Integration is disintegrating

Theoretical and historical lessons for reforming the Eurozone

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October 22, 2016

The oxymoronic title of this essay represents an explicit tribute to Hyman Minksy's intuition on financial instability in a modern capitalist economy. When he argued that (Minsky 1986, p.320) "a capitalist economy is inherently flawed because its investment and financing processes introduce endogenous destabilizing forces" he meant that periods of financial stability, by encouraging risk-taking and financial innovation, paradoxically[1] sow the seeds of emerging instability in the economy. "Stability is destabilizing"[2] beautifully summarises this concept.

Even though Minsky's analysis is prevalently focused on the US economy and its financial, monetary and government institutions, it is not improper to apply his theoretical tools to the case of the European Monetary Union. As a matter of fact, the Eurozone crisis could be seen as a sort of Minskyan financial crisis that has turned into a crisis in the real economy, affecting several EU member states. We shall nonetheless leave Minsky aside for a moment, in order to further clarify the proper interpretation of the Eurozone crisis, as it leads to policy implications that are remarkably different to those of the standard interpretation.

[1] In recent years, prestigious institutions such as the Bank for International Settlements (BIS) have been recognising the reinforcing feedback mechanism of risk perception diminishing as the financial system nurtures imbalances that make it more and more vulnerable. Borio and Drehmann (2009) have referred to this phenomenon as the "paradox of financial instability".

[2] The original quote from its *John Maynard Keynes* (1975, p.11) is "Because Keynes arrived at his views on how a capitalist economy operates by examining problems of decision-making under conditions of intractable uncertainty, in his system, *stability, even if it is the result of policy, is destabilizing*" (emphasis added).

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The European Monetary Union is often assimilated to the *gold-exchange standard* in the interwar period, or even to the pre-1914 *gold standard*, in so far as its members have given up their monetary and exchange-rate policies. When in his *A Tract on Monetary Reform* (1923) Keynes argued against the restoration of the pre-war gold standard, it did so on the ground that a system of exchange rates managed and controlled by central banks' intervention would have been preferable than disruptive fluctuations in the domestic price levels. His argument was still based on a 'classical' mechanism of equilibrium in the trade balance, accomplished through realignments in the terms of trade of similar competing nations. From his words (*ibid.*, pp.71-72):

> In conditions of equilibrium the internal and external purchasing powers of a currency must be the same, allowance being made for transport charges and import and export taxes; for otherwise a movement of trade would occur in order to take advantage of the inequality. [...] If, therefore, we find that the internal and external purchasing powers of the home currency are widely different, and, which is the same thing, that the actual exchange rates differ widely from the purchasing power parities, then we are justified in inferring that equilibrium is not established, and that, as time goes on, forces will come into play to bring the actual exchange rates and the purchasing power parities nearer together.

As in today's mainstream interpretation of the Eurozone crisis, excessive and unstable financial flows were only considered the outcome of 'real' trade imbalances, which in turns are the result of divergences in relative costs and prices. If, in the gold-standard era, world capital movements and their fluctuations manifested in speculation over the values of currencies, in the Eurozone, a *de facto* single currency area, they appeared as rising interest rates on government and corporate bonds of deficit countries in the periphery.

Nevertheless, rather than the monetary 'orthodox' Keynes, both the pre-1914 and the euro-area crisis are better explained by reversing the causal order of events and concentrating on the autonomous and predominant role of international financial flows. In fact, as Rudolph Hilferding (1910) put it, the long-lasting "latest phase of capitalist development" is one of *Finance Capital*, where "large banks increasingly acquire the power to dispose over fictitious capital". Hilferding's pioneering analysis put bank capital at the centre

of the process of capitalist accumulation, which was more and more assuming the configuration of a close relationship, if not dependence, between great industrial monopolies and monopolistic financial capital. Whereas many aspects of his interpretation have been made obsolete by the structural transformations underwent by both the industrial and the financial component of the capitalist system (if they can be distinguished today), his great merit was to underline the independent and crucial role that banks and other financial institutions play in conditioning each different "regime of capital accumulation". This shows remarkable resemblances to the cross-border operations of banks and other financial institutions in the so-called 'core' of the euro area, that during the pre-crisis years have fuelled unsustainable economic developments in capital-receiving peripheral countries. Interestingly, in chapter 22 of *Finance Capital* one finds a detailed explanation of how, and for what purposes, the export of capital might take place (p.326):

> If capital export in its most advanced form is undertaken by those sectors of capital in which concentration is most advanced, this in turn accelerates the growth of their power and their accumulation of capital. It is the largest banks and the largest branches of industry which succeed in obtaining for themselves the best conditions for the valorization of their capital in foreign markets, and acquire the rich extra profits in which lesser capitals cannot even dream of participating.

