DEBT RELIEF FOR THE EMU COUNTRIES: A CHANCE TO RESTORE EUROPE'S POWER AND TO STABILIZE THE EURO

– A DISCUSSION PAPER –

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Abstract

Government spending on bailing out banks and financing a variety of stimulus packages following the US real estate and financial crisis led to a sharp increase in the already very high level of public debt also of the member countries of the European Monetary Union (EMU).
Countries such as Greece, Italy, Belgium, France and even Germany in particular depend on very low or at least low interest rates to stabilize their financial situation. Thus, the central reason for the European Central Bank's low interest rate policy, which has been in place for almost 10 years, is to provide the highly indebted countries of the EMU with a significant reduction in the interest burden in favor of a solution to the debt problem: giving time for a lot of necessary reforms to increase economic development. But none of this has succeeded in the last 10 years.
Instead, the budgetary situation in the euro countries is getting worse, the disparities in economic development are increasing rather than diminishing, thereby endangering the stability of the euro and thus the future of the single currency.
There is an urgent need for sustained higher net investments in nearly all sectors of all countries from Greece to Germany: instead, net investment in the countries of the EMU is clearly decreasing and Europe is in danger of being left behind not only by the two economic powers USA and China.
This outlines a problem that is as pressing as it is topical: the question of how to restore Europes' economic power. The key lies in the question of how can we be able to solve the crippling debt problem of European countries quickly and sustainably.
The answer given by the discussion paper is a kind of debt relief, implemented as a conversion of a relevant amount of the government bonds held by the ECB. Conversion means extending the repayment to 80-100 years and the interest rate to be set very low. Of course a binding agreement is inevitable that net new debt can only be taken up to the maximum value of the GDP growth of a certain period. Only countries can participate in the debt conversion which commit themselves to making higher net investments to be specified more precisely, to carry out reforms especially concerning the efficiency of taxation, respectively set lower and upper limits for some taxes of the central government, and harmonize them within narrow ranges. Also it is necessary to

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reasonably reduce and largely deregulate bureaucracy and put an end to shadow economy and corruption.
By regaining financial strength as a result of a debt conversion, which is only possible within a strong supranational framework, the advantages of membership in the European Monetary Union will once again become evident, and the European Union can again become a shining example of freedom and prosperity, the way that Robert Schuman did formulate as a vision in the declaration of May 9, 1950.

Keywords: Debt conversion European Union, Debt relief EU, European Economic Union, European Union, Low interest rate EU, Net investment EU, Monetary policy EU, Public debt EU

JEL Codes: E58 (referring also to O52, H60, G01)

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1. Research Purpose

Topicality

At least since the US real estate and financial crisis, it is not only Europe that is suffering from a high level of public debt. Government spending on bailing out banks and financing a variety of stimulus packages (with the exception of very small states such as Estonia) led to a sharp increase in the already very high level of public debt. As a result, the problem arises of a general drastic reduction in net investment in almost all the countries of the European Monetary Union. And the very problem hereby is that this resulting investment backlog in Europe, will cause Europe to fall increasingly behind other countries, in particular the countries of South-East Asia and China.
Countries such as Greece, Italy, Belgium, France and even Germany in particular depend on very low or at least low interest rates to stabilize this situation. See, in this regard, the remarks in Chapter 2. Thus, the central reason for the European Central Bank's low interest rate policy, which has been in place for almost 10 years, is to provide the highly indebted countries of the European Monetary Union (the euro area) with a significant reduction in the interest burden in favor of a solution to the debt problem: giving time for necessary reforms to increase the profitability of national tax systems, time to strengthen the industrial structure, and time to sustainably reduce bureaucratic barriers, or even corrupt structures in politics and business.

Aim of the discussion

None of this has succeeded in the last 10 years: hesitant or non-existent reform of almost all governments in the European Monetary Union, or pressure from populist parties and the shift away of ever-larger sections of the population from the idea of European integration is making it increasingly difficult to implement forward-looking reforms politically.
This means that it must be established that, so far, the European debt problem has not even been solved approximately.
Instead, the budgetary situation in the euro countries is getting worse, the disparities in economic development are increasing rather than diminishing, thereby endangering the stability of the euro and thus the future of the single currency.
There is an urgent need for sustained high investments in the traditional and increasingly modern digital infrastructure of all countries from Greece to Germany: instead, net investment in the countries of the European Monetary Union is clearly decreasing (see the facts presented below) and the economic foundation of economic strength is eroding more and more and Europe is in danger of being left behind not only by the two economic power centers USA and China, but also by some Southeast Asian countries and maybe also Japan. See Chapter 3. In this respect, it is clear that a key impact of the debt crisis in Europe is the investment backlog caused by it.
This outlines a problem that is as pressing as it is topical: the question of how to restore Europe to old economic and thus also political and social-democratic strength as a model for large parts of the world:

The key lies in the question of how can we be able to solve the crippling debt problem of European countries quickly and sustainably.

Research objective

The following contribution to the discussion therefore would like to present a new groundbreaking proposal on this subject: that of debt relief through debt conversion. Chapter 4 therefore elaborates concrete proposals on how such a debt conversion might be implemented.

In general, a debt relief must always be an expropriation of the creditor and thus to be rejected in terms of regulatory policy. At present, however, there is a historically unique situation in which a relevant part of the public debt in the form of government bonds is held by the European Central Bank: In the event of a waiver of receivables, however, this is ultimately not burdened economically, since it is itself the money-producing institution eo ipso: thus, a waiver of receivables can be implemented without any impact on the real world – if it is done "correctly". Finally, see Chapter 5.

2. Defining the problems of recent European economic weakness

2.1 Europe’s key financial policy problems

Economically, Europe and—for us as citizens of the European Union more specifically—the EMU as the zone of the common European currency, are confronted with four key financial policy challenges:

1. high national debt of many, if not almost all, countries, resulting in an increasing loss of fiscal strength and policymaking power
2. the ensuing pressure on the ECB to keep the interest level low, or even negative, to reduce the interest to be paid by the indebted countries, which, on the other hand, leads to a massive loss of monetary policy-making capacity
3. as a consequence of globalization the increasing inability of the countries to tax the production factor capital or the profits it generates, plus the hereof resulting dependency on building up national debt if they do not wish to lose their financial policymaking power once again
4. the pressure on the national budgets to take “austerity measures” to keep the national deficits from getting even more out of hand, which most notably leads to a reduction in public investment activities and hence an investment backlog

It is obvious, that all this ultimately also applies to large parts of the world—in particular the USA, Japan, the UK, and many emerging as well as developing countries. Yet this is not the subject of this article—except, perhaps, for the remark that the solution of a debt relief for the EMU that is outlined below basically also represents a viable alternative for other countries especially like Japan or the US, so Europe would not be isolating itself economically by agreeing to a debt conversion.

