The Euro

And Its Threat to the Future of Europe

IN 1992 a fatal decision was made in Europe to adopt a single currency, without providing for the institutions that would make it work. Europe decided to tie itself together with a single currency – creating within Europe the same kind of rigidity that the gold standard had inflicted on the world (pxii).

Today, the United States has largely recovered from the Great Recession while Europe, and especially the eurozone, remains mired in stagnation. The Euro was conceived with a mixture of flawed economics and ideology (pxiv).

There are close similiarities to the programs that the IMF imposed on developing countries and emerging markets, and those that have been imposed on Greece and other afflicted countries in the wake of the Great Recession (pxv).

Behind the euro project was a serious intent to move toward more political integration. But the design of the "single-currency project" was so influenced by ideology and interests that it failed not only in its economic ambition, bringing prospertiy, but also in its ambition of bringing countries closer together politically (pxvi).

We should not be surprised that certain ideas and policies serve certain interests of those who make them, even if they use more abstract ideas to argue for them. Economics and politics cannot be separated – as much as economists would like them to be (pxvii).

A key reason that globalization has often failed to produce benefits for large numbers in the world is that economic globalization outpaced political globalization and so, too, for the euro (pxvii). The euro has led to an increase in inequality, resulting in the weaker countries becoming weaker and the stronger countries becoming stronger (pxviii).

The neoliberal economic agenda has succeeded in increasing inequality and the euro provides a detailed case study on how this has been accomplished (pxviii). The euro was supposed to be a means to an end, not an end in itself – it was suppposed to increase economic performance and political and social cohesion throughout Europe. But it should be evident that everything has gone awry (pxix).

For most Europeans, the European project, the further integration of the countries of the continent, is the most important political event in the last 60 years. To see it fail, or to suggest that it might fail, or to suggest that one aspect of the project – its currency system – might fail, is viewed as almost heresy (pxx).

But reality sometimes delivers painful messages: the euro system is broken, and the cost of not fixing it very quickly will be enormous (pxx). Europe made a simple and understandable mistake; it thouht that the best way toward a more integrated continent was through a monetary union, sharing a single currency (pxxi).

The eurozone and the euro – both the structure and its policies – have to be deeply reformed if the European project is to be saved (pxxi).

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The Euro Crisis

This part of the world has been experiencing a long period of near-stagnation. The unemployment rate in the eurozone reached 10 percent in 2009 and has been stuck in double digits ever since. On average, more than one out of five youths in the labour force are unemployed, but in the worst-hit crisis countries, about one out of two looking for work can't find jobs (p3).

The statistics presage a European future with lower growth and living standards, perhaps for decades to come. Parties of the extreme right and left and others advocating the breakup of their nation-states are ascendant (p4).

The underlying mistake is the creation of a single currency without creating a set of institutions that enabled a region of Europe's diversity to function effectively with a single currency (p5). The Maastricht Treaty formally established the European Union and created much of its economic structure and institutions – including setting in motion the process of adopting a common currency, which would come to be known as the euro (p6).

The euro was a political project and in the case of any political project, politics matters. Even with the best intentions, when new institutions and policies are created on the basis of oversimplified views of how economies function, the results can not only be disappointing but disasterous (p7).

The structure of the eurozone – the rules, regulations and institutions that govern it – is to blame for the poor performance of the region, including its multiple crises (p7). A single currency entails a fixed exchange erate among countries and a single interest rate so there needs to be an array of institutions that can help those nations for which the policies are not well suited. Europe failed to create those institutions (p8).

There has to be sufficient flexibility in the rules to allow for adaptation to differences in circumstances, beliefs and values. Power was centralized in the European Central Bank in 1998. And with strong constraints on deficiet spending, the individual countries were given insufficient flexibility in the conduct of their fiscal policy to enable a country facing adverse circumstances to avoid a deep recession (p8).

The structure of the eurozone, its rules and regulations, were designed to focus on inflation, not to promote growth, employment and stability. Germany and others have sought to blame the victims, those countries that suffered as a result of the flawed policies and the flawed structure of the eurozone. Yet without the needed reforms of the structure of the eurozone itself, Europ cannot return to growth (p9).

Why would well-intentioned statesmen, attempting to forge a stronger, more united Europe, create something that has had the opposite effect? The founders of the euro were guided by a set of neo-liberal notions about how economies function, that were fashionable at the time but that were simply wrong (p10).

While in most of the world, market fundamentalism has been discredited, especially in the aftermath of the 2008 global financial crisis, those beliefs survive and flourish within the eurozone's dominant power, Germany (p10).

These failures in the eurozone can thus in large part be attributed to the combination of a misguided economic ideology that was prevalent at the time of the construction of the euro and a lack of deep political solidarity. This combinatoin led the euro to be created in a way that sowed the seeds of its own destruction (p10).

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Most important, the euro was a political project, supposed to enhance the political integration of Europe, bringing the people and countries of Europe closer together and ensuring peaceful coexistance. Instead of peace and harmony, European countries now view each other with distrust and anger (p12).

Old stereotypes are being revived as northern Europe decries the south as lazy and unreliable, and memories of Germany's behavior in the world wars are invoked (p12).

The eurozone has essentially stagnated, and its economic performance has been particularly dismal since the global financial crisis. Critics of the euro always said its test woiu ld be when the countries of the eurozone faced an asymmetric shock, a change that hit some countries differently than it did others (p12).

Some of those outside the eurozone such as Sweden and Norway have been doing quite well. There is one overriding factor contributing to the eurozone's poor performance: the euro (p12). Germany holds itself out as a success, providing an example of what other countries should do. Its economy has grown on average just 0.8 percent a year, a number which, under normal circumstances , would be considered close to failing (p13).

Germany is talked about as a success only by comparison with other countries of the eurozone. It is true that the global financial crisis exposed the euro's weakest point: the way it impeded adjustments to shocks that affect parts of the eurozone differently (p13).

In this case, the global financial crisis was the precipitating event: suddendly, Greece, Spain, Portugal and Ireland found themselve without access to credit, and in a crisis for which the founders of the eurozone had not planned (p14).

In the East Asia crisis a decade earlier, exchange rates plummeted in the affected countries, helping the countries adjust. In the peripheral euro countries, this couldn't happen (p14).

A movement towards so-called fiscal prudence, low deficits and debts, was not sufficient to ensure that the euro would work, and possibly not even necessary. So much importance was assigned to these fiscal concerns that they became known as the convergence critieria (p15).

But the way the euro was designed led to divergence : when some country had an adverse shock, stronger countries gained at the expense of the weaker (p15). The fiscal constraints imposed as part of the convergence critieria contributed to the divergence (p15).

Rhetoric about solidarity aside, the reality is a more divided Europe with less chance to undertake the sort of policies that would restore the region to prosperity (p15). Blaming the victim will not solve the euro propblem – and it is in large measure unfair. And with such a "blame the victim" mentality, it is no wonder that solidarity has been weakened (p15).

The story that it was flaws in Greece that had brought on the euro crisis might be convincing if Greece were the only country in the eurozone with difficulties. But it is not. Ireland, Spain, Portugal, Cyprus and now even Finland, France and Italy face severe difficulties. With so many countries facing problems, one cannot help but suspect that the problem lies elsewhere (p16).

Before the crisis, Spain and Ireland were running surpluses – their revenues exceeded their spending – and both had a low ratio of debt to GDP. If Germany's theory that deficits and debts were the cause of the crisis were correct, then Spain and Ireland should never have had a crisis (p17).

It was the deep crisis and its long duration that led to the debts and deficits, not the other way around (p17).

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Criticism of the euro has focused on the “programs” imposed on the crisis c ountries that required suppport – Portugal, Ireland, Greece, Spain, and, later, Cyprus. Designed by the Troika, which is the triumvirate of the IMF, the ECB and the European Commission, these programs effectively required crisis countries to surrender large elements of economic sovereignty to their “partners” in return for assistance (p17).

The loan, together with its conditions, and the country’s timetable for meeting the conditions is called the “program” (p17). These programs did save the banks and the financial markets, but otherwise they were a failure: Debt is up, so it is less sustainable. In many crisis countries inequality is up, as are suicides and mass suffering, and incomes are down (p18).

Only one of the crisis countries, Ireland, has returned to precrisis levels of GDP. The depth and duration of the recessions were far greater than the Troika’s models had anticipated (p18).

The dominant powers in the eurozone not only believed, wrongly, that low deficits and debts would prevent crisis, they also believed in a big does of austerity – cutbacks in expenditure intended to lower the deficit (p18).

Since Herbert Hoover, such policies have been tried repeatedly and have repeatedly failed. Austerity fails to restore prrosperity; worse, it deepens recession. Austerity has always and everywhere had the contractionary effects observed in Europe: the greater the austerity, the greater the economic contraction (p18).

Why the Troika would have thought that this time in Europe it would be different is mystifying. Countries in crisis couldn’t lower their exchange rate, which would boost their trade by making experts cheaper. Thus, in the view of the Troika, to regain “competitivity” they had to lower wages and prices (p19).

Some of the Troika reforms led to lower wages directly, by weakening workers’ bargaining rights, and indirectly, by increasing unemployment. The Troika hoped that lower wages would lead to lower prices of export goods, and thus higher exports. In most cases though the increase in exports has been disappointing (p19).

Germany has become the dominant country in the eurozone, and as such, they could ensure that all the burden of adjustment rest on the poorer “partners”, the countries in crisis.By blaming the countries and focusing on fiscal deficits, Germany and others in the eurozone had misdiagnosed the source of the problem (p20).

What is needed is not structural reform of individual countrires so much as structural reform of the eurozone. The Troika has done an amazingly bad job of selling the structural reforms, but no salesman, no matter how good coiuld have sold them (p20).

Given the history of failed austerity programs one has to ask why would anyone believe they would work in Europe when they failed everywhere else? The answer is ideology, deeply held beliefs about how the economy functions, which change little, if at all, as the evidence against these beliefs mounts (p21).

Alternatively, there might have been a political agenda – bringing down left-wing governments, teaching electorates in other countries the consequences of electing such governments, and making it more likely that a conservative economic and social agenda would prevail more broadly within Europe. This political agenda played some role (p21).

Finally, many have argued that there is an elements of vindictiveness, alsmost anger, at least in the c onditions imposed on Greece, at the seeming defiance of leaders, such as when they turned to a referendum to assess popular part for the programs (p21).

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It is hard to believe that responsible officials in the eurozone would make an entire nation suffer simply because they disagree with the country's choice of leaders. Yet the tone of some of the discussions has left the impression that this in fact may have been the case (p22).

There have to be common understandings of what makes for a successful economy and a minimal level of "solidarity", or social cohesion, where countries that are in a strong position help those that are in need. Today, there is no such understanding, no real sense of solidarity (p22).

Germany says repeatedly that the eurozone is not a "transfer union" – that is, an economic grouping in which one country transfers resources to another, even temporarily in a time of need. What leaders of the eurozone boast about is more normally described as muddling through (p22).

The afflicted countries may say "having invested so much to stay in the euro, surely it will pay us to do the little more that is being asked of us – even if it prolongs and deepens the depression". In reasoning so, they fly in the face of the basic economic principle of letting bygones be bygones (p23).

Governments in the afflicted country do not want to tell their citizens that they have suffered in vain. So, any signs of life in the eonomy are now grounds for claiming that austerity programs are working. In these terms, no matter how Europe's political leaders try to paint a rosy picture on the programs they have imposed on the crisis countries, they are a failure (p23).

The problem is that Germany has used its economic dominance to impose its own views, and those views are not only rejected by large parts of the eurozone but also by the majority of economists. Research over the past half-century has shown that not only is therre a presumption that markets and not efficient and stable, it has also explained why that is so and what governments can do to improve societal well-being (p24).

The world has paid a high price for this devotion to the religion of market fundamentalism/neoliberalism, and now it's Europe's turn. The eurozone embedded many of these neoliberal ideas into the currency's "constitution" – without providing for enough flixibility to respond to changing circumstances or revised understandings of how economies function (p25).

As a result, the European Central Bank focuses only on inflation – even in times of high unemployment. Beliefs about how economies function matter a great deal, and it should not be a surprise that the outcome of an economic project so influenced by flawed concepts would fall short of expectations (p25).

The ideology held that market forces rule, that they prevailed, whatever the institutional arrangements, provided that markets where given enough scope to do their magic. Without common deposit insurance in the banking system, where a single entity ensures deposits throughout the eurozone, and swithout some system of shared debt, free mobility of labour and capital ensure that economic efficiency will not be obtained (p26).

Within the current structure of the eurozone and EU, the perspectives of finance ministries and the ECB have come to dominate. For instance, when the programs were being designed for Greece and other crisis countries, the labour ministries were not meaniingfully involved as provisions related to labour markets and unions were being formulated (p27).

Europe might pretend that, in the end, everyone was consulted, but that approval was given as if a shotgun was held to their head, and in the background hovered the reality that a no vote would plunge the country deep into a crisis (p27).

The breakup of the eurozone will be costly. But so, too, will staying together without making the necessary reforms. The current strategy, muddling through, is enormously costly. Neither is a pleasant alternative (p29).

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In asking what Europe should do it does little to opine “they should never have married”. But there are circumstances where, taking into account the history, it is better to part ways (p29). In short, Europe should move in one of two directions: there should be “more Europe” or “less Europe”. This means a choice a) implementing he reforms that would make the euro work for all of Europe or b) scaling down the currency project (p31).

The easiest, least costly way, would be for Germany to exit. Alternatively, and at a greater cost, it could be done with the exit of some of those in the “periphery” (p32). The euro crisis is far from over. Greece will stay in depression. It will not be able to pay back its debt. Germany may pretend otherwise, saying that the debts have only to be “reprofiled” – that is, payments stretched out over decades. But such charades are no healthier than any other hypocrisy (p32).

The best way forward requires creating a shared understanding of basic economics that goes beyond the market fundamentalism that has informed the eurozone project to date.

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The Euro: The Hope And The Reality

The Euro was founded with three hopes: 1) that it would bring Europe ever closer together, and was the next stage in European integration; 2) that the closer economic integration would lead to faster economic growth; and 3) that this greater economic integration and politicial integration would ensure a peaceful Europe (p34).

No one had ever tried a monetary union on such a scale, among so many countries that were so disparate (p34). Political integration was supposed to strengthen democracy and democratic ideals throughout Europe (p35).

But the construction of the euro has instead increased the perceived democrratic deficit in Europe, the gap between what Europe does and what its citizens want. As noted already, one of the reaons for the failure of the eurozone is that economic integration has outpaced politicial integration (p35).

The hope was that the politics would catch up with the economics. But as divisiveness and the democratic deficit have grown, the likelihood that that will happen has diminished (p35).

Euro suppporters reason that if Europe is to play a role on the globval stage similar to the United States, it, too, must share a common currency. Could one imagine, they ask, an America with multiple currencies? But the question is: is having a monetary union necessary for achieving such a goal (p36)?

Even the United States, which spends an order of magnitude more on its military than any other country in the world, cannot impose its will on others under the new rules of the game. If Europe were to pursue such influence, it would require massive increases in military spending nonetheless (p36).

The problem is more that it is difficult to reach a consensus about military objectives: another aspect of the diversity across Europe. With Germany so strongly dependent on Russian gas, for example, it might be expected to be more reluctant to support strong measures against Russia (p37).

But the lack of political integration in Europe is not the source of the problem: it is a lack of consensus. The major challenge in enhancing Europe's influence is to strengthen common understandings. The euro leads to more divisiveness and so the euro is in this respect counter productive (p37).

The second argument for more political integration focuses on the role that the EU has played in sustaining peace within the core of Europe. But there is no evidence that sharing a single currency would reduce the probability of conflict. In fact, the currency union might run counter to the cause of greater economic integration (p38).

Everyday when citizens use the currency they are reminded of their identity as Europeans. But the importance of this has surely been diminished as we have moved to electronic money and the use of debit and credit cards (p39).

But it should have been celar at the onset that such psychological benefits, if they exist, would be overwhelmed if the euro failed to deliver in its main promise of furthering prosperity. Indeed, if it actually led to worsened economic performance, one might have anticipated a backlashn not just against the euro but against the entire European project (p39).

Greater economic integration, or certain forms of it, may impede the ability of different countries to realize societal well-being by advancing their own conceptions of what the state should do and how it should do it (p41).

The euro was influenced by ideas about the functioning of the economy, that, even as the euro was being designed, were being discredited and were badly out of date. Those in one part of the eurozone, such as Greece, are unhappy about being told what to do by others with different views of the nature of society and the role of government (p41).

Germany's decision in the 1990s to constrain wages was a form of competitive devaluation that disadvantaged other countries in the eurozone (p41). Germany took pride that the Budesbank, their central bank, had maintained tight control over the ir money supply and that Germany for decades had not faced high inflation (p42).

That is why the countries that belonged to the euro had to commit themselves to low levels of deficits and debts. The obsession with deficits was, however, largely a matter of pure ideology: there is little if any evidence that such deficits and debts would have signficant spillover effect on others (p42).

On the other hand, wage policies such as that of Germany, where until recently there was no minimum wage, do have spillover effects. With the fixed exchange rate of the euro, Germany couldn't lower the value of its currency . But it could lower its cost of production by enacting policies that lowered wages and gain advantage relative to its neighbours (p43).

Sadly, the creators of the euro paid absolutely no attention to this important externality. Consider the simplest task of a central bank – setting interest rates to balance the risk of inflation versus unemployment. If the circumstances of the countries for which the central bank is responsible are different, then a policy that might be appropriate for a country fighting inflation would be totally inappropriate for one worried about unemployment (p43).

Sharing a commony currency and a central bank could be a disaster. A democratic compromise might be bad for both: unacceptable inflation in one, coupled with unacceptable unemployment in the other. In each of these instances, unless one could show a compelling reason for the countries to have a shared currency, it would seem to make little sense to do so (p44).

The European integration project saw integration being accomplished step-by-step. One of theose steps, the creation of the euro, a single currency, was done prematurely before the requisite conditions wree satisfied, and in ways that have pulled Europe apart (p45).

Close economic integration can be achieved without sharing a currency. The United States and Canada have had a free trade agreement since 1988 (p45). Among the architects of the euro, there appeared to be simply a presumption that sharing a common currency would promote every aspect of economic integration (p46).

When a grouip of countries choose to have a single currency, they effectively fix their exchange rates. They take away this adjustment mechanism. That should imply a more poorly performing economy. What should have underlain the design of the euro was a recognition of market failures and imperfections; an acknowledgement of the lack of robustness of the standard competitive model (p48).

Had therre been a recognition of limitations of markets, perhaps the founders of the euro would have been more cautious in its creation, paid more attention to details, and put more emphasis on ensuring that the institutions that would have enabled it to work were simultaneously put in place (p49).

There was of course a certain popular appeal to having a single currency. People could travel from one country to another without exchanging currency (p49). But in the absence of adjustment mechanisms, the exchange rate gests so far out of alignment that it cannot function (p50).

In the case of Argentina, which had fixed its exchange rate in 1990 to the dollar, the misalignment became intolerable by 2001. But after the country abandoned the dollar peg, letting its exchange rate fall by some 75 percent, it grew impressively. So far all the countries within the euro have stayed in but at a great cost (p50).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The modest benefits that do exist are overwhelmed by the costs of the crises that so frequently arise as real exchange-rate misalignments emerge (p50). More broadly, Europe's integrtion provides insights for globalization in general (p51).

Globalization is nothing more than the closer integration of the countries of the world – and nowhere has that integration been taken further than in Europe. The problems in achieving a successful monetary union in Europe have dampened enthusiasm elsewhere, for instance in both Africa and Asia for this form of economic integration (p51).

The fundamental insight to glean is that economic integration will fail if it outpaces political integration. In the absence of sufficient solidarity, certain groups will almost surely be made worse off than they would in the absence of integration (p52).

In the absence of solidarity, it is hard to have politicial integration, precisely because no one is confident that they system will work for them. Conversely, when there is a high level of solidarity, then there will be more confidence in collective decision-making (p52).

With this higher level of solidarity, there will be greater willingness to give up more degrees of political sovereignty and to have greater political integration. One is more likely to accept lossess for oneself if it contributes in some way to the general well-being (p52).

But when economic circumstances differ markedly – when some countries are debtors and others creditors, then political integration becomes more difficult. What is required then it not only that they have similar economic structures but also similar belief systems – beliefs about social justice and how the economic system works (p53).

It is hard for an economic federation to work if the different members of the federation have different views of the laws of economics. These differences have impeded not just the formulation of appropriate programs in response to the euro crisis but have meant that programs designed by, or acceptable to, Germany have often been viewed as imposed on those accepting them (p53).

Perhaps the most obvrious instance of such differences in conceptions of how the economy functions is "austerity", the belief that by cutting spending or raising taxes a country in recession experiencing a fiscal deficit could be brought back to health (p54).

