Eurozone Groupthink and Denial on a Grand Scale

William Mitchell[1]
University of Newcastle, Australia

1. Introduction

> *Thrall* … slavery, bondage … a state of servitude or submission (Merriam Webster online dictionary).
>
> *Groupthink* … a pattern of thought characterized by self deception, forced manufacture of consent, and conformity to group values and ethic (Merriam Webster online dictionary).

This paper is drawn from Mitchell (2015), which traced the origins of the Eurozone back to the desire in the immediate post-World War II period to end the destructive Franco-German rivalry that had caused several major military conflicts, which culminated in German aggression in 1939. Against this background, Mitchell (2015) also examines the way in which the discussions of European economic integration, which had initially begun with the general context of a Keynesian approach to economic policymaking, were transformed by the emergence of Monetarism in the 1970s. The flawed design of the Economic and Monetary Union (EMU) that was finally agreed on and formulated in the Maastricht Treaty in 1991 reflected both these elements. The dysfunctional response to the Global Financial Crisis (GFC) is a direct result of the mistakes made in the lead up to Maastricht and reflect the dominance of what we might call neo-liberal Groupthink over sound macroeconomic management.

The paper is laid out as follows: section 2 considers the path that the European Member States took on the way to establishing the EMU. It also documents examines the impact of the GFC and the policy response taken by the key institutions (European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF), which are collectively known as the 'Troika', given their role in the disastrous Greek bailout. Section 3 considers the options that are available to the Member States of the Eurozone and explains why an orderly dismantling of the entire (failed) experiment is in the best interests of all. Short of that happening, it is argued that unilateral exit and the restoration of currency sovereignty is the best option of any single Member State. Concluding remarks follow.

2. The European Project – Overextended and in the Thralls of Neo-Liberal Groupthink

The great European visionaries in the immediate post-World War II period did not desire to put the European economies into a straitjacket of austerity and hardship. Rather they aimed to achieve peacetime prosperity. Europe's political leaders devised the "European Project" as an ambitious plan for European integration to ensure that there would be no more large-scale military conflicts fought on continental European soil. The Project began at a time when the advanced nations had embraced a broad Keynesian economic policy consensus with governments committed to sustaining full employment and advancing the general prosperity for all citizens. Recognising that the performance of the capitalist system could be derailed by destructive class conflict between labour and capital, national governments took on the role as a mediator, with policies designed to improve the conditions and rewards of work, in addition, to providing security for profit realisation.

[1] William Mitchell is Professor of economics and Director of the Centre of Full Employment and Equity (CofFEE) at the University of Newcastle, Australia. He is also a visiting professor at the CofFEE-Europe, Maastricht University and an expert on European affairs. His latest book – *Eurozone Dystopia: Groupthink and Denial on a Grand Scale* – was published by Edward Elgar (May 2015). A Spanish translation of the book was published in May 2016 and a Finnish version later in 2016.
His daily blog is available at http://bilbo.economicoutlook.net/blog

The Keynesian era emerged out of the Great Depression, which taught politicians that without major government intervention, capitalism is inherently unstable and prone to delivering lengthy periods of unemployment. Full employment came only with the onset of World War II, as governments used deficit spending to prosecute the war effort. The Keynesian era of macroeconomic policy that followed was thus marked by government deficits supplementing private spending to ensure that all workers who wanted to work could find jobs (Mitchell and Muysken, 2008).

The broad political and economic consensus that emerged after the war brought very low levels of unemployment in most Western nations, which persisted until the mid-1970s, although some European nations had bouts of sustained higher unemployment as a consequence of having to defend their weaker currencies with the context of the Bretton Woods fixed exchange rate system.

Within this broad policy consensus, the discussions about integration were conditioned by the long-standing Franco-German rivalry. France was determined to create institutional structures that would stop Germany from ever invading it again. It saw an integrated Europe as a way of consolidating a dominant role in European affairs but was determined to cede as little national sovereignty as possible to achieve these aims. France was also resentful of the influence that the US was exerting in Europe, particularly through the Marshall Plan, which intrinsically tied West Germany to the US. It was also highly suspicious of the IMF, which it considered to be a vehicle for American imperialism within Europe (Bird, 2014). France considered that, with the German reputation in tatters, it could assume the dominant political role in any pan-national structure. It also wanted the administrative arm of a “European” institution to be inter-governmental in nature (that is, agreements between national governments would determine policy) rather than a separate decision-making structure (such as what has become the European Commission).

The Germans, suffering a deep shame for past militarism and associated deeds, had only their economic success including the technical capacity of its industry and the “discipline” of the Bundesbank to generate national pride. As well as a need to expand its export markets for its increasingly dominant manufacturing sector, Germany wanted to be part of the “European Project” to demonstrate a rejection of its ugly history. But an obsessive fear of inflation meant that this participation had to be on German terms, which meant that the new Europe had to eventually accept the Bundesbank culture. This became a grinding process.

