



**Why the euro is the gold  
standard writ large – and like  
the gold standard, will fail.**

Ann Pettifor  
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**Prime**

# **Why the euro is the gold standard writ large – and like the gold standard, will fail.**

Ann Pettifor, 30<sup>th</sup> July 2015

“A paradox lurks in the foundations of the eurozone. Governments in the monetary union lack a central bank that has their back, while the central bank lacks a government to support it.”

Yannis Varoufakis, Financial Times, 28 July, 2015

On 20<sup>th</sup> July, 2015 Jacques Delors, one of the most influential politicians in Europe’s recent history, reached the grand old [age](#) of ninety years. The day before, President Hollande of France celebrated the event in [a speech](#) that paid respect to the elder statesman. He told the weekly Journal du Dimanche, that “in the past week “the European spirit prevailed” in addressing the Greek crisis.<sup>1</sup>

“The past week” was a reference to the long, brutal and historic negotiations held overnight on the 12<sup>th</sup> July, 2015 between Eurozone leaders and Greece; and Greece’s subsequent capitulation to micro and macro economic conditions set by her creditors. During the negotiations “the European spirit” seemed to have evaporated. Many would argue that it had been absent for longer than that.

Back in February 2015, the European Central Bank had “[shaken the Eurozone’s utopian foundations](#)” by rejecting Greek collateral for monetary policy operations.<sup>2</sup> Later it used its powers to enforce fiscal conditions on Greece. Then after Greece’s government announced a referendum on the Eurozone’s austerity conditions, an ECB insider, in an extraordinary and illegal action, leaked details of the outcome of an ECB governors meeting – before that meeting had ended. This ‘front-running’<sup>3</sup> of a critical decision by ECB governors on the amount of emergency liquidity to provide to Greece, encouraged a run on banks in Athens. In a Forbes blog – [the Day the Euro Died](#) - Frances Coppola explained how the media were harnessed to pile the pressure on Greece’s financial institutions – and thereby its government:

“... the most damaging of the leaks was given to Robert Peston of the BBC on the morning of Sunday June 28th. The choice of both media institution and reporter is significant: Robert Peston’s reporting of Northern Rock’s liquidity problems in September 2007 famously caused a run on the bank. And Peston did it again. He reported IN ADVANCE of the ECB governing council’s decision that the ECB was going to “turn off” ELA. By the time the ECB announced its decision, some hours later, Greek ATMs were rapidly running out of cash.

“Where the leak to Robert Peston came from we do not know. But front-running the ECB governing council’s decision is tantamount to spreading

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<sup>1</sup> 90<sup>th</sup> birthday of Jacques Delors. Europa, 20<sup>th</sup> July, 2015.

[http://eeas.europa.eu/delegations/new\\_zealand/press\\_corner/all\\_news/news/2015/jacques\\_delors\\_en.htm](http://eeas.europa.eu/delegations/new_zealand/press_corner/all_news/news/2015/jacques_delors_en.htm)

<sup>2</sup> The blog was posted by this author and was posted on Social Europe on 5<sup>th</sup> February, 2015.

<sup>3</sup> The practice by market-makers of dealing on advance information provided by their brokers and investment analysts, before their clients have been given the information.

rumors to start a bank run, which is illegal in most Eurozone countries (though apparently not in Germany). And since the Eurosystem is responsible for ensuring financial stability, deliberately starting a bank run is a major breach of the mandate of both the ECB and the national central banks. Whoever leaked this should be summarily dismissed.”<sup>4</sup>

Some regarded both the leak and the denial of sufficient liquidity to Greece’s banking system by the ECB as an attempt to destabilize the government, and unseat the governing Syriza party. In other words, many perceived these actions as an attempt at a coup d’etat.

Given this context President Hollande’s reference to the ‘European spirit’ prevailing would likely have jarred not just with Europeans, but also with the grand old statesman Jacques Delors himself. In a 2011 interview in EurActiv, Delors explained that the problems of the euro resulted from EU leaders disregarding his famous 1989 report on *Economic and Monetary Union in the European Community* (my emphasis).

“[The report’s] economic part was much more significant than the monetary part. But it wasn’t listened to. In consequence, when we prepared the Treaty of Maastricht, it was in vain that I recalled the necessary balance between the two ‘legs’, so to speak, the monetary leg and the economic leg. “The monetary leg has prospered. It worked in good conditions. But the economic leg remained inert, so to speak. So I started again in 1997. I was no longer with the [European] Commission, I was a European activist, leading a small think-tank, Notre Europe. I sent to the French leadership my proposal, because it was question of a Stability Pact, which corresponded to the monetary part, so I proposed a pact to coordinate economic policies. No one supported it. So don’t be surprised if it turned out that way!”<sup>5</sup>

These respective statements by Hollande and Delors reveal a great deal about both the illusions and disillusionment of leading Europeans. The vision they shared of peace, unity and economic solidarity built on a common market of European nations, was to be captured and channelled into a monetary system – the European Monetary Union (EMU) - that mainly serves the interests of global finance capital, as discussed below. Because so few European politicians paid serious attention to monetary theory, policies and operations, they were easily duped.

