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Hana Lipovská[1]

Joseph E. Stiglitz: Euro – How a Common Currency Threatens the Future of Europe

Book Review

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In his lecture on the occasion of being awarded the Nobel Prize for Economics for year 2001, Stiglitz spoke out vigorously against the classical economics based on a limited impact of government and markets functioning without government interventions. We do not see the invisible hand of the market, he remarked, because either it 'simply doesn't exist' or 'at least [...] it is palsied' (Stiglitz 2001). In the basic dichotomy between *free market* and *state interventions*, Stiglitz stands as a strong critic of neoliberalism and is entirely on the side of state interventions.

This view also forms the essential character of his (so far) latest book *Euro – How a Common Currency Threatens the Future of Europe*. The monograph thus does not discuss the origin and development of euro, establishing the monetary union or monetary integration during the Great Recession but is primarily 'about economics and economic ideologies and their interactions with politics' (p. 42). For Stiglitz, the ideology against which he speaks out is the 'unwavering faith in markets' (p. 47), that is, **neoliberalism** or market fundamentalism (both terms are virtually used as synonyms). For Stiglitz, as an American economist, the common European currency is only an academic opportunity to speak out against the individual aspects of neoliberalism, based on a specific and rather dramatic European case.

The book is divided into four parts. The first part (Europe in Crisis) describes the theoretical expectations for the common currency and essential arguments in favour of its adoption; in the third chapter, he provides a concise overview of the development of the eurozone's basic economic markers in comparison to the development of (predominantly) the American economy. In the second part (Flawed from the Start), he explains the conditions under which euro could work. He emphasises that despite the expectations, or rather wishes, of the founders of the monetary union, euro did not lead to higher and more profound integration, but, on the contrary, it contributed to numerous divergences. The last chapter of the second part is devoted to the criticism of European Central Bank's currency policy. The third part (Misconceived Policies) criticises the crisis programmes proposed by the 'Troika' (European Central Bank, European Commission, International Monetary Fund) during the Greek economic crisis. In the final fourth section (A Way Forward?), he outlines three possible ways of solving the problems of the eurozone. The first (and, in Stiglitz's opinion, the most suitable) way is implementing his proposal of the seven structural reforms of the eurozone. The second option is an 'amicable divorce', illustrated by Greece or Germany leaving the monetary union. Finally, the third option is his concept of the so-called 'flexible euro'.

Throughout the monograph Stiglitz keeps emphasising that **euro is not an economical project**. He reminds that euro 'was a political project, and in the case of any political project, politics matters'. (p.41) and, consequently, it 'was not an end in itself but a means to broader ends' (p. 576). Allegedly, euro is like a bad marriage where it is not clear whether it should be saved (p. 88). Therefore, the European politicians must choose whether they want 'more Europe' or 'less' (p.50).

Stiglitz gradually uproots the three fundamental arguments that are in favour of euro despite its flaws. In his view, the 'influence of the united Europe on the world stage' is not to be accomplished by a deeper monetary integration but through consensus of the member states of the European Union. Contrary to the persisting beliefs, Stiglitz is convinced that there is not any proof that the use of common currency would reduce probability of conflicts. Therefore, he does not see any link between a deeper monetary integration and achieving peace. Eventually, he also disclaims the argument that euro will help to create European integrity. He does not find the economical argumentation in favour of the single currency compelling, because the savings in transaction costs are not significant enough to prevail over the costs of the crises (p. 131–132).

1 **Hana Lipovská**: Assistant, Faculty of Economics and Administration, Masaryk University. Email: lipovska.hana@seznam.cz

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In Stiglitz's opinion, the Great Recession after 2008 started a 'lost quarter-century', that is, the stagnation of the European economies. The eurozone will stay weaker than it would be if the crisis did not occur or was better managed (p. 159). The external observable reason is the weak economic growth of the eurozone (compared, e.g. to the United States). Stiglitz reminds that since the creation of eurozone in 1999, its overall growth is not increasing; it is still below the growth trend of the gross domestic product before the creation of euro and that this contrast is getting even greater. However, there is nothing about the structure of economies of the eurozone's member states that would prevent growth.

In the spirit of Mundell's **theory of Optimum Currency Area**, Stiglitz explains which adjustment mechanisms enable the currency area in the United States to work. Unlike the United States, the eurozone does not meet the migration requirement, because it does not have one common language, one common social security system and one common health insurance. Whilst the exodus of the inhabitants of one American state into another does not cause serious problems, the depopulation of Greece after the unemployed Greeks left for work to the northern and western European states is already a problem. Also, unlike the United States, the eurozone does not have a common budget; therefore, the states affected by the crisis cannot expect financial support from the centre. Another advantage of dollar over euro is the existence of *Federal Deposit Insurance Corporation* and also the American banking system itself. Allegedly, a free movement of workforce or capital cannot function without a common deposit insurance and sharing the debts. Thus Stiglitz paradoxically suggests bringing the eurozone closer to the US system, that is, the **system in which the last economical crisis emerged**. Actually, according to some studies, the United States is not an optimum currency area either (e.g. Kouparitsas 2001).

