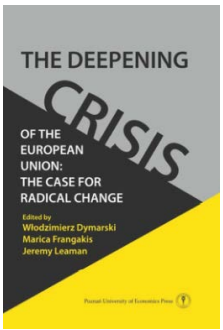

Michel Husson

Chapter 2

THE POLITICAL ECONOMY OF THE "EURO-SYSTEM"

* in Wlodzimierz Dymarski, Marica Frangakis, Jeremy Leaman (eds),
The Deepening Crisis of the European Union: The Case for Radical Change,
Pozna University of Economics Press, 2014.

Introduction

This chapter seeks to show how the current crisis of the Eurozone stems from the original design faults of the "Euro-system", whose contradictions, revealed by the financial crisis, are of a structural nature. This demonstration is carried out through a statistical and analytical methodology which gives this study a "technical" character. But it is a necessary stage for the development of a more solid diagnosis of possible exits from the current crisis, or rather from its specifically European dimension. This crisis has deeper roots than the symptom through which it has been expressed, namely a sovereign debt crisis. Thus, there are only two responses adapted to the structural nature of the European crisis: either the break-up of the Euro-system or its radical re-foundation. The others confine themselves to staggering the contradictions over time or programming a socially unacceptable regression.

The Euro-system denotes here the whole constituted by the single currency and the rules which have accompanied its implementation (most of which concern the European Union as a whole), notably the budget pact, the functions allocated to the European Central Bank (ECB), the restricted nature of the European budget and the rejection of harmonisation.

The analysis concerns eleven countries, namely the member countries of the Eurozone from its constitution in 1999, from which we have excluded Luxembourg and added Greece, which joined in 2001[1]. We can distinguish two

[1] Thus we do not include the five countries which subsequently joined the Euro zone: Slovenia in 2007, Cyprus and Malta in 2008, Slovakia in 2009 and Estonia in 2011.

big groups of countries[2]. The "North" comprises five countries: Germany, Austria, Belgium, Finland and Holland. The "South" is made up of Spain, Greece, Ireland, Italy and Portugal. The eleventh country is France which we have placed apart to the extent that it most often occupies an intermediary position.

1. An incoherent construction

The passage to the euro was associated with two essential rules: the fixing of budgetary norms (3% of the Gross Domestic Product for the deficit, 60% for outstanding debt) and the operational rules of the ECB: independence, a single objective (controlling inflation) and a ban on the financing of public deficits. In these conditions, where the instrument of the exchange rate disappears, the only variable of adjustment becomes wages, and this is why we speak today of "internal devaluation" to describe policies of wage austerity.

This construction rested on an underlying hypothesis, which a certain number of economists rejected at the time, with many more joining them later. This hypothesis was that budget and wage discipline combined with the liberalisation of capital movements would be enough to ensure the convergence of the economies participating in the Eurozone.

Things did not pan out as planned, and the aim of this article is to understand the chain of events leading to the current crisis which concerns the very bases of the Euro-system. We will start from an apparent paradox: the countries of the South have seen their competiveness deteriorate, even while the wage share has fallen in these countries. This note indicates a major phenomenon which will serve as point of departure: inflation rates have not converged in spite of a generalised fall in the wage share in value added [Husson 2010]. This latter trend implies that real wages have increased less quickly than labour productivity, in other words that competitiveness as measured by wage costs has no a priori reason to worsen because of a slippage of wages. Wage discipline has effectively been implemented but this has not sufficed to ensure the convergence of inflation rates.

[2] The data concerning North and South are obtained by aggregation or weighting according to economic weight measured by GDP. As a proportion of the total for the Euro zone (11 countries), the North accounts for 43.4% (Germany: 28.3%; Austria: 3.0%; Belgium: 3.8%; Finland: 1.9% Holland: 6.4%). The South accounts for 35.3% (Spain: 11.0%; Greece: 2.3%; Ireland: 1.9%; Italy: 18.0; Portugal: 1.9%). France represents 21.3%. The validity of this distribution, defined a priori, was tested at a preliminary phase of the study.

The competitiveness of a country can worsen in two ways: either because the unit labour cost[3] of the country considered increases more quickly than that of its competitors; or because inflation is more rapid in this country. The first cause is excluded: as a general rule the unit labour cost has stayed constant or fallen because of the fall in the wage share. Take the example of Greece. We note that the wage share fell from the mid-1980s and continued to do so after Euro entry in 2001. It only began to increase again in the years preceding the crisis (Figure 2.1). The same chart shows that the evolution of real unit labour costs is absolutely similar[4].

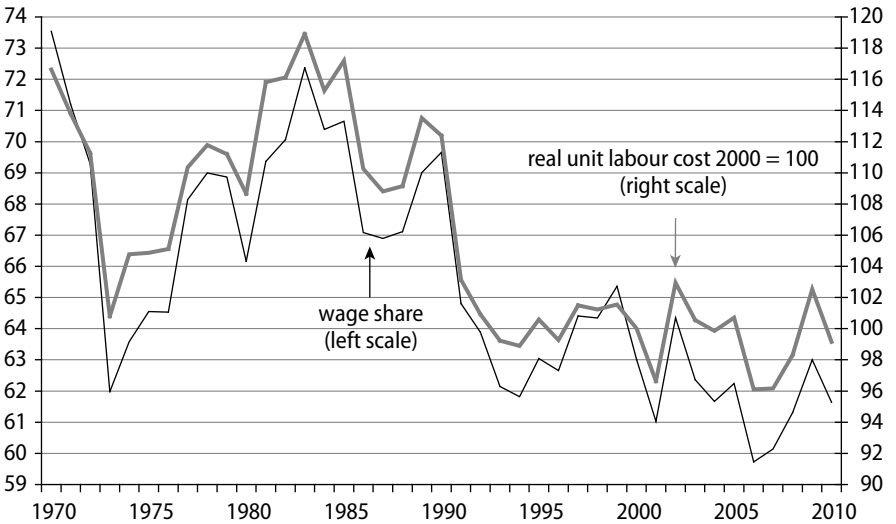

Figure 2.1. Wage share (in % of GDP) and real unit labour costs (2000 = 100) in Greece 1970–2010

In these conditions, Greece's price-competitiveness could not worsen because of an excessive growth of real wages, in other words growth which was higher than that of productivity. It should then be inferred that it results from a more rapid rise in price levels. This can be verified by Figure 2.2: the loss of price-competitiveness relative to the Eurozone average does not result from wage drift but essentially from a more rapid increase in prices. This first finding relating to the limited case can be generalised to the zone as a whole. In all countries, practically without exception, the configuration is similar: the

[3] See annex 1 for the definition of unit labour cost.

[4] Unless there is an indication to the contrary, the data originates from the Ameco data base produced by the European Commission.

real unit labour cost varies relatively little, in such a way that the essence of the increase of unit labour cost expressed in current Euros can be attributed to price increases.

