BEYOND THE EURO: LIMITS TO ECONOMIC POLICY IN THE EU

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Received on January 15, 2019

Accepted on February 10, 2019

Abstract

The euro's crisis is often theorized as that of a fixed exchange-rate monetary system, whose rigidity in the face of heterogenous national economies is the main factor behind the Eurozone's troubles. We argue instead that the euro should be primarily considered as a successful attempt to further the integration of the European economy within an ordoliberal framework, part of an institutional continuum stretching from the European Single Market to the present. Further, we note that the constraints placed by the euro on national economies are deeply entangled with those deriving from EU membership, so that both are likely to weigh on any attempt to break with neoliberalism at national level.

Keywords: *E6, F45.*

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INTRODUCTION

The Global Financial Crash is often regarded, this side of the Atlantic, as the "crisis of the euro", so that the end-result of three decades of neoliberalism in Western countries –economic and financial instability alongside growing inequality and labour precariousness– presents itself as a crisis of European integration.

This narrative gained some credence after the panic of public debt markets that engulfed the continent in 2010, after which the Eurozone underwent a round of significant reforms: the enhancement of the Stability and Growth Pact into the Fiscal Compact, to curtail public spending, the creation of the European Stability Mechanism, to monitor bail-outs to Member States, and that of the Single Resolution Mechanism, to centralize banking supervision; all of which were meant to address the fiscal profligacy and financial excesses that were blamed for the Eurozone's woes. Indeed, these reforms avowed goal was to stop the over-spending of private and -specially- State debtors before the markets struck: as they had done on mortgage, and later public debt markets, between 2008 and 2010.

No symmetric mechanism was placed on those creditor states whose accumulating surpluses were on the other side of the EMU's imbalances. Any attempt at a balanced response to the Eurozone's crisis, by breathing some Keynesianism into the monetary union -whether by increasing sizeably its budget or providing for automatic transfers between regions- has proven politically unfeasible: a state of affairs whose chronification spells dire consequences for European democracy itself. It is therefore not surprising that amongst the radical Left, the break-up of the Eurozone is no longer a taboo subject.

The first part of this article reviews the existing debate on the euro, questioning the popular idea that the crisis of the Eurozone is, mutatis mutandis, an example of traditional balance-of-payments problems in a fixed exchange-rate system (such as the Gold Standard or the European Monetary System). In particular, we point to the evidence that structural drivers different from relative unit costs are central in explaining the divergences between Member States. We highlight, specially, the effects of supply-chain restructuring and cheap credit that (monetary) economic integration has facilitated. Seen in this light, euro-exit is more likely to benefit peripheral countries by increasing their autonomy vis-à-vis the capital flows re-organizing Europe's economy, than from the ambiguous expansionary effects of exchange-rate devaluation. In addition, we underline that the euro has not merely accompanied the reshaping of national economies by private capital flows -but rather, it jeopardizes the possibility of an alternative economic policy through the institution of an independent central bank that limits the power of national policy-makers.

The second part of the article is concerned with this ordoliberal set-up of the EU, highlighting the links between the euro and other mechanisms of European integration, particularly those of the Single Market, whereby public policy is constrained to replicate and enhance "market discipline". This entanglement defies any attempt to picture the euro as an anomaly within the process of European integration or to provide an easy separation between the limits placed upon national economic policy by the Eurozone and the EU. This necessarily extends any discussion on euro-exit to a consideration of the costs and benefits of EU membership in the definition of alternative policies to the current austeritarian framework.

In our conclusions, we review these arguments with two warnings. Firstly, given how the divergences within the European economy provide tangible benefits to relevant actors in the process of EU integration, the latter is unlikely to reform itself from within. Some break with the current integration process is therefore required in order to develop a progressive economic strategy: one that does not shy away from recovering the State as a starting base for economic policy. Secondly, any such depart must take into account the exhaustion of national Keynesianism in the European peripheries: requiring us to revisit the economic policy alternatives available to the Left.

THE "CRISIS OF THE EURO" AND ITS CRITICS

In the Great Recession, the dominant discourse delinked the 'US-imported' crisis from the euro and the EU. Instead, the single currency was first portrayed as an overall success that contributed to macroeconomic stability, even if the 2008 crisis had "revealed weaknesses in the governance and crisis management capabilities of the euro area" (Pisani-Ferry and Posen 2009: 2). Thus, the logic of further integration continued to apply: "current events […] have highlighted the advantages of a single currency and shown the value of deepening euro area coordination", argued the Commissioner for Economic and Financial Affairs (Almunia 2009).

