Levy Economics Institute of Bard College

Public Policy Brief

No. 135, 2014

THE EURO TREASURY PLAN

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The Public Policy Brief Series is a publication of the Levy Economics Institute of Bard College, Blithewood, PO Box 5000, Annandale-on-Hudson, NY 12504-5000.
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The Public Policy Brief Series is produced by the Bard Publications Office.

ISSN 1063-5297
ISBN 978-1-936192-41-0

Preface

It was only a matter of time until the euro area was hit with the kind of crisis from which it is still struggling to recover—this was understood well in advance, by many at the Levy Institute and elsewhere. The problem has always stemmed from a structural weakness in the design of the currency union: member-states gave up control over their own currencies but retained responsibility for fiscal policy. This situation rendered them subject to sovereign debt runs—which occurred when the fallout from a banking crisis fell squarely on euro area national treasuries—of the sort that countries controlling their own currencies do not face.

As we have pointed out previously, member-states are in some ways in the same situation as US states, which are forced to cut back when the economy contracts—that is to say, at the very moment when expanded public spending is required to place a floor under the economic collapse. But US states have the benefit of a treasury at the federal level that can spend without the same sovereign debt concerns (which the US federal government did, briefly, before succumbing in 2010 to a misguided notion of "fiscal responsibility," not to mention congressional obstruction). The eurozone member-states, however, do not have the benefit of this treasury–central bank combination at the level of the central government—a lacuna Jörg Bibow addresses with the proposal outlined in this policy brief.

There are limits to what the European Central Bank (ECB) can (and is willing to) accomplish on its own, and as Bibow observes, even the "quasi-fiscal" measures it has already undertaken are vulnerable to legal challenge. He calls for pairing the ECB with a Euro Treasury that would pool future public investment spending for the eurozone. The proposal, in other words, aims at the heart of the euro's design flaw. However, "completing the union" in this way—with a strong treasury at the central level—is (at the risk of understatement) politically problematic.

Bibow's Euro Treasury proposal anticipates some of these major political reservations. Spending would not be undertaken directly by the Euro Treasury. Rather, the latter would provide grants to member-states, funded by the issue of Euro Treasury securities. Moreover, the grants would be proportionate to member-states' shares of eurozone GDP. The Euro Treasury would have the authority to tax and raise revenue—earmarked for servicing its debt—with member-states' revenue contributions also proportionate to their GDP shares. In other words, the proposal does not amount to a "transfer union"; it is specifically designed to avoid redistribution between regions.

The Euro Treasury's expenditure levels would also be guided by strict rules, such that fiscal policy at this level would involve no discretion. The initial, eurozone-wide level of public investment that would be funded by Euro Treasury securities, as well as subsequent annual expenditure growth, would be agreed to by national governments at the outset, with a goal of eventually reaching a target ratio for the common debt (Bibow conceives of Euro Treasury debt at 60 percent of eurozone GDP by the end of the century).

A Euro Treasury would provide a stable funding base for eurozone infrastructure over the long term and, given that the initial aggregate level of public investment would exceed current (depressed) levels, a near-term fiscal boost. Debt taken on at the center would enable national treasuries to achieve and maintain (structural) budget balance without stifling the economy (spending funded by Euro Treasury grants would not count toward the Stability and Growth Pact limits). Gradually, the preponderance of public debt in the eurozone would shift from high-interest national debt to low-interest Euro Treasury debt. Member-states' expanded fiscal space would enable countercyclical fiscal policy to be used effectively at the national level, which would be aided by the distribution of all-purpose grants by the Euro Treasury to support national treasuries in times of severe recession (Bibow outlines the more complicated arrangements that would be needed to handle economic and financial shocks that disproportionately affect some member-states over others).

A Euro Treasury would also provide the safe assets needed by the financial system, as well as support any planned "banking union." As Bibow maintains, the key to a well-functioning banking union is an ECB–Euro Treasury combination that can handle systemic financial crises and provide an "ultimate fiscal backstop" to a common resolution authority. In other words, the fiscal burden of future banking crises would no longer fall to the vulnerable national treasuries.

The current crisis in Euroland is not over. And as long as the structural vulnerability at the core of the eurozone system remains—a divorce between monetary and fiscal powers—further crises of this magnitude should be expected.

As always, I welcome your comments.

