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Sovereignty, the exchange rate, collective deceit, and the euro crisis

Abstract: *This paper presents an interpretation of the European crisis based on balance-of-payments imbalances within the Eurozone, highlighting the role of the "internal" real exchange rates as a primary cause of the crisis. It explores the structural contradictions that turn the euro into a "foreign currency" for each individual Eurozone country. These contradictions imply the inability of national central banks to monetize the public and private debts, which makes the euro crisis a sovereign crisis similar to those typical of emerging countries, but whose solution presents additional obstacles.*

Key words: *exchange rate, euro crisis, sovereignty*

The European Union (EU) is a successful work of political engineering, but the decision to create the euro was misguided and looms over it. The EU has been fulfilling its role in assuring peace and fostering an atmosphere of political cooperation among the member countries, supported by a deep commercial and financial integration that brought the economic interests of European actors closer together. However, the euro crisis jeopardizes this construction. Since the euro acts like a foreign currency for its member countries (a currency that the country can neither issue nor depreciate), it will remain a permanent source of "internal

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depreciations," imposing very high costs on people and economic growth. The single currency, originally conceived as an additional element consolidating the integration process, proved itself a source of internal asymmetry and imbalances. This has been keeping the Eurozone stagnant since 2009: between then and 2013, while the southern countries and Ireland posted negative growth rates, the supposed beneficiary—Germany—grew a mere 0.7 percent a year.[1] Things did not improve in 2014; in fact, they continued to deteriorate, with Germany itself posting negative growth in the second quarter. And the prospects are not good, because deflation poses a menace to the Eurozone countries: in spite of the European Central Bank's (ECB) efforts to pursue an annual inflation target in the vicinity of 2 percent, inflation throughout 2014 was close to zero. Some countries are already experiencing deflation—which will make their recovery even harder. On the other hand, a European country like the United Kingdom, which was able to devalue its currency after the 2008 crisis, is already in full recovery, notwithstanding that the British economy, with its large financial industry, was the one that suffered the most in the financial crisis. Having its own currency made a crucial difference.

Given this context, this paper discusses the European crises based on the contradictions created by the single currency and internal imbalances in the Eurozone. Its core thesis is that the central cause of the crisis lies in the imbalanced internal exchange rates, where the exchange rates are those emerging from a comparison of unit labor costs within the Eurozone. Contrary to common belief, the euro crisis is not a fiscal crisis, but an exchange rate crisis. Furthermore, the crisis was initially economic and financial in nature, but, after a certain point, the financial problem was reasonably resolved by the ECB, whereas the economic problem associated with imbalanced internal exchange rates remains without satisfactory resolution. This interpretation is in line with the developmental macroeconomics that a group of Brazilian economists have been elaborating. It holds that the exchange rate plays a key role in macroeconomic equilibrium and the development process (Bresser-Pereira, Oreiro, and Marconi, 2014).

[1] According to data of the Organization for Economic Cooperation and Development (OECD) Southern countries' 2009–13 yearly growth rates were all negative: Portugal (−1.4 percent), Spain (−1.4 percent), Greece (−5.2 percent), Italy (−1.5 percent), and Ireland (−1.1 percent).

The world of appearances

The euro's structural contradictions, which were present from its inception, were manifested in a sovereign financial crisis that began in 2010 and was relatively resolved by the European Central Bank's December 2012 commitment to repurchasing sovereign securities on the secondary market whenever needed. But these contradictions persisted in the economic crisis arising from an internal exchange rate mismatch that is being addressed with an austerity policy. This solution suggests that the problem is a fiscal one, and does not consider profoundly reforming the euro so as to allow the depreciation of the currencies of indebted countries. In this context, as we will see below, the euro becomes a fetish, a symbol of the integration of the European territory and the cohesiveness of its internal economic structures; it represents the approximation of heterogeneous economic spaces, their harmonization and convergence. That is, the freely operating market forces within a space unified by a single currency and by freely moving goods, capital, and labor would inevitably lead to a natural convergence that would bring the region's wage and profit rates closer together. At least, that was what was supposed to happen with the structuring of the Eurozone, according to the neoclassical ideology that inspired their policymakers. The euro was born out of the illusion that a single currency, far beyond simply reducing transaction costs, would also add to the system's stability and predictability by eliminating foreign exchange risk. Therefore, countries on the periphery of the European Union would undergo a catching-up process spurred by increasing competitiveness and stimuli for technological development and production plant modernization.

