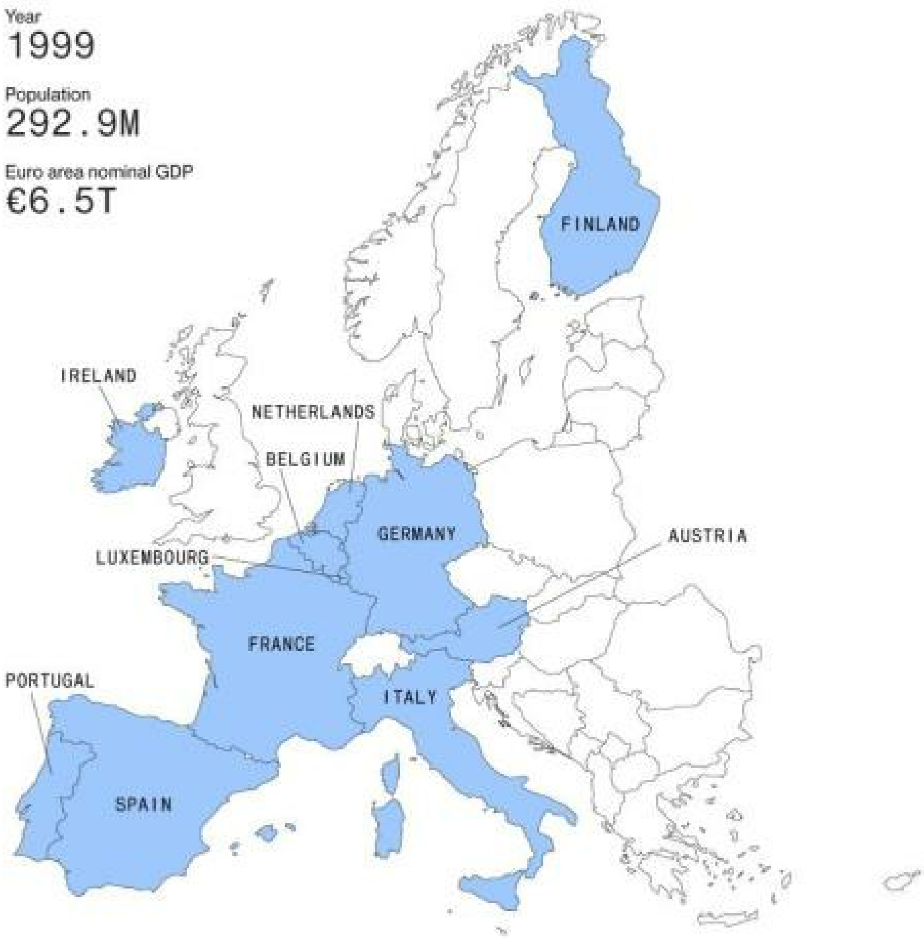
Michael Roberts Blog

20 years of the euro 1. Has it been a success?

January 1, 2019

Today is the 20th anniversary of the launch of the euro and the Eurozone single currency area. Starting with eleven members, two decades after its birth, membership has grown to 19 countries and the euro-area economy has swelled by 72% to 11.2 trillion euros ($12.8 trillion), second only to that of the US and positioning the European Union as a global force to be reckoned with.



The euro is now used daily by some 343 million Europeans. Outside Europe, a number of other territories also use the euro as their currency. And another 240 million people worldwide as of 2018 use currencies pegged to the euro. The euro is the second largest reserve currency as well as the second most traded currency in the world after the dollar. As of August 2018, with more than €1.2 trillion in circulation, the euro has one of the highest combined values of banknotes and coins in circulation in the world, having surpassed the US dollar.

That's one measure of success. But it is not the most important benchmark considered by its founders. The great European project that started after the WW2 had two aims: first, it was to ensure that there were never any more wars between European nations; and second, to make Europe an economic and political entity that could rival America and Japan in global capital. This project would be led by Franco-German capital. The euro project went further and aimed at integrating all European capitalist economies into one unit to compete with the US and Asia in world capitalism within a single market and with a rival currency to the dollar.

