Explaining the Euro crisis: Current account imbalances, credit booms and economic policy in different economic paradigms

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Abstract: The paper proposes a post-Keynesian analysis of the Eurozone crisis and contrasts interpretations inspired by New Keynesian, New Classical, and Marxist theories. The origin of the crisis is the emergence of a debt-driven and an export-driven growth model, which resulted in rapid increase in private debt ratios and current account imbalances. The reason the crisis escalated in southern Europe, but not in other parts of the world, lies in the unique dysfunctional economic policy regime of the Euro area. European fiscal rules (and the Troika) impose fiscal austerity on countries in crisis and the separation of fiscal and monetary spaces has made countries vulnerable to sovereign debt crises and forced them to comply with the regime. We analyse the role the different paradigms attribute to current account imbalances, fiscal policy and monetary policy. Remarkably, opposing views on the relative importance of cost and demand developments in explaining current account imbalances can be found in both heterodox and orthodox economics. Regarding the assessment of fiscal and monetary policy there is a clearer polarisation, with heterodox analysis regarding austerity as unhelpful and large parts of orthodox economics endorsing it. We conclude that there is a weak mapping between PKE, NCM, NKM and MPE and different economic policy suggestions for the Euro area, which we label Keynesian New Deal, European Orthodoxy, Moderate Reform and Progressive Exit respectively.

Keywords: Euro crisis, European economic policy, sovereign debt crisis, current account balance, fiscal policy, Quantitative Easing

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1 Introduction

The global financial crisis (GFC) began 2007 in the US in the market of financial derivatives on subprime mortgages. By 2008/09 literally all advanced economies were in a severe recession. In most countries the ensuing recovery was a weak one; only in the southern European Euro member states did the crisis turn into something akin to the Great Depression and only in these countries did the crisis morph into a sovereign debt crisis. These developments pose challenges to economic theories and offer a unique occasion to assess the explanatory power of different economic paradigms. This paper advocates a post-Keynesian (PK) explanation of the Euro crisis and systematically contrasts it with New Classical mainstream (NCM), New Keynesian mainstream (NKM), and Marxist Political Economy (MPE) approaches and reviews what their authors have argued with respect to the role of monetary union and current account imbalances and the role of fiscal and monetary policy. At the background of these problems are different issues of immediate importance for economic policy. What are the effects of a monetary union: is it essentially a fixed exchange rate arrangement or does the divorce of fiscal and monetary space pose deeper problems? Are current account imbalances due to divergence cost developments or a side effect of financial bubbles in some countries? Is financial discipline essential in a monetary union or has austerity exacerbated the crisis?

From the PK view the origin of the crisis is the emergence of a debt-driven and an export-driven growth model, which resulted in rapid increase in private debt ratios and current account imbalances. The reason the crisis escalated in southern Europe, but not in other parts of the world lies in the unique dysfunctional economic policy regime of the Euro area. European fiscal rules have been designed to impose fiscal discipline and imply fiscal austerity. But it was the separation of fiscal and monetary spaces that has made countries vulnerable to sovereign debt crises and forced them to comply with the regime. The Troika then imposed harsh austerity in countries in recession. Thus while the origins of the crisis lie in unstable neoliberal growth models, in particular real estate bubbles and a debt-driven growth model, the escalation of the crisis into a sovereign debt crisis and a depression in southern Europe is to a large extent the result of the EU's economic policy regime. The main effect of currency union, in this view, is not in terms of a fixed exchange rate regime, but that the divorce of fiscal and monetary spaces undermine the ability of nation states to combat recession.

We identify four economic policy strategies for the Euro area and argue that these are linked with the different economic paradigms, but any mapping of positions is a messy one: the crisis has led to debates between and within paradigms and new battle lines are drawn, in particular within the mainstream. Post-Keynesians regard the Euro crisis as the outcome of the neoliberal economic policy regimes of the Euro area. This lends itself to a *Social Europe* or *European New Deal* approach that seeks to overhaul the economic policy regime, giving a prominent role to European fiscal policy, which would be supported by central bank purchases of government bonds and a shift to a coordinated and egalitarian wage policy (Hein 2013, Stockhammer 2016). Ultimately this aims at institutionalizing anti-cyclical fiscal policy at the European level and wage-led growth strategy. This is in sharp contrast to the strategy that we will refer to as European Orthodoxy, which argues that the imbalances prior to the crisis were due to fiscal profligacy in southern European countries, paired with excessive wage growth (e.g. Feld et al 2015). Thus austerity and labour market deregulation are essential to restoring order. Fiscal union is detrimental because it can create moral hazard problems for fiscal policy. While this is the line taken by the German finance ministry and, effectively, the European Commission, and is broadly consistent with New Classical economics, the crisis has shown new fault lines with the mainstream. There is also a *moderate reform* position that is connected to the NK paradigm. It highlights the rapid growth of private debt and financial bubbles as important factors for the crisis and argues that in the short run austerity is harmful and indeed, that excessive ('frontloaded') austerity is regarded as having exacerbated the crisis (Baldwin et al 2015). Labour market reform is desirable, but is not helpful during a recession. The Marxist view on the Euro crisis is less fully developed, but many Marxist writers regard the Euro area's policy arrangements as serving Germany's needs. Monetary union enabled German capital to improve its competitiveness at the expense of other EU countries (Lapavitsas 2015a, 2015b). At the core of Marxist analysis is development of profitability and fiscal and monetary policy gets comparatively less attention. This approach lends itself to a *progressive exit strategy* that regards the European institutions as unreformable (from a pro-labour perspective).

The paper is structured as follows. Section 2 presents the basic economic paradigms regarding the role of demand, income distribution and nature of money. Section 3 covers debates on the cause and the significance of current account imbalances. Section 4 discusses different perspectives on austerity and fiscal policy. Section 5 summarises the debates on credit booms and monetary policy. The different positions are brought together in section 6, where we seek to show the tenuous link between paradigms and policy strategies.

2 Post-Keynesian, New Classical, New Keynesian and Marxist paradigms

This section briefly reviews the main economic paradigms to see how their analytical framework shapes their analysis of the Euro crisis. In PKE the economy is demand-led in the short as well as in the long run (Lavoie 2014, King 2002). Excess capacity and involuntary unemployment are regarded as normal in capitalist economies and supply is regarded as adjusting via induced technological progress. Path dependency and hysteresis thus are pervasive features and economic policy interventions can have short as well as long-run effects (Lavoie 2009, Setterfield 2011, Stockhammer 2011). Among the demand determinants in PKE two stand out for our context: First, PKE has offered an extensive analysis of financialisation and financial instability (see below). Second, income distribution plays a central role in PKE. Following Bhaduri and Marglin (1990) a rich analysis of demand regimes has been developed. A rise in the wage share has a negative effect on investment (higher profits lead to higher investment), a positive effect on consumption (because capitalists save more than workers) and a negative effects on net exports (because the higher wages imply a loss of competitiveness). The net effect will depend on the relative size of the partial effects and may differ by country and time period. If the net effect of a rise in the wage share is positive, i.e. if the consumption effect outweighs the investment (and net export effect), the demand regime is called wage led, if it is negative it is called profit led (Lavoie and Stockhammer 2013). Neoliberalism is analysed as a group of growth models where pro-capital distributional changes in a wage-led demand regime lead to potential stagnation, but external demand stimulates growth in an unstable fashion, giving rise to debt-driven and export driven growth models.