There will never be unanimity, but when there are large disparities, it is inevitable that there will be considerable disgruntlement with whatever decision is taken (p54). The demand of the Troika for privitization of Greek government-owned assets is dictated as much by ideology as by evidence and theory (p55).

There are deep divides across Europe about what gives rise to a well-functioning economy. So long as each country is allowed to choose for itself, matters are fine. But it is not so fine if economic integration entails giving one country the power to dictate to others what they should do (p55).

It is especially troublesome when the policies foisted on the country don't work. But the costs of the mistake are borne by the country upon whom they are imposed, not by those imposing them. This is the story of the eurozone (p56).

Are the gains from this aspect of economic integration, the euro, great enough to justify the loss of self-determination (p56)?

Germany's finance minister, Wolfgang Schäuble, has repeatedly emphasized the importance of rules, and if there are rules, they must be obeyed. Of course, many of the most heinous crimes that have been committed are by those who simply said they were just obeying rules (p57).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

For a society to function there must be the right rules, and the right degree of flexibility to deviate from the rules when appropriate (p57).

If some countries think minimal access to water or electricity is a basic right, or t hat workers should have certain basic rights to collective action, then they will be deeply unhappy if contrary policies are imposed on them – and they should be (p57).

From the very start, the European project was afflicted with a democratic deficit. It was a top-down project, conceived by foresighted leaders, who were less successful as salesmen. Repeatedly, when various aspects of the European project were subjected to referendum – anti EU sentiments prevailed. Even when pro-EU forces won, there were significant votes on the other side (p58).

Of course, Europe has recognized this, and it has slowly but steadily been moving toward greater democratic accountability – except on one front: the monetary union. If the euro is to be successful, it has to be an economic project that is consistent with, and even reinforces, other fundamental values. It has to strengthen democracy. But the euro has done the opposite (p59).

The most powerful institution in the eurozone is the European Central Bank, which was constrcuted to be independent – another neoliberal idea that was fashionable at the time of the construction of the euro. And though it remains fashionable in some quarters, it is increasingly being questioned (p59).

Though they would almost surely deny it, the ECB’s decision to shut off funds to the Greek banking system in the summer of 2015 was an intensely political act (p59). The growing democratic devicit is seen most obviously in the fact that when given t he opportunity, the countries of Europe have repeatedly rejected the policies imposed on them (p59).

In each country, a newly elected government is told in effect that they have no choice: accept the conditions or your banking system will be destroyed, your economy will be devastated, and you will have to leave the euro (p60).

Early on there were suggestions from Germany that Greeece give up its vote as a member of the eurozone until it had been rehabilitated, until it was out of the “program”. It was reminicent of the United States where in most states those in prison cannot vote, and in others, people convicted of a felony lose their right to vote forever (p60).

When George Papandreou, prime minister of Greece, proposed a referendum in 2011 to get the support of his people for the program that was being demanded, the leaders of the Troika were genuinely offended. What, ask the people (p60)?

Perhaps the worst instnace of this “nondemocratic” stance became evident after Greece elected a leftist government in January 2015. Harsher conditions were imposed. The Greek people had wanted two things and they could not have both: they wanted an end to austerity and the restoration of growth and prosperity; and they wanted to stay in the eurozone (p61).

Tsipras knew that staying in the euro, was for the moment, more imporant than growth and prosperity and that’s what he opted for. For the moment, Greece have stayed inside the eurozone, and the eurozone has been kept whole – but at great cost to European democracy (p62).

Within the EU and eurozone, governments were supposed to have retained large domains of soverigenty. What happened in Greece and what was happening elsewhere within the eurozone gave lie to this idea (p62).

The eurozone institutions, such as the ECB are a far cry from democratic. The democratic deficit that had been appartent at the birth of the eurozone has grown even larger (p62).

Stiglitz, Joesph (2016). The Euro and it’s threat to the future of Europe. Penguin Random House UK.

Europe's Dismal Performance

Today, it is plain to see that the eurozone has been performing dismally. Nothing conveys how bad things are in Europe as their impression of when things are going well, The slightest signs of growth or a reduction in unemployment are trumpeted as the harbinger of the long awaited recovery – only to be followed by disappointment as the economy stagnates (p63).

While already it is clear that Europe is facing a lost decade, there is a risk that in a few years' time we will be speaking of Europe's lost quarter-century. Of this we can be sure: Eurozone output will forever be lower than it would have been without the crisis, forever lower than it would have been had the crisis been managed better (p63).

As those, for instance in Ireland celebrate a return to growth they need to remember: every economy recovers from a downturn. The test then of a policy is not whether there was an eventual recovery but how long and deep the downturn was before the recovery (p64).

With downturns nearly a decade long – with GDP in most of the crisis countries slated to be lower in 2017 than a decade earlier – the management of this crisis can hardly be called a success. The eurozone's overall performance is dismal, and that of the crisis countries, disastrous: unemployment is very high; youth unemployment is very, very high (p64).

The eurozone's performance on all accounts has been worse than those countries in Europe t hat do not belong to the eurozone, and worse than that of the United states. Even Germany, often held up as the paradigm of success, has been performing poorly (p65).

These data speak for themselves. They show how badly things are going. The fact that the eurozone is doing so much more poorly than countries elsewhere suggests that there is a common cause for the eurozone's travails: the euro (p65).

The widely shared fear that the real test of the euro would occur when the eurozone faced a shock – with the shock affecting different countries differently has proved warranted (p65).

GDP in 2015 was merely 0.6% above that in 2007. Germany, the so-called champion, has grown by 6.8 percent over the eight years since 2007, but at an average annual rate of just 0.8 percent adjusted for inflation, a rate that under normal conditions would have been described as near stagnation. It only looks good by comparison with its neighbours in the eurozone (p66).

The downturns facing some of the eurozone countries are comparable to or deeper then the Great Depression. By 2015, non-eurozone Europe had a GDP some 8.1 percent higher than in 2007, in comparison to the 0.6 percent increase within the eurozone (p67).

No country using the euro came near the success of Poland, 28 percent growth, or Romania, 12 percent growth. From 2007 to 2015, while eurozone output stagnated, US output grew by almost 10 percent (p68).

An important element of well-being is economic security, and the crisis countries have been marked by significant increases in insecurity, reflected by astounding increases in unemployment and cutbacks in systems of social protection (p68).

Another important element of well-being is "connectedness" especially ties with members of one's faimily. Here again, there is great suffering in the worst-afflicted countries, as large numbers of young people have had to migrate to London, or Berlin or Sydney to obtain jobs. Ireland experienced a newarly 75 percent increase in the number of long-term emigrants from 2007 to 2013 (p68).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Cutbacks in social programs have heightened insecurity. In Greece, for instance, government expenditure fell by some 22 percent between 2007 and 2015. This was especially painful for lower and middle-income Greeks (p69).

The EU and the eurozone, by creating a single currency and promoting the free flow of labour and captial, was supposed to create a more productive Europe. So, too, the structural reforms imposed on Greece and Spain and the other crisis countries were supposed to increase productivity (p70).

If there has been any increase in productivity, that effect has been overwhelmed by the increase in unemployment (p70). While Greece's productivity has declined by 6.5 percent from 2007 to 2015, even Germany has seen a decline of 0.7 percent, while the United States has had a 7.9 percent increase over the same period (p71).

Unemployment is an area where the eurozone performance has been particularly dismal, with average unemployment reaching almost 11 percent in 2015, close to record highs. Even more troubling is the increase in youth unemployment – twice the level of the overall unemployment (p71).

These young people will never achieve the incomes that they would have achieved if job prospects were better on graduation from school (p71). Fewer people are working and those who are working are working fewer hours. Even in the so-called star performer, Germany, hours worked per worker fell by almost 4 percent between 2007 and 2014 (p72).

It's worth noting that the allegedly lazy Greeks worked almost 50 percent more hours than the allegedly hardworking Germans in 2014 (p72).

In Spain, in the years before the crisis, inequality had been coming down, but by 2014, the Gini coefficient, a standard measure of income inequality was about 9 percent over its 2007 level. In the case of Greece, the Gini coefficient increased by 5 percent from 2010 to 2014. It usually takes years and years to move the Gini coefficient by a few percentage points (p72).

By 2012, according to Oxfam, a third of Grreeks were below the poverty line and 17.5 percent of the population, more than one million, of those between 18 and 60 lived in households with no income at all (p72). From 2008 to 2012, according to UNICEF, the proportion of Greek children living in poverty increased from 23 percent to 40.5 percent (p73).

It is now abundantly clear that Europe's economy has not been performing well – and has not been performing well at least since the onset of the crisis. But what about its performance before the crisis and what are the prospects going forward (p73)?

There is not even an overall euro-area growth spurt after the formation of the eurozone. The euro may have helped create bubbles in Spain and Ireland, but it didn't seem to increase growth for the eurozone as a whole (p73).

Incomes now are far below the trend that GDP had followed in the years before the euro. By the end of 2015, the gap between that number and the eurozones's actual GDP was 18 percent. If we add up the gaps year by year, by 2015, the cumulative loss was in excess of €11 trillion (p73).

The gap is still increasing and will continue to increase as long as the eurozone continues with its current policies. But assume, optimistically, that somehow it managed to return growth to its prior level. Then the total value of the lost output is almost €200 trillion (p74).

If one believes that this performance is even partly due to the introduction of the euro, then there is a heavy burden on the currency's advocates to whow that the economic and political benefits exxceeed these very hefty numbers (p74).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Germany and those who are doing relatively well now blame the crisis on fundamental flaws in the structure of the crisis countries (p74). But neither the national character nor the insitutional or legal frameworks of the crisis countries changed since 2008 (p75).

If that was causing the problem today, one should have seen consistently bad performance both before 2008 and after. It is clear that there is nothing about the structurre of these economies that prevents growth. The data are consistent with our hypothesis that there is something that impedes adjustment – the euro (p75).

When there is a short and shallow economic downturn, economies often bounce back and make up for lost time. By contrast, when downturns are long lasting, therre is little or no bounce back (p76). The euro crisis has been deep and long, with deep and persistent consequences (p76).

Those who enter the labour force in a bad recession year have a significantly lower lifetime income, and this is especially true of those who remain unemployed for extended periods. We also know that those who lose their job in a recession face a significant loss of future income, especially if they face protracted unemployment (p77).

The Troika has forced the tearing up of the social contract, the bonds which existed among members of society. Moreover, there has been a destruction of human and organizational "capital", and at the minimum, human knowledge and capital has not increased as much as would normally have been the case (p78).

Germany is sometimes held out as a counterexample to the crisis afflicting the rest of the eurozone. Its leaders have seemed to argue that others should follow its examples: if you play by the rules, keeping deficits and debts low, you will prosper (p78).

As noted earlier, Germany has grown at an average annual rate of 0.8 percent from 2007 to 2015 adjusted for inflation, a rate that is about the same as that of Japan during 2001 and 2010 while it was still in its famous twenty-year malaise (p78).

But even in Germany, large fractions of the population have seen stagnation or even decreases in their incomes. From 1992 to 2010, the income share of the top 1 percent increased by about 24 percent, and from the mid-1980s until the mid-2000s, Germany's Gini coefficient and poverty rates have climbed steadily (p79).

Germany's success in achieving competitivness came partly at the expense of those at the bottom, though it does a much better job of protecting those at the bottom than the United States does (p79).

While Germany is hardly the success that it would like to claim for itself, its modest success does not provide a template for others. Its growth is based in part os strong trade surpluses, which are not achievable for all countries.

As mentioned, critics of the euro said the test would c ome with a crisis: there woiuld then be large losses, as the euro impeded adjustment. the critics were right (p79).The theory and evidence are totally on the side of critics of the euro (p80).

The basic idea though is simple. If Greece, for instance, had not been tethered to the euro, when the crisis struck, it could have devalued its currency. Tourists, deciding where to take a vacation would have found Greece so much cheaper and would have flocked to the country. Its income would have increased, helping it to recover quickly (p80).

Even more, its central bank, realizing the depth of its economic downturn, would have given a further boost to its economy by quickly cutting interest rates – in contrast to the ECB, which even raised interests rates in 2011 (p80).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Germany's suggestion that the failures of the countries of the eurozone are due to their profligacy seems so out of touch with economic reality, so demonstrative of a total lack of analysis. Germany had the good fortune for many years of producing goods that were in high demand by China, the engine of global economic growth (p81).

The timing of the eurozone's weakness is not a coincidence. It is causation, not just correlation. Advocates for the euro might claim that the euro will enable a strong comeback. Such an argument might have been more persuasive a few years ago (p82).

Other statistics – the marked increase in suicides – may give a better sense of the stress ordinary individuals are feeling. Newspaper articles have graphically depicted the social sosts of the crisis – pictures of large numbers of citizens picking through garbage and begging, closed stores, social unrest manifested in violent protests (p82).

We need to keep remembering: monetary arrangments are a means to an end, not an end in themselves (p82).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

When Can a Single Currrency Ever Work?

The arrival of the euro simplified the life of a traveler. It has replaced 19 different currencies in 19 different countries with a single currency. Creating a single currency involved creating a central bank, the European Central Bank, for the entire eurozone (p85).

The ECB determines the interest rates that prevail throughout the area and acts as a lender of last resort to the banks of the eurozone (p85). When the central bank wants to stimulate the economy, it lowers interest rates making credit more available. Lowering interest rates leads to a lower exchange rate, making exports more competitive and discouraging imports (p86).

Today, except among a lunatic fringe, the question is not whether there should be government intervention but how and where the government should act, taking account of market imperfections (p86).

When two countries or 19 of them join together in a single-currency union, each cedes control over their interest rate. Because they are using the same currency, there is no exchange rate, no way that by adjusting their exchange rate they can make their goods cheaper and more attractive (p86).

Since adjustments in interest rates and exchange rates are among the most important ways that economies adjust to maintain full employment, the formation of the euro took away two of the most important instruments for ensuring that (p86).

If, for instance, Greece imported more than it exported, the imbalance could and would be corrected by making the value of its currency weaken; that would make exports more attractive, and imports less so. With fixed exchange rates this can't happen (p86).

Ceding control over exhchange and interest rates can be very costly for a country. There will be enormous problems unless something else is done. But the "something else" that needed to be done was much larger than what Europe did or is likely to do (p87).

Economist Robert Mundell receieved a Nobel Prize for asking and answering the question, what are the conditions in which a group of countries can easily share the same currency? His analysis made clear that the countries of the eurozone are too diverse to easily share a common currency (p87).

It made sense that the countries of the eurozone worried about being too disparate. They understood excessive disparities would put straings on the euro: one part could be facing deep recessions and another inflation. One part could have a large trade surplus, another a large trade deficit (p87).

Any interest rate that worked for one part could exacerbate the problems of another. Somehow, the founders of the euro believed that in the absensce of excessive government deficits and debts, these disparitities would miraculously not arise and there would be growth and stability throughout the eurozone (p88).

The evidence is now all too apparent. Even countries with no government deficits and low public debt, like Spain and Ireland, had crises. There has been neither growth nor stability in the eurozone and the countries have diverged rather than converged (p88).

The founders of the euro seemed to believe that statisfying the convergence criteria was key in ensuring the viability of the euro. They were obviously wrong. Neoliberalism , market fundamentalism, led them astray (p89).

Many Europeans look at the United States and ask, if the 50 states of the United States can all share the dollar, why can't the 19 states of the eurozone share a single currency (p89)?

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

There are three important adjustment mechanisms within the United States that enable a single currency to work. Unfortunately, none of them are present within Europe – or at least present in sufficient strength to make the eurozone work (p89).

First, migration is relatively easy in the United States. Americans are used to moving from one region to another; Europeans are not (p90).

Second, in the United States it makes little difference in the larger scheme of things whether people move to the jobs or the jobs move to the people. In Europe, each country wants to be sure that enough jobs move to each country to preserve their economy, culture and identity (p90).

Another big difference is that Americans' identity does not change as they move. Despite the ease of working in a new location, a Pole in Ireland is still fundamentally a guest. His political and cultural identity and hopes for the future will more than likely continue to be Polish (p90).

After a shock the states in the United States will receive financial support from the federal government in one way or another. In Europe, these programs are financed by national governments. So if Greece has a crisis, its government has to cover the increased welfare payments – precisely at the time when government revenues are falling (p91).

Also, in the United States, the banking system is, to a large extent, a national banking system. If any bank runs into a severe problem, the institution is bailed out not by the individual state but by a federal agency. Up until now, each country within Europe is responsible for its own banks. Weak banks lead to the government's fiscal posiiton worsenting, and that in turn weakens the banks further (p92).

The reforms in the design of the eurozone ought to attempt to move Europe toward the American model., to a system where a single interest rate and a single exchange rate are consistent with shared prosperity (p92).

Even at the founding of the euro, most realized that differences among the countries of the eurozone were large and that the union lacked the type of insititutional arrangements which would allow disparate economic entities to share a single currency (p92).

The hope was that the countries would converge, that over time, they could become more similar, and with sufficient convergence, it could become a currency area that would work reasonably well. They assumed that the required institutions would arise as were needed (p93).

The political momentum created by the euro, it was hoped, would be strong enough to accomplish this. There were two key challenges in making a single-currency area works: how to ensure that all of the countrires can maintain full employment and that none of the countries has persistent trade imbalances, with imports exceeding exports year on year (p93).

The problem with a common interest rate and exchange rate is simple: if different countries are in different situtions, they ideally want different interest rates to maintain macroeconomic balance and different exchange rates to attain a balance of trade (p93).

If Germany is overheated and facing inflation, it might want the interest rate to rise, but if Greece is facing a recession and high unemployment, it wants the interest rate to fall. The monetary union makes this impossible (p93).

Of course, as in the United States, there are other institutions that can help in such a situation, then the disadvantage of not being able to set different interest rates can be overcome. But Europe didn't pay attention to the necessary complimentary institutions (p93).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

No matter how much countries converge in terms of deficits and debts, there will continue to exist large differences in structure (p93). It is virtually impossible for all the countries in the eurozone to attain full employment and external balance simultaneously, in the absence of other institutional arrangements of the kind found in the United States (p94).

An economy facing a slump has theree primary mechanisms to restore full employment: lower interest rates, lower exchange rates or increase spending and decrease taxes. The common currency eliminated the first two mechanisms (p94).

Then the convergence critieria effectively eliminated the use of fiscal policy. Worse, in many places it forced countries to do just the opposite, cutting back expenditures and raising taxes in a recession, just when they should be increasing expenditures and cutting taxes (p94).

Between 2009 and 2014, all but Luxembourg exceeded the 3 percent deficit limit at least once. Countries that exceeded the limit were required to increase taxes or lower spending, weakening total demand. These austerity policies weakened the European economies further (p95).

Out in the real world the confidence theory has been repeatedly tested and failed. Paul Krugman has coined the term confidence fairy as a response. When Hoover tried to reduce the deficit in the years after the 1929 market crash, he didn't restore confidence; he simply converted a stock market crash into the Great Depression (p95).

Likewise, when the IMF forcibly made the countries under its programs rreduce their deficits, it, too, converted downturns into recessions, and recessions into depressions. As it is, the convergence criteria not only prevents a country from responding to a downturn but creates a built-in mechanism for deepening it (p96).

Economists refer to such provisions as "built-in destabalizers". Well designed economic systems have built-in stabalizers not destabalizers (p96). The irony is that while the convergence criteria were intended to help the countries converge, and the austerity imposed wsa intended to reduce the fiscal deficit, typically, the effects were just the opposite (p97).

Even if the ECB set interest rates in the interests of the eurozone as a whole, the weakest economies would be left facing unacceptable levels of unemployment. Had they not been in the eurozone, these countries could have lowered their interest rates (P97).

The ECB pays not attention at all to the unemployment rate. Twice in 2011 the bank raised interest rates despite the euro crisis (p97).

Another problem posed by a single-currency area relates to external imbalances – where imports consistently exceed exports, requiring the country to borrow to finance the difference (p97). When exchange rates can adjust, a devaluation makes that country's goods cheaper and imports more expensive, reducing imports and increasing exports (p98).

This is the market mechanism for correcting external imbalances. This mechanism is short-circuited in a currency area (p98).

As curious as it may seem, the neoliberal advocates of the euro thought that in some ways unemployment was a good thing. Consider a country exporting shoes, which suddenly finds the demand for its products diminished (p98).

It has simultaneously an unemployment problem and a trade balance problem. The notion is that if only one let nature take its course, both problems would self-correct. The unemployment would lead to lower wages, lower wages would lead to lower prices, exports would then increase, imports descrease, to the point where imports and exports were in balance (p98).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Meanwhile, the increased demand for exports would help restore the economy to full employment. In the meanwhile, families would suffer from unemployment; children's lives would be ruined, as a result of lack of nutrition or access to health (p99).

Humanitarian versions of these "tough" policies emphasized the importance of the safety net; but the convergence criteria meant that increased expenditures on such assistance had to come out of somewhere else in the budget, like public investment, hurting the economy's future growth (p99).

