1. A structural and monetary perspective of the euro crisis

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1.1 INTRODUCTION

This chapter presents an analysis of the financial crisis by combining a Marxian and financial Keynesian perspective. Both are framed in a long-run, structural perspective of capitalist dynamics. We are experiencing the crisis not of a generic neoliberalism or a empty financialization, but of money manager capitalism, which was built upon centralization without concentration of capital, new forms of corporate governance, aggressive competition, capital market inflation, indebted consumption. A world able to gain from the same old exploitation in new forms, to provide internal demand and present itself as a stable Great Moderation. It can be characterized as financially privatized Keynesianism, based on a new monetary policy and a new autonomous demand driving the process, a configuration that is necessarily unsustainable. The crisis is evolving from a Great Recession to a Lesser Depression.

The chapter is divided into seven sections. Section 1.2 first gives a general scenario of the global and European crises since 2007–2008. Sections 1.3 and 1.4 summarize the main approaches – mainstream and heterodox – on trade imbalances, and Section 1.5 offers a truly credit money view of external imbalances. Section 1.6 complements this analysis by looking into the new geography of the industrial and trade relations within the European Union (EU) and Section 1.7 applies the previous discussions to the concrete reality of the euro crisis. Finally, in Section 1.8 some preliminary conclusions are provided.

Mainstream theory woke up relatively late to the euro crisis, and it is fair to say that it is still in denial regarding many aspects of the current global trend towards very unstable stagnation. The euro crisis was first posed as a fiscal problem, caused by the profligate behaviour of some peripheral countries, and then moved into a current accounts crisis, caused by nominal rigidities, market distortions and lack of discipline in those same nations. The heterodox approaches underline the role of the Economic and Monetary Union's (EMU) design faults more and more, which have allowed Germany and its satellites to pursue a neo-mercantilist strategy, accumulating huge current account surpluses, recycled as capital flows to the periphery to debt-finance their deficits. Using this outlook the euro crisis is mainly a balance-of-payments (BoP) problem, caused by cumulative differences in relative prices that have led to distinct growth strategies: export-led in the core, and debt-led in the periphery, focused on consumption and real estate investment.

As with most heterodox approaches, we accept as a baseline scenario that (1) public debts are the consequence and not the cause of the European problems and (2) the process of asymmetric integration interacted with growing financialization to create different national economic structures and subsequent modes of existing in the EMU. We also agree that the strategy of real deflation through austerity and labour market reforms is a disastrous option that, in the end, might become the ultimate cause of the problem this strategy is trying to avoid in the first place – the collapse of the EMU. However, this is not to say that everything has been said about the euro crisis, not only on the mainstream side but also on the heterodox side.

We argue that the euro crisis is not due mainly to the current account imbalances, nor to fiscal deficits, not even to the euro itself. In order to understand the euro crisis, one needs to focus on the changes in finance and industry in the last 15–20 years. First, how are the so-called trade imbalances dealt with in the Eurozone, and what is its true meaning, origin and connection with the financial imbalances? Second, how has the restructuring of German manufacturing created a transnational value chain in production and a new geography of industrial and trade relations between, roughly, the Centre-North and the South-West of the European continent?

1.2 A QUICK REMINDER OF THE GLOBAL AND EUROPEAN CRISES

Neoliberal capitalism during the so-called Great Moderation decades was a paradoxical kind of 'financial and privatized Keynesianism' (Bellofiore, 2013). To understand why and how it led to the Great Recession we have to look deeper into the features of what Minsky labelled 'money manager capitalism' (Bellofiore, 2014). During the 1990s and early 2000s, in the USA the tendency was for the household sector to become a net borrower.

The non-financial corporate sector ended as a net lender in the years before the crisis and banks lost their best customers. Financial innovations won the day: they reduced risk individually, but increased it globally. In terms of social class relations, these dynamics had devastating consequences. Workers were 'traumatized' in labour markets and within the capitalist labour process, so that the Phillips curve was flattened. Pension and institutional funds fostered a 'capital asset inflation' that, at least for a while, was hedging corporations' balance sheets *ex post*. Instability was hidden under the carpet as savers entered into a 'manic' phase, deceived by assets appreciation, while the propensity to save from income fell dramatically. 'Indebted' consumers internally boosted effective demand, thereby providing outlets to Asian and European neo-mercantilism.