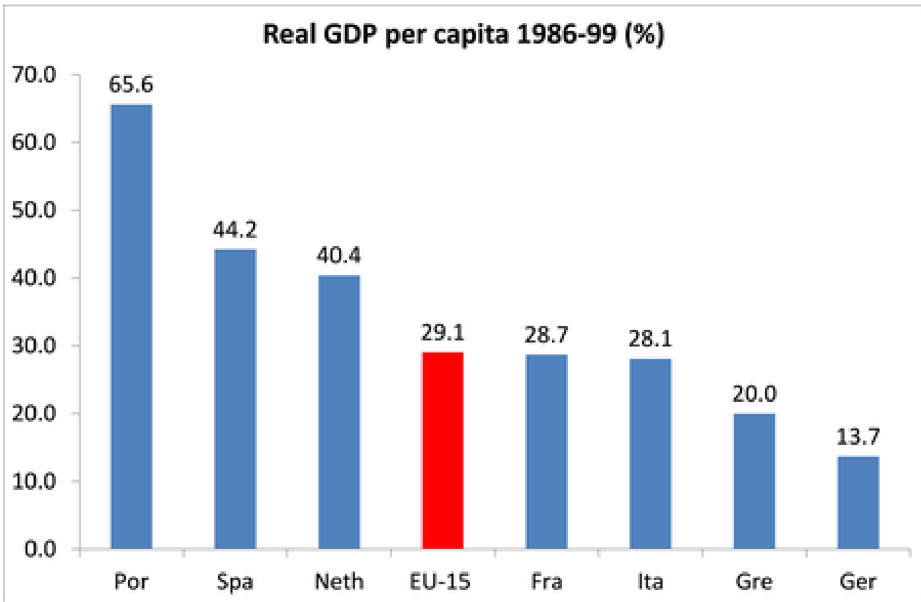
In part one, I'll consider whether the euro has been a success for capital in the participating states; and whether it has been good news for labour. In part two, I'll consider whether the euro will still be here in another 20 years.

How do we measure the success of a single currency area in economic terms? Mainstream economic theory starts with the concept of an Optimal Currency Area (OCA). The essence of OCA theory is that trade integration and a common currency will gradually lead to the convergence of GDP per head and labour productivity among participants.

The OCA says it makes sense for national economies to share a common monetary policy if they (1) have similarly timed business cycles and/or (2) have in place economic 'shock absorbers' such as fiscal transfers, labour mobility and flexible prices to adapt to any excessive fluctuations in the cycle. If (1) is true, then a one-size-fits-all monetary policy is possible. If (2) holds, then a national economy can be on a different business cycle with the rest of the currency union and still do okay inside it. Equilibrium can be established if there is 'wage flexibility', 'labour mobility' and automatic fiscal transfers.

The European Union has shown a degree of convergence. Common trade rules and the free movement of labour and capital between countries in the EU has led to 'convergence' among participants in the EU. Convergence on productivity levels has been as strong as in fully federal US, although convergence more or less stopped in the 1990s, once the single currency union started to be implemented.

So the move to a common market, customs union and eventually the political and economic structures of the EU has been a relative success. The EU-12/15 from the 1980s to 1999 managed to achieve a degree of harmonisation and convergence with the weaker capitalist economies growing faster than the stronger (graph below shows growth per capita 1986-99)..



But that was only up to the point of the start of EMU and preparations for it in the 1990s. The evidence for convergence since then has been much less convincing. On the contrary, the experience of EMU has been divergence.

The idea that 'free trade' is beneficial to all countries and to all classes is a 'sacred tenet' of mainstream economics. But it is a fallacious proposition based on the theory of comparative advantage: that if each country concentrated on producing goods or services where it has a 'comparative advantage' over others, then all would benefit. Trading between countries would balance and wages and employment would be maximised. But this is empirically untrue. Countries run huge trade deficits and surpluses for long periods; have recurring currency crises; and workers lose jobs from competition from abroad without getting new ones from more competitive sectors.

