

Malcolm
Sawyer

**Can the Euro
be saved?**

'Malcolm Sawyer, like a safety inspector, examines the design faults of the European Union and highlights measures to make the European system safe. His book will be indispensable after the next financial crisis focuses European minds. I heartily endorse his analysis.'

Ann Pettifor, City University London

'For an open-minded, clear and analytical discussion of the problems of the euro and the eurozone, the reader can do no better than Malcolm Sawyer's book. Whatever one's position on the single currency, this is a must-read.'

John Weeks, University of London

The economies of the eurozone countries are plagued by multiple crises, which cast major doubts over the future of the euro. In this engaging new book, leading economist Malcolm Sawyer argues that the entire policy framework of the eurozone was fundamentally flawed from its foundation. He shows how these 'design faults' intensified the crisis and are now locking in perpetual self-defeating austerity.

Sawyer proposes a bold alternative agenda for reviving the continent's economic prosperity and saving the euro. He argues, however, that the required solutions are certain to encounter huge obstacles. He therefore concludes that Europe faces a bleak economic future, blighted by low growth, high unemployment and social division.

This major contribution to one of the key economic debates of our time will be essential reading for everyone interested in Europe's future.

Malcolm Sawyer is Emeritus Professor of Economics at Leeds University Business School

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Malcolm Sawyer, *Can the Euro be Saved?*

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The Euro Crises

During the past decade, there has been much talk of the 'euro crisis', with profound economic and financial difficulties besetting the euro area.¹ It would be more appropriate to talk of a set of interrelated crises plaguing the euro area and its citizens. There is an existential crisis which still rumbles on with the question of whether a fixed exchange-rate system and a monetary union without political union are sustainable. There are strong elements of sovereign debt crises. There are balance-of-payments crises with large underlying current account imbalances between member countries which have been addressed through internal deflation but would become manifest again if there were any significant recoveries in countries such as Portugal and Greece. There is an unemployment crisis, particularly concerning youth unemployment.

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This book aims to set out the nature of the economic and political problems facing the euro area, which can be put under the heading ‘Euro crises’, exploring the ways in which the design of the euro area and its policy agenda were faulty from the beginning and how those ‘design faults’ have stymied the economic prospects of the people in the euro area. It outlines a broad policy agenda which could address those ‘design faults’, without which it is argued the economies of the euro area will continue to stumble. But the implementation of a policy agenda along the lines suggested is not presently promoted by any significant political forces and would face enormous obstacles.

There is a marked contrast between the first decade of the euro (1998 to 2007) and its second decade (2008 to 2017). The euro was launched as a virtual currency for financial transactions in 1998, with introduction to the public in 2001. By 2001, 12 countries had adopted the euro, which are labelled EU-12 below, and were subsequently joined by a further seven.² It was launched with great hopes for potential contributions to economic and political integration within the European Union and stimulating economic growth and employment. Even now (2017), the European Union website can state that:

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A single currency offers many advantages, such as eliminating fluctuating exchange rates and exchange costs. Because it is easier for companies to conduct cross-border trade and the economy is more stable, the economy grows and consumers have more choice. A common currency also encourages people to travel and shop in other countries. At global level, the euro gives the EU more clout, as it is the second most important international currency after the US dollar.³

Reviewing the first decade, the European Commission was able to claim that:

[w]e have good reason to be proud of our single currency. The Economic and Monetary Union and the euro are a major success. For its member countries, the EMU has anchored macroeconomic stability, and increased cross border trade, financial integration and investment. For the EU as a whole, the euro is a keystone of further economic integration and a potent symbol of our growing political unity. And for the world, the euro is a major new pillar in the international monetary system and a pole of stability for the global economy. (Joaquín Almunia 2008, then Commissioner for Economic and Monetary Affairs in European Economy)

Despite the optimism expressed by the European Commission (EC), the economic performance of

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the euro area in the first decade of the euro could be described as lacklustre. The economies of the member states grew, but not as quickly as comparable countries nor as quickly as hitherto.⁴ The EU-12 had an average growth rate over the period 2002 to 2008 of 1.7% per annum, with Germany at 1.3%, France 1.8% and Italy 0.9%. Unemployment had tended to decline, though the average rate over 2002 to 2008 was 8.1% with a rate of 7.6% in 2007. The European Commission (2008: 6), among others, claimed that ‘the bulk of these improvements reflect reforms of both labour markets and social security systems carried out under the Lisbon Strategy for Growth and Jobs and the coordination and surveillance framework of the European Monetary Union (EMU), as well as the wage moderation that has characterised most euro area countries.’ The promised boom in trade between the euro countries did not materialize.⁵ By the mid-2000s, signs were already there of problems arising. There were differences in inflation, and more significantly the current account imbalances between the EU-12 were widening.

