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COMMENTARY

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The COVID-19 crisis: A Hamilton moment for the European Union?

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1 | INTRODUCTION

According to Jean Monnet, one of the founding fathers of the European integration after World War II, Europe always needs a crisis to make progress in integration. The COVID-19 crisis seems to deliver a perfect case to go forward. The pandemic represents an exogenous shock for all EU member countries. But the impact is asymmetric. Countries with already high public debt before the crisis would run into great difficulties in financing the measures needed to stabilise their economies. Against this background, a number of politicians and academics have called for a "Hamilton moment" and proposed mutualising the new debt at the European level and providing the financial means to the countries most seriously hit by the pandemic.

In 1790, upon a proposal by the Union's finance minister Alexander Hamilton, the debt of states accumulated during the War of Independence was assumed by the Union. Hamilton interpreted this act as "cement" for the Union. Should the EU follow this example and move in the direction of a fiscal union? This article tries to demonstrate that the historical comparison is not well founded, and the establishment of a fiscal union in Europe needs a change of the Treaty on the Union.

2 | NEVER LET A CRISIS GO TO WASTE

European integration saw many ups and downs and always needed a crisis to make an important step forward. According to this perception, on the one hand, European integration is based on a grand political design. On the other hand, progress in political reality can only be achieved—and the manifold obstacles overcome—under the pressure of a crisis.

In short, politics must use the opportunity, following the motto: never let a crisis go to waste. Since the start of (Western) European integration after the end of WWII, there has been no shortage of crises. The great financial crisis of 2008/2009 was only partly used to deepen

integration—and mainly wasted. The turbulences caused by the current pandemic now offer an almost unique chance to do better.

For many observers—among them German Finance Minister Olaf Scholz—this crisis offers a "Hamilton moment", referring to the situation after the American War of Independence. Alexander Hamilton, the first Finance Minister of the Union, proposed the assumption of the debt that states had accumulated to finance their participation in the war. Hamilton argued that the debt of the 13 states was not the consequence of permissive fiscal policy, but due to external circumstances—today, one would call it an exogenous shock—namely the war. The debt was the price of liberty (Hamilton, 1790). On 4 August 1790, the US Congress accepted Hamilton's proposal to assume, that is, nationalise, states' debt. Negotiations ended in a compromise. In exchange for the bail-out, the authority to tax imports, the most important source of revenue, was transferred from the states to the federal government (Sargent, 2012). (The compromise also included the decision to make Washington the future capital.) For Hamilton, the bail-out was an act "to cement more closely the union of the states" (Hamilton, 1790).

What conclusions can for Europe be taken from the American experience? The corona crisis could be seen as a Hamilton moment for the following reasons. The economic consequence of the pandemic is a deep decline in economic activity in all countries. The shock is exogenous and symmetric. However, the impact of the shock is asymmetric in so far as some states are exposed to the risk of an unsustainable fiscal situation if they increase their already high level of debt by financing economic recovery measures.

The Hamilton element is seen in an approach that allocates the new debt at the EU level and provides the means to countries in greatest need.

3 | THE US EXPERIENCE

The decision of 1790 had an important influence on the history of the United States in the period that followed, up until the Civil War. The bail-out did not lead to a stable, sustainable system of state finance. States, relieved from their debt, started to finance expensive projects by incurring new debt. In the course of the next decades a number of states became insolvent. As a consequence, the reputation of the federation and of the states as borrowers suffered. "The irresponsibility of states also gravely damaged the reputation of the federal government and made external borrowing prohibitively expensive" (James, 2015, p. 176). In the end, fiscal union proved to be explosive rather than cement and contributed to the tensions which ended in civil war. "It took 4 years of awful civil war to force rebels to accept not only Abraham Lincoln's interpretation of what it meant for all men to have been 'created equal' but also the type of federal union that Hamilton and Washington had begun and that Abraham Lincoln preserved and extended" (Sargent, 2012, p. 23).

