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A Hamiltonian moment for Europe?

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1. By way of introduction: Europe is facing multiple crises[1]

A new European Parliament (EP) was elected in June 2024, followed by the appointment of a new European Commission (EC) this autumn. The new EC faces significant challenges, including Europe's sluggish growth and declining competitiveness, threats to social cohesion and increasing political fractures — as shown by the rise of populist parties in nearly every EU Member State —, increasing threats to internal and external security following Russia's war of aggression against Ukraine and, of course, the overarching challenge of addressing climate change.

These challenges are not only extremely urgent but may also conflict with each other in the sense that addressing one — such as the EU's growth and competitiveness issues — may come at the expense of another, such as tackling climate change for economic growth is challenging to fully decouple from greenhouse gas (GHG) emissions, which are a primary driver of climate change.

I am unsure how best to address this situation, often referred to as a **'multiple crises'** or **'polycrisis'** scenario (Lawrence/Janzwood/Homer-Dixon 2022, Henig/Knight 2023), nor do I know which priorities should be set in tackling these issues. However, it seems evident that all of these crises demand a greater problem-solving capacity from governments, which implies both increased financial resources and more EU-wide cooperation, as these crises are shared by all EU Member States and transcend national borders.

A common theme linking the economic, political, social, security, and ecological dimensions of the multiple crises facing the EU is the need to generate funds for public investment at significantly higher levels than seen in past decades. The so-called **Draghi Report** on the Future of Europe's Competitiveness (European Commission 2024) argues that the EU's public investment ratio must be increased by approximately 5 percentage points of GDP for the foreseeable future, returning to levels last observed during the post-WW2 recovery period. Similar figures are supported by national reports, such as those for Germany (see e.g. Dullien et al. 2024).

This brings me to the questions I would like to address in this talk:

1) *How can such significant levels of public investment be financed, given the high levels of debt in most EU Member States?*

2) *What role should the European Union play in supporting Member States? In other words, does the EU need its own **'Hamiltonian moment'**?*

Before we can explore these questions, let's take a brief look at Europe's public finances and the EU regulations governing them.

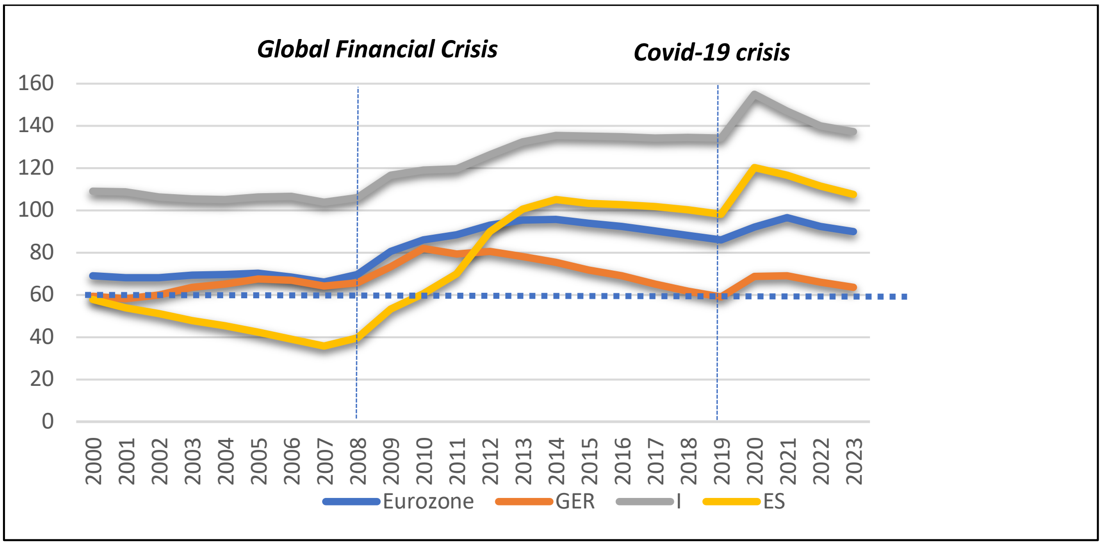
[1] Keynote delivered at the 15th edition of the International Conference ,The Future of Europe' organised by the Bucharest University of Economic Studies on October 24th 2024.