Effective demand in PKE is monetary demand. First, money is a liquid asset that is held, in part, to allow flexibility in a world with an uncertain future. Money is thus, in particular in times of crises, held as an asset and not as a means for real transactions. Second, money is created endogenously as a side effect of commercial bank lending. In the PK view credit creates deposits, not vice versa as in most standard economics textbooks. Money is neither a commodity (as in Marxian and classical economics) nor is created by central banks (as in Monetarist theory). Third, while money is created, in the modern economy, by private banks, its origins lie with the state and sovereign authority. The state is not only the largest borrower, but it also uses legal and coercive powers to establish its currency. State authority is at the foundation of the hierarchy of monies. This analysis of money has great similarity with that of economic sociologists like Ingham (2004) or anthropologists like Graeber (2011). Money is based on sovereign power but is created by profit-seeking private institutions. Fourth, in a monetary production economy the lending decisions of banks become a key variable. Keynes (1936) and Minsky (1986) highlight the role of financial factors, credit and leverage cycles are an important explanation of business cycles and economic crises as private lending decisions tend to be highly pro-cyclical, amplifying booms and trapping the economy in liquidity and debt-overhang crises.

In mainstream economics the economy is anchored in a deep (and stable) equilibrium determined by supply side factors such as technology and preferences, at least in the long run. Whereas in the NCM version the economy is always regarded as being driven supply factors, the NKM version allows for short run dynamics that are driven by demand shocks. These models still are rooted in a labour market equilibrium, a NAIRU, in the longer term (Nickell 1998, Stockhammer 2008). If adjustment is slow because of wage and price rigidities there may be a positive role for government intervention. Before the crisis the NKM has given priority to monetary policy for this. Since the crisis, it has been recognized that situations, like a low inflation environment, may arise where monetary policy ceases to be effective because of the zero lower bound (De Long and Summers 2012, Eggertson and Krugman 2012). In addition there is an empirical recognition that fiscal multipliers may be higher in recession than during periods of high growth (Blanchard and Leigh 2013, Auerbach and Gorodnichenko 2012). The NKM has also given rise to a literature of bubbles in the form of noise trader models (Shleifer and Summers 1990). While these arguments potentially have great import for Euro crisis, they have yet to be tied in a rigorous analysis.

In the context of this paper, two central features of mainstream treatments of money and finance should be highlighted. The first is its focus on the ‘medium of exchange’ function of money rooted in the historical neoclassical view of money as a commodity (Ingham, 2004). This becomes evident in the analysis of optimum currency areas (OCA) (e.g. Ricci, 1997) which focuses on transaction cost reductions in evaluating the benefits of currency unions and does not discuss the historical connection between monetary and fiscal spaces (Goodhart, 1998). The second central point is the continued use of the loanable funds model of finance, despite some objections from within the mainstream (Jakab and Kumhof, 2015). In the context of the Eurozone crisis, this approach is especially associated with Sinn (2010, 2011, 2012) who argues that prior to the crisis, German savings were ‘exported’ to the south and hence unavailable to finance investment in Germany. Many of the NK-leaning contributions in Baldwin and Giavazzi (2015) similarly make use of loanable funds concepts such as the natural rate of interest. Since the loanable funds model and the natural rate of interest are non-monetary concepts, their use underlines the continued attachment of the mainstream to a separability of monetary and real analysis in which money is neutral at least in the long run.

MPE is critical of the capitalist mode of production but shares a supply-side focus in its analysis of capitalist dynamics. However, the supply side is associated with class struggle and the degree of exploitation rather than with preferences and technology. MPE is based on a classical surplus model where investment occurs out of surplus (Goodwin 1967). The constraint to growth is surplus extracted from workers, and traditional macroeconomic topics of fiscal and monetary policy have not featured prominently in MPE.

MPE has traditionally been based on a commodity theory of money (Marx 1976, dos Santos 2012), but recently there have been attempts to go beyond that (Graziani 1997, Bellofiore 2005). Credit and the banking system is regarded as a source of instability, because they allow for temporary expansion of economic activity (e.g. Hilferding 1910)

PKE differs from mainstream economics and MPE on several grounds. First, it has a strong focus on demand formation, whereas NCM and MPE tend to favour supply-side factors. PKE offers an analysis of demand regimes that allows for wage-led as well profit-led growth. There is no a priori assumption that profits get reinvested and higher wage growth can result in higher aggregate demand. Mainstream economics routinely assumes that wage moderation has positive growth and employment effects; in other words they assume a profit-led demand regime.[1] Marxist theory usually has a secondary, short-run role for demand, but it tends to assume that growth is profit-led in the long run (e.g. Dumenil and Levy 1999, Foley and Michl 1999). Crises originate from the (lack of) production of surplus value or from a rising organic composition of capital, not from lack of demand. Indeed, in Marxist theory crises are often regarded as rooted in overaccumulation, i.e. excessive investment due to competitive pressures (e.g. Brenner 1998).[2] PKE regards money as created by commercial banks, whose lending decisions are likely to be pro-cyclical. Consequently regards liberalized financial systems as a major source of instability. From this perspective European monetary integration, which led to more capital flows, but was not accompanied by stronger financial

[1] A similar argument can be made for mainstream economics. New Keynesian economics has a short-run role for aggregate demand, but asserts the dominance of supply-side factors in the long run and it usually is silent on the possibility of wage-led growth. Indeed, a downward-sloping labour demand function, i.e. a profit-led demand regimes, are routinely assumed.

[2] MPE has theorized constellations that PK would characterize a wage-led demand regime under the heading of underconsumption crises. However, these constellations create a tension to the Marxist theory of exploitation, because they allow for increased wages to have a positive effect on profitability. The link between exploitation and profitability thus gets broken.

regulation appears a destabilizing force. Money is not a purely private institution, but backed by government authority. The separation of monetary and fiscal spaces thus threatens to undermine the ability of governments to act in times of crises. This analysis is distinct from NCM and MPE analyses, which tend to have more of a supply-side focus and from the NKM, which recognizes financial instability, but regards monetary policy as sufficient for stabilization except for cases when inflation hits the zero lower bound.