In any case, Jacques Delors doth protest too much. Twelve central bankers, pictured above, largely drafted the 1989 Delors [Report](#). He had personally suggested that the Committee for the Study of Economic and Monetary Union should rely almost exclusively on the advice of central bankers. As if to reinforce the role of these bankers in determining the future of the monetary union, the Delors committee met in Basle,

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<sup>4</sup> Frances Coppola: *The Day the Euro Died*, 29<sup>th</sup> June, 2015. <http://www.forbes.com/sites/francescoppola/2015/06/29/the-day-the-euro-died/>

<sup>5</sup> Delors: *Franco-German alliance is Europe’s ‘tree of life’*. Euroactiv, 7 April, 2011. <http://www.euractiv.com/future-eu/delors-french-german-relationship-eu-tree-life-interview-503851>

home to many private financial institutions and also to the granddaddy of all central banks – the Bank for International Settlements. It should come as no surprise, then, that the Delors Report largely represented banking interests. Nor that these interests captured and exploited the ‘European spirit’ and are right now in the process of destroying it.

The Delors Report was shot through with commitments to provide

- a) the assurance of total and irreversible convertibility of currencies;
- b) the complete liberalization of capital transactions and full integration of banking and other financial markets; and
- c) the elimination of margins of fluctuation and the irrevocable locking of exchange rate parities.<sup>6</sup>

Not that these elements were entirely new. Article 67 of the foundational [Treaty of Rome](#) (1957) had already begun to chip away at the achievements of Bretton Woods during the years of *Les Trente Glorieuses*, or ‘golden age’ of economics. Article 70 of the 1957 Treaty started the process of requiring EEC member states to dismantle restrictions on movement of capital with “third countries”, aiming at “the highest possible degree of liberalization”. It was the management of capital mobility that had so largely contributed to peace, full employment, high levels of investment and economic stability during the ‘golden age’ of the Bretton Woods system. Back in 1957, Articles 67 and 70 set Europe on a path that would end with the dismantling of Bretton Woods.

Later, during the 1950s and 60s study groups such as the Bellagio group and the Bilderberg group began to look at European monetary integration.<sup>7</sup> On 27 November 1962, a Luxembourg banker, Pierre Werner delivered a lecture in Brussels. In it

“he asserted the relevance of a European *unit of account defined in relation to gold* as a means of giving a kick start to a European monetary system.” (My emphasis).<sup>8</sup>

Then in 1965 Pierre Werner, this time as Prime Minister, Finance Minister and Foreign Minister (yes, he held all three posts) of Luxembourg gave an indication of

“the priorities of the Grand Duchy’s foreign, and particularly its European, policy, in which economic integration occupied a prominent place. Monetary policy as the vehicle for this... became one of the fundamental pillars of long-term government action, and the international money market which was just then emerging in Luxembourg was gradually associated with it.”<sup>9</sup>

<sup>6</sup> P. 14, *Report on Economic and Monetary Union in the European Community*. April 17, 1989.

[http://aei.pitt.edu/1007/1/monetary\\_delors.pdf](http://aei.pitt.edu/1007/1/monetary_delors.pdf)

<sup>7</sup> P. 15. *A Rereading of the 1970 Werner Report in the light of family archives*, by Elena Danescu, 27 August, 2013.

[http://www.cvce.eu/content/publication/2012/4/9/fa9f4dda-beb6-4caa-8095-29cfe4e451bc/publishable\\_en.pdf](http://www.cvce.eu/content/publication/2012/4/9/fa9f4dda-beb6-4caa-8095-29cfe4e451bc/publishable_en.pdf)

<sup>8</sup> P. 21 *A Rereading of the 1970 Werner Report in the light of family archives*, by Elena Danescu, 27 August, 2013. As above.

<sup>9</sup> As above.

As a result of his lectures, speeches and statements on European monetary policy, not to mention the “priorities of the Grand Duchy” Pierre Werner was appointed by the European Council of Ministers on 6 March 1970, to chair a committee of experts to design a monetary system for the European Union.

The key elements of his committee’s recommendations, and the emerging Euro system as developed subsequently by the Delors Commission, both replicated the financial architecture of the nineteenth century gold standard, and then entrenched the structure to render the Euro system ‘irrevocable’. Any return to a Bretton Woods-type system would be barred.

