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Book review

Cesaratto, Sergio (2020): *Heterodox Challenges in Economics: Theoretical Issues and the Crisis of the Eurozone*, Cham, Switzerland (277 pages, Springer, softcover, ISBN 978-3-030-54447-8; also available as an ebook)

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This book is an updated translation of the Italian second edition. The aim of the book is to attract a wider readership to a discussion around theoretical debates and economic policies, mainly, as the title says, those related to the eurozone. From the introductory chapter, one gets the impression that the author wishes to get into a dialogue with non-specialists, who he calls *social forum economists* or pseudo-economists and who have taken a liking for economics as a consequence of the global and eurozone financial crises, in particular those who flirt with alternative economics, local currencies and modern money theory. As Cesaratto (p. 2) says, ‘I wanted to convince my friends that support Modern Money Theory (MMT) that heterodox economics is much broader than they believe’.

From the outset, my impression is that this dialogue is highly successful. Cesaratto adopts a style of presentation where a fictitious student keeps putting forth objections or questions to which the author answers in the clearest possible way, also making use of boxes where useful or additional anecdotal material can be found. In addition, at the end of each chapter, the author provides comments about additional references. The book, or at least most of the chapters and more specifically those that deal with policy issues, is highly useful.

The book can be said to be split into two parts. In the first part, besides the introductory chapter, Cesaratto discusses theoretical issues in three chapters: the surplus approach of the classical tradition, including several pages devoted to Marx and basic Marxian beliefs; the essential aspects of marginalist economics, including the concept of the natural rate of interest; and, finally, what he calls the incomplete revolution brought about by Keynes, due to the remains of marginalist economics found in *The General Theory* (1936), with Keynes attempting to distance himself from the natural rate of interest by introducing the liquidity trap. In a number of places, Cesaratto expresses his misgivings about theories or arguments based on subjectivism, expectations and uncertainty. Except for this restriction, Cesaratto’s vision is very much in line with post-Keynesian economics, in particular post-Keynesian monetary economics, although his virtual student implies on occasion that the author is a Marxist, but obviously of Sraffian descent.

I will focus on the second part of the book – the bigger part. It starts with a presentation of the theory of endogenous money and a discussion of the external constraint that countries cannot avoid, with an extensive and clear explanation of the various components of the balance of payments. This is followed by a reconstruction of the modern economic history of Italy, culminating with how the eurozone crisis came to Italy. Cesaratto concludes with a chapter that discusses how central banks, in particular the European Central Bank (ECB), can set short-term interest rates and influence

long-term rates through quantitative easing. The chapter goes over the various new liquidity-providing programmes set by the ECB and in particular those of Mario Draghi. It goes into a detailed analysis of how payments are settled in the multicountry eurozone and the implications of the TARGET2 system. The chapter includes two long appendices that explain the evolution of the consolidated balance sheet of the Eurosystem and the functioning and evolution of TARGET2 balances.

I am in full agreement with the explanations provided by Cesaratto. In particular, he offers an enlightening explanation of how German banks got rid of their Italian (and Spanish) bonds, which were bought back by Italian banks, thanks to the cheap loans provided by the ECB under its long-term refinancing operations (LTRO), via the central bank of Italy, with the purchase thus ultimately being financed by the TARGET2 credit balances of the Bundesbank with, as a counterpart, the TARGET2 debit balances of the Banca d'Italia.

Cesaratto is quite harsh concerning the mercantilist German policy, the European Union, the eurozone and the ECB. He argues that, thanks to the sole goal of inflation targeting, 'the central bank is very effective at regulating wages by threatening an increase in the interest rate, which would have negative effects on employment' (p. 79). He cites a 2005 text of his where he says that 'the European economic policy is a demented plan' (p. 173). He argues sarcastically that 'it is untrue that the euro is a failure; it is a success' because it is a successful 'instrument that disciplines the working classes, especially the undisciplined south' (p. 188). When asked whether Europe can change, Cesaratto answers straightforwardly, 'no, Europe cannot change' (p. 187), a negative answer also provided recently by Malcom Sawyer as I recalled in a book review in this journal (Lavoie 2019).

As mentioned earlier, Cesaratto intends to dialogue with MMT supporters. While certainly influenced by MMT works when describing monetary economics, as he himself points out, Cesaratto shows signs of annoyance when mentioning 'the rather Mesianic way they [MMT exponents] broadcast their message' (p. 133) and their belief that 'monetary sovereignty is the cure of all ills' (p. 135). There are two main differences between Cesaratto's views and those of MMT. First, MMT advocates claim that 'the State can spend even without having first collected taxes or without first financing itself through government bonds'; Cesaratto on his part argues 'that the State can finance its spending by selling bonds to commercial banks that create credit in its favour as they do for private operators' (p. 100), something which I referred to as post-Chartalism (Lavoie 2003).

