

THREE ESSAYS ON THE LIMITS AND POSSIBILITIES OF
ECONOMIC SOVEREIGNTY IN THE EUROZONE

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Abstract

There is no disputing Germany's dominant economic role within the eurozone (EZ) and the broader European Union. Economic leadership, however, entails responsibilities, especially in a world system of monetary production economies that compete according to political and economic interests. The first paper looks at the historical context of the US's undisputed leadership among monetary production economies following the end of World War II to help frame the broader discussion on the financial requirements of the leading economy in the new system of states after the war. It goes on to discuss how certain constraints regarding the external balance do not apply to the leader of the monetary production economies, the United States. In addition, the paper presents Hyman P. Minsky's proposal for a shared burden between the hegemon and other core industrial economies in maintaining the stability of the international financial system as a multilateral financial framework to alleviate the burden of hegemonic responsibility in stabilizing the international economy. The second paper makes use of European economic traditions reliant on statecraft to revisit the region's integration under the leitmotiv of economic sovereignty as a continental project. Specifically, it looks at the work of List, Keynes, and the Chartalists. The work of F. List sets European economic unification in its historic place as a strategy founded in large part on exploiting economies of scale (demand and supply-side) by political and economic

aggregation of smaller non-self-sustaining economies into one market. Keynes's international economics serves as the most useful orienting blueprint to begin to address the particularity of economic unification among sovereigns absent political unity. Chartalist insights into the political nature of central banks can assist in framing the European Central Bank's often clumsy attempts to hold together the Union. The third paper explores how the Great Financial Crisis overturned the equilibrium between debtor and creditor members in the EU. Violators of Maastricht Treaty quantitative limits (for instance, Germany was in breach of the limit on government deficits from 2001-2005) were not paraded as irresponsible freeloaders. The 'macroeconomic imbalances' within Europe and the world were not overly concerning, as financial sector participants chased yields in the periphery and the non-traded sectors absorbed capital. Nonetheless, ever since the sovereign debt crisis in Europe tested the political and financial infrastructure of the currency union, the coexistence between the different growth regimes has faltered as creditor nations have become increasingly hostile towards those carrying a trade deficit. The paper looks at how trade tendencies within the EZ and the broader EU have in fact consolidated Germany's grip on the economic destiny of the continent. It goes on to critically assess the potential for sovereign solvency within a currency union built over a highly competitive industrial infrastructure.

APPROVAL PAGE

The faculty listed below, appointed by the Dean of the School of Graduate Studies have examined a dissertation titled “Three Essays on the Limits and Possibilities of Economic Sovereignty in the Eurozone”, by Ignacio Ramirez Cisneros, a candidate for the Doctor of Philosophy degree and certify that in their opinion it is worthy of acceptance.

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CHAPTER 1

GERMAN ECONOMIC DOMINANCE WITHIN THE EUROZONE AND MINSKY'S PROPOSAL FOR A SHARED BURDEN BETWEEN THE HEGEMON AND CORE ECONOMIC POWER

Abstract

There is no disputing Germany's dominant economic role within the eurozone (EZ) and the broader European Union. Economic leadership, however, entails responsibilities, especially in a world system of monetary production economies that compete according to political and economic interests. In the first section, historical context is given to the US's undisputed leadership of monetary production economies following the end of World War II to help frame the broader discussion developed on the requirements of the leading economy in the new system of states after the war in the second section. It goes on to discuss how certain constraints regarding the external balance do not apply to the leader of the monetary production economies, the United States. The third section looks at Hyman P. Minsky's proposal for a shared burden between the hegemon and other core industrial economies in maintaining the stability of the international financial system. Section four looks at Germany's leadership role within the EZ and how it must emulate some of the US's trade policies to make the EZ a viable economic bloc. The break-up scenario is considered in the fifth section. The last section summarizes and concludes.

KEYWORDS: Germany; Eurozone; Hyman P. Minsky; Economic Leadership; Solvency; Endogenous Balance of Payments Position; Realization Problems

JEL CLASSIFICATIONS: B27; E42; F13; F45; F55

“Round Germany as a central support the rest of the European economic system grouped itself, and on the prosperity and enterprise of Germany, the prosperity of the rest of the Continent mainly depended.”

John Maynard Keynes (2007, 9)

“To secure allied support for strategic export controls against the Soviet Union, the United States must provide alternative markets in the West.”

Dwight D. Eisenhower (as cited in Amsden 2007, 47)

Introduction

There is no disputing Germany’s dominant economic role within the eurozone (EZ) and the broader European Union (EU). Its GDP represented 29 percent of total EZ GDP in 2016 and, as of 2015, it was the top intra-EU trade partner for 18 out of 28 countries—it figures in the top three intra-EU trade partners for all EU countries except Estonia and Cyprus (Eurostat 2015). In 2016, Germany’s share of intra-EU exports represented almost 23 percent, while its share of EU exports with the rest of the world (ROW) was 28.6 percent.¹ Almost 60 percent of Germany’s exports still go to other EU nations, though for reasons it is largely responsible for, the growth of exports to the ROW has been growing faster. The German trade surplus, however, is larger with the ROW than it is with other EU nations.

Economic leadership in the world or in a region, however, entails responsibilities, especially in a world system of monetary production economies that compete according to political and economic interests. At the end of World War II, the undisputed leadership of the monetary production economies was bestowed on the United States. It gained control of Middle Eastern oil exports, ended bilateral trade blocs that had previously discriminated against US exports, redesigned the relationship between Europe and its former colonies, led

¹ Both shares are likely higher. The “Rotterdam effect” refers to the distortion in trade statistics from registering exports from the last port of exit, and imports as the port of arrival whether the goods will be reexported or not. This means trade statistics of both the Netherlands (Rotterdam) and Belgium (Antwerp) are inflated and a large amount of their trade is in fact from other nations, among them most prominently Germany.

technological innovation in civilian and military industries, and continued the Atlanticist hegemony on relations between Europe and the other large world economies and large territorial political states. In the first section of the present paper, historical context is given to help frame the broader discussion developed in the second section on the specific responsibilities the leading nation-state had acquired in the new system of states after World War II. The second section goes on further to discuss how certain constraints regarding the external balance do not apply to the leader of the monetary production economies. The third section looks at Hyman P. Minsky's proposal for a shared burden between the hegemon and other core industrial economies (namely, regional hegemons) in maintaining the stability of international financial structures. Section four looks at Germany's leadership role within the EZ and how it must emulate some of the US's trade policies in order to make the EZ a viable economic bloc of sovereign and semisovereign states. The break-up scenario is considered in the fifth section, as well as some of its implications for the peripheral EZ countries. The last section summarizes and concludes.

Historical Context

At the end of World War II, the political elite of the United States began to draw its plans for a postwar world. Beyond terminating sterling bloc privileges so crucial to its wartime ally,² the United Kingdom, and fostering or at least giving tacit support to national independence movements in the former European colonial sphere, de facto moving the world away from bilateralism in trade (Skidelsky 2000; Kolko and Kolko 1972), it had to project its

² Great Britain had its large deficit during the war largely subsidized by not allowing sterling bloc countries to convert their sterling balances into dollars. Naturally, this group of countries had accumulated substantial sterling holdings during the hostilities. In addition to restrictions on convertibility, sterling bloc countries deposited their dollar reserves in London, allowing for use of the "dollar pool" in payments for imports from the United States (Skidelsky 2000, 194). Certain restrictions on foreign transactions for "residents" were maintained in the sterling bloc well into the 1960s.

own leadership strategy. In recognition of its liberal political traditions, it could not enforce loyalty via the threat of overt military interventions after hostilities had ended. Therefore, the United States centered its attempts to limit European influence in the periphery of the world economy, as mentioned above, by promoting or minimally not hindering the movements for national liberation (Arrighi 1994; Amsden 2007)³ and by opening negotiations on tariff reductions via the General Agreement on Tariffs and Trade (GATT). However, if the United States was to successfully limit their European partner's formerly privileged access to markets in the developing world, it would need to replace the bilateral trade relations with an alternative. The cornerstone of the US's hegemonic strategy regarding its political economy at that time consisted of creating new and stable markets for itself and its allies. Hence, as part of the US's Cold War strategy, the productive capacity of the war-torn European powers was to be reestablished. This, in turn, would entail opening its large domestic market to imports from these select countries. The United States would become the market of preference for exports originating from the other major modern industrial nations outside the Soviet bloc.

Table 1.1

US Imports and Exports of Machinery, Transport Equipment, and Other Manufactures		
Year	As % of total US exports	As % of total US imports
1960	52.95	40.06
1969	62.44	60.44

Source: Statistical Abstract 1970, United States Census Bureau.

³ The 1956 Suez Canal incident is a case in point. Eisenhower took the side of Nasser against the threat of military aggression from France and the United Kingdom (Harvey 2003) in their attempt to retake the strategic maritime corridor.

Table 1.2

US Imports and Exports of Finished Manufactures		
Yearly average	As % of total exports of merchandise	As % of total imports of merchandise
1936–40	52.36	18.72
1941–45	71.34	17.97
1946–50	56.34	17.89
1951–55	62.69	20.36
1956–60	58.68	31.06
1961–64	57.9525	37.09

Source: Statistical Abstract 1960 and 1965, United States Census Bureau.

The US plan to isolate the Soviet Union—its new geopolitical foe—forcing it to modernize its economy with very limited technology transfers from the ROW⁴ would not obtain default compliance from war-torn countries eager to restart their trade. The United States would have to offer substantial benefits in return for acquiescence by those European nations willing to trade with the Soviet Union and its satellites—also keen to modernize their economies alongside their neighbors to the West, and thus in need of strategic imports. The first inducement to comply with this quid pro quo was the large partition of aid needed for reconstruction under the Marshall Plan. However, once reconstruction was well underway, the new world hegemon would need to offer markets for the output of the now large-scale civilian industrial production coming from new and old allies. Given the state of the world economy at the time, the chance to trade with the new great world power, gaining access to its large and stable consumer markets unaffected by the hostilities, offered the European

⁴ Kolko and Kolko (1972) document how the Soviet Union insisted on imposing a limited amount of reparations on Germany during the 1945–46 negotiations with the other occupying forces in order to supply itself with machinery and industrial goods from Germany’s more advanced industrial sector. The United States, on the contrary, was adamantly opposed to reparations requirements and was well aware that the Soviet Union mainly occupied the agricultural region of Germany.

powers and Japan much more than just an economic lifeline. It offered jobs that brought relative political stability and, ultimately, industrial wealth.

In other words, the United States would carve out its extremely large sphere of influence by special commercial relations with European powers and Japan, keeping the manufacturing base of those nations profitable and growing.⁵ At the same time it offered defense services from an at times real (and at times perceived) and expanding “communist threat.” This new kind of hegemonic strategy, via trade relations with other ideologically aligned Western core economies and the would-be Asian economic powerhouse of Japan (all stripped of their former imperial holdings and thus geographically unable to compete for supremacy with either of the two superpowers), ensured secular economic growth on the foundation of manufacturing and exports. The expansion of manufacturing, and the economic growth thus derived, undoubtedly went a long way in gaining the goodwill of the US bloc of nations (including, among others, the countries of Western Europe, the former sterling bloc countries, Japan, and several nations in Southeast Asia). It allowed these nations to export their way into regained economic stability. This proved to be a *consensual* strategy (Guha 1997) of the Cold War, as opposed to blatant coercion. As elicited from Eisenhower’s statement in the epigraph (Amsden 2007), the United States recognized that the best form of persuasion in their hegemonic project would be via commercial ties that helped solidify civic support for the liberal-democratic ideology—though oftentimes not so democratic praxis—that it wished to symbolize.

⁵ “early US Cold War policies... created the conditions of the subsequent intensification of inter-capitalist competition—by upgrading and expanding the Japanese and Western European productive apparatuses—and because they constrained the capacity of capitalists to shift onto labor the burden of intensifying competition—by promoting near full employment in the North and development in the South” (Arrighi 2007, 166).

However, as Minsky's articles on international economics in the 1980s (Minsky 1983, 1986) clearly show, the limits of this strategy were being felt by the mid-1970s. Even before then, the whole Triffin dilemma⁶ discussions on the (for the time) exceptionally large accumulation of short-term dollar liabilities by foreigners signaled a forced change in the role of the United States as world superpower. The US's large and increasing balance of payments deficits were flooding world markets with dollars. The United States had transitioned from capital exporter to the capital-famished economies of Western Europe and Japan to the main market for manufactures from overseas. However, it was still sending more capital abroad than it attracted; that is, investment abroad by US residents was greater than foreign income to US residents plus investment in the United States by foreigners. This gave the reindustrialized European nations access to both its extremely large and stable domestic market, as well as a new form of reserve asset that was independent of traditional metallic constraints.⁷ Both of these enticements—the affluent export market and the use of the dollar as a reserve currency—further integrated the industrialized countries into the US's international economic order. However, the strategy of assuring loyalty by trade came at a price. In the short run it would harm US manufacturing enterprises by openly conceding market share to exporters from Cold War allies (see tables 1 and 2). Nonetheless, at the time,

⁶ The Triffin dilemma refers to the complications in maintaining adequate liquidity levels of key international currencies used as reserves by most central banks in the world in view of the requirements this implies for the net reserve position of the issuing countries of said currencies. If key reserve currency issuers pursue a reduction in the balance of payments deficit, the ROW will be deprived of adequate liquidity and income required to maintain a functioning international financial market. Thus, the United States must provide income and credit flows so that users of the international financial system can service a substantial network of *international* liabilities and yet, simultaneously, pursue *national* policies conducive to economic growth and stability; see Triffin (1960, 1978).

⁷ Not all allies appreciated the break from the gold exchange standard, the most vocal opponent being France under de Gaulle (Hudson 2003).

the Cold War *raison d'état* carried more weight than the struggle for market share or, for that matter, the immediate bottom line of many US corporations.

The Hegemon's Role in Leading the Monetary Production Economies

Once Western Europe and Japan had been successfully reconstructed and industrial production was on sure footing, the United States would help generate the dollar flows overseas via trade with its Cold War allies. This function of consumer of first resort for export-grade manufactures was assumed by the United States exclusively on account of its privileged status as world economic hegemon. No other country could take the initiative in maintaining policies leading to high levels of consumption exclusive of the otherwise forceful need of relying on export markets without eventually running down their foreign exchange reserves and risking severe international imbalance. The US consumer markets would not be constrained by the US's long-term export performance; rather, the other core countries' long-term export performance would partially depend on US consumer markets (Wray 1994). This implies that the international hegemon cannot at the same time be the economic leader and yet be constrained by concerns of accumulating foreign exchange, i.e., by concerns with the *affordability* of its leadership. On the contrary, the hegemon creates the conditions by which it carries out its role as supposed guarantor of the reproduction of the world system precisely by not restricting its actions to financial affordability. To a large extent, the exigencies of supremacy are too urgent to leave to the arithmetic of clerks.⁸ More importantly, in absence of an international clearing and overdraft system as proposed by

⁸ The great German philosopher Immanuel Kant had warned in 1795 that, "This arrangement [viz. a credit system] the ingenious invention of a commercial people [England] in this century constitutes, in fact, a treasure for carrying on of war, which exceeds the treasures of all other states; and it can only be exhausted except by the forthcoming deficit of the exchequer, which however can be long delayed by the stimulus to national commerce and its expansionist impact upon production and profits. This facility in making war, together with the inclination to do so on the part of rulers—an inclination which seems inborn in human nature—is thus a great hindrance to perpetual peace" (as cited in Triffin [1997]).

Keynes⁹ or a proposal like Minsky's discussed below, there must be at least one nation in the system delinked from the rules governing external balance so that others can trade advantageously.

The US's particular status as the leader of the *monetary production economies* implied other important obligations as well. The main *financial* obligation was the need to bring stability to the international financial system and to offer solutions when conditions were endogenously made unstable, for instance, the bold and controversial international demonetization of gold in 1971. Fulfilling both obligations—providing affluent consumer markets for international exporters and looking after international financial stability—were of the highest importance. They gave a level of credibility to the perception that the hegemon's actions represented and looked after the *general* interest.¹⁰ No leadership role at the international level can be successful without the ability to offer systemic solutions to other major stakeholders,¹¹ both in the political and the economic sphere. In the words of Arrighi (2007, 166), “hegemonic states play governmental functions at the global level.”

The required role to be assumed by Germany, the core country of the EZ today, is not dissimilar to that of the United States during the Bretton Woods period. After the recently bygone period of large capital outflows—utilized mainly in the EZ periphery for propping up real-estate bubbles, for government expenditures to avoid labor conflicts, or to give the impression of *catching up* with the more economically powerful members, as reflected in

⁹ Regional preferential trade blocs (Kregel 2017), or trade blocs organized along cultural affinities may also prove a valuable alternative.

¹⁰ “Once again, [the] capability to remake the inter-state system was based on a widespread perception among the rulers and subjects of the system that the national interests of the hegemonic power embodied a general interest” (Arrighi 1994, 65).

¹¹ For Arrighi (1999, 289), global leadership “must be willing and able to rise up to the task of providing system-level solutions to the system-level problems....”

high unit labor cost growth (Flassbeck and Lapavitsas 2013)—it must now offer concrete solutions.

The maintaining of low interest rates for an extended period would not suffice; nor was continuing quantitative easing sufficient. If Germany is to live up to its regional hegemonic role, implicitly bestowed upon it once major stakeholders in the West signed off on German reunification, it must offer systemic solutions to the severe problems of unemployment and slow growth in the peripheral EZ. It must do so by creating stable fiscal and financial conditions for the sovereigns in the periphery, fostering the impetus to finalize the economic integration and catching up (convergence). These stable conditions must include continuing bank credit and portfolio flows, but also foreign direct investment and tailored official development financing, including technology transfers (Ozawa 1989). The latter two financial flows could lay the groundwork for the increasing current account deficits that the regional hegemon will have to sustain in the future as part of a systematic longer-term solution to the currency union's economic woes, as was the case with Japan and its regional commercial partners in the late 1980s (Ozawa 1989).

Minsky's Proposal for a Shared Burden in Sustaining International Liability Structures

Already in the early 1980s, Minsky had alerted other economists to the problems that could arise if the sole burden of providing income in dollars to peripheral or non-core countries were laid exclusively on the shoulders of the United States: "While the responsibility for maintaining the viability of the international financial structure falls largely on the United States, the proximate beneficiaries from the viable financial structures include banks, firms and households which are not United States entities. Such concentration of

responsibility (and costs) and dispersal of benefits can interpose political obstacles to actions needed to assure the viability of today's financial structure: United States workers may lose jobs so that Brazilian debts to Swiss bankers that manage accounts for Arab interests can be validated" (Minsky 1986, 9).

Minsky recognized that a negative US trade account, supporting the ROW's servicing of their large *dollar* official and private sector liabilities, would imply a loss of domestic market share for US manufacturers and a worsening employment situation. "A United States deficit on current account that is large enough to provide dollars for interest on perhaps \$1,000 billion of such debt will cause severe employment dislocations and downward pressure on profitability of United States industry" (Minsky 1986, 19). He thus called on the Western European countries and Japan, which benefitted greatly from the generous aid tied to Cold War objectives, to take on some of the responsibility in providing the dollar income to the ROW. Income flows in hard currency would enable debtor countries to deliver payments for both debt service and their imports bill.

Minsky's call for international cooperation among the industrial powers of the West to help developing nations earn the dollar income required to bring stability to the international financial markets was an arrangement that paid heed to the tripartite interests involved, namely those of: 1) the international hegemon, 2) the core industrialized countries, and 3) the developing countries. Specifically, the burden of maintaining the world's dollarized liability structure would not fall solely on the shoulders of the United States, nor would the working classes of the core industrialized nations need to relinquish more of their hard-earned productivity increases. Developing countries, for their part, involved in incipient

industrialization and “catching up” processes would be able to finance their strategic imports at least partially through increased exports.

This proposal/scenario was as close to a win-win-win situation for these interests as one could conceive of since Keynes’s bancor proposal. Keynes’s plan sought to achieve a similar break with the zero-sum game of beggar-thy-neighbor export market competition by eliminating the deflationary bias of the gold standard’s adjustment policies. More specifically, Keynes sought to create an international legal structure for a clearing union that ensured surpluses were to be spent or sustainably lent out thanks to enlightened international financial policy (Bibow 2017; Davidson 1985). In any case, Minsky’s rather informal and ad hoc proposal when compared to Keynes’s official one is far superior to both the “structural adjustment” paradigm of the Washington Consensus, and the more visceral neocon paradigm of a “New American Century.”

Minsky’s main argument in his articles on international financial conditions in the early 1980s is that the balance of payments becomes in large part *endogenous* to the hegemon’s actual role as such in the world economy. This point is also emphasized, though clad in different rhetoric, by post-Keynesians of the *chartalist* camp (Wray 2012) who insist that the reduction of the negative US trade balance is not and cannot be a macroeconomic goal in itself. Once the dollar overcame the pound sterling as the dominant reserve currency, the US trade balance would have to respond to the stipulations of the international financial system it now led. During the Bretton Woods period, this meant making sure neither weak growth in trade nor dollar shortages would in any way undermine friendly governments in strategic allied countries.

However, the United States had to continue sustaining the world's effective demand by being one of the consumers of first resort to core countries like Germany and Japan, as well as to the new economic colossus, the People's Republic of China. The negative effects that the very large trade deficit has had on the United States in absence of an official industrial policy¹² or an employer of last resort/job guarantee¹³—and that Minsky had foreseen in the early 1980s—can largely explain the demographic composition and socioeconomic impulses to the Trump election. In fact, the US's need to run the negative current account may in fact be the main reason to implement the job guarantee, due to its countervailing effects both domestically and internationally. A tailored job guarantee is also useful in targeting certain sectors that require special attention, i.e., a certain independence from market exigencies.¹⁴ Moreover, Minsky was adamant in pointing out that the hegemon could not adopt protectionist policies in a world of complex international financial linkages, where domestic and offshore money markets were intimately intertwined. The hegemon—or, in Minsky's (1986) words, the “country whose money is the principal currency of denomination for international indebtedness and whose national money market is the international money market”—must make its currency sufficiently elastic to reassure the validation of commitments on debt legacies built up during its rule. Any hesitancy in this

¹² “...a major portion of the income and profit sustaining expenditure in the United States will have to come from a Federal deficit rather than profit determined investment. Hopefully the non-market determined expenditures by the Federal government will be real income and productivity enhancing, but the record on this account is not good. Military expenditures and transfer payments are the preferred expenditures” (Minsky 1986, 21).