The unsustainable fiscal situation only ended when another bail-out of some states was refused, and the window of state credit was closed. The regime that individual states in the United States have to present a yearly balanced budget and that the option of a bail-out by the union is excluded goes back to this time.

A fundamental difference between the assumption of debt in the United States and the current situation in Europe is that the union, in the former case, already existed. The states followed the advice of an acting finance minister of the union to assume the debt of individual states. This union was the result of the common war of independence. From this perspective, would it not be logical to create in Europe in the first place a defense and foreign policy union

before claiming a Hamilton moment to establish a fiscal union? By the way, it took more than a hundred years for the federal state to expand substantially. Finally, one should not disregard the fact that democracy practiced in the United States at that time excluded many people from voting.

4 | LESSONS FOR EUROPE

4.1 | Different approach—Same objective?

Using the Hamilton moment in the United States implied nationalising fiscal policy to form, to "cement" a federal state. Conducting monetary policy to manage a fiat currency or to have a common currency at all played no role (Sargent, 2012, p. 27). The Federal Reserve System was only established a century later in 1913, and it was two decades later, in 1935 when the Federal Reserve became a central bank, and the 12 regional reserve banks lost their semiautonomous status and much of their original independence (Meltzer, 2003, p. 5).

From this perspective, "Europe" chose the opposite approach by first introducing a single currency and establishing a central bank before it would nationalise (in this case centralise, i.e., "Europeanise") fiscal policy. However, it was a rocky road leading to European Monetary Union (EMU). European integration—before the fall of the iron curtain in 1989 restricted to the Western part—initially started as a political project. The post-World War II period was marked by a desire for political reconciliation, especially between France and Germany. The first step towards integration was founding the European Coal and Steel Community with a central institution, the High Authority, which had a supranational character. The Community of six countries guaranteed the Europeanisation of coal and steel production, which had previously formed the basis for war. This foremost political project was soon followed by a draft treaty establishing the European Defence Community. This initiative was obviously premature, and it failed in 1954 when the French parliament did not ratify the treaty. This event marked the end of plans to establish a European Political Community. European integration as a primarily political project turned into a vision, at best (see e.g., Issing, 2004).

Probably somewhat overstretching the comparison with the United States during and after the War of Independence, one might note that this period after the end of World War II was a kind of "European moment" for creating a political union. However, the political circumstances and divergent positions between countries were far from providing a basis for such a development. In the following decades, European integration left the political track and switched to the path of economic integration by removing all barriers and bringing about the four fundamental freedoms: the free movement of people, goods, services and capital. However, the European Economic Community and EURATOM (the Treaty of Rome 1957) and the Treaty on European Union (1992)—with later amendments—also established European institutional elements such as the Commission, Parliament and Court of Justice. Policy competences for trade, agriculture and competition were transferred to the European level.

The biggest step in the direction of state formation was the introduction of a common currency. The euro was introduced on 1 January 1999 and replaced national currencies in 11 countries. The competence for monetary policy was transferred to the Eurosystem, consisting of the European Central Bank (ECB) and the national central banks. In 2020 European Monetary Union (EMU) included 19 member countries that lost their sovereignty in this crucial field. The competence for foreign currency issues is divided between the ECB and the European Council.

The EU Treaty demands that all member states will ultimately adopt the euro as their currency. The United Kingdom and Denmark have an opt-out and opt-in clause, respectively. After Brexit, Denmark remains the only EU member that is not committed to joining the euro. (The case of Sweden is still debated.)

Talking of a Hamilton moment for "Europe" includes, in principle, all 27 EU member states. However, it makes a big difference whether the consequences for the conduct of fiscal policy concern all EU members or only the 19 countries that share the euro as their common currency. Although the pandemic crisis is the origin of calling for the Hamilton moment in Europe and the specific European programs include the whole EU, in the following the focus is on EMU. This is because there is a long tradition of arguments that a monetary union cannot stay alone and needs the presence of a fiscal union.