3. Current Account Imbalances, Cost-Competitiveness and Demand Booms

The role of price competitiveness, in particular, unit labour costs in determining Eurozone current account balances has been a subject of major controversy. The debate cuts across the heterodox/orthodox divide in the sense that opponents and proponents of the cost/competitiveness view can be found on both sides. Even when agreement is reached on the importance of costs and competitiveness, heterodox and mainstream scholars often arrive at very different policy conclusions. Importantly, there is also disagreement across different schools of thought regarding the significance of current account imbalances for the Eurozone crisis.

3.1 A Post-Keynesian View on Current Account Imbalances and the Euro Crisis

PKE have offered quite divergent account of causes of European current account imbalances. German PKs well before the crisis highlighted that Germany has pursued a strategy of real depreciation both through exchange rate policy (e.g. Thomasberger 1995)) and later through wage policy (Priewe 2011). They then typically conclude with calls for wage coordination across countries and emphasise that this requires a redirection of fiscal and monetary policy (Hein and Truger 2005). In particular they call for higher wage growth and fiscal expansion in the surplus countries. Mazier and Petit (2013) and Cesaratto (2015) argue that cost divergences are the prime cause of the Eurozone imbalances and that this is due to the lack of exchange rate adjustment imposed by the currency union. At the other extreme Storm and Naastepad (2015a,b, 2014) argue that demand factors and not costs are the key drivers of current account imbalances, rather, they are due to differences in credit growth and private debt.[3] Samarina et al (2015), though less polemical against the cost argument, provide econometric evidence for the role of credit in determining current account imbalances. Other post-Keynesians like Stockhammer and Sotiropoulos (2014) take a more balanced view and argue that both costs and demand factors are driving the external imbalances. In terms of the Euro crisis, Stockhammer (2016) and Stockhammer and Onaran (2012) argue the EU economic policy regime is the source of the crisis, specifically their neoliberal economic policies aimed at labour market flexibility and financial integration.

Though the competitiveness-imbalances debate is of interest in itself, the imbalances are in our view not the key explanatory factor for the Euro crisis. Both the UK and USA have similar imbalances, financial crises and a debt-fuelled boom; yet, these did not lead to sovereign debt crises. The rigid EMU policy architecture is what differentiates the Eurozone from these economies. In particular, the inflexible rules on monetary and fiscal policy effectively makes these pro-cyclical, which can turn recessions into depressions and financial crises into sovereign debt crises. Even if Eurozone member states had balanced external accounts, the separation of monetary and fiscal policy and their pro-cyclical rules would

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[3] There is an empirical debate regarding the size and significance of cost and income elasticities of demand for exports and imports. Storm and Naastepad (2015a) estimate import and export equations for selected Eurozone countries and find that unit labour costs are numerically small and statistically insignificant. But these findings are difficult to reconcile with other studies. For instance, Carlin, Glyn and Reenen (2001) investigate the relationship between export market shares and RULC using a panel of twelve manufacturing industries for fourteen OECD countries. They conclude that RULC are important determinants even if they cannot fully explain changing export positions. Using a fixed effect model for a panel of Euro members from 1999 to 2011, Stockhammer and Sotiropoulos (2014) find that unit labour have statistically as well as economically significant effects.

severely hamper responses to banking crises (for instance) and this delayed response alone can lead to further crises.

3.3 The mainstream on Current Account Imbalances and the Euro Crisis

Within the mainstream there exist various positions on the reasons for and the significance of intra-Euro current account imbalances, but it is difficult to tie them directly to New Classical or New Keynesian traditions. However, there emerge distinct lines in terms of economic policy recommendations. On the more orthodox side Wyplosz (2013) argues that fiscal deficits in the periphery caused demand booms, which induced trade deficits. Thus fiscal indiscipline, not cost divergence has caused external imbalances. It follows that fiscal austerity is needed to curb demand booms and chronic trade imbalances. Beyond austerity, Wyplosz (2013) calls for ECB as lender of last resort, a no bail out rule and a banking union.

European Commission (2010) argues that the current account imbalances are due to different demand developments rather than cost divergences and the credit booms and property bubbles played an important role in determining demand in member states. However, the main policy conclusion it derives centre on labour market deregulation in the deficit countries: “Member States which have accumulated large current account deficits and large competitiveness losses […] need to undertake the necessary relative wage and price adjustments and facilitate the reallocation of resources from the non-tradable to the export sector. In countries with fiscal imbalances, this adjustment should go hand-in-hand with sizeable fiscal consolidation” (European Commission 2010, 37). While the wage divergence was not at the root of the problem, wage cuts and fiscal austerity are the solution.

On the New Keynesian side we find arguments that are much closer to PK analysis. Benassy-Quere (2015) states that the Euro itself is not the source of the crisis. He argues that a key flaw of the Maastricht Treaty is its deflationary bias: there is an upper limit on borrowing but no limit to lending. Further, fiscal deficits are capped but this is not so for fiscal surpluses. He calls for a Eurozone budget for stabilization purposes, debt restructuring and shared sovereignty, meaning that surplus countries need to reduce the gap between demand and supply, in other words, the burden of adjustment must be symmetrical. This reasoning is in line with PKE that current account imbalances are not the cause of the crisis and that the roots of the crisis lie in the EMU policy regime. Similarly, De Grauwe (2015) argues that the crisis is related to the design flaws of the Eurozone and that the external imbalances are related to booms and busts rather than costs divergences. De Grauwe (2015) contends that absence of a lender of last resort is the key reason for the crisis – as a general solution, he recommends a further political union. This ensures that political will is present to address this crisis and future crises.

3.3 Marxists on Current Account Imbalances and the Euro Crisis

Lapavitsas et al (2012) argue that the Euro crisis is closely tied to the Eurozone's external imbalances, with the latter being primarily determined by cost divergences. Much blame is placed on mercantilist Germany and its wage suppression strategy. Flassbeck and Lapavitsas (2013) argue that in a common currency, wages across member states must grow in line with the union's inflation target, any deviation leads to imbalances and crises, although the mechanism which actually triggers the crisis is left rather vague. Southern economies substantially overshot the defined wage target at the same time as core economies (especially Germany) undershot it before the crisis, meaning that both must adjust. Given their analysis, Lapavitsas (2015a, b) call for deficit countries to exit the Euro. Though this view is similar to post-Keynesians like Priewe (2011) and Mazier and Petit (2013), it is in contrast to the majoritarian view in PKE. Marxist explanations appear to implicitly assume a profit-led demand regime, unlike PKE; stagnant wages in Germany produces profit led growth dynamics, in particular, export surpluses. A problem with this story is that even if one accepts the alleged primacy of relative ULC in determining trade balances, the theory lacks an explanation of why economic growth in the deficit countries consistently *exceeded* that of the surplus countries.