Following the 'sovereign debt crisis' of 2010, the blame for the troubles of Eurozone shifted to the alleged fiscal profligacy of the peripheral countries. Accordingly, the original EMU set-up, in particular the system of macroeconomic and fiscal surveillance, had to be strengthened to ensure fiscal austerity and neoliberal structural reforms –the only possible cure for the excesses of national governments whose over-indebtedness had ultimately provoked the crisis (Schäuble 2011, Trichet 2010).

But public debt in the periphery, with the exception of Greece, had soared only after the 2008 crisis with the socialisation of private banking debt and through the effect of countercyclical measures (see, for example, Storm and Naastepad 2015, Seccareccia 2017). Thus, the 'fiscal profligacy' story was soon replaced with the view that the Southern periphery has been suffering from "existing rigidities in product and labour markets", which had caused unsustainable macroeconomic imbalances in the Eurozone (Juncker 2015: 3),[2] which had later required public intervention.

A sometimes alternative (e.g. Wyplosz 2013), sometimes complementary explanation (e.g. Calmfors *et al.* 2012), argued that the creation of the single currency, in particular through the harmonization of nominal interest rates, had induced financial flows from the core to the periphery that fuelled credit booms and excessive domestic demand, which resulted in current account deficits and reduced competitiveness through higher inflation. Similarly, other authors argued that the lower perceived risks of the periphery fuelled a boom in cross-border investment to it that boosted demand and prices there while deflating the core, again making the former uncompetitive because of accumulated differences in relative cost levels (e.g. Krugman 2013; Stiglitz 2016).

Overall, what we may term the "orthodox" view argues that the "linchpin of the EZ vulnerabilities stem from the build-up of large current account imbalances" (Baldwin and Giavazzi 2015: 35), whatever their origins, and the associated debt flows, which ended with a "classic sudden-stop" that uncovered a balance-of payments crisis that could not be corrected through changes in the exchange rate. The intervention of peripheral governments to tackle the crisis, in particular the banking crisis, without the possibility of monetising government debt was the amplifier of this initial "shock", by generating a State-banks 'doom-loop' debt crisis (Baldwin and Giavazzi 2015).

From this analysis, rebalancing foreign accounts *through changes in relative unit costs between countries* is a necessary condition for a sustainable recovery. The conservative side of the mainstream favours further neoliberal austerity and product-market and labour-market reforms (e.g. Sinn 2014), Wyplosz 2016), a view with significant leverage in Brussels. The more progressive side considers going back to domestic currencies in order to recover the alleged equilibrating forces of the exchange rate and regain autonomy in fiscal and monetary policy ('less Europe'), at least as an alternative to the more popular 'more Europe'-route, that would reshape the monetary union in a more Keynesian vein (essentially moving

[2] A similar though more nuanced hypothesis was elaborated by the "Varieties of Capitalism" approach, that argued that the existence of institutional asymmetries in different countries of the same monetary union would promote divergent costs dynamics that could not be corrected through the exchange rate (Hall 2018).

towards a fully-fledged banking, fiscal and even political union in the medium run and in the short run by inflating prices and demand in the core) (e.g. Krugman 2013, Stiglitz 2016).

"Heterodox" approaches also increasingly identify the causes of the euro crisis with a balance-of-payments crisis (Bellofiore *et al.* 2015). Indeed, many "heterodox" commentators tend to conceptualise the single currency as essentially a fixed exchange-rate system that became unsustainable when divergent production costs led to the current account imbalances between the core and the periphery (e.g. Lapavitsas 2019: 67-80, Mazier and Petit 2013), often in analogy to the crisis of emerging economies within the world monetary system (Frenkel 2014, Eichengreen *et al.* 2014). In this view, as summarised by Cesaratto (2015: 142), "the original sin is in the current account imbalances brought about by the abandonment of exchange rate adjustments and in the inducement to peripheral countries to get indebted with core countries". Though these explanations of the imbalances typically differ from the "orthodox" ones by engaging with more "political" topics such as the German 'neo-mercantilist' strategies (Bellofiore *et al.* 2011; Cesaratto and Stirati 2010; Flassbeck and Lapavitsas 2015, Cesaratto 2017), which are largely left unaddressed by mainstream authors, they also tend to focus on the rigidities of the euro as a currency as the main reason for the build-up of current account imbalances between Member States.