Once again, the consequences of these aggressive, if not 'imperialistic' (in Hilferding's words), cross-border flows of capital show an extraordinarily resemblance to recent developments in the Eurozone (*ibid.*, p.275, p.279):

> There is an observable tendency for the balance of payments to deteriorate in a country which has reached the peak of the boom and is close to a crisis. Prices during the boom encourage imports, which rise far above their normal level, whereas exports do not increase to the same extent since the absorptive capacity of the domestic market remains considerable [...]
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> England [...] was only able to promote its exports of means of production so vigorously by supplying them not only as commodities but as capital; that is to say, not by selling means of production abroad but by sending them abroad as capital investments.

It is therefore striking that the separation between 'real' developments in the current account balance and the autonomous nature of international financial flows, that is currently a central tenet of the theoretical analysis proposed by the Bank for International Settlements, was as crucial for interpreting the pre-1914 gold-standard world as it is today for conceptualising the Eurozone crisis primarily as a financial crisis. If one reads the critical reappraisal that Robert Triffin undertook of the gold-standard before 1914, there is an astounding parallelism with the current debate. In *The Evolution of the International Monetary System: Historical Reappraisal and Future Perspectives* (1964), the Belgian economist resumed the mainstream interpretation on the mechanisms of adjustments between countries in the gold-standard era in the following way (pp.6-7):

> The importance of international capital movements, and of their fluctuations, is often obscured by the disproportionate emphasis often placed on comparative price and cost fluctuations as the major factor in balance-of-payments disequilibria and their correction. Attention is thereby centered on the current-account items of the balance of payments, and tends to suggest that most disturbances arose in this area and had to be corrected promptly by the restoration of equilibrium between receipts and expenditures on current - or even merely merchandise - account.
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> In fact, however, international capital movements often did cushion - and even stimulate - vast and enduring deficits, or surpluses, on current account without calling for any correction whatsoever

As he further explained below (p.8), even the distant gold-standard world was characterised by the predominance of international capital flows and the emergence of a core-periphery pattern between capital exporting and capital importing countries, the latter subject to unstable variations in their economic activities that mostly originated from what Triffin called "perverse fluctuations in the availability of capital imports":

> The cyclical pattern of international capital movements, however, had a very different impact upon the capital-exporting and the capital importing countries. A mere slowdown of capital exports could help relieve, in the first countries, any pressures on central-bank - and private-bank - reserves arising from unfavorable developments in other balance-of-payments transactions. [...]

> The borrowing countries, on the other hand, were far less able to control the rate of their capital imports which tended, on the whole, to swell in boom times and dry up in hard times, contributing further to the economic instability associated with their frequent dependence on one or a few items of raw material or foodstuff exports, themselves subject to wide quantity and/or price fluctuations. All in all, therefore, the balance of payments of the countries of the so-called 'periphery' would be assisted, over the long run by the large capital imports available to them from the financial markets of industrial Europe, but these countries would pay for this dependence through perverse fluctuations in the availability of such capital and in their terms of trade over the cycle.

The historical comparison of the Eurozone crisis with the functioning of the gold-standard before 1914 establishes an important characteristic of the international monetary system: when movements of capital across borders are effectively permitted with little regulation, the explanatory role of the current account balance is vastly overplayed by the importance and independence in direction and scope of gross financial flows. It is therefore of paramount importance to have a clear idea over the origin and nature of the Eurozone crisis if one wants to reach proper policy implications for how to solve it.

