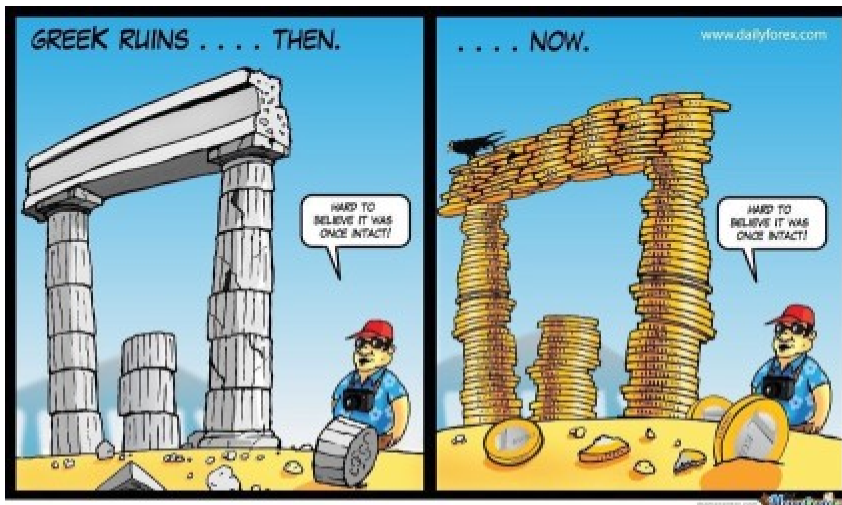
The Best Take on Greece



(click for larger image)

This is the best take on Greece that I have seen. Warning: NSFW (language).

Quoting the **last few paragraphs,**

> ***Europe's creditors are behaving exactly as one might naively predict private creditors would behave, seeking to get as much blood from the stone as quickly as possible, indifferent to the cost in longer-term growth. And that, in fact, is a puzzle! Greece's creditors are not nervous lenders panicked over their own financial situation, but public sector institutions representing primarily governments that are in no financial distress at all. They really shouldn't be behaving like this.***
>
> ***I think the explanation is quite simple, though. Having recast a crisis caused by a combustible mix of regulatory failure and elite venality into a morality play about profligate Greeks who must be punished, Eurocrats are now engaged in what might be described as "loan-shark theater". They are putting on a show for the electorates they inflamed in order to preserve their own prestige. The show must go on.***

> ***Throughout the crisis, European elites have faced a simple choice: Acknowledge and explain to electorates their own mistakes, which do not line up along national borders of virtue and vice, or revert to a much older playbook and manufacture scapegoats.***
>
> ***Such tiny, tiny people.***

Thanks to Guillermo (@groditi) for pointing to this article. You may agree or disagree, but there's a lot of truth here.

Trackback

Advent of the Southern Euro

Drachma and Euro

[Update 2 June 30, 2015, 1:35 pm with comment and image via Neil Wilson (@neilwilson).]

[Updated June 30, 2015 1:20 pm left-coast time GMT -8 with two new comments from joao.]

In his near-future novel *Supersad True Love Story* (Random House, 2011) **Gary Shteyngart introduced the idea of a**

“northern euro” and a “southern euro.” Mr. Shteyngart has been correct on so many issues that he may need to update his resumé, changing his job description from “writer” to “futurist.”

Today saw another potential step in this progression. **There is speculation that Greece will leave the euro zone but still use the euro as currency.**

What Is Money?

Money is anything that is widely accepted in exchange for goods and services in ordinary commercial transactions.

It’s important to have a **good, working definition of “money.”** One of my graduate fields was in monetary theory and I’ve taught money and banking many times. Here’s the definition I use →

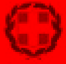
For Greece, the relevant part of the definition is “widely accepted.” A Greek euro is not money outside Greece. That means t**he Greek euro is, *de facto,* a separate currency. Greece might as well just go back to the drachma. (Indeed, Twitter user joao called the currency the “euro-drachma.”)**

Is Greece Blackmailing the ECB?

Via Neil Wilson on Twitter:

> ***Some sort of font failure makes the Greece debt restructuring request look like a ransom note***

Indeed:



HELLENIC REPUBLIC
THE PRIME MINISTER

Athens, 30 June 2015

To the Chairperson of the Board of Governors of ESM
and President of the Eurogroup
Mr. Jeroen Dijsselbloem

Dear Chairperson, dear President,
On behalf of the Hellenic Republic ("the Republic" or "Greece"), I hereby present a request for stability support within the meaning of Articles 12 and 16 of the ESM Treaty.