Today the architecture of that euro system devised by the Werner and Delors Committees appears increasingly unstable. Many economists expect Greece to exit the Eurozone in due course. Germany positively promotes this outcome. There are some economists that believe the Eurozone as a whole will collapse, with Germany the first to exit.<sup>10</sup> Is the Eurozone approaching a seminal moment like that day in September, 1931 when Britain was the first to exit the gold standard, an exit many had believed impossible?

In this brief review of the key elements of the European Monetary Union (EMU) and its parallels with the gold standard, I want to show just how much the two systems hold in common.

However it is important to note at the outset how they differ. The genius of those who designed the structure and operation of the European Monetary Union (EMU) was this: unlike the architects of the gold standard, the bankers of the Delors Report simply abolished all European currencies, to be replaced by a new, shared currency, the Euro answerable to – bankers.

The key point is that the Euro not only acts as a store of value and facilitates financial transactions across borders – it also fulfills Jacques Delors’s ambition and acts as a powerful symbol of European unity. It is this double identity that has helped it to endure since 2001.

So in addition to serving the interests of bankers and creditors - the Euro was in part created, and heavily sold to citizens, as a perceived way and a symbol for bringing Europe and Europeans together. Like gold under the gold standard, the currency acquired the status of a fetish for many, both amongst the European elites in Brussels and Frankfurt, but also amongst those in the periphery countries.

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<sup>10</sup> See Shahin Valléejuly: How the Greek Deal Could Destroy the Euro, in the New York Times, 27 July, 2015. [http://www.nytimes.com/2015/07/28/opinion/how-the-greek-deal-could-destroy-the-euro.html?\\_r=0](http://www.nytimes.com/2015/07/28/opinion/how-the-greek-deal-could-destroy-the-euro.html?_r=0)

As Stathis Kouvelakis has noted:

“Before the 2008-2010 crisis, the most Europhile countries within the European Union were precisely those of the south and the periphery. It must be understood that for these countries, EU membership signifies a certain modernity, both economic and political, an image of prosperity and power that the euro comes to validate at a symbolic level. This is the fetishistic aspect of money that Karl Marx emphasized: having the common currency in their pockets, the Greeks symbolically reach the same level as the Germans or the French.”<sup>11</sup>

Thus the EU’s treaties proclaim economic convergence, but flaws in the design of the Euro have led to huge economic *divergence* between the periphery (e.g. Ireland), and the north. This has led in turn to rising political divisions across all of Europe.

The monetary leg, to quote Delors, has prospered, and enriched global financial markets. The economic leg has been allowed to wither on the vine, and as a result, and inevitably, the political “European dream” is in very grave danger. European unemployment is very high at 11% and shows no downward trend. Wages are falling in real terms; prices are low and in eight countries prices are currently negative. In other words, deflation has taken hold in a substantial part of the Eurozone. Economies are diverging along a north/peripheral axis into current account deficit and surplus countries. Anti-Euro parties have drawn in activists from across the political spectrum – and provide evidence of growing political tensions and unrest throughout the continent.

The system’s architecture is now at risk of collapse. The inflexible “rules’ or Maastricht criteria are openly flouted not only by southern European countries, but also by Germany. Eurozone debt as a share of GDP jumped to €9.4 trillion in the first quarter of 2015, and at 92.9% of GDP is way above the Maastricht criterion of 60% of GDP.<sup>12</sup> By this measure the whole Eurozone is in non-compliance – and should be expelled from er, the Eurozone. These public debt levels will continue their inexorable rise, thanks largely (and counter-intuitively for orthodox economists) to “austerity” policies that are largely deflationary.

The plain truth is that the Euro is a product of utopian neoliberal economists and their ambitions for a monetary system governed *only* by market forces. According to the ideology, market forces must be beyond the reach of any European state. It is this utopian vision and its embodiment in the “rules” of the Euro system that is deeply flawed, and is the cause of economic failure and of social and political instability within the Eurozone.

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<sup>11</sup> Stathis Kouvelakis: *The No is not defeated. We continue*. Partial translation of “*Le non n’est pas vaincu, nous continuons*” interview in *Revue Ballast*, 27 July, 2015. English translation by Ian Cosh.