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. Growing debt had its ultimate *raison d'être* in the insufficiency of income to support consumption of non-manufacturing goods and services. This caused an escalation in expenditures generating rents for the financial sector. Based on a burgeoning private debt, the process was unsustainable and collapsed the first time with the dot.com crisis. A return to military Keynesianism (after September 11) and then to a revised form of the asset bubble-driven, privatized Keynesianism led to a second bubble phase. The proliferation of subprime mortgages was an attempt to keep the real estate bubble inflating by any means. Commodities price inflation worried the Fed and other central banks; and from 2004, the Fed began to increase interest rates such that by 2005 US house prices softened. 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. This time the 'depressive' phase was inevitable, and the economy fell into the biggest crisis since the Great Crash.

The subprime crisis broke out in July 2007. 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. After a brief Keynesian interlude between late 2008 and early 2009, the turning of private debt into public debt created pressures to cut public expenditures. The spread of austerity and the domino effects after the Greek crisis beginning in 2010 brought out into the open the fallacies in the institutional design of the euro. Not only the arbitrary ceilings to public deficits and the debt to gross domestic product (GDP) ratio, but also the rules denying the European central bank the possibility to buy government bonds.

In this chapter we want to extend and go deeper into this perspective, taking into account some characters of current global capitalism and the changing European reality that are somehow underestimated in the present debate, which is focused too much on trade imbalances. We therefore have to take into consideration the deep modifications in the structural productive configurations of different European areas, and the transformation in finance and balance sheets. As we detail below, these considerations put the challenging question of the destiny of the single currency under an entirely new perspective.

1.3 TRADE IMBALANCES: THE MAINSTREAM CONSENSUS

Until the development of the 'sovereign debt crisis', the build-up of external trade and financial imbalances within the Eurozone went unnoticed. Such blindness is the result of the prevailing neoliberal consensus supported, first, by the theory of Optimum Currency Areas, according to which complete financial integration and capital mobility would absorb any future external shocks within the EMU, and more recently by the neoclassical growth theories, in particular the inter-temporal approach to current accounts. According to the latter, current account imbalances in low-income countries are the necessary outcome of the convergence process. One way or the other, an attitude of 'benign disregard' towards the external accounts of Eurozone countries seemed justified. According to the above neoclassical models, based on optimizing and forward-looking households and firms, current account balances are always consistent with efficient resource allocation, as long as excessive public deficits or other (nominal) distortions do not prevail (see Blanchard and Giavazzi, 2002).

When, towards the end of 2009, it became increasingly difficult to ignore Europe's own and internally generated difficulties, national and fiscal policies were seen as the main cause of the external imbalances within the EMU. A new consensus emerged around the idea that it is necessary to 'reassess the sustainability of government finances . . . but that the exclusive focus on fiscal sustainability is unwarranted and insufficient to understand the issues facing the euro area' (Holinski et al., 2012, p. 2). Trade imbalances have received renewed attention as they have started to be seen not as a reflection of a successful convergence process, but the result of nominal rigidities and market distortions that led to the accumulation of large stocks of foreign debt (Giavazzi and Spaventa, 2010).[1]

This new consensus represents a *revisionist* approach to the role of current accounts in a monetary area (Collignon, 2012).

The peripheral countries in the Eurozone (Ireland, Greece, Portugal, Spain and Italy) are charged with having allowed excessive nominal wage growth relative to the core countries. Higher nominal unit labour costs caused higher inflation in those economies, deteriorating its competitive power and introducing disruptions in the way the monetary policy operates at the European level (Mongelli and Wyplosz, 2008, p. 15). These distortions led to a real exchange rate appreciation instead of a depreciation, reduced exports and redirected demand from domestic to foreign goods. At the same time, the behaviour of the real exchange rate also favoured non-tradable sectors. The current consensus is that 'the imbalances that matter for the stability of monetary union are the result of either fiscal profligacy – as in Greece and to some extent Portugal – or of an unchecked expansion fuelled by capital flows feeding unsustainable growth of the non traded sector – as in Ireland or Spain' (Giavazzi and Spaventa, 2010, p. 14). When markets became aware of such unsustainable patterns, these countries started facing problems with their BoP (Giavazzi and Spaventa, 2010; Carney, 2012; Sinn, 2012).