In accordance with Stiglitz's Neo-Keynesian beliefs, the main culprit of the eurozone's failure is **neoliberalism**. In his opinion, the market fundamentalists believe that 'if only the government would ensure that inflation was low and stable, markets would ensure growth and prosperity for all' (p. 48). Stiglitz believes that this idea had became obsolete long ago, but in Germany, the leading economy of the European integration, it survived until the crisis. Moreover, neoliberalism is allegedly strongest in finance ministries and central banks and weakest in labour and education ministries (p. 82), so it 'let [the founders of the euro] astray' (p. 207). He only regards it as a sort of modern religion, because the markets by themselves 'can't do the adjustments necessary to ensure full employment and external balance' (p. 252). When creating a single currency area, he adds, full employment in all the member countries, macroeconomical stability and trade equilibrium are crucial.

Stiglitz's criticism of neoliberalism is famous, yet it does not change the fact that neoliberalism does not exist as a single economic direction, school or way of thinking. Neoliberalism is a mere label used by the left-wing for Thatcher's or Reagan's policies (e.g. Auerbach 2006). Similar to the other critics of free market and laissez-faire, Stiglitz blames the market ('neoliberalism', in his vocabulary) for the failures that are actually the failures of governments and consequences to state interventions. However, it is the governments who should have wider role in the economy (p. 78).

The statement 'blame the victim', which is repeated several times, suggests that apart from the 'market – state intervention' line the monograph also follows the '**Germany – Greece**' line. Whilst the author praises Janis Varoufakis, the Greece minister of finance, as an excellent economist, he strongly criticises the conception of the 'Swabian housewife' by Angela Merkel. In fact, he considers a relative success of Germany within the eurozone as a failure: the average annual rate of 0.8% p.a. would have been 'under normal conditions [...] described as near-stagnation' (p. 165) and the German economy should be evaluated based on its absolute results, the grade would be 'perhaps D-' (p. 189). The German growth is based on trade surplus, which other states cannot achieve: if the trade equilibrium of the eurozone as a whole is balanced, Germany's surplus must mean trade deficits of the other economies. In the spirit of the Keynesian thinking, he sees surpluses as a more serious problem than deficits because they contribute to the deficit of the global demand. Therefore, he blames German surplus with Spain or Ireland, which resulted in more divergence of the European states, for the global secular stagnation after the Great Recession. After the creation of the eurozone (and eliminating the exchange-rate risk), the markets (which are failing in Stiglitz's opinion) underestimated the risk associated with the national debt. The low interest rates thus helped to blow up the real estate bubble – for example, more homes were constructed in Spain than in France, Germany and Ireland combined (p. 262).

If euro did not exist, Greece could easily devaluate its drachma, thus supporting exports and limiting imports and, consequently, increasing the economical growth. In the monetary union, Greece could only follow the way of internal devaluation, that is, lowering wages and salaries. However, Stiglitz remarks that the competitiveness of the southern part of the eurozone could be secured by weakening euro because of rise in German wages and prices (p. 67). However, Germany not only did not increase the wages but even 'enact[ed] policies that lowered wages' (p. 116). However, Stiglitz does not provide any supporting evidence for this strong statement

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– and we are not aware of any concrete legislative norm enacting lowering the wages. In Stiglitz's opinion, the alleged competitive devaluation in the form of lowering the wages is just another form of 'beggar-thy-neighbour' policies (p. 115).

Stiglitz is characteristic for his **criticism of the Troika**. As the chief economist of the World Bank, he became a famous critic of the Bretton-Wood institutions. He criticised and still criticises the anti-crisis packages of the International Monetary Fund during the East Asian crisis as well as the new anti-crisis packages for Greece. He emphasises that IMF 'masquerades its "demands" as simply "proposals"', even though Greece actually does not have any other choice but to accede to them (p. 394). In his opinion, the Troika's packages do not help Greece but are only mechanisms to ensure that debtors pay and the creditors get their money back (p. 403). He finds another parallel between the Greek and East Asian crises in the fact that Greece does not have control over the rotary presses 'printing' the currency in which it is indebted. Just as the developing countries were indebted in dollars in 1997, Greece is now indebted in euros. The moment Greece ceased to be able to meet its obligations the eurozone authorities have become 'credit collection agencies' and Greece began to lose its sovereignty (p. 268).

Using many examples, he demonstrates that during recession, Troika preferred particular interests of the western economies (and their selected businesses) over the interests of Greece. Thus the focus was, for example, on the definition of 'fresh milk', right size of a loaf of bread, parameters of running apharmacy and other items of a seemingly irrelevant agenda, which, however, made it easier for certain groups to enter the Greek market. Primarily, the reforms helped the foreign countries by increasing the income of the multinational corporations (p. 482). Likewise, the ordered privatisation was, in Stiglitz's opinion, convenient to the regional German governments (p. 427).

