"Can the Eurozone Be Saved?" Conference, November 4-5, 2013
LBJ School of Public Affairs, The University of Texas at Austin

<u>Rapporteur Notes</u>

Introduction
Rapporteur: Peter La Fountain

Douglas Biow provides a welcome, tells the heritage of the conference. 2011 and 2013.

Prof. James Galbraith introduces the conference. Brings up the defining question of the conference, places this conversation as the continuing successor to the conference in 2011.

Greece as the "cockpit and fulcrum" of this crisis. Refers to anecdote about a copy of "The Affluent Society," by John Kenneth Galbraith, printed in Greek and bound with matchsticks and shellac, presented to Prof. Galbraith by Greek prisoners. This establishes the drama of the moment within the history of the struggle for democratic rule, and of the struggle for survival for noble institutions.

First Session, 9:00 – 10:30
Rapporteur: Peter La Fountain

- Will Inboden, LBJ School, Moderator
- Joerg Bibow, Professor of Economics, Skidmore College
- Thomas Ferguson, Professor of Political Science, UMass-Boston
- Kunibert Raffer, Assoc. Prof., Department of Economics, University of Vienna
- Enno Schröder, Economist, Institute for New Economic Thinking
- Landon Thomas, Reporter, NY Times

Will Inboden:

- During the last conference, there was palpable sense that the world was about to end. Has the crisis evaporated? Or has time just gone by and we're just consumed by other things?
- Will notes he is "neither an economist, nor the son of an economist."
- But as a historian, he is interested in timeframes, causality, and responsibility. Professional heritage of a historian lead him to ask: when did the crisis begin? Who were the pertinent actors?
- Then the policy question: what are the prescriptions going forward?

Joerg Bibow:

- Quick answers to lead off. Is the crisis over – no. Can the euro be saved – yes. But it can only be saved by substantially redefining what it is. We need to reset the euro, because it has failed.
- Proposal: a new fiscal union, via his treasury plan.

  Current issues with current 'euro regime':

  1. Cannot prevent symmetric shocks: economic downturns, et al.
  2. Cannot prevent endogenous, asymmetric shocks: German wage repercussions, et al.
  3. Dealing with global financial crises. If the whole financial system collapses.

- ECB is vulnerable because it does not have the euro treasury working with it in tandem. Bailouts not legally possible, etc. Euro treasury as missing element.
- We want the public sector to balance its books permanently. But how is this possible? Because it runs counter to the deficit financing we're used to; and because we don't expect the private sector to balance its books, unless we're really in boom times.
- Closed economy public sector *implies* that private sector must also balance their books. Almost never happens.

  Summarizing other euro rescue proposals. Claims they're all only half-measures.

  1. Buying up existing public debt and creating new bonds. Reducing borrowing costs.
  2. Regime reform for sharing risk, to combat asymmetric shocks.
  3. "Modest Proposal," et al.

Key points of his Eurobond fix:

1. Pool Eurozone debt and investment and create new unified treasuries debt
2. Eurozone does not do spending themselves; local national treasuries do the spending, based on GDP shares
3. Euro treasury will collect taxes to service debt – again based on GDP shares.
4. Threat of investment cuts would be the carrot

Summary of this: it's a system of continuous central deficit spending, to secure spending/finance. All posited on the GDP ratio of each country.

ECB will only deal in euro-denominated bonds. This will not be a transfer union, by design.

- Biggest issue is preserving the "golden rule" of public finance. How do you keep debt spending going, when the push is going hard the other direction?
- Securing public investment; backstop for fiscal stability.

Thomas Ferguson (UMass-Boston)

Opens with two jokes:
1. Ancestors at Ellis Island asked: "Do you support the overthrow of the United States by violence or force?" he said "violence," and sent to Texas.
2. "Where there's no conflict, there's no interest." Frank Erwin quote.

Summary of the Crisis:
- Metaphor: this is the eye of the hurricane. You just think that the Eurozone crisis is over, because it's calm. The recovery is happening at a glacial pace. We've shored up the banks; but we haven't done much more. Very low levels of aggregate demand; very high unemployment.
- German elections are an excuse. Elections come and go; there is no political will among the players, anywhere.
- Debts of the southern countries are unpayable. German reparations levels. "We all know how the German reparations get repaid."
- Instead of collecting, we "extend and pretend" to borrow the Obama phrase.
- No joint liability; no union. Sort of a hopeless situation. So what happens in hopeless situations? The Great Depression. The deep hole happens. Initial reaction to crisis; switch the parties. The incumbent party goes out, and vice versa. Then several years later, the labor and industrial unions

start to break apart. "Then the swamp creatures start to come out." They start to act like the socialist parties did in the early 1930's.
- Socialist parties have been "brain dead." They haven't been able to have any kind of leadership on this. The way out of this could come from Spain, Portugal, etc. – with the start of violence. Even in the Parisian suburbs, there are places the police won't go into.
- We're waiting for the political shock, rather than the economic one. If you can't get people employed, there will be a revolution. The quiet "rotting out" of Europe.
- Believes that revising the euro will be a messy process. And we should expect that.