¹³ “Because a balance-of-trade deficit tends to constrain profits, an economy in which imports react strongly to income—as is now true of the United States—will experience constrained increases in profits when the domestic economy expands. This weakens the expansion and increases the investment and government deficit needed to achieve and sustain full employment” (Minsky 2008, 168).

¹⁴ For instance, a job initiative plan to promote STEM jobs in renewable energy sectors could be implemented, thus guarding strategic industries even in the face of increasing foreign competition.

regard will severely, if not definitively, weaken its position, as its alliances are tested by the lack of action.

Minsky was writing in the midst of widespread defaults in Latin America and other regions of the developing world and did not hesitate in regard to where ultimate accountability should lie. The country in whose currency most international financial market liabilities were denominated would have to take the lead. The US's role in the medium- and long-term stabilization would involve the subordination of short-term national prerogatives to (*longue durée*) international responsibilities: "There is no solution without a large United States trade deficit" (Minsky 1986). This realization no doubt signaled the transition from commercial and industrial leadership to overt financial hegemony over international capital and money markets, a trend identified by Braudel (1980) and Wallerstein (1980, 38) as the traditional path of hegemonic transition.

Minsky's emphasis on the US's need to run current account deficits has another angle of significant importance when viewed in the context of his work. Minsky held the belief that *at the national level* in a monetary production economy it is in general preferable for the private sector to net accumulate government liabilities than for the government sector to be in surplus vis-à-vis the private sector, mainly because "government debt is free of default risk; whatever the government debt contract says will be forthcoming will, in fact, be forthcoming" (Minsky 1986, 39). The economic agent whose liabilities are the most liquid,¹⁵ i.e., at the top of the money pyramid (Bell 2001), should be the one running the deficits due to their liabilities' safety and high demand. In the international economy, as well as in the

¹⁵ "Furthermore, government debt is marketable, and its marketability is ultimately guaranteed by the Federal Reserve System, a guarantee that does not necessarily extend to other debt. Thus, the owners of government securities are assured of the ability to modify their portfolio as their needs or preferences change" (Minsky 2008, 39).

EZ, the same principle applies. The international and regional hegemons should, however paradoxical, run the trade deficits—i.e., should be consuming at a level that ensures the current account is negative—because of their high productivity and high per capita income. Their liabilities are at the top of the *international* money pyramid (Mehrling 2013) and thus define international liquidity preference. Apart from fostering stability, this kind of growth-biased international trade position will go a long way in promoting *goodwill* among other nations in the international and regional system of states. Furthermore, it will encourage a suitable environment for “catching up” thanks to an economic framework that is absent the chastening of the financially less favored—that is to say, absent *austerity*.

German Regional Hegemony

The successful export-led development paths pursued by geographically and demographically smaller nations, such as Germany and Japan, inevitably led to huge appreciations of their currencies in the post-Bretton Woods world (Brenner 2002, 2006). This somewhat moderated their spectacular increases in export growth and brought about their own economic difficulties. Germany was only spared the worst of these effects from 2005 onwards thanks to the combination of the adoption of the euro and the incomes policy put in place to check increases in unit labor costs vis-à-vis the rest of the euro participants (Flassbeck and Lapavitsas 2013). This aside, the project of European commercial and financial integration makes sense to the extent Europe can override the historical trend of compulsory exports to keep high rates of effective demand and employment. The continuing process of integration will also assist in limiting the transfer of even more sovereignty to actors outside the region (Cencini and Schmitt 1991; Cencini 1997), which determine international economic performance due to their control over massive consumer markets.

As global *economic* hegemony moves to the East (Arrighi 2007), as witnessed by China surpassing the United States in GDP as measured in purchasing power parity terms, the importance of consumption is again highlighted as an economic *fix*¹⁶ to the problems of stagnation and secular decline. The United States continues to pursue policies as though it were the sole superpower without addressing the stagnation in real wages in its domestic market (except during bouts of extreme asset price inflation). On the other hand, in its promotion of the “One Belt-One Road” (or new Silk Road) initiative, China is in the process of market creation that will provide crucial resources both to the Chinese manufacturing leviathan and to the large working class whose real wages grew over 11.5 percent a year from 2000 to 2015 (ILO 2016). Stable and healthy consumer markets can overcome the stagnant state of industrial and productive forces in the international economy, just as they had in the post–WWII economic boom.

At this point, the issue of hegemony becomes crucial in understanding the relationship between the financial system and consumer markets, a concept encompassing more than just commercial or industrial preeminence (Anderson 2017). Healthy and stable consumer markets will undoubtedly require overt macro policy aiming at full employment, most likely with reduced weekly hours in comparison to the traditional workweek. However, the hegemonic nation-state must initiate the macroeconomic full employment policy because

¹⁶ The reference is to the use of the term as in David Harvey (2006) and Beverly Silver (2003). The idea implies both a temporary solution to a crisis of accumulation, and a changing landscape along with changing fixed capital investment—especially in Harvey’s concept of a *spatial fix*. That is, the (momentary) solution for a crisis of accumulation oftentimes implies changes in infrastructure and landscape that become an outlet for investment and a possible starting point for a new wave of accumulation. Fixing secular stagnation by strengthening consumer markets in accordance with the post-Keynesian tradition will thus also imply a modification in the urban landscape and productive apparatus of those societies. However, it does not necessitate more shopping malls or retail stores. It might involve more care economy industries or leisure activities, like subsidized higher education, production of art, sporting holidays, travel, university programs for human development (open to people of all ages and not exclusively for professional development), religious studies, and charity work, among many others.

of its use—in both monetary and fiscal policy operations—of a currency considered a final means of settlement for a region with a very large population and considerable purchasing power. The EZ region comprises 19 member states with over 341 million people and a high but stagnant (since the global financial crisis of 2007–09) real GDP per capita. The income streams generated by the fiscal expenditures of the hegemon and the financial flows made possible by its monetary operations largely determine both worldwide and regionwide solvency and liquidity. The control over a currency of such commercial and financial importance gives the hegemonic nation-state the financial means to both comfortably stabilize sovereign debt crises by financial arrangements (e.g., the Brady bonds initiative) and to overcome secular stagnation by initiating full employment policies. Neither of these faculties threatens its financial solvency; on the contrary, if anything it strengthens it, not least of all because its currency determines *international liquidity preference* (thanks to the international character of its money and capital markets). Moreover, the hegemon alone can avert critical deterioration in the terms of trade in the face of persistent trade deficits. Due to its special role in the system of states, and its setting of the conditions that “rule the roost” when it comes to international liquidity preference,¹⁷ it can count on an elevated international demand for its highly liquid liabilities—which can be administered through interest rate policy, similar to bank rate during the pre–World War I gold standard (Minsky 1986). If this elevated international demand for its debentures were to weaken momentarily, historically it has shown the ability to coerce reserve hoarders (by “moral suasion”) to alter their antisocial trade policies, as in the cases of Germany and Japan during Plaza Accord and Smithsonian

¹⁷ The Fed has immense power in determining interest rates beyond domestic money and capital markets, not only through traditional monetary policy operations but also by way of its swap agreements with other major central banks.

Agreement dialogues—though perhaps not without temporarily straining certain relationships (see, for instance, Koo [1988]).

Keynes, for his part, understood that a full employment fiscal policy implemented by any country other than the world hegemon would most likely be self-defeating in a world of increasing multilateral commercial ties precisely for the reasons mentioned above. Export performance and foreign exchange holdings for all but the world monetary and financial leader determine the solvency required for promoting full employment. This understanding is at the root of Keynes's postwar international monetary clearinghouse plan and perhaps one of the reasons he forcefully lobbied for the Bretton Woods plan in spite of the drastically reduced demands made on the United States with respect to his own proposal (Williamson 1983; Skidelsky 2000). The international clearing system proposed by Keynes (1963) was the minimum financial infrastructure required to allow individual nation-states to successfully implement the macro policies of the *General Theory*. The international clearinghouse proposal framework functioned to avoid antisocial neo-mercantilist competitive devaluations and the irresponsible hoarding of reserves by surplus nations. The resulting guaranteed reflux of financial and income flows to the commercially and industrially weaker nations under the Keynes' plan thus provided the means for the implementation of the domestic macro policies spelled out in the closed economy framework of the *General Theory*. These refluxes would go a long way in promoting emulation by economically weaker nations.

Hence, absent a growth-biased international clearing union, the dominant state within the currency union must be the *first mover* in the implementation of full employment policies, as it has acquired a unique international financial status, placing its debt a notch

above the rest in the global debt (liability) pyramid. By promoting such policies, it will both exert and acquire hegemony, as the history of the US's relations vis-à-vis its strategic Cold War allies testifies. In such a scenario, the hegemon will obtain the goodwill of the more economically challenged nation-states that cannot initiate countercyclical fiscal policy without the threat of deterioration both in their terms of trade and in their perceived default risk. This international posture is a potential alternative to what David Harvey (2003) has called the “political economy of retrenchment” that has dominated the EZ recovery policies.

The Break-up Scenario and its Possible Consequences

The most apparent alternative to German regional economic hegemony would seem to be the definitive disintegration of the EZ, in view of the crisis-prone nature of the periphery and the low growth of certain economically important countries, like France and Italy. This would most likely be followed by a strengthening of US influence in the region—at a minimum, monetarily speaking, with renewed accumulation of dollar reserves where previously little were needed—seeking to counter rapprochement with Russia, the major energy supplier to Europe. In a scenario of renewed US influence, it is difficult to imagine anything but a further intensification of austerity measures, derived from US-originated economic policies.¹⁸ The new deutschemark would appreciate dramatically, in line with post-Bretton Woods patterns, forcing Bundesbank intervention. The accumulation of immense amounts of dollar reserves to keep German industry from being completely priced out of export markets (and the subsequent sterilization) would continue until once again a new Smithsonian Agreement or Plaza Accord would be required. The EZ peripheral

¹⁸ Austerity or deflationary adjustment leading to unemployment and excess capacity in response to fluctuations in prices and demand is the main prescription of neoclassical economics, the dominant economic paradigm taught and dogmatically held in the United States and most of its satellites—including, of course, the United Kingdom.

countries would depreciate their new national currencies, default on their euro liabilities, and try to attract foreign capital seeking higher yields in an environment of continuing low interest rates. Their hope this time would be to avoid rapid unit labor cost increases—increasingly more difficult to do by “democratic” means, due to the historic lows in the consensus-building capacity of leading political parties. That is, the seemingly continuous boom-bust cycle would start anew, but with smaller states even more vulnerable to severe limitations on their fiscal and monetary sovereignty.¹⁹

Most importantly, the disintegration of the currency union would make the crucial alternative to the commonly prescribed export-led growth path and mainstream hypostatization of competitiveness considerably more difficult for EZ countries. This alternate path is that of growth based on scale-driven European consumer markets under a single currency regime encompassing over 340 million citizens, an idea not too dissimilar from that which Raul Prebisch (1965) had envisioned for the Latin American economies. With growth rates for the most part still stagnant in Europe, and the United States flirting with a more protectionist economic model in clear contradiction to the world of multilateral trade it forged after WWII, the promise of growing export markets can only come from the East. China’s fast development and increasing real wages are creating an export bonanza, but mainly for large players within the EZ. Germany’s exports to China alone for 2015, the latest year for which data is available, represented over 56 percent of total EZ exports to the largest Asian economy, while Germany, France, and Italy’s combined exports to China took up almost 80 percent. The projected value of imported goods into China for the years 2018–22,

¹⁹ “In comparison with free-trade imperialism, the institutions of US hegemony have considerably restricted the rights and powers of sovereign states to organize relations with other states and with their own subjects as they see fit” (Arrighi 1994, 67).

according to Chinese authorities, will be \$8 trillion (Xinhua 2017) or the equivalent of 74 percent of its 2016 nominal GDP.

Therefore, abandoning the unified currency puts both the EZ core and the periphery back to where it was before the currency unification in regards to the inter-state system, competing for export markets instead of possibly cultivating a large domestic market (as far as currency is concerned). As has been the European tradition for centuries (Dehio 1962), no European state would be strong enough to put together the *continental* policy that is urgently needed today to bring solutions to the current high unemployment/low growth equilibrium, resulting in a political-economic vacuum. The stronger states would probably thrive by increasing exports to Asia thanks to their decades-long fomentation of an industrial policy based on high capital intensity, while the weaker peripheral nations would further intensify their status as satellites of these European powers, possibly siding with one over the others. This scenario must surely evoke similar, not-so-long-gone historical conjunctures.

As mentioned above, the main alternative to export-led growth is the continuing development of the EZ as an internal market. The freedom from having to accumulate foreign exchange to service the great majority of government liabilities gives the currency bloc countries significant leeway regarding the balance of payments. Thus, intra-EZ trade can in effect be viewed as *domestic* for *currency* purposes—by no means a minor detail. This opens up the possibility of coordinating stabilization and stimulus policies within the bloc to help tame financial markets reacting to the *self-induced* fears from the perceived insolvency of heavily indebted sovereigns, which, for their part, require adequate financial support to stimulate their domestic economies. Historically the European nations have been heavily trade dependent. Nonetheless, the currency bloc now has to a degree internalized historic

trade patterns as far as payments are concerned, which makes possible a cooperation geared toward regulating antisocial hypercompetitive forces. Previously an economic situation like the one today might have triggered a new wave of intensified neo-mercantilist political-economic policies throughout the continent. Under the unified currency, due to the circumventing of the *transfer problem* within the currency bloc (thus avoiding the need to accumulate and hoard foreign exchange), battles for commercial and industrial supremacy may be averted within a shared framework, however weak that framework is today.

The idea of a strong commercial state other than the world hegemon itself taking the initiative in reducing its trade surplus is not unheard of. In the early 1980s, Japan began its voluntary export restraints on automobiles precisely to avoid the mounting international stigma associated with its policies of limiting imports. In what today appears to have been a lucid premonition, at the time there was a fear among Japanese economic authorities that the (for the time) extremely large bilateral surplus vis-à-vis the United States might eventually trigger protectionist policies in the United States (Ozawa 1989, 9; Ozawa 1993, 134).

Conclusion

There are undeniable limits to a single country's strategic use of the balance of payments to stabilize and/or strengthen financial markets in key regions of interest. Minsky clearly describes these limits and the heavy burden they impose on the hegemon. The sustained effort in promulgating the world's effective demand by way of a single nation's negative current account can only be temporary, as the eventual end of the Bretton Woods period attests. For this reason, as we have seen, Minsky places partial responsibility in stabilizing international liability structures on other key nations in the international system of states that have been direct beneficiaries of the hegemonic commercial quid pro quo with the

United States. Germany will require the same kind of assistance from other surplus nations within the EZ if a growth strategy is to be successfully implemented. This kind of mutual assistance in the European state system is not historically unheard of. However, there is little doubt it will require class leadership other than that of the absentee/leisure/rentier class, which has resisted euthanasia and in turn tightened austerity on pensioners, the youth, and weaker regions of the currency union.

Apart from the valuable growth bias it establishes, Minsky's proposal for a shared burden among core countries also deals with the necessity of a political union accompanying the incipient economic (currency) union. The leadership role of the regional hegemon implies taking responsibility for the stability and, more importantly, the viability of the currency union. This commits the leading nation politically to the sustainability of the development paths of the weaker nation-states. Certainly the political strength of Germany increases in this hegemon-led regional scenario, where the leading nation spends liberally on its allies, i.e., makes its current account endogenous to the external balances of its regional allies. For their part, peripheral nations were already very limited regarding sovereignty even before the currency union took effect. They will continue to sacrifice monetary sovereignty, especially in their capacity to set an interest rate policy and in their capacity to devalue; however, the peripheral countries in the EZ gain fiscal sovereignty by averting the need to acquire non-euro-denominated debt, thus potentially enhancing their capacity to pursue countercyclical fiscal policy with the support of the conscious regional hegemon. They also gain sovereignty in so far as the conscious hegemon and its regional allies strengthen a highly educated and affluent consumer market, perhaps at present the largest in the world, with cultural similarities and a shared, though at times highly conflictive, history. Hence, the regional

currency union represents a step forward in two key ways. It not only encompasses a large and exceedingly efficient regionwide productive apparatus, but also has enormous potential as a large market for *realization*—the extremity of the M-C-C'-M' circuit referred to in the value-theory tradition. That is, the currency and economic union has untapped potential in consumption and realization, though it bewilderingly not only refuses to harness this potential, but chooses to downsize its consumer market at every opportunity that arises. This potential, exploited properly, would allow the currency union a certain level of independence from export markets it has virtually no influence over.²⁰

Thus far, the main response to the sovereign debt crisis and its aftermath in peripheral EZ nations has been that of *coercion* (austerity) with little or no *persuasion* (Guha 1997). Absent persuasive political-economic policies that minimally ameliorate the very difficult fiscal challenges the peripheral sovereigns face within the EZ, the most attractive option will be the exit strategy (Goodhart 2007). The lack of realization on the part of German political and economic authorities concerning their historic leadership role will only weaken their continued economic prosperity and might once again intensify tensions and distrust among its neighbors toward its political-economic objectives. Without assuming its leadership role within the EZ, Germany would be exerting, in the words of Ranajit Guha (1997), *dominance without hegemony*. The remnants of what was once the currency union would further contribute to chaos in the world system, as a lack of leadership tends to foment. Each country would most likely revert to fending for itself as they regain their capacity to devalue and thus peg to stronger currencies—bringing the region as a whole back to where it was before the

²⁰ See Kregel (2013) for a discussion on China's structural economic change toward increasing consumption to move away from the export-led development trap, which is increasingly less and less attractive in an economy with the sophistication and strength of the People's Republic of China.

European monetary union was established. The temptation for devaluation to avoid establishing an economy-wide incomes policy—including checks on profits—would take over and hostile commercial strategies would once again dominate the European arena.

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CHAPTER 2

THE ODD FISCAL 'IMPLICIT BARGAIN' IN THE EUROZONE, A CONTINENTAL VIEW OF SOVEREIGNTY: LIST, CHARTALISM AND KEYNES' INTERNATIONAL ECONOMICS.

Abstract

At present, the European customs and currency union finds itself in a transitional period. Without a path forward toward greater political unity, it has prematurely bound constituents by 'hard law' fiscal limitations (the Maastricht criteria, Stability and Growth pact, Fiscal Compact) not dissimilar to those applying to provinces, states, or Laender. In other words, it is caught in an odd 'implicit bargain' (Goodhart) where members are expected to abide by de jure fiscal constraints with no central authority having the fiscal capabilities for stabilization, redistribution, and state-building (Arrighi) expenditures --all of which are indispensable in modern credit economies. The present paper makes use of European economic traditions reliant on statecraft to revisit the region's integration under the leitmotiv of economic sovereignty as a continental project. Specifically, we look at the work of List, Keynes, and the Chartalists. The work of F. List sets European economic unification in its historic place as a strategy founded in large part on exploiting economies of scale (demand and supply-side) by political and economic aggregation of smaller non-self sustaining economies into one market. This proposal for a new Continental System sought to lay the foundation for 'catching-up' or emulation of world economic leaders. Keynes's international economics serves as the most useful orienting blueprint to begin to address the particularity of economic unification among sovereigns absent political unity. Chartalist insights into the political nature of central banks are of great value, and can help frame the European Central Bank's

often clumsy attempts to hold together the Union within a broader scope. Despite its differential treatment of members thus far, the ECB could become a centerpiece institution in the consolidation of Europe as a self-sustaining pole of international effective demand. The overriding thematic principle encompassing the different authors (and traditions) discussed is that of European economic sovereignty in a region continuously struggling to balance political independence with economic co-dependence, and possibly unity.

Keywords: sovereignty, eurozone, sovereign-constituent fiscal implicit bargain, continental political economy, international macroeconomic viability

JEL classification: B15 B52 E12 F15 F45

‘In the union of the three kingdoms of Great Britain and Ireland the world witnesses a great and irrefragable example of the immeasurable efficacy of free trade between united nations.’
Friedrich List [1841] 1885.

‘...it would be ruinous to have thirty or forty entirely independent economic and currency unions. Therefore I would encourage customs unions and customs preferences covering groups of political and geographical units, and also currency unions...’
JMK [1941] 1980.

Introduction

At present, the European customs and currency union finds itself in a transitional period. Still without a path forward toward greater political unity, it has prematurely bound constituents by ‘hard law’ fiscal limitations (the Maastricht criteria, Stability and Growth pact, Fiscal Compact) not dissimilar to those applying to provinces, states, or *Laender*. However, in the words of one of the Eurozone’s (EZ) prescient critics, ‘the (implicit) bargain in most federal countries is that the constituent states abide by fiscal rules, while the central federal government provides the main redistribution and stabilization functions (Goodhart 2007,145).’ In the EZ today, this foundational *implicit bargain* described by Goodhart is only

met halfway. With an EU budget at less than 1% of 2019 GDP, it is by design completely inadequate to perform the key fiscal requirements needed by a conglomerate of monetary production economies of the size and complexity of those adopting the common currency. Large expenditures as a percentage of total region-wide GDP are not only needed for financial stabilization, and social stabilization (redistribution), but also for structural capital investments --i.e., state-building investments (Arrighi 1994). Thus, peripheral constituents, as well as larger members with trade deficits, are expected to abide by stringent fiscal limitations that render them prone to financial and societal chaos¹.