As you are aware, the Republic faces urgent and pressing financial problems in the second half of 2015 and for the whole of 2016 given that:

- no disbursements from its second program (the "Program") have been made since July 2014;
- the Republic does not have access to market financing within the meaning of Article 1 of the Guideline on Loans ("Guidelines") by the European Stability Mechanism ("ESM");
- the Program expires on 30 June 2015, and our application for an extension to conclude the pending negotiations has not been accepted; and,
- the Emergency Liquidity Assistance ("ELA") has not been extended by the ECB, and therefore, capital controls in the Greek financial system were necessary to maintain the financial stability of the Euro area.

Given the above and given that today, 30 June 2015, is the deadline set by the Eurogroup in the 20 February 2015 statement to reach agreement, Greece requests financial stability support from the ESM in the form of a two-year loan ("Loan") as all of the conditions provided in Article 13 of the ESM Treaty and in Article 2 in the Guidelines are met. The Loan will be used exclusively to meet the debt service payments of Greece's external and internal debt

(click image for larger version)

How Will the Euro-Drachma Be Implemented?

To understand this you need to **understand how interbank settlements work in the eurozone.** Let's start with **the definition of "interbank settlements." Let's say you want to buy something at a store that banks with Wells Fargo.[1] You bank with Citibank. You use your debit card to buy something in the store. The interbank settlement system is the mechanism that moves funds from your Citibank account to the store's Wells Fargo account. In the U.S., most large banks are members of the Federal Reserve system which handles interbank settlements. In the eurozone, it's the European Central Bank. Here's the description from the ECB website:**

> *TARGET2 is the real-time gross settlement (RTGS) system owned and operated by the Eurosystem. TARGET stands for Trans-European Automated Real-time Gross settlement Express Transfer system.*

The speculation about creation of a euro-drachma began with this tweet from Megan McArdle (@asymmetricinfo):[2]

> *I don't think ECB will force Greece out of euro; I think it*

> ***will have to devalue if it wants to reopen its banks ever.***

Which, of course, led me to ask how Greece could devalue the euro vis-à-vis the euro. An answer was supplied by joao (@mar67760521):[3]

> ***Yes, TARGET2 shutdown by the ECB will mean Greece has €-dramchas type of currency, not yet though***

> *Yes, TARGET2 shutdown by the ECB will mean Greece has €-dramchas type of currency, not yet though*

> ***No, Greece will still use the € but can't get the money out of Greece. TARGET2 gets shutdown.***

So, effectively, Greece will have its own euro. (Interestingly, the ECB did much the same thing with Cyprus a few years ago.)

Joao was kind enough to supply some additional input (and a valuable web link). I have concatenated tweets per the "+" sign in the originals.

> ***ECB has put a cap on TARGET2, as of this moment, it is in effect because Bank of Greece choose too obey ECB. There is nothing that says BoG has to obey the ECB and if the ECB decides to shutsdown TARGET2 for good, it will mean that BoG is now independent. It can still print €'s without ECB consent.***

So there you have it. The decision rests with Greece. I doubt very strongly that the Greek central bank will actually print euros. But, from a purely academic viewpoint, it would make for an, um, interesting situation.

For an interesting and mildly entertaining analysis, see Greece and the Art of Liquidity.

Will This Work?

No.

The ECB Weighs In

Les Echos interviewed Benoît Cœuré, Member of the Executive Board of the ECB. The interview was published on the ECB website on June 29.

> ***Interview with Les Echo***
>
> ***Interview with Benoît Cœuré, Member of the Executive Board of the ECB, conducted by Nicolas Barré, Catherine Chatignoux, Jean-Philippe Lacour, Etienne Lefebvre, Guillaume Maujean, Dominique Seux and François Vidal, Les Echos, on 29 June 2015.***
>
> ***Is Greece's exit from the euro area now the most probable hypothesis?***
>
> *Greece exiting the euro area, which used to be theoretical, can unfortunately no longer be ruled out. It's the result of the Greek government choosing to end discussions with its creditors and resorting to a referendum, causing the Eurogroup not to prolong the second adjustment programme.*
>
> *The ECB, like the other European authorities, wishes Greece to stay in the euro area. That's the substance of the proposal made last week by the Commission, the IMF and the ECB in the form of a programme of reforms and a financing offer that is much more favourable than anything proposed in the past. Europe has never abandoned Greece.*
>
> ***In what way were these proposals more favourable?***
>
> *They gave Greece the time and the freedom to reform its economy, for example its labour market, while envisaging a demanding budgetary path, but taking account of the*

deteriorating economic climate. The primary surplus requested was reduced to 1% of GDP in 2015, compared with 3% previously. We were also proposing larger cuts in military spending to create room for manœuvre elsewhere.

