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EUROZONE ECONOMIC CRISIS WILL CONTINUE UNTIL STRUCTURAL FLAWS ARE ADDRESSED, NEW LEVY ECONOMICS INSTITUTE STUDY SAYS

New Report Suggests Euro Treasury to Make Dysfunctional Euro Regime Viable

ANNANDALE-ON-HUDSON, N.Y.— The European Central Bank cut interest rates this week and announced a plan to start buying assets in an effort to stimulate the eurozone's stagnating economy. While there has been considerable debate as to whether the ECB went far enough, a new study from the Levy Economics Institute of Bard College argues that the euro crisis is not nearly over, and that the eurozone remains extraordinarily vulnerable to renewed stresses because of the flawed design of the euro currency union. By decoupling central bank and treasury institutions, member states gave up control over their own currencies but retained responsibility for fiscal policy, which exposed them to sovereign debt runs. Levy Research Associate Jörg Bibow calls for a Euro Treasury to establish a treasury-central bank axis of power that exists in at the center of control in sovereign states.

"Today, as almost all member-states continue struggling under adverse debt dynamics, questions remain over the effectiveness of the European Central Bank's (ECB) powers to stem area-wide contagion due to the lack of a treasury partner—exposing the ECB to legal challenges of its quasi-fiscal policies," writes Bibow in his new Public Policy Brief, *The Euro Treasury Plan*. "As a result, the euro currency union remains stuck in a crisis of its own making, with little hope of emerging from it under its flawed and dysfunctional regime."

To address the dysfunctional flaws at its core and also provided needed stimulus to end the crisis, Bibow proposes the creation of a Euro Treasury to act as a vehicle to pool future eurozone public investment spending, which would be funded by proper eurozone treasury securities. "While the flawed euro regime has caused a massive investment slump, both public and private, the Euro Treasury scheme would steady public investment spending," he writes. "This would safeguard the eurozone's infrastructure and common future, and it would also help stabilize economic activity and investment spending generally."

In Bibow's plan, member-state governments would agree on the initial volume of common area-wide public investment spending and on the annual growth rate of public investment thereafter. For example, assume agreement on 3 percent of eurozone GDP as the initial volume and a 5 percent annual growth rate thereafter. By extension, if the implicit Maastricht assumption of 5 percent annual nominal GDP growth were to hold, the eurozone would henceforth see steady investment in its

common infrastructure, while the common Euro Treasury debt stock would converge to a steady-state level of 60 percent of GDP by the end of the century. Furthermore, to head off one major political obstacle, there is no need for the Euro Treasury to directly undertake the investment spending itself. Instead, it would give investment grants to member-state governments exactly in line with member-states' GDP shares (say, five-year averages). At the same time, the Euro Treasury would apply its power to tax and raise revenue to meet the interest service on the common debt, with member-states' tax contributions also being proportionate to their GDP shares.

"With both grants and tax contributions based on member-states' GDP shares, redistribution is excluded by design: the Euro Treasury is specifically designed not to be a transfer union, which rules out one key political obstacle for fiscal union," writes Bibow. "Within one generation Europeans would share both a common infrastructure stock and the public debt that has funded it, writes Bibow. "No debt mutualization of existing national debts would be involved, though. The scheme is purely forward-looking, with new common debt funding new public investment as the basis of the region's much alluded to, but currently grimly neglected, common destiny and future."

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Public Policy Brief No. 135, 2014: *The Euro Treasury Plan*

To read the full text of this policy paper or to learn more about the Levy Economics Institute of Bard College, please visit http://www.levyinstitute.org/publications/the-euro-treasury-plan.

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