Ivanova (2012) posits that the unevenness of capital accumulation across the world engenders imbalances and in turn leads to crises. In a similar vein, Lapavitsas (2015a, b) argue that the sole purpose of the Euro project is to serve the European hegemon – Germany. Similarly, Varoufakis (2016) notes that the USA pushed for European integration to expand the market for German exports. He explains that this was part of US foreign policy after they were no longer a surplus country. If Germany is able to build up its external surpluses, it provides a pool of savings that can be recycled into the US economy. Given this line of reasoning, there is a hegemonic power dynamic to the Euro crisis and following Lapavitsas (2015a, b); a Euro exit might reclaim some power, in particular, monetary control. Overall the Marxist approach focuses on the role of cost divergences and downplays the role of capital flows and real estate booms as factors that lead to demand booms, which can induce trade deficits. It understands the Euro crisis as a balance of payment crisis due to the fixed exchange rate system rather than the outcome of a flawed EMU policy framework.

The central finding of this section is that there is no consensus on the causes of the Eurozone imbalances and the role this plays in the Eurozone crisis. Table 1 groups the literature in terms of what they regard as the main cause of the imbalances and what their policy suggestions are. Interestingly most mainstream contributions identify different demand developments as the main cause of imbalances. These are often linked to financial factors. However, their policy recommendation is internal devaluation, i.e. wage cuts, and fiscal austerity in the deficit countries. Other mainstream economists draw different conclusion from the strong role of financial factors. Baldwin et al (2015) also identify private debt booms as the core cause of the crisis. They warn against excessive austerity, but do endorse labour market reform. Wyplosz (2013) is one of the few mainstream contributions that highlight fiscal profligacy as the cause for imbalances. Marxists along with some post-Keynesians have highlighted cost divergences as the major factor for the imbalances. As a consequence Lapavitsas (2015a, b) advocates Euro-exit. However the majority of PKE and some New Keynesians see the root cause of the crisis in the flawed design of the EMU policy regime.

Table 1. The role of current account imbalances and policy recommendations

	Euro-exit for deficit countries or a dissolution of the Euro	Moderate reform: fiscal discipline at member state level, QE & Automatic stabilizers at Union level	Keynesian New Deal/Social Europe: Inflationary adjustment in Centre countries, QE in support of fiscal policy	Internal devaluation and fiscal austerity in deficit countries
Fiscal indiscipline as cause of current account imbalances				Wyplosz (2013)
Cost divergence as cause of current account imbalances	Flassbeck and Lapavitsas (2013), Lapavitsas (2015a, b)		Cesaratto (2015), Priewe (2011) Stockhammer and Onaran (2012),	
Capital flows and credit booms as cause of current account imbalances		Benassy-Quere (2015), De Grauwe (2015)	Stockhammer (2016), Storm and Naastepad (2015a,b, 2014)	Sinn and Valentinyi (2013), European Commission (2011)

4. The effects of austerity and fiscal policy strategies

Beyond examining the causes and effects of European current account imbalances, most analyses of the Eurozone crisis also discuss the roles of fiscal and/or monetary policies both during the build-up of the crisis, and to explain subsequent developments and suggest solutions. PKs in particular have been highly critical of the EMU fiscal and monetary policy regime and the practical policies it has entailed.

4.1 A Post-Keynesian view on fiscal policy and the Eurozone crisis

PK economists have been consistent in arguing that the EMU fiscal policy regime is flawed both before and after the introduction of the common currency (e.g. Godley, 1992, 1997;

Arestis et al., 2001). The separation of monetary and fiscal policy was held to be a major shortcoming, an argument based on the PK understanding of the nature of money (see section 2), which is absent from OCA theory. Thus PKs argued long before the Eurozone crisis that the currency union was ill-prepared to combat serious downturns and that the constraints placed on fiscal policy would exert a deflationary bias (Hein and Truger, 2002). Out of all the approaches we survey, this matter was the most central to PK treatments as there exists a consensus within that paradigm that fiscal policy is an essential stabilisation tool. Consequently, PKE views fiscal stances as a key reason for the prolonged depression in the periphery. For instance, based on recent estimates of regime-dependent multipliers Stockhammer et al. (2016) show that a large share of the divergent performances of Anglo-Saxon and European core economies on the one hand, and peripheral economies on the other hand can be explained through their differing fiscal stances. PKE also rejects the claim that excessive government deficits prior to the GFC are to blame for the Eurozone crisis. Rather, it highlights the role of private sector debt and inequality in driving credit-led booms which eventually unraveled in 2007-2008 (Stockhammer, 2015).

While PKE agree in their criticism of the Maastricht Treaty and the Stability and Growth Pact, there is some disagreement within PKE regarding the relative importance of the fiscal framework in explaining the Eurozone crisis. Some PKs, in particular those close to Modern Monetary Theory, have well before the crisis highlighted that the divorce of fiscal and monetary space would at some point force governments into austerity (Parguez 1999, Bell 2003; see also Lavoie, 2013), whereas others stress current account imbalances and interpret the Eurozone crisis as a balance-of-payments crisis (Cesaratto, 2015). There is a widespread consensus within PKE that the existing EMU fiscal policy regime is seriously flawed and that austerity will be harmful both in the short and in the long run. For this reason, PKs advocate a fundamental reform of the EMU policy regime which enables the implementation of countercyclical and *discretionary* fiscal policy actions at the European and/or the national levels (Hein, 2013; Stockhammer, 2016).

The emphasis on fiscal policy measures to stabilise output in PKE arises both from a relative skepticism of the efficacy of monetary policy and from its analytical framework which holds that capitalist economies are not self-adjusting toward full employment. While in mainstream models fiscal policy (and thus also austerity) typically only has short-run impacts, PKE strongly emphasises the hysteresis effects of both booms and recessions (e.g. Stockhammer, 2008). This, in conjunction with a rejection of the premises of expansionary austerity (Botta, 2015) also means that PKs advocate *discretionary* fiscal stimulus. The separation of monetary and fiscal policy within the EMU can explain why the financial crisis turned into a sovereign debt crisis only in the Eurozone. Having lost control of monetary policy, and with the European Central Bank being constrained by a restrictive mandate, member states surrendered the sustainability of their public finances to the sentiments of private bond markets and were unable to implement the fiscal measures necessary to counter financial crises.

4.2 The mainstream on fiscal policy: from the New Consensus to orthodoxy versus the New Keynesians

Whereas PK opinions of fiscal policy have been highly uniform both over time and between different authors, mainstream views on fiscal policy have varied. Before the Eurozone crisis, much of the academic literature was focused on investigating how fiscal policy could best be constrained (Fatàs and Mihov, 2003). As Mongelli (2002) notes, the costs of currency unions in terms of losses of policy autonomy were increasingly de-emphasised in the OCA literature. The main problem, in the Eurozone and elsewhere, was widely held to rather be fiscal indiscipline (Afonso, 2005). Additionally, fiscal stimulus was increasingly viewed as being ineffective based on empirical research (Hemming et al, 2002), and the idea on which expansionary fiscal consolidations was based was gaining traction (Giavazzi and Pagano, 1990). Overall, these research programmes contributed to a convergence between the NC and NK strands of mainstream economics, leading to the emergence of the 'New Consensus' model in which macroeconomic stabilization was envisioned to be fully undertaken by monetary policy. The EMU fiscal policy regime thus very much reflected the mood of the time, with its main purpose being the enforcement of discipline.

