Article

Review of Radical Political Economics
1–20

DOI: 10.1177/0486613417703955
rrpe.sagepub.com

Neoliberalism, Profitability, and the Crisis in the Eurozone

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Abstract

This paper aims to analyze the roots of the sovereign debt crisis around the Eurozone countries. Furthermore, it seeks to deconstruct the orthodox argument which states the crisis is caused by fiscal indiscipline of some of its members. In doing so, the article bears on the political economy tradition, integrating the elements of hierarchy and asymmetry among the various actors, and poses the hypothesis that the crisis in the Eurozone is due to three highly correlated causes: (1) the unfolding of the 2007 crisis that originated in the United States, (2) the *financialization* of the global economy, and (3) the intra-Eurozone imbalances, a legacy of the neoliberal institutional framework of the last decades. To associate the Euro crisis with this neoliberal architecture, moreover, the main tendencies of contemporary capitalism are described, pointing to the theoretical contribution of Marx, particularly regarding his hypothesis of a tendential fall of the profit rate. Finally, some concluding remarks are considered, stressing alternatives to the budget austerity measures and to the necessary ruptures with this neoliberal institutional framework.

JEL Classification: B51; P16; H63; N14

Keywords

crisis in the Eurozone, political economy, neoliberal capitalism

1. Introduction

Throughout the 1990s, the European integration process deeply intensified and, in 1999, with the introduction of a common currency, the Euro, reached a benchmark in its trajectory. This integration process of the "old continent" was supported by neoliberal political changes, both institutional and ideological, which proclaimed the liberalization and the deregulation of markets as the most efficient way to allocate resources. The application of these rules, following their advocates, would result in high growth rates, economic development, and well-being for the countries. The current European scenario, however, is characterized by insignificant growth (if not negative), very high levels of unemployment, and intense social tensions that undermine and

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Date received: March 17, 2015
Date accepted: December 5, 2016

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contradict these prerogatives, whose academic foundation is the aforementioned neoclassical theory.[1]

Having said this, the paper has as its main purpose an analysis of the roots of the sovereign debt crisis in the Eurozone countries, with the additional intention of deconstructing the orthodox reasoning that the current crisis comes from the fiscal indiscipline of some of its members. In doing this, the article bears on the political economy tradition, which aims to integrate the aspects of hierarchy and power asymmetry among all types of agents, and seeks to sustain the hypothesis that the crisis in the Eurozone is due to three highly correlated causes: (1) the unfolding of the 2007 crisis that originated in the United States, (2) the *financialization* of the global economy, and (3) the intra-Eurozone imbalances, a legacy, as mentioned above, of the neoliberal institutional framework of the last decades.

Precisely, the paper contributes in an original way to the debate over the intra-Eurozone imbalances as a consequence of this neoliberal institutional arrangement which was strictly applied to the Eurozone countries, and has as its foremost goal the restoration of capital profitability.

The article is divided into four parts, as follows: in the first (section 2), we aim to describe the institutional framework that preceded the Euro's introduction and that had as its pivot the Maastricht Treaty, approved in February 1992. After that, in section 3, we investigate the trends in neoliberal capitalism, which began at the end of the 1970s, bearing on the theoretical contribution of Marx. Particular attention is given to the relationship between the restoration of profitability and the compression of wages in contemporaneous capitalism, as well as the law of tendential fall of profit rate—the most important law in modern political economy according to this author. Section 4, in sequence, talks about the imbalances among the Euro countries. Imbalances that are at the root of Europe's crisis and that reveal, in reality, the limitations and failures of the institutional architecture are presented in sections 2 and 3. While section 4 presents two groups of countries that can be clearly distinguished: the Southern (peripheral) countries comprising Portugal, Ireland, Italy, Greece, and Spain, and the Northern, or core countries, composed by Germany, Austria, Belgium, Finland, and the Netherlands. We choose to exclude France from the sample (unless stated) for its intermediate position on the variables under concern, as well as Luxembourg and some other countries which joined the Eurozone later as in the case of Slovenia (2007), Cyprus (2008), Malta (2008), Slovakia (2009), Estonia (2011), and Latvia (2014).[2] In the last section, some final remarks are considered, stressing alternatives to the austerity measures and to the necessary ruptures with the neoliberal institutional framework.

[1]The correlation between neoliberalism and the neoclassical theory is not perfect. As a matter of fact, the term neoclassical is quite inaccurate, because it presupposes a continuity between the old classical political economy authors of the surplus approach—authors from William Petty to Karl Marx, including François Quesnay, Adam Smith, and David Ricardo, who assumed that real wages (distribution) were exogenously given—and marginalists (the neoclassical ones), who assumed that real wages (equilibrium ones in the long run) were determined by supply and demand (endogenously) like any other price. It should be noted that empirically, several neoclassical economists do exist who are not neoliberals in the sense of radical defenders of the free market ideology. This is mostly the case of the so-called New Keynesians who, although using the neoclassical tool, accept—to a large extent—government intervention to deal with (what they call, in their vocabulary) "market failures." Undoubtedly, however, there are a significant variety of interpretations of the term neoclassical economics even among the more cautious interpreters. On the latter point, see Lawson (2013).

[2]In 2014, the southern countries accounted for 34 percent of the GDP of the eighteen Eurozone countries, while the Northern countries accounted for 43.13 percent. Luxembourg, Slovenia, Cyprus, Malta, Slovakia, Estonia, and Latvia, on the contrary, sum up, between them, no more than 3 percent of the GDP of the Eurozone countries.

2. The Institutional Framework Preceding the Introduction of the Euro

The Euro model, based on a Monetary Union with the adoption of a single currency, the Euro, brings us to the European Union Treaty, also known as Maastricht Treaty. In this treaty, approved in February 1992 by the twelve members of the European Community,[3] three stages for the implementation of the European Monetary Union (EMU) were agreed upon. During stage I, the signatory countries agreed to eliminate capital controls and to strengthen the independence of their Central Banks, aiming to make their internal laws compatible with the Treaty. In stage II, developed between January 1994 and December 1998, the member countries were expected to coordinate their economic and monetary policies to achieve quantitative targets set for the reduction of inflation, interest, and exchange rate fluctuations between national European currencies, in addition to the control of the deficit and public debt (União Europeia 1992). In 1997, particularly, the Stability and Growth Pact (SGP) was approved. According to this pact, the so-called convergence criteria to be met by the entering countries would be: (1) inflation in the last preceding twelve months should not have exceeded by more than 1.5 percent the lowest inflation rate of the member countries, (2) public deficit should have been kept at a maximum of 3 percent of GDP, (3) public debt no higher than 60 percent of GDP, and (4) long-term interest rates, in the preceding year, should not have exceeded more than 2 percent the rates of the three member countries with the "best performance" in terms of inflation. Stage III, in turn, beginning in January 1999, had as a milestone the inauguration of the European Central Bank (ECB) and the Euro's introduction as a unity of account for all financial assets in eleven out of fifteen member countries of the European Community.[4]

Therefore, since 1999 one of the key institutional pillars of the EMU has been the ECB whose board is responsible for issuing the Euro and for the formulation and implementation of the common monetary policy of the Euro member countries. In other words, with the monetary union, the national central banks have lost the capability to formulate and execute monetary policies, a function that is now undertaken solely by the board of the ECB, which defines the common basic interest rate for all countries of the Euro area. With the Euro's introduction, consequently, those national central banks have lost the ability to implement domestic rate of exchange policies.

The Maastricht Treaty, it is noteworthy to mention, institutionalizes, due to Germany's demand, price stability as the main objective of the ECB, subordinating all other duties to this one point. The full and complete independence of the ECB against any agency or entity of the European Community and national governments is clearly stated. In respect to fiscal policy, by the way, the Maastricht Treaty and the main agreements of the EMU imprison the National States insofar as they prohibit the ECB to fund governments of the Euro area. That is, the fiscal policy of these National States must be subjected to the equilibrium requirements established by the SGP.

