THE EXPECTED FAILURE OF THE EUROPEAN ECONOMIC AND MONETARY UNION:

A FALSE MONEY AGAINST THE REAL ECONOMY

Alain Parguez
University of Franche Comté and the University of Ottawa

INTRODUCTION: CREATING EX NIHILO A NEW CURRENCY THAT SHOULD BE THE ANCHOR OF THE GLOBAL MONETARY SYSTEM: THE EURO

The Economic and Monetary Union (EMU) has been established by the Treaty of Maastricht (1992) and reinforced by the Treaty of Amsterdam (1997), enshrining the so-called Dublin Agreement on the "Growth and Stability Pact." The sole purpose of the EMU is to create *ex nihilo* by fiat decree a new currency, the Euro, which will be substituted for all the existing currencies of countries having signed the EMU Charter. The Euro is intended to generate the conditions for full integration of the European economies and thus ensure long-term, steady growth. What is explicitly at stake, for instance in the Growth and Stability Pact, can be spelled out as the European Model of Globalization. The Euro should reinforce the aggregated European economies relative to the two major competitors: the United States and the Japan-East Asia area. It should help Europe to benefit from globalization and the rules of the free market while protecting it against their destabilizing impact.

The prerequisite for such a bold agenda is that the Euro would need to be the soundest currency in the world, and therefore the strongest one, relative to the U.S. dollar, the yen and indeed all Asian currencies. The drafters of the European Treaties were reasoning within the framework of a free-market version of the fixed exchange rate model. The European Council of Ministers, which is with the European Central Bank the supreme institutional authority, should determine the exchange rate of the Euro. Those exchange rates would, in turn, have to be endorsed by the so-called financial markets, the collection of financial investors distributing the world capital fund.

Enhancing the strength of the European economy in the global economy would require very high and absolutely stable exchange rates between the Euro and competing currencies. Such a strong currency should attract financial capital from everywhere in the world. In would be the end of the so-called U.S. supremacy over the global monetary system.

Alain Parguez: 85, Boulevard Lefebvre, Paris, France 75015.

This plan could not be implemented if international wealth-holders did not believe enough in the official value of the Euro to substitute assets in Euro for assets in U.S. dollars (and/or yen). The whole structure of the EMU aims at convincing international financial investors of the high real value of the Euro. To impose such a permanent belief amid financial markets, it has set up rules that must be enforced in both the short and the long run.

In the first part, we will put forth all those rules explaining how all of them fit in this vision of a financial markets-led economy. This is why a second part will be devoted to a critical reappraisal of the Euro economics, explaining why it is both inconsistent and at odds with the major principles of a monetary production economy. We will then deal with the forecasted impact of the implementation of the Euro in the context of the world financial crisis.[1] Contrary to the initial postulate, the Euro will not be an anchor for a new world financial order.

THE ECONOMIC AGENDA OF THE EMU: SETTING UP THE RULES CONVINCING FINANCIAL MARKETS

These rules are being imposed in two stages. The Treaty of Maastricht sets up the rules that should convince the markets that the new currency would be created as a very strong one. It was not enough for the architects of the new European model. They wished to lead the markets to believe in their undaunted commitment to what Kregel [1998] calls the "Stability Culture." A new more constraining set of rules has been therefore imposed by the Treaty of Amsterdam enshrining the "Growth and Stability Pact" vision. Growth could be the long-run outcome of the implementation of the soundest currency in the world. The rules can be divided into two major components: the first one deals with the very nature of the Euro; the second with the constraints imposed on fiscal policies.

The Nature of the Euro

As long as we can draw some consistent economics from the European Treaties and the supporting literatures [Artis and Winkler, 1997] the Euro has very peculiar characteristics. The new currency will be managed by a supra-national European Central Bank (ECB) independent from both member states and European institutions. It has a sole mission: to maintain indefinitely, both in the short and the long term, an absolute stability of prices expressed in Euro all over Europe. Ensuring this absolute commitment to a zero-inflation target, the ECB must convince financial investors that, for all of the foreseeable future, the purchasing power of the Euro will be constant. A careful reading of the Growth and Stability Pact and of the reports of leading European central banks (i.e., the Banque de France, the Bundesbank) leads to the conclusion that the ECB and only itself has the target of zero *expected* inflation. All of the rules constraining the European monetary system have been drafted both to allow the ECB to impose zero expected inflation and to convince international investors that it could meet their requirements.