Apart from the Troika, the **European Central Bank** and monetary policies, in general, are also subject to Stiglitz's criticism. He criticises the structural flaws of ECB, its mandate (fighting inflation) and inefficient allocation of resources in the market economy. In a quite innovative manner, he identifies the reason of the problems as not enough independence of the central banks on the government, but, on the contrary, the fact that 'Europe has taken this[independence] to an extreme', (p. 351) and that the central bankers are captured by the financial sector, to which they continue to return (p.352). In accordance with his criticism of neoliberalism, he does not agree with a traditional argument that independence is necessary for the fight against inflation. The anti-inflation monetary policy is allegedly a manifestation of a distrust of democracy, because fighting inflation by monetary policy is not a purely technocratic matter (p. 362). According to Stiglitz's teachings, inflation is not a major economic issue (in particular, because of the cheap imports from China): the only issues are growth and employment. Thus he suggests that ECB adopts a dual mandate (similar to the Federal Reserve) and starts using a different portfolio of instruments. As a traditional critic of Milton Friedman, Stiglitz unsurprisingly continues by criticising monetarism, which, in his view, never was a real theory (p.373), but he also criticises inflation targeting and even quantitative easing.

During the crisis, the monetary policy was also associated with unconventional **fiscal policies**. For the governments, saving the banks was primarily a bootstrap operation (p. 435): banks lent the government money by buying government bonds and the government guaranteed the banks, allowing them to get access to money from markets at lower rates – and to be able to lend some of that money to the governments. Given the Greek government's indebtedness to the German and French banks, the rescue packages were adopted primarily in order to rescue these banks but with a motto of 'helping Greece'. On the contrary, Stiglitz's statement '*One shouldn't feel too sorry for the private sector creditors: typically they have been well compensated for their risk*' (p. 446) is nonsensical. As the creditors, the banks also function as financial intermediaries and their punishing will thus primarily affect the ordinary small savers. Thus Stiglitz, as an enemy of commercial banks and bankers, completely disregards the interests of households.

He also sees the problem in **three types of divergence.** He identifies the first divergence in relation to the movement of workforce. He correctly points out that a rational individual decides based on the taxed salary, which, however, does not depend only on the marginal productivity but also on the tax system. With a homogeneous marginal productivity, we should observe migration (of qualified workers in particular) from the highly indebted countries to the less indebted countries. The consequence to such migration is the increased tax burden on those who stayed in the country (p. 304). In Stiglitz's view, the solution is the introduction of a very controversial instrument: Eurobonds, a common obligation, which would allow the countries affected by the crisis to reduce the cost of debt servicing and thus reduce taxes. Expansive fiscal policy would, at the same time, increase their income and restore growth. This concept is purely Keynesian (in the spirit of balanced budget multiplier) but also very controversial because of the risks of moral hazard and information asymmetry associated with the potential Eurobonds. According to Stiglitz, another divergence is the divergence of public investments, where the wealthy countries can invest (e.g. in the infrastructure) more than the poor countries. He sees the solution in more support to the development banks. The third divergence is the technological divergence, which has its roots in failure of the markets. He intends to prevent this via industrial policies (and thus an increasing level of state intervention in the economy).

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As a part of his fiscal measures, Stiglitz also suggests imposing a carbon tax, because the climate change is, in his opinion, the most serious market failure of these days, and also a luxury tax, which would allegedly affect imports in particular (p. 422). This tax is thus a hidden equivalent of the customs (which Stiglitz does not admit) and, therefore, a continuation of the trade war (which he criticises in the book) only by different means.

The focus of Stiglitz's monograph can be summarised in the seven points of his **structural reform**. Under the 'more Europe' motto, he prescribes to the sick eurozone a bank union, Eurobonds and a common framework for stability (i.e. automatic stabilisers on a pan-European level, new budget rules or solidarity fund for stabilisation). He also asks for a convergence policies by which he means 'fighting the current account deficits' and expansive wage and fiscal policies in the surplus countries (these should increase wages and strengthen the rights of the employees in the collective negotiations). Macroeconomic support of the full employment and growth is to be achieved primarily by changing the ECB's mandate and by promoting environmental investments to ensure environmentally sustainable growth. The last point of his programme is the commitment to shared prosperity by which he means fighting against 'the race to the bottom' or the political integration through the tax system (p. 561).

It is clear that from the three alternatives outlined in the final part of the book (structural reform, amicable 'divorce' and flexible euro), Stiglitz considers the structural reform as the only right path. He describes the other two strategies only superficially and, to a large extent, one sidedly.

Stiglitz's monograph is a remarkable mixture of quality economical and political–economical observations reflecting the author's experience and, above all, his thorough personal knowledge of the background of the crisis games and players and his considerably one-sided criticism of the free market and the set of economical principles, which he labels with a pejorative name 'neoliberalism'. This imbalance and ideological bias harm the otherwise good monograph. We can unanimously agree with his strong conclusion that euro is only a 17-year-old, poorly designed experiment, which is a threat to the future of Europe. However, we can hardly identify with his hostile attacks on the market and market economy.

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