The SGP, in turn, approved with the purpose of restraining "irresponsible" fiscal behavior by the European Union member countries, has seen since its birth, however, a loosening of its rules. It is interesting to note that in 1999, Belgium and Italy, for example, with public debts higher than 110 percent of their GDP, were in clear breach of the Maastricht rules. These countries, which should have supposedly suffered financial penalties for disrespecting the rules, ended up not being penalized, as well as France and Germany, countries that in the years following to the Euro's introduction disobeyed the Maastricht rules in relation to imbalances in public budgeting.

[3]The European Community at that time consisted of Germany, Belgium, France, the Netherlands, Luxembourg, Denmark, Ireland, the United Kingdom, Portugal, Spain, and Greece. Later, in 1995, Austria, Finland, and Sweden joined the Maastricht Treaty. The adhesion to the Treaty, however, did not mean the adoption of the Euro as a single currency. That is why the United Kingdom, Denmark, and Sweden opted to stay out of the Eurozone.

[4]These countries were Germany, Finland, Belgium, the Netherlands, Austria, France, Portugal, Ireland, Italy, Spain, and Luxembourg. The entry of Greece to the Eurozone was approved only in June 2000.

By and large, one can say that the integration process of the EMU transcends the economical aspect and reports us to the end of World War II. And although for reasons of space and focus, we do not trace the comings and goings of this integration over sixty years, we do point out that in the view of its formulators this should be the *grand finale* for the unification of a continent scarred by centuries of intense rivalry and ongoing wars. And, in this sense, the introduction of a currency independent of any particular State would perhaps help to overcome the notion of national sovereignty. From a political standpoint, nevertheless, the dogma that pictures capitalism as a system best managed by market forces, that is, without the National State, lacks all and any serious understanding of the real history and origin of the capitalist interstate system. The European liberal cosmopolitanism, in addition, presupposes a political unity of the continent that, at least till these days, does not exist, given the heterogeneity of these European national states—featured by strong cultural, linguistic, and, above all, capitalist economic development differences (Amin 2012; Fiori 2007, 2011).

From the economic perspective, on the contrary, the ease with which trade transactions could be dealt with in any member country, alongside the reduction in the degree of contractual uncertainty of exporters and importers, certainly contributed to popularizing the advantages of a single currency. But that does not mean the process of a Monetary Union did not suffer technical criticism since its conception, criticism based largely on the so-called theory of optimum currency areas, originally posited by Mundell (1961), McKinnon (1963), and Kenen (1969), and later on developed through the contribution of Tavlas (1993), among others.[5]

Actually, in the field of *heterodox political economy*—the area in which this paper fits in—the criticisms to the institutional architecture of the Monetary Union stem from its political and ideological neoliberal nature (Arestis and Sawyer 2011; Husson 2012; Lapavitsas 2012; Stockhammer and Onaran 2012). This neoliberal project is based on the assumption that the liberalization of capital flows (trade and financial deregulation), budgetary discipline, and the flexibility in the labor market would ensure the per capita income convergence of the economies that entered the Eurozone. For these reasons, before we proceed to the chain of events that led to the crisis in the Eurozone and the specific internal imbalances between those countries, we are going to describe, in the next section, the major tendencies of neoliberal capitalism with recourse to Marx's theory.

3. Trends of Neoliberal Capitalism in the Light of Marxian Theory

Since the mid-1980s, contemporary capitalism presents as a stylized fact a more distinguished growth of finance capital compared with that of industrial capital (see Figure 1).[6]

Taking into account, however, the pursuit of profit as the driving force of capitalism, it is interesting to notice this financialization of the economy from behind the movement of profit rate. This, in turn, can be described as follows:

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[5]We cannot deny the reductionism and limitation, since its formulation, of these criticisms as a result of their neoclassical theoretical foundations that are hard to support vis-à-vis the formal inconsistencies of the law of diminishing returns, as exposed by the capital controversy. Furthermore, according to this literature, ultimately, a monetary zone would only be optimum in the case of one country, and yet under the assumption that its regions were "symmetrically affected by disturbances," which makes that theory useless in practice. In this sense, see Jonung and Drea (2009) and Eichengreen (1997).

[6]Theorizing financialization is beyond the confines of this article. It should be mentioned, however, that financialization, according to Lapavitsas (2011), can be posited as a systemic transformation of mature capitalist economies that comprises three fundamental elements: first, the fact that large nonfinancial corporations have reduced their reliance on bank loans and have acquired financial capacities (financing investment primarily by retention of their own profits); second, that banks have expanded their mediating activities in financial markets as well as lending to households; and third, that households have become increasingly involved in the realm of finance both as debtors and as asset holders.

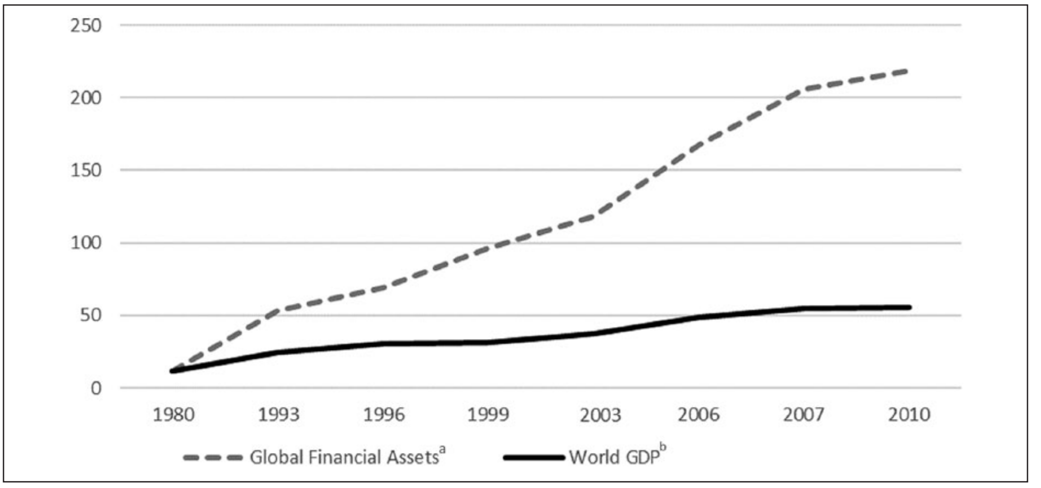

Figure 1. World GDP and Global Financial Assets—US$ Trillions
Source: McKinseys Global Institute.
[a]Includes stocks and debentures, government bonds, private debt securities, and banking applications; does not include derivatives.
[b]Instruments, machines, equipments, facilities, buildings, civil works, technology, and anything else that allows future production of an increased flow of goods and services.

$$r = \frac{s}{c+v}. \tag{1}$$

Each capitalist performs his profit rate by the ratio of his profits (surplus-value, s) to the investment made, that is to say, the expenditure on machinery, equipment, and raw materials (c, constant capital) plus the amount spent in labor-power (v, variable capital). Dividing both parts by v, Marx obtains,

$$r = \frac{\left(\frac{s}{v}\right)}{\left(\left(\frac{c}{v}\right)+1\right)}. \tag{2}$$

$\frac{s}{v}$ is the rate of surplus-value, which means the degree of exploitation of workers, and $\frac{c}{v}$ represents the organic composition of capital.[7] For Marx, in the capitalist mode of production, there would be a progressive tendency for the rate of profit to fall, due to the progressive development of the social productive power of labor and to the persistent increase of the organic composition of capital. That is, each capitalist's search for cost-reducing technical innovations (or profit-increasing product innovations), at prevailing prices and wages, that provide a super-profit (a higher than average initial profit rate), would determine technical progress to be labor saving and capital intensive.

[7]Besides the organic composition of capital (and the surplus-value), the average profit rate depends on the turnover time of the circulating capital. As a diminishing turnover time from the circulating capital means an acceleration on the performance of the surplus-value, this leads to an increase in the average profit rate (Marx 1993a, vol. III, chapter XIII).

