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Returning to Sargent: United States then, Europe now

José Juan Ruiz

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Introduction

On 8 December 2011, in the midst of the European sovereign debt crisis, the economist Thomas J. Sargent (Pasadena, California, 1943) gave a speech of acceptance for the Nobel Prize, awarded by the Swedish Royal Academy for his “empirical research into cause and effect in macroeconomics”. The timing could not have been more apposite. That very week, on 8 and 9 December, Angela Merkel and Nicolas Sarkozy tabled a Fiscal Compact at the European Council, a proposal that was vetoed by David Cameron of the United Kingdom. The 17 members of the Eurozone and six candidate countries agreed a new intergovernmental treaty with strict public spending and debt limits. Italian spreads at the time were more than 500 basis points above the bund and interest rates on public debt were nudging 3,7% in France, had already reached 7% in Italy and Spain, 15% in Ireland, Portugal and Cyprus, and exceeded 35% in Greece. Silvio Berlusconi had just resigned and been replaced by the technocrat Mario Monti. In September 2011, Jürgen Stark had become the second German, following Axel Weber, to resign from the Executive Board of the European Central Bank (ECB) in one year, a sign of the internal tensions over the direction of monetary policy.

Sargent did not deal with abstract history in his speech: he spoke directly about a constitutional crisis unfolding in real time. Notably however he did not prescribe a solution: he set out two American experiences (from the 1790s and 1840s) and left his audience to draw their own conclusions. But the implicit message was devastating for the EU architecture: a monetary union in the absence of a fiscal union is inherently unstable, precisely the problem implicit in the Articles of Confederation prior to Alexander Hamilton.

As analysts pointed out at the time, Sargent's investigations into the connections between monetary and fiscal policy had a direct bearing on understanding the European situation, since they demonstrate that monetary and fiscal policy are interconnected: a government can finance itself with taxes, debt or the printing of money, and these three pathways are not independent.

Just seven months later, on 26 July 2012, Mario Draghi uttered his three most famous words ("whatever it takes") when he stated: "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough". The irony was exquisite, because what Draghi did was exactly what the "unpleasant arithmetic" of Thomas Sargent and Neil Wallace (1981) predicted. Monetary policy had to shoulder the entire burden because the other elements of a sustainable monetary union – above all a central fiscal capacity for dealing with asymmetrical shocks – were absent and not even seriously considered for a long time. Draghi had to deploy the ECB's full powers to save the euro. The ECB stepped in with the fiscal capacity the European Union (EU) lacked, precisely because of the opaque coordination between fiscal and monetary policy that Sargent highlighted as a source of uncertainty.

The institutional response to the speech was limited. Sargent was invited to deliver the same speech at Banque de France on 1 March 2012. The European debate was dominated by two opposing viewpoints that Sargent's speech encapsulated perfectly: one side emphasised fiscal discipline as the solution (the response that typified the 1840s), while the other pointed to the systemic roots of the financial turbulence. The European political response of December 2011 (the Fiscal Pact) clearly favoured the interpretation of the 1840s (discipline, rules, sanctions) without considering the interpretations of the 1790s (joint fiscal capacity, common revenues). Sargent would have pointed out that one viewpoint without the other was incomplete.

There were no direct public references from European politicians to the Nobel acceptance speech –the leaders were too preoccupied with the crises that bedevilled every Council meeting– but Sargent's analytical framework set the tone for the academic and institutional debate in succeeding months. In June 2012, the European Council unveiled the so-called "Four Presidents' Report" (by the presidents of the Council, the Commission, the Eurogroup and Draghi himself), which represented a moment of truth by opening the door to a banking, fiscal and political union. This report was essentially an institutional response to the diagnosis that Sargent had set out in Stockholm six months previously: in the absence of any form of fiscal union, the monetary union could not survive. The European tragedy is that, 13 years later, this fiscal union remains unfinished.

1. Sargent's analytical framework

1.1. The intertemporal budgetary constraint

Thomas J. Sargent's central argument rests on an equation that shapes the entire fiscal architecture of a political union: the value of a public debt market is equal to the net present value of all the future primary surpluses that are expected.

If the markets do not believe that the government can generate sufficient future surpluses, the debt will trade at a discount.

This is exactly what happened with US debt (under the Articles of Confederation) in the 1780s and what the European sovereign spreads revealed in the 2012 euro crisis.

1.2. Sargent's five principles

- The ability to borrow today depends on expectations about future revenues, not about past debt.
- Free-rider problems exist between subordinate governments and the central government.
- Good reputations can be costly to acquire and easy to lose.

- It is difficult to maintain distinct reputations with different parties simultaneously.
- Opaque fiscal-monetary coordination generates uncertainty (Sargent-Wallace, 1981).

1.3. The two American experiences

Sargent's Nobel Prize acceptance speech in 2011 described a typical chicken-and-egg problem applied to the construction of safe assets: in order for public debt to be deemed a safe asset you need fiscal credibility, but to build fiscal credibility you need to be able to issue debt that the market accepts. Alexander Hamilton, first secretary of the Treasury, resolved the quandary in 1790 with a simultaneous package: assumption of debts, a federal monopoly on tariffs and a constitutional commitment.

The story of that experiment seared into economists' memories the fact that, in order to ensure the successful conversion of an asset into a safe asset, not only does it have to be well designed but it also has to have institutional accompaniment –a sufficiently large tax base to ensure the servicing of the debt, clear and irreversible rules regarding fiscal discipline– and irrevocable evidence that the participants are prepared to spend political capital to ensure the fulfilment of its institutional framework, especially if crises and headwinds arise.