This is the argument made by Merler and Pisani-Ferry (2012) who portray the euro crisis as a classic sudden stop, known in the context of emerging markets. Due to reasons other than productivity differentials, foreigners refuse to provide capital or residents are unable to generate enough liquidity by selling domestic assets. They argue that the 'Troika' loans in Ireland, Portugal and Greece, and TARGET loans in all the peripheral countries have covered up the internal BoP crisis in Europe. According to Sinn, TARGET has been the mechanism through which the Euro system and the Bundesbank in particular have been 'lending money to the crisis-stricken Eurozone members' (Sinn and Wollmershäuser, 2011; Sinn, 2012).

The crisis thus changed the official narrative and, after public debt, trade imbalances gained central stage in the process. Current account imbalances led to the accumulation of large stocks of foreign debt and, when sovereign markets collapsed, risk aversion among private investors left large funding gaps unfilled. The sovereign and external debt led to a BoP crisis, which would have been catastrophic if it was not for TARGET flows and Troika loans, which have replaced private capital flows in the peripheral countries of the EMU.

More recently, a second trend has developed, although not applied to the EMU, based on the idea that the focus on current accounts misses 'the spectacular evolution and integration of international financial markets over the past quarter century. Global imbalances are financed by complex multilateral patterns of gross financial flows, flows that are typically much larger than the current account gaps themselves' and 'entail potential stability risks that may be only distantly related, if related at all, to the global configuration of saving-investment discrepancies' (Obstfeld, 2012, pp. 3, 5). The main thesis behind this growing literature is that current accounts exclude changes in the Net International Investment Position (NIIP) resulting from an increase in the volatility of non-flow factors, such as the effect of price shocks on large stocks of foreign assets. The focus is on the economic significance of NIIP, which is still mostly determined by current accounts, but suffers an increasing influence of factors connected with the growth in gross flows (and corresponding stocks).

1.4 TRADE IMBALANCES: THE HETERODOX APPROACH

Heterodox alternatives have always argued that monetary integration and capital market liberalization are unlikely to bring convergence. Such approaches to the euro crisis can be divided into two main groups. The first focuses mostly on the design faults of the EMU and its theoretical foundations. These design faults led to an asymmetric process of integration, fostered by financial flows, which undermined peripheral countries' capacity to compete in the international markets creating current account imbalances. Probably the most important line of criticism concerns the role of the European Central Bank (ECB) in the defective structure of the Eurozone: 'the Eurozone has a central bank without a government, governments without central banks, and banks without an effective lender of last resort' (Toporowski, 2013, p. 572). Arestis and Sawyer (2001, 2011) pay special attention to the differences in terms of national unemployment levels, and to the deflationary bias imposed by the Stability and Growth Pact.

The second group of heterodox critics includes all those analyses that, albeit in different ways, discuss the European crisis in the context of a finance-dominated capitalist regime. These views see the European crisis mostly as a BoP problem originating in the precarious integration of peripheral countries into the Eurozone and exacerbated by the financial and banking crises. The sovereign debt problems are not the cause but the consequence of such dynamics.

Perhaps one of the most stringent criticisms of the mainstream approach included in these analyses arises from the post-Keynesian view of financial balances.[2] Two main implications can be derived from this analysis. First, the explosion in public deficits did not happen because of governments' chronic profligate behaviour but as a consequence of the shift in the balance of the private sectors towards a surplus, as a consequence of the deleveraging process forced by the financial crisis. Second, for the accounting identity to hold, external surpluses in one country must be matched by external deficits in other countries. This is the main reason why it is almost impossible for all the countries in the Eurozone to run current account surpluses in the same way that Germany does.

It is also consensual among the heterodox community that one of the main causes of the European crisis is the German neo-mercantilist strategy that considers net external surpluses as a crucial source of profits. It is a Luxemburg-Kalecki model, or a Kaleckian foreign trade model (Lucarelli, 2011), in which Germany relies on the deficits of peripheral countries to generate demand for its own exports. It is also undisputed that in the face of a process of wage compression and decreasing labour share of income fostered by the process of European asymmetric integration different regimes of 'capitalism under financialization' (Hein, 2012) emerged in the Eurozone. The export-led neo-mercantilist type,[3] matched by domestic-led[4] and debt-led[5] regimes. In general, both regimes are associated with current account, private sector and public deficits, but only in the first case are these deficits related to high levels of debt-financed consumption. Moreover, these 'growth strategies' were based on the expansion of consumption and/or household debt, in the case of countries like Portugal and Greece, or of corporate investment, mostly in the real estate sector, in the case of Spain and Ireland.