4.2 | Fiscal policy—The open flank

"Normally", a state has its own (fiat) money—and its own money is an essential element of a national state. According to the "state theory of money" (Knapp, 1923), money is the creation of state authority. It was an innovation in monetary theory when Mundell (1961) and McKinnon (1963) developed the theory of Optimal Currency Area (OCA), according to which regions/states sharing economic features such as mobility and flexibility of labour could take great advantage of having a common currency, regardless of national borders. The OCA theory delivered economic arguments for introducing a common currency for multiple states.

Still today the euro is a currency without a state. This unusual regime leads one to ask—can it work? Is such an arrangement sustainable?

It remains an open question to what extent politicians arguing for the introduction of the euro and signing the Maastricht Treaty were aware of the manifold and complex problems implied in this arrangement. The then German Chancellor Helmut Kohl, however, was clear and explicit when he declared in the German Parliament on 6 November 1991:

> *It cannot be repeated often enough. Political Union is the indispensable counterpart to economic and monetary union. Recent history, and not just that of Germany, teaches us that the idea of sustaining an economic and monetary union over time without political union is a fallacy (translation O.I.).*

According to his fundamental position, which was shared by many politicians and economists in Germany, political union should come first and monetary union later, at least it should be a contemporaneous decision. However, after the decision in Maastricht to introduce a common currency, no steps in the direction of political union were taken. The very idea even disappeared from the scene. Obviously resistance to such a development was too strong (Szász, 1999, p. 222).

As a consequence, EMU started in 1999 without any progress in the direction of political union. During the negotiations before Maastricht a consensus existed that unconstrained national fiscal policies would be a threat to the stability of EMU. The main source for such a threat was that the euro would become the common denomination of national public debt in the future. Therefore, national government bonds would no longer be exposed to the exchange rate risk that existed before. The disappearance of this risk would remove a barrier to permissive credit financing via the issuance of euro-denominated bonds by national governments. In the end, the credibility of the euro area as a whole could deteriorate and large fiscal deficits in one or more countries would push

up real interest rates for all members of EMU. (The experience of the US financial system in the decades following the bail-out of 1790 could be seen as a cautionary example.)

Concerns about the open flank of unconstrained national fiscal policies for the stability of the eurozone were more than justified. What options did exist to close this flank without taking at least first steps in the direction of fiscal union? In a major disagreement in the run-up to Maastricht, some countries preferred more or less nonbinding arrangements, while other member countries under the leadership of Germany insisted on explicit rules.

As a compromise, a reference value of 3% of gross domestic product was set for the overall annual deficit and of 60% for overall government debt. This rule and its surveillance were specified in the Stability and Growth Pact of 1 July 1998. Concerns over permissive national fiscal policies are also the basis for the no-bail-out clause in the treaty. Neither the Community nor individual member states are liable for or assume commitments of governments or other public entities. Finally, the prohibition of monetary financing by the ECB must also be seen not only as protection of its independence but also as a precaution against alleviating deficit financing thereby contributing to a debt crisis further down the road.

These regulations, being aware of risks for the stability of the euro coming from unconstrained national fiscal policies, try to provide the fundament for the functioning of an institutional arrangement with a single currency and a European central bank, on the one side, and fiscal policies which in principle remain the responsibility of sovereign national states, on the other side.

EMU was expected to start without fiscal/political union. The "fiscal flank" was seemingly closed by European rules for national fiscal policies protecting the euro's stability against permissive national fiscal policies. In that respect, this decision reflects a kind of "anti-Hamilton moment" as it denies the need to transfer substantial competence for fiscal policy from the national to the Union level. Theoretically, such a system based on fiscal rules could work efficiently and last indefinitely (Issing, 2008). The experience of the first 20 years, with a huge number of cases of European fiscal rules being violated, shows the apparent political naïvety of such an opinion.

