**Headline:** The European Union Still Hasn’t Considered an Economic Proposal That Can Save It

**Teaser:** The latest ideas are too little, too late, and still hamstrung by institutional barriers that block genuine economic recovery. They do not represent a “Hamiltonian moment.”

By Marshall Auerback

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**[Article Body:]**

On May 5, [Germany’s constitutional court ruled](https://www.euronews.com/2020/05/15/germany-constitutional-court-gone-nuclear-what-happens-next-will-shape-the-eu-future-view) that parts of the European Central Bank’s bond buying operations to avert a mounting economic depression were illegal. In the wake of that decision, many new proposals have surfaced. First, the European Central Bank (ECB) added a further €600 billion to its [earlier announced pandemic emergency purchase program (PEPP)](https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html) to support Europe’s rapidly faltering economy. This brings the total bond buying up to [€1.35 trillion](https://www.marketwatch.com/story/ecb-expands-pepp-asset-buying-program-to-135-billion-euros-2020-06-04). Additionally, a €500 billion [“Next Generation” recovery fund](https://ec.europa.eu/commission/presscorner/detail/en/speech_20_941) was introduced by the governments of France and Germany, a figure that was [later increased to €750 billion by European Commission (EC) President Ursula von der Leyen](https://braveneweurope.com/emma-clancy-behind-the-spin-on-the-eus-recovery-plan).

The numbers behind these programs sound impressive, but taken in aggregate, the proposals simply tweak the legal and fiscal status quo. The ECB proposals blithely ignore the problematic legal issues raised by the May 5 German constitutional court decision. And the Next Generation fund, although on the surface not suffering the same legal deficiencies as the ECB’s actions, is insufficiently large to yank the EU out of its COVID-19 depression, which will require *trillions* of euros to compensate for the lost economic output, not billions. Almost daily, the continent is experiencing record collapses in economic output—[even powerhouses like Germany](https://www.ft.com/content/de9a6723-51bd-4962-a410-ef0f4d210440), as well as the periphery nations of the south. The problem is that at this stage, the EU can ill afford any more baby steps if it wants the European Union to survive as a workable political construct, or the euro to survive as a viable currency.

The Franco-German proposal in particular has been described as “[Europe’s Hamiltonian moment](https://www.project-syndicate.org/commentary/french-german-european-recovery-plan-proposal-by-anatole-kaletsky-2020-05),” which is about as accurate a characterization as comparing the dabbling of a five-year-old finger painter with the works of Claude Monet. Both activities might be crudely characterized as “painting,” but that’s about as far as the comparison goes. The original “Hamiltonian moment” was a [“historic constitutional compromise forged by the first U.S. Treasury secretary Alexander Hamilton, James Madison, and Thomas Jefferson”](https://www.piie.com/blogs/realtime-economic-issues-watch/europe-last-channeling-alexander-hamilton) in 1790. The parties accepted the concept of debt mutualization by agreeing that the newly constituted federal Treasury would assume *all the existing debt* “[incurred by the U.S. states during the War of Independence.](https://www.piie.com/blogs/realtime-economic-issues-watch/europe-last-channeling-alexander-hamilton)” In exchange for the acquiescence of the Virginians, Jefferson and Madison, Hamilton agreed to move the nation’s permanent capital from the north to Washington, D.C. Until that compromise was reached, Congress had been at a political impasse.

[Breaking the logjam](https://en.wikipedia.org/wiki/Compromise_of_1790) “made possible the passage of the [Residence](https://en.wikipedia.org/wiki/Residence_Act) and [Funding (Assumption)](https://en.wikipedia.org/wiki/Funding_Act_of_1790) Acts in July and August 1790” that allowed the state debts to be federalized. But the compromise did *not* create a new Treasury or governing structure. That spadework had already been done. The Constitutional Convention gathered in 1787, and the delegates’ handiwork in the form of a new constitution was ratified in 1789. This laid the foundations for a true fiscal transfer union as it gave the national government substantially greater fiscal powers than had existed under the old [Articles of Confederation](https://www.history.com/topics/articles-of-confederation).