Similarly, from a Marxian perspective, it is possible to describe such profit rate in macroeconomic terms, as Duménil and Levy (2003) and Foley and Michl (1999) have done:

$$r = \frac{\left(s / \left(v+s\right)\right)}{\left(\left(c+v\right) / \left(v+s\right)\right)}. \tag{3}$$

Here, $s/(v+s)$ is the share of profit in total income, and $(c+v)/(v+s)$ is total capital per hour worked, which is another measure of the organic composition of capital (this ratio can also be read as the ratio of capital to output, since output is equal to total income, or equivalently the inverse of what is frequently loosely called “capital productivity”). Then, decomposing the determinants of the profit rate from equation 3, we get a distributive effect—the capital-labor struggle in national income—and a technological effect, that is, the productivity from sector I:

$$r = \left(\frac{s}{v+s}\right) \times \left(\frac{v+s}{c+v}\right). \tag{4}$$

The tendency for the profit rate to fall has in Marx a fundamental feature. For him, this means nothing less than “the most important law of modern political economy, and the most essential for understanding the most difficult relations. It is the most important law from the historical standpoint” (Marx 1993b: 748). The emphasis Marx gives to this issue has stirred heated debates and controversies within the Marxian field,[8] and still does to this day.

In this intricate debate, Yaffe (1972) and Postone (1996) seem to rescue a central element within Marx’s method to defend the law of a tendentially falling rate of profit: the contradiction of capital in its process of reproduction, insofar as, on one hand, there is capital as value in process, value trying to expand itself without boundaries and, on the other hand, there is the working population (increasingly smaller in relation to capital—not in absolute terms) imposing limits to this expansion.[9] The very accumulation of capital, therefore, imposes limits to the extraction of surplus-value. There are barriers beyond which it is impossible, for a given amount of labor-power, to either increase absolute labor time or reduce necessary labor time for the reproduction of the working class, in as much as each worker cannot work more than twenty-four hours per day and necessary labor time may not be less than zero. Here arise the natural limits to the extraction of surplus-value. To the extent that the rate of surplus value approaches these extremes, its neutralizing effect over the organic composition of capital is diminished and, consequently, the profit rate will tend to fall.[10]

[8]See, among others, Baran and Sweezy (1966), Sweezy (1987), Joan Robinson (1942), and Josef Steindl (1952).

[9]Schematically, such an argument becomes clearer, as the numerator of the profit rate is the mass of surplus-value, and this is the result of the rate of surplus-value times the number of employed workers at a given rate, that is, if s grows and v tends to zero, the limit of $\frac{s}{v}$ = + infinity (∞). But as S (mass of surplus-value) = $\left(\frac{s}{v}\right) \times V$, if $\left(\frac{s}{v}\right)$ tends to infinity (∞) and V tends to zero, the limit of $S = 0$, because $S = \infty \times 0 = 0$.

[10]Marx associates his law of the falling rate of profit even with an increase in the rate of surplus-value, but as seen above, this rise has limitations. It is worth noting, however, that for Marx this law, although a characteristic feature of capitalist technical progress, denotes just a long-term tendency. In several passages of chapters XIII and XIV from Volume 3 of *Capital*, Marx claims it is quite possible for the profit rate to fall for other reasons and/or that this fall can be temporarily overcome.

[11]For a better measurement of the rate of profit, within Marxian vocabulary, it would be necessary to have information about the amount of productive and unproductive labor, as well as total capital advanced in production.

The empirical analysis of the rate of profit, despite limitations surrounding the appropriate measurement of Marxian categories,[11] reveals that it reversed its downward picture in the neoliberal era (Duménil and Levy 2011; Glyn 2006; Husson 2008, 2013; Moseley 2007; Shaikh 2010). And although there is still no consensus on the restoration of the profit rate to levels akin to those obtained prior to the "Fordism-Keynesianism" crisis, the crucial question to know is, "what actually happened so that there was this marked transformation in the behavior of the profit rate?"

As it can be seen in Figure 2, the profit rate notably presents two distinct phases. The first phase corresponds to the period of the dismantling of the Fordist mode of accumulation and of its associated Keynesian policies. This phase, commonly referred to as the "stagflation crisis," was associated with a sharp decrease in capital profitability. The second phase, beginning in the early 1980s, on the contrary, has as a hallmark some very specific reforms and policy measures such as, mentioned earlier, deregulation and increased flexibility in the labor market, trade and financial liberalization, as well as privatizations and the rebirth of monetarism. At this second phase, named neoliberalism, there has been a recovery in profit levels.

The investigation of the determinants of the profit rate, as it turns out, also reveals distinct patterns. The "capital productivity" evolution, for example, shows that during the period of the stagflation crisis, this variable plummeted, which means that the organic composition of capital had an overwhelming impact on the fall of the rate of profit in this period (Figure 3). In the neoliberal years, in contrast, the organic composition of capital has had a much more modest and stagnant character. This phenomenon is more likely to be associated with two causes. In the first place, we can highlight the financial and macroeconomic instability of the post-Bretton Woods environment, leading this way to a sluggish Gross Capital Formation—this mismatch between capital accumulation and the profit rate is also set in the context of the dominance of shareholder

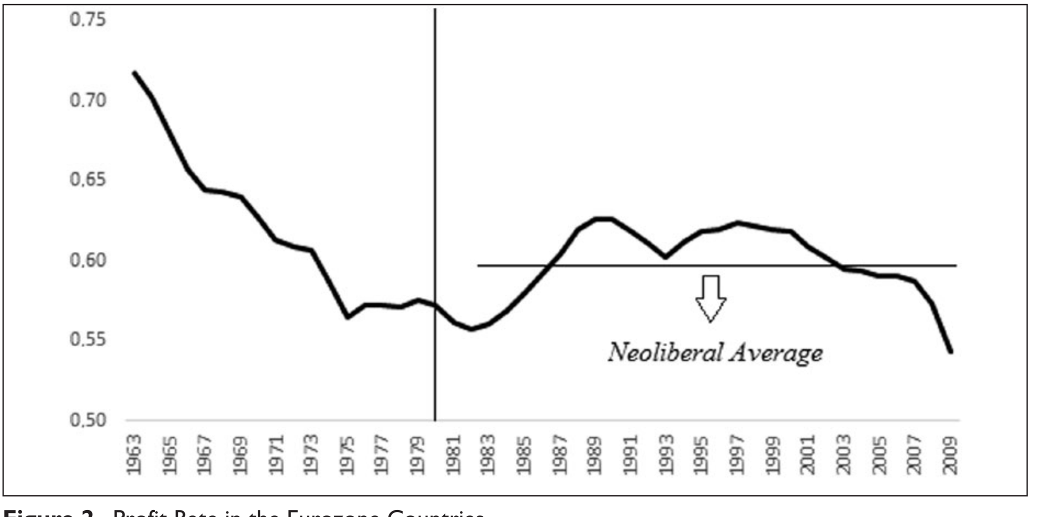

Figure 2. Profit Rate in the Eurozone Countries
Source: Author's elaboration based on Marquetti and Foley (2011) and Annual Macro-economic database.

[12]For Marx, the cheapening of the elements of constant capital could be a counteracting cause for his law of the falling tendency of the rate of profit, that is, although the mass of means of production did grow in relation to a given labor-power, the increase in value of constant capital relative to variable capital could not keep up with the respective increase in its mass. In other words, the strong technological innovation since the 1980s, resulting from the new information and communication technologies, while devaluing the existing equipment at an accelerated pace, ended up weakening the rising trend in the organic composition of capital.