1.5 TOWARDS A TRULY CREDIT THEORY OF MONEY PERSPECTIVE ON EXTERNAL IMBALANCES

We argue that both orthodox and heterodox views that put trade imbalances in the centre miss fully integrating the role of money and finance in their analysis. The specificities of a monetary union, in which reserves are endogenously generated by the creation of credit, question the validity of the argument that the euro crisis is just one more BoP crisis. Moreover, the stress on current accounts fails to capture the relevance of financial flows in the EMU, and its relation with saving and investment decisions, which we have argued is a crucial dimension.

From the mainstream point of view, those theories based on the NIIP represent a major evolution when compared with the traditional approaches, but do not break with its main assumptions. NIIP works as a national constraint, meaning simply that the net present value of the future excess of imports over exports has to be equal to net holdings of foreign assets. Furthermore, current accounts are seen as limited by the predetermined size of international assets and liabilities that can be 'recycled', hence the importance of gross flows. In the end what we have is an upgrade of the well-known 'loanable funds theory': gross capital flows might trigger or amplify specific phases of the cycle, but they have a 'real basis', determined by 'real' economic decisions of saving and investment. This analysis seems to fail to understand that the focus on saving/investment relations is not suited to a credit economy where credit takes place and has 'free will' well beyond real consumption decisions. Underlying this analysis rests the idea of money neutrality, so embedded in the neoclassical theory.

This view resembles what the mainstream considers the 'normal' case of bank deposits creation, in which credit is based on existing resources. In fact, this is a 'soft' version of a *commodity theory of money*, what has been named a *monetary theory of credit* (Toporowski, 2013). It is an instance of a *real analysis*, the essence of the neoclassical growth models, crucial to the process of monetary integration in Europe. As argued by Schumpeter (1954), such an analytical framework applies to a world in which investment can only be carried out by transferring real resources from saving units to investment units. We are rather in favour of what Schumpeter called *monetary analysis*, where money is not secondary, but introduced on the very ground floor of the analytic structure. It is better to start from debt/credit relationship – that is, from capital *finance* as a clearing system that cancels debts and credits and carries forward the difference – with money payments as a residual consequence (*credit theory of money*).

In reality, capital flows cannot be addressed as a stock of pre-existing endowments, necessary to carry on production and investment, in high productivity countries. The loanable funds theory does not hold in a world where, as demonstrated by the modern heterodox monetary theories, the circuit of production is a monetary phenomenon: the starting point is the endogenous creation of credit-money, *ex nihilo*, which will be validated by future production/expenditure. It seems obvious, therefore, that we must look at current account determination and imbalances from a monetary perspective.

There is no intention here to go deeply into the heterodox thinking of money. One should take into consideration two very distinctive functions: money as (bank) credit, the result of decisions relative to production and investment; and money as wealth, the result of savers' choices among different assets according to their liquidity preference. These two are not the same, as assumed by mainstream theory, and the source of the confusion is due to the difference between *saving* and *financing*.

The distinction between saving (income not consumed) and financing (access to purchasing power) is crucial to assess the centrality of current accounts in the explanation of today's imbalances. According to Borio and Disyatat (2011), the common association between (global) current account imbalances and the financing of credit booms implicit in the majority of the analysis is misleading. In a closed economy, saving simply captures all the income not consumed, therefore, the only way to increase saving is to produce something that is not consumed (that is, to invest). And to do so, one needs financing. This means that 'in ex post terms, being simply the outcome of various forms of expenditure, saving does not represent the constraint on how much agents are able to spend ex ante' (Borio and Disyatat, 2011, p. 7). This constraint is determined by financing conditions, which are not necessarily related to the levels of saving or the direction and dimension of current accounts.

In an open economy, current accounts register the net capital outflow/inflow that is, from the accounting point of view, equivalent to the difference between saving and investment. But this accounting equivalence does not mean that: (1) there is a link between global financial intermediation and current accounts or (2) 'real' saving and consumption decisions determine the type or direction of financial flows. In the same way, current accounts do not tell us: (1) the extent of investment that is financed from abroad or (2) the contribution of offsetting gross flows to the existing stocks of debt and sectoral imbalances.

