercise their monetary sovereignty: by devaluating both the dollar and the pound, and by issuing money to increase monetary liquidity and thus to keep low the interests on public debt. Either the European Central Bank follows the same path, bail out its member countries, and puts a stop to the financial crisis, or the euro will go into collapse, and the only question will be to know whether it will have an organized or a chaotic end, and whether this end will result from the countries' perception that they do not need a foreign currency, or from the panic produced by a financial shock.

The cause of the 2008 crisis and of the rich countries's long recession was the deregulation of the financial markets, the explosive increase in the private debt, and bank bankruptcy. It was, in other words, the neoliberal belief, "scientifically" justified by the neoclassical orthodoxy, that the markets are self-regulated. But the Europeans have been twice the victims of this orthodoxy, because the Maastricht treaty that created the euro was governed by an absurd assumption: that the private sector would always be balanced, because it is coordinated by the market, and for this reason the only concern should be about the public sector.

Should this orthodox principle, known as the "Lawson doctrine" (finance minister of the Thatcher administration), be a mere idle theory, it would pose no problem, but it was central to the definition of the euro. In the treaty that created the euro, the European leaders established a parameter for the politicians, by limiting the public deficit to 3% and the public debt to 60% of GDP, but they did not think of establishing a limit for private indebtedness and for the whole country's indebtedness, that is, for the current account deficit.

Why haven't they also established a limit of 3% of GDP for this deficit? It would be a second limit, perfectly consistent with the public deficit's limit. Had it been established, the alarm concerning the countries currently in crisis would have sounded much earlier, and the crisis could have been avoided. After all, the euro

crisis was not originally a fiscal crisis (which only materialized due to the need to bail out the banks), but a private indebtedness crisis.

Now this same orthodoxy refuses to listen to the angry outcry of people in crisis. It says that to bail out the countries implies to promote fiscal irresponsibility. This is a view that underestimates people's intelligence. After all, what sense does it make for big countries that have fought so much for their national autonomy to have a currency that is not theirs? A currency their citizens cannot use to face the financial crisis? At this moment they must be thinking something that was unthinkable not long ago. They must be evaluating the alternative of leaving the euro. A withdrawal that will be traumatic even if it is planned. But it is probably better than continuing to have as "theirs" a currency that is foreign and does not guarantee the country's security and sovereignty.

Folha de S. Paulo, December 5, 2011

Euro, to think the unthinkable

Today in the Eurozone, it is unthinkable to abolish the euro, and yet the Europeans should think seriously about this alternative

In 1979 in China, it was "unthinkable" to head toward capitalism, and yet Deng Xiaoping thought it and forestalled the stagnation that occurred in the Soviet Union. In 2001 in Argentina, it was unthinkable to end the "plan de convertibilidad"; De la Rúa surrendered to this unthinkable, and the cost was a brutal crisis. Today in the Eurozone, it is unthinkable to abolish the euro, and yet the Europeans should think seriously about this alternative. The creation of the euro was a mistake, because there was no state behind it, and because it became a foreign currency for each one of the 17 nation-states that adopted it – a currency that, in times of crisis, they can neither issue nor devaluate.

The unthinkable is often pure fear and conservatism from leaders without vision. In this major euro crisis, Greece became an insolvent country, but it was said that to restructure its debt was "unthinkable"; when the debt was restructured with a write-down of 21%, it became unthinkable to increase this percentage; when the write-down was increased to 50%, it became unthinkable that the European Central Bank would support Greece and the other countries and banks, but a little later the BCE began to moderately buy government bonds and flooded the European banking system with liquidity. The unthinkable eventually turned out to be the solution.

Not long ago, Greek withdrawal from the euro was unthinkable, but today the economists of the European Commission and of the BCE are studying what shall then be done. They are right, but their leaders would act more wisely if they demanded studies about the extinction of the euro.

But the defenders of the unthinkable exclaim: "it would mean disorder and chaos!" I don't think so. The crisis of Europe's Southern countries, triggered in 2010, is a balance-of-payment crisis: it was caused by the overvaluation of the implicit euro, expressed by an average wage that is incompatible with the level of productivity. Its consequence were high current account deficits followed by high foreign indebtedness, particularly in the private sector. The public debt was already high because, in view of the 2008 global financial crisis, all the countries had adopted an expansive fiscal policy.

The extinction will imply some risks and costs, but the cost of trying to solve a crisis caused by current account deficits by reducing fiscal deficits was already considerable, including in terms of sacrificing democracy, and will continue to be high for many years, for all the countries, including Germany.