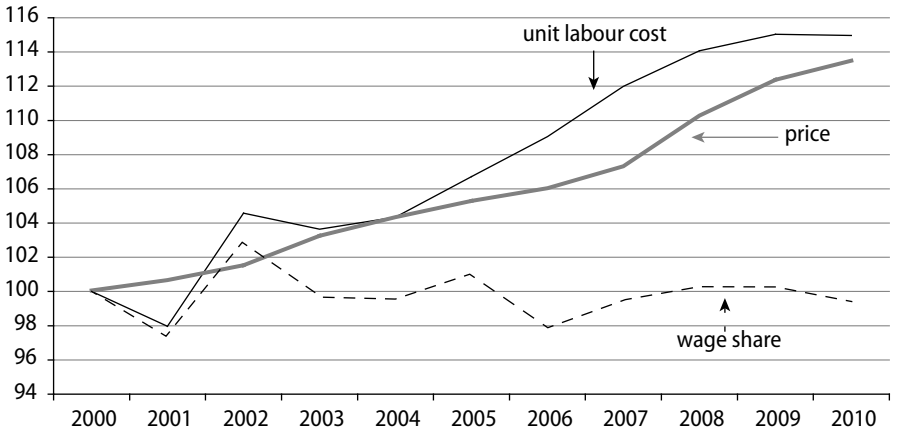

Figure 2.2. Components of Greece's price-competitiveness 2000–2010 (in relation to the Eurozone average (2000 = 100)

Source: Ameco

Comparison between the South and the North brings out two phenomena: in the South, the real unit labour cost is virtually constant, but it has fallen in the North, mainly because of the wage freeze policy implemented in Germany. But, all things being equal, the countries of the South are characterised by a more rapid rate of price increases (Figure 2.3).

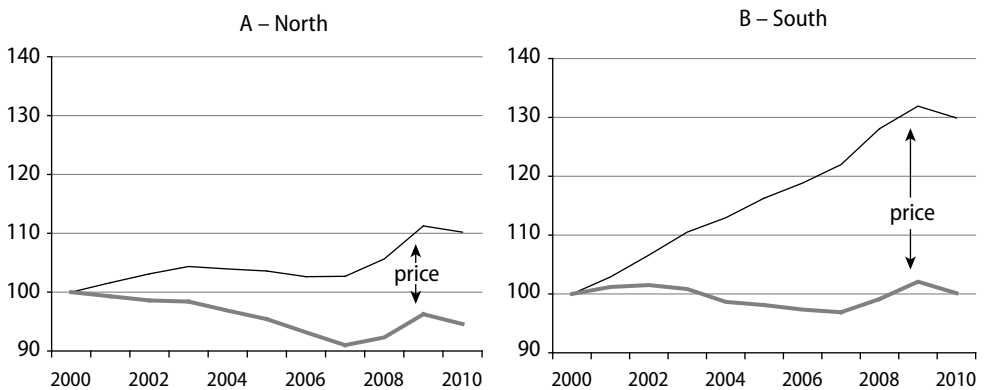

Figure 2.3. Real and nominal labour cost 2000–2010 (2000 = 100)

Such a panorama allows us to reconcile our two initial observations. Over the last decade, the evolution of the share of wages in the countries of the zone shows no evidence of "wage slippage". In other words, real wages have increased in line with labour productivity. On the other hand, highly differentiated inflation rates have considerably broadened the spectrum of unit labour costs which define the cost-competitiveness of each country.

This note suggests that we start the analysis from the existence of a "structural inflation" specific to each country. Such an approach has inspired notably the work of Jacques Sapir [Sapir 2006, 2011] and a recent study by two researchers at the Asian Development Bank (Felipe & Kumar 2011).

2. The determinants of structural inflation

The objective of an economic union between countries at different levels of development is à priori to lead to a form of harmonisation and convergence. This process of adjustment implies a more rapid growth of less developed countries, accompanied generally by a higher inflation rate. This points to an initial contradiction of the path chosen: how to reconcile the objective of convergence, which is accompanied by differentiated inflation rates, and the establishment of a single currency, which implicitly supposes the convergence of these inflation rates?

The process of convergence has indeed taken place. Analysis of the period 1990–2008 shows that the countries which had the lowest GDP per head in 1990 recorded the highest growth rates. But this convergence was accompanied by higher inflation: between 2000 and 2008, prices increased by 18.2% in the Eurozone, but by 27% in the South, against 11.8% in the North. France was situated around the average (18.4%) and Germany well below (8.3%).

This first explanation of structural inflation can be combined with another which stems from factors internal to the economies considered. The first bears on the dynamic between the manufacturing sector and the rest of the economy. There is in a general manner a productivity differential between these two big sectors. Let us allow that the real wage is indexed on the generally more rapidly rising productivity of labour in the manufacturing sector. We can distinguish two polar cases in the rest of the economy. If the real wage is indexed on a less rapid productivity, the productivity differential between sectors is found in the form of a difference in the increase in wages. But it can also be the case

that wages in the manufacturing sector serve as a motor and pull the wages of the rest of the economy. In this case, this wage increase tends to go beyond the rhythm of the productivity gains resulting in increased inflation. There is a vast literature on this subject and the configurations can be more complex, factoring in also the relative prices between sectors. But the general idea is fairly simple: the diffusion, in the form of wages, of productivity gains from the sectors where they are highest towards the rest of the economy is a source of inflation. To understand this causality, we can use a simple indicator, the wage differential, calculated as the average difference of growth of real wages between the economy as a whole and the manufacturing sector over the period 1995–2007. We can verify that there is a close link and clearly distinguish the ten countries (Ireland being excluded because of an absence of data) of the North and the South.

Box 2.1. A simple modelling of structural inflation

Because of colinearities, we make two separate estimates which give the results below:

Equation 1

infla = + 1.164 wagedif + 10.0 GINI – 0.62 $R^2 = 0.953$

(6.1) (4.0) (0.8)

Equation 2

infla = + 1.005 wagedif – 0.096 gdph + 4.10 $R^2=0.916$

(3.0) (2.4) (6.0)

infla: rate of inflation (2000–2008)
wagedif: wage differential (1995–2007)
gdph: average GDP per head (1991–2000)
GINI: coefficient de Gini (2000)

The average of the two estimates can then be written:
infla = + 1.084 wagedif + 5.0 GINI – 0.048 gdph + 1.74
It leads to the estimates shown in chart 2.4 below.

Inflation can also be the product of a conflict over distribution, all the more marked in that the level of income inequality is high. We note that this functions convincingly: inflation is higher in the countries where the Gini co-

efficient (a composite indicator measuring income inequality) is itself higher. We have in total three lines of explanation of structural inflation:

- a process of convergence: measured by GDP per head over a period;
- a sectoral dynamic: measured by the wage differential between the economy as a whole and the manufacturing sector;
- a conflict over distribution: measured by the Gini coefficient.

