THE TRUE NATURE OF THE CRISIS IN EUROPE

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It is necessary to radically rethink the problem of international finances and of the current account deficits

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 Newspapers do not publish data on this deficit because they do not receive it from economists.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.