

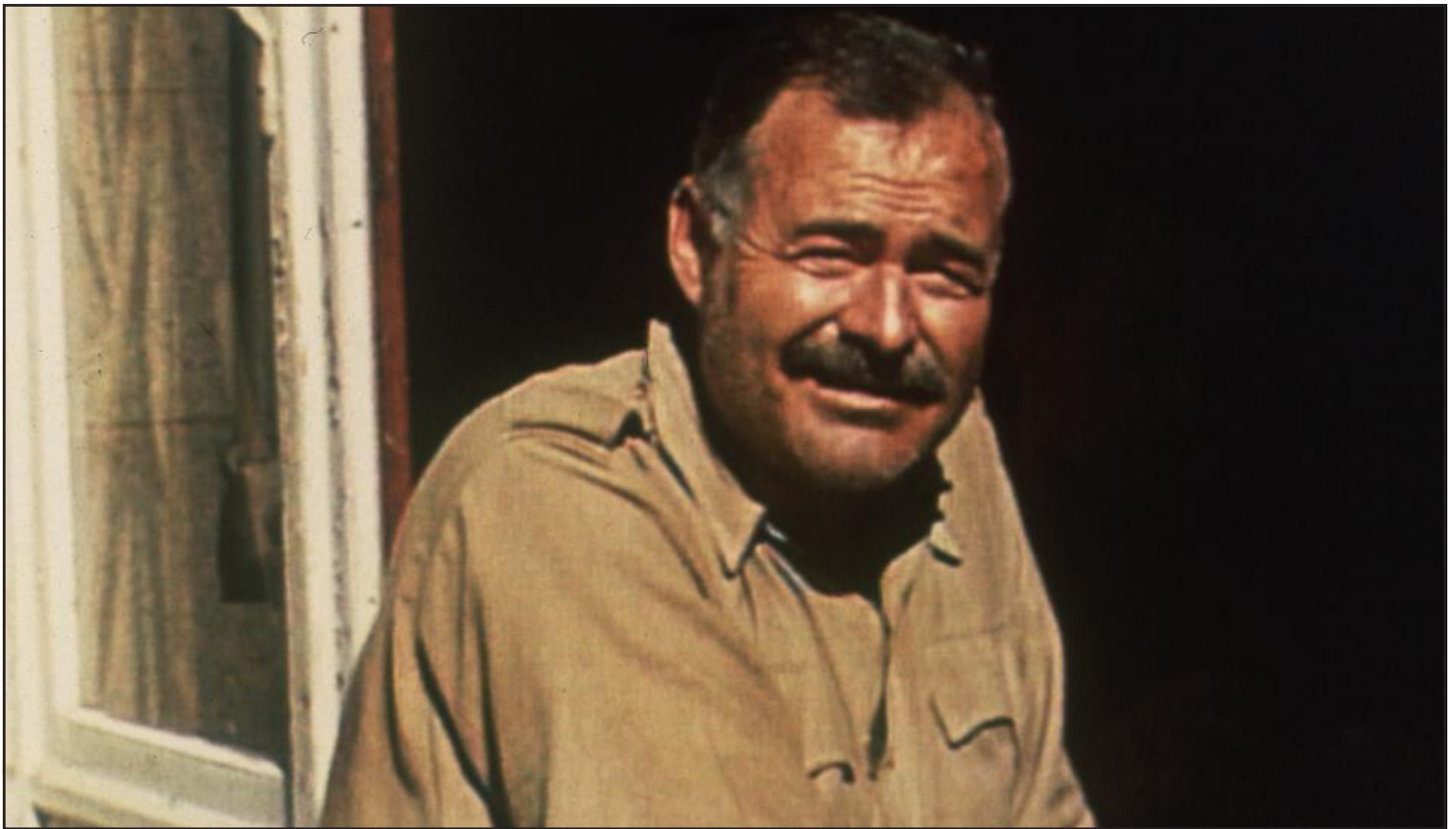


Gradually, Then Suddenly... Clarity Comes To The EU

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How do you go bankrupt? Gradually, then suddenly.

– Ernest Hemingway



1944: American author Ernest Hemingway (1899 - 1961) squinting as he sits near an open window in the sun, Mont St. Michel, France. Hemingway was in France covering World War II as a correspondent. (Photo by Anthony Potter Collection/Getty Images) GETTY IMAGES