Although there are few cases in history of assets made safe by decree, there is a large and well-supported literature on the requirements needed to ensure the credibility of long-term commitments.

To illustrate the success of Hamilton's plan, Sargent's analysis focuses on two specific experiences. The first is the foundational experience of 1790, when Hamilton took on the entire debt of the 13 US states: approximately $80 million (40% of GDP), which comprised $55 million in federal debt and $25 million of the states' debt. Hamilton proposed the federal assumption of state debts, a federal monopoly on tariffs and rejecting discrimination between creditors. The justification was clear: the debt incurred by a shared national cause (independence) was eligible for the conversion. The outcome was that federal credit was restored and foreign investment started to flow into the new country.

Sargent also highlights a second experience: the refusal by the federal Congress to conduct a second bailout after the crisis of 1837. The consequence of the decision was that nine US states suspended payments of debt they had incurred in order to build infrastructure projects in their

territories. Congress ruled that such debts had not been incurred in order to pursue a "national cause". The consequence of these defaults in the medium term was that more than half the states rewrote their constitutions to require balanced budgets.

This distinction between debt incurred for shared public goods and debt incurred by local decisions is constitutive of fiscal federalism.

2. Similarities in detail: the US (1780s and 1840s) vs. the EU (1990s and 2026)

The Nobel Prize acceptance speech continued with a comparison between the 18th-century economic history of the US and the EU of the 2011-2014 fiscal crisis.

The timing of the speech and the parallels that were already apparent between the US of 1780 and the Europe of the sovereign debt crisis is fascinating. In order to gain perspective and topicality however, figure 1 displays a comparison showing a more contemporary version of the EU, that of 2025-2026. To avoid wasting the reader's time it has been deemed unnecessary to provide in-depth detail about each of the columns, but a lengthy guided bibliography is included at the end of this document covering each of the cells of the two comparative columns.

Figure 1.
Institutional parallels: Articles of Confederation vs. EU 2025-2026

Dimension	US Articles of Confederation (1781-1789)	EU (2025-2026)
Constitutional structure	Confederation of sovereign states	*Sui generis supranational union*
Central fiscal capacity	Non-existent (no tax-raising power)	Very limited (national contributions)
Central budget (% GDP)	<1%	~1.0%
Own sources of revenue	None (voluntary requisitions)	Limited (customs, partial VAT, plastic)
Problematic debt	Continental + state: ~$77M	National: FR €3.3T; IT €2.9T; ES €1.6T

Aggregated debt/GDP	~40%	Eurozone: 88.5% (Q3 2025)
Monetary union	*De facto (Spanish dollar)*	Yes (euro, ECB since 1999)
Order of reforms	Fiscal first (1790), monetary later (1791-1792)	Monetary first (1999), fiscal pending
Trade policy	13 separate policies	Unified but under pressure (Turnberry, summer 2025)
Fiscal unanimity	Yes (for federal taxes)	Yes (treaty reforms)
External threat	Great Britain (trade discrimination)	Threefold: US + China + Russia
Defence spending	State militias, with no federal army	~2.1% GDP; NATO: 3.5%+1.5% by 2035
Joint debt	No (discredited)	Partial: NextGenerationEU (NGEU) >€700 Bn (temporary)
Sub-national debt bailouts	Yes, 1790 (cause: independence)	NGEU pandemic; no permanent mechanism
Fiscal discipline	None until post-1840	Reformed SGP 2024
Central bank	Not until 1791	ECB (1998)
Nº constituent units	13 states	27 Member States. (21 Eurozone)
Economic heterogeneity	Moderate (agrarian economy)	High (per capita GDP: Luxembourg 10x Bulgaria)
Common identity	Yes (War of Independence)	Under construction (no “Glorious Cause”)

Source: author’s own compilation.

The debt and deficit situation in the US then and the EU now is also highly revealing (see Figure 2). The last column (US counterpart, 1790) has been included to underscore the parallels –and to a large extent EU countries’ ex ante attitudes to the creation of a European safe asset– assigning to each of the 13 American states a current European country. This assignation does not of course have any purpose other than to emphasise the fact that others have already gone through what the EU is now experiencing.

Figure 2.
EU debt/GDP (Eurostat Q3 2025) with American parallels from 1790

Country	Debt/GDP Q3-2025 (%)	Deficit/GDP 2024 (%)	US counterpart, 1790
Greece	149.7	-2.4	Massachusetts (high debt, beneficiary)
Italy	137.8	-3.4	South Carolina (slow payment)
France	117.7	-5.8	No parallel (single systemic weight)
Belgium	107.1	-4.2	Connecticut (moderate-high debt)
Spain	103.2	-3.2	New York (dynamic economy)
Portugal	95.0	0.5	Rhode Island (undergoing reform)
Austria	83.0	-4.6	New Jersey (intermediate position)
Germany	63.0	-2.5	Virginia (debt paid, OPPOSED)
Netherlands	43.0	-1.8	Pennsylvania (favourable)
Ireland	38.0	4.0	Maryland (debt paid)
Eurozone	88.5	-3.1	Federal total: ~40% GDP
EU-27	82.1	-3.1	N/A

Source: author's own compilation.