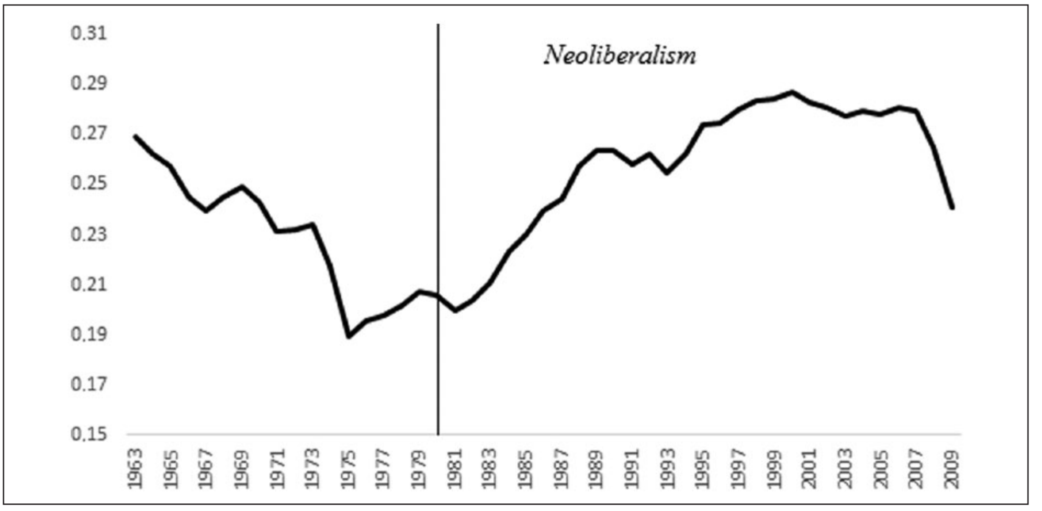

Figure 3. "Capital Productivity" in the Eurozone Countries
Source: Author's elaboration based on Marquetti and Foley (2011).

value maximization, at the level of the firm, as the main corporate objective (Guttmann 2008). Afterward, it is reasonable to link this stagnant organic composition of capital to a possible incorporation of technological innovations regarding the third industrial revolution.[12]

The examination of the influence of the distributive factor in the determination of the profit rate, as it should be, also seems interesting. As can be seen in Figure 4, phase I, corresponding to the "stagflation crisis," was associated with a reasonable increase in the workers' share of national income. This event, by decreasing the degree of exploitation of labor-power, exacerbated the intrinsic tendency for the rate of profit to fall.[13]

Bearing in mind the crisis of capital profitability of the 1970s, therefore, it becomes easier to interpret the subsequent expansion of finance capital seen in Figure 1. Nevertheless, one cannot lose sight of the fact that the respective profitability standards imposed by financiers in the neoliberal period were only made possible by an increase in the level of exploitation of labor-power, that is, the wage rigidity and the employment flexibility, as well as the systematic recourse for cheap and poorly protected labor, through international outsourcing and offshoring[14] (Chesnais

[13]For some theorists, labeled profit squeeze theorists, the growing power of workers during this period was a key reason for the decline in the rate of profit. Glyn (2006), for example, by highlighting the strengthening of unionism and legislative changes that supported the bargaining position of workers, can be included in this school. According to the British author's calculations, by the way, the number of average hours annually worked in the OECD countries fell from 2,000 in 1950 to 1,750 in 1973, the equivalent of more than half a working day less per week. Marx, from another angle, asserts: "Nothing is more absurd . . . , than to explain the fall in the rate of profit in terms of a rise in wage rates, even though this too may be an exceptional case" (Marx 1993a: 347). In fact, as we can note from Figure 4, the Golden Age of capitalism seems to be an exceptional case.

[14]In global terms, China and, to a lesser degree, India have a prominent role in this scenario. The wage rate of an average worker in China, for example, is about one-twentieth of that in the United States, one-sixteenth of that in South Korea, one-fourth of that in Eastern Europe, and half of that in Mexico or Brazil (Li 2008). That is to say, the Chinese labor-power, huge in quantity, productive, and extremely cheap, allows the Chinese and foreign capitalists to make profits through its intense exploitation—in light of this, it is not surprising that China receives large amounts of foreign investments.

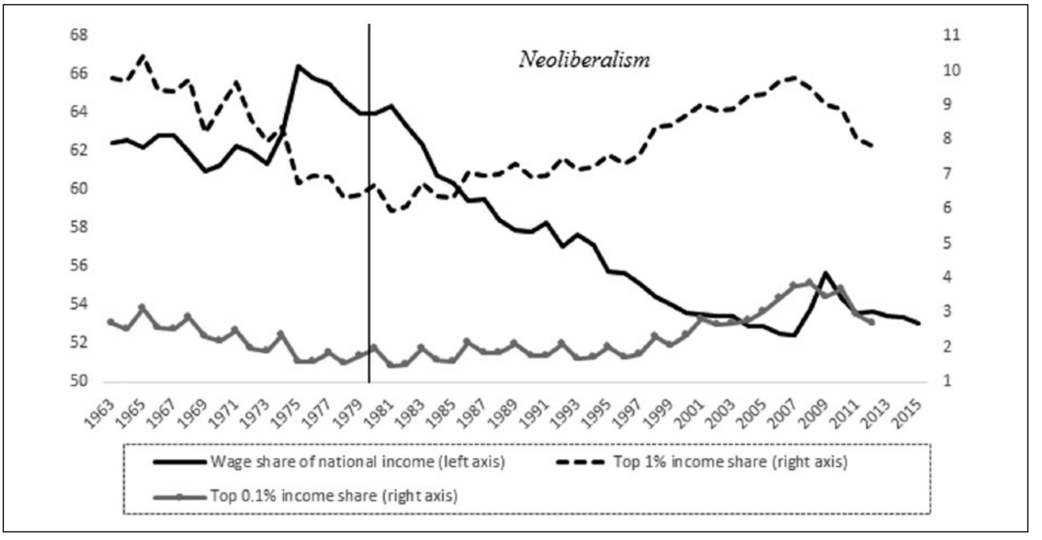

Figure 4. Wage Share of National Income, Top 1 and 0.1 percent Income Share in the Eurozone Countries
Source: Annual Macro-economic Database and the World Wealth and Income Database.

2004). As can be seen in Figure 4, the wage share of national income in the Eurozone countries during neoliberalism suffered a sharp decline. Similarly, the top 1 percent income share in the Eurozone countries since 1980 began to grow and only seems to have a point of inflection (still uncertain) with the outbreak of the crisis that originated in the United States in 2007. Besides, between the years of 1999, with the introduction of the Euro, and 2007, the top 0.1 percent income share showed a remarkable increase of 83 percent.

The neoliberal policies, instituted intentionally to reverse the decline in profitability, if seen from this point of view, were very successful. As a result, we should interpret neoliberalism as a political project to reestablish the power of economic elites (Duménil and Levy 2011; Harvey 2005). In this context lies the implementation of the Maastricht Treaty, analyzed in section 2. To put it differently, no wonder price stability due to Germany's demand is the main objective of the ECB, given that inflation is substantially harmful to rentiers.[15]

In this sense, if it is true that neoliberalism has triggered the restoration of profitability by compressing wages, it is also true that, paradoxically, it has driven the intra-Eurozone imbalances and ultimately the sovereign debt crisis as well. The next section therefore has two objectives: first, it tries to locate the usual literature about the intra-Eurozone imbalances and, second, it tries to make clear how this institutional neoliberal regime, by reestablishing the profit rate over the

[15]"In the US, for example, the share of the national income taken by the top 1 per cent of income earners fell from a pre-war high of 16 per cent to less than 8 per cent by the end of the Second World War, and stayed close to that level for nearly three decades. While growth was strong this restraint seemed not to matter. To have a stable share of an increasing pie is one thing. But when growth collapsed in the 1970s..., then upper classes everywhere felt threatened... After the implementation of neoliberal policies in the late 1970s, the share of national income of the top 1 per cent of income earners in the US soared, to reach 15 per cent (very close to its pre-Second World War share) by the end of the century. The top 0.1 per cent of income earners in the US increased their share of the national income from 2 per cent in 1978 to over 6 per cent by 1999, while the ratio of the median compensation of workers to the salaries of CEOs increased from just over 30 to 1 in 1970 to nearly 500 to 1 by 2000" (Harvey 2005: 15–16).

last decades, has induced these same imbalances in the Eurozone. In doing this, we intend to contribute to the debate with an unconventional argument about the European crisis in general and its internal bluster specifically.

4. The Crisis and the Imbalances in the Eurozone Countries

After the disclosure of fraud in Greece's public accounts and its excessive indebtedness, it became conventional, within mainstream literature, to attribute the crisis in the Eurozone to the irresponsible behavior of the governments of the peripheral economies of the Euro.[16] For some authors within the mainstream, such as Van Overtveldt (2011), the Southern countries had embraced populist policies, during the "fat years of Maastricht," which were now compromising them. For others, the crisis was the result of the Welfare State, and of excessive labor costs in these countries, which had made them noncompetitive due to high unemployment benefits, early retirement, few hours worked, and so on.

