A period of respite for the euro

Luiz Carlos Bresser-Pereira

Folha de S. Paulo, July 2, 2012.

Perhaps the solution would be to create a federal European State; it lies not in austerity first and fiscal union later.

Faced with the euro crisis, the summit of the European leaders reversed the decision taken two weeks ago and decided to guarantee direct financing to Spanish banks, without further indebting the Spanish State. The measure was necessary, because the previous decision had been poorly received by the financial markets that correctly considered that the public debt was becoming riskier. This gives the euro a period of respite, but it does not change the fundamental problem: Europeans are struggling with false alternatives. The solution does not lie in austerity or growth. Perhaps the solution would be to create a federal European State, but it lies not in austerity first and fiscal union later, as Germany wants, nor in financial help and austerity softening first, and political union later, as France demands.

The opposition between austerity and growth is a false one, because growth does not solve Europe's fundamental problem, which is an exchange rate problem: the implicit exchange rate of the indebted countries became appreciated in relation to Germany's, because in the last 15 years Germany's real wages diminished as compared to wages in indebted countries. Yet the alternative of federalizing Europe, that dominates French media these last few days, is more consistent. In fact, if Europe or the Eurozone were transformed into a State, there would be at the same time a greater solidarity between the countries and a loss of fiscal autonomy, and the financial crisis would be interrupted, unless the financial markets didn't trust the Eurozone as a whole.

But this is a utopian proposition. Europeans are not prepared for this loss of autonomy. I do not believe that, between a well concerted discontinuity of the euro and the loss of sovereignty, Europeans will choose the second alternative. And even if this is not true, it is impossible to build a federation in which the central government controls 2% of the total tax collection; it would need to collect 15 to 20 times more, which only could be done along several years.

What is then the solution? For me, there is no doubt: the solution is, through an agreement and based on a careful planning, to abolish the euro. It is to do a monetary reform by which the countries return to their domestic currencies, instead of having a "foreign currency" such as the euro for each one of them, since they cannot individually issue nor depreciate it. And it is also to devaluate the currencies of the indebted countries and, at the same time, to establish a banking union in order to protect the banks from depreciation. Thus, the European Central Bank will not disappear. It would take on new functions: managing this banking union – a basis for the future and gradual building of a federation and restoration of the euro.

It is therefore false the alarmist idea that the end of the euro will mean the end of the European Union. In fact, the euro was a mistaken decision, at a time when Europe was not prepared to have a common currency. The damages that it is causing are already considerable. And the risk of a collapse only increases if the Europeans insist on self-deception with misguided solutions: whether austerity, which is radical and probably ineffective, or federation, a mere utopia in the short run.