As foreseen, the lack of a central government (Big Government² [Minsky 2008]) in the EZ has thus implied sovereigns have had to continue performing the cited fiscal functions within their boundaries of jurisdiction, though greatly handicapped by ideological (austerity) fundamentalists at the helm of crisis management institutions in the region. Hence, paradoxically, those called to enact the ‘main redistribution and stabilization functions’ are strong armed into ‘abiding by fiscal rules’, hampering the very viability of the currency union. As a result, EZ sovereigns cannot exploit all the tools and policies learned by the over 80 years of macroeconomic management. In other words, they are unable to exploit their ‘big government’ prerogatives to the degree modern credit economies inevitably require³. That is, they are inhibited from countercyclical policies aimed at countering instability of profits and

¹ In the words of Minsky (1993, 14) ‘the successful operation of market economies requires positive intervention.’

² Minsky, discussing the resilience of the US economy since WWII stated ‘[i]f I were to cite the most important reason for the success in avoiding a deep depression... I would select the deficits induced by big government.’ (Minsky 1979, 27). Elsewhere, Minsky (1993, 8) stated ‘[b]ig governments, either automatically or as the result of discretionary policies, were able to run stabilizing deficits which serve to contain downside instability of aggregate profits and aggregate demand.’

³ Before macromanagement was officially practiced as such, statecraft involved many macroeconomic responsibilities: stabilization of the currency, managing the nation’s budget under a gold standard, financing large public investment projects (such as railroad construction), attracting foreign capital, and looking after the balance of payments (Von Laue 1963, 8).

aggregate demand, and likewise handicapped in creating and bolstering new markets as potential future outlets for private sector investments (i.e., state-building). Consequently, real adjustments to demand shocks have taken the place of fiscal and monetary buffers in the wealthiest region of the world, with arguably the most productive industrial sector, taking back economic policy to pre-Keynesian times.

Making use of fiscal expenditures to stabilize incomes and in turn the financial sector (in the last instance, income streams either validate, *or not*, financial liabilities at large), as well as to combat the intrinsic deficiencies of modern market economies (unemployment and inequality [Keynes 1936]), is *not* a policy *option*. Rather, fiscal expenditures are a compulsory, nay foundational requirement in all modern credit and market economies. Credit economies implode or in the best of cases, deflate slowly, in the absence of oriented fiscal expenditures. The inability to use over 80 years of accumulated knowledge in macroeconomic stabilization and growth policies has thus led to recurring sovereign debt crisis and budget conflicts in the region, while eroding the very belief that a true and fully developed implicit bargain may be possible within the customs and currency union of increasingly contrasting economic fate for its members.

Our discussion of the limits and possibilities of sovereignty within the EZ starts with a determination of the relationship between economic viability and sovereignty focusing on the application of macroeconomic policy as a determinant of the relationship. Section III looks to the work of Friedrich List to historically frame the discussion of increasing regional integration. List's work centered on the strategic unification of Western Europe as an economic bloc to counter encroachment by foreign free-trade interests (i.e., reestablishing a *Continental System*). These foreign interests with the help of local allies (agricultural

interests, middle classes of big towns, leaders of port cities) sought to control the continental market for high value-added goods (manufactures) to the detriment of Britain's competitors. Section IV evaluates chartalist theory's crucial insights into the historical *ancillary* role monetary authorities have had vis-a-vis the central government, making them at their core political institutions. As part of this ancillary role, we examine the central bank's management of public debt as its essential operational task. Sovereigns cannot perform stabilization and redistribution policies as well as state-building expenditures (Arrighi 1994), all of which form the backbone of economic sovereignty as such, without a designated market maker for its debentures. Section V looks at the role the ECB has played in trying to keep the currency union afloat by acting as a continental liquidity provider despite its absurd self-imposed restrictions set in place in alleged compliance with the prohibition to directly fund constituents. Section VI stresses the importance of demand-side economies of scale that emerge from continental unity; for example having the prerogative to choose its strategy for crisis management --EU authorities involved the IMF, though not out of need for foreign exchange reserves⁴--, as well as access to funding for crucial state-building investments. All state-building investments are long-gestation projects, in Minskian parlance, Ponzi in nature, and can easily overwhelm the financial capabilities of even the strongest European sovereign. In section VII, Keynes's international economics is revisited as an orienting blueprint for how the European customs and currency union can address the particularity of economic unification among sovereigns absent political unity, also pointing out its main limitations.

⁴ The IMF's Independent Evaluation Office report on the EZ crisis (Takagi 2016) clearly states how Spain and Italy refused to adopt an IMF crisis management package in early 2012 though encouraged to do so by EU authorities. Both countries' sovereign debt was under severe stress. Their refusal called the ECB into action to calm markets.

Sovereignty and Economic Viability: a Starting Point

A useful starting point to our discussion of economic sovereignty comes from Mitchell's critical diagnosis of the EZ (2015). In describing the Mitterand government's reversal of his predecessor's (Giscard d'Estaing) monetarist policy stance, Mitchell states (2015, 81), '[Mitterand's] government set about doing what a sovereign government should do: use fiscal and monetary policy to expand employment, reduce unemployment, and expand the social wage.' If in fact these aspects ultimately determine whether or not a government is economically sovereign, it would seem that it is rather the general historical trend toward renouncing state authority over the increasingly disembedded economy that has largely defined the policies of the Post-Bretton Woods international financial system (Harvey 2007, Naomi Klein 2008, Rodrik 2018), engulfing a majority of countries worldwide to differing degrees, rather than EZ membership itself causing the difficulties for troubled constituents⁵. Naturally, to the extent that the design of the customs and currency union embodied this larger global trend, it indeed has played a role in undermining economic sovereignty, especially for (trade-) deficit members. Nevertheless, at present, in perhaps a unique case of hegelian 'cunning of reason', the fragile common destiny still binding EZ members together may also provide the economic underpinning for a regional/continental policy framework. Not unlike other regions, such as North America and the Far East, most European trade takes place within the region itself. To continue to deflate their main export market (other European countries), in a world of renewed nationalist/protectionist trends, is patently at odds with both labor and business interests.

⁵ Mitchell and Fazi (2017) would also appear to agree that the aggressive curtailment of political-economic sovereignty under the EZ framework is in fact a reflection of the cited more general economic policy under the undisputed leadership of the US after the collapse of the Soviet Union.

Nationalist or statist political economy and consequently the use of macroeconomics as a tool for populist politics has seen a rebirth in view of the catastrophic failures of private-sector self-governance and self-regulation (Fazi and Mitchell 2018). To this effect, ironically, the faulty design of the currency union, the product of ideals from a past (hegemonic) way of thought that belittled the role of the state, erected a powerful regional central bank that can be exploited under the aegis of a new international economic environment --that of state-centered economic populism (see part V). Furthermore, we may add, state leadership, i.e., ‘socialization of investment’, and state-building capital investments are required to meet the international challenges to sovereignty in a world of continuous dispute over hegemony (Arrighi 1994, 1999), of which Europe is, for better or worse, often at the center of⁶. Hence to continue exercising a deflationary administration for the currency union flies in the face of its citizenry’s economic interests.

Hence, the main issue hovering over Europe becomes once more how to deal with increasing continental economic unity while respecting national sovereignty. Attempting to resolve this complex *longue-duree* issue is naturally made worse by the austerity fundamentalists expounding, knowingly or not, rentier interests. It is the unresolved nature of how economic unity will take shape that is eroding the gamut of possibilities available to European constituents; viz., it is the lack of a proper solution to its transitional ‘implicit bargain’ that is leading to equivocal policy and actions in the midst of members’ contrasting economic destinies. The disastrous results from said policy were made clear in the differing approaches by the Troika to the solvency crisis suffered in Italy and Spain, on the one hand, and Greece, on the other, according to an IMF internal assessment (Takagi 2016). The former

⁶ The disputes over the 5G network, european shares in the financing of NATO, and the protests over the construction of Nordstream 2 pipeline are just a few examples. See also Heiko Mass (2018).

refused an IMF loan program and were supported via LTROs beginning in late 2011 to quash bond market incredulity of their state finances, yet Greece was given no choice (Takagi 2016).

Hence, the issue of sovereignty becomes the crucial aspect in the assessment of economic viability, be it for a nation-state or a regional grouping. A nation unable to enact countercyclical fiscal policy, redistribution expenditures, and structural market building is hardly financially sovereign, and fails at promoting social mobility and high levels of employment. In this sense, only a sovereign state can have a viable self-sustaining macroeconomy and vice-versa, macroeconomics is only fully implemented insofar as a state is sovereign. The work of List, that of the modern day Chartalists, and the international economics of Keynes developed at the end of his life, when Britain had lost its empire and was forced to rely more heavily on its domestic market, all point toward taming market forces for the purposes of making economics a socially viable endeavor. The work of these European state-centered economists form a theoretical foundation for a properly continental European view of the region's internal struggles in balancing constituents' political independence with their economic co-dependence and unity.

List and the Continental Tradition of Political Economy

The master of continental political economy warned almost two hundred years ago that '[a]ll examples which history can show are those in which the political union has led the way, and the commercial union has followed' (List 2017, 58)⁷. Certainly, the validity of List's premonition rings prophetic in view of the vast economic difficulties the experimental

⁷ Immediately before the cited passage, List states 'Among the provinces and states which are already politically united, there exists a state of perpetual peace; from this political union originates their commercial union...' (2017, 85)

and somewhat idealistic --utopian, even-- European currency union has experienced because of the financial crisis at the end of the first decade of the century. However, List's foreboding was not without a dash of historical irony. List was the leading theoretical advocate of the German Zollverein, a customs and currency union established before the German Empire secured the political unity of the territories. In a way, List's life's work refuted his quoted historical axiom.

List understood there were valid motives in which pushing forward to join a commercial/currency union⁸, despite a lagging political union, made economic sense. Their exposition form one of the underlying threads of List's proposal for a new though territorially reduced post-Napoleonic Continental System. These motives were 1) that the (European) home market is invariably more important than foreign markets in regard to strategies of catching up (*emulation*) to the leading economic powers, and must be secured as such; and that 2) both a large population and extensive territory endowed with plenty of natural resources are requirements for a nation to survive in the context of (imperial) free market policies⁹. Hence, considering the overwhelming economic strength of the dominant Imperial power of the time, Great Britain, smaller nations would need to adhere to unions if they were to move beyond mere agricultural societies and consequently overcome their state of economic dependency. 'Only through alliances with more powerful nations, by partly sacrificing the advantages of nationality, and by excessive energy, can it [a small nation]

⁸ The Zollverein had two currencies, the Prussian currency and the Bavarian currency.

⁹ List (2017, 76) defines 'free trade' as 'the exportation of agricultural products and the importation of manufactured goods.' According to List, *only* agricultural nations still close to subsistence can benefit from free trade, in addition to the free trade imperial power itself. Today it may be better to think of free trade as the interests pushing for the enforcement of trade-related intellectual property rights, open capital accounts, investor-state dispute settlement procedures favorable to foreign investors, and the harmonization of regulatory standards, skewing the until recently growing international economic integration toward powerful special interests (Rodrik 2018). Convergence is near impossible under these conditions.

maintain with difficulty its independence' (List 2017, 75-76). Though List believed the nation (viz., affinities in culture, history, and language) was the ultimate binding element in full political and economic unions, circumstances might drive nations mired down in economic dependency toward the formation of unions, notwithstanding the lack of national unity¹⁰.

In contradistinction to List's continentalist economic thought, today foreign traditions in political economy, emphasizing further reductions in aggregate demand to counter external imbalances or demand shocks, are hardly benefitting European unity. These foreign yet hegemonic paradigms (ideologies), viz., the neoclassical canon (Reinert 2008), encourage further entrenchment of industrial incumbents such as Germany into neo-mercantilism (Bibow 2017, 2018) disguised as free trade --using the elimination of tariffs and exchange rates to further strengthen its dominant trading status. By limiting the fiscal powers at the disposal of sovereigns, internal markets are not harnessed to their full potential, strengthening dependence on extra-EU exports irrespective of the consequences to economic partners. The work of Friedrich List, on the other hand, represents a European tradition in political economy in support of nation and market building to counter aggressive free-market interests¹¹. These interests tend to prescribe policies to competitors of the dominant nation that maintain them beholden to export-led models of development, rather than promoting their own domestic market.

¹⁰ There emerges a dialectic by which sovereignty is achieved by ceding certain national prerogatives with the intent to form a union with other countries, to salvage political-economic independence threatened by the imperial power --at the time, Great Britain.

¹¹ Free market interests tend to prescribe policy that maintain potential competitors of the dominant free-trade nation beholden to exporting to those countries with much larger domestic markets, rather than strengthening their own consumer markets.

The work of List, on the other hand, was infused by the eagerness to see continental unity as the way to achieve parity with Great Britain. Developing expanded (regional) internal markets by promoting an industrial base was the key strategy in tackling the most pressing issue of the day --recurrent agricultural surpluses¹². Naturally, Europe's main economic concern today lies elsewhere. The European continent is at the forefront of technological know-how in many major industrial sectors. List's relevance lies in his emphasis on the strategic importance of uniting and taking full advantage of the expanded continental market. This is especially so in light of Europe's recent contempt for its economic unity and [co-dependence](#)

It was precisely this European economic tradition aimed at shielding home markets from British imperial designs that placed the continent at the forefront of industrial competencies. List's goal of creating a continental market as a *self-sustaining* world-economy (Ramirez Cisneros 2018), to use modern parlance (Wallerstein 1980), must be salvaged from the collective unconscious of European political economy¹³. A 'Self-sustaining'¹⁴ economic region is one that can manage its macroeconomy by countering the 'intrinsic deficiencies of capitalism' (Keynes 1997), at a minimum by enacting countercyclical fiscal policy in pursuit of full employment. In doing so, the sovereign nation or region avoids the more severe forms of rentier hegemony, and consequently the imposed

¹² In the middle of the XIX Century, agricultural products and all other primary products were sold at better prices to the British than in the domestic market. Therefore, as was usually the case, the landed interests represented the greatest political obstacle to the industrialization of the German Territories.

¹³ In a way, by inspiring the German, the US and the Russian (via Sergei Witte) drives for industrialization and development, Friedrich List is arguably the most important political economist of the XIX Century.

¹⁴ Self-sustainability is meant to convey the ability of sovereigns to choose the path toward recovery after an endogenously engendered financial crisis, often difficult to avoid but the consequences of which can be successfully overcome.

austerity by hardened ideologues that symptomatically act as if the chastisement of the innocent was an economic virtue (Krugman 2018).

Additionally, List's focus on internal development of productive capacity by bettering transportation ways (canals, roads, railways) is in a way an important historical antecedent of Keynesian aggregate demand management (infrastructure investment as a way to further macroeconomic objectives)¹⁵. Keynes's revolutionary theoretical breakthrough emerged during the decline of the British Empire. At the time, Great Britain was attempting more than ever to foster its domestic market to support the economy in the midst of the collapse of the Gold Standard and of international trade (Burk, Kathleen; Skidelsky). Furthermore, the gaining strength of the Labor Party had allowed for full employment policies to enter respectable political dialogue. Moreover, the financial exhaustion of fighting and funding allied efforts in WWI had so severely impaired Britain's external financial standing (Burk), that its days as world economic hegemon were, correctly as it turned out, feared over. Thus it could no longer shift liquidity flows simply with changes in interest rates (bank rate). For both List and Keynes the issues of demand management and price stability to counter deflation were to be addressed chiefly via statecraft/macroeconomics. The practice of state-centered economic policy was far more desirable in achieving economic objectives than its alternative, viz., deflation and/or economic depression. Furthermore, both economists understood that the use of deflationary policies were ultimately signs of economic dependency that sacrificed new economic output to old wealth.

¹⁵ List in yet another way is a precursor to the theory of effective demand, specifically regarding the deflationary effect of aggregate savings. '[Adam Smith] does not consider that this theory of savings, which in the merchant's office is quite correct, if followed by a whole nation must lead to poverty, barbarism, powerlessness, and decay of national progress. Where everyone saves and economises as much as he possibly can, no motive can exist for production... the wealth of nations is to be attained in a manner different to that of the private rentier.' (List 2017, 94).

Chartalism: Sovereign Money and State-Building

Some years after his classic critique of the flaws of European currency unification (1998), upon further reflection of the deficiencies of the ‘Stability and Growth Pact’, Goodhart states,

‘... there has usually been an (implicit) contract between the federal and the provincial (subsidiary) layers of government. On its side the subsidiary (state) government agrees to some fairly stringent (often federally imposed) constraints on its ability to run deficits. On the other hand the federal government implicitly (or even explicitly) guarantees the debt of the lower governments, *and*, partly through automatic stabilizers and partly directly, offsets adverse asymmetric shocks affecting differing regions by a system of inter-regional fiscal transfers.’

In essence, by adhering to the fiscal pact, EZ constituents were reinforcing the subsidiarity imposed on them by currency unification. Nevertheless, oddly, the subsidiarity did not really imply subordination to a central government or federal state, as would be the case under a standard implicit bargain, but predominantly to a central bank. The traditional role between state and central bank --namely, the ancillary nature of the latter to the former-- was turned on its head. This reversal in subsidiarity reinforces the EZ’s incomplete arrangement critiqued by Goodhart. The main problem with the EZ framework, according to Goodhart, was precisely the impairment of central governments’ ability to perform their macroeconomic fiscal responsibilities (stabilization of incomes and redistribution), *having lost their debt management arm* --viz., their central bank. Goodhart goes on to state,

‘[h]istorically, nation states have been able, in extremis, (whether in the course of war or other --often self-induced-- crisis), to call upon the assistance of the money-creating institutions, whether the mint via the debasement of the currency, a Treasury printing press, or the Central Bank... The Euro area will not be like that.’ (Goodhart 1998, 410).

Since ‘they can no longer, at a pinch, call upon the monetary authority to create money to finance their domestic national debt’ (Goodhart, 1998, 410), EZ constituents would become subsidiary agents limited to hard budget constraints with the aggravating element of

not having formed a federal body to fill the void. That is, no collective body had been designated to take responsibility for performing counter-cyclical, redistributive, or state-building expenditures. Arguably, few theoretical insights have been as historically validated as the foreseen problems caused by the ‘divorce between the main monetary and fiscal ties’ (Goodhart 1998, 410) chartalists had denounced in the lead up to currency unification.

Nonetheless, for all its prescient value Goodhart’s critique left out a crucial aspect germane to his argument. Other chartalists (Wray 1998, 2016; Bell 2001; Forstater 2003) have accentuated how states require their monetary agencies/authorities to stand ready to support sovereign debt markets *at all times*, not just ‘in extremis’ or ‘at a pinch’, as appears to be Goodhart’s view. Central banks are continually and invariably called to perform sovereign debt management as other chartalists clearly note (Wray 2015)¹⁶, during war and peace, during bouts of deflation and inflation, during times of cyclical abnormalities and times of stability.

In fact, Goodhart recognizes elsewhere (1988, 9) central banks owe their very existence, to a degree, to the management of state debt. As modern market economies evolved into ever more complex financial systems, central banks became indispensable. The funding of state-driven market-building investments in commercial and transportation infrastructure, along with the financing of defense industries, necessitated the existence of central banks. They evolved into a vital public-private organization not only for the financing

¹⁶ Wray (2015) describes the extent to which the Treasury and the Fed must collaborate to guarantee smooth credit conditions in liquidity markets as payments are made to and made by the Treasury in the course of their normal business proceedings with the non-government sector. To think that central bank independence can encroach on the cited proceeding, interrupting the due course of transactions banks intermediate and fund, shows a lack of understanding regarding how modern monetary systems work.

of these first-order necessities, but also crucially for smoothing credit conditions when such large amounts of capital were summoned.

Thus, not only is sovereignty defined by the capacity to enact fiscal policy conducive toward both stabilization of incomes and redistribution (fiscal transfers), as Goodhart identified, it is likewise determined by the ability to carry out state-building investments¹⁷. The latter not only creates wealth for private citizens –often times more so for the courtiers surrounding the seat of power than for the broader citizenry–, but also, and more importantly, it supports economic activity going forward (List 2017, Hudson 2009). The enactment of state-building investments calls for a non-profit seeking financial institution to hold and distribute sovereign debt. By doing so, states can mobilize the real resources aimed at making social provisioning possible (see section VI).

For centuries state-building expenditures involved leveraging social hoards (wheat, and later bullion as well [Hudson 2019]) to create both an elastic means of payment for retail trade, as well as larger-value promises-to-pay required for wholesale borrowing/lending. Eventually, the banks with this intended aim evolved into quasi-public¹⁸ purpose institutions, and became the vehicle to ensure against the over-leveraging of cash hoards (precious metals and promissory notes endorsed by the major exchange houses), i.e., that economizing on cash did not lead to out-of-control elasticity of money. Setting aside their at times spotty track

¹⁷ Our use of the concept of state-building is inspired by the work of G. Arrighi (1994). According to Arrighi, ‘economic nationalism’ came about in the battle for economic supremacy between British and French mercantilism. One of the ‘ingredients’ of economic nationalism was ‘domestic economy-making’ that involved both war-making and state-making. The latter implied the build up of a state bureaucracy to promote private accumulation of wealth that in turn bolstered the strength of the state bureaucracy to better position itself in the inter-European mercantilist battle. Our concept, on the other hand, emphasizes both the macroeconomic importance of having something like a ‘capital budget’, and the benefits of infrastructure development for modern credit economies that seek to maintain their international commercial/trade relevance.

¹⁸ Undoubtedly, the non-profit seeking nature of central banks goes a long way toward ensuring a proper oversight, notwithstanding the persistent criticism from the wider public, economists, and even the executive branch regarding its performance, power, and purpose (Todd 2012) –criticism, often times well deserved.

record –history is replete with examples where state-centered clearing banks failed in their oversight responsibilities, but also of extended periods of stability (Roberds and Velde 2016a, 2016b)– without central banks, the monetization of social hoards for the purpose of government promotion of basic infrastructure in pursuit of social provisioning would have been near impossible. For this reason, central banks have always been crucially important institutions for modern nation-states. They are tasked with continually stabilizing and supporting the macroeconomy, but also with supporting state-building in general --tasks well beyond the macro objectives of price stability and full employment.