Dimitri B. Papadimitriou, *President*
August 2014

Contrary to German chancellor Angela Merkel's recent claim, the euro crisis is not nearly over but remains unresolved, leaving the eurozone extraordinarily vulnerable to renewed stresses. In fact, as the reforms agreed to so far have failed to turn the flawed and dysfunctional euro regime into a viable one, the current calm in financial markets is deceiving and unlikely to last. The euro regime's essential flaw and ultimate source of vulnerability is the decoupling of central bank and treasury institutions in the euro currency union. We propose a Euro Treasury scheme to properly fix the regime and resolve the euro crisis. The Euro Treasury would establish the treasury–central bank axis of power that exists at the center of control in sovereign states. As the eurozone is not actually a sovereign state, the proposed Euro Treasury is specifically designed not to be a transfer union. No mutualization of existing national public debts is involved either. The Euro Treasury would be the means to pool future eurozone public investment spending, funded by proper eurozone treasury securities. Benefits and contributions would be shared across the currency union based on members' GDP shares. The Euro Treasury would not only heal the euro's potentially fatal birth defects but also provide the needed stimulus to end the crisis.

Fixing the Flawed Euro Regime

The euro crisis has exposed existential flaws in the euro regime. Preceding the crisis, intra-area divergences and the corresponding buildup of grave imbalances remained unchecked. As those imbalances eventually imploded, member-states were found to be extremely vulnerable to systemic banking problems and abruptly deteriorating public finances. 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. 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.

At the heart of the Euro Treasury scheme proposed here is a simple and straightforward idea. The idea is to create a Euro Treasury as a vehicle to pool future eurozone public investment spending and have it funded by proper eurozone treasury securities. 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. In fact, the biggest part of the adjustment would be completed within 30 to 40 years. In other words, within one generation Europeans would share both a common infrastructure stock and the public debt that has funded it. 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.

A Minimalistic but Functional Fiscal Union and the Subsidiarity Principle

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. The Euro Treasury would be separate from and run parallel to the European Union (EU) budget, which would remain the sole instrument of any intraregional redistribution.

There would also be no discretion in fiscal decision making, which takes care of the other main political obstacle to fiscal union in Europe. The Euro Treasury would function on the basis of a strict rule. For as long as there is no full-fledged parliamentary democracy in place in the eurozone, there is a strong political case for organizing public investment spending on a strict rule when managed and funded from the center. Member-states would still be required to abide by all the rules of the current euro regime, including recent reforms, *but this would apply to current public expenditures only*—as national public capital expenditures would form a separate capital budget funded through common Euro Treasury securities.

The euro crisis is widely, if wrongly, blamed on fiscal profligacy and a supposed lack of compliance with the rules of the (so-called) Stability and Growth Pact (SGP). While the SGP features a seemingly big "stick" of onerous sanctions, which may be unenforceable in practice, the Euro Treasury would handle the compliance issue far more convincingly, automatically withholding investment grants in case of noncompliance with the balanced (structural) budget rule as applied to current expenditures—and by the full amount of the target gap. Member-states would thus have a very strong incentive not to miss out on the investment grant "carrot." Failure to achieve a target—and the public finance costs in terms of missed investment grants—would surely reverberate with the public media and financial markets.

In line with the subsidiarity principle, the Euro Treasury's power to tax would be strictly limited to obtain revenues to service the interest on the debt and keep the debt ratio stable at its target level. On the revenue side of the plan, special tax provisions would be designed to generate revenue earmarked for servicing the debt. This may be bolstered by a deposit of international reserves equivalent to member-states' yearly tax obligations. Legally, any eurozone member-state could follow the example of the Fiscal Compact and enter into an intergovernmental treaty outside the EU framework, together with measures to be introduced in national legislation.

The foremost economic case for the proposed Euro Treasury is that the current euro regime, including both recent reforms and potential reforms along the lines of the Van Rompuy (2012) report or the European Commission (EC 2012) blueprint, does not provide a viable path for Europe's currency union. The euro is without firm footing as long as the ECB is missing a treasury partner that would establish that vital treasury–central bank axis that stands at the center of power in sovereign states. The current regime leaves all players vulnerable. Lacking a central bank partner, the national treasuries are subject to default and, hence, runs. Lacking a Euro Treasury partner and Euro Treasury debt, the ECB is subject to legal challenges of its quasi-fiscal policies as applied to national debts.