So does the responsibility for breaking off talks lie entirely with Greece?

The decision to interrupt discussions was taken by the Greek authorities. That also surprised us, for we were coming to the end of some quite focused and fruitful exchanges.

Conclusion

At this point, I am mystified as to why the Greeks want to stay in the eurozone. Now that they've been locked out of the interbank settlement system, there's very little advantage to be gained from continuing on that path. Bring back the drachma!

[1] Banks named are for example purposes only. This does not imply any endorsement.

[2] In all tweets I have removed the Twitter handles of those mentioned in the message. If you're curious you can follow the links to see the original tweet.

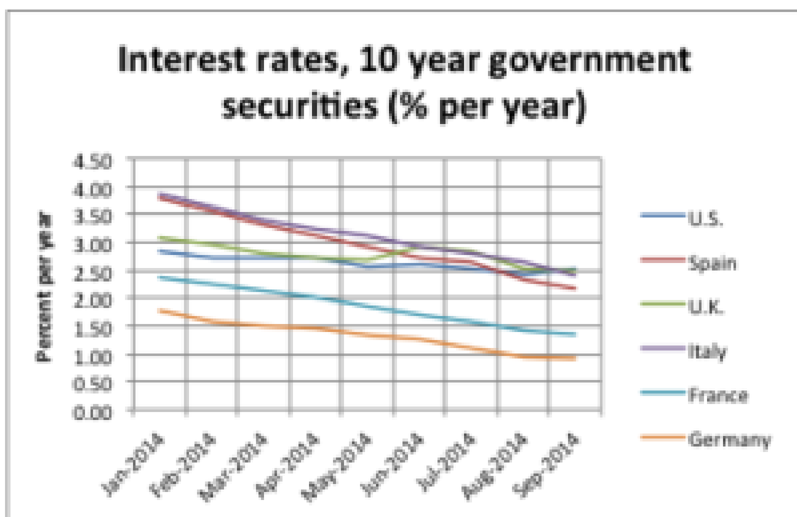
[3] joao is probably located in Brazil. Roughly translated "joao" is "John." Search for "Joao de Deos"

Global Interest Rates

The other day, someone I regularly read on Twitter (@DividendMaster) noticed s**omething interesting about interest**

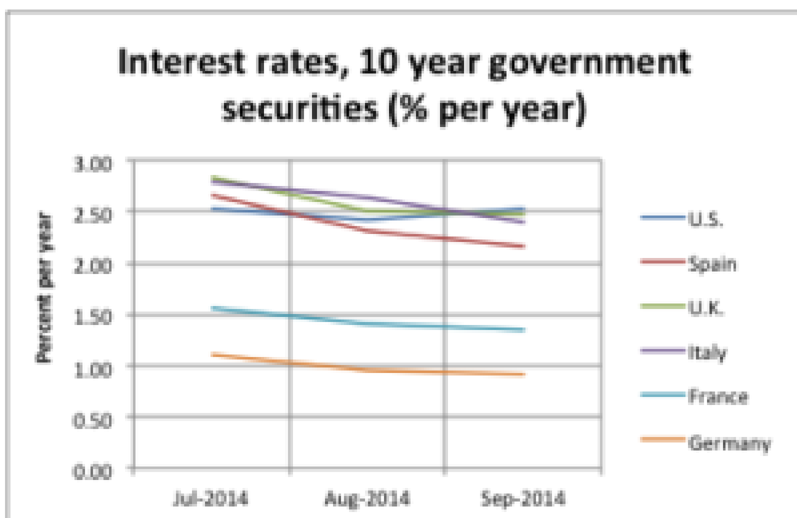
rates, specifically ten-year government notes in OECD countries.[1] (As always, my methods are transparent. [Click here] to download the Excel workbook (includes both monthly and annual data).