Being a crucial part of sovereign fiscal disbursements, the role of state-building expenditures is intimately tied to the history of modern nation-states as such (Arrighi 1996), and thus is also essential to the history of the so called *banking principle* (Keynes 1980, Kregel 2019). Nation-states owe their existence in part to their capacity to mobilize society's resources by making their liability notes (cash), via central bank intermediation, the standard for payments in retail transactions, and their longer-term liabilities the benchmark financial instrument in capital markets. By exploiting their currency sovereignty (Forstater 2003, Wray 2015), they can undertake projects that are not immediately pecuniarily profitable, but are nevertheless required for social reproduction. Hence, during times of stability, it was not uncommon for central banks' promises to pay to trade at above par with precious metals (Colwell 1859), despite their far greater elasticity. No other institution is better placed to apply the banking principle, i.e., to leverage social hoards, than the central government by way of its Treasury/Exchequer and its subsidiary debt management arm, the central bank¹⁹, precisely because it is the embodiment of the social contract.

¹⁹ “The tendency of a national bank is to increase public and private credit. The former gives power to the state, for the protection of its rights and interests: and the latter facilitates and extends the operations of commerce

The exploitation of the banking principle renders economic discipline for sovereigns qualitatively different than for private sector agents. For a select group of states, standard solvency criteria does not apply (i.e., whether they are engaging in hedge, speculative or ponzi finance [Minsky 2008]). The common restrictions on matching income flows and payment outflows that businesses and households are all beholden to, do not apply to these select sovereign governments. Rather, the shopkeeper mentality of miserly economizing, when adopted by nation-states, leads sooner rather than later to failed-state status²⁰. States validate their legitimacy and authority precisely by their fulfillment of fiscal commitments that foster wealth creation and economic stability. At least one economic agent must be delinked from hard income constraints on spending so that solvency is made possible for those private entities obliged to match payment inflows and outflows, and run a surplus in the long-run (Ramirez Cisneros 2018). Naturally, this agent must be the sovereign having been invested with collective sanction as the bearer of the social contract. Furthermore, due to purposes altogether beyond the altruistic or patriotic, the decoupling of the sovereign from hard budget constraints entails the submission of short-term private oligarchic interests in order to be successful (Hudson 2019). Pushing forward state-building projects to strengthen the state involves initiatives far beyond the petty interests of high finance (Arrighi 1994) and the rentier, normally pushing for balanced budgets out of fear for its holdings of public debentures becoming non-performing.

among individuals. Industry is increased, commodities are multiplied, agriculture and manufacturers flourish: herein consists the true wealth and prosperity of a state.” (Hamilton 2015, 237)

²⁰ “A nation consisting of such insane misers would give up the defence of the nation from fear of the expenses of war, and would only learn the truth after its property had been sacrificed to foreign extortion...” (List 2017, 94).

Without a doubt, some of the weaker trading nations in the EZ have been constrained in carrying out their sovereign mandate to both manage the macroeconomy (i.e., stabilization and redistribution) and to foster new market creation by way of state-building investments²¹. The odd implicit bargain currently in place does not allow the exploitation of the sovereign banking principle to the extent required in order to guarantee full employment and an increasing real wage, both of which require state-building investments and thus deep sovereign debt markets.

The Need for an Assertive Central Bank

The strongly validating ECB stance called for by the acute circumstances of the euro area crisis, has only partially enabled peripheral sovereigns to fulfill their fiscal responsibilities stated above, as required in all modern complex monetary production economies. By far the majority of the ECB's Quantitative Easing (Asset Purchase Program and previous large-scale central bank purchase operations) has gone to purchasing sovereign debt. This may be mainly due to the particularities of liquidity operations and portfolio preferences of the European banking system and actors, however, it also showed that when tested, the ECB abided by its commitment to act as the ultimate monetary backstop for sovereigns. Without the financial support from a monetary entity whose solvency is virtually unassailable, creating fiscal solvency for sovereigns²², monetary production economies cannot maintain a semblance of stability; not at the national level, and much less so at the

²¹ The task of economic development is a continually required undertaking. Even high-income countries must seek to upgrade infrastructure to keep up with competitors and to ensure that neither technology permanently displaces large sectors of workers, nor the country stagnates in regard to service sector absorption of those displaced.

²² In describing the liquidity support the central bank offers banks holding treasury securities, Minsky mentioned in passing how these liquidity operations entailed an endorsement of public debt. 'The sale of Treasury securities was an assured way of acquiring cash because the Federal Reserve was committed to sustaining the money value of Treasury securities.' (1993, 5)

international level (Minsky 1979, Ramirez Cisneros 2018). Central banks have provided this support throughout the ages (Colwell 1859). In fact, as stated above, it is among their primary roles.

Making use of a region-wide, in essence *continental*, central bank to support and encourage the political-economic independence of sovereigns, allowing them to avert the worst of the pre-keynesian austerity policies –at least in the cases of Italy and Spain–, is thus required to maintain national sovereignty in all constituent states. Without deference to a degree of financial sovereignty for even those constituents that pose no realistic systemic risk on account of their small size, the continuing viability of the currency union is perilously undermined. In the words of Goodhart (2007, 151), ‘[t]here were few, arguably no, offsetting benefits (carrots) for countries committing themselves to give up their own abilities to use fiscal policy to mitigate asymmetric shocks’, and as a result, we might add, the ECB has had to compensate for this lack of stabilizing mechanisms at a level superseding the individual nation-state. Hence, though the ECB is providing fiscal space to sovereigns, however reduced it may be, the very continuation of the EZ warrants the primacy of economic sovereignty over central bank policy independence, as things stand today²³. The primacy of political-economic independence over central bank independence²⁴ is not a novel reordering of priorities. On the contrary, important historical antecedents can be found. The agreement between the US Treasury and the Fed to fix long term rates on government securities during

²³ To the degree it shields the monetary authority from short-term populist interests, central bank independence is naturally a valuable monetary axiom. However, the monetary authorities should not override or undermine the long term economic development goals of a sovereign in the name of price stability.

²⁴ Even in ‘normal’ times central bank’s prerogative to set policy independently of elected officials’ is inordinately geared toward ‘price stability’. Price stability can be a cipher for acting in the interest of the rentier class (financial oligarchy) (Posen 1993). In a way, class consciousness was born out of the social strife caused by the financial oligarchy’s refusal to accept debt write downs, as can be seen clearly as far back as two millennia B.C. (Hudson 2019). Debtor class consciousness has existed for millennia.

the WWII military buildup (Hetzel and Leach 2001) and campaign is one in a long list of examples (Wray 2014).

Even mainstream sources (Condon 2019) appear to believe the era of central bank independence has most likely come to an end for the foreseeable future. The multiple rounds of QE in support of both domestic credit markets and sovereign solvency has largely debased the belief in central bank operations' independence (Mitchell and Fazi 2017). This is one of the few positive aspects resulting from the GFC. The eroding of the periodically unassailable belief in central bank independence, which waxes and wanes with the changing global (and geopolitical) realities regarding national(-ist) objectives (Toniolo 2005, Toniolo and Borio 2006), has translated into expansions of central bank balance sheets to record levels. The trillions of dollars distributed by the ECB in liquidity support to banks and large portfolio managers, in essence, cleansing balance sheets harboring non-performing assets, is testimony to the ultimate subsidiarity of monetary authorities. The purported and until recently desirable autonomy of central banks was in reality, according to some (Posen 1993), a cipher for independence from democratic control. Thus it hid the true political nature of monetary institutions –an insight Chartalists have always understood (Wray 2014). Even for organizations functioning largely according to technical rationality²⁵ –as opposed to an overt political rationality–, which in itself is disputable as a proper description of 'normal' central bank policy (Goodhart 1988, Borio 2005), the crisis has once again shown that central banks are shot through with political interests²⁶ and thus never truly neutral. During times of duress

²⁵ Neither in its macro responsibilities of overseeing financial market stability (the promotion of price stability and full employment), nor in its micro functions of regulating credit providers and looking after the health of the payments system (Minsky 2008, Goodhart 1988, Kregel 2019) do central banks strictly function under an instrumental or technical rationality.

²⁶ Without a doubt, the refusal to take over banks after injecting trillions of dollars of liquidity into the banking system, reflects just how strong some of these interests were.

central banks reveal their role as appendices of the Exchequer/Treasury, confirming that money is largely a creature of the state, or minimally requires substantial state support to serve its purpose (Wray 2014). Only during times of peace and stability can the case be made with any legitimacy, and then mainly by the rentier class, that central banks should act primarily to combat inflationary increases in credit.

The ECB's active assistance of public sector solvency is key at this early stage of the common currency endeavor. By maintaining eligibility of sovereign debt as collateral in liquidity operations²⁷ even during the worst of times, as occurred only belatedly in the US fiscal and monetary union with the passing of the Glass-Steagall act of 1932 (Burgess 1946, 121), peripheral sovereigns can recover some of their lost fiscal capabilities. Even internal EU documents recognize the dangers involved in the loss of fiscal wherewithal upon joining the currency union.

‘States that do not have full control over their central banks can get in a situation, as banks, in which a liquidity and maturity mismatch between their assets and liabilities occur. In such a situation a phenomenon similar to a “bank run” can happen to a State. In order to avoid such a situation a State needs a source of unlimited liquidity such as a central bank acting as lender of last resort’ (Repasi 2013, 15).

Liquidity support and sovereign solvency assistance are thus basic prerequisites for a properly functioning currency union dependent upon unified capital markets (Schelkle 2018).

Until a region-wide fiscal entity emerges, or ‘hard law’ regulations governing members’ fiscal budgets can be agreed upon that are flexible enough to allow struggling countries to enact countercyclical fiscal and credit policies, and yet impose a degree of discipline (tied to managing increasing labor costs in line with a living *family* wage), there

²⁷ The Glass-Steagall act of 1932 allowed banks to hold government securities as collateral for holdings of federal reserve notes –in high demand at the time due to the nationwide distrust of most banking institutions. This measure both secured the banking-system’s solvency and elevated government debt in the liability pyramid placing it on equal standing with many private sector credit instruments.

will be little alternative to the ECB's actively political role. The more resolutely it intervenes in support of its members, the less prone they will be to speculative attacks or runs.

Categorically, the greatest moral hazard is that which liberates the oligarchy from the consequences of their mismanagement of the economy. By no means would moral hazard apply to helping member states immersed in a systemic crisis.

The main institutional obstacle to ECB support for sovereigns was the limitation on the Public Sector Purchase Program (PSPP) to capital key ratios for each member of the ECB, along with the percentage restrictions on holdings both of a particular debt issue, and of total debt outstanding (up to 25% and 33% respectively [Claeys, Leandro and Mandra 2015]). This constraint is bewilderingly in denial of the asymmetric nature of regional demand shocks. It directly interferes with the fulfillment of the ECB's duties, and precipitated the entry of non-European agents, such as the IMF, into the crisis management process, with its known repertoire of burdensome conditionalities (Ocampo 2015). Limiting purchases of EZ member's bonds to proportionality with the capital key is not part of the statute governing the ECB. Rather, it is a decision of the ECB dating back to May, 2010 (European Central Bank 2010) and may be in violation of article 124 of the statute (European Union 2012), that allows central governments access to the ECB on the basis of prudential considerations.

As stated above, the central bank's political character reveals itself during times of severe financial duress, and therefore, its supposed independence can be seen for the illusion/utopia it really is. During financial crises, both private sector financial assets and banking sector liabilities not backed by government guarantees cease to convey value, and sovereign solvency is severely eroded. The definition of a failing sovereign is precisely one

that cannot perform redistribution policies (direct taxation and targeted spending to ameliorate the conditions of the producers of value), stabilization measures of aggregate demand, and structural (state-building) investments. Hence, the central bank must support the value of otherwise illiquid sovereign debt so that capital markets do not implode at the first sign of systemic market turbulence²⁸ –not at all uncommon in credit and monetary production economies–, but also in accordance with its duties to the entity from which it derives its charter and legitimacy as the ultimate purveyor of liquidity and currency –i.e., the state.

Unification Under a Continental Project

In the best of cases, it is short-sighted to base a monumental endeavor aimed at unifying regional markets on cutting transactions costs. According to one of Europe’s foremost proponents of continental unity, Friedrich List, for whom saving on transactions costs –internal tariffs, at the time– was nevertheless key, the purpose of a customs union was structural change and ultimately, sovereignty. As stated above, only structural change could lead to economic independence by securing regional markets as a home base for catching up industrially.

Ensuring sovereignty would be unthinkable without structural change designed to counter powerful free-trade interests seeking to take over markets for their own benefit. Thus, a customs and currency union ultimately serves not only to take advantage of cost reductions in both cross-border transactions and domestic interest rates, but more importantly

²⁸ See note 22. Minsky understood that capital markets largely function on the foundation of safe assets provided by the state and are thus reliant on the central bank as the purveyor of liquidity in exchange for these assets. Liquidity operations involving the central bank thus both sustain and bolster the banking system, as well as support the value of public debt. This dual role of liquidity operations is at the root of the ‘doom loop’ dynamic where bank risk and sovereign risk intertwine.

to capitalize on economies of scale, especially on the demand-side, that could more than compensate for the loss in local domestic control of monetary policy. Exploiting the demand-side scale effects from a customs and currency single market, with largely unified capital markets, holds the potential to vastly increase economic sovereignty. Namely, by increasing the size of the European domestic market, a space for realization is carved out in which ‘internal exports’ (or government deficits [Kalecki 1954]) can help overcome a major contradiction of market economies –viz., that production itself rarely creates a sufficient level of demand to consume produced goods–, gradually eliminating a degree of dependency on international export markets²⁹. In other words, the possibility of forging a region-wide macroeconomic and full employment³⁰ strategy becomes a reality.

Additionally, the large and internationally relevant nature of the ECB, covering the single largest economic union in the world, has the clout, prestige, and virtual limitless liquidity to contain a *systemic* financial crisis precisely due to the size and affluence of the market it oversees. Minsky (1979, 16) citing R. S. Sayers’ classic study on central bank operations, would state ‘[i]t is the duty of every bank and most of all the central bank to be rich’, denoting how banks’ wealth was a product of their sustained contractual payment inflows from clients.³¹ In other words, banks were supposed to be rich because their clients’ projects were lucrative, reflecting due diligence by bank appraisers. Without a doubt, the EZ

²⁹ Pressuring the domestic economy to increase exports is, in a way, a sign of economic dependency. During the Gold Standard promoting exports was a requirement to bolster market confidence.

³⁰ As stated above, full employment policies are fundamentally a development problem to the extent one sector absorbs redundant labor force from another, i.e., the manufacturing sector absorbs hidden unemployment from the countryside, and the service sector absorbs redundant labor from the industrial sector.

³¹ Minsky also believed that in normal times banks structure their balance sheet so that the flow of funds from debtors is relatively constant and low-risk. Furthermore, the axiom was used in support of the real bills doctrine, that bank credit was only minimally inflationary if and when geared toward hedge and speculative projects. An investment portfolio mainly comprising the latter projects increases the likelihood of staying rich, i.e., ensuring a reflux of funds in the bank’s favor at the end of the payment period.

is a place where wealth creation is a reality, thus making the ECB, in Minsky parlance, a very rich bank –despite not being a profit seeking institution. In essence, the wealth of the continent is the bedrock of wealth for the ECB. In addition, Minsky also stressed that central banks not only had the duty of being rich (on ledgers and financial statements), but of *acting* rich, viz., injecting large amounts of funds to backstop a systemic crisis. Hence, the ECB allowed the EU and EZ authorities the prerogative to decide the course of action it deemed best during the systemic crisis without *necessarily* having to submit to external actors, such as the IMF. The decision to make the IMF a part of the crisis resolution process was a political decision. It was by no means a decision stemming from a lack of funds³².

Therefore, the ECB has shown itself capable of managing financial difficulties by administering multiple rounds of QE including targeted support for sovereigns³³. Policy options of such magnitude, and the sheer disregard for quantitative limitations they imply, would be unimaginable even for most G-7 nations as history shows. For instance, in 1976, the UK was forced to approach the IMF for a loan to pay back its creditors after drawing heavily on a credit line arranged by the US Treasury and other official lenders under the aegis of the Bank of International Settlements (Burk and Cairncross 1992). The UK, on its own, was unable to counter a run on the pound caused by a myriad of factors including the international oil crisis, the increasing government deficit and the deteriorating external balance. At the time, their application for funds was the largest single application for an IMF loan in history. In contrast, the international standing of the euro is an order of magnitude

³² It has been known for decades that the inclusion of the IMF in financial crisis resolutions is often more about cloaking the proposals with a veil of multilateral legitimacy than for an actual need of funds. ‘The Fund’s multilateral character enables it to make suggestions which, if coming directly from the US or other creditors, would be rejected as interference in the affairs of a sovereign state.’ (Burk and Cairncross 1992).

³³ Its participation in crisis management as part of the Troika is a different story.

above any national European currency. Today, the euro's global share of disclosed official currency reserves stands at over 20%, while its share of global trade payments flows accounts for almost 36%, just shy of the dollar's 40% share (European Central Bank 2018). The combined size of the economic union shields members from having to use foreign currency in either official reserves holding, or the invoicing of trade --both of which are demand-side economies of scale. This in turn makes them significantly less vulnerable to the spread of financial crisis triggered by the depletion of foreign reserves³⁴, at one time not an uncommon occurrence in Europe (Burk and Cairncross 1992, Mitchell 2015).

In the post-Keynesian tradition, especially in the work of Minsky, a foundational macroeconomic tenet is that market economies, in which investment decisions are made by private firms, regularly experience difficulties, at times quite severe, and will collapse in the absence of strong non-profit seeking and public purpose institutions. 'Capitalism, which is driven by profit seeking activities, is inherently evolutionary: strong institutions which sometimes bind and constrain and which other times promote and induce entrepreneurial activity are necessary if capitalism is to be a viable economic order.' (Minsky 1993, 15). These institutions³⁵, part of Minsky's oft cited 'ceilings and floors', are designed to counter economic trends potentially leading to severe dislocation (boom and bust cycles), but can also promote recovery once a crisis takes hold. Minsky believed these 'binding and promoting' institutions and tools were at the root of the resiliency of the US economy and banking system –resiliency that also buttressed the rest of the capitalist world (Minsky

³⁴ Additionally, it effectively shields EZ members from the more aggressive manifestations of hybrid warfare such as economic sanctions, by controlling a regional financial network at their disposal for their trade and to clear payments even with trade partners falling out of favor with global superpowers.

³⁵ In the US, institutions such as the FDIC, in charge of providing insurance for depositors, the SEC, tasked with oversight of securities markets, and, for instance, many of the institutions established in response to the financial difficulties of the Great Depression.

1979)– after WWII and came in the form of government deficits, ‘refinancing actions’ by the Treasury, central bank interventions, and regulation of certain ponzi-like credit arrangements leading to financial fragility. At the international level, initially the US’s large aid and capital flows followed by large current account deficits were the major stabilizing force in absence of such institutional ceilings and floors at the international level. However, these demand-side economies of scale were only available for a select few. The US, as the largest economy in the world, with the largest consumer market, had the capacity to unleash powerful fiscal and monetary policy instruments without regard for the effects on its external balance.

Though Minsky never discussed in depth the economic significance of the demand-side economies of scale --mainly, when the sheer size of the domestic economy is such that access to its markets define international solvency³⁶-- he undoubtedly comprehended it. Minsky believed the US’s role as the provider of liquidity and income flows to sustain the international dollar liability structure was attributable to its considerable decoupling of effective demand from the performance of the current account (Minsky 1983, 1986; Ramirez Cisneros 2018). This significant relaxation of the balance of payments constraint provided unparalleled freedom of maneuverability during a crisis. However, according to Minsky, other core countries, were called to exploit their demand-side economies of scale to temper hyper-competitive trade strategies causing damaging international financial instability, ‘[t]he United States has provided an umbrella for the economic growth and stability of Europe and the rest of the capitalist world in the years since World War II...’, however ‘[i]t seems clear that in any future financial crises involving international banking, the [the enactment of] lender of last resort operations, and the generation of large scale government deficits, will

³⁶ Other demand-side economies of scale include having your currency at the top of the international currency pyramid, and consequently, having your debt at the top of the international liability pyramid.

have to be shared...’ (Minsky 1979, 28). In other words, the US’s deficit in trade had been the main guarantor of stability in the international economic arena, but other core nations, especially Western European powers and Japan, would have to step up to the plate (Ramirez Cisneros 2018). Thus, already as far back as 40 years ago, Minsky was calling for Europe to do more. Namely, European allies had to contribute in the generation of income flows by dual deficits (fiscal and trade) for the rest of the world. The current scale of the currency union gives Europe the capacity to take on its long awaited responsibility to bolster international economic conditions conducive to worldwide financial stability and resiliency. As a regional bloc, it could also largely decouple from burdensome current account constraints usually associated with smaller economies.

From the perspective of macroeconomics and the fiscal faculties of the state, continental unification adds yet another important component. Most if not all state-building investments happen to be of a ponzi nature. Not, of course, in the sense of a fraudulent pyramid scheme –*a la* Madoff–, but rather to the degree payments to shareholders and creditors occur well in advance of the first scheduled revenue flows. In Minsky’s words, ‘every long gestation investment scheme is a Ponzi scheme’³⁷. Hence, state-building projects in particular, all of which are ‘long gestation’ ventures, require large fiscal expenditures that often overwhelm even G-7 nations’ fiscal prowess. Regional unification is key in enhancing the ability to undertake the development and modernization projects required by all modern economies, projects the private sector cannot venture into without substantial effective or shadow underwriting by the government. By enlarging markets to the point of self-sustainability (List 2017), unification thus summons the large reservoirs of funding

³⁷ This included, in his view, real estate projects and the financing of plants. ‘[I]f the financing of a plant that takes a long time to build is separated from the finances of the owning corporation (Minsky 1979, 23).’

capabilities needed. Long gestation state-building ventures are not at the disposal of all sovereigns. In fact, the need to establish a World Bank with a view to help fund basic infrastructure projects for fiscally challenged, i.e., *underdeveloped*, nations illustrates the strain long gestation projects can have on sovereigns.