There is a fifth aspect in addition to the four already mentioned key financial policy challenges that should be kept in mind in all attempts to resolve the problems:

- the dramatic loss of peoples' confidence in the European Union as a sustainable political and social institution, necessary to help European countries to successful compete in the future

which makes it necessary to create measures that further do not promote either national populism or the abandonment of the idea of European integration.

2.2 Approach to regain fiscal and monetary governance power of the European Economic Union (EMU): debt relief

Based on the key policy challenges mentioned above, this article puts forward the thesis that Europe only can regain its economic and political strength if

1. national debt can be substantially and sustainably reduced within a very short period
2. new debts at the previous level are avoided in the future
3. European monetary policy thus regains its autonomous policymaking power in the ordoliberal sense of only being responsible for monetary stability[2]
4. as a consequence, the euro is secured and strengthened as "Europe's common currency"[3] that is needed for many different reasons, and
5. the EMU is given the unique opportunity to convince the people of the European Union of the benefit of the idea of European integration—a benefit to be felt directly and individually—thus reversing the increasing forces of the disintegration of Europe so they regain the radiant power of a united Europe as put forth by the founding fathers of European integration.[4]

3. ECB and EMU countries: Lost power to shape monetary and fiscal policy

It would be impossible to conduct in this short article a profound analysis of all underlying problems or causes of the increasing loss of monetary and fiscal policymaking ability. Therefore it is offered only a brief description of the situation below.

3.1 ECB's loss of autonomy in monetary policy

In my 2017 article in this same journal, entitled "Niedrigzinspolitik und Quantitative Easing der Europäischen Zentralbank (EZB) [Low interest rate policy and quantitative easing of the European Central Bank (ECB) while respecting European public debt)]"[5]

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[2] See Walter Eucken (1952): Grundsätze der Wirtschaftspolitik, Bern, Tübingen 1952

[3] See for example Wolfgang Eibner (2006): Understanding International Trade: Theory & Policy, Munich 2006, Chapter 15

[4] See the Schuman-Declaration of 9 May 1950: https://europa.eu/european-union/about-eu/symbols/europe-day/schuman-declaration_en

[5] Wolfgang Eibner (2017): Niedrigzinspolitik und Quantitative Easing der Europäischen Zentralbank (EZB) unter Beachtung europäischer Staatsverschuldung (Low interest rate policy

it was taken a look at the national debt in Europe to explain why the high national debt in Europe leaves the ECB virtually no alternative as to pursuing its low interest rate policy, which is continuing unabated.
Figure 1 shows the development of the key interest rates for the ECB compared to the Fed, the Bank of Japan, and the Bank of England:

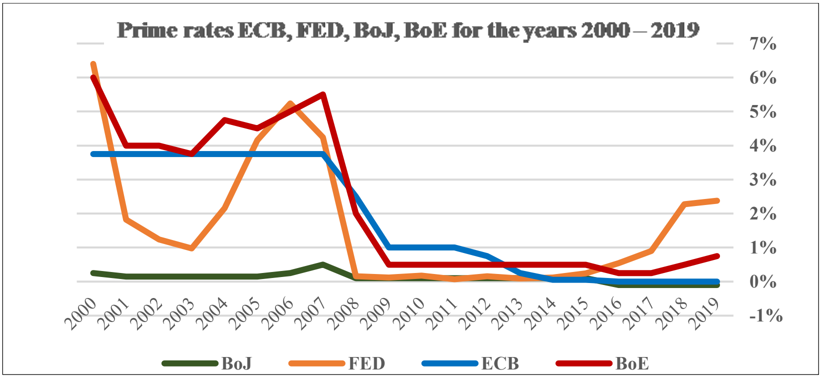

Figure 1: Key interest rates in the EMU (ECB), the USA (Fed), Japan (BoJ) and the UK (BoE) during the period 2000 to August 2019.[6]

Abandoning the low interest rate policy in favor of key interest rates at a "normal level" of the past 30 years would increase the interest burden of national debt by a factor of three to four: a burden on the national budget which could no longer be manageable or financially feasible and would increase the inhomogeneous economic development in the EMU countries even more; hence there will be no return to a higher interest level in the EMU as long as the debt problem persists.

We realize how impressive the positive impact of the low interest rate policy on the budget is when we compare the interest on public debt paid in the EMU during 2008 and 2018 with the interest burden that would have accrued if the ECB had not lowered the interest rates after 2007: the savings are more than EUR 1 trillion Euro between 2008 and 2016 in the EMU countries, which equals about 2% of the EMU's annual GDP[7]; German taxpayers alone—or the German national budget—saved EUR 370 billion

and quantitative easing of the European Central Bank (ECB) while respecting European public debt), in: Estonian Discussions on Economic Policy, Vol 25, No. 2, 2017

6 ECB (2019b): Key ECB Interest rates, in: https://www.ecb.europa.eu/stats/policy_and_exchange_rates/key_ecb_interest_rates/html/index.en.htm; Federal Reserve Bank of St. Louis (2019): https://fred.stlouisfed.org/series/FEDFUNDS; Bank of England (2019): www.bankofengland.co.uk/boeapps/iadb/Repo.asp; Trading Economics (2019): https://tradingeconomics.com/japan/interest-rate

7 See Deutsche Bundesbank (2017): Monatsbericht July 2017, p. 35

between 2008 and 2019; France, EUR 350 billion; and Italy, EUR 261 billion, equaling 15% of the country's GDP[8].

Figure 2 shows the consequences of climbing interest rates for selected countries in three interest rate scenarios which, historically speaking, must even be considered moderate:

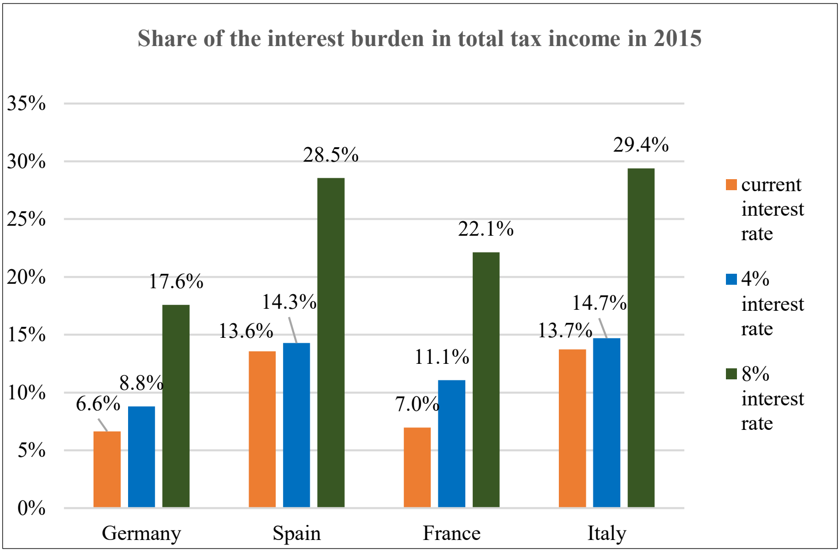

Figure 2: Share of the interest burden in the total annual tax income of Germany, Spain, France, and Italy with alternative interest rates on the respective national debt.[9]