If exports had grown in the eurozone at healthier rates, that would have stimulated the economy and helped restore full employment. But there is another, less healthy way of reducing a trade deficit. Imports fall when incomes plummet: one can achieve a current account balance by strangulating the economy (p99).

There are several reasons that internal devaluations might not work: wages may not fall and any fall in prices may not lead to an increase in exports. These elements have played themselves out in the euro crisis (p100).

There are many in Europe, including Jean Claude Trichet who blame the failure of the internal devaluation mechanism on wage rigidities – on the failure of wages to fall even in the presence of high unemployment (p100).

They believe that markets on their own, in the absence of unions and government intervention, would be flexible. In their attempts to blame the victim, these critics focus on constraints imposed by government and unions. But across Europe, and around the world, one can see high unemployment rates with little adjustment in wages in economies with weak unions and without government constraints (p101).

The Troika has been consistently disappointed: the growth in exports has been smaller than expected, but the decrease in GDP has been much larger than they expected – even larger than can be accounted for by the disappointing performance of exports (p101).

Internal devaluation increases economic fragility by bringing more households and firms to the brink of bankruptcy. Inevitably they cut back on everything. The cutbacks in imports were one reason that trade balance was improved; the cutbacks in domestically produced goods is one reason that GDP declined so much (p102).

Even when wages fell, firms often didn't pass on the wage cuts to prices. They were worried that if they needed funds they couldn't turn to the banks. It became impertive for them to build up their balance sheets. One way that firms have to strengthen their balance sheets is to maintain prices (p102).

Sure, there is a long-run cost of keeping prices high – but the short-run benefits in a world of austerity and tight finance that the eurozone had created in the ciris countries outweighed those costs (p102).

We see this reluctance to pass on wage cuts in the form of lower prices dramatically in the data. If wage cuts were fully passed on, real wages would have remained constant; prices would have fallen in line with the reduction in labour costs (p102).

While eurozone leaders were preaching about the importance of the restoration of competitiveness in the crisis countries, they were actually undermining competitiveness – for both the structure of the eurozone and its policies led to a higher cost of capital, as banks were weakened and money fled the crisis countries (p104).

The increase in risk meant that firms were less willing to undertake investments or even increase employment at any interest rate. So once again, internal devaluation, while intended to increase competitiveness, restore external balance, and promote employment, had just the opposite effect – not just in the short run by even in the long (p104).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Had countries not joined the euro together, those with wage rigidities could have lowered their exchange rate, and they could have sustained their economies by lowering interest rates. By joining the eurozone, they gave up these options (p105).

When a country lowers its exchange rate to get a competitive advantage over others, we say it has engaged in a competitive devaluation. It is a form of beggar-thy-neighbour policy. But when wages are suppressed so that the real exchange rate is lowered relative to one's neighbours it is another form of beggar-thy-neighbour (p105).

Meanwhile the burden of the invidious policy is placed on the workers in the country engaging in the policy. The European Central Banks is mandated to focus exclusively on inflation. In effect, the eurozone, in its very construction, was biased toward having higher unemployment (p106).

At the time of construction of the eurozone, no one conceived that interest rates would ever reach they point where they couldn't be lowered – that they would hit the zero lower bound. Once that happened, the adverse effect of its neighbours' slowdown couldn't be offset by monetary policy. No wonder that German growth has been so anaemic (p106).

It should have been expected that taking away the ability to adjust the exchange rate could lead to trade deficits, and that trade deficits would put at risk the stability of the eurozone. But trade deficits are often not caused by government profligacy . They are often caused by private sector excesses, and accordingly curbing government profligacy won't necessarily prevent large and persistent trade deficits (p107).

When a country experiences a trade deficit, unemployment will normally increase as a result of the deficiency in demand. But since Keynes, democratic governments tend to respond to such increases in unemployment by increasing government spending (p108).

So, it is not the increase in government spending that causes the increase in trade deficit, but the increase in trade deficit that causes the government spending (p108).

There was another reaon why many of the founders of the eurozone may have been less worried about trade deficits caused by the private sector. They believed that if that ever happened, it would not be a problem: in their ideology, the private sector could do no wrong (p108).

That they believed this was testimony to their faith in markets: there is a long history of market excesses, to which Spain and Ireland's housing bubbles add futher examples (p108).

Some in Europe, and especially in Germany are in denial – they continue to believe, in the face of overwhelming evidence to the contrary, that if one controls government deficits, one can manage trade deficits (p108).

It is hard to distingusish between a "good" trade deficit – one that is the natural consequence of economic forces- and a "bad" deficit. After the fact, it is clear that the Spanish deficits were "bad". The funds flowing into the country were used to finance a real estate bubble. That was a mistake (p109).

But it was a private sector mistake, just as the tech bubble and the housing bubbles in the United States were private sector mistakes. But beforehand it is hard to tell good investments from those that are part of a wave of irrational exuberance (p109).

Market fundamentalists could never tolerate government even attempting to make such a distinction. But even as it seemed obvious that the market had gone awry, with the real estate bubbles in Spain and Ireland, the eurozone's neoliberal economic leaders were waxing poetic about the wonders of the market (p109).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Thus, the euro is caught between a rock and a hard place. Markets by themselves can't do the adjustments necessary to ensure full employment and external balance. Internal devaluations don't work (p109).

Regulating the economy in other ways to ensure that imports are in line with exports, would require interventions in the market economy that would be intolerable, at least from the perspective of the neoliberal ideology that underlies the euro (p109).

Countries that try to fix their exchange rate relative to others face not only protracted periods of unemployment, they are also prone to crises. The same is true of the countries within a currency area. They, too, cannot adjust their exchange rates (p110).

The economic costs of these crises are enormous. They are felt not only in the high unemployment and lost output today but in lower growth for years – in some cases decades (p110). It is when sentiments change quickly that a debt crisis is likely to follow, as lenders refuse to roll over their debt as it becomes due, and the country can't find anyone who is willing to lend (p110).

The country's choices are then limited; it either defaults or it goes to the IMF for a rescue package, accepting the loss of its economic sovereignty with a loan accompanied by strong conditions (p111).

If the foreign lenders demand repayment from the banks, and the banks can't come up with the money, we then have a financial crisis (p111).

If the government doesn't want to finance its spending by printing money, with the possible resulting inflation, it has to cut back on spending, plunging the economy into a downturn (p111).

In the case of the euro, of course, there is no option of the exchange rate, say for Greece or Spain, falling to correct a trade imbalance. This made the economic, debt and financial crisis even worse (p111).

To bring back a semblance of "balance", those in the crisis countries are being sactificed. With a big enouch recession or depression, imports are brought into alignment with exports (p112).

Of course, the bankers don't like to blame themselves; they blame the borrower. But if there is an irresponsible borrower, it means at minimum there is an irresponsible lender, who has not done due diligence. Lenders are suppposed to be the experts in risk management (p112).

The interaction between short-sighted financial markets and short-sighted governments creates a potentially explosive mix, which, when combined with fixed interest rates, is almost sure to explode (p112).

The possibility that depositors could take a loss has undermined confidence in banks throughout the weaker countries of the eurozone and contributed to funds leaving these banks, thereby contributing to Europe's malaise (p113).

Money rushed into Spain and Ireland in the years after the start of the euro in 1999, and expecially in the years preceding the crisis in 2008. Lenders somehow thought that the elimination of exchange-rate risk meant the elimination of all risk (p114).

The low interest rates at which funds were available in Spain and Ireland helped create the real estate bubbles. In the years before the 2008 crisis, more homes were constructed in Spain than in France, Germany and Ireland combined (p114).

The real estate bubble distorted the Spanish economy. Private sector irrational exuberance, not government spending, put the Spanish economy off-kilter. In the absence of the eurozone, a country flooded with speculative money could have raised interest rates to dampen the real estate bubble. But being part of the euro made this impossible. A country like Span and Ireland facing a real estate bubble could and should have imposed capital gains taxes or imposed restrictions in lending by local banks. But the market fundamentalist ideology dominant in the eurozone ruled these measures out (p115).

Debt crises typically do not occur in countries that have borrowed in their own currency. They can at least meet the promises they made by printing more of their own money. The United States will never have a Greek-style crisis, simply because it can print the money that it owes (p115).

But short-sighted governments, often egged on by international financiers and even the IMF, encouraged borrowing in a foreign currency, because the impact on today's budget was less, simply because the nominal interest payments were lower (p116).

The eurozone created a new situation. Countries, firms and households borrowed in euros. But though they were borrowing in the currency they used, it was a currency that they did not control (p116).

Greece does not control the printing presses of the currency in which it has borrowed. They owe money in euros. Their creditors are not willing to roll over their debts. Their earning s of euros from exports are insufficient to pay was is owed. They simply can't meet their obligations (p116).

Markets should have recognized the new risky situation that the eurozone had created, and limited their lending in response. But as so often happens, they were caught up in another episode of irrational exuberance – euro-euphoria (p116).

To avoid this situation, Europe as a whole could have borrowed in euros, on-lending the proceeds to the different countries, who would then be responsible for repayment of the money. But it chose not to centralize lending in this way. In making this choice, the eurozone leaders enhanced the likelihood of a debt crisis (p116).

When lenders wouldn't lend to, say, Spain, the only recourse the country had was to turn to their partners in the eurozone, to get money through the European Central Bank or though some other mechanism (p117).

Without access to funds, the country would careen toward bankruptcy. But there is no good international legal framework for dealing with the bankruptcies of countries, as Argentina and man other countries have learned (p117).

As soon as some of the countries in the eurozone owed money to other member countries, the currency union changed: rather than a partnership of equals, the ECB and the eurozone authorities have become credit collection agencies for the lender nations, especially Germany (p117).

The power to withhold credit becomes the power to force a country to effectively cede its economic sovereignty, and that is precisely what the Troika, including the ECB, have done, most visibly to Greece and its banks, but to a lesser extent to other crisis countries (p117).

They have imposed policies not designed to promote full employment and growth but to create surpluses that in principle might enable the debtor countries to pay what they owe (p118). The way Europe has chosen to get rid of trade deficits is to put the economy into depression (p118).

When the country is in a depression, it no longer buys goods from abroad. Imports are reduced. The "cure" is as bad or worse than the disease. But even trade surpluses are a problem. Germany has been running huge trade surpluses – consistently larger than China's as a percentage of GDP (p118).

As mentioned, if some country is running a surplus, exporting more than it is importing, other countries must be running a deficit, that is, importing more than they are exporting. So if deficits are a problem, so too are surpluses. If China's surpluses are a global problem, so too are Germany's (p118).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Similarly, if the exhchange rate is set so that the eurozone as a whole has a trade balance, and Germany is running a surplus, that means that the rest of the eurozone must have a deficit. In some respects , surplues are an even bigger problem than deficits because they contribute to a shortfall in global demand (p118).

Before the crisis, Germany recycled its surpluses, in effect, lending them to the periphery countries, like Spain and Ireland, which allowed them to run deficits. But in doing so, it helped create the euro crisis and enhanced divergence within Europe (p118).

The periphery countries became debtors, with Germany as the great creditor. As we have noted, there is no greater divide than the one between creditors and debtors (p118).

Trade imbalances can be a problem whether they originate in the public sector, as in Greece, or in the private sector, as in Spain and Ireland. The convergence critieria only focused on the public sector problem. Historically, private sector borrowing has been as or more important (p118).

The countries in surplus often look at their trade surplus and the associated savings as a badge of honor. Savings is a virtue. Germany says that all countries should imitate what it does. But anything Germany does to create its surpluses is, in effect, increasing some other country's deficit (p119).

It is hardly a virtue if one can only obtain it bvy forcing someone else to be a sinner – if one's actions inevitably lead to problems in another country (p120).

Today , with a deficiency of aggregate demand leading to slow growth, some 200 million people are unemployed around the world. Typically, it is easier for the surplus country to deal with its surplus than it is for the deficit country to do something about its deficit (p120).

There is ample scope, for instance, for both Germany and China to increase wages, especially at the bottom. Until recently, Germany hasn't had a minimum wage, and even now, its minimum wage is only 8.50 euro an hour, as compared to 9.47 euro per hour in France. If Germany workers' incomes increased, they would buy more, including more imported goods (p120).

When individuals, firms and countries impose costs on others which they do not themselves have to pay – economists say that there is an externality. German trade surpluses impose externalitites on the rest of the world, including their parters in the eurozone (p120).

Currently, at the global level, we have no way of inducing countries not to run surpluses (p120). Within the eurozone too, nothing has been done to curb surpluses (p120).

The founders of the euro knew that making a single currency work for a diverse set of countries would not be easy. But their analysis of what it would take was deeply flawed: the convergence critiera that they formulated, limiting public deficits and debts, made the task of achieving full employment throughout Europe even more difficult (p122).

If the euro is to work, the "incomplete project" needs to be completed in a hurry. They have to put in place the institutional arrangements required to make up for the loss of countries' ability to use the interest and exchange rate to maintain full employment and to keep imports in line with exports (p122).

Instead, Germany has tried to blame the euro crisis on failures to enforce budgetary discipline. But it is the very structure of the eurozone itself, not the failings of individual countries, that is to blame. Market mechanisms such as internal devaluation are not an adequate subsitute for the loss of the ability to adjust interest and exchange rates. The euro created the euro crisis (p122).

Market economies can suffer from crises simply as a result of the dynamics of capitalism; in the absence of adequate regulation, there are often credit bubbles. But the ideology of neoliberalism ignored these sources of volatility as it conveniently focused on the budgetary failures in Greece, which were easier to understand and excoriate (p123).

Instead of correcting the underylying problem, they continue to implement policieis based on obviously flawed theory. As the crisis unfolded, they renewed their commitment to the convergence criteria, binding themselves to stricter enforcement (p123).

That they did so suggests one thing: it was a matter of ideology, not economic science. It was a willful failure not to look at the evidence. It may not have been in Germany's interest to understand the failures, for that might have called upon it to do more than just lecture its partners (p123).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The Euro: A Divergent System

The eurozone was a beautiful edifice erected on weak fouindations. The cracks were clear from the beginning but after the 2008 crisis they became fissures. By the summer of 2015, 16 years after the euro was launched, it looked as if Greece would have to exit (p124).

A huge creditor/debtor schism had opened up and political power within the eurozone rested with the creditors, and Germany in particular. The crisis countries were forced into deep recessions and depressions. Europe had created a divergent system even as it thoiught it was putting together a convergent one (p124).

One of the strengths of the eurozone was that captial and labour could move freely throughout the region. Free mobility was supposed to lead to the efficient allocation of labour and capital (p125). If governments did their part then markets would do the rest (p125).

The leaders of the eurozone should have known that there was a significant body of economic analysis – theory and evidence – showing that these expectations were wrong (p125). Ever-foolish capital markets thought the elimination of exchange-rate risk meant the elimination of all risk and rused into the periphery countries (p125).

In some cases they created credit bubbles, in all cases they created upward pressure on prices and current account deficits that were not sustainable. One country after another went into crisis as markets eventually realized that the current account deficits were unsustainable and as real estate bubbles burst (p126).

Trade deficits became a regular feature of these countries' lives. The same irrational money that had created the euro crisis, realizing the enormous mistake that had been made, did what finance always does in such situations: it leaves (p126).

As the euro crisis emerged, money left the banking systems of the weak countries, going to those in the strong countries. As money flowed out of their banking systems, the banks in weak countries had to constract their lending (p126).

The magnitude of the contraction was enormous and affected especially small and medium-size enterprises. Lending to small and medium-sized enterprises was nearly halved in Portugal, down by two thirds in Greece and Spain and down by more than 80 percent in Ireland (p127).

By 2015, the European Commission was celebrating " green shoots" for the continent's SMEs, which account for 67 percent of employment in the European Union. To many, the upbeat tone sounded premature, particularly in the crisis countries (p127).

SMEs haven't recovered in Greece, where more than a thried continue to report "access to finance" as the single largest obstacle to doing business (p127).

With common comprehensive deposit insurance for all banks in the eurozone, no one would worry about the loss of money to their bank account; there would be no incentive for money to flow from the weaker countries to the strong (p129).

Germany is worried that with common insurance, there would be a net transfer from strong countries, like Germany, to the weak and as Germany constantly insists, the eurozone is not a transfer union. Therefore, Germany seems to have backed off being willing to have common deposit insurance, at least anytime soon, even with common supervision and common resolution (p130).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

For the eurozone, the worry is that the rigid application of rules makes forbearance more difficult. Decisions made in Brussels and Frankfurt may not be those best suited for the economies around the eurozone (p130).

Bank regulators are typically not economists. They are just following rules. But this rigid application of ruoles, in the absence of common deposit insurance, may make it even risker for depositors to keep their money in the banks of the weak country (p131).

Europe not only allowed Capital to flow freely within its borders but also financial firms and products – no matter how poorly they are regulated at home. The regulatory race to the bottom would have existed within Europe, even without the euro (p131).

Still, the eurozone was designed with the potential to make it all worse. With funancial products moving ever more easily throughout Europe, the opportunity to take advantage of a whole continent of people who might be duped into buying financial products that are not suitable for them proves irresistible (p132).

Well-paid lobbyists from the financial secotr approach any or all with a large gift or campaign contribution as the antibribery and electoral laws of that country will allow. Excessive regulations, these opponents claim, could stifle the financial system and thus prevent it from fulfilling the important functions that it must fulfill if the economy is to prosper. The result is that in most countries, the financial sector is underregulated (p132).

The threat of a regulaory race to the bottom is why therre has to be strong regulation at the European level. The losses of a few years ago seem ancient history now, not to be mentioned in any polite converstation of regulatory reform (p133).

In the absence of an adequate system of financial regulation and supervision at the Euroean or eurozone level, each country has a responsibility to its own citizens, to make sure that they are not taken advantage of by others selling flawed financial products (p133).

An economic framework that combines free mobility of labour with country debt creates divergency, just as the free mobility of capital does. This may sound surprising, after all, in standard theory, free mobility is supposed to ensure that workers move to where their returns are highest (p134).

That would be true if wages were equal to the marginal productivity of a worker (p134).

In the case of Ireland, the European Central Bank forced the government to take on some of the debts of private banks, to socialize losses, even though earier profits had been privatized (p134).

The fact that skilled labour is more mobile than unskilled creates another driver of divergence and inequality (p134). When skilled workers leave, a country is said to be hollowing out; their departer lowers incomes and future growth prospects (p135).

Hollowing out robs these countries of potential entrepreneurs who will start new businesses and academics who will train the new generation of researchers. The poorest workers, whjo are stuck at home, wind up paying for the mistakes of bankers and politicians of an earlier era (p135).

Decreased availability of loans to small and medium-sized enterprises further diminishes opportunity in the crisis and near-crisis countries, encouraging even more migration, especially of those talented and more educated individuals who can get jobs elsewhere in the EU (p135).

But the outward migration also hides the severity of the underlying downturn, since it means that the unemployment rate is less, possibly far less, than it would otherwise be (p135).

Stiglitz, Joesph (2016). The Euro and it’s threat to the future of Europe. Penguin Random House UK.

Countries with large inherited debtrs have limited public revenues to spend in provinding amentities; and this is even more true in the crisis countries where the Troika is forcing deep cutbacks in government spending (p135).

As noted, one of the important adjustments mechanisms in the United States is internal migration. If such migration leads to the depopulation of an entire state, there is some limited concern, but this pales in comparison to the justifiable worries of Greece and Ireland about the depopulation of their homelands, with its risk to their culture and identity (p136).

As economies weaken, because of the fiscal constraints imposed by the convergence critieria, the governmnets of those countries are unable to make competitive investments in infrastruct ure, technology and education (p137).

European-wide investments, financed by the European Investment Bank is a partial fix. Creating national development banks is another fix. Some multinational development banks can borrow money at a lower rate than any of their member countries can borrow (p137).

Contrary to the presumption in standard theory, countries do not necessarily converge in technology – knowledge. East Asia is the exception but countries in this region achieved convergence through active government policies called industrial policies (p138).

Countries with technological advantages often maintain those advantages, unless there are countervailing forces brought about by government policies. Policies aimed at closing the technology gap are called industrial policies but European competition laws prevent or at leas inhibit such policies (p139).

The prediminant view in neoliberal policy circles at the time the euro was founded was that market forces would on their own lead to convergence; industrial policies were neither needed nor effective. This view has been largely discredited (p139).

The eurozone should actively encourage such industrial policies especially for the countries that are lagging behind. Such active policies hold out the promise of real convergence (p139).

As mentioned, Germany runs a trade surplus while the periphery countries run deficits. Running a trade surplus simply means lending to the rest of the world; running a trade deficit means borrowing (p139). Some countries, most notably Germany have increasingly become creditor countries and others debtors (p140).

This creates a divergence in economic interests and perspectives: it makes it all the more difficult for a common curency to work for the benefit of all (p140).