Generally speaking, this latter view is shared by authors such as Smaghi (2013) who argues that countries which lost "competitiveness" (competitiveness here meaning labor cost) prior to the crisis experienced the lowest growth after the crisis. Similarly, Draghi (2012) argues that the Eurozone crisis was caused by the fact that since the introduction of the euro, unit labor costs have increased by 28 percent in deficit countries, 2.5 times as much as in surplus countries.[17]

Moreover, for authors such as Dadush (2010) and Sinn (2014), the trend of increase in unit labor cost—expressed in real wages growing faster than labor productivity—in the Southern Eurozone was caused by its rigid inflexible labor markets, strong unions, and strong employment protection.

Needless to say, the view that the Eurozone crisis was driven by fiscal indiscipline in the peripheral countries—where national debts would supposedly have soared already before the crisis—is widespread and represents the emphasis European policymakers give to fiscal austerity. For instance, Wolfgang Schäuble (2011), Germany's influential Finance Minister, writes: "It is an indisputable fact that excessive state spending has led to unsustainable levels of debt and deficit that now threaten our economic welfare." Jean-Claude Trichet (2010), former President of the ECB, also agrees with this explanation when he says: "the roots of the sovereign debt tensions we face today lie in the neglect of the rules of fiscal discipline that the founding fathers of Economic and Monetary Union laid out in the Maastricht Treaty." The governor of the Bank of France, Christian Noyer (2012), is included in the list as well by stating that the "main origin of the crisis lies in the lack of fiscal discipline on the part of most Member States... [These Member States] ran up deficits and debts, including during times of growth. As a result, in 2008, when the crisis started, these countries had no more fiscal room and their public finances deteriorated substantially." Likewise, the well-known German professor and economist Hans Werner Sinn (2010) points out the "lesson to be learned from the crisis is that a currency union needs ironclad budget discipline to avert a boom-and-bust cycle in the first place."

At this point, it is interesting to highlight that when we mention the word imbalance, it is relating the interconnection between current account imbalances, fiscal imbalances, and competitive

[16]By peripheral economies of the Euro, we are referring to Portugal, Ireland, Italy, Greece, and Spain. By core countries of the Eurozone, in contrast, we bear in mind Germany, Austria, Belgium, Finland, and the Netherlands. From now on, by the way, we follow Husson's (2012) hypothesis of a two-tiered Europe, labeling the peripheral countries as the "South" and the core countries as the "North."

[17]For Bagus (2012), the imbalances were created by an artificial boom financed by credit expansion and not by genuine real saving—the only variable, in his theoretical framework, capable of triggering capital accumulation.

imbalances. It is impossible to investigate one without paying attention to the others, even considering that any mechanical notion of twin deficits must be seen with caution.

Another classical reference, in this debate, within mainstream literature is Blanchard and Giavazzi (2002). These authors focus their analyses on savings–investment differentials (equivalently, on current account balances and their associated capital flows) in the run-up and immediately after the transition to the euro. According to them, the savings–investment correlations had fallen significantly even before but especially with the advent of the euro—a signal the authors are interpreting as an increased financial integration that would come with the adoption of a single currency. Thus, they show that the current account balances of the member states increased with per capita income, which would reveal that capital would be flowing from the Eurozone core countries, capital-abundant countries, to their less advanced, capital-scarce, euro area partners. This, in turn, would reflect within the euro area the virtuosity of approaches dealing with catch-up and convergence. That is, the Eurozone system would be creating an optimistic expectation regarding the rapid convergence of the periphery countries with the core of the Eurozone.

In this comforting explanation, catch-up countries would have strong investment requirements that would call for inflows of foreign capital and therefore current account deficits. Furthermore, increased integration of capital markets would be likely to result in large current account deficits and, in such a context, deficit countries would not need measures to reduce their imbalances (Blanchard and Giavazzi 2002).

Throughout this section, however, we try to refute all these interpretations, as we assume this is a capitalist crisis engendered by the neoliberal institutional arrangement presented previously, which reinforces the imbalances between the Northern and Southern countries. That is, the imbalances and the North–South differences are the by-product of the neoliberal regime that is also responsible for the rise of the rate of profit. And therefore the sovereign debt crisis is just a manifestation or rather a consequence arising mainly from the measures taken to bail out the private banks since the 2008 recession.[18]

As a starting point, we must remember that the purpose of an economic union between countries with different levels of development is to generate some form of harmonization and convergence. This implies that the less developed countries should grow faster. From Table 1, we note that this process, in a way, actually did happen, as those countries, which in 1990 presented the lowest levels of GDP per capita, were, in the period 1990–2008, the ones that recorded the highest rates of growth.

It so happens that this type of convergence was followed by higher inflation. As one can see in Figure 5, the peripheral countries were the ones that had the highest inflation rates during the period. It is worth noting, moreover, that these higher rates of inflation did not come about only due to their higher economic growth, insofar as less developed countries structurally present higher rates of inflation, either by reason of bottlenecks, lack of infrastructure, and economies of scale, or also because of a greater distributive conflict. In other words, this means that even in the absence of asymmetric shocks, the acquiescence to the same monetary policy thwarts the convergence of inflation levels in different national economies (Mathieu and Sterdyniak 2007).

[18]This does not disqualify that accounting fraud and excessive public indebtedness did in fact occur in Greece, but the same does not apply to Spain and Ireland, countries that until the outbreak of the 2008 crisis recorded fiscal surpluses. In relation to Greece, already in 2004, with the change of government, the European commission was informed of the accounting manipulation that allowed the entry of this country into the Eurozone. Then, the fraud was denounced by the new government, which later, with the help of the US investment bank Goldman Sachs, enacted new manipulations, discovered only in late 2009 with the return to power of the Labour Party.

Table 1. Growth Rate of GDP and GDP Per Capita.

	Average Growth Rate of GDP		Index of GDP Per Capita (Euro = 100)	
Countries	1990–2008	1999–2008	1990	1999
Ireland	5.86	6.04	76.2	117.8
Spain	2.98	3.74	75.1	71.0
Greece	2.77	4.13	51.5	56.1
The Netherlands	2.71	2.50	110.5	119.4
Austria	2.55	2.55	120.2	121.9
Finland	2.37	3.57	156.0	115.7
Portugal	2.20	1.77	43.6	57.0
Belgium	2.10	2.30	114.0	114.2
Germany	1.88	1.65	120.9	119.1
France	1.85	2.19	119.6	110.4
Italy	1.36	1.54	112.4	97.4
Euro	2.60	2.91	100.0	100.0
South	3.03	3.44	71.8	79.9
North	2.32	2.51	124.3	118.0

Source: World Bank Database.

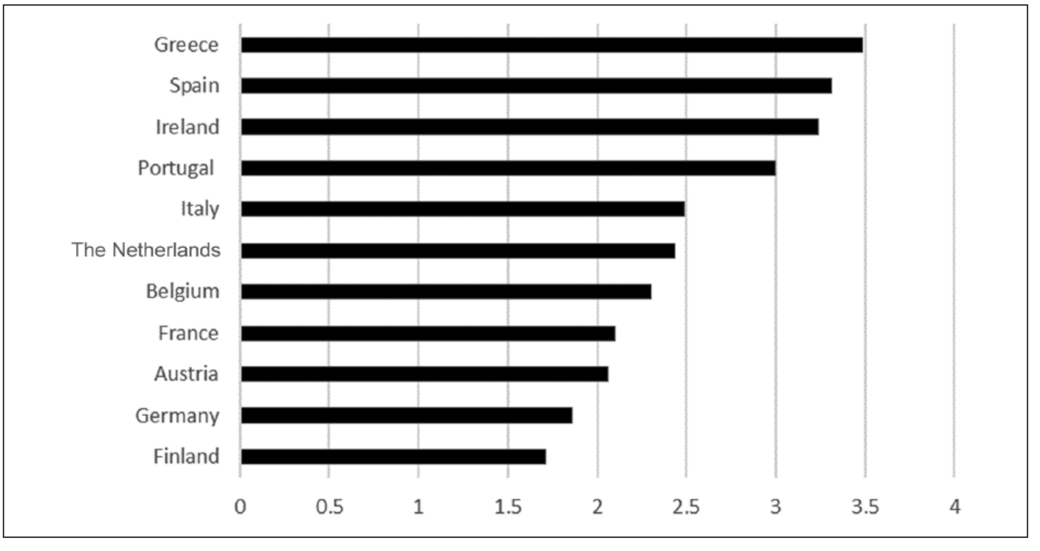

Figure 5. Annual Average Rate of Inflation, 2001–2008
Source: Eurostat.