The ECB should comply with its mission by discretionary determination of the aggregate supply of money. It is therefore postulated that the ECB can fix the amount of credits granted by banks to private agents and member states. In a first stage, the ECB is thus budgeting a Europe-wide rate of growth of the quantity of Euros. In a second stage, it is enforcing this target through three transmission channels:

1. The determination of required reserves;
2. Open-market operations; and
3. Capital controls, the ratio between credit and bank equity. This last channel is not mentioned by the Treaties but they do not forbid it. It is already implemented, and according to European law, what is not forbidden but is required to reach the European targets, is authorized.

Assuming that the ECB can impose the quantity of money it wishes, how can it get a permanent zero inflation? Clearly the architects of the Euro did not believe in the simple monetarist model [Artis and Winkler, 1997]. They relied upon the existence of an independent demand for Euro as some financial investment. There was always a real rate of interest that equated the demand for and supply of the Euro in real terms. Such an equilibrium real rate of interest was nothing but some neo-Wicksellian natural rate of interest consistent with a zero expected inflation. The link between the real rate of interest and the zero expected inflation is ensured by the impact of the natural rate on the real economy. The equilibrium rate of interest must permanently deflate aggregate demand enough to generate a rate of unemployment high enough to convince international wealth-holders not to expect inflation, even remotely into the future. This Non-Expected Inflation Rate of Unemployment (NEIRU)[2] should prevent forever wage inflation, the sole cause of long-term inflation according to the "stability culture" of the European Central Bankers. It should even be high enough to allow for some wage-deflation in money terms to root the soundness of the Euro into the expectations of wealth-holders. As shown by Seccarreccia and Parguez [1998], this neo-Wicksellian policy bestows an absolute power on the Central Bank in determining the equilibrium level of unemployment and therefore the required level of real interest rates. Reading the Growth and Stability Pact leads to the conclusion that so pervasive is the fear of inflation that the NEIRU will be very high and quite above the conventional old Non-Accelerating Inflation Rate of Unemployment (NAIRU).

The *sine que non* condition for the ability of the ECB to impose the Euro is, according to the European Treaties, to suppress any interference of member states in the process of money creation. The ECB has therefore been explicitly forbidden to create money, directly or indirectly, at the request of member states (or of any other European institution). This prohibition has three logical consequences:

A member state having to finance a deficit could never sell bonds to the ECB. It could also never "monetize" its outstanding debt by asking the ECB to buy a share of its outstanding debt.

Therefore, in line with the conventional interpretation of the prohibition, member states will be obliged to finance their deficits by selling bonds to commercial banks or other financial institutions. Neither commercial banks nor other private holders of government bonds could ever automatically discount them at the Central Bank. The ECB should even abstain from acquiring those bonds if it could be an indirect way of financing government deficits. Government bonds should thus lose their liquidity and the bank's demand for them would simply vanish. Being unable to finance their deficits, governments would have to balance their budgets, whatever their fiscal constraints.

At last, any connection between the Treasury and the Central Bank should disappear. Member states will have no checking account at the Central Bank. This last aspect of the prohibition should prevent states from creating money in the short run to match the discrepancies between flows of expenditures and flows of taxes. They should always spend what they already have received as taxes.

Since member states are deprived of their monetary power, the Euro will be a pure-private money[3], created at the sole request of private agents by banks obliged to comply with the targets set by the Central Bank, sustained by the expectations of the financial markets!

The Constraints of Fiscal Policy

The constraints of fiscal policy have been spelled out to reinforce financial markets' expectations of a very strong currency. The architects of the European Treaties explicitly wished to encapsulate in a set of constraints what the markets view as sound economics. They assumed that balanced budgets and even fiscal surpluses were what the markets wanted to rank the new currency as the strongest one [Artis and Winkler, 1997; and Artis and Zhang, 1997].

While the Treaty of Maastricht allowed for *maximum* aggregate government deficits (including social security) of three percent of GDP, it already imposed more constraining rules:

1. The deficit should always be low enough to reach, at the date the Euro will be implemented, a ratio of Gross Domestic Debt to GDP not higher than 60 percent. In the long run, deficits should target a lower ratio.
2. If there is a deficit, its counterpart should be only tangible investments.[4]

The "Growth and Stability Pact" supersedes the Maastricht rule by imposing a more stringent constraint that should be met as soon as the Euro will be officially created as the sole currency of the EMU. All member states have to target in the "medium-run" a balanced budget and, if they can, a fiscal surplus. A careful reading of the Growth and Stability Pact leads to the conclusion that fiscal surpluses should be the rule to enhance the value of the currency.