There are, however, some problems with this analysis. First, empirical evidence indicates that changes in competitiveness, especially in price competitiveness, played a more nuanced role in shifting the economic structure of the Eurozone (Celi *et al.* 2018, Syrovatka *et al.* 2018). We should note the endogeneity of cumulative divergences in productive specialisations and technical capabilities within countries (Felipe and Kumar 2014; Storm and Naastepad 2015); along with companies' global offshoring strategies, resulting in shifting strength of domestic and foreign upstream and downstream linkages well beyond the Eurozone, including the formation of the Central European Manufacturing Core with the integration of the Eastern periphery in the German productive network (see Stehrer and Stöllinger 2015) against a general pattern of deindustrialization or 'impoverishment of the productive matrix' (Simonazzi *et al.* 2013)

At the same time, current account imbalances were mostly driven by aggregate demand. Indeed, of the period, the most significant trend was the asynchronicity between the German real estate cycle --much attenuated compared to that of almost all OECD countries- and the boom in the periphery; along with the income effects of the precarisation of labour and rising inequality (Celi *et al.* 2018, chapter. 5, Portella-Carbó 2015, Schröder 2015, Storm and Naastepad 2015, Storm and Naastepad 2016, Stockhammer 2015).

Given productive capabilities and structural interrelations of Eurozone countries, changes in aggregate demand necessarily entailed growing trade imbalances (Portella-Carbó and Dejuán *forthcoming*), which reflected symbiotic modes of demand growth (the core is 'led' by exports and the periphery by consumption and residential investment) and worsening, hierarchical centre-periphery production relations (Celi *et al.* 2018).[3]

Most importantly, while current account imbalances may cause a BoP crisis, the latter is ultimately triggered by the lack of international reserves necessary to finance current imports and meet immediate obligations, in particular servicing external debt. However, in the Eurozone there is no reserve constraint because the European Central Bank (ECB) has the means to provide the necessary reserves to the financial system that cover capital withdrawals and finance current account deficits (Lavoie 2015a, 2015b, Bellofiore *et al.* 2015). In this respect, the TARGET2 payment system, which operates like Keynes' International Clearing Union but with less restrictions (Lavoie 2015a, Cesaratto 2013), combined with the refinancing operations by the Eurosystem, has avoided any shortage of liquidity in deficit countries.

[3] As Celi *et al.* (2018: 17) explain: "new peripheries now gravitate around a changing core, the baricentre of the EU moving from North–South to North–East".

Moreover, as Febrero *et al.* have argued (see also Febrero *et al.* (2015)):

> "The ECB had no choice but to provide reserves to countries experiencing a massive capital outflow. Otherwise: (i) it would have lost control over the overnight interest rate; (ii) the payment system would have collapsed because deposits in euros in the periphery could not have been used as means of payment in the whole EZ; and (iii) it could not deny the provision of reserves to banks holding eligible collateral" (Febrero *et al.* 2018: 229).

Creditworthiness, not reserves, is thus the real constraint on the symbiotic modes of demand in the centre and periphery. In other words, the common currency would have eased, rather than enhanced the need for contractionary policies in the face of current account deficits, thus contributing to the expansion of the European periphery before the crisis - at the cost of expanding private (and in the Greek case, public) over-indebtedness and asset bubbles facilitated by capital movements.

What triggered the debt crisis in Europe was not, in the end, the worsening current accounts, but rather the contagion effects of a revision of credit risk following the US real estate collapse – which, with capitals flying for safety to Germany, Luxemburg and The Netherlands, among other countries, soon led over-exposed peripheral financial systems and the Governments that were called to bail them out into a crisis (see Celi *et al*. 2018: 143-155 and references therein).

The role of the ECB in the crisis appears crucial in understanding the true nature of the limits placed on policy-makers by the EMU: it declined to intervene, at first, and only did so later with harsh conditionalities -though it had the means to provide credit to the countries of the periphery after they were drained of private liquidity from the very start of the crisis.