Progressive taxes and broad welfare benefits act as strong automatic stabilizers; as tax systems have become less progressive through much of Europe and welfare benefits have been trimmed, one would expect more volatility (p142).

There is a regulatory race to the bottom for taxes. Countries compete to attract firms, capital and highly skilled workers, and one way that they can do that is through lower taxes. With such easy mobility it is ismilarly hard to have very progressive taxes. Rich individuals threaten to leave and locate themselves and their businesses elsewhere (p142).

Luxembourg and Ireland provide the worst examples, effectively giving some of the largest multinationals a free pass on taxes. The resulting reduction in progressivity in the tax-and-transfer system means that inequalities of income and wealth in most of the eurozone countries has increased – compounding the effect of the divergence among countries to which the structure of the eurozone has contributed in so many ways (p143).

Stiglitz, Joesph (2016). The Euro and it’s threat to the future of Europe. Penguin Random House UK.

Since economic systems are constantly evolving, knowing how they work is truly difficult. The founders of the euro changed the rules of the game. They fixed the exchange rate and they centralized the determination of the interest rate (p143).

Hubris led them to believe that they understood how the economic system worked, and that they could tinker with it in these major ways and make it perform better (p143).

With the best of intentions, Europe created a more unstable and divergent economic system – one in which the wealthier countries got wealthier and the poorer ones get poorer, and in which there is greater inequality within each country (p143).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Monetary Policy and the European Central Bank

At the heart of the monetary union is the European Central Bank. The bank has a mandate to focus only on inflation, even when, today, a critical problem facing Europe is unemployment and many are worried about deflation and falling prices (p145).

The ECB seems more consonant with the interests and perceptions of bankers than of the citizens of the countries that it is supposed to serve (p146).The construction of the ECB was based on certain ideological propositions that were fashionable at the time. That's why it mandate is limited by the Treaty of Maastricht of 1992 to a single-minded focus on inflation (p146).

The deeper problem of the ECB is the absence of democratic accountability. Central banks have always made political decisions – even when limited to assessing the risks of inflation; they simply make a pretence of just being technocratic (p146).

The decision to make the ECB independent, without adequate political accountability, and to focus only on inflation, were themselves political decisions, with strong distributive consequences (p146). This is markedly different from the mandate of the US Federal Reserve, which is supposed to not only control inflaiton but also to promote growth and full employment (p147).

Over a time, a belief developed within large parts of the economics profession that for good macroeconomic performace it is necessary to have low and stable inflation maintained by monetary authorities. We know that is wrong, now. The damage done by the financial crisis is far greater than any damage that might be inflicted by all but rampant inflation (p147).

It wasn't the ECBs fault: inflati on had been its mandate; it was simply doing what it was told to do. Europe seemed to be saying that an open-market economy with free competition resulted in an efficient allocation of resources, in spite of the massive body of economic research, theory, and empirical evidence showing that that was not the case in the absence of adequate government regulation (p148).

The job of the ECB was to prevent inflation by regulating the amount of money in the economy (p148). Market failures are particularly prevalent in financial markets. Good financial regulation can at least reduce the frequency and depth of the crises brought on by the excesses of the financial markte players. The devotion of central bankers to the ideology of free markets is too strong (p149).

On both sides of the atlantic, central bankers overestimated the rationality of markets and underestimated the costs that underregulated markets impose on the rest of society (p149).

Even without the crisis Europe has paid a high price for imposing too narrow a mandate on the ECB. It was virtually inevitable that with no focus on unemployment at the ECB, the average unemployment rate would be higher than it woiuld have been had full employment been among its principal mandates (p149).

The single-minded focus on inlfation was particularly unsuited for a global environment in which other central banks had more flexible mandates. There are those in America who celebrated Europe's flaws. Europe was giving America a gift, allowing it to export more at the expense of its exports and to import less from Europe (p150).

In short, the result of the ECB's focus on inflation is that growth and stability are lower than they would otherwise have been – ironic since the alleged p urpose of the economic framework of the eurozone was to promote growth and stability (p150).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Archconservative, Milton Friedman believed that central banks caused the Great Depression by restricting the money supply. In Friedman's theory, the economy would have quickly been back to full employment and even would have faced inflation (p151).

Instead, economic growth in Japan, Europe and the United States was anemic, and many countries even faced deflation (p151). The ECB had an impossible task: to restore all of the countries of the eurozone to full employment with its hands tied behind its back (p152).

Rather than asking how to maximize what it could do, the economic conservatives dominating the construction of the ECB focused on imposing limitations on it (p152).

Firms borrowing in different countries can face markedly different costs of capital. Those in weak countries face a higher interest rate – when what they really need is a lower one. To conservatives, the ideal was "free banking", the absence of all regulations (p152).

Friedman persuaded Chilie's oppressive dictator Augosto Pinochet to try it around 1975. The disastrous results were predictable and predicted: banks recklessly created credit, and when the credit bubble eventually burst, Chile entered a deep recession (p153).

More recently, the Great Recession was a textbook example of the dangers of underregulated markets. Both in its structure and its function, the ECB made a political choice that reflected the views of economic conservatives (p153).

Monetary policy, as technical as it may seem, has long been recognized as being political: inflation reduces the real value of what debtors owe, helping them at the expense of creditors. No wonder, then, that bankers and bond market investors so strongly rail against inflation (p153).

On the other hand, the fight against inflation typically entails raising interest rates, which lowers growth and hurts employment and workers. Balancing inflaton and unemployment is, or should be, a political decision (p153).

In the 2008 crisis, hundreds of billions of dollars were effectively given by central banks in the advanced countries to commercial banks, in the most massive government-assistance program to the private sector ever conceived (p153).

If monetary policy were a simply a technocratic matter, it might be left to technocrates. But it is not. There are large distributive consequences. Indeed, central banks have played an important role in increasing inequality (p154).

Inequality is important because divided societies don't function well; it leads to lack of cohesiveness that has political, economic and social consequences. Unfortunately, central banks everywhere, and especially the ECB, have largely ignored their role in creating inequality. Their excessive focus on inflation has led to higher unemployment, which has increased inequality (p154).

Central bank policies have helped ratchet wages down. In recessions, real wages t ypically fall, but then, in the recovery, just as they start to increase, inflation hawks scream about the risks of inflation, interest rates rise, and unemployment increases to a level making further wage increases difficult (p154).

Jean Claude Trichet, in the early days of the crisis, repeatedly argued that there should be more wage flexibility, a euphemism for saying that wages should be cut. But Europe faced a lack of demand so cutting wages would weaken demand and deepen the recession (p155).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The political nature of the ECB became especially apparent with the euro crisis – who was blamed, who was saved, and under what conditions. Most dramatically, the bank decided not to act as a lender of last resort for Greece in the summer of 2015 (p155).

The ECB had become Europe's sledgehammer, the tool by which Greece was forced to accede to what the Troika wanted. There is no technical manual available but in reality, it is a judgement that was strongly coloured by the political consquences of alternatives (p156).

The prioritization of banks over citizens was as evident in Europe as it was in the United States during the crisis. As Ireland's crisis emerged in 2010, Trichet demanded that Ireland assume the liabilities of its bankrupt banks – and the cost of restructuring the banks led to an increase in Ireland's debt to GDP ratio from 24% in 2007 to an estimated 95.2 percent in 2015 (p156).

While there is some debate about whether Ireland would have assumed some of these debts withoiiut intervention, there is little question that some of the debt was assumed only because the ECB made it a condition for getting assistance (p156).

Ordinary laws of capitalism require the government should not have assumed any liabilities until shareholders and bondholders had been entirely wiped out (p156). The ECB apparently worried about the effect that forcing shareholders and bondholders to bear more of the costs in Ireland might have had on other European banks (p156).

But they should have worried about this before the crisis, ensuring that European banks were adequately capitalized and had not engaged in excessive risk-taking. The critical issue is this: The Troika was asking ordinary Irish citizens to pick up the tab for regulatory failures of the ECB and other regulatory authorities within the eurozone. This is unconscionable, but evidently not to the bankers in the ECB (p157).

Financial markets have successfully sold the idea that independent central banks lead to better economic performance. Europe has taken this mantra to the extreme (p157). The central question of governance is the extent of accountability of the ECB to the democratic process (p157).

The crisis of 2008 provides perhaps the best test of the hypothesis of the virtues of central bank independence – and those countries without independent central banks performed far better than those with (p157).

We would like a central bank to reflect the broad interests of society. But central banks in most countries are captured by a small group, the financial markets. Those at Goldman Sachs and other large banks have been trying to sell the idea that what is good for Goldman Sachs and the other big banks is good for all, it simply isn't true (p158).

And anyone who subscribed to this idea was surely disabused of it by the Great Recession and the abuses of the financial sector. It was not that difficult for these democratically unaccountable central bankers to go along with ideas such as "self-regulation" (p158).

But central bankers make decisions that are not just technocratic: there are potentially large distributive consequences, and so long as that is the case, there cannot be full delegation to technocrats. The mere proximity and entanglement of central banks leadership and staff with the private financial markets ensures a convergence of priorities and perspectives (p159).

It should have been obvious that the incentives of banks and bankers were to engage in excessive risk taking and socially destructive activities. It was willful neglect that central bankers, in Europe and the United States, failed to take this into account (p159).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Central banks, including the ECB make political decisions. They face trade-offs. In Europe, they could have demanded that Ireland not bail out its banks. They could have demanded that the Greek restructuring be done in a way that insurance was paid off (p160).

Not even the leaders of the ECB would deny that they face such choices. But if trade-offs exist, the people making them need to be politically accountable. In Europe, the governance is even worse than in the United States (p161).

If pursuing a 2 percent inflation target versus a 4 percent inflation target were to lead to much slower growth, it is doubtful that many voters would support that target given the chance (p161). Slightly higher inflation might lead to lower bond prices, even as it led to higher employment and wages. Bondholders would be unhappy, even as the rest of society celebrated (p161).

But central banks that are not democratically accountable almost always pay more attention to the views of bondholders and other financiers than to the workers. There is a political agenda in pretending that setting monetary policy is a technocratic matter best left to experts in the financial sector (p161).

Removing central banking from political accountability effectively transfers decision-making to the financial sector, with its interests and ideology. The deregulation agenda that financiers pushed in Europe and America was really about rewriting the rules and regulations of the financial market in ways that advantaged those in the financial markets at the expense of the rest of society (p162).

It was feared that democratic governments would be tempted to inflate the economy before an election. A stronger economy would help get the government reelected – with the price of inflation to be paid afterward (p162).

Democratic electorates are however more intelligent than this hypothesis gives them credit. In fact, democratic electorates have strongly punished governments that overspent (p163).

Certain economic models shaped the construction of the eurozone; these ideas are at best questionable, and at worst wrong. Institutions built on faulty ideology are not going to work well; economic institutions built on flawed economic foundations are going to serve the economy poorly (p163).

The ECB has been, to say the least, controversial. The world has moved into a new era, with inexpensive Chinese goods helping to dampen prices. The strong restraints on the ECB clearly limit its ability to adapt in ways that it could and should. The ECB's narrow mandate and narrow set of instruments puts Europe adt a distinct disadvantage (p164).

Trichet will be remembered for his colossal misjudgements, in particular raising interest rates at moments when the economy was contracting. He played a disastrous role in the development of the euro crisis, forcing the Irish government to assume the liabilities of its banks (p165).

The Irish people were unjustly forced to pay that price for others' mistakes – a double injustice, because it was in effect a transfer of money from the poor to the rich. But Trichet knew where he stood: he was an ally of the bankers against ordinary workers, constantly demanding wage cuts that w ould lower their standards of living (p165).

Mario Draghi is given credit for the eurozone's survival, with his famouns speech in 2012 promising "whatever it takes" to save the eurozone. Few speeches in history have had such an impact – bringing down interest rates on sovereign bonds throughout the region (p165).

No one knew whether the ECB had the authority and resources to do "whatever it takes". A few academics and pundits worried, what would happen if the promise was tested? What would happen if Germany successfully opposed the ECB doing "whatever it takes" (p165)?

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

In short, no one knew whether Draghi was an emperor with or without clothes. And so long as it was not shown that the emperor had no clothes, remarkably, the markets acted as if it did, whether it did or it didn't (p165).

Over the nearly two decades since its creation, the ECB has not been able to assure full employment and economic stability for all of Europe. But it has not even achieved reasonable growth, employment and economic stability on average. It has had a double-dip recession and reapeatedly faced threats of deflation, with an unacceptably high level of eurozone unemployment (p166).

In the brief history of the ECB, we have seen costly misjudgements and the u se of its enormous power to obtain outcomes that benefit the banks and the major powers within the European Union at the expense of citizens and the weaker countries. This should be deeply troubling (p166).

There are alternative ways of structuring central banks that are more likely to lead to better economic performance, especially from the perspective of the majority of citizens. Doing this should be high on the agenda of reform for the eurozone. It is one of the essential tasks if the eurozone is to be restored to growth and prosperity (p166).

Ideas that were fashionable at the time the eurozone was created – such as all that a central bank had to do was to focus on inflation – are now widely discredited among both academic economists and policymakers including the IMF. Yet these ideas are set in stone in the ECB and still widely held within powerful groups inside the eurozone (p167).

This puts the ECB in a difficult position: following its mandate puts it on a course that is opposed by large fractions of European democracy.

In recent decades, central banking has been dominated by a succession of beliefs – one might call them religious beliefs, for they are held with firm conviction, and even passion. The good news concerning central bankers is that their religions evolve, even if they change their beliefs very slowly in response to evidence against the currently fashionable doctrines (p167).

Monetarism

At one point, the religion was called monetarism – all central bankers believed that one should increase the monetary supply at a fixed rate and, accordingly, monetary authorities should keep an eye on the money supply (p167).

No sooner had Milton Friedman snnounced this new law of nature than nature played a trick on him, and on the countries that followed his dicta: the velocity of circulation started changing (p167). Monetarism swept the world of central bankers as the cult of the day. It was based on a simplistic model, one that could be grasped easily by central bankers with limited abstract capacities (p168).

Inflation Targeting

As this monetarism religion waned in the onslaught of overshelming evicence that it did not provide good guidance, a new religion took its place – inflation targeting (p168). Never mind about unemployment or growth, that was the responsibility of someone else. Countries around the world adopted this policy (p169).

With inflation targeting, one needed a technician to calculate the inflation rate and then plug the number into the formula, and the interest rate would pop right out. The money supply should be increased or decreased until the target was reached (p169).

Countries following such a simplistic policy also had disastrous results. When food prices rose rapidly in 2007, inflation rose too, but it made no sense to raise interest rates because they would not lower global food prices. Raising interest rates would have a negligible effect. The only way to achieve an effect on inflation was to cause sectors of the economy to go into depression by raising interest rates very high. No matter how important one thought inflation was, the cure was worse than the disease (p169).

The ECB focused excluseively on inflation, after all, that was its single mandate, and for a long time it continued to be used as an indicator of monetary stance – a holdover from the days when monetarism reigned king.

Quantitative Easing

When the Federal Reserve put interest rates down to zero, and still the economy did not recover, it felt it could and should do more. One idea was to purchase long-term bonds, driving down the long term interest rates and providing more liquidity to the economy. This was called quantitative easing (p170).

The problem in quantiative easing in the United States from 2009 to 2011 was that the money that was created wasn't going where it was needed and where the Fed wanted it to go – to increase spending in the United States on goods and services (p170).

By the time that the ECB considered undertaking quantitative easing, it was known that it was a weak instrument. The ECB could have taken more aggressive measures to ensure that the money didn't go into credit bubbles, and that more of the money went into supporting new businesses and expanding old businesses. But their philosophy of "trusting the market" made them reluctant to do so (p171).

The problem was that banks weren't lending out money.

The Natural Rate Hypothesis

Critics of an active monetary policy argue that if one tried to get the unemployment rate below a critical level, called the natural rate, and hold it there, there would be ever-increasing inflation. The job of central bankers became to eep the unemployment rate at the "natural rate" (p172).

But if there is a natural rate, it is a movable target, and we almost never know what it is. The risks of underestimating or overestimating the natural rate are borne by different people. Central bankers have managed these risks focusing more on financial markets than on workers, and in doing so there has been an increase in inequality than what would otherwise have been the case (p173).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Crises Policies: How Troika Policies Compunded the Flawed Eurozone Structure, Ensuring Depression

Those ou tside of Europe, and many in Europe, have been appalled at the unfolding drama in the crisis countries, especially Greece, Spain, Portugal and Cyprus. Pictures abound of middle-class individuals suddenly in jeopardy: retirees whose pensions have been cut to the bone; and young people, college graduates, who have looked and looked for a job and can't find one, living in homeless shelters (p177).

Innocent citizens are being forced to bear the consequences of decisions that have been made by politicians – ironically, often politicians from the same political party of the right that the Troika seems so fond of (p178).

The biggest display of callousness has not been in any politician's comments, public or private, but in the actual policies the Troika has foisted on these countries in their moments of desperation. Astonishingly, even with the avalanche of evidence that the Troika's porgrams have failed the people of the countries they were supposed to help, its leaders have been claiming success for their austerity. This stretch of the imagination could only be achieved by wearing blinders (p178).

Yes, the Troika's 2010-1013 Economic Adjustment Program for Ireland had brought the country's financial sector and government back from the brink of economic collapse. But the austerity the Troika imposed helped ensure that Ireland's unemployment rate remained in double digits for five years, until the beginning of 2015, causing untold suffering for the Irish people and a world of lost opportunities that can never be regained (p178).

And Ireland is one of the best cases. In 2011, the IMF bailed out the Portuguese government as it faced spiraling borrowing costs in the wake of the global financial crisis. The IMF has also claimed its Portugal probram as a success. Yet austerity kept the fundamentals of the economy feeble. By 2015, GDP per capital was down an estimated 4.3 percent from before the crisis (p179).

Unemployment was still above 12 percent in early 2016. Growth predictions in the next years are sluggish. The government might be borrowing with more ease but the Portuguese people never experienced a real recovery (p179).

In mid-2015, with nearly a quarter of the Spanish workforce still unemployed, the German Council of Economic Experts was claiming Spain as the prime example of the virtues of austerity. It was with these fundamental perversions of the definition of economic success that the Troka blundered forward to its worst misadventure yet, in Greece (p179).

There, its program has been wrong and destructive, and almost unbelievably narrow-minded. More than that, it bordered on inhumane. Still, in 2015 the Troka doubled down on its manmade disaster (p179).

Europe demanded that Greece end a program of "forbearance" against those who owed money on their mortgages: in order to save great swaths of its population from homelessness and deeper destitution, Greece has implemented a temporary ban on home foreclosures when the crisis set in (p180).

Europe was betting that toughness would yield a bonanza for the banks, and the amount Europe would need to recampitalize them would be reduced accordingly. Greece pleaded with the Troika to soften its draconian demands, but the Troika held fast (p180).

Perhaps the one advantage of the Troika's Greek tragedy is that it provides a paradigmatic example of the problems with the eurozone's policiy response to the global financial crisis and its aftermath. It should be kept in mind that the policy mistakes the Troika forced on Athens in its time of need are simply amplified versions of those established through pressure, cajoling, and loan conditions on other crisis-hit countries (p181).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The real crunch arrived when it came time for Greece to borrow more, to finance its huge fiscal deficit and to repay loans coming due. No one would lend. And if the government couldn't borrow, they couldn't repay what was owed. Default was the next step (p181).

German and French banks, let alone Greek banks, that held significant amounts of these bonds might themselves become insolvent. Worse, because of the lack of transparency in the financial market, no one knew exactly how each bank would be affected (p182).

Finance ministers naturally focus on financial markets. But the European project was not supposed to be about financial markets – they were simply a means to an end. The means became an end it itself (p182).

As one program after another unfolded , as one country after another went into crisis, two things stood out: (1) each coiuntry that undertook one of the programs went into a deep downturn, sometimes a recession, sometimes a depression, from which recovery was at best slow; and (2) these outcomes were always a surprise to the Troika, which would forecast a quick recovery after an initial drop (p182).

These dismal forecasts made it clear: the Troika's grasp of the underlying economics was abysmal. While the Troika may now want to shift blame the truth is otherwise. Greece's depression wasn't because Greece didn't do what it wsa supposed to; it was because it did (p183).

So, too, for the other crisis countries. Their downturns were largely because the coiuntries had failthfully followed the Troika's instructions (p183).

The program for Greece highlitys most clearly the problems of all the programs imposed on the crisis countries because it illustrates most clearly the mindset of the Troika (p184).

The leaders of Europe like to think of the crisis programs as providing both symptomatic relief – getting over the immediate problem – and creating the basis for long term adjustment. More accurately, one can think of the programs as a mechanism to ensure that debtors pay the costs of adjustments and creditors get repaid (p184).

Some of the creditor countries, particularly Germany, did not want its taxpayers to know that costs that might be imposed on them; they wanted their citizens to believed they were going to get repaid, even if that was essentially impossible (p184).