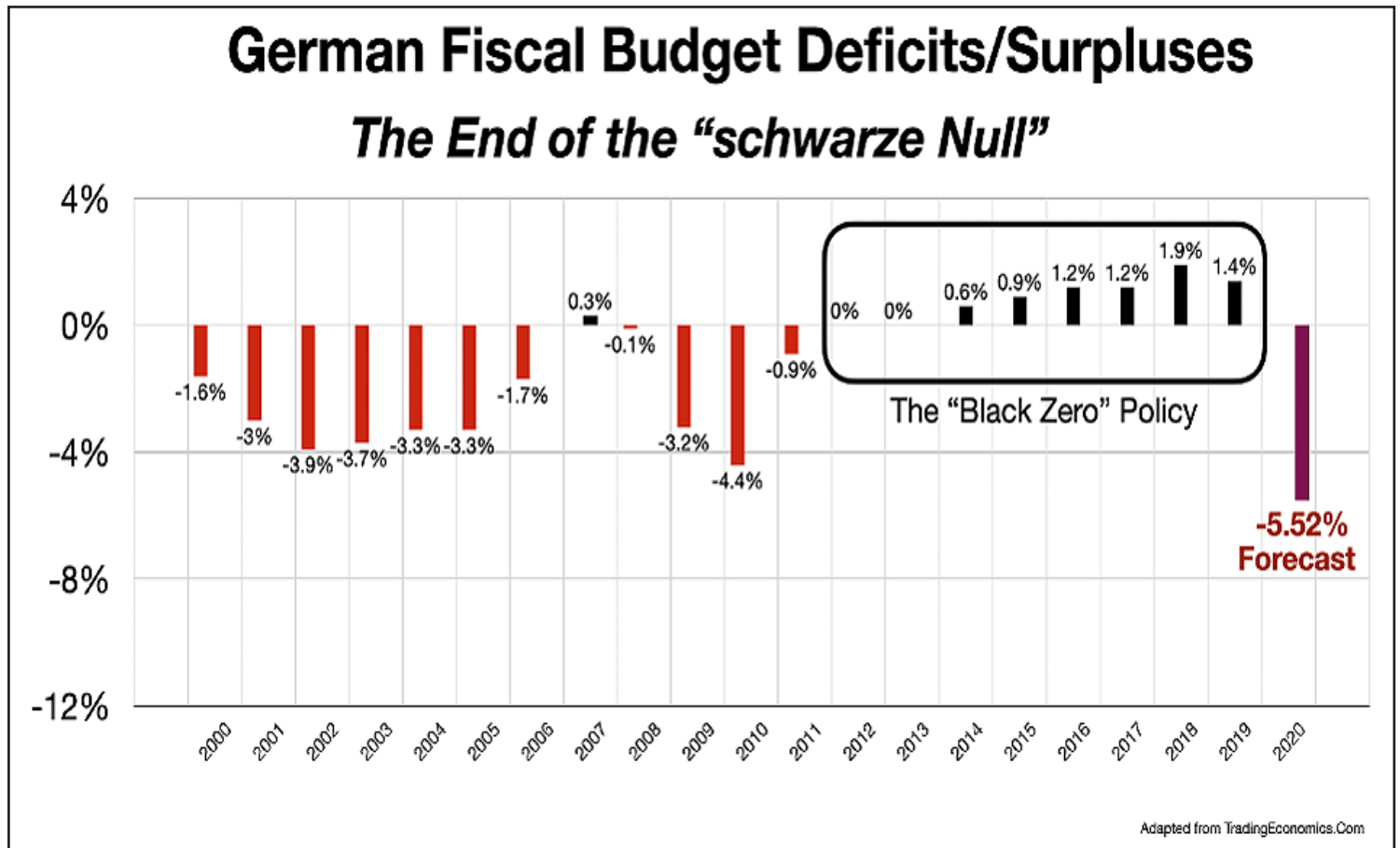
Hemingway's great contribution to financial economics, and life wisdom generally, applies to intellectual bankruptcy as well. Old ideas retain their grip on public opinion long after they have lost their potency or relevance (as John Maynard Keynes also warned us – *“Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist”*). But if we attend carefully to the drumbeat of events, especially in a crisis, we can feel “gradually” sliding towards “suddenly.” A lengthy period of gathering unease and uncertainty suddenly tips into clarity. What was unlikely, improbable, remote – all at once becomes obvious.

“Suddenly” is here now, today, in Europe. The Covid-19 pandemic has pushed the EU towards a climax in public policy and continental governance. Taboos are being broken. Political leaders are finding themselves forced to say

things they swore they would never say. Europe is finally engaging with the necessity for a more robust federal model. The resistance has retreated to its last lines of the defense.

What does clarity look like?

- Germany has finally, and abruptly, set aside its pet fiscal philosophy known as the Black Zero – described in the *Financial Times* as “a bizarre political commitment to a balanced budget [which] has long been a mantra of the Teutonic ruling classes.”



Black Zero is Over CHART BY AUTHOR

This is a long-awaited step towards a modern policy for a meaningful economic stimulus. Germany may be ready to accept – as other nations have done – the idea of public debt as a “national blessing” (in the words of Alexander Hamilton – more on Hamilton below.) Perhaps now we can retire those old photos from the 1920s, the wheelbarrows full of worthless hyper-inflated currency.

