National Currency – The Supreme Weapon against Deficits

All public debts are not worth the same. In this respect, it is crucial to have a clear distinction according to the monetary system adopted by the country with which we analyze public debt. Indeed, a country benefitting from a fluctuating exchange rate, that is one in which the currency isn’t able to be exchanged into another currency over a certain period of time at a fixed rate, or indeed into a precious metal as was the case with gold standard, never risks going into bankruptcy. A sovereign country that freely issues currency-denominated loans does not have to face the potential consequences or usual measures of market retaliation or pressure whenever they engage in spending that greatly exceeds their budgetary capacities. To jump into programs allowing it to stimulate its economy and to guarantee its citizens their social benefits, this country – which enjoys the absolute monopoly in the issuance of its national currency – avails of a solution that allows it not to increase taxation and stop sinking amidst the mass of markets to be financed. Indeed, it is sufficient to credit bank accounts with the currency that it alone has the power to issue. Contrary to a country having abdicated its monetary sovereignty by indexing its currency to another one and which is thus naturally limited in its capacities to print, and even more so, to spend its own currency. The example of countries having correlated their national currency to the American Dollar shows beyond a doubt that they can only issue their currency in amounts that allow them to maintain the level or the fluctuation range defined in relation to the dollar. Their freedom to print their own currency is also restricted by the compatibility with this indexation, which instantly renders their currency non-sovereign and extremely subjected to market waves that do not hesitate to launch into speculative attacks against a currency that would have been issued in too large of amounts and forced to leave this indexation – in other words, default payment. Their freedom to print their own currency is also restricted by the compatibility with this indexation, which instantly renders their currency non-sovereign and extremely subjected to market waves that do not hesitate to launch into speculative attacks against a currency that would have been issued in too large of amounts and forced to leave this indexation – in other words, default
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Let’s digress a little to note also the known risk that the private sector takes by borrowing in a currency other than its own, thereby placing it in an extremely fragile situation, for the same reasons as those likely to affect its own state. This brings to mind the acute crisis of certain Eastern European countries (such as the Czech Republic or Latvia) whose households and businesses had borrowed in Swiss Francs prior to the 2007 crisis, persuaded by their banker that the interest rates of that currency would remain low, with promised savings on their substantial financing costs vis-à-vis their own currency or that of the Euro. Logic pushed so far that the private sector of certain emerging European nations had even borrowed up to 90% in foreign currencies, the regional European average being 50% of private credit arrangements contracted in foreign currencies, of which 20% on average only in the Swiss Franc. If the interest rates of the Swiss Franc were indeed maintained at insignificant levels as the bankers of these emerging Eastern European nations had thought, its safe haven status had to, however, catapult it to more than 30%! The consequences proved catastrophic for those debtors who did not normally have any revenue in Swiss Francs and nonetheless were forced to make repayments of 30% higher on their debt. Let’s also think about the number of French municipalities and towns which had, under the impetus of a (sadly famous) European bank, decided to index their borrowings to the exchange rate of this same Swiss Franc, convinced by their banker that they would maintain their financing costs under pressure with respect to the “high stability” of this currency. French towns which today find themselves in an inextricable situation,
near bankruptcy, since this massive appreciation of the Swiss Franc forced them (by the series of ratchets under their contracts) to have to pay interest rates of almost 25% per annum on their debts! In conclusion, no one – neither state nor the private sector – should venture into debt in a currency that is not its own without risking default if a single parameter goes wrong.