Econometric analysis verifies the validity of this approach and establishes the significance of the explanatory variables introduced (Box 2.1). One can then synthesise the determinants of structural inflation as follows: 1. inflation is highest in the countries where growth is most rapid because of a process of convergence; 2. inflation is all the higher when the average wage increase is close to that of the wage in the manufacturing sector; 3. inflation is highest in countries where the higher degree of inequality leads to more marked conflicts of distribution.

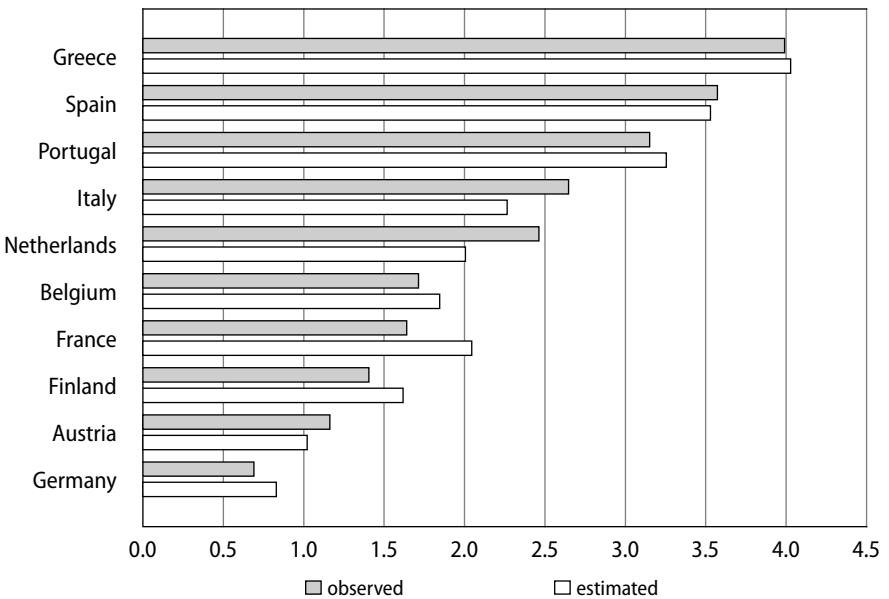

Figure 2.4. An estimate of inflation (2000–2008) (%)

The differences in structural inflation rates have not been reduced. That would have led to wage adjustment. But wage moderation has not been enough to compensate for the inflation differentials because the countries "in convergence" were able to escape this constraint because of the existence of two "leakage variables".

3. The current balance, first "leakage variable"

If the single currency had not been introduced, these differences in structural inflation would have been managed by exchange rate adjustments. In the absence of this possibility, trade deficits could to a certain point grow inasmuch as the deficit did not lead to a challenge to the national currency. If, for example, Spain had kept the peseta, it would not have been able to sustain a trade deficit which was running at up to 10% of GDP in 2007: its currency would have been attacked. There is a first "leakage variable" in relation to the logic of wage and budgetary discipline of the Euro-system.

In the period preceding the introduction of the Euro, trade between the two big zones was practically balanced. But divergence developed very rapidly with a growing deficit in the South, and increased surpluses in the North (Figure 2.5). France, as usual, occupied an intermediary situation but the recent growth of its deficit has brought it progressively closer to the South. As to the Eurozone as a whole, its foreign trade is tendentiously balanced.

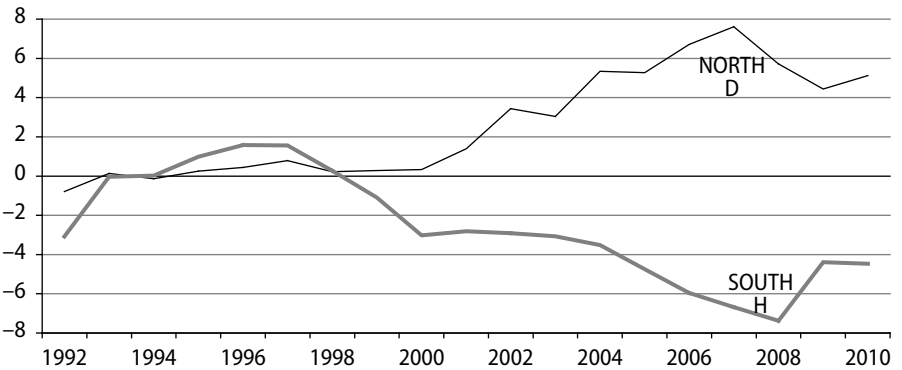

Figure 2.5. Trade balance in % of GDP 1992–2010

4. Real interest rates, a second "leakage variable"

One of the rules of the Euro-system was to liberalise capital movements, while ECB interest rates played a directing role. This rule has functioned well and has led to a perfect equalisation of interest rates (Figure 2.6A). But, to the extent that differences between inflation rates were maintained, indeed sharpened, this nominal uniformity of interest rates was accompanied by a growing di-

vergence of real interest rates net of inflation specific to each country. The general trend was downwards, but it was still more marked in the countries of the South where inflation was highest (Figure 2.6B).

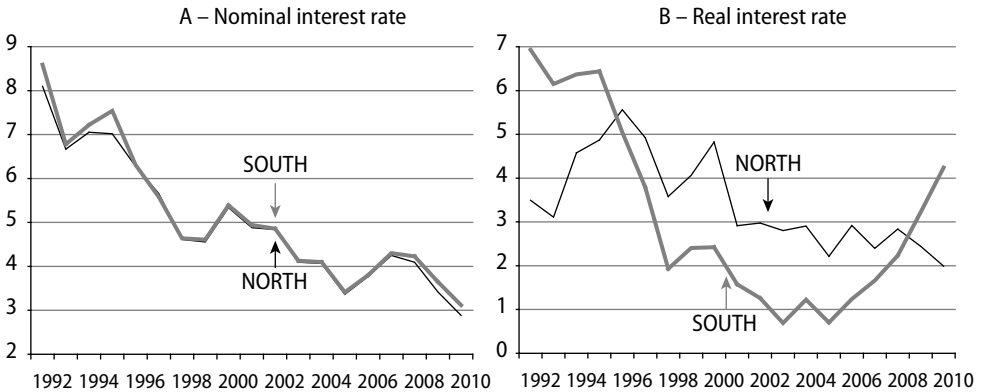

Figure 2.6. Nominal and real interest rates 1992–2010 (%)

Between 2000 and 2007, real interest rates were thus on average 2.7% in the countries of the North, as against only 1.2% in the countries of the South. These low interest rates have led to a significant increase in rates of household indebtedness, at 36% in the South as against only 4% in the North. We observe a significant link between the average level of real interest rates and the growth of household indebtedness (Figure 2.7). The higher growth in the countries of the South was then in part sustained by this process of over-indebtedness which fed property bubbles, notably in Spain.