These higher inflation rates in the peripheral countries of the Euro have contributed to two events. In the first place, they contributed to the divergence in real interest rates between the Eurozone countries. Between 2000 and 2007, for example, the real interest rate in the Northern countries was in average 2.7 percent and in the Southern countries only 1.2 percent. These low interest rates, in turn, led to a substantial increase in private debt, a 36 percent increase in the South versus only a 4 percent in the Northern countries. As shown in Figure 6, there is a link

[19]It is important to realize that this increased private debt is also explained by the increased supply of loans resulting from reduced exchange rate risk (and possibly lenders' perception of reduced default risk) once the peripheral countries joined the Eurozone.

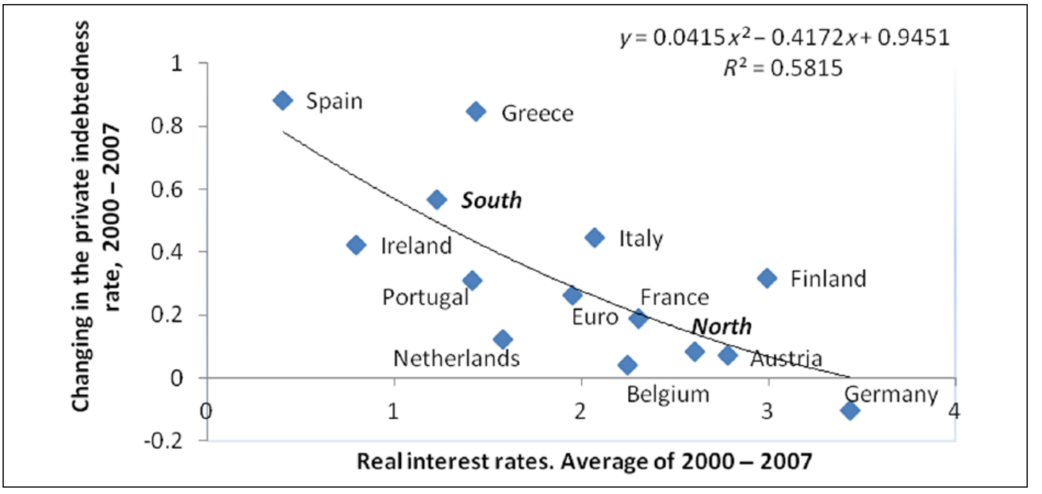

Figure 6. Real Interest Rates and Private Indebtedness
Source: Author's elaboration based on Annual Macro-economic Database.

between the average level of interest rates and the growth in household indebtedness. The great economic growth in the countries of the South was therefore partly underpinned by a debt-led regime, which has fueled housing bubbles, notably in Spain.[19]

On the contrary, the higher inflation rate in the Southern countries, given the impossibility of nominal exchange rate devaluation, has made the exports of these peripheral countries of the Eurozone more expensive, and their imports, in contrast, cheaper $[E = e(p^{\text{international}} / p^{\text{domestic}})]$. Having the opposite movement taken place in the Northern countries, it has contributed to further asymmetries in the intra-zone competitiveness. Hence, since the Euro's introduction, as Figure 7 shows, there has been a tendency for the Northern countries to present surpluses in their current accounts whereas the Southern countries present deficits.

This disequilibrium in the balances of current accounts among the Eurozone countries, however, cannot be explained only by the rate of inflation. It must be said that, in a neoliberal world, the flexibility in labor markets, or, to be more accurate, the reduction of labor costs, also brings competitive advantages.[20] From Figure 8, we can notice, as a general framework, a decline in real unit labor costs for the whole Eurozone. Until the introduction of the single currency in 1999, in fact, most of the Eurozone countries made a huge effort toward convergence in the sense of lowering these costs. And this competition toward lowering labor costs was later on won by Germany

[20]It is worth noting that this mechanism is not always valid, but strictly so in neoliberal capitalism. That is, the current pattern of incentives nowadays stimulates a race to the bottom in which countries, taken individually, try to reduce their labor costs and flexibilize labor markets. Palley (2004), for instance, makes an analogy with the prisoners' dilemma: given that each country has an incentive to gain a marginal competitive advantage by reducing its labor cost, if one country reduces its cost and the other does not, the former has a larger payoff. The greatest overall payoff, nevertheless, would happen when no country decreases its labor costs and the lowest overall payoff when both have done so. Thus, due to the pattern of private incentives, in the absence of compulsory labor standards, the global (or regional) economy would bear only an equilibrium in which both countries reduce their labor standards (suboptimal). For Palley, in this sense, the only way to stop this process would be through cooperative measures that, by changing the pattern of incentives to governments and entrepreneurs, would carry the economy into a superior equilibrium with higher wages and output.

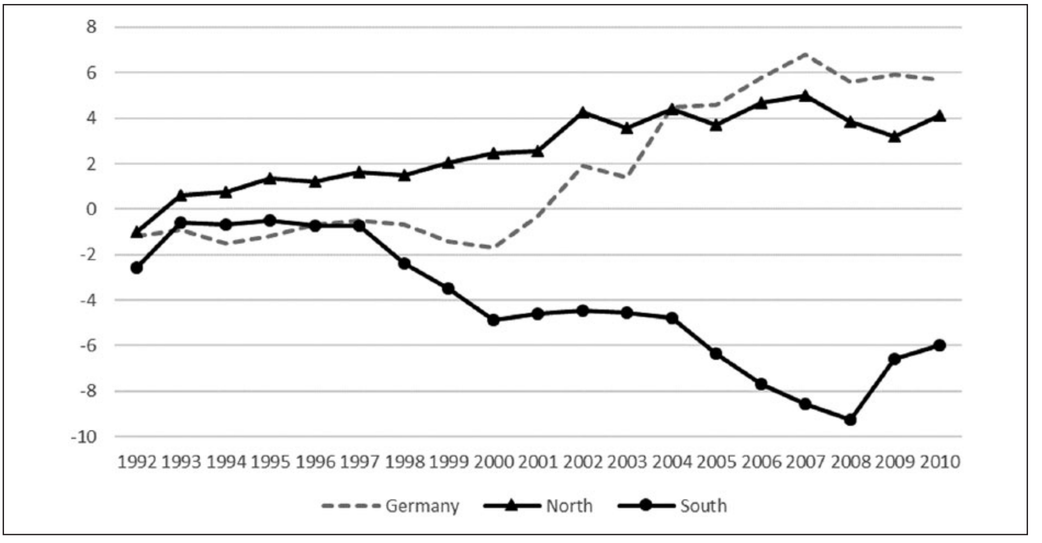

Figure 7. Current Account Balance in % of GDP, 1992–2010
Source: Annual Macro-economic Database.