From a practical point of view, there would be no major problems. Of course, new banknotes would have to be issued. And, at a certain point, rather than going back to the old currencies, the countries would jointly transform the euro into a "national euro": the German euro, the French euro, and so on. Afterwards, the countries with high current account deficits and high foreign indebtness would devaluate their currency. Which would cause a drop in wages, and some inflation. But this is a much more human and efficient way of practicing austerity and reducing wages than the one that is being used today: through recession and unemployment.

In the case of the euro, it is not just the fear of inflation that makes its extinction unthinkable. It is also the fear that it may "deconstruct" the European Union. But there is no such a risk; the EU is the most extraordinary case of political and social construction that I know, and it will only gain from taking a step back now. There will be room, in the future, for many steps forward.

Folha de S. Paulo, February 27, 2012

Saving the euro or saving Europe

The cost of a bailout of banks will be much lower than the cost of the austerity today and that might be a crisis of the euro that the governments are not able to control.

The biggest decision European governments will have to take does not lie on whether or not to flexibilize the fiscal austerity policy they are embracing to face the euro crisis, but rather on determining whether it is worth it seriously risking the survival of the European Union itself in order to save the common currency. We are aware that the fiscal austerity policy is wrong. A problem which in its origin is not fiscal (the immoderate debt of each State or government) but rather of exchange nature (the immoderate debt of each country or nation- state) is handled as if it were a fiscal problem. It is true that insofar as private debt was nationalized, which always takes place during financial crises, public debt has

increased, and the financial market lost confidence in the capacity of States to pay it. But in the countries plunged into crisis, austerity exacerbates instead of mitigating the fiscal situation of governments, since the reduction in its income outstrips the decrease in expense.

The real aim of the austerity policy is to spur recession, to increase unemployment and consequently, to decrease salaries. This way the real imbalance existing in the Eurozone is corrected: the soaring deficits in current account resulting from the implicit exchange rate overvaluation of the countries under speculative attack. But the cost of this policy of depreciating implicit exchange rate through unemployment is unacceptable in democracies. And it is inefficient. To promote the depreciation of overvaluated currencies is more rational.

I know this alternative is unviable for the countries of the Eurozone. Is it really so? If the austerity policy turns out as a critical threat not only to the survival of the euro, but to the European Union itself, why not seriously consider the extinction of the euro?

It is hard to assess the extent to which the crisis of the euro is threatening this remarkable accomplishment of political engineering called the European Union. But it is getting increasingly clear that this threat is a real one. The right-wing nationalist parties in Europe are becoming steadily aggressive towards the euro and the European Union itself. We have recently witnessed this in France, where the candidate of the National Front garnered 20% of the vote, and in the Netherlands where the Prime Minister was compelled to resign due to the pressure of the right-wing party. But there is no point in limiting the problem to the right. There is a burgeoning number of Europeans who challenge a union that – in the way it is being installed, with a common currency – entails more costs than benefits.

After having published in this column an article entitled “Euro, thinking the unthinkable” (27.2.12), I found out there are already many groups in Europe seriously discussing the alternative of agreed extinction of the euro. The great objection put forward concerns the solvency of the banks of countries of the indebted countries that took loans in other countries. As these countries, also in an agreed manner, would devalue their new currency on the day of the monetary reform, their banks would run the risk of bankruptcy. This is a legitimate objection, but the reform would encompass an ample bailout package to the banks. The cost of this bailout, nevertheless, will be much lower than the cost of the austerity today and that might be a crisis of the euro which the governments are not able to control.

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Euro, a less-than-zero sum game

Two weeks ago, Greece voted under the sign of protest, and the two parties that are ruling the country during these two years of crisis suffered huge electoral losses and, together, were not able to form a government. In two weeks Greece will vote again, but now the expectation of the establishment is that it will vote under the sign of fear, and defeat the Coalition of the Radical Left (Syriza) that was the great winner of the recent elections.

It is not good to act dominated by anger or fear. And this applies not only to Greece, but also to the Eurozone, that doesn't know what to do in view of the big mistake it made by creating the euro. In normal times, prudence is the best advisor; yet in abnormal times the governments will need to act without fear and to innovate, if they wish to prevent major economic and human damages.

