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Is the Euro Fit for the Future?



KRONBERGER KREIS
Lars P. Feld, Clemens Fuest, Justus Haucap,
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STIFTUNG Marktwirtschaft

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Executive Summary

The Economic and Monetary Union (EMU) of the European Union (EU) has experienced the most severe period of inflation in its history. After inflation in the euro area temporarily rose above 10 percent, it has again been close to the European Central Bank's (ECB) medium-term inflation target of 2 percent since 2024. The return to low inflation rates, however, does not necessarily guarantee the long-term stability of EMU. Rather, the high-inflation period from 2021 to 2023 once again exposed its fundamental institutional weaknesses.

Against this background, the Kronberger Kreis, the scientific advisory board of the Stiftung Marktwirtschaft, examines whether the EMU is adequately prepared to address future challenges. The analysis focuses on the ECB's monetary policy strategy, the rules and institutions of the monetary union, and the conditions for and limits to a stronger international role for the euro.

The experience of recent years demonstrates that price stability cannot be guaranteed by an independent central bank alone. A stable monetary union requires a credible institutional framework that strengthens individual responsibility and limits adverse incentives for Member States. The EMU combines supranational monetary policy with largely national fiscal policies. However, the long-term viability of this institutional arrangement depends on clearly delineated responsibilities and the commitment of Member States to ensure sustainable public finances. Nonetheless, it is precisely these conditions that are increasingly put in doubt.

These structural weaknesses became particularly apparent during the period of high inflation. High inflation was not solely the result of the COVID-19 pandemic, disrupted supply chains, or the energy price shock triggered by Russia's war against Ukraine. The exceptionally expansionary monetary and fiscal policies pursued during the pandemic have been identified as major contributing factors to the rise in inflation. The ECB responded significantly later than in previous inflationary episodes. Furthermore, the ECB's strategy deviated from the Taylor principle, which implies that central banks should respond to rising inflation with greater urgency and decisiveness.

Concurrently, European fiscal rules were rendered more and more complex and less binding, with the result that they now exert considerably less disciplinary pressure on Member States' fiscal policies. Moreover, the introduction of the Transmission Protection Instrument (TPI), which allows for purchases of individual Member States' government bonds in order to limit risk premia, further expanded the ECB's role as a crisis manager supporting highly indebted Member States, while key reforms of the monetary union initiated in the wake of the euro crisis remain incomplete. There is still no orderly mechanism for sovereign debt restructuring, nor has the sovereign-bank nexus been effectively curtailed. As a result, considerable adverse incentives persist, thereby increasing the monetary union's vulnerability to crises and heightening the risk of fiscal dominance.

These institutional shortcomings affect not only the stability of the monetary union but also the euro's international role. Current geopolitical changes may indeed create opportunities for the European single currency to assume greater international importance. However, lasting confidence in a major international reserve currency, cannot be achieved through joint European debt instruments or an expansion of joint liability. On the contrary, what matters are stable institutions, sound public finances, competitive economies, and a monetary policy that remains credibly focused on price stability. Strengthening the euro's international role therefore requires, above all, reinforcing the monetary union's institutional framework and improving Europe's economic performance.

In order to enhance the stability of EMU and the euro, and to ensure their continued suitability for the future, the Kronberger Kreis recommends the implementation of the following reforms:

1. Liability, decision-making and control should always be located at the same level in both monetary and fiscal policy.

2. Price stability should again receive a greater weight in the monetary policy strategy by adhering more closely to the Taylor principle and incorporating it into monetary policy communication, while also taking signals from monetary and credit developments more seriously. Quantitative easing through balance-sheet expansion should be confined to exceptional crisis situations and should subsequently be unwound swiftly.

3. Asset purchases aimed at reducing the financing costs of individual Member States should be avoided. At the same time, the necessary institutional reforms should be implemented and the required instruments established in order to relieve the ECB of its role as a sovereign debt crisis manager.

4. The key adverse incentives (moral hazard) that encourage free-riding in government borrowing and banking supervision should be eliminated.

5. European fiscal rules should be strengthened, with a particular emphasis on ensuring an effective reduction of high debt-to-GDP ratios in the aftermath of crises.

6. A credible sovereign restructuring mechanism should be established in order to create incentives for sustainable fiscal policy and enable effective crisis resolution.

7. The regulatory privileges enjoyed by sovereign bonds in banking regulation should be phased out in order to break the sovereign-bank nexus.

8. The euro's international role should be strengthened on the basis of a realistic assessment of its potential. Its regional influence can be increased through the establishment of deeper trade relations and greater economic integration. Any effort to establish the euro as a global reserve currency must take account of the associated costs and risks.

9. Perceived fiscal stability is a key prerequisite for a stronger international role of the euro as a reserve currency. Binding fiscal rules and the alignment of liability and control are indispensable in this regard.

10. The notion of Eurobonds and joint liability should be disregarded. Instead, priority should be given to fiscal consolidation in highly indebted Member States, market-oriented structural reforms, increased trade, stronger economic growth, and the removal of regulatory barriers.

1. Introduction

1. Is the euro well equipped to meet future challenges? The short answer to this question is an unequivocal “No”. In this study, the Kronberger Kreis provides a more detailed response. It examines the state of EMU following the COVID-19 pandemic, the energy crisis and the surge of inflation from 2021 to 2023, as well as at the onset of a renewed bout of inflation due to the rise in energy prices resulting from the war in Iran. This study focuses on the monetary policy of the ECB and its independence from the fiscal policies of the Member States. Whether the euro is fit for the future depends on the institutions and rules of the EU designed to ensure that the price level and the financial system remain stable over the long term and that public finances remain sustainable even in times of crisis.

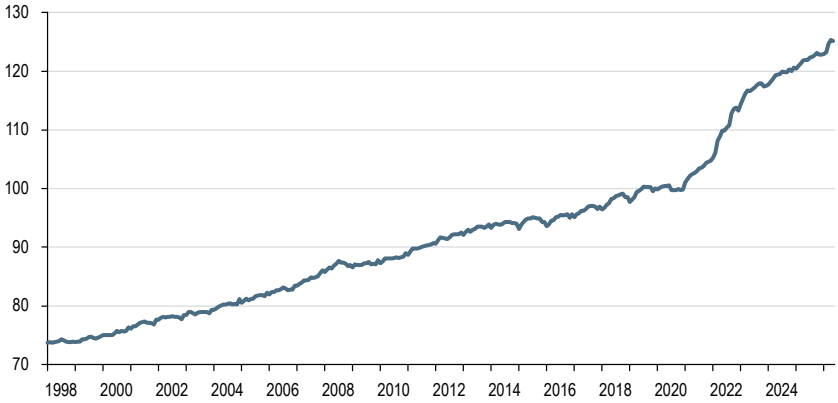
2. In the decade from 2009 to 2019, the ECB expanded its balance sheet more and more strongly through large-scale asset purchases and low-cost loans to banks. At the same time, central bank interest rates were first lowered to close to 0 percent and subsequently into negative territory. This was prompted by the global financial crisis, which erupted in the summer of 2007, and the subsequent euro sovereign debt crisis, which led to far-reaching reforms of the architecture of the monetary union. Despite the accommodative monetary policy, money and credit growth in the euro area remained subdued until 2019. This was due to private and public borrowers, as well as the banking system, having to consolidate their balance sheets in the aftermath of the crises. In parallel, inflation remained, on average, at approximately 1 percent between 2013 and 2019.

3. During the COVID-19 pandemic of 2020/2021, the central bank balance sheet, government spending and public debt were increased massively. The money supply grew very rapidly, driven above all by public-sector borrowing. From the beginning of 2021, inflation began to rise more and more quickly. Russia’s invasion of Ukraine in February 2022 then served as an accelerant and drove energy prices higher. The ECB did not begin to raise the relevant policy rate until July 2022, at first from -0.5 percent to 0 percent. By that month, consumer price inflation had already reached 9 percent. Shortly beforehand, the ECB had created a new programme for purchasing government bonds of individual Member States, the so-called Transmission Protection

Instrument (TPI), with which it intends to counter any undesirable increases in the spreads on bonds issued by highly indebted Member States.

4. The surge in inflation since 2021 resulted in a lasting increase in the price level and a corresponding loss of purchasing power of more than 20 percent within three years (Figure 1).

Figure 1: Consumer Price Index for Germany



Consumer price index (CPI), Germany, level, monthly, 2019 Q4 = 100.

Source: German Federal Statistical Office; authors' calculations.

5. Expansionary monetary and fiscal policy during the COVID-19 pandemic contributed to this inflation, as did the energy price shock triggered by war and sanctions. The ECB responded far too late to the rise in inflation, particularly when compared with earlier inflationary episodes. When publishing its revised strategy in July 2021, it even announced that it intended to keep the policy rate at a negative level for an extended period and would tolerate a temporary, moderate overshooting of the 2 percent inflation target.

6. Against this background, the Kronberger Kreis examines the change in the ECB's strategy in 2021, as well as the review conducted in 2025 that, largely

reaffirmed this strategy. It is questionable whether the strategy is sufficiently focused on the objective of price stability in the future.