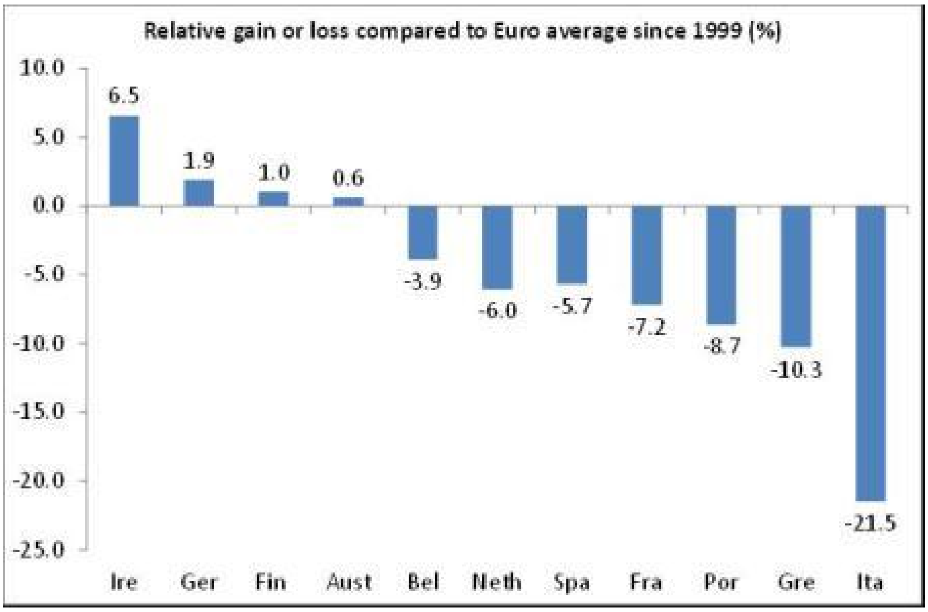
The Marxist theory of international trade is based on the law of value. In the Eurozone, Germany has a higher organic composition of capital (OCC) than Italy, because it's technologically more advanced. Thus in any trade between the two, value will be transferred from Italy to Germany. Italy could compensate for this by increasing the scale of its production/export to Germany to run a trade surplus with Germany. This is what China does. But Italy is not large enough to do this. So it transfers value to Germany and it still runs a deficit on total trade with Germany.

In this situation, Germany gains within the Eurozone at the expense of Italy. All other member states cannot scale up their production to surpass Germany, so unequal exchange is compounded across the EMU. On top of this, Germany runs a trade surplus with other states outside the EMU, which it can use to invest more capital abroad into the EMU deficit countries.

The Marxist theory of a currency union thus starts from the opposite position of neoclassical mainstream OCA theory. Capitalism is an economic system that combines labour and capital, but unevenly. The centripetal forces of combined accumulation and trade are often more than countered by the centrifugal forces of development and unequal flows of value. There is no tendency to equilibrium in trade and production cycles under capitalism. So fiscal, wage or price adjustments will not restore equilibrium and anyway may have to be so huge as to be socially impossible without breaking up the currency union.

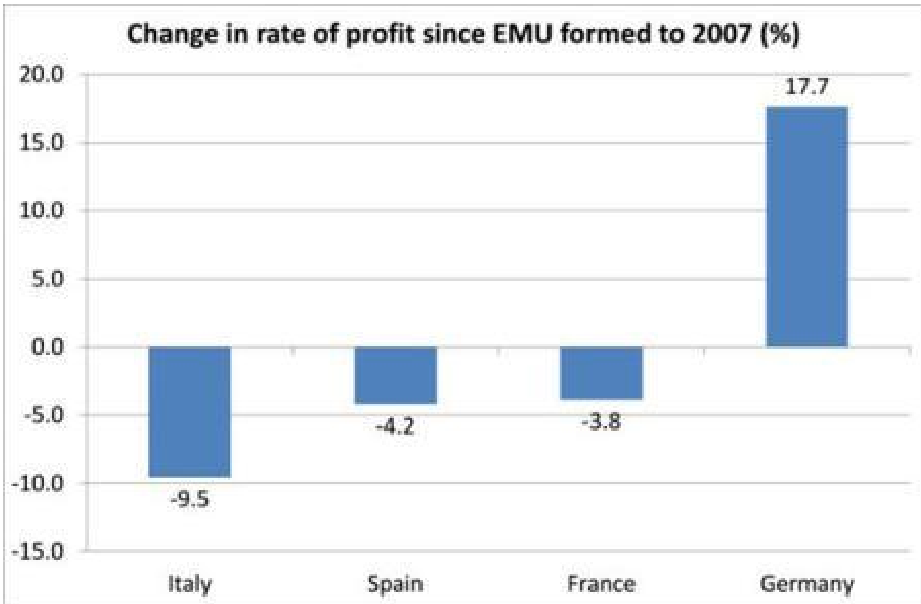
The EU leaders had set convergence criteria for joining the euro that were only monetary (interest rates and inflation) and fiscal (budget deficits and debt). There were no convergence criteria for productivity levels, GDP growth, investment or employment. Why? Because those were areas for the free movement of capital (and labour) and where capitalist production must be kept free of interference or direction by the state. After all, the EU project is a capitalist one.

