Book Review

Reviewed by Dirk Ehnts

Email: dehnts@googlemail.com

Heterodox Challenges in Economics: Theoretical Issues and the Crisis of the Eurozone
by: Sergio Cesaratto
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Sergio Cesaratto has written a timely book: How can heterodox economics help to analyse the (crisis of the) Eurozone and what kind of reforms would help? He addresses non-economists, which is an excellent idea given that there is a lot of interest in the issues he raises. Seven long chapters, along with an epilogue, comprise the 296 pages. Cesaratto lets a student ask simple questions throughout the book, which he then answers. This kind of Socratic style works very well, while naturally leading to further reading at the end of each chapter, as the topics covered are expansive.

Cesaratto starts by asking the central question of his book: "What should an informed and committed citizen know about economics?" He laments that a 'mountain of lies' had spread to convince Europeans that fiscal austerity was necessary. He compares mainstream economics to goldfish living in a fishbowl with a memory so short that they always discover new worlds and, by implication, know and learn very little about the patterns that evolve around them. Nevertheless, Cesaratto believes that economic analysis can help informed citizens and therefore it is worth the effort. He first points out that society consists of groups which must somehow divide the economic pie, while also determining the citizens' civil rights.

Cesaratto then follows a historical line through Chapters 2–4. He starts with the classicals and the surplus approach. Cesaratto argues that societies started with a surplus, which he defines "that part of the product that society can freely use once the amount needed to reproduce the same output in the next period has been set aside." He argues that when gatherers and hunters transitioned to farmers, government began. Via Smith, Ricardo, Marx, Keynes and Sraffa, he arrives at further insights: the free market would not automatically lead to full employment; "the nature of prices is closely linked to the topic of the distribution of income"; capital values thus depend on prices, which are the basis for calculating capital values. Cesaratto regrets that mainstream economics, criticised in Chapter 3 ('Marginal economics') is no longer as a means to stimulate critical inquiry.

Marginal theory has two strong implications: "there is only one natural distribution of income (i.e., to each his/her own); and when this distribution prevails there is full employment." Chapter 3 also strongly hints at Keynesian critiques of marginalism: for

Keynes, investment creates saving and not vice versa, as the marginalist economists thought. This shifts the focus to banks, who finance investment, and to the state, which according to modern monetary theory “can spend even without having first collected taxes or without first financing itself through government bonds.” Cesaratto writes that “citizens pay for the [public] services with taxes”, with the state taxing the rich like Robin Hood. However, it is unclear what the author thinks true, since earlier he writes that “public spending generates, via the income multiplier, both tax revenue and the saving of those who buy government bonds that finance deficits.” If true, citizens pay for their public services/goods by giving working time as well as goods and services to the state. MMT gets the character of money as a tax credit right, but Cesaratto seems to confuse monetary with real analysis here.

His view on public debt is somewhat complicated. First, he sees foreign-owned public bonds as worrisome, since domestic bond holders can be coerced through ‘freezing the debt or capital controls’. Second, he thinks that the average interest rate on public debt matters as well as the growth rate of GDP. The usual argument applies: public debt is stable under certain values for the interest and growth rate. High interest rates lead to a ‘trap’; low interest rates ‘provide room for expansive fiscal policy’. This view of public debt has fallen out of favour during the COVID-pandemic, though. Greece, whose debt/GDP ratio topped 210%, sailed through the crisis without any financial/fiscal hiccup. With negative growth rates and positive interest rates, not a single Eurozone country saw a return of the Euro crisis (from the early 2010s). Neither did austerity policy rear its ugly head. Why not?

Cesaratto discusses the Pandemic Emergency Purchase Programme (PEPP), which the European Central Bank introduced in March 2020. However, he concludes that interest rates on Italian Government bonds would remain at unsustainable levels because it ‘did not completely reassure the markets’. Cesaratto also misses the importance of the activation of the escape clause (only days after the PEPP) added to the stability and growth pact after the global financial crisis. Until at least the end of 2023, there are no more ‘excessive deficits’. This means that Eurozone national governments have regained their monetary sovereignty – for now! They can spend as much as they wish without running into the twin problems of either an ‘excessive’ deficit or a lack of demand for government bonds. The Eurozone has proven very flexible during the pandemic and the results have been nothing short of impressive. Instead of imposing austerity, the expansionary fiscal stance has led to record low unemployment in the Eurozone. While surely the response could have been better, it seems that Brussels (and Berlin) and Frankfurt have learned something.

Cesaratto also discusses the Keynesian liquidity trap, claiming that central banks could fail to bring the interest rate to zero. His argument seems to be that “central bank’s demand for bonds is met with strong sales and interest rates do not fall”. This is not convincing. If the central bank offers prices to bond holders that imply a zero yield, why would sellers not accept the high price that the central bank offers to pay? Why would Cesaratto believe that a bank would not accept a free lunch and instead negotiate for a lower price to sell at? With all the talk about expectations and guidance, banks will surely understand that the central bank is willing to overpay in order to create zero yields. The Bank of Japan has been engaged in yield targeting for many years and never failed to get what it wanted. Oddly enough, Cesaratto begins the next section with the admission that recent events would have confirmed the power of central banks to reduce interest rates.