2. Public finances in the EU

The establishment of the European Monetary Union in 1999 represents the most significant leap forward in European integration over the past half-century. Introducing a common currency — initially for 11 and now 20 EU Member States — not only Europeanized monetary policy and created a powerful symbol of European unity but also put pressure on Eurozone Member States to further harmonize various policy areas (referred to as 'spill-overs' in neo-functionalist integration theory, see e.g. Haas 1961) and created incentives for non-member states to eventually join the club.

In preparing for the Monetary Union, the need to politically or, at minimum, fiscally unify the Member States was extensively debated. Historical experience with the formation of monetary unions has shown that only those combining monetary with fiscal and political union have endured (see e.g. Bordo/Jonung 2003; Griffiths 1991, Theurl 1992). However, it was — and still is — unthinkable for the EU's Member States to relinquish legal sovereignty over fiscal policy, taxation, and law-making, which are core elements of national policymaking. On the other hand, it was clear that the public budget policies of individual Member States within a Monetary Union would impact other Member States and the central authority of monetary policy, the European Central Bank (ECB). Due to externalities — both positive and negative — such as spill-over effects of stabilization policies, credibility impacts of deficit policies, or inflationary consequences of excessive indebtedness, there was a recognized need for controlled cooperation, if not outright harmonization or centralization, of public budget policies. In most policy areas in the EU, the approach to balance legal sovereignty with the functional need for policy coordination has been the **'Open Method of Coordination'** — an unsanctioned exchange of information about requirements and measures, taking the form of EU surveillance and national reporting (see e.g. van Gerven/Stiller 2023).

Figure 1: History of Public Debt in the EU (as % of GDP)

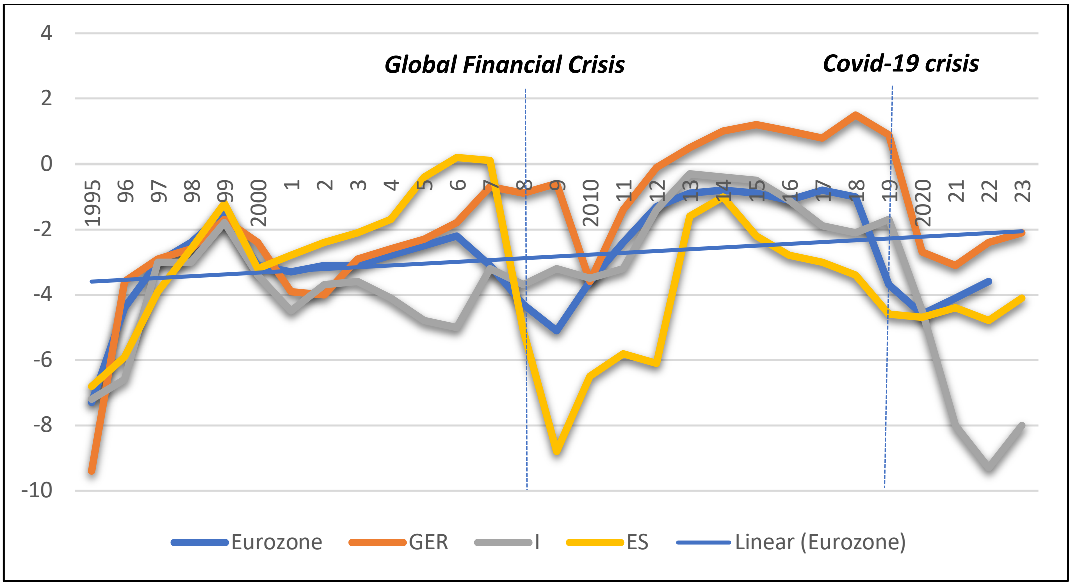


Source: Ameco online

At the initiative of several influential Member States concerned that 'soft coordination' might not be sufficient to influence other Member States expected to avoid 'solid' fiscal policies, a stricter, sanctionable approach to public budget policy was introduced. The **European**