This explains why the core countries of EMU diverged from the periphery. With a single currency, the value differentials between the weaker states (lower OCC) and the stronger (higher OCC) were exposed with no option to compensate by the devaluation of any national currency or by scaling up overall production. So the weaker capitalist economies (in southern Europe) within the euro area lost ground to the stronger (in the north). The graph below shows how each member state has fared in growth relative to the Eurozone average.



Franco-German capital expanded into the south and east to take advantage of cheap labour there, while exporting outside the euro area with a relatively competitive currency. The weaker EMU states built up trade deficits with the northern states and were flooded with northern capital that created property and financial booms out of line with growth in the productive sectors of the south.

Even so, none of this would have caused a crisis in the single currency union had it not been for a significant change in global capitalism: the sharp decline in the profitability of capital in the major EU states (as elsewhere) after the end of the Golden Age of post-war expansion. This led to fall in investment growth, productivity and trade divergence. European capital, following the model of the Anglo-Saxon economies, adopted neo-liberal policies: anti trade union laws, deregulation of labour and financial markets, cuts in public spending and corporate tax, free movement of capital and privatisations. The aim was to boost profitability. This succeeded somewhat for the more advanced EU states of the north, but less so for the south.



Then came the global financial crash and the Great Recession. This exposed the fault-lines in the single currency area.

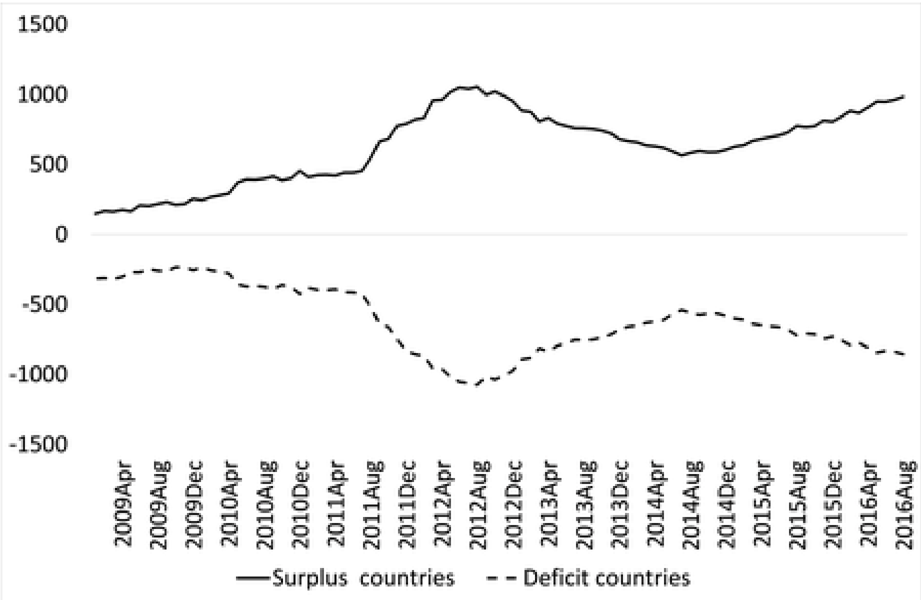
thenextrecession.wordpress.com/2019/01/02/the-euro-part-two-will-it-survive-another-20-years

The euro – 2. Will it survive another 20 years?

January 2, 2019

In part two of my analysis of the euro currency, I consider the impact of the global slump of 2008-9 and the ensuing euro debt crisis on prospects for the euro.