In fact, as Michel Aglietta (2012a, p. 128) pointed out, the integration of countries that are at different development levels tends to heighten differences instead of leveling the field because, "industrial activity fosters increasing returns … that make the best use of manufacturing industries that are already dominant as a result of dynamic returns to scale." In the case of the euro crisis, as we will see, this imbalance deepened because the social compact achieved in Germany that prevented real wages from rising in that country was not matched by Southern countries. Because no similar social agreement occurred in those countries, which are now experiencing crises, they showed a relative increase in the unit cost of labor compared to Germany and, therefore, their economies suffered a

loss of real competitiveness. This loss could not be resolved via currency depreciation. Instead, they were sentenced, as was the case under the gold standard, to resolving the problem only by means of highly costly internal devaluations.

This false sense of harmonization and convergence transcends the level of discourse and theory to create practical effects because, for a lengthy period of time, it drove the financial system's asset pricing and systemic risk assessment. In other words, the apparent economic harmonization that the single currency fosters, in addition to increasing economic imbalances between countries, contaminated asset pricing and credit-risk assessments. South European interest rates dropped to levels close to those found in countries like Germany and France. This showed that the European Union's harmony and convergence were more than an appearance; they were a convention that economic actors disseminated and shared. Thus, until the crisis erupted, it was a common belief that the payment capacities of public and private actors in Greece, Italy, and Portugal were very close to German ones because their interest rates supposedly proved that they all shared a single, harmonic economic space that tended to converge.

However, behind the apparent harmony lay a process of economic changes moving in the opposite direction; in spite of the extinction of domestic currencies and elimination of foreign exchange operations, the euro carried a hidden set of implied or internal exchange rates that became increasingly mismatched after the single currency's creation, leading European productive structures toward divergence, toward increased technological and industrial disparity, instead of convergence. As a consequence, the fetish of the euro made itself felt in 2010 when the crisis erupted because the single currency, whose "natural" characteristic was supposedly to lend cohesiveness to an economic space, hid (and still hides) a system of internal exchange rates that tends to enhance the region's internal economic disparities, thereby compromising the economic union process. The fetish implied that the euro's internal contradictions would lead the countries associated with them to a lengthy economic depression with no end in sight, insofar as the fetish prevents even considering a mutually agreed and planned discontinuation of the euro.

These contradictions are severe from a financial standpoint because the euro is a foreign currency for the Eurozone countries, as we will discuss below. The architecture of the Eurozone

uncoupled monetary policy, which is centralized at the regional level, from sovereign fiscal policy, which is decentralized at the national level. Given this, the political and fiscal mechanisms available to address crises and imbalances were constrained by the absence of monetary sovereignty. At the same time, the markets were unable to provide such adjustment mechanisms and operated in the opposite direction, reinforcing the imbalances. Therefore, the single-currency regime stands as a major source of stress for the integration process that became explicit in the current economic crisis, which revealed the euro's contradictory nature.

The exchange rate as a root of the euro crisis

In the media, among politicians, and in academia, the euro crisis is most often depicted as a fiscal crisis. According to this view, excessive public spending and indebtedness lie behind the economic and financial crisis. Also according to this view, some national states were deemed responsible for the crisis, whose description as a "sovereign debt crisis" directly refers to the public nature of overindebtedness. Fiscal irresponsibility and the falsification of fiscal data on the part of Greek authorities, which surfaced in early 2010, helped to fuel this interpretation.

The fiscal interpretation of the crisis is convenient to certain groups for three main reasons. First, by blaming the crisis on the most severely affected countries and hiding internal exchange imbalances, it legitimizes an asymmetric adjustment that exempts the least-affected countries from the burden of adjustment. That is, an asymmetric diagnosis is provided, leading to asymmetric solutions. German leaders, for example, stood behind this thesis and adorned it with moral arguments in an attempt to validate the punitive aspect of the adjustments base on the irresponsible behavior of public officials. Second, the adjustment proposed based on this interpretation —an internal devaluation—implies penalizing wages instead of capital returns, while a solution to reestablish domestic currencies that could be more depreciated against the "German euro" would imply reducing the income of both wage earners and rentier capitalists, and not just of the former. The third convenient reason, which Serrano (2011) discusses, is to ideologically reinforce the liberalizing project that used the national states' fiscal crisis as additional justification to deepen the liberal reforms, reduce the public sector's role in the economy, and dismantle Europe's welfare state.

An alternative interpretation, which has been rather well explored in texts such as Aglietta (2012a, 2012b), Hein (2012), and Dullien et al. (2013), points to the monetary union's internal imbalances and private indebtedness as the main causes of the crisis. All countries in the monetary union, therefore, share the crisis, because it arises from a problematic monetary construction. This paper aligns itself with this interpretation and intends to show that it was the private sector that originally became more indebted than was reasonable, which led to high current account deficits and moderate public deficits, thereby emphasizing the exchange-rate nature of the euro crisis. In other words, the euro crisis is a foreign exchange crisis because—despite having first emerged in 2010 as a financial crisis caused by a loss of confidence in states' repayment capacity, expressed in rising sovereign interest rates—its fundamental cause lies in mismatched real exchange rates present within the Eurozone. Its secondary cause can be found in the states contracting debt to bail out their banks within the context of the 2008 global financial crisis. This crisis financially weakened states that, with the exception of Greece, were in comfortable fiscal situations —in some cases better than Germany's—so that the fiscal problem was definitely not the cause of the euro crisis.