Within this outlook it is important to consider that countries in the Eurozone share the same payment system: 'a cross border payment between banks in two countries in the euro zone automatically generates balancing credit claims between the national central banks and the ECB. This is the mechanism that irrevocably unifies the former national currencies, converting a set of currencies whose exchange rates are merely fixed at par into a single currency' (Garber, 2010, p. 2). Even though a technical feature such as a payment system does not suffice in order to create a new currency, its existence has important implications in terms of the macro monetary structure of the EMU. In the case of a monetary union, as long as the liabilities created by individual national central banks remain equivalent and valued at par, there is no limit to the amount of reserves the Euro system can create.

The first point is, therefore, that in a monetary union such as the EMU, with a common payments and monetary system, where reserves are endogenously generated by the creation of credit that needs not to be backed by any commodity, a BoP problem loses some of its meaning. This is not to say that individual countries might not face payment difficulties, however, and until the central bank has exhausted all the means at its disposal to prevent a collapse in payments, these difficulties will mainly be a matter of liquidity rather than solvency – though, admittedly, in a big crisis and in a debt deflation/balance sheet recession, it becomes harder and harder to delineate a liquidity crisis from a solvency crisis.

Two other factors seem crucial in assessing individual macroeconomic situations within a monetary union. The first refers to liquidity conditions in the markets, which are related, on the one hand, to the institutional design of every monetary area and, on the other, to the circulation of gross flows. The accumulation of foreign reserves through trade surpluses is no precondition for the stability of the system, as long as there is a central bank willing to act as a lender of last resort, replacing the market in case of a liquidity crisis; moreover, imports from other euro countries do not require any holding of foreign currency by local citizens, since they can be financed by credit generated internally. The second has to do with patterns of investment and balance sheet management, that is, the internal capacity to generate cash flows to meet debt obligations, investment and (gross) financing flows are crucial in determining the adjustment dynamics inside the Eurozone. They are connected in multiple ways, most of them bearing no relation to trade and current accounts.

Similarly, the association of current account imbalances with the financing of credit booms in deficit countries ignores the fact that current accounts are not an indicator of how much of the domestic investment is financed from abroad. Indeed, as pointed out by Johnson (2009), any country can show a balanced current account and still have its investment financed from abroad. Net balances reflect offsetting pluses and minuses, which represent assets and liabilities with different characteristics. As a consequence, the excessive focus on current accounts does not prevent future crisis or the emergence of financial fragility.

The mainstream sees the problem as a lack of saving in the periphery, the heterodoxy as excess saving in the core. Behind the view underlying both heterodox and mainstream approaches that trade deficits are the origin of their financial imbalances looms a causal relationship between the trade and capital accounts that seems unlikely in a world where trade transactions capture only a small fraction of transactions across jurisdictions, all of which require financing.

A *monetary analysis* implies looking beyond the transfers of real resources and net capital flows, as registered in current accounts. In order to understand the structure and dynamics of capitalist economies it is necessary to understand the impact of financial flows on the various sectors, and how these condition economic decisions and increase the fragility of the economy.

1.6 THE CHANGING LANDSCAPE OF THE EUROPEAN AND GERMAN INDUSTRY

A key determinant of the process of change in Europe, before the current crisis, was the capital–labour relation. The rollback strategy led to the weakening of the working class: an outcome also achieved through new productive networks, and to the progressive enfeebling of the national trade unions in the EU countries. This was very instrumental in setting up a highly fragmented labour market. The progressive freedom of the circulation of capital and not of workers in the Eastern countries was also a way to realize what Sinn (2006) nicknamed the German Bazaar economy.

The current industrial vision in the EU is that the only competitive possibility for the EU economy is in moving upstream in the value chain. In this view higher investment accelerates the incorporation of new technologies into the production process, thus leading to more efficient and more environmentally sustainable production. Critics have pointed out that in a perspective like this, unemployment is primarily a problem of labour costs and that the way to a more labour-intensive European economy is to pass through a higher proportion of low-paid service jobs in the private sector.

The building of a European industrial structure was based on a process of 'centralization', but there was no 'concentration' process in the classical way, leading to a highly integrated company. This 'centralization without concentration' consists of a double move. On the one hand, the strategic functions of a corporation become more and more centralized; on the other hand, however, production operations results in a strong disarticulation via the imposition of global supply chains. Centralization conceals a very high level of concentration of capitalistic power; as a matter of fact, the firms at the top of each network have the classical prerogatives of the managers: they decide for the other companies how to plan the quantities of outputs in a given period of time, the pace and the speed to deliver the batches of outputs, how to arrange in sequences a mix of different items and so on.