In this respect, the theoretical framework proposed by the analysts of the Bank for International Settlements appears more suitable for conceptualising the crisis in the euro area as the result of 'excessive financial elasticity'. In fact, they argue that the 'financial elasticity' of domestic monetary and financial regimes is greatly influenced by the policy and institutional regime at the international level (Borio et al. 2014). *Monetary regimes* that concentrate mostly on price rather than financial stability are more likely to amplify financial elasticity, as they are not compelled to adopt a restrictive monetary policy as long as the rate of inflation remains low and stable. Moreover, the transmission of an excessive loose monetary policy from core economies to the rest of the world is immediate and direct when currency areas extend beyond national jurisdictions (i.e. the case of the international role of the US dollar, or of the euro in the European Union). As far as *financial regimes* are concerned, when the mobility of capital across borders is unrestrained, external sources of finance contributes to the domestic building up of unsustainable credit and asset prices booms. As a matter of fact, the history of

the international monetary system, from the Bretton Woods agreements to the financial crisis in 2007, is about the progressively dismantling of capital controls, even on short-term financial flows, as well as about a shift from financial stability and regulation towards financial liberalisation and the obsession with price stability. In this respect, the European Union represents a supreme and radical example of how those policies and institutional arrangements were adopted over the past thirty years. For this reason, the analysis of the financial and economic crisis in the Eurozone - given its systemic nature - cannot be performed without considering the role of the institutions and rules that have been codified in the EU Treaties.

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The 'rigidity' of a monetary union and its tendency to create 'unwanted' imbalances was clear well before the euro - and even the European Monetary System - was introduced. Nicholas Kaldor (1971a) was simply one amongst many to criticise the Werner Report[3] because it assumed that economic and monetary union could precede the political union. In Kaldor's view, the latter would have been necessary to deal with external imbalances, as if they were regional divergences within a single country that needed to be addressed through structural fiscal transfers.

In that case, the Cambridge economist was nonetheless looking at 'real' imbalances, which nowadays appear to be less relevant than external financial imbalances in explaining the emergence of financial crises. This should not surprise, given that he was still writing in an expiring but still living period of limited movements of capital across nations. The restriction of short-term capital movements was a legacy of the Bretton Woods conference of 1944, from which many institutions of the post-war period were born. Among these, was the International Monetary Fund, whose *Articles of Agreement* explicitly mentioned the possibility for its members to apply capital controls and restrictions, as Article VI (Section 3) "*Controls of capital transfers*" still declaims:

> Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise

[3]The Werner Report (1970), a policy document sponsored by the then Prime Minister of Luxembourg Pierre Werner, was intended as a blueprint for the institution of a European Monetary Union in a three-stage process. The objective should have been achieved through the irreversible convertibility of currencies, free movement of capital, and the permanent locking of exchange rates that would eventually lead to a single currency.

> these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2.

When it comes to the European Economic Community (the European Union after 1992) instead, the free circulation of capital had always represented a central theoretical dogma for the supporters of monetary integration in Europe. Ever since Mundell's (1961) theory of 'Optimal Currency Area', where mobility of labour and capital assumes a central role, the freedom of movement of capital has invariably been considered a crucial element for the single market to work efficiently. Even the Werner Report, that Kaldor ardently contested, despite recognising that "speculative movements of capital have assumed enormous proportions" and that they could "make still more difficult the control of economic development by Member States", advocated the completion of capital liberalisation in the European Community (p.9, emphasis added):

> A monetary union implies inside its boundaries the total and irreversible convertibility of currencies, the elimination of margins of fluctuation in exchange rates, the irrevocable fixing of parity rates and the *complete liberation of movements of capital*.

The principle of free movement of capital became part of the European *acquis communautaire* only after the European Single Act in 1986, which was followed by the harmonising Council Directive 88/361/EEC that imposed the liberalisation of all capital movements between member states as a necessary step for the monetary union to be established (Commission of the European Communities 1990). By 1 July 1990 all remaining restrictions were lifted. The Maastricht Treaty (1992) then solemnly codified the freedom of capital movements in Article 63 of the TFEU:

> [a]ll restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. [...] all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

