‘Two or three things I know about her’:
Europe in the global crisis and heterodox economics

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Europe is in the middle of an economic and social storm. Although the turmoil since the mid-2008 originated elsewhere, the European dynamics may turn the Great Recession into a full-blown Great Depression. Within this dynamics, the faulty design of the ‘single currency’ is a key element, together with the neomercantilist fracture dividing the ‘core’ of Northern Europe and the ‘periphery’, mostly composed of Southern European countries. The paper gives a quick reminder of what the true nature of the global crisis is (Section 2). The neoliberal Great Moderation was a paradoxical kind of financial and ‘privatised Keynesianism’. The heart of the Anglo-Saxon model has been the overcoming of the stagnationist tendencies emerging from ‘traumatised workers’ thanks to the transformation of ‘manic savers’ into ‘indebted consumers’. I will then (Section 3) dissect the peculiarities of the neomercantilist export-led posture. The eventual establishment of the euro as the ‘single currency’ was in stark discontinuity with the Maastricht Treaty originating from the Delors Commission (Section 4). The real puzzle is to understand how the euro actually came into being from such fragile foundations, and also why for many years it seemed a happy experiment. The institutional setting of the eurozone and the German self-defeating obsession for fiscal austerity decisively drove the area into a double-dip recession. A way out of the crisis (Section 5) requires not only monetary reforms and expansionary coordinated fiscal measures, but also a wholesale change of economic model. This latter must be built upon a new ‘engine’ of demand and growth. A monetary finance of ‘good’ deficits is called for realising a radicalised ‘socialisation of the investment’: a class and Keynesian new deal.

Key words: Great Recession, Privatised Keynesianism, Neomercantilism, European public debt crisis, Socialisation of investment

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* University of Bergamo. The arguments developed in this article depend on continuous conversation and dialogue over the years with V. Giacché, M. Lavoie, A. Parguez, G. Reuten, M. Seccareccia, J. Toporowski, G. Vertova and L.R. Wray. In this paper I develop an interpretation of the global and European crisis coming from joint contributions with J. Halevi and F. Garibaldo (Bellofiore and Halevi, 2011; Bellofiore and Garibaldo, 2011). I have summarised the theoretical ground of my reading of capitalist crises in Bellofiore (2012A) and presented a more detailed exploration of the multiple dimensions of the Great Recession in Bellofiore (2012B). My intellectual debts to A. Graziani and H. Minsky are too obvious to be stressed. The comments of referees have helped to make the paper better, though of course any remaining error is my fault. The title of the article refers to J.L. Godard’s movie.

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Europe is in the middle of an economic and social storm. Although the turmoil since mid-2008 originated elsewhere, the European dynamics may turn the Great Recession into a full-blown Great Depression. Within this dynamics, the faulty design of the ‘single currency’ is a key element, together with the neomercantilist fracture dividing the ‘core’ of Northern Europe and the ‘periphery’, mostly composed of Southern European countries.

To put the European crisis in context, it is useful to remind ourselves of the true nature of the global crisis (Section 2). The neoliberal Great Moderation was a paradoxical kind of financial and ‘privatised Keynesianism’.1 The heart of the Anglo-Saxon model was the attempt to overcome the stagnationist tendencies emerging from ‘traumatised workers’ resulting from the transformation of ‘manic savers’ into ‘indebted consumers’. This ‘autonomous’ consumption, fuelled by finance and bank debt, was the engine driving the growth of a dynamic but unsustainable ‘new’ capitalism, manipulated by an innovative kind of monetary policy.

Section 3 examines the peculiarities of the neomercantilist export-led approach that dominated the European macroeconomic landscape since World War II, particularly since the 1960s and 1970s. The eventual establishment of the euro as the eurozone’s ‘single currency’ was in stark discontinuity with the Maastricht Treaty originating from the Delors Commission (Section 4). The Treaty was a mainly French project, which Germany resisted, and it was designed under the Iron Curtain. The real puzzle is to understand not only how the euro actually came into being from such fragile foundations, but also why for many years it seemed a happy experiment. The eurozone’s sovereign debt crisis was imported; it was not at all endogenous. But the eurozone’s institutional composition, coupled with Germany’s self-defeating obsession with fiscal austerity, ultimately drove the area into a double-dip recession.

With this in mind, we may better understand why a way out of the crisis (Section 5) requires not only monetary reforms and expansionary coordinated fiscal measures. It also relies upon a wholesale change of economic model, based upon a new ‘engine’ of demand and growth. A monetary financing of ‘good’ deficits is needed for the realisation of a radicalised ‘socialisation of the investment’: a class-based and Keynesian new deal.

2. The US-based ‘new’ capitalism: the real subsumption of labour to finance in a system of privatised Keynesianism

The most widespread heterodox economic interpretations of the global crisis refer to Marx and Keynes. Although ‘financialisation’ is assigned a central role, analyses usually seek allegedly more fundamental ‘real’ factors. Thus, there are those who believe the falling-rate-of-profits story (related to the rise in capital composition), in which the problem was inadequacy of the surplus value produced. There are also those who are persuaded by the underconsumption narrative, in which the worsening income

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1 The term ‘indebted Keynesianism’ is associated with the name of Colin Crouch (2009). As Crouch (who kindly wrote to me in Italian asking for references) realised, the same term was used by me, in an article with Joseph Halevi in 2005 in Italian (in English since 2007) to characterise the paradoxical privatised, asset-bubble Keynesianism of the 1990s and early 2000s.
distribution leads to a ‘world of low wages’ and a realisation crisis. From this perspective, the problem was that there was too much potential surplus value. Of course, this second rationalisation of the crisis is easily compatible with a left Keynesian interpretation stressing the lack of effective demand, and it may be followed by a plea for a wage-led recovery. However, much more interesting is the fact that it is possible to argue a position that starts from two of the heretics of Keynesianism and Marxism: Minsky and Sweezy. This approach integrates finance, effective demand and capital accumulation. According to Minsky there is rising leverage during the upswing; however, a problem with the Minskian story is that during the Great Moderation the non-business sector became less and less indebted. The Sweezy story underlines the importance of rising US households’ indebtedness since the late 1970s and early 1980s.

