Sovereignty, the exchange rate and the Euro crisis

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The adoption of the single currency in January 2002 *

- It was initially a major success.
- Countries like Britain and Sweden, which rejected the idea, proved to be apparently mistaken.
- But since 2010 the Eurozone faces a major crisis that is **threatening the survival of the EU**.
- It is clear today that the creation of the Euro was a major policy mistake.
- Britain, the most hit economy by the 2008 financial crisis, is already recovering, while nobody knows when the Eurozone will grow again.

*The euro was introduced to world financial markets as an accounting currency on 1 January 1999, replacing the former European Currency Unit (ECU).

The origin of the crisis was the Agenda 2010: no wage increases for no unemployment

- In 2003 Schroeder made the agreement.
- In 2002 the Euro was launched, interest rates fall in the South countries turned euphoric; wages increased more than productivity, the unitary cost of production increased in relation to Germany, their internal exchange rate appreciated, they lost competitiveness, the private sector got indebted.
- Italy had entered the euro with an overvalued Italian Euro;
- In consequence of the lack of competitiveness, the incurred in major current account deficits.
- In 2010 the Euro crisis broke up as a financial crisis, but, as we will see, it is essentially an economic crisis.

Unity labor cost increased more in the South

(wages/productivity)

	1996-2011
Germany	8%
France	15%
Portugal	24%
Spain	35%
Italy	37%
Greece	59%

Source: Marko Malovic (2012) apud *The Economist*.

The crisis began in 2010 as a financial crisis

- The financial system doubted of the capacity of the South countries to honnor their public debts,
- Indeed, the public debt increased with the 2008 Global Financial Crisis, which led the states

1. to expansionary policies
2. and to the rescue of their banks

- The symptom of the financial crisis were the interest rates, which skyrocketed.

Strangely, the financial crisis was typical of countries that get indebted in foreign money

- A foreign money is a money in which the public and the private sector get indebted, but the state cannot either

–depreciate, or

–print money.

- I realize the seriousness of the crises when, in October 2011, I wrote an article saying that the Euro was a foreign money to the European countries as it is for developing countries.

But the financial crisis was solved when, in December 2012

the president of the ECB committed the bank to repurchase sovereign securities on the secondary market whenever needed.

- In that moment the financial crisis was resolved and the Euro ceased to be a pure foreign money,
- but the Eurozone countries continued not to have a national money.
- And the economic crisis was not solved...

The economic crisis is associated to loss of competitiveness

- After the Agenda 2010, of 2002,

the great increase in unit labor costs (ULC) in the South countries and Ireland in relation to Germany showed

1. –that the internal Euros of these countries was highly overvalued, and
2. –that this overvaluation involved loss of competitiveness,

which resulted in high current account deficits and in high indebtedness of the private sector.

- The state only later on got also highly indebted.

Two types of crisis

Economic crisis: expressed in recession;

caused by underconsumption, or by profit-squeeze, or by the tendency to the overvaluation of the exchange rate, which leads to loss of competitiveness

Financial crisis: expressed, -in developing countries, into balance of payment crisis (or currency crisis) and in high public debt (what could also be called "fiscal crisis";

--in rich countries = banking crisis.

Both are associated with (high) inflation.

Causes:

underconsumption,

Exchange rate populism, caused by (1) growth with foreign savings, (2) the use of the exchange rate to control inflation. The resulting overvaluation causes loss of competitiveness.

Fiscal populism. To incur in excessive budget deficits, which may (1) increase the inflation (not necessarily) and also (2) increase the interest rate.

Exchange rate populism is more detrimental than fiscal populism.

Forms of neutralizing crisis

-an economic crisis is by engaging in contractionary fiscal and monetary policies depreciation;

-a balance of payment crisis: the same plus neutralizing the Dutch disease and avoiding the use of (1) the policy of growth with foreign savings and (2) the policy of controlling inflation with the exchange rate.

The problem was not in the budget deficit caused by fiscal populism,

but was in the current account caused by exchange rate populism in the South

- Before the crisis

1. the budget deficits of the South were moderate, except Greece;
2. the public debts of theses countries were also under control,

- while
- the private debts and current accounts deficits were very high.

In 2007, the public debt was under control

Only the private debt was to large

	2007	2011
Public sector	50,7%	193,9%
Private sector	90,2%	225,1$

Thus, the crisis is an (internal) exchange rate crisis

- It is a crisis caused by the internal overvaluation of the exchange rate of the South countries,
- The balance of payment was defined by the increase of the unit labor cost (ULC) of the South countries in relation to Germany,
  - and
- In large current account deficits.
-