Second, Cesaratto believes, as do several post-Keynesians, that MMT advocates underestimate the external constraint which he considers to be one of the two key concepts of his book. To the question, 'is it true that a country with its own currency can borrow freely abroad provided it does so in its own currency', he responds, 'I have expressed my position on the question clearly: no, nein, niet' (p. 152). Cesaratto's position is based on the concept of a hierarchy of currencies. For him, most countries cannot borrow abroad in their own currency, and thus will be subjected to the original sin; but even if they can, they are likely to do so at very high interest rates so as to cover the depreciation risk inherent in weak currencies, thus inducing them to borrow in a foreign currency. And what about the monetary sovereignty associated with a pure flexible exchange regime? Cesaratto says he does not trust 'magical recipes' and has no faith 'in the miraculous function of completely flexible exchange rates' (p. 153).

The last issue I wish to touch on is whether the eurozone crisis was or was not a balance-of-payments crisis? Cesaratto (2017; 2018) has argued in the past that indeed it was. Febrero et al. (2018) and I (Lavoie 2015) have argued that it was not, as we thought

that the existence of the eurozone TARGET2 mechanisms were such that a balance-of-payments crisis was impossible. This disagreement used to puzzle me, because I felt that we all built our understanding of the mechanisms underlying the eurozone crisis and the functioning of TARGET2 on a common monetary analysis. Reading this book has helped me to understand Cesaratto's point of view.

Denomination risk, according to him, is the main reason for which yields on sovereign bonds of the eurozone south rose to unsustainable levels:

In the case of Spain, foreign investors who saw an increase in public debt and foreign debt began to suspect that the country would choose to convert its debt into a new national currency, which would devalue, so they would lose on bonds in the new currency ... Foreign investors therefore asked higher interest rates to cover the risk of denomination. (p. 150)

A similar claim is made later:

The spread crisis concerned the risk of denomination. In other words, the difference between Italian and Spanish government bond interest rates and the corresponding German interest rate covered the risk that the former two countries might leave the EMU and redenominate their sovereign debt in new currencies. (p. 181)

For Cesaratto (p. 180), the main cause of spread increases was the investors' fear that the eurozone would implode and that the GIPS (Greece, Italy, Portugal, Spain) would leave the monetary union and revert to their own currencies. It is true that there was a lot of talk about a Grexit, and that once GIPS spreads had risen to very high levels, the euro could be left for dead by some observers, or as Cesaratto claims, 'in July 2012, it seemed extremely doubtful that Italy and Spain would remain in the euro' (p. 181). But why did spreads rise in the first place? As Cesaratto himself acknowledges, there is no federal government backed by a central bank, and the 'European monetary union was designed very badly on the basis of bad mainstream economic theories' (p. 180). In addition, the ECB gave itself the sole mandate of maintaining price stability and claimed that its credibility rested on sticking to this sole objective while avoiding attempts to perform other tasks.

My own point of view is that hedge funds became fully aware of these flaws that made eurozone governments no longer default-risk free, as argued by MMT scholars. Investor funds proceeded to speculative attacks against the countries that were most susceptible to the doom loop of commercial-bank insolvency and sovereign-debt illiquidity. The ECB had already acted too little and too late in 2010, and has been under tremendous pressure from the German media and German institutions to do nothing ever since. The attacks and talks of a eurozone break-up stopped with Draghi's famous 'whatever it takes' statement, which was understood as a significant turnaround in ECB policy, thus vowing to act as a purchaser of last resort. Speculators immediately relented, and yield spreads declined without the ECB actually buying any bond.

In my opinion, the eurozone crisis cannot be qualified as a balance-of-payments crisis when, as written by Cesaratto (p. 217) himself,

via the combination of Target2 and ECB refinancing operations, peripheral countries could accommodate capital flight from their bonds without incurring a financial crisis, but more in general that they could sustain foreign deficits by putting them on the Target2 account.

What makes it a balance-of-payments crisis, from Cesaratto's perspective, is that the periphery high spreads were caused by the denomination risk generated by the belief that the GIPS would decide or would be forced to leave the monetary union as a consequence of the fiscal straitjacket imposed by the various fiscal pacts.

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