Two interpretations are possible: either the new rule will be applied over the business cycle— surpluses must be higher than deficits to meet the Maastrict constraint, or the rule fixes a target which all states must reach in the span of five years (the so-called "medium-run"). The context seems to support the second interpretation which has been endorsed by the Bundesbank and the Banque de France. It means that five years after the official implementation of the Euro, all budgets should be indicating a surplus.[5] Surpluses should be used to pay back the debt. This interpretation is consistent with the inability of member states to finance their deficits.

Governments that cannot comply with the fiscal constraints will be condemned by a Court formed by the European Council, the supreme body of Europe, excepting the ECB, whose members are prime ministers or finance ministers. The guilty state could be required to pay a fine equal to 0.5 percent of its GDP per year of excess spending. The fines will be hoarded by the ECB, without any mechanism for their redistribution. Fines would be levied even if the cause of the excess spending is a severe depression. The only exception is a depression which exceeds a fall of two percent of real GDP. Governments will be guilty (a) as soon as they are not able to converge on the targeted surpluses and maintain them; (b) if fiscal deficits are considered too high to attain the target; (c) if deficits exceed three percent of the GNP. Even pro-Euro economists [Artis and Winkler, 1997] emphasize the discretionary power of the majority of the European Council to determine what is an excess deficit, when below three percent of the GDP. According to their interpretation, the ECB would play a leading role as advisor to the European Council. In any case, no bail-out mechanism exists to assist a state coping with a depression. Indeed, levying the associated fines will act to worsen the depression and act to increase the deficit. We are thus led to discover both that the architects of the EMU had no concern for political feasibility and that they used an outmoded pre-Keynesian vision of the economy as their plan.

A CRITICAL APPRAISAL OF THE EMU ECONOMIC AGENDA: THE ENSHRINEMENT OF AUSTERITY

It will be shown that contrary to the hopes of European official economics, the Euro will be a very weak currency because it will be an artificial currency whose supporting rules are contradicting the major principles underlying modern monetary production economies. It will be shown that the Euro is therefore a "false" money artificially supported by policies targeting a permanent austerity or economic "atonement."

The Underlying Theory of Money and the Euro

From the set of rules established by the European Treaties to create the Euro as the soundest currency, we can deduce these three major principles:

1. The Euro will exist because there must be a permanent demand for the Euro as a component of real wealth held by international investors. Those investors are sharing their wealth between real assets and financial assets, more or less liquid, denominated in U.S. dollars or Euros, the two major competing currencies. The demand for

the Euro is just the share of their aggregate wealth they want to hold in Euros instead of dollars and real assets. The demand for the Euro is thus a financial investment of a predetermined amount of real wealth. The amount of wealth to be invested in Euros is determined by real expected interest rates relative to those that could be earned by holding dollar balances. Ultimately, what will explain the shift from dollars holdings to Euro holdings is the relative rate of expected inflation. By imposing a zero permanent expected inflation, the European Treaties target a premium on holding Euros so high that the composition of wealth-holders' portfolios shifts dramatically and the real value of dollar balances collapses relative to Euro balances. Such an understanding of money highlights the demand for money as pure hoarding!

2. On the other side of the money market is the supply of money. It has been proven that the supply of money should be fully exogenous relative to the demand for money and *a fortiori* to the requirements of circulation. Being under the absolute control of the ECB pledged to zero inflation, the quantity of Euros must be perfectly scarce. The Euro will be the scarcest resource in the world. The European Treaties are endorsing the view that ultimately the value of a commodity depends upon its scarcity. Money is the scarcest of all commodities because its supply can be fixed at any level consistent with the zero expected inflation principle. As it has been shown elsewhere [Parguez, 1998b] the EMU is thus restoring some version of the gold standard, a standard in which the Euro should be gold, the most abstract form of gold. Under the old gold standard, variations in world gold extraction could contradict the scarcity principle and impose unwanted fluctuations in prices and interest rates. The EMU is protected against the damaging consequences of relying upon a true commodity by substituting an abstract gold, the quantity of which can be as scarce as required for true gold. This scarcity view of money explains why the state, within the EMU, must not have any possibility of imposing an increase in the quantity of Euros. The prohibition is a logical consequence of the scarcity principle. Any monetary power by the state would contradict the quantity targets fixed by the ECB. International wealth-holders would no more believe in the real value of Euro and the demand for the Euro would collapse.

