

SYMPOSIUM

THE EUROPEAN ECONOMIC AND MONETARY UNION

The Papers

J. A. Kregel

Currency Stabilization through Full Employment: Can EMU Combine Price Stability with Employment and Income Growth?

John Smithin

Money and National Sovereignty in the Global Economy

Alain Parguez

The Expected Failure of the European Economic and Monetary Union: A False Money Against the Real Economy

**Charles A. E. Goodhart
and Jan J. G. Lemmen**

Credit Risks and European Government Bond Markets: A Panel Data Econometric Analysis

Invited Comment

Peter B. Kenen

The Outlook for EMU

Introduction

Mathew Forstater

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On January 1 of this year, the Euro was launched. Although actual notes and coins denominated in Euro will not begin circulating until January 1, 2002, the exchange rates between the currencies of the eleven participating countries (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain) and the Euro have been irrevocably fixed, so that their currencies for practical purposes stand in a relation much like nickels, dimes, and quarters

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do to the dollar in the U.S. In anticipation of this event, eminent monetary economists (representing France, Italy, and the U.K., as well as Canada) were invited to participate in a Roundtable on the topic at the 1998 Eastern Economic Association annual meetings. The papers from the panel are now presented here, along with an invited comment from Peter B. Kenen.

Taken as a set, the papers are frankly pessimistic about the Euro. This pessimism is rooted in a rejection of the underlying theoretical basis of the plan, which Alain Parguez refers to in his paper as "Euro-economics." Euro-economics is first and foremost pre-Keynesian in its basic outlook and assumptions. Inflation is clearly Public Enemy No. 1 (if not the only public enemy recognized), and the principles of "sound finance" rule the day (with strict limits on deficit-GDP and debt-GDP ratios). The papers thus express a natural concern about the ability of member countries to respond effectively to deficiencies in aggregate demand and conditions of unacceptably high unemployment with its negative effects on human welfare.

But there is a more fundamental, albeit related, issue. Even if there were no imposed limits on countries' deficits and national debts, the structure of the EMU makes it nearly impossible for a country to enact a counter-cyclical fiscal policy even if there were the political will. This is because, by giving up their national monetary sovereignty, countries are no longer able to coordinate their fiscal and monetary policy, essential for a comprehensive and effective remedy to periodic demand crises. Why would countries voluntarily sacrifice the ability to conduct a coordinated macroeconomic policy, especially at a time when official unemployment rates are in double digits and there are clear deflationary pressures? The papers suggest that the answer can be found, again, in Euro-economics (and perhaps more than a bit of Euro-politics).

As one of the contributors has pointed out elsewhere, most of the analytical work on the Euro has been conducted within the Optimal Currency Area paradigm, itself rooted in a Mengerian/metallist/monetarist view of the origins, nature, and evolution of money [Goodhart, 1998]. Very different conclusions concerning the Euro are reached when seen from the perspective of an alternative, "Cartalist" (or Chartalist) view that money is a creature of the state. The state has the power not only to tax, but to designate what will suffice to retire tax (and other) obligations to the state, that is, what it will accept at its pay offices. By determining public receivability, the state can create a demand for otherwise worthless pieces of paper, leading to general acceptability. The state can issue this currency, and use it to purchase goods and services from the private sector. Thus, a variety of state powers, such as government's ability to tax, declare public receivability, create and destroy money, buy and sell bonds, and administer the prices it pays for goods and services purchased from the private sector, constitute a menu of instruments through which macroeconomic policy may be conducted based on the principles of functional finance [Lerner, 1943; 1947; Mosler, 1997-98; Forstater, 1999; Wray, 1999]. Under such a system, national budgets may be freely utilized as means to promote full employment, price stability, and other macroeconomic goals.

But such a system is predicated on a one-to-one correspondence between money and the state—"One Nation, One Money"—and only with such a strict correspondence does government debt become truly riskless, enabling the state to buy anything for sale—and, indeed, settle any obligation—in terms of the money of account. There may of course be real economic constraints (those imposed by resources and technology), and, as is only too well-known, political constraints, but there are no financial constraints under such a system. When nations forfeit their monetary sovereignty and the one-to-one correspondence is severed, however, as is the case under the present arrangements of the EMU, they do face financial constraints. Nations become, in effect, like U.S. states, subject to fiscal discipline and in danger of default. The analogy with a private firm or household—a false analogy under a state money system—becomes appropriate, as governments now have to finance their spending, and suffer over their budgets.

Under the EMU, if investors are at all hesitant about any one member's debt, they can buy another member's debt without incurring currency risk, since there is no exchange rate variability among the currencies of member countries. Because member nations now are dependent on investors for funding their expenditure, failure to attract investors results in an inability to spend. Furthermore, should a member's revenues fail to keep pace with expenditures due to an economic slowdown, investors will likely demand a budget that is balanced, most likely through spending cuts. In other words, market forces can demand pro-cyclical fiscal policy during a recession, compounding recessionary influences.

As Kregel's paper points out, one alternative to coordinating fiscal and monetary policy at the national level would be to coordinate policy at the Euro level. In other words, if member nations cannot conduct counter-cyclical fiscal policy (as U.S. states cannot) because of their loss of monetary sovereignty, the ECB might be assigned the responsibility of undertaking necessary fiscal actions (as the federal government in the U.S.). Kregel's plan goes beyond generic aggregate demand management to propose a public works program that at once guarantees full employment while controlling the value of the currency. As Parguez warns, however, for such a plan to be implemented within the framework of the EU would require substantial reform of much of Maastricht and an abandonment of the underlying commitment to Euro-economics. It is our hope that it will not take a major economic crisis, with unacceptable (because avoidable) social and human costs, to demonstrate the need for appropriate reform.

NOTES

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