There is a high price associated with such a charade, with most of the costs borne by Greek citizens. Under Troika programs not only was there too much emphasis on restoring fiscal balance, but they also went about restoring balance in the wrong way; the programs resulted in more adverse effects on output, employment, and societal well-being than necessary (p185).

The IMF especially should have known that poorly designed tax measures can backfire – tax revenues fall, and so, too, can economic output (p185).

At the center of the macroeconomic programs is austerity – a contraction in government spending and an increase in revenues. But austerity has never worked (p185).

The obvious immediate goal was to make it so that that countries wouldn't need to borrow more, and that's where the austerity programs fit in: cut expenditures and raise taxes enough, and there would be no need for outside finance (p186).

But such matters are not so simple. Austerity leads to economic slowdowns, lowering revenues and increasing social expenditures on items like unemployment insurance and welfare; any imporovement in the country's fiscal position is much less than expected, and the suffering is much greater than expected (p186).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

This is the fundamental difference between the Swabian housewife, which Germany's chancellor Angela Merkel so famously talks about, and a country: the Swabian housewife has to live within her budget, yes, but when she cuts back on her spending, her husband doesn't lose his job (p186).

Yet that's exactly what happens when austerity is imposed on a country: the government cuts spending, and people lose their jobs. Countries that borrow to finance investments in, say, infrastructure, education and technology can be better off, and especially so if there are underutilized resources, as is the case with unemployment (p186).

Austerity is then bad both in the short term – it leads to higher unemployment, and in the long term – it leads to lower growth (p187).

The only way governments in crisis countries can repay what is owed is by running a surplus. That such a surplus would normally lead to a weak economy is obvious: when the government has a surplus, it is taking away from the purchasing power of citizens more than it is adding back through its spending. Thus it is contributing to a lack of demand (p187).

Given the history, it is shocking that Germany and the Troika have demanded that Greece and other crisis countries maintain large primary surpluses. In the case of Greece, it insisted that the primary surplus reach 3.5 percent by 2018 (p188).

Even the IMF knows that such a target will only extend and deepen the country's ongoing depression. No matter how faitfully Greece fulfills the structural reforms, no matter how successful it is in raising revenues or cutting back on pensions, no matter how many people are left to die in underfinanced hospitals, the depression will continue (p188).

Austerity is now a built-in destabilizer in the crisis countries. As the economies weaken and tax revenues fall, tax rates will have to increase and this will depress the economies still further. As the market comes to realize this, the adverse effects will be all the larger (p188).

France has been betting on lowered corporate income tax leading to more investment. But what is holding back investment in France and elsewhere in Europe among the large corporations is lack of demand for their products (p189).

Without demand for their products, firms will not invest, even if the tax rate were close to zero (p189).

If France wanted to stimulate its economy, it should have lowered taxes on corporations that in invested in its country and created jobs, and increased taxes on those that did not. The eurozone crisis implies a hidden agenda: downsizing government and decreasing its role in the economy (p190).

Normally, the IMF warns of the dangers of high taxation. They worry about the disincentive effect, the discouragement to work and savings. Yet in Greece, the Troika has insisted on high effective tax rate even at low income levels (p190).

The Troika demanded that Greek firms, including mom-and-pop operations, pay all their taxes ahead of time, at the beginning of the year, before they have earned any money and before they even know what their income is going to be (p190).

The requirement is intended to reduce tax evasion, but in the circumstances in which Greece finds itself, it destroys small businesses. Such draconian measures inevitably lead to more tax evasion – again, seemingly in contradiction to another major thrust of the Troika programs (p191).

Allegedly one of the largest nonpayers of taxes in Greece is the German company that managed Athens airport until 2013. According to some, this company is hundreds of millions of euros in arrears (p191).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

High taxes lower demand for Greek tourism, simultaneously hurting employment, GDP and Greece's current account – and tax revenues might actually decrease. But the Troika would hear none of this (p192).

The Troika undermined tax collection in other ways: when taxes are viewed as imposed by outsiders at high levels, in ways that make no sense, resentment builds, and trust and voluntary compliance erode. Property taxes can be a good thing but the Troika couldn't even get that one right (p192).

Under the Troika programs, Greece adopted a new property tax, but with their small property the only thing separating many ordinary Greeks from outright poverty, the tax was deeply resented. The strict enforcement of the tax against unemployed people with no source of income would mean the loss of their major asset (p193).

What should have been deployed was a progressive property tax on all large property holdings (p193). There is an alternative way of raising revenues, and that is selling stat e assets i.e. privatization. Of course, such sales do not directly or necessarily improve the balance sheet of the country and its government (p194).

When a country sells its assests in a fire sale, its "net worth" is decreased with long-run consequences – either less revenues for the government, because it doesn't own an asset that yields returns, or greater costs, because it now must pay rent for office space, having sold its own buildings (p194).

The best case for privatization is when the government has proven itself incapable of managing an asset well and where there are several competitors for the asset, each of which would improve the efficiency of management (p194).

The worst case ofr privatization is when the asset is sold to a monopolist, who uses his market power to exploit customers – with consumers and firms even worse off under even an efficient monopoly than under an inefficient government operator (p194).

Moreover, privatization gives rise to an unhealthy political dynamic: the monopolist uses its profits to buy political influence, which extends and enhances its market power. Privatization can thus result in increased corruption in addition to a less competitive and overall less efficient economy (p194).

When the privatization results in foreign ownership further problems arise. In the case of Greece, the problems with privatization have already become evident. Some of the privatizations, past and proposed, have been to enterprises owned in part by the German government (p194).

These failings undermine confidence in the entire Troika program, not just in Greece but I n all of the crisis countries, and raise troubling questions abo9ut whose interests are being served by its programs (p195).

The second part of restoring fiscal balance, after raising revenue, is cutting spending. The debts of Ireland and Spain increased not so much through ordinary spending as through bank bailouts. Ordinary citizens are the most dependent on public expenditures like schools, publicly provided medical care, social programs, and welfare benefits (p196).

The rich can take care of themselves, and there are other obvious options for cuts, if there were the political will to pursue them. There exists a massive set of inefficient subsidies, some hidden within the tax code, often to well-off business groups, the elimination of which would lead to a more efficient economy and more equal society (p197).

Most countries, for instance, have large energy subsidies, in particular for fossil fuels. The irony is that a very large fraction of spending at the EU level goes to distortionary agricultural subsidies, much of which goes not to small farmers but to large agribusinesses (p197).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

In the case of Greece, the Troika has focused on cutting public sector pensions, which it views as outsized. One cannot retire with dignity on a monthly pension of under the poverty line of 665 euro – and yet 45 percent of Greece's retirees are attempting to do that (p197).

In early 2012 Greece was actually spending less per person over 65 than were Germany and most of the other eurozone countries. Both before and after the Greek crisis of the summer of 2015, the Germans argued that Greece's debt should not be restructured – a contract is a contract – even thoiugh it was patently clear that the debt should have been restructured (p197).

Somehow this belief in the sancity of contracts did not extend to pensions. Not paying a promised pension fully is, in effect, tearing up the contract. Worse still, cutting pensions affects the most vulnerable members of society – in contrast with a debt contract, where the lenders are financially sphisticated and understand the risks of default (p198).

Reducing pensions from their promised level is wage theft, merely in a different form. Greece's Council of State, its highest administrative court, recognized the illegality of the proposed pension cuts. To the Troika, the violation of these individuals' basic rights seemed an annoyance (p198).

Its resp onse was to demand other reforms that would "fully compensate for the fiascal impact o fthe Constitutional court ruling". Citizens feel, justifiably, that they are not getting their money's worth out of their taxes, and tax compliance decreases. Another vicious circle begings, where the Troika is clearly more part of the problem than the solution (p198).

The financial sector was at the center of the Great Recession, and it has been at the center of the euro crisis (p198). A real estate bubble fueled by excess housing credit brought down Spain. The cessation of a mojor engine of economic growth – real estate investment – combined with the curtailed lending ensured that recession would follow (p199).

Eurozone policy towards Spain was in many ways predictated on a bootstrap operation, wherein lending the the government would help bail out the banks, and lending to the banks would help bailout the government, as the banks bought government bonds when no one else was willing to do so (p200).

What finally restored stability, but not strong growth, to Europe was Daghi's promise in 2012 to do whatever it takes to support the European sovereign bond market. As noted earlier, no one knows, of course, ehether the ECB can in fact do whatever it takes if theat day of reckoning finally arrives (p200).

The ECB went so far as to stop acting of lender of last resort, forcing Greece's banks to shut down for three weeks – hardly evidence of a willingness to do whatever it takes, more evidence of the political role of the ECB (p201).

If there is an exit from the euro of one or more members, the knowledge that the euro is not a binding commitment amongst its members will make the Draghi confidence trick far less likely to work next time. Bond yields could spike and no amount of reassurance from the ECB and Europe's leaders would suffice to bring them down from stratospheric levels (p201).

The IMF is consistently brought in to provide liquidity when there is a lack of confidence by markets. The IMF is a se ionor creditor which means it gets paid back first leaving other creditors further down the queue. The IMF then makes these bonds riskier and the policies the IMF pursues almost guarantee a bigger economic downturn (p201).

The first symptom of the crisis was the high interest rates paid by Greece on government debt followed by Greece being closed out of the market – no one would buy any new bonds that the Greek government might try to issue (p201).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The eurozone's immediate response was to provide credit, not so much to help Greece but to help their own banks. But to demonstrate to German taxpayers that they would not be subsisizing Greeks, the Troika demanded a high interest rate, so high that it was clear from the outset that Greece's ability to repay the debts would be low (p202).

If one imposes stiff conditions and charges high interest rates, then the economy will stagnate and the debt-to-GDP ratio will increase.

Some in Germany claim high interest rates were necessary to discourage moral hazard, the risk that governments would spend recklessly and then turn to Europe for assistance. But no government would willingly put itself through the torture that Greece has endured. Moreover, whatever mistakes in lending occurred earlier, punishing Greece today doesn't rectify yesterday's mistakes (p202).

The real moral hazard problem arises for banks, who have an incentive to induce countries to borrow excessively. Repeated bank bailouts encourage this kind of behaviour: the Mexican, Latin American and East Asian bailouts, each of which bears the name of a country, are really bailouts of the European and American banks that lent recklessly (p202).

If instead of just bailing out failing banks, the government took shares in those banks, then the country's fiscal position would be that much stronger when the banks rebounded (p203).

True to history, eGermany and the Troika did little to address the bank's moral hazard in the case of Greece and some of the other European bailouts. Indeed, as we saw in the case of Ireland, the ECB demanded, secretly, that Ireland bail out its banks (p203).

Germany's demand for high interest rates was well in excess of those sat which Germany could borrow. This dealt a blow to any notion of European solidarity. What does solidarity mean if one country is able and willing to make a profit off its neighbout in its time of need (p203).

Of the total lent to Greece, only 10 percent ever got to the Greek people. The rest went to pay back creditors including German and French banks (p203).

Debt restructurings are an essential part of capitalism. If a co untry or a firm or family is temporarily facing difficulty in servicing its debt, then a short-=term loan to help it through the troubled period makes sense. But if there is a long-term problem, the loan needs to be written down (p203).

Typically, a country has a bankruptcy law to allow this fresh start. The same principle applies to nations. But there is no international law for restructuring debt. There are, however, moves within the United Nations to create such a framework (p203).

The severe austerity makes little sense even from the perspective of the creditors. It's like a 19th century debtor's prison. Imprisoned debtors cannot make the income to repay. So, too, the deepening depression in Greece will make it less and less able to repay (p203).

Debt restructurings are not a panacea - they do not resolve all of a country's problems. In the case of Greece, the IMF has recognized the need for a debt restructuring, but unless there is relief from the extreme austerity measures now in place, the prospects for the country remain bleak (p203).

One shouldn't feel too sorry for the private sector creditors; theypically they have been well compensated for their risk, in terms of interest rates well in excess of the safe interest rate. If they have not been well paid it reflects a lack of due diligence on the part of the creditors or a bout of irrational optimism (p203).

There are strong incentives to "pretend and extend" - pretend that the debtor is only having a temporary problem and extend the loan so as not to recognize the loss (p203). The problem with pretend and extend is that it provides no framework for the resumption of growth; it condemns the debtor country to neverending misery; there is no fresh start (p204).

There is an argument that Greece should begin the process of debt restructuring on its own, if Germany doesn't accede: even the IMF says that debt restructuring is absolutely necessary. After Argentina restructured its debt and devalued, it grew rapidly - the fastest rate of growth around the world except for China's (p205).

Both Greece and Argentina were being strangled by austerity. Both countries under IMF programs saw rising unemployment, poverty and immense suffering. But the Argentine people rose up and said no. Greece is in a similar situation: if conditions continue as is, it will mean depression without end (p206).

The macroeconomic and financial sector dimensions of the programs have predominantly determined the fate of the crisis countries. In most countries, it was private sector misconduct, not public sector profligacy that brought on the crisis (p206).

Greece had the biggest and the fastest fiscal consolidation among the advanced European economies in the aftermath of the global financial crisis, rapidly cutting back expenditures and raising new revenues. The bailouts appeared aimed more at saving the euro than at preserving the well-being and economy of the crisis countries (p206).

For German politicians, it was easier to vilify Greece and provide indirect assistance to German banks through a bailout loan, called a "Greek bailout", and then impose policy conditions on Greece that would seemingly force it to repay what was borrowed (p207).

It would have been easy to restore Greece to growth: deep debt restructuring; a primary surplus of 1 percent by 2018, not the 3.5 percent that Europe demanded, and reasonable structural reform focused on the central issues facing the economy today (p207).

The best evidence is that a country going through a deep downturn never bounces back to make up for what was lost. What is lost is lost forever. The social and political consequences are already evident in the eurozone with the growth of more extreme political parties: the centrist parties that had staked their reputation on the success of the Troika programs have been discredited (p207).

The failures in the eurozone almost surely have contributed to broader skepticism about the value of European integration, evidenced most starkly in the strong support for leaving the EU in the UK (p208).

The vast majority of academic econmists side with the view that austerity has never worked. But in the immediate aftermath of the financial crisis, three economists chapioned the seemingly paradoxical notion of "expansionary contraction". But even the IMF pointed out that when governments contract spending, the economy contracts (p208).

The fact that in a few instances austerity was associated with economic expansions on ly meant that but for the aust erity, the expansion would have been even stronger. In such cases, austerity had worsened the level of unemployment; the austerity had not caused the reduction in unemployment (p209).

The crises, and how they have been managed, have had adverse effects on inequality. In Spain, inequality before the crisis had been going down; in the aftermath of the crisis it increased (p212).

Since those at the top spend a smaller percentage of their income than the rest, an increase in inequality lowers aggregate demand, and thus economic performance. This is especiallly so when, as now, monetary policy is unable to stimulate the economy. In recent years the IMF has stressed how inequality weakens growth (p212).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The Troika seems reluctant to reconsider its programs, even as evidence mounts that they were not working in the way antipated (p213).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Structural Reforms That Further Compounded The Failure

The Troika program imposed structural reforms on the crisis countries as a condition for providing assistance. Structural reforms refer to changes in the structure of the economy and in the individual markets within – for instance, labour markets and financial markets (p214).

After the financial crisis of 2008, therre was a broad c onsensus that there was a need for deep structural reforms in financial markets throughout the advanced countries. In the crisis countries, the Troika demanded structural reforms ranging from the trivial to the counterproductive (p214).

The most demanding reforms were those imposed on Greece, and they were remarkably ineffective, sometimes even destructive (p214). There wree no changes in the structure of the afflicted countries that could acco unt for their going from near full employment precrisis to massive unemployment after 2010 (p215).

Without any of these structural reforms Greece grew at a faster rate than the EU from 1995 to 2007, until the global crisis, and so did Spain. But it is not "structural impediments" that are holding the crisis countries back – it is the eurozone itself (p215).

Because struct ural problems thus cannot be the cause of the crisis, structural reforms within the individual countries will not be the cure. The eurozone's leaders disingenuously pretended such reforms would make the citizens of the crisis countries better off. It is now obvrious that they did not do that (p215).

In the absence of flexible exchange rates, the only way to correct current account deficits is to have a real exchange adjustment – that is, to lower the prices of goods that the country sells abroad (p216).

Improving technology is important but typically cannot be done overnight – and the Troika policies set back the agenda. Government investments in infrastructure, education and job training had to be curtailed under the onslaught of austerity (p217).

When it came to promoting competition, the Troika mysteriously focused on nontraded consumer goods rather than on traded goods (p217).

Here are a few controversial reforms in the Greek program:

Fresh milk: In 2014 the Troika forced Greece to drop the label "fresh" on its truly fresh milk and extend allowable shelf life. Dutch and other European milk producers would like to increase sales by having their milk, transported over long distances, appear as fresh as the local product (p218).

Size of a loaf of bread: Another seemingly strange debate in the middle of a depression: the Troika demanded that Greece change its regulations concerning the size of loaves of bread. In the past, loaves could only be sold in specified sizes. There is a long-standing literat ure explaining how such standards actually increase competition, because they facilitate comparison shopping. But the Troika wanted stores to sell any sized loaf (p218).

Pharmacies: A major complaint of the Troika concerned restrictions on drugstores (p218). For instance, Greece required that each pharmacy be owned by a pharmacist and did not allow over-the-counter drugs to be sold outside pharmacies. The Troika claimed that Greek regulations led to high drug prices. Again, it was somewhat mysterious how the Troika would get so exercised over this, when there were so many other profound problems. Lower prices for drugs would not do anything to lower Greece's balance of payments. Many Greeks felt some solidarity with their neighbourhood pharmacy. They were willing to pay a slightly higher price and to even support a regulatory system that allowed that. But the Troika seemed to have another agenda: opening up Greece to multinational chains that could now sell these

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products (p219). The fact that the Troika failed to connvince most Greeks about these aims showed the deep popular distrust aboiut their motives. No one gave the Troika the benefit of the doubt (p220).

There is no evidence that these restrictions have any effect on national savings rates.

Weakening labour: The alternative to increasing competitiveness through improved productivity is lowering wages. Higher unemployment would lead to lower wages, lower wages would lead to lower prices, and this process of "internal devaluation" (p220) would eventually restore equilibrium and bring the country back to full employment. It was a very costly way of achieving what a flexible exchange rate would have accomplished (p221).

The Troika demanded more flexible labour markets – reforms that would weaken workers' bargaining power, lower wages still further, and increase profits. The Troika even put into question their commitement to the basic right of collective bargaining (p221).

The intentions seemed so clear to one of Papandreou's loyalists that he resigned from t he government rather than be party to this abnegation of basic workers' rights.

No country should want the finance ministry to set its labour laws; our democracies are designed to make sure that weight is given not just to the interests and perspectives of financial markets, and thankfully so (p222).

Even more so, no country would w ant its labour laws written by the parliament of another country – let alone the finance ministry of another country (p222).

While the government of the crisis country always accedes to the demands, they do so with effectively a gun held at the head: the feared consequences of not doing so are simply too great not to accede. The Troika sold the reforms on the grounds that they would help the econmy grow. Greece showed dramatically that they had the opposite effect (p222).

Some of the structural reforms had an even worse outcome: local firms would be displaced by large European multinationals, lowering the income of those within the country (p223). Income in the crisis country weent down by a multiple of the profits that were effectively transferred abroad (p223).

If Greeks start buying Dutch milk, imports are increased and the trade balance worsens. And similarly for many other so-called structural reforms. In each of the crisis countries, there are reforms that might have led to a stronger economy, both in the short and in the long run (p223).

Industrial Policies: Germany has benefited from being wedded to the "weaker" countries of the eurozone, because the currency today is weaker than say the German mark would have been (p224).

Without a concerted government effort, theose countries that are behind will remain behind. There is a range of government policies called industrial policies, which have proven effective in pushing economic restructuring. But the austerity measures imposed by the Troika have forced a scaling back in public expenditures that might have facilitated such a structural transformation (p225).

Markets, on their own, often produce excessively high levels of inequality – levels that are, or should be, socially unacceptable, and actually undermine economic performance. Economic inequality leads to political inequality, which leads to writing the rules for the market economy in ways that perpetuate and extende economic inequality in a vicious circle (p225).

Some of the crisis countries emerged from long periods of fascism, with relatively high levels of inequality, and it would take a concerted effort on the part of government to create a more inclusive society. But, again, many of the Troika policies lead to more inequality and a less inclusive economy (p225).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Before the crisis, Spain was one of the success stories in bringing down wage inequality; since the crisis, inequality and poverty have been growing there as they have in the other crisis countries (p226).

Well-being indicators have all pointed downward since the adoption of the program that was so confidently predicted to restore growth. By the end of 2014, some 36 percent of Greeks were "at risk of poverty or social exclusion". The rate is highest in the eurozone and some 10 percent points higher than the currency union's average (p226).