In this context, Tables 1 and 2 illustrate two arguments: (1) Europe's problem lies not in public debt, but in private debt; and (2) the problem does not lie in public deficit, but in the current account deficit, which includes the deficits of households and

Table 1
Public and private debt (% of GDP)

	Public debt		*Private debt*	
	2007	*2011*	*2007*	*2011*
Germany	65.2	80.0	167.6	159.6
Greece	107.2	170.3	118.1	142.8
Spain	36.3	70.5	285.8	279.9
Ireland	24.9	104.1	283.8	411.6
Italy	103.3	120.7	176.1	188.5
Portugal	68.4	108.2	294.8	331.1
France	64.2	85.7	198.5	221.9

Source: Authors' calculations based on data from the Organization for Economic Cooperation and Development.

Table 2
Foreign (current transactions) and public deficits (surplus, deficit, as % of GDP)

	Foreign deficit		*Public deficit*	
	2007	*2011*	*2007*	*2011*
Germany	7.5	6.8	0.2	−1.2
Greece	−14.6	−9.9	−6.8	−9.0
Spain	−10.0	−3.8	1.9	−6.2
Ireland	−5.3	1.2	0.1	−10.3
Italy	−1.3	−3.1	−1.6	−3.6
Portugal	−10.1	−7.0	−3.2	−5.9
France	−1.0	−1.75	−2.7	−5.7

Source: Authors' calculations based on data from the Organization for Economic Cooperation and Development.

firms. Debt and public deficit were not at issue prior to 2008; they became a problem after the respective states were forced to bail out their banks. In terms of public debt stock, Greece and Italy had debt in excess of 100 percent of gross domestic product (GDP), but the same is not true for other European countries. The Spanish and Irish cases are illustrative, as they possessed low public debt levels before the crisis (36.3 percent and 24.9 percent, respectively), but high private-sector debt stocks relative to GDP (285 percent and 283 percent, respectively). The public debt problem becomes generalized after the crisis, when a substantive rise in the indicator can be seen for all the selected countries, as Table 1 shows.

Table 2 shows that the current account deficit was a problem shared by the countries that the crisis hit the hardest, but the same cannot be said of the public deficit. Once again, Ireland and Spain illustrate cases of good fiscal indicators and terrible current account deficit indicators. The accumulation of current account deficits in those countries reflects increased public indebtedness, which took place based on foreign savings. As we will argue, the emergence of Europe's current account deficits and excessive private-sector indebtedness is directly related to imbalances in the real exchange rates that stand as the ultimate cause of the European crisis.

The exchange rate is a bilateral, or "bimonetary," phenomenon, as it concerns the price of one currency in terms of another. The Eurozone, the circulation area for a single currency, lacks a system of nominal exchange rates. However, the exchange-related root of

the single currency's crisis refers to internal (or implied) exchange rates that are determined by the *value* of each country's exchange rate, which depends, in turn, on the comparative unit labor cost index (Bresser-Pereira, 2013). Internal exchange rates measure the economies' competitiveness, as if the countries still retained their domestic currencies, based on the evolution of the unit cost of labor in each country relative to others. As a consequence, in spite of the single currency and the consequent fixed rate of currency exchange, it is clear that multiple internal exchange rates exist. That is, each country within the Eurozone has its own currency: the French euro, the Italian euro, the German euro, and so on. As a result, each such currency may be deemed depreciated for certain countries and appreciated for others within the Eurozone. In other words, the euro binds a set of countries to a strict exchange rate system that is fixed on the monetary level, and to a system of variable exchange rates at the real internal level. The variation of unit labor costs causes internal exchange rates to become mismatched and leads to excessive current-transaction surpluses for some countries, as well as equally excessive deficits for others. This would not be the case if each country had a currency of its own. Even if each country's *real* competitiveness varied as a function of its comparative unit labor cost index, they would not lose *monetary* competitiveness and run deficits, as such variations would be reflected in their exchange rates, which, according to the Balassa–Samuelson effect, would depreciate as the index increased, or appreciate as it dropped.

