Going Forward from B to A? Proposals for the Eurozone Crisis. The Introduction of "Fiscal Currencies"

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After reviewing the main determinants of the current eurozone crisis, this paper discusses the feasibility of introducing fiscal currencies as a way to restore fiscal space in peripheral countries, like Greece, that have so far adopted austerity measures in order to abide by their commitments to eurozone institutions and the International Monetary Fund. We show that the introduction of fiscal currencies would speed up the recovery, without violating the rules of eurozone treaties.

At the same time, these processes could help transition the euro from its current status as the single currency to the status of "common clearing currency," along the lines proposed by John Maynard Keynes at Bretton Woods as a system of international monetary payments. Eurozone countries could therefore move from "Plan B," aimed at addressing member-state domestic problems, to a "Plan A" for a better European monetary system.

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An increasing number of economists and commentators believe that the current (spring 2016) economic policy path that some eurozone countries are following will undermine the rules of the European Monetary Union (EMU) originally put in place in the Maastricht Treaty in 1992 (subsequently modified in 2007 by the Lisbon Treaty, and in 2011 with the "Sixpack") and eventually lead to either the collapse of the European cohesion or a period of prolonged stagnation.

The rules of the EMU structure were based on two assumptions, both of which have proven to be untenable. The first was the belief in a smooth transition from simple agreements among different national states to a federation, creating the "United States of Europe,"[1] which would not only complete the institution of a common market, but also share the same constitution, thereby ensuring common rights for the "European citizen," with a common foreign policy, an integrated fiscal system, and a common currency. Had this belief been realized and accomplished smoothly with the approval of the population of each member state, then the currently missing institutional mechanism of a unified fiscal structure large enough to be an automatic stabilizer facilitating federal fiscal transfers to member states at times of need would have made the eurozone sustainable. This process was, however, stopped by the ill-conceived proposal for a European Constitution, which, albeit ratified by several member states, was rejected by the French and Dutch voters in 2005, de facto halting any further attempts to put the United States of Europe project on strong foundations.

The second assumption inspiring the logic of the Maastricht Treaty, and its subsequent modifications, was based on the ordo-liberal economic dogma that prevailed then and continues to this day, mainly by Germany's dictum. It asserts that markets: would self-adjust towards full employment; the central bank would be independent from governments and be concerned only with price stability; and national governments would be responsible for fiscal policy subject to the Treaties' guidelines; guarantee property rights; and smooth the functioning of markets irrespective of the asymmetries in their real economies. This (German) logic inspired the 1 The "Ventotene Manifesto" is believed to be one of the major sources of inspiration for a plan towards a federation of European countries; see Spinelli and Rossi (1941). 3 structure of the ECB, avoiding the possibility of acting as lender of last resort to governments when needed; it also inspired the limits to government deficits and debts codified in the Maastricht Treaty, which were made even more stringent in the Sixpack.

In the public debate that ended with the signing of the treaties, it became clear that the adoption of a single currency would mean the renunciation of domestic authorities having any role in the formulation of monetary and exchange-rate policies. This, in the face of asymmetric shocks, would imply divergence and crisis handling among member states in accordance with their underlying real economies. To spur growth in regions lagging behind, a system of fiscal transfers—the Structural Funds and the Cohesion Fund—was therefore established. Moreover, some provisions were later included in the treaties to force countries to take corrective actions, reversing their surplus positions whenever their current account balance exceeded a given threshold relative to their GDP. The mechanism of fiscal transfers, however, is insufficiently funded to act as an automatic stabilizer at the level experienced in the US (with a sufficiently large federal budget in the order of 15 percent), while the requirement for surplus-reversing— introduced only in 2011 as part of the "Macroeconomic Imbalance Procedure"—has not been applied thus far, given the large external surpluses of Germany and other countries of the European North.

The euro's faulty architecture was thus well-known before its implementation started (Papadimitriou and Wray 2010, 2012).[2] In a prescient contribution, Godley (1992) wrote:

> […]if all these functions are renounced by individual governments they simply have to be taken on by some other authority. The incredible lacuna in the Maastricht programme is that, while it contains a blueprint for the establishment and modus operandi of an independent central bank, there is no blueprint whatever of the analogue, in Community terms, of a central government.

The paper is structured as follows. In the next section, we briefly review the historical evolution of the imbalances that led to the prolonged stagnation of the eurozone periphery and the outright 2 On the other hand, there was a hope that countries not satisfying the requirements for an optimal currency area would converge to such requirements once the common currency had been adopted; see Frankel and Rose (1998), among others. crisis (which dominated in Greece) that has stimulated a debate on how to reform the eurozone institutions—a plan commonly referred as "Plan A," or "Plan B" —focusing instead on implementing domestic policies that do not necessarily terminate the current Eurozone agreements. There is also the option of which countries in deep crisis, such as Greece, may very well choose to abandon the euro, possibly precipitating the collapse of the Eurozone monetary system. In this paper, we will not investigate this possibility. Instead, in the third section, we present a proposal, based on Papadimitriou (2016) and Papadimitriou, Nikiforos, and Zezza (2014, 2015a, 2016), for the introduction of a domestic fiscal currency compatible with keeping the euro as legal currency. In the fourth section, we discuss how some simple changes in the functioning of the ECB Target2 system may lead the way to a more sustainable monetary architecture; in the final section, we offer our conclusions.

Notes

1. The "Ventotene Manifesto" is believed to be one of the major sources of inspiration for a plan towards a federation of European countries; see Spinelli and Rossi (1941).

2. On the other hand, there was a hope that countries not satisfying the requirements for an optimal currency area would converge to such requirements once the common currency had been adopted; see Frankel and Rose (1998), among others.

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