The US New Deal and Resolving the Eurozone Crisis

Without the debt buy-outs or national guarantees or fiscal transfers

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* Stuart Holland formerly was a Member of the House of Commons and Shadow Financial Secretary to the UK Treasury. In his twenties he was personal adviser on European affairs to Harold Wilson, and gained the consent of Charles De Gaulle to the 2nd British application to join the EEC. He proposed the case for a New Messina Conference which was endorsed by Andreas Papandreou and François Mitterrand and led to the commitment to economic and social cohesion in the first revision of the Rome Treaty in the 1986 Single European Act. He proposed Union Bonds and a European Investment Fund in a 1993 report to Jacques Delors. As an adviser to António Guterres he recommended that the terms of reference of the European Investment Bank should include investments in health, education, urban renewal and environment, as well as green technology and innovation which has enabled the EIB to quadruple its total borrowing and investments since 1997 and to offer the potential to fulfil the aspirations of the EU for a European Economic Recovery Programme.

1. Executive Summary

One of the reasons for the failure of European heads of state and of government to resolve the Eurozone crisis is German resistance to debt buy-outs, national guarantees and fiscal transfers between member states.

This paper argues that none of these are necessary for Europe (1) to stabilise the crisis by converting a share of national debt to EU bonds, and (2) for net issues of Eurobonds to finance recovery.

In so doing it draws on the precedent of the US New Deal, as did an earlier report recommending bond finance to Jacques Delors which he then endorsed as Union Bonds in his White Paper of December 1993.[1]

It suggests that if the New Deal precedent were to be stressed by Timothy Geithner it could carry major resonance and encourage conviction that Europe can resolve the Eurozone crisis.

There should be a distinction between Union Bonds which are not traded and net issues of Eurobonds which would be traded and attract global surpluses to finance a New Deal style social investment led recovery.

Unlike the current German proposals for a further Treaty revision, this can be done within existing Treaty provisions and by existing institutions.

2. The New Deal and Europe Now

1. European governments have been trying to resolve the Eurozone crisis by debt buy-outs. Manuel Barroso has just proposed Stability Bonds which would be guaranteed by member states.

2. Angela Merkel is opposed to both because mutual guarantees could mean the German taxpayer underwriting the debt. But in funding the New Deal the Roosevelt administration did not buy out the debt of member states of the American Union, nor require them to guarantee US Treasury bonds nor demand fiscal transfers from them.

3. The US funds its Treasury bonds from federal taxes whereas Europe does not have a common fiscal policy. But member states can finance a share of their national debt converted to EU Bonds without fiscal transfers between them.

4. While some member states are deeply indebted, the Union itself has next to none. Until May last year and the beginning of national and other debt buy-outs it had none at all. Even with this, Union debt in terms of ECB buy-outs still is less than two per cent of Union GDP.

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[1] Stuart Holland (1993). *The European Imperative: Economic and Social Cohesion in the 1990s.* Nottingham: Spokesman Press, Foreword Jacques Delors. European Commission (1993). Growth, Competitiveness, Employment: The Challenges and Ways Forward into the 21st Century. Brussels: December.

5. This is less than a fifth of the debt to GDP ratio of the US in the 1930s when the Roosevelt administration began to shift savings into investment through the expansion of US Treasury bonds. Unlike the US the EU has a neglected late starter advantage.

3. Eurozone Stabilisation by Union Bonds

As submitted by former heads of government such as Giuliano Amato, Guy Verhofstadt, Michel Rocard, Mario Soares and others,[2] there is a case for two different bonds as a response to the crisis: (1) Union Bonds for debt stabilisation and (2) Eurobonds to finance growth and recovery.

1. National debt converted to Union Bonds need not be traded. If held and managed by the EU in a debit account such bonds would be ring fenced against downgrading by rating agencies.

2. Member states' share of the converted debt would be serviced by them from their national tax revenues, without the need for a common fiscal policy, joint and several liability or fiscal transfers from other member states.

3. There also is a clear European precedent. The European Investment Bank has issued its own bonds for fifty years without national guarantees or fiscal transfers and already is more than twice as large as the World Bank. Member states service their borrowing from it from their own tax revenues.

4. The transferred debt would not need a Treaty revision or a new institution but could be held by the European Central Bank or the European Financial Stability Facility.

5. Conversion of national debt of up to 60 per cent of GDP would mean that most member states other than Greece would be Maastricht compliant on their remaining national debt. Greece would be a special case but manageable as such.[3]

4. Not Binding Germany – Enhanced Cooperation

The conversion of national debt of up to the Maastricht limit of 60 per cent of GDP could be on an enhanced cooperation basis without obliging all member states to adopt it.

Enhanced cooperation had *de facto* force in the creation of the Euro which was adopted by some of the then 15 member states but not by the UK, Denmark or Sweden. The procedure simply means that some member states can do something without binding others.

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[2] Giuliano Amato, Guy Verhofstadt and Others (2011). A plan to save the euro, and curb the speculators. The Financial Times International Edition, July 4th.

[3] Whether or not there also is restructuring and write-down of Greek debt, Greece would need debt buy-outs by the EFSF, but this would be manageable in macroeconomic terms and low cost relative to the alternative of its quitting the euro and risking a contagion effect on other member states and German, French and other banks.

● Germany, Austria, the NL and Finland therefore could keep their own bonds without liability for the converted debt since the member states whose debt was converted would service their share of it.