<sup>12</sup> From Eurostat news release, 22 July, 2015. <http://ec.europa.eu/eurostat/documents/2995521/6923259/2-22072015-AP-EN.pdf/bf173a0e-0eba-4ab9-878c-6db8d1f6452b>

## What are the “rules” of the Euro?

Here, crudely summarized are the ‘rules’ that 19 Eurozone member countries must follow. They must:

1. abandon their own national currency, in order to adopt a Europe-wide currency over which they will have no control and minimal influence
2. accept that the value of this common currency, detached from any state, will be controlled (sic) by technocrats, bankers and financial markets
3. accept that the currency might be or become overvalued, relative to the EZ’s domestic economies, or undervalued (as it is for Germany now)
4. agree to lower internal prices and wages as *the sole way* of correcting imbalances. Falling prices and wages will, it is assumed, make the nation’s exports more competitive
5. give up oversight over Europe’s central bank, and instead delegate central bank governance to unaccountable central bankers and technocrats based in Frankfurt
6. give up to the ECB and creditors, including the all-powerful actors in bond markets, the power to determine, or influence, interest rates across the spectrum of lending: for the base rate, short and long-term loans, safe and risky loans, and in real terms: i.e. relative to inflation
7. accept that the ECB has a mandate to use monetary policy and operations for one primary purpose only: price stability (a mandate that it has not honoured) and not full employment, as is the mandate of the US’s Federal Reserve
8. agree to remove any barriers that limit the free flow of capital across the borders of the Eurozone – one of the foundational ‘four freedoms’ of the European Union
9. refrain from undertaking democratically-driven decisions to increase or cut public spending in response to a slump or boom
10. agree to limit (under almost all economic circumstances) government annual deficits (expenditure in excess of income) to 3% of the nation’s annual income (GDP)<sup>13</sup>
11. ensure that the total stock of public debt does not exceed 60% of annual income or GDP

Finally Eurozone governments must submit to these “rules” without any arrangements for political or fiscal union and transfers between those within the “monetary union” being put in place.

These broadly are the conditions attached to Eurozone membership, set out in the two current Treaties.<sup>14</sup> The rules and procedures are opaque and complex, making them hard for citizens to understand. As noted earlier, the Treaties refer to “economic and monetary union”, whereas the reality is that there is only a monetary union that lacks its essential “economic” counterpart.

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<sup>13</sup> Save where “the excess [over 3%] is only exceptional and temporary and the ratio remains close to the reference value” – Article 126.2 of the Treaty on the Functioning of the EU

<sup>14</sup> The Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) and their Protocols, set in their present form by the 2007 Treaty of Lisbon.

Who or what institutions benefit from them?

To answer these questions, it might be helpful to look back at history and reflect on parallels between the Euro and earlier monetary experiments with the same ambitions as the Eurozone.

### **The gold standard**

Private financial interests drove the development and extension throughout the 19<sup>th</sup> century of the gold standard in the United States and Britain, and its revival and restoration in the 1920s in Britain, Europe and the US. It evolved as a ‘mechanism’ most useful to those engaged in international trade – and in particular to those engaged in international banking and other financial transfers. It achieved the goals set by international creditors largely because it tied the hands of governments, forced them to rely on private wealth (international capital markets) and prevented adjustments being made to exchange rates, interest rates and fiscal policy to favour the domestic economy. Instead the gold standard prioritised the interests of foreign creditors. It was based on private wealth’s distrust of governments and their ability to manage the economy, tax or impose tariffs. Added to this was a fear of inflation - the worst possible prospect for any creditor as it erodes the value of debt. Far preferable, from a creditor perspective, is deflation – which increases the value of debt relative to falling profits, wages and prices.

Doing business with governments across borders, in different currencies, is often very safe and lucrative for creditors. Governments have foreign reserves earned from exports and tax revenues from an endless stream of taxpayers. Both tax and export revenues, if denominated in hard currency, can be diverted as ‘rent’ for the repayment of foreign loans. Furthermore very high premia can be earned on good sovereign loans and easily cover any bond market losses on defaults.

However, in the absence of international law governing and enforcing international financial relationships, cross-border financing can also be risky. In the nineteenth century the value of a sterling loan to a Latin American country (for the purpose of say, building a railway) could fall dramatically if the value of a loan was inflated away, or if the loan was repaid in devalued local currency. British bankers that lent money for big infrastructure projects across different parts of the world would periodically face losses on these loans.

That was why bankers backed by the economist David Ricardo, led the world in 1821 in establishing a “gold standard” by which all foreign financial assets (including debts) could be valued and repaid. Britain was then the world’s largest trading nation, with London at the centre of world commodity markets. The City of London was the world’s most dominant creditor. The gold standard ensured that countries redeemed their

debts, not in the fluctuating values of flexible exchange rates, but in currencies whose value was fixed in relation to gold.