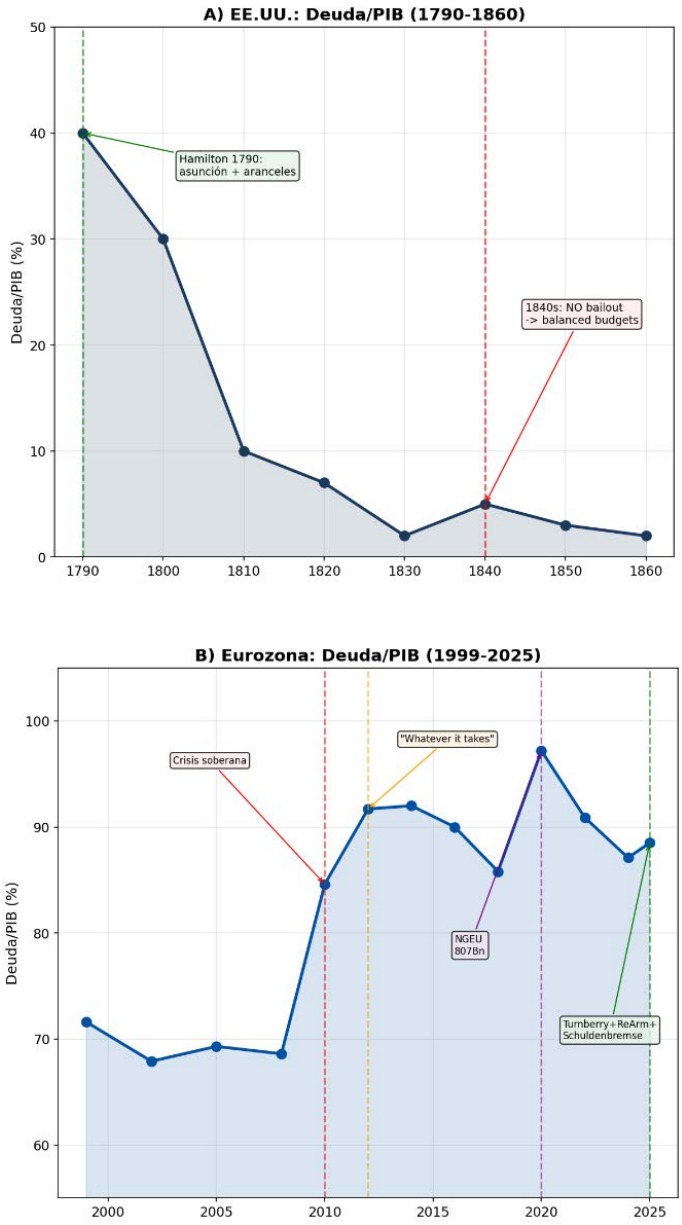
The historical observation is that the opposition to Hamilton's assumption of debt in 1790 came from the states that had already paid their debt (Virginia, Maryland, Georgia). In 2025, EU countries with low debt ratios (Germany 63%; the Netherlands 43%; Scandinavian countries) are traditionally those that have been very active in their opposition to any debt mutualisation suggestion that has so far been proposed.

The political dynamic is identical, separated by 235 years, but the scale bears no comparison: the combined debt of France, Italy and Spain exceeds €7,8 trillion; the total debt of the 13 states in 1790 was $25 million.

As is well known, Hamilton's mutualisation worked extremely well. The figures show how the debt/GDP ratio fell from 40% of GDP to less than 10% in 1830[1]. But then the crisis of 1837 arose, and the entire edifice was put to the test once again.

1 The 1837 crisis was one of the worst to hit the US in the 19th century. To understand it, it is necessary to go back to the preceding decade. Between 1825 and 1837, the states embarked on an ambitious programme of infrastructure investments (canals, railways, roads) overwhelmingly financed by debt, a large part of it owed to European investors, particularly British and Dutch. The reasoning was that the infrastructure would generate sufficient growth to repay the debt. Various states set up public banks that issued bonds and released credit linked to these projects. The states' indebtedness multiplied: it went from $13 million in 1820 to more than $170 million in 1838. The Panic of 1837 was triggered by a combination of factors: President Jackson's Specie Circular (1836), which required purchases of federal land to be paid for in gold and silver rather than banknotes, caused credit to dry up suddenly; the insolvency of British banks reduced the flow of capital to the US and the price of cotton (which constituted the backbone of the South's economy) collapsed. The resulting recession was severe: it lasted until 1843, with banks falling like dominoes and unemployment shooting up in the cities. The impact on states' finances was devastating. Tax revenues fell just when maturity dates of debts started to become due and the infrastructure projects, many of them incomplete or mismanaged, failed to generate the expected returns. During the recession towards the end of the 1830s, many states went into default. Nine states (Arkansas, Florida, Illinois, Indiana, Louisiana, Maryland, Michigan, Mississippi and Pennsylvania) stopped servicing their debts between 1841 and 1842. Four of them (Arkansas, Florida, Michigan and Mississippi) renounced them completely: they refused to recognise the debt as legitimate. European bondholders then discovered that the Eleventh Amendment to the US Constitution denied them protection in the federal courts to seek redress against the sovereign states. They did not have the right to sue an American state in a federal court. Their only hope was that the federal government would take on these debts, as Alexander Hamilton had done in 1790. And indeed, there was a prolonged debate in Congress in the 1840s regarding a possible second bailout of the states' debts. Bailout advocates explicitly invoked the Hamiltonian precedent of 1790: if the federal government had taken responsibility for the states' debts once, it should do so again to restore American credit in the international markets and to protect the country's reputation. The European banks, with Barings at their head, lobbied intensely for this option. The Reverend Sydney Smith, a celebrated British writer who had invested in Pennsylvania bonds, published a series of furious letters in London newspapers denouncing the immorality of the American default. But the opponents won the debate with an argument that Sargent considers decisive: the 1790 debt had been incurred for a shared national cause (the War of Independence), whereas the debt from the 1830s was the outcome of local investment decisions in diverse projects, many of them speculative or corrupt. There was no national cause that justified mutualisation. A federal bailout would create a perverse incentive (moral hazard): if the states knew that the federal government would rescue them, they would spend recklessly. Congress rejected the bailout. The institutional consequences were profound and lasting. More than half the states rewrote their constitutions in the succeeding years to include some form of balanced budget amendment, in other words rules that restricted or prohibited the issuing of state debt without explicit popular approval (a referendum) or that required balanced budgets. As Sargent points out, these new constitutions forced the states to renounce the efficiency gains derived from tax smoothing (the intertemporal smoothing of taxes postulated by Robert J. Barro in 1979): a government that cannot incur debts has to raise taxes in a recession and lower them at a time of growth, exactly the opposite of the ideal. But the no-bailouts discipline turned out to be more important than the theoretical efficiency. The lesson that Sargent draws for Europe from this episode is so clear that it does not need to be made explicit: if the debt is not incurred for a shared reason, it should not be borne collectively. National European debts incurred for domestic reasons (pensions, current expenditure, local investments) have no Hamiltonian justification for being mutualised. The discipline must come from credible fiscal rules –the European equivalent of the American balanced budget amendments– not from unconditional bailouts.