Moreover, the widely differing levels of national debt in the individual member states of the EMU—and the resulting interest burden—also bear a lasting responsibility for the weakening of the euro and the great danger of a breakup of the common currency zone as a result of an overly inhomogeneous economic development. If especially the debt problem could be resolved and the countries were to regain their fiscal policymaking ability, the economies of the EMU countries might once again become more homogeneous thanks to suitable reforms—which could now be financed—and it would therefore become more likely that the single European currency becomes viable for the long term.

From an economic point of view, it should be clear that in the age of globalization with great (economic as well as political) hegemonic powers such as the USA or China, a disintegrated Europe with a patchwork of autonomous national pygmy currencies (and even the DM or the FF would be dwarfish compared to the US$, renminbi/yuan, and

[8] Matthias Janson (2019): Deutschland spart dank Niedrigzinsen 368 Mrd. Euro, in: Statista, Staatsfinanzen, 19.1.2019: https://de.statista.com/infografik/16588/zinsersparnis-von-euro-staaten/

[9] Data from: Eurostat (2017): http://ec.europa.eu/eurostat/de/data/database Code: gov_10a_main

yen) in the international competition (which is also substantially impacted by financial markets) would be hopelessly left behind.

On the other hand, it is obvious that a prolonged low interest rate policy—or even a negative interest rate policy, which some economists demand (irresponsibly so, in this author's opinion)—will have a devastating impact on the allocation of national economic as well as business resources in the medium and long term: if the extreme case were to happen where due to high negative (key) interest rates even investments with a negative return are profitable (because the financing costs would be even "more negative" and therefore impact the return on investment in a positive way), it is clear that even the most nonsensical (because ultimately not resource-creating but resource-consuming) investments would be made.

Therefore, if the ECB does not wish to risk a major European recession (probably on the scale of the 1929 global financial crisis), a return to an autonomous fiscal policy will only be possible if the debts are reduced for the long term.

One argument must be addressed and—unfortunately—rejected as unfeasible: it goes without saying that generally speaking, European national debts and a strengthening of homogeneity of Europe's economies can also be achieved by way of "classic" economic policy. Starting points for this approach would be, e.g., deregulation, less bureaucracy, an efficient tax system, rational national spending (take sunset legislation, zero budgeting, or sustainable controlling, for instance), curbing lobbying or even corruption, or significantly reducing misplaced social benefits for persons unwilling to work or for economic refugees not able to integrate in modern industries.

Right now, the problem is just that there is no European country where politicians are prepared to take these measures—be it for populist considerations or resulting from sheer economic incompetence. And Europe no longer has the time required to achieve this by classical economic means.

The European Union is caught in a lasting process of disintegration, "national" politics and an ever larger part of the population no longer supporting "the European idea" and is turning away from the EU, having adopted a nationalistic way of thinking we have not seen since the end of World War II. A positive answer to the general question of whether the EU tends to be a good or bad thing, e.g., declined from 71% after the foundation of the EMU in 1991 to an all-time low of 47% in 2011[10]. In 2019 the question of whether or not people tend to trust the EU was given a positive reply only by 33% in France, 37% in Italy, 29% in the UK, and in Germany, too, only by 48% compared to 51% as late as 2018[11]. Moreover, approval also correlates with the economic

[10] European Commission (2013): 40 years Eurobarometer, Effects of the economic and financial crisis on European public opinion, p. 1; https://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Archive/index

[11] European Commission (2019): Standard Eurobarometer - Spring 2019, Public opinion in the European Union, June 2019, p. 7; https://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurvey Detail/instruments/STANDARD/surveyKy/2253 . It should be noted in all these political surveys

development. As a result, the positive responses have increased again since 2013, especially in the countries with a good economic development; right now the obviously daunting consequences of Brexit also seem to be softening the criticism of Europe somewhat (2019); conversely, we can state that an economic downturn will instantly lower the approval ratings again.

If action is not taken soon to unambiguously show the people of Europe advantages of and from Europe, the European idea will be in enormous danger—and hence Europe's role in the world probably as well.

3.2 EMU countries' loss of power and autonomy in fiscal policy

The above remarks serve as a transition to a discussion of the fiscal policy situation in the euro countries.

We must assert the fact that in the globalization process, countries throughout the world, but especially within the EU generally lower their taxes to compete with one another – inside the EMU – thus subverting the founding fathers' idea of European integration. One of the most significant results of this is that countries outbid each other in cutting taxes on productive capital (which is internationally very mobile and prone to tax evasion if taxes become too high).

This makes it ever more difficult (globally) to tax the factor capital. While government spending generally increases in relation to the GDP, this naturally leads to a growing shift from taxing the production factor capital to taxing the production factor labor in the form of direct taxation of wages or indirect taxation of consumption in the form of all kinds of consumer taxes—to which are popularly added "environmental taxes" that are "easy to sell", such as energy, electricity, heating oil, mineral oil, CO_2, coal, diesel, climate, soil sealing taxes, or whatever. Yet all this places a massive burden on citizens, whose purchasing power is enormously diminished as a result. This in turn can trigger an economic vicious circle where companies must get further tax relief so they can maintain their sales level and the government makes transfer payments to ever larger parts of the population (basic security benefits, basic pension, housing benefits, etc.) in order to maintain social peace. One of the central means to achieve this fiscal policy balancing act is deficit spending.

Figure 3 shows the public debt of the EMU countries for 2018. It turns out that 10 of the 18 euro countries are above the ceiling of 60% total debt in relation to the GDP[12] as set forth in the EU's Stability and Growth Pact—including the large economies of Italy, France, Spain, and Germany. Estonia is the only EMU country with a negligible national debt.

that the survey results are only partially comparable over time due to the question which is repeatedly formulated differently.

[12] See Article 126 (2) FEU as a general note Article 1 Protocol No 12 on the Excessive Deficit Procedure:https://www.ecb.europa.eu/ecb/legal/pdf/de_protocol_12_from_c_11520080509de0 2010328.pdf

However, since a great many EMU countries have clearly shown us the limits of government debt on account of the interest burden it generates, the countries must attempt to curb their public spending. Due to the election cycles, serious cuts in pension and social benefits are hardly feasible.