By contrast, the Treaty on European Union (aka the Maastricht Treaty) is a framework that more closely approximates America’s discarded Articles of Confederation. Much like the former American colonies, under the Maastricht Treaty, fiscal powers largely remain the provenance of the state governments; minimal centralized taxation and spending powers exist for the EU as a whole. The European Commission (which will manage the recovery fund) still needs unanimous approval from the EU member states to carry out its functions under the new proposals. And the composition of grants relative to loans is still yet to be determined. Four of the smaller member state governments in the north—Austria, the Netherlands, Sweden, and Denmark—have all [indicated](https://www.reuters.com/article/us-germany-netherlands-eu-recovery/netherlands-wants-loans-for-eu-recovery-germany-favours-grants-idUSKBN2322SS) a preference for the funding to be allocated in the form of loans, rather than outright grants. But piling debt on top of existing heavily debt-laden southern countries such as Italy or Spain effectively diminishes any tangible benefits these countries stand to receive, as the bulk of their fiscal efforts will be devoted toward debt repayment, as opposed to economic reconstruction. This has been effectively another lever of power of the EU’s northern states over the southern ones, as well as a huge growth constraint.

The Next Generation fund would empower the EC to borrow on its account, which has led the proposal’s supporters, [notably global investment research firm Gavekal’s Anatole Kaletsky](https://www.project-syndicate.org/commentary/french-german-european-recovery-plan-proposal-by-anatole-kaletsky-2020-05), to claim that it creates a new class of eurobonds, and therefore, “might be remembered as the moment when Europe became a genuine political federation.” A closer look at the details tells a different tale. As Sony Kapoor, managing director of the think tank Re-Define, [points out](https://www.politico.eu/article/this-isnt-europes-hamilton-moment/): “The European Commission already has €52 billion of [bonds outstanding](https://www.bloomberg.com/opinion/articles/2020-05-20/coronavirus-germany-and-france-move-closer-to-a-euro-bond?sref=BX5f2LOD).” In other words, it’s not a new class of bonds, just a bigger amount. Kapoor also [rightly notes](https://www.politico.eu/article/this-isnt-europes-hamilton-moment/) that:

“the recovery fund does not… make provisions for a permanent increase in the EU’s meager budget or give the Commission the ability to raise its own funds. Nor will existing debt be subsumed into a fiscal union as Hamilton did. Not even the responsibility for the new debt being created will be shared jointly among all EU countries, as the now-abandoned initiative for ‘coronabonds’ proposed.”

In other words, there is no mutualization, no new fiscal treasury, but rather a temporary augmentation of the EC’s existing budget and, even then, one that is not big enough to engender economic recovery. The proposal envisages raising the European Commission’s budget to [2 percent of EU gross national income](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_940), hardly sufficient given that Italy, Spain and France [are all likely to sustain double-digit contractions in GDP this year](https://www.ft.com/content/dd6cfafa-a56d-48f3-a9fd-aa71d17d49a8). And the proposal would be hardly an exercise in nation building, as all of the countries will be battling each other for the few scraps available on the table.

Unlike the latest ECB announcement, the Next Generation proposal at least has the virtue of being structured with a view toward avoiding potential future legal challenges, precisely because it does not mutualize existing national debts. And the fact that it has Germany’s backing is not insignificant. Jörg Kukies, Germany’s deputy finance minister (and one of the architects of the initiative), [explicitly acknowledged](https://www.ft.com/content/2503ce9c-cde9-4301-bba0-8301f7deaf3b) that true European sovereignty could not evolve “as long as fiscal union remains incomplete.” But the fact remains that this particular structure does not really advance that cause (even Kukies himself acknowledges that the Next Generation fund does not mutualize national debts). The new initiative likely passes legal muster but at a cost of failed economic effectiveness.

In regard to the ECB, the central bank’s proposed increase to its previously announced PEPP program ignores the fact that the European Court of Justice (ECJ) has yet to deal with the problematic issues raised by the May 5 [constitutional court ruling in Germany](https://www.project-syndicate.org/commentary/german-constitutional-court-ecb-ruling-may-threaten-euro-by-katharina-pistor-2020-05). Absent clarification from the ECJ, the central bank’s ability to carry on its bond buying activities is therefore constrained. The implications of that judgment are simply being ignored, even though, in [the words of Deutsche Bank’s former chief economist Thomas Mayer](https://www.telegraph.co.uk/business/2020/06/07/germans-fear-ecb-following-weimar-reichsbank-inflation-trap2/):

“The ECB has no legal or democratic mandate for what it is doing, and it is giving the false impression that there is a free lunch. We are heading for a constitutional crisis in the European Union and there are no means for diffusing it. The euro is simply not viable and the next couple of years are going to determine whether it all breaks apart. The markets don’t understand what is happening.”