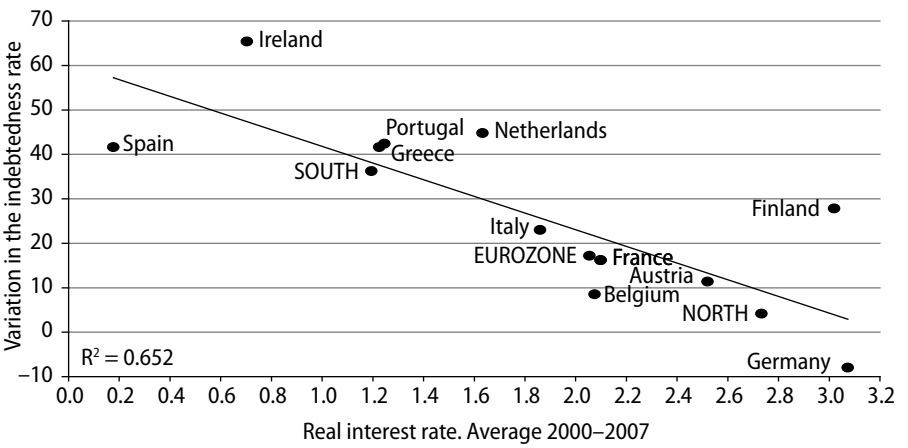

Figure 2.7. Real interest rates and household indebtedness (%)

5. The German case

The history of the place occupied by the German economy on the world market can be told starting from that of its external balances, measured here by its current account balance as a proportion of GDP. During the period separating the two generalised recessions (1974–75 and 1980–81) the surplus progressively disappeared. The 1980s saw a vigorous reestablishment, in such a way that the surplus recorded on the eve of reunification was comparable to that which can be observed today. The reunification of 1991 led to a quasi-instantaneous disappearance of this surplus, which remained very low through the 1990s. The turnabout came after 2000 and saw a spectacular restoration of the surplus which reached 7% of GDP on the eve of the crisis (Figure 2.8).

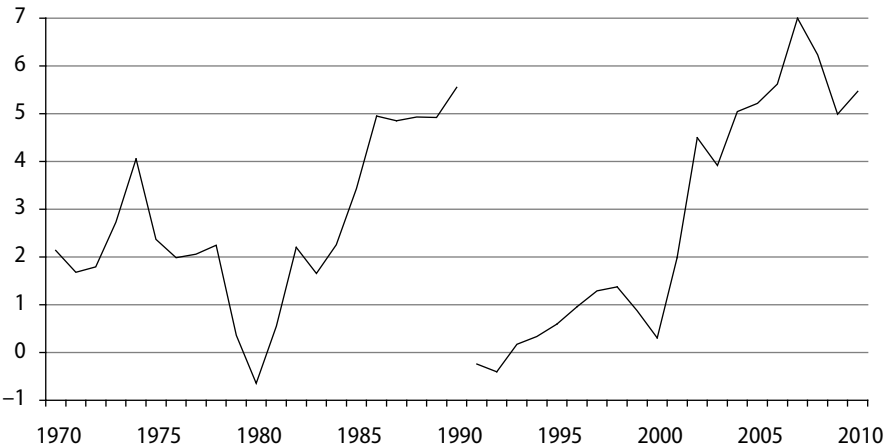

Figure 2.8. German external balance in % of GDP 1970–2010

This re-establishment of Germany's current account surplus was achieved through a squeeze on wages. Until the introduction of the euro, most countries made efforts at convergence, in the form of a reduction of unit labour costs or, what is practically the same thing, a fall in the share of wages. But everything changed in Germany after 2000: the share of wages began to fall, in an accelerated manner from 2004. In a few years, real unit labour costs fell by nearly 10%. In the rest of the Eurozone, including in the South, real unit labour costs (in other words the wage share) fell much more slowly (Figure 2.9).

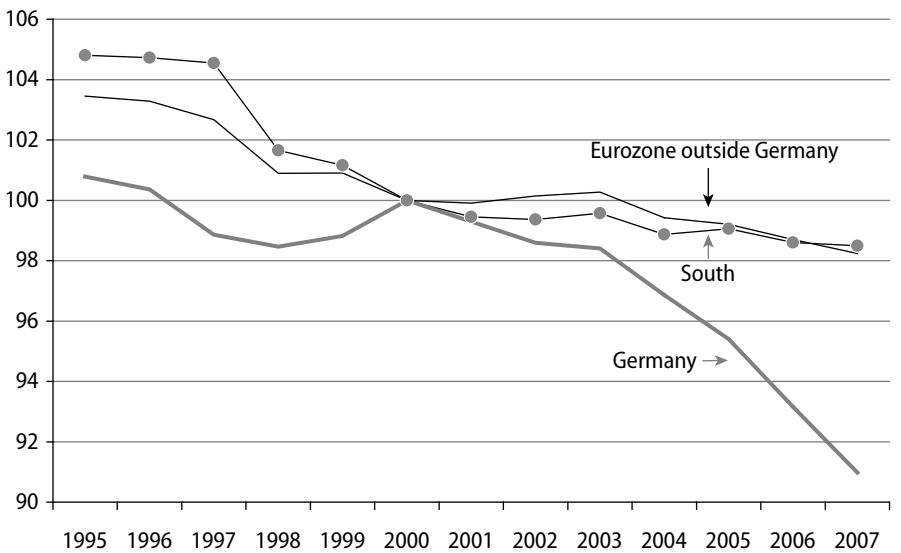

Figure 2.9. Real unit labour costs (2000 = 100)

This note is decisive: the relative competitiveness of Germany was sharply modified. And differential inflation rates sharpened the difference even further. Between 1998 and 2007, the nominal unit labour cost remained constant in Germany, while it increased by 27% in the South and by 15% in the unit constituted by France and the North excluding Germany. However these modifications in relative competitiveness are not sufficient to explain the evolution of trade balances. Another element needs to be added, partly linked to the previous one: the relative growth of internal demand, and in particular consumption. Here again the differences in trajectory are considerable. Over 10 years, between 1997 and 2007, consumption increased in volume by 28% in the Eurozone outside Germany (30% in the South) but by only 9% in Germany. This difference confers a supplementary advantage to Germany: the reestablishment of margins and the quasi-stagnation of consumption allow it to increase its productive capacities. We can verify that econometrically (Box 2.2): wage costs alone cannot account for the evolution of trade balances, so we must add another argument, in the event the growth of private consumption.

Box 2.2. A modelling of trade balances

The econometric equation explains the variation of the trade balance by the growth of consumption and that of the unit labour cost in the exposed manufacturing sector. It is tested over 10 countries (lack of data for Ireland) and gives an estimate of good quality:

$$\text{balance} = -21.2 \cdot \text{cons} - 15.8 \cdot \text{ulcmanuf} + 41.7 \quad R^2 = 0.733$$
$$(2.4) \qquad (1.6) \qquad (4.0)$$

balance: variation of the trade balance (1998–2008)
cons : growth of private consumption (1998–2008)
ulcmanuf : growth of unit labour cost in the manufacturing sector (1998–2008)

6. A composite indicator of divergence

To better objectify the differences in structure between countries, we build a composite indicator of divergence starting from the four following characteristics defined in relation to the average of the Eurozone over the period 2000–2007:

- growth: difference in average growth rate;
- inflation: difference in average inflation rate;
- public deficit: difference in average balance (as % of GDP);
- trade balance: difference in average balance (as % of GDP).

