Europe’s social peace requires a return to fiscal discipline

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Opinion Eurozone economy
The EU’s post-pandemic recovery plans should make room for a debt redemption fund

Wolfgang Schäuble

Keynes believed short-term economic intervention was necessary in times of crisis to stabilise the economy © Getty Images

Wolfgang Schäuble

yesterday

The writer is president of the Bundestag and a former German finance minister

“In the long run we are all dead,” wrote John Maynard Keynes 98 years ago. He believed short-term economic intervention was necessary in times of crisis to stabilise the economy. New stimulus programmes, including the EU’s post-pandemic recovery fund, are in line with this tradition. I was in favour from the outset — to the surprise of some people.

During my time as German finance minister, I had a reputation for frugality as a matter of principle. Yet then, as now, my goal was sustainability: borrowing in times of crisis to stabilise the economy makes sense, as long as the question of repayment is not forgotten. The need to pay back the debt later is often overlooked. Many governments focus on the "easy" bit of Keynesianism — borrowing — and then postpone repayment of their debts. This leads to continually expanding sovereign debt. Sooner or later, inflation looms. Keynes saw this as a major threat, citing its potential for "overturning the existing basis of society".

Currency values are under pressure in many regions of the world, including the EU. Here, more than elsewhere, debt-financed fiscal policy is flanked by monetary measures. Monetary supply in the eurozone has been massively increased, without being adequately matched by an increase in the volume of goods and services. This boosts the inflationary expectations of firms and private households. In this way, the eurozone risks a currency devaluation that could take on a virtually unstoppable dynamic.

Already the consumer price index exceeds the European Central Bank's benchmark of "below but close to 2 per cent". Central bankers are not alone in their alarm. Keynesian economic experts like Larry Summers or Olivier Blanchard lament the crossing of red lines on public debt and point to the increased likelihood of runaway inflation. In real estate, shares and art works, the danger is already acute. The asset price index rose last year by 6.3 per cent. Indeed, quarterly growth rates even reached double digits. A significant portion of the monetary overhang created by the ECB is evidently being invested on capital or property markets and is feeding speculative bubbles.

This is no mere economic problem. It also creates risks for the social fabric. Most lenders to states are wealthy individuals and entities. Public borrowing increases their wealth, widening the gulf between rich and poor. Keynes once warned that profiteers would become the object of hatred. Now the gap between "haves" and "have-nots" poses a huge threat to social cohesion.

We must therefore return to monetary and fiscal normality. The burden of public debt must be reduced. Otherwise, there is a danger that the Covid-19 pandemic will be followed by a "debt pandemic", with dire economic consequences for Europe. With their ageing populations, EU countries will struggle to match the US and China in productivity and competitiveness if they allow excessive debt to jeopardise their financial flexibility. Thus, all eurozone members must engage in efforts to return to stricter budgetary discipline.

Experience shows that balanced budgets in countries with high levels of debt are almost unattainable without external pressure. Left to their own devices, members of a confederation of states are likely to succumb to the temptation of incurring debt at the expense of the community. I have discussed this "moral hazard" with Mario Draghi on many occasions. We have always agreed that, given the structure of European monetary union, competitiveness and sustainable financial policies are the responsibility of member states.

I am sure that he intends to uphold this principle as Italian prime minister. It is important for Italy and the EU as a whole. Otherwise we will need a European institution with powers to enforce compliance with jointly agreed rules. This would require treaty amendments. Yet, even without such amendments, the European Commission is assuming more importance in this area.

A promising approach for Brussels to take would be a eurozone debt redemption pact, similar to the sinking funds devised by Robert Walpole and Alexander Hamilton. As the first Treasury secretary, Hamilton obliged the new US states in 1792 to deposit good collateral, practise budgetary discipline and reduce their debts. That was the crux of the oft-cited "Hamilton moment", not the mutualisation of debts sometimes recommended for the EU.

The debt redemption plan worked and could work again today. It provides a mixed strategy of "carrots and sticks" like that pursued by the IMF — another legacy of Keynes. I am confident that Europe will be wise enough to also follow the British economist in this aspect of his doctrine.

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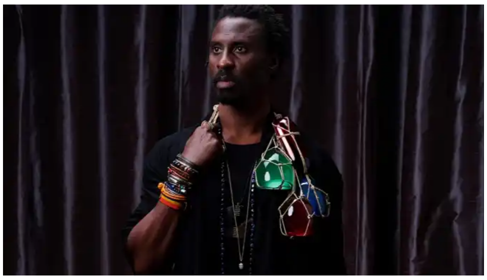
- 
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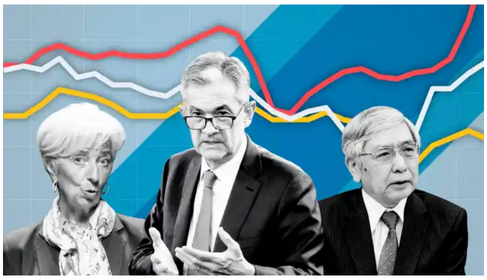

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