7. Since 2023, the inflation rate has fallen back close to the ECB's target of 2 percent. The European economy, however, is characterised by internationally, comparatively weak growth in potential output. The German economy in particular has been stagnating for years and remains in a structural crisis. Many Member States exhibit high debt-to-GDP ratios, and both debt ratios and interest expenditure are expected to rise further. France is currently the subject of critical observation by financial markets. In Germany, the easing of the debt brake and substantial planned spending on defence and public investment are expected to lead to a rapid increase in the government debt-to-GDP ratio. The Kronberger Kreis assesses the risks that rising public debt in the euro area poses to the stability of the euro and the role of Germany as an anchor in this context.

8. In this regard, the institutions and rules of the monetary union are not sufficiently robust. Following the global financial crisis and the euro sovereign debt crisis, consolidation efforts were undertaken and several important reforms of the institutional framework were implemented. These measures, however, were insufficient in three respects. First, implementation remains incomplete in some areas, or reforms have been rolled back. Second, new instruments have in some cases been introduced that point in the wrong direction. Third, significant gaps in the regulatory framework still remain.

9. European fiscal rules, for instance, were initially strengthened but were not applied with sufficient rigour in some Member States. More recently, they have been reformed again, but with the result that they have become more complex, more flexible and less stringent and now exert even less of a disciplining effect on fiscal policy than before. The introduction of TPI further expanded the ECB's role as a crisis manager. By contrast, the European Stability Mechanism (ESM) still lacks sufficient instruments and sanctioning powers to implement structural adjustment programmes in the event of a sovereign debt crisis in Member States regardless of their size. Significant gaps in the regulatory framework remain because there is still no orderly mechanism for sovereign debt restructurings and the sovereign-bank nexus has not been broken.

10. Consequently, there is a risk that, in the event of excessive indebtedness and a debt crisis in a larger Member State, the ECB will have to shoulder the

main burden of support. This entails the risk of fiscally driven inflation. It is therefore urgently necessary to break the reform deadlock and make the euro fit for the future.

11. In June 2025, ECB President Christine Lagarde, in a widely noted contribution entitled “Europe’s ‘global euro’ moment”, discussed the “profound shift in the global order” and noted that even “the dominant role of the US dollar, the cornerstone of the system, is no longer certain” (Lagarde 2025). The high level of uncertainty, she argued, was harming the European economy, yet at the same time the current transformation also offered Europe opportunities to take greater control of its own future and for the euro to gain greater global significance.

12. In this context, the Kronberger Kreis examines the development of the euro’s global role and the conditions that are relevant for strengthening that role. In fact, the euro’s importance as a reserve currency declined during the euro sovereign debt crisis from 2010 to 2013 and has not significantly recovered since. The internationalisation of the euro is closely linked to the stability of the monetary union and the performance of the European economy. Member States whose economies are growing slowly or stagnating ought to prioritise structural reforms and systematic deregulation in order to facilitate growth-oriented structural change driven by technological innovation, free markets and competition. Catching up with the United States in terms of economic output per capita would help the EU preserve and expand its global importance. It would also help to create the basis for a stronger international role for the euro. Unresolved questions concerning liability and control in a monetary union whose Member States retain broad fiscal sovereignty would need to be settled before the euro can compete internationally with the US dollar. In this regard, the Kronberger Kreis proposes a series of measures aimed at the further development of the architecture of the monetary union.

2. In Brief: The Rules Governing the Supranational Euro

13. With the establishment of EMU, the independent, supranational ECB assumed responsibility for the common currency, the euro. More precisely, it is the Euro-system that determines the course of monetary policy in the monetary union. The national central banks are represented on the ECB Governing Council by their governors and presidents and participate in its decisions. In fact, the ECB Executive Board, comprising the ECB President, the Vice-President and four other members, accounts for only a minority of the Council's membership. Furthermore, the national central banks also play a pivotal role in implementing the policies adopted and analysing the effects of these policies. They contribute national expertise to the decision-making process.

14. According to the EU Treaties, the ECB's primary objective is to maintain price stability in the euro area. Without prejudice to the objective of price stability, the ECB is also to support the general economic policies in the EU in order to contribute to the objectives of the Union. The ECB's independence is enshrined in the EU Treaties. This makes it formally the most independent central bank, insofar as the pertinent provisions can be amended solely by unanimous agreement among the Member States. In comparison, the legislation governing the US Federal Reserve can be amended by a simple majority in Congress.[1] This was also the case with regard to the Deutsche Bundesbank during the period in which the Deutsche Mark was in circulation.

15. The ECB itself determines how the objective of price stability is to be implemented. As part of its strategy, it has defined its objective as stabilising the rate of increase in the Harmonised Index of Consumer Prices (HICP) at 2 percent over the medium term. Monetary policy serves to achieve this objective. The central bank influences money market interest rates so that inflation settles at around 2 percent over the medium term.

16. Because of the interactions between monetary and fiscal policy, the central bank cannot by itself ensure price stability under all circumstances. This requires public finances to be sustainable and national governments to ensure

1 Strictly speaking, a majority of 60 out of 100 votes is required in the US Senate to overcome a filibuster, a tactic whereby a minority of senators can prevent the passage of legislation or a vote by prolonging debate.

that they remain so without resorting to any form of monetary financing. Fiscal rules were therefore introduced at the very beginning of the monetary union. The Member States, which retained broad sovereignty over fiscal policy, were expected to comply with these rules in order to limit the tendency towards government deficits (Kronberger Kreis 2012, 2023). A no-bailout clause was also introduced to reinforce national responsibility for fiscal policy. Over the years, the fiscal rules were repeatedly amended, became more complex and were ultimately weakened (Kronberger Kreis 2023).

17. In response to the recession triggered by the global financial crisis of 2008/09, interest rates were lowered to close to 0 percent and new monetary policy instruments were deployed. In particular, the quantity of central bank money was expanded substantially by means of large-scale asset purchases and longer-term as well as targeted liquidity operations with banks (Kronberger Kreis 2016, 2021, 2022). This resulted in a quantitative easing of monetary policy beyond reductions in interest rates.

18. In response to the shortcomings in banking regulation and supervision that were exposed prior to the financial crisis, European banking regulation was strengthened through stricter capital and liquidity requirements, the ECB was assigned responsibilities for micro- and macroprudential supervision, the banking union was established, and a Single Resolution Mechanism and Single Resolution Fund were created (Kronberger Kreis 2011, 2015).

19. European fiscal rules were initially strengthened and additional rules were implemented. Following various rescue programmes, the European Stability Mechanism (ESM) was established to oversee the management of fiscal crises and, when deemed necessary, to provide assistance, contingent upon the fulfilment of specific criteria. In addition, new programmes for central bank intervention in sovereign bond markets were introduced. During the financial crisis, the ECB launched the Securities Markets Programme (SMP). This was followed in 2012 by the so-called Outright Monetary Transactions (OMT) and, most recently, in 2022, ahead of the start of monetary policy tightening, by the Transmission Protection Instrument (TPI). The latter stipulates that the ECB will intervene in instances where specific conditions are met, with the aim of curbing the escalation of risk premia on government bonds (Kronberger Kreis 2022).

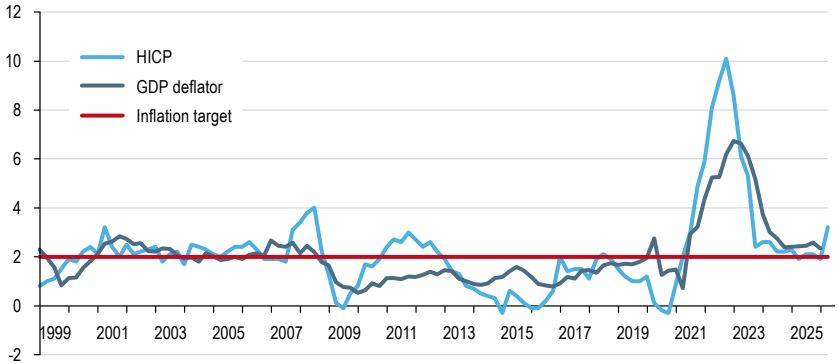
3. Is Monetary Policy Sufficiently Focused on Price Stability?

20. The ECB has committed itself to reviewing its monetary policy strategy regularly at five-year intervals. Most recently, a major review was conducted in 2020/2021, resulting in several changes to the strategy.[2] In 2025, a more narrowly focused review was carried out, which largely reaffirmed the 2021 strategy.

Inflation Developments to Date

21. Post-2020 developments have been marked by high inflation. At its peak, the inflation rate, as measured by the Harmonised Index of Consumer Prices (HICP), exceeded 10 percent. A comparison with inflation developments since 1999 demonstrates the exceptional nature of the years from 2021 to 2023 (Figure 2).

Figure 2: Inflation Developments in the Euro Area since 1999



Inflation target: HICP initially below 2 percent; from 2003, below but close to 2 percent; from 2021, 2 percent over the medium term. The chart shows 2 percent.

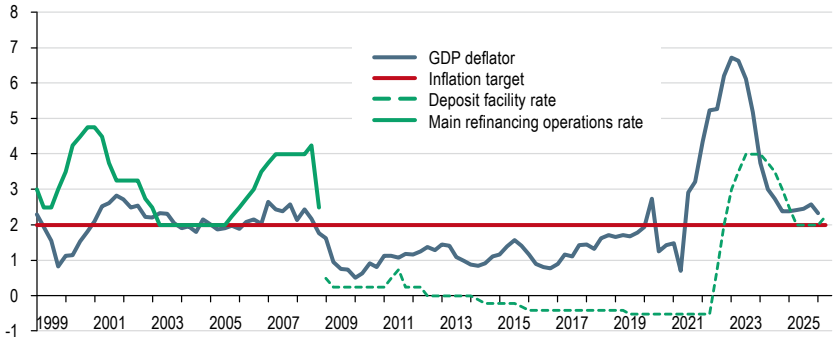
Sources: Eurostat, ECB.