At the heart of this new arrangement was the desire by bankers and international creditors to maintain the value of their assets. Second they wanted to ensure that countries prioritized revenues from exports that earned gold, or 'hard' currency, over domestic economic expansion. Under the gold standard, sovereign debtors were not easily able to default on, devalue or to inflate away the asset that was the loan. On the contrary: when gold flowed out of a country, the only economic instrument for re-stocking central bank vaults was (it was argued) by deflating the economy: raising interest rates, cutting domestic wages and prices, and slashing government spending. This process was intended to stimulate exports, and attract new flows of gold, which would enable the country to strengthen the value of the currency again.

Unfortunately gold supplies were scarce, which exacerbated the stresses and strains of maintaining the link between gold and the currency.

However, the major flaw at the heart of the gold standard was a result of the vain attempt by its backers – 'classical' economists - to ground money on a commodity like gold. Many, like Ricardo, failed to understand that the value of credit issued by banks is linked, not to a commodity, but to the collateral offered in exchange for that credit, when a borrower applies for a loan. The value of gold, a scarce commodity, is determined differently: by the forces of supply and demand. So the effect of trying to limit the availability of credit by linking it to the limited supply of gold, led to a contraction in the money (or credit) supply – a typically monetarist approach. This led in turn to falling prices, profits and wages and to rising unemployment.

While many of the gold standard's backers surely had a full understanding of monetary systems based on credit, nevertheless they still drove the gold standard system forward, because of its benefits for global capital markets – and because of its fetishistic quality, mentioned above. They understood that the lustre of gold – just like the symbol of a Euro coin – held a special fascination for the public, and this fascination could well serve the interests of the finance sector.

So, while gold backing gave international creditors confidence in a currency, there is considerable doubt that the credit issued by private international bankers was ever backed up by equivalent stocks of gold in central bank vaults. Credit, as is now well understood, is created without any need to reference a commodity. It is conjured by bankers 'out of thin air' every time an application for a loan is made. Nevertheless the myth that credit was always backed by gold or specie (gold or silver coins) - like the myth (or fetish) of the Euro as a unifying and modernizing force - was sufficiently pervasive to support the system for decades, and to facilitate international lending and borrowing.

Despite its many contradictions and flaws, the actual operation of the gold standard forced painful economic “adjustments” – deflation rather than devaluation - on the sovereign debtor that periodically proved unbearable for its citizens.

Ron Chernow in his history of the American banking dynasty *The House of Morgan* writes that

“among the farmers of the South and West the (19th century) gold standard generated fanatic hatred. The United States was still an agrarian debtor nation, and poor, rural debtors far outnumbered big city bondholders. These farmers had many legitimate grievances, for they contended with the curse of steadily falling prices in the late nineteenth century. Deflation meant they had to repay debt in dearer money – a recipe for ruin. There was no central bank to expand credit during hard times...

This discontent made bankers the favorite bogeymen in rural political demonology. So venomous was the mood that several western states outlawed bankers, and Texas banned them altogether until 1904. This pervasive anger in the hinterlands crystallized around the House of Morgan, which was seen as a mouthpiece for European finance. A popular, grass-roots mythology claimed that the Bank of England and New York bankers had suborned Congress into enacting the gold standard.”<sup>15</sup>

The motivation that drove bankers to advocate for, and design, the gold standard was the fiction that foreign debts *can and will* always be repaid in full. By this means do international creditors set out to avoid the discipline imposed by market forces on domestic traders and creditors in the real economy – where losses relating to unpaid bills or debts are not uncommon. Indeed, according to free market theory, economic decisions must be accompanied by co-responsibility for the risk of lossmaking; whoever takes economic decisions must also carry financial risks, as Kunibert Raffer has argued (in making the case for a sovereign debt insolvency process).<sup>16</sup> In the Soviet economy for example, the state made every effort to remove the risk of losses, and producers and farmers were largely ‘protected’ from market forces. This led to gross inefficiencies. Today we are witness to a similar Soviet-style system operating within the western banking sector, where banks have become Too Big To Fail. This too is leading to gross inefficiencies and distortions of “free markets”.

To help creditors bypass the discipline of market forces, the gold standard boxed in sovereign debtors; prioritised foreign international creditors over domestic interests; transferred losses to local capitalists and their workers; and made it difficult for governments to default on debt repayments. Specific demands were made by

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<sup>15</sup> Ron Chernow, *The House of Morgan. An American Banking Dynasty and the Rise of Modern Finance*, page 72. Grove Press, 1990.

<sup>16</sup> Kunibert Raffer: *What's good for the United States is good for the Rest of the World. Advocating an International Chapter 9 Insolvency*, 1993. Bruno Kreisky Forum, <http://homepage.univie.ac.at/kunibert.raffer/kreisky.pdf>

creditors of governments in the utopian belief that these would “sever the link between economic decisions and financial risks”.