With the outbreak of the GFC, however, a divergence within the mainstream has emerged. With regard to the Eurozone crisis in particular, two broad views can be distinguished. Certain mainstream analysts as well as European policy-makers, who may be said to hold a broadly New Classical view of economic theory regard the Eurozone crisis as having fiscal roots arising from insufficient discipline. For instance, Wyplosz (2013) seeks to show empirically that European current account imbalances were largely caused by public deficits and argues that austerity is necessary to curb these imbalances. Similarly, Feld et al. (2015) argue that a lack of fiscal discipline, which in their view also contributed to private debt buildups, lies at the root of the crisis. Some analysts who do not argue that the crisis has fiscal roots still hold that austerity is now inevitable to restore competitiveness, provide incentives for 'structural reforms' and ensure fiscal sustainability (e.g. Corsetti, 2010). Fiscal expansions for instance at the European level, would in this view create moral hazard and should be avoided.

A second view, which may be termed ‘New Keynesian’, argues that solvency issues of EMU member states are merely a symptom of the crisis. These writers regard austerity as damaging in the short run but view fiscal consolidation as necessary in the long run. Many contributions in Baldwin and Giavazzi (2015) which represent the ‘New Keynesian’ perspective lament a lack of fiscal discipline prior to the crisis but none of them view it as having fiscal roots. Tabellini (2015), who before the crisis highlighted reasons for fiscal indiscipline (e.g. Alesina and Tabellini, 1990) now takes a position on the shortcomings of the EMU fiscal policy regime similar to arguments put forward by PKs, but does not draw the same wide-ranging implications regarding reform of the policy framework (Tabellini, 2016). Similar views have been expressed by De Grauwe (2015). De Grauwe and Ji (2013) seek to show that Eurozone austerity has been highly damaging and unhelpful in the short run. However, there has been little application of recent research results on fiscal multipliers on New Keynesian discussions of the Eurozone crisis. While Frankel (2015) acknowledges the devastating effect which the underestimation of fiscal multipliers pointed to by Blanchard and Leigh (2013) has had in the Eurozone, there is no systematic connection between the plentiful New Keynesian results on non-linear and regime-dependent effects of fiscal policy (Gechert et al., 2015; DeLong and Summers, 2012) and practical policy recommendations for the Eurozone in the way that there has been for the US (Ball et al., 2014). Thus, for instance, while PKs stress the need for discretionary fiscal policy actions to combat recessions, the New Keynesian mainstream largely concurs with the Five Presidents’ Report according to which automatic stabilisers at the European level will be sufficient (cf. Reissl and Stockhammer, 2016) and should be combined with enhanced fiscal discipline at the national level (cf. e.g. Pisani-Ferry, 2016; Tabellini, 2016).

4.3 Marxist views on fiscal policy

It is difficult to identify a uniform Marxist view on fiscal policy in general or in the context of the EMU in particular. Many Marxist-inspired analyses broadly agree with the PK case for fiscal policy effectiveness and stress the adverse effects of austerity (Bellofiore, 2013; Bellofiore et al., 2015).[4] However, some Marxist authors doubt the general effectiveness of fiscal policy. For instance, Roberts (2012, 2016) argues that Keynesian multipliers ignore the effects of different types of government activity and induced expenditures on the rate of profit. He contends that Keynesian multipliers should be replaced with Marxian ones which attempt to take into account the possible effects of public spending programmes on the rate of profit and can thus lead to the conclusion that fiscal stimulus would be ineffective (see Carchedi, 2012). Ivanova (2012) argues that the GFC is merely a symptom of a deeper structural crisis of accumulation manifested in global imbalances which are outcomes of the processes of globalisation and financialisation. Fiscal policy interventions, while they can provide a temporary relief, cannot address these fundamental 'real' imbalances such as an overaccumulation of capital in certain parts of the world, and thus cannot provide a lasting solution. Regarding the Eurozone crisis in particular, Marxian analyses emphasise current account imbalances and divergences in competitiveness, linking them to power relations between core and peripheral economies, while detailed discussions of the effects of fiscal policy do not feature as prominently (e.g. Lapavitsas 2015a; Flassbeck and Lapavitsas, 2013). As we shall see, a similar conclusion can be reached regarding Marxist analyses of monetary policy.

Table 2 briefly summarises the views outlined above with regard to fiscal policy. PKs have consistently been highly critical of austerity and the abandonment of fiscal stabilisation

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[4] Riccardo Bellofiore is quoted here as a Marxist, but he regards himself as both a post-keynesian and a Marxist. Theoretically he tries to square a Marxist labour theory of value and a PK theory of endogenous money and financial instability.

policy in mainstream economics prior to the crisis. They argue that a fundamental reform of the EMU's fiscal policy regime is necessary to enable expansionary policies to combat the crisis. The mainstream, meanwhile, is today less uniform than it was before the Eurozone crisis and there are two broad views. One views austerity as necessary to overcome the crisis while the other, to varying degrees, is in favour of some form of expansionary policy. Marxists reject the view that the Eurozone crisis was caused by fiscal indiscipline but are divided on whether a reform of the EMU's fiscal framework and fiscal expansion can provide a remedy.

Table 2. A summary of arguments on fiscal policy and the effects of austerity

	Fiscal Policy cannot cure structural crises	Austerity to curb excessive demand and/or lack of competitiveness in periphery	Enhanced discipline at member state level & automatic stabilisers at European level	Fundamental reform of EMU fiscal policy regime enabling discretionary fiscal policy
Fiscal indiscipline as cause of Eurozone crisis		Wyplosz (2013), Feld et al. (2015)		
Eurozone crisis is not due to fiscal factors	Ivanova (2012), Roberts (2012, 2016)	Corsetti (2010), Sinn (2015)		
Austerity has exacerbated crisis in Europe	Lapavitsas (2015a), Flassbeck and Lapavitsas (2013)		Tabellini (2016), Pisani-Ferry (2016), De Grauwe (2015)	Hein (2013), Stockhammer (2016), Bellofiore et al. (2015)

5. Financialisation, credit booms and monetary policy

The discussion above showed that there are fairly clear distinctions between mainstream and heterodox analyses of the role of fiscal policy in the Eurozone crisis and also that there is a large amount of disagreement within the mainstream. A similar conclusion can be drawn from an analysis of the roles of financial factors and monetary policy in explaining the crisis, to which we now turn.