2 Ahead of the 2021 review, the Kronberger Kreis had already published a comprehensive study containing a series of recommendations (see Kronberger Kreis 2021).

22. It is instructive to compare consumer price inflation, which is subject to particularly large fluctuations due to import and energy prices, with the GDP deflator, which is the broadest measure of domestic inflation. It encompasses the prices of all goods and services produced domestically, including capital goods and the government sector, but excludes imports.

23. Three periods can be distinguished. Until the onset of the financial crisis in 2007, the ECB was very successful in stabilising inflation close to 2 percent, whether measured by consumer prices or by domestic inflation. Initially, the ECB had set a target of below 2 percent (i.e. a range of 0 to 2 percent). In its first strategy review in 2003, this was refined to below but close to 2 percent. Inflation declined during the recession of 2008/09. Over the following ten years, it averaged close to 1 percent. While domestic inflation gradually rose to close to 2 percent by 2019, consumer price inflation fluctuated markedly due to changes in import prices (Wieland 2021). The third phase commenced with the rise of inflation in 2021.

Figure 3: Policy Interest Rate and Inflation in the Euro Area since 1999



Inflation target: HICP initially below 2 percent; from 2003, below but close to 2 percent; from 2021, 2 percent over the medium term. The chart shows 2 percent. Policy rate: With the switch to full allotment, the deposit facility rate replaced the main refinancing operations rate as the market-relevant policy rate.

Sources: Eurostat, ECB.

The Taylor Principle

24. Figure 3 illustrates how the ECB's interest rate policy has changed over time. It shows the relevant policy rate at each point in time[3] together with domestic inflation. In the years preceding the financial crisis, the ECB consistently raised the policy rate swiftly whenever inflation threatened to rise above 2 percent. Consequently, it was able to keep the inflation rate fairly close to 2 percent.

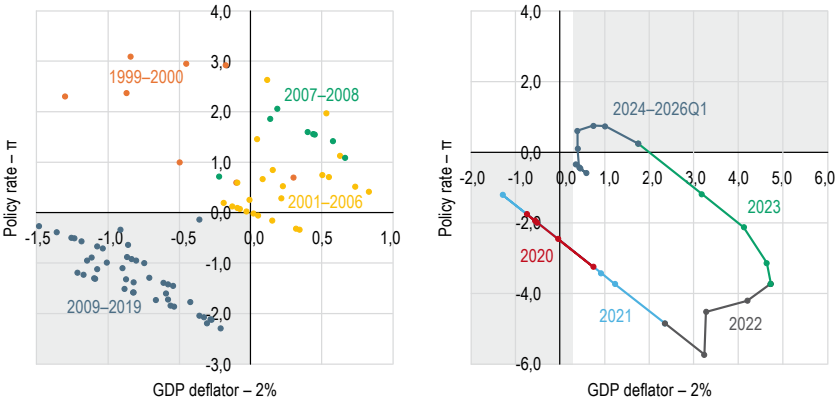
25. In the years following the financial crisis, when inflation was significantly below the stipulated target, the ECB lowered the policy rate and kept it well below the inflation rate. In doing so, the ECB Governing Council implemented the so-called Taylor principle from 1999 to 2019. It sought to stabilise inflation by adjusting the nominal policy rate by more than one-for-one in response to deviations of inflation from its target. As a result, the real interest rate, i.e. the nominal interest rate minus the inflation rate, was positive when inflation was close to or above target and negative when inflation was below target. This can readily be seen in the left-hand panel of Figure 4. Prior to the financial crisis, the points are concentrated mainly in the upper-right quadrant. However, following the recession and the subsequent period of low inflation, there was a shift in concentration to the lower-left quadrant.

26. However, in 2021 and 2022 the ECB abruptly departed from this principle. It allowed the real interest rate to fall as inflation rose.[4] Monetary policy thus amplified inflation instead of restraining it. The low real interest rate supported aggregate demand and thereby gave firms additional scope to pass higher costs on to customers through higher prices. The unusual response of the ECB Governing Council in those years, compared with that of earlier Governing Councils, is particularly evident in the right-hand panel of Figure 4, where the trajectory extends far into the lower-right quadrant. In fact, under its new strategy, the ECB had even announced that it intended to keep interest rates negative for an extended period and

3 Following the switch to full allotment in central bank refinancing operations, the policy rate relevant for monetary policy changed in 2008 from the ECB's main refinancing operations rate to the deposit facility rate.

4 The ECB was not alone in pursuing this approach. Like the ECB, the US Federal Reserve also departed from the Taylor principle. In this way, accommodative monetary policy amplified the inflationary surge (Tatar and Wieland 2024, Wieland 2024, Bordo, Cochrane and Taylor 2024).

Figure 4: Real Interest Rate versus Inflation Gap



Real interest rate: policy rate (as in Figure 3) minus inflation as measured by the GDP deflator. Inflation gap: inflation as measured by the GDP deflator minus the 2 percent target.

Sources: Eurostat, ECB, Hegemann and Wieland (2025a).

would accept a temporary, moderate rise in inflation above the target rate:[5]

> *[…] the Governing Council today revised its forward guidance on interest rates. It did so to underline our commitment to maintain a persistently accommodative monetary policy stance to meet its inflation target.*
>
> *In support of its symmetric two per cent inflation target and in line with its monetary policy strategy, the Governing Council expects the key ECB interest rates to remain at their present or lower levels until it sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with*

5 In a press interview, ECB President Christine Lagarde subsequently expressed regret at having placed so much weight on this guidance in the ECB's communication: "'But what I regret personally is to have felt bound by our forward guidance,' she adds, referring to the commitment the ECB had given not to start raising interest rates until it had stopped buying billions of euros in mostly government debt, which it did slowly over the first six months of 2022. 'I should have been bolder. (…) But what we should have learned is that we cannot just rely only on textbook cases and pure models. We have to think with a broader horizon.'" Financial Times, October 27, 2023.

inflation stabilising at two per cent over the medium term. This may also imply a transitory period in which inflation is moderately above target.

27. From the perspective of the *Star Trek* series, the ECB Governing Council followed the mission "To boldly go, where no man has gone before" and explored a "space quadrant" it would have been better not to visit. In other words, the central bank responded far too late, with its first interest rate increases coming only in the summer of 2022. In 2023, it eventually raised the policy rate rapidly to around 4 percent. Concurrently, the tightening of monetary policy resulted in significant turbulence within the banking system in the spring of 2023. By 2024, the ex post real interest rate was once again above the inflation gap, as can be seen in the right-hand panel of Figure 4. Most recently, however, the ex post real interest rate calculated in this way has turned slightly negative again, i.e., domestic inflation remains above the policy rate of 2 percent.

28. The Taylor principle would have called for a different approach, with earlier and possibly more gradual interest rate increases spread over a longer period. This would have afforded the financial sector more time to adapt to the elevated level of interest rates. So-called Taylor rules for policy rates, which consider both the inflation gap and the output gap as indicators of the state of the economy, have been shown to provide reliable real-time warning signals indicating the need to tighten monetary policy as early as 2021.[6] Against this backdrop, the recent interest rate increase in June 2026 was overdue, and further rate increases are likely to be necessary.

29. In its study on the ECB's 2021 strategy review, the Kronberger Kreis had already recommended that the ECB pay greater attention to the Taylor principle and use Taylor rules in communicating its strategy. Another reason for this recommendation was the Federal Constitutional Court's (2020) requirement of proportionality in the use of monetary policy instruments, since Taylor rules imply a proportional monetary policy response to inflation developments. At the time, the Kronberger Kreis had also taken the rapid increase in

6 See, for example, Tatar and Wieland (2025) and Hegemann and Wieland (2025a).

money growth observed in 2020 as grounds for warning of possible stagflation.[7] This subsequently materialised, particularly in Germany.

30. Many economies, including the United States, experienced a similar development in the aftermath of the global pandemic and the subsequent energy crisis that followed Russia's invasion of Ukraine. However, the findings of empirical studies suggest, that this development cannot be attributed solely to Putin and his war, but that the prolonged expansionary monetary and fiscal policies also made a significant contribution.[8]

31. The Kronberger Kreis therefore reiterates its recommendation that greater weight should be given to price stability in the monetary policy strategy by paying closer attention to the Taylor principle, using Taylor rules in the communication of the monetary policy strategy, and taking signals from monetary and credit developments more seriously.

7 Kronberger Kreis (2021), pp. 51-52: "However, developments in the wake of the coronavirus crisis point in a different direction. The growth rate of the money supply has risen sharply and has been around ten percent since the second quarter of 2020, a level last reached just before the financial crisis (Figure 3). In contrast to the development before the financial crisis, the increase in money growth this time is related in particular to a strong increase in public sector credit. If this high money growth continues, it will give rise to risks of higher inflation or even stagflation in the medium term."