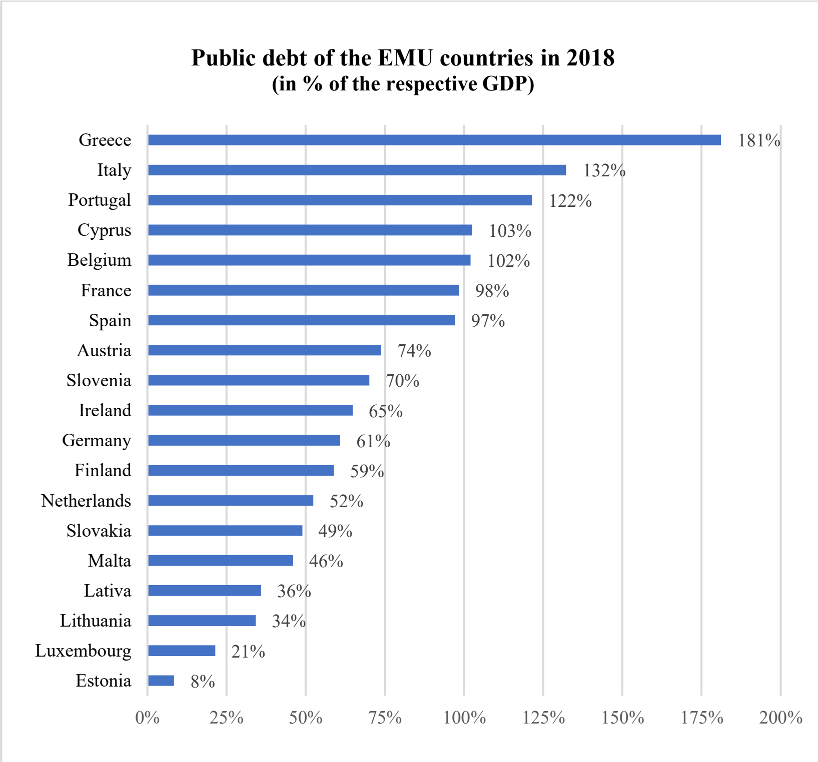

Figure 3: Government debt of all euro member countries in 2018 in percent of the respective gross domestic product at market prices.[13]

Consequently, cutting down on investments is considered the only proven means to reduce deficit spending. This results in reduced investments especially in transport infrastructure, but also in modern communication infrastructure.

[13] Data from: Eurostat (2019a): https://ec.europa.eu/eurostat/de/data/database Code: gov_10dd_edpt1

Figure 4 shows this steady decline in net investments (i.e. the difference between gross investments and depreciations) using the examples of Germany and the EMU—which decline only is slowed down for the period of the economic boom from 2015 till 2018:

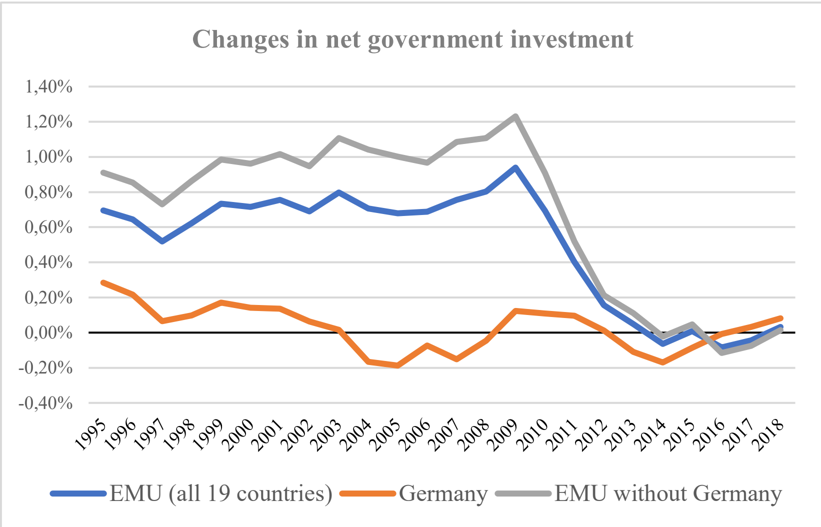

Figure 4: Development of net investments in Germany and the EMU, 1995–2018.[14]

The European Investment Bank (EIB) stated that this turned into an investment backlog of 100 billion Euro per annum in the field of energy efficiency alone, of 50 billion in transportation infrastructure, of 55 billion in broadband and data center development, of 90 billion Euro in the environment and water sector—and there is also a shortage of 230 billion Euro per year in education[15]; thus Europe lacks 550 billion Euro per year in all relevant investments to ensure its sustainability in the global competition.

Figure 5 shows the net investments of the EMU countries in absolute terms; Figure 6 shows the in part extremely low level of government net investments in relation to the respective GDP in the EMU countries, which can be compared with the markedly higher investment ratios (base 2015) of 1.23% in the USA and 1.15% in Japan[16]; data for China cannot be calculated for comparison purposes because it has a different system, but they

[14] Eurostat (2019b): Nettoinvestitionen (net investments): https://ec.europa.eu/eurostat/data/database , Code: gov_10a_main; nama_10_gdp

[15] Stefan Lange (2015): EIB warnt vor gigantischer Investitionslücke in Europa, in: Finanzen of 7 May 2015: https://www.finanzen.net/nachricht/aktien/eib-warnt-vor-gigantischer-investitionsluecke-in-europa-4328725

[16] Own calculations based on: The World Bank (2019a): Net investments relative to GDP, in: https://data.worldbank.org/indicator/GC.NFN.TOTL.GD.ZS?view=chart

are significantly higher, too: if we add “private” plus “government,” the ratio is a staggering 20%.[17]

Compared to the data shown in Figure 6, this states that Europe is patently lagging behind, or specifically, it shows the dramatic financial weakness of Europe, which almost exactly 100 years ago was the financier of the entire rest of the world (with the exception of Japan).