Stability and Growth Pact (ESGP) was established in 1997 to reassure countries like Germany that unsound fiscal policies would not pressure the ECB to 'monetarily bail out' other Member States. The ESGP stipulates that a Member State's total public debt should not exceed 60% of GDP; if it does, measures must be taken to reduce indebtedness appropriately. Additionally, a Member State's structural deficit should not exceed 0.5% of GDP, while the total (cyclically unadjusted) deficit should not exceed 3% of GDP. This **(near) balanced budget rule**, lacking strong theoretical support aside from the general idea of the Barro-Ricardian equivalence theorem, was to be enforced with automatic sanctions, barring exceptional circumstances such as the COVID-19 crisis or the Russia-Ukraine war.

Figure 2: History of Public Deficits in the EU (structural deficit, excessive deficit procedure)



Note: Linear (Eurozone) linear trend for the Eurozone

Source: Ameco online

Although some critics argue that the ESGP's sanction mechanism lacks credibility, that the post-revision ESGP is non-transparent, and that its 'binding-one's-hands' effect is insufficiently strong, there is no doubt that fiscal policy in the Eurozone has become more restrictive since the ESGP's enactment[2]. It is also more restrictive than fiscal policies in other major economies, such as the USA or the UK, which are not bound by the ESGP regulations. The ESGP's three numerical benchmarks clearly serve as constraints on fiscal policy. This undeniably restrictive stance has been blamed for the Eurozone's sluggish economic performance following the Global Financial Crisis and the COVID-19 crisis (see e.g. Paetz/Watzka 2023), and has, in any case, negatively impacted public investment spending (see e.g. Sigl-Glöckner et al. 2022).

[2] See Fig. 1 and 2, where public deficits are far below the ESGP threshold level and falling in trend, and public debt levels falling towards the ESGP threshold level except for extraordinary crisis periods.

3. Meeting the public investment needs in times of high indebtedness and restrictive fiscal policy

The fiscal regulations in the Eurozone reflect both a desire to appease financial markets and an implicit assumption that some Member States require strict, enforceable rules to control their **'deficit bias'**. However, can this fiscal straightjacket — which has faced strong criticism since its inception (see e.g. Artis/Winkler 1997, Eichengreen/Wyplosz 1998) — still function effectively under conditions of multiple crises that demand an active state? Or does the EU need its own 'Hamiltonian moment'?

Before delving into the concept of a 'Hamiltonian moment', let's examine the EU's fiscal framework as a factor that either enables Member States to remain capable of action or, conversely, restricts their fiscal flexibility just when it is needed most. Defenders of the European Stability and Growth Pact (ESGP) have always argued that adhering to the rules is the only way to regain and sustain fiscal capacity, as otherwise, the burden of servicing rising public debt through interest payments could eventually become unsustainable. Although this argument lost much of its force during the period of exceptionally low interest rates following the Global Financial Crisis, those extraordinary conditions now appear to be in the past.

Yet, the defenders' argument for a rule-based fiscal policy is valid only in advocating for rules in general; it is not a convincing argument for a strict balanced-budget rule (see e.g. Heise 2023). If seriously implemented, a balanced-budget rule would drive public debt levels down to around 10% in the long run[3] — far below the stipulated 60% threshold and certainly not an 'optimal level of public indebtedness' by any standard. Thus, if fiscal sustainability is accepted as a justification for a rule-based fiscal policy, the rule should not — assuming realistic potential growth rates, accepted inflation rates, and tolerable debt levels — target balanced structural budgets. Instead, it could reasonably allow for structural deficit-to-GDP ratios of around 3–5%.[4] Furthermore, assuming realistic marginal tax rates and fiscal multipliers, such structural deficits would enable public investment at levels consistent with those proposed in the 'Draghi report.'