Take a look at this and see if you notice **anything interesting:**



Monthly Interest Rates, 2014 (click the image to enlarge)

That's pretty hard to read. Here's a closeup of the last three months:



Interest Rates, Last Three Months (click for a larger image)

Yes, you're reading that right. **The U.S. interest rate was the highest among these six countries in September. Spain and Italy? Really? (If it's any relief, the interest rate on Greek sovereign debt was 5.89%, indicating that there is at least some sanity in the world.)**

Also note that **France and Germany are borrowing at interest rates considerably less than what the U.S. is paying.**

The usual explanations for interest rate differentials among various countries are (1) differential inflation rates and (2) expected future exchange rate changes. Naturally the two are related. However, **expected future exchange rate changes also incorporate a variety of other risks, including exchange rate risk and default risk.**

Let's assume the risk of U.S. default is less than either Italy or Spain. We need a theory of expected future exchange rates. **The appropriate short-run model is *uncovered interest parity* (UIP)**.[2]

Uncovered Interest Parity

UIP theory says **the interest rate[3] on comparable securities in two countries should be equal after adjusting for expected future exchange rate changes**.[4]

$$\underbrace{i_\$}_{\substack{\text{Interest rate on dollar deposits} \\ = \\ \text{Dollar rate of return on dollar deposits}}} = \underbrace{\underbrace{i_€}_{\text{Interest rate on euro deposits}} + \underbrace{\frac{(E^e_{\$/€} - E_{\$/€})}{E_{\$/€}}}_{\text{Expected rate of depreciation of the dollar}}}_{\text{Expected dollar rate of return on euro deposits}} \qquad (4\text{-}1)$$

Uncovered Interest Parity

Thus we see **the expected rate of depreciation of the dollar is equal to the interest rate differential. We can use this to**

construct the following table:

Country	Sep-2014	Change vis-à-vis U.S.
France	1.3500	1.1800
Germany	0.9200	1.6100
Italy	2.4000	0.1300
Spain	2.1620	0.3680
United Kingdom	2.4753	0.0547
United States	2.5300	

UIP in Action

The markets are saying **the U.S. dollar is overvalued with respect to these currencies. The dollar is expected to depreciate vis-à-vis each of these countries.**

But there's still one problem. **All these countries except the U.K. and the U.S. use the euro. How can the dollar be expected to depreciate by different amounts against a single currency? It can't. There is only one spot U.S. dollar – euro exchange rate. The remaining differences must be due to default risk.**

Default Risk

Let's assume Germany's sovereign debt has about the same risk as U.S. government securities. We need to modify our UIP equation to account for default risk. The easiest way is to simply define the default risk premium as follows:

$$i_{\$} = i_{\epsilon G} + \frac{E^{e}_{\$/\epsilon G} - E_{\$/\epsilon G}}{E_{\$/\epsilon G}} + \frac{E^{e}_{\$/\epsilon O} - E_{\$/\epsilon O}}{E_{\$/\epsilon O}} + R_D$$

$$R_D = \left(i_{\$} - i_{\epsilon G} + \frac{E^{e}_{\$/\epsilon G} - E_{\$/\epsilon G}}{E_{\$/\epsilon G}} + \frac{E^{e}_{\$/\epsilon O} - E_{\$/\epsilon O}}{E_{\$/\epsilon O}} \right)$$

UIP With Default Risk

where the subscript *$/€G* refers to the expected depreciation of the dollar vis-à-vis the euro in Germany and *$/€O* is the apparent expected depreciation of the dollar vis-a-vis another Eurozone country. Thus we have the following premiums for the risk of default:

Country	Sep-2014	Change vis-à-vis U.S.	Default risk premium
France	1.3500	1.1800	0.4300
Germany	0.9200	1.6100	0.0000
Italy	2.4000	0.1300	1.4800
Spain	2.1620	0.3680	1.2420
United Kingdom	2.4753	0.0547	
United States	2.5300		

Default Risk Premiums

Conclusion

What's really interesting about this is that **Italy is viewed as higher risk than Spain. Default risks for other Eurozone countries are in the Excel workbook.**

[1] OECD (2014), "Finance", *Main Economic Indicators* (database). DOI: 10.1787/data-00043-en (Accessed on 21 December 2014)

[2] Material in this section is based on chapter 4 from Robert C. Feenstra and Alan M. Taylor, *International Macroeconomics* (2012). Worth Publishers, New York. Disclaimer: I wrote the instructor's resource guide for this textbook.