In a pioneering paper, Jeong et al. (2010) calculated the Eurozone countries' internal equilibrium exchange rates (which they refer to as "fundamental") employing the theoretical hypothesis of "national euros."[2] The authors' findings indicate that the euro is overappreciated for Southern economies (France, Italy, Spain, Portugal, and Greece) and underappreciated for Northern ones (Germany, the Netherlands, Belgium, Austria, and Finland). In 2008, for example, they find that the German euro was

[2] Williamson (1983) develops the concept of fundamental equilibrium exchange rate and defines it as the exchange rate level that enables the economy to simultaneously achieve domestic and foreign equilibria, where domestic equilibrium is given by the use of production resources without generating inflationary pressures, and foreign equilibrium is that which enables a sustainable current account. In spite of the controversy surrounding this concept as an indicator of the appropriate exchange rate level, the evolution of rates as calculated by Jeong et al. (2010) is regarded as a relevant indicator of intra-European exchange rate disequilibria.

depreciated by around 20 percent, while the Spanish euro was appreciated by around 50 percent, in real effective terms. This exchange rate imbalance was built over the 2000s, and reflects the different evolution of prices and wages, as well as of productiveness, between the various Eurozone countries. According to Mazier (2012), these exchange rate mismatches reflect a structural heterogeneity between Northern and Southern Europe.

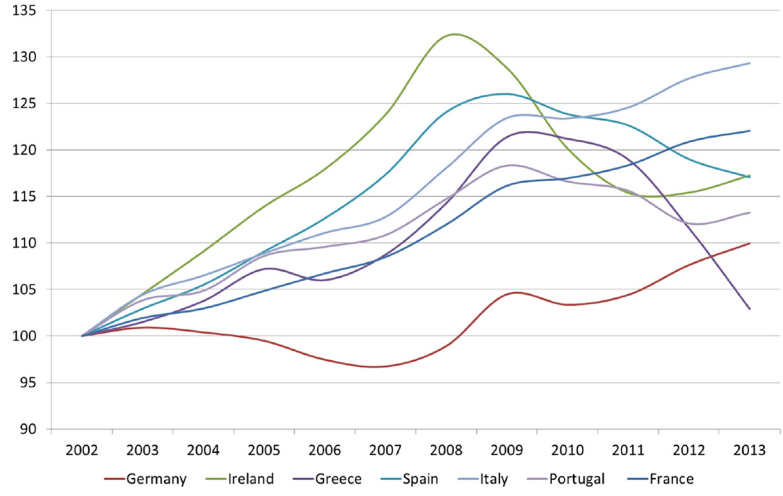
The differences across countries in the unit labor cost evolution determined these exchange mismatches. In the early 2000s, the German Social Democrat administration promoted and implemented a social compact between firms and workers—"Agenda 2010"— under which workers agreed to forgo wage increases hand in hand with productivity; in exchange, firms agreed not to carry out any more dislocations (transfers of plants to other countries), and, more broadly, to guarantee employment. As a consequence, the compact ensured wage constraints, resulting in lower inflation and higher productivity gains in Germany. The reforms were national and did not take into account impacts on the international level within the Eurozone; as such, they had a noncooperative nature that reinforced the exchange rate mismatches in the Eurozone, as other countries made no similar arrangements. Figure 1 illustrates the various paths and highlights Germany as the country with the mildest unit labor cost increase by far. Note also that the crisis partially corrected these imbalances, but, with the exception of Greece, by 2013 the selected countries had not recovered the lag relative to Germany that they had been accumulating since 2002.

As a result, these mismatches intensified the intra-European productive asymmetries. That is, over this period, manufacturing concentrated where it was already prevalent, specialization manufactured goods with higher value added, and greater technology content was reinforced in Northern countries, while Southern ones further specialized in nontradable industries such as services and real estate. These changes in productive structures went hand in hand with growing current transaction imbalances within the Eurozone, as Southern countries lost competitiveness, incurred current account deficits, and the private sector became indebted to the financial industry.

The financial system and Eurozone asymmetries

Granted the obvious differences, the Eurozone economies' adjustment may be compared to the working of a fixed exchange rate

Figure 1 Unit labor cost (2005 = 100)



Source: Authors' calculations based on data from AMECO

system under the gold standard. According to David Hume's model of the theoretical paradigm for adjustment under the gold standard, market forces, absent the ability to adjust the nominal exchange rate, should cause domestic prices to adjust in order to align economies and their foreign balance. The flow of foreign funds into an economy with positive trade balances would adjust the economy's domestic prices, causing price inflation that would reduce the competitiveness of its goods until the trade balance was neutralized. Likewise the flow of funds from an economy running a deficit would cause a deflationary adjustment that would rebuild the economy's competitiveness.