Hilferding (1910, p.311) would have probably rationalised this historical process by claiming that "the development towards finance capital enhance

the importance of the size of the economic territory". It is not surprising then that the imposition of credit controls and limitations on the movements of capital, whose reintroduction came to be considered "impossible" (Pauly and Goodman 1993), still remains a taboo in the European Monetary Union. Even the International Monetary Fund, after the long parenthesis of the 'Washington Consensus', which preached fiscal discipline, privatisations and the liberalisation of capital accounts, is currently rethinking its position on all these issues that it is now starting to consider as 'oversold' (Ostry et al. 2016). In fact, some sort of controls over the amount, nature and direction of the gross financial flows between Eurozone banks would have contained the creation of unsustainable credit and asset prices booms in many peripheral countries. It would have, more importantly, reduced to a minimum the capital outflows that so much contributed to the speculation on peripheral countries' public debts in 2011 and 2012, which in turns justified contractionary fiscal budgets that ultimately brought many Eurozone member states into a double-dip recession in 2012 and 2013. In conclusion, the Eurozone does not necessitate a 'Capital Markets Union'[4], which would represent the final and ultimate act of liberalisation and integration of member states' financial systems. Instead, if the issue of 'excess financial elasticity' is to be addressed seriously, the euro area, and perhaps the European Union writ large, would require the re-imposition of some degree of controls and limits on cross-border financial flows among its member states.

The liberalisation of capital movements in the European Union represents only one aspect - the *financial* one - of the institutional arrangements that enhanced the 'financial elasticity' of that economic area. With respect to the *monetary* aspect, many authors, De Grauwe (2013) among them, have insisted that the one-size-fits-all monetary policy of the European Central Bank requires all euro area countries to be in a similar phase of the business cycle. In this respect, while the sluggish economic performance of the German economy in the first years of the monetary union necessitated a policy of low interest rates, the opposite was true for many peripheral countries, were credit booms were fuelled by the combination of low nominal interest

[4]On 30 September 2015 the European Commission launched an 'Action Plan on building a Capital Markets Union', that would establish a single market for capital across the 28 EU member states. Among its purposed objectives one finds the aim of reaching "more cross-border risk-sharing and more liquid markets", which the BIS theoretical framework puts in evident contrast with the other stated aim of "fostering a stronger and more resilient financial system".

rates and higher inflation rates. Moreover, the ambiguous institutional structure of the Eurozone happened to be detrimental also in terms of remedial measures that a country with a lender of last resort (i.e. its central bank) can implement in preventing a crisis of confidence in its banking sector or speculation over the value of its government bonds. Instead, the architecture of the European Monetary Union does not confront any of these criticisms and, as Obstfeld (2013) rightly observes, it gives total and absolute priority to the maintenance of price stability (Article 2 of its Statute) over financial stability in the private and public sectors. Finally, there is a bitter irony in recent events, which testifies that central banks can do very little, if nothing at all, to revamp inflation in a deflationary environment in which many Eurozone countries are currently living. The ECB interest rate on the marginal lending facility has been reduced to the historical minimum of 0.25 in March 2016, while the rate on deposit facility has been turned into negative already in June 2014. Together with such extremely loose interest rate policy, the undergoing Quantitative Easing programme of the European Central Bank, started in March 2015 and successively extended in duration and scope, has spectacularly failed to reach the ECB inflation target. As of August 2016, annual inflation in the euro area was 0.2%, quite far from its "below, but close to, 2%" target, with many countries, such as Italy and Spain, registering outright deflation.

Furthermore, and connected to both the financial and the monetary dimension, the role of the payment system Target2 before and after the crisis has been dual. In operative terms, it technically eliminated the possibility of balance-of-payments crises in the single currency area, substituting private interbank lending when peripheral countries suffered drastic capital outflows between 2011 and 2012. In this very respect, Target2 has shown strong similarities with Keynes's International Clearing Union (Lavoie 2015). It thus contributed to eliminating the 'country risk' of investing in one country's assets with the danger that a sudden devaluation would reduce the face value of that investment. On the other hand, and in contrast with the proposal of Keynes (1943), it cannot impose limitations on capital transfers between private banks and financial institutions. With the disappearance of the 'currency risk' and with no limits on the movements of capital, speculative cross-border financial flows could flourish. Therefore, the combination of a facilitator of gross financial transactions and the existing free mobility of capital across such extended economic area has enormously contributed towards increasing the financial elasticity of the Eurozone before the crisis, as

BIS data on cross-border transactions, credit to GDP ratios and asset prices demonstrate. Once again the very configuration and institutional setting of the European Monetary Union was not neutral in the process of building imbalances. Borrowing the words of Minsky once again (1986, p.353):

> As a result of these constitutional flaws, speculative finance and the growth of market institutions that facilitate the rolling over and refinancing of positions are destabilizing developments during prosperous times.