3. It has been proven that the ECB must always ensure the "monetary equilibrium rule." Given the function of the demand for money, the Bank has to fix the supply of Euros at the level which must adjust the effective level of interest rates to its natural level. Such a view is rooted in the postulates that the level of interest rates is determined by market forces, it is thus endogenous, and that there always exist some level of interest rates imposing zero expected inflation. The natural rate of interest could change through time but the Central Bank should always be informed of its level. The EMU would thus be always in the situation of a perfect monetary equilibrium, the whole supply of Euros being absorbed by the hoarding of Euros.

The existence condition of money, the demand for money as an investment, is rooted in Patinkin's tradition and mostly in the Monetary Equilibrium school spelled out in the 1930s by Koopmans [1933]. Money exists because it has, like any commodity, an intrinsic value, and it has such value because it is held instead of spent. It is held because of its specific yield accounting for its own utility. The value of money is

thus independent of circulation. This characteristic explains why the conception of the Euro is suffering from what has been called "Patinkin's paradox" [Parguez, 1969]. The difference between a barter economy and a monetary economy is that "money" is used as a general intermediary of private transactions. Even Koopmans, Patinkin and all neo-classical economists define money as the general means of payments. According to the general principles of neo-classical economics, this means of payments exists because its use is increases wealth. The paradox lies in the nature of the demand for money defining the equilibrium amount of money. As pure hoarding, a specific investment of wealth, the demand for money is the quantity of money which is withdrawn from circulation. Money has a value as long as it is not used as a means of payment. It is obvious that the underlying theory of the Euro is suffering from this paradox. The strength of the Euro is determined by the willingness of wealth-holders to hold it instead of spend it. The architects of the EMU have been so obsessed by the constraint of convincing international wealth-holders to hold Euros instead of dollars, that they have ignored the requirements of circulation. Like all neo-classical economists, they have rejected the role of the state as a prerequisite for the existence of money. Money will be a pure private investment and the Euro should be the soundest currency given that all links between the currency and the state have been severed. The privatization of money had been clearly spelled out by Koopmans and the entire monetary equilibrium school.

From Hayek and Koopmans to Friedman and Patinkin, all neo-classical economists have deduced the demand for money from the scarcity principle ruling its supply. Money exists because there is a portfolio demand for it; the prerequisite for this demand is the expected value of money, its real yield. This real yield is inversely related to the scarcity of money. Here lies the logical core of all kinds of neo-classical perspectives on money [Parguez 1975; Parguez, 1998a; and Parguez, Seccarreccia and Vallageas, 1998]. The scarcity theory of value implies the strict exogeneity of the money supply. In an exogenous money system, the Central Bank must discretionarily determine the supply of the commercial banks' money. It is not an empirical issue, but a pure logical constraint. The Euro has been shaped to fit the neo-classical rule of exogeneity. Neither existing currencies nor even gold could meet this constraint. Euro economics is thus endorsing Rueff's interpretation [1945, 1958] of world financial crisis. A staunch supporter of the scarcity theory of value, Rueff thought that world crises were the result of the non-scarce nature of the world currency: the U.S. dollar. An absolute exogenous money should be substituted for the dollar. Gold was not scarce enough since both its quantity and its price could vary. As it has been shown, the new Euro fits Rueff's plan by creating the perfect gold standard regime. Such a conception explains both the absolute independence of the ECB, which had never before existed, and the demise of state intervention in money creation.

The equilibrium condition of Euro economics is the neo-classical condition. The ECB is always imposing equality between the available quantity of currency and the quantity wealth-holders want to hoard. The EMU would always be in a situation of monetary equilibrium. In the EMU, money should therefore always be "neutral." In the context of an imperfect economy relative to the requirements of perfectly flexible markets, to attain the natural rate of interest should require first the attainment of the equilibrium rate of unemployment, the NEIRU. Euro economics is therefore the ultimate aspect of the neo-Wicksellian agenda which has been spelled out by Seccarreccia, Parguez and Vallageas [1998]. The level of the NEIRU is determined by the ECB accounting for the fears of international wealth-holders. These pessimistic expectations are rooted in the assumed rigidities of labor markets. They cannot be curbed without forecasting a very high NEIRU. Money should therefore be "neutral" as it had been spelled out by Hayek, the Monetary Equilibrium school and the more recent neo-classical economists. In the context of an imperfect economy relative to the requirements of perfectly flexible markets, attaining the actual rate of interest requires first attaining the equilibrium rate of employment, the NEIRU. The level of the NEIRU is determined by the ECB accounting for the fears of international wealth-holders which are themselves rooted in the assumed rigidities having a damaging impact on the financial markets.