The Great Recession can be interpreted as one of the ‘great’ crises punctuating capitalist accumulation and isolating one from the other among different ‘forms’ of capitalism (Bellofiore, 2011). So-called ‘free competition’ capitalism ended in the Long Depression of the late nineteenth century: this was a typical falling-rate-of-profit crisis resulting from the increase in capital composition. In the decades that followed, a ‘trustified’ capitalism emerged, in which the restructuring of labour processes was pursued through technological (Henry Ford) and organisational (Frederick Taylor) innovations. The consequent increase in the rate of surplus value ultimately led to the Great Crash of the 1930s, a crisis of too much profitability—and hence a crisis of realisation. World War II and military Keynesianism opened the way to the alleged ‘Keynesian’ era of ‘managerial capitalism’. During this period, effective demand problems were solved primarily through Kalecki’s ‘domestic exports’, i.e. monetarily financed state deficits providing outlets to capitalist firms. For a while, this established a quasi-permanent full employment that favoured workers in their struggle over wages and position within the process of production. The conflict over the exchange value and the use value of labour power was strong enough to resist the tendency for a fall in the relative wage typical of capitalism at the end of the 1960s and early 1970s. Although this was not the unique ‘contradiction’ bringing the so-called ‘Fordist’ era to an end, it was the basic one. This new ‘great crisis’ may thus be described as a social crisis. It is, once again, a crisis of insufficient profitability, this time caused by a direct antagonism endangering the fundamental ‘capital relation’.

In this context, neoliberalism can be recognised for what it truly is. Reagan’s and Thatcher’s monetarist U-turn rested on a decisive compression of the money supply and the consequent upsurge in money and real interest rates, which squeezed private investment and spread uncertainty. Together with the attack on trade unions, wages and social provision, this could have created the conditions for another 1930’s style ‘Great Crash’, caused by a lack of effective demand, were it not for unexpected and powerful, expansionary countertendencies. The first countertendency took the form of Reagan’s ‘twin deficits’: the fiscal deficit supported internal demand, while the negative trade account provided external outlets for European and Asian neomercantilism (what Krugman has termed ‘weaponised Keynesianism’). The second countertendency was caused by Greenspan’s ‘privatised Keynesianism’. Since the mid-1970s the ‘class struggle from above’ produced a continuous ‘traumatisation’ of workers (anecdotal evidence traces the same term ‘traumatised worker’ to Greenspan himself). Yet, what came into dominance was Minsky’s ‘money-manager capitalism’ (Whalen, 1997). The savings of the middle-class and workers’ households were channelled into private institutional funds and asset markets, fuelling a ‘capital-asset price inflation’.
Managers were co-opted through stock options and their assigned mission of maximising dividends and share values. This new configuration of finance took over corporate governance and shaped production itself. Indeed, together with a ‘destructive’ competition between global players in manufacturing and services breeding overproduction (Crotty, 2000), this kind of corporate governance generated a process of ‘centralisation without concentration’. Mergers and acquisitions rendered capital more ‘centralised’. However, this did not universally bring about a higher ‘concentration’ of units of production in vertically integrated industrial companies. Instead, it connected those units in transnational networks. The result was a disappearance of a homogeneous working class and its replacement by the fragmentation and precariousness of a working class ‘lost in space’ (Bellofiore and Vertova, 2006).

The transformation of working conditions depended upon the subordinated integration of households within finance through the stock exchange (but also through bank debt). Rather than the generic term ‘financialisation’, this structure of relations might more accurately be termed a ‘real subsumption of labour to finance’. One reason is that this financial configuration impacted directly on the process of production, generating longer working hours, requiring greater effort from workers and forcing an increase in the labour supply provided by families. To better grasp the interconnection between financial and real dynamics since the late 1980s, Toporowski’s interpretation of capital-asset price inflation is useful (Toporowski, 2010A). The rate at which money flowed from funds to financial markets enabled non-financial firms to issue shares more cheaply, the returns of which increasingly depended upon speculative gains. This process gave way to an ‘overcapitalisation’ of productive enterprises, and ownership titles were issued in excess of the needs for industrial and commercial financing. The money mopped up by those issues was invested in short-term financial activities, propelling a cumulative upward disequilibrium in asset prices without any self-adjustment mechanism. Markets became more liquid and the supposed quality of collateral assets was thought to be regularly improving. This led to a perceived ex post increase in the ‘cushions of safety’ (Kregel, 2008). Increasing indebtedness emerged mostly from financial businesses and households rather than from the physical investment of non-financial firms, reminiscent of the pre-1986 Minsky story, but coherent with his post-1986 description of money-manager capitalism. Banks ceased to be institutions selecting and monitoring industrial firms as their main debtors and went hunting for returns in consumers’ credit and in fees from securitisation.