The network/chain-like structure of the European industry and its geographical dispersion implies that the flows of products and services within each network/chain are made up of sequential acts of import and export, arranged in series. It is therefore extremely useful to understand both who exports and what is exported to a chain where the final product is consumed or exported to another country, and who imports intermediate goods essential to complete its chain of production for both domestic final consumption or for export. This is essential to understand where the added value is created. Looking at intra-European trade in this way, the current account balance fails to focus on the actual process of power and value redistribution occurring in the EU and in the euro area.

In Europe, a process of heightened 'destructive' competition, as well as offshoring through the Foreign Direct Investment (FDI) and outsourcing, culminated in record levels of mergers and acquisitions in the two years immediately before the start of the current crisis, 2006–2007. Greater centralization was dictated by the oligopolistic strategy of controlling larger market shares. Yet the merger movement jeopardized the existing oligopolistic structure in many industrial branches, so that some of the big players were themselves increasingly at risk. The opening up of Eastern Europe to Western European capital after the fall of the Berlin Wall in 1989 accelerated the industrial restructuring that had begun in the late 1970s, while an additional powerful stimulus came from China's entrance into the global manufactures market.

This is what brought about the new social division of labour in Europe: an integrated industrial system with an uneven territorial distribution of core competencies and corporate headquarters. These new extended or virtual companies are the new key industrial players in Europe and they consider the EU territory as a strategic resource. They can, indeed, organize their networks by utilizing all kinds of legal, fiscal and social obligations, as well as skills and competencies availability, as a way to fine-tune their internal division of labour.

This struggle among capitals has generated new productive facilities, though the existing ones already carried significant unused capacity. This is why we can argue that the current crisis is also characterized by oversupply in key sectors. This situation has been compounded by huge investment in 'green prairies' to create industrial bridgeheads.

It is in this context that we locate the German export boom. According to some authors (for example, Danninger and Joutz, 2007), the important factors were new ties to fast growing trading partners as a result of a desirable product mix or long-standing trade relationships and the regionalized production patterns through offshoring production to lower cost countries, partly as a result of European economic integration. The offshoring of production to lower cost countries, also within the EU-27 area, to implement a very aggressive export strategy has compounded wage moderation and shrinking social protection. The rationale of this strategy is that high-tech investment can give Germany an edge over the new competitors such as India and China, making the medium-high sector of these mass markets available for its exports, ahead of a never-ending catch up attempt by India and China.

The current account imbalances among the Eurozone countries are the symptoms of an underlying cause: the nature of the economic model briefly outlined above, intertwined with the underlying power relations among nations both in terms of market and political power. We find the considerations put forward by Simonazzi et al. (2013) extremely useful as they once again argue against the (orthodox, but also heterodox) view that we witnessed a standard BoP crisis in Europe. When the crisis erupted, the key factors triggering the 'external' crisis for deficit economies in the Eurozone were not the 'fundamentals' but instead mounting (speculative) self-fulfilling prophecies.

These authors' perspective fit well with our picture about industrial changes in Europe and Germany. They focus on the crucial factors to explain the accumulation of German current account surpluses after the introduction of the euro. 'Since 1999 the growth of the German economy has been driven not only by exports but also by imports, in particular of parts and components linked to the relocation abroad of supply chains'. Moreover, 'the primary reason for the rise of current account surpluses after 2001 was a sharp fall of domestic private investment as a share of GDP, accompanied by a growth of foreign direct investment driven by offshoring activities' (Simonazzi et al., 2013, p. 659).

Wage deflation and rising inequality (courtesy of the Hartz reforms) has been made tolerable by cheaper prices and inferior quality of goods consumed by an increasing number of the population: a dynamic that appears bad for the export of superior quality consumption goods from advanced Southern countries displaced by emerging areas.

The competitive advantage of Germany within the Eurozone is only partially related to the differences in price competition, and rests mainly on the quality of the products and the coherence of the productive matrix with the external trade demand, namely, from China and other countries, with a new emerging middle class.

1.7 WRAPPING UP ABOUT FINANCIAL AND INDUSTRIAL INTEGRATION IN THE EUROZONE

The task now is to understand in which way the critique outlined above can be extended to the existing analysis of the crisis of the Eurozone. Both the approaches summarized in Sections 1.3 and 1.4 focus on the impacts of monetary integration on trade tendencies and, therefore, on current account imbalances. Mainstream economists point to nominal rigidities and fiscal profligacy, which have disrupted the otherwise automatic convergence mechanism between the euro countries.