Furthermore, attempting to reduce national public debts to very low levels without establishing this vital link and organizing deficit spending at the center is not a workable solution anyway. The current regime envisions member-states running (near-)balanced public budgets forever, which would see public debt ratios decline toward (near) zero in the long run. This is a truly impossible endeavor. Not only would it starve the financial system of safe assets, but it would also set up a lopsided regime that shifts all debt onto weaker (private) shoulders, thereby creating perfectly avoidable economic fragilities. Debt—and, in fact, growing public debt—is a very natural concomitant phenomenon of economic growth. The euro regime is lacking a central fiscal institution with the power to spend, tax, and issue debt. This void is the key source of its vulnerability and poor performance.

Especially following a financial crisis marked by excessive leverage, the private sector will seek to run a financial surplus. Only when the recovery has turned into a new boom can we expect the private sector to reach a balanced financial position (or even a temporary deficit). Given a structural financial surplus for the private sector over the cycle, the public sector can only realistically balance its books structurally if the country runs perpetual external surpluses. This amounts to the German model, which provided the root cause of the unresolved euro crisis. Replicating the German model for the eurozone as a whole will persistently depress the domestic economy and provoke global tensions—as it already does.

As to the evolution of national public debts under the Euro Treasury plan, steady deficit spending on public investment funded at the center would allow *and enable* national treasuries to (nearly) balance their structural current budgets. Within one generation, there would be little national public debt left to worry about. While mimicking the original Maastricht criteria of fiscal rectitude and stability at the union level, the overall outcome would also resemble the situation in another, functioning currency union: the United States.

In essence, perpetual deficit spending from the center, organized through a Euro Treasury issuing proper eurobonds, meets the systemic requirements of the region, while also providing the safe assets the financial system needs to function. The Euro Treasury is the missing element in the current euro regime: it can actually make that very regime, with its inherent flaws, work.

Safeguarding Europe's Infrastructure and Common Future

The Euro Treasury would play a number of essential roles that are vital to turning the euro regime into an engine for joint prosperity. First of all, while the flawed euro regime has caused a massive investment slump, both public and private, the Euro

Treasury scheme would steady public investment spending. This would safeguard the eurozone's infrastructure and common future, and it would also help stabilize economic activity and investment spending generally. This is the feature that distinguishes the Euro Treasury plan from alternative proposals emphasizing public investment as a prerequisite for recovery and growth: the Euro Treasury would provide a straightforward way of funding Europe's infrastructure. It would thereby exemplify the fact that both sides of the balance sheet matter: the issuance of common eurobonds would serve to fund the infrastructure upon which Europe's future rests. The current austerity crusade rejects the conventional understanding of the "golden rule of public finance," whereby governments finance public investment by debt issuance rather than taxes, and impoverishes Europe. The Euro Treasury would turn that golden rule into the anchor of the European integration process.

There may also be a role for the European Investment Bank (EIB), the European Investment Fund, the EC's so-called "project bonds," and private-public partnerships. But these instruments can only complement, not substitute for, a proper Euro Treasury issuing proper Euro Treasury securities. For instance, the EIB's expertise can be called upon in selecting and designing particular projects, but its balance sheet cannot be levered up to an extent that would make a Euro Treasury superfluous. The EIB's capital subscriptions are backed by the EU (rather than the eurozone, adding a further complication) member-states' national treasuries, each of which is in a vulnerable position due to its divorce from a fully empowered national central bank. The eurozone will not be able to overcome its vulnerability to crisis and jointly invest in its future, thereby anchoring the European integration process in a safe and sound way, without establishing a strong treasury–central bank axis at its center.

National Automatic Stabilizers and Eurozone Stabilization Policy

The experience of macroeconomic performance under the euro regime has revealed insufficient fiscal stabilization space both following the normal cyclical downturn in the early 2000s and, even more so, in the context of the severe crisis that began in 2008. The SGP triggered procyclical consolidation in the 2000s. Under market and policy pressures, member-states have counterproductively pursued brutal austerity policies since 2010. The common presumption—that fiscal profligacy and a supposed lack of ambition in the good years are to blame—is missing the point. The current euro regime is flawed and dysfunctional.

