EUROPEAN INTEGRATION 03.03.2021 | Benjamin Lemoine & Éric Monnet & Benjamin Braun

Beware the low-hanging fruit

Recent proposals for ECB debt cancellation create a dangerous illusion, namely that a small technocratic fix can solve a massive political problem

Almost one year ago, a group of economists and political activists launched a public campaign in which they called for the cancellation of the sovereign debt held by the European Central Bank (ECB). Now in February 2021, the group published an open letter prominently supported by, among others, French economist Thomas Piketty, former EU Commissioner László Andor and the leader of the Belgian socialist party, Paul Magnette. It was widely covered in the press and the public debate, even forcing the ECB to publicly take a stand against it.

Their letter argued that central banks aren't doing enough to spur investment and combat climate change, and that excessive public debt restricts governments' ability to promote a more equal and ecological society. Cancelling the debt held by the ECB, roughly 25 per cent of total public debts, would – 'without harming anyone' – lighten governments' debt burden and allow them to issue new bonds on the capital market to invest in the green economy.

Although attractive at first sight, the debt cancellation proposal actually creates a dangerous illusion, namely that a small technocratic fix can solve a massive political problem. The proposal, by fetishising the debt-to-GDP ratio, reinforces the idea that public debt is a problem as such; it fails to acknowledge just how deeply entangled public debt and central banking are with private finance; and it diverts political capital away from the Global South, where sovereign debt cancellation by foreign creditors is truly needed.

In short, what the cancellationists don't seem to realise is that their proposal is designed to entrench the status quo. Cancelling debt owned by public institutions in order to appease private investors is the opposite of what we believe should be the progressive agenda: to free government finance from the dictate of private investors.

The entanglement of public and private creditors

The case for cancellation rests on the assumption that private investors will be eager to lend money to member states just after the ECB has written off its sovereign bonds holding. However, this overlooks the extent to which public and private actors areentangled in the current macro-financial architecture of the euro area. In fact, conceptions of creditworthiness, discipline and structural reforms are shared among private or public creditors.

A more relevant historical example for the current debate would be what happened in France in 1928. In contrast to 1953, this is strictly speaking a historical precedent for the cancellation of public debt held by a central bank.

In the governance mechanisms of the European single currency, fiscal surveillance and emergency lending mechanisms are the public complements of private market discipline. The power relationships encapsulated in those mechanisms mean that cancellation cannot be a painless accounting exercise. Indeed, private investors have already voiced their opposition to any form of debt cancellation. This reluctance could lead to an increase of the sovereign risk premium, threatening to neutralise the gains from debt cancellation.

So before considering cancelling the debt owned by public institutions, governments should make sure that their treasury departments won't depend on private creditors' beliefs, appetite and political desires in the first place.

Re-writing the past out of it balance of powers' context

When proponents of ECB debt cancellation recognise that the direct economic consequences of cancelling the ECB's debt would be low (because it is essentially an accounting mechanism), they share the view that it would nonetheless be a 'foundational moment' which, through its symbolic force, will guide the European Union towards a more environmentally sustainable economy.

Here, the cancellationists frequently refer to the 1953 London conference, when West Germany had two-thirds of its public foreign debt forgiven by the Allies, which they claim was a key event in Europe's post-war reconstruction. It is true that the agreement had beneficial consequences for the German economy because it reduced debt servicing.

But it was not a foundational moment that changed the political class' perceptions of public debt. Nor did it involve central banks.

The cancellation took place in the context of the Cold War and economic reconstruction, under a policy consensus that prioritised state investment over financial markets and rejected the notion that public debt constrained governments. In fact, countries that joined the Bretton Woods institutions established in 1944 did not even have to report government debt statistics. For the United States, the reconstruction of West Germany was a Cold War priority, and cancelling its debt weighed little in comparison with US defence spending in Western Europe at that time.

Rather than a transformative technocratic fix, the London Agreement of 1953 was a side-effect of a deeper political transformation that subordinated private financial markets to the requirements for debt-financed public investment. It was only one measure among many. The Bretton Woods era's macro-financial architecture of 'embedded liberalism' era marginalised the importance of marketable public debt as we know it today and institutionalised public-sector dominance over monetary and credit affairs. This was made possible by a shift of political power from state managers representing the interests of the financial sector to state managers whose constituencies were trade union leaders and industrialists.

