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“LOST AT SEA: THE EURO NEEDS A EURO TREASURY”
Euro-zone remains stuck in existential crisis. Current policy course means eventual shipwreck.

Euro Treasury has to complement ECB to create strong CB-Treasury axis at center for euro to survive and prosper.

€Treasury plan delineates minimalistic but functional fiscal (but not transfer) union that would resolve crisis & foster recovery.

Structure
1. Euro regime flaws, vulnerabilities, and crisis
2. Wrong-headed crisis management & recent regime reforms
3. What to do then?
4. The Euro Treasury plan
5. Concluding observations
1. EURO REGIME FLAWS, VULNERABILITIES, AND EXISTENTIAL CRISIS

Buba baggage haunting the euro
EURO REGIME FLAWS

1. No proper defenses against symmetric shocks
   + Normal downturn (‘global slowdown’) in 2001
   + Global recession in 2008-9

2. No prevention of endogenous asymmetric shocks
   + German wage repression & intra-area divergences

3. Defenseless against systemic financial crises
   + The divorce between monetary and fiscal authorities is deeper
     underlying cause of vulnerability
   + Euro is a currency without a state, a monetary union but not a fiscal
     union; *Euro Treasury is missing*
VULNERABILITIES
TREASURY-CENTRAL BANK AXIS UNTIED (FLAW NO. 3)

- “Divorce” leaves everyone involved vulnerable!

  + National treasuries
    - Bank bailouts, public debt surges, no monetization option (“QE”).

  + National central banks
    - Prohibited from being LOLR to government.
    - Under ECB control, merely facilitate bank bailouts (except ELA).

  + ECB
    - Prohibited from being LOLR to governments.
    - In practice, ECB can extend emergency liquidity to system as a whole but supporting particular institutions or MS problematic.

★ Who & how would ECB recapitalization work in case of losses?
★ ECB is missing Euro Treasury partner! (Goodhart 1998)
AND EXISTENTIAL CRISIS

- A balance-of-payments crisis
  - Divergences and imbalances (flaw no. 2)
  - Sudden stop/sudden reversal

- A banking crisis
  - Common market without common policy
  - Asset price bust and recession (flaws nos. 1-3)

- A sovereign debt crisis
  - Largely a consequence of the above (Greece special case)

- Plus: “growth crisis” (or: debt deflation)
  - Consequence of misdiagnosis & mismanagement of crisis
Myths rather than theory and facts continue to inspire policy

2. Wrong-headed crisis management & ill-guided regime reforms
CRISIS MISMANAGEMENT

- In absence of central fiscal backstop, and given the “no-bail-out clause”, official support was less than prompt

- Initially ECB’s emergency liquidity support quite flexible

- But – lacking proper LOLR mandate and fiscal partner (deep pockets) – ECB became more hesitant as solvency issues (both banking & sovereign) became apparent

- ECB’s de facto quasi-fiscal role highly problematic

- Paired with “expansionary” fiscal austerity and “growth-enhancing” structural reforms the outcome is nothing but disaster!
REFORMS THAT ARE NO FIX

- So-called “Stability & Growth Pact” strengthened
  + “Six-Pack”
  + “Fiscal Compact”
  + “Twin-Pack”
  + …

- Essentially, reforms aim at more discipline, more constraints on national fiscal sovereignty.
- Based on belief that lack of discipline (“fiscal profligacy”) was problem (“sovereign debt crisis”). Misdiagnosis!
- No regime fix at all!
Essentially, eurozone is now aiming at running balanced budgets forever
+ Defies “golden rule” of public finance.
+ National public debt ratios would fall to very low levels.

In closed economy public sector can only balance its books if private sector does too, which is rarely so.

Following a financial crisis (= excessive leverage) the private sector typically aspires large financial surplus.

Hence austerity is bound to cause recession – unless large and persistent CA surplus an option.

Eurozone too large and global recovery too fragile!!!
+ Eurozone reneging on G-20 commitment
+ U.S. Treasury not amused about Germany …
3. WHAT TO DO THEN?

Need for creative solution
HOW ABOUT OTHER REFORM PROPOSALS?