Between 1994 and 2011there was a major internal appreciaton

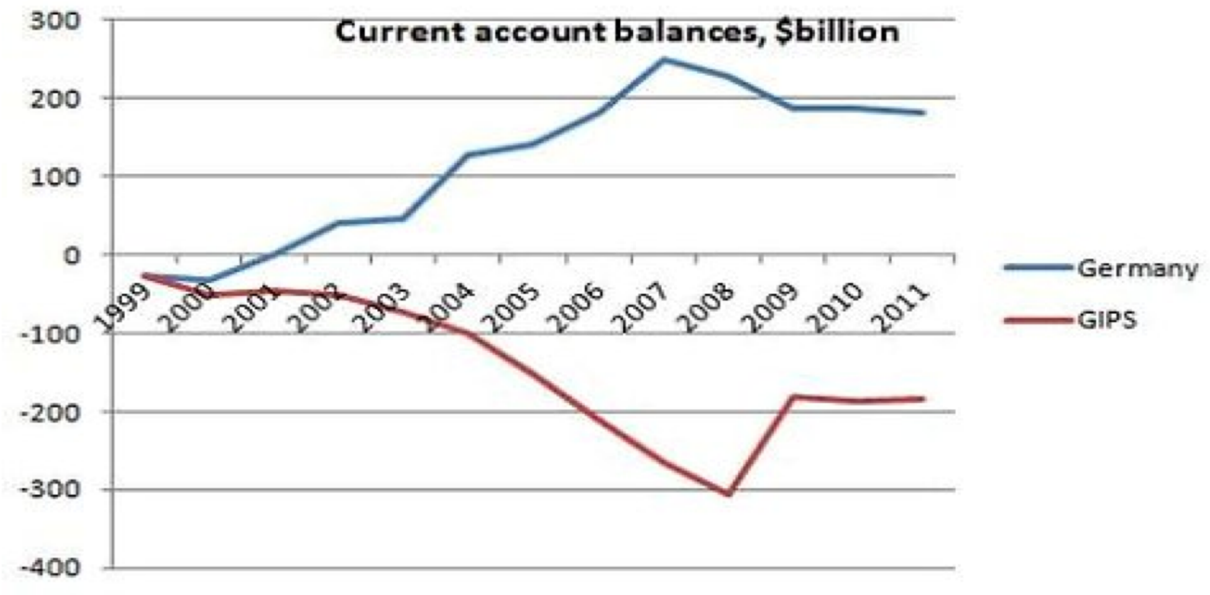
Germany	−23.1
France	−13.0
Italy	+3.1
Spain	−5.5
Portugal	−7.9
Greece	−21.8
Ireland	−7.0
Euro Zone	+3.3

Source: Duwicquet, Mazier e Sadadoui (2012).

In 2007 the current account deficits were very high while the budget deficit was very low

	2007
Current account deficit	6,0%
Budget deficit	1,4%

Current account: Germany x GIPS (199-2011)



Source: The Economist Intelligence Unit/Krugman (2011*)

The medicine adopted was austerity, as if it was a fiscal crisis

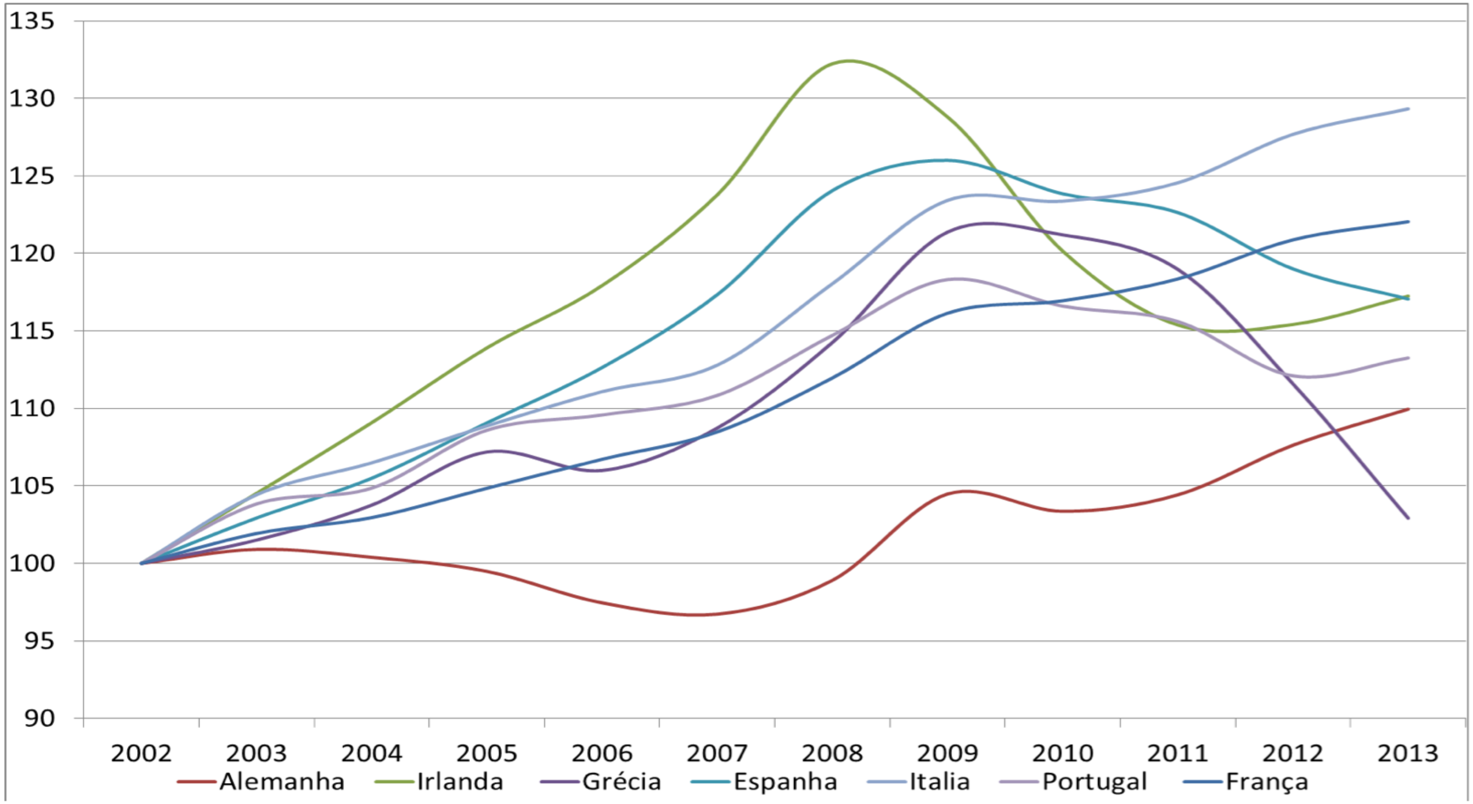
- Does this mean that the Troika (EU Comission-IMF-Germany) and their economists are incompetent?
- That they are using a medicine that will not address to the problem?
- No.
- They are doing internal depreciation.
- They just are adopting the easier way for they to solve the problem, in the short-term.
- The least costly for the very rich, the most costly for the the middle class and the poor.