The Euro Is Therefore Not a True Money

The principles underlying modern monetary production economies have been spelled out by the Theory of Monetary Circuit, which is the most advanced aspect of the post-Keynesian conception of money [Graziani, 1996; Parguez, 1996; and 1997; Parguez, Seccarreccia and Vallageas, 1998]. Such a conception of money escapes from the fundamental contradiction of the neo-classical theory of money (Patinkin's paradox).

The first principle of the modern theory of money is that, in a dynamic capitalist economy, money is the existence condition of the sequential production process. It is ruled by the flux/reflux principle which constrains all productive agents, both firms and the state. In the first stage of the production process, firms and the state determine their desired expenditures. In a second stage they have to be granted credit by banks, commercial banks, and the Central Bank as the state bank as well. In a third stage they can spend the amount of money they got as a counterpart of credits. In the case of firms, money appears as deposits with the commercial banks while in the case of the state, it appears as deposits of the Treasury with the Central Bank. The state must therefore always have a checking account with the Central Bank. Firms cannot spend the receipts they do not have, nor can the state spend the taxes that do not yet exist. Both the receipts of the firms and the taxes of the state are part of the reflux generated by the initial expenditures of the firm and the state. Firms spend their available quantity of money to finance their circulating capital requirements mostly in the form of wages and salaries. The state spends the quantity of money it received from its own bank to pay for the quantity of labor it needs to finance the so-called transfer expenditures (pensions, social compensation, interest on bonds) and its equipment-goods acquisitions. In the fourth stage, the state can raise taxes (income tax, sales tax) while firms get their receipts by selling commodities and securities to income earners. In the fifth stage, firms and the state alike use their receipts or taxes to pay back initial credits, which entails an equal destruction of money.

Such a monetary circuit explains why modern money is entirely determined by the requirements of circulation. It is perfectly endogenous because the amount of newly created money is determined by the effective demand for credit of firms and the state. The demand for money is thus the amount of money which is needed to carry on the production plans of both private commodities and collective goods – in the case of the state.

Money has an extrinsic value which stems from its circulation. Money is not a commodity and cannot be treated as a special commodity. It is a single abstract token which has a general purchasing power because spending it generates real wealth. This abstract token is endowed with value because accepting it as an income is to acquire a right to future real wealth, the result of firms and state spending.

Having just an extrinsic value [Wray, 1999], money cannot be a scarce resource – some kind of abstract gold. The scarcity theory is irrelevant in a credit-driven modern economy. The logical consequence of the rejection of the scarcity principle is that the hoarding of money plays no part at all in the determination of the value of money. Either it does not exist, or it is a mere residual appearing in the last stage of the monetary circuit. It determines that part of aggregate savings which is not held in securities. It is thus reflecting the share of the initial quantity of money which is not canceled through taxes, the acquisition of commodities and securities.

The monetary equilibrium is thus inconsistent with the major characteristics of positive economics. The level of interest rates cannot be the outcome of a market mechanism since there is no neo-classical market for money. Interest rates are therefore exogenous, which prevents the existence of a Wicksellian natural rate of interest ensuring the neutrality of money.

The modern theory of money recognizes the crucial role of the state. As it has been shown, the modern state, contrary to states in ancient agrarian economies and to states in charge of a full command economy like the former USSR [Wittfogel, 1959], is a monetized, credit-driven producer of collective useful goods. It can never finance its required expenditures by taxes because taxes will be the ultimate outcome of aggregate initial expenditures for a given desired saving rate [Parguez, 1997]. The state is therefore obliged to have access to credit.

The fundamental prerequisite for banks' ability to grant credit is that the state bestows on their deposits or liabilities the characteristic of money. As shown by Mosler [1997-98] and Wray [1999], the state may create the extrinsic value of bank money if two conditions are fulfilled. The first is that bank money can be freely used to pay taxes as if it were true state money. The state therefore has the power to create money at will by drawing checks on its account at its own bank, the Central Bank. It can legally impose that this money be accepted because it will be used to pay taxes. This condition has been emphasized by the modern neo-chartalist approach [Wray, 1999]. The second crucial condition is the state's legal money must be deemed as a source of real wealth by the community. The more state expenditures contribute to the generation of real wealth, the higher will be the legal extrinsic value of the currency issued by the state.