In practice, however, the gold standard did not automatically adjust domestic prices; its survival depended on the actions of central banks and on collaboration between governments. According to Eichengreen (2008), the playbook for the gold standard was short-term interest rate manipulation by national central banks in order to change the credit volume and aggregate demand as a means to affect the price level and, in addition, to align capital flows and financing needs.[3] That is, a trade balance deficit was corrected with a contractionist monetary policy of rising interest

[3] Keynes (1924) shows how adjustments to the bank rate establish foreign equilibrium under the gold standard regime.

rates, with the deliberate purpose of generating deflationary pressures and attracting foreign capitals in order to avoid gold and strong currency reserve losses. In addition to using interest rates, the system's proper operation assumed an "international solidarity" among the leading countries, consisting in the provision of lines of credit for countries having trouble maintaining the domestic currency to gold parity, and also in coordinated monetary policies to prevent interest rate hikes in one country from triggering rounds of similar hikes elsewhere.

The differences from the gold standard begin with the fact that the adjustment mechanism via interest rate manipulation does not work in the case of the euro, where the common, ECB-determined interest rate is indifferent to national peculiarities and does not aim to neutralize any foreign imbalance. Another difference is the importance assigned to current account deficits, which, under the gold standard carried the severe symbolism of "gold loss," while in the case of the euro, current account deficits do not appear to concern European authorities, perhaps because they are regarded simply as an unimportant debt flow that the market will adjust at some point. In addition, unlike the gold standard, in the case of the single currency the European Central Bank backs it. According to Bordo (2013), the presence of an important institutional commitment and apparent cooperation among the countries in the monetary zone enabled deeper and more prolonged imbalances to build before the current crisis unfolded.

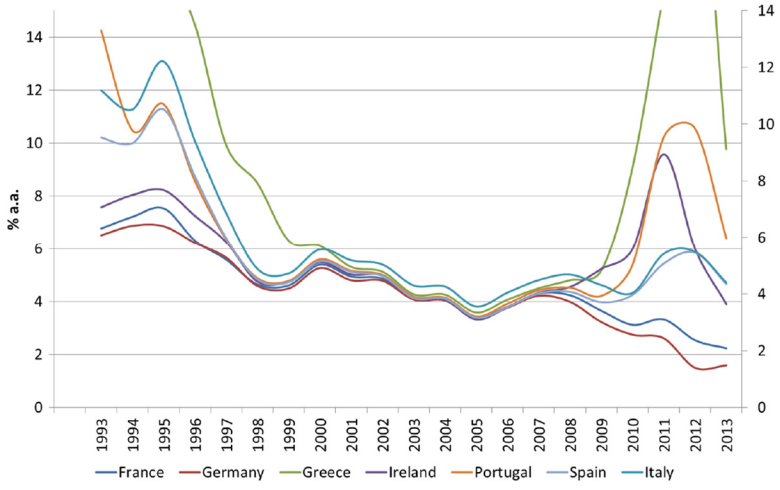
Given this context, what the Eurozone showed was the absence of adjustment mechanisms, combined with an utter lack of concern regarding current account deficits.[4] Capital flowed from the north to the south, but instead of increasing the recipient economies' production potential, it went into financing consumption and activities such as real estate speculation. The market forces therefore operated in the opposite direction, deepening the imbalances, sustaining current account deficits with abundant financing for countries in deficit. The capital flows recycled the German, Dutch, Austrian, and Finnish surpluses and placed them at the disposal of Spaniards, Italians, Greeks, Irish, and Portuguese. Excessive available credit contributed to the formation of bubbles in these

[4] The euro is more similar to the disastrous gold standard model that was in force between the two world wars, when surplus-posting countries sterilized gold inflows from current transaction surpluses, preventing inflationary adjustment and making it difficult for countries showing deficits to adjust.

economies, such as the real estate bubble in Spain. In this country, gross private-sector indebtedness exceeded 300 percent of GDP, while the public sector's net debt hovered in the vicinity of 40 percent of GDP in 2008.

As discussed in the first section, the notion of harmonization and convergence drove the financial system's actions in asset pricing and systemic risk assessment to greater and greater risk. Since the euro entered into circulation in 1999, banking activity boomed and interest rates plunged in South European economies. Figure 2 illustrates the process of interest-rate convergence. In Spain, Italy, Portugal, and Greece, long-term interest rates dropped from around 8 percent in 1995 to around 4 percent in 2011. Homogeneous credit terms and dropping interest rates in the periphery of the Eurozone encouraged public and private debt and overheated those economies (Belluzzo 2013). This overheating, in turn, produced periphery inflation rates higher than average for the euro, which was a determining factor in increasing internal real exchange rate mismatches. A vicious cycle then formed where current account deficit financing promotes consumption, price increases, internal exchange rate mismatching, increased current account deficit, and foreign-deficit financing. As a result, the exchange rate played the role, as noted in Bresser-Pereira (2014), of denying competent firms in the South access to

Figure 2 Long-term interest rates in Europe (ten-year sovereign bonds)



Source: Authors' calculations based on data from the Organization for Economic Cooperation and Development

domestic and foreign demand, while expanding this access for Northern countries. In this context, the financial system served as an accelerator for exchange and productive imbalances.