5.1 Financialisation, credit booms, and the role of the ECB – a post-Keynesian view

A reform of European fiscal policy along post-Keynesian lines would also entail a reorientation of monetary policy and the ECB's mandate. PKs have been highly critical of the role of monetary policy in the mainstream 'New Consensus' model (Fontana, 2009, Bibow, 2010) and have questioned mainstream accounts of the monetary policy transmission mechanism (e.g. Rochon and Rossi, 2006; Hannsgen, 2006; Forder, 2006). PKs have also noted that mainstream accounts do not sufficiently discuss the role of monetary policy in managing financial instability (Morgan, 2009; Tymoigne, 2009). Indeed, accounts of the build-ups of financial fragilities in the global economy and within Europe in the context of an increasing financialisation of advanced economies often linked to increasing degrees of income inequality have been central to PK explanations of the GFC and its aftermath in the Eurozone (Palley, 2013; Stockhammer, 2014; Samarina et al., 2015). Since financial instability and credit bubbles play a central role in PK theories of crises, including its explanation of the Eurozone crisis (Stockhammer, 2016), the PK perspective argues that financial stability rather than price stability should be the primary goal of monetary policy, achieved through targeted interventions in markets exhibiting bubble-dynamics. The origin of financial bubbles is viewed firmly in private markets rather than in government interventions.

PKs also argue that unconventional monetary policies such as quantitative easing by themselves are suboptimal tools for curing recessions (Fullwiler, 2013). While it is accepted that asset purchase programmes have been successful in depressing long-term interest rates, PKE has long argued that low rates during a depression are unlikely to lead to an increase in borrowing and expenditure. In an empirical study of the UK case, Lyonnet and Werner (2012) do not find significant effects of QE on real economic activity. While PKs argue that conventional or unconventional monetary policy is an imperfect substitute for fiscal policy in reviving economic activity, they do recognise the role which asset purchase programmes can play in bailing out the private sector and especially in providing maneuvering space for fiscal authorities through depressing rates on government bonds, especially within the policy framework of the Eurozone (Lavoie, 2015; Stockhammer, 2016). Whereas in the Anglo-Saxon economies, central banks made extensive purchases of government debt, the ECB put much greater focus on purchasing private sector assets and lending to financial institutions on a major scale through the LTRO programme. The ECB did not act as a lender of last resort to those peripheral governments facing solvency problems on an unlimited basis until the inception of the OMT programme which was however tied to strict conditionalities and has never been used by any member state. Rather, the ECB has been a lender of last resort only to the private sector. Only in early 2015 did it begin to purchase public sector securities on a broader basis (Claeys et al., 2015). Since the ECB was long prevented from credibly ensuring the solvency of all Eurozone national governments, a sovereign debt crisis could emerge, whereas there was never any such danger for the US or the United Kingdom. The tight connection between monetary and fiscal spaces which was disturbed by EMU and did not feature in mainstream discussions of currency unions hence becomes key to PK explanations of the Eurozone crisis.

5.2 Mainstream: from EMH to undertheorised QE

Before the GFC, the mainstream held that monetary policy can affect the real economy in the short run (Woodford, 2009), that it should be the primary or only stabilization tool, and that it should be used to target inflation. Importantly, the main task of monetary policy was to target variables in the real economy rather than stability in financial markets. Central banks reacted to the GFC through cutting interest rates as would be prescribed by theory,[5] but as rates were approaching their lower bounds more wide-ranging measures were believed to be necessary (Joyce et al., 2012). Large scale asset purchase programmes, often referred to as quantitative easing (QE) were instituted by the Federal Reserve and the Bank of England. The ECB was overall more hesitant. A full-blown QE programme comparable to those of the US and the UK was not implemented until early 2015 (Cukierman, 2013; Tabellini, 2015; Micossi, 2015). The Fed's QE was initially justified by Bernanke using the naïve money multiplier model (Bernanke, 2009) but over time the justification became more sophisticated (Ricketts, 2011). There remains, however, some disagreement about the efficacy, particularly in terms of stimulating real economic activity, of QE (e.g. Joyce et al., 2011, Martin and Milas, 2012). Hausken and Ncube (2013), comparing the effects of unconventional monetary policies in the US, UK, Japan and the Eurozone find that the ECB's approach has been less successful than those of other central banks in lowering various interest rates, whilst the impact on real economic activity was slight in all cases.

The QE programmes in particular in the Anglo-Saxon countries were enormous in size, quadrupling the size of central bank balance sheets (Fawley and Neeley 2013). While there is an ongoing debate on its effects, it is clear that in this field policy has moved ahead of (mainstream) economic theory. The interpretation of QE raises several thorny issues for which mainstream economics is ill equipped. It requires both a theory of money creation and a theory of the functioning and stability of financial markets. Both have become subject of debate within the mainstream. While before the GFC the consensus view was that financial

[5] The ECB's response was notably more tardy than those of other central banks since it kept rates at levels more appropriate to conditions in core economies and even raised them twice in 2011, whilst the periphery was suffering a severe recession.

markets are, by and large, efficient and stable, there has since been a substantial amount of research that demonstrates the link between build-ups of private debt, often associated with real estate bubbles, and economic crisis (e.g. Schularick and Taylor 2012, Drehmann et al 2012). However, this research, while done by mainstream institutions, is typically empirically driven rather than theory guided. Most of that research has a broad historical sweep and is not focused on the Euro crisis, but e.g. Baldwin et al. (2015) argue that the private debt and in particular private cross-border lending is an important factor in explaining the Euro crisis.

But one can once more discern a rift within the mainstream which has emerged as a result of the crisis. A New Classical camp, including many German economists and various policy-makers, argues against the measures which the ECB has taken to date. As became apparent in our analysis of different views on current account imbalances, this New Classical view also comprises both writers who believe that (public or private) credit-led booms are important in explaining the crisis and writers who stress 'real' factors, chiefly divergences in competitiveness as causal factors (cf. e.g. Feld et al., 2015; Sinn, 2015; Wyplosz, 2013). Their criticisms of unconventional monetary policy have mostly focused on warnings about a conflation of fiscal and monetary policy which is perceived as a threat to central bank independence. Issing (2012) contends that unconventional monetary policies could compromise central banks' focus on price stability. Sinn (2010) argues that Eurozone QE creates moral hazard and might endanger reforms and austerity which he views as necessary. Drudi et al. (2012) concur, arguing that Eurozone QE should be tied to strict conditionalities.

Similarly to the debate about fiscal policy, however, there is here also a NK camp which argues that the extensive unconventional monetary policy measures by the ECB are necessary to promote recovery (Levy, 2014; Giavazzi and Tabellini, 2015) and that these can be designed so as to avoid moral harzard (De Grauwe and Ji, 2015). Additionally, as outlined above, some exponents of the NK view have begun to stress the implications of the ECB's monetary policy for national fiscal policies which are also highlighted by PKs. These authors also stress the role credit bubbles in explaining the Eurozone crisis and some exponents of the NK view have come close to PK positions in arguing that financial instability is a basic feature of capitalist economies (Baldwin and Giavazzi, 2015, p. 54). However, they stop short of calling for a full reform of monetary policy in this light and there is no clear divide between the two mainstream camps on the origins of financial instability, with a general view being that ECB policy has at least partly contributed bubbles in the periphery (Micossi, 2015).

