Heiner Flassbeck – “Let nations go bankrupt!”

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If the euro does not become a currency for all the euro zone nations, it is doomed to failure and will result in much more suffering for its citizens.

Heiner Flassbeck is an economist, as well as publisher and editor of “Makroskop” and “flassbeck economics international”

Originally posted in German at Makroskop

Translated and edited by BRAVE NEW EUROPE

In a guest article for the *Frankfurter Allgemeine Zeitung*, fourteen German and French economists commented on proposed measures towards a deepening of European Monetary Union – which had been decided on a few weeks earlier in Meseberg at the Franco-German summit. They hailed the Meseberg Declaration with enthusiasm, but called for further measures (here the article in the *FAZ*, signed by Marcel Fratzscher and Clemens Fuest among others). These economists recommended breaking taboos in order to strengthen the euro zone, and in particular:

“to enable an orderly default by states and the participation of private creditors – without automatism.”

This extreme fixation on debt cuts by states can now only be called manic. It shows that either radical ideologues are at work or – worse – people who consider themselves experts, but who have no idea what they are talking about, let alone what they would do if their recommendations were accepted.

“Breaking the vicious circle of banks and government”

The economists specify their demands as follows:

“… three essential elements are necessary in order to put together a meaningful overall package of reforms. Firstly, politicians must complete the banking union and end the vicious circle of banks and national governments. To this end, they must break another

important taboo, namely the limitation on concentration of national government bonds on bank balance sheets. This could be done by introducing capital requirements on high concentrations of government bonds".

The "vicious circle of banks and national governments" is supposed to mean that banks are willing to finance any national debt because they believe it is completely risk-free. And with this assessment, it has to be said clearly, the banks are completely right. It is no coincidence that government bonds have so far been exempted from banks' capital requirements because people know that a state's bonds will never fail as long as they are in its own currency. This market and regulatory wisdom, developed over many decades, is currently being lost, as the above statement demonstrates.

There is no currency crisis in the euro zone

In the past there have undoubtedly been defaults on government securities denominated in foreign currencies – resulting in losses for banks and others. Argentina is the classic recent case. There have also been many currency crises which have ended in the devaluation of a national currency and thus with losses for those who had invested in this currency, including in government bonds. But these are currency risks that investors, who buy government bonds denominated in an independent national currency, have to accept. These currency risks may lead to higher interest rates (reflected in a higher yield) but not in a premium for the default risk. We have repeatedly seen yield increases on government bonds when many investors withdrew from a particular sovereign bond very quickly (the famous sudden stop) because they expected a devaluation of the currency in which the bond was issued.

However, if a bank operates predominantly in a particular currency area and holds government bonds from this currency area, then it has no currency risk. In this case government bonds are risk-free, because the state always has sovereignty over the monetary system and can ensure that its bonds can be serviced with "fresh money". Consequently, the concentration of bonds in the banks' own currency is perfectly sound and absolutely justified.

This is particularly evident for very large and economically strong economic areas, because a devaluation of the currency is not considered a permanent risk even for banks operating internationally. Would anyone think of serving the US Treasury with an insolvency order because the dollar is weak? Only if he wanted to make a fool of himself.

Does any nation have its own currency in the euro zone?

This seems to be different for Europe, however, although all nations in the euro zone have a common currency. But not a single country – in accordance with the ideas of these economists – is allowed to have its own currency. Everyone behaves as if they possess only foreign currency. This would result in the monetary system being denationalised in the euro zone. States would then have to operate just like companies, supervised by a large technocratic bureaucracy named the European Central Bank (or European Monetary Fund) , which would ensure that democracy is permanently eliminated, because everyone would be subject to neo-liberal conditionality forever, no matter what they opted for in democratic elections.

Given the strange ideas of these economists, we need to ask all the countries that are already members whether they really wanted to enter a system in which they would give up not only their own former currency, but the possession of an “own currency” altogether. Since all countries would reply that with the entry into European monetary union they actually only wanted to exchange their own national currency for their own European currency, one would have to conclude that their decision had occurred in a state of “objective error” or error of fact, as the lawyers call it. The signatures under the European treaties would therefore be invalid from the outset.

“Whatever it takes”

Greece, many will interject, was a case in which a state was already bankrupt when in possession of its own currency. That’s right. However, it is only true because, even then, those responsible in Europe, and especially in Berlin, did not realise what a merger of national governments with a single currency was all about. In that case, ideology prevailed over reason (even in large sections of the left, which had nothing better to do than to demand sovereign default).

After the disaster with Greece, the European Central Bank (ECB) at least hinted that it might have understood what it means to be the central bank of every single country in the euro zone, even if once again there has recently been considerable confusion concerning its role in Italy.

Let me make it perfectly clear: no euro-zone country should ever again have a debt cancellation or similar stupid action that could give the impression that one of the countries involved does not have its own currency. The ECB must eliminate interest rate divergences as soon as they appear on the markets. However, critics in Germany will say that this is only possible if everyone abides by all the rules at all times. That’s true, but it only applies to the sensible rules. And it applies first and foremost to Germany, which is responsible for by far the greatest violation of the rules of reason and refuses even to talk about it, let alone attempt to make up for its past failings.