Furthermore, the single monetary policy compounded matters insofar as, given a certain nominal interest rate, real interest rates were different in the various European economies, higher in countries like Germany and lower in deficit-posting ones, where the credit-fueled consumption boom led to higher inflation rates. In this sense, the same ECB-defined interest rate may be expansionist for Portugal (providing a lower real interest rate) and contractionist for Germany (imposing a higher real interest rate).

According to Hein (2012), Europe's financialized capitalism produced two opposite growth models: the "debt-led consumption boom" and its counterpart, "export-led mercantilism." In the former, found in Spain, Greece, and Ireland, economic dynamism came fundamentally from debt-financed consumption. In these economies, aggregate investment made a timid contribution to economic growth while real estate price increases were significant. Likewise, inflation and unit labor cost increases in these economies were higher than the European average, contributing to their loss of competitiveness. As a consequence, the European periphery's debt crisis is also a domestic and foreign competitiveness crisis arising from the existence of the euro (Sapir, 2012). This model of growth with foreign savings is not viable in the medium run because, as Bresser-Pereira and Gala (2007) show, foreign capital or savings inflows tend to cause real exchange appreciation, and higher real wages and imports, which imply reduced exports, investments, and domestic savings on the side of demand. On the inventories level, growth with foreign savings led to excessive private- and public-sector liabilities, which gave rise to the financial crisis when the model became exhausted.

The debt-led consumption boom model's counterpart includes "export-led mercantilist" countries like Germany, Austria, and the Netherlands. In these economies the contribution of private consumption and domestic demand to growth was low, while current account surpluses made an important contribution. Weak domestic demand was accompanied by low inflation rates and low unit labor cost increases, reinforcing the exporting position of these economies (Hein, 2012). Their exporting model benefited from the demand caused by the consumption boom in other

European countries, and resulted in a creditor position, as the current-transactions surplus was offset by net capital outflows via the financial account.[5]

Foreign currency and sovereign crisis

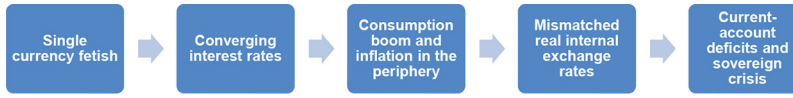
The European crisis may be summarized as seen in Figure 3, that is, a process in which the single currency fetish caused interest rates and other credit conditions to converge, causing a consumption boom in the European periphery that resulted in higher prices and wage inflation in these countries, which, in turn, contributed to mismatched real exchange rates, ultimately resulting in a balance-of-payments crisis.

As in a Minskyan financial cycle, the accumulation of imbalances took place in an atmosphere of stability, where balance of payment deterioration took place simultaneously with economic growth for European actors. The process was interrupted by the U. S. subprime crisis, which marked a time when expectations deflated and contradictions were made explicit. On the financial level, the exhaustion of the indebtedness cycle generated rising interest rates on loans, mismatched actor equity balances, and a contagion that also affected actors in creditor countries. On the real level, consumption and investment brutally contracted, demanding an active stance from nation-states. On the one hand, this prevented a larger crisis by socializing private-sector losses; on the other, it launched a fiscal crisis.

But there is another utterly crucial element to understanding the euro crisis: the fact that the public and private sectors became indebted in a foreign currency. This is because *the euro is essentially a foreign currency* for every country in the Eurozone, as noted in Bresser-Pereira (2011) and Aglietta (2012a); a currency that countries can neither issue nor devalue, and, for these two reasons, is a currency removed from each nation-state's sovereignty. Japan, for instance, is able to have a public debt above 200 percent of GDP and not be threatened with a currency crisis because this

[5] According to Hein (2012), France, Italy, and Portugal do not fit either model. Although they do not match the debt-led consumption boom, growth in those countries was driven by domestic demand, accompanied by either a relative increase (Portugal) or a relative decrease in wages (France, Italy) and, in any case, with sizable public deficits.