Within the German “stability” environment, it was seemingly overlooked that Germany, in fact, relied on robust import growth from other European nations for its prosperity. The fact that not all nations in a Bundesbank centric “stability environment” could have balance of trade surpluses was ignored (see Bibow, 2012).

After World War II, the advanced nations also agreed to fix their exchange rates relative to the US dollar, which in turn was linked to the price of gold, because they believed this would bring economic stability. But the so-called Bretton Woods system, established in July 1944, to provide international financial stability was under pressure from the start.

The use of the US dollar as a reserve currency was a basic source of instability for the Bretton Woods system. The system required the US to run balance of payments deficits so that other nations, who used the US dollar as the dominant currency in international transactions, were able to acquire them. In the 1950s, there had been an international shortage of US dollars available as nations recovered from the war and trade expanded. But in the 1960s, the situation changed. Nations started to worry about the value of their growing US dollar reserve holdings and whether the US would continue to maintain gold convertibility. These fears led nations to increasingly exercise their right to convert their US dollar holdings into gold, which significantly reduced the stock of US held gold reserves. The so-called Triffin paradox was that the expansion of US dollars into world markets, also undermined confidence in the dollar’s value and led to increased demands for convertibility back into gold. The loss of US gold reserves further reinforced the view that the US dollar was overvalued and, eventually, the system would come unstuck (Triffin, 1960).

The way out of the dilemma was for the US to raise its interest rates and attract the dollars back into investments in US denominated financial assets. But this would push the US economy into recession, which was politically unpalatable. It was also increasingly inconsistent with other domestic developments (the War on Poverty) and the US foreign policy obsession with fighting communism, which was exemplified by the build up of NATO installations in Western Europe and the prosecution of the Vietnam War. The US spending associated with the Vietnam War had overheated the domestic US economy and expanded US dollar liquidity in the world markets further. The resulting inflation was then transmitted through the fixed exchange system to Europe and beyond because the increased trade deficits in the US became stimulatory trade surpluses in other nations. These other nations could not run an independent monetary policy because their central banks had to maintain the exchange parities under the Bretton Woods agreement.

The other major problem was that countries with trade deficits always faced downward pressure on their currencies and in order to maintain their exchange rates they had to: buy their own currencies in the foreign exchange markets using their foreign currency reserves; push up domestic interest rates to attract capital inflow; and constrict government spending to restrain imports. These nations thus often faced recessed growth rates, higher unemployment, and depleted foreign reserves, and this created political instability. The effective operation of the system required the nations to have more or less similar trade strength, which was of course an impossibility and ultimately proved to be its undoing.

The Franco-German rivalry structured a series of less than effective compromises on the way to monetary union. The 1957 Treaty of Rome was heavily biased in favour of the occupied France at the expense of the aggressors Germany and Italy. But Germany's growing industrial and export strength became an increasingly significant threat to the French economy. German industrial ambition eventually required France to compromise on its own fierce resistance to ceding any national sovereignty to a European level entity.

The early experience with the Common Agricultural Policy (CAP), introduced in 1962 as the first major initiative of the newly formed EEC, should have taught the European nations that entering a currency union would be a fraught exercise. France wanted to protect French farmers and Germany wanted to expand its industrial export market. To achieve their goals, the Germans agreed to provide subsidies through the CAP to French farmers: a gnawing tension that remains today. But the administrative viability of the CAP required a very stable exchange rate environment because a multitude of agricultural prices had to be supported across the Community.

Quite apart from their obligations under the Bretton Woods system, once the Member States locked in the CAP they were also trapped into pursuing the impossible task of maintaining fixed exchange rates. The German mark became the strongest currency in the 1960s as Germany's export strength grew, which put France and Italy under constant pressure of devaluation and domestic stagnation and undermined the CAP.

The various agreements to maintain fixed parities between the European currencies (before the demise of the Bretton Woods system and after) all largely failed because of the different export strengths of the Member States. Effectively, these currency arrangements became 'mark zones', reflecting the dominant position of Germany and the supplicant positions of the rest of the participating nations. But instead of taking the sensible option and abandoning the desire for fixed exchange rates, the European political leaders accelerated the move to a common currency when the Bretton Woods system collapsed in 1971. The lessons from the Bretton Woods fiasco were not learned and the dysfunctional design of the EMU, in part, reflects this inability to learn from history.

By the end of the 1960s, after a decade of currency turmoil, the European Project was floundering. There was growing tension between the French and other Member States of the European Community, as well as the US. Charles De Gaulle made the famous statement in 1962 that, "Europe represents the first opportunity France has to regain what she lost at Waterloo: world dominance" (Soutou, 1996: 131). The situation changed a little when Georges Pompidou replaced De Gaulle in April 1969. The former was more receptive to Community enlargement (specifically, the entry of Britain) and deeper economic integration between the Member States. The Heads of State or Government of the Member States convened at The Hague on December 2, 1969 to discuss these issues. The idea of an economic and monetary union (common currency) was seriously advanced for the first time at the Hague summit conference and it was proclaimed to be "a turning point in history … [and the] …irreversible nature of the work … [towards a] … united Europe" (European Council, 1970).

