Euro Threatens Europe – Why, How and What to Do about It?

Euro ohrožuje Evropu – proč, jak a co s tím dělat?

(From new economic literature)

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Joseph E. Stiglitz: *The Euro. How a Common Currency Threatens the Future of Europe*. W. W. Norton and Company. New York, London, 2016. 416 pp.

The book is yet another of a series of publications aimed at the general public (not only for economic and financial experts) dealing with the euro crisis, the euro area crisis, and the European integration crisis. Among them we see, for example, a book of Philippe Bagus *The Tragedy of the Euro* (2010). Who followed was David Marsh with the book *The Euro. The Battle for the New Global Currency* (2011). Another book is that of Thilo Sarrazin *Europa braucht den Euro nicht. Wie uns politisches Wunschdenken in die Krise geführt hat* (2012). We should also pay attention to the book of Jean Pisani-Ferry *The Euro Crisis and its Aftermath* (2014). Hans-Werner Sinn contributed to these series of the euro crisisbooks with his books *Gefangen im Euro* (2014) and *Der Euro – von der Fridensidee zum Zankapfel* (2015).

The world-renowned American Keynesian economist, the Nobel Prize winner in economics, a sharp critic of neoliberalism (or, in his words, market fundamentalism) is an author of the reviewed book. Joseph Stiglitz is particularly well known for his criticism of the International Monetary Fund (IMF) and the World Bank (WB) restructuring programmes, where he worked for several years as a chief economist. He uses not only his experience gained in these institutions but also his knowledge gained in discussions with economists from the finance ministries and central banks of the European Union (EU) as he states in *Acknowledgments*. In the reviewed book he repeats his sharp criticism of the IMF and WB, which led to his departure from the World Bank.

The book is divided into four parts and twelve chapters. Part one is called *Europe in Crisis*. It consists of four chapters. The first chapter is called *The Euro Crisis*. According to J. Stiglitz, the euro crisis has occurred since 2010. What this crisis is about is not explicitly explained. From the context we can derive that under the "euro crisis" the author does not mean a crisis of the euro as a "currency crisis". This "euro crisis" may perhaps mean a debt crisis of some euro area countries. Perhaps the "euro crisis" is the author's claim that the euro has failed to meet expectations, both in the economic direction (increase of competitiveness and living standards), and in the political direction (strengthening European integration). The author considers "the way it impeded adjustments to shocks that affect parts of eurozone differently" the greatest weakness of euro (pp. 13–14). The euro contributed to divergence within the euro area. Although Stiglitz praises the

creation of the European stabilization mechanism, further reforms, as he said, constitute an unacceptable compromise. However, the chapter is more devoted to the criticism of neoliberalism and IMF and WB programmes than the "euro crisis". Stiglitz proposes two options for further development of the euro area, which are discussed in more detail in the following chapters: 1) "More Europe", i.e., joint bank deposits insurance. 2) "Less Europe", i.e., to curb monetary integration by exit of peripheral countries or Germany from the euro area, introducing the "northern" and "southern" euro[1], or introducing a "flexible euro".

The second chapter, The Euro: *The Hope and Reality*, assesses the expected and real benefits and costs of replacing national currencies with the euro. In the chaotic sequence, the expectations are assessed here that the euro will contribute to a greater importance of the EU in the world economy, that it will contribute to maintaining peace, and that it will contribute to greater political cohesion in Europe. In all these directions, the euro did not meet the expectations. Greater attention is paid to economic aspects of the benefits and costs of the single currency. J. Stiglitz does not recognize the widespread view of reducing the exchange rate risks and the costs of eliminating them. On the contrary, it explains that eliminating this risk will eliminate the geographical diversification of production and will lead to undesirable concentration, for example, in countries with better infrastructure. The decline in transaction costs is considered to be secondary. On the contrary, a big hope is that the exchange rate can be "realigned" or "misaligned", which, in other words, means that the exchange rate can be devalued. J. Stiglitz repeatedly criticizes Germany for a labour market reform, which has led to a slow wage growth, thereby increasing German competitiveness, but he is not bothered by the use of devaluation. Another weakness of the euro is that it weakens democracy, partly because the European Central Bank is independent, and because the EU authorities demand the promotion of austerity programmes from debtors.