Heterodox studies maintain that convergence is not the automatic outcome of free capital movements. The euro mechanism reinforced existing fragilities, by allowing for a neo-mercantilist strategy from the centre towards the periphery. The result was the erosion of exporting capacity and the widening of trade imbalances, financed with the savings from surplus countries.

The main difference between these views is that while the first is based on unrealistic assumptions and theoretical anachronisms, such as money neutrality, the second points to (what we think are the) real tendencies: it is undeniable that financialization and monetary integration worked together to increase the fragility of the already weaker economies in the EMU, and that this has had an impact on trade, which has little to do with downward wage rigidities or excessive public deficits. Similarly, there is no doubt that, as argued by the heterodox authors, the strategy of real deflation through austerity and labour market reforms is a disastrous option that, in the end, might become the ultimate cause of the problem this strategy was trying to avoid in the first place – the collapse of the EMU. However, current account imbalances assume centre stage in both approaches. They diverge largely when it comes to explaining the causes of trade imbalances, and even more so in the strategy to reduce them, but in both approaches the euro crisis is seen, mainly, as a BoP crisis.

In fact, these are very distinctive monetary configurations. First and foremost because, as we described above, countries in the Eurozone share the same payment system. From a theoretical viewpoint, we question the possibility of having a normal BoP crisis in a monetary union. It does not make much sense in fact to think so. These economies are subject to liquidity and financial disturbances that are not necessarily related with current account deficits, and will not experience a BoP crisis as long as the monetary union works as a monetary union. One may then dare to question if trade imbalances are not a necessary part of the functioning of credit economies.[6]

As Toporowski (2013) remarks, in current international monetary systems, exchange rates are driven by capital flows and expectations, rather than trade balance: money is nowadays bank credit, whose value derives from convertibility into other forms of bank credit or into financial assets, with convertibility into other fiat currencies playing a minor role. Consequently, international reserves are less and less made by gold, or central bank fiat money, but claims on or deposits in international commercial banks. On the contrary, the euro is built upon a Ricardian theory of money perspective, where fiat money issued by a central bank claims not to be (as it is) a liability, growing out of debt/credit relations, and must be held scarce by the issuer, setting price and quantity. In this fictional world, employment arises out of competitiveness, and exchange rate flexibility (aiming at competitive devaluation) is a substitute for wage flexibility (aiming at competitive deflation). The single currency leaves only the second option as viable. The desired devaluation, however, internally reduces real incomes because of rising import prices; and it achieves decreasing export competitive advantage the higher the import content. And of course devaluation cuts the real consumption of the working class.

The single currency area must be seen as a credit matter, not just a purely monetary matter. In a truly credit theory of money perspective, wage and price reductions give way to a balance sheet deflation and a rise of the real value of debt. Moreover, exchange rate movement, even when managed by sovereign central banks, affects not only the trade balance but also the cost of managing foreign debt (Toporowski, 2013). From this alternative perspective, a strong, overvalued currency, which negatively affects the trade in goods and services, 'reduces the domestic money value into which foreign obligations may be converted. Specifically, it makes it cheaper to convert a government's foreign debt obligations into domestic debt obligations that are then easier to service from tax revenue' (Toporowski, 2013, p. 578).

Another reason to be wary about the conclusions drawn from a simplistic analysis of the Eurozone crisis as a BoP problem due to trade imbalances is the aggregation of very distinctive countries into one 'periphery'. If we consider the sectoral balances of these 'peripheral' countries of the Eurozone, the only characteristic shared by all of them is indeed their current account deficits. All these countries have faced a liquidity problem, and a subsequent difficulty in obtaining cash flows to finance their liabilities in the short and medium term, but the analysis stops there and does not consider the specificities of the hidden structural dynamics in each country.