The composite indicator is calculated as the average of these four elementary indicators (after normalisation by taking the reduced centred variables). Figure 2.10 allows us to see the classification of the countries of the zone according to this indicator of divergence. The countries which diverge "positively" are those which have benefited from higher growth, accompanied by higher inflation and public and trade deficits. The correlation between these four trends is obviously not total, and it is the function of the composite indicator to sum them up in a single magnitude, defined necessarily in a conventional manner.

The classification of the countries reflects the division between North and South. All the countries of the North have a negative indicator, which means that their growth is rather lower but "virtuous" from the viewpoint of deficits

and inflation. Reciprocally, the relative indicator is positive for all the countries of the South. France is as usual in an intermediary position, even if it "leans" a little to the South, and is not very far from Italy.

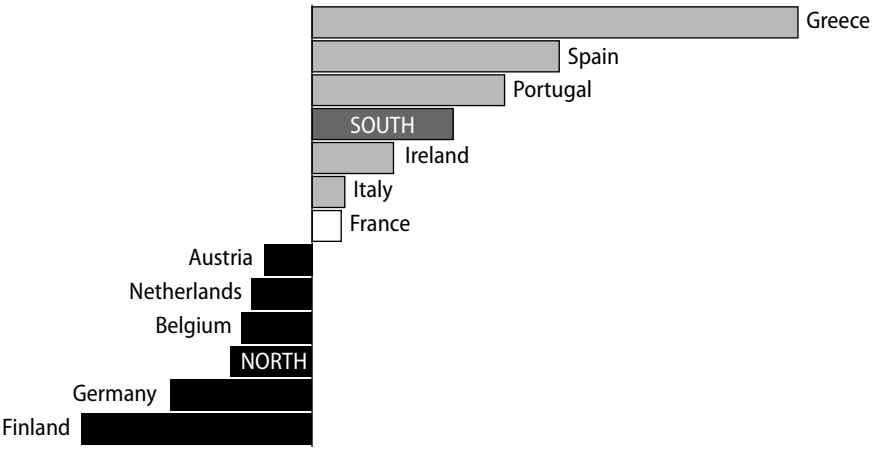

Figure 2.10. Indicator of "relative divergence"

We can verify that this composite indicator is well correlated to the other socio-economic indicators. We have employed two of them. The first is the rate of poverty with which the divergence indicator is positively correlated (Figure 2.11A). A second link can be established with an indicator of social democracy constructed as the average of those that Manfred Schmidt [2008] and Thomas Meyer [2011] have drawn up (Figure 2.11B).

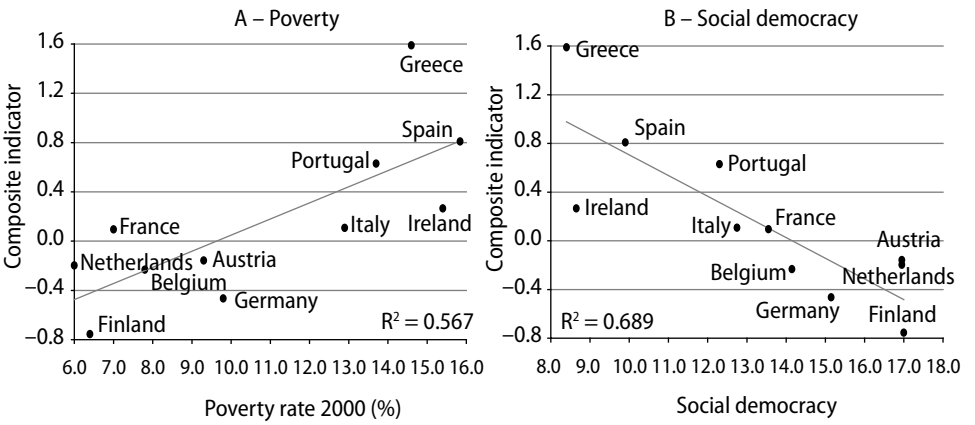

Figure 2.11. Composite indicator and socio-political indicators

This indicator of divergence allows us to shed light analytically on the socio-economic coherence of each of the countries of the Eurozone which brings out the deep structural differences not showing, as we have seen, any clear trend to convergence. But it can also be used to explain the differential impact of the economic crisis on public finances.

7. From recession to debt crisis

Any recession has a mechanical impact on the public deficit. But if we related the growth of the deficit between 2007 and 2009 to the fall in GDP in 2009, we note a great diversity in the breadth of this impact (Figure 2.12A). Globally, the countries of the South show a degradation of the budgetary balance and a much higher breadth than that of the countries of the North (Figure 2.12B).

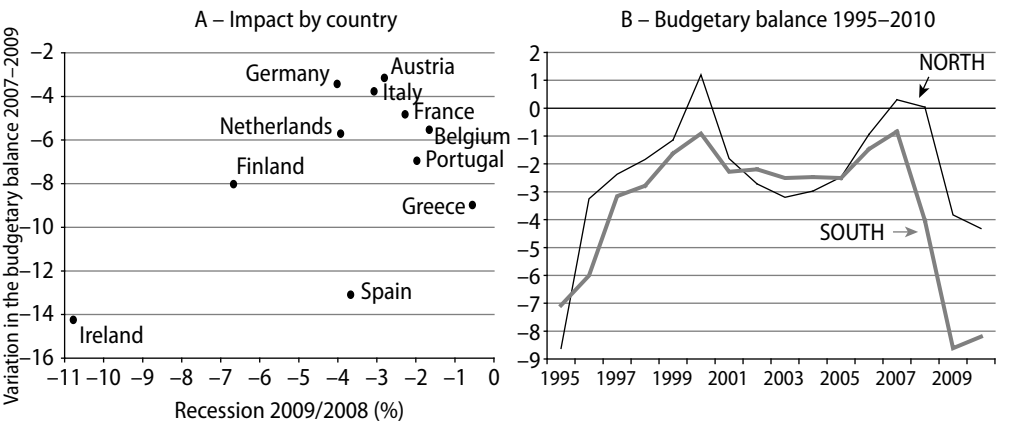

Figure 2.12. Impact of the recession on the budget deficit

We will here abstract from the mediations explaining this differential repercussion to relate it to the structural characteristics of each country, measured by the divergence indicator defined above. We test a new econometric equation which explains the budgetary deterioration by two variables: the breadth of the recession and the indicator of divergence. This equation gives significant results (Box 2.3). This result is significant, because it establishes that the breadth of the budgetary deterioration can be linked to specificities of the national economies.

