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WITH A COMPLEMENTARY CURRENCY, GREECE CAN DEVALUE – AND REMAIN IN THE EURO AREA

The European project is at risk. The current PIIGS (Portugal, Ireland, Italy, Greece, Spain) Dilemma shows that Europe's monetary union was built with a structural flaw. When introducing the Euro, the joining nations threw important economic adjustment screws over board – the possibility to adjust their currencies' exchange rates and monetary tools to support underperforming nations – without any monetary substitutes.

The standard recipes and their negative effects

As a result, all underperforming nations have become dependent on compensations, loans, debt restructuring, haircuts and other *exogenous* goodwill policy options "kindly" offered to them by their stronger neighbors. Alternatively, they are forced to undertake extensive fiscal cuts at great social and political costs, although it is not at all evidenced that these cuts really contribute to long-term recovery. Indeed, quite the opposite is likely to occur.

The most disliked recipe: Greece exits the euro

The prevailing view is that draconian cuts are preferable to Greece or other PIIGS exiting the Euro and getting back to issuing national currencies. Against this view, some argue that, for all the disadvantages, this would at least enable countries to adjust their currencies' exchange rates against the Euro and enter the path to recovery. But if exiting the Euro is not an option, how can a nation like Greece recover at all?

The "Baron von Münchhausen recipe":

Karl Friedrich Hieronymus Freiherr von Münchhausen, a 17th century German gentleman, soldier and honest businessman, and a teller of tall tales, claimed to have extracted himself from a swamp by pulling on his own hair. With the right monetary tools at hand, Greece could pull itself out of the economic swamp just the same way, *endogenously*: it could re-establish its monetary adjustment facilities not by exiting the Euro, but with the help of an official Complementary Currency.

Jane Jacobs' heritage

Just as the late Jane Jacobs anticipated in her regional economic theory,[1] one single monetary policy for an area like the Euro zone – hosting a handful of prospering metropolitan areas as well as underdeveloped regions and "problem child" nations – can never work properly for all.

[1] See Jacobs (1984).

"Imagine a group of people who are all properly equipped with diaphragms and lungs, but share only one single brainstem breathing centre. (…) Suppose some of these people were sleeping, while others were playing tennis. (…) In such an arrangement, feedback control would be working perfectly on its own terms, but the results would be devastating because of a flaw designed right into the system." … "Nations are flawed in this way, because they are not discrete economic units, although intellectually we pretend that they are and compile statistics about them based on that goofy premise. Nations include (…) differing city economies that need different corrections at given times, and yet all share a currency that gives all of them the same information at a given time. The consolidated information is bad specific information for them even with respect to their foreign trade, and it is no information at all with respect to their trade with one another, as opposed to their international trade."

Jacob's visionary proposition was to install currency feedback mechanisms for *"specific economic units".* A Complementary Currency would allow Greece, just like any other economically underperforming area, to adjust its local economic situation while remaining in the currency union. The principle of subsidiarity and the noble idea of a "Europe of Regions" – to date no more than empty phrases – would be animated, at least in monetary regards.

How to establish a "Complementary Euro" for Greece?

There are several ways to establish a Complementary Currency, of which we here mention two. One is the introduction of an independent currency that would be managed in parallel to the legal currency. It is not a recent idea. In Switzerland, the WIR Bank is successfully operating a Complementary Currency system since 1934, with anti-cyclical effects on the economy. [2] The state of Uruguay commissioned the Dutch development-NGO "STRO" last year to develop and implement C3|U, a legal and nation-wide Complementary Currency that was meant to assist SMEs and Non-Profits to economically help each other, in the form of a financial solidarity network with its own medium of exchange. [3] And there are other examples. [4]

An adjustment of economic activity in Greece could be significantly softened through the introduction of a similar Complementary Currency approach. Willem Buiter (2009) recommended for the U.S. to introduce the "Rallod" as "inside money" complementary to the Dollar by decoupling bank accounts from central bank money and establishing an adjustable exchange rate between the two.[5] That way, a trend devaluation of bank accounts combined with comparably lower and even negative interest rates would become possible, which could boost lending and spur growth. In a recession scenario this would even allow for negative interest rates (or yields) on the decoupled bank accounts, to avoid deflation.[6]

Buiter was concerned with business cycles, and his proposal was designed for the special situation of the dollar and not for a currency union. However, a similar approach could help Greece to pull itself out of the economic swamp, ***with immediate applicability:*** By delinking the bank deposit accounts in

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[2] http://www.ewp.rpi.edu/hartford/~stoddj/BE/WIR_Update.pdf
[3] Aktie STRO, NL: http://www.stro.org.uy/. For a brief description of the project see, for example, http://taoofmoney.wordpress.com/2009/05/27/latin-americas-quiet-monetary-reform/
[4] Kennedy (2004)
[5] Buiter, W.: Negative Interest Rates – When are they Coming to a Central Bank Near You? In: Financial Times, Willem Buiter's Maverecon Blog, May 7, 2009. http://blogs.ft.com/maverecon/2009/05/negative-interest-rates-when-are-they-coming-to-a-central-bank-near-you/
[6] Economist Gregory N. Mankiw also proposed for the FED to establish negative interest rates: "It May Be Time for the Fed to Go Negative", in: New York Times, April 18, 2009. http://www.nytimes.com/2009/04/19/business/economy/19view.html

individual European countries from their common monetary base, an exchange rate could be established between the two, rendering bank accounts into a complementary currency in an instant.

A surprise devaluation of the value of those accounts vis-à-vis the Euro *while retaining the currency union* would lead to increasing price levels in the complementary currency of the adjusting countries, thereby relatively reducing their imports and fostering their exports. The devaluating regions would benefit from raising nominal fiscal revenues and reduced fiscal deficits, without nominal expenditure contraction.[7] The exchange rate between Euros and certificates can be fixed or floating, with the daily exchange rate announced by the central bank as envisaged by Buiter (2009). Commercial banks would invest reserves in Euro-denominated liquid and illiquid assets. Proceeds from invested Euro reserves would pay for their cost of operation, much like central banks do.

The devaluation of the certificates vis-a-vis the Euro would help in the external adjustment process and restore competitiveness. Domestic and external demand would both expand which is exactly what may not be engineered under current circumstances in Euro area countries.

There are more references to be taken into account when talking about "internal currency exchange rates": The British Pound, at a closer look, is complemented by "complementary Pounds" issued in Jersey, Scotland and Ireland, with the oddity that they are accepted in parity to the British Pound by U.K. governance, while on the open market a free floating exchange rate between them has remained in place.[8]

Europe's structural flaws can be cured. It is high time to think outside of the box, and develop monetary tools that can repair the limits of a monetary union that was born in a much less than optimal monetary area but was not given the instruments to cope with it.[9]

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[7] The appreciation of the Euro base money relative to bank accounts would result in an inflow of Euro deposits within banks and could help to refinance public debt and reduce the need for euro liquidity support and debt restructuring. The chargeable conversion of bank account deposits would result in a preference of local consumption over imported goods and boost the local economy. This would not be a competitive devaluation, since it would be coordinated with the ECB and jointly agreed upon by all euro members. The ECB would continue to set Euro base money exogenously, thereby controlling euro price inflation.

[8] For a short overview see http://en.wikipedia.org/wiki/Banknotes_of_the_pound_sterling

[9] Thanks to Abdourahmane Sarr and Biagio Bossone for their contribution of ideas which formed the basis of this essay and resulted in a similar publication here: http://www.economonitor.com/blog/2011/07/greece-can-devalue-and-stay-in-the-euro/