Lastly, a final consideration on trade liberalisation in the European Union needs to be made. When Martin Wolf in early 2012 asked on the columns of the *Financial Times* whether a country can have a balance-of-payments crisis in a currency union, the answer he gave was a positive one, adding that it could manifest as either, or both, a credit crisis or a “regional economic slump”. It should be clear by now that the Eurozone does in fact have a “workable mechanism for dealing with the creditworthiness crises” caused by outflows of private capital and consequent pressures on governments’ borrowing. A properly functioning common central bank, as the European Central Bank has progressively become through time, can technically prevent both a ‘credit crisis’, through its payment system and its refinancing operations, and a sovereign debt crisis, as long as it acts as a lender of last resort for its member states. Nonetheless, there is some truth in the assertion that balance-of-payments crises - or excessive current account deficits as one ought to be calling them - are the accounting manifestation of imbalances in the ‘real economy’. In the pre-crisis years, imports have boomed in many peripheral countries, especially Greece and Spain, while they grew much less in Germany; at the same time export growth in Germany was little more sustained compared to the periphery. Far from being a sign of deteriorating price competitiveness, current account deficits emerged in peripheral countries, either because they overdeveloped in certain non-tradable activities (e.g. construction sector), or because domestic consumption could not keep up with domestic production. Even though this is practically irrelevant in terms of the external financial sustainability of those deficit countries, imports growing in excess of exports in whatever economic area, be it a region or a country, is most of the time a sign of economic weakness. As Anthony Thirlwall in an article written for the *Financial Times* in October 1991 sought to explain: “Emu is no cure for problems with the balance of payments”. With that he simply meant that any economic unit in which export growth is strong

relative to import demand will generally present high rates of productivity-induced growth and low unemployment rates. The theoretical foundation of this argument dates back to the first Keynesian authors, but it has been better investigated by Kaldor in his inquiries over the "causes of growth and stagnation" of economic systems, where he identified in the rate of growth of exports the explanatory factor for the rate of economic development of a given region, through Harrod's foreign trade multiplier. Resuming other 'Kaldor's growth laws' on the relation between manufacturing output and overall income mediated by the macroeconomic role of increasing returns, in *Causes of Growth and Stagnation in the World Economy* (1984, p.67) he summarised his export-led growth theory as follows:

> International statistical comparisons have firmly established that differences of growth rates of GDP are mainly explicable in terms of differences in the growth rates of the manufacturing sector; countries with high rates of GDP growth have invariably been those whose manufacturing industry has grown at an even faster rate and whose exports of manufactures have grown at a still faster rate. Harrod has shown (three years before the publication of Keynes' *General Theory*), in his theory of the "foreign trade multiplier", that changes in export demand have multiplier and accelerator effects which operate so as to adjust, via changes in the general level of output, the level of imports to that of exports. [...] It follows, moreover, that the growth rate of exports, together with the income elasticity of imports, govern the growth rate of the economy.

Although exports are crucial in determining the growth prospect of a country or a single region, for Kaldor this does not necessarily imply that the opening of trade between different economies is beneficial for everyone, as the Ricardian theory of 'comparative advantages' would suggest. Classical and neoclassical theories of international trade declare that free trade favours convergence among countries and regions, yet Kaldor (1981) explains that this might happen if traded goods are sufficiently homogeneous and substitute (i.e. agricultural products), and their market is characterised by perfect competition and diminishing or even constant returns to scale. None of this assumptions obviously hold true in the real world of oligopolistic competition and increasing returns to scale, where traded goods are most often sophisticated and complementary industrial products. The combination of all these

characteristics, in the absence of protectionist measures such as tariff barriers and quantitative restriction on trade, might well lead to the concentration of production activities in certain areas and economic divergences between countries and regions. In this case, the principle of 'cumulative causation' (Kaldor 1970, p. 484) explains the unequal economic development of different areas by illustrating how:

> the region that is initially more developed industrially may gain from the progressive opening of trade at the expense of the less developed region whose development will be inhibited by it.

It is here that the European Union enters the scene. The Treaty of Rome of 1957, establishing the European Economic Community, had as its principal purpose the institution of a common market among the six original founding members. Therefore, the first among several "FOUNDATIONS OF THE COMMUNITY" was codified in Article 9, under the title "FREE MOVEMENTS OF GOODS":

> The Community shall be based upon a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect.