Are they being successful?

- There was some competitive recovery for the South countries, as ULC show, but

1. The South is stagnant;
2. Human suffering is very high;
3. There is no perspective of economic recovery;
4. The threat of a desastrous deflation is increasing (today, 0.3%).
5. People lost confidence in politics and in the EU;
6. Right wing political parties are booming.
7. Germany – “the winner” – is growing poorly.

Progress in reducing ULC unbalances has been small, except for Greece



Source: AMECO, developed by the auth

The Troika's strategy is essentially muddling through, but we must acknowledge some progress

- Rejecting Eurobonds, but eventually accepting the BCE buying government bonds in the secondary market.
- Rejecting the restructuration of debts; after, accept it limitedly.
- Reject the creation of a permanent rescuing fund; then, accepting (ESM).
- Rejecting BCE rescuing banks, but eventually accepting huge increase in liquidity
- Rejecting the centralization of bank supervision, but finally adopting it.
- Anyway, these were good institutional reforms.

A sovereignty crisis?

The Euro crisis is often defined as a sovereignty crisis because it would would be caused by the fiscal crisis of the state.

Actually it is a sovereignty crisis because when a country is indebted in foreign money it is at the mercy of the creditors.

Solutions for the crisis.
Less austerity is not a solution

- Austerity

1. is innefective, because austerity is pro-cyclical; and
2. Is highly inneficient, because the cost-benefit is very high in economic and human terms,

- Less austerity will also will just mean a little less suffering now but suffering for a longer time.

Either the federation alternative is a solution

- The Federation is the ideal solution.
- It means transfering national sovereignties of the 17 countries that form the EU to central power.
- Financial attacks would be inviabilized, but
- 1. European fiscal system is not prepared for that (Brussels controls 1% of total budget when it should control at least one third).
- 2. Europeans are not ready to lose their national sovereignty to save the euro: they still value more the nation than the euro.
- 3. There is no time.

An agreed and well programmed partial discontinuation of the euro

It is, increasingly, the best alternative, because its costs are much smaller than the political collapse of the Euro, which is becoming each day a real possibility, given the increasing possibility of deflation, and the deep unhappiness of the European citizens with the Euro and the EU.

The “common currency” alternative

–a solution that should be carefully considered

- It was proposed by Fréderic Lordon (2014: 190–191), based on contributions from several authors, such as Jacques Mazier (2012), Jacques Sapir (2012) and Heiner Flassback and Costas Lapavitsas (2013). The Euro would remain in existence, but it would coexist with national Eurozone currencies, €–Fr, €–Lire, €–DM. The new currencies “would be at fixed parity with the Euro, which would remain convertible into all other external currencies, and their own foreign parity would take place via the Euro.

Too costly?

- The establishment always say that solutions involving full or partial discontinuation of the Euro are too risky and too costly.
- The overstate the risks and costs.
- More risky and more costly is to try to try to solve the crisis with austerity.

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