The euro crisis: to think the unthinkable

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Five selected articles published in *Folha de S. Paulo* on the financial sovereign debt crisis.

The euro, just a foreign currency?

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> **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 exposed themselves voluntarily to a sovereing debt crisism they run 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.

Euro, to think the unthinkable

February 27, 2012

Today in the Eurozone, it is unthinkable to abolish the euro, and yet the European 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 consequences 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 indebtedness 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.

Saving the euro or saving Europe?

May 7th, 2012

> **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 that, in its origin, is not fiscal (involving the immoderate debt of each State or government) but it is rather of exchange nature (involving the immoderate debt of each country or nation- state) is handled as if it was just 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 overvalued 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 also 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 that the governments are not able to control.

Euro, a less-than-zero sum game

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> **It is already clear that the euro is a less-than-zero sum game – a game in which everyone loses.**

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.

Euro – the risks of a taboo

July 16, 2012

> **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 today 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 discontinuing the euro in a concerted manner. And the Spaniards I have found are paralyzed; 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.