The free-trade orientation of the EEC was the main reason behind Kaldor's (1971b) scepticism towards Britain joining the Common Market. He was coherently convinced that (p.71):

> Unless we manage to become the fast-growing industrial centre of the Community [...] we may be faced with the same problem of declining total demand and employment as our development areas have had during the last twenty years, and with no more ability to counter it by local policies, without external assistance.

This last passage finally hints to his brilliant and crucial distinction on how the principle of 'cumulative causation' manifests between different regions of a single country or between different polities. In the context of the European Economic Community, or the European Union today, the discrimination is fundamental, as it typifies the conceptual and practical failure of an institutional arrangement in which some important decisional competences are shared in a dysfunctional way. In particular, Kaldor criticised the process

of European economic integration for its lack of coherence among policy instruments and the practical neutralisation of the public authorities in their capacity to pursue the economic objectives of full employment, price stability and a healthy balance of payments. In contrast to a sovereign political entity (Kaldor 1970, p.488):

> a region which forms part of a political community, with a common scale of public services and a common basis of taxation, automatically gets 'aid' whenever its trading relations with the rest of the country deteriorate. There is an important built-in fiscal stabilizer which arrests the operation of the export-multiplier: since taxes paid to the Central Government vary with the level of local incomes and expenditure, whilst public expenditures do not (indeed they may vary in an offsetting direction through public works, unemployment benefit, etc.), any deterioration in the export-import balance tends to be retarded (and ultimately arrested) by the change in the region's fiscal balance in the relation between what it contributes to the central Exchequer and what it receives from it.

In adhering to the Common Market, each member state would automatically renounce to any instrument of trade policy - tariffs or quotas - that it could use to benefit its trade balance without the provision of any equilibrating mechanism of fiscal transfers at the Community level. Intra-Community transfers, which constitute an essential feature of federal as well as unitary states, where not envisaged in the Treaty of Rome, although the Werner Report mentions the necessity of "financial transfers" to realise equilibrium within the Community "in the same way as within a nation's frontiers". In a later document, the so-called 'MacDougall Report' (1977), that explored the possibility for the Community to establish a proto-federal budget, the issue of "Inter-regional balance of payments" was supposed to be dealt with a "horizontal budget equalisation mechanism" that would have entailed annual intra-EEC financial transfers amounting to a modest 2% of the Community GDP. A far cry from the current "European Structural and Investment Funds", which amount to 454 billions of euros for the years 2014-2020: on a yearly average they represent only 0.44% of EU GDP[5]. Moreover, the European Union is not simply a free trade area with a 'Common Customs Tariff',

[5]Author's calculation using the 2015 reference value for the EU GDP.

it is also a single market with several strict rules on competition. As the elimination of tariffs and quotas ruled out any selective restriction of imports, even with 'infant industry' or 'substitutive' purposes, other dispositions of the Treaties do not allow member states to freely perform the kind of policies that could help promote exports in certain strategic sectors or firms. Particularly severe is the legislation on 'state aid', which is regulated by Article 107 of the Treaty on the Functioning of the European Union:

> Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

Whereas general tax measures (e.g. R&D subsidies) and employment legislation are allowed, selective interventions such as loans, subsidies and grants or preferential treatments for certain goods and services are forbidden and generally sanctioned by the European Commission. To summarise, the complete liberalisation of trade between EU member states, without any institutionalised system of transfers from surplus to deficit areas - as it would be the case between regions within any country - is likely to be conducive to increasing divergences among countries in terms of industrial and export capacities. The concentration of financial capital, that is already existent in the European Union, is now being accompanied by the concentration of productive activities, organised along a core-periphery structure where the periphery acts as a subcontractor to the assembler core, which therefore sells the final product and captures the higher share of value added incorporated in it.

In the end, the economic (i.e. productive) sustainability of many countries in the so-called 'periphery' will depend on the capacity of the EU to reform itself by either adopting a less free-trade orientation or by substantially increasing the amount of fiscal transfers between regions. In fact, some degree of protectionism[6], combined with a more consistent and redistributive EU budget would represent the best policy and institutional configuration.