But the Troika not only did too little to help those at the bottom; they did too little to prevent the concentration of wealth and income at the top. There were alternative ppolicieis in which the burden of adjustment would have been more fairly shared, and in which the increase in poverty would have been smaller (p226).

In Greece and elsewhere, the Troika should have focused on major concentrations of economic and political power and sources of economic rents. Instead, the important reforms that would curb the Greek oligarchs were largely left off the agenda (p226).

The Troika could have pushed for the progressive property tax aimed at the oligarchs rather than the tax they insisted upon, a nonprogressive one that hurt so many who were suffering so much (p227).

Such a comprehensive and progressive property tax would, of course, have been resisted by the oligarchs who own so much of Greece's wealth, and that makes it precisely the kind of issue on which the Troika should have weighed in (p227).

What the Troika is doing to small businesses in Greece is hard to fathom: they are forcing small businesses, which can't move anywhere else, to pay a year's tax in advance (p228).

The financial sector had failed berfore the crisis to perform the basic services that it is supposed to provide – allocating capital, providing funds to small and medium-sized enterprises, and managing risk (p228).

In Greece, the banks remain largely in the hands of the Greek oligarchs. They have continued their practice of "connected" lending to their other business interests and those of their friends and family. Particularly invidious is their lending to the media that they own – which often loses money but enhances their political influence (p228).

As it became clear during the crisis that the Greek banks would have to be recapitalized, it made sense to demand voting shares for the government. But when Papanedreou proposed this, the Troika resisted. He nonetheless persisted but when he left office these efforts were undone (p229).

Before the crisis, several European countries had embarked on strategies to move toward renewable energy. Countries like Greece and Spain had the potential to produce solar and wind power that they could export to the rest of Europe (p229).

The private sector on its own won't make these investments, not without an adequate carbon price. Why in the midst of Greece's unemployment , with youth unemployment peaking at 60 percent, was the Troika talking about how old milk can still be called fresh, or how bread should be sold (p230).

While there has been no disaster on par with the IMF's unforgivable destruction of Indonesia's private banks, the destruction of the Greek banking system was almost comparable. In 2011 alone, 17 percents of deposits fled, and by the end of 2015 the assets of Greek banks were down nearly 30 percent from their 2010 peak (p231).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The flight was facilitated by the single-market principle in the absence of a banking union, but it was aggrevated by Troika policies. The eurozone claims Spain as a success, simply because growth has returned, even as youth unemployment remains high (p231).

Even Ireland, which is held up as proof that the Troika programs can work is not a success when measured by broader gauges. GDP per capital adjusted for inflation in 2015 was only 3.4 percent higher than in 2007. And this is for the best performing country (p231).

Even the star performer Ireland has seen its debt to GDP ratio almost quadruple, from 24 percent to 95 percent. But the eurozone programs have been a success, in the sense that German and French banks have been repaid (p231).

European leaders have recognized that Europe's problems will not be solved withoiut growth. But they have failed to explain how growth can be achieved with austerity and with ill-conceived structural reform measures (p232).

Instead, they argue for restoring confidence, and that the restoration of confidence will bring about restoration of growth. However, because austerity has destroyed growth and lowered standards of living, it has also destryoed confidence, no matter how many speeches are given about the importance of confidence and growth (p232).

"Confidence" will only be restored when there are fundamental reforms in the structure of the eurozone itself and in the policies that it has imposed on those partners in the eurozone in crisis. But that will only happen when there is a greater sense of political cohesion and social solidarity than is evident today (p232).

Europe's performance has been dismal and there is more in store. Many in the crisis countries have survived only by drawing on their savings, some by selling the family silver, others by selling the family home. But it is a strategy of mere survival, without hope (p232).

Just as Greece has become the poster child for bad behaviour by a eurozone member, the Greek program has become the poster child for the mistakes of the Troika. The eurozone rules didn't dictate that Greece would be instructed to go from its huge fiscal deficit to an unconsionably high 4.5 percent surplus in very few years (p233).

Nor did they dictate the harsh forecolusure policies, pushing an increasing fraction of Greeks into poverty. There is something in the last memorandum, signed soon after the Greeks had rejected t he same program by an overwhelming vote of 61 percent, which provides more t han a hint that it was sheer hypocrisy (p234).

The agreement begins by affirming "Success requires ownership of the reform agenda programme by the Greek authorities", and suggesting that there is that ownership (p234).

The same two forces that had constructed the failed IMF programs in so many countries around the world could be found in the program for Greece: corporate and financial interests in alignment with and supported by ideology: but this time it was playing out within the very borders of Europe (p234).

This, then, is the situation facing the eurozone: they have constructed a monetary arrangement characterized by divergence rather than convergence, where crisis are likely not to be rare occurrences, but frequent events that have to be constantly dealt with (p234).

And the interests and ideology of the dominant powers have propagated policies that are extraordinarily painful for those within the crisis countries. While some in northern Europe like to blame the problem on those in the south, Ireland and Finland are reminders that culture and geography are not the driving forces (p234).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

And since the countries of Europe are all tied together, even the well-performing economies will be dragged down. The double-dip recessions are no surprise. And the reforms made since the beginning of the euro crisis do not suffice: some, in the half-finished state that they are likely to remain for years, may make matters worse (p235).

In the discussions prior to the euro, it was thought there was a trade-off: a single currency would bring higher growth, but there would be slower adjustment to a disturbance. But for the eurozone as a whole there was no burst of growth after the launch of the euro (p235).

The evidence suggests that the benefits were nil, but the costs – as the crisis was managed – were palpable. Of course, in the years preceding the creation of the euro, not everything had gone smoothly. There was exchange-rate volatility. Some countries faced bouts of high inflation. Post-fascist Spain had high unemployment. Still, none suffered as they have suffered in the euro crisis (p235).

In the euro crisis, in a single year, the Greek economy shrank by 8.9 percent and that was followed by year after year of continued contraction. Greece had unemployment in 1999 of 12.1 percent. But that was less than half of its peak above 27 percent in 2013 (p236).

Had they known back in 1992, when they signed up for the euro, what they know now, it is hard to see how the people of Europe could have supported it (p236).

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Creating a Eurozone that Works

The euro can and should be saved – but not at any cost. Not at the cost of recessions and depressions that have afflicted the eurozone, the high unemployment, the ruined lives, the destroyed aspirations. One can create a eurozone that workis, that promotes prosperity and advances the cause of European integration (p239).

The halfway house in which Europe finds itself is unsustainable: there either has to be "more Europe" or "less"; there has to be either more economic and political integration or a dissolution of the eurozone in its current form (p239).

What has already been done is not nearly enough. What is required is "more Europe" than the existing arrangement, and certainly "more Europe" than those who say that the eurozone is not a transfer union are willing to countenance (p239).

The depressions that have marked the euro crisis, with their long lasting effects, are avoidable. There needs to be a fundamental commitment of the eurozone to maintain the economies at full employment. Markets do not on their own maintain full employment, and markets on their own are not in general stable (p240).

In the absence of government intervention, there can be persistent unemployment and high instability (p240). Most critics of the euro crisis policies have focused on austertity, and rightly so. But without appropriate reforms in the structur of the eurozone restoring the countries to full employment will lead to unmanagable current account deficits (p240).

The eurozone needs to be reformed so that all countries in the eurozone can attain and maintain full employment. While the programs that have been imposed on the crisis countries are intended to eventually lead the country back to full employment, the path is extraordinarily costly with uncertain success (p240).

Six structural changes - changes in the basic rules governing the eurozone and their shared economic frameworks – are essential.

Structural Reform #1: A Banking Union

This reform is one on which the European leaders already agree. A common banking system – banking union – entails more than common supervision. It entails common deposit insurance and common procedures for what should be done with banks that cannot meet their obligations (p241).

Without it, money will flow from the banking system of "weak" countries to the banks in the strong countries, weakending further those already having problems. But inflexible implementation of banking regulations would exacerbate the already present downturn (p241).

While rigid enforcement of standards makes sense for a bank in isolation; it's counter productive: the econoimic slowdown arising from decreased lending will lead to even more defaults, in a downward vicious spiral (p242).

The incongruence between the pace of markets and that of politics presents a problem for the euro's survival. Many European leaders recognize that eventually a single banking framework with common regulations and common deposit insurance, and resolution will be necessary (p242).

But the benefits of waiting are nil, and the risks substantial (p242).

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Structural Reform #2: Mutualization of Debt

Some mutualization of debt is necessary if therre is not to be divergent movements in labour. The movements in populaton are only destabilizing, they are inefficient – undermining the very rationale for free movement of labour (p242).

There are already proposals on how to design such a system, in a way that won't lead to excessive borrowing. there could be a requirement that except when the economy is in recession, any increase in debt over a certain level be subject to a referendum within a country (p243).

The position of some in Europe against such mutualization – claiming that Europe is not a transfer union – is wrong on two counts:

1. It exaggerates the risk of default, at least the risks of default if debt is mutualized; and 2. Any system of successful ecomonic integration must involve some assistance from the stronger countries to the weaker (p243).

Structural Reform #3: A Common Framework for Stability:

Europe faces two paramount questions 1. how to promote stability within the eurozone as a whole and 2. how to ensure that all of the countries in the eurozone are doing well. With the exchange rate and interest rate no longer in the toolkit, other tools will have to be found to ensure that each of the countries in the eurozone remains prosperous (p243).

There are six parts to a stability reform agenda (p243).

[1] A Common Fiscal Framework – beyond a suicide pact:The Germans have emphasised the need for all countries to follow the rules. They worry without such rules, there will be ecomonic chaos. Germany's stance is predicated on the belief that profligate government spending leads to crises – and that it led to the eurozone crisis. That is simply wrong (p245). A government should behave not like the Swabian housewife but like the modern firm – which looks at its balance sheet and undertakes debt of the returns on the investments that it finances exceed the cost of capital (p245).

[2] A Solidarity Fund for Stabilization: The leaders of Europe had committed themselves to helping Greece grow but they obviously didn't do that. Even for the crisis countries that have done everything they were told to do, the return to prosperity has been slow. What is needed is enough funding to help countries facing adverse shocks to maintain full employment and grow again (p246).

The solidarity fund for stabilization could be used to fund unemployment and other cyclically related social expenditures and to support active labour market policies that help move people into new jobs in a restructured economy (p246).

What is thus needed is a European-wide small and medium size lending facility, like the United States' Small Business Administration, which provides loans and or partial guarantees for small business loans (p246). The European Investment Bank is the largest multilateral lending institution, a European-wide institution that has succcessfully financed infrastructure projects around the region. That aspect of its mission could clearly be strengthened (p247).

[3] Automatic Stabilizers: When the economy is facing a downturn, money needs to be injected into the system automatically. Unemployment insurance is an example. Normally, as workers lose their jobs from a negative "shock",they cut back on their spending so that the effects get multiplied. But if workers are protected with unemployment insurance, this multiplier is short-circuited (p248).

In joining the Euro, countries gave up the automatic stabilizer of flexible exchange rates, making it all the more important to strengthen other automatic stabilizers. Regarding a banking union, first having coimmon regulation and supervision and then, gradually, perhaps, common deposit insurance is unlikely to work for the forseeable future (p248).

[4] Flexibility in Credit Creation: Credit declines when the country goes into trouble, increasing the depth of the downturn. Some small businesses can't even get enough working capital to function. There needs to be not just a broad mandate, to focuse on employment, growth, and stability, but also a more flexible way in which the eurozone's banking system is run (p249).

Capital requirements can be tightened in those countries facing excess demand. This would force a reduction in lending, which in turn would dampen inflationary pressures there. Similarly, capital requirements could be loosened in those countries facing weak demand (p249).

As another example, lending standards for mortgages should be tightened at a place or time where there appears to be a bubble forming. A key reform for creating a vi able euro is creating an ECB with broader mandates and more instruments, that are more flexibly managed (p250).

[5] Stabilizing Fiscal Policies: Fiscal policy directed at needed investments, needs to be ut more in the center of macro-stabilization. The United States and the EU both need large investments in education and technology, if there are gong to be continuing increases in standards of living (p251).

Recently, Robert Gordon has suggested that we are moving into an era of much slower pace of increase in standards of living. But this is due to decisions made to invest less in basic research, technology and education: it is from these that future increases in standards of living largely come (p251).

This runs counter, of course, to conservative ideology focused on downsizing government. Thus on both sides of the Atlantic, the downturn has been met by cutting taxes for corporations and rich individuals matched by cutbacks in government spending (p251).

Structural Reform #4: A True Convergence Policy – Toward Structural Realignment

The absence of the exchange rate mechanism in Europe means t hat real exchange rates can get out of alignment, as a result of differences in the rates of growth of productivity or prices across countries. There are three parts of the strategy to respond (p252):

[1] Discouraging Surpluses: If the eurozone as a whole typically has a zero balance, that means if some country runs its economic policy in ways that result in a surplus, necessarily other countries must have a deficit (p252). Thus, the surplus countries – Germany in particular – can even be throught of as being a fundamental cause of the fiscal and trade deficits and the unsustainable credit expansion in other countries of the eurozone (p253).

A current account surplus means that a country has to be lending, just as a deficit means that a country has to be borrowing. Germany's surpluses thus almost inevitably led to divergence among the countries of the eurozone (p253).

As noted earlier, no difference is more important than that between a creditor and a debtor, and Germany's persistent surpluses converted the basis of the eurozone from solidarity to the conflicting relationship of creditor and debtor (p254).

Europe needs a true convergence policy, and such a policy needs to discourage surpluses. Keynes proposed a solution – a tax on surpluses. This tax would not only discourage a country from having a surplus, but the revenues could be used to help fund the solidarity fund for stabilization outlined earlier (p254).

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[2] Expansionary wage and fiscal policies in Surplus countries: Under Chancellor Gerhard Schröeder, incomes at the bottom actually fell. It is easier for a surplus country to take actions on reducing its surplus than for the deficit countries to reduce their deficits (p255).

Not only should surplus countries raise their minimum wages, the should strengthen workers' bargaining rights and engage in expansionary fiscal policies. They have easy access to funding for such expansionary policies (p255).

[3] Reversing the other divergence policies: Rich countries have an advantage over poor ones in many ways. They can , for instance, provide a higher-quality education for their children. Europe can't correct for all of these differences – though in the future, with greater solidarity, it can do a far better job (p255).

Structural Reform #5: A Eurozone Structure That Promotes Full Employment and Growth For All of Europe – Macroeconomics

Europe could have a stable economy beset by low growth and high unemployment. That is the direction in which Europe seems to have been moving. It feels satisfied when it manages to prevent another crisis – even if a quarter of its young people are unemployed and growth has been mediocre at best (p256).

The key macroeconomic reform is changing the mandate of the ECB – not just to focus on inflation but to promote full employment, growth, and economic stability. The ECB should have particular responsibility to make sure that the finanical sector is working the way it should – lending to small and medium sized enterprises (p256).

Structural Reform #6: Structural Reforms of The Eurozone to Ensure Full Employment and Growth for All of Europe

Four common structural reforms that can help ensure sustainable growth with full employment:

[1] Making the Financial System Serve Society: There are reforms in the legal, regulatory and tax frameworks of Europe that would help focus the financial sector on the long term – and on doing what it should do, not doing what it shouldn't (p258).

[2] Reforming Corporate Governance: Firms, too, have become increasingly shortsighted, focusing on quarterly returns. Europe has to understand what led to America's short-termism, and to make sure that it takes actions to ensure that the disease of short-termism doesn't spread more to Europe (p258).

Some of Europe's institutions have successfully proven a bulkwark against the extremes found in the United States, where CEO pay has now risen to be 300 times that of the typical worker. The rewriting of the rules in way s that might result in firms focusing on the long term would lead to an economy with higher and more stable growth (p259).

[3] A Super-Chapter 11 for Bankruptcy: A regular feature of capitalism is that firms and households get too indebted; they need a fresh start (p259). In the United States, there is an expedited procedure for forms to go through bankruptcy; their debt is written down quickly, so that the firm can continue producing and jobs are not lost. This is called Chapter 11 (p260).

When many firms and households are simultaneously going bankrupt, it is even more important to have an expedited process – a Super Chapter 11. Such a Super Chapter 11 is particularly important in the crisis countries right now (p260).

[4] Promoting Environmental Investments: A eurozone that works has to have not just high growth but sustainable growth, and sustainability entails not just economic sustainability but environmental

sustainability. But it will be hard to incentivize firms to make “green investments” if there is no price on carbon – that is, if those who pollute are not forced to pay the consequences of their pollution (p260).

That is why it is important for there to be a high, European wide price of carbon (p260).

Competition between jurisdictions can be healthy, but there can also be a race to the bottom. Capital goes to jurisdictions that taxes it at the lowest rate, not where its marginal productivity is highest. To compete, other jurisdictions must lower the taxes they impose on capital. Thus, the scope for redistributive taxation is reduced (p261).

The eurozone’s structure has not only led to more money at the top but also to more people in poverty at the bottom. The failure of the eurozone to create a true stability framework has thus contributed to inequality (p261).

The EU needs to limit the race to the bottom, the kind of tax competition that worked so well for a few countries like Luxembourg but at the expense of the others. This is a real example of an externality – of an action by one country which poses harm on others (p261).

Given t he easy mobility around the European Union, the major responsibility for redistribution must lie at the EU level. The EU shoiuld follow the United States in levying taxes based on citizenship, wherever individuals are domiciled or resident (p261).

A true growth and stability agenda interacts strongly with other elements of the reform agenda: the only sustainable prosperity is shared prosperity (p261). How Europe has responded to shocks has typically exacerbated the downturns rather thatn restored the afflicted countries quickly to full employment (p262).

Germany has emphasiszed the importance of obeying the rules. Of course, obeying the wrong rules can lead to disaster – the wrong rules within the eurozone have led to its poor economic performance. The IMF has often owned up to its mistakes but the other members of the Troika have been less forthcoming (p262).

If the eurozone is to work, it has to recognize large differences among the countries, and policy frameworks have to be sufficiently flexible to accommodate these differences. There has to be a greater ability to adapt to differences in economic circumstances and beliefs (p263).

Even within the United States, each state has wide discretion to pursue different policies. The basic prinicples are understood: those arenas that do not give rise to external effects on other countries should be reserved to the individual countries. This principle is sometimes referred to within the European Union as susidiarity (p263).

Crisis Policy Reform #1: From Austerity to Growth

European leaders have recognized that Europe’s problems will not be solved without growth. But they have failed to explain how growth can be achieved with austerity. Instead, they assert that what is needed is a restoration of confidence. But Europe’s sorry record of failed policies have undermined confidence (p263).

The big winners are the wealthy, who own stocks and oter assets that have increased in value as a result of low interest rates and QE, the big losers are the elderly, who put their money into government bonds, only to see the interest rates generated virtually disappear (p264).

Even with restrictions on the size of the deficit, the government can stimulate the economy; increases in spending matched by increases in taxes increases GDP, because the stimulative effect of the spending is greater than the contractionary effect of the taxes (p265).

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Crisis Policy Reform #2: Toward Debt Restructuring

As noted earlier, the eurozone has taken two strategies out of its toolkit – interest rates and exchange rates. The ECB won't allow inflation, and the Troika wo n't allow indebt ed governments to spend in order to invest in their country's future. That leaves only the third alternative – debt restructuring. Debt restructuring is an essential part of capitalism (p266).

If some country needs debt restructuring to enhance growth, it should be done quickly and deeply. It is important that the debt write down be deep – otherwise, lingering uncertainty about the possibility of another debt restructuring will cast a pall over the recovery (p266).

A deep debt restructuring provides more fiscal space for expansionsary policies, so long as the government does not have a primary deficit. Money that would have been sent abroad to service the debt stays at home (p267).

In one sense, these proposals are modest; they fall far short of the degree of economic and political integration that defines the United States and other federal structures sharing a common currency. But what is required is far more than what exists today (p268).

These changes would at least hold open the promise of an increase in solidarity among European countries, rather t han the divisiveness that has marked recent years. The euro was supposed to set the stage for further political integration. Many thought it would speed up such integration. Today we can see it has had the oppposite effect (p268).

Not surprisingly, many of these reforms are resisted by politicians who prefer the security of being "a big fish in a small pond" to the prospect of playing an uncertain role in a politically more important EU/eurozone. It was simply naïve to believe that sharing a common currency would change these political dynamics (p268).

The euro was not an end in itself but a means to broader ends. So far, the euro not only has failed to achieve these broader ends but has had the opposite effects: poorer growth and more divisiveness. These or similar reforms are necessary to prevent the divergence, instability, stagnation, growth in inequality, and increase in unemployment that have marked the euro project (p269).

Doctrines and policies that were fashionable a quarter century ago are ill suited for the 21st century. The reforms are designed to free the eurozone from its unfortunate historical legacy, and to give it sufficient flexibility to address new problems and to incorporate new ideas as they evolve (p269).