Figure 3.
US debt/GDP (1790-1860) vs. Eurozone (1999-2025)



Source: author's own compilation.

250 years later, the Europeans escaped from the 2011-2014 sovereign debt crisis by the skin of their teeth. Now however, while it is not a full-blown crisis, they face another adverse situation that brings Sargent to the fore once again.

3. The three simultaneous shocks

In 2025-2026 the EU is facing three simultaneous shocks to an architecture that, in Sargent's terms, continues being essentially confederal.

3.1. A security shock

The NATO summit held in The Hague in June 2025 established a defence spending target of 3.5% of GDP as a core component, plus 1.5% of additional security, totalling 5% of GDP by 2035. The EU's defence spending in 2024 was approximately €343 billion (1.9% of GDP). The estimate for 2025 is €381 billion (2.1%). The gap of up to 3.5% represents around €250 billion extra per annum, equivalent to six times the EU's annual budget. The ReArm Europe plan deploys €800 billion in loans and guarantees, but it is insufficient in the long term.

3.2. A trade shock

The deal agreed at Turnberry (July 2025) imposes a 15% tariff on EU exports to the US. Meanwhile, the EU committed itself to purchases of American energy worth $750 billion over 10 years and acquisitions of American military equipment.

Goldman Sachs estimates an impact of -0.4 percentage points on Eurozone GDP by the end of 2026. There is a clear analogy with British trade discrimination in the 1780s: a foreign power that exploits the fragmentation of the bloc.

3.3. A competitiveness shock

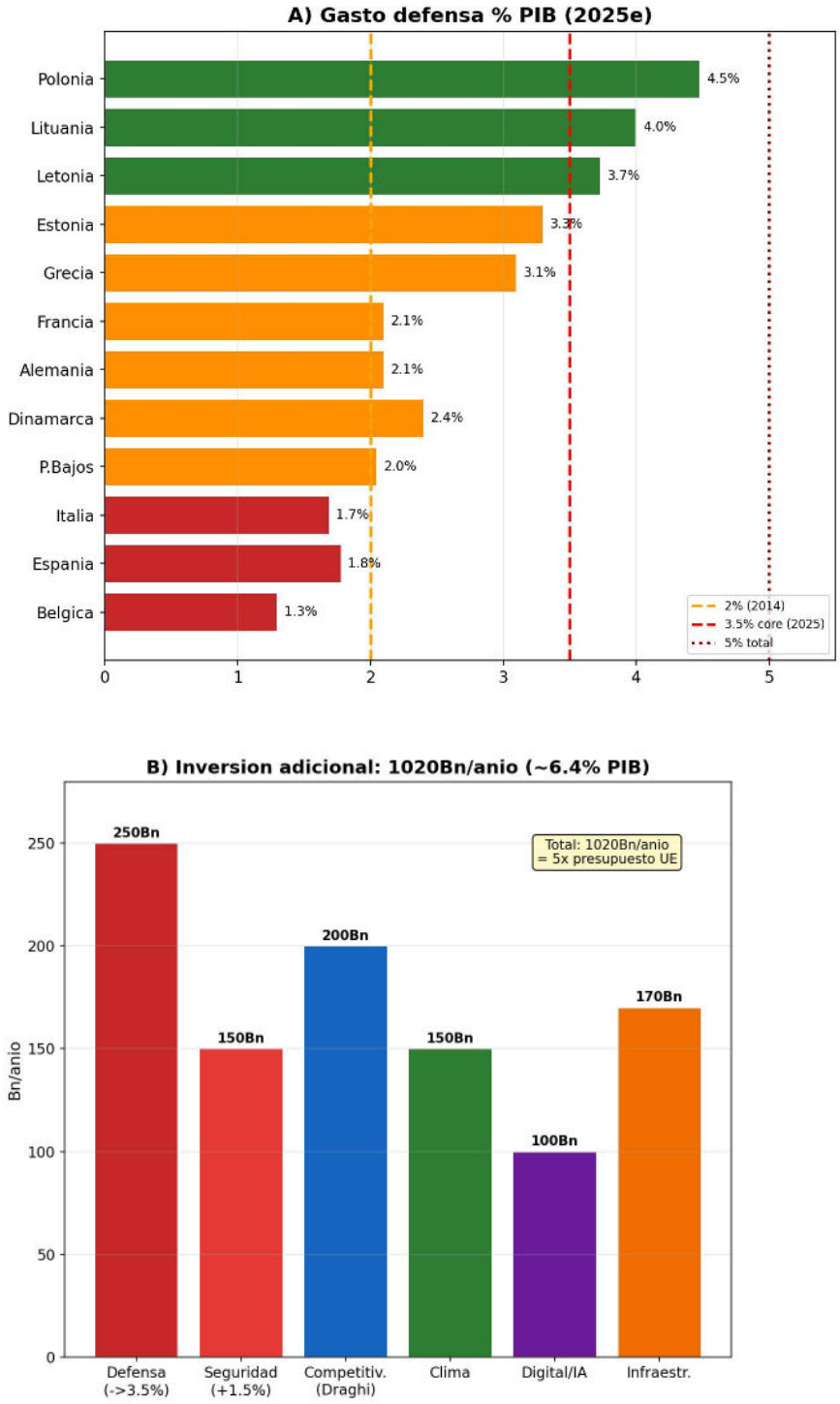
The Draghi Report (2024) quantified the European investment shortfall at €800 billion per annum, approximately 5% of GDP. Broken down into its constituent parts it looks like this: climate transition (€150 billion per annum), digital and artificial intelligence (€100 billion), infrastructure (€170 billion) and general competitiveness (€200 billion). Adding in defence (€250 billion) and security requirements (€150 billion), the total climbs to €1,020 billion per annum, which is 5.5 times greater than the EU budget (Figures 4 and 5 summarise this threefold vulnerability).