Box 2.3. Budgetary deterioration and specificities of national economies

After verifying the pertinence of this indicator, we introduce it as explanatory variable of the growth of the public deficit in the econometric equation below:

ddef = 1.07 recession – 4.23 indic – 2.39 $R^2 = 0.782$
(4.5) (4.2) (2.1)

ddef : variation of budgetary balance 2008–2010
recession: variation of GDP 2008–2009
indic: indicator of divergence

8. The history of the Euro: a simplified tale

The elements of analysis above show that the countries of the Eurozone are effectively polarised, in such a way that the distinction between a "North" and a "South" is globally validated. The countries of the South share common characteristics of which the main one is higher structural inflation. The latter leads to a loss of competitiveness and a growth of current account deficits despite a fall in the wage share close to the average for the zone. These countries did, however, record higher growth during the decade 1995–2005. This performance is authorised by two "leakage variables": capital inflows covering trade deficits which by definition do not threaten the national currency; the fall of real interest rates (as counterpart to higher structural inflation) favours growth drawn by indebtedness.

But the crisis has disturbed this configuration. The most significant result of this analysis is undoubtedly the following: the sovereign debt crisis is the symptom of a specific crisis of the Euro-system. This is obviously not the sole dimension of this crisis – which, more broadly, threatens the functioning of real existing capitalism – but it is specific to the Eurozone and does not manifest itself with the same sharpness in the other capitalist countries: the USA, UK, Japan and so on. It results from the unstable and incoherent mode of functioning of the Eurozone which has lasted over a decade but on the basis of processes which cannot be indefinitely extended.

Let us allow for an instant that the debt crisis is overcome: the dysfunctions of the Eurozone will not, for all that, disappear because it will continue

to combine a single currency for countries whose structural characteristics are different, if nothing is planned to manage this situation or begin a process of convergence.

9. The return of the external constraint

The depth of this crisis can be measured by detailing in a more precise manner the link which exists between the budget deficit and trade deficit of each country. It is necessary to start here from this fundamental relation[5]:

Need for public financing = private savings + capital inflows.

This accounting equality means that the need for public financing (positive if the budget is in deficit) is at the end of the day covered by two possible sources: by national private savings (companies and households) and/or by capital inflows corresponding to the current account deficit. This relation is of an accounting nature, which means that it is always verified. In other words, the variation of one of its terms is necessarily compensated by a variation of the two others, but this says nothing of the adjustment mechanisms which guarantee its realisation.

This relation provides a framework which allows us again to clearly distinguish the countries of the North and the South. Until the crisis, public financing needs evolved in a relatively similar manner in the two groups of countries. But its counterparts bring out two inverse configurations. In the North, national savings rates increased strongly after the introduction of the euro, as did capital exports, the counterpart to the trade surpluses, rising tendentiously: net inflows of capital became negative (Figure 2.13A).

In the South, the configuration was the opposite, and is characterised by a very marked periodisation. Before the introduction of the euro, the countries of the South reduced their budget deficits so as to satisfy the membership criteria, with a fall in private savings offset by supplementary capital inflows as counterpart. Until the crisis, the public deficits did not increase but, starting from the mid-2000s, the configuration prevailing before the euro returned little by little: trade deficits deepened, leading to capital inflows which offset the fall in private savings. The outbreak of the crisis was reflected by a big increase in public deficits. At the same time, trade deficits fell, and thus capital inflows. The loop was closed by a big fall in the private savings rate (Figure 2.13B).

[5] See Annex 2 for its construction.

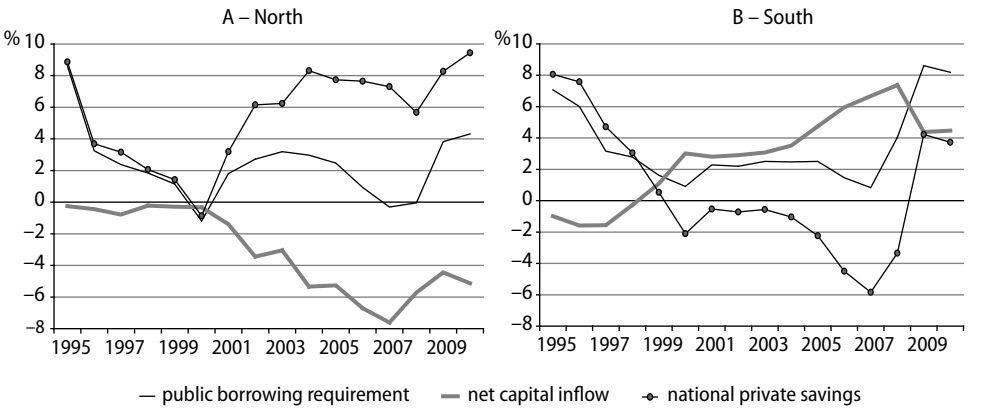

Figure 2.13. PSBR, net capital Inflows and private savings in the North and South groups

Here a fundamental element of the crisis comes into play: it has put an end to the quasi automatic capital inflows which prevailed until now. In other words, the countries of the South, the hardest hit by the debt crisis, should also reduce their trade deficit. This is only possible by increasing national savings. But this mode of adjustment is only compatible with a notably reduced growth. There is indeed a very close link in the countries of the South between the rate of growth and the variations of the rate of private savings. The conclusion of this analysis is clear: the countries of the South have certainly registered a higher growth than those of the North between 1995 and 2005 (Figure 2.14A) but this growth was not sustainable because it rested on a fall in the national savings rate (Figure 2.14B).

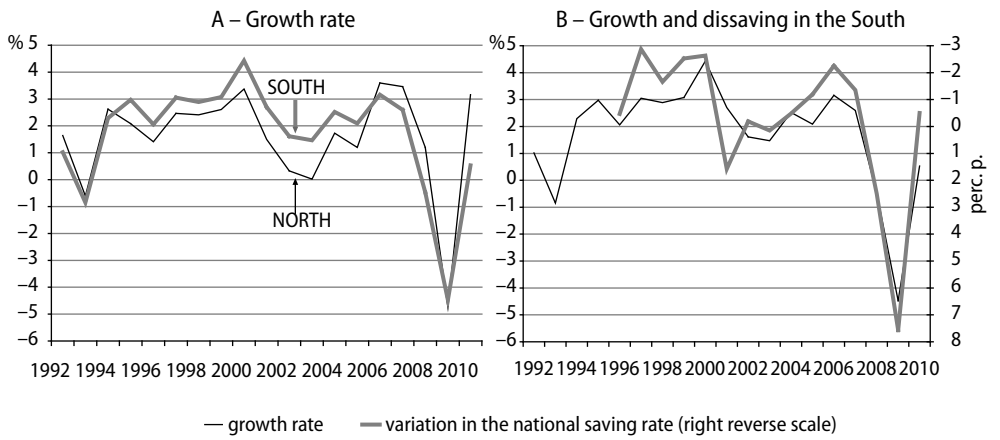

Figure 2.14. Growth and savings in the Eurozone

This *dissaving* in the countries of the South had as counterpart a growing inflow of capital, favoured by financial deregulation and the convergence of interest rates. But, from the time when these capital inflows falter, the equation of equilibrium of the balances functions otherwise: the public financing requirement can only be covered by a considerable increase in the rate of national saving — of around 10% of GDP — which in turn slows growth (Figure 2.14B).