The ECB remains far more constrained, far less well adapted to the economic realities of today than the Federal Reserve. The creditor/debtor relationshop between northern and southern Europe is corrosive. Unless the reforms suggested or something along a similar line are made, this corrosion will only deepen. The damage that is being done will be hard to undo (p270).

There is little liklihood of sufficient progress in undertaking the deep reforms in the structure of the eurozone with sufficient speed. Delay is costly in another way: as Europe struggles with a flawed eurozone, other crises emerge – most notably the threat of a breakup of the nation-state in Spain (p270).

Europe needs urgently to begin thinking about alternatives to the single currency arrangement (p271).

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Can There Be An Amicable Divorce?

Making the reforms suggested previously is the first best course. But there is more than a small possibility that they won't be done. If divorce happens then Europe should strive to make it as amicable as possible (p272).

Is a Greek exit or Grexit possible withouit destroying Greece's economy or imposing high costs on the rest of the eurozone? If Greece could manage then presumably so could countries that are far better off. There will of course be costs (p273).

But there are huge costsin the currrent strategy of muddling through. For the eurozone as a whole, we calculate them in the trillions of dollars. But in a reasonably well-managed divorce Greece would do far better than it is doing under the current programs imposed upon it by the Troika (p273).

The divorce would restore dignity to the Greek people, who have been treated shabbily by Germany and the Troika; it would restore democracy. As say, Greece departs the monetary union, the question is: what would replace it (p274)?

The normal presumption has been that Greece would go back to the drachma, with all the problems associated with that. Those depicting this alternative ignore that in the last two decades of the drachma, Greece grew faster with lower unemployment than in the almost two decades since entering the eurozone (p274).

A Grexit could provide a way from moving from old currency to e-money – in a way that would facilitate the Grexit and strengthen the Greek economy. We now have a much more efficient electronic payments mechanism and in most of the world we could have an even more efficient one , if it were taken out of the hands of the monopolistic financial system (p275).

Electronic transfers are extraordinarily cheap, but banks and credit card companies charge exorbitantly for the service, reaping monopoly profits as a result (p275).

With electronic money , leaving the euro can, in principle, be done smoothy, assuming there is cooperation with other European authorities. Upon a Grexit, the Greek-euro would come into being. It would be money inside the Greek banking system. Everybody could have full use of the money and it would have the same well-defined value relative to the ordinary euro and any other currency (p275).

The government could quickly create new bank accounts for the few people who remain unbanked. While the modern banking system based on fiat, paper, money didn't suffer from the vagaries of gold discoveries, it suffered from something much worse: volatility in the creation of money and credit by the banking system, giving rise to booms and busts that have characterized capitalism (p277).

There are individuals and firms who would like to spend but cannot get access to credit. That is one of the central problems in Greece and Spain. The ECB, with its belief in markets and its misunderstandings of monetary policy, has devoted little atttention to the flow of credit (p278).

A near-zero interest rate does not mean businesses can get access to credit at such a rate – or at any rate. In spite of the single market, there is not a single lending rate. The disparity in lending rates is part of the divergence built into the eurozone system (p278).

There is the worry that leaving the euro could lead to the crash of the banking system and at a minimum a severe heart attack for the economy. This is a false fear. In a modern economy, banks effectively create credit out of thin air, backed by general confidence in government, its ability and willingness to bail out the banks, which includes its power to tax and borrow (p279).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Once we restore a country's economic sovereignty, as the country leaves the eurozone, its ability to create credit is largely restored. It can add "money" to the payments mechanism by lending money to small enterprise with a proven reputation that wants to build a hotel on an island where the demand for hotel rooms has persistently exceeded supply (p279).

Not only didn't the banks make good judgements but they systematically failed to fulfill what they should have seen as their major responsibility – providing credit to businesses to create new jobs. By some accounts their real lending amounts to just 3 percent of their activities. But by any account, bank finance has been absorbed in other directions (p280).

There were always obvious problems in delegating the power of the credit creation system, backed by government, to private institutions: they could use their power to benefit their owners, through what we know as connected lending (p280).

But circumscribing connected lending didn't address the key underlying problem: credit is scarce; giving private banks the right to create crredit with government backing gave them enormous "economic rents" (p280).

They could use this economic power to enrich themselves and their friends. Indeed, it was through the banking system that the Russian oligarchs were largely created. In western countries, matters are done more subtly – but creating enormous inequality – though not of the magnitude of Russia (p280).

Throughout history, moneylenders have had a bad reputation, because of the ruthlessness with which they exploit the poor, especially at moments of extreme need. At such times there is enormous assymetry in bargaining power which the moneylenders sweep in to exploit (p281).

Somehow in the magic of neoliberalism, this long history was forgotten: bankers no only didn't suffer from the stigma of being called moneylenders, they were elevated to being the paragons of capitalism (p281).

Freed of constraints, bankers, our 21st century moneylenders, have shown themselves every bit as ruthless as the moneylenders of the past; in fact, they are in some ways worse, because they have discovered new ways of exploiting both the poor and investors (p281).

The financial sector has enriched itself on the back of government credibility, without performing the societal functions that banks are supposed to perform. In doing so, the financial sector has become one of the major sources of the increased inequality in Europe and around the world (p281).

In effect, in the currrent system all the "value" of the underlying government credit guarantee is captured by the financial sector (p282).

In a 21st century banking system, a bank's ability to lend is, in a sense, given only temporary. It is c onditional on compliance with the rules and standards established. The government would allow for entry into the banking system with an open auction of rights to issue credit, which would make competition more vigorous than under the currrent arrangments (p283).

The system of auctioning credit woiuld ensure that banks not earn excessive returns; most of the value of the public's backing to the creation of credit would be captured by the public, rather than as now by the bankers (p283).

At the same time, the new system of credit creation ensures that the social functions of finance are more likely fulfilled, at least better than under current arrangements (p283). One of the major contributors to macroeconomic instability is the instability in credit supply, in particular, to the supply of credit for the purchase of produced goods and services (p284).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Ensuring greater macro-stability would do more than anything else to ensure the viability of the banking system (p283). As noted, the government can simply create credit through a government bank or delegate credit creation through auction mechanism just mentioned (p284).

If the government is dong an adquate job of bank supervision and has imposed appropriate regulations, for example, on connected and excessively risky lending, the amount of capital required will be limited (p285).

Freed from the conditions imposed as part of the “assistance”, freed from austerity and counterproductive structural reforms, a country would actually be in better shape. Greece, the worst afflicted of the crisis countries has virtually eliminated its trade and its fiscal deficit (p285).

If the elmination of those deficits had been the sole objective of the Troika programs, then the Troika programs could be declared a success. But the goals were broader and the costs of achieving the reductions in the trade and fiscal deficits has been absolutely enormous (p286).

Outside the eurozone, Greece or any of the other crisis countries would be able to use the flexibility in its exchange rate to corrrect any trade imbalance and strengthen the economy (p286).

A further concern is will those who export to Greece be willing to accept Greek-euros as payment? They almost surely would. The modern financial markets know full well lhow to manage those risks (p287).

The current account deficit can be managed through trade chits. Under this proposal, government would provifde to any exporter a chit, a “token”, electronically recorded, the number in proportion to the value of what was exported. To import a Greek-euro worth of goods, there would be a requirement to pay a Greek-euro’s worth of chits or “trade tokens” (p287).

With the system of trading chits, the trade deficit can be controlled, enhancing overall stability. Where every import needs a chit, there is either a trade surplus or a trade balance. The government coiuld use this system to limit the size of the deficit or surplus as well (p288).

By issuing both import and export chits, the trade balance can be kept within any prespecified bounds. The experience of Europe, and elsewhere, has shown that it is not so much government borrowing that gives rise to crises, but national borrowing (p288).

In some cases, the national borrowing was government borrowing as in the case of Greece, but in many other cases such as Ireland and Spain, it was private borrowing. When a crisis hits, the debt quickly moves from the private balance sheet to the public’s (p289).

Greece can easily survive withoiut the funds from the IMF and the eurozone. It has done a good job of adjusting its economy it had a trade surplus by 2014. There will be uncertainties in the process of leaving the eurozone but Europe should help with “adjustment assistance” in the transition (p290).

Solidarity would suggest that the money be in the form of grants. Even if the assistance was not forthcoming, the transitions could be managed with relative smoothness. If there is a need for government finance beyond the amount that would restore the economy to full employment, then government will have to raise taxes (p290).

The information available through the electronic payment system, will, however, enable it to do a much better job of collecting taxes already on the books, making the necessity of raising tax rates even less likely. Most of the crisis countries have a large debt denominated in euros (p290).

As mentioned, debt restructurings are a central feature of modern capitalism. Still, they are often contentious. The Greek government could do a few things to smooth the process. First, the government should declare all euro-denominated debts payable in Greek-euros. Such redenominations have happened before. Indeed, upon entry ionto the eurozone, debts that had been denominated in drachmas got converted into euros (p291).

If the Greek euros trade at a discount relative to the ordinary euro, it would be tantamunt to a debt restructuring, but one done smoothly (p291). With a backdrop of European solidarity, Greece could proceed with a debt restructuring that went well beyond the minimal set of principles adopted by the international community in 2015 (p292).

Simply having Greece leave will not resolve the problems of the eurozone, either now or in the long run. Germany and perhaps some other northern European countries coiuld leave. This would be an easier way to bring Europe back to health (p292).

The departurre of so me of the northern countries would allow an adjustment of the exchange rate of the remainder relative to that of the northern countries (p292). The downward vicious circle that has been part of Europe since the onset of the crisis would be replaced by a virtuous circle of growth and prosperity (p293).

The increased strength of the econmies in southern Europe w ould enable them to service their debts, and even pay down some of the debt. What is at fault is the structure of the euro itself. Greece had many negotiators with a panoply of styles, and none fared well. There is really no need for recrimination (p294).

Many within Europe will be saddened by the death of the euro. But it is not the end of the world; currencies come and go. The euro is just a 17 year old experiment, poorly designed and engineered not to work (p294). It is better to abandon the euro to save Europe and the European project (p295).

Stiglitz, Joesph (2016). The Euro and it’s threat to the future of Europe. Penguin Random House UK.

Toward a Flexible Euro

Europe today would like to pretend that if only member countries could obey the rules, if only there had not been an American-made financial crisis, all would be well. But in its heart of hearts, Europe must know that is not true (p296).

Countries that obeyed the rules went into crisis and so it was not just the southern countries or countries on the periphery, but also Ireland and Finland. The nature of the market economy is that "stuff happens". And that stuff that happens affects different countries differently, and requires large adjustments. The euro makes those difficult at best (p296).

The alternative to an amicable divorce involves "more Europe" and must surely be the best path forward for Europe. But it appears too much for at least some of the countries in the eurozone to stomach. The amicable divorce is equally unpalatable (p297).

Sharing a commony currency is not, or should not be, at the heart of the European project, but perception is, at least to some extent, reality. If significant numbers of people in Europe see an amicable divorce as a surrender, then it coiuld set back the agenda for European integration (p297).

One last alternative - the "flexible euro". It entails recognizing that there has been some progress in creating the eurozone, though not enough to make the single currency work. The hope is that different countries or groups of countries could have their own euro (p298).

Over time, perhaps with the evolution of sufficient solidarity, those bounds could be reduced, and eventually, the goal of a single currency set forth in the Maastricht Treaty of 1992 would be achieved (p298).

Each country or group of countries could create an electronic currency – along the lines described in the previous chapter. Money could be easily transferred from one person's account to another, for instance, upon the purchase of goods and services (p298).

Countries could decide to allow a trade deficit or insist on a trade surplus, simply by changing t he ratio of chits, described earlier, one received for a euro of exports relative to those needed for imports (p299).

In this system, the value of one country's euro could verary relative to that of another's. This is the flexibility in exchange rates that the current system lacks (p299).

Eurozone leaders, if they wished, could achieve parity among the different or regional euros simply by adjusting the chit system. The eurozone approach of trying to achieve the desired real exchange rate adjustments t hrough magical productivity adjustments has been very painful (p300).

Europe has put in place a process of productivity divergence, as the sources of finance in weak countries sour and as public investments in infrastructure, education and technology plunge (p300).

If the eurozone follows through quickly on its commitment to create a real banking union, with common deposit insurance, it would do much to prevent the extremes of divergence in access to private finance. So, too, if Europe were to encourage industrial policies, rather than proscribe them, the lagging countries would have a better chance of converging toward the leading ones (p301).

If we look inside the countries, matters are bad: workers and small businesses are paying he price but it was others who benefited in the creation of the earlier imbalances. We are asking innocent bystanders to pay for the mistakes of others (p301).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The system is rife with externalities – where the actions of some individuals and firms impose high costs on others. Whenever there are externalities, there is a need for public action. America's banks polluted the global economy with toxic mortgages: regulators should have done something about this, but they didn't (p302).

Within the eurozone, something similar occurred. In some cases such as Ireland and Spain, there was a real est ate bubble, in others, the excesses took different forms. Some might complain: Aren't we interfering with the market. But the eurozone itself is a massive interference with the market (p302).

It fixes a critical price, the exchange rate. It says there has to be a single interest rate for the entire region, set by a public body, the ECB. Europe has gotten itself into the current mess partially by assuming that markets are more perfect than they are (p302).

Markets exhibit enormous volatility in both prices and quantities: interest rates demanded of borrowers from different countries have moved violently in different directions, and capital and credit flows have fluctuated in ways that are virtually uncontrollable under current arrangments (p302).

Workers are told that they shoiuld simply accept being buffeted by these maelstroms that are not acts of nature but creations of irrational and inefficient markets (p302). Workers should accept wage cuts and the undercutting of social protections, in order for the capital markets to enjoy their "freedom" (p303).

The flexible euro system is intended to bring a modicum of order to this chaos, which has not even produced the higher growth in GDP that was promised – let alone the social benefits that were supposed to accompany this higher GDP (p303).

Decades ago we learned that one could not let a market economy manage itself. That is why every country has a central bank determining interest rates and regulatory authorities overseeing banking. Some arch-conservatives would like to roll back the clock – to a world without central banks and with free banking with no restraints (p303).

Anyone who has read his economic history knows what a disaster that would likely be (p303).

European cooperation would be helpful to ensure smooth functioning of a flexible euro. Even if there is hesitancy on the part for this proposed alternative, the system is such that it can be undertaken by any grouping within the eurozone. These countries would then work together to ensure the realtive stability of movements in the local euro exchange rates (p304).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The Way Forward

The underlying flaws in the contstruction of the euro were part of flaws in economic understanding but also in part of lack of political wll and solidarity. The same lack of economic understanding and solidarity led to the flawed response to the crisis (p306).

The euro was supposed to “serve” the European people; now they are asked to accept lower wages, higher taxes, and lower social benefits, in order to save the euro. And it’s not just Europe’s economy that is being sacrificed but, in many ways, confidence in its democracy (p306).

Economists have a poor record in forecasting but the Troika may have set new records in serially bad forecasting when it came to their programs around the eurozone – political forecasting is even more difficult (p307).

The afflicted countries will be given just enough hope for the furture to stay inside the eurozone. The citizens of Greece and other afflicted countries irrationally see not being in the eurozone as not being part of Europe or the EU, forgetting about Denmark, Sweden and the UK, which are in the EU but not in the eurozone; or forgetting about Switzerland, Iceland and Norway, which are not even in the EU but which are very much part of Europe (p307).

No one can be sure when the political will sto stay in the euro will break in one country or another. But when that break does happen, there is a risk of the floodgates crashing down: if any country exits smoothly , then almost surely others will join (p307).

Europe’s leaders viewed themselves as visionaries when they created the euro. They thoiught they were looking beyond the short term demands that usually preoccupy political leaders. The future of Europe now depends on whether the current political leaders of the eurozone can combine a modicum of economic understanding with a sense of European solidarity (p308).

One possiblility, a real one – is that the architects of austerity truly believe in the economic doctrines they espouse, in spite of the overwhelming evidence against them accu mulated over more than three-quarters of a century (p308).

Advances in beharioural economics and psychology provide some explanation for the persistence of such beliefs - the theory of confirmation bias holds that individuals discount informaiton that is not consistent with their prior beliefs. And in our complex world, it is easy to do so (p309).

Arguments such as: the programs were well designed but the failure was one of implementation on the part of a country, are disingenuous – an attempt to shift blame for the failure of the program onto the victim of the program (p309).

There was an attempt to blame Greece for the poor performance and even the poor design of the program. But Greece negotiated progams with the troika over a half-decade, first with a mild-mannered, intelligent, conciliatory Georte Papandreou, then with his successor, Antoinis Smaras, and finally with the Syriza government. It is hard to detect much, if any, difference in outcomes (p309).

It is not surprising that Germany and others in the eurozone would blame Greece. They would rather hold onto their incoherent and discredited theories; to reconcile what happened with what their theories predicted meant that they had to blame Greece (p309).

Even the way the money was given to Greece had the effect of making Greece look more dependent on Germany and its other eurozone partners than it was. The short-term credit with tranches being dribbled oiut, helped reinforce the unfavorable image of Greece (p310).

Stiglitz, Joesph (2016). The Euro and it’s threat to the future of Europe. Penguin Random House UK.

As we've seen, Greece has gotten but a pittance of the money loaned – most of it went to private sector creditors – but it has paid a high price to preserve other countries' banking systems. In the case of the predatory lender, it is about money – the banks and other predatory lenders have figured out how much they can fleece poor people within the law (p310).

Politically, it was unpalatable for any Greek politician who cares about his country to simply throw people out into the street, as one Troka demand implied. But with Greece resisting the Troika time after time it looks like an unrepentant borrower. At least back at home, Germany's case for treating Greece so tough was reinforced (p311).

The German attitude – "there is no alternative", referred to as TINA, set the tone for the noegotiations. When individuals come to a belief that is countered by evidence – beliefts that cannot and will not be shaken by evidence – we say that they are blinded by ideology (p311).

In the arena of economics, so closely linked to politics and policies that shap society, it is no surprise that ideologies often play an important role. Almost as surprising as the Troika's not learning from history – that such private and public austerity virtually always beings recession and depression – is that Europe's leaders have not learned from the experiences within Europe (p312).

The IMF should be complimented at least for recognising some of the mistakes in the policies that had been imposed in cases like Greece and Ireland. Apparently, the other members of the Troika were unhappy with such honesty (p312).

Why would Europe act in this way? Why did European Union leaders resist Papandrewou's first proposal for a referendum, or the Syriza government's 2015 referendum – refusing to extend even by a few days the June 30 deadline for Greece's next payment to the IMF? Isn't Europe all about democracy (p312)?

That concern for popular legitimacy was incompatible with the politics of the eurozone, which was never a very democratic project. When Sweden and Denmark sought public approval to join the eurozone, their citizens said no (p313).

Perhaps these polities understood that unemployment would rise if the country's monetary policy were set by a central bank that focused single-mindedly on inflation. Today, part of the popular resistance to the euro is the concern of excessive influence of Germany and the ideas and ideologies that prevail there (p313).

In many other countries, prevailing opinion agrees with those expresed by the research department of the IMF: austerity is contractionary and the Troika policies are coiunterproductive. Yet somehow the old adage that "he who pays the piper calls the tune" has by and large played out (p313).

With the strongest economy in the eurozone, Germany's dominance of policy is perhaps not a surprise (p313). But even I n Germany, some polls show that almost two-thirds of its citizens think their country would be better off outside the eurozone – though for different reasons (p314).

They believe that they will eventually be forced to "share" with their poorer neighbours to the south in some bailout. What unfolded 16 years after the start of the eurozone was the antithesis of democracy: Many European leaders in Europe wanted to see the end of Prime Minister Alexis Tsipras's leftist government (p314).

They seemed to believe that they could bring down the government by bullying it into accepting an agreement that contravenes its mandate. In the end, they failed to bring down the government – Tsipras was given a new mandate in 2015 with an even larger majority (p314).

But he was forced to accept conditions that were antithetical to what the vast majority of Greece's people wanted. To enforce the rules, Wolfgang Schauble, Germany's finance minister, together with Karl

Lamers, the CDU former foreign affairs chief, have proposed “ a European budget commissioner with powers to reject national budgets if they do not correspond with the rules we jointly agreed”. In effect, an appointed commissioner would have the ability to veto the action of national parliaments (p314).

Though few would admit it, the debate – the struggle – over the euro is as much or more about power and democracy, about competing ideologies, visions of the world and the nature of society, than it is about money and economics (p315).

This is not simply an academic debate about left and right. In the current case, the Greek, Portuguese and Spanish citizens seem to have ba better grasp of economics than Germany’s finance minister or the Troika (p315).

Even if one weren’t deeply committed to democracy and the democratic process, the success of the programs being foisted on the crisis countries depends in part on “ownership”, on their believing that the medicine, as painful as it is, is the right medicine. The polls show convincingly that the majority have not been convinced (p315).