We may therefore spell out the characteristic of a true currency: it is an abstract token which allows for circulation because it has a legal extrinsic value stemming from the fact that it represents a right to future wealth. We may accept the proposition that the higher the rate of employment is (the lower the rate of involuntary unemployment), the greater will be the extrinsic value of the currency, and the sounder it will be [Parguez, 1998a and 1998b].

It is now straightforward to show that having encapsulated the neo-classical theory of money, Euro-economics rejects all the characteristics of a true modern money. Depriving member states of any monetary power, it is substituting financial markets for the state as the ultimate source of legitimacy for the new currency. Such an absolute privatization of money would lead to a privatization of the state itself. To finance their desired expenditures, member states will have to be granted credit by private banks. They will have to pay interest rates fixed by the Central Bank and their ability to borrow will depend on the ability and willingness of private banks to finance government expenditures. Banks should be constrained first by the monetary targets fixed by the Central Bank and second by the reluctance of their stockholders to support expenditures which are not market-oriented (like social expenditures). Private banks would therefore impose very stringent credit-worthiness rules on state demands for credit. A credit-worthy state should pledge to balance its budget, to get to a zero *ex post* deficit, so as to protect the banks against the risk of accumulating public debt. Government bonds will no longer be liquid assets, since according to the prohibition, they could no longer be automatically discounted by the Central Bank.

Fiscal constraints are therefore the logical consequence of the privatization of money. They should ensure that states can get the quantity of money they need as long as they comply with market requirements. Substituting financial markets for the state always requires, as it has been shown, depleting enough aggregate demand to adjust the rate of employment to the level desired by financial investors, the so-called equilibrium, or natural rate of unemployment, the NEIRU. The required constraint on aggregate demand is operated by the Central Bank, assisted by the financial fiscal norms imposed on states' expenditures. The more reluctant international wealth-holders are to be convinced of the pledge to permanent zero inflation; the higher should be the NEIRU, and the lower must be the level of employment. We are thus led to the conclusion that the real value of the currency is inversely related to the level of employment. The real value of the currency is no longer supported by the ability to create real wealth by spending it. The Euro will never be accepted as a right to future wealth. In terms of the modern theory of money, it is a "false" money – an abstract token deprived of any extrinsic value that has to be artificially sustained by targeting an increasingly high NEIRU. The technical infeasibility of Euro rules will make the financial markets more and more reluctant to be convinced of the strength of the new currency.

First, we must address the ability of the Central Bank to impose monetary targets in a non-neo-classical world. It has been recognized for some time that reserves requirements are not an efficient mechanism. Central Banks are obliged to provide banks with the *ex post* reserves they need to sustain the credits they have already

granted to firms and states. This rule is just a consequence of the banks' place in the financial sequential process of modern economies. Debt-to-equity ratios are not efficient since banks can always control the value of their stocks by extending pure financial credits. Open-market operations remain. The Central Bank has to hold a large stock of public debt it can increase at will if it wants to control the quantity of money by selling or acquiring government bonds. The ECB could not efficiently handle open-market operations[6] since it is forbidden to acquire new bonds directly and it cannot acquire bonds held by private banks because it would be an indirect way of financing government expenditures. In any case, the balanced budget rule will equate the new supply of bonds to zero. If states run surpluses and pay-back the existing debt, the stock of bonds will fall. Thus, the very rules which have been imposed to root the scarcity principle in the EMU will paralyze the ECB and prevent it from forcing the scarcity principle upon real economics. Secondly, there is a worse technical flaw in the EMU. The more international wealth-holders will substitute Euros for dollars in their liquid portfolio, the more the ECB will be deprived of any power to control the stock of Euros. It would have to strive to curb the domestic demand for credit which it cannot do directly.

Ultimately, the fate of the Euro will depend upon the fiscal austerity rules. States could not be granted credits by private banks if they do not meet the constraint of running a balanced budget or a fiscal surplus. To comply with this constraint, states will have to slash their social expenditures because they are the most adverse to the brutal instincts of financial investors. Fiscal austerity should deplete the economy enough to allow for demands for credit to meet the Central Bank target. On the other side, private banks will no longer be automatically provided with reserves by government expenditures since they are financed by credits from private banks. This drain on reserves will oblige banks to borrow reserves from the Central Bank which would be in a position to impose targeted interest rates high enough to adjust the rate of unemployment to the NEIRU. A spiraling process of deflation could thus be engineered and convince wealth-holders to endorse the targeted value of the Euro. A permanent policy of economic "atonement" would be the *sine qua non* for imposing an artificial currency. The more this process raises unemployment, the more the Euro will be deprived of value, the more markets would have to be convinced by imposing increasing austerity, leading to more unemployment.

