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What the eurozone needs is functional finance

From Dr Fadhel Kaboub.

Sir, The eurozone's obsession with "sound finance" is the root cause of today's sovereign debt crisis. Austerity measures are not only incapable of solving the sovereign debt problem, but also a major obstacle to increasing aggregate demand in the eurozone. The Maastricht treaty's "no bail-out, no exit, no default" clauses essentially amount to a joint economic suicide pact for the eurozone countries.

The eurozone needs a functional finance approach to economic policy, which requires that the European Central Bank, as the monopoly issuer of the currency, acts as a lender of last resort to allow the expansion of aggregate demand through government spending. The ECB's refusal to use its firepower is what is driving eurozone bond yields to unsustainable levels. The ECB can easily purchase Italian debt to lower yields, but such action would constitute a violation of Article 123 of the European Union treaty. Unfortunately, the likelihood of a swift political solution to amend the EU treaty is highly improbable. Therefore, the most likely and least painful scenario for Italy (Greece, Portugal, Spain etc) is an exit from the eurozone combined with partial default and devaluation of a new national currency.

It has been fascinating to watch the entire world turned upside down during the past few weeks over the eurozone's self-inflicted economic pain – the same pain that so many developing countries have suffered under the Washington consensus austerity measures and sound finance principles.

The takeaway lesson is that financial sovereignty and adequate policy co-ordination between fiscal and monetary authorities are the prerequisites for economic prosperity. In the end, what matters is not the level of the deficit or the national debt, but rather their effects on employment, price stability and economic growth.

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