Thus, the ECB has pressured Member States to adopt neoliberal reforms in exchange for its aid (e.g. by threatening to cut banking liquidity and stop bond-buying programmes). A case in point is that of Spain: in August 2011, when attacks on Spanish sovereign had escalated following the lack of purchases by the ECB in the secondary market (De Grauwe and Ji 2013), the President of the ECB 'reminded' the Spanish President that support was conditional on furthering labour reforms, public spending cuts and the liberalisation of markets (Trichet and Fernández Ordoñez 2011), which were finally undertook by the Spanish Government.[4] And it has been a major player in the collective reforms shaping the Eurozone (e.g. by promoting, shaping and decisively influencing the workings of what would become the European Stability Mechanism, which regulates the IMF-style bail-outs of EMU states, and the Fiscal Compact, a stricter Stability and Growth Pact to reduce and control national public budgets) (Beukers 2013, Braun 2017), always in concert with other EU institutions. Because of the decisive powers that the ECB continued to yield, the "crisis of the euro" is not due to a "flawed currency union" that makes a balance of payments crisis an ever-present possibility. Rather, as the monopoly issuer of an international reserve currency, the ECB had sufficient mechanisms as to maintain the liquidity of the financial system and the solvency of the sovereign.

By choosing not to defuse crisis situations and to expose fiscal policy to financial market's discipline, the ECB proved instrumental in advancing the austeritarian framework shared by the EU i.e. the precarisation of labour and anti-egalitarian reforms in public spending and taxation. That such actions could proceed unchallenged, whilst political crisis engulfed those national Governments that were implementing them, can only be attributed to the manner in which key elements of European economic policy-making (which are well exemplified by the workings of the ECB) are institutionally insulated from democratic control.

[4] Another letter was sent to the Prime Minister of Italy Silvio Berlusconi on the same day, with analogous content (Trichet and Draghi 2011).

MONETARY AND ECONOMIC INTEGRATION IN EUROPE

Ordoliberalism may be seen to provide a theoretical underpinning to the aforementioned monetary arrangements (*cf.* Cesaratto 2017: 982-984). A succinct summary of ordoliberalism's core tenets has been provided by Blyth (2013: 157): "the appropriate state policy was not to set the conditions of investment or to manipulate the level of prices via monetary stimulus, as the Keynesians argued. Instead, given its concern with limiting private power, competition policy, supported by the monetary policy of a politically independent central bank, formed the institutional core of the economic constitution. A dedicated monopoly office would ensure that the economy as a whole conformed to the metarules of competition, while an independent monetary authority would play the supporting role of keeping prices stable. Both institutions would be separate from and would not directly answer to the parliamentary state", prescriptions which obviously apply to the workings of the ECB along with those of the Commission's DG Competition.

Contrary to the Hayekian focus on the spontaneous ordering of "free markets", ordoliberals maintain that strong public regulation is required in order for market mechanisms to continue operating upon capitalist economies (Dardot and Laval 2009: 187-218). While only one of several strands of thought within the German post-WWII conservative movement in which it took shape (Storey 2017), ordoliberalism (and its strong rhetorical appeal to public regulation and rules-based economic policy) provided an alternative framing for the neoliberal counter-revolution against the more consumerist and individualistic tones of its Anglo-American counterparts, eventually matching the rising German hegemony in the European continent from the 80s to the present by embedding itself into the very fabric of European integration.

Cast in this light, the workings of the euro are not a striking anomaly, but rather stand in close affinity to the wider set of institutions related to the EU (namely, the Single Market and Economic Governance rules), whose main aim is to constrain economic policy in a pro-market direction, isolating it from democratic pressures (Gill 1998, Bonefeld 2016).

The continuity between the euro and other EU policies is not but one of shared intellectual origins. Historically, the transition from the Common Market to the Single Market from the mid-80s onwards (including the strengthening of competition policy, which had been only lightly applied beforehand (cf. Akman and Kassim 2010, Buch-Hansen and Wigger 2010) and the path towards monetary integration coincide (Eichengreen 1996: 236-242, Fazi and Mitchell 2017: 86-92). This is not by chance: the liberalisation of capital movements (one of the "four freedoms" enshrined in the Maastricht treaty) entails the abandonment of either an independent exchange rate or an independent interest rate policy (as per Mundell's Trilemma). Given the fear that exchange rate fluctuations could severely limit the level of trade and services flows within the European economy and the difficulties of maintaining fixed exchange rates in the absence of coordination on interest rates, the eventual communautorisation of monetary policy seems, in retrospect, almost inevitable (Padoa-Schioppa 1994).