This resolved the paradox of the ‘manic saver’, mesmerised by the rise in asset values, who turned into the ‘indebted consumer’—with the associated collapse of the propensity to save on income. Stock market and housing bubbles sustained the expansion of consumption on credit, where consumption was ‘autonomous’ from earned income and stimulated by perceived wealth effects, a perception validated and heightened by financial companies and ‘originate and distribute’ banking practices. As a consequence, the monetary circuit changed dramatically (Seccareccia, 2010). The injection of credit money into the system now found its main point of entry in households’ indebtedness rather than the financing of production. The liquidity injected by banks and financial intermediaries into households’ debt accounts was later transferred to firms through ‘goods’ or ‘financial’ markets, thus enabling, at the same time, both the finance of production and the realisation of (surplus) value.

This ‘subordination’ of labour to finance was ‘real’ not only because it affected production and valorisation within the labour processes; it also transformed the
relationship between banks and firms and endogenously boosted effective demand. Wage deflation, capital-asset inflation and the increasingly leveraged position of households and financial companies were complementary elements of a perverse mechanism where real growth was doped by toxic finance. Nonetheless, it is important to recognise that ‘fictitious’ capital had ‘non-fictitious’ fallouts. It was a dynamic configuration of capitalism capable of manufacturing consent and yielding hegemony. The middle classes, too, were sedated by escalating property values and found an illusory security from uncertainty (Toporowski, 2010B). However, households’ indebtedness in no way corresponded to a state of economic and social welfare. The US ‘overspending’ consumer matched the US ‘overworking’ job earner. Growing debt had its ultimate raison d’être in the insufficiency of income to support the consumption of non-manufacturing goods and services. This caused an escalation in expenditures generating rents for the financial sector.

This new configuration of capitalism was aided by the new role of the central bank as lender of first resort (De Cecco, 1998) to support capital-asset price inflation. The central bank managed the creation of liquidity with the objective of sustaining the continuous increase in asset values; it also assured the viability of the ‘shadow’ banking system and financial intermediaries. Through Greenspan, quantitative monetarism stepped down, being replaced by a policy where money was made available in unlimited amounts at any interest rate established by the central bank. The money supply became flat and was finally recognised as endogenous even within the mainstream. It was an eminently ‘political’ management of effective demand, manipulating indebted consumption as the pillar of autonomous demand. This dynamic has been labelled ‘privatised Keynesianism’. Because of workers’ ‘traumatisation’, it was possible to have a reduction in unemployment without an increase in wages, so that the so-called Phillips curve flattened out (Lavoie, 2007). However, the resulting full employment was not characterised by ‘decent’ wages and stable jobs. It was, instead, a full underemployment, with unemployment penetrating into the employed labour force through the spreading of part-time and casual/informal occupations.

3. The Great Recession and European neomercantilism

Anglo-Saxon ‘new’ capitalism was based on financialisation, the casualisation of labour and an original monetary policy. This system of capitalist development generated income and wealth inequality together with debt consumption. But it was precisely the indebted consumers who had served as the engine of growth in money-manager capitalism who now provided the final consumers for the exports of the neomercantilist economies of Japan, Germany and other parts of Europe and, more recently, China. Although the manic saver–indebted consumer pair seemed to be a stabilising factor during the Great Moderation, this form of capitalism ultimately proved to be unsustainable (Godley, 1999). It collapsed a first time in the early 2000s because of the dotcom crisis and a second time in 2007 because of the bursting of the housing bubble supported by American subprime loans. The new monetary policy was unable to make ends meet in inflation, considering oil and raw material prices. Although capital-asset prices were not considered a problem—and wage inflation was not on the agenda—commodities price inflation worried the Federal Reserve and other central banks; thus, from 2004 the Fed began to increase interest rates such that, by 2005, US house prices softened. The proliferation of subprime mortgages, with the enticement
of poor households to enter the financial swamp, was an attempt to keep the real-estate bubble inflating by any means. The hope that the increase in borrowing costs could be offset by a further rise in asset values, thereby expanding the value of the collateral used in loan applications, faded away. The widespread view that opaque securitisation packages would efficiently distribute risk and that the emerging countries’ savings would cover the deficits of the USA, the UK, Australia and Spain was revealed to be a double deception.

When the crisis broke in July 2007, toxic finance spread throughout the world. The collapse of interbank relations augmented the negative impact of financial imbalances. European finance was the first to crumble and, with a lag, the large exporting countries were severely hit by the plummeting demand of indebted US consumers. The consequent sharp reduction in China’s growth impacted hugely on Europe’s main manufacturing nations, with Germany and Italy at the forefront, dissolving any illusion of a ‘delinking’.

The neomercantilist model dates back to the late 1940s and the persistent German surpluses, originally recycled through the European Payments Union (1950-58), which served to reduce intra-European deficits. During the 1960s the trade balance gave rhythm to economic policies, with ‘stop and go’ being used to gain net exports in Germany, Italy and France. Net exports for the whole European area were an impossible goal, because when deficit countries compress income to adjust, this retroacts on the exports and employment of surplus countries. With no clearing mechanism, deficit countries have to bear the burden of adjustment by going into recession, with negative repercussions on the exports and related employment of the surplus countries.

To maintain a net surplus, Germany had then, as now, to reduce economic activity, with a corresponding increase in unemployment. An alternative for deficit countries is to let their currency devalue. However, this alternative is not an option under a fixed exchange rate system, such as Bretton Woods (1944–71), the European Monetary System (EMS; 1979–92) or with the European Monetary Union (EMU) today. But it surfaced as an option after Bretton Woods collapsed in 1971.