In the third chapter, *Europe's Dismal Performance*, the author compares the development of GDP (and GDP per capita) in the euro area and other EU countries and the USA. Between 2007 and 2015, the real GDP per capita fell in the euro area by 1.8%, while in the EU outside the euro area it increased by 0.8% and in the USA it increased by 3.2%. "There is common cause for the eurozone's trails: the euro" (p. 65). Where does J. Stiglitz take the arguments that the euro is behind the weak GDP growth? Traditionally: "If Greece, for instance, had not been tethered to the euro, when the crisis struck, it could have devalued its currency." (p. 80) Didn't the author forget here, for example, about the almost certain inflation or hyperinflation, coupled with the devaluation – what would such a devaluation of Greek currency be good for? Notwithstanding the fact that maintaining the competitiveness of currency devaluation is certainly not the right way for a developed economy. Was the euro responsible for the indebtedness of the Irish or Spanish banking sector, which led to the debt problems of the governments of these countries and their austerity measures? The author does not ask this question. While he states that the Greek government is incredibly wasteful (and let us add: an austerity restrictive policy necessarily followed), he does not

1 *However, in the following text (chapter 10), the "southern euro" does not appear; only the new "northern euro" (German one) and the original euro (which the southern countries keep) remain.*

say that it was not caused by the euro. Where did the responsibility of debtors and the creditors' judgment remain?[2]

The second part of the book, *Flawed from the Start*, starts with the fourth chapter, *When Can a Single Currency Ever Work*? The author explains these issues by comparing the single currency in the US states and the single currency of euro. There are three conditions: 1) labour mobility (high in the US, low in Europe), 2) large federal budget (let us add: about 20% of GDP in the US, 1% of GDP in the EU) and 3) uniform banking system enabling to save banks at the federal level. In the US, these conditions are met; they are not met in the EU.

A part titled "Why Currency Areas Are Prone to Crisis" constitutes another interesting part of this chapter. Will the reader learn at least here what the "euro crisis" is? Right at the beginning of this section we state the parallel of the "euro crisis" with the "Argentine crisis" between 2001 and 2002. Again, however, there is an interpretation of debt crisis and a lack of adjustment mechanism in the form of currency exchange rate depreciation (Greece, Spain). In addition, however, an attitude of creditors for why they lent to over-indebted countries is explained here: 1) the shortsightedness of financial markets (creditors, i.e., bankers, do not understand the situation, debtors, i.e., governments are irresponsible towards future generations), 2) the increasing indebtedness is enabled by loans from IMF, ECB and governments. However, their help, in each instance, "is really just a bailout of Western banks" (p. 113).

In the fifth chapter *Euro: a Divergent System*, the author explains other negative effects of introducing the euro. What this concerns is that the capital markets mistakenly assumed that other risks would automatically disappear with the elimination of exchange rate risk. That is why they invested capital in peripheral countries. What use was made of this capital? Instead of "raising productivity" of these countries, it served to finance consumption, real estate bubbles (in Spain and Ireland) and government deficits (Greece). The euro is to blame again. The author does not address the failure of rational decision-making by creditors and debtors. Another interesting idea in this part of the book (also in other chapters) is a systematic rejection of budgetary discipline, the refusal to reduce budget deficits and public debts (the Fiscal Pact, and the demands of the "Troika" in particular towards Greece). From the Keynesian economist such as J. Stiglitz, of course, we can expect expansionary policy support. However, uncompromising, one-way and persistent fiscal expansion, which does not allow for any other option, is striking (in this chapter and elsewhere).

The European Central Bank also received similar complaints in chapter six *Monetary Policy and the European Central Bank*. The ECB's task, set by the Maastricht Treaty of 1992, is to achieve inflation target (co called inflation targeting). J. Stiglitz writes about "fixation on inflation". However, focusing solely on inflation is a mistake. The ECB, like the US Fed,

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2 *Let us add a parallel: just as the euro did not cause excessive debt to the Greek government or Irish banks, the Czech koruna did not prevent fiscal restrictions in the Czech Republic between 2011 and 2012, which contributed to the subsequent recession. In the peer-reviewed book the Czech Republic is mentioned only in the enumeration of the member states of the European Union (pp. 46 and 331).*

should pursue two more goals: fighting unemployment and financial stability. Moreover, the author criticizes all central banks (not just the ECB) that their efforts to reduce inflation have led to rising unemployment and, thus, increasing inequality. To be objective, let us mention the recognition that J. Stiglitz gave to Mario Draghi, Governor of the European Central Bank. He "may have saved the euro area" with his famous speech delivered on 26 July 2012, stating that the ECB will do everything in its power to save the euro.