In addition, the decision for a country to correlate its currency – or even abandon it altogether – in favor of another therefore amounts to giving up fully its monetary policy, and sometimes tax, which provides yet an immense privilege. In these times of European turbulence, we think obviously about the members of the EU handing over the reins of this privilege to the supranational institution known as the European Central Bank. As these countries only use, and not issue, Euros, they are able to finance their lifestyle with tax levers and bond issues. From this point of view, an emerging country that has a sovereign currency clearly has more flexibility in determining its public policies than Germany! Hyperinflation is certainly a threat – it remains the only one! – able to limit the enthusiasm of those nations which are still fully sovereign in their ability to print their currency in virtually unlimited quantities to fulfill their duty to their citizens. Of course, we think about the textbook case of Zimbabwe or Weimar… However, a country that was even a few years ago the second most important economic power in the world, and today is the third, strongly credits bank accounts and prints money en masse – Japan –, without any hyperinflation and even without incurring the slightest surge in its financing costs. It is precisely because Japan has a monopoly on issuing yen and its public debt is denominated in this currency that it does not suffer the fate of Greece despite a reduced ratio of debt to GDP even less enviable than that of this same Greece. And the argument of a few according to which the Japanese public debt is only quasi held by its citizens is not welcome. A sovereign country remedies its sovereign debt and honors its creditors by crediting their accounts, that its public debt be held by strangers or by its own citizens.

Hence the reason for a fundamental ingredient which is always at fault with the Euro, which is far from being a “sovereign” currency unlike, for example, a country like the U.S. which has its own sovereign currency. In fact, for the members of the Euro zone, everything happens as if they had opted for a foreign currency, somewhat like how certain “dollarized” countries indexed their currency to a standard. Indeed, certain mechanisms of assistance to members in need are already acting as shock absorbers and even the presence of the ECB instills some flexibility. Nevertheless, the countries united under the Euro banner are not recipients of considerable advantages that are conferred on nations
issuing a sovereign currency. In this regard, the Greek creditors unveil this structural weakness intrinsic to European nations which use a de facto non-sovereign currency. In fact, a country which issues its own sovereign and freely convertible currency can never go bankrupt since there are no limits as to how much of its own money it can print in order to settle its debts and operating expenses. There are no restrictions stopping it from borrowing on markets and, in absolute terms, it can issue its currency in sufficient quantities to pay interest and its debts so as to finance its multiple deficits... Thus, this country is not, in theory, subjected to any spending limitations since it benefits from the sovereign privilege of crediting several bank accounts in its own national currency without worrying about the surge of interest rates on its bonds. Indeed, it does not issue its borrowings under the restriction knowing that, whatever happens, it can pay the interest by printing even more of its national currency... This is precisely why a country such as Japan, whose debt ratio/GDP is double that of the PIIGS, pays modest interest on its Treasury bonds: it issues a sovereign currency. However, a country which borrows in a currency that is not its own or whose national currency is indexed to a foreign currency (or to gold) risks defaulting on payment in case of a grave financial crisis. That is why certain European nations must be faced with an increased spiral on the financing of their debts even when their ratios are less spectacular than those of Japan, or even the U.S. From the point of view of member nations of the European Union, the Euro remains somewhat like a foreign currency. It is little like if the member nations had indexed their former national currency – even underlying – to the European currency, and a little as if they had permanently incurred debt in a foreign currency where they do not benefit from the privilege of issuing it as it would seem proper for them. Thus, the different central banks of countries which adopted the Euro and all have accounts with the ECB – only to issue these same Euros – benefit only from limited monetary reserves: the funds provided to these nations by the ECB are effectively proportional to their Treasury bills subscribed by the markets and investors. A country like Spain is therefore restricted in this arena and forced to borrow at impossible rates since it does not have the advantage of printing its own bills or the possibility of unlimited support from the ECB. Today, European leaders are still ignoring this weakness in the system. Indeed, they act as though they do not understand the concept of monetary sovereignty whereas the implementation of the Euro presented since its introduction a “congenital” defect?