Furthermore, the scale of the customs and currency union creates new opportunities for furthering strategic projects to strengthen regional sovereignty beyond fiscal policy. The foreign minister of Germany recently pointed out ““Europe United" means this: We act with sovereignty at those points where nation-states alone cannot muster the level of power a united Europe can” (Maas, 2018). Besides collaboration in military projects³⁸, unification has allowed official promotion of the use of the euro in energy markets (European Commission 2019), as well as the yet unsuccessful attempt to launch Instex, an alternative to the worldwide payment platform controlled by the US known as SWIFT. Both projects, pioneered by official European organizations, have received support in the belief they would further promote much needed European sovereignty vis-a-vis the US³⁹, till now, the guarantor of economic affairs for the region –as can be seen still today in its opposition to Nordstream 2.

Limitations of the ‘Keynes Plan’ and its Implications for EZ Constituents.

For Keynes, the limitations to economic sovereignty weighed heavily on his mind in designing the Post WWII financial system. For this reason, his main apprehension was whether core nations’ could endure the difficult transition from war to civilian economies

³⁸ A case in point is the new European fighter jet project; a representative state-making project and a boon for private contractors (Brzozowski 2019).

³⁹ ‘The outstanding aim of our foreign policy is to build a sovereign, strong Europe. Only by joining forces with France and other European nations can a balance with the US be achieved.’ (Maas 2018).

without a relapse into ‘autarky’⁴⁰. This imbued his analysis and proposals that laid the groundwork for an international financial system with an expansionary bias (Keynes 1980). Keynes evidently foresaw the difficulty the United Kingdom would face in regaining its footing as an economic powerhouse having exhausted itself financially in two World Wars. Additionally, the effects from clause VII of Lend-Lease (Skidelsky 2000) lead to the de facto dissolution of the Sterling Bloc. In other words, his main concern lay with the sovereignty of a core capitalist industrial and financial powerhouse (Kregel 2019), Great Britain. Over-indebtedness, and the loss of its imperial territories, significantly undermined British sovereign solvency –and hence a weakened implicit bargain.

Keynes’s design of the international clearing union, devised primarily out of patriotic duty, sought to ensure Britain could rebuild after the war without extending the hardships from a wartime economy to peacetime (Skidelsky 2000). The system he designed was meant to eschew austerity as a policy for overcoming heavy debt burdens at the macroeconomic level. By creating a framework that established clear channels of reflux from creditors to structural (long-term) debtors, the onus of financial stability was placed on the commercially dominant nations (Davidson 1985, Kregel 2019). The cited international reflux channels proposed by Keynes were designed precisely to encourage the pursuit of macroeconomic policies put forward in the *General Theory* (Bibow 2017, Ramirez Cisneros 2018). In other words, the advocated reflux mechanisms offered countries financial support at the international level enabling them to focus on elevating national income without immediate

⁴⁰ Rearmament was one of Keynes’s main concerns for the post-war period. He designed his international clearinghouse proposal so that deficient levels of world-wide liquidity would not hamper reconstruction leading to restrictions in trade. This would go a long way in avoiding some of the more hostile commercial and industrial policies that were common in Europe in the lead up to the Second World War.

concern for the balance of payments. In doing so, multilateral commerce would avoid falling prey to hypercompetitive trade strategies between European powers that in the interwar period had created segmented areas of commercial privilege (a German area, a British dominated area, a Franco-Benelux region, etc.). Hence, under an international framework guaranteeing reflux of surpluses, countries could prioritize domestic economic issues – specifically, for Keynes this meant tackling inequality and unemployment– without kneeling to hard-currency type international financial constraints that inevitably lead to systemic breakdown. For Keynes, macroeconomic demand management was the best way to tackle systemic problems inherent in market economies (inequality and unemployment) instead of the customary curtailment of consumption and government expenditures to attempt to create the savings to (re-)build an export sector. The Keynes plan would have led the way forward to an unparalleled degree of economic sovereignty for nation-states.

Keynes’s envisioned international financial system gave a select group of nation-states room for maneuverability to focus on domestic economic programs based on a ‘practical best’ for market systems (Minsky 1993) –namely, functioning at an approximation to full employment. Pointedly, during the Gold Standard, countries were unable to pursue macroeconomic policies that could bring a certain level of control over the often painful fluctuating conditions of the economy⁴¹. In holding the exchange rate within the margin of gold points, both private consumption and public expenditures were curtailed to keep domestic prices and imports from adversely affecting the external balance. Precisely, herein laid Keynes’s abhorrence of the Gold Standard: adjustment meant *deflation*. In a word,

⁴¹ The traditional form of the trilemma taught in textbooks suggests mainly monetary policy was constrained under fixed exchange rates. In fact, fiscal policy was equally limited if not more so, much as it is in the EZ today.

Keynes viewed the Gold Standard as an obstacle to economic sovereignty understood as the capacity of states to counter the inherent faults of monetary accumulation in capitalist systems, for which accumulation of money balances (or reserves) introduced a deflationary bias into the economy. Therefore, his designed international financial framework sought to bolster sovereignty by encouraging collaborative multilateralism. As a result, nation-states could use directed expenditures to mitigate inherent flaws in the system, like hoarding, instead of the default strategy: diminishing consumption and public investment. His proposal for an international clearing union also envisioned the economic hegemon leading by example, i.e., spending its way out of crisis, and in doing so, overriding traditional concerns regarding sovereign solvency.

Hence the encouragement by Mitchell and Fazi for constituents to re-adopt their national currency as a measure to regain some of the sovereignty lost to the EZ supra-national institutions does not consider that outside the common currency, it is doubtful a collaborative multilateralism exists today⁴². The most likely scenario for sovereigns after currency fragmentation would be pegging to stronger currencies among them the euro, along with the de jure full conversion of euro denominated debt into foreign debt. Pegging to a foreign currency is often not a sovereign decision at all, but rather an imposed constraint in a strategy to attract foreign direct investment⁴³. Hence, peripheral members would most likely fall deeper into export-led development strategies in the context of deteriorating terms of trade. However, and leaving aside for a moment whether there is space for new exports in a

⁴² One can confidently state that outside the EZ, after default, the exiting nation would come under the control of ruthless multinational agencies as the history of debt restructuring processes has proven time and time again.

⁴³ The reason most countries with weaker currencies peg to a stronger currency is to promote external competitiveness (to counter Dutch disease), reduce currency risk for investors, and to keep domestic purchasing power in check. Exiting the euro would thrust nations back into abiding by all three considerations.

world where incumbents dominate established export markets, the increasing nature of industrial assembly is that of increasing integration of value chains (Kregel 2019). Hence, the import content of finished exports can greatly reduce the actual effect of a persistently undervalued currency or a one-off devaluation (Toporowski 2013).

Arguably, during the interwar period, when commercial bilateral blocs formed due to the failure to find a suitable substitute for the Gold Standard, the economic sovereignty of certain peripheral countries strengthened to the extent they had more freedom from international pressures to play by the deflationary rules of the game. During this period, countries were pushed to partially delink from the international financial system and pursue policies that reestablished a minimum level of domestic demand to counter the collapse of international trade in large part due to the failure of the system: the liberal Gold Standard, obstinate in enforcing non-viable economic austerity (Toniolo 2005). The Soviet Union, long marginalized from the international financial system by then, was itself pursuing the domestic route to bring its economy into industrial maturity (Rostow). Ramping up military production was, like with others, one of the main ways to achieve the goal. Though full employment or approximations to full employment were achieved in blocs of countries turning their backs to the international financial system years before the Keynesian era, Keynes realized that the autarkic rout had carried the threat of military conflict between core capitalist states (Skidelsky 2000). Cooperation on the other hand, could lead to better outcomes. However, the economic hegemon had to lead by becoming the consumer market of choice for exporters and the engine of international demand.

The plan for the clearing union was undoubtedly set up by Keynes, the loyal servant of the crown, to support his nation after the demise of the empire. He was well aware that

clause VII of Lend-Lease implied Great Britain would no longer lead the commonwealth nations and all other countries formerly tied to sterling. Naturally, this implied Great Britain could scarcely expect to have its negative external trade balance compensated by its old allies and client states, as had been the case. Great Britain would have to play by the new rules made in the interest of the true winner of both world wars, the United States, and its pursuit of multilateralism (Kolko and Kolko). It would have to compete with other core industrial nations in a more level playing field. Even its role as the main financial entrepôt in the West—perhaps nowhere else was it easier to raise capital for different international ventures (Burn 1999)—was eventually surpassed, though much less so than the loss of its currency share in total official reserve assets would suggest.

Writing in this particular historic setting, Keynes did not *explicitly* take into account the needs of peripheral countries and the effect this would have on the stability of the international financial framework. His overriding priority was avoiding the zero-sum game in trade between world economic powers, a concern shared by the US (Kolko and Kolko). In a response to a critic of his international currency proposal for the Bretton Woods negotiations, Keynes explicitly stated “[t]he Currency Plan aims at providing reserves to tide over short-term fluctuations [,] an orderly method for altering exchange rates when necessary, and for ensuring multilateral clearing of current trade transactions” (Chandavarkar 1987, 140). In other words, his framework lacked the immediate aim and ambition to support ‘convergence’, or to promote new industrializers. As the financial crisis in the EZ has shown,

the convergence⁴⁴ or catching up aspect was also not prioritized in the institutional design of the EZ, to the detriment of the region as a whole.

As history has shown, if a country, currency union, or financial system does not address the long term lenders situation, as was the case even with Bretton Woods, it risks major turmoil. Typically, the financial sectors of highly industrialized countries step up to fill the void of long-term credit to perennial debtors –with few exceptions convergence countries are structural debtors. The latter then become unstable when investors finally realize the Ponzi nature of the capital flows to debtors (Kregel 2004, 2006)⁴⁵. Even more so than the Keynes Plan, the EZ was conceived mainly as a financial scheme to promote trade among the core powers, with the fundamental difference that the Keynes Plan was envisioned as a full employment and growth biased scheme (Skidelsky 2000). The EZ, on the other hand, harbors an oligarchic deflationary bias, and its main actionable agency at the macroeconomic regional level pursues price stability above all else. As a result, the EZ has learned the hard way that it ignores the long-term debtors situation at its own peril.

A further limitation of the Keynes Plan relevant to the EZ situation today was its focus on a ‘hard law’ program, especially so in the first drafts (Skidelsky 2000). The intention to put into writing a series of binding regulations that would compel the US to recycle (or relinquish) their gold surpluses were struck down during negotiations with the US’s Treasury representative, Harry Dexter White. Scholars studying the negotiations in detail acknowledged that the only hard law ordinance making it into writing, embodying the

⁴⁴ Historically, convergence has been at the root of development theory ever since the Mercantilist era, and has been crucially important for countries with an established agricultural sector needing an expansion into manufacturing to dispense with agricultural surpluses (List 2017, 75-6)

⁴⁵ Typically, this occurs when their heroic growth projections do not come to fruition. Decades of economic deflation follow, in which the debtor nations fight to regain competitiveness through a combination of contractionary fiscal and monetary policies designed to shrink domestic markets.

intention to counter the long-term accumulation of trade surpluses, was the scarce currency clause, a dead letter according to experts (Skidelsky ‘Resurrecting Creditor Adjustment’, Chandavarkar). The cited clause would presumably enable deficit countries to discriminate against goods from surplus nations that made no effort at promoting a reflux of their currency to nations they were, nonetheless, content to trade with. The attempt by Keynes to establish a ‘hard law’ regulatory framework for a multilateral institution that would contribute to overcoming European proclivity toward extreme forms of mercantilism –originally espoused as a reaction to cosmopolitan free-trade British policies— was undoubtedly a noble purpose. However, it required US deference to a leading-by-growing strategy that never fully materialized in the form Keynes thought best --that being, a supranational organization binding the main creditor nation to recycle its surpluses. Nevertheless, once its geopolitical interests were weighed against its creditor interests, the US eventually became aware that it would have to establish clear currency reflux mechanisms to prevent another European retrenchment into autarky (Davidson 1985, Ramirez Cisneros 2018).

Be it a strategy for negotiation or perhaps real reluctance by the new economic incumbent, the United States, to enter into binding international treaties, it became clear that even amongst wartime allies, the way to achieve a harmonization of economic policy within a shared ideological framework would be negotiations and diplomacy leading towards cooperation --not ‘hard law’ obligations. In the end, the US would go to great lengths to guarantee its currency would not become scarce (Davidson 1985, Minsky 1986, Ramirez Cisneros 2018). This was especially so in regards to its support of strategic partners in Western Europe and Asia, to whom funds were distributed by aid, and later were the beneficiaries of strong commercial ties. Regarding the EZ, ‘hard law’ has the benefit of

enshrining rules to the effect that not even the regional hegemon could escape adherence. However, for this very reason, it is difficult to gain the approval of all parties, especially surplus nations, and may take years to achieve. In the meantime, ad hoc measures and collaboration between constituents must ensure nation-states can perform their implicit bargain. The alternative is a failed customs and currency union, rather than a union of countries charting a potentially unparalleled prosperous regional market.

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CHAPTER 3

INTRA-EU TRADE TRENDS AND DEMAND-SIDE ECONOMIES OF SCALE: THE NEW COEXISTENCE BETWEEN GROWTH REGIMES IN EUROPE.

Abstract

While the Eurozone (EZ) has been largely successful in forging integrated K markets and designing a monetary system that clears cross-border payments flawlessly (target2), it has yet to find a successful path forward in addressing trade relations to bolster partners' financial stability. Before the Great Financial Crisis overturned the equilibrium between debtor and creditor members, different growth regimes coexisted within the currency union. Violators of Maastricht Treaty quantitative limits (for instance, Germany was in breach of the limit on government deficits from 2001-2005) were not paraded as irresponsible freeloaders. The 'macroeconomic imbalances' within Europe and the world were not overly concerning, as financial sector participants chased yields in the periphery and the non-traded sectors absorbed capital. Nonetheless, ever since the sovereign debt crisis in Europe tested the political and financial infrastructure of the currency union, the coexistence between the different growth regimes has faltered as creditor nations have become increasingly hostile towards those carrying a trade deficit. Section I looks at the historical context of European integration, namely the case of Germany, through the lens of the work of Friedrich List. In List's work, integration serves as a strategy to counter trade dependency that irrevocably leads to financial dependency. Section II looks at how trade tendencies within the EZ and the broader EU have in fact consolidated Germany's grip on the economic destiny of the continent. Section III explains Germany's economic dominance by focusing on the technological complexity of exports. Section IV critically explores the potential for sovereign solvency within a currency union built over a highly competitive industrial foundation.

Section V describes the Post-Keynesian demand-side economies of scale available to an economic bloc amassing the industrial prowess encompassed within the EZ.

Introduction

While the Eurozone (EZ) has been largely successful in forging integrated K markets and assembling a monetary system that clears cross-border payments flawlessly (target2), even by members accumulating large liabilities vis-a-vis other members, it has yet to find a successful path forward in addressing trade relations to bolster partners' financial stability. Before the Great Financial Crisis overturned the equilibrium between debtor and creditor members, the most dramatic events of which occurred in Europe some years after 2008 and continued for much longer, different growth regimes coexisted within the currency union. Violators of Maastricht Treaty quantitative limits (for instance, Germany was in breach of the limit on government deficits from 2001-2005 due among other things to the costs of reunification) were not paraded as irresponsible freeloaders. It could be argued, exporting powerhouses like Germany benefited from fellow partner's debt-financed or consumption-led growth --about 60% of German exports went to EU members at the time¹--, and exporters to Germany benefited from their supply chain linkages to German industries as well as from large capital inflows. The 'macroeconomic imbalances' within Europe and the world were not overly concerning, as financial sector participants chased yields in the periphery and the non-traded sectors absorbed capital --especially the real estate sector (Atoyan, Jaeger, and Smith 2012). Nonetheless, ever since the sovereign debt crisis in Europe tested the political and financial infrastructure of the currency union, the coexistence between the different

¹ 'Thus while other nations were pursuing 'Keynesian full employment' economic policies after WWII, Germany mostly ran tight budgets and maintained growth by keeping the value of the currency low to boost exports. Ironically, they benefited from the Keynesian policies elsewhere that allowed for strong economic growth and strong import demand for German goods and services.' (Mitchell 2015, 40)

growth regimes has faltered as creditor nations have become increasingly hostile towards those carrying a trade deficit. Once the GFC turned into a sovereign debt crisis, export-led growth became the mandate for all beleaguered members caught in the path of capital retrenchment --a mandate, well known to be in outright denial of the circular flow of the Balance of Payments².

As all of this took place, shares of total intra-EU trade changed drastically. Certain non-EZ members (receiving German foreign direct investment [FDI]) began increasing their trade shares at the expense of EZ members. The major beneficiaries of this salient shift were the Visegrad-4 countries. The Czech Republic, Poland, Hungary and Slovakia (the only euro member of the group) have seen their combined intra-EU export shares increase by 132% since 2002, being at the same time on the receiving end of significant German FDI. On the other hand, over the same period, France, Italy, and the UK (pre-brexite) have all ceded their intra-EU export shares by significant margins (31%, 15%, and 43% respectively). In contrast, Germany and the Netherlands, the largest intra-EU exporters, have seen their shares unchanged.

Hence when the US was running trade deficits of over 4% of GDP (peaking at almost 6% before the 2008 collapse)³ and the EU periphery was sustaining growth with debt fueled real-estate bubbles (a recipe for disaster, as it turned out), the EU growth regimes could co-exist in a somewhat symbiotic way. Nonetheless, Following the GFC, trade surplus nations acquired increased leverage within decision making institutions, as is wont to happen after severe financial disruptions. The balance between creditors and debtors within the Union

² 'The eurozone is at war with double entry book keeping' was the phrase from the Financial Times journalist Martin Wolf (reproduced in Bibow 2012), alluding to the flawed logic behind compelling all nations to adopt export-led macroeconomic strategies: for every surplus nation there must be debtor ones.

³ <https://fred.stlouisfed.org/series/A019RE1A156NBEA>

became increasingly shaky as deflationary macroeconomics and rentier interests took hold over policy.

Section I looks at the historical context of European integration, namely the case of Germany, through the lens of the work of Friedrich List. In List's work, integration serves as a strategy to counter trade dependency that irrevocably leads to financial dependency. European integration operates as a key step in expanding economic sovereignty by reducing said dependencies regionally, carving out a space for growth from the deflationary norms governing international markets. Integrated capital markets, a single monetary system for ECB members, and a common market (free transit for both output and inputs) lay the groundwork for a growth-biased coexistence between different growth regimes whose economic destiny is institutionally bound together. Section II looks at how trade tendencies within the EZ and the broader EU have in fact consolidated Germany's grip on the economic destiny of the continent. The UK, Italy, and France have all ceded intra-EU export shares in the over 20 years of the euro experiment while Eastern European nations tied in with Germany's export sector have made significant gains at the larger economies' expense. Section III explains export competitiveness using the work of Storm and Naastepad (2015, 2016) by focusing on the technological complexity of exports and showing how it is at the root of the rise of the Visegrad-4 in intra-EU trade. Section IV critically explores the potential for sovereign solvency within a currency union of the size and industrial prowess of the EZ to argue that through membership, the individual constituent nations have partially overcome economic 'original sin'. This particular benefit of EZ membership should give sovereigns more leeway in deciding their course of action regarding whether to transition away from their current growth regime. Section V describes the Post-Keynesian demand-side

economies of scale available to an economic bloc of the EZ's unique industrial and financial configuration that can be exploited to guarantee sovereign solvency to all members including those practicing domestic demand-led growth regimes.

Historical Context

The purpose of adopting a single currency, deepening economic integration almost to its limit, is to add a slew of monetary and financial economies of scale to the already existing infrastructure of the customs union, in effect consolidating the single market by enabling the free movement of capital. The history of customs unions shows that larger territories move to enshrine as hard-law the symbiotic economic relationships already in place with smaller sovereigns⁴. Contrary to optimal currency area literature, the lowering of transactions costs is but one of the less important objectives of customs unions. For instance, at the time of the establishment of the German Zollverein, the lowering of tariffs was no doubt an important objective but by no means its ultimate purpose. Lowering tariffs (transactions costs) in the German Territories was just a steppingstone to larger, more significant objectives; arguably the overriding one being economic and political integration itself. Deepening integration gave the new commercial union the material wherewithal to counter its state of trade dependency to hostile powers. At the time, Britain was the dominant European commercial power. It astutely promoted open trade as the means toward prosperity to the detriment of competitors' national manufacturing (List). However, the historical record shows its main rivals knew better and chose a different path, i.e., *emulation* --that is, time-limited protection geared toward industrial upgrading and eventually parity.

⁴ Toniolo and Clement (2005) distinguish the over century old tradition of informal cooperation on monetary policy between western nations' central banks that included e.g., a gold pool, dollar lending, and coordinated changes in interest rates, from 'hard-law' agreements that formalize into national law the principles adopted in international treaties.

Needless to say, the German long-run project of economic sovereignty implied undergoing significant structural change. Such a deep-rooted transformation was pioneered by the State through the promotion of strategic industries such as railways, mining, textiles, industrial banking, as well as encouraging liberal corporate law to stimulate private sector risk-taking. In developing a national manufacturing sector to slowly even out the terms of trade (reverse the static Ricardian comparative advantage in favor of Great Britain's manufactures)⁵, using more of the nationally produced raw materials in the secondary sector (List), international price cycles for raw materials could be weathered without deep depressions. More importantly, Germany would escalate in the value-added ladder⁶.