The third part of the book *Misconceived Policies* contains two chapters. The seventh chapter of *Crisis Policies* rejects the demands of the Troika (the IMF, the ECB and the European Commission) associated with providing additional loans. These are austerity measures to reduce public budget deficits that have led to a deepening recession and rising unemployment in these countries (Greece, Ireland, Spain, Portugal, Cyprus). At the same time, however, J. Stiglitz objectively states that (on the example of Portugal) "without such assistance, of course, Portugal would have had to have even more drastic cutbacks, because it too was cut out from the capital markets" (p. 179). J. Stiglitz proposes a process that he believes is correct: "alternative policies that would have set these countries on the road to recovery – a growth policy rather than austerity, and a deep debt restructuring." (p.183)[3]

Stiglitz rejects the analogy used by Angela Merkel (p. 186): the Swabian housewife has to manage her budget, just as the government must. When, according to Stiglitz, the Swabian housewife lowers her household spending, her husband will not lose work. But if the government does this, unemployment will rise. However, the sense of this analogy is, in the view of the author of this review, different. Every entity (household, government) has to manage the income it has. Nothing more, nothing less. This applies to every government and every household, both German and Greek.

It is not surprising, therefore, that in chapter eight, *Structural Reforms that Further Compounded Failure*, Stiglitz assesses the reforms that the "Troika" requires in Greece (e.g. to promote a competitive environment or weaken the power of trade unions and allow wage cuts) as counterproductive, weakening the Greek economy and its ability to repay debts. According to J. Stiglitz, the "Troika" should demand structural reforms, namely the transition from industrial production to services, innovation and knowledge-based economy. In addition, it should endeavour to reduce income gaps and thus prevent the spread of poverty. In the banking sector, the government's voting rights should be strengthened in order to stop the connected lending. However, the "Troika" did not request any of this.

Final fourth part *A Way Forward*? begins with the ninth chapter *Creating a Eurozone that Works*, in which Stiglitz proposes seven[4] euro area reforms. Let us pay more detail attention to them.

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3 *There are also contentious claims in this chapter: "In the aftermath of the collapse of Lehman Brothers, the whole world has gone into an economic recession, with financial markets froze." (p. 182) Truly the whole world?*

4 *On page 241 Stiglitz talks about six reforms, but proposes seven.*

1) Establish a banking union with a common fund for bank deposit insurance, joint supervision and a common procedure to solve bank failures that cannot fulfil their obligations (so-called joint restructuring of banks).
2) Mutualization of debt, e.g. by the issuance of eurobonds by the European Central Bank, for which the whole euro area is guaranteed.
3) A common framework for stability based on the criticism of the Maastricht criteria. These are "automatic destabilizers" – if GDP drops, tax revenues will fall, budget spending must be curtailed and GDP decline will deepen. Here Stiglitz proposes six measures, namely: a) the creation of a capital budget (distinguishing consumption and investment expenditures, the restriction would only apply to consumption expenditures), b) the creation of a solidarity fund for stabilization (e.g. co-financing of unemployment benefits), c) the introduction of automatic stabilizers (providing automatic financial support in case of economic problems, again e.g. unemployment support), d) flexibility in granting credits (diversification of ECB instruments to regulate commercial bank loans), e) regulating the economy to prevent excesses (e.g. to control excessive credit expansion, to prevent bubbles in the real estate market), f) to stabilize the fiscal policy, under which Stiglitz intends to invest in research, technology and education.
4) Real convergence policy, which the author has in mind to prevent surpluses of current balance of payments accounts,[5] to carry out expansive wage and fiscal policies in countries with these surpluses, to avoid divergence by investing in infrastructure.
5) Macroeconomic reform to promote economic growth and employment by extending the mandate of the ECB in this direction (not just focusing on inflation).
6) Other structural reforms. In particular, to reform the financial market to ensure the recycling of savings for their productive use (how to achieve this is not explained), and to reform corporate governance (the same note), by using laws to speed up bankruptcy management, and ultimately to encourage environmental investment.
7) Carry out fiscal reform, specifically halting tax deregulation and introducing tax collection by citizenship. This will reduce capital movements within the EU, increase the equality of incomes in individual countries and the common prosperity.