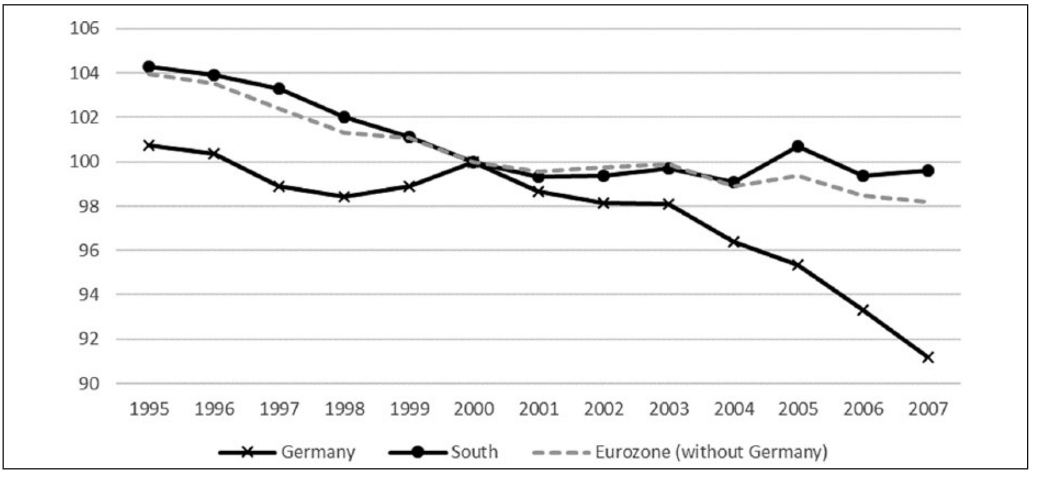

Figure 8. Real Unit Labor Costs (2000 = 100)
Source: Annual Macro-economic Database.

which, first under Gerhard Schroeder's administration and afterward under Angela Merkel's tutelage, performed a wage freeze without precedent throughout this period, along with pressures to weaken labor unions and to cut back on the value of workers' pensions.

The low rate of inflation in conjunction with reduced labor cost, therefore, were the variables that artificially triggered the rise in competitiveness in Germany and which explain its remarkable surplus in the current account, as already shown in Figure 7.[21]

[21]A third element may be considered here: the weak growth of domestic demand, and in particular of consumption, because between 1997 and 2007, for example, the consumption, in volume, increased 28 percent in the Eurozone, 30 percent in the South, but only 9 percent in Germany. Anyway, what should be clear is that Germany's competitive gains have nothing to do with increases in productivity induced by investment. In this sense, see Research on Money and Finance 2011: 16, chapter 1.

In general, the depth of the Euro crisis can be better grasped by highlighting the existing link between the budget deficit and the trade deficit in each country. From the accounting equality, we know that

Need for public financing = private savings + capital inflows

This equation says that ultimately the public deficit is covered by two feasible sources, that is, private savings (households and firms) and/or the influx of capital, corresponding to the deficit in the current account. This relationship, moreover, despite not saying much about the self-adjusting mechanism, provides an analytical tool that allows us to clearly distinguish between the Northern and the Southern countries.

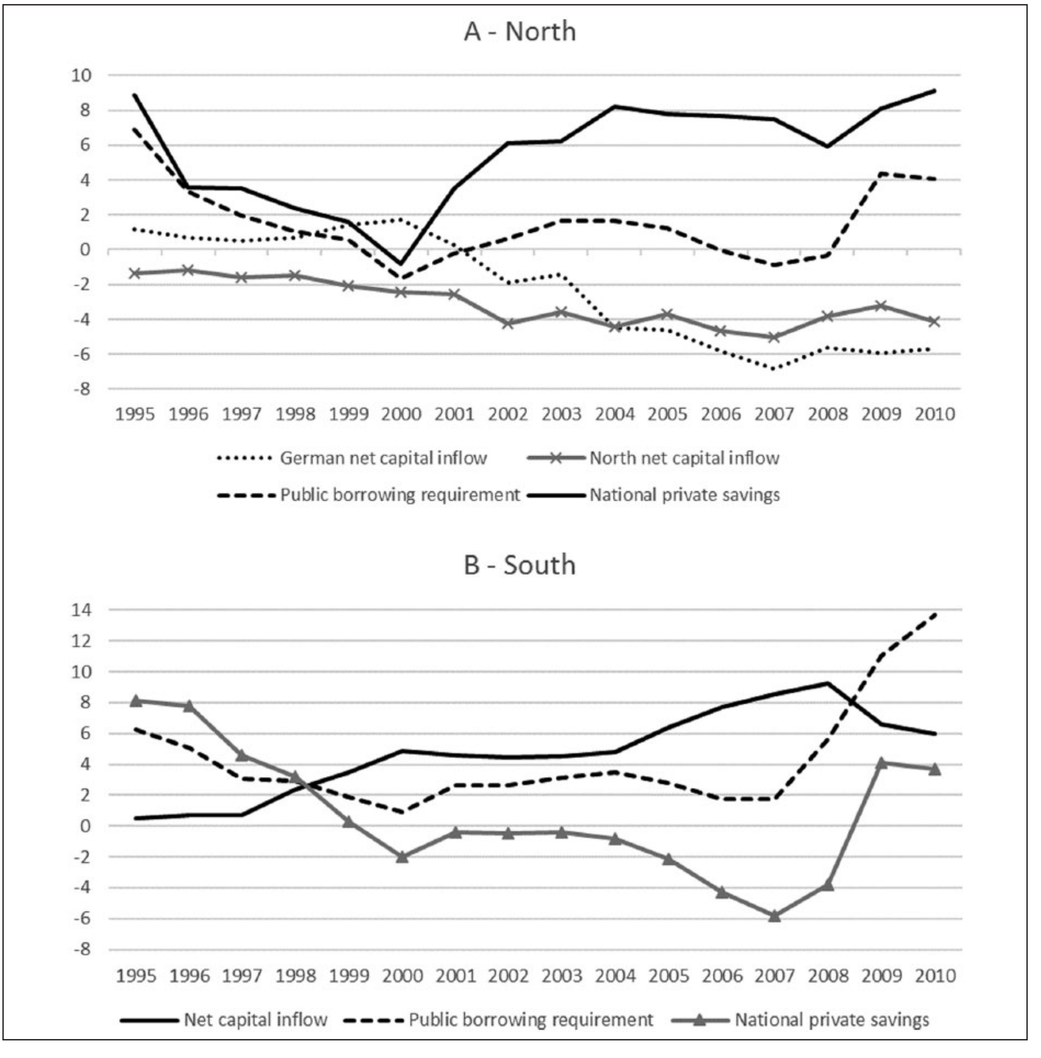

Figure 9. Public Borrowing Requirement, Net Capital Inflow, and National Private Savings
Source: Annual Macro-economic database and Husson (2012).

[22]As we can assume from Figure 9A, the bulk of German surpluses has not derived only, or even mostly, from the periphery but from across the Eurozone.

Until the crisis, in fact, the need for public financing evolved, relatively, in a similar manner in both groups of countries. In the North, however, after the introduction of the Euro, the national savings rate increased substantially, as well as the exports of capital (above all in Germany)—a counterpart of the trade surplus—represented by the negative influx of capital in Figure 9A.[22]

In the South, on the contrary, the scenario was the opposite and very well periodized. Before the introduction of the Euro, these peripheral countries reduced their budget deficits to comply with the SGP, having as a counterpart a fall in private savings that was offset by capital inflows. Until the crisis, public deficits did not rise, but from the mid-2000s, the imbalances became sharper, because trade deficits deepened, leading to massive capital inflows offset by a decline in private savings. The current account deficit of these countries in the South, it is worth noting, was—with the free movement of capital established by the Maastricht Treaty—financed through increasing external banking indebtedness, both public and private, as well as the inflow of foreign portfolio investment arising from the surplus countries, which, as a matter of fact, have fed upward spirals of asset prices, spurring, as stated before, housing bubbles in Spain, Ireland, and Greece. The outbreak of the crisis, last but not least, manifested itself as a large increase in these countries' public deficit. At the same time, there was capital flight followed by a big increment in the rate of private savings (Figure 9B).