[3] "interest rate" means "yield to maturity" here and throughout.

[4] Feenstra & Taylor, p. 113.

DExit Revisited

No Euro (Image is from the Adesso Fuori Dai Coglioni (AFDC) initiative "Referendum 'No Euro' E' Iniziata la Raccolta Firme" http://www.adessofuoridaicoglioni.it/referendum-no-euro-e-iniziata-la-raccolta-firme/).

In May, 2012 I noted a proposal from Mr. Paul Feldman of Spencerville, MD. At that time there was a great deal of discussion about the possibility of **GRexit, the possibility that Greece would exit the Eurozone. Mr. Feldman made the brilliant proposal that Germany should give up the euro instead, presumably restoring the Deutschemark as the national currency. His reasoning was that without Germany the other Eurozone countries would have to get their acts together since**

they could no longer depend on bailouts from Germany.

Naturally, I fully endorsed Mr. Feldman's proposal for DExit. I also claimed credit, albeit a tiny amount, for inventing that word (tip: **Deutschland**). **And, with that, the whole issue vanished.**

Until today. **"Marketplace" (American Public Media) included a story about Alternative for Deutschland (AfD)**, **a new political party that wants to pull Germany out of the euro.**

> ***There's a political tornado brewing in that country that could blow the euro off course and reignite the debt crisis. Germany's newest political party – Alternative for Deutschland (AfD) – which wants to pull out of the single currency – is on the rise.***
>
> ***"I think we are becoming a real force in German politics, " says party worker Friedrich Hilse. " We have broken through into the European parliament, we have won seats in three regional assemblies, and we're likely to get into the Bundestag (the German parliament) at the next election."***

Currently, AfD has about seven percent of the votes in Germany. But **two factors** make it worth noticing. First, **AfD has come out of nowhere and grown rapidly**. And second, **the party's appearance and appeal break the "German consensus" that more European integration is better**.

Having said all that, **I don't forecast the Eurozone breaking up any time soon. But nationalism is on the rise across the continent. The AfD is yet another indication of this**

.

Image is from the Adesso Fuori Dai Coglioni (AFDC) initiative "Referendum 'No Euro' E' Iniziata la Raccolta Firme" (http://www.adessofuoridaicoglioni.it/referendum-no-euro-e-iniziata-la-raccolta-firme/).

Germany Harmonizes With Other European Countries

Angela Merkel

"Harmonization" has been a key word in discussions of European integration. In the past this has usually meant **talking about tax regimes in the different countries, with Ireland's low taxes held up as an example of anti-competitive behavior.** "Anti-competitive" means Ireland is better at competing for business than other European countries. **Persuading Ireland to raise their tax rates would be closer to cartel price-fixing.**

But the latest move is from Germany. **Germany harmonizes with**

other European countries by imposing their first-ever minimum wage. CNN has a story about this. By increasing their minimum wage (from a base of zero) Germany moves closer to the rest of Europe.

Money, Income, and Wealth

Money, income, and wealth are three words familiar to everyone. People often use them interchangeably. But to economists these three words have very different meanings. My goal is to explain what each means and how the three are related.

Money

Money is anything that is widely accepted in exchange for goods and services in ordinary commercial transactions. In other words, money is whatever you use to buy stuff. Many people call paper bills and coins "money." Economists call those items **currency**. **Today just under half of the U.S. money supply is currency.**

A while back some otherwise sensible economists proposed having the U.S. Treasury Department mint a $1 trillion coin. Getting into the spirit of this idea, I asked my Twitter friends to name the coin and (if possible) provide a design. The winner was the Freddie Krugerrand:

The Freddie Krugerrand

[A note from my attorneys: the above coin is not legal currency anywhere as far as I know. Attempts to copy and spend it will almost certainly get you in a lot of trouble.]

But you can buy stuff with things that are not currency. Your personal check is one example. If you use a **debit card** to transfer funds from your checking account to the sellers account, as far as the Federal Reserve is concerned that is identical to writing a check. What counts is not the paper check or the piece of plastic that is the debit card. What matters is the balance in your checking account. For historical reasons, the Federal Reserve calls these balances **checkable deposits. Those balances are a little more than half the U.S. money supply.**

Wait – the Federal Reserve?

