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Fix the euro!

Without higher government expenditure, the eurozone will disintegrate when the next recession hits

Read this article in German.

The euro was and is a daring experiment. The 'one central bank, many governments' construction entails risks. That can also be observed by looking at functioning, modern money systems. Canada, for example, provides some interesting details. According to law, the Canadian central bank has to accept short-term government bonds (under six months) and issue government deposits to the same extent. In essence, direct state financing, frowned upon in the eurozone, is part of daily business there.

Due to this construct, there's almost total confidence in the ability of the Canadian central government to meet its financial obligations. If the government needs additional money, it merely has to issue new government bonds and deliver them to the central bank. That is all. Neither higher tax income nor the sale of government bonds to Canadian and/or international investors are necessary to produce the necessary financial resources. After all, the Canadian parliament has decided on a budget – what sense would it make to still have a veto in a democracy?

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In the aftermath of the big financial crisis, Canadians were, incidentally, also faced with the question of whether they should pursue recovery through a strict austerity policy and, hence, cut state expenditure. The conservatives and social democrats made this argument whilst the liberals were against it. The liberals won the elections and increased government expenditure every year under Prime Minister Trudeau. Unemployment fell almost continuously. It currently stands at 5.6 per cent. This development makes sense. Higher expenditure leads to higher income for enterprises and thereby to an expansion of production. Employment depends on production.

From this perspective, unemployment is the result of lower expenditure. An increase in expenditure by the state or private sector leads to more employment. Because no one can force the private sector (households and businesses) into more expenditure, the level of unemployment depends a great deal on the amount of government expenditure. As the Canadian state can increase its expenditure at will, political responsibility for unemployment lies with the state. The state can spend more and therefore reduce unemployment. If the government and, as the case may be, the opposition parties, do not want to raise expenditure, voters can directly decide on this course of action at the ballot box.

The EU at a crossroads

The crux: there's no central government in the eurozone. There's the European Commission. But it has no financial ministry. It finances itself from contributions from member states. This means that the European Union cannot take on political responsibility for the amount of unemployment in the eurozone. Its budget is just too small. But national governments cannot take over responsibility either because their expenditure is too strictly regulated by the Stability and Growth Pact. So we have a political as much as a fiscal problem in the eurozone. There's no institutional body that can deliver additional expenditure in times of crisis and there's also none that can take on the political responsibility for the amount and use of this expenditure.

In early deliberations about the common European currency, a European finance ministry was still envisaged. But in the 1990s, belief in market forces led to the situation where the macroeconomic stabilisation role of the state was ignored and only the central bank was set up as a guardian against inflation. The hope that this would be enough for stability and growth disintegrated. There has been high unemployment since the end of the 90s due to low state expenditure. As a result, the pressure on wages was missing, inflation rates are low, and this brought us low interest rates and high public debt.

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For several years now, the EU has been at a crossroads. Like a rabbit caught in the headlights, it is looking for possible alternatives. One option would be to set up a European finance ministry, which finances itself via eurobonds. The European Central Bank would then have to buy those up in an unlimited way. Or, the member states go back to national currencies. In both cases, the state could again

fight unemployment and thereby also produce wage pressure. However, it could come to economic disruption for the German export sector if markets in neighbouring countries disappear, after they've regained their competitiveness via devaluation. A reconstruction of the eurozone is clearly preferable.

The latest changes in interest rates in the US indicate that the probability of a recession is increasing. Through the expansion of the amount of money in circulation and the programme of buying up loans, the euro is undervalued. The base rate is at zero per cent. Hundreds of billions of bad loans can be found in bank balance sheets and the eurozone is showing a current account surplus in comparison to the rest of the world.

Therefore, currency and trade policy are already at their most expansive. When it comes to economic policy, the EU has its back to the wall. Fiscal policy is all that's left in order to overturn a crisis – but something fundamental would have to change. If European policy doesn't prepare its economic policy instruments now, then the 'markets' will reign and continue to damage European democracy. A European finance ministry could give politicians the necessary room to negotiate. The clock is ticking.



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