8 The analyses by Barro and Bianchi (2026), Giannone and Primiceri (2024), and Ascari et al. (2024), for example, show that inflation was not triggered solely by Russia's war against Ukraine and the ensuing energy crisis. Rather, in these analyses, demand-side impulses, in particular monetary and fiscal policy as well as government financing, play at least a similarly important role in the inflationary surge.

4. Are the Institutions of the Monetary Union Fit for the Future?

32. Monetary and fiscal policy are closely interrelated. In particular, the sustainability of public finances is an essential prerequisite for price stability, with sustainability ensured through fiscal instruments rather than through any form of monetary financing.

The Risk of Fiscally Driven Inflation

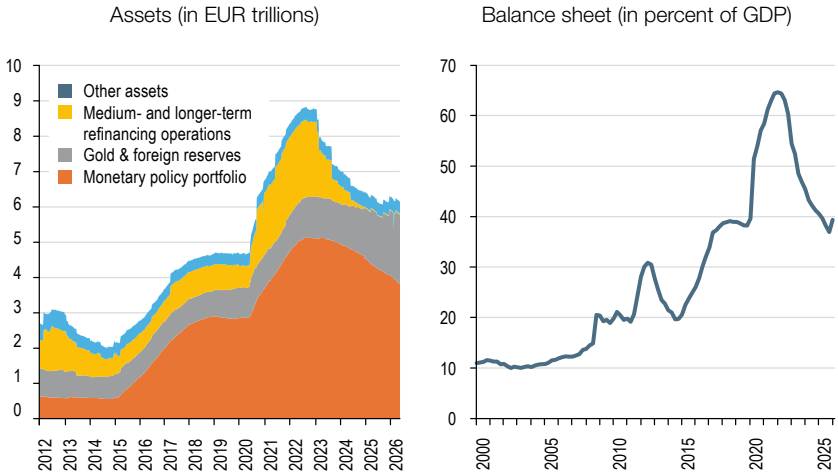
33. A number of channels have been identified though which fiscal policy may drive inflation. One is the standard Keynesian mechanism: expansionary fiscal policy increases aggregate demand relative to the supply of goods and services. This enables firms to increase prices, to enter into higher wage agreements, and to pass these higher costs again on to their final customers. Government borrowing creates demand for savings, requiring real interest rates to rise. The central bank must raise policy rates to bring them into line with the higher real interest rate, and sufficiently above it to restrain aggregate demand and stabilise inflation again.

34. It is evident that there are further links between fiscal policy, monetary policy and inflation because monetary policy has fiscal implications. The creation of money by a central bank generates seigniorage revenue for the government, inflation acts as a tax on monetary wealth, an (unexpected) increase in the price level reduces the real, purchasing-power-adjusted value of debt, and monetary policy affects government bond yields and spreads. Higher debt can therefore lead to higher inflation, either because inflation expectations rise in anticipation of future monetary policy easing or because the resulting increase in the price level itself reduces the real value of outstanding debt.

35. The fiscal implications of monetary policy measures are particularly evident in changes in the central bank balance sheet. Quantitative easing through purchases of government bonds and other securities led to substantial holdings on the ECB's balance sheet (see Figure 5). In doing so, the ECB reduced the supply of government bonds in the market and increased the amount of central bank money held in banks' accounts. Through quantitative easing, it sought to induce portfolio shifts, raise securities prices and other

asset prices, reduce risk premia and thereby increase aggregate demand and the inflation rate.[9] The fiscal implications include lower yields on government bonds. The decline in the ECB's balance sheet to date has been driven primarily by changes in the terms of longer-term refinancing operations and repayments by banks (Figure 5).

Figure 5: Developments in the ECB Balance Sheet and Securities Holdings



Source: ECB, Eurostat.

36. With programmes such as OMT and TPI, the ECB has also positioned itself to use targeted interventions to limit the yields on individual countries' government bonds when they reach a level it considers inappropriate. On the

9 Quantitative easing in the form of balance-sheet expansion when policy rates are close to 0 percent is a sensible approach when a deflationary development is expected (see Kronberger Kreis 2021). This strategy, implemented during the financial crisis, had already been developed in research in light of developments in Japan in the late 1990s (see Orphanides and Wieland 2000). It should, however, be regarded as a crisis instrument. The balance sheet should therefore be reduced swiftly after the exit from the low-interest-rate policy in order to restore room for manoeuvre in possible future crises.

one hand, the ECB has already had a limiting effect simply by announcing these programmes. On the other hand, there is a risk that governments may refrain from politically unattractive consolidation measures and instead hope for ECB intervention. This applies in particular to TPI, which, unlike the OMT programme established in the midst of the euro crisis, is not tied to the consolidation and reform conditions of an ESM stabilisation programme.

37. There are many historical examples of fiscally induced inflation (Bordo and Levy 2021, Hegemann and Wieland 2026). In particular, budget deficits have frequently led to persistent inflation when they were financed through money creation and were not backed by future tax increases or government spending cuts. High budget deficits, however, do not necessarily result in higher inflation rates. Their effects depend on the independence and credibility of monetary policy, the effectiveness of fiscal rules and the degree of economic slack. High and rising government debt nevertheless increases the risk of fiscally induced inflation. The inflation expectations of participants in financial, goods or labour markets may be based on the expectation of a delayed monetary policy response. Budget deficits and rising government debt can therefore lead to inflation even if the central bank is independent and committed to price stability.

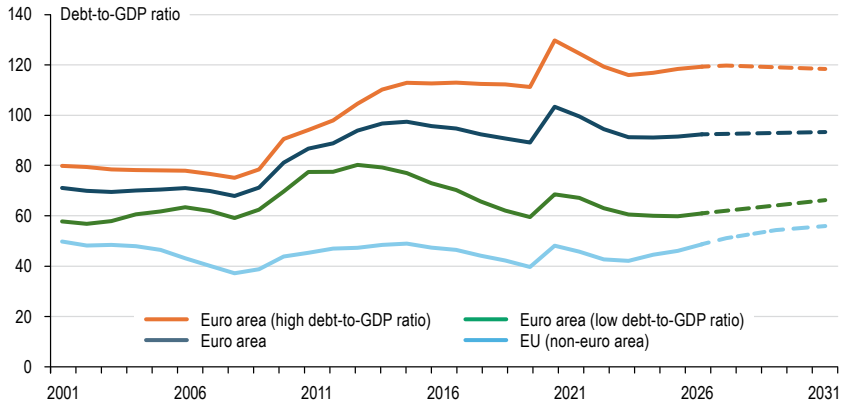
38. In this context, developments in deficits and government debt are a cause for concern. On average, the fiscal position in the euro area still appears to be manageable, when compared with that of the United States. For the euro area, a budget deficit of just over 3 percent of GDP is expected in the years up to 2029 (IMF 2026), while the figure for the United States is likely to be around 7.5 percent of GDP. According to projections, the US government debt-to-GDP ratio will quickly rise above its 2020 peak of 130 percent. In February 2026, Philip Swagel, Director of the Congressional Budget Office, stated: “Our budget projections continue to indicate that the fiscal trajectory is not sustainable.”[10] This could cause a further rise in inflation, which could in turn spill over to the euro area.

39. In addition, developments within the euro area are characterised by significant heterogeneity, and upon closer inspection, entail significant medium-term risks in many Member States (European Commission 2025). Among

10 Director’s Statement on the Budget and Economic Outlook for 2026 to 2036, https://www.cbo.gov/publication/62050.

the major economies, the IMF projects the largest increases in the debt-to-GDP ratio for France and Germany. In Italy, where the ratio is already considerably higher, it is expected to remain at a persistently high level, while in Spain it is projected to decline owing to a higher growth rate. To assess whether a higher debt-to-GDP ratio leads to greater fiscal consolidation, we divide the countries into two groups: those with a debt ratio above 90 percent and those with a ratio below 90 percent. It emerges that highly indebted countries have, on average, not reduced their debt ratios since the euro sovereign debt crisis of 2011/12 (Figure 6). The average debt-to-GDP ratio for the euro area declined after the financial and euro sovereign debt crises mainly because Member States with lower debt ratios, in particular Germany and the Netherlands, consolidated their public finances, supported by economic growth. Moreover, IMF projections indicate that the debt ratios of both groups are likely to rise in the future. This applies not least to EU Member States that do not use the euro and have so far had lower debt ratios.

Figure 6: Developments and Projections for Government Debt-to-GDP Ratios in the EU

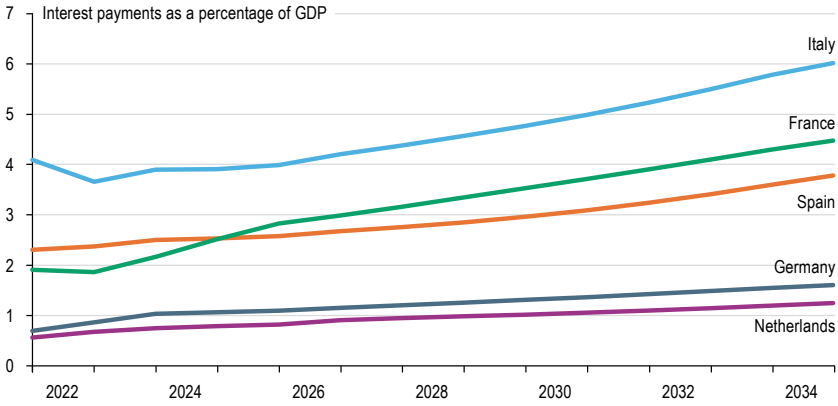


Quelle: IMF, Wieland (2024), authors' calculations.