Naturally, the economic problems besetting the EZ today no longer revolve around establishing a secondary sector, having successfully erected perhaps the most productive industrial base in the world. Nevertheless, in essence, the underlying objective for the single market is substantially the same as in all efforts at integration. If the EZ as a regional bloc is to become a viable project it must strengthen members' economic sovereignty (i.e., political-economic independence). By reviving economic growth with the aim of social mobility, either through more balanced trade between debtors and creditors (for instance, via a region-wide industrial policy), or increased tolerance and financial support for domestic demand-led growth regimes, the EU members can delink from the decidedly deflationary international financial system. Either strategy of economic growth based on social mobility would go a long way toward addressing the sovereign debt problems plaguing the region since the 2008 financial crisis that reappeared during the covid-induced economic troubles and will

⁵ By the dawn of WWI, German manufacturing had overcome its backwardness and had by certain estimations surpassed British manufacturing in many important sectors (Burk, Mearsheimer).

⁶ In other words, the German commercial unification took place within a context of what today might be called an 'industrial policy', precisely what is lacking in the region today (Botta 2014)

undoubtedly reemerge in future crises. Therefore, either by political pressure from austerity exhaustion, or by market upheaval, major stakeholders --especially creditors, surplus governments, and EU institutions-- will feel pressure to come up with a more definitive and long-term solution to the recurring financial crises targeting sovereigns.

Though decoupled from gold, the post-Bretton Woods financial system was unable to sustainably unencumber sovereigns from the inherently deflationary Balance of Payments constraint. On the contrary, periods of rapidly increasing capital flows that gave the appearance of easing financial constraints ultimately led to harmful capital reversals. Not unexpectedly, the threat of capital reversals eventually engendered reserve hoarding (Rodrik) which in turn precipitated neo-mercantilist strategies mainly in Asia. Europe took a different route, most likely as a result of the detrimental historical consequences of hostile devaluations in the period between the World Wars. Nevertheless, the problem of insurance against hostile capital outflows, or a balance of payments crisis, needs reckoning with. Hence, in lieu of the currently lacking political framework ('hard law') required to take the single market to the next level of integration, EU/EZ institutions and surplus members may have little choice but to buoy smaller members' commercial feasibility, partially lifting them out of the most stringent form of 'original sin'. This commercial support can be achieved by either enacting macro policies that may eventually infringe upon Maastricht quantitative constraints (for instance, by funding Employer of Last Resort programs, or supply chain onshoring), or mutualizing sovereign debt (Micossi 2020), or issuing GDP-indexed bonds (Blanchard et. al 2016), to name a few of the currently discussed options. Supporting weaker member's fiscal solvency in an age of volatility in markets and new non-economic risks (pandemic viruses, kinetic conflict in Eastern Europe and possibly in the Straits of Taiwan)

will allow for a transition toward an export-led growth regime in the medium term, if they opt to do so, under much less dire financial and democratic circumstances than a full-blown systemic crisis. Needless to say, switching growth regimes implies a tectonic structural shift and should not be forced on a member, especially when at its most vulnerable. Otherwise, if nothing is done, the costs of membership will continue to outweigh the as of yet meager gains⁷ (Shelckle 2018).

Having already aggregated trading partners, many integrally bound by well over a century of commercial liaisons, the institutional infrastructure is partially in place to enact policies of regional interest above internationalist financial interests --in general, not dissimilar to the incipient bipartisan US turn toward increased economic nationalism (notably, the Biden administration has not eliminated the tariffs on China)⁸. The size and industrial prowess of a bloc of nations of the magnitude of the EZ enables heretofore unforeseen possibilities for fulfillment of the single market's potential as a tool for both convergence (*not* the Maastricht kind, but true convergence based on socio-economic upward mobility) and a common European destiny --two of the founding objectives in the documents leading up to its charter. However, as we shall see, Germany, the dominant economic power in the region and dominant trading nation, appears to be placing its strictly national interests above the interest of the community of stakeholders from which it nevertheless profits, risking the very perpetuation of the currency union. Furthermore, Germany appears to be taking advantage of its membership in the currency union to carve out its own internal

⁷ Arguably, the most important of the gains from membership is a degree of alleviation from 'original sin', as shown in the very tight interest rate spreads in sovereign debt with respect to the German benchmark.

⁸ Larry Fink, who heads the largest asset management firm on the planet, read the proverbial writing on the wall regarding the present-day international financial system. "The Russian invasion of Ukraine has put an end to the globalization we have experienced over the last three decades." It may very well be time to refocus economic policy closer to domestic markets not so much as a preference but as an obligation." (Zilber 2022).

market, while profiting from reduced (labor) costs outside the currency union to consolidate its export incumbency.

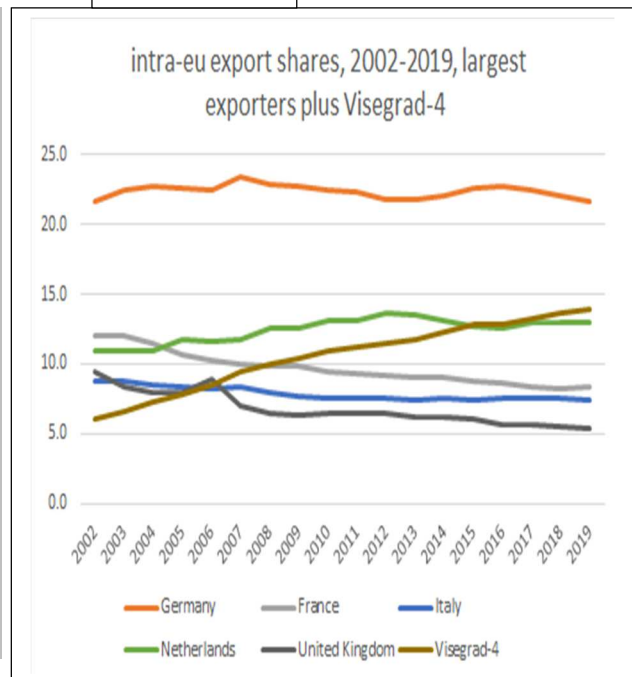
Trade Shares within the EU since the Single Currency

One way to gauge the degree to which the EU has become Germany’s domestic market is by looking at export shares within the EU. Since the adoption of the single currency, for instance, France and Italy, have ceded their intra-EU export shares (Table 3.1) by 31%, 15% respectively, while the former member, the UK, has seen its share over the same period drop by 43% (!); a staggering drop for these industrial powerhouses and members of the G-7. Germany, on the other hand, the largest of the EU economies, has kept its share of total intra-EU exports stable (Figure 1)⁹.

Table 3.1.

Export shares within EU, change over time.			
GEO/TIME	2002	2019	Change
Czechia	1.8	4.2	2.4
Germany	21.7	21.7	0.0
France	12.0	8.3	-3.7
Italy	8.7	7.4	-1.3
Netherlands	10.9	13	2.1
Poland	1.9	5.3	3.4
United Kingdom	9.5	5.4	-4.1
Visegrad-4	6.0	13.9	7.9

Figure 1



⁹ The percentage of total German exports going to EU countries has however fallen over this same period. In 2002 63.65% of Germany’s total exports were going to other EU partners, while in 2019 the share had fallen to 58.44%.

In stark contrast to the sizable drops seen in larger European economies except for Germany, the Central European countries known as the Visegrad-4, the Czech Republic, Poland, Hungary and Slovakia, have seen their combined intra-EU export shares increase by 132%. With a combined share of 6% of intra-EU exports in 2002, it stood at 13.9% by 2019. In this regard, they place second only to Germany's 21.7% and rank above the Netherlands' 13%. Throughout the period, the Visegrad-4 have become an integral part of Germany's supply chain, having received a considerable amount of German foreign direct investment (Table 3.2). As a group, they placed third as a destination for German FDI at almost 10% of total FDI stocks, only behind Austria and Denmark, countries open to foreign investment decades before the Visegrad former Soviet bloc countries made their entry into international capital markets.

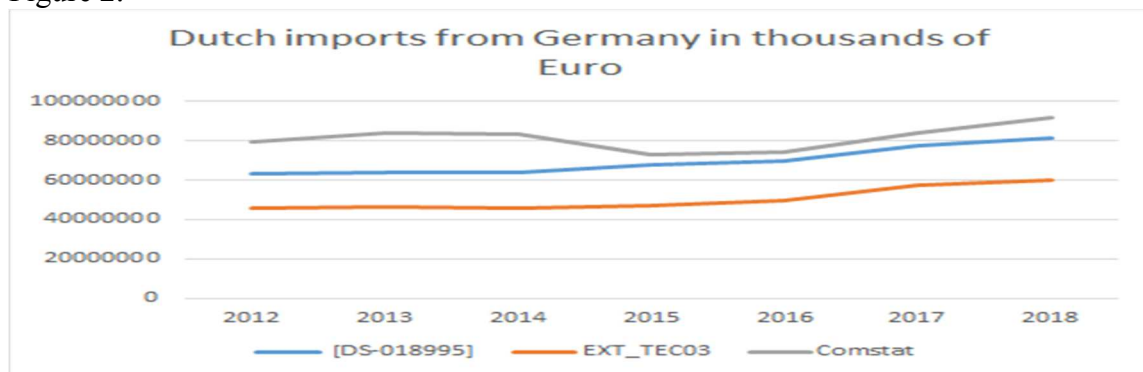
Table 3.2.

German FDI stocks in Europe as of 2018	
GEO	2018
AUT	14.996
DNK	11.965
Visegrad-4	9.687
ITA	7.962
POL	6.551
NLD	5.42
FRA	5.4

Along with the Visegrad-4's notable rise in prominence in intra-EU trade, the Netherlands has also managed to increase its export share in the first 20 years of the single currency experiment. However, when dissecting the NL's increased export share, two things stand out. First, the NL has been a long-time re-export hub of German output; the economic ties between the Ruhr and the Netherlands date back to the middle of the XIXth century

(Klemann and Wubs 2014). Second, over a fifth of all EU imports from China in 2019 went to the NL, indicating a significant intermediation trade of Chinese goods entering the EU through Dutch ports, as we shall see. As far as the first salient factor, according to some estimates, by 1910 Dutch imports from Germany amounted to 30 percent of GDP (Kleman and Wubs 2014, 8). Today, only France imports more goods from Germany than the NL, a country with four times the Dutch population. Given both the historical ties between the Ruhr and Rotterdam --almost two hundred years of business ties--, and the current data showing a slight increase in overall share of re-exports in total exports (increasing from 42% in 2002 to 45% in 2021¹⁰), it is highly probable a non-negligible portion of Dutch exports to EU members are in fact German¹¹. Figure 2 shows two data sets for Dutch imports of German goods, one includes quasi transit (DS-018995) while the other does not (EXT_TEC03); the difference between them is considerable. Hence, it is safe to say a portion of the 13% increase in the Dutch share of intra-EU exports since 2002 should in fact be attributed to Germany (and China as well, as we will see below).

Figure 2.

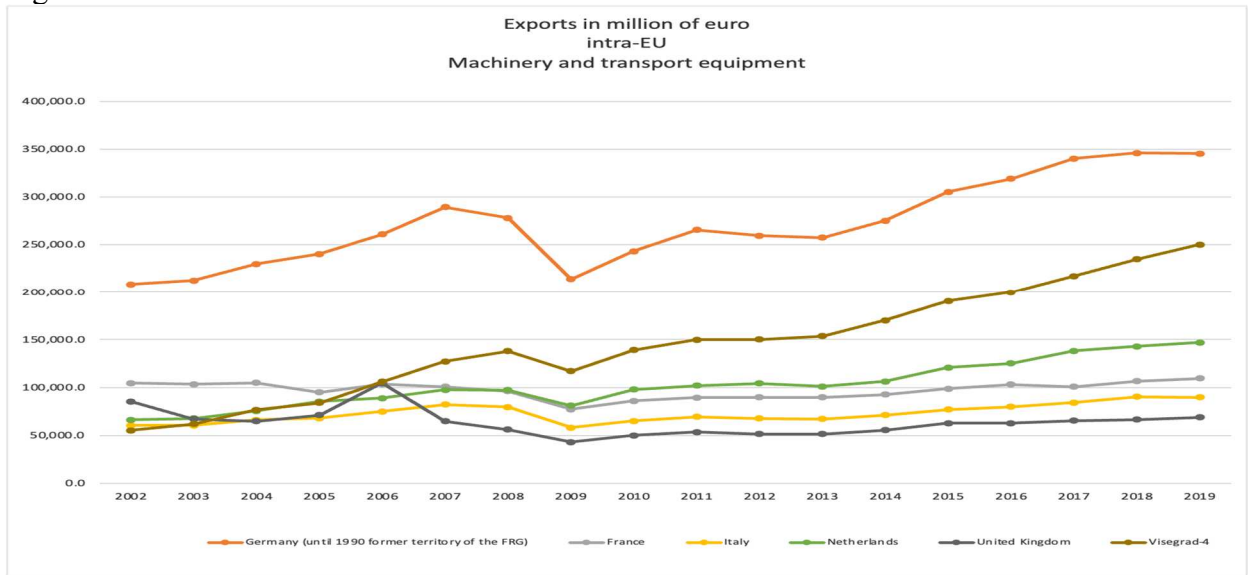


¹⁰ The percentage of re-exports in Electrical machinery and equipment is close to 80% and has increased by 6 percentage points since 2002 (CBS 2022).

¹¹ In 2019, 17.4% of all German exports within the EU went to Belgium and the NL, a larger share than either France, the UK, or any other single nation. A significant portion of these German exports to the Low Countries are then reexported to other EU partners thus hiding the true amount of German trade most likely with the UK and France as well as other member states as can be surmised by the large Dutch exports to other EU countries.

The growth in the export share for the Visegrad group of members, on the other hand, is quite different. For instance, since 2002, the Visegrad-4 nations have increased their exports of Machinery and Transport equipment to the EU --the largest component of EU exports by SITC category (Eurostat 2021)-- by 78% in nominal terms (figure 3), going from an already quite high 14% of GDP to an astonishing 25% of GDP in 2019¹² (table 3.3).

Figure 3.



During that time, the other great manufacturing powerhouses of Western Europe have not fared as well. While Germany and Italy have kept their exports of Machinery and Transport equipment as a percentage of GDP stable, France and the UK have seen significant drops. France’s drop off in EU exports of this key category amounted to 31.4%, while the UK’s amounted to 39.5%. Table 3.4, shows the impact of this dropoff measured as a percentage of GDP. As a result of this nosedive in their exports of machinery and transport equipment to other EU members,, the UK and France have suffered significant losses in their

¹² The Visegrad countries seem to have transitioned into industrial manufacturing for export rather quickly after the collapse of the Soviet Union most likely due, among other reasons, to a tradition of manufacturing in their time behind the Iron Curtain.

EU *trade balance* of said rubric as a percentage of GDP (table 3.4). In contrast, the Visegrad-4 nations have drastically improved theirs, becoming major players in the export of manufactures in the last 20 years. Germany, meanwhile, has suffered declines yet not by enough to alter its positive trade balance in this most important of export sectors. The big winners have been NL and the Visegrad-4 according to table 4.

Table 3.3.

Exports of Machinery and Transport Equip as % of GDP		
	2002	2019
Germany	9.48	10.01
France	6.58	4.51
Italy	4.48	5.01
Netherlands	13.19	18.13
United Kingdom	4.52	2.73
Visegrad-4	14.16	25.12

Table 3.4.

Trade balance within the EU in Machinery and Transport Equipment as % of GDP		
	2002	2019
Czechia	5.13	15.03
Germany	3.26	1.88
France	-0.03	-1.73
Italy	-0.43	0.16
Hungary	8.56	9.97
Netherlands	4.35	8.16
Poland	-1.27	1.64
Slovakia	-0.07	8.38
United Kingdom	-0.30	-2.12

In other words, by observing both the role of its suppliers, the Visegrad-4, and the trade data from its re-exporting partner (NL), the extent to which German industry is slowly taking over export markets within the EZ and the broader EU is apparent. Germany has successfully integrated non-euro countries on or near its eastern border into its industrial export sector¹³ seeking to economize on (labor) input costs¹⁴. Hence, from the data above, it appears the true German trade surplus with its European partners is materially

¹³ Of the Visegrad countries, only Slovakia has adopted the euro.

¹⁴ Outsourcing/offshoring to Eastern Europe most likely contributes to its export competitiveness within the currency union by relieving pressure on domestic wages.

underestimated, surprisingly perhaps less by its exports through Rotterdam and Antwerp than by its significant negative trade balance with the Netherlands to the tune of €63 billion in 2019. The hefty deficit with the NL both artificially inflates total intra-EU trade, and diminishes the German surplus within the EU. The EU-28 imported almost €128 billion worth of transport and machinery equipment from NL in 2019, a greater amount than all other EU nations except for Germany. The NL holds a surplus in this trade rubric alone of slightly over €66 billion (larger than Germany's *total* surplus in trade with the EU) --an inconceivably large sum amounting to over 8% of Dutch GDP. Almost 30% of the €128 billion in EU imports from NL were destined for Germany, an inordinately sizable percentage for a country that shares the NL's high-tech specialization. The most likely explanation points to a considerable portion of Asian imports coming in through Rotterdam and other Dutch ports earmarked for Germany. Furthermore, according to government data, the re-export share of Dutch machinery exports is well over 50%, and machinery exports account for the largest share of Dutch exports (24% in 2019 [CBS 2022]).

NL imported a total of over €93.5 billion of machinery and transport equipment in 2019 from two countries alone, China and Germany --a strikingly high figure. Imports from Germany represented 37.5% of total Dutch imports of transport and machinery equipment from EU partners, while a massive 53.7% of its imports from outside the EU of this same sector came from China. Hence, due to the high re-export content of Dutch machinery exports (over 50%), chiefly due to the disproportionately high imports of machinery and transport equipment from both Germany and China, the NL is markedly distorting intra-EU trade data. It is artificially inflating trade within the commercial bloc by re-exporting Chinese and German goods to other EU members. Notably, the majority of the NL's total export of

machinery and transport equipment is directed to other EU countries (71.1%). In serving as intermediary in Asian imports to Germany¹⁵, the NL has racked up a substantial trade surplus with Germany (€63 billion in 2019), which buries the accurate size of the German trade surplus within the bloc. Furthermore, over 45% of all EU exports to Germany come from two countries, Belgium and NL, the two most important re-export and quasi-transit hubs in the common currency area. A considerable portion of said transit trade is of Asian origin. Both countries receive large proportions of imports from Asian industrial incumbents (Japan, South Korea, and China); yet another indication that Germany's true trade balance with its European partners is decidedly underestimating its large surplus with EU partners.

Therefore, when looking at trade, and after taking partial account of the likely distortions in the data, Germany emerges as the major beneficiary of the single market and common currency. From the demand side, the single currency has in essence enlarged Germany's internal market to encompass all the euro club nations. At the same time, its suppliers in Central Europe, lying outside the currency area (except for Slovakia), have become fertile ground for outsourcing lower-value manufacturing supply chains¹⁶. The Visgrad-4 offer reduced costs in part no doubt thanks to their weaker currencies and the capacity to manage the exchange rate, at all levels of skill in manufacturing (Storm and Naastepad 2015, 2016). This expedient use of the single market as a domestic market, all the while still capitalizing on opportunities for labor arbitrage outside the common currency area, albeit within the legal framework of the EZ, may infringe upon the original goals of the common currency area. Thus it seems Germany's political economy erodes the underlying

¹⁵ The Dutch trade surplus with Germany in 2019 amounted to over 63 billion euros, while Belgium's trade surplus with Germany stood at 20.5 billion euros.

¹⁶ However, as we shall see, they have become strong players in higher value-added sectors as well.

inspiration for European market integration by astutely exploiting its geographical advantages as well as its institutional ones (namely, euro membership) to capture a homebase for its export behemoth. Other EZ members' on the other hand see themselves pitted simultaneously against historic German export competitiveness on the one side --part of the bargain of a currency union, no doubt--, and the Central European labor market that serves as an active reserve army of highly qualified workers for Germany's export sector, on the other. Furthermore, and perhaps more worryingly, they find themselves confronted by Germany's recalcitrant resistance to growth regimes other than their own export-led model.

It is also worthwhile to highlight that the Maastricht Treaty enshrined hard-law regulations limiting members' government deficits and debt-to-GDP ratios, inserting a creditor --and thus *deflationary*-- bias into the institutional scaffold of the EU. In contrast, only a *tacit* understanding exists that cooperation and regional solidarity should play a part in investment strategies (Schelkle 2018). Therefore, any much-needed reflux mechanisms to deficit EU partners would arise out of goodwill, a lofty and arguably scarce virtue in the history of European statecraft. In summary, it is increasingly evident that something needs to give. Either a rational degree of fiscal accommodation is given to domestic demand-led economies within the bloc, or the stark corollaries of continuing stagnation and crisis will take hold --in a continent that has felt the wrath thereof perhaps like none other.

Non-Price Competitiveness of the Visegrad-4

The trade dynamics described in section III dovetails with the pivotal heterodox literature on the importance of non-price competitiveness in the EZ. Contrary to the mainstream belief in the efficacy of the price elasticity mechanism, it seems the quality of the goods produced (i.e., their complexity) is the main determinant of success in export-led

growth regimes (Simonazzi, Ginzburg, and Nocella 2013; Storm and Naastepad 2016; Graebner et al 2019). The work of Storm and Naastepad (2014, 2016) has been decisive in this regard. By showing that labor costs represent only a fraction of gross output prices (which include costs of inputs, labor, and profits), the authors deal a heavy blow to the narrative that ULC misalignments had been the main driver of the EZ crisis. Consequently, any feasible decline in real ULC would have at best only a marginal impact on exports given the small share of labor costs in final prices to begin with.