By itself, the Euro Treasury's essential function in managing and funding public investment spending in the eurozone would not actually constitute a stabilization policy as it is commonly understood. Based on a strict rule, public investment spending would not be countercyclical but merely steady. Indirectly, however, the Euro Treasury would contribute to the public finance function of stabilization in significant ways. Most important, by requiring and enabling the decline of national public debt ratios to very low levels, in abidance with the rule of balancing *structural current* budgets at the national level, the Euro Treasury setup would allow automatic stabilizers at the national level to have the necessary fiscal space to function freely. The Euro Treasury would leave the main fiscal stabilization responsibility at the national budget level, where large built-in automatic stabilizers exist.

Of course, the existence of a central Euro Treasury would also establish the institutional capability for a stronger common response to common (symmetric) shocks. For instance, the above strict rule could be augmented to cover severe recessions (say, declines in GDP by 2 percent or more). In this case, the Euro Treasury could (automatically) extend additional all-purpose grants to support member-states' budgets (on the basis of their GDP shares). The effect would be a temporarily faster rise in Euro Treasury issuance and a correspondingly milder rise in national debt issuance. This may be advantageous, since the Euro Treasury would be paired with a central bank—the ECB—while the national treasuries are not (and are therefore inherently vulnerable). Once recovery is established, the tax for servicing Euro Treasury debt could be *temporarily* raised so as to assure reconvergence to the target debt ratio for Euro Treasury debt within a certain time period.

Mutual Insurance and Temporary Transfers

Asymmetric shocks are a different matter. And two varieties, presenting very different kinds of policy challenges, actually need to be distinguished. One issue is to respond to exogenous asymmetric shocks. These are shocks that do not arise from nonconforming behavior of members or the (mal)functioning of the policy regime itself, but are, rather, properly exogenous, leaving member-states with opposing policy and/or adjustment requirements (the focal point of optimum currency area theory). In this case, mutual insurance recommends itself. In fact, a mutual insurance scheme featuring *temporary* fiscal transfers may be specifically designed strictly for stabilization purposes, rather than redistribution. This is achieved by making fiscal transfers a function of the rate of change of economic activity rather than the level. Transfers would be triggered when the rate of change of economic activity in any particular member-state deviated from the union average by a certain margin. Transfers would be temporary by design. They would automatically end in case of reconvergence of the rate of change to the average. If it is assumed that asymmetric shocks are randomly distributed, then transfers would tend to balance out for countries over time, and no permanent transfers would arise.

Such a mutual insurance scheme may be run on the basis of a rainy day fund, but it seems far more straightforward to use the Euro Treasury as the conduit through which member-states make or receive temporary fiscal transfers, depending on their relative cyclical position vis-à-vis the eurozone average. The required size of the mutual insurance budget could be very small in practice, but still provide significant stabilizing effects. As in the case of symmetric shocks, the stabilizing effects in case of exogenous asymmetric shocks would also largely work through automatic stabilizers in place at the national level—with added temporary breathing space provided by a mutual insurance scheme featuring the Euro Treasury, at the center, functioning as a conduit and liquidity pool for any temporary mismatches arising from automatic operation of the mutual insurance scheme.

Maintaining Balanced Competitiveness Positions

Mutual insurance runs into trouble if endogenous asymmetric shocks are not prevented. These are shocks that result from within the policy regime itself as member-states deviate from a policy course required for convergence and cohesion. In contrast to randomly distributed exogenous shocks that can be appropriately countered without leading to permanent transfers, the endogenous variety leads to rising intra-area divergences and the buildup of imbalances—imbalances that can ultimately give rise to permanent transfers.

The starkest example of an endogenous asymmetric shock occurred when German wages stopped growing under the euro. As Germany persistently diverged from the common stability-oriented wage norm, member-states' competitiveness positions shifted out of kilter and intra-area imbalances ballooned. The eventual implosion of these imbalances is at the heart of the euro crisis, which prompted support from the ECB's balance sheet and emergency loans from quasi-fiscal rescue facilities. At least until a fiscal transfer union becomes politically acceptable, preventing the emergence of endogenous asymmetric shocks will be vital.

Essentially, member-states must heed the "golden rule of monetary union": their unit-labor-cost trends must stay aligned with the currency union's common price stability norm, unless truly exogenous asymmetric shocks warrant any intra-area adjustment in competitiveness positions. A symmetric rule with real bite focusing on the golden rule of monetary union must replace the current Macroeconomic Imbalances Procedure. Averting permanent transfers presupposes averting persistent divergences in competitiveness positions.

