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Original Articles

Balance of Payments or Monetary Sovereignty? In Search of the EMU's Original Sin

Comments on Marc Lavoie's "The Eurozone: Similarities to and Differences from Keynes's Plan"

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In a rece ozone (EZ) crisis "in the setu eferred to here as ew that sees the sour he (prevaili s from the conserv ent account (CA) imb and in inducing ncreasing number of economists would add German neomercantilist policies as an exacerbating

factor. While the BoP crisis is a fact, better institutional design would perhaps have avoided the worst aspects of the current crisis and permitted more effective action by the European Central Bank (ECB). Leaving aside the political infeasibility of a more progressive institutional setup, it is doubtful that this would fix the structural imbalances exacerbated by the euro. Be that as it may, one can of course blame the flawed institutional setup and the lack of ultimate action by the ECB for the crisis, as Lavoie seems to argue. Yet, since this institutional set up is absent, the EZ crisis manifests itself as a balance of payment crisis.

Keywords:

balance of payments   ECB   Eurozone crisis   Lavoie

Notes

In a similar vein, Sinn and associates at CESifo maintain that “there [are] widely contrasting interpretations of the crisis: one interpretation [stresses] self-fulfilling erosion of confidence, whereas another [emphasizes] fundamental macroeconomic imbalances” (CESifo 2012: 69). “Erosion of confidence” can be attributed to the absence

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Since sp … iverge about its adequacy. Posen and Veron (2014) are for the half-full view, Merler (2014) is pessimistic.

Also close to this view is Andrea Terzi who acknowledges that "[e]xchange rate risk was coming back to the single currency area and this widened spreads in a similar fashion just as, during ERM, spreads had reflected the risk of exchange rate realignments" (Terzi 2014: 2). He does not, however, attribute a major role to intra-EMU foreign imbalances. He explains the return of redenomination risk rather as a result of a divorce between monetary and fiscal policy in the EMU and regards the EZ sovereign debt increase as the result of "cyclical factors" (the global crisis of 2008–9; Terzi 2014: 22), arguing that if "the ECB had been allowed to trade member states' bonds, targeting their yield, we would not have seen any sovereign debt crisis" (Terzi 2014: 21). Terzi does not discuss the existence of foreign imbalances, though in a cryptic footnote he observes that the "fact that net exports largely originate from a specific geographical area within the Eurozone makes internal imbalances appear problematic" (Terzi 2014: 22).

In a hyper-gold-standard regime such as the EMU, such an adjustment would rely on domestic price deflation mechanisms without any possibility of resorting to exchange rate corrections.

CESifo economists point out that the Basel banking regulation system that freed banks from the obligation of holding capital against government bonds supported the convictio … he belief in Europea … shäuser 2012: 47 …

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Kalecki (1934) adds the “domestic exports” constituted by government deficit spending to the realization of social surplus in foreign markets. In his great paper on Tugan-Baranowsky and Rosa Luxemburg (1967) both markets were subsumed under the label of “external markets,” that is, markets outside the conventional “income-spending circuit” (Cesaratto 2015). According to Kalecki, spending by external markets, as well as investment spending induced by the expected rate of expansion of external markets, is financed by creation of purchasing power by the financial sector, or by sellers’ acceptance of bonds issued by the buyer:

> Financial processes connected with securing a surplus in foreign trade and with “domestic exports” are … very similar in character. The analogy is obvious in the case when the capitalists of a given country grant a foreign loan or a loan to their government which is used for purchase of commodities in that country. The capitalists lend money abroad or to their government in return for bonds. Funds obtained by a foreign country or by the government flow back through the purchases of commodities to the capitalists … . As a result, the profits of the capitalist class in a given period increase by an amount equal to the value of the government or foreign bonds received, which is equal in turn to the surplus secured in foreign trade or to “domestic exports” respectively. (Kalecki 1934: 18–19)

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> … non- … tment, … s). Other … on of the … dity … ances as such are a manifestation of the internal macroeconomic tensions within

EMU that have surfaced with the crisis. Some argue that these tensions are similar to those which, in the absence of a monetary union, would have resulted in balance-of-payments crises, which in fixed exchange rate regimes would imply a need for exchange rate realignments similar to those that occurred with the collapse of the Bretton Woods system (Sinn and Wollmershäuser 2012). It has been argued that Target balances would then be similar to quasi-unlimited foreign exchange reserves. (Cour-Thimann 2013: 12, 17–18)

Contrary to many initial convictions, capital flights from the EZ periphery roughly correspond to repatriation of the former EZ core-country loans that financed the current account deficits of the periphery (see Cesaratto 2013a: 370–71; Cour-Thimann 2013: 21).

On these crises, see the pathbreaking paper by Diaz-Alejandro (1985), as well as a paper by Kaminsky and Reinhart (1999). They point out the links between financial liberalization-cum-fixed exchange rates and banking and BoP crises. Following Reinhart (2011), I defined this as an "unfortunate sequence of events" (Cesaratto 2013b). See also Bagnai (2013).

A similar story is told by Whelan (2013). In the classical currency crises narrative of the 1980s and 1990s, ultimately it is "the government's concern about its ability to repay

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banks were indeed buying peripheral treasury bonds with loans from the Eurosystem denominated in euros, thus incurring redenomination risk. This remained high until Draghi’s famous reassuring statement. Notably, the renationalization of peripheral debt was only apparent: following Sinn’s logic, it is as if the Eurosystem was officially lending the funds withdrawn by the core-EZ private sector to the periphery through the LTRO. Indeed, the net international investment position of the periphery did not change at all, but just reshuffled with lower private and higher official loans.

Moral hazard refers to an alleged propensity of “profligate” peripheral countries to profit from a proactive ECB and relaxation of fiscal rules.

An unfortunate sequence of events also took place in the non-EZ Baltic states and Hungary, which pegged their currencies to the euro.

Until 2011–12 nobody would have included Italy (and perhaps Spain) in the EZ periphery. In those years the PIGS became PIIGS.

Sinn and Wollmershäuer (2012: 500) compare re-creation of liquidity by the Eurosystem to the American “printing of dollars” to finance the U.S. current account deficit that preceded collapse of the Bretton Woods system. Bordo (2014) rejects the comparison because T2 and the liquidity facilities are institutional features of the EMU (whereas Bretton Woods did not adopt Keynes’s International Clearing Union). Rather, he
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