The existing fiscal regulations in the EU are evidently internally inconsistent and could only be defended on the basis that, for ecological reasons, stimulating growth through a substantial increase in deficit-financed public investment is unwarranted. Although this position aligns with arguments for **'post-growth'** or **'zero-growth'** economics (see e.g. Kallis 2011, Hickel 2021, Jackson 2021), it has not yet gained widespread acceptance as a guiding principle for EU fiscal policy. Furthermore, while there is no inherent theoretical link between public investment spending and deficit-financing — public investment can certainly be funded through taxation — it is hard to deny that public investment is often more difficult to justify and defend in democracies than general consumption or social spending. This implies that the

[3] This is the case as long as we assume – as has been done by the architects of the ESGP – positive nominal GDP-growth rates to continue in the long run.

[4] If we take the values for average annual GDP growth, inflation rates, and targeted debt-to-GDP ratio assumed by the EU Commission when establishing the European Stability and Growth Pact — namely, 3%, 2%, and 60%, respectively — then, according to Evsey Domar's financial arithmetic (Domar 1944), a structural deficit of 3% of GDP would be sustainable. If the targeted debt-to-GDP ratio were raised to 100%, a sustainable structural deficit would increase to 5% of GDP.

current EU fiscal regulations act as a straitjacket, preventing the scale of public investment needed to address the demands of today's multiple crises.

Revising the EU's fiscal framework is a well-established practice: since its inception, the European Stability and Growth Pact has undergone several modifications — some aimed at tightening restrictions, with the most recent revisions intended to better accommodate exceptional circumstances (see e.g. Hukkinen/Viren 2023). However, none of these changes have fundamentally questioned the general emphasis on restrictive, balanced-budget goals. Given that any significant revision, including a true reorientation as outlined, would require a qualified majority in the EU Council — and facing likely opposition from the **'frugal few'** hardliners — it is difficult to envision how such a transformation might take place.

4. A Hamiltonian moment . . .

This is where the idea arises that the EU needs its own 'Hamiltonian moment.' The term 'Hamiltonian moment' is named after Alexander Hamilton, the first U.S. Treasury Secretary, and refers to the decision to mutualize the individual (already accumulated or 'old') debts of the former colonies at the federal level. This move established a new layer of fiscal authority, marking the first step toward fiscal union and – in direct opposition to the Jeffersonian vision that opposed a strong, centralized federal state – paved the way for political union. It has been argued that this 'Hamiltonian moment' was only fully realized when the assumption of the colonies' debts was complemented by the federal government gaining taxation powers, as Alexander Hamilton put it, to be "an essential cement of our Union" (Hamilton 1850: 387).

A 'Hamiltonian moment' refers, to be clear, to a step towards **nation-building** or, more modestly, the creation of a federal — or in Europe's case, a supranational — level of governance with the power to conduct its own independent fiscal policy. This step has been consistently resisted by the EU's decision-making body, the EU Council. The EU's own financial resources, administered by the European Commission, are minimal relative to the budgets of Member States (MS). Moreover, EU institutions like the European Stability Mechanism (ESM), established after the Global Financial Crisis to provide low-interest loans to struggling MS, rely on backing from individual MS, not the EU as a whole.

However, ideas about a **'fiscal capacity'** for the EU, strongly influenced by France, have been part of the European discussion since 2012 as elements of the proposal for a **'Genuine European Monetary Union'** (GEMU)[5]. This shift took a historic step forward with the establishment of the **Next Generation EU** (NGEU) program and its **Recovery and Resilience Facility** (RRF) during the COVID-19 crisis. This program enabled the EU to borrow up to €750 billion to provide loans and grants to MS in need. Many commentators have described this move as the EU's own 'Hamiltonian moment,' marking a significant departure from prior limits on EU fiscal integration[6].