40. Debt dynamics could deteriorate significantly if real interest rates remain positive, since they depend on the difference between the interest rate and

economic growth. If nominal interest rates exceed nominal growth, an adverse snowball effect arises. In an environment of heightened uncertainty about future economic growth and rising government interest expenditure, fiscal trends can therefore deteriorate rapidly. Countries with high debt-to-GDP ratios are particularly vulnerable if they are hit by adverse shocks, such as the current energy crisis. Figure 7 shows that projections for interest expenditure as a share of GDP point clearly upwards in the large Member States of the monetary union.

Figure 7: Interest Expenditure in Selected Member States



Source: European Commission (2025).

Free-Riding and the Dilemma of Fiscally Sound Member States

41. In the course of the most recent reform of the EU fiscal rules, uniform numerical rules were replaced by country-specific expenditure paths based on debt sustainability analyses. These depend heavily on assumptions about growth and interest rates and therefore also on monetary policy. Furthermore, there are incentives to employ overly optimistic assumptions. This undermines the credibility of the fiscal rules (see Kronberger Kreis 2023, Wieland 2024, Scientific Advisory Board at the Federal Ministry of Finance 2025).

42. Rising debt-to-GDP ratios could increase risk premia on government bonds. Moreover, the increase in Germany's debt-to-GDP ratio is likely to raise the general level of real interest rates in the euro area. Germany has been regarded as the fiscal anchor of the monetary union for decades. During the European sovereign debt crisis, it provided a safe haven and fiscal support for the new stabilisation mechanism and the assistance programmes. Following the European debt crisis, Germany's reformed debt brake helped to reduce the debt-to-GDP ratio (e.g. Langer et al. 2025, Scientific Advisory Board at the Federal Ministry of Finance 2025). Germany's borrowing capacity and that of other low-debt Member States, combined with possible fiscal transfers to less fiscally sound states, as well as the expectation of possible ECB interventions in future crises, are likely to have kept the yield spreads of highly indebted Member States lower than would otherwise have been the case (Altavilla et al. 2014, Falagiarda and Reitz 2015, Krishnamurthy et al. 2018).

43. Chien et al. (2025) conducted a study that sought to quantify the transfers resulting from the expansion of national central bank balance sheets. The increase in the Euro-system's aggregate balance sheet is largely attributable to the expansion of the balance sheets of the national central banks, which carry out most of the bond purchases. These bond purchases are financed predominantly through the issuance of bank reserves in the core countries, while their central banks build up claims on the central banks of the peripheral countries via the so-called TARGET2 system. This is part of a single monetary policy. It means, however, that the Deutsche Bundesbank, for example, financed its balance-sheet expansion mainly through the issuance of bank reserves, whereas the Banca d'Italia did so through the issuance of TARGET2 liabilities.

44. According to Chien et al. (2025), exchanging marketable assets, such as government bonds, for non-marketable assets, such as reserves or TARGET2 claims, inevitably gives rise to transfers. Some market participants obtain financing below market interest rates and thereby receive transfers, while others incur costs above market rates. Chien et al. (2025) estimate that between 2004 and 2023 this resulted in cross-border transfers from Germany to other countries equivalent to 10.9 percent of its GDP, while Italy and Spain received cross-border subsidies equivalent to 5.7 percent and 7.5 percent of their GDP, respectively. These transfers, however, benefited taxpayers in those countries only in part, another part accrued to their banks.

45. Member States that are financially stable find themselves confronted with a strategic dilemma (Kronberger Kreis 2023). They safeguard the stability of the monetary union and implicitly provide stabilising transfers through the ECB's balance sheet. As a result, more highly indebted Member States have little or no incentive to consolidate their public finances. They may even seek to loosen the EU fiscal rules. Ultimately, such an arrangement would mean that fiscally sounder states either use their capacity to assume liabilities to support additional common debt or accept an inflationary policy. The latter, however, is inconsistent with the objectives of the monetary union and would destroy trust in the euro. To make the monetary union fit for the future, it is therefore urgently needed to close the gaps in the regulatory framework that foster these adverse incentives and free-riding.

The Sovereign-Bank Nexus and the Risk of Financial Dominance

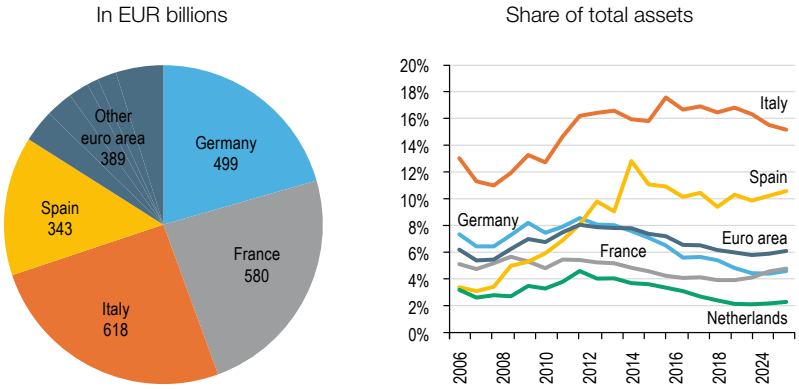
46. There is also a potential link between banking and financial stability, on the one hand, and monetary and fiscal policy, on the other. Though considerable progress has been made since the financial crisis with regard to banks' capital ratios, particularly risk-weighted capital ratios. Moreover, despite turmoil in the banking system, the ECB managed to raise policy rates rapidly in 2023, whereas this tightening of monetary policy should have begun earlier. A degree of fragility nevertheless remains, which may allow for persistent incentives to delay monetary policy tightening, refrain from curbing asset price booms and take fiscal risks.

47. In particular, the sovereign-bank nexus persists. European banks invest disproportionately in domestic government bonds. European governments, in turn, tend to intervene with fiscal support when domestic banks come under threat. The sovereign-bank nexus describes a self-reinforcing risk loop in which banks hold large amounts of their own sovereign's bonds, so that bank failures place a burden on the government budget while, conversely, the condition of public finances can endanger the stability of banks.

48. This nexus is reinforced by the regulatory privileges of government bonds and constitutes a key stability risk in the euro area. This is evident, among other things, from the fact that banks remain heavily exposed to their own sovereign through large holdings of government bonds or public-sector loans. Figure 8 shows these exposures both in absolute terms and as a share of total assets. This gives rise to a risk of financial dominance, i.e., central banks

face an incentive to postpone monetary policy tightening because it would have adverse effects on the stability of an undercapitalised banking system and could also trigger fiscal risks through the sovereign-bank nexus.

Figure 8: Continued High Bank Exposures to Their Own Sovereigns



Source: ECB.

49. In view of the risks and adverse incentives discussed above, the architecture of the monetary union continues to exhibit significant gaps. In certain domains, such as the efficacy of the fiscal rules and the ECB's willingness to intervene, it has moreover been further weakened in recent years. The ECB is being pushed even more than before into the role of crisis manager, a role it cannot fulfill.

Gaps in the Regulatory Framework and the Necessary Reform Agenda

50. The gaps in the regulatory framework can be illustrated by comparing the status quo described in Section 2 with the proposals put forward by the Kronberger Kreis (2011, 2012) and by the German Council of Economic Experts (Feld et al. 2016a, 2016b; German Council of Economic Experts 2013, 2014, 2015a, 2015b, 2019) to which members of the Kronberger Kreis contributed.

Figure 9 illustrates the corresponding concept of a fully developed institutional framework for a monetary union of Member States retaining broad fiscal sovereignty.

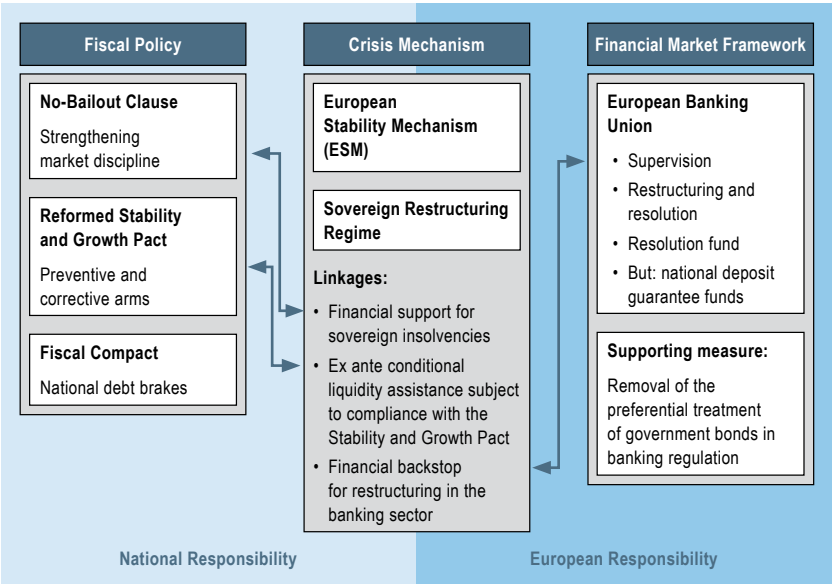
51. This concept for the architecture of the monetary union, a "Maastricht 2.0", so to speak, combines the imperatives of crisis prevention and management. It consists of three pillars, differentiated according to the degree to which responsibility is assigned to the European level. The guiding principle is to preserve the alignment of liability and control. The framework is intended to address two fundamental weaknesses that became apparent during the financial and euro crises: insufficient economic and fiscal policy discipline, exacerbated by dysfunctional sanction mechanisms and inadequate financial market regulation and supervision. Furthermore, there was no credible crisis-response mechanism for banking and sovereign debt problems that could contain moral hazard and ensure market discipline.