In contrast to the United States, "Europe" started with monetary union. For quite a number of politicians, monetary union should take the lead and serve as a pacesetter for political union (Issing, 1996). This idea goes back to Jacques Rueff, who, as early as 1950, expressed: "'L'Europe se fera par la monnaie ou ne se fera pas". This idea is also the background of the so-called "monetarist view" popular in France. Fixing the exchange rate irreversibly would force economic policies in fields like labour market policies to converge. Following this theory, the optimum currency area criteria, which were not or not fully fulfilled at the start of monetary union, would adjust in an endogenous process. In some cases, such as Spain, labour market reforms were indeed taken under the pressure of a crisis. In a situation of high unemployment and without the instrument of currency devaluation, the only remaining option was to reduce regulations in the labour market.

The success of this adjustment process enforced by a single currency has been very unsatisfactory. It is telling that the five Presidents (Juncker, Tusk, Dijsselbloem, Draghi, & Schulz, 2015) in their report published 16 years after the start of EMU present a long list of reform measures which are necessary for the functioning of economic and monetary union.

The former President of Germany Richard von Weizsäcker expressed an even more ambitious vision of the euro's state-forming power. When he was asked whether it was right to begin with monetary policy when a common foreign policy was the real objective, he replied (Von Weizsäcker, 1994):

> *It's the other way round: if this common foreign policy is to be realised, it will only come about through monetary union. Such monetary union will of course be implemented only with some delay. And it will not be cheap. Compensation payments will have to be made if the exchange rates of areas that are at different stages of economic development are no longer able to fluctuate in relation to each other. Getting used to monetary union is for me the only discernible route by which a common foreign policy can ultimately be achieved (translation O.I.).*

However, such visions that the euro would work as a pacesetter to political union have not materialised. To the contrary, the present arrangement has proven to be unstable and has caused major political frictions between member states. Is using the COVID crisis as the Hamilton moment—notwithstanding the anything but encouraging experience of the United States during the first decades—to take steps in the direction of fiscal union the solution?

4.3 | Dangerous steps towards fiscal union

Long before the COVID-19 crisis, several initiatives were taken to move EMU (and EU) in the direction of a fiscal union. In this context, a permanent "candidate" is the proposal to issue Eurobonds. For the specific challenges caused by the pandemic crisis, the Italian government proposed "corona bonds" to signal that the idea is not to create a permanent instrument but a specific, unique one for overcoming financing problems caused by the pandemic. However, one might raise doubts as to whether such a singular act would not prepare the ground for more joint liability instruments on future occasions. Climate change constitutes such a dramatic challenge that the argument for European "green bonds" would look almost irresistible. In any case, the objections against this instrument are of a general character (Issing, 2009) and political resistance has been so strong up to now that this proposal has not succeeded. (To what extent the European Recovery Fund comes close to corona bonds is beyond the scope of this discussion).

A major initiative to complete the unfinished house by taking steps towards fiscal union was the report of the five presidents representing the European Council, the European Commission, the Eurogroup, the European Central Bank and the European Parliament (Juncker et al., 2015).

In this context, among the many proposals, the establishment of a euro-area treasury deserves the highest interest. (Similar suggestions prefer a European finance minister.) This euro-area treasury should enable "joint decision-making on fiscal policy" required in a fiscal union (Juncker et al., 2015, p. 18). The presidents make clear that this partial transfer of national fiscal sovereignty needs arrangements for democratic accountability, legitimacy and institutional strengthening. To reach this goal, they suggest closer cooperation between the European Parliament, national parliaments and the Commission.

However, democratic accountability and legitimacy cannot be achieved by such "soft" conditions. The transfer of fiscal sovereignty must be based on a change of the Treaty. The combination of limited transfer of fiscal sovereignty and limited democratic legitimacy is a dangerous path to follow (Issing, 2015). There exists no such thing as "partial" democratic legitimacy.