The markets might soon wake up, however, given that the Bundesbank (which purchases German government bonds on behalf of the ECB) will be [prohibited](https://www.reuters.com/article/ecb-policy-germany/bundesbank-must-stop-buying-govt-bonds-if-ecb-cant-prove-need-court-idUSL8N2CM5J2) from taking part in bond buying operations from August onward unless the ECB can meet the German constitutional court’s objections.

Perhaps the ECB assumes that by August the issue will be resolved by the European Court of Justice. However, the questions raised by the German court will almost certainly be pursued in future challenges, if for no other reason than there are other legitimate grounds to challenge the activities of the ECB.

The recent German court decision contested the ECB’s sovereign bond buying operations on the basis that they breached the treaty’s [proportionality principle](https://www.europeanlawmonitor.org/eu-legal-principles/eu-law-what-is-the-principle-of-proportionality-a-subsidiarity.html) (i.e., the ECB’s actions were not commensurate with its stated monetary policy objectives), as opposed to making the argument that the central bank’s actions violated its “[no bailout](https://en.wikisource.org/wiki/Consolidated_version_of_the_Treaty_on_the_Functioning_of_the_European_Union/Title_VIII:_Economic_and_Monetary_Policy#Article_125)” clause. On the face of it, however, the latter is an even stronger basis on which to challenge the ECB’s actions. It is hard to look at the ECB’s bond buying activities under any objective basis and suggest that they do not violate the “no bailout” provisions of the Maastricht Treaty, because in the absence of the ECB’s purchases, these countries would certainly go bust.

Herein lies the paradox: In economic terms, as the sole issuer of the currency, the ECB is the only entity keeping the single-currency member states solvent. However, as Wolfgang Munchau [has highlighted](https://www.ft.com/content/e0ac5f7a-8b85-11ea-9dcb-fe6871f4145a), “the monetary union owes its survival to successful rule-bending. It was a masterpiece of legal engineering in the last crisis to set fire to a no-bailout clause in European treaties, and then create a bailout umbrella on its ashes.” Calling these actions daily liquidity management or reserve maintenance procedures does not disguise their underlying illegality.

At some point down the line, a direct legal challenge will be framed in these terms, whether from Germany or some other member state. In the meantime, the legal ambiguity of the ECB’s status restricts its ability “to respond to a crisis with appropriate size and timeliness,” [as Kapoor concludes](https://www.politico.eu/article/this-isnt-europes-hamilton-moment/). That is a huge problem, given the ECB’s unique currency-issuing function and its effectiveness hitherto in staving off mass insolvency and a likely evaporation of the euro.

Ultimately, what is required is a proposal that operates in accord with existing EU institutional arrangements, and which also are consistent with the recent German court ruling. Per capita distributions to the various nation-states via ECB would fulfill this requirement, as this activity is aligned with existing treaty provisions and, most importantly, is consistent with the proportionality principle.

Why? [As I have argued before](https://www.counterpunch.org/2020/04/10/last-chance-to-save-the-euro/):

“[Germany’s] fundamentally strong position vis a vis other member states wouldn’t change, much as per capita distributions from Washington don’t fundamentally alter the relative economic positions of California versus, say, Arkansas. The distributions would effectively amount to swaps of national debt for reserves, which in turn would immediately adjust national government debt ratios downward (because as an accounting matter, reserves are not counted as national debt). This goal would be to dramatically ease credit tensions and thereby foster normal functioning of the credit markets for the national government debt issues. The governments in turn could use this newfound fiscal relief to pursue fiscal packages that revive their domestic economies (as opposed to using the mechanism for covert bank bailouts).”

**The EU’s Big Need**

What is required is a bit of creativity and real statesmanship to ensure that policy is not perpetually subject to irrational austerity constraints, or endless court challenges because of monetary improvisations that mask illegal activities. Per capita distributions from the ECB may not sound as groundbreaking as a “Hamiltonian moment,” but that’s the whole point: they are consistent with pre-existing Maastricht Treaty provisions, and they don’t ride roughshod over them. Hence, they avoid time-consuming legal wrangles that would constitute the equivalent of fiddling while Rome (or Berlin, Madrid, Paris) burns. These ECB-led per capita distributions provide the sole possible, reasonable and prudent basis to save the euro, as well as laying a more realistic foundation for a viable fiscal transfer union.

The sooner this is realized by Europe’s main policymakers, the better, because if the courts do ultimately decide to pull the plug on the ECB’s current activities, there will be no safety net left.