Figure 3 Fueling the Euro crisis



debt is essentially in yen. In the case of the Eurozone, the European Central Bank's management of the single currency was "independent" and aimed strictly at an inflation target that is not designed to meet the needs of the various European countries. Therefore, the Eurozone's monetary architecture does not abide by the sovereignty of European countries. Crucially, it does not offer them shared sovereignty.[6]

Thus the euro, as a foreign currency, confers an important institutional trait on the countries under its jurisdiction, consisting of their inability to issue domestic and foreign, private and public debt in their own currencies. As a consequence, national central banks cannot guarantee monetization of public and private debts when needed. In addition, the ECB does not guarantee monetization of these debts. As a result, the Eurozone's debt crisis also stands as a *sovereign crisis.*

In this context, the indebtedness of South European countries is a foreign currency indebtedness, and the resulting balance-of-payments crisis is a sovereign crisis similar to those Latin America experienced in the 1980s and 1990s. While the solution to a sovereign debt crisis lies in the national central bank's issuing currency and monetizing liabilities,[7] foreign-currency debt crises imply the possibility of default—something that only can happen if the debt is in foreign currency. The solution to such a crisis lies in (1) adjusting the economy in such a manner as to make real transfers abroad, that is, to generate trade surpluses capable of raising funds

[6] Miranda (2012, p. 36), for instance, asserts that: "The euro is a unique currency among its international peers. It is a single currency issued and managed by a statutorily federative central bank whose equity capital belongs to a politically nonexistent federation and whose deliberative power is entirely independent from its adopting sovereign states. It is thus a currency that countries share, but that does not, as a monetary policy instrument, have a unified sovereign debt bond to show for itself because budget administration is decentralized, that is, because fiscal federalism does not exist."

[7] The American case of quantitative easing is illustrative: in spite of the financial crisis and the U.S. fiscal and foreign deficits, economic actors never questioned the Federal Reserve's ability to ensure the solvency of public bonds.

to repay debt and honor interest, or (2) renegotiating the debt, which may take place under extremely adverse conditions as a result of growing risk spreads and often ends up subjecting a country to terms imposed by multilateral agencies, financial markets, or creditor countries. In this sense, the euro created the possibility for traditionally peripheral crises to take place in Europe.

The European case faces an additional problem that crises in emerging countries do not have: the alternative of orienting the domestic economy to current account surpluses is hampered by the inability to adjust relative prices by means of nominal exchange rate devaluation. The adjustment must take place via prices and wage deflation. In this sense, the euro crisis has exchange-rate-related causes, but not exchange-rate-based solutions. Because the exchange rate devaluation that is needed to address the balance-of-payments crisis does not occur, a stalemate ensues.

Stalemate and alternatives facing the euro

On August 2, 2012, the European Central Bank's Board of Directors announced that it would carry out definitive transactions in secondary sovereign bond markets, aimed "at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy." This fundamental policy shift returned to the euro some of its national currency nature; it resolved or mitigated the financial problem. But it failed to address the economic problem: internal exchange rate mismatches due to imbalanced unit labor costs in each country. There were also clear improvements to countries' current accounts, but they were due more to the recession and consequent de-absorption, and much less so to lower wages in indebted countries.

The "German path" to resolving the euro crisis is the path of internal devaluation, of asymmetrically correcting the internal exchange rate mismatches. That is, it is up to countries running deficits (and not those running surpluses) to perform an "internal devaluation"—a deflationary adjustment of prices and wages to correct the real internal exchange rate.[8] This path may theoretically correct implied exchange mismatches, but will require a lengthy period of time and will imply a massive social cost that, in practice,

[8] The other side of the German path is the "internal appreciation" of surplus-posting countries, that is, inflationary price and wage adjustments.

may not be feasible in European democracies. This "way out" of the crisis has a historical parallel in England's 1924 return to the gold standard, where reestablishing the prewar parity demanded a comprehensive deflationary adjustment. In "The Economic Consequences of Mr. Churchill," Keynes (1925) argued against restoring the gold standard. For him, the change in relative prices during the war prevented restoring the parity, and adjusting prices and wages would only lead to unemployment and recession.[9] As Keynes had predicted, England's recessive therapy set into motion a deflationary crusade that culminated in a massive recession and social unrest.

In political terms, the internal devaluation currently under way is a nonsolution given the time it takes to produce results, its enormous social cost, and the possibility of a failure to ultimately achieve the desired adjustment. In addition, if today's imbalance is resolved, there is no guarantee that it will not reappear further down the road. In spite of the regulatory steps being considered and put into place, chief among which is the unified regulation of major European banks by the ECB, and notwithstanding the improved current accounts of indebted countries, the euro's economic crisis is far from being resolved.

The reaction of indebted governments and many of the critics of the implemented solution is to argue for less austerity. But fiscal looseness would only delay solving the crisis, and does not offer a true resolution. At the opposite end, to continue building the European multinational state according to federative principles and reestablishing the connection linking control over money creation, fiscal authority, and political sovereignty is not a solution, either. The presence of a federal fiscal authority is crucial to mitigating shocks and their asymmetric effects on the various countries within a region (Goodhart, 1998).[10] Similarly, articulation between national fiscal authorities and the ECB would lend soundness to management of a shared public debt and guarantee the debt issued by national governments. On the other hand, this would necessitate creating a mechanism to control spending on the part of private actors, which would have no alternative but to go into

[9] In this and other works, Keynes stands as a critic of the gold standard's deflationary adjustments. According to him, wages can only be reduced with unemployment and recession, partly because only an unemployed worker would accept returning to work for a smaller wage.