For the procedure to be part of EU institutions and supported by them, it needs nine member states. But it depends *only* on the member states initiating it. It cannot be blocked by any member state dissenting from, or not wishing to be part of it. They can discuss it, but not vote to oppose it, as in the footnote below.[4]

France could lead on the procedure and avoid the supranational implications of the Merkel proposals for a new austerity Treaty, especially by stressing that Union bonds for debt stabilisation would be matched by issuing internationally traded Eurobonds for recovery and growth.

5. European Recovery by Eurobonds

Net issues of Eurobonds could be traded and would attract surpluses from the central banks of emerging economies and sovereign wealth funds.

Eurobonds and the ECB

In principle Eurobonds could be issued by the European Central Bank on the lines of The Modest Proposal.[5]

● Bloomberg's volunteered last week that if the ECB were to do so the interest rate could be as low as 1.9 per cent.[6]

This could be opposed by Angela Merkel both on the basis that the ECB should remain independent and that such a rate would be lower than that on which Germany recently failed to clear an issue of its own bonds.

The independence of the ECB is qualified by a Treaty provision that without prejudice to its primary responsibility to preserve the internal and external stability of the euro it shall support the general economic policies of the Union as defined by the European Council.

But the politics, and also possible or probable opposition from the ECB itself, could be side stepped by Eurobonds being issued by the European Investment Fund which now is part of the European Investment Bank Group.

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[4] A decision authorising enhanced cooperation shall be adopted provided that at least nine Member States participate in it. The Council shall act in accordance with the procedure laid down in Article 280 D of the Treaty on the Functioning of the European Union. All members of the Council may participate in its deliberations, but only members of the Council representing the Member States participating in enhanced cooperation shall take part in the vote. The voting rules are set out in Article 280 E of the Treaty on the Functioning of the European Union.

[5] Yanis Varoufakis and Stuart Holland. A Modest proposal for Overcoming the Euro Crisis. Levy Economics Institute, Bard College, Policy Note 2011, May.

[6] Following meetings last month by Varoufakis on The Modest Proposal with both Bloomberg and the Fed.

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The Initial Design Role for the European Investment Fund

The European Investment Fund was designed to issue the EU bonds recommended in 1993 in the Delors White Paper. Its twin design role was to use them both to finance a US New Deal inspired recovery programme and also to finance a European Venture Capital Fund.[7]

Germany and France were opposed and the EIF's design role for a European Venture Capital Fund was downgraded to ineffectual loan guarantees for SMEs.

Recovering the EIF Design Role as Part of the EIB Group

● Since the EIF now is part of the EIB Group, this would strength its original design role for net issue of bonds to finance growth.

The EIB could advise on Eurobond issues by the EIF, drawing on its long standing credibility with markets in issuing bonds successfully without debt buyouts, or guarantees, or insurance schemes or fiscal transfers.

● At a meeting of a working group of the Economic and Social Committee of the Union in Brussels on November 16th a representative of the EIB Group confirmed that the EIF could issue Eurobonds without any Treaty revision.

Co-Financing EIB Projects

The traded Eurobonds could co-fund EIB project finance and be serviced by revenues from EIB projects rather than fiscal transfers between member states. Project control would be retained by the EIB.

Eurobonds also could finance the original design role for the EIF of a European Venture Capital Fund for SMEs, reinforcing the competitiveness of small and medium firms in the European periphery including new high-tech start-ups.

- *Cohesion and Convergence*

The EIB has been given both cohesion and convergence remits by the European Council since the 1997 Amsterdam Special Action Programme to invest in:

> health, education, urban renewal, the urban environment, green technology, financial support for small and medium firms and new high-tech start ups as well as the earlier decision of the 1994 Essen European Council that it should fund trans-European transport and communications networks.

● Since the 1997 Amsterdam European Council the EIB has successfully quadrupled its annual investment finance to the equivalent of two thirds of the Commission's Own Resources from national fiscal transfers.

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[7] Holland, Stuart. (1993). *The European Imperative: Economic and Social Cohesion in the 1990s.* Op cit.

By quadrupling these again by or before 2020, aided by co-finance from Eurobonds, its bond funded investment finance would be the equivalent of Marshall Aid and could make a reality of the European Economic Recovery Programme.

6. US and Global Implications

If some member states of the Eurozone default, and the single currency serially disintegrates, there clearly would be catastrophic consequences not only for Europe but also for the US and the global trading system.

- Offsetting Default Risk

By contrast, net issues of Eurobonds would:

1. Secure the euro as a reserve currency and contribute to the more plural global reserve system which is one of the main aims of the Brazil, Russia, India, China and South Africa.

2. Contribute to balanced global growth which is a central aim of the G20 by recycling global surpluses.

- Implications for the US

The implications for the US of the Euro as a global reserve currency are two sided:

1. The dollar would no longer have the advantage of being the sole reserve currency

2. Inversely, it would not be subject to the risk that it could not sustain this.

● Net gains for the US would depend on net issues of Eurobonds to finance the European Economic Recovery Programme rather than only debt stabilisation.

With such a recovery, and with Europe a third of the global economy, US exports would increase.

In its own interest, yet also to mutual advantage, China could agree to an orderly reduction of its holdings of dollars, or to maintain them while a share of its net surplus flows are into Eurobonds.

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