The global slump dramatically increased the divergent forces within the euro. The fragmentation of capital flows between the strong and weak Eurozone states exploded. The capitalist sectors of the richer economies like Germany stopped lending directly to the weaker capitalist sectors in Greece and Slovenia, etc. As a result, in order to maintain a single currency for all, the official monetary authority, the ECB, and the national central banks had to provide the loans instead. The Eurosystem's 'Target 2' settlement figures between the national central banks revealed this huge divergence within the Eurozone.



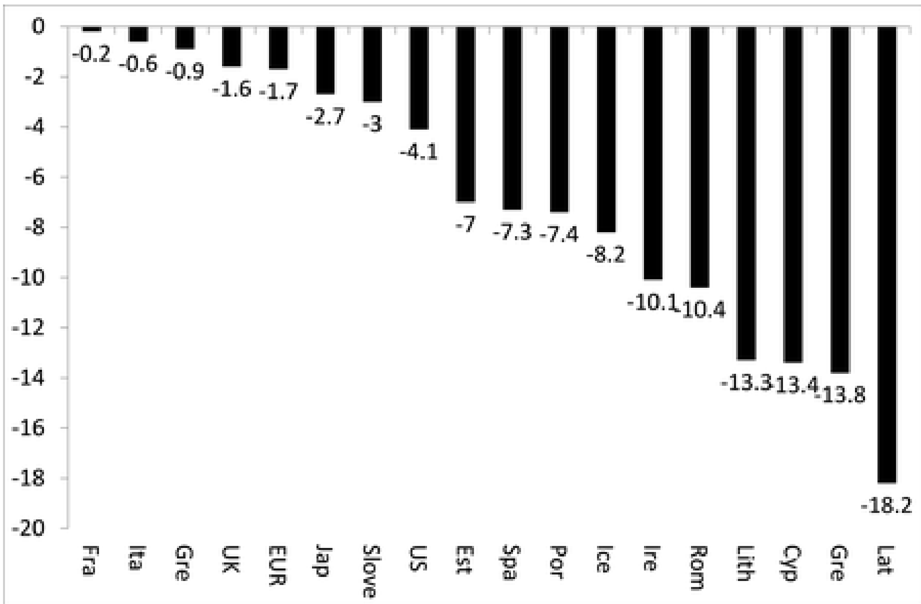
The imposition of austerity measures by the Franco-German EU leadership on the 'distressed' countries during the crisis was the result of the 'halfway house' of euro criteria. There was no full fiscal union (tax harmonisation and automatic transfer of revenues to those national economies with deficits); there was no automatic injection of credit to cover capital flight and trade deficits (federal banking); and there was no banking union with EU-wide regulation and weak banks could be helped by stronger ones. These conditions were the norm in full federal unions like the United States or the United Kingdom. Instead, in the Eurozone, everything had to be agreed by tortuous negotiation among the Euro states.

In this halfway house, Franco-German capital was not prepared to pay for the 'excesses' of the weaker capitalist states. Thus any bailout programmes were combined with 'austerity' for those countries to make the people of the distressed states pay with cuts in welfare, pensions and real wages, and to repay (virtually in full) their creditors (the banks of France and Germany and the UK). The debt owed to the Franco-German banks was transferred to the EU state institutions and the IMF – in the case of Greece, probably in perpetuity.

The ECB, the EU Commission, and the governments of the Eurozone proclaimed that austerity was the only way Europe was to escape from the Great Recession. Austerity in the public spending could force convergence on fiscal accounts too (123118-euroeconomicanalyst-weekly). But the real aim of austerity was to achieve a sharp fall in real wages and cuts in corporate taxes and thus raise the share of profit and profitability of capital. Indeed, after a decade of austerity, very little progress has been achieved in meeting the fiscal targets (particularly in reducing debt ratios); and, more important, in reducing the imbalances within the Eurozone on labour costs or external trade to make the weaker more 'competitive'.