The 1970 *Werner Report*, commission by The Hague summit, studied a number of functioning federal systems (including Australia, Canada and the USA) and outlined a comprehensive timetable for the creation of a full economic and monetary union by the end of the decade. The Committee made it clear that monetary and fiscal policy would have to be centralised with the "centre of decision of economic policy … [to] … be politically responsible to a European Parliament" (European Commission, 1970: 13).

A later study by the MacDougall Committee in 1975 also emphasised that an effective economic and monetary union would require a strong fiscal presence at the federal level which could use the currency-issuing capacity of the "federal" authority (government) to redress asymmetric shocks across the regional space of the "federation". They assessed that: "It is most unlikely that the Community will be anything like so fully integrated in the field of public finance for many years to come as the existing economic unions we have studied" (European Commission, 1977: 11).

There are many competing explanations as to why Werner's plan failed to materialise, but the basic reason is that, in an era of growing currency instability, the French fear of German dominance and their unwillingness to cede power to supranational institutions, combined with the German inflation obsession, stood in the way. The two nations could clearly find ways to cooperate on a political level but trying to form an economic and monetary union was difficult (Maes, 2002).

In 1972, the Governor of the Danish Central Bank said, "I will begin to believe in European economic and monetary union when someone explains how you control nine horses that are all running at different speeds within the same harness" (McAllister, 2009: 58).

What eventually allowed the 'nine horses' to be harnessed together was not a diminution in Franco-German national and cultural rivalry but rather a growing homogenisation of the economic debate. The surge in Monetarist thought within macroeconomics in the 1970s, first within the academy, then in policy making and central banking domains, quickly morphed into an insular Groupthink, which trapped policy makers in the thrall of the self-regulating, free market myth – which we now refer to as *neo-liberalism*.

At that point, the "European Project" entered its denial phase and started to overextend itself and pursued monetary integration in defiance of the insights provided in the previous reports (Werner and MacDougall).

The introduction of the Monetarist inspired Barre Plan in 1976 showed how far the French had shifted from their Gaullist "Keynesian" days. Across Europe, unemployment became a policy tool aimed at maintaining price stability rather than a policy target, as it had been during the Keynesian era up until the mid-1970s. Unemployment rose sharply as national governments, infested with Monetarist thought, began their long-lived love affair with austerity. It is in this environment that the on-going discussions about European integration began to be framed.

The Delors Report (European Commission, 1989), which informed the Maastricht conference, disregarded the conclusions of the Werner and MacDougall Reports about the need for a strong federal fiscal function because they represented "old fashioned" Keynesian thinking, which was no longer tolerable within the Monetarist Groupthink that had taken over European debate.

The new breed of financial elites, who stood to gain massively from the deregulation that they demanded, promoted the re-emergence of the free market ideology that had been discredited during the Great Depression. The shift from a Keynesian collective vision of full employment and equity to this new individualistic mob rule was driven by ideological bullying and narrow sectional interests rather than insights arising from a superior appeal to evidential authority and a concern for societal prosperity.

The Monetarist (neo-liberal) disdain for government intervention meant that the proposed *Economic and Monetary Union* constructed counter stabilisation policy purely in terms of central banks adjusting interest rates to maintain price stability irrespective of the impact on economic growth and unemployment. It also suppressed the capacity of fiscal policy and no amount of argument or evidence, which indicated that such a choice would lead to crisis, would distract Delors and his team from that aim.

Delors knew that he could appease the French political need to avoid handing over policy discretion to Brussels by shrouding that aim in the retention of national responsibility for economic policy making. He also knew that the harsh fiscal rules he proposed that restricted the latitude of the national governments would satisfy the Germans. Monetarism had bridged the two camps.

While refusing to create a "federal" fiscal authority to ensure there was an institution aligned with the currency-issuing central bank and which could respond to asymmetric spending declines across the Member States, the planners then set about ensuring that the Member States, themselves, would be incapable of responding effectively in an economic crisis.

They imposed arbitrary fiscal rules – the so-called *Stability and Growth Pact* (SGP) – that ensured neither growth or stability would evolve. The rules were plucked out of the air as another of many French-German compromises. They were not justified by any appeal to evidence nor economic theory (Eichengreen, 1997; Mitchell *et al.*, 2006; Le Parisien, 2012a, b). The neo-liberal Groupthink that had consumed the whole process of integration erected a wall of denial and the European politicians successfully convinced people that by maintaining price discipline, economic growth would be maximised.