Every developed country has a central bank that is in charge of managing the quantity of money in circulation. In the U.S. the central bank is the [Federal Reserve system.](#) **The U.S. currency is, of course, the dollar.** But beware – other countries use currencies called "dollars" that usually cannot be exchanged for U.S. dollars one-for-one. For example, the

exchange rate between the Canadian dollar (CAD) and the U.S. dollar (USD) on October 4, 2013 was 1.03213 CAD per USD. In other words, it took 1.03213 Canadian dollars to buy one U.S. dollar. (I use Oanda.com to find exchange rate information. Usual disclaimers apply.)

In Europe, a group of countries has decided to use a single currency, the euro. The **European Central Bank** controls the quantity of euros in circulation.

Back to Money

There is one other minor part of the U.S. money supply: travelers' checks. They make up less than one percent of the U.S. money supply so we'll ignore them. Here's what the U.S. money supply looks like for the last three months:

Date	Currency	Checkable Deposits	Other	M1
6/1/13	44.29%	55.12%	0.60%	100.00%
7/1/13	44.42%	55.57%	0.01%	100.00%
8/1/13	44.56%	55.24%	0.20%	100.00%

As of August, 2013, the U.S. money supply (M1) was $2.55 trillion. That's a lot of money. But **U.S. gross domestic product for 2013 will be about $16.7 trillion.** That means **every dollar in circulation will be spent about 6.5 times ($16.7/$2.55)**. Economists call that number the ***velocity of circulation of money***. (In fact, GDP does not really measure total spending, but it will be close. Asset transactions, for example, are paid for with money, but are not counted in GDP. Also, previously-owned products such as used cars are not part of GDP.)

As always, my methods are transparent. Click here to download the Excel workbook that includes the data shown above as well as much more.

Income

Income is the total earned by an individual or household during a specific time period. Economists call **income a flow variable**, which means **it has time units attached**. It makes no sense to say "I earned $1,000." A moment's thought will convince you that **there is a big difference between $1,000 per day and $1,000 per year. Income always has time units attached.**

Most of us work for a living and think of our income as what we earn from our jobs. But **there are other sources of income: interest, dividends, and other income flows from lending part of our assets to businesses or governments.** Some people may own rental housing units such as apartment buildings. The income they earn is called rent.

Many households save part of their income. There are many reasons for saving: a college fund for your kids, retirement, a down payment on a house, and an emergency fund are a few of the possibilities. **When a household spends less than its after-tax income, the difference is saving.**

Wealth

The accumulation of past saving plus interest, dividends, and capital gains (or losses) is called wealth. Unlike income. **wealth is a stock variable with no time units attached.** At any point in time your wealth is a certain number of dollars. **Wealth increases with additional saving** (a flow that increases wealth), interest, dividends, and capital gains (also flows that increase wealth). **Wealth decreases with spending out of wealth** (a flow that decreases wealth). **Wealth can also decrease because of capital losses.**

The relationship between wealth and saving is typical of many stock-flow relationships:

$$W_t = W_{t-1} + S_t - D_t$$

Think of W_t **as wealth at the end of this year and** W_{t-1} **is wealth at the beginning of the year.** S_t **is saving during the year (including interest, dividends, and so on) and** D_t **is "dissaving," the amount withdrawn from wealth during the year.** This is typical of stock-flow relationships in economics, finance, and other fields. (Note that dissaving includes capital losses, if any.)

Conclusion

I hope this article has clarified the relationship between money, income and wealth. You should understand that **money is used to purchase goods and services. While income and wealth are valued in money units, that is their only relationship with money. Income is the annual flow of purchasing power earned by an individual**. Most people earn at least part of their annual income by renting their labor to a business or government agency. **Wealth is the accumulation of past saving plus any increases or decreases.** It will help you learn these differences by practicing using the terms correctly.

A New Eurozone Conspiracy Hypothesis

In today's New York Times, business columnist Floyd Norris proposes a new eurozone0 conspiracy hypothesis: suppose the ongoing eurozone crisis was actually planned all along by Germany.[1]

Better sit down because this is a good one. According to Mr.