## **So how do the “rules” of the gold standard compare to those of the Eurozone?**

### **1. Abandonment of control over the currency**

On joining the Eurozone countries voluntarily give up control over the nation’s currency. Under the gold standard, participating governments and their central banks effectively lost control over the nation’s currency, and to a large extent over economic policy. This “rule” of the gold standard – the removal of governmental and central bank control over the exchange rate – was not exactly replicated by the Euro system. Instead all national currencies were simply abolished, and replaced by a currency that – as now structured – is accountable to no government(s) or people(s), and is issued by no state.

As Eichengreen and Temin explain in a recent paper:

“The gold standard was preserved by an ideology that indicated that only under extreme conditions could the fixed exchange rate be unfixed. The euro has gone one step further by eliminating national currencies.”<sup>17</sup>

The euro’s value is instead determined by invisible and unaccountable foreign exchange traders and/or speculators, and bond market dealers, based behind computer screens in Shanghai, London, Frankfurt or New York.

The actual operation of the currency and its role in global capital markets is managed by central bankers from the member states that are governors on the board of the ECB. They operate behind a veil of secrecy and obscurantism; and under opaque ‘rules’ that are often (and have had to be) invented ‘on the hoof’, such as the recent announcement by the ECB governor, Mario Draghi of a policy of Outright Monetary Transactions (OMT).

As a result of its construction, the value of the Euro can rise or fall well below a level that reflects economic activity in individual countries. Instead, and like the gold standard, the euro’s value has been maintained at high levels primarily designed to protect the assets of international bond-holders and private and official creditors.

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<sup>17</sup> Barry Eichengreen and Peter Temin: *Fetters of Gold and Paper* National Bureau of Economic Research Working Paper 16202 <http://www.nber.org/papers/w16202>

## 2. The period of euphoria: the initial advantage of an over-valued currency

Just as with an over-valued currency under the gold standard, the initial experience of an over-valued Euro can appear advantageous to citizens of a new, poorer member country – like Ireland, Greece or Spain. There follows a period of excess. Imports appear cheap, and so, as happened in the case of Greece, Spain and Ireland, citizens rush out to buy new goods and services from richer countries. German, French and other European manufacturing sectors benefited significantly from the sale of cars and military equipment to the Greek government and to Greek firms and individuals. German and French banks lent crazy money at low rates. Greeks tell stories of the sudden appearance of 4x4 vehicles on their streets, and of loans taken out by neighbours to buy new homes and second homes.

In the case of the gold standard the currency appeared to be protected from inflation and volatility. With the adoption of the Euro, creditors believed their Greek loans were backed by a strong currency, in turn backed by a strong economy, Germany. This led them to offer low rates of interest to Greek borrowers – even after the crisis of 2010 when it was revealed that Greece’s government had misled the world about the scale of its debts - in the belief that they would be repaid in full. As Adam Davidson explained in the New York Times:

“In lending money (€7bn) to Greece at 5.3 percent interest (bondholders) weren’t calculating Greece’s ability to pay. They were calculating the German government’s willingness to help out German banks.”<sup>18</sup>

As it turned out, they were right. Governments and central bankers had already bailed out international bondholders after the Lehman bankruptcy in 2008. After the first of the Greek crises, in 2010, bondholders were again largely bailed out by Eurozone governments, and although some took a “haircut” – i.e. were repaid less than they were due – nevertheless the burden of losses was transferred ultimately on to Greek taxpayers.

By then the period of euphoria was well and truly over.

## 3. No co-ordinating body to maintain balance and stability

The second important characteristic of the gold standard system was that it had no international coordinating body that could help stabilize economic and financial imbalances between countries in surplus, and those in deficit. The Eurozone operates in pretty much the same way: there is no coordinating institution set up to manage and stabilize *economic* and financial imbalances between member countries.

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<sup>18</sup> Adam Davidson, *Why Greece’s Lenders Need to Suffer*. New York Times Magazine, 28 July, 2015. [http://www.nytimes.com/2015/08/02/magazine/why-greeces-lenders-need-to-suffer.html?\\_r=0](http://www.nytimes.com/2015/08/02/magazine/why-greeces-lenders-need-to-suffer.html?_r=0)

#### 4. Unfettered capital mobility

A third “rule” of the gold standard was one that gave citizens and firms unfettered freedom to engage in international transactions. In other words, the freedom to buy or sell abroad, to move money (or gold) across borders, regardless of the impact on the domestic economy. Private bankers, traders and wealthy elites welcomed this freedom to move capital abroad.

The removal of restrictions on capital mobility were as indicated earlier, mooted in the foundational Treaty of Rome of 1957. Their importance to the development of the European Common Market was signaled when the Single European Act of 1987 removed all remaining restrictions on capital mobility. This Treaty preceded the establishment of the Euro as a “non-physical” currency in 1999, and the circulation of the Euro in notes and coins from 2002.