52. The proposed framework is intended to promote economic and fiscal policy discipline, with a view to preventing excessive increases in public and private debt and effectively reducing moral hazard in both the public and private sectors.

53. Although many of the reforms introduced after the European sovereign debt crisis were broadly aligned with this approach, important gaps remain. A credible sovereign restructuring mechanism would be needed to create strong incentives for governments to pursue forward-looking policies aimed at ensuring sustainable public finances and to enable an effective response in the event of a crisis. Instead, the fiscal rules have recently been loosened considerably. In addition, the institutional framework calls for the gradual removal of the privileges of government bonds in banking regulation. This is still missing, and consequently the potentially crisis-inducing interdependence between sovereigns and banks in the euro area persists.

54. The objective of this proposal is to relieve the ECB of its role as crisis manager. Instead, the ECB has further expanded this role, most recently through its Transmission Protection Instrument (TPI) for government bond purchases. TPI goes beyond the OMT programme established during the crisis because it removes the requirement of a conditional ESM programme as a prerequisite for large-scale ECB interventions in sovereign bond markets in support of individual financially weak Member States.

Figure 9: A Stable Institutional Framework: Maastricht 2.0



Source: German Council of Economic Experts (2013).

55. By contrast, under the proposed institutional framework, national governments will continue to bear full responsibility for their respective budgets. This ensures that private creditors bear the consequences of fiscal policy mistakes. The ESM serves as a conditional fiscal backstop and provides targeted support only with the consent of the other Member States and within the framework of strict reform programmes. A debt restructuring regime with predefined creditor participation reduces uncertainty in the event of financial crises and removes the market expectation that the ECB will intervene as a permanent crisis manager. These elements are intended to break the cycle of moral hazard and restore market discipline, allowing the ECB to focus on its core monetary policy mandate rather than on emergency interventions in crisis situations.

Address Moral Hazard or Advance Common Borrowing?

56. Cochrane, Garicano and Masuch (2025) present a comprehensive overview of the historical progression and institutional development of the euro. Their study also concludes that the eurozone's institutional framework is inadequate to meet future challenges.They criticize the current course, arguing that it is leading to a crisis. Similar to the Kronberger Kreis and the German Council of Economic Experts in its earlier composition, they conclude that, in a monetary union without a corresponding fiscal union, overindebted Member States must be allowed to default, just as private companies can. If, by contrast, the central bank repeatedly intervenes to prevent sovereign default or suppress bond yields, Member States lose the incentive to maintain fiscal discipline, inevitably leading to repeated interventions and recurring inflationary pressures. The primary issue that therefore needs to be addressed is the so-called moral hazard, i.e., the risk of misconduct. The incentives that give rise to such misconduct need to be eliminated. Like the Kronberger Kreis, Cochrane, Garicano and Masuch (2025) propose a series of reforms based on establishing a framework for orderly sovereign insolvency and debt restructuring.

57. Other proposals move in the opposite direction. Calls have once again been made for the introduction of so-called Eurobonds. These would be common debt instruments that entail joint and several liability, or at least create the impression that such guarantees exist for Member States' debt. Blanchard and Ubide (2025), for example, propose replacing a substantial share of national bonds with Eurobonds, amounting to at least 25 percent of national bond issuance. The aim of this exchange would be to create a deeper and more liquid Eurobond market. According to Blanchard and Ubide (2025), this would help Europe's financial ecosystem compete with that of the United States. In their view, the central problem is the absence of a sufficiently large market for European government bonds. Blanchard and Ubide (2025) expect this approach to provide all Member States with more favourable financing conditions. To this end, they regard a joint and several guarantee for these so-called blue bonds as the ideal solution. If this were not feasible, they advocate public backing through the direct allocation of a share of value-added tax revenues.

58. However, there is reason to fear that common guarantees for the debt of highly indebted Member States would raise rather than lower the yields of low-debt Member States such as Germany and the Netherlands (see Hegemann

and Wieland 2025a). Presently, merely three of the twenty euro-area Member States, together accounting for approximately 21 percent of outstanding government debt, have an AAA rating indicative of safe-asset status. If Eurobonds weaken incentives for fiscal discipline in these countries, it becomes questionable whether Eurobonds could in fact be regarded as safe assets. Proposals for Eurobonds disregard problems of moral hazard and asymmetric information, as well as the resulting adverse incentives that are central to modern financial economics and political economy. In contrast, proposals such as those advanced by the Kronberger Kreis, the German Council of Economic Experts in its earlier composition, and Cochrane, Garicano and Masuch (2025) address these challenges directly.

5. Will the Euro Soon Play a Greater International Role?

59. The aforementioned advantage that US government financing may enjoy as a result of the deep and liquid market for US Treasury securities is closely linked to the role of the US dollar as an international reserve currency. International demand for US Treasury securities leads foreign investors to accumulate increasing amounts of claims denominated in US dollars. This allows the United States to finance a larger current account deficit on a sustained basis. At the same time, it enables the US government to benefit from lower financing costs. This phenomenon is also referred to as the "exorbitant privilege" arising from the role of the US dollar as an international reserve currency.

Government Financing and Reserve Currency Status

60. Jiang et al. (2026) estimate that the loss of this "exorbitant privilege" would be equivalent to an increase of just under 90 basis points in US borrowing costs. They put the present value of this advantage at USD 33 trillion. Another empirical study by Gomez-Cram et al. (2026), co-authored by one of the authors of Jiang et al. (2026), concludes that the United States has already exhausted this privilege. According to their portfolio calculations, market participants have no longer regarded US Treasury securities as safe since the increase in government debt associated with efforts to mitigate the effects of the COVID-19 pandemic. They reach this conclusion because, according to their calculations, US Treasury securities are no longer favourably priced relative to AAA-rated corporate bonds or foreign government bonds, particularly German Bunds.

61. Alongside the disruptions in the international trade and financial systems caused by the tariff war initiated by the Trump administration, observers and ECB representatives have identified opportunities for the euro to play a greater international role. In a widely noted blog post in June 2025, ECB President Christine Lagarde stated:

> *„We are witnessing a profound shift in the global order (…). But the shift under way also offers opportunities for Europe to take greater control of its own destiny and for the euro to gain global prominence. At present, the euro is the world's second most-used currency, accounting for 20 percent*

of global foreign exchange reserves, compared with 58 percent for the US dollar. Increasing the euro's global status would bring tangible benefits: lower borrowing costs, reduced exposure to currency fluctuations and insulation from sanctions and coercive measures."

62. When it was introduced, the euro essentially inherited the international reach of the Deutsche Mark. The ECB retained the Deutsche Bundesbank's neutral stance towards the international role of its currency and did not actively promote it. At the beginning of the euro era, its first President, Willem Duisenberg, stated that it was best to leave its (international) development to market forces (Duisenberg 1999). Several years ago, however, a shift towards more active promotion of the euro's international role took place. The European Commission had advocated such a policy, and ECB representatives adopted the same position. The 2019 report on the international role of the euro (ECB 2019) already marked a change in the ECB's stance towards actively promoting the euro's international role.

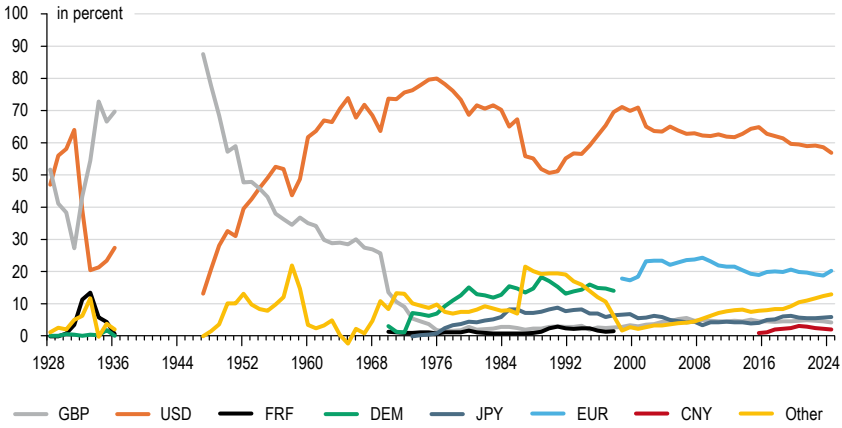
63. In this context, it is important to examine whether the euro has made progress, whether the importance of the US dollar has declined, and what implications this has for the key questions concerning whether the euro is fit for the future: namely, whether priority should be given to creating deep markets through common bonds or to eliminating adverse incentives and moral hazard.

64. Figure 10 shows the development of international reserve currencies since 1928. After the First World War, the British pound began to lose importance. Following the Second World War, the US dollar increasingly assumed the role of the leading international reserve currency. This creates structural demand for US-dollar-denominated securities in international financial markets. Since the late 1950s, around 60 to 70 percent of international reserves have been held in US dollars. The dollar is frequently held in the form of US Treasury securities. After declining to 50 percent in the 1980s, the dollar's share recovered and stabilised between 60 and 70 percent. Most recently, it stood at 58 percent.