A proposal by the EU Commission in 2020 submitted by the former Commissioner Pierre Mascovici represents an attempt to undermine national competence for fiscal policy via a seemingly harmless route.

For many years, some EU Member States refused to cooperate fully in the fight against tax evasion and avoidance. Since European decisions in the area of tax policy require unanimity, each country has a right of veto. So what could be more natural than to break the resistance against seemingly reasonable measures by replacing the requirement of unanimity with decisions by qualified majority? At first glance, everything seems to support strengthening the EU's ability to act by moving to the majority principle in this case so as to finally correct the present maladministration. Once the qualified majority rule has been introduced for this special purpose, it is more than likely that it will ultimately apply to tax policy issues in general and not just for the current situation.

This initiative is a telling example of the "Juncker Method" which was once described by the former President of the Commission: We make a decision, let it be known and wait some time to see what happens. In case there is no outcry and no revolt, because the majority has not understood what was decided, we just continue, step by step, until there is no way back (see Stiftung, 2016, p. 5, translation O.I.).

This method may be used in minor issues of daily business, but it is unacceptable when it comes to fundamental questions of transferring competences from the national to the European level. The more the Commission and politicians try to press ahead towards fiscal union through the backdoor of acts designed to circumvent the need for legitimacy via changes of the Treaty, the more those activities will backfire and undermine the credibility of the process.

5 | CONCLUSION

"Hamilton moment" is a nice catchword. However, it would be dangerous to create the impression that using the corona crisis implies the chance for a state-creating moment in Europe comparable with its achievement in the United States. First of all, the historical analogy is simply wrong. The union that assumed the debt from individual states already existed. If Europe wants to establish a fiscal union by transferring sovereignty on taxation and public spending from the national to the European level, there is only one democratically legitimate way to do so—a change of the Treaty that must be ratified by all governments and parliaments, and even confirmed by a referendum in some countries. In Germany, such a decision requires a change in the constitution. Seeking a shortcut by seizing a supposed Hamilton moment creates an illusion that might backfire and ultimately undermine popular support for deeper European integration.

Europe must find its own way. And this way to fiscal and finally political union must not use the backdoor of more or less tricky ploys which undermine the democratic accountability of national parliaments. European politics must choose the front door of an open process leading to democratic legitimacy via a change of the Treaty.

Reference to a Hamilton moment neglects many of the specific institutional aspects of European integration. Following the COVID-19 crisis argument and the plans for a common fight against the economic and social problems, all 27 members of EU should be included. The vision that a common currency would work as a pacesetter for a common foreign policy and finally political union turned out to be an illusion. Will a fiscal union accelerate the adoption of the euro by all 27 EU members? And if so, will tensions caused by a substantial increase in already high political and economic heterogeneity break up the euro area?

These and other problems are not addressed by the proponents of a Hamilton moment. Brexit has not least demonstrated that one country did not accept the call for "creating an ever

closer union among the peoples of Europe" which is stated in the preamble of the Treaty on European Union. And the people of the United Kingdom might not be alone.

What about this message coming from the COVID-19 crisis: Organise cooperation and solidarity within the present institutional arrangement. The complexity of the decision-making process presents a challenge to achieve a viable compromise. First, meet this test at both levels—European and national—to agree on democratically legitimised actions. After a success, one might first present an uncompromising analysis of all remaining problems, coming to a common understanding on where the Union and all member states want to go and design a road map which leads to the newly defined "finalité". In case there is no agreement, the challenge is to find an arrangement which can deal with the obvious divergences. The supporter of the Hamilton moment argument should be reminded that, after a long series of crises, the United States needed a civil war to find common ground.

Relying on the "Monnet method" once too often by using the crisis for a "jump" into an inconsistent arrangement of strengthened European institutions, and remaining weakened competences of national states, might end in chaos, rather than in a Europe prepared to meet the great challenges stemming from geopolitical tensions and climate change.

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