It was capital mobility that made it easy for Europeans to trade with each other. But it was not until the Eurozone system was firmly established, and Greece had joined the Eurozone in 2001, that German, French and US banks felt sufficiently confident of Euro-wide implicit bailout guarantees to risk making larger-scale loans to poor, potentially unreliable Greek borrowers – including the Greek state. And it was capital mobility, facilitated by their country’s entry into the Eurozone that gave wealthy Greeks the freedom to move their funds out of Greece, and to accelerate those flows without impediment when the country began to experience difficulties.

#### 5. Deflation as a correction to imbalances

Under the gold standard, a scarcity of gold forced participating governments to deflate their economies.

Just as with the gold standard, so with the Eurozone: an over-valued currency based on Eurozone (Maastricht) rules can have the same deflationary impact on a member country. Even while GDP collapses, and internal prices and wages turn negative as they are now in Greece, Greece’s currency - the Euro - can be maintained at artificially high levels by the ECB. In a deflationary environment an over-valued currency intensifies economic contraction. Unemployment and bankruptcies rise, and as demand falls, the money supply contracts and wages and prices tumble further. Then, as Wynne Godley warned way back in 1997,

“there is nothing to stop it suffering a process of cumulative and terminal decline leading, in the end, to emigration as the only alternative to poverty or starvation.”<sup>19</sup>

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<sup>19</sup> Godley, W. 1997. “Curried Emu – The Meal that Fails to Nourish” Observer (London), August 31. Quoted in Dimitri B. Papadimitriou and L. Randall Wray in *Euroland’s Original Sin*, in Policy Note 2012/8, Levy Economic Institute of Bard College.

This is because a Eurozone country:

“... doesn’t just give up “control over monetary policy” as normally understood; its spending powers also become constrained in an entirely new way. If a government does not have its own central bank on which it can draw cheques freely, its expenditures can be financed only by borrowing in the open market in competition with businesses, and this may prove excessively expensive or even impossible, particularly under “conditions of extreme emergency.”<sup>20</sup>

This last point is exactly why bankers and other international creditors favour the Euro system: it forces governments to turn to the private sector for finance. In an emergency such financing can be extremely expensive for the debtor, and lucrative for creditors – the world’s bond markets.

We have seen how in Greece the ECB has used its ability to withhold liquidity from the Greek banking system as a way of enforcing the Troika’s economic programme of fiscal ‘austerity’. As a result we are witness to the emigration of Greece’s youth and talent to other parts of Europe – determined to find alternatives to “poverty or starvation”.<sup>21</sup>

While other members of the Eurozone may regard Greece as an outlier, and as a country that has brought its difficulties upon itself, they too may suffer collectively from the rigidity of the Euro system. Godley again:

“... [I]f Europe is not to have a full-scale budget of its own under the new arrangements it will still have, by default, a fiscal stance of its own made up of the individual budgets of component states. The danger, then, is that the budgetary restraint to which governments are individually committed will impart a disinflationary bias that locks Europe as a whole into a depression it is powerless to lift.”<sup>22</sup>

As this goes to press the Eurozone is struggling to emerge from a prolonged period of high unemployment, falling real wages and prices, and low levels of investment. Some countries have faced depressions that have rivaled those of the 1930s. In fact, over the 10 years from 2004 to 2014, the average annual change in real GDP in the Eurozone has been just 0.7% (compared to 0.9% for the whole EU), and since 2007, the average change in Eurozone GDP is negative, at -0.1% per year (the figure for Greece is -0.4% per year).<sup>23</sup>

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<sup>20</sup> Godley, W. 1997. “Curried Emu – The Meal that Fails to Nourish” *Observer* (London), August 31. As above.

<sup>21</sup> Wynne Godley, *Maastricht and All That*, in the *London Review of Books*, Vol. 15. No 19. 8 October, 1992.

<sup>22</sup> Wynne Godley: *Maastricht and All That* – as above.

<sup>23</sup> Eurostat data, [http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Real\\_GDP\\_growth,\\_2004%E2%80%9314\\_\(%25\\_change\\_compared\\_with\\_the\\_previous\\_year;\\_average\\_2004%E2%80%9314\)\\_YB15.png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Real_GDP_growth,_2004%E2%80%9314_(%25_change_compared_with_the_previous_year;_average_2004%E2%80%9314)_YB15.png)

## 6. Protectionism and the rise of nationalism

Under the gold standard political reactions were predictable: farmers and entrepreneurs fought back and sought protection from the ‘fantastic’ and unaccountable machinery that was the gold standard. Protectionism and defensiveness became rife. And as Karl Polanyi argued in *The Great Transformation* the effect was the opposite to that wished for by international creditors: national governments were lobbied by their citizens to intervene, to raise tariffs, and to protect the domestic economy from the fluctuations of the gold standard.