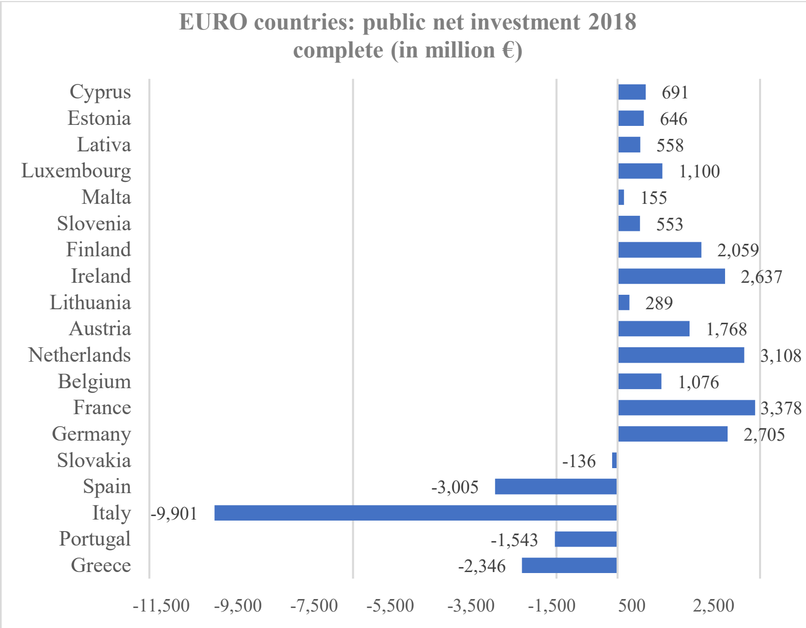

Figure 5: Government net investments of the EMU countries in 2018 in absolute amounts.[18]

A major reason for the sharp 20% drop in European gross investments since 2007 is the general strong indebtedness of almost all EMU states, which in some part accelerated as a consequence of the US real estate and financial crisis and the resulting budget restrictions.

This once more shows the importance for the future of Europe that it has significantly and sustainably to increase its financial leeway if it does not want to loose its traditional

[17] Own calculations based on: The World Bank (2019b): Own calculations based on https://data.worldbank.org/indicator/NE.GDI.TOTL.CD , https://data.worldbank.org/indicator/NY.ADJ. DKAP.CD , https://data.worldbank.org/indicator/NY.GDP.MKTP.CD

[18] Own calculations based on: https://ec.europa.eu/eurostat/de/data/database , Codes: gov_10a_main

role as leader in the global economy in competiton to the USA, China, and other Southeast Asian countries.

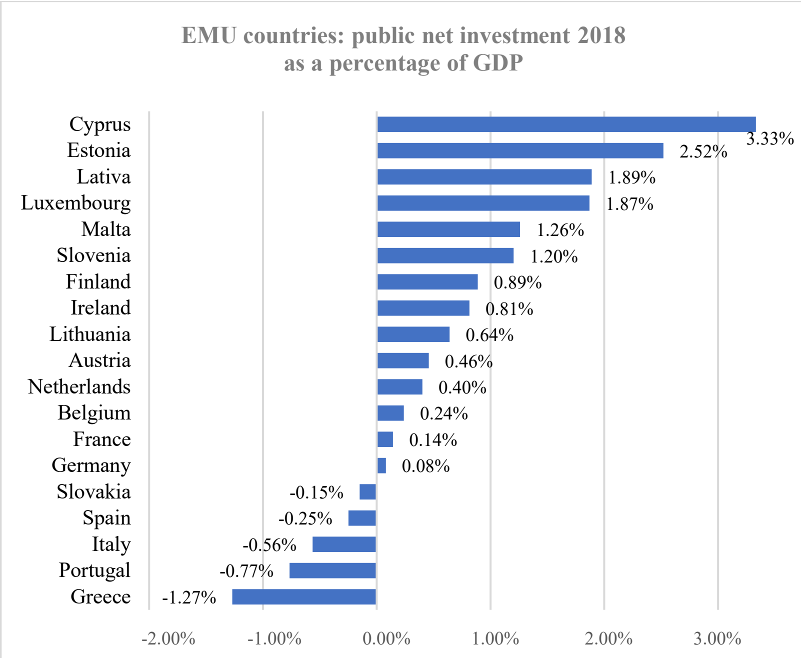

Figure 6: Government net investments of the EMU countries in 2018 in percent of the respective GDP.[19]

China in particular is about to build not only a global trade infrastructure with its Silk Road Initiative, financed with Chinese capital[20], but also to quite deliberately exploit Europe's investment weakness by granting "favorable" Chinese loans to European countries in order to make infrastructure investments possible. This is done indirectly through credit financing or else directly via participations and joint ventures in fields of investment that Europe can no longer finance by itself. For example, China and the Asian Infrastructure Investment Bank (AIIB), which was initiated by China, are financing infrastructure projects in 2019 for 2.5 billion Euro in Italy alone[21] (e.g., the ports of Trieste and Genoa) and even intend to issue bonds in China in yuan[22]. In Greece, for

[19] Own calculations based on: https://ec.europa.eu/eurostat/de/data/database , Codes: gov_10a_main

[20] Handelsblatt (2019a): Die neue Seidenstraße. Chinas Marsch nach Westen, in: Handelsblatt, No. 63 of 29/30/31 May 2019, pp. 44-50

[21] Jin Liqun (2019): „Wir wollen Länder in Südeuropa unterstützen", in: Handelsblatt, No. 124 of 2 July 2019, p. 10

[22] Regina Krieger (2019): Italien. Panda Bonds für den Schuldenstaat, in: Handelsblatt, No. 63 of 29/30/31 May 2019, p. 50

instance, the Chinese government-owned shipping company COSCO already owns 51% of the port of Piraeus with the option of increasing its stake to 67% in 2021. Since 2019 Piraeus, being an important hub of the New Silk Road, has been the container port with the highest turnover in the Mediterranean.[23] It is obvious that this is going to result in a variety of dependencies, especially if loans are not refinanced according to schedule or cannot be serviced as contractually stipulated.[24]

In conclusion of this discussion, Figure 7 juxtaposes government net investments to interest payments on public debt.

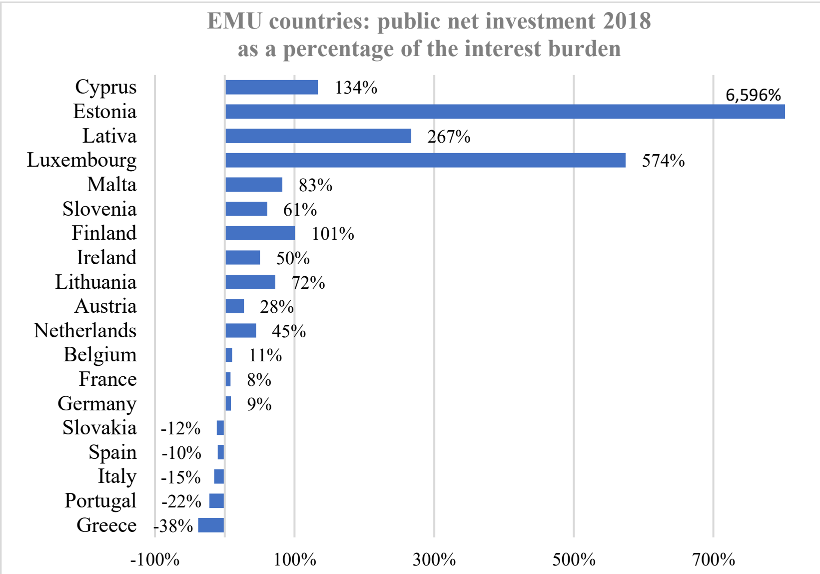

Figure 7: Government net investments of the EMU countries in 2018 in percent of interest owed.[25]

It is evident that the ratio of interest burden and net investments inhibits or, when the figures are negative, even destroys growth to an unacceptable degree, especially in the major industrial countries of the EMU, Italy, Spain, Germany, and France. Sustainable investment ability right now only is given in the case of Finland and the small countries Cyprus, Latvia, Luxembourg, and especially Estonia.