The implications of such a finding are important given the Troika prescribed internal devaluations ultimately targeting labor's small share in output prices. The 'misaligned' ULC explanation of the EZ crisis became the kernel of justifications for austerity. However, because of Storm and Naastepads' finding, an alternative analysis was required. The key to their alternative view looked beyond the price mechanism, and settled on the *quality* of the exported products. Their research showed non-price factors to be the catalyst for success in export performance, namely, the technological capabilities linked to manufacturing high-tech or high-quality exports. Graebner et al (2019), for their part, used the Economic Complexity Index (ECI) to show how the export performances of EZ countries competing in low and middle tech industries/markets lagged in comparison to those with a more complex productive structure. One of the major factors in the differential performance of highly complex vs. less complex productive structures has been the greater exposure to competition with China at the lower end of the technological scale. As we can see in figure 4, the ECI has been trending down for Germany, the UK, France, and Italy, while the NL has seen its trending slightly upward. Quite the opposite is true for the Visegrad-4 (figure 5). They have

seen their ECI trend upward over the period with present values comparable to the G-7 industrial powerhouses of Europe.

Figure 4.

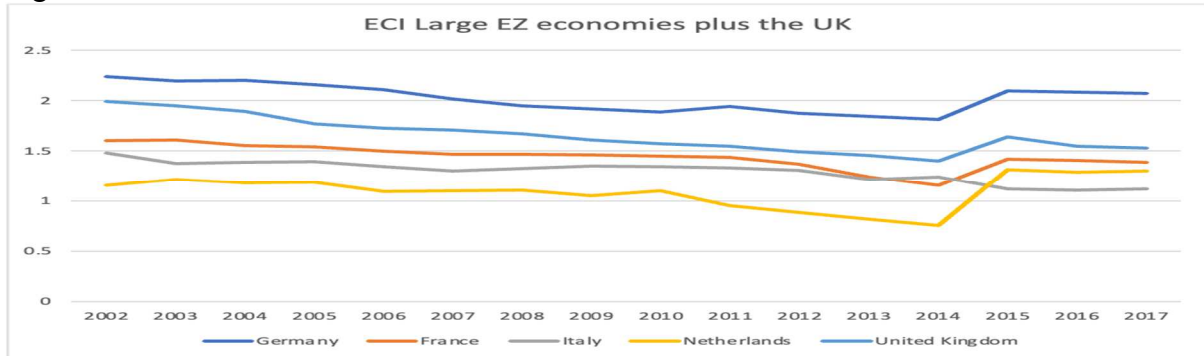
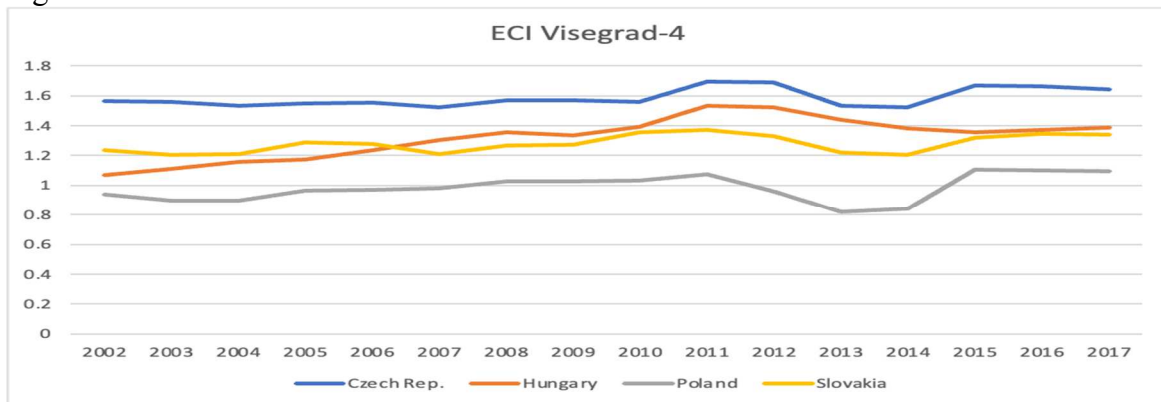


Figure 5.



The data on technological complexity of output as a percentage of GDP (according to R&D) shows similar behavior (table 3.5). The Visegrad-4 nations surpass even Germany in high value-added output as a percentage of GDP, led by both CZ and Hungary. Hungary in particular has become an important outsourcing hub for Information and Communications Technology (ICT) as well as for Pharmaceuticals. Furthermore, Visegrad-4 nations' value added for goods in the top bracket of complexity has increased considerably since the

inception of the euro, contrary to France, Italy, and the NL (and the UK). Visegrad-4 value added in the next highest industrial bracket of complexity has increased by an even greater margin (3.45 percentage points, a more than 55% increase) and only trails Germany, the manufacturing behemoth of the region and worldwide leader in the automotive and machinery sector. Both France and the UK have seen slight declines in the Medium- and High-tech group of industries' value added, while Italy and the NL have seen slight increases. Notably, all countries in the table have seen declines in the Medium-Low Tech industries, where increased competition from China has been felt the most. When it comes to *total* value added in manufacturing, only Germany and the Visegrad-4 nations have seen increases, a trend that appears to confirm that up to now higher tech industries are partially shielded from Chinese competition. Notably, only Germany and Visegrad-4 members saw simultaneous increases in high tech manufacturing value added as well as in total manufacturing value added. Thus, the information on the technological complexity of manufactures could shed light on the behavior of intra-EU exports in general. Countries that have been successful in the market for high-tech manufactures have fared better overall in intra-EU exports than those seeing declines in this sector.

Regional Scope of Financial Resiliency and Risk Sharing

The idea that the adoption of a unified currency brings economic benefits to the extent it lowers transactions costs, a prevalent argument in the Optimal Currency Area (OCA) literature, is one of the most short-sighted views of economic unification of all time.

Economic unification under modern federations or confederations brings together a wide array of territories under common economic management in the belief increasing the size of markets will bring positive externalities all members can reap. These come principally in the

form of economies of scale but also by way of a common political economy (a customs union, a common market, and a collective economic policy). In other words, the economic benefits from unification transcend the micro considerations put forward by the OCA literature, and go to the heart of the heterodox understanding of economies of scale¹⁷. From Allyn Young to Kaldor and Thirlwall, including the literature on the Verdoorn laws, the heterodox awareness of the macroeconomic relevance of mainly external economies of scale focused on the productivity benefits from innovation thanks to large-scale production. The heterodox tradition opportunely emphasized aggregate demand's role in enabling these economies of scale, namely by incentivizing growth using fiscal policy to stimulate innovation (a non-reversible economy of scale). However, some of the most powerful

¹⁷ '...the existence of increasing returns which are known to be an important feature of [the] manufacturing industry, quite independently of the Verdoorn Law and one which is frequently emphasised in other contexts -- as for example, in analysing the effects of economic integration.' Kaldor 1966, 13.

Table 3.5.

		Manufacturing value added as percentage of GDP according to technological complexity (R&D) OECD Stan Database														
		High RD			Medium-High RD			Medium RD			Medium-low RD			Total		
		2002	2010	2017	2002	2010	2017	2002	2010	2017	2002	2010	2017	2002	2010	2017
France		2.37%	1.75%	1.83%	3.69%	2.95%	2.77%	3.65%	2.72%	2.58%	5.37%	4.05%	4.03%	15.08%	11.46%	11.22%
Germany		2.31%	2.51%	2.60%	9.91%	10.89%	12.09%	4.00%	3.46%	3.35%	5.67%	5.05%	4.79%	21.89%	21.91%	22.83%
Italy		1.50%	1.34%	1.39%	4.88%	4.74%	5.44%	3.19%	2.59%	2.65%	9.07%	7.14%	7.15%	18.64%	15.82%	16.63%
NL		1.60%	1.42%	1.07%	4.10%	3.51%	4.26%	1.86%	1.73%	1.75%	6.45%	4.99%	5.26%	14.02%	11.65%	12.33%
UK		2.45%	2.20%	1.89%	3.30%	2.36%	2.69%	2.15%	1.54%	1.45%	5.80%	4.52%	4.03%	13.71%	10.61%	10.07%
Visegraad-4		2.67%	3.12%	3.38%	6.22%	8.29%	9.67%	3.88%	3.59%	4.14%	8.85%	6.58%	6.15%	21.62%	21.58%	23.34%

economies of scale brought to the forefront by the ambitious project of regional currency unification bear upon expenditures and the upscaling of sovereign debt in the debt pyramid (Bell, Mehrling). These demand-side economies of scale, the other side of the coin to conventional economies of scale, work to varying degrees to help loosen the balance of payments constraints for commercially weaker members by way of the assorted institutional externalities such as the relative uniformity of sovereign debt, the ECB's large balance sheet, and access to an enlarged capital market. These in turn rest on the economic strength of the continental economy stemming from its vast supply chains, and the historic European industrial prowess. In other words, the known benefits from economic unification in the heterodox tradition, i.e. the innovation and cost reductions associated with increasing economies of scale, should be extended to sovereign expenditures thanks to the attendant risk sharing from the adoption of the common 'hard' currency (Shelkle 2018). The formation of an economic bloc accounting for an eighth of global GDP, sharing a payments system, credit markets, and an internationally valued unit of account creates previously unimaginable prospects in regard to macroeconomic and structural fiscal policies to stabilize, stimulate, and possibly relaunch a prosperous and growing region.

From the supply side, the sheer size, manufacturing know-how, and technological proficiency of the Eurozone are unequivocally major factors with regards to the potential to deploy economies of scale from the expenditure side. Heterodox economics has always understood the socio-material provisioning process and economic growth as a dialectical whole encompassing the demand side (consumption, realization, distribution) and the supply side (productivity, gross capital formation, development). For such a large region of the world, prosperous, with remarkable industrial capabilities, the unification of the monetary

system and of capital markets on top of the customs union contributes to the solvency of the region as a whole, not least of which, due to the geographical extension of the purchasing power of the currency. The currency spans an advanced industrial economic bloc backed by centuries of knowhow tied to mass production of manufactures of the highest quality, and whose income elasticity of demand creates positive feedback effects as economies grow (Kaldor, Thirlwall). As a result, contrary to most regions of the world, producers in the EZ have no need to transform domestic profits into foreign currency to hedge against the risk of devaluation. The payment of dividends or purchases of raw materials --with the exception perhaps of certain hydrocarbons-- does not necessarily entail passing through the forward market to limit currency risk. Nor do European portfolio managers feel the need to substitute away from euro instruments.

Hence, due to all the above, the integration of the monetary system and of capital markets have at least partially upgraded commercially weaker members from soft currency status (Schelkle 2018). Euro area countries no longer need to juggle foreign debt while their central banks conduct monetary policy operations in a currency backed by other 'key' currencies, thus requiring sterilization and higher interest rates. Accordingly, sovereigns' rollover risk should be significantly reduced, as well as the potential for maturity mismatches due to the increased capacity to lengthen the term of debt instruments. In other words, financing either a current account deficit or a government sector deficit does not depend on the confidence investors take from forex stocks held in reserve at the central bank, accumulated by trade surpluses or capital inflows. Hence, the elasticity of supply of the common currency does not depend on a reaction function in turn dependent on the trade balance and capital account equilibrium.

Members' central banks, as co-participants in the Eurosystem, conduct monetary policy transactions issuing euro liabilities to purchase sovereign bonds. In other words, as regards every-day market liquidity operations in capital markets, sovereign bonds are the instrument of choice making them the most liquid financial instrument in the eurozone, though still marginally tiered. A low estimate would place Eurosystem holdings of sovereign bonds at 75% of all holdings¹⁸, which by some calculations would account for 30% of sovereign bonds outstanding (Micossi and Avgouleas 2021). Nevertheless, however tiered the sovereign bond market may be, given both (1) sensitive political reasons tying together national fiscal authorities and central banks, in addition to (2) the lack of benchmark German bonds to fulfill investor demand for safe assets, national central banks have exercised moral suasion encouraging national bias in their banking systems' portfolios (Acharya and Steffen 2015). Arguably then, the shared risk and the upgrading of European sovereign debt in the international liability pyramid amounts to a partial and tiered avoidance of what has been referred to as 'original sin' (Eichengreen, Hausmann and Pannizza 2003; Flandreau and Sussman 2004; Mehl and Reynaud 2005). The partial avoidance of 'original sin' is perhaps the most important economic benefit the EZ has offered its commercially weaker members thus far, reflected mainly in lower interest rate spreads (Schelkle 2018), and longer average maturities on their debt instruments.

Undoubtedly, as mainstream economists like to point out, smaller nations also benefit from the prestige of forming part of a union with a sophisticated understanding and practice

¹⁸ Rough estimate based on the following. According to the ECB (2022), as of January 2022, the Public Sector Purchase Program accounted for 76% of all cumulative purchases in accordance with the unconventional policy deployed under the Asset Purchase Program beginning in mid 2014. Non-conventional policy has relaxed eligibility standards and thus enlarged the pool of assets purchased. Thus it is safe to say that at least 75% of Eurosystem holdings are sovereign bonds.

of monetary policy, largely inherited from the Bundesbank (see Bibow 2012, 2018 for an insightful critical assessment). However, a credible monetary policy reacting to unwanted price fluctuations, and thus showing independence (mainly from unions and social-democratic governments [Posen 1993]) *during times of relative stability*, is but one (lesser) positive externality tied to common currency membership. In fact, the central bank's role as market maker for sovereign debt during bouts of acute financial duress (via unconventional monetary policy¹⁹) is much more important than the credibility derived from enacting conventional policy in times of stability. Discharging its responsibility as last-ditch liquidity purveyor to the market is perhaps the cardinal yet tacit mandate of a central bank. In fact, the central bank owes its very existence to the sovereign, having been founded to play the mediating role between the treasury/exchequer and high finance (i.e., the 'credit market', investors, money managers, brokerage houses). Therefore, in financially trying circumstances, the central bank must act convincingly, performing its emergency interventions without regards to either quantitative limits or supposed moral hazard, despite the complex ethical outcomes (like increasing inequality) resulting from central banks' 'balance sheet shocks'. The ECB, for its part, fulfilled its tacit duty by enacting asset purchases however sluggishly and tardy. Without it, the currency union would have succumbed under the pressure of the extreme spike in liquidity preference during the run on the shadow banking sector in the US and the short selling that ensued in the aftermath of the collapse of the housing market ponzi scheme in 2008.

¹⁹ QE was at one time considered inflationary quasi-fiscal policy and thus frowned upon by mainstream economists.

In summary, secular regional economic development, i.e., building domestic markets²⁰ as an integral part of an industrial strategy geared toward continental balance of power (Hamilton, List, Dehio 1962, Mearsheimer 2001), has given Europe a distinctly competitive large-scale industrial base. At times, the pursuit of economic superiority within the framework of ensuring a continental balance of power led to dire competitive and military instability on the continent. However European continental sovereigns have now decided to hitch their wagons together. This economic state of affairs places the region in a unique position with regards to capitalizing on demand-side economies of scale. An unprecedentedly wide array of use-values is produced in the region, whose income elasticity of demand is high, all summoned for purchase by the same token. Therefore, establishing a region-wide currency²¹ expands the real purchasing power for the entirety of participants, in turn endowing the monetary system with previously unavailable faculties to extend output growth and employment, were it deployed for such purposes. Government deficits or increases in the money supply in one member, injects income regionally with significantly less sovereign risk if enacted by the larger economies (Ramirez Cisneros 2018). Depending on specific multipliers and propensities to import, the impact of local fiscal policy will be felt regionally. The intertwined monetary framework tying together fiscal policy enacted by individual members potentially lays the groundwork for cooperation between members practicing different growth regimes. Deficit nations need the high-quality use values from

²⁰ The Mercantilists' emphasis on erecting domestic enterprises and nurturing home markets to use as launching pads to then capture foreign markets as sources of demand for domestic output essentially ties together the mode of production with the mode of consumption (realization). One of Keynesian economics' most important legacies is giving equal importance to consumption and production, demand, and supply. Both the mode of distribution and the mode of production are of equal importance within Post-Keynesian economics as well.

²¹ Money is useful insofar as it can purchase goods today or in the future (it can also purchase influence, status, goodwill, elections, financial instruments, etc.). As Clower (1965) famously quipped 'money buys goods, and goods buy money, but goods cannot buy goods.'

partners pursuing an export-led growth path, while the latter are glad for the markets. From this historical coexistence of unique circumstances --large industry in need of new markets, high productivity, pursuit of sovereignty (balance of power), and over 150 years of labor organization-- the possibility of economies of scale from expenditures emerges.

Demand Side Economies of Scale

By no means is the list below an exhaustive account of what may be described as demand-side economies of scale. However, it represents an entry point for further research to either expand or limit the capabilities sovereigns have at their disposal, in accordance with the heterodox tradition of macroeconomics and political economy, to utilize fiscal expenditures to fulfill economic objectives. As mentioned above, these economies of scale emerge from a process of deep economic integration that meet certain criteria, some of which have been discussed above: technological proficiency, a strong industrial base, political stability (rule of law), (at one time) an emphasis on social mobility, to which we may also add strong collective bargaining.

1. Increased autonomy for crisis containment and recovery. Choosing the strategy for containment and recovery after a financial crisis is a major economy of scale on expenditures. As discussed above, it arises in large part from the currency and customs unification of arguably the most industrialized region of the world. EZ membership releases troubled sovereigns from forcefully going to the IMF for either emergency funding or the financing of recovery programs. EZ members, as constituents of the Eurosystem (the ECB and member central banks), have arguably the second most important central bank in the world at their disposal in case of a systemic crisis. Since October of 2014, the ECB has enacted multiple rounds of asset purchases within its unconventional monetary policy

approach (the Asset Purchase Program [APP]), elevating cumulative net purchases to over 3.3 trillion euros --an unprecedented level of policy accommodation. Widespread sovereign solvency concerns lingered in the region ever since the financial crisis provoked by the collapse of the US real estate sector in 2008 spread to Europe in 2011. As a result, the ECB became the most important stakeholder in EZ emergency financing. Via the Public Sector Purchase Program, by far the largest component of the APP, the ECB continues to add to its stock of long-term government bonds with no end in sight. According to some estimates, by 2023 its holdings of LT government bonds may rise to 50% of outstanding (Utermohl, Krizan and Barthalon 2020), placing it in violation of its self-imposed constraint limiting purchases to no more than a third of a member's debt (Canepa 2019). In addition, the European Facility Mechanism, a kind of European IMF, has become the largest lender to troubled sovereigns. In summary, EZ constituents are not compelled to solicit credit from historically US-controlled multilateral organizations if access to credit markets is temporarily lost. Having a regional emergency stopgap lender is potentially a major macroeconomic breakthrough brought about by the EZ currency unification that is yet to be fully exploited. Fundamentally, it enables the region to begin to create a consensus around (growth-biased) conditionality for sovereigns in need of emergency funds having developed institutions for this purpose. Therefore, by sharing a common market and institutions, all stakeholders in the debt restructuring process are thus exposed to both the deleterious effects of exceedingly burdensome austerity as well as irresponsible deficit spending (i.e., purely for 'social investment' without regards to productivity).

To further illustrate the importance of crisis management autonomy, it may be helpful to highlight a revealing episode involving two larger economically troubled euro-members.

European financial difficulties escalated in late 2011 in the aftermath of the turmoil in capital markets following the collapse of the US real-estate market. The situation threatened to become a full-blown region-wide sovereign solvency emergency. Seeing the spreads on deficit members' debt widen versus the German benchmark, EU authorities encouraged Spain and Italy to adopt an IMF crisis management program. However, according to the IMF's Independent Evaluation Office report (Takagi 2016), both countries refused to adopt IMF programs. We can only speculate as to why, but perhaps the belief of both Rome and Madrid was that the ECB needed to step up and deliver relief in accordance with longstanding central bank mandates rather than pass the buck entirely to the fiscal authorities. In any case, as expected, their stalwart refusal ultimately forced the hand of monetary policy officials. To calm markets, the ECB adopted easing policies (LTROs) beginning in late 2011 (Takagi 2016) and thus both members avoided the stiff (at times punitive) conditions to qualify for an IMF program. Conversely, a different standard altogether was applied to weaker sovereigns. Neither Greece nor Cyprus received the deference bestowed on Italy and Spain. The smaller economies were made examples of in show trial fashion perhaps to give the impression of independence (the moral hazard debate²²). The austerity measures imposed on Cyprus, for instance, included a bail-in of billions of euros by depositors holding unsecured balances above 100,000 euros. In return, it received 10 billion euros to prop up its banking sector²³, reeling from its exposure to the Greek economy. Incidentally, a few months later the EU would offer Ukraine, a non-member, over 11 billion euros in aid, with no conditionality or accountability. Years later, in 2016, EU auditors would conclude that the

²² Both Portugal and Ireland also adopted crisis management programs with the IMF but were not pushed to the brink of sustainability with austerity as Greece and Cyprus were.

²³ There are some that attribute the inclusion of the bail in as part of the aid program to the fact that a particular bank in question, Laiki Bank, was a conduit for tax evasion by Russian citizens.

aid to Ukraine largely was entirely unaccounted for (Gotev 2016). On the other hand, Cyprus would ‘successfully’ exit its IMF plan financially ‘more stable’, but with over 15% unemployment.

These *political* decisions accentuating differential treatment for smaller member-states, including dispensing financial aid to highly corrupt non-members at glaringly better terms, hearken back to a particularly contentious resolution made in September of 2008 by US financial authorities. Lehman Brothers was on the brink of collapse. Potential purchasers required guarantees from the Treasury (or the Fed) to go forward with the deal. Despite fully apprehending the potential for severe market upheaval (Hilsenrath et. al 2008), ex-Goldman Sachs CEO and serving Treasury Secretary, Hank Paulson, refused to offer a lifeline to his former competitor. Prior to Paulson’s consequential decision, the Fed had already discarded injecting liquidity into the failing institution on grounds its powers set by Congress had already been tested to the limits with previous interventions (the Fed believed it needed greater room for maneuverability from elected officials). To no one’s surprise, the fateful decision triggered bankruptcy and frantic selloffs in already critically unsettled financial markets, effectively freezing overnight lending between banks (Kessler 2018). A few months earlier, the Treasury under Paulson had likewise stayed on the sidelines and watched on as the Fed stepped in with guarantees to facilitate the sale of the deeply burdened Bear Stearns to JPMorgan Chase, fearing chaos throughout the banking sector at large from an eventual collapse. By then, the federal government had already taken over mortgage guarantee companies Fannie Mae and Freddie Mac reeling from the damage of plummeting real estate prices and widespread foreclosures. Ironically, the Bailout of AIG would commence, once more on initiative of the Fed, the same week Lehman creditors and many Americans, needing

cash for working capital and to pay off debts, were left to fend for themselves (Antonicic 2018), a decision directly benefiting Paulson's former employer. The NY Fed would initially step in with \$85 billion to maintain AIG afloat, but loans and capital injections would escalate to a whopping \$182 billion (!). In the end, the Fed and the Treasury would make a profit from their positions in AIG (US Department of Treasury 2012), which illustrates that intervention (in the case of financial institutions, by way of subsidized mergers or orderly bankruptcy) is much preferred to the alternative. Hence, having the option to choose the crisis management strategy can drastically modify the outcomes from financial restructuring not only in the private sector, but unequivocally also with sovereigns.