This new configuration is here to stay and the possibility of growth recommencing will be all the more reduced in the countries of the South. The latter have indeed accumulated an enormous deficit in terms of net external assets: it represents nearly 60% of GDP, whereas the countries of the North have positive net external assets, amounting to nearly 35% of GDP (Figure 2.15).

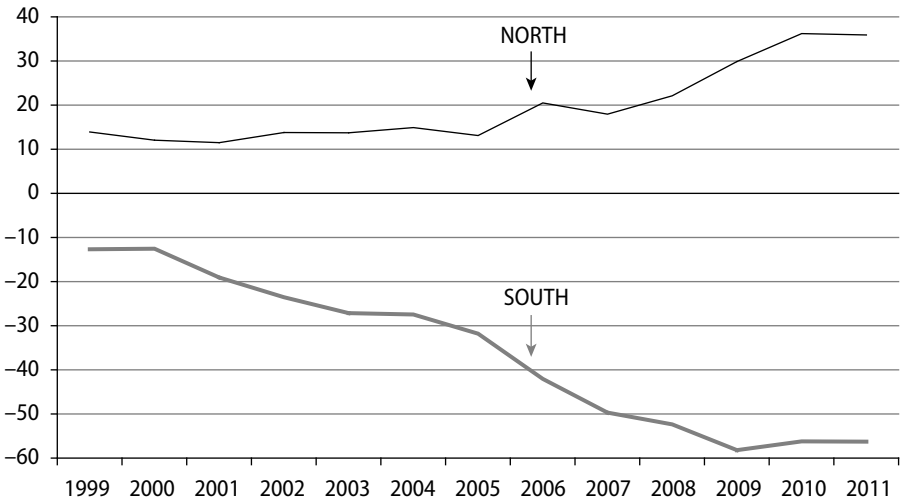

Figure 2.15. Net external assets 1999–2011 (% of GDP)

10. Facing the debacle

The worm was in the fruit, for a basic reason which it was possible to anticipate: "nothing in theory or practice allows support for the postulate that monetary constraint would allow the forcing of the real convergence of the European countries" [Husson 1996]. The single currency "postulates the realisation of a homogeneous space to which it is supposed to contribute" [Husson 2001].

With the passing of time, the introduction of the Euro-system will probably appear as a terrible error stemming from a dogmatic, indeed neurotic, blindness, and in any case from a total incomprehension of the challenges to a genuine European construction. Today, the Eurozone has become the weak link of the world economy, and we can even say that Europe is in the process of devouring its own children. The policies pursued at the European level amount to a blind headlong rush which plunges the whole zone into an infernal spiral of austerity and/recession. Unemployment is setting in at unprecedented levels, and the only way out is a shock therapy targeted on the deconstruction of the social model.

The recent debate concerning the growth aspect which should be "added" to the abundance of austerity pacts put in place on the pretext of budgetary rigour is completely false, inasmuch as the "growth" invoked should find its miraculous source in "structural reforms" which can only mire the Eurozone in recession. There is a new form of dogmatic obstinacy which totally neglects the question of rhythms by making no distinction between the levers of a conjunctural recovery, and a resumption of "potential growth" whose hypothetical effects can in any case only be felt in the medium to long term. Before such foolishness, one is entitled to be not just "dismayed" (*atteré)*, like many economists in France, but quite simply terrified.

It would be fruitless to try and rewrite history, and better to examine the possible means for emerging from this real impasse. We can distinguish several possible scenarios: management on an ad hoc basis, structural adjustment, exit from the euro and radical re-foundation of European construction (+common currency). None of these however represent an ideal way.

European policy oscillates between structural adjustment and ad hoc management. One day, it throws oil on the fire, only to activate the extinguisher the day after. The recent history of Europe is an alternation between the strengthening of austerity mechanisms and the salvaging of the situation at the edge of the abyss. The incoherence of successive decisions and the total inability to anticipate developments are the sign of a deep dilemma: how to go back to "business as usual" when it is this latter which has led to the crisis? These oscillations around an impossible trajectory contribute to what can be characterised as "chaotic regulation" [Husson 2009], which is the horizon of capitalism after the crisis. If we do not resign ourselves to social regression, we need to envisage alternative paths.

The first such is exit from the Euro: when the Euro-system is not viable, it is necessary to get out of it. But this simplistic logic forgets that for over a decade, contradictions have accumulated and have led to an accumulation of

public and private debt, inextricably mixed, at the heart of the banking system. Exit from the euro would not in itself lead to a return to the *status quo ante*. Many arguments have been exchanged on this question, in particular about the Greek case. The main argument is that the return to a national currency would initiate a competitive devaluation allowing foreign trade to be boosted and ensuring that the central bank can finance the deficit. But such a measure would not in itself resolve the problem of the weight of debt already taken on and would lead *de facto* to an austerity comparable to that of structural adjustment[6]. The new currency would be exposed without protection to generalised speculation which would unleash an unending cycle of devaluation/inflation. A generalised exit, in other words a total break-up of the Eurozone, would not, according to all the evidence, yield a co-operative solution at the European level: it would lead to a chaotic trade war. More generally, the Euro exit strategy tends to transform the social question into a national question, as shown in more detail by three Greek economists who are members of Syriza [Laskos, Milios & Tsakalotos 2012]. The threat of a Euro exit can, however, contribute to the construction of a relationship of forces as an instrument of dissuasion: an exit of one country from the Eurozone could have significant repercussions on the other countries.

11. A crisis of the Euro-system beyond the sovereign debt crisis

If a return to the past is not a viable solution and if the current Euro-system is incoherent, it is then necessary to aim at a re-foundation of the European construction. Taking account of the above analysis, it is however necessary to distinguish two objectives each of whose realisations supposes a break with the Euro-system as it currently functions. The first objective would be to absorb the weight of the accumulated debt, which hinders any revival of activity and any reorientation of the mode of development. That implies radical solutions, namely the restructuring of the debt and the socialisation of the banks. This radicalism is moreover not dictated by a desire to outbid, but a concern for coherence.