The main danger to Germany and France came from Italy. During the 1970s, by pegging the lira to the US dollar (which was falling relatively to the Deutsche mark and the yen), Italy more than compensated for inflationary excesses through competitive devaluations. At the time, Italy’s export fundamentals were the strongest both in Europe and in the bilateral trade with Germany. This served as a motivation for the EMS, with its exchange rate mechanism (ERM), which emerged during the 1980s as a German concern that was also strongly favoured by the Netherlands and Belgium. The Netherlands was organically connected with Germany whilst Belgium had strong links with France. These countries, together with Switzerland, Austria and Scandinavia (especially Finland and Sweden), are Germany’s ‘satellites’: their economies earn intra-European trade surpluses, while maintaining trade deficits with Germany (the only exception being the Netherlands, whose positive account is due to the fact it provides the German economy with financial and services support). The satellites’ position is similar to Berlin’s: net exports through productivity growth, stable prices and limited fiscal budgets; plus net foreign balances to finance welfare expenditures without burdening the state deficit.

The key role of the financial sector encouraged France to take an anti-inflationary stance and to join Germany and the ‘satellites’, with the aim (less and less achieved) of gaining net exports by drastically reducing imports. In the meantime, despite the wider
band assigned to the lira in the first half of the 1980s, its devaluations did not compensate for inflation, causing Italy’s net exports to decline. This tendency was reinforced during the second half of the 1980s (especially after 1987), when the EMS mutated into a fixed exchange rate system without any change in parities. The added paradox was that the Bank of Italy fixed interest rates high enough to encourage huge capital imports, making the lira a ‘strong’ currency in the ERM, Italy’s deteriorating trade balance notwithstanding. That policy was instrumental in forcing a capitalist restructuring and wage squeeze. But it also actively contributed to a further deterioration of the public debt because of the widening share of interest payments within budget deficits, and the government debt has been at the mercy of capital markets ever since.

The EMS/ERM caused a division of Europe into two parts, from the point of view of the current account balance. On the positive side of the ledger were Germany and the ‘satellites’; on the negative side was Italy, whose trade surplus could rise steeply any time the lira was devalued—the more so if, as happened in 1992, wage contracts were decoupled from inflation. Portugal and Spain, with Greece, were deeper into negative territory. France represented a case of its own; mistakenly considering itself to be on a par with Germany, it slid further and further into an economic reality that put her on the negative side. This situation encouraged the French élite to try to share in the benefits of German financial stability and command over money through a ‘single currency’. During the EMS regime—and until reunification with East Germany in 1990—the Federal Republic of Germany realised huge net exports as a proportion of GDP, reached again (and surpassed) only in 2007–08. The EMS made Europe as a whole the primary market supporting Germany’s positive net exports and profits for its big business. Its external position with other trade partners was much more variable, based on exchange rates and product specialisation. However, the price to be paid was a slow rate of growth. In the meantime, France did not profit from Italy’s declining trade surpluses and it became, more and more, an economy based on services and finance.

The EMS came to an end in 1992–93, because German reunification was only partially financed through taxes; it was also financed by fiscal deficits and capital imports. The Bundesbank was very much opposed to what became known as Kohl’s ‘Reaganomics on the Rhine’—namely, the incurring of large budget deficits financed by foreign debt instead of tax increases. It was for this internal conflict with Kohl, even more than the ever-present desire to discipline Italy and other EMS members, that Germany’s central bank drastically raised the short-term rate of interest in 1991–92. A consequence was the sharp appreciation of the Deutsche mark, especially in relation to the lira, and from 1992 to 2000, Germany’s current account was negative (although there was still a positive balance in its merchandise account). The primary reason for Germany’s deteriorating current account balance was the net export performance for Germany as a whole: while West Germany realised an enormous surplus, this was far outweighed by the colossal deficit of East Germany. It may seem that the Bundesbank’s high interest rate policy—which, in the name of fighting inflation, countered the increase in domestic demand and wages resulting from public expenditures associated with reunification—eventually failed to achieve the aim of defending the neomercantilist stance of German capital. And it may seem, too, that the ability to finance the international expansion of German capital was vanishing. However, this was not in fact the case. The 1990s were not a lost decade. Rather, they were the beginning of a period of restructuring, inflicted on the German labour market and processes, involving a
strong push towards the transnationalisation of many German industrial conglomerates. During this period, German firms shifted from an automation strategy, characteristic of the 1970s and 1980s, to a strategy of offshoring upstream activities, mainly to Eastern Europe but also to Northern Italy and others area in the old EU-15. Together with the introduction of the ‘single currency’ locking in the participants of the EMU at fixed exchange rates, these economic policies and industrial behaviours were the pillars of the resurrection of Germany’s export-led capitalism during the 2000s.

4. The unlikely march into the euro and the sliding into the global crisis

The European ‘single currency’ was born with an original sin. From the beginning it embodied the tendency for permanent recessionary drift, differences in relative competitiveness among member nations, a wage squeeze, mounting social inequality, the dismantling of trade unions and continuous industrial restructuring. Sensible criticisms were made (Gaffard, 1992). It is understandable that within the structurally heterogeneous European area, where there are radical variations in both the productive power of labour and (material and immaterial) infrastructures, the push for a nominal convergence cannot but give way to a progressive deepening of real divergences. The inbuilt and ongoing tendency towards self-dissolution of the EMU can be counteracted only through a dual strategy of common fiscal (and transfer) policy, governing resource redistribution between regions within the eurozone, and industrial policies aimed at overcoming the backwardness of certain constituent regions. In contrast, the European Union (EU) budget (in relation to GDP) is ludicrously low, fiscal competition among states is the rule and industrial policy is officially oriented towards deregulation (though actual practices diverge).