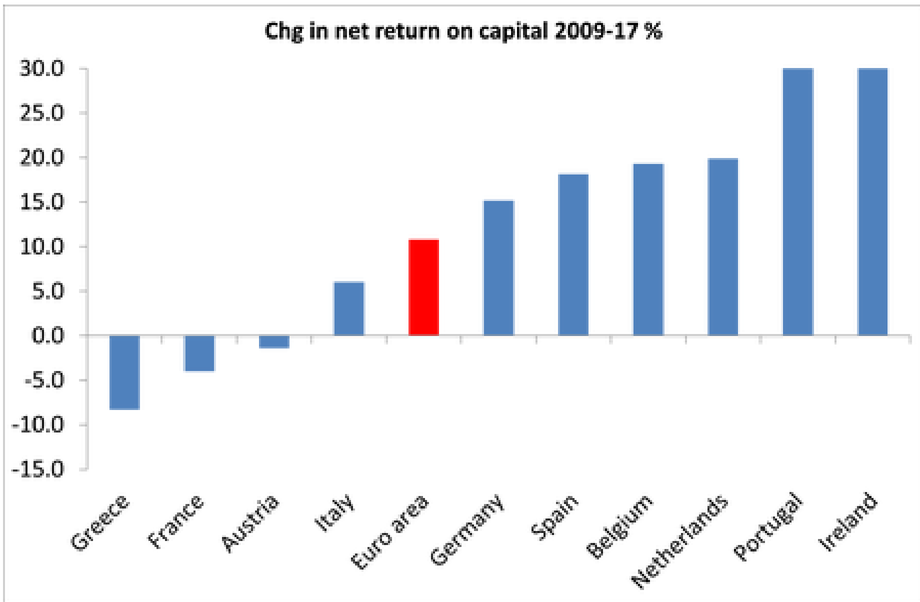
The adjusted wage share in national income, defined here as compensation per employee as percentage of GDP at factor cost per person employed, is the cost to the capitalist economy of employing the workforce (wages and benefits) as a percentage of the new value created each year. Every capitalist economy had managed to reduce labour's share of the new value created since 2009. Labour has been paying for this crisis everywhere.

Reduction in labour's share of new value added 2009-15 (%)



Source: AMECO, author's calculations

The evidence shows that those EU states that got a quicker recovery in their profitability of capital were able to recover from the euro crisis (Germany, Netherlands, Ireland etc) faster, while those that did not improve profitability stayed deep in depression (Greece).



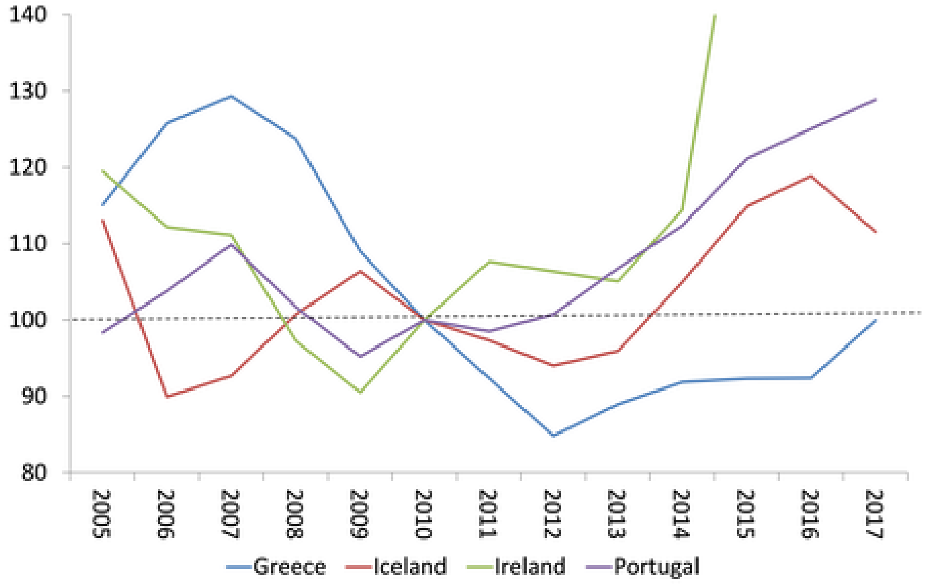
One of the striking contributions to the fall in labour's share of new value has been from emigration. This was one of the OCA criteria for convergence during crises and it has become an important contributor in reducing costs for the capitalist sector in the larger economies like Spain (and smaller ones like Ireland). Before the crisis, Spain was the largest recipient of immigrants to its workforce: from Latin America, Portugal, and North Africa. Now there is net emigration even with these areas.