Despite disagreements within the mainstream and, surprisingly, despite contributions within the New Keynesian paradigm which highlight the important role of inherent financial instability in causing economic crises, mainstream economics seems to have been very welcoming of the recent move toward a capital markets union (CMU). While from a PK perspective, the CMU reinforces the potential for financial instability and certainly will not function as a countercyclical 'buffer' against recessions (Reissl and Stockhammer, 2016), the mainstream appears to agree with the European institutions that CMU will enhance the functioning of the common currency and reduce financial instability (Valiante, 2016; Martinez and Philippon, 2014).

5.3 Monetary policy and financial crises in Marxist analysis

The general lack of coherence regarding Marxist theories of money and finance make it difficult to identify a uniform Marxist position on monetary policy. Indeed, there are few publications which explicitly discuss this topic in the first place. One exception is Roberts

(2016) who, in discussing responses to the GFC, invokes Keynesian arguments to claim that monetary policy is likely to have little effect in promoting a recovery from deep recessions. In another contribution (Roberts, 2015) that “in a slump or crash, capitalists try to hoard and avoid investment. If profitability stays low, then even a low rate of interest or mountains of ‘liquidity’ will not release that hoard”. Thus, once more, the rate of profit becomes the crucial variable. Ivanova (2012) holds similar views about monetary policy as those about fiscal policy set out above, and in general believes that financial crises are merely reflections of deeper, structural imbalances and thus that financial explanations of the GFC are inadequate. Lombardi (2014) warns about potential inflationary effects of QE thus adopting a conclusion rather akin to what a monetarist might argue. There do not appear to be any Marxist-inspired contributions on monetary policy in the context of the Eurozone crisis in particular. And although some Marxist authors have written extensively on financialisation (e.g. Lapavitsas, 2011), there also does not appear to be any systematic treatment of financial instability and credit bubbles in the context of the Eurozone crisis from a Marxian perspective since most analyses focus on ‘real’ factors, especially divergences in unit labour costs (Flassbeck and Lapavitsas, 2013; Lapavitsas, 2015a,b). However, Bellofiore et al. (2015) agree with the point, most prominently associated with PKE, that the design flaws of the EMU, with the separation of fiscal and monetary spaces and the lack of an effective lender of last resort must play an important role in explanations of the Eurozone crisis.

Table 3 provides a brief overview of the different opinions on monetary policy, quantitative easing, and the role of credit bubbles and financial instability. PKs view monetary and fiscal policy as closely connected in that monetary policy regimes and practical policy decisions can exert strong influence on fiscal policy space. Since PKs believe that fiscal policy measures are necessary to combat the Eurozone crisis, they argue that these must be supported by ECB action. Furthermore, they question the primacy and the goals of monetary policy put forward by the mainstream and argue that monetary policy should be used to prevent private credit bubbles which for PKs represent a major source of economic instability and are central to explanations of the Eurozone crisis. Consequently, a European CMU is not seen as helpful in promoting financial and economic stability. Mainstream views are varied, with differing views on the importance and causes of financial instability in explaining the Eurozone crisis. Nevertheless, there appears to be universal support for a European CMU. A clearer division emerges with respect to the desirability of QE, with many analysts opposing it on the grounds of moral hazard and others supporting it. Marxist economists, meanwhile, tend to argue that financial instability and credit bubbles in the Eurozone and elsewhere are symptoms of structural crises. There are few concrete discussions of monetary or financial markets policy in the context of the Eurozone crisis.

Table 3. Credit booms and monetary policy positions

	ECB policy produces moral hazard	ECB policy action necessary for recovery	QE & reform of ECB necessary to support fiscal policy	Monetary policy cannot address structural crises
	CMU will promote recovery and financial stability		CMU will be a source of instability; monetary policy should promote financial stability	
Financial bubbles a major factor for the Euro crisis	Feld et al., 2015	Giavazzi and Tabellini, 2015 De Grauwe and Ji, 2015	Lavoie, 2015 Stockhammer, 2016	
Euro crisis caused by ‘real factors’	Sinn, 2010 Drudi et al., 2012			Ivanova, 2012 Roberts, 2015 Flassbeck and Lapavitsas, 2013

We view PK explanations of the Eurozone crisis and consequent proposals for its resolution as the most coherent. The policies advocated by those analysts whom we have summarised under the heading of New Classical economics have been unsuccessfully applied throughout the periphery for years without apparent success. The New Keynesian strand of mainstream economics questions some of these views, but does not present a comprehensive challenge to them as it often stops short of drawing conclusions which fundamentally undermines these views. Meanwhile, Marxists have offered few practical recommendations apart from exit from or a dissolution of the Eurozone which, as Realfonzo and Viscione (2015) point out, also do not represent full solutions unless coupled with policy recommendations on what to do following such a step. The next section provides a more comprehensive discussion of the issues presented thus far.

6. Economic paradigms and economic policy strategies for the Euro area

The above sections discussed a large number of different views, both theoretical and empirical, on aspects of the Eurozone crisis. A general conclusion is that contrary to what the title of Baldwin and Giavazzi (2015) suggests, there is no consensus view on the causes of or remedies for the crisis. Indeed, even the mainstream of economics is deeply divided on these issues, whilst European policy-makers remain committed to austerity policies and the crisis narrative of what we have summarised as the New Classical view. Table 4 summarises the main policy conclusions which have emerged from the discussions above. In doing so, we present four policy paradigms which can roughly be mapped to the four theoretical approaches we have identified.

Table 4. Policy strategies for the Euro area

	European Orthodoxy	Moderate Reform	Keynesian New Deal/Social Europe	Progressive Exit
Current account imbalances	Internal devaluation and fiscal austerity in deficit countries to restore competitiveness.	Restoration of competitiveness is necessary but should not be accompanied by austerity.	Inflationary adjustment in Centre countries: higher wages and fiscal expansion.	Euro-exit for deficit countries or a dissolution of the Euro.
Fiscal Policy	Austerity and enhanced fiscal discipline at national level. European fiscal policy produces moral hazard.	Fiscal discipline at national level but introduce automatic stabilisers at European level.	Refom EMU policy framework to allow discretionary fiscal policy at national and/or European level.	Either siding with PKE or holding fiscal policy to be ineffective in solving crisis viewed as structural.
Monetary Policy & Financial Markets	Unconventional monetary policy action must be tied to conditionalities (moral hazard). CMU to promote financial stability.	QE to stimulate economic activity. CMU to promote financial stability.	QE important to support fiscal policy. Reform of ECB mandate. Monetary policy to promote financial stability. CMU contributes to instability.	As above.