- Nay-sayers are being shamed into silence: The Dutch have toned down their moralizing, their scolding of the Southerners for their non-Calvinist ways – and are talking lately about “solidarity,” “empathy” and “compromise” –
- The European Central Bank has re-conceived and broadened its mandate yet again, executing a swift about-face on the question of support for the bonds of the distressed Southern members – which has allowed those countries to float new loans at reasonable rates

Negative clarity counts just as much, maybe even more:

- Italian political opinion has “suddenly” tacked hard against “Europe” – even the pro-European parties have signaled that they are out of patience with EU unmutualism –the threat of an Italian Exit is no longer dismissible

- And of course that means \$2.5 Tn of Italian debt is “suddenly” at risk – with credit rating agencies poised to drop the hammer and declare it all “junk” – which must concentrate wonderfully the minds of bankers all across Europe
- Best of all — or worst, or most fatuously – the German Supreme court has chosen this moment, after years of dithering, to instruct the *Bundesbank* to cancel its participation in the ECB’s bond buying program (generally regarded as the only effective component of the EU’s response to the crisis). Even more outrageously, the German court asserted its right to nullify rulings by the European Court of Justice, flaunting the EU treaty itself

The German Court’s move is decisive. It “suddenly” extracts the discussion from the realm of mere possibilities and scenarios and points of view, the uncertainties associated with “gradually.” Possibilities and scenarios can be ignored, deferred, set aside. But now we have court orders, hard deadlines, and legal challenges involving the legitimacy of the entire EU constitution. Nothing is veiled. The absurdity of the anti-EU position (distilled to its sclerotic essence in the German Court’s remonstrance against history and common sense) is “suddenly” apparent to just about everyone. It is quite refreshing.

And so, finally, after weeks of warnings, threats and counter-threats over the fate of the European Project, all of which seemed to hang on whether Germany would countenance a change in the financial framework of the EU (such as it is), the German Finance Minister Olaf Scholz suddenly burped up a new credo:

I believe that, as part of deeper EU integration, a temporary assumption of debt at the European level should not be taboo....

Then, oddly, he cited a remote, ancient and un-European history lesson – specifically the deal that Alexander Hamilton engineered with Thomas Jefferson and James Madison, in 1790 (!), to have the new federal government of the United States assume the Revolutionary War debts of the individual states, in return for ratification of the Constitution. Scholz happily asserted:

Hamilton’s deal was a decisive step in the construction of the U.S.

The “construction of the United States”? How often do the Europeans cite the U.S. as a model of governance these days? What can this mean, but that “suddenly” has arrived? A great change is immanent.

Keep in mind that the prior position of Scholz’s boss, Angela Merkel, had been quite the opposite, until now.

First of all, not long ago she could declare a “new chapter in U.S.-European relations” which meant that Europe “really must take our fate into our own hands.” The old relationship with America was “over.” German public opinion was just as harsh. Last year, polls found that

About 85 percent of Germans consider their country’s relationship with the U.S. to be “bad” or “very bad,” while a clear majority want Germany to distance itself from the U.S.

Second, and of much greater importance, Merkel has been on record for years saying she would fight against the idea of any sort of common European debt obligation – a eurobond – “as long as I live.”

But old ideas are sloughing off. “Suddenly” on Monday of this past week, Merkel joined with French President Macron to launch a new initiative to raise €500 Bn of common EU debt –eurobonds, by any other name. The *Financial Times* made it plain: “*The plan would mean the joint issuance of European debt.*”

Headlines announced: “Merkel, Macron Conjure Hamilton Moment to Fight EU Break-Up.” Merkel stated the rationale: The EU is facing the “gravest crisis in its history, and such a crisis demands appropriate answers.” Macron drew the implication: “This is the transfer of real budget money to the worst-affected regions and the worst-hit sectors.”

The commentariat is still rubbing its eyes in measured amazement – can it be that the end of this drama is nigh?

“Merkel and Macron outlined a plan to create spending power via EU- borrowing to distribute money via grants. If you

have common bonds, is that not a fiscal union of sorts? It is radical stuff: a solution to the problem....May 18 2020 could turn out to be a historic day.”

“The German-French proposal carries historic weight and should be understood as a eurobond trial balloon.”

And so – “suddenly” – Hamilton, and Madison, and Jefferson have burst out of the 18th century into the 21st, jumping the Atlantic ocean to boot, along with magic words like “federalism” –

“We might have seen a Hamiltonian moment.”

“Markets however seem to be focusing on the principle of the thing rather than the scale... This is a step towards fiscal confederation.”

“The political signal here is that the EU is more than a grouping of nation states and has its own federal identity.”

“The symbolism of Berlin’s embrace of mutual debt issuance in the name of solidarity is more powerful than the real economic impact.”

“The architects of EU federalism have been working toward such a settlement for years.”

Hemingway and Hamilton – the American model is “suddenly” in play, in Old Europe. Covid-19 is a violent precipitator and accelerator of many changes. It has brought much suffering, but also now much clarity, and the future looks brighter today for the EU than it did a week ago.

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