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The sovereign debt crisis: The case of Spain

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Abstract The sovereign debt crisis is often evoked as one of the main causes of the economic difficulties faced by net importing countries and as the rationale behind the austerity measures imposed on their residents. Nothing seems more evident than a country whose global, commercial and financial, imports exceed its global exports has to finance its deficit through a foreign loan. This inevitably leads to the formation of an external debt. Yet, things are less straightforward than they might appear, and a rigorous analysis is called for to verify whether any country' sovereign debt is ever justifiable. The paper shows that it is because net global imports are paid twice that net importing countries run up a sovereign debt. The case of Spain is symptomatic and provides statistical confirmation of the pathological increase in the country's external debt.
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La crisis de la deuda soberana o pública: el caso de España

Resumen La crisis de la deuda soberana suele considerarse como una de las principales causas de las dificultades económicas a las que se enfrentan los países importadores netos. Constituye asimismo la razón que justifica las medidas de austeridad impuestas a sus residentes. Nada parece más evidente que un país, cuyas importaciones globales, comerciales y financieras, exceden sus exportaciones globales, tenga que financiar su déficit mediante un préstamo extranjero. Lo que conduce inevitablemente a la formación de la deuda exterior. Sin embargo, la realidad es más compleja de lo que parece. De ahí que sea necesario un análisis riguroso que aclare si la deuda soberana de cada país está justificada. Este artículo muestra que no lo está, desde el momento en que los países importadores netos se encuentran con una deuda soberana debido al doble coste de las importaciones globales netas. El caso español es sintomático y aporta confirmación estadística del aumento patológico de la deuda exterior del país.
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1. Introduction

The aim of this paper is to show – starting from Keynes's analysis of what he called 'the transfer problem' and then referring to Schmitt's (2012, 2014, 2017) investigation – that countries incur a sovereign debt only as a consequence of a pathology affecting the present system of international payments. In particular, it will be shown that it is because net imports are paid twice – in real terms and, *additionally*, in monetary terms – that net importing countries run an external debt. The pathology is such that deficit countries have to make up for the difference between commercial and financial purchases and sales even though their residents have fully paid for their net imports.

To help understand the origin and nature of countries' sovereign debts, the paper considers the case of Spain and provides statistical confirmation of the existence of a fully unjustifiable external debt that has caused a substantial increase in Spain's unemployment. Official statistical data show that Spain's external debt has increased far beyond what can be explained by the evolution of the economic 'variables' accounting for it.

The second part of the paper is devoted to showing that Schmitt's positive analysis leads to a normative proposal, i.e. to a reform capable of dealing with the pathological nature of countries' sovereign debts. If implemented, the reform would enable each net importing country to avoid the formation of a new sovereign debt and allow it to gain the amount of national income paid by its residents for their net foreign purchases. Today, Spain loses part of its domestic income and incurs a sovereign debt. Thanks to the reform, Spain would gain the domestic income corresponding to its net imports, and would incur no sovereign debt. This would be made possible by guaranteeing the real payment of Spain's net imports through a transfer to the rest of the world (R) of an equivalent amount of its (Spain's) current output, which means, without failing to fully pay their due to the country's foreign creditors.

2. From Keynes's 'transfer problem' to countries' sovereign debt

In 1929 Keynes addressed the problem posed to Germany by the payment of war reparations at the end of the Great War and arrived at the astonishing discovery of a pathology that multiplied the cost of Germany's payment by two. He based his analysis on the necessity for Germany to find both the amount of domestic income covering for the real payment of war reparations, and, in addition, the amount of foreign currency needed to transfer the payment to the Allies. The first requirement was at the origin of what Keynes called the *budgetary problem*, while the second, which he named the *transfer problem*, was the cause of the duplication. In Keynes's own words, the budgetary problem was that of 'extracting the necessary sums of money out of the pockets of the German people' (Keynes, 1929a: 1), while the transfer problem was that of 'converting the German money so received into foreign currency' (Keynes, 1929a: 1).

The budgetary problem consisted in the need for German residents to pay war reparations in their own national income; the transfer problem consisted in the additional requirement for Germany to pay war reparations in a foreign currency. The transfer problem arose because of the need to convert the first payment, in domestic money, into a payment in foreign currencies. The question asked by Keynes concerned the cost of the conversion and one can formulate it as follows: is the cost of war reparations in German domestic currency in addition to the one in foreign currencies? That is, do the two payments, by Germany and by its residents, add up to one another? Keynes's answer was yes, and he explained the double charge affecting Germany by claiming that the payment in foreign currencies would have entailed the devaluation of the German currency. 'For I hold that the process of paying the debt has the effect of causing the money in which the debt is expressed to be worth a larger quantity of German-produced goods than it was before or would have been apart from the payment of the debt' (Keynes, 1929c: 405).

Keynes's fellow economists did not understand his deep intuition. In particular Ohlin and Rueff argued that in order to pay for war reparations Germany had merely to reduce its foreign borrowing and transfer abroad part of its 'buying power'. The financial outflows would have had the effect of decreasing 'the buying power in Germany and thus its importations of foreign goods' (Ohlin, 1929a: 173), and of increasing 'the buying power in the lending countries and, thus, their importation of German goods' (Ohlin, 1929a: 173). Yet, the Swedish and the French economists failed to notice that Keynes's argument was with the failure of the system of international payments to provide a mechanism allowing for the cost-free conversion of payments between monetary sovereign countries, and not with the economic difficulties faced by Germany. They did not understand that international payments cannot reduce to inter-regional payments and that Keynes's analysis dealt precisely with the problem of converting domestic into international payments.

Let us propose a formal proof of Keynes's intuition by referring to the law of supply and demand applied to the currencies involved in the payment of German war reparations. Assume that the exchange rate between German national money, GM, and the money of the rest of the world, MR, is on a par: 1 GM for 1 MR, and that the amount to be paid in war reparations amounts to x MR (= x GM). The condition for Germany to be able to honour its external debt is to earn x units of MR. As Ohlin (1929a, 1929b) and Rueff (1929), Keynes (1929a, 1929b, 1929c) agreed with the need for Germany to increase its net exports in order to obtain the amount of MR required to pay for its war reparations. Let us therefore suppose German net exports to be equal to x MR, and analyse what happens to the German currency's exchange rate when the rest of the world pays Germany for its net foreign sales and, then, when Germany pays the Allies their due, Fig. 1.

The payment of German net exports by the rest of the world defines a demand of German currency in terms of MR. On the other hand, the payment of war reparations (which forces German residents to pay an amount of x GM in taxes) defines a demand of MR in terms of GM. Apparently, the two opposite demands balance each other and should have no effect on German national currency. Yet, this means to forget that the law of supply and demand exerts its effect according to the *elasticity* of supply: the lesser the

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