Figure 4.
The three shocks

Shock	Component	Size	Sargent parallel
SECURITY	The Hague NATO target	3.5% core + 1.5% = 5% GDP 2035	National cause: justified common debt
	EU spending 2024	€343 Bn (1.9% GDP)	Insufficient
	EU spending 2025e	€381 Bn (2.1 % GDP)	First time >2%
	Shortfall of up to 3.5%	~€250 Bn/additional years	6x EU budget
	ReArm Europe	~€800 Bn	Hamilton limited to defence
TRADE	Turnberry tariffs	15% EU exports	British discrimination 1780
	Purchases of US energy	$750 Bn over 10 years	Negotiating weakness
	GDP impact (GS)	-0.4 pp end-2026	Reduces expected surpluses
COMPETITIV.	Draghi shortfall	€800 Bn/year (5 % GDP)	Investment for future {s_t}
	Climate	€150 Bn/ year	European public good
	Digital/AI	€100 Bn/ year	Technological sovereignty
	Infrastructure	€170 Bn/ year	PG + national mix

Source: author's own compilation.

Figure 5.
Defense spending and additional investment



Source: author's own compilation.

Taking these figures as the starting point, the next step is to apply the Sargent equation to the EU's current travails.

4. Sargent's equation applied to the EU

Is the EU as a whole capable of generating a process of credible and consolidated future primary surpluses? The answer requires a comparison of America's current real fiscal capacity with that of the EU/Member States.

Figure 6.
Comparative fiscal capacity: federal US vs. central EU, 2025

Indicator	Federal US	Central EU	Ratio
Budget/GDP	23.3%	~1.0%	23x
Absolute budget	$7.0 T/year	€186 Bn/year	38x
Own revenues	>$5 T (income tax + payroll + corporate + tariffs)	~€30 Bn (customs + plastic + partial VAT)	>100x
Debt/GDP central government	~100% (held by public)	~4.5% (temporary NGEU)	22x
Interpersonal transfers	Massive (SS, Medicare, Medicaid)	Minimal (<0.5% GDP)	>50x
Deficit/GDP	-5.9% (FY2025)	-3.1% (EU-27, 2024)	US worse

Source: author's own compilation.

The last column (Ratio) quantifies the asymmetry between yesterday and today. In terms of the budget to GDP ratio, the current European position is 23 times greater and the difference in the own revenues/budget ratio is more than 100 times greater. The second and third columns encapsulate the difference between a federation and a confederation.

The figures also show something more recent: in 2025 the US had a severe fiscal problem. Objectively it is worse than the European fiscal problem (debt at 121% of GDP; deficit at 5,9%). The great difference however is that the US has a structurally superior fiscal capacity than that of the EU because it directly controls its revenues.

The markets know this: hence US treasuries continue –for now– being a safe global asset. They also know that the EU is not a federation but a confederation, which is why it is so interesting to observe the national spreads of European countries compared to the US10Y and the German *bund*.

The figures from early February show that all European sovereign bonds are trading below US treasuries.

Figure 7.

European countries' spreads compared to the US10Y and the German *bund*

Country	Yield 10Y (%)	*Spread vs. US treasury (bp)*	*Spread vs. bund (bp)*	*Rating (Fitch)*	Debt/GDP
US treasury	**4.17**	**—**	**+130**	AA+	~121%
Germany (*bund*)	2.87	-130	—	AAA	63%
Netherlands	2.98	-119	+11	AAA	43%
Finland	~2.95	-122	+8	AA+	~75%
Austria	~3.05	-112	+18	AA+	83%
Ireland	~3.00	-117	+13	A+	38%
Portugal	3.21	-96	+34	A-	95%
Spain	3.31	-86	+44	A-	103%
Belgium	~3.25	-92	+38	AA-	107%
Greece	3.48	-69	+61	BBB-	150%
Italy (BTP)	3.53	-64	+66	BBB	138%
France (OAT)	3.57	-60	+70	AA-	118%

Source: author's own compilation.

But prudence is called for when interpreting this premium. Two mutually interacting factors have a bearing on it: the diverging monetary policy and credit risk of the Federal Reserve and the ECB.