In reverse, the introduction of capital controls in case of euro-exit seems equally unavoidable. But the TFEU allows for unilateral restrictions on capital movements only for reasons of public order, fiscal nature or financial supervision (art. 65). Indeed, during the crisis of the Eurozone, two countries (Cyprus and Greece) have introduced capital controls for lengthy periods. In both cases, the EU and the IMF have only agreed to these measures in exchange for the introduction of hard austerity measures, but it seems improbable that this consent could be gained in other circumstances -opening such restrictions to be challenged by European institutions.

In fact, the European Court of Justice has already explicitly ruled out the possibility of capital controls on the basis of strengthening the "competitive structure of the market concerned or modernising and increasing the efficiency of means of production" (C-367/98 Commission vs. Portugal), that is to say, for precisely those ends that might tempt a "heterodox" policy-maker.

These restrictions arise from the nature of competition policy, which mostly operates under the discretion of the Commission. Competition policy, and particularly the rules on State Aid (art. 107-109 TFEU), only allow industrial policy, economic planification or public management of a sector or firm when it does not distort private competition; meaning that with the exception of social services and public goods (under the 'SGEI' definition), public intervention in the economy must be "non-discriminatory", that is to say, run its operations as if privately-owned and allowing entry for private competitors. In this, the EU imposes itself a restriction which does not operate at the level of the global economy, since the WTO only applies the notion of "non-discriminatory" treatment to commercial operations involving imports and exports (Anderson *et al.* 2018).

Another limit to public intervention comes, as we discussed before, from the fact that fiscal authorities and the financial systems of Member States can only resort to lender-of-last-resort liquidity by the ECB if they do not challenge the general outlook of neoliberal political economy, which makes it almost impossible for any national Government to pursue any anti-austerity politics against the will of private capital.

Consider the difficulties of pursuing straight-forward Keynesian expansionary policies from the public purse. Fiscal policy may not be backed by direct monetary financing (art. 123-125 TFEU) and the mandate of independence to central bank authorities (art. 130 TFEU) in all its activities (Gooodhart and Lastra 2017), that apply equally outside the Eurozone. Taken together, they leave the State vulnerable to the pressures of financial markets whenever it is forced to meet its liquidity requirements. At the same time, the Fiscal Compact sets limits to the levels of deficit and indebtedness, imposing a long-term balanced budget rule on public spending growth over time whose violation may be sanctioned by the ECJ; while deficit-spending itself may be fined on the basis of article art. 126 TFEU. Finally, the maintainance of unanimity rule on matters of taxation (that is to say. the possibility for any single Member State to yield a veto) naturally favours tax competition between Member States over tax harmonization, further eroding the ability of Member States to finance their spending - specially in the presence of several tax havens within the EU itself (Chardonnet and Langerock 2017).

Taken together, these restrictions are designed to frame a particular mode of economic integration, where there are no limits to the mobility and operation of capital and thus, to the ability of private profit-seeking capitals to organize production in the international level, forcing countries to compete amongst themselves in order to remain attractive for private investment. Though these effects are generally regarded as a product of the economic logic of "globalisation" (that is to say, the effects of the internationalisation of capitalism against a fragmented pattern of polities), they are in fact *politically* enhanced by European integration[5] .In these conditions, a Member State that left the euro while staying in the EU might gain some space for expansionary policies , but may still lack sufficient tools to shape its economy away from the current mode of development.

It seems, therefore, that the contours of an alternative may not be those of "pump-priming" Keynesianism, where manipulating the level of aggregate demand was the solution to all economic problems. Indeed, in those countries most affected by the economic crisis, the room for expansionary manoeuvres is extremely limited by its peripheral insertion in European and global supply-chains, which create an almost-permanent risk of external crisis: one that is only exacerbated by the departure from the European bloc.[6]

By losing access to a reserve currency, a peripheral country leaving the euro would be limited by the need to ensure a balanced current account, a problem that is highly unlikely to be solved through devaluation

[5] On the distinction between the "economic" and "political" logics of capitalism, see Wood 2006.
[6] This barrier to development and its consequences in the form of mass unemployment has been important in Spain at least since the events leading to the Stabilization Plan of 1959, (Portella-Carbó 2017).

alone (Krugman and Taylor 1978, Nouira and Sekkat 2012).[7] While easing the external constraint becomes the pre-condition for an acceleration of economic growth (Thirwall 2011), in the short-run the latter may prove insufficient to absorb the high rates of unemployment in the European periphery.