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[5] Several official and semi-official bodies contributed: Enderlein et al. (2012), European Commission (2012), van Rompuy et al. (2012), Juncker et al. (2015),

[6] See e.g. Cooper (2020), Mayer (2020), Friedman (2020), Emerson (2020).

My focus here is not to draw historical parallels between the Confederation period of the 13 American colonies that formed the young, independent United States in the late 18th century and the European Union in the early 21st century[7]. Instead, I aim to elaborate on the elements still missing for the mutualization of (new, not yet accumulated) debt to constitute a truly 'Hamiltonian moment' — which, to be clear, I view as an important and welcome step toward deeper European integration and a more robust Eurozone.

First and foremost, Next Generation EU has been declared a unique, one-off, and temporary measure. Those commentators who initially opposed this step question the credibility of this uniqueness, suspecting that similar measures might be introduced in the future whenever struggling Member States cite exceptional circumstances (see e.g. Vaubel 2020, Cooper 2020). However, emergency measures like Next Generation EU are far from the standing 'fiscal facility' that would enable the European Commission to conduct deficit-financed capital budgeting[8]. Such a facility would be essential for providing the public investment goods that the EU urgently needs, especially given that individual Member States are currently constrained by restrictive financial rules.

5. . . . in the offing

To truly ignite a 'Hamiltonian moment' for Europe — even if different from the U.S. experience in the late 18th century (see e.g. Sobel 2020) — a permanent 'fiscal capacity' would be required. This would mean granting the EU Commission the authority to borrow up to 5% of EU GDP annually (equivalent to €750 billion) to provide grants and loans to Member States in need, specifically for investments aligned with key economic goals, such as advancing digital and ecological transitions or fostering innovation. Any borrowing facility would also need a dedicated revenue source to cover at least the interest on the debt, thereby ensuring a sustainable primary balance (see e.g. Eichengreen 2020). Such sources could include a green tax or a transaction tax — options that were previously dismissed during discussions on the Next Generation EU program.

Establishing a permanent fiscal capacity would also necessitate a transparent, rule-based system for loans and grants, one that avoids the perception of continuous redistribution from wealthier to less wealthy Member States and minimizes free-rider incentives. This requires an economically functional model of fiscal federalism — an approach familiar to some EU Member States, who could contribute valuable experience in this regard[9].

Finally, the framework of fiscal federalism, including the power to tax, must be legitimized not only through EU law — likely requiring amendments to the EU treaties — but also through the consent of European citizens. This means strengthening the legislative powers of the European Parliament and moving toward a directly elected European Commission, as opposed to the current system where it is appointed by Member State governments.

[7] This has been done many times over: see e.g. Issing (2020), Bini Smaghi (2020), Boskin (2020), Georgiou (2022).
[8] For the budgetary concept of ‚capital budgeting' see Heise (2023).
[9] Bibow (2020) provides a very rudimentary version.

6. By way of conclusion: a long way to go

Many commentators have been quick to dismiss the possibility of a Hamiltonian moment for Europe, fearing that an additional supranational governance layer would only become another institution inclined toward deficit spending. However, with EU regulations limiting deficit spending at the Member State level and a shrinking pool of profitable investment opportunities for private companies — the 'natural' borrowers in capitalist economies — governments increasingly become the only viable source of borrowing and investment if transformational growth is to be achieved. The scale of public investment needed to drive this transformational growth cannot be supported under current EU fiscal regulations, which have proven challenging to amend in any substantial way.

Thus, a Hamiltonian moment for Europe may indeed be essential to create the necessary fiscal space. Only time will tell whether the Next Generation EU program and its Recovery and Resilience Facility, enacted in response to the COVID-19 crisis, will be remembered as such a moment or as a missed opportunity. Ultimately, a true Hamiltonian moment would require the EU to gain taxing authority and establish a federal fiscal structure, legitimized by the European Parliament and a directly elected European Commission accountable to the people of Europe—a vision that remains distant but perhaps achievable over time.

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