The question to be answered is ‘how was such a fragile construction able to take-off at the end of the 1990s?’ And how could that have happened after the EMS was dissolved during the early 1990s and the Maastricht Treaty became dormant? Here, some myths must be dispelled. The first is that the Maastricht Treaty was a consequence of the collapse of actually ‘existing socialism’. The second is that there was continuity between the Treaty and the euro. In reality, the Treaty was the offspring of the second term of the Delors Commission (1988–92), with the project being integrally defined in a Europe (and Germany) that had been split in two by the Iron Curtain. It is also important to note that the eurozone was a French project, not a German one. During the late 1980s, US capitalism was considered an inferior model to Japanese and some European capitalisms. In this context, France wanted to share control over monetary policy with Germany, which at the time was a manufacturing giant but a political dwarf. Whilst the UK could have filled the role of the eurozone’s financial centre, it never truly wanted to enter the game. The dismantling of the Berlin Wall and the subsequent disbanding of ‘socialism’ in Eastern Europe and the USSR were the events that marked the failure of the strategy: this is due to the economic fallouts already mentioned and the fact that the political underpinnings were vanishing. Germany itself started looking towards the East, but it was unable to expand its influence as a

2 Several other good reviews of the European dynamics convey my characterisation of the processes that were occurring. Among them, an early one is Grahl (1997).
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consequence of the reconstruction of Eastern Germany and the turmoil in ex-Yugoslavia and Russia, where the role and interests of the USA are not to be forgotten.

The answer to the question about how the euro project was reborn from its own ashes like a phoenix comes from the twin considerations that, during the 1990s, Germany was in a relatively weak position and that the made-in-the-USA ‘new’ capitalism was thriving. The reduction in interest rates during that decade helped the entire European area to meet the Maastricht criteria on public finance, whereas Germany had difficulties in fulfilling them completely. De Cecco recently argued that:

[the] Bundesbank did not want the Euro and tried to raise public opinion against it. The Euro was the price that the French extorted to maintain Germany attached to Western Europe and avoid new nationalistic escapades … Bundesbank had to retreat on a second-rate position, imposing that the ECB was created in her likeness, and even that its statute magnified some Monetarist features that Bundesbank won in practicing, but that were never ratified by law. (De Cecco, 2012A)

This posture was repeated once and again by Germany: it was behind the Maastricht parameters, behind the Growth and Stability Pact signed in Dublin–Amsterdam and behind the Fiscal Compact.

Germany overcame the reunification shock, while pushing forward a radical restructuring of the labour market and process. With the ‘satellites’, it benefited from faster capitalist development in the periphery. The real-estate bubble was spreading throughout Europe, as a consequence of which Ireland and Spain had significant GDP growth: this is why their public budgets were so ‘virtuous’ before 2007–08. In a world of lower and lower interest rates, the government deficits of Greece and Portugal, as well as the management of the Italian government debt, made room for ongoing financial investments for German and French banks.

The multispeed dynamics of Europe is well known by now and can be grasped through a Luxemburg–Kalecki vision. Net exports were the driving force in the ‘core’ (Germany and the ‘satellites’), with the resulting profits invested abroad. The insertion of Europe in the ‘new’ capitalism’s financial world meant that these investments found their way into ‘toxic’ finance. Further, with the ‘single currency’, the Treasury bonds of the European ‘periphery’ played for European banks and finance (especially, French and German) a role similar to subprime loans in the USA. Germany, like the rest of Northern Europe, had a historical need to export to Southern Europe, where it realised the largest part of its profits. Thus, trade deficits in France, Italy, Spain, Portugal and Greece were crucial to Germany’s competitiveness. They also held down the nominal valuation of Germany’s currency, the euro (compared with what it would have been under the Deutsche mark or with a euro restricted to the net exporters). Moreover the ‘single currency’ deepens—not just because of wage repression, but also due to the increase in the productivity of labour—a competitive deflation and thus a real devaluation benefiting the ‘core’ area, whose net exports rose exponentially. This structural strength is due to Germany’s specialisation in technology sectors, advanced machinery and high-quality manufacturing, and not just wage deflation.

After the 1990s and during the first decade of the new millennium, the net neomercantilist position of Europe was balanced, thanks to Europe’s net exports to the USA. The latter did not offset a widening imbalance with China, and they were conditional on instabilities in Russia and Latin America. When asset bubbles in these areas burst and huge recessions followed, the US boom provided the only outlet of last resort,
The initial euro devaluation relative to the dollar notwithstanding, the European downturn made sense. After the dotcom crisis, Germany again saw its net export model of growth flourish (thanks also to the wage repression policy related to the so-called Hartz reforms), without the risk of competitive devaluations within the area, and Italy was able to put its external accounts into better shape, especially in certain of its manufacturing sectors, becoming the second exporter in Europe. Capitalist growth was vibrant and strong, not in the country as a whole, but in particular areas: less and less so in the much mythologised old industrial ‘districts’, but rather in the so-called ‘fourth’ capitalism of small and medium-sized enterprises, which were strong in innovation and marketing and became globally competitive thanks to exports and foreign direct investments (Colli, 2002). After the dotcom crisis, these ‘pocket multinationals’ have been particularly swift in moving into high value-added production. However, this new incarnation of the made-in-Italy model was inherently fragile. First, it lacked systematic investment in R&D; second, it completely hinged upon a foreign-centred model of accumulation; and third, it had no structural/intersectoral coherence. It could survive only at the price of continuous restructuring and becoming increasingly dependent on the worsening conditions of labour—just to be able to defer the competition coming from China and East Asia.