Kunibert Raffer (University of Vienna)

- Leading off: the eurocrisis may well get worse, under the austerity measures underway.
- No need to save Eurozone. Counter-example: the US is a currency union with bankrupt states, but the dollar still existed.
- Neolibralism pretext a good excuse for enhancing neoliberalism. (Cited to Prof. Galbraith.)
- Skeptical of Eurobonds. Interest rates for some countries too low, the debt was heaped on them.
- Warning of "democracy deficit" in Europe, if bureaucrats were in charge of redistribution and setting figures and rates.

EURP – EU Recovery Program – fighting austerity program's effects.

Iceland example: there was an increase in social outlays, plenty of contribution from referenda. They bounced back. The Icelandic idea was to ignore the IMF.

IMF response was to castigate Iceland for not having a balanced budget, at risk even for 2014 FY. Some latent sarcasm here from Raffer, noting that we expect others (US, et al.) to have balanced budget.

Key ideas:
- Re-regulation
- Reducing sovereign debts to manageable level
- Banks should be paying the debts themselves, not the taxpayers end austerity. et al.
- Substantial time spent on "sweeteners" – eliminate these. In Greece, there were sweeteners during the recovery for investors. (Moral hazard?)

There are some debts on paper that have no economic underpinning. That is, what kind of capital investment are these debts bound up in?

Enno Schröder (Institute for New Economic Thinking, New School for Social Research)

Raises the big question at this conference: is the diagnosis to the problem correct? Notes also that some debts will "never ever" be repaid.

- Going down to the granular level to answer a guiding question for this presentation: are unit labor costs a red herring?

- Rooted arguments in postwar accounting identities of economics.
- How large is the competitiveness effect and aggregate expenditure? Presents an accounting decomposition.
- Italy and France are the competitiveness laggards, based on the data regarding the expenditure switch. The Irish situation a mystery.

- Germany's expenditure restraint stands out; leads to an export surplus. Germany is taking the "low road" to external surpluses. Is this a model for Europe?
- Foreign expenditure over domestic expenditure ratios presented in slides. Germany and Spain; France and Italy. Negative expenditure switch in France and Italy.
- France and Italy of as the "competitiveness laggards." Ireland as the good "catch up economy," but the Irish recovery is still largely a mystery.
- Lots in these slides, from a quantitative perspective. Refer to slides later for more in-depth view on Schröder's analysis. Good comparative data on countries within Eurozone.

Landon Thomas – Reporter, New York Times

- Only non-economist on the panel here. Will use his journalistic approach: keep it simple, short, and use other people's work liberally (with citations).

- Cites Randall Henning. Alexander Hamilton got the states to buy into the concept that the states needed to take responsibility and balance their own books, without bailout.

- Eurozone needs to build up a sense of communal responsibility, engendering belief that it's the people's responsibility to cover these debts and be responsible.

- Cites the idea that states' debts are actually small. Debt-to-GDP ratio is 13-14% in Texas. Posits the idea that domestically in the US, there is a sense of communal responsibility within the state itself. The federal government will not bail out a state, although will be substantially involved with encouraging and articulating ideas.

- Greek: went from 120% to 170% Debt to GDP ratio increase since the beginning of the crisis. Achievement on fiscal progress side of the ledger, but the debts are still going up.

- Belief that we're in a 1790 moment. We need an Alexander Hamilton for Europe.

- "Ideas are hard, but they're also simple." – his guiding concept.

- Summary takeaway of Thomas: we need more leadership, and more sense of responbility.

Q+A, Chaired by Will Inboden

1. **LT** asks **ES** what are the policy recommendations in your PhD research?
   ES: Message is that in Germany you do not have to fear losing export market share if you let your wages rise a little bit. Spain does not need to reduce its labor costs to have its export shares grow. They're not connected. There is still a competitiveness due to the product mix in the economies. The economies in Europe are not homogeneous.

2. **WI** asks about **JB** democracy deficit, and how to combat that. **JB** notes that we're moving away from rule by referendum, for example. That's a substantial shift.