In such a context where the Euro presents this original sin heavy to assume, it is strictly impossible for a number of these member nations to reboot via a massive depreciation of their national currency. Incapable of reestablishing their captivity in favor of boosting their exports, these
countries thus find themselves in a catch-22 system of deflation and buried under the weight of their ever worsening indebted situation. As their citizens are only – after all – human beings, who for the most part have very largely punctured their threshold of tolerance, default payment remains therefore the only honorable solution. With, at the helm, financial and economic chaos. This is why we in Europe are currently living an authentic revolution of mentalities which are forcing us to mourn an illusion that comfortably cradled us. With, at the helm, financial and economic chaos. This is why we in Europe are currently living an authentic revolution of mentalities which are forcing us to mourn an illusion that comfortably cradled us. The myth of the state as protector and ultimate refuge has officially given up the ghost, since we know now that our – non sovereign – state can go bankrupt. The myth of the state as protector and ultimate refuge has officially given up the ghost, since we know now that our – non sovereign – state can go bankrupt. Well before the creation of the Euro, the Canadian, Robert Mundell (born in 1932) specified the conditions for a successful monetary union. These works garnered him the Nobel Prize in 1999, i.e. precisely the year in which the single currency was launched. According to Mundell, a shared currency by a geographic region would only be viable in the case of mobility of capital and labor, flexibility in salaries and prices, similar economic cycles and tax transfers within the zone. In other words, money and workers should be able (and want) to travel and establish themselves in different parts of the EU. Prices should even decrease if necessary and not only increase. The members of this Union should benefit both from economic expansion or suffer economic contraction together. Finally, a solidarity (ideally automated) should allow some regions in turmoil receive financial support from an agency created for this purpose or by a federal government. Today, the European Union does not have any of these advantages, making it an unsustainable Union, at least according to the Mundell criteria, unlike the United States whose structure allows it to absorb economic shocks. Of course, an unemployed person in South Carolina can move to Texas where he has just found work while a Greek would find it very difficult to establish himself in Sweden and vice versa. Apart from the language barrier and mindset, a European country, devastated from, or undergoing, a sharp economic slowdown would, in addition, receive no subsidy from its central administration allowing it to stay the course and successfully fight the recession. Thus, the union in effect in the U.S. only functions because its workforce can move freely from state to state, where constant interzonal capital flows and institutionalized automatic mechanisms cushion financial shocks. Indeed, not content with these congenital defects, the European Union turns out to be even a machine producing bubbles – that is to say, imbalances – due to a single interest
rate divided by regions and nations which are thus subject to actual divergent exchange rates between them. In the actual European context, the Euro actually acts as a gold standard, whereby the adjustments and essential readjustments – which cannot be achieved through the relief valve of appreciation and devaluation – are done exclusively by the transmission belt of prices and salaries. The Euro clearly cannot be converted into gold, but – in the absence of the characteristics described by Mundell and in the presence of a uniform rate of interest for all members – it compresses economies and produces recession. Since the prevailing gold standard is reflected in adjustments to support systematically weak economies and currencies while sparing the strong countries. Is this not the peripheral Europe which suffered and cashed in all imbalances within the framework of the actual European crisis? Remember the purpose of the gold standard which exerted a downward pressure on some fragile currencies of nations undergoing economic contraction and therefore high unemployment, unable to make the necessary domestic adjustments. The Euro – as the gold standard – makes the situation worse for countries in recession by creating deflation. Let us never forget that maintaining the gold standard which effectively had to hinder fighting – even prevent – the Great Depression. Let us also remember that it is the countries which were not members – or which quickly exited it at the time – which first reestablished themselves or pulled themselves out of it with limited damage. It is more or less understood that speculation and the financial world were launched with heads lowered, since the beginning of the 1990s, into the delightful game of playing Greek, Italian or Portuguese interest rates against German rates. Thus, giddy profits were recorded by investing in peripheral nations or the Southern countries which were not supposed to go bankrupt thanks to the umbrella of the Euro. As such, the financial system neglected a fundamental point, i.e. in the absence of a currency that may be devaluated if necessary, this devaluation thus takes another form: default payment… Therefore, the actual European disappointments – which are not the result of fiscal indiscipline – are amplified by this single currency which is not used as a lever to lessen the pain of economic and social recovery for Europeans.