“the utopianism of the market liberals led them to invent the gold standard as a mechanism that would bring a borderless world of growing prosperity. Instead, the relentless shocks of the gold standard forced nations to consolidate themselves around heightened national, and then, imperial boundaries.”<sup>24</sup>

In the early twentieth century, heightened nationalism and protectionism intensified international rivalry and conflict. These tensions climaxed with the First World War. Soon after the first shot was fired, the gold standard was abandoned by many nations.

It was revived again in the 1920s under pressure from the world’s most powerful bankers. In Britain it was Churchill that agreed to enter the system, despite his own severe reservations about its likely impact on British industry.

Once again the economic strains proved unbearable, as Europe and the United States endured financial crises, dramatic rises in unemployment, general strikes and stock market crashes. Finally the system collapsed in 1931 when Britain left the gold standard, largely on the advice of John Maynard Keynes – who was bitterly opposed to it. The United States under President Roosevelt followed suit in 1933.

### Where now for the Eurozone?

The way forward for countries trapped within the Eurozone looks bleak. The economic zone as a whole is a mess – there is no other way to describe it.

The herculean choices facing Eurozone leaders are these:

- 1) To remain within the current “corset” that are the Eurozone rules and framework. The risks of taking this path are that more and more countries – including big important countries like Italy and France - will fall into deep economic depressions with rising and unpayable public debt and substantial imbalances. With the rise of a fascist party in France and of right-wing and populist forces in Italy, the prospects do not look pretty.

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<sup>24</sup> Fred Block: Introduction to *The Great Transformation* by Karl Polanyi, for a new edition published by Beacon Press, 2001.

- 2) Abolish the euro (a huge and complex task) and return to national currencies, with all the economic and political risks associated with dismantling the system; but with the possibility of countries regaining economic policy autonomy.
- 3) Create a more limited Eurozone of states whose economies are more integrated and convergent – either by creating e.g. “the northern Euro” or by ‘shedding’ Greece, and in due course other states who fall into very grave difficulties
- 4) Create a political and fiscal union – preferably with its own democratically accountable institutions - for either all the current EZ members, or for an initial vanguard of countries – to create a system of economic as well as monetary union; and preferably at the same time change the mandate of the ECB to make it more accountable to democratic institutions.

All of these choices are fraught with difficulty. But remaining within the “corset” of a monetary union designed to serve the interests of global, mobile capital at the expense of European firms and citizens, risks not just economic failure on the scale of the 1920s and 1930s – but also political conflagration. It would be best if Europe’s leaders learnt from, and did not repeat history. Above all they must finally acknowledge the deep flaws behind the utopian visions of free market, neoliberal ideologues – before Europe plunges into even deeper crises.

While the demise of the gold standard in 1931-3 came too late to rescue Europe from fascism, it engendered great progress in Britain and the United States. The economic recovery in Britain was almost instantaneous. In the United States freedom from the fetters of gold led to President Roosevelt’s New Deal – and to rapid economic expansion. Perhaps Eurozone leaders can take hope from Diaz Alejandro’s description of the reaction to the 1931 collapse of the gold standard in periphery countries:<sup>25</sup>

“In the periphery, the demise of the mentality had profound effects... the disastrous news from the rest of the world... made policymakers and informed opinion feel not only that local conditions were not so bad, after all, but also that no one knew, in Centre or Periphery, exactly what were the roots of the crisis nor how it could be overcome. After a terrible fright, this stimulated an almost exhilarated creativity. The old authorities and rules on economic policy were shattered. It was a time calling for reliance on one’s discretion.”

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<sup>25</sup> As quoted in: Holger Wolf and Tarik. M. Yousef p. 10 in *Breaking the Fetters: Why did countries exit the interwar Gold Standard?* October, 2005. Paper prepared for the conference on *The New Comparative Economic History* in honor of Jeffrey G. Williamson, held at Harvard University on November 4-5, 2005. <http://web.cenet.org.cn/upfile/98181.pdf>

With the shattering of the fetters that bind European countries to the Eurosystem – an “exhilarated creativity” and reliance on a democratic nation’s own discretion, may well break out.

Above all, the shattering of the Eurozone’s fetters, and its status as a fetish, and the rebuilding of a Europe based on democratic and accountable institutions, might help to reinvigorate Jacques Delors’s “European Dream” of economic and political union, peace, unity and stability.

End.

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