As everyone knows, the ECB has lowered interest no fewer than eight times in recent quarters –2% in total– whereas the Federal Reserve has settled, for now, at an interest rate of around 4%. Meanwhile, since Donald Trump was elected the dollar has fallen against the euro by 8.1%.

The combination of the two means that for global investors who bought European and American bonds on the day of Trump being elected –and kept hold of them until the present day– the yield in US dollars on their European bonds has been 9,7%, and 6,7% on their American bonds. In other words, they have earned 300 basis points of positive spread on EU countries' bonds.

Figure 8.
Breakdown by country

Country	Yield 10Y Nov-2024 (%)	Yield 10Y Feb-2026 (%)	Cum. coupon ~15m (%)	Est. price var. (%)	Return € (%)	Efecto FX €/ US$ (%)	Total return US$ (%)
Germany	2.40	2.87	+3.06	-4.23	-1.17	+8.1	+6.8
Netherlands	2.55	2.98	+3.25	-3.87	-0.62	+8.1	+7.4
France	3.15	3.57	+4.02	-3.78	+0.24	+8.1	+8.3
Belgium	3.05	3.25	+3.89	-1.80	+2.09	+8.1	+10.3
Spain	3.10	3.31	+3.96	-1.89	+2.07	+8.1	+10.3
Portugal	2.90	3.21	+3.70	-2.79	+0.91	+8.1	+9.1
Italy	3.55	3.53	+4.53	+0.18	+4.71	+8.1	+13.0
Greece	3.30	3.48	+4.21	-1.62	+2.59	+8.1	+10.8
Ireland	2.70	3.00	+3.45	-2.70	+0.75	+8.1	+8.9
Austria	2.75	3.05	+3.51	-2.70	+0.81	+8.1	+9.0
EZ weighted average	**~2.95**	**~3.20**	**+3.77**	**-2.25**	**+1.52**	**+8.1**	**~+9.7**
US treasury (ref.)	**4.30**	**4.17**	**+5.49**	**+1.17**	**+6.66**	**—**	**+6.7**

Source: author's own compilation.

A break-down by countries sheds light on the underlying mechanism. An

American investor who bought bunds at 2.40% on the day of Donald Trump's election would have obtained 6.8% in dollars –practically the same as one who invested in treasury bonds at 4.30%, which would have yielded 6.7%– but anyone who had bought Italian BTPs at 3.55% would have gained 13%. In other words, the exchange rate effect (the euro having appreciated 8.1%) has been more powerful than any difference in interest rates.

The market is not only assessing the processes of European national surpluses but is also simultaneously making a downwards reassessment of the fiscal position of the US. And for now, this judgement translates into a depreciation of the dollar or, seen from this side of the Atlantic, into a revaluation of the euro. There is little in the global economic situation to suggest that this trend will come to an end.

The implication is paradoxical. Even if Europe does not manage to create its own safe asset, the erosion of the dollar's status as a safe refuge currency creates inflows of capital into more profitable European assets placing upwards pressure on the euro. The effect is perverse: all Eurozone countries lose exchange rate competitiveness equally, but the improvements in financing costs are disproportionately received by countries with the greatest spreads against the *bund*; in other words, countries to which the markets attribute the greatest credit risk: those that accumulate the greatest deficits and stocks of debt.

The appreciation of the euro socialises the losses of competitiveness; the compression of spreads privatises the financiers' gains. It is an implicit redistribution that no treaty has foreseen. The spreads to the *bund* are essentially the market's translation of Sargent's equation: they reflect the difference between the credibility of each country's process of surpluses and that of Germany. The recent convergence is notable. The BTP-*bund* spread fell from 116 basis points at the start of 2025 to 66 basis points at the time of writing, and Italian and Spanish bonds are as close to the bund as they have been for several decades. The total yield in dollars confirms the same thing: Italy has provided the best European sovereign investment during the period (+13% in dollars), precisely because it combines a superior carry with a compression of spreads and the shared appreciation of the euro.

But the most striking figure is the French anomaly. French bonds trade at ~70 basis points above the bund, which is worse than Italy (~66 basis points), something unthinkable prior to 2024. In the yields table, France (+8.3% in dollars) outperforms treasury bonds, but falls significantly below Italy (+13%) and Spain (+10.3%). The market is saying that the French process of expected surpluses has deteriorated more than Italy's. This verdict reflects the deficit of 5.8%, the political instability and the difficulty in gaining approval for fiscal stabilisation.

But when the dollar simultaneously depreciates 8.1%, the message is different. With a deficit of 5.9%, debt at 121% of GDP, self-inflicted uncertainty surrounding tariffs that has become extremely high and the growing suspicion of the politicisation of the Federal Reserve, what the markets reflect is exactly what Sargent-Wallace (1981) predicted: if fiscal policy dominates, monetary credibility deteriorates and the exchange rate reflects this.

The historical irony is considerable. Europe, which Sargent used in 2011 as a case study of an incomplete fiscal union, is witnessing its spreads converge, its currency appreciate and its bonds generating superior yields in dollars. The US, which Sargent used as the model for a successful resolution of the fiscal problem (Hamilton, 1790), is witnessing its currency depreciate, its deficit climb and investors starting to demand a premium for holding on to treasuries over the long term. Roles are being to some extent reversed.

But the European convergence is fragile: a large part of the peripheral improvement is due to the NGEU transfers, which run out after 2026. Without a permanent replacement –without completing Europe's equivalent of Hamilton with its own revenue sources and joint debt for public goods– the spreads may once again diverge. And if they do so just when the positive exchange rate effect dissipates (because the dollar stabilises or rebounds), the dollar yields of European bonds would plummet. And this would reveal that the convergence was cyclical, not structural.