It must be stressed that, before the Great Recession, European trade imbalances were not considered to be a binding constraint and there was no urgent concern about government finances. In fact, where real-estate bubbles did not spur growth (as they did in Spain and Ireland), government deficits were seen to be essential counterweights to the stagnationist tendency springing from the German economic policy approach. The drama about sovereign debt is ill-posed even today: looking at the eurozone as a whole, ratios of public deficit and debt to GDP are comparable, or lower, than they are in the USA or Japan—not to mention the UK.

This being the case, the eurozone crisis was not endogenous, but came from outside. The European troubles were the ‘bounce’ of the collapse of privatised Keynesianism. However, this does not absolve European policy makers or make the eurozone’s institutional arrangements and policies less problematic. There was the redoubled paradox that it was exactly the neomercantilist model that served Germany so well, that made her more (not less) imperilled by crises. The 2011–12 German illusion of replacing the shrinking Southern European export markets with those of emerging countries inevitably and rapidly waned, as the global economy risks a double dip into the Great Recession.

The global crisis came to Europe not directly through households’ debt deflation, since personal indebtedness was yet much lower than in the USA or UK. The early chains of transmission were the already depressed state of expectations in Europe, the mortgage and financial crisis in the UK and the bursting of the housing bubble in Spain, the Eastern Europe financial troubles, and the fall in imports from the rest of Europe in all of these regions. Later came the collapse of exports to China and the fall of German and Italian manufacturing exports. In 2008–09, Europe avoided a complete breakdown because of three factors conflicting with the ‘anti-Keynesian’ rhetoric of European governments: the working of automatic stabilisers, targeted pro-industry programmes and state policies openly shielding workers from unemployment (e.g. Germany financed a temporary reduction in working hours). Italy was protected from the worst waves of the crisis by the provincial nature of its financial and banking system, but it took almost no action, in the hope that an export-led recovery would arrive,
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sooner or later. At that time, Angela Merkel even talked about a deficit spending policy, driven by tax cuts. But it did not last—and a self-destructive mechanism set in as soon as some ‘green shoots’ of recovery seemed to materialise on the horizon in mid-2009.

After having cut the rate of interest, which exceeded 4% in the summer of 2008, the ECB did not follow its monetarist prescriptions to the letter, instead rewriting its own material constitution, refinancing budget deficits in secondary markets and providing huge amounts of liquidity. The problem was that these manoeuvres were reactive, in the wake of the crisis, rather than providing the firepower or showing the determination needed to put an end to speculation: too late and (at that point) too little. It is curious that if, at the beginning of the crisis, Greece’s debt had been wiped out, the costs for Europe would have been serious (because of balance-sheet interconnections) but acceptable. As the domino effect spread the crisis to Ireland and then Portugal, even a cancellation of their debt would have been dangerous but still tolerable. On the contrary, the dynamics that was set into motion by trying to avoid a default for a longer time, without any rescheduling or scaling down of the amount of debt to be repaid, ended up in a sort of hidden Greek default within the euro, without any of the advantages of defaulting or devaluing. During the summer of 2011, after having hit Ireland and Portugal, the crisis hit Spain and then Italy; at this point, the quantitative change in the dimension of the countries involved caused a qualitative leap in the scale of the crisis.

The crisis in Europe is not due to Greece nor is it the result of government indebtedness of a particular country (both in absolute terms and in relation to GDP). As Toporowski (2010C) argued, what matters is the willingness (or not) of the ECB to refinance government deficits. Even with a hypothetical euro limited to Germany and its ‘satellites’, the sovereign debt crisis could burst. Belgium, for example, has a debt-to-GDP ratio close to 100%.3 Excluding default, a first way out could be inflation, a second growth, a third a mix of the two. Both inflation and growth increase the denominator in the ratio of deficit (or debt) to nominal GDP.

Another misunderstanding is that global imbalances within the eurozone ought to be a problem for the EMU. As Lavoie recently wrote:

there is no limit to the debit position that a national central bank can incur on the books of the ECB, that is, its liabilities with respect to the rest of the Eurosystem are not limited … Furthermore, national central banks in debit are charged the main official rate, which is also the rate gained by those with claims on the Eurosystem. Thus these imbalances can go on forever … [I]f there is some lack of confidence in the system, we should observe an increase in the size of the balance sheets of the central banks of the countries under suspicion, as well as an increase in the size of the balance sheet of the ECB … A current account deficit of Spain or Italy with respect to the rest of the eurozone is no more meaningful than the current account deficit of the Mezzogiorno relative to Northern Italy. (Lavoie, 2013, pp. 22, 27)4

3 In the article, Toporowski writes ‘Netherlands’, but this is clearly a slip.

4 An anonymous referee objected: ‘that deficit [of Mezzogiorno relative to Northern Italy] is perfectly meaningful—it is limited by the available transfers and credits from the rest of Italy. And the limit on the deficit translates directly into a limit on economic activity in the Mezzogiorno, which is therefore balance of payments constrained. The Mezzogiorno is financially constrained as is Spain and in both cases net export performance and other current flows are a key determinant of the constraint.’ In my view this is a very different issue from the one that Lavoie and I (but also other authors, such as Wray or De Cecco) are proposing. What s/he implies is that current account deficits have negative real effects on economic activity, which I fully accept and even strongly argued in the past, and still support as a true problem. This argument, however, points towards the need of transfer and structural policies to redress the balance: it does not mean that in themselves the current account imbalances are directly the cause of the European mayhem, since this should be foreign to a true monetary union. A similar line of thought can be read in De Cecco (2012B,
A problem is that the rules and conventions first forbid and now strongly discourage the ECB and national central banks of the eurozone to buy Treasury bonds on primary or secondary markets. All of this notwithstanding, however, the ECB has recently intervened on secondary markets, and the Bundesbank bought Germany’s Bunds in recent auctions.