In fact, in 2007, that is, on the eve of the subprime crisis, nothing could have indicated the imminence of a crisis with major dimensions involving the European sovereign debt. The housing crisis in the United States, nonetheless, had become a crisis of the global banking system from the very moment that those toxic securities tied to mortgages were sold as legitimate. Thereby, we came upon a global recession: global banks got weak in terms of liquidity and solvency, including the European banks.[23] The global recession, particularly in 2008 and 2009, meant that National Governments had to intervene to support their domestic economies (obviously, the capacity to collect taxes and the yield of National Governments were reduced, insofar as their domestic economies shrank). The Northern countries were then better able to sustain their economic activity by raising their public deficit, but the Southern countries, already constrained by current account deficits, had to increase their public debt to exorbitant levels—at least in the view of market players such as the credit rating agencies. At the same time, we must bear in mind that the fiscal stimulus measures adopted by these countries in the South to combat the economic downturn were frowned upon by these international agencies of credit rating—who, since 2008, with the default episode of Iceland, were on alert over the high level of indebtedness of some European countries. For these reasons, already at the beginning of 2009, with the lowering of the rating of credit risk of these peripheral countries of the Euro area, fears coming from some investors that these countries could not pay their debts were triggered—having as a catalyst the manipulation of public accounts in Greece at the end of 2009. In the last instance, therefore, with the solvency of these countries also a concern, the confidence of investors dropped even more, intensifying the sale of public securities arising from peripheral countries in exchange for German bonds (Krugman 2011). And it was precisely because of the desperate attempt to sell the bonds of the peripheral countries—generating a fall in their prices and, consequently, an increase in their interest rates (to compensate for the risk)—that the European financial crisis became a crisis of sovereign debt. The Greek imbroglio, in addition, unambiguously makes clear, due to the intricate and complex financial relationships among banks, governments, and companies in a context of globalized and deregulated finance, how severe and contagious the collapse of a small Southern country may be to the soundness of the economies of the North and the Euro itself.

[23]It is worth remembering that with the introduction of the single currency, and the consequent elimination of exchange rate risk, governments of several member countries from the Eurozone came into debt, in Euros, in the international market, which resulted in the expansion of indebtedness to nonresident investors, leaving these countries potentially exposed to the volatile mood of financial markets.

In this sense, the austerity policies embraced since 2010 in a context of low economic growth, as shown in Table 2, have exacerbated the negative impact of the crisis and stopped contributing even with the decline in the debt to GDP ratio. Thanks to the massive dismissal of civil servants (along with growing private unemployment), budgeting cuts, cuts in salaries and pensions, and liberalizing reforms in health and social security, we are witnessing a true offensive against labor and what is even worse: the dismantling of the European Welfare State for the sake of banks and the interest of finance.

5. Final Remarks

Throughout this paper, we have argued that the current fiscal crisis of many Euro countries stems not from the fiscal profligacy they supposedly display, as suggested by economic orthodoxy, but rather from the bailout policies and the socialization of private losses, exacerbated by the decline in economic activity and in tax revenues arising from the global recession of 2008. The resulting augmentation of the level of indebtedness, in conjunction with the reversal of the general state of expectations and, as a consequence, of liquidity conditions, led to a rise in risk premiums demanded by creditors, establishing, in this way, a vicious circle of growing levels of public debt in these countries.

We have also demonstrated that the intra-Eurozone imbalances between the North and the South countries originated precisely from the neoliberal regime whose main historical function was to restore capital profitability through the compression of the wage share.

The solutions to this European crisis, however, are multidimensional and would require another article in itself. Yet, we must highlight some final comments on the subject.

First of all, it is urgently necessary to discard, from the range of alternatives, the austerity policies, which have caused the collapse of demand, the absence of growth, a shortage of private

Table 2. GDP Growth, Unemployment, and Public Debt.

Countries	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
GDP growth rate (percentage change on previous year)											
Ireland	3.7	4.2	6.1	5.5	5.0	−2.2	−6.4	−1.1	2.2	0.2	−0.3
Greece	5.9	4.4	2.3	5.5	3.5	−0.2	−3.1	−4.9	−7.1	−7.0	−3.9
Spain	3.1	3.3	3.6	4.1	3.5	0.9	−3.8	−0.2	0.1	−1.6	−1.2
Italy	0.0	1.7	0.9	2.2	1.7	−1.2	−5.5	1.7	0.4	−2.4	−1.9
Portugal	−0.9	1.6	0.8	1.4	2.4	0.0	−2.9	1.9	−1.3	−3.2	−1.4
Unemployment rate (% labor-power)											
Ireland	4.6	4.5	4.4	4.5	4.7	6.4	12.0	13.9	14.7	14.7	13.1
Greece	9.7	10.5	9.9	8.9	8.3	7.7	9.5	12.7	17.9	24.5	27.5
Spain	11.4	10.9	9.2	8.5	8.3	11.3	18.0	20.1	21.7	25.0	26.4
Italy	8.4	8.0	7.7	6.8	6.1	6.7	7.8	8.4	8.4	10.7	12.2
Portugal	7.1	7.5	8.6	8.6	8.9	8.5	10.6	12.0	12.9	15.8	16.4
Public debt/GDP											
Ireland	30.7	29.5	27.3	24.6	25.1	44.5	64.8	92.1	106.4	117.6	122.8
Greece	97.4	98.6	100.0	106.1	107.4	112.9	129.7	148.3	170.3	156.9	173.8
Spain	48.8	46.3	43.2	39.7	36.3	40.2	53.9	61.5	69.3	84.2	93.9
Italy	104.1	103.7	105.7	106.3	103.3	106.1	116.4	119.3	120.8	127.0	132.5
Portugal	59.4	61.9	67.7	69.4	68.4	71.7	83.7	94.0	108.3	123.6	128.8

Source: Eurostat and International Monetary Fund.

domestic credit (due to liquidity retention of banks), and full social regression around the old continent.

Regarding the possibility of a particular country to exit from the Euro, one should be cautious. In general, it is argued that the exit of a specific country from the zone would allow the return of its exchange rate policy, which would be able, then, to foster its external competitiveness. Nonetheless, such a measure in itself would not solve the problem of the already accumulated debt, and it would likely lead the country into hyperinflation, as a result of excessive capital flight. The exchange rate devaluation, furthermore, could even raise the cost of debt. On the contrary, a generalized exit of countries, that is, an overall fragmentation of the zone, would give rise to a currency war among National States and could drive the resulting deadlock into exaggerated nationalism—which history has shown to be extremely dangerous.

The maintenance of the "Euro project," in turn, should be guided by radical changes in its institutional framework, other than the search for profit. In this sense, a fundamental goal has to be the absorption of the weight of accumulated debt in the peripheral countries, which, as a matter of fact, makes the restoration of economic activity in these nations much more difficult. A brutal restructuring of this debt, or its cancellation, associated with the nationalization of banks would be necessary steps on this new road. The public ownership of banks would be, indeed, the only way to untangle the web of debts, given that sovereign debt is mostly held by banks. The proof for this are the examples of Bankia in Spain, *Crédit agricole* in France, and the greatest absurdity according to which the ECB pours billions of Euros into banks instead of helping the National States directly. The possibility for the ECB to fund the States directly, by the way, could be fruitful, in that it would act as a fiscal transfer mechanism, as likely fruitful would be the injection of capital in the European Investment Bank, the tax on large fortunes, capital controls, the issue of Eurobonds, and so on.

The necessary European rebuilding, in short, can only be forwarded through principles of political and economic cooperation that reject inadequate rules as the ones set by the Maastricht Treaty. It is noteworthy that, by determining a fiscal deficit-ceiling without setting a limit to surpluses, these rules forge asymmetries in deflationary conditions and just reinforce the gap among the Eurozone countries. The sovereign debt crisis, as stated in this paper, reveals a deep crisis within the Euro system that requires the rebalancing of the German economy—toward a more inward orientation and increases in the wage share—and, above all, a rupture with the neoliberal institutional framework. This institutional framework, which was brought in to restore profitability, has provided excessive wage restraints and undesired flexibility of European labor markets besides triggering a process of ideological homogeneity surrounding the celebration of individualism. In this process, the ethics of solidarity are replaced by the ethics of efficiency, and thus the programs of income redistribution that try to reduce regional imbalances find strong resistance within societies. The solution to this crisis, therefore, rests on a paradox, because the principles of economic cooperation and of a Europe based on solidarity among Nations—elements urged when the integration took shape—are incompatible with the very capitalist logic. This contradiction, notwithstanding, makes the future an uncertain and challenging period.

Acknowledgments

I thank Tiago Appel, Norah Coleman, Alexis Saludjian, and Yongjoon Park for their very valuable comments. I also appreciate the constructive suggestions from the reviewers Davide Gualerzi, Martha Campbell, and Ramaa Vasudevan. Usual caveats apply.

Declaration of Conflicting Interests

The author declared no potential conflicts of interest with respect to the research, authorship, and/or publication of this article.

Funding

The author received no financial support for the research, authorship, and/or publication of this article.

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