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[23] Gerd Höhler (2019): Piräus. Auf dem Weg zur Nummer eins, in: Handelsblatt, No. 63 of 29/30/31 May 2019, p. 49

[24] Compare: Joschka Fischer (2018): Abstieg des Westens (The Decline of the West), Cologne 2018; or Martin Winter (2019): China 2049. Wie Europa versagt (How Europe is Failing), Munich 2019

[25] Own calculations based on: https://ec.europa.eu/eurostat/de/data/database, Codes: gov_10a_main

4. Regaining monetary and fiscal policymaking autonomy by way of ECB-initiated sustainable debt reduction of the EMU countries through debt conversion

The conclusion of the remarks in the previous chapters is therefore that the national debt of the European countries needs to be significantly and sustainably reduced in the short term; in the absence of other alternatives, this is only possible by way of a debt relief or debt conversion.
These steps are naturally impossible to take toward private or government creditors without causing the most serious disruptions not only in the financial markets. Therefore repayment claims can be canceled or reduced only by someone who ultimately does not suffer from a such a waiver: in our system, this can only be the Central Bank—in the case of the EMU countries, the European Central Bank (ECB):
It is the only one that can implement the short-term approach to solving the four fiscal challenges mentioned in chapter 2.1 above: sustainable debt reduction. Since regulatory policy makes debt cancellation unfeasible, the only realistic solution is a sustainable debt conversion.

Below there will be discussed several first approaches to such a debt conversion which of course must be both sustainable and, most importantly, a one-time measure, as otherwise it would open the door for even more dubious fiscal management in the future.

The following issues must be cleared up:

1. Which kind and what amount of the national debt can be the subject of a debt conversion to begin with?
2. What might the terms of such a debt conversion be with regard to interest, duration, and repayment?
3. How could countries in the EMU be "compensated" which, because of their low debt, would not benefit at all from a debt conversion or only disproportionately little compared to other countries (e.g. Estonia compared to Greece)?
4. How can it be prevented that after such a debt reduction countries again finance their national budget by borrowing and become highly indebted once more?
5. What binding agreements must be made to allow for participation in the debt conversion process?

To answer all these points satisfactorily, we would need explanations that go beyond the scope of this article and that are yet to be presented in detail elsewhere.
The discussion below therefore only outlines approaches as to what the above five core elements of a debt conversion initiative might look like, which I sincerely hope will also initiate the discussion in science and politics about the implementation of such a necessary debt reduction for Europe.

4.1 Which kind and what amount of the national debt can be the subject of a debt conversion to begin with?

Figure 8 once again shows the problem: government debt in the EMU countries in relation to the GDP:

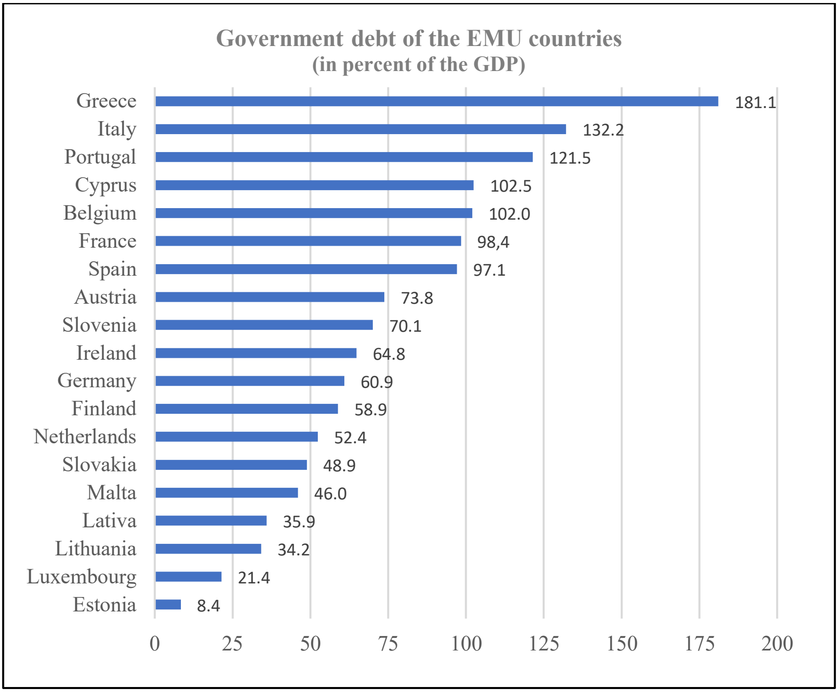

Figure 8: Government debt of all euro member countries in 2018 in percent of the respective gross domestic product at market prices.[26]

Figure 9 lists the countries with the largest debts, showing that most of the total debt is raised in the form of government bonds.

[26] Own calculations based on: Eurostat (2019a): https://ec.europa.eu/eurostat/de/data/database Code: gov_10dd_edpt1

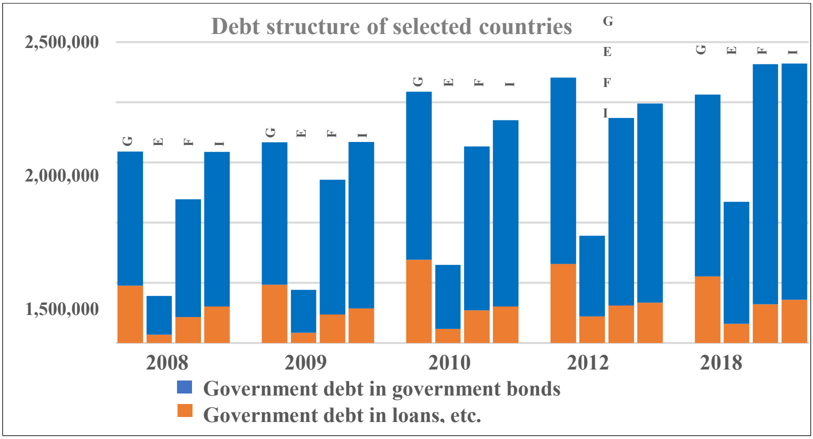

Figure 9: Absolute government debt in billion Euro of Germany, Spain, France and Italy, presented in government bonds and other loans (mostly debt securities).[27]

As part of its program to buy up government bonds (quantitative easing) since 2015, the ECB had already bought up EUR 2.1 trillion under the PSPP[28] by mid-2019; thus, in relation to the total government bonds of EUR 8.0 trillion issued by the EMU countries, the ECB already has a 26% share of the total government bonds in the euro zone.[29]

So, if these government bonds, which the ECB already owns, were to be made the object of a debt conversion—with the ECB having the option to buy up further government bonds as it decided to do so in September 2019—the countries participating in the debt conversion would experience a "fair" quantitative debt reduction because it would be proportional to the GDP of the individual countries. In absolute terms, this procedure would give Germany the greatest relief, whereas in relative terms it would be the same as that offered to Greece.