CONCLUSION: THE UNSUSTAINABILITY OF THE EMU

As it has been illustrated, in its present form, the EMU is the new and perfect gold zone that should stabilize the world economy because the Euro-gold would supersede the dollar. There had been an existing gold zone when, in the early 1930s, France rallied around the last European supporters of the gold standard (i.e., Italy, Holland, Belgium, Switzerland, and Eastern Europe). In the context of the world crisis, as soon as the USA left the gold standard, the gold zone failed. France strove to maintain its pledge to the gold standard by deflating the economy through fiscal squeeze policies. Their impact was to accelerate the pace of deflation in France and the whole gold zone. In the mid-thirties, all members of the gold zone (except Switzerland) had to abandon the gold standard after the collapse of their currencies. The fate of the new gold zone should be the same.

The core currencies of the EMU, the French franc and German mark, have been suffering since the early 1980s from a long period of stagnation. Real rates of unemployment are among the highest of the OECD countries while real wages are stagnant or falling and rates of growth insignificant. The cause of this long-term rise in unemployment and downward pressure on labor income is the long-term policies of fiscal and monetary restraint which have been imposed to defend the targeted values of the currencies [Seccarreccia and Parguez, 1998]. Since the early part of this decade, in order to meet the criteria set out in Maastricht, France and Germany and all other members of the future EMU have worsened their policies of monetary and fiscal austerity. They have increasingly slashed expenditures, maintained high taxes and social contributions, while pegging average real interests above American levels. In all EMU countries, the average real rate of interest is at least twice or thrice the real rate of growth.

In the late 1990s, most EMU countries have run policies of fiscal austerity so drastic that they enjoy zero deficits and sometimes surpluses. Were they accounting for their cyclically-adjusted budgets, they would be running enormous structural surpluses – the proof of the deflationary impact of those policies.

The effective implementation of the Euro, in the context of the new world crisis, would still worsen the situation of real economies within the EMU. Governments will be obliged to impose more and more stringent pro-cyclical policies to meet the targeted fiscal surpluses. As we have shown, they could not escape from the fiscal straight jacket because of the absolute monetary constraint imposed upon them. It seems that the architects of the EMU have been taught some lessons by the collapse of the gold zone after 1936[7]. They have carefully shaped the institutional mechanism suppressing any degree of liberty for member states. The more the depression forces revenues down, the greater will be expected deficits; the lower the amount of money raised by financial markets, the greater will be the resulting cuts in expenditures.

The ultimate result of this race to deflation will be a fall in the real value of the Euro. To sustain the currency, the ECB would have to target higher rates of unemployment, pushing the real rate of interest increasingly above the real rate of growth. Defending the Euro against the world crisis would therefore accelerate deflation in the EMU and that spiraling process should again lower the real value of the EMU. Contrary to the hopes of its architects, the Euro will increase financial instability in the world economy. By exporting its self-imposed deflation, Europe will, like in the early 1930s, accelerate the pace of the world crisis. The alternatives are either a collapse of the EMU, or a considerable rethinking of its underlying economic ideology. The second option would require substituting high-wage full employment for zero inflation NEIRU as the main target of the EMU [Kregel, 1998]. Endorsing this alternative would require understanding that there is no NEIRU because the prerequisite for a sound currency is full employment without wage deflation. If such an alternative were to be chosen, the Euro could be accepted as a true right to future increased real wealth: the essential condition of a strong currency, as it has been explained. The problem is that such a commitment requires a total reshaping of the Euro in both its structure and underlying economic vision. Kregel's alternative is an astute version of the government as employer of last resort (ELR) program put forward by Mosler [1997-98], Wray [1999] and many others [Parguez, 1998a].

Because of their monetary constraints, member states will ask the ECB to finance public job creation programs coordinated at the European level. Those programs should offer a job to anybody seeking employment.

New workers will be hired at a predetermined wage fixed at the EMU level. This wage (or set of wages) should be high enough to sustain a normal consumption fund. Those programs should apply to socially needed activities and indeed comply with the desires and ability of the newly employed.

Being rooted in a high real-wage, full-employment economy, the Euro would be a true and sound currency.