A more relevant historical example for the current debate would be what happened in France in 1928. In contrast to 1953, this is strictly speaking a historical precedent for the cancellation of public debt held by a central bank. After the First World War, the Bank of France held a large part of short-term public debt, which was seen as inflationary. The economic stabilisation plan of 1928 included a new monetary law and a devaluation of the franc. The devaluation of the franc led to an increase in the nominal value of the gold reserves held by the central bank (in francs). This increase was used to cancel part of the public debt held by the central bank, i.e. the revalued gold replaced the cancelled public debt in the central bank's assets.

Twenty years of structural reforms have been dedicated to engineering societies and 'enlightened public opinions' compatible with the

This set of measures (devaluation, new monetary law and reduction of public debt) *was* a transformative moment – just not a progressive one. France went back to the gold standard. For a few years, the stabilisation of 1928 had positive consequences for the French economy, but when the Great Depression hit in 1930, the rules of the gold standard pushed the

macro-financial architecture laid down by the Maastricht Treaty.

country into a deep and long deflation.

Structural implications for the Eurozone

We are no longer in 1928. However, the example suggests that, without a prior change in the way in which public debt is traded on financial markets and perceived by state managers and the political class, a debt cancellation by the central bank is more likely to entrench neoliberal fiscal orthodoxy than to lay the foundation for a new macro-financial order. As the 1953 agreement shows, debt cancellation is not a technical issue that can be taken out of context. Before making the debt harmless, the whole framework of debt management, finance regulation, treasury financing and fiscal rules must be changed. Otherwise, the consequences of debt cancellation will contradict the original objectives of its proponents.

Unless flanked by radical political changes regarding debt and tax rules, ECB debt cancellation risks playing into the hands of fiscal conservatives. The ECB would cease its purchases of government bonds and governments would be forced to tighten their fiscal stance. What's more, cancellation would likely take the form of a deal negotiated in the inner sanctums of the ECB in Frankfurt and the Council and Commission in Brussels, excluding any possibility for a public, democratic debate about the bigger macro-financial picture and the role of the central bank within it.

Without a profound change, ECB debt cancellation risks taking us back to the pre-2008 situation, with no debt mutualisation in Europe, with tightened fiscal rules and debt ceilings, and without the ECB playing the role of lender of last resort for public debt. Instead, we should emancipate the ECB from its role as a mere safety net for financial markets, and governments from their role as mere collateral suppliers for the shadow banking system.

Twenty years of structural reforms have been dedicated to engineering societies and 'enlightened public opinions' compatible with the macro-financial architecture laid down by the Maastricht Treaty. The economic and political outcomes could have hardly been worse. It is high time to redirect this zeal for structural reform to engineer a macro-financial architecture compatible with economic and political democracy.



Benjamin Lemoine

Paris

Benjamin Lemoine is a researcher in Sociology at the Centre National de la Recherche Scientifique (CNRS) based at the IRISSO – Univeristé Paris Dauphine (PSL). His research focuses on the transformations of sovereign bond issuing techniques and market in the 20th and early 21th century. He is currently investigating how sovereignty,is embedded in juridical configurations of global finance. He is the author of *L'ordre de la dette, Enquête sur les infortunes de l'État et la prospérité du marché*, La découverte, 2016.



Éric Monnet

Paris

Éric Monnet is an economic historian, Full professor (Directeur d'études) at the EHESS and at the Paris School of Economics, research affiliate at the Center for Economic Policy Research. His research focuses on the history of monetary policies, the international monetary system and financial systems in France and Europe in the 20th century. From 2013 to 2019, he worked as an economist at the Banque de France. He is the author of *Controlling Credit*, Cambridge University Press, 2018.



Benjamin Braun
Cologne

Benjamin Braun is a political scientist at the Max Planck Institute for the Study of Societies in Cologne. He specialises in international and comparative political economy. Currently, his research focuses on the politics of central banking and on the political economy of asset manager capitalism. He tweets @BJMbraun.