The alternative concerns the mode of debt absorption: either it is done little by little, at the current rate, at the price of at least a decade of regression

[6] On the question of euro exit, see: [Husson 2011, 2012].

and the economic, social and political somersaults which would accompany it; or the debt is brutally restructured or cancelled, so as to return accounts to zero. In this logic, the socialisation of the banks is necessary for an ultimately technical reason, because it is the sole means of disentangling the web of debt, since sovereign debt is in its greatest part borne by the banks. That is shown by the examples of *Bankia* in Spain or *Crédit Agricole* in France and still more by the absurd paradox through which the ECB massively aids the banks (€1,000 billion) rather than the states in difficulty. Finally, the third aspect of this triptych is the possibility of the ECB directly financing the states.

A Keynesian arsenal could effectively be mobilised: an increase in the capital of the EIB (European Investment Bank) and its loans (€60 billion); mobilisation of unused Structural Funds (€82 billion); taxation of financial transactions (€50 billion per year); project bonds to finance large scale investment. The schedule for a return to budgetary equilibrium could — and probably would — be staggered. Rather than blindly loaning considerable sums, it would be better to mutualise the support to the banks. The EFSF (European Financial Stability Facility) or the ESM (European Stability Mechanism) could be used to directly recapitalise the banks in difficulty and this could be completed by a common deposit guarantee system. A lowering of the Euro exchange rate, a dose of inflation, a boost to wages in Germany, all these factors could support *ad hoc* policies, but they would only modify the margin of the calendar of adjustment.

12. Break with the Euro-system in the name of another European project

If we reject structural adjustment and exit from the Euro, the only coherent path is that of cooperative harmonisation. This would rest on a European budget based on a unified tax on capital incomes which would finance the necessary transfers (harmonisation funds) and socially and ecologically useful investment. This "federalism" is basically the indispensable supplement to the existence of a single currency and to the construction of a common economic space. Imagine for a moment a country like France where each of the twenty-one regions had to ensure the balancing of their finances and their "external" exchange transactions, while the national budget was limited to 1% of GDP. We can see the absurdity of such a construction, which is nonetheless the basis of the Euro-system.

But the objection is that this "Europeanist" project would not be possible in the current context. There would then be no way out, either national or European. If such was the case, once again the only orientation remaining would be to modulate the austerity programmes so as to stagger them over time, hoping that this would allow them to be rendered compatible with a revival of "growth", whatever its concrete content. But this would be an austerity without end. Patrick Artus shows that, in the case of Spain, the necessary developments (debt reduction, reduction of the public deficit, creation of new jobs) would perhaps take decades [Artus 2012]. And this is logical: several decades of accumulated disequilibria converted into debt leads to as many decades of debt reduction.

To get out of this impasse, there is a path which would involve a unilateral break with the currently existing Europe in the name of another European project. We can speak here of a transitional programme combining rejection of the rules of the Euro-system with a will to generalise the alternative experience to the zone as a whole. We do not simply wait for the miraculous appearance of a "good" Europe but instead adopt a "protectionism of extension" which consists in protecting the experience of social transformation while proposing its extension [Husson 2011, 2012]. It is such an approach which underlies the emergency plan advanced by Syriza for the Greek elections of June 17, 2012. It was centred on these three points[7] : 1. Cancellation of the memorandum, all austerity measures and employment counter reforms; 2. Nationalisation of the banks; 3. A debt moratorium to identify and cancel illegitimate debt.

The main conclusion of this analysis is that the crisis of sovereign debt reveals a deeper crisis, that of the Euro-system. The crisis of capitalism has revealed an incoherent project: marrying a monetary union of different countries, while rejecting any means of ensuring their convergence or organising their relations. The necessary European re-foundation can only take shape through a rejection of unsuitable rules, which can only increase the gap between the countries of the Eurozone. But it is not reduced to this objective: the alternative demands other ruptures, and notably a different distribution of wealth, which is necessary to its coherence. A break with the Euro-system can only find its legitimacy in a rupture with neoliberal capitalism and a project of cooperative extension. The principles of a solidarity based Europe are indeed incompatible with a pure capitalist logic. That is what makes the future both uncertain and demanding.

[7] It is striking to note that the international press has presented euro exit as the main issue of this debate although this perspective was not part of the programme of Syriza.

Annex 1. Labour cost, wage share and competitiveness

The wage share (WS) can be defined simply as the relation between wage remunerations (REM) and GDP (pQ), or: WS = REM/pQ. The remunerations (including social security contributions) can be broken down into wages per head (w) and number of employees (N). We have then REM=Nw and we can reformulate the share of wages so as to show the real wage (w/p) and productivity (Q/N): WS = (w/p) / (Q/N).

The unit labour cost (ULC) represents the labour cost per unit produced. At a very global level, it can be calculated by dividing the total remunerations by the GDP in volume: ULC = REM/Q.

The real unit labour cost represents the real labour cost per unit produced. It is written: RULC = REM/pQ.

We find then the expression defining the share of wages, which is a very close indicator of the real unit labour cost. The two magnitudes differ according to relative prices (the real wage is calculated taking the price of consumption rather than the price of GDP) and because of the correction necessary to take non-employees into account in the calculation of productivity.

The competitiveness-cost of a country results from the comparison between its unit labour cost and that of its competitors. As a general rule, we need to introduce the exchange rate to make this comparison, but that is obviously superfluous inside the Eurozone. Taking account of the definitions recalled above, the unit labour cost can be simply broken down in the following manner: ULC = p · WS.

This breakdown shows that the competitiveness-cost of a country can worsen in two ways:

- because the unit labour cost of the country considered increases more quickly than that of its competitors;
- because inflation is more rapid in this country.

Annex 2. The equation of equilibrium of balances

The starting point is a simplified national accounting. It comprises four "agents" or "institutional sectors", households, companies, the state and the exterior (the rest of the world). The first line of the overall table below describes the various contributions of the agents to the GDP. The three following lines record the operations linking these agents: wages. taxes, financing operations. Uses appear to the left, resources to the right. Each line is balanced: the total of uses is equal to the total of resources.

	Households		Companies		State		Exterior	
GDP	C		I	GDP	G		X	M
Wages		SAL	SAL					
Taxes	T					T		
Financing	S			END	D			B

Households draw their income from wages alone (SAL).They use them to consume (C), to pay taxes (T) and save the remainder (S). Uses are equal to resources: SAL = C + T + S.

Companies realise added value (GDP) and complete this resource by indebtedness (IND). On the uses side, they pay wages to households (SAL) and invest (I): GDP + IND = I + SAL.

The state collects taxes (T) and realises public expenditure (G). The difference between the two is the budgetary balance (D): D = T – G.

The balance of trade describes the trade relations of the country, namely its exports (X) and its imports (M), the difference representing the trade balance (B): B = X – M.

As this accounting context is completely balanced, the line called "financing" is self-evident. We obtain then this fundamental accounting equality:

$$D = (S - IND) - B$$

where:

(S – IND) – represents the net savings of the private sector comprising households and companies. D is the budgetary balance (positive in case of surplus),

D – represents then the public financing need. B is the trade balance (positive in case of surplus),

B – corresponds then to capital inflows.

Hence the relation can be summed up as follows:

public financing need = private savings + capital inflows.

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