1.8 CONCLUSIONS

Both mainstream and heterodox analyses assume that the euro was crucial for the growing trade imbalances. Whether you blame it on well-paid laziness in the periphery, as in the mainstream approach, or neo-mercantilist strategies from the centre, as in the heterodoxy approach, the euro has messed up the price system and led to decreasing exporting capacity in the periphery, compensated by imports from the centre. Actually, there is a prevailing view among the heterodoxy, inspired in the postwar centre-periphery theories, which sees the euro as the product of a deliberate exploitation strategy of the periphery by the centre. Our point is that the common 'periphery-core' dichotomy, based on current account positions, hides important aspects of national economies. We rather think that the euro is part of a broader strategy to reorganize individual capitals and compress the rights of the working class through financial liberalization and exposure of national economies to international competition. The monetary union was one more step towards this strategy, but its fundamental pillars are to be found in the previous process of financial and trade liberalization. It has nothing to do with laissez-faire, or a retreat of the State. It is rather a neoliberal policy variant within the world economy as contested terrain.

The widespread view of European imbalances as the result of a German strategy of 'beggar thy neighbour' is partial and inaccurate. The magnitude of changes in trade patterns happened before and beyond the euro. A key argument in our chapter is the role financial flows play in the growing imbalances: instead of amplifiers of trade problems, financial flows are a crucial factor in building the current account imbalances, either because they can have an impact on the way investment and production are structured or because of the growing importance of other sources of change in current accounts. Current account imbalances could rather be a consequence of the way capital has circulated in Europe. Inflation differentials and relative exchange rates are more likely to be symptoms of financial dynamics (motivated of course by growth and returns expectations in specific sectors) than the drivers of such flows.

The mainstream recipe based on more liberalization, combined with labour market reforms and wage cuts to increase competitiveness and force a shift towards the production of tradables, might even balance trade accounts (as it is now) but will not solve the underlying causes of such imbalances or prevent future financial disturbances. On the other hand, asking for more inflation in the core countries might be a very reasonable demand from the viewpoint of the working rights of German workers, but definitely is not the answer to the euro problems.

From an empirical point of view, we question the true responsibilities of the common currency in the current crisis. There is no doubt that the artificial limitations imposed by the euro institutional framework have made things much worse, but it is equally important to analyze what happened before and beyond the euro. The exposure to liberalized financial markets started before the introduction of the common currency and had major impacts on the way these economies are structured. Financial integration was pursued from at least the early 1990s leading to a common capital market and a common market in financial services. On the other hand, the analysis of industrial and trade relations in Europe cannot ignore the growing importance of Central and Eastern European countries (some of them out of the monetary union).

This leads us to question about exiting the euro. Exit strategies are problematic since their gains are uncertain, and it is even more unlikely that they will be followed by an anti-austerity stance. They are also uncertain, due to the scale of financial and industrial integration, and because of the innovative and productive hierarchical/geographical stratification of the European area.

If we look at the trade imbalances through the lenses of industrial restructuring and geography of European trade flows, like Simonazzi et al. do, we reach the same conclusion: exiting the euro, and the same reflationary policies, do not seem to go to the heart of the matter. The former option may likely turn out sour not only because the exchange rate that would help the needs of trade may lead to worsening balance sheets, but because the most important factors in nurturing disequilibria in the deficit countries are structural. They have to do with the way Germany has constructed a transnational value chain of firms network and articulated beyond national borders its matrix of production, how the geography of trade has been changed, the output composition and import content of different countries, the impoverishment of the ties among peripheral nations and so on.

Here and now, the issue is not to resurrect a generic Keynesianism of anti-austerity policies and boosting effective demand – as necessary as these moves are. The problems are also structural, they pertain to industrial, trade and financial policies on the scale of the continent (within and outside the Eurozone). For sure, the rejection of too simplistic explanations produces all the difficulties of building a holistic, but still coherent, narrative of the world we live in. But it might be worth trying.

NOTES

1. In 2010, Giavazzi and Spaventa published a paper claiming that the external payments situation of member states was disregarded in the monetary union. They criticize the view put forward by traditional convergence models, such as Blanchard and Giavazzi (2002).
2. The sum of the difference between income and expenditures of each of the sectors of the economy must be zero: as long as a country can preserve a trade surplus and a balanced (or deficit) fiscal account, its private sector will be accumulating financial assets (or claims on the external and public sectors). See Godley (1999).
3. Finland, Germany, Austria, Netherlands, Belgium.
4. Ireland, Greece, Spain.
5. Italy, Portugal.
6. Minsky (1986) clarified that the international credit system requires imbalances to let the international debt–credit interconnection on which today's international money is built run smoothly. Toporowski (2013) denotes the failure to provide a trade deficit to accommodate foreign debt payments as a kind of credit neo-mercantilism.

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