In chapter 10 *Can there Be an Amicable Divorce*? Stiglitz deals with two variants. 1) The variant where some indebted country (as an example, only Greece is used) leaves the euro area. For Greece it will not be a problem. The new currency (drachma, Greek euro or other) will devalue, strengthen competitiveness, overcome the current account deficit, ensure economic growth, and thus resolve the government budget revenues. Stiglitz does not say what Greece will be exporting due to the devalued currency (tourism accounts for

5 *In particular, the following constructions are worth mentioning (pp. 252–254). Surpluses in one country's foreign trade lead to trade deficits in another country. Trade deficit (import of foreign goods) reduces demand for domestic production. In these countries with a trade deficit, the dangers of the economic recession are reinforced. This leads, on one hand, to growth in fiscal spending and to public finance deficits (which governments have to borrow), and credit expansion to prevent the recession. Only Germany is mentioned as a "surplus" country. What does Stiglitz propose? Referring to Keynes, he suggests "tax on surpluses" from which a "solidarity fund for stabilization" would be created.*

7% of Greek GDP). 2) The second option is that Germany will leave the euro area, possibly also other "northern European country" with the "northern-euro" as their currency. The original euro will devalue in relation to the "northern euro", which will boost export and economic growth, etc.

Eleventh chapter *Toward a Flexible Euro* proposes another option for the euro area. Individual countries or groups of countries will have their own euro. It would be just an electronic currency. Unlike the current national currencies, the new euro would be supplemented by "marketable trading chits" that would be issued by individual countries (governments) to ensure that their foreign trade is balanced. In the future, it could "move towards a single currency".

In the final twelfth chapter *The Way Forward* the author asks three questions. 1) Where will the euro area go? Reforms will be inconsistent. No "amicable divorce" or "flexible euro" will happen. Indebted states will receive additional loans. Joseph Stiglitz does not predict further development. 2) Why does the euro area move in this direction? Clear explanations are difficult to find at long sides of the text of this chapter (and not just here). Probably because the "Troika" did not realize that the required fiscal restrictions (imposed on Greece; Stiglitz does not speak of other countries) are unacceptable to voters. 3) Why does the European project have such a meaning? Let's quote literally: "The West is attempting to contain a newly aggressive Russia, China … is confronting the West with new economic and strategic realities. This is no time for European disunity and economic weakness." (p. 318)

Stiglitz's book is an in-depth analysis of the development of the euro area and outlines a number of its current economic problems. It contains interesting suggestions on how to reform the monetary system in the euro area. However, I will only state two reservations about his views. Firstly, he blames a single currency of this monetary union for almost all of its past, present and future economic problems. I have mentioned the reservations about this approach above. Secondly, it is possible to make reservations about the many times used term "euro crisis". The book does not really deal with the "euro crisis" at all. To do this, it would be necessary to evaluate the long-term development of the euro exchange rate (appreciation trend), the high euro share in foreign exchange reserves (around 20%), the euro's share of the foreign exchange market turnover (around 25%), the use of the euro as the reference currency in exchange-rate systems (27 countries and their currencies), enlargement of euro area members (currently 19). And also the fact that the attitude of the public (according to opinion polls) towards the euro in the euro area is very favourable.

Joseph Stiglitz proposes a number of measures that should stabilize the euro area. Some suggestions come from fantasy realm, such as the taxation of Germany's trade surplus or the emergence of the "northern euro". Other reforms are already being implemented, such as the creation of a banking union. Other proposals have been discussed for years, such as eurobonds. Most importantly, I consider the final words of J. Stiglitz the most important: "The euro can be saved, should be saved, but saved in a way that creates the shared prosperity and solidarity." (p. 325)

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