2. Primacy of domestic economic goals over the external balance. Having the ability to stimulate the domestic market without the external balance largely predetermining the course of action is a pivotal part of the Keynesian system. However, even in the post-Bretton Woods era, when the financial system moved from the gold exchange standard (based on 'key currencies' backed by gold) to a dollar exchange standard, thus affording greater flexibility in the balance of payments on account of the greater elasticity of supply of the dollar, most national economies were still compelled to strictly adhere to policies geared toward promoting equilibrium in foreign trade and exchange rates (Marshall-Lerner theorem). These disciplining policies on sovereigns derived from the international financial system limit the forbearance for development and growth. International creditors still needed to see an underlying productive infrastructure capable of generating enough foreign exchange to fulfill profit expectations. Furthermore, capital markets had to be sufficiently open, and central banks committed to tight monetary policy enabling investors to smoothly manage foreign exchange transactions to minimize the risk of devaluation. Hence, for most countries,

attempting to achieve a growth rate compatible with a sustainable foreign balance (Kaldor 1966) is more or less a rigid requirement even in the short run. Naturally, finding that growth rate, according to Kaldor, looked differently according to the stage of economic development achieved.

Needless to say, trade imbalances can have a detrimental impact on employment and output in certain scenarios. If trade partners pursue aggressive (neo-mercantilist) trade policies at its expense, or if allies are reluctant to assist in carrying the burden of sustaining international liability structures (Minsky 1983, 1986; Ramirez Cisneros 2018), deficits can indeed become onerous²⁴. In this regard, the case of US trade with Japan in contrast to its trade with China is highly illustrative. To avoid tariffs protecting US producers and jobs, Japan chose to effectuate FDI in the US automobile sector during the 90's within the framework of Voluntary Export Restraints. Their preemptive action helped launch another 30 years of friendly trade ties and continuing regional alliance. China, on the other hand, has taken a much more hostile stance. Its heavily state-led industrial policy aiming at becoming an economic global superpower, the 'Made in China 2025' strategy, seeks to dominate hi-tech sectors such as telecommunications, robotics, semiconductors, miniaturization, among others. In other words, by prioritizing a government-led industrial policy without concessions to foreign competitors, for instance, by opening capital markets or increasing real wages --a more Keynesian approach²⁵-- as its next phase of economic development, China appears to be signaling its intention to perpetuate the 'trade imbalances' that characterized the last 30

²⁴ Trade deficits, in this case, can become a burden though not chiefly due to increasing debt stocks. It is rather the deficits' negative impact on domestic employment and growth that will cause problems (Minsky 1983, 1986).

²⁵ A Keynesian alternative development strategy for an industrial behemoth like China would include an increasing share of consumption to drive growth as they structurally change their economy into a high-income, high-consumption society.

years of its economic planning. It would appear the East Asian behemoth is climbing the value-added ladder having adopted a confrontational strategy (Intellectual Property theft, forced technology transfers, compulsory shared ownership, input quotas from domestic sources, political representation on boards of directors). This hostile strategy has ushered in significant trade tensions, ultimately giving way to political tensions. In summary, trade deficits can be harmful in certain scenarios. Nevertheless, there are manifold historical cases where they need not be worrisome per se. Both US trade relations with allies during and after Bretton Woods (Ramirez Cisneros 2018), as well as the Asian Flying Geese model, have proven as much.

As alluded to above, nations caught in original sin (Eichengreen, Hausmann and Pannizza 2003; Flandreau and Sussman 2004; Mehl and Reynaud 2005) face significant limitations on their fiscal policy space (Kaldor 1966, Thirlwall 1983). Bringing commercially weaker nations beholden to the whims of international credit markets into a much wider and deeper regional financial network has important implications. For instance, all sovereign debt is now handled uniformly in monetary policy operations. The debt uniformity shields commercially challenged members in principle from certain automatic courses of action regarding macroeconomic policy management. For example, repairing the external balance can occur at a rational pace instead of an all-out structural transformation of the economy to promote exports, requiring deep cuts in household income. The fiscal space allowed to weaker members is especially important in a continent with more than a few nations pursuing debt-driven growth regimes (Stockhammer). As stated above, in the Post-Bretton Woods world, when beholden to original sin, and thus having to satisfy money demand for hard currency (for imports of consumer goods, imports of capital goods vital for industrialization,

for oil purchases, saving, travel, and servicing debt), countries pledge themselves to an export policy centered on its highest earning sectors. Concentration of economic resources in high-earning export industries often leads to the capture of economic policy virtually wholesale. Working families' income growth and the economic activities of the non-tradable sectors in general are throttled to find that elusive growth rate at which foreign equilibrium is achieved. However, as stated above, within the framework of the eurozone, the regional currency's elasticity of supply is no longer directly tied to either export performance or to foreign investors' appetite for risk. The untethering of the money supply to foreign exchange reserves places members in a decidedly different financial situation than most middle income and low income countries whose demand for foreign exchange does in fact predetermine monetary policy as well as long-term structural policy.

Hence, ensuring the feasibility of domestic macroeconomic policies to foster economic growth where they previously were not, can help fulfill other more pressing socio-economic objectives (such as social mobility, or full employment). Not since Keynes was tasked with designing an international clearing system for postwar reconstruction and enduring peace has the possibility of balancing national sovereignty with foreign sector pressures been at the center of discussions on international financial stability regarding core industrialized nations. In his design of the clearing system, Keynes had stipulated mandatory reflux mechanisms from surplus to deficit nations that fundamentally circumvented recurring systemic deflationary traps. By guaranteeing finance in the rebuilding process when deficits were structural, followed by the promotion of trade as states graduated from dependency on financial aid, Keynes' built-in reflux mechanisms afforded sovereigns consequential fiscal accommodation over an extended period of time. In a word, Keynes had devised an

international financial system that enabled the long term sustainability of his nationally-centered macroeconomic policies set out in the *General Theory* by doing away with the beggar-thy-neighbor deflationary bias that loomed over Europe in the years between the wars, while balancing the interests of creditors and debtors.

Therefore, allowing sovereigns leeway to maneuver around the strictest original sin entails greater discretion by fiscal and monetary authorities in choosing the best path to achieve their economic goals. Supporting exports in ferociously disputed international markets while attempting to increase market share can be part of said goals but need not be the, in the short run, often unattainable main one. Furthermore, as stated above, the once foreign debt burdened fiscal authorities could now address stress in financial markets spilling over into the ‘industrial circuit’ with a combination of policies aimed at restarting economic activity. The increased leeway to address market turbulence was in part the purpose of the Keynesian project; namely, giving economic authorities the wherewithal and the adequate fiscal space (sovereignty) to prioritize the national economy without overbearing restrictions foisted on them by strict adherence to the international financial system and its banker mentality²⁶. Largely inspired by the acknowledgment that a) the UK had lost its empire, b) would eventually lose its economic privileged zone (sterling bloc), and c) thus had seen its standing as the world economic super power irreversibly eroded (Burk 1985), the driving principle behind Keynes’s bancor international clearing system was the realization that the UK depended on its domestic economy more so than ever. The rebuilding and/or

²⁶ F. List believed economic policy was too important an issue to be left to accountants obsessed with balancing books. He believed that the process of the formation of capital at the aggregate level (the nation) had little to do with the ‘accumulation of values of exchange’ as the Rentier held (List 2017, 94). Contrary to this ‘shopkeeper mentality’ of ‘insane misers’ looking to increase savings for accumulation’s sake, the nation should ‘expend on the education of [its] heirs’ to foster the productive powers of manufacturing and ‘mental capital’(List 2017, 94).

restructuring process all belligerents would have to endure after WWII would lead to trade deficits for the foreseeable future. This stark financial reality, however, could not be allowed to short-circuit the entire international financial system and threaten once again another European military conflagration.

3. Solvency not defined by conventional accounting parameters for the private sector.

Since the early days of the Gold Standard, in the Mercantilist era, and all the way to its collapse in the interwar period of the 1930s, sovereign solvency has been largely defined by the balance of payments. Mercantilists perhaps were the first to understand the role played by the balance of payments in outlining the relative financial and political success of the nation-state. They believed the European power that gained the upper hand in trade (via tariffs and quotas, the efficacy of its diplomatic missions²⁷, and the odd naval blockade) would secure a sufficiently large monetary base to sustain a growing economy. The metallic monetary base, increasingly mediated by a superstructure of contractual (paper) promises-to-pay, supported the revolving fund of credit that sustained long-run industrial modernization. In other words, the revolving fund served to augment investment, which further consolidated an already advantageous trade position. Increased credit led to increased investment that fostered a widening industrial base. The expansion of the industrial base in turn promoted further trade surpluses and a larger monetary base (Hudson)²⁸. In other words, Mercantilists practiced a

²⁷ ‘...although proclaiming its wish not to interfere “with the internal concerns of other nations”, the British government had generally tried to encourage the German states and cities to stay out of the Zollverein -a policy which, of course, contradicted its political desire to encourage German unity and only confirmed the suspicions of German nationalists that Liberal England’s pious claims to be acting for the general good were belied by its official policy.’ (Kennedy 1980, 43)

²⁸ The classical political economists on the other hand, especially the Ricardian school, cunningly pursued ‘free trade’ based on the theory of comparative advantage in support of Britain’s well established trade incumbency. For its potential rivals, the adoption of Free Trade came at the expense of a nationalist political economy fomenting domestic industrialization (List). Eatwell (1982, 91) states the main idea thus. ‘But fundamentally the free market works to strengthen the competitive advantage of successful economies and weaken the position of the unsuccessful. The successful will tend increasingly to dominate trade, while the unsuccessful decline.’

form of cumulative causation tying together trade, finance, banking, money, investment, and production well before the concept emerged as such in the 20th century²⁹. There is no doubt the dynamic described, centered on trade in manufactures, played a vital role in establishing the upper hand in Ricardian comparative advantage. The long-term corollaries of this commercial advantage led to a separation between hard currency nations and soft currency debtor nations exporting luxuries, cash crops, and raw materials.

However, as described in 2., for a region as large as the EZ, with its vast industrial resources and know-how, and a very large consumer base to assist in realization, the balance of payments constraint can be meaningfully attenuated. The European continental economy historically lacks energy resources but till now has more than compensated from this scarcity by its comparative advantage in the manufacture of machinery and transport equipment. Therefore, if the EZ were to exploit the power of its common political economy, it could seek to graduate to a different stage of sovereign solvency with regards to the balance of payments --namely, a stage where a negative trade balance, or even a negative current account for the region as a whole, need not cause alarm and is rather a sign of strength (and confidence from foreign investors). Due to the depth and transparency of its financial markets, the sophistication of its means of production, the relatively high standard of living (more so in the core), and eventually a return to its focus on increasing standards of living, running negative trade balances (and possibly CAs) need not carry the looming threat of capital reversals.

²⁹ Twentieth century scholars in European economic history (Braudel 1980, Wallerstein 1980, Arrighi 1994) that owe much to the Mercantilist political economy place international trade as the major factor in determining economic and political power within the World System.

Naturally, not all Eurozone members need to be running a CA deficit --nor a CA surplus for that matter. Each member has a specific economic structure that will render it more or less prone to a CA surplus due to whether it has adopted an export-led growth model or a domestic consumption-led (wage-led) model. Great Britain ran a trade deficit on goods for decades on end throughout the XIXth century (Chartener 1949) that benefited its trade partners with income flows, and yet was able to balance the deficit with its trade on invisibles. This long-run balance of payments pattern allowed other European countries to emulate Britain's industrial incumbency and slowly catch up. The paradigmatic example was that of a unified Germany that became a threat to the British Empire leading eventually to major clashes (Mearsheimer 2001).

The other major factor defining sovereign solvency is the government balance. The at-times tenuous relationship between a government's fiscal needs and creditors' demand for safe investment vehicles is one of the cornerstones of the financial history of the modern nation-state. There is a paradox at the heart of this tension between governments pursuing ambitious strategic investment or security objectives on the one hand, and the wealthy investors participating in capital markets on the other. Government spending increases economic activity at the aggregate level benefiting the rentier as well as the entrepreneurial classes, and labor (and international trade partners). However, wealthy creditors holding government debentures require governments to offset the government deficit at least partially from taxing households and businesses³⁰, as funding debt payments exclusively by issuing

³⁰. "The payments of principal and interest on the [federal government's] securities are backed by the full faith and credit of the U.S. government. Considering the sound financial history of the federal government and its ability to raise substantial tax revenues, Treasury securities are viewed as having the lowest risk of default of any major financial investment in the world." Dupont, Dominique and Brian Slack "The Treasury Securities Market: Overview and Recent Developments." Federal Reserve Bulletin. Dec 1999

more debt (debt rollover of principal and interest payments) may trigger a loss of confidence in the government's solvency (a Minskian Ponzi scheme). Loss of investor confidence can lead to serious financial crises and capital market upheaval. However, taxing businesses and households is a drag on the economy. Therefore, to avoid a collapse in economic activity, the tax rate cannot conform to investors' preferred level of the government deficit. Hence, fiscal policy in the form of deficit spending must strike a balance between the antagonistic interests of entrepreneurial classes and labor on the one hand, that benefit from ambitious government social, infrastructure, and military investment, and the timid rentier on the other. Making things even more complex, the latter suffer from paralyzing fear that excessive government spending may fan the flames of inflation --which can only happen if capacity utilization is at a peak--, undermining the value of their paper investments. As a result, for countries with Modern Money (see Wray 2012), the treasury/exchequer is obliged to coordinate policy with the central bank to insure bond sales (open market transactions) are sterilized as the government (deficit-) spends to fulfill its ambitious strategic goals (security, infrastructure, social investment, subsidizing private industry, aiding allies, etc.). Central banks though outwardly obsessed with inflation (Papadimitriou and Wray 2021), also react to keep speculation in check and to prevent excessive liquidity from overflowing into asset markets, though with a much greater tolerance for action toward the latter.

Considering the above, for the region as a whole, through the unifying of customs, currency, and economic policy, the solvency of the economic bloc as such is no longer defined by the strict parameters of matching income and payments flows, to which the private sector and smaller nations are beholden. Solvency for large industrialized economic federations, with very sophisticated and deep financial markets, depends on their own

budgeting practices and more importantly, on *proper oversight*. Keeping high levels of foreign exchange reserves pursuant to a successful strategy to balance the CA long-term is not a macroeconomic objective per se (Forstater 2003, Wray 2012, Kelton 2020), especially for a union that counts three G-7 nations among its members. The same can be said for balancing the government budget. High income countries running a negative current account require a government deficit for the private sector to run a surplus --a healthy economic sectoral balance outcome (Wray 2012).

In the case of the US government, for instance, its solvency stems from adequate governance of fiscal affairs via legislative debate and approval of budgets, on the one hand, and government oversight of financial markets on the other (especially so given the size and global relevance of its capital markets [Minsky 1983]). By creating transparent public accounting in accordance with the rule of law, the groundwork is laid for the private sector, duly tied to traditional solvency requirements and to considerations of productivity (competition), to create wealth and employment. Financial superpowers determine their economic objectives in accordance with *real* resource constraints (e.g., availability of qualified labor [Forstater 2003, Wray 2012, Kelton 2020]). Mobilization of financial resources to achieve these economic objectives occurs after the latter have obtained legislative approval --hence the importance of democratic oversight over the budgeting process to avoid a takeover of the state treasury by unscrupulous groups (e.g., the Neocons in the US). Domestic financial markets have a narrow disciplining influence over economic superpowers in the short run, although foreign markets may exert stronger pressure. Arguably, economic superpowers commandeer markets and harness their force for their own

aims, though at times, capital markets may resist (capital strikes, collapse of exchange rates, hoarding, inflation).

Having a central bank of global relevance that oversees regional banking systems and supplies liquidity in line with the general state of liquidity preference, enables the fiscal authorities that chartered the bank to mobilize the level of credit necessary to fulfill their real economic objectives. As stated above, in liberal democracies, economic objectives emerge from a political negotiating process. In essence, the financial solvency of an economic bloc already harboring the industrial prowess to compete internationally with any other top industrial exporter in a wide array of manufactures is further enhanced by democratic oversight to curtail public sector control fraud. In other words, sovereign solvency consists of avoiding the hijacking of fiscal competencies by special interest groups. Therefore, standard solvency requirements that call for matching financial outflows and revenue in the long run, be it for the current account or the government balance, do not apply to the EZ as they would to individual constituents. The commercial strength of the currency union and the depth of the region's financial markets place it in a privileged position. Thus, absent a fiscal deficit-spender at the level of the Union, members should utilize the fiscal space afforded to them by *regional* solvency in their pursuit of sovereign economic objectives³¹. Otherwise, the deflationary political economy pursued by the Troika will unequivocally lead to something even more severe than sovereign insolvency --i.e., the collapse of the Union.

4. International demand for the currency coupled to the strength of the consumer market and attendant rising euro balances (euro euro). While consumption in the EZ stood at

³¹ For instance, said objectives could be full employment and price stability, or alternatively full employment, increasing standards of living (social mobility), and rational use of natural resources, or whatever goals each sovereign were to pursue (security, *gradual* transformation of energy infrastructure, etc.)

less than 54% of GDP, it still ranks as the second largest consumer market (World Bank 2022) in the world under a single currency, significantly above that of China in nominal terms. A consumer market of that size, embedded within stable political regimes, has helped establish the common currency as the second most important unit of account in the world. According to the latest Swift monthly data (SWIFT 2022), the euro trails the dollar by slightly more than 5% in their share of global payments at slightly at 35.5% vs 41.2%. Therefore, transacting and invoicing such a large share of global payments in a regional currency³² entails demand for the euro will not be associated with its relative scarcity. On the contrary, the currency's comparative strength will increasingly depend on the ease with which business transactions can be carried out in euros, i.e., the currency's relative abundance or elasticity.

Furthermore, the presence of a central bank overseeing the payments system of an entire region, with a balance sheet rivaling the size of the Fed's, ensures continuing currency homogeneity between sovereign issuance and monetary policy tools. In other words, by means of its common monetary policy, the ECB thwarts fragmentation in the monetary system between stronger and weaker members such that a euro issued in the periphery trades at par with one from the core. The size and elite status of the ECB provides assurances that redenomination risk will not distort the transmission mechanism of monetary policy. Powerful assurances from an influential central bank ensures that demand for sovereign debt, even during times of crisis, will become increasingly inelastic with respect to quantity, independently of the tier (core vs. periphery). Moreover, steady demand for sovereign bonds is reinforced by large capital pools and portfolio managers' need for safe and liquid

³² Though the euro is still to a large degree a regional currency, new initiatives promoted by the EU seem to be looking to enlarge its international footprint.

investments. Investment grade instruments can be hard to come by --a problem the whole world witnessed the effects of during the GFC of 2008-09, in no small part driven by demand for AAA rated bonds (Zoltan Pozsar 2011).

Additionally, as stated above, the regional currency serves as the universal token to acquire use-values of the highest quality throughout the entire eurozone (and beyond). In fact, non-price competitiveness stemming from the quality of European manufactures lies at the core of the continent's historical comparative advantage. Since the Mercantilist era, as European statesmen discovered the path dependency underlying the link between trade, the preservation of the monetary base, and the upgrading of manufacturing capabilities, European powers mobilized resources and erected institutional protections to avoid being caught on the wrong side of exchanges defined by Ricardian comparative advantage³³ (i.e., exporting raw materials). According to some experts like Reinert, mercantilist statecraft can be traced as far back as the age of the Italian city-states.

Hence, high levels of consumption and industrial output in the EZ underlie the international demand for the regional currency. Insofar as both can be sustained and expanded, the euro will have an increasing role in financial markets. In addition, the need to manage euro balances regionally and internationally will emerge. Thus, demand for a currency that derives its value from centuries of continental industrial development in what seems as almost continual waves of industrial revolution will increase as foreign euro balances grow in accordance with policies to reactivate economic growth throughout the region. Along with this economic reactivation increasingly open to government investment,

³³ Of course, there were concerns about sovereignty and national defense that factored into the equation of pursuing an active industrial upgrading policy which is made clear, for instance, in the works of Alexander Hamilton (2015).

overseeing and servicing growing international euro liabilities will become necessary. Increasing foreign balances and actively engaging foreign partners to manage international liability structures is precisely the path of development followed by the eurodollar market that eventually catapulted the dollar to international status and widespread international use.

In summary, if the regional stakeholders, including, needless to say, deficit nations, can pull together to change the axis of policy focus from pre-Keynesian quantitative limitations on government debt, fiscal deficits, and ECB purchases, all stemming from ideological roots in austerity economics, European capital markets may find a path of convergence in regional growth. To counter uneven development within the bloc, the key financial precondition of a liquidity guarantor (ECB) has been met so that capital markets can fulfill their role in expanding productive capacity. Furthermore, the know-how built up by decades of production of high-quality use values in turn supports the push for increased consumption and capital stock. Hence, consumption for the region can be set high enough to ensure a high standard of living so that vital commodity exporters, commodities the region lacks to supply its industrial output and energy needs, will find the European market in turn a vital part of their own commercial network.

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VITA

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