In the days of the repeated crises in emerging markets, when the IMF programs failed, the IMF would say that the programs were well designed. They wanted to shift the failures to the countries : the problem was with implementation. So, too, with the repeated failure of the Troika programs (p316).

It was the so-called experts in the finanical sector who developed regulatory and macro-management models that led to the crisis in 2008. It was the experts who believed that the euro would lead to stronger economic performance (p316).

In much of the world, there is a growing understanding that the ideology of the right has failed, and so, too, its economic doctrines of neoliberalism. Beginning around 1980, the country began a bold experiment, of lowering taxes at the top, allegedly to improve incentives, and “free the econmy”, deregulationg, especially the finanical sector (p317).

The results are now in: the bottom 90 percent have seen their incomes stagnate, large proportions of the populatjion have seen their incomes fall. Only those at the very top have done well. The right rewrote the rules of the market economy in ways that benefited the few, that is whey there is now a campaign to wonce again rewrite the rules, but this time to benefit the vast majority of Americans (p317).

The eurozone was another attempt to rewrite the rules – another attempt that has led to more inequality and economic stagnation. With these ideas having failed on both sides of the Atlantic, it is no wonder that their devotees are on the defensive and have to rely on force to achieve their political ends (p317).

The issue here however, is not who is right or which view is right. The economic framework of the eurozone is being used to push for a particular set of views concerning the economy and society – and these persepctives are effectively being imposed on the crisis countries (p318).

Europe was the source of the Enlightenment, which resulted in the increases in living standards that have marked the last two centuries. The enlightenment, in turn, giave rise to modern science and technology. We too often forget that for eons before, st andards of living had changed little (p318).

America was lucky to have been founded just as these ideas were percolating, and so one sees them strongly reflected both in its Declaration of Independence and its Bill of Rights. The struggle to create political and social systems fully reflecting these enlightenment values is never ending (p319).

Economic divergence, especially when combined with a sense of unfairness and deep differences in views about values and economic principles, makes it difficult to forge a European consensus around other issues. European solidarity and even a minimal sense of justice and fair play, have withered (p321).

Stiglitz, Joesph (2016). The Euro and it’s threat to the future of Europe. Penguin Random House UK.

In many ways, we have become a global community – a community with a system of global governance without global government. The voice of Europe with its values needs to be heard, and it will be heard more clearly if the European project succeeds. It will not be heard if Europe is in disarray and there is not shared prosperity (p322).

The experiences of the eurozone have one further important lesson for the rest of the world: be careful not to let economic integration outpace political integration. A variety of proposals for monetary unions elsewhere have been quietly put on the back burner (p322).

Another lesson is that markets are complex institutions: simplistic tinkering, based on ideology rather than a more profound understanding of how markets actually work, can lead to disastrous outcomes (p322).

Too often, it seems as if saving the banks or even just the euro is given precedence over human welfare. Success is measured in sovereign bond spreads – the difference between what the bonds in Greece or Italy are paying and those that Germany is paying. When the spreads came down, victory was declared (p323).

So, too, programs were decalared a success when unemployment started to fall or GDP started to grow – not when unemployment or living standards were restored to what they would have been but for the crisis (p323).

There should be a single, simple measure of the success of any economic program, and that is the well-being of a country's citizens, and not just the top 1 percent. Well beeing is more than just income. For most individuals, meaningful and decent work is an important part of their life, and an economy that deines meaningful work for large fractions of its citizens is a failed economy (p324).

For young people, the prospect of living their dreams, a life with hope and aspirations, is critical to their well-being. For old people, a retirement with dignity and a modicum of security is essential to well-being (p324).

Research on individual and societal well-being has shown perhaps the obvious: individuals care about security and about jobs. A symptom of how bad things have become in many of the crisis countries, has been the dramatic rise in suicides (p325).

The euro's moment of glory was short, even in the brief time it seemed to be working, the imbalances that would eventually bring on the euro crisis, were building up, and the euro is to blame. The euro can be saved, and should be saved but saved in a way that creates the shared prosperity and solidarity that was part of its promise (p325).

The reforms are not economically difficult; they are not even institutionally difficult. But they require European solidarity – a kind of solidarity fundamentally different from the suicide pact that some leaders within Europe are calling for (p325).

Fo all the emotions that the euro has brought on, it is just an artifice, a human creation, another fallible institution created by fallible men (p325).

Three messes emerge clearly from this analysis. A common currency is threatening the future of Europe. Muddling through will not work. And the European project is too important to be sacrificed on the cross of the euro. Europe – the world – deserves better (p326).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Afterword: Brexit and Its Aftermath

Britain's June 23, 2016 referendum on leaving the European Union – by a vote of 52 percent to 48 percent – set forth a firestorm of political and economic upheaval on both sides of the English Channel. Europe's response was dominated by the same harsh respnse that greeted Greece's June 2015 ballot-=box rejection of its bailout package (p327).

Herman van Rompuy, former EU council president called the referendum "the worst policy decision in decades". In so saying, he revealed a deep antipathy towards democratic accountability. But in most cases in which voters have been directly turned to, they have rejected the euro, the European Union, and the European Constitution (p327).

It seems in the interests of everyone for there to be an "amicable divorce", to work out the best economic relationship consistent with the democratic wishes and concerns of those on both sides of the channel (p328).

Anything the EU does to the UK to try to punish it would have an "equal and opposite effect", hurting itself at least as much in the process. Jean Claude Junker's line is that Europe must be unrelenting in its punishment, and should offer little more than what the UK is guaranteed under normal global agreements (p328).

What a respons! According to Juncker, Europe is not to be held together because of he benefits that accrue. No, Europe is to be held together by threats and fear – of what would happen if a country leaves (p328).

Most politicians in the UK are arguing for a careful and judicious divorce; they are even hoping for an amicable one.Many in Europe just want a quick divorce. And as noted, some like Juncker want a settlement so painful that no one should ever again think about leaving the Union (p329).

The UK was wise not to join the euro but the failures of the euro nonetheless reverberated in the UK referendum. Neoliberalism and the perspectives of corporate elites provided the intellectual lodestar guiding not just the creation of the euro, but much of the evolution of the European Union (p330).

The EU will have to disengage itself from such ideology and the interests it serves. A common theme contributed to the outcome of both the American Republican primaries and the British EU referemdum: large portions of he population have not been doing well (p330).

The neoliberal agenda of the last third of a century might have been good for the 1 percent but not for the rest. This stagnation, or worse than stagnation would eventually have political consequences. That day now appears to have arrived (p330).

For the U.S. the data reveal the dire straits in which we find ourselves: median household income, adjusted for inflation, is today less than 1 percent higher than it was in 1989. Death rates have increased, including from social diseases like drug abuse, alcholism and suicide (p331).

The data for the UK and Europe is only a little better. There are two categories which lost out in those three decades, and continue to suffer or stagnate. Those at the very bottom, including poor farmers in the poorest countries, have been hard hit by trade agreements that allowed the rich countries to maintain their massive subsidies (p331).

But t he group that did worst of all - seeing virtually no groth in their incomes in the span of two decades – was the working class in Europe and America. Things were not going well for them before the crisis but the crisis made things much worse, especially for the most vulnerable (p331).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

Massive and controversial cutbacks in the basic fiber of society – in health care and welfare – were required to make up for he largesse of the banks. It all seemed so unfair – and it was. A third of a century ago, the bankers and others from the elite implicitly made a set of promises, not dissimilar to those made at the time of the founding of the euro (p332).

The result: growth slowed, and economic stagnation and increased insecurity followed for vast portions of society. Most European countries, with the exception of Scandanavia, were not far behind. On both sides of the Atlantic, many on the left bought into some of the neoliberal ideas (p333).

Their critique of the right was that it had a cold heart. But it became increasingly difficult to distinguish between compassionate conservatives and the "new left". Bill Clinton in the US, Tony Blair in the UK and Gerhard Schroeder in Germany all introduced reforms that those on the right had struggled to make for decades (p333).

Elites within the left and right seemed to have reached a broad consensus about many of the tenets of the economic order. There were just disagreements about details. There was broad support on the center-right and the "new" left for an economic agenda which included liberalization and deregulation, globalization, and lower taxes (p333).

But this elite center-right/center-left consensus wasn't really working for most citizens. The economic and political order just wasn't delivering for most Americans and Europeans. Citizens knew that the system was unfair and rigged, but after the crisis and the lopsided "recovery" they saw it as even more unfaire, more rigged than they had imagined (p334).

They lost what little trust they had in the political process to correct it. They voted for politicians who promised to rectify the situation. Barack Obama campaigned on a platform of "change you can believe in" but somehow it didn't happen (p334).

Little wonder: the politicians in the US and the UK and elsewhere were to a large extent of the same ilk, servants of the same ideology; accountable to the same special interests as those that had promised that globalizaton would bring benefits for all (p334).

Weakening bargaining positions of workers, for instance, meant a declining share of labour and greater insecurity. It meant too that there was no counterbalance to corporate political influence. Financializsation, accompanied by short-termism, led to lower growth so that workers were getting a small slice of a small pie (p335).

The right – Conservatives in Britain and the Republicans in the US said we simply needed to double down on our bet: more of the same would do the trick – more budget cuts, more trade agreements, more financial market liberalization, lower tax rates for corporations and individuals (p335).

It was like medieval blood-letting: when the doctors saw the sick patient was not recovering, they demanded still more blood letting – it was clear that the bad humors that wre causing the disease were still present (p335).

Within the eurozone, the center-left was defending the failed policies that have been shown to lead to stagnation and worse. Their citizens grasped that austerity wasn't working, but Germany would have none of it (p335).

So austerity continued, and citizens felt increasingly disempowered. What they cared about most – the decisions that affected their lives and livelihoods – were seemingly out of their hands, and in their hands and in the hands of those without democratic accountability (p335).

The UK, of it's own accord, had imposed austerity on itself. The Tories were under the influence of the same mistaken economic doctrines, the same ideology that prevails in Germany. They believe that the deficit is the source of the UK's economic weakness. They also believe that through trickle down economics, this growth would benefit all (p336).

The center-left and center-right have two problems. They are unable either to adequately explain why what they promise has not been delivered or to provide viable alternatives. More broadly, they have lost their credibility. Given the gap between what they promise and what is delivered, why should they be trusted (p336)?

This has left an opening for those of more "extreme" positions of both the left and the right. Actually, what gets labeled now as the "far left" is what, in another era, would pass for moderate. The Center with its neoliberal ideology, has moved so far to the right that so-called mocerates no longer seem so (p336).

These moderates, now viewed as extremists, habe put forward an agenda which would actually lead to more growth and more equality. They have called for an end to austerity and recognition that any change in economic policy may have large distributive consequences which have to be taken into account (p336).

The extreme right has focused on two themes, besided the excesses of the financial sector: trade and immigration. There is more than a grain of truth in the charges that trade liberalization and immigration have played important roles in the plight of the working class, as uncomfortable as that reality is to the center of politics (p336).

The minimum wage was raised in the UK from £6.70 to £7.20 per hour, and with further planned increases to about £9 per hour by 2020. It wasn't enough but it was still something, especially when seen in comparison with the seemingly much richer US, where the minimum wage remained at $7.25 an hour, lower than it had been in the late 1950s in inflation-adjusted terms (p337).

Ironically, the most important policy that would have led to more jobs would have been an end to austerity. On both sides of the Atlantic, citizens seized upon trade agreements as the source of their woes (p338).

The Trans-Pacific Partnership, TPP and the Transatlantic Trade and Investment Partnership, TTIP have been negotiated in secret, with corporate interests at the table – but not those of either ordinary citizens or workers (p338).

Unemployment has remained stubbornly high in Europe and destrruction of jobs in one sector does not automatically mean the creation of jobs in another. All that the argument "trade is good" I mplies is that the winners *could* compensate the losers, but that doesn't mean that they *will*. Under neoliberal policies, they *don't* (p338).

Without generious compensation and active training policies, trade has hurt many people. And those who have been hurt are angry, and feel they were lied to by centrist politicians who said that the new trade agreements would make them better off (p340).

They feel even angrier as they are now told that t hey not only have to accept cuts in wages and job protections, but also in social programs upon which they rely – in order to "compete". The politicians who told them that these trade agrreements would make them better off are now telling them that to "do well" under these trade agreeements, they must accept a substantial lowering of their standards of living (p340).

No wonder they no longer trust these politicians or the political system.

The subject of migration has become even more tinged with emotion than trade. Many of the refugees are victims of civil conflicts to which Western powers contributed, both by what they did and did not do.

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The colonial leagacy still plagues many of these ex-colonies, and providing help to the refugees from this oppression is the moral responsibility of all, but especially the ex-colonial countries (p340).

In labour markets this means that an influx of more unskilled workers leads to lower wages (p340).

Within Europe, places that have done a better job in reducing unemployment will predictably get more than their fair share of refugees. Workers in these countries bear the cost in depressed wages and unemployment that is higher than it would otherwise have been, while the corporations may celbrate the benefits of getting cheapter labour, the burden falls on those least able to absorb it (p341).

Therefore, the generosity is largely borne on the back of ordinary workers – and among t he beneficiaries are the corporations who could obtain labour at a lower cost. The leaders of Europe are working at the behest of corporate interests – for whom t he stress on workers is precisely what they want – to have a more pliant labour market, one where the power of unions could at last be broken (p342).

The neglect of the adverse effects on workers was totally consistent with the perspective of those who see so much of the EU's neoliberal agenda as working in the service of corporations (p342).

As in trade, the advocates of immigration liberalization overestimate the overall benefits, and under estimate the distributive consequences. If the most talented individuals from Greece migrate out of the country, it can result in weaker job-creation and lower wages for the unskilled workers remaining behind (p342).

Thus, Germany and other European countries get improved health services while the Greeks suffer from poorer access to doctors. Outside the unrealistic models of perfect markets, free mobility of capital and labour can lead to divergence rather than convergence. Free migration may result in a lowering of the welfare of both the country receiving the migrants and the country sending them (p343).

The only sure winners are the migrants themselves and the corporations that get their cheaper labour. While the neoliberal analysis of migration was clearly flawed, it was as wrong to focus on immigration as the source of the plight of workers as it was to focus on trade (p343).

Free migration was like the euro: an example of economic integration outpacing political integration. Putting a single currencey before the institutions that would make it work has been an economic and political disaster – impeding further economic and political integration. The same goes for migration (p344).

Within the UK there was great skepticism about the EU at the time of joining, perhaps more skepticism than elsewhere in the region, and what has happened since has only made matters worse. Europe, and especially the eurozone, has been badly mismanaged, to the point where average unemployment in recent years has been persistently above the American rate, and frequently in the double digits (p344).

With English becoming the universal language, migrants find it particularly attractive. Not tied to the euro, it has also been able to achieve high employment – making it very appealing to immigrants just happy to have a job (p344).

The dysfunction of the eurozone, the trampliong of sovereignty in the crisis countries, has made Europe a "club" that seems less and less attractive – especially as Germany has seemed to dominate in a high-handed way that seems offensive to many (p344).

If those policies had been able to restore these countries quickly to full employment, that would have been one thing, but the abject failure of such policies – combined with the arrogance and unforgiving way in which they have been implemented – has only made things worse (p345).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

This in turn has reinforced a long standing view of the EU as a rule-bound, unthinking bureaucracy. The UK's Conservative Party had long played on this. It was a useful ploy, to blame the EU bureaucracy for whatever ills befell the country, and these views may also have reinforced existing stereotypes (p345).

What has happened inside the eurozone has fed another long standing view of the EU: that there is a large democratic deficit. And while the british did not suffer directlty from the democratic deficit so evident in the euro crisis, it played directly into their perceptions of the EU itself (p345).

Attention since mid-2015 has shifted from the euro crisis to the migrant crisis – the hundreds of thousands of refugees, mainly from war-torn Middle east, and especially Syria, but also from North Africa, sub-Saharan Africa, and farther afield (p345).

We have a global economic system that leads to prices for cotton that are so low that a Mali farmer cannot support his family – and migration is the only way to stave off death for his children. Europe managed the migrant crisis poorly (p346).

The divergences across Europe to which the euro contributed made this almost inevitable: it was hard to construct an equitable burden-sharing agreement. From an economic perspective, it made sense for those countries with near full employment to accept the lion's share of immigrants, and for the wealthier countries to help the poorer countries with the social costs of immigration (p346).

But Germany repeatedly stated that "Europe is not a transfer union", blocking this just and reasonable approach. The immediate aftermath of the referendum was as bad, or worse, than those arguing for "remaining" had claimed. The pound fell almost 11 percent in four days, to a 30 year low. The stock market fell dramatically. The rating agencies downgraded British debt (p346).

But the reality is that the UK is not likely to be much worse off – and potentially better off – so long as the divorce is not too unpleasant , and so long as Europe doesn't violate its obligations under WTO rules. The United States and Canada have both prospered without free migration between them and withoiut a single market or full economic integration (p348).

The world has suffered greatly from warring countries and some degree of global cooperation is clearly beneficial. The principle of subsidiarity is cru cial: that those activities which are local in nature, which have limited externalities on others, should remain to be decided at a lower level of government (p349).

The eurozone thought that limited fiscal deficits and public debts wree critical to making a single currency work. In so thinking, the founders of the eurozone created a divergent system that has contributed strongly to the eurozone's stagnation and growing lack of political solidarity (p349).

The current president of the European Commission, Jean-Claude Juncker, in his role of Prime Minister of Luxembourg, was the master of the race to the bottom. Of course, this race served corporate interests well (p350).

In trade negotiations between the US and Europe, the US has demanded that consumers not have the right to know – that there be no labelling on food products. This is because labeling puts American GMO products at a disadvantage. So far, in this case, the EU trade negotiators have not given in (p351).

Many in Europe argue that if the UK is to be given any special benefits, the UK must accept the principle of free migration. In doing so, they are attempting to link trade and financial market integration with labour market integration. This kind of linkage makes little sense (p352).

It is not as if the UK's stance on immigration gives its banks or its car manufacturers a competitive advantage. Clearly, if one were to worry about "unfair" competitive advantages in labour markets, one should worry about the lack of an adequate minimum wage or adequate job protection. But Europe has been silent on these matters (p352).

Stiglitz, Joesph (2016). The Euro and it's threat to the future of Europe. Penguin Random House UK.

The UK has been the strongest advocate within the EU for "light" regulation, both under Labour and the Conservatives. The financial sector may be worried that without the pressure from the British, the demand for stronger regulation from so many European quarters will prevail (p353).

The reality though is that the unrelenting commitment to austerity by the European Commission will probably do more to encourage the exit from the eurozone than anything the UK does. It is the failure of the eurozone not Brexit – that will in the end undo the eurozone (p354).

Hopefully, the Brexit referendum will be a wake-up call to the EU's leaders: unless they make the EU more democratice, more democratically accountably, and more economically successful, the likelihood of further integration, political or economic, could be nil (p354).

The failure of the EU to deliver economically for large parts of its citizenry is not because of inexorable economic forces: it is the result of economic policies, too often shaped by neoliberal ideology and corporate and financial interests (p354).

The citizens should want to be in the EU because of the prosperity it brings, not because they fear the wrath that will be brought down upon them by their friends and neighbours if they leave (p354).

If the euro is to work, there has to be more Europe – not necessarily like the Federal structure in the US, but still far more than exists today. The current half-way house is unsustainable. One cannot have an economic union without some sharing of the risks and burdens (p355).

To abide by the refrain "Europe is not a transfer union" means that the euro cannot work. Many of Europe's leaders have been quick to dismiss any move towards "more Europe". Europe is not ready for it, so they claim (p355).

But if that is the case, neither is Europe ready for a single currency or f ree migrati on or a single market. If more of the countries in Europe succeed in attaining full employment, that will automatically result in better burden sharing, and enhance the willingness to accept new migrants (p356).

But if Europe continues with changes in labour legislation that weakens workers' bargaining rights, and if, as expected, wages don't rise very much, that will increase the resistance to accepting new migrants (p356).

The evisceration of the middle classes and its consequences is much the same on both sides of the Atlantic. But voting in anger does not solve the problems. It may lead to politicians in power and a political and economic situation that is even worse for those who have voted that way (p357).

The European project was intended to bring countries closer together. In some ways it has worked. Young people all over Europe now identify themselves as Europeans. They are hopeful about the future of Europe. Perhaps it is simply naïve youthful enthusiasm (p357).

But their elders have lost hope and for good reason. They have seen a project intended to promote solidarity and well-being do just the opposite; it seems held hostage by corporate interests and neoliberal ideology (p357).

At both sides of the channel, politics should be directed at understanding the underlying sources of anger; how, in a democracy, the political establishment could have done so little to address the concerns of so many citizens (p358).

This can't be done with the neoliberal ideology that has prevailed for a third of a century.So few of the leaders on either side of the channel understand this (p358). The Brexit referendum was a shock. The shock may set off waves on both sides of the channel that will lead to a new, reformed European Union.

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