The reality was that these rules ensured that most Member States would be in breach if a significant non-government spending collapse occurred. The GFC demonstrated the madness of the straitjacket that the Member States signed up for. Once in breach, the Excessive Deficit Mechanism built into the monitoring and compliance process of the rules, then ensured that these States would be forced to impose austerity (pro-cyclical fiscal shifts) at the very time economic theory would advise in favour of discretionary expansion of public spending and/or tax cuts (counter-cyclical fiscal shifts). The whole process had a surrealistic air about it at the time.

The GFC exposed how ridiculous the Groupthink mantra was. But those who dared question the Monetarist supremacy at the time, and instead, advocated Keynesian remedies to reduce the entrenched European unemployment, were met with derision from the Commission economists and the likes of the IMF who had embraced the new economic theory and its policy implications.

By insisting on economic and monetary union under these terms, and then imposing self-defeating austerity onto the nations enduring the worst of that dysfunctional design, the European political elites have undermined the long-standing European Project. Germany had successfully reinvented itself as a good European citizen, after its disastrous and criminal behaviour during World War II. But as the perceived “enforcer” of austerity, Germany is now vilified again: the “ugly German” has returned. The unelected economic mandarins in Brussels and Frankfurt, aided and abetted by the unaccountable officials from the IMF, now have influence on who remains in political office in some nations (for example, the appointment of Lucas Papademos in Greece).

The Eurozone is now enduring its eighth year of crisis, locked down in a straitjacket of economic austerity and driven by an economic ideology that is blind to the evidence of its own failure.

The neo-liberal policies of deregulation and the demonisation of the use of discretionary fiscal deficits (government spending greater than tax revenue) created the crisis in the first place, and now the same sorts of policies are prolonging it. The current policy approach has institutionalised economic stagnation, widespread retrenchment, and the deterioration of working conditions and retirement pensions. A recent IMF report concluded that the neo-liberal agenda which involved “increased competition” and a “smaller role for the state” has “not delivered as expected” and has not “increased growth”, has “increased inequality” with costly consequences and that “(a)usterity policies not only generate substantial welfare costs ... but also ... worsen employment and unemployment” (Ostry *et al*., 2016: 38-40). Further, “the benefits of some policies that are an important part of the neoliberal agenda appear to have been somewhat overplayed” (Ostry *et al*., 2016: 40).

Millions of European workers remain unemployed, youth jobless rates are still around 50 per cent in some advanced nations, inequality and poverty rates are rising, and massive daily losses of national income are being endured. The dramatically high youth unemployment rates will ensure that the damage will span generations and undermine future prosperity as a cohort of jobless youth enter adulthood with no work experience and a growing sense of dislocation from mainstream societal norms.

The Eurozone political elites claim that there is no alternative (TINA) but to impose more austerity by cutting fiscal deficits and enforcing widespread cutbacks to social welfare systems. This is couched in the language of “structural” adjustment, which proposes that workers have been receiving excessive pay relative to their productivity and states have been lavishing excessive generosity on their citizens in the form of income support and other benefits, while punishing the business sector with pernicious regulative environments.

The major political parties in most nations, whether in government or opposition, have unquestionably accepted the dominance of this neo-liberal ideology, which has not only homogenised the political debate but also obscured the only credible routes to recovery.

The citizens were initially bullied into accepting the euro and all that went with it by their political leaders and now the same leaders are seen to go cap in hand to the Troika to preserve their hegemony, while imposing untold social and economic hardship on their citizens. Open expressions of racism are proliferating (for example, the “lazy Greek” narratives). The media and politicians now regularly engage in the language of retribution, with cooperation giving way to hostility, resentment, and a breakdown in the social order (for example, Bild, 2010; *The Economist*, 2011).

The 2014 European Parliament elections demonstrated that anti-austerity parties at the extremes of the political spectrum enjoyed stunning success in several countries. The 2015 election of Syriza in Greece invoked hope that the people were finally expressing their anti-austerity voice. But its brutal crushing by the Troika has shown that the “European Project” has now become an anti-democracy exercise, where the preferences of the “people” come a poor second to the desires of the elites to maintain their hegemony with the support of financial capital. These instabilities will only deepen as the “European Project” disintegrates. The right-wing parties promote anti-immigration policies, which are becoming increasingly popular.

Economic austerity has morphed into a very nasty confection. And now, the migration disaster has arrived and paralysed the increasingly dysfunctional European Union. It is time for a major rethink of the whole exercise and, in the next section, we argue that the process has to start with dismantling the unworkable monetary union.

3. The Options for the Eurozone

A correct assessment of the current state indicates that fiscal deficits have to increase. Austerity is exactly the opposite of the policy response that is required. A sustained recovery in the Eurozone and elsewhere requires a categorical rejection of mainstream macroeconomic theory and practice and a reorganisation of the institutional structures to allow deficits to increase. We argue that this can only be done if the EMU is dismantled and full currency sovereignty is restored to the individual Member States.