The question is whether we are on the verge of a Hamiltonian tipping point, in which Europe completes its fiscal architecture and the convergence becomes permanent, or witnessing a circumstantial mirage where the relative weakness of the US conceals Europe's absolute weakness.

There is no ambiguity about Sargent's budget constraint: either Europe generates sufficiently large revenues of its own as backing for joint debt (the €290-480 billion per annum estimated above) or the joint debt will inherit the worst credit profile of the group when the next crisis reveals that the process of European surpluses continues to be as insufficient as in 2011. The NGEU clock is counting down to 2026. Afterwards, what awaits is either Hamilton or the 1840s.

5. The 1790/1840 distinction: the analytical key

The most productive lesson for Europe from the entire American experience (1790s and 1840s) is neither undiluted Hamilton nor the status quo. It is the intermediate solution:

- Permanent joint debt for genuine European public goods (defence, climate transition, technological sovereignty) with Hamiltonian justification.
- Strengthened national fiscal rules (Stability and Growth Pact –SGP– reformed in 2024) for debt accumulated due to domestic decisions, fulfilling the role of the state constitutions following the 1840s.
- New sources of revenue for the EU to back the joint debt, without which the process of surpluses lacks credibility.

Germany's fiscal shift in March 2025 (the reformed *Schuldenbremse* plus a €500 billion fund) broke a taboo: if Germany is willing to take on massive debts for defence at the national level, the argument against joint European debt for these same ends loses logical cogency.

Figure 9.
Balance of forcest

Criterion	1790 (bailout approved)	1840 (no bailout)	Application to EU 2025-2026
Nature of debt	War: shared national cause	Local infrastructure	TWOFOLD: defence/climate = shared; national debt = local decisions
Justification	Everyone contributed to the common public good	Diverse projects with no national dimension	Defence and climate DO have Hamiltonian justification; current national spending DOESN'T
Moral risk	Low: unique and unrepeatable cause	High: incentive for irresponsible spending	Low if they are European public goods; high if generalised
Outcome	Federal credit restored; treasury bonds, appreciated	*>50 % states adopt balanced budget amendments*	If there is joint defence: a step towards partial fiscal union
Credibility conditions	Hamilton: federal monopoly on tariffs	Fiscal discipline emerging from non-bailout	EU's own revenues (European VAT, carbon, digital tax)
Kareken-Wallace logic	Not applicable: bailout accompanied by fiscal capacity	*Applicable: unconditional bailout = moral hazard*	Reformed SGP 2024 + conditionality = European version of 1840

Source: author's own compilation.

Figure 10.
Viable minimum coalition for the fiscal Eurozone

Dimension	S1: Status quo	S2: Partial Hamilton	S3: Full Hamilton
1 Description	National rules + EU ~1 %	Permanent fund: defence, climate, investment + own revenues	Massive transfer of fiscal competences
American parallel	Art. of Confederation maintained	Hamilton 1790 for PGs + 1840s discipline	Constitution 1787 + complete Hamilton
EU budget (% GDP)	~1.0-1.2 %	~2.0-3.0 %	>5 %
Joint debt	NGEU expires	Permanent for public goods (€200-300 Bn/year)	Partial assumption + permanent emission
Own revenues	No change	European VAT + carbon + digital tax	European income tax
EU {s_t} process	Insufficient	Medium: progressive improvement	High: treasury bond-type convergence

Sovereign spreads	Persistent and volatile	Gradual reduction	Elimination (European bond)
Strategic autonomy	Impossible	Partial (defence + tech)	Full
Vulnerability	Maximal (permanent Turnberry)	Significantly reduced	Minimal
Political viability	High (inertia)	Medium-high (German shift)	Very low in the short term
Horizon	Default	2026-2030	>2035

Source: author's own compilation.

Figure 11.
Extensions to the analytical framework

Factor	Description	Effect	Weight
Scale of the State	Member States spend ~50 % GDP; federal USA 1790 ~2 %	OBSTACLE	-5
Economic heterogeneity	Per capita GDP: Luxembourg 10x Bulgaria	OBSTACLE	-4
Political identity	*No equivalent to the Glorious Cause*	OBSTACLE	-4
Unanimity (Art. 48 EU Treaty)	Any Member State has the power of veto	OBSTACLE	-5
Inverted order	Monetary first, fiscal pending	OBSTACLE	-3
Shared COVID experience	*Shared shock (2020)*	CATALYST	+2
NGEU as precedent	>€700 Bn in joint debt issued	CATALYST	+4
Reformed Schuldenbremse	Most conservative country changed (March 2025)	CATALYST	+5
Triple existential threat	US + China + Russia simultaneously	CATALYST	+5
Visible cost of inaction	Turnberry: without autonomy = weakness	CATALYST	+4

Source: author's own compilation.

A simple addition of the numerical values that have been arbitrarily assigned to the obstacles and catalysts shows that the net balance generates a very precarious equilibrium of political economy: the sum total gives a result of -1.

Far from providing grounds for melancholy, what this result may also do is provide reasons for thinking that what today constitutes mistrust may tomorrow constitute support. All that is needed is for the real risks in the form of the external threats that currently assail us to be perceived in a more convincing and stark way. Discovering what is really at stake should change what in other analyses the present author has referred to as the various EU countries' "pain thresholds" and pave the way to our being able, as Draghi has put it, to go from fear to hope.