It is already clear that the euro is a less-than-zero sum game – a game in which everyone loses. All social classes lose: rent-seekers and financiers who receive commissions from them, because the interest rates are negative; entrepreneurs, because they do not have the opportunity to invest and make profits; workers, because they become unemployed. And all the countries lose: Greece, that was irresponsible; Spain and Italy, that were fiscally responsible, but incurred current account deficits; Germany, that has no one to sell to and is forced to give discounts. But the weakest players pay more than the other two groups: the workers, because they are the ones who become unemployed for a long time until wages fall in actual terms and the necessary domestic or implicit depreciation occurs; the debtor countries, because they are requested to achieve "austerity", that is, depression, so that exchange rate devaluation occurs. And, in the end, all of them may lose much more if an uncontrolled crisis breaks out.

It is more rational to abolish the euro in a concerted manner, and, in the same monetary reform, to devaluate the currency of the countries in deficit. Given the absurd of the fact that each Eurozone sovereign country has a common "foreign" currency (a currency that they cannot issue nor devaluate) and given the cost that is already being incurred, its extinction is just a matter of time. And, in practice, it is already being made possible. As Martin Wolf remarked (*Valor*, May 30), "with a rising share of cross-border risk now assumed by the European Central Bank, the way to break-up is becoming more open" (because now the banks owe the BCE, rather than owing other countries' banks).

Contrary to what is being said, the extinction of the euro will not destroy the European Union; rather, it will strengthen it, because this remarkable union will no longer be threatened by the euro. And it will not imply chaos nor hyperinflation; rather, it will appease the financial markets, that will work with bonuses that are once again issued by sovereign Nation-states, because the banks will be rescued, and the countries will soon grow again. In the future, after the countries have conceded a much higher fiscal power to the central power, and when they decide to surrender their sovereignty, they may form an European State, and have the euro back. For the moment, they shall have the European Union, which is quite something.

Folha de S. Paulo, June 4, 2012

Euro – the risks of a taboo

It would be better for all the European countries if they decided in mutual agreement to discontinue the euro.

I have spent two weeks in Spain, taking part in two academic conferences and exploring the country's beautiful northern region. I found a rich, sunny, but sad Spain, with few people in the streets and restaurants. A very different Spain from that happy and optimistic country that I had found in the visits made in the last 10 years. During all those days I read *El País*, the great Spanish newspaper, and the climate of its news and of the opinions expressed in it is even more somber. I see Spain in the middle of the euro crisis, a Spain at a dead end.

In the last elections, Spaniards rejected the social democratic government of José Luís Zapatero, because it accepted the "austerity" imposed by the Germans and by the Troika (European Commission, European Central Bank, IMF). They elected a conservative Prime minister, Mariano Rajoy, who promised a more independent management of the country, but in his first six months of government the banking crisis worsened, Spain was forced to ask for help, and now the Troika imposes greater spending cuts, increased taxes, and the elimination of citizens' rights.

In view of this situation, I am telling my Spanish friends that austerity will not solve their problems (with which many of them agree), and that it would be better for all the European countries if they decided in mutual agreement to discontinue the euro, in order to thus avoid a greater crisis and guarantee the European Union. But they do not reply to this remark. For them, the survival of the euro is a taboo.

Last week, in view of the adjustment of 65 billion euros imposed to Spain, the Argentinian president Cristina Kirchner could not help showing her indignation and remembering her own country. Because Argentina's situation in 2000 and 2001 was very similar to that of the indebted Eurozone countries. The Argentinian Plan de Convertibilidad had transformed the Argentinian peso into a foreign currency, as the euro is a foreign currency for the Europeans: a currency they cannot issue nor devaluate. And no one had the courage to revolt against it and propose to abandon the peso's legal parity with the dollar, because that parity had become a taboo. Whoever spoke against it would be "betraying" Argentina. It is precisely the same thing that is happening today in the Eurozone: to propose to depreciate the currencies of the indebted countries is treason.

The Argentinians were not able to prevent the collapse of their economy and the hyperinflation. It was only after both things had happened, after the most terrible financial crisis that I have known had hit its people, that the government was changed, and the problem was faced – with courage. Will the Eurozone also

have to wait for a violent crisis in order to react? Or will it be able to take enough measures of bank centralization and fiscal union in order to prevent this violent crisis? European governments are betting on this second alternative, even if it has a much higher cost than the cost of taking a step back and descontinuing the euro in a concerted manner. And the Spaniards I have found are paralyzed, because they know that they cannot put pressure on their government to unilaterally abandon the euro. They can, however, stop making the issue a taboo subject and start to discuss it. To prohibit the debate is risky. It may cost dearly for them and for all the Europeans.

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