Stabilizing and Backstopping the Financial System

Establishing a strong treasury–central bank axis at the eurozone's center is also vital for anchoring the stability of the financial system. The vulnerability of the original euro regime has become most obvious in this very area. Europe set out to establish a common market, but forgot to pair it with a common policy. Various initiatives are under way today to coordinate, harmonize, or properly integrate national and EU policies in the area of financial stability policy. These include laying down a new, single set of rules for banks (the Capital Requirements Directive IV) and establishing European Supervisory Authorities as well as a European Systemic Risk Board.

Ongoing reforms in this area are supposed to establish a "banking union," which is now considered a required complement to monetary union. It is widely held that banking supervision has been set on a sound footing through the Single Supervisory Mechanism set to take effect in November 2014. Other critical elements in the banking union plan remain works in progress, especially the issues of a common deposit insurance scheme and a common resolution framework or mechanism. Following the experience of the Cyprus crisis in 2012–3, there has been a shift in the approach to resolution that focuses on bailing in creditors, so as to better protect taxpayers. This may be a laudable idea, but it is also rather hazardous. The culprits may be penalized and asked to contribute to the cleanup later on, but in times of emergency there could be severe limits to the practicability of stemming contagion by bailing in creditors (including depositors).

The public authorities must be in a position of strength to be able to effectively counter systemic events. Coupling the "deep pockets" of the Euro Treasury with the "quick" pockets of the ECB is essential for having in place a strong bulwark against the threat of a financial meltdown. The central bank can meet any emergency liquidity needs of the financial system. But it requires a treasury to act as the ultimate backup in case of solvency issues. Only the two of them, working together, can properly safeguard the financial system and counter systemic threats to the euro union. Hence, if banking union is a required complement to monetary union, so is fiscal union, featuring a sufficiently strong Euro Treasury at the center.

With proper common supervision in place, any fiscal burden stemming from a financial crisis should fall on common treasury shoulders too. As a necessary backstop for the financial system, the Euro Treasury would replace the unwieldy European Stability Mechanism (ESM), which is backed by national contributions; that is, national treasuries that are individually vulnerable, since they are divorced from their national central banks. With the establishment of a Euro Treasury partner, the ECB would henceforth operate only in Euro Treasury securities and never touch national sovereign debt. With the Euro Treasury in place, national public debt ratios would be required and enabled to decline to low, safe levels. Accompanied by banking regulations that effectively prevent the concentration of national sovereign debt instruments on bank balance sheets, the Euro Treasury would thereby cut through the "bank–sovereign (doom) loop" and make the "no-bailout clause" workable at the same time.

A "rainy day fund" may be set up for this purpose, funded by contributions from the financial industry. But when a major calamity strikes, the requirement for truly "deep pockets" still remains. The ECB has the liquidity firepower to stem contagion, but it lacks a partner with the equivalent of the US Treasury's deep pockets. Any viable banking union deserving of the title presupposes an adequate central fiscal capacity. Existing instruments are ill designed and inadequate for this purpose. Cross-border banking in a financial union requires a common resolution authority, including a common fiscal backstop. In the eurozone banking union, the Euro Treasury, funded by a debt instrument designed to emulate US Treasury securities, would be the ultimate backstop.

While the Euro Treasury is generally operable on the basis of a strict rule, some discretion would be necessary and inevitable in the area of crisis management and resolution. This is no different from the current situation regarding the ESM, except that the Euro Treasury would have a much sounder funding basis and would restore the treasury–central bank axis of power at the center.

Attractive Transition: The Euro Treasury as Recovery Program

The Euro Treasury would heal the euro's potentially fatal birth defects. As proposed, it creates a central fiscal institution operating side by side with the ECB. Establishing the treasury–central bank axis at the center of power of the eurozone is essential. Over time, a sizable, common euro public debt stock would emerge, while national public debt levels would shrink to low and safe levels. No debt mutualization would be involved, though. Steady deficit spending at the center to fund the public investment that is the basis of Europe's common future would allow and enable national treasuries to balance their structural current budgets.