1. Eurobonds
   + Some debt mutualization

2. Fiscal union of kinds
   + More discipline & austerity, but with some risk sharing

3. Recovery programs
   + Public investment as stimulus
STRAIGHT-FORWARD SOLUTION POSSIBLE!

- A solution that:
  - Fixes the flawed regime ("missing element")
  - Secures public investment in Europe’s future
  - Establishes low borrowing costs for all members
  - Allows effective discipline "carrot-type"
  - Provides immediate recovery boost
  - Fosters more symmetric rebalancing
  - A fiscal union that is NOT a transfer union
    - Gives us Eurobonds (= safe assets for financial system) but without mutualization of existing national public debt

- How is that magic supposed to work then?
Establishing strong Central Bank-Treasury Axis at center

3. THE EURO TREASURY PLAN
EURO TREASURY PLAN AS REGIME FIX

- Establish Euro Treasury as a means to pool eurozone public investment spending and have it funded by proper eurozone treasury securities.
  - Say, 3% of GDP, growing at 5% annually
  - A “fixed rule” (no discretion since political union missing)
- Euro Treasury gives grants to member states based on their GDP shares (say, 5-year average)
- And Euro Treasury collects eurozone tax to service euro treasury debt on basis of MS GDP shares
  - No redistribution! Separate from EU budget!
- Member states must balance their *structural current* budgets, or get their investment grants cut (“carrot”)
- Continuous deficit spending from center – based on age-old “golden rule” of public finance – turns flawed euro regime into a viable one – *Euro Treasury as the missing element!*
Convergence to steady state of central and national debt ratios

Outcome resembles Maastricht stability ideal and U.S. reality in normal times
KEY ROLES OF EURO TREASURY

1. Safeguards Europe’s infrastructure & common future by using straight-forward funding
   + Eurobonds without debt mutualization
     ❌ Financial system needs safe assets; also intern. reserves

2. Anchors stability of financial system
   + Banking Union needs Fiscal Union: €Treasury = backstop
     ❌ Euro Treasury replaces unwieldy ESM
     ❌ Provides common euro Treasury yield curve = basis for common market!

3. Anchors national fiscal stabilization
   + Enables decline in national debt ratios, thereby creating space for free working of automatic stabilizers
     ❌ Perhaps boosted from center in deep (common) recessions
   + Provides conduit for mutual insurance scheme in case of *exogenous* asymmetric shocks
     ❌ Complemented by “golden rule” of currency union (ULC-trends aligned) to prevent emergence of *endogenous* asymmetric shocks
EURO TREASURY PLAN AS RECOVERY BOOST

Direct boost
- Boost of public investment: Proposed 3% exceeds current 2%
- Refocusing on structurally balanced CURRENT budget = less austerity

Indirect boost
- As national debt ratios set on decline, funding costs decline
- €treasury debt provides common treasury term structure, creating level playing field independent of borrowers’ nationality at reduced rates

Germany will see stimulus, allowing for more symmetric (i.e. less deflationary) rebalancing

Also, ECB gets chance to get ‘clean’ again and will only deal in euro treasury but not national debts (no bailout clause upheld!)

BUT: No burden sharing of debt legacies in crisis countries
- As Euro Treasury plan is not a transfer union
- Hopefully better performance will foster solidarity in due course
End delusion and denial – This crisis is not nearly over – It’s high time to get serious!

5. CONCLUDING OBSERVATIONS
Crisis misdiagnosis still prevails. Regime flaws and German conduct rather than fiscal profligacy caused crisis.

Current euro regime, including recent reforms, remains deeply flawed, dysfunctional, and unworkable.

- Euro still on track for eventual breakup (sorry Mr. Draghi)

Other proposals found lacking

Euro Treasury offers straight-forward solution

- Secures public infrastructure and provides safe Eurobonds
- Backstops “banking union”, replacing SMP
- Enables effectiveness of national “automatic stabilizers”, facilitates risk sharing
- Provides minimalistic but functional fiscal union that is not (much-dreaded) transfer union!

Establishes vital Treasury-CB axis at Euroland’s center!

- The missing link and condition sine qua non.
This presentation is based on my study “Lost at sea: The euro needs a euro treasury”. See here:

Other recent research papers by myself on the euro crisis:

For more information see my homepage at:
+ [http://www.skidmore.edu/~jbibow/](http://www.skidmore.edu/~jbibow/)
+ [http://www.levyinstitute.org/scholars/?auth=20](http://www.levyinstitute.org/scholars/?auth=20)