It is useless to blame the markets or rating agencies. Italy, for example, is one of the countries whose budgets deficit did not increase substantially during the crisis. But austerity policies and the inability to set into motion a process generating growth, precisely what is required to maintain a ‘sound’ fiscal policy, made the medium-term unsustainability of a widening spread of Italian Treasury bonds relative to German ones easy to calculate, given the huge stock of debt. Markets and rating agencies are merely registering the failure of political leadership, which could assure some reasonable way out of the crisis through growth and/or inflation rather than remaining a prisoner of a self-defeating austerity. It is this political ineffectiveness that pushes up the interest rate spreads, exposing one country after another to the risk of default. Because of their deflationary nature, the economic policies of European countries are pulling down the rate of growth, while the rest of the world either comes to a stop or slows down. It is not surprising that it is increasingly more difficult to sustain public debts—it is a sort of paradox of thrift applied to public finance. Further complicating matters are the fact that there is no political sovereignty over money in the ‘single currency’ area, no ECB’s explicit role of as lender of last resort and no ECB’s direct financing of government deficits. Adding irony to injury, Germany is allowed not to care about the public deficits within the eurozone; but its industries and banks will be severely hit by the effects of the austerity policies of the other European countries on its effective demand and its balance sheets.

Paraphrasing György Lukács’s remarks on the German intelligentsia of his time, the eurozone policy makers appear to inhabit a ‘grand hotel on the abyss’. A beautiful hotel, equipped with every comfort, on the edge of an abyss of nothingness and absurdity. Euro technocrats are daily contemplating the abyss, between excellent meals or artistic entertainments. They are inept and powerless to do whatever it takes not to plunge into that abyss, dragging the remains of the European social model down with them—and perhaps also the world economy.

P. 44, emphasis added: ‘it is a contradiction to strive vigorously towards monetary union and at the same time demand that national current account deficits and surpluses still be considered as important policy variables. Who knows or cares about Wisconsin’s current balance with the rest of the US or Magdeburg’s with the rest of Federal republic of Germany? I have deliberately quoted a Land in former East Germany to stress the fact that its current account with the rest of Germany has rightly become uninteresting and unknown to most Germans since re-unification.’ The same referee seems to admit the point at issue when he goes on saying: ‘It is true that the ECB is a unified central bank (although the Buba has been muttering about collateral to cover its internal credit swings).’ The qualification about the collateral is beside the point, because it has to do, once again, with a different issue—namely, the quality of the loans made by the banks. In the end the referee resorts to a normative statement: ‘in normal circumstances one would not expect a central bank to carry out unconditional and unlimited recycling of regional/national/sectoral surpluses to deficit regions, countries or sectors. Such unlimited recycling would abolish the financial constraints which are necessary for a capitalist economy. Lender of last resort activities suspend these constraints temporarily.’ This is true, of course, and amounts to say that if agents—including, most crucially, the policy authorities—‘contradictorily’ (cf. the quote above by De Cecco) act as if we were not in a monetary union (and this includes crucially the role of the central bank as lender of last resort and as provider of finance to government), the monetary union simply dissolves.
5. The missing way out, the socialisation of investments and the good deficits

One might ask whether an exit option from the euro would be desirable—for Greece\(^5\) or other eurozone countries. This is a counsel of despair, though one can no longer exclude the possibility of dissolution of the ‘single currency’. Leaving the euro would dramatically increase the external debt burden, as it would be accompanied by a huge devaluation. In addition, its feasibility requires a condition that is absent in Greece, i.e. a continuous series of significant government primary surpluses. Otherwise, the concurrent impossibility of financing the internal debt will likely lead to the insolvency of the domestic banking system. The worsening of the structural foundations of competitiveness, which has been going on for decades, makes an improvement in the balance of trade something that may be very slow or non-existent. The conclusion would be different, for example, for Italy. But the Italian exit would simply mean the end of EMU, the destruction of the EU ‘single market’ and the bellum omnium contra omnes. Something good may come sooner or, more likely, later—for the survivors.

One may also ask whether there might be a blueprint for a monetary unification different from the euro as a ‘single currency’. The answer is a resounding yes. It is clear that a real convergence of the European economies would have required policies that are the opposite of those identified in the Maastricht Treaty and afterwards put into practice. In particular, temporary but substantial increases in government deficits financed by new money—deficits that might be labelled ‘productive’, contributing to a different composition of output and a higher level of productivity within the system. At the beginning, this kind of Wicksellian–Schumpeterian policy (suggested, e.g., by Gaffard, 1992) cannot but entail higher inflation and an increase in the debt-to-GDP ratio in the catching-up countries. But price increases and fiscal ‘imbalance’ would be reabsorbed as long as the policy is effective. It is also clear that these structural policies not only need fiscal transfers, but would also be helped by some flexibility in the exchange rate. De Brunhoff (1997), drawing on Keynes’s plan at the Bretton Woods conference, suggested to adopt not a ‘single currency’, as a circulating medium, but a ‘common currency’, as a reserve currency for the clearing mechanism among central banks of the member states, within a system of fixed but adjustable exchange rates. These latter would be changed in case of significant trade deficits of some countries, with the commitment of net exporters to expand their economies and thereby symmetrically shrink the imbalances. Once the euro was implemented, however, it became difficult to see a path from here (the ‘single currency’) to there (the bancor-like ‘common currency’) without passing through hell.