This means, on the one hand, that a re-balancing of aggregate supply towards higher value-added production is necessary. But it also means that the (re)distributional aspect of progressive policies (including the regulation of the labour market) should be enhanced so that a fair distribution is not made conditional on a return to growth. Neither are they likely to be easily pursued within the EU.

CONCLUSIONS

Exit from the EU need not be anymore an abstract occurrence. The United Kingdom has begun the negotiations to establish the terms in which it is to cease membership, and though the final outcome of this process is still unknown (and the result of the referendum may yet be reversed), it sets a precedent for other Member States.

The dynamics of the Brexit popular vote point to a real problem of European integration (the growing discontent against the loss of popular sovereignty), but also to a real danger of European disintegration: a resurgence of nationalism. It hence tasks the Left with imagining, concretely, a departure from the EU: not as a goal in itself, but as a means to an alternative.

Gill (1998) spoke of a Gramscian "historical bloc" that could be formed around a German-dominated process of European integration, with finance, globalized capital and associated interests at its centre. This was a prescient view. Finance, of course, has been well-served by the solution to the "euro-crisis". It is obvious that the financial system of core countries has been protected from their heavy exposure to debtors in the periphery (recall that in the middle of 2008 French and German financial institutions were the largest creditors of the Southern periphery, which were already in dire straits due to the financial crisis (O'Connell 2016). The socialisation of enormous amounts of private debt in the periphery, especially in Spain and Ireland, protected creditors in core countries and their government from another blow –in addition to facilitating the transfer of relatively 'healthy' assets at sale prices to dominant financial groups.

Equally, globalized capital has found an inexhaustible "reserve army" in the impoverishment the popular classes in the periphery, who were especially vulnerable to the cuts in public expenditure and increased taxation, the privatization of public assets, and liberalisation of labour and product markets -and so have those less-successful fractions of capital that have boosted profits at the expense of falling wages in the periphery; while rapid growth in exports to Asia and the US has delayed the consequences for the Central European Manufacturing Core of the drying up of internal demand in Europe (see Celi *et al*. 2018, especially Ch. 6). In these circumstances, it seems unlikely that the EU will reform itself -least of all because of its Byzantinean process of decision-making, which still requires the Council's unanimity for a reform of the Treaties.

At the same time, one should be cautious about the type of economic policies that could be pursued outside of the EU. One may wish to revisit the abandonment of national Keynesianism in Western Europe throughout the 70s and 80s (i.e. before the re-launch of European integration in 1986, through the Single European Act), from the end of Bretton Woods in 1971 to Mitterrand's *tournant de la rigueur* in 1983 (Glyn 2001, Fazi and Mitchell 2017), through the lenses of the external constraint, which severely reduces the abilities to reflate in an increasingly integrated national economy, regardless of the flexibility of the monetary system -requiring a long-term effort to channel investment towards the modernization of

[7] In a review article, economic historian B. Eichengreen (2008: 4) writes that the statistical evidence is not overwhelming" when the real exchange rate is analysed as a determinant of economic growth. He concludes, however, that it can be considered "a facilitating condition", though, the general evidence should be regarded as mixed at best.

productive structures . Given the unprecedented levels of inequality and poverty in the periphery, strong redistributive programmes will simultaneously be needed to improve the well-being of the majority -that will be deeply contested if, as we have argued, a swift return to growth cannot be guaranteed. To build a "historical bloc" for this progressive form of *austerità*[8] (an alternative to neoliberalism that does not entail a faster pace of economic growth) is a collective task for the Left to perform: for such is the most likely form of a break with the model that European integration forces on the EU's Member States.

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8 We use the Italian term to echo Berlinguer's call for a working-class-led form of austerity, most famously in his closing speech at the *Convegno degli intellettuali* (1977), as an opportunity for transforming (Italian) society beyond the logic of capitalism.

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