In a number of ways, the Euro Treasury would also provide short-term recovery support, both directly and indirectly. One direct stimulus arises from the fact that the proposed amount of public investment spending exceeds current spending. Due to counterproductive austerity measures, public investment has plunged and now stands at only 2 percent of GDP, threatening to undermine Europe's common future. A return to, say, 3 percent would thus provide an immediate and direct boost to growth.[1]

Another direct stimulus effect results from the fact that focusing the eurozone's fiscal regime on balancing national structural *current* budgets (while separating and pooling the capital budget at the center) fundamentally changes the austerity outlook overall; the required degree of further consolidation would be diminished. A related important effect would arise indirectly through declining interest rates. In principle, member-states would see their contributions, in the form of taxes, to meeting the interest burden on the Euro Treasury debt gradually build up over time, as their debt service on national public debt declined simultaneously.

Replacing a flawed regime with a functional one and gradually transitioning from servicing high-interest national debt to servicing low-interest common debt would result in significant overall budgetary relief. This benefit would arise as soon as national debt ratios were seen as being set on favorable trajectories. In other words, the Euro Treasury would allow for a favorable effect on national budgets that should be stimulative overall. Currently, euro crisis countries are laboring under highly adverse conditions, and are forced to achieve very sizable primary budget surpluses. Ultimately, dynamics for the Euro Treasury debt should be similarly favorable to those of US Treasury debt. Permanent primary deficits are a realistic prospect. This benefit would gradually be shared among currency union members as the transition progressed.

Benign Rebalancing

Currently, the rebalancing process inside the euro currency union is very asymmetric: euro crisis countries are forced into a costly debt deflation process without any concomitant pressure on creditor countries to expand. The Euro Treasury plan would make for a more symmetric and benign (less deflationary) rebalancing of the currency union. For instance, Germany would see a significant rise in public investment spending. Moreover, fiscal adjustment in line with the Euro Treasury (golden) rule would add to the expansionary fiscal effect, given the country's quite sizable structural current budget surplus. This example underlines the importance of interpreting the balanced-budget rule of the SGP in a sensibly symmetric way: if members were allowed to target excessive budget surpluses, this would risk undermining intra-union balance just as much as in the opposite case.

At the same time, normalization of credit spreads and convergence of interest rates across the currency union would also beget important relief for private borrowers, especially in euro crisis countries. The current fragmentation of financial markets within Europe's currency union defeats the whole purpose of both the currency union and the common market. Companies in euro crisis countries are put at a lasting competitive disadvantage in financial markets solely as a result of a dysfunctional currency regime. With the Euro Treasury added to the euro regime, the term structure of Euro Treasury debt would become the common benchmark for financial instruments issued by debtors of euro member-states, irrespective of nationality. As a level financial playing field is established, the promise of the common market and common currency would finally be fulfilled.

Debt-legacy Challenge Remains an Open Issue

The Euro Treasury scheme would essentially relaunch the euro, placing it on a sounder footing but leaving the debt overhangs that are a legacy of Europe's failed currency union experiment unaddressed. A fiscal union that is specifically designed not to be a transfer union cannot directly address this issue. However, by switching from a public thrift campaign that can only impoverish Europe to a public investment campaign designed to secure Europe's future, the Euro Treasury scheme would reignite growth and thereby establish more favorable debt dynamics across the union. Even Germany, with its public debt ratio north of 80 percent, would relish this benefit. Ending the debt deflation process under way in euro crisis countries through renewed growth would do much good in itself, even as debt restructuring may be put on hold for the time being. GDP growth through public deficit spending at the center would also greatly improve the situation of banks across the union, even without more direct capital support.

But ultimately, growth alone will not heal the division between creditor and debtor nations that has come to afflict Europe's currency union. In this regard, one should not lose sight of the fact that, in essence, ECB liquidity prevented debt restructurings that would have left big holes in the balance sheets of German banks in particular, with corresponding hits to German taxpayers instead of taxpayers in today's euro crisis countries. Perhaps improved overall performance under the new euro regime proposed here could lead, over time, to more solidarity and forgiveness in dealing with the consequences of blunders for which debtor and creditor nations are jointly responsible.

Note

1. The initial boost could be temporarily bigger if it were agreed to start with higher public investment in the next few years, gradually declining to 3 percent of GDP thereafter. Furthermore, the member-states may be advised to normally use the 0.5 percent structural deficit allowed by the SGP for public investment.

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Bibow holds a bachelor's degree with honors in economics from the University of the Witwatersrand, a diplom-volkswirt from the University of Hamburg, and MA and Ph.D. degrees in economics from the University of Cambridge.