The total amount of government bonds to be converted would ultimately have to be determined politically, with the economic cornerstones—as explained above—being provided by the fact that after conversion the EMU countries should have significantly lower debt and interest burdens. This in turn would allow for considerably higher net investments in all relevant aspects of the national economy—in line, for example, with the EIB's demands listed in chapter 3.2.

[27] Own calculations based on: Eurostat (2019a): https://ec.europa.eu/eurostat/de/data/database, Code: gov_10dd_edpt1

[28] PSPP: Public Sector Purchase Program of the ECB, which bought up to EUR 90 Billion government bonds of EMU countries per month from 2015 to 2018 and up to 40 billion since end of 2019

[29] ECB (2019a): ECB Asset purchase program: https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html#pspp

These investments could then be used to remedy the structural weaknesses especially in the so-called “southern countries” of the EMU, which would make the economies in the euro zone more homogeneous. This would also mitigate, and ideally even remove, many problems a common currency creates in an inhomogeneous currency zone. If this succeeds, nothing will prevent the rise of the euro to a global currency that is equivalent to the US$. What is more, a homogeneous economic area would also be able to resolve the central problem of the extreme discrepancies in the trade balance of euro countries that are strong and those that are weak exporters. If it is possible to significantly improve the industrial structure and thus the competitiveness of the so-called “southern countries” by way of suitable investments and reforms, their import pull from the “northern countries” will diminish and the trade balances in the EMU might be restored, which is a basic prerequisite for a common currency to work—and secure the surviving of the Euro and thus the EMU.

Based on these arguments, a conversion of 50% of the government bonds circulating at a specific date is proposed, which, as Figure 9 shows, would be feasible in all countries via government bonds already bought up or still to be bought up by the ECB. (A past date would make sense, say 12/31/2018, to prevent the countries to quickly increase their debts during the debt conversion process.) As explained above, the ECB currently already holds 26% of the government bonds, and it could buy up another 24% during the further implementation of its expansive monetary policy, which it has already announced[30].

4.2 What might be the terms of such a debt conversion with regard to interest, duration, and repayment?

Two aspects are relevant for answering this question: The goal is to restore Europe’s economic strength and financial power in the global competition. Politically and economically, the tool of a debt reduction can be used only once—if at all. Hence a bold move is required:

It is proposed to extend the term to 80 to 100 years from the respective date of issue. The advantage of this is that inflation makes debt repayment a nearly irrelevant issue, and if the final maturities are extended by at least 20 years (after all, the issue dates differ by years, too) this does not put too great a strain on the financial markets.
This long period of 80-100 years to the final maturity of the debt instruments has four main reasons:
1. the securities market in Euro is already much smaller than that of the US-$-,
2. the ECB's purchase program to date has already significantly reduced the freely available trade in Eurobonds; for example only around 35% of German federal bonds are in institutional hands[31];

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[30] Philip R. Lane (2019): Monetary Policy and Below-Target Inflation, Speech by Philip R. Lane, Member of the Executive Board of the ECB, at the Bank of Finland conference on Monetary Policy and Future of EMU, Helsinki, 2 July 2019: https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190701~0c1fa3c8fc.en.html

[31] Handelsblatt (2019b): Neues aus der Nullzins-Welt, in: Handelsblatt, No. 161, of 22 August 2019, pp. 28 - 29

3. with each further purchase of government bonds by the ECB, the amount of euro bonds available on the markets decreases
4. with the planned exit of European countries from the debt cycle as a start by the debt conversion, the volume of available bonds in the euro area will once again fall sharply. In this respect, this long maturity is essential in order not to allow the securities market to collapse in euros.

It further is necessary to lower the interest rate to 0.1%. This also largely relieves the countries of their interest burden, and it becomes possible to finance the most pressing task, that of massively boosting investment.

An additional advantage of this approach is that the government bonds remain fully tradable securities on the capital markets and can be channeled back to the markets by the ECB. This will enormously boost their liquidity in tradable securities (which are then listed as triple-A securities again).
This is significant in as much as the euro capital market is currently considered too narrow compared to the dollar capital market.

4.3 How could countries in the EMU be "compensated" which, because of their low debt, would not benefit at all from a debt conversion or only disproportionately little compared to other countries?

Naturally, countries such as Estonia are extremely critical of a debt reduction program: the European Council would be able to enact such a move and the pertinent agreements only unanimously, so it would require the consent of all EMU countries.
Therefore the countries with a low debt level should be given the right to alternatively sell an amount of government bonds to the ECB at the new terms until they have reached the maximum limits according to the ECB's capital key (this will be a low double-digit billion euro figure, which is economically irrelevant in the context of the debt conversion program), *or to be granted a correspondingly higher debt ceiling than the future limits outlined below.*

4.4 How can it be prevented that after such a debt reduction countries again finance their national budget by borrowing and become highly indebted once more?

Obviously, debt reduction will not achieve its purpose if the debtor country simply reverts to its old behavior, making up for inefficiencies in government tax and expenditure policies by engaging in deficit spending.

Therefore it is critically important that such a treaty about debt relief limit or control the countries' national autonomy with respect to future borrowing. This might also be achieved via a redefinition of Articles 126 and 140 TFEU, which definitively and strictly allows the EMU member states to take on a maximum amount of new net debt at the level of its previous year's economic growth. This stipulation is based on the idea of the so-called balanced debt, which does not place a burden on a country's future economic

strength only if its net new debt does not build up more than its economy grows[32]; therefore the reference figure of the previous period's growth is also important, as it already establishes the maximum possible credit limit right at the start of the fiscal year. Obviously, the disadvantage of such a limit is that it works procyclically, which makes a countercyclical policy difficult, because a debt-based countercyclical fiscal policy is no longer allowed. Yet previous experience with national debt suggests that this is the less evil.
In order to add some countercyclical elements into the debt process after all, a mean value of GDP growth of several previous years might be set as a reference value.
To make sure these kinds of arrangements are agreed upon by the countries not only to be ultimately ignored—as happened with the previous EU Stability and Growth Pacts—an effective means of sanctioning is needed to enforce treaty compliance.