We do not have many options other than this one to create, willingly, well and with an appropriate institutional framework, the safe asset that will enable us to carry out reforms and investments so as to drastically reduce our vulnerabilities in an era dominated by the economics of coercion.

There is so much at stake that before concluding it is worth reflecting how the coalition that will support this institutional change in the current EU may be assembled: with unanimity or being content with a coalition of the willing? The 18th-century American experience again offers inspiration.

6. Coalitions and unanimity

The Philadelphia Convention of 1787 resolved the confederal unanimity problem with an audacious mechanism: the ratification of the new constitution would require only nine of the 13 states, not the unanimity that the Articles of Confederation demanded. This meant that a sufficiently large –but not universal– coalition could see the reform through, leaving the dissenting states with the choice of either signing up to a *fait accompli* or being excluded. Rhode Island, which did not send delegates to the Convention, ended up ratifying in May 1790, the last of the 13, when the alternative was to remain isolated from a union that already worked without it.

The EU faces an analogous but institutionally more rigid problem. Treaty reforms require unanimity (Article 48, Treaty on European Union, TEU), which bestows the power of veto on each of the 27 Member States. Within the framework of cooperative game theory, the players are assigned a score that is proportional to their ability to turn a losing into a winning coalition. With unanimity, all the players have the same power. This means that in formal terms Malta has the same blocking ability as Germany, a distortion that paralyses reforms where the costs and benefits are asymmetrical.

The off-ramp already exists in the Treaty itself: enhanced cooperation (Article 20 TEU), which enables a minimum of nine Member States to move towards deeper integration without requiring that everyone takes part. It is not a theoretical precedent: the Eurozone itself was a *de facto* case of enhanced cooperation. Schengen too. The same goes for the Prüm Convention on law enforcement.

The question is not whether the mechanism is legal –it is– but whether there is a viable minimum coalition willing to take the step towards shared fiscal capability. Figure 12 identifies such a coalition.

Figure 12.
Eurozone debt/GDP trajectories under three scenarios (2025-2040)

Country	Debt/GDP	Defence %GDP	Willingness
Germany	63.0	2.10	YES
France	117.7	2.10	YES
Italy	137.8	1.69	YES (conditional)
Spain	103.2	1.78	YES
Netherlands	43.0	2.05	POSSIBLE
Belgium	107.1	1.30	YES
Poland	N/A EZ	4.48	YES (defence)
Portugal	95.0	1.55	YES
Greece	149.7	3.10	YES
Finland	~75.0	2.20	POSSIBLE
Ireland	38.0	2.00	RELUCTANT
Austria	83.0	2.10	POSSIBLE

Source: author's own compilation.

The calculus for a coalition of 9-12 countries shows that the four largest (Germany, France, Italy and Spain) are decisive: without any one of them, the coalition is unviable. But the admission of mid-sized countries committed to defence (Poland, Greece, Finland) or with a federalist tradition (Belgium, Portugal) could create a coalition that represents more than 80% of Eurozone GDP. Once this threshold has been achieved, the pressure on the non-participants is inverted: the cost of being excluded exceeds the cost of joining, exactly as happened to Rhode Island in 1790.

The annex contains other extensions to the model described in the analysis.

Conclusions: seven proposals

1. Strategic autonomy requires fiscal capability. Alexander Hamilton understood that a credible foreign trade policy would require federal revenues. The EU cannot aspire to strategic autonomy from the US and China without central fiscal capability for financing European public goods.

2. The order matters, but the reversal has already been made. Hamilton: fiscal and then monetary. Europe: monetary and then fiscal. While it cannot be undone, it can be completed. The pressure of 2025-2026 could be the catalyst.

3. The distinction between 1790 and 1840 is the key. Joint debt for genuine European public goods (defence, climate, technology) has a Hamiltonian justification; general mutualisation of national debts does not. The reformed fiscal rules of 2024, if they are credibly applied, play the same role as the state constitutions in the 1840s.

4. Crises as constitutional catalysts. The threefold pressures of 2025 (Turnberry tariffs, Chinese competition, Russian threats) is analogous to the fiscal crisis of the 1780s. The German fiscal pivot and the ReArm Europe programme suggest that the pressure is reaching the threshold of institutional reform.

5. Unless the EU has its own revenues, joint debt is not credible. Without a credible process of surpluses at the central level, joint debt inherits the worst national credit ratings. New sources of the EU's own revenue (European VAT, carbon border tax, digital tax) are essential to back €290-480 billion per annum.

6. Fiscal-monetary coordination is unavoidable. Over the long term the ECB cannot remain independent of the Member States' aggregate fiscal policy (Sargent-Wallace, 1981). The current arrangements are opaque: exactly the situation that, as Sargent warns, provides a source of uncertainty.

7. The intertemporal budget constraint is not just an equation. it is a linguistic expression of the constitutional dilemmas of political unions. Is the EU a community of destiny willing to share risks in order to generate common public goods or an association of convenience where each member minimises its contributions? Hamilton answered this question for the US in 1790. Europe has not yet answered its own. But the data, the gulf in defence, the vulnerability in trade and the threat from the east are forcing it to provide an answer.Inerabilidad comercial, la amenaza desde el este están forzando una respuesta.

Annexes

I. Extensions of the analysis

There are three possible extensions (EXT) of the model set out above:

1. Development of EXT-1: budgetary constraint with differentiated public goods

The most direct extension breaks the Sargent constraint down into two levels. EU level (European public goods): the joint debt is backed by surpluses generated by the EU's own revenues devoted to defence, climate and technology. National level: each Member State backs its debt with its