This is not the occasion to review the day-to-day policy recommendations accompanying the evolution of the European crisis. The dimensions of these are multiple, as are the proposals: from the banking union to the fiscal union, from the Eurobond to an upsurge in public investments—each appearing unable to work alone. The unblocking of the European real ‘imbalances’ involves an intervention that concerns not only a reflaction on the demand side and/or a recoupling of wages to productivity. A strong intervention on the supply side and in the productive structure, along with financial stabilisation, is also called for. Being a fiscal union in the short term is utopian. The

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\(^5\) The arguments for an exit of Greece from the EMU are presented in Lapavitsas et al. (2012).
Eurobond solution, as a common guarantee for all the public debts of the eurozone countries, and a coordinated fiscal expansion, going at a higher speed in the ‘core’, are part of an alternative platform. As Varoufakis (2011) observed, one has to see Eurobonds as something more than a credible instrument to achieve low-cost public debt financing for the countries in trouble. They have to be regarded as the foundation for a coordinated expansion of expenditure and investments on a European scale. It amounts, in fact, to a proposal for a renewed and innovative new deal for Europe, with the potential to directly affect the structural basis of growth by improving the quality of output and increasing the productivity of labour. Given the nature of the worldwide crisis, originating from the collapse of the asset bubble-driven ‘privatised Keynesianism’ centred on indebted consumption—and given the apparent impossibility to start a new phase of development in investment or net exports—a new policy based on an expansion of public expenditure looks to be the only way out. An increase in wages and a reduction of inequality would multiply the expansionary momentum.

Insight into a genuine way out of the current crisis may be found in the structural Keynesianism of those who are explicitly critical of capitalism and of the ‘really existing’ Keynesianism implemented after World War II. Examples include the convergent writings by Parguez, on ‘good’ versus ‘bad’ deficits, and Minsky’s criticism and radicalisation of Keynes’s ‘socialisation of investment’.

There is no such thing as economic development not based on debt. Recent decades have confirmed that ex post government deficits are the condition for the net creation of income in the private sector. However, as Parguez (2013) insists, we should not forget that there are ‘bad’ and ‘good’ deficits. ‘Bad’ deficits are the non-planned result of the tendency to stagnation, of shock therapies, of deflationary policies, of the unsustainability of toxic finance, etc. In contrast, ‘good’ deficits are planned ex ante deficits. Their aim is to build up, and improve, a stock of productive resources. They are a means for the production of wealth: a long-term investment in tangible goods (infrastructure, green conversion, alternative forms of transport, etc.) and intangible goods (health, education, research, etc.). A gender-balance and nature-friendly approach becomes inherent and crucial to this policy. Welfare itself has to be transformed from supplying nominal subsidies to direct intervention ‘in kind’, as part of a wider horizon of ‘planning’. A deficit spending programme of this type immediately raises the government-debt-to-GDP ratio—but the subsequent growth in the denominator will make this jump only temporary. Such an intervention may have positive effects seen from a capitalist point of view, those effects that fascinate post-Keynesian economists. It would support the real economy from the demand side, it would stabilise the financial sector by providing ‘sound’ financial assets and it would increase the productivity in the system. This kind of intervention can—and must—be part of a minimum programme of a class-oriented left. It is clear, however, that this yields not a stable model of a new capitalism, but rather an ‘imbalance’: an uneven terrain where the issue of overcoming capitalism in the end has to be dealt with.

Here, the conclusions in John Maynard Keynes (Minsky, 1975) are very useful. His perspective is that of a ‘socialisation of investment’, coupled with a ‘socialisation of employment’ and a ‘socialisation of banking’—nothing new, one might say. Did not Keynes, himself, say that capitalism needed a thorough ‘socialisation of investment’? Not quite. The General Theory, Minsky observes, is to be read as a product of the ‘red 1930s’. Keynes himself emphasised its conservative, not socialist, implications. Once full employment is achieved—thanks mainly to a high level of private investment supported
by economic policy (including an expansion in the money supply, which lowers the interest rate) and the resultant positive expectations—there is no reason to argue against the market allocation of resources, according to the Cambridge economist, Keynes. Minsky claims that the ‘bastard’ Keynesianism of the so-called Golden Age had its origin in Keynes’s ambiguities. He would object to a return to ‘Keynesianism’, which has never been adequate. It was a form of capitalism where taxation and transfers governed consumption, monetary policy ruled investments, government spending brought about either waste or military expenditure, and rent positions and finance were nurtured. He called this a strategy of ‘high profits–high investment’, leading to an artificial consumption and putting at risk the biological and social environment.

This is Minsky. We have to come back to square one, he insisted: to 1933. We have to rethink a Keynesian new deal that deals with the fundamental questions: ‘for whom is the game played?’ and ‘what kind of product do we want?’ Minsky favoured a society in which the real structure of consumption is determined by government investments, the driving force building a different supply side. In this, as in his other writings, Minsky explicitly reclaimed a ‘socialisation of the towering heights’, a ‘communal’ consumption, capital controls, the regulation of finance, banks as public utilities, etc.. Minsky, like Parguez, asks the state to create employment ‘directly’. This might be inflected as a piano del lavoro (‘employment plan’) in the tradition of Paolo Sylos Labini and Ernesto Rossi. The Great Recession—the final crisis of neoliberalism as we knew it—and the European disaster—as the deadlock of neomercantilism—are precisely putting the issues of ‘how’, ‘what’ and ‘how much’ to produce on the agenda. Hic Rhodus, hic salta.

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