65. Between the mid-1970s and the end of the 1990s, the Deutsche Mark had a certain degree of regional importance as a reserve currency, accounting for a share of between 10 and 20 percent. The French franc, the British pound and the Japanese yen had considerably smaller shares. With the

introduction of the euro, the European single currency inherited the importance of its predecessor currencies as international reserve currencies. In the 2000s, its share exceeded 25 percent, but subsequently fell to 20 percent and has remained at that level ever since.

Figure 10: The US Dollar Dominates as an International Reserve Currency



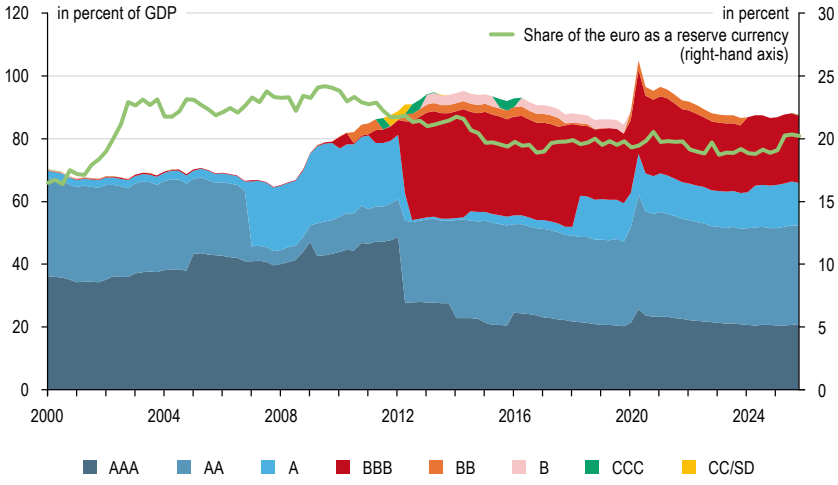
Source: IMF, Eichengreen and Flandreau (2009), Hegemann and Wieland (2025b).

66. The international importance of a currency depends, not least, on the perceived fiscal stability of the issuing country. Weak public finances undermine confidence and limit a currency's potential as a reserve currency. This is a key reason why, over the past year, many observers have come to believe that the US dollar could lose some of its international appeal. The Trump administration's aggressive tariff policy, talk of "taxing" foreign holders of US Treasury securities under a so-called Mar-a-Lago Accord, President Trump's repeated attacks on the Federal Reserve and its independence, and, not least, the prospect of a rapidly rising government debt-to-GDP ratio have raised doubts in financial markets. In particular, following the "Liberation Day" tariff announcements on 1 April 2025, the US dollar experienced capital outflows. In the meantime, however, the US dollar has once again proved to be a

safe haven, most recently during the US-Israeli war against Iran and the resulting energy price shock in the spring of 2026.

67. Doubts about US fiscal policy, however, do not automatically imply a greater international role for the euro or, as a consequence, more favourable financing conditions for the Member States of the monetary union. The relationship between a currency's international importance as a reserve currency and perceived fiscal stability has already had an adverse effect on the euro's international role in the past (Hegemann and Wieland 2025b). As the creditworthiness of several euro-area Member States deteriorated during the European sovereign debt crisis from 2010 to 2014, the euro's share of global reserves declined almost simultaneously (see Figure 11). The creditworthiness of euro-area governments is weaker today than it was before the euro crisis, and the euro's share as a reserve currency remains relatively low. In any event, it has so far failed to regain the share of international reserves it held in the second half of the 2000s.

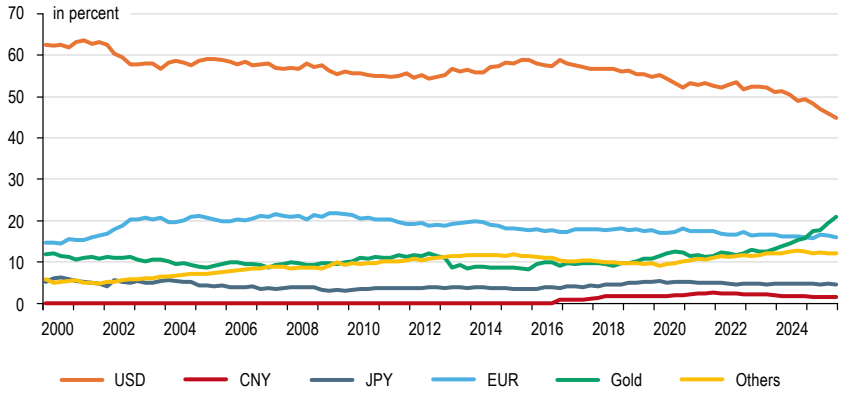
Figure 11: The Euro's Importance as a Reserve Currency Declined During the Sovereign Debt Crisis



Source: Bloomberg, ECB, Hegemann and Wieland (2025b).

68. Another factor affecting the attractiveness of US dollar reserves is the utilisation of financial sanctions by the United States and its allies. This contributes to a certain degree of fragmentation, for example through parallel payment systems and reserve holdings in non-traditional currencies and gold. Since the EU often imposes similar or even more far-reaching sanctions than the United States, the attractiveness of the euro is likely to be affected as well. Interestingly, however, the Chinese yuan has not benefited significantly from this as a reserve currency. Its role remains very limited. Given the substantial restrictions on capital movements, this is not surprising. Instead, countries have, in particular, increased their gold reserves. By now, if gold is included as a reserve asset, it is the second most important reserve asset, well ahead of the euro (see Figure 12).

Figure 12: The Importance of Gold as a Reserve Asset Has Increased



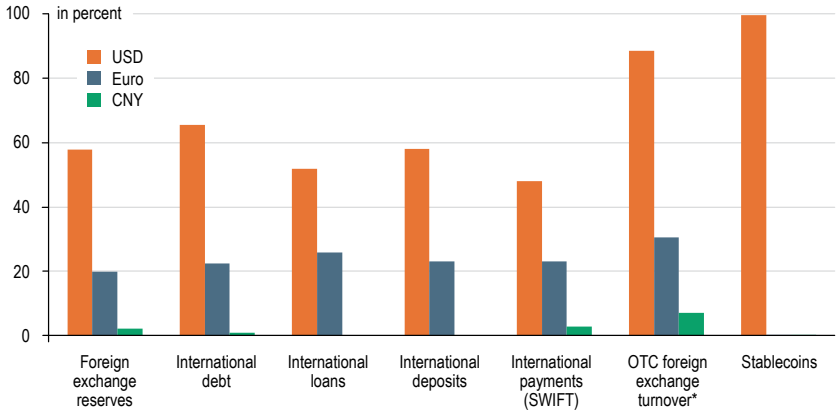
Source: IMF, Hegemann and Wieland (2025b).

69. Furthermore, there are a number of other factors and instruments that must be considered when assessing the international role of the US dollar. Figure 13 compares the importance of the US dollar, the euro and the yuan across a range of other instruments.

70. The US dollar accounts for 60 percent of foreign exchange reserves, yet

more than 60 percent of international debt instruments are denominated in US dollars, as are more than 50 percent of international loans. In addition, almost half of international payments via SWIFT and nearly 90 percent of over-the-counter foreign exchange transactions are conducted in US dollars. The US dollar also plays an even more important role in the world of cryptocurrencies that have emerged in recent years. It accounts for almost 100 percent of so-called stablecoins. These are privately issued cryptocurrencies whose value is fixed to a national central bank currency. Until now, these stablecoins have primarily served as on- and off-ramps to the world of cryptocurrencies. This encompasses a wide range of private, largely speculative and more or less money-like instruments based on blockchain technology.[11]

Figure 13: Importance of the US Dollar, the Euro and the Chinese Yuan across Different Instruments



*As each transaction in the foreign exchange market involves two currencies, the shares of turnover add up to 200 percent. The data on foreign exchange reserves refer to the end of 2024, the data on international debt to the fourth quarter of 2024, the data on international loans and deposits to the first quarter of 2025, the data on OTC foreign exchange turnover to 2022, and the data on stablecoins by market capitalisation to September 2025.

Source: IMF, ECB, BIS, SWIFT, Defillama and authors' calculations.

11 This technology is now used in a wide range of applications. It is a decentralised, tamper-resistant database. Data are stored in chronological blocks that are cryptographically linked to one another. Since all network participants maintain the same copy of the ledger, no central authority, such as a bank, is required.

71. Given these diverse international roles of the US dollar, significant network effects are likely to help ensure that the US dollar will not lose its considerable international importance any time soon.

Stablecoins, the Digital Euro and Eurobonds: Implications for Government Financing

72. The Trump administration's recent initiative concerning the international role of the dollar is the so-called "Guiding and Establishing National Innovation for U.S. Stablecoins" (GENIUS) Act of summer 2025. The White House uses exuberant language, describing it as a "historic piece of legislation" that would enable the United States to lead the global digital currency revolution to make the United States the "crypto capital of the world". The GENIUS Act, it argues, will "secure the US dollar's status as the global reserve currency. By boosting demand for US Treasury securities, stablecoins will play a crucial role in ensuring the continued global dominance of the US dollar as the world's reserve currency" (US Congress 2025).