Therefore a binding agreement is inevitable that net new debt can only be taken up to the maximum value of the GDP growth of the average of the last five years.
Moreover, an EMU member country will be expelled from the EMU—and hence the common currency—at the end of the second year following the breach of this rule.

In contrast to what is happening right now, such an expulsion or withdrawal would probably tend to be regarded as a strengthening of the euro by the financial markets, as it would ensure financial discipline and homogeneity of the common currency zone—and thus strengthen the sustainability of the EMU as well as of the euro as an important global alternative to the still dominating US Dollar.

4.5 What binding agreements must be made to allow for participation in the debt conversion?

The above remarks make it more than clear that the countries participating in a debt conversion must also adhere to clear and nonnegotiable terms regarding the use of the budget that becomes available as a result of the reduced (repayments and) interest owed—so as not to undermine the original purpose of the debt conversion.

It is proposed that only countries can participate in the debt conversion which

- *commit themselves to making investments—to be specified more precisely—at an amount to be set at least at 60% of the interest saved in various sectors to be defined jointly*
- *carry out reforms especially concerning the efficiency of taxation and the tax system, respectively*
- *set lower and upper limits for central taxes of the central government, such as, specifically, corporate income and transaction taxes within the EMU countries, and harmonize them within narrow ranges in the medium term*
- *reasonably reduce and largely deregulate bureaucracy while maintaining or even increasing performance-oriented social standards*

[32] Evsey D. Domar (1944): The Burden of the Debt and the National Income, in: American Economic Review, Vol. 34 (1944), pp. 798-827

- *implement good governance rules to put an end to the shadow economy and corruption*

With such a mix of measures and its regained financial power, a Europe that is again committed to the idea of integration would return to the top of the global economy—and thus to prosperity and social peace[33].

5. Conclusion and summary: Debt relief as a viable solution for restoring European economic and political weakness to future economic power again

It was pointed out in the previous study that the EMU countries have lost their capacity for monetary and fiscal action as a result of excessive public debt:

Due to the high level of public debt, the ECB is forced to pursue a permanent low interest rate policy if it does not want to risk the insolvency of EMU countries. An interest burden at pre-financial crisis levels not only cannot be shouldered by Greece without having to make massive cuts in all areas of government spending. Countries such as France and Italy would also have to reduce their spending to such an extent that it would push a large part of the citizens into the arms of populist parties, thereby jeopardizing not only European integration, but possibly even the democratic structures of the European countries might be endangered.

Apart from these political aspects, the high debt burden and the compulsion to reduce debt are already heavily leading to a sustained decline in net investment in almost all EMU countries, which will sustainably weaken Europe's technological leadership, and will increasingly sideline Europe, especially in comparison with the US and China.

This suggests that public debt should be reduced sustainably and, above all, in the short term. With conventional measures such as 'saving' this is, for the reasons discussed above, nether possible in short term nor without the loss of confidence of the European people in the idea of European integration.

As a result, only a debt relief as a debt conversion remains as an appropriate measure for an all-round win-win situation in Europe’s EMU countries, while respecting the regulatory framework.

A first proposal has been made on the basis of five key aspects to make such a debt reduction concrete, which shows that this is feasible:

[33] The connection between prosperity and social peace is almost uncontroversial in economic and political literature; see, for example, the literature study on the interdependence of prosperity and democracy by Uwe Sunde (2006): Wirtschaftliche Entwicklung und Demokratie: Ist Demokratie ein Wohlstandsmotor oder ein Wohlstandsprodukt? In: IZA DP No. 2244, Forschungsinstitut zur Zukunft der Arbeit, Institute for the Study of Labor, see also Ludwig Erhard (1957): Wohlstand für alle, Düsseldorf 1957 or especially Dan Usher (1981): The Economic Prerequisite to Democracy, Oxford 1981

- *A conversion of a relevant amount of the government bonds circulating at a specific date and held by the ECB is proposed*
- *It is necessary to extend the term of repayment very far from the respective date of issue and the interest rate has to be set very low*
- *A binding agreement is inevitable that net new debt can only be taken up to the maximum value of the GDP growth of the average of the last five years*
- *Only countries can participate in the debt conversion which*
  - ✓ *commit themselves to making investments—to be specified more precisely—at an amount to be set at least at 60% of the interest saved in various sectors to be defined jointly*
  - ✓ *carry out reforms especially concerning the efficiency of taxation and the tax system, respectively*
  - ✓ *set lower and upper limits for central taxes of the central government, such as, specifically, corporate income and transaction taxes within the EMU countries, and harmonize them within narrow ranges in the medium term*
  - ✓ *reasonably reduce and largely deregulate bureaucracy while maintaining or even increasing performance-oriented social standards andimplement good governance rules to put an end to the shadow economy and corruption*

We should expect that no nation would want to evade such a debt conversion; rather, the EMU would have enormous attraction for other EU countries and the EU to third countries. In accession negotiations the EU could then again direct its focus much more on a clear commitment to liberty, human rights, and social responsibility.

- Individual European countries are not able to take such a step: if, say, Poland's National Central Bank were to undertake such large-scale public financing, this would indubitably result in an enormous loss of confidence especially in the country's currency, and thus in a drastic devaluation. Moreover—and this is ultimately the crucial point—an individual country would not be able to institutionally make sure that such a course of action is a one-off measure, because such an assurance would be solely based on the power of the respective country and therefore utterly lack credibility. This is different in a supranational structure such as the EMU, which can generate maximum confidence in the binding terms of a one-time debt reduction based on a contractual agreement among all member nations and which possesses one of the most important international reserve currencies: the euro.
  (Plus, we may assume that if the EMU were to actually decide on a debt conversion as outlined above, both the USA and Japan would react in a similar way: especially in Japan, the Central Bank already holds a major share of government bonds.)

- Faith in the future of Europe as a true union of European nation states would also be restored among European citizens:
  By regaining financial strength as a result of a debt conversion, which is only possible within a strong supranational framework, the advantages of membership in the European Monetary Union will once again become evident, and—especially if the above-mentioned follow-up measures are taken—the European Union can

again become a shining example of freedom and prosperity, the way that Robert Schuman—and here we return to the beginning of this article—formulated as a vision in the declaration of May 9, 1950.[34]

The only thing we need is COURAGE – if not: Europe might end as Rome did 1,500 years ago.

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