Such a plan would require that the ECB reject the scarcity principle by creating money at the request of some European planning agency. That would contradict the core of the EMU, the prohibition to create money at the request of any institution. The whole EMU economics would have to be rejected. At the same time, the amount of money spent to create jobs would be accounted as member states expenditures[8], the forecasted deficits of which would instantaneously increase, which would violate the supreme fiscal target of balanced budgets or fiscal surpluses. The EMU would thus have to renounce its vision of a currency led by austerity-addicted financial markets. Ultimately, this alternative requires so dramatic a "cultural revolution" that it is still highly improbable, though it would be imposed by the second great world economic crisis, as happened to the first gold zone.

NOTES

The first version of this paper was written for the session on the EMU at the Eastern Economic Association Meetings in New York, February 1998. For this revised version, the author has to thank Thomas Ferguson, Mathew Forstater, Warren Mosler, Edward Nell, Mario Seccarreccia, Randy Wray, and an anonymous referee. All errors are my own.

1. Such a crisis had not, of course, been expected. Even now, European leaders are reluctant to admit the existence of a new global crisis.
2. The NAIRU is simply targeting a constant inflation, whatever its rate can be.
3. Such a private-money has never existed. As it will be shown later, money, not credit relationships, has always been the result of a decision of the state.
4. Tangible investments are the sole investments in real infrastructure.
5. This poses a technical problem. If states have no more checking account with the Central Bank, those surpluses should appear in their checking accounts at private banks.
6. Central banks are already lacking government bonds because of balanced budgets. Governments bonds are more and more scarce.
7. France could never reach balanced budgets in the first half of the 1930s. All public debt was "monetized."
8. Since there is no true European budget, because there is no true European state.

REFERENCES

Artis, J.M. and Winkler, B. *The Stability Pact: Safeguarding the Credibility of the European Central Bank*. Centre for Economic Policy Research, London, 1997.

Artis, J.M. and Zhang, W. *On Identifying the Core of the EMU: An Exploration of Some Empirical Criteria*. Centre for Economic Policy Research, London, 1997.

Graziani, A. Money as Purchasing Power and Stock of Wealth, in *Money in Motion: The Post Keynesian and Circulation Approaches*, edited by G. Deleplace and E. J. Nell. London: Macmillan, 1996.

Koopmans, J. Zum Problem des Neutralen Geldes, in *Beitrage Zur Geldtheorie,* edited by F. Hayek. Vienna: Universitat Press, 1933, 118-180.

Kregel, J. A. Currency Stabilization Through Full Employment: Can EMU Combine Price Stability with Employment and Income Growth? Paper presented at the Eastern Economic Association Annual Meeting, February, New York, 1998.

Mosler, W. B. Full Employment and Price Stability. *Journal of Post Keynesian Economics*, Winter, 1997-98, 167-82.

Parguez, A. L'intégration des variables financières dans le modèle de Don Patinkin, in *Économies et Sociétés*, serie MP, no. 22, mars, 1969, 518-546.

__________. Monnaie et Macroéconomie, Economica, Paris, 1975.

__________. Beyond Scarcity, in *Money in Motion*: the Post Keynesian and Circulation Approaches, edited by G. Deleplace and E. J. Nell, London: Macmillan, 1996, 155-199.

__________. Government Deficits within the Monetary Production Economy: the Tragedy of the Race to Balanced Budgets. unpublished manuscript, 1997.

__________. Full Employment, the Value of Money, and Deficit Financing: the Theoretical Foundation of the Employer of Last Resort Approach within a Circuitist Framework. Paper presented at the Fifth International Post-Keynesian Workshop, Knoxville, June, 1998a.

__________. The Hidden Agenda of the EMU: A Gold Standard without Gold. Unpublished manuscript, 1998b.

Parguez, A., Seccarreccia, M. and Vallageas, B. The Theory of the Monetary Circuit: An Overview of Some of the Issues. unpublished manuscript, 1998.

Rueff, J. *L'Ordre Social*. Paris: Surey, 1945.

__________. Rapport sur la situation financiére. Imprimerie nationale, Paris, 1958.

Seccarreccia, M. and Parguez, A. Les politiques d'inflation zèro: la vraie cause de la hausse tandancielle du chômage dans les pays occidentaux, in *Objectif plein emploi: le marché, la social-démocratie ou l'économie sociale?*, edited by D.G. Tremblay. Montreal: Presses de l'University du Québec, 1998.

Wittfogel, K. Oriental Despotism: A Comparative Study in Total Power. Princeton: Princeton University Press, 1959.

Wray, L. R. *Understanding Modern Money: The Key to Full Employment and Price Stability*, U.K.: Edward Elgar, 1999.