73. Regardless of whether one considers this assessment appropriate, this does not sound like an administration intent on relinquishing the dominant international role of the US dollar. In fact, the approach taken by President Trump and his administration has some parallels with that of the Nixon administration. On the one hand, President Nixon ended the central role of the US dollar in the Bretton Woods system, which he regarded as too costly for the United States, and repeatedly exerted strong pressure on the Federal Reserve to keep interest rates low. On the other hand, he pursued initiatives that strengthened and expanded the international role of the US dollar in offshore markets, for example through the petrodollar agreements.

74. The Trump administration's stablecoin initiative has drawn strong criticism from certain observers because of concerns that private stablecoins pose risks to the stability of the financial system, among other reasons because issuers may not make adequate provision for crises of confidence. The corresponding MiCA regulation in the EU is considerably more cautious in its approach (Hegemann and Wieland 2025b).

75. In contrast to the approach of the US Federal Reserve, the ECB advocates the issuance of a central bank digital euro. It regards the digital euro as one of several elements of its strategy to give the euro a more prominent role.

Accordingly, it has developed a plan to issue digital euros for consumers and businesses. In doing so, it aims at strengthening the sovereignty of the monetary union and the role of the euro in transactions. The process has already advanced to the point where the EU is expected to establish the necessary legal framework in 2026, allowing the digital euro to be issued in 2029.

76. Indeed, the euro has long existed in digital form. Banks in Europe hold digital central bank money in the form of deposits with the central banking system. These amount to EUR 2,640 billion. Cash, by contrast, accounts for only one quarter of central bank money. Households and businesses hold private digital euros created within the banking system, including in the form of current account balances and savings deposits. These amount to just over EUR 15,600 billion (M3 excluding currency in circulation). Banks benefit from their large-scale role in creating money denominated in the official currency. Customer deposits are a comparatively inexpensive source of funding. So far, banks have successfully resisted competition from the digital euro, which would give all citizens access to central bank deposits.

77. According to the ECB's plans and the Commission's proposed regulation, the digital euro is to be issued by qualified entities, primarily credit institutions. To avoid adverse effects on the liquidity and profitability of the banking system as a result of large deposit outflows from banks, the ECB's plans envisage restrictions both on the range of users and on the amounts that may be held in individual accounts. Accordingly, holdings in an account are expected to be capped at around EUR 3,000, and the digital euro would not bear interest. The digital wallet would be linked to a bank account. A "waterfall mechanism" would ensure that any amount of a payment exceeding this limit is covered through conventional accounts held with intermediaries.

78. The prospect of a central bank digital currency for the general public has been questioned from several quarters (see, for example, Waller 2021, House of Lords Economic Affairs Committee 2022). In this context, central bank digital currency has repeatedly been described as a "solution in search of a problem". The United States therefore has no plans to introduce one and has explicitly ruled it out. By contrast, the design envisaged for the European Monetary Union, with substantial restrictions intended to protect the structure of the financial system, runs the risk of making the digital euro so unattractive that it may attract little demand or use (see Broemel, Meyer-Gohde and Wieland 2023). If a project that has been pursued and promoted for so long were

to fail, this could entail some reputational damage for the ECB. From a fiscal perspective, however, it can be noted positively that the digital euro at least constitutes a safeguard against a potential loss of seigniorage that could result if users migrated to private digital currencies. This concern was already raised in 2019, when Facebook announced plans for its own digital currency, Libra. That initiative ultimately appears to have failed as a result of regulatory obstacles.

79. In their proposal to exchange government bonds on a large scale for jointly guaranteed Eurobonds, Blanchard and Ubide (2025) have now put forward an alternative approach intended to strengthen the euro's international role and reduce financing costs for the Member States of the monetary union. Proponents frequently invoke the experience of the United States after the War of Independence. In 1790, Alexander Hamilton successfully advocated consolidating the war debts of the individual states into federal bonds. The aim was to reduce the financing costs of the jointly fought war of independence towards the levels prevailing on British government bonds.

80. However, Lustig (2026has demonstrated, drawing upon the research of Payne et al. (2025), that the goal of such low financing costs was not attained until the 1880s. In the intervening period, the financial crisis of 1837 ultimately led to defaults on debts that individual states had accumulated to finance infrastructure programmes. Crucially, the federal government did not bail out the states. As a result, they accepted binding debt rules and limits on their fiscal sovereignty. Like Cochrane, Garicano and Masuch (2025) and the Kronberger Kreis (2012, 2016, 2021, 2022, 2023), Lustig (2026) therefore argues that the European Monetary Union must first address adverse incentives and moral hazard and should refrain from joint liability for Eurobonds.

81. There has been no significant further progress since the euro's initial phase in key areas that shape its international role. These include the euro's role as a global reserve currency, as an internationally used means of payment, as a currency for trade invoicing, as a currency for international bonds and loans, and with regard to cross-border bank deposits and claims. Overall, these developments suggest that a major decline of the US dollar as the internationally dominant currency is highly unlikely in the near future. Furthermore, the hypothesis that there is a trend towards a multipolar currency system is questionable.

82. The euro's role is primarily regional. Previous efforts to strengthen its international role have met with little success. Future policy should be guided by a realistic assessment. The euro has gained importance in neighbouring countries, and this regional influence can be preserved and expanded through deeper trade and integration. Policymakers must, however, take into account the costs and risks of promoting the euro as a global reserve currency, including volatility, adverse network effects, credibility risks in the event of failure and geopolitical retaliation.

83. Calls for Eurobonds and joint liability should be ignored. Instead, the focus should be on fiscal consolidation in highly indebted Member States and the implementation of market-oriented structural reforms. Strengthening trade and economic growth and removing regulatory barriers are essential. The European Monetary Union is still (relatively) young, and it will take some time before it reaches the maturity of the dollar. Reforms to make the European Monetary Union fit for the future should strengthen and preserve the alignment of liability and control.

6. Conclusion: Reforms to Make the Euro Fit for the Future

84. From its assessment of the state of the European Monetary Union following the high-inflation period from 2021 to 2023, the Kronberger Kreis derives the following recommendations for ECB policy and for reforms of the institutional framework:

1. The overarching principle that should govern monetary and fiscal policy, government financing, and the regulation of the financial system should be that liability, decision-making and control must always reside at the same level.

2. In the field of monetary policy, the responsibility for decision-making lies with the ECB, and in particular with the ECB Governing Council, which has the necessary instruments at its disposal. Greater weight should be given to price stability in the monetary policy strategy by paying closer attention again to the Taylor principle, using Taylor rules in the communication of the monetary policy strategy and taking signals from monetary and credit developments more seriously. Quantitative easing through balance-sheet expansion should be regarded as a measure to be employed in crisis situations, such as the threat of deflation when interest rates are close to 0 percent. Thereafter, the balance sheet should again be reduced swiftly.

3. Conversely, asset purchases aimed at reducing the financing costs of individual Member States should be avoided. However, the ECB can only be relieved of its role as sovereign debt crisis manager if major gaps in the regulatory framework are closed through reforms and other instruments for crisis management. If this does not happen, key adverse incentives for fiscal policy and the resulting fragility of the monetary union in times of crisis will persist.

4. The fundamental issue to be addressed concerns the existence of significant adverse incentives (moral hazard) that lead to free-riding in the areas of government debt and banking supervision. This makes the monetary union vulnerable to crises.

5. The fiscal rules that members of the monetary union are required to follow have been loosened too far. In particular, they have failed to ensure that large Member States reduce their debt-to-GDP ratios again following crises that have caused those ratios to rise. The fiscal rules should therefore be strengthened to ensure an effective minimum reduction in debt-to-GDP ratios.

6. A credible sovereign restructuring mechanism is necessary to create strong incentives for governments to pursue forward-looking policies aimed at ensuring sustainable public finances and to respond effectively in the event of a crisis.

7. Furthermore, the regulatory privileges of government bonds within the framework of banking regulation should be progressively eliminated. This would break the potentially crisis-inducing interdependence between sovereigns and banks in the euro area. It would also create the conditions necessary for a common deposit insurance scheme.

8. Previous efforts to strengthen the euro's international role have met with little success. Future policy should be guided by a realistic perspective. The euro has gained importance in neighbouring countries, and this regional influence can be preserved and expanded through deeper trade and integration. Policymakers must, however, take into account the costs and risks of promoting the euro as a global reserve currency, including volatility, adverse network effects, credibility risks in the event of failure and geopolitical retaliation.

9. There is a link between a currency's international importance as a reserve currency and the perceived fiscal stability. In this context, strengthening the fiscal rules and ensuring the alignment of liability and control within the monetary union are important prerequisites for strengthening the euro's international role. This, in turn, would have a favourable effect on Member States' financing costs.

10. Calls for Eurobonds and joint liability should be ignored. Instead, the focus should be on fiscal consolidation in highly indebted Member States and the implementation of market-oriented structural reforms. Strengthening trade and economic growth and reducing regulatory

impediments, is imperative. The European Monetary Union is still comparatively young, and it will take some time before it reaches the maturity of the dollar.

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Is the euro well equipped to meet future challenges? In the wake of the COVID-19 pandemic, the energy crisis and the high-inflation period from 2021 to 2023, this question has acquired renewed urgency. Although inflation has since fallen significantly, the experience of recent years has exposed fundamental weaknesses in the institutional framework of the European Monetary Union.

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