Item 4: Interdependence: Coordinating stimulus for global growth

Endgame for the Eurozone?

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Professor Costas Lapavitsas,
School of Oriental and African Studies,
United Kingdom of Great Britain and Northern Ireland

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Costas Lapavitsas
SOAS/RMF
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Unusual nature of EMU

- Not merely a system of fixed exchange rates

- A formal alliance to create an international reserve currency – the main competitor to the US dollar.

- A formal alliance to create a domestic monetary standard – the national money of 17 sovereign states.
Inherent weakness

- International and domestic roles of the euro clash with each other.

- The changes needed to make them compatible are highly unlikely given the social, political and institutional conditions in Europe.
Domestic Euro - International Euro

- The domestic euro is managed by the ECB via interest rates and controls on credit provision.

- The international euro is not directly managed. It is supposed to be non-existent within the EMU. No reserves required.

- In effect, international money has reappeared within the EMU.
For the euro to work

- The factors affecting its international functioning must be eliminated within the EMU – diverging inflation, imbalances in current accounts and capital flows.

- The factors affecting its domestic functioning must be handled by the ECB according to each country’s specificities.
‘International’ functioning within EMU

- Systematic divergence in competitiveness/inflation
- Systematic imbalances in current accounts
- Sudden and violent shifts in capital flows
Unit labour costs/Inflation, core-periphery

Allemagne: (-----)
Irlande: (-----)
Grèce: (-----)
Espagne: (-----)
Portugal: (-----)
Current account deficits, core-periphery

Allemagne: (-----)
Irlande: (-------)
Grèce: (--------)
Espagne: (-----)
Portugal: (-----)
German ‘other’ capital flows by region
Periphery has accumulated euro-denominated debt for ‘international’ and ‘domestic’ reasons. The debt is held publicly and privately.

Peripheral debt appears entirely ‘domestic’, since it is denominated in euro, but much of it is in reality ‘international’.
EU policy toward the periphery

- Fix ‘international’ malfunctioning through austerity, privatisation, liberalisation.

- Replace private flows from abroad with official flows the ECB and EFSF as well as by ELA.
Target 2 flows


Source: Haver, Bundesbank, Central Bank of Ireland, Bank of Greece, Banco de Espana, Banco de Portugal, Citi Investment Research and Analysis
Results:

- Collapse in demand, huge social costs, debt position has worsened.
- Shortage of domestic private credit as banks hoard liquidity with ECB.
- Tightening of links between national banks and nation states.
Bank fixed-term deposits, Eurosystem
Peripheral bank holdings of public bonds

Government securities as a % of total MFI assets for ES, GR, IE, IT, PT

Source: Bundesbank
Could it be done otherwise?

- Marshall plan for the periphery to raise productivity
- Rebalancing the German economy
- Debt forgiveness
- Restructuring finance
- Income and wealth redistribution

- Little chance of this happening, hence a break-up is likely
Greece – a depression

- Huge reduction in labour costs
- Disappearance of liquidity
- Vast contraction of public spending
- Persistent debt – public and private
- Contraction of all sources of demand
Current outlook in Greece is unsustainable

- Output contraction, 2008-11: 14%, 2012: 7-9%, 2013: perhaps 5-7%

- Unemployment: Adult >24%, Youth > 55%

- Public debt: 2012 perhaps 160%, 2013 perhaps 170%

- A humanitarian crisis in urban centres
Outcomes?

- Greek default and exit from EMU in 2012-3 taking command over ‘domestic’ money and treating euro as ‘international’ money

- Economic, social and political instability for a long time

- First step in unravelling of EMU.