Perhaps, it would have been better to leave out the whole discussion of the liquidity trap as to not confuse the reader. Not much seems to have been gained.

Chapter 5 discusses money as an external constraint, which is a very Italian concept. Before the *vincolo esterno* can be debated, Cesaratto takes the reader through monetary theory. He agrees with MMT that money is what can be used to make tax payments. He correctly explains banking, loans, and clearing. Reserves in his view are used exclusively for payments between banks. One wonders why the federal government is not discussed, since it creates reserves when it spends and removes them when it taxes. However, that is not what Cesaratto envisions: “Like private entrepreneurs, the state becomes indebted to the banking system by selling it bonds, in exchange for which the banks create a deposit in the state’s name out of thin air.”

While Cesaratto suggests that some elements of his monetary and fiscal theory are recognisable as MMT, this is not what MMT says. In the Eurozone, national governments spend by having their respective central bank mark up the account of the receiving bank, which in turn marks up its customer’s account. The government’s account at the central bank is then debited. Since the government cannot own money, which is an IOU it issues, the balance at the central bank does not represent money. It is therefore not included in any of the calculations of the monetary quantity. Tax revenues and bond revenues are recorded on the government’s account and move the balance up. Central banks are only allowed to make payments on behalf of their respective treasury if the government’s account was positive at the end of the last business day. This is how the Greek government ran out of money: spending more than it received in tax revenues and not able to sell enough bonds in order to return its account to a positive balance.

Cesaratto then discusses currencies and their use for payments to purchase goods and services from the rest of the world. He argues that the trade balance leads to changes in official reserves. This would be true if there were no financial transactions, like purchases of real estate or government bonds by foreigners. That is why he believes that trade deficits lead to an accumulation of foreign debt on which the country has to pay interest. It is not clear who is the debtor here – the country? The central bank? Why does it have to pay interest? Did it have to borrow? Anyhow, default would be inevitable. This is the external constraint, for both industrialised and emerging countries. Therefore, even without the Euro, Italy would still be a problem, Cesaratto thinks.

The way that his arguments are put forward in this chapter will not convince all readers. His discussion of trade and current accounts falls short. When he assumes that the private sector, through national saving, finances the public deficit, he misuses the term ‘finance’. Only economic actors can finance their spending, but sectors do not ‘finance’ at all – their deficits and surpluses are statistical shadows of past payments. It is also not correct to write that European countries would issue state bonds ‘in a currency they do not print’. Firstly, money creation is about digital balances in the TARGET2 payments system (soon to be replaced by T2). Secondly, all national central banks in the Eurozone are suppliers of euros. As stated above, a government can only run out of money because its central bank is not allowed to spend on its behalf – it can still create euros for national banks that borrow using collateral. Cesaratto ends the chapter by a discussion of whether a sovereign currency can avoid the external constraint.

Chapter 6 discusses the recent history of the Eurozone. Cesaratto explains that “peripheral countries borrowed from core countries, which happily granted loans to expand their exports to the periphery.” This seems to be grounded in neoclassical theory, as German saving(s) is meant to have financed real estate in Spain and Ireland, which created incomes that were then spent on German exports. It is puzzling why Cesaratto, who correctly explains endogenous money, resorts to a neoclassical view at the international level. His discussions of economic history are very good, though. Cesaratto points out that 'monetary mercantilism' in Germany are incompatible with the Eurozone's institutions (or lack thereof). He thus has a pessimistic view about the Eurozone's future.

His main argument is:

> "A stateless currency means that when monetary unification causes imbalances, there is no federal body designated to restore balance through fiscal transfers. Moreover, in the absence of a federal fiscal policy, countercyclical measures implemented by monetary policy are less effective."

The policy response to the COVID-pandemic has shown, however, that maybe Cesaratto was overly pessimistic. He sees two possible outcomes: another financial crisis that would ultimately destroy the Euro (he does not say why but seems to have in mind a repeat of austerity policies) or the continuation of the Eurozone with more ordoliberal reforms. Cesaratto does not, however, conclude that nothing can or should be done. He would like to see Italian interest rates on its public debt reduced.

Chapter 7 on monetary policy concludes the book. Cesaratto believes that lower interest rates are expansionary and higher interest rates contractionary. He also believes that higher interest rates appreciate the domestic currency and that the exchange rate exerts influence on the trade balance. His discussion of the floor system and unconventional policies used by the ECB is excellent. He does not forget that the bail-out of the European periphery mainly served German and French banks, to whom banks from the periphery were indebted. This chapter, an economic history of the Eurozone, is perhaps the book's strongest.

The book lives up to its title. Cesaratto is well versed in heterodox economics and asks the right economic (and political) questions. Cesaratto skilfully makes the point that there is no economic policy mechanism in place that would ensure full employment. After the publication of the book, the pandemic hit. The Eurozone quickly reacted not by repeating austerity policies, which would have destroyed the Eurozone, but by turning the ECB into a dealer of last resort and temporarily scrapping the Stability and Growth Pact. Also, 'Next Generation EU' was created, which means that for the first time the European Union countries issue joint debt. These recent developments, however, do not mean that the book is outdated. The analysis and the history are still valid and would interest anyone who wants to understand the economic problems of the Eurozone.