European Orthodoxy, which roughly corresponds to the views of New Classical economics, strongly emphasizes moral hazard problems in monetary and fiscal policy, and is in favour of austerity and/or internal devaluation to restore competitiveness and correct current account imbalances. Academic voices which closely correspond to this policy paradigm include Sinn (2010) and Feld et al. (2015). The *Moderate Reform* paradigm also takes its inspiration from mainstream economics but can most closely be mapped to what we have summarised as New Keynesian views on the Eurozone crisis. It shares a number of views, including the need for labour market reforms and, eventually, fiscal consolidation with European Orthodoxy but is critical of austerity and more open to a reform of the EMU policy framework toward a limited fiscal union. Comprehensive statements of the Moderate Reform camp's views on causes of and resolutions for the crisis can be found in Baldwin et al. (2015) and also among the contributions to Baldwin and Giavazzi (2015). However, it must be noted that many academic contributions cannot be mapped one-to-one to our stylised policy paradigms. For instance, some of the contributors to Baldwin et al. (2015) and Baldwin and Giavazzi (2015), such as Wyplosz, Corsetti or Feld, fit more closely into the New Classical paradigm and, as the previous sections showed, have at times expressed policy conclusions closer to the European Orthodoxy in terms of endorsing austerity while others (e.g. De Grauwe, 2015) come very close to the 'ideal type' of the Moderate Reform paradigm. This further underlines the observation that the mainstream is deeply divided and at times inconsistent in its analysis of the Eurozone crisis and that nothing approaching a 'consensus' view exists even in academic debate, let alone policy-making.

Similarly, it is difficult to clearly map Marxist contributions to a particular policy paradigm. This is mostly the case because there are in fact few Marxist works that discuss the Eurozone crisis in great detail. In addition, most Marxist contributions make few positive suggestions about monetary and fiscal policy in the Eurozone. One reason for this, exemplified also in Mavroudeas (2015), is that Marxist explanations of the Eurozone crisis tend to focus on what they view as ‘deep structural’ causes, including falling profit rates and competitiveness divergences based on neo-mercantilist growth models in the core economies. Such views – leading to the belief that the Eurozone is beyond repair – also underlie consequent calls for unilateral exits or dissolution of the Eurozone which is why the policy paradigm corresponding to Marxist views is termed *Progressive Exit*. Influential statements of this view have come from Flassbeck and Lapavitsas (2013) and Lapavitsas (2015a,b). Once again, the imperfect fit between theoretical views and policy paradigms becomes apparent. For instance, Flassbeck can hardly be called a Marxist, whilst Lapavitsas certainly can. At the same time, Marxist-inspired contributions such as Bellofiore (2013) are much closer to PKE and the corresponding policy paradigm which we have termed European New Deal or Social Europe. It is this latter policy paradigm which the present authors endorse, and which will be set out in more detail for the rest of the section. The paradigm takes its chief inspiration from PK contributions along the lines of Hein and Truger (2011) and Stockhammer (2016).

Table 4 shows that there is a marked difference between the Moderate Reform paradigm and the European New Deal and the underlying PK contributions. As indicated, some ‘New Keynesian’ contributions come close to what PKs are arguing, without however drawing the same comprehensive policy conclusions. Our discussion of PK contributions indicated that the Eurozone’s design is more deeply flawed than most mainstream contributions would care to admit. At the same time, we do not believe that the Eurozone is beyond repair. Rather, we concur with Realfonzo and Viscione (2015) that the crucial questions is how a country does or does not remain in the Euro, that is, what policies are adopted in order to combat the crisis. Some PKs have interpreted the Eurozone crisis as a balance of payments crisis. While we concur that current account imbalances and intra-European capital flows are important aspects, particularly in explaining how financial fragilities could build up within Europe, we also contend that the fiscal and monetary policy framework is the more crucial element in understanding the crisis. The roots of the crisis lie in credit bubbles in the periphery which eventually, in the fallout from the GFC, collapsed, leading to recessions which subsequently escalated into the sovereign debt crisis. However, within the current EMU policy framework, any serious recession, regardless of whether or not it is preceded by current account imbalances, could lead to a deep depression due to the restrictions on stabilising policy interventions. Conversely, if the current constraints on fiscal policy did not exist, it is not clear why persistent current account imbalances should ever necessarily lead to a crisis, let alone the deep depression or the sovereign debt crises we have observed. The flawed design of the EMU policy framework is thus the key to understanding the crisis and a European New Deal based on this recognition would be effective in overcoming the crisis and putting the Eurozone on a solid foundation, thus making exits or a dissolution unnecessary.

The major feature of the European New Deal policy package would be a thorough reform of the EMU's fiscal and monetary policy framework to remove the constraints currently placed on the ECB and national governments. While we accept the potential importance of 'structural' factors such as divergences in competitiveness, inequality and financialisation in explaining the Eurozone crisis, we do not believe that these can readily be separated from monetary and fiscal matters. Rather, both are interlinked in that monetary and fiscal policy regimes as well as concrete policy measures are important factors in determining the productive structure of an economy, and especially in determining how problematic current account imbalances and divergences in competitiveness are in the first place. In addition to an increase in national fiscal maneuvering space, there should thus be a fiscal authority at the

European level which possesses the capacity to implement discretionary spending programmes rather than merely automatic stabilisers. Both national governments and a supranational fiscal authority would require full and unconditional backing from the ECB to eliminate the possibility of a repeat of the sovereign debt crisis. Under such a constellation, it is no longer obvious why current account imbalances within Europe would necessarily be a problem in and of themselves.

To the extent that current account imbalances are symptoms of credit bubbles in parts of Europe, an appropriate solution would be a control of credit growth. This in turn would require tackling the roots of credit growth, including inequality, financialisation and financial deregulation. A reformed ECB which, along with supporting European fiscal policy, would be tasked chiefly with promoting financial stability through targeted interventions would contribute greatly towards that goal. This would however be desirable regardless of whether or not financial instability is linked to current account imbalances. To the extent that current account imbalances reflect divergences in productive structures or in cost competitiveness, they should be combated through large scale public investment programmes in the periphery and appropriate wage growth in the core economies. More generally, a European wage policy should aim at generating sufficient domestic demand to promote high employment in Europe and reduce inequality. However, the goal of all such policies would not be balanced current accounts in and of themselves, but rather to reach the goal of convergence between Eurozone members at a high level of economic welfare and economic and financial stability.

The main lesson from the Eurozone crisis should be that such convergence is not, as held by the European authorities, an automatic process. Rather, it can only be the outcome of equitable, wage-led growth in income and productivity, buttressed by a truly sustainable monetary and fiscal policy framework which eliminates the possibility of a sovereign debt crisis and thus the deflationary bias inherent in the current set-up. It can thus only be brought about by positive action and cooperation at the European level. Otherwise, at the latest when the next crisis hits, the question of whether or not to exit from or dissolve the Eurozone will no longer pose itself since peripheral economies will be left with little choice.

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