The second decade of the euro has been a ‘lost decade’ of slow and often negative growth and high unemployment. Further, ‘while already it is clear that Europe is facing a lost decade, there is a

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risk that in a few years' time we will be speaking of Europe's lost quarter of a century' (Stiglitz 2016). The second decade of the euro has been dominated by the financial crisis and its aftermath, a widespread recession and firefighting sovereign debt and banking crises.

A central theme of this book is that the euro area suffers from major 'design faults', and so resolving the economic malaise of the euro area will require a massive redesign: I develop some ideas for this in chapter 4. I would echo the sentiments of de Grauwe when he wrote that:

The Eurozone looked like a wonderful construction at the time it was built. Yet it appeared to be loaded with design failures. In 1999 I compared the Eurozone to a beautiful villa in which Europeans were ready to enter. Yet it was a villa that did not have a roof. As long as the weather was fine, we would like to have settled in the villa. We would regret it when the weather turned ugly. With the benefit of hindsight, the design failures have become even more manifest as the ones that were perceived before the start. (De Grauwe 2013: 1)

The caveat is that for some of us the eurozone never looked like a wonderful construction (Arestis and Sawyer 1996).⁶ As de Grauwe (2015) notes from the start, some economists (albeit a minority)

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‘warned that . . . design failures would lead to problems and conflicts within the currency union, and that the Eurozone in the end would fall apart if these failures were not corrected’.

The ‘design faults’ have been present through the existence of the euro, though they were brought into sharp relief by the financial crisis and recession. Some of the ‘design faults’ were presaged by the convergence criteria for membership of the euro dating from the Maastricht Treaty of 1992. In those criteria, emphasis was placed on limits on budget deficits and public debt, on inflation (but not on inflationary conditions), and on stability of the exchange rate, but not on whether the exchange rate was at an appropriate level; nor was any attention given to the current account positions and their sustainability. These ‘design faults’ were intensified by the adoption of the Stability and Growth Pact, and the nature of the relationship of the European Central Bank with national governments and with the financial sector, and its reluctance to act as a lender of last resort. These ‘design faults’ were significant factors in the relatively poor performance of countries forming the eurozone, even before the financial crisis, and intensified the effects of that crisis and constrained the policy responses. The policies of the euro area are locked into an austerity

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agenda with the requirements to drive a balanced budget, no matter what the economic circumstances of the country concerned, including its requirements for public investment in infrastructure.

There are still, and will long remain, considerable diversities between the member countries in terms of their economic circumstances and political and institutional arrangements, which have not been significantly reduced by the experience of a single currency. The present EMU policies make a return to prosperity very difficult, and the future for euro-area prosperity appears bleak. The euro itself will likely continue, though the membership of the euro area may diminish. However, it will be argued that, with the present policy arrangements, there will not be prosperity across all members of the euro area.

There is a need for fundamental reforms within the EMU to secure future prosperity across the union. The reforms which are required for a prosperous EMU are outlined. The present policies can be described as *ordo-liberal* – combining neo-liberal macroeconomic policies with the constitutional embedding of those policies. This is exemplified by the ‘fiscal compact’, which not only lays down the requirement for a balanced structural budget but also embeds those requirements in national constitutions. The types of reform which are required

could be labelled those of ‘more Europe’, and as such will meet intense political obstacles when the political climate appears hostile to such developments. The policy changes, particularly with respect to fiscal and monetary policies, challenge the dominant ordo-liberal agenda of the euro area.

The attention throughout this book is on economic policies within the euro area and on alternative policies which address the euro crises. There is another important agenda which has to be simultaneously addressed – that is, the democratic deficit within the European Union. Such an agenda should consider giving more power to the European Parliament in economic (and other) decision making; fiscal policies under the democratic control of national parliaments; and ending the independence of the European Central Bank.