Norris's model, the story begins in 1992. Having been frustrated twice in the 20th century in their attempts to take over Europe by military force, the government decided to use economics instead. His reading of the history of the euro as a German conspiracy is entertaining and insightful. Unfortunately, he is limited to the space allocated by his Times editors. Here on GonzoEcon we are our own editors and can consume as much space as we want. Let's look back at the real beginning, 33 years ago.

Ancient History: The ERM

In March, 1979, France and Germany formed the Exchange Rate Mechanism (ERM). The ERM was designed to "stabilize exchange rates, reduce inflation, and prepare for monetary integration."[2] Other countries joined the ERM, including Italy, the Netherlands, Belgium, Denmark, Ireland, and Luxembourg.[3] Participating countries were required to keep their exchange rates within a 2.25% band around each bilateral exchange rate.[4] However, the peg was, to some extent, a crawling peg. There were nine realignments between 1979 and 1985.

Naturally, other countries joined the ERM. The United Kingdom signed up in 1990 at an exchange rate of 2.95 deutschemarks per pound and a band of 6%. Everything was fine until the West German government made a critical policy error involving German reunification.

More Recent History: German Reunification

Once upon a time there were two countries named Germany. West Germany was a modern democracy, while East Germany was part of the Soviet Union (USSR).[5] In 1987 former U.S. president Ronald Reagan gave his famous "tear down this wall" speech, calling on Soviet leader Gorbachev to remove the concrete wall separating East and West Germany. Two years later, the wall came down, the Soviet Union dissolved, and the two Germanies

became one in 1990.

The problem was the exchange rate conversion. West Germany used the deutschemark, while East Germany used the ostmark. The ostmark was a nontraded currency, but the black market rate was around 8 ostmarks per deutschemark. However, to integrate peacefully, the West German government agreed to convert ostmarks to deutschemarks at a 1:1 ratio.[6] Effectively, there was a huge transfer of purchasing power from West Germany to East Germany. In response, the Bundesbank began printing deutschemarks. Inflation surged and the Bundesbank reversed course, causing interest rates to rise. As predicted by Irving Fisher and Robert Mundell (among many others), German interest rates were high relative to other countries in the ERM. There was a financial flow into Germany, increasing the demand for deutschemarks and causing the DM to appreciate. To maintain the peg, other ERM members were forced to raise their interest rates. However, those countries were not facing an inflation problem. Many experienced recessions.

The United Kingdom and George Soros

The United Kingdom was in an especially difficult situation because their economy was already in a recession. Raising interest rates would make the recession worse. The choice was stark: make the recession worse or get rid of the peg. The lowest-cost alternative was to drop out of the ERM.[7] Incidentally, George Soros placed huge bets on the pound depreciating, effectively selling the currency short and putting pressure on the Bank of England. The Bank bought £15 billion. Not enough. On September 16, 1992 ("Black Wednesday") the Bank raised interest rates from 10 to 12%. Still not enough. The Bank announced its intention of raising interest rates to 15%. Finally, at 7 pm, Chancellor Norman Lamont announced that Britain would leave the ERM and interest rates would be reduced to their initial 10% level. Italy also

dropped out of the ERM. In testimony before the House Banking Committee, C. Fred Bergsten, the director of what later became the Peterson Institute for International Economics said, "Successfully defending a fixed rate can also be quite costly. Mr. Bachus [Rep. Spencer Bachus, R-Alabama] asked, "Are there alternatives?" Well, you can defend a fixed rate if you are willing to push interest rates to 20 percent, 50 percent, 100 percent or if you are willing to push the economy into a recession, but those are huge, costly steps. Countries usually aren't willing to do it; and, as a result, they may get the worst of all worlds – huge costs in trying to defend the fixed rate and then it is still knocked off by speculation, and all sorts of crises result."[8]

Mr. Soros made a huge pile of money on the deal. But it's pretty clear that the fundamentals were on his side. The ERM was simply untenable without macroeconomic coordination among the member countries.[9] The fundamental condition proposed by Dr. Mundell's theory of optimum currency areas is a high degree of economic integration among members of the currency union. Germany was experiencing inflation while the U.K. was in a recession. There is hardly any better indicator of a lack of integration.

A Conspiracy in Three Steps

Which brings us back to Mr. Norris. Remember him? The guy with the conspiracy theory? Contrary to Dr. Bergsten's earlier statement, Europeans learned a different lesson from the collapse of the ERM. "… common currencies had to be rigid, so there was no possibility of an attack on a weak currency by speculators."[10] And, of course, a single currency is the ultimate defense against speculation.