3. Question on comparison of US to EU regarding political component of economic crisis. The fact we cannot balance a budget, et al. – is this a fitting parallel?
   TF: Every time aggregate demand fails, there's a political crisis. Comes from governments not making enough efforts to employ people. The political failure of the Obama Administration is pinned on not getting fuller employment for American citizens. Cites 2010 elections as the

bellweather of that. You only need one explanation for one major crisis in each country – in Europe it's an aggregate demand failure as well.
JB: There is some parallel, but in the US it's purely a political crisis. ECB is not on the side of failing countries, while in the US the Treasury is most definitely on the side of the investors/bankers in keeping the financial services sector afloat. There's a vested interest in the private sector that you do not see in Europe. There's an institutional problem.
LT: The US has been fine. We always seem to come out OK. Largely agrees with JB.

4. Question about the Australian model. The country could consume the goods that it would export. When a country is small it doesn't export, it consumes. ES focused on expenditure switching rather than expenditure reducing, which is good. ES's conclusions can be checked against a traded goods vs. non-traded goods model.
   ES: Appreciates critique. Key question is: what is the price setting behavior of firms between large and small countries? Unit labor costs are not quite flexible between countries. There is assumed to be a markup between countries.
   TF: Refers to new Storm and Naastepad paper on relative labor costs; says that they cover the same ground and reach the same conclusions as **ES** but in a different way.
   JB: It's shallow to divide the expenditure switching and price reduction. It's both things happening at the same time. Consumption and imports will stagnate, concordant with wage controls. But the key thing is: when Germany acts, it triggers ECB intervention.

5. **LT** to **ES**: How much can you spend in Germany, as a policy solution? What's the limit, between increased wage by fiat, and encouraging the overall demand in Germany via "having fun" and domestic consumption.
   ES: Germany herself does not have any external problems, so can afford to spend this money right now. The idea is that they can do expansionary policy until they hit a balance of payments constraint. Reiterates that Germany has taken the low road. Asserts expenditure switch can be quantified.
   JB: Claims a problem: notes that Bundesbank reports say German expenses have had little or no effect at all. The wages and incomes can increase but to no avail. A German boom would have little to no effect on the overall European economy. Raises tax cuts as additional way forward.
   KR: One country's surplus gets invested in something. It got invested in the Southern periphery.
   KR to **LT**: Disagrees on earlier point. The 11^{th} Amendment to the US Constitution is essentially a "no bailout" clause which has been not enforced with much effect over the years.

6. Question/statement from floor: The rebalancing is the major problem, and that's not happening in Europe right now, by any actors. But also: monetary policy in US and Japan is desperately trying to get us out of recession, and it's not working from the central bank perspective. Maybe we're dealing with a labor problem. We're dealing with a depression on the wage side, and maybe we need to have a governmental foray into labor markets to really resolve our problems.

7. Yanis Varoufakis: notes that everyone on the panel is addressing different, and complementary parts of the political and economic crisis. Disagrees with JB, however. Euro treasury will need to come into existence at some point, but what about political feasibility? German treasury elites will "torture the data" to make German economy impenetrable to many reforms.

   YV notes again the holistic nature of dealing with the crisis, the many different aspects. However, goes after **JB**'s ideas here. Member states will be cut off if they cannot reform their structural deficits. What do you mean? Structural deficit is a term open to a lot of discretion. Who's to say what that actually means? There is a danger of taxation without representation.

JB replies it's a fixed rule in his plan, there is no discretion or redistribution. Says you need to get the buy-in from other countries, that it's in the best overall interest for everyone. Basically this is a realistic scenario. Massive redistribution, as JB understands YV's idea, is not feasible at this point.
YV: Notes that it is a "very strange" point **JB** makes about political representation asymmetry between a European treasury with tax-collecting powers and the democratic feedback loop.

8. **TF** with a closing point: if you cannot get a population employed within a reasonable amount of time, then the entire political system will shut down. This is a lesson from the 1930's. "The world is real." Don't take your eye off the ball here.

9. **ES** with a closing point defending empirical analysis. Pushes back, gently mocking, against **JB**'s Bundesbank/"it's all relative" argument. Notes it all depends on choice of methodology.

10. **KR**: So what about the low interest rates of common bonds? The number of countries that can guarantee the bonds are quite small. Common bonds may not cause a sizeable effect on interest rates. Also, we still need a mechanism to deal with state insolvency. Additionally, let's get real. Any measures designed to help a country, if they increase debt or inflation, should be questioned as to whether they actually helped the country or not!

11. **LT**: Respect what these countries have gone through. They need to take ownership. And LT seems to show some skepticism toward central control to lead out of this crisis. Conditionality is not a bad word, and countries to show they're taking responsibility for their own recovery.

12. **JB**: Needs to make a necessary correction to the panel's analysis. Eurobond proposals will be indeed backed be by the member states. But **JB**'s fundamentally different position has a European treasury with taxing authority that goes along with it.