The European Monetary Crisis: No Exit in EU

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Peter Praet, Chief Economist of the European Central Bank, defended the ECB's policies at Levy Institute's annual Minsky meeting at the Ford Foundation this past week in New York. In his remarks, he retreaded the EU's wheels with the same rhetoric of inflation fighting and fiscal tightening that drove the EU off the road and into the ditch to begin with. The effect of his pronouncements of EU intentions was to only further reveal the growing gap between reality and ECB ideology over their inability to successfully address the euro crisis.

Europe risks becoming a real lived version of Jean Paul Sartre's No Exit in which its constituent countries are locked into a dysfunctional currency union for an eternity. Euro entry has been a Faustian bargain. There is presently no exit clause once joining except exiting the European Union itself. Entry promised membership into a rich club of nations in which Europe's southern periphery and former Soviet bloc areas to the east would converge with Europe's richest nations. The devil of membership, however, is in the details. Euro rules preclude a wholesale list of policies historically demonstrated to develop nations.

In short, the answer to the question of whether Europe's periphery is merely in purgatory or eternal damnation rests with whether Europe is willing to undertake a revision of the rules guiding the relationships among its constituent members. The European Central Bank understood the currency union would be complex, but their assumptions regarding rules that create economic development and stability have proven erroneous and mitigate against convergence and growth across Europe.

Among the faulty assumptions is that markets are the best arbiters of risk and worthy investments. This is enshrined in article 123 of Treaty on the Functioning of the European Union. At best, the rule was predicated on the idea that past monetary imprudence (think Zimbabwe or Weimar Germany) of some nations meant governments can't be trusted with monetary and fiscal independence. Not every country, however, is Zimbabwe with a dictator serving several decades, or a Weimar Germany saddled with inflation generating war reparation payments. By contrast, nations in the past, from Europe's richest, to East Asia Tigers, to the US have used domestic credit creation to fund infrastructure that enabled wealth creation beyond the costs of expenditure on that infrastructure.

The ideology and group think resident among central bankers, however, says "halt, you can still develop infrastructure, but you must be disciplined by the 'Father Knows Best' wisdom of the markets." This is highly problematic. First, it suggests there is something intrinsic to markets that always makes for better decisions than public sector managers. In effect, we are told that we must pay a fee (de facto tax) to private banks in the form of the higher prices they charge for credit over what states can as the price for the private sector's 'superior' capacities of decision making on investments.

Second, it ignores the evidence from recent decades revealing that private credit has become remarkably inefficient. Private finance is supposed to be a service enabling greater growth in the real economy of production and services. This argument made more sense in the Bretton Woods era following WW II until the 1970s when economic growth was strong and financial institutions comprised some 15% of corporate profits in the US. Yet, since the liberalization of finance from the 1970s, economic growth has continued to diminish in the West, meanwhile in the most liberalized 'finance gone wild' economies, like the US, finance now comprises some 40% of corporate profits. The bottom line is that deregulated capital markets in recent decades have taken an ever-increasing share of our economy, while producing less economic growth. Finance no longer enables economic growth by providing a needed service, but instead impose a massive rent seeking tax on the economy.

Lastly, it ignores the different metrics by which markets and states measure investment success. Private markets prefer a quick kill, with profits coming fast and furious. By contrast, states genuinely interested in development need to make infrastructural investments where the benefits accrue to the whole economy. Thus, the benefit, or profit, is harder to capture by a specific interest. Moreover, the time horizon on state investments may be unacceptably long for private investors.

In short, European Central Bank assumptions and European Union rules on monetary have locked Spain, Italy, Greece, Portugal, Ireland, the Baltics and former Soviet bloc countries into a kind of Sartrian "No Exit." Only a change in the rules that permit historically successful strategies for development will instead make this current crisis merely a painful purgatory stage rather than eternal economic damnation as a cost for being part of a European Union.

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