Speaking of speculation, here's what Mr. Norris has to say (hypothetically, of course). Germany learned three lessons.

1. Their export-oriented industries would be subjected to

periodic devaluations from other European countries. These ongoing devaluations would reduce German exports and have a deflationary impact on the economy.
2. A currency union would, on the other hand, be helpful to Germany. The exchange rate of the common currency – let's call it the euro – would be below the deutschemark exchange rate because the euro's exchange rate would be kept low by less competitive economies. After all, the euro's exchange rate is nothing more than the weighted average of hypothetical individual country currencies.
3. After the currency union, Germany could adopt a low interest rate policy. This would create low interest rates for other Eurozone members, banks would "open the credit spigot and create a debt-financed boom in much of Europe." The result: massive imbalances, deeply indebted countries (Greece, Italy, …) and a crisis that could only be solved by acquiescing to German policies. The debtor countries would be forced to give up a large part of their national sovereignty.

Conclusion

There is much more in Mr. Norris's column. I urge everyone to read it. Are Germany's politicians and economists really that smart? I don't know, but some people apparently believe it.

Endnotes

[1] Norris, Floyd, " As Europe's Currency Union Frays, Conspiracy Theories Fly." New York Times, June 15, 2012, p. B1. Available at http://www.nytimes.com/2012/06/15/business/as-europes-currency-union-frays-conspiracy-theories-fly.html?smid=pl-share as of June 15, 2012.

[2] http://olesiafx.com/Kathy-Lien-Day-Trading-The-Currency-Market

/George-Soros-the-Man-Who-Broke-The-Bank-Of-England.html. Accessed June 15, 2102.

[3] Notably, in order to join the ERM, Ireland had to give up pegging the Irish pound to the British pound.

[4] For those keeping score at home, eight countries mean 28 bilateral exchange rates for each country to track. The formula is n(n-1)/2.

[5] For insight into life in East Germany, it's hard to beat the movie *The Lives of Others (2006)*.

[6] The actual ratio included two steps. Ostmark balances above 4,000 were converted at a 2:1 ratio. Wikipedia has a good page explaining all this in detail.

[7] Those who see an analogy with Greece, Spain, *et. al.* today are not alone.

[8] Testimony before the House Banking Committee, available at http://commdocs.house.gov/committees/bank/hba57160.000/hba57160_0f.htm.

[9] Again, this sounds eerily familiar.

[10] Norris, *op. cit.*

Better sit down because this is a good one. According to Mr. Norris's model, the story begins in 1992. Having been frustrated twice in the 20th century in their attempts to take over Europe by military force, the government decided to use economics instead. However, history shows the actual beginning was in March, 1979, when a number of European countries

Grexit? Why Not Dexit?

"Grexit" is the term coined by Linda Yueh as shorthand for Greece leaving the euro zone. But a letter to the editor in a the May 26 Wall Street Journal proposes a different solution. If Germany left the euro, the remaining countries would be forced to get their fiscal houses in order. A Dexit (Deutschland) would remove any hope of being bailed out by Germany. I tip my hat to Mr. Paul Feldman of Spencerville, Maryland, for coming up with this (although I will claim credit for Dexit). Since the Wall Street Journal has once again mucked up the urls on their website, I am taking the liberty of posting Mr. Feldman's letter in its entirety. Good creative thinking!

Germany, Not Greece, Should Abandon Euro

Germany, rather than Greece and the other debtor countries should drop out of the euro ("France, Germany Joust Over Euro Bonds," World News, May 22). It would instantly become clear to the debtor/deficit countries that gaining control of their budgets is their only possible course of action.

So long as they hope that the Germans will "rescue" them, they will keep putting off the day of reckoning. With Germany out of the euro, rescue would no longer be an option.

Paul Feldman

Spencerville, Md.

It’s Greek to Me

It’s Greek to me. The Greek prime minister is on Twitter. I follow him. Usually his tweets are in Greek followed a few minutes later by the English translation. Saturday, there were 13 consecutive tweets in Greek, no translation. Suspicious.

Greek PM: 13 and Counting

The last 13 tweets by Greece’s pm have been exclusively in Greek. Normally he follows a Greek tweet with an English translation. Not now. What’s he trying to hide? I can read a little Greek, but this calls for crowdsourcing.