[6] Protectionist measures around the world are on the rise. They are adopted as a natural instrument of industrial policy by many successful countries, China above all. The European Commission (2016) reports that, between 1 July 2014 and 31 December 2015, 201 new "Relevant Measures" have been introduced, which contribute to the stock of 1059 measures registered after 2008, while only 180 have been removed since then.

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In conclusion, the European Monetary Union has not played a neutral role in the current crisis. In fact, it has remarkably contributed to the emergence of financial and structural imbalances among its members. Nonetheless, commercial, financial and monetary integration among European countries have always been endorsed with the justification that it would provide economic efficiency and stability to the countries involved. Less advanced economies, by lifting protectionist restriction to trade, by liberalising their capital accounts and by joining the single currency would have reduced their productivity and income per capita gaps with richer member states. The emergence of current account imbalances and financial flows towards peripheral countries, in the decade before the crisis, were seen as positive signs of convergence and of financial markets working efficiently (Blanchard and Giavazzi 2002).

Nowadays, it appears as pure fantasy to argue that economic, financial and monetary integration has brought convergence among EU member states. As reported in Table 1, Eurostat data on GDP per capita, industrial production, corporate insolvencies and employment rates are as clear as merciless. A visible and dramatic pattern has emerged since 2010, were peripheral countries are performing badly in each and every variable, other countries such as France and the Netherlands show better but not extraordinary results, while Germany is registering a fairly satisfactory performance, especially with respect to corporate insolvencies and employment rates.

	GDP/capita	Industrial production	Insolvencies	Employment rates
Spain	-0.5%	-6%	+40%	-7.7 pp
Portugal	-3%	-3.3%	+40%	-3.5 pp
Italy	-5%	-7.7%	+38%	-2.2 pp
Greece	-17%	-11.7%	+11% (2014)	-10.9 pp
France	+2.4%	+0.7%	+14%	-0.1 pp
Netherlands	+2%	-3.6% (2014)	-7%	-0.5 pp
Germany	+6.3%	+8.8%	-21%	+6.1 pp

Table 1: Differences in selected variables among major Eurozone countries between 2010 and 2015. *Source*: author's elaboration based on Eurostat and Credit Reform data.

These are simply indicators of an extraordinary and potentially unsustainable process of economic divergence that has been affecting the Eurozone over the past years. It is a dramatic situation that would require substantial and radical reforms in the Eurozone's policies and institutional structures, a

change in the paradigm of economic integration that however appears all but foreseeable. As long as the socio-economic and political situation remains fairly stable, the current European Union, and especially its Eurozone core, constitutes the promised land of liberalism as well as the perfect institutional arrangement for the socio-economic and national interests that are dominate its policy-making process. As Friedrich von Hayek clearly illustrated in 1939 (p.267), discussing how to conceive a minimalist federal state that could overcome the vicious twist of nationalism and socialism:

> The federation will have to possess the negative power of preventing individual states from interfering with economic activity in certain ways, although it may not have the positive power of acting in their stead.

Therefore, those theoretical and historical lessons presented above indicate a distinct and crucial dilemma for the survival of the European project: either a political union is effectively constituted, with the properly functioning institutional configuration of a federal state, or many indispensable policy competences (e.g. financial controls and limitations, monetary sovereignty, trade policy, etc.) will have to be renationalised.

Finally, the reference to Minsky in the title has an intentional double meaning. Apart from celebrating his analysis on how financial crises are built in periods of overconfident but relative prosperity and growth, the purpose of paraphrasing his most famous work - *Stabilizing an Unstable Economy* - was to suggest something more about the nature of the European Monetary Union and its monetary and financial integration. The argument that embraces each and every aspect of the analysis presented above is crucial: euro area developments of the past 15 years should be understood as a systemic failure, not just as the fault of few incautious countries or the merit of other virtuous ones. Instead, the Eurozone crisis has been facilitated, worsened and prolonged by the dysfunctional institutional configuration of the European Monetary Union itself, together with its process of integration and the economic philosophy from which it has taken inspiration. Nowadays, more and more economists and international institutions accuse the euro area of being the "black hole" of global economic growth. Nevertheless, the time for repentance might have expired and the long-lasting economic crisis might carry the European Union down to Hell, as the Commendatore's statue with Don Giovanni in Mozart's opera. *Integration, even if it is the result of policy, is disintegrating.*

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