Keynesians blame the crisis in the Eurozone on the rigidity of the single-currency area and on the strident 'austerity' policies of the leaders of the Eurozone, like Germany. But the euro crisis is only partly a result of the policies of austerity. Austerity was pursued, not only by the EU institutions, but also by states outside the Eurozone like the UK. Alternative Keynesian policies of fiscal stimulus and/or devaluation where applied have done little to end the slump and still made households suffer income losses. Austerity means a loss of jobs and services and *nominal* and real income. Keynesian policies mean a loss of *real* income through higher prices, a falling currency, and eventually rising interest rates.

Take Iceland, a tiny country outside the EU, let alone the Eurozone. It adopted the Keynesian policy of devaluation of the currency, a policy not available to the member states of the Eurozone. But it still meant a 40% decline in average *real* incomes in euro terms and nearly 20% in krona terms since 2007. Indeed, in 2015 Icelandic real wages were still below where they were in 2005, ten years earlier, while real wages in the 'distressed' EMU states of Ireland and Portugal have recovered.

Iceland's rate of profit plummeted from 2005 and eventually the island's property boom burst and along with it the banks collapsed in 2008–09. Devaluation of the currency started in 2008, but profitability up to 2012 remained well under the peak level of 2004. Profitability of capital in Iceland has now recovered but EMU distressed 'austerity' states, Portugal and Ireland, have actually done better and even Greek profitability has shown some revival.

Net return on capital for Iceland and Greece (2005=100)



Source: AMECO

Those arguing for exiting the euro as a solution to the Eurozone crisis hold that resorting to competitive devaluation would improve exports, production, wages, and profits. But suppose Italy exits the euro and reverts to the lira while Germany keeps the euro. Under the assumption that there are international production prices, if Italy produces with a lower technology level than that used by the German producer, there is a loss of value from the Italian to the German producer. Now if Italy devalues its currency by half, the German importer can buy twice as much of Italy's exports but the Italian importers can still only buy the same (or less) amount of German exports. Sure, in lira terms, there is no loss of profit, but in international production value terms (euro), there is a loss. The fall in the value rate of profit is hidden by the improvement in the money (lira) rate of profit.

In sum, if Italy devalues its currency, its exporters may improve their sales and their money rate of profit. Overall employment and investments might also improve for a while. But there is a loss of value inherent in competitive devaluation. Inflation of imported consumption goods will lead to a fall in real wages. And the average rate of profit will eventually worsen with the concomitant danger of a domestic crisis in investment and production. Such are the consequences of devaluation of the currency.

The political forces that wish to break with the euro or refuse to join it have expanded electorally in many Eurozone countries. This year's EU elections could see 'populist' euro-sceptic parties take 25% of the vote and hold the balance of power in some states like Austria, Poland and Italy. And yet, the euro remains popular with the majority. Indeed, sentiment has improved in 13 member states since they joined, with double-digit bumps in Austria, Finland, Germany and Portugal. Even in Italy, which has witnessed a roughly 25-point decline, around 60% of people still favour sharing a currency with their neighbours. Greeks are still 65% in favour. What this tells me is that working people in even the weaker Eurozone states reckon 'going it alone' outside the EU would be worse than being inside – and they are probably right.

Ultimately, whether the euro will survive in the next 20 years is a political issue. Will the people of southern Europe continue to endure more years of austerity, creating a whole 'lost generation' of unemployed young people, as has already happened in? Actually, the future of the euro will probably be decided not by the populists in the weaker states but by the majority view of the strategists of capital in the stronger economies. Will the governments of northern Europe eventually decide to ditch the likes of Italy, Spain, Greece etc and form a strong 'NorEuro' around Germany, Benelux and Poland? There is already an informal 'Hanseatic league' alliance being developed.

The EU leaders and strategists of capital need fast economic growth to return soon or further political explosions are likely. But as we go into 2019, the Eurozone economies are slowing down (as are the US and the UK). it may not be too long before the world economy drops into another slump. Then all bets are off on the survival of the euro.