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# Rebalancing the Euro Area: The Costs of Internal Devaluation

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countries would increase growth and it would come with higher inflation, but it would allow rebalancing without a Great Depression in parts of Europe.

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## Acknowledgements

Earlier versions of this paper were presented at the PERG Workshop Europe in Crisis, Kingston University, UK, April 2012, and the PKSG Workshop, SOAS, June 2012. We have benefited from the discussions there and from comments by Paul Auerbach two anonymous referees, and the editor. All remaining errors are ours.

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## Notes

<sup>1</sup>The Euro area overall has in the past decade had close to balanced current account, that is it rarely exceeded  $\pm 1\%$  of GDP. However, individual Euro member states have had substantial deficits or surpluses. In this sense the Euro area has had on aggregate internal imbalances. Of course, member states have had substantial surpluses or deficits with the rest of the world.

<sup>2</sup>This section

<sup>3</sup>The EU (and the Euro area) has been (and is) inflexible) to serve a role in the face of (symmetric) shocks in the face of (symmetric) shocks.

<sup>4</sup>Buiter & Marston (1995) argue that the clause is not precise.

<sup>5</sup>These are the Keynesian criticisms of the Euro area.

<sup>6</sup>This assumption is, however, not necessarily true. It may be relative to the adjustment process in the short run.



<sup>7</sup>A theoretical attempt to present in a Marxian fashion all these points as necessary moments within a specific organization of capitalist power can be found in Milios & Sotiropoulos (2010) and Sotiropoulos et al. (2013). They argue that the strategy of the euro corresponds to a mechanism for continuously exerting pressure for the reorganization of labour in the various member countries. In this sense, it is not just an income issue. Working people are being systematically attacked both at the 'centre' and at the 'periphery' of the Euro area in their conditions of production and reproduction. This strategy can be approached as an ideal design for the organization of capitalist power, the practical application of which has proved far from being perfect. The plan for the single currency very obviously generates strategic benefits for the collective capitalists of all the countries that participate in it.

<sup>8</sup>There is a certain economic logic to this. The real interest rates that businesses face are the nominal interest minus the inflation rate. But the inflation in producer prices (at which a firm can sell its output) depends on its sector. A Spanish automobile producer's prices are set by the world market (and not by Spanish inflation), whereas the real estate market has a regional dynamic (the real interest is negative if nominal interests are, say, 3% and house prices rise by 10%). The same nominal interest meant quite different real interest rates for different sectors; given a regime that encouraged capital flows, this meant that finance would be channelled to real estate (or, more broadly, non-trad

<sup>9</sup>The term (German) export surplus term is potential surplus when export surplus banks could invest the surplus (yes) and loan it to and lend to Spain to account imbalances

<sup>10</sup>In equ

<sup>11</sup>AMECC ion's Director

<sup>12</sup>Cesara market policies and German Neo-Mercantilism are more relevant.

<sup>13</sup>For useful brief presentations of the history of Phillips curve regression models see Galí et al. ([2001](#)), Montoya & Döhring ([2011](#)), Goodhart & Hofmann ([2005](#)).

<sup>14</sup>One could argue that the Phillips curve should be homogeneous of degree one with respect to import prices and past wages. If this condition is imposed the long-run effects are  $-1.42$  and  $-2.19$  for the 1999-2011 and the 1990-2011 samples respectively (available upon request).

<sup>15</sup>Okun ([1962](#)) presents several versions, all estimated with quarterly data. The first version estimates the difference in unemployment as a function of difference in (the logarithm of) GDP and is identical to our specification. The second version first calculates a potential GDP and an output gap. The unemployment rate is then related to the output gap.

<sup>16</sup>These inflationary policies will need a corresponding monetary policy and interventions in the workings of financial sector. The fact that we do not discuss them here does not reflect their importance but merely the scope of this paper.

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