[10] Establishment of such a fiscal authority would imply establishing a centralized budget and a market for unified sovereign debt bonds.

debt for as long as this spending is not brought under control and the current account deficit does not remain under control. Crises of confidence facing country A or country B, having emerged in 2008 from excessive private-sector indebtedness, would be dissolved by a central management and European countries would thus regain sovereignty, albeit a shared sovereignty, in conducting their economic and political fates. The solution is theoretically perfect, but unrealistic. The Eurozone is very far from standing as a federative state.[11] While the real competitiveness of the Southern countries is not recovered through the fall of wages (which a depreciation would achieve in a much more sensible way than an internal depreciation would), its current account will only be balanced at the cost of long-term recession, which is continuing to unfold.

We consider two alternatives to be feasible. The first one is an agreement to dissolve the single currency and return to national currencies. In this case, the way out of the crisis would involve a devaluation of South European currencies and, with it, a devaluation of the wealth of the residents. This would at first deepen the problem of indebtedness via currency mismatch, but it would enable those countries to recover competitiveness. As a result, the currencies of the North European countries would appreciate, jeopardizing their export-led model. The ECB would be retained to coordinate the actions of national central banks, which would recover sovereign power.

The second alternative is to turn the euro into a "common currency" instead of a "single currency," as proposed by Fréderic Lordon (2014, pp. 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 coexist with national Eurozone currencies, €-Fr, €-lira, €-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.[12] The strategic point, then, is as follows: national denominations would (evidently) be convertible into one another, but only at the BCE [CBE] window, which operates as

[11] For instance, in a recent survey of Ipsos for Accenture, when asked how they self-identify, 49 percent of the French responded French, and only 14 percent responded European (*Le Monde*, December 2, 2014).

[12] Quite simply, if €-Fr $=x$€ and 1€ $=y$\$, then 1 Fr-€ $=x.y$\$.

an exchange agency or clearing house of sorts. As a consequence, convertibility between private actors would be forbidden, and *there would be no intra-Europe exchange market.*"

Either solution would solve the problem involved in the fact that the euro is a foreign currency that is always subject to highly costly internal devaluations. Why are these alternatives (the second and more realistic one in particular) not adopted? Why insist on internal devaluation when it has already imposed such high costs and implies still more to come? Some argue that an agreement to discontinue the euro would be a step backward, but a strategic retreat is often necessary. Some also say that the crisis caused by the monetary reform would be too big and imply the end of the European Union itself. This retort, however, does not stand; the menace facing the European Union is the austerity strategy and the economic stagnation it causes, while discontinuing the euro is a way to consolidate the political union. The costs of monetary reform are high, but can be mitigated as long as the reform is carried out competently. Firms indebted in "foreign euros" that the reform did not devalue, or devalued less, would face a problem, but there is no reason why the cost should be borne by them only; this cost could be shared equally by creditors and obligors. As Flassback and Lapavitsas (2013, p. 38) noted, "a system of orderly devaluation (and revaluation on the other side) might preserve much better the core idea on which economic integration in Europe was founded, namely free trade, rather than the current arrangements."

The reform will inevitably imply short-term costs, but its medium-term benefits will be great. In fact, the question has not been properly analyzed because, as seen, the euro has become a *fetish.* In Marxian sociology, the concept of a fetish is used to characterize a delusion that naturalizes a certain social environment; the fetish is therefore a "grand deceit" that consists of mistaking the appearance of phenomena for their essence (Rubin, 1987). The "single currency fetish," or euro fetish, evokes an appearance consistent with what the currency symbolizes, but hides an essence that lies behind the process and that, at the same time, transforms the economies in the European monetary zone. National currencies are particularly prone to becoming subjects of fetish because they are the utmost symbol of sovereignty. When the euro was created, Europeans saw it as the sign of the constitution of a multinational state in Europe. This is a viable utopia, but was not at that

time. A central entity was missing that answered for a substantive portion of Europe's tax burden, not a mere 1 percent. Also missing was each country's willingness to abandon sovereignty in lieu of European sovereignty, and the basic solidarity that involves substantive income transfers to poorer regions.

History has examples to offer where the pursuit of utopia led to disaster, but there may also be cases where disaster can be prevented with utopias: the path to federalizing the European Union is certainly the utopia to be pursued. In the end, whatever alternative is chosen to address the stalemate that the single currency has become, the path will not be easy, but while the European stalemate persists, two important question stand: will the euro become a European currency, and thereby help to preserve the union? Or will it remain a foreign currency, and continue to act as a force that undermines the union?

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