The TINA mantra has been a powerful organising framework for conservatives to promote the myth that fiscal discipline and widespread deregulation will allow a free market to maximise wealth for all. The neo-liberal economic framework promoted vigorously by many economists, the multinational agencies such as the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD), and conservative politicians including the Eurozone establishment in Brussels and Frankfurt, blinds the public eyes to realistic alternatives by confining the boundaries of the public debate through the use of selective priorities, wrongful causalities, and scandalous misrepresentations of reality.

The European policy making elites – the politicians, the supporting bureaucracies, the central bankers and expert consultants – remain trapped in neo-liberal Groupthink that created the euro monster in the first place. It is a group dynamic that resists change and explains the arrant disregard of viable alternative policy paths that could restore growth.

It was obvious that the Eurozone was doomed from the start and now the same neo-liberal ideology masquerades as the solution. It is characteristic of group behaviour that is patterned by Groupthink to suppress alternative thinking and evidence that is contrary to the dominant viewpoint.

Eventually, the European economies will stabilise and start growing again, but the residual damage from the austerity will be massive and span generations. Millions will be poorer and without reasonable opportunities as a result. The neo-liberal political leaders will rejoice and claim success but they won’t advertise the low base from which the growth has resumed.

The EMU is a flawed system and has to change. The question is: What changes are necessary to overcome the flawed design that now works against prosperity? There are three broad approaches to this question.

The Dominant "Reform" Narrative

The dominant narrative within Europe is to debate some changes, for example, the creation of a European-level unemployment insurance scheme, within the overall confines of the current system that emphasises internal devaluation (given Member States cannot vary their exchange rate) and sustained fiscal rectitude.

Popular among these proposals are those that seek to add cyclical responsiveness (increasing the "automatic stabilisers") to the policy mix, and hence, provide European level support to regions in crisis, and proposals that seek to reorganise and reclassify government debt to reduce the vulnerability of the EMU to private bond markets. They are all what might be called "austerity" proposals in that they offer palliative care solutions ("band aids") to stop the breach. In that sense, they fail to address the cause of the breach itself, the lack of a fully functioning fiscal authority and the bias towards pro-cyclical fiscal policy as a result of the SGP rules.

In its current configuration, the design of the EMU deliberately reduces the potency of the automatic stabilisers embedded in the structure of fiscal policy to provide spending support in times of crisis. Müller (2013) notes, "the EU budget is too small and its transfer mechanisms (such as the structural and regional funds) are too rigid to enable a short-term adjustment of different cyclical development".

Enderlein *et al.* (2012) proposed boosting the automatic "cyclical response" capacity in Europe through the creation of a "a cyclical adjustment insurance fund" (p.30), which would be managed by Eurozone finance ministers and build its kitty from contributions from nations experiencing above the average Eurozone growth rates and pay out to nations in crisis, to "reduce pressure on public finances" (p.31). The scheme would thus force nations to reduce their domestic spending in times of buoyant economic growth and provide some relief in bad times. Significantly, the authors stress the "the system cannot become a hidden instrument for permanent transfers" (p. 31) and nations might only be permitted to "take out what they once paid in" (p. 32).

The presumption is that the "federal" redistribution would be neutral across the economic cycle and across space, a proposition for which there is no rationale other than fiscal conservatism. Their reasoning is symptomatic of the Groupthink among European economists that led to the problem in the first place. Many of the authors of this report were involved in various studies that gave rise to the design of the EMU. Now, as the system they lauded has failed, their approach is to patch it up with various *ad hoc* measures, all of which are ring-fenced by the austerity mentality. They (p.7) propose a simple rule for the limits of democracy, "sovereignty ends when solvency ends". The application of this rule inevitably leads to a violation of democracy because the risk of insolvency is intrinsic to the flawed design of the monetary system. Member States are forced to issue debt in a currency they have no control over and the ECB is formally precluded from giving any guarantees (although of course it has violated that prohibition via programs such as the SMP). Default risk and insolvency are always lurking, waiting for the next major economic downturn to arrive. Thus as soon as a nation falls into crisis, its citizens lose the capacity to influence their own destiny and are, instead, at the behest of unelected officials in the European Commission, the ECB and the IMF. That doesn't appear to be a road map for a sustainable and prosperous Europe. Pisani-Ferry *et al.* (2012) propose a similar type of transfer system.

The so-called debt-mutualisation proposals (for example, Delpla and von Weizsäcker, 2010; Varoufakis *et al*., 2013), which place harsh restrictions on the democratic autonomy of the Member States and fiscal flexibility, just continue the irrationality and dysfunction of the SGP. Further, Germany's dominant position in policy development will always see it veto any moves to establish European-level debt that is shared among the nations.

The Creation of a European Level Fiscal Capacity

The current design of the Eurozone determines that the Member State governments are not "sovereign" in the sense that they are forced to use a foreign currency and must issue debt to private bond markets in that foreign currency to fund any fiscal deficits. Their fiscal positions must then take the full brunt of any economic downturn because there is no "federal" counter stabilisation function. The EMU is a federation without the most important component.

The Member State governments thus can run out of money and become insolvent if the bond markets decline to purchase their debt. Among other things, this means the elected governments cannot guarantee the solvency of the banks that operate within their borders.

An obvious economic solution for the Eurozone, then, is to bring the fiscal policy responsibilities (spending and taxation) in line with the monetary issuing capacity and allow the federal fiscal authority to run deficits commensurate with the non-government spending gap. This would ensure that total spending in the Eurozone would be sufficient to generate enough jobs to satisfy the desire of the workers across the regional span of the common currency. This is the option outlined long ago by the Werner and MacDougall Committees.

Establishing a Federal Fiscal Authority (FFA) within a reformed European Parliamentary system, would thus directly redress the stagnant spending conditions across the Eurozone, align fiscal capacity with the need to create a full banking union, and maintain a democratic accountability of fiscal policy. There would never be a question of solvency, which means the private bond markets could never determine the policy decisions made by the FFA and Member States would avoid the devastation of pro-cyclical fiscal interventions.

A more coherent change within this context would be for the ECB to fund deficits of the FFA (the Overt Monetary Financing option we consider later) and thus consolidate the fiscal policy responsibilities and operations of the FFA with the monetary policy obligations and related liquidity management functions of the ECB.

The problem is that the FFA option is not politically or culturally tenable as the MacDougall Study Group clearly understood. An essential requirement for an effective monetary system with multiple tiers of government is that the citizens have to be tolerant of intra-regional transfers of government spending and not insist on proportional participation in that spending. The other side of this coin is that a particular region might enjoy less of the income it produces so that other regions can enjoy more income than they produce. To achieve that tolerance there has to be a shared history, which leads to a common culture and identity. Language is an aspect of this, but not necessarily intrinsic.

Citizens within an effective federal system have to share a common sense of purpose and togetherness to ensure that the monetary system works for all states/regions rather than those that have powerful economies. That capacity and required tolerance is largely non-existent in the Eurozone, which is why talk of a fiscal union will be largely inconsequential (Soros, 2013).

An example of this political and cultural shortfall in Europe is the fact that politicians think it is appropriate to refer to large economies such as Spain and Italy as “peripheral” nations. The “core-periphery” nomenclature came out of development economics, and the periphery referred to nations or regions which were underdeveloped or less developed, without basic infrastructure or human capital. Referring to rich civilisations such as Italy and Spain in this way indicates a deep malaise (Soros, 2013).

Moreover, it is not just the historical and cultural differences that are at odds with the idea of a fully integrated economic and political union. For the FFA to provide effective fiscal support for growth and prosperity in the Eurozone, a major paradigm shift in economic thinking is required. When the old hatreds and suspicions in Europe combined with the emergence of neo-liberal economic thinking, the outcome was the Delors Report and the subsequent unworkable design of the Maastricht Treaty. That mindset biases the Eurozone towards stagnation.

A new way of economic thinking, which recognises the opportunities that a truly sovereign federal government has if it utilises its currency appropriately, is required. That sort of paradigm change is unlikely to happen at the Eurozone level such is the differences between the Member States. In that context, the next section argues that break up and the restoration of national currency sovereignty is the only way forward for the Member States, either in an orderly manner together or as a unilateral individual choice.

The Exit Option

There is nothing irrevocable about the euro or the Eurozone. While there are no formal exit mechanisms established in the relevant Treaties, short of military occupation, the Member States can do what they like. In this section we make the case that the exit option is the only viable way for the Member States of the Eurozone to regain their sovereignty and rebalance their economies. It would be ideal if the Eurozone nations agreed to an orderly dismantling of the common currency and a restoration of the individual currency sovereignty for each nation. In lieu of such an unlikely turn of events, exit remains the superior unilateral option for an individual nation.

European politics and policy making is caught in two very powerful and destructive vices at present. The first is the age-old Franco-German rivalry. A corollary to this rivalry is a disdain for the “Latinos” who by geographic proximity cannot be ignored, much to the angst of those further north.

The second is the domination of “free-market” economics, the neo-liberal Groupthink, which though empirically deficient and riddled with internal theoretical inconsistencies, still rules the academy and through its graduates, the policy making sphere. The GFC exposed the deep flaws in mainstream economics and its shortcomings as a basis for policy decision-making.

As we argued in Section 1, the rise of Monetarism, which originated out of the academy in the US, created a “post national” tension among the politicians, which cut across the old state based rivalry between the nations in Europe. Whereas the early discussions about monetary union placed the national state at the forefront, by the time Delors and his Committee met, the global capture of economic policy by the financial elites was already well entrenched and the promotion of Monetarist economic ideology aided their agenda (Bhagwati, 1998). The old national rivalries have persisted but their expression has become increasingly channelled by the neo-liberal narrative, which created the EMU monster. Neither of these vices will release their destructive grip on European affairs easily.

The cultural and historical aspects of the Franco-German rivalry are permanent constraints on European progress. These differences suggest that both of the large European nations would be better off pursuing their own economic destinies. But they can only do that if they also free themselves from the vice-like grip of neo-liberal economics.

The dominance of free market thinking has so perverted the European Project, that the failure of the economic plan is now endangering the beneficial political and legal aspects that have accompanied the formation of the European Union.

The resistance to root-and-branch reform of the Eurozone by the Troika is symptomatic of the hold that the neo-liberal Groupthink has on the decision-making elites. When “exit” is mentioned, the mainstream economists all produce catastrophe predictions in the form of massive and ongoing currency depreciations leading to an uncontrollable surge in inflation, and a terminal debasement of the new currencies. They predict the collapse of national banking systems following massive capital outflows. They predict that there would be massive outflows of skilled labour, which would undermine the future productivity of any exiting nation. They predict that the exiting nations would have to default on their debt obligations, which would not only force the nation into a costly, drawn out legal morass, but would also see it being shunned by international capital markets. As a consequence, they claim that the exiting governments would not be able to fund themselves and would run out of money. Further, they predict that credit would also become unavailable to the private sector businesses and housing markets would collapse.

The catastrophe scenario (for example, Goodhart and Tsomocos, 2010) sees the nation mired in depression, poverty and isolation. Civil anarchy would erupt and give way to totalitarian regimes with vicious secret police departments enforcing order through torture and death squads. This future would surely be many times worse than a future within the Eurozone.

Conversely, building on an understanding of Modern Monetary Theory (MMT), which demonstrates the capacity enjoyed by a national government that issues its own floating currency to pursuing domestic policy objectives, one realises that the catastrophe scenario is just an ideological scare campaign to maintain the neo-liberal hegemony and suppress democracy (Mitchell, 2015).

Mitchell (2015) provided a detailed framework for a nation seeking to exit the Eurozone (see also Policy

Exchange, 2012, among others). Any exit scheme has to address the same issues:

1. How to handle the euro denominated public and private debt that is outstanding.
2. How to handle bank deposits denominated in euros within the exiting nation.
3. How to ensure financial stability is maintained.
4. How to deal with on-going current account deficits? Trade controls?
5. How to introduce the new currency (for example, unilaterally or as an interim dual currency).
6. How to manage the inevitable large currency depreciation and to minimise the resulting inflation risk and protect real living standards.
7. How to reduce speculative capital flows (for example, using capital controls).
8. How to deal with any changes to the legal framework governing cross-border trade if the nation also is expelled from the EU, among other issues.

Refer to Policy Exchange (2012) and Mitchell (2015) for a complete discussion of these issues. It should be made clear that no one really knows for sure what would happen. It would be hard to project the costs of the exit. But we can deduce several things based on historical experience. It is highly likely that the benefits of exit would outweigh the costs, if the exit decision is, simultaneously, accompanied by a decision to reject the flawed neo-liberal, austerity approach in favour of a fiscally active policy stance that seeks to maximise wellbeing of the citizenry. If the exiting nation continues its idolatry of financial markets and considers it can "do" austerity in a more gradual manner, then the exit will likely be even more costly than provided for by the current outlook.

Abandoning the culture of austerity and restoring currency sovereignty would provide the exiting government with numerous opportunities to bring idle resources, including the unemployed, back into productive use.

- Real economic growth would be immediate and the massive daily income losses associated with austerity terminated.
- The bond markets would become supplicant when faced with a currency issuing nation because the central bank could control interest rates and force investors out of the market whenever it chose. Whether investors chose to buy any new public bonds issued in the new currency would become irrelevant (Mitchell and Muysken, 2008).
- The newly empowered state would still be able to spend and purchase anything that was available for sale in its own currency, including all idle labour. It would be able to introduce a Job Guarantee and eliminate mass unemployment (Mitchell, 1998).
- The new state would be able to protect the capital of its banking system and guarantee deposits in the local currency. It could also introduce capital controls to head of speculative attacks on its currency a position now advocated by the IMF (Ostry *et al.* 2011).

It is often argued that the exiting country would face hyperinflation. Most of the commentary surrounding the risk of hyperinflation following an exit concentrates on scenarios where the government is unable to access private debt markets as a result of a depreciating currency (and other stability concerns), and instead enters the 'taboo' world of the central bank directly funding government spending.

In fact, it has been proposed to end the practice of issuing public debt to the non-government altogether, an artefact of the Bretton Woods system, which effectively ended in August 1971, and, instead engage in what has been called Overt Monetary Financing (OMF) (Bossone, 2013a, 2013b; Bossone and Wood, 2013; McCulley and Pozsar, 2013; Turner, 2013; Wood, 2013a, b).

There are several variants of OMF proposed but effectively it would require the ECB to use its currency issuing capacity to underwrite the fiscal deficits of the Member States in order that they create growth and employment in their domestic economies without encountering the restrictions that private bond markets place on their spending. OMF, erroneously called the "printing money" option, is universally considered to be taboo among neo-liberals because they wrongly claim it will lead to inflation, and perhaps hyperinflation. However, an understanding of MMT shows that it can be a very effective way for governments to responsibly manage economic growth without having to issue public debt. OMF is a strategy that could render the EMU workable even within the confines of the current Treaty as long as the harsh fiscal rules were abandoned. But, moreover, it represents a desirable operational option should the euro be abandoned by one or more nations, in which case the OMF would be facilitated by the newly empowered central banks in the exiting countries. McCulley and Pozsar (2013: 17) argue that OMF would ensure monetary policy works to, “support the fiscal authority in raising nominal demand, not to stimulate private borrowing *per se*”.

There are two arcane textbook notions that render OMF taboo for neo-liberals. One is just plain wrong while the other has limited applicability during a recession. The first notion is the “money multiplier”, which links so-called central bank money or the “monetary base” to the total stock of money in the economy (called the money supply). The second notion, the Quantity Theory of Money (QTM), then links the growth in that stock of money to the inflation rate. The combined causality then allows the mainstream economists to assert that if the central bank expands the money supply it will cause inflation, which is their prima facie case against OMF.

There are two major flaws in the concept of the money multiplier. First, the empirical evidence clearly shows that empirical estimates of the money multiplier are not constant and so can hardly be used to make predictions. Second, the stylised textbook model of the banking system isn’t remotely descriptive of the real world (for a summary of the shortcomings, see FRBNY, 2008; Bank of England, 2014).

The QTM a classical thesis is similarly flawed. The problem with the theory is that neither of the required assumptions holds in the real world. First, there are many studies that have shown that velocity of circulation varies over time quite dramatically. Second, and more importantly, capitalist economies are rarely operating at full employment. The Classical theory essentially denied the possibility of unemployment. The fact that economies typically operate with spare productive capacity and often with persistently high rates of unemployment, means that it is hard to maintain the view that there is no scope for firms to expand the supply of real goods and services when there is an increase in total spending growth. If a firm has poor sales and lots of spare productive capacity, why would it hike prices when sales improved?

Thus, if there was an increase in availability of credit and borrowers used the deposits that were created by the loans to purchase goods and services, it is likely that firms with excess capacity will respond by increasing the supply of goods and services to maintain or increase market share rather than push up prices. In other words, an evaluation of the inflationary consequences of OMF should be made with reference to the state of the economy. Any increase in spending, whether it is private or public, carries a risk of inflation if it pushes the economy beyond its capacity to respond by increasing the production and sales of goods and services.

For nations mired in recession with large quantities of idle resources, it is highly unlikely that increased deficits will invoke a major inflationary spiral. That situation certainly describes the state of many European nations in the aftermath of the GFC and the imposed austerity.

The main source of inflation would be the rising prices of imported goods and services in terms of the local currency as a result of any currency depreciation, once the government floated it. History tells us that such depreciations are short and sharp. Argentina is an example. However, more recent “European” experience is also available to guide our thinking. When Iceland’s financial system collapsed in 2008, the government refused to bail out the private banks and instead restructured domestic bank deposits within newly nationalised banks, pushing all foreign exposure into the bankruptcy process. International markets started to get the jitters in early 2008 and capital inflow to Iceland dried up, which led to a weakening of the króna, and inflation began to accelerate due to the rising price of imports including petrol. The bank collapse exacerbated the currency crisis and the króna depreciated by 50 per cent over 2008 in terms of the euro. But the decline was finite. In the first half of 2010, the króna had appreciated by nearly 10 per cent and by October 2010, the inflation rate, which had peaked at 21.9 per cent in January 2009, was back down to the central bank’s threshold bank of 4 per cent.

4. Conclusion

Many Eurozone Member States now face a future of stagnation and elevated levels of unemployment and rising poverty if they remain in the Eurozone. Restoring currency sovereignty and targeting domestic expansion with a strong commitment to full employment is the best path forward for any or all Member States.

The constraining forces of the neo-liberal Groupthink, however, make such a move very difficult to achieve. Eventually, social instability will put a "wrecking ball" through the failed European Project and the nations will have to seek their own paths.

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Author contact: bill.mitchell@newcastle.edu.au

SUGGESTED CITATION:
Mitchell, William (2016) "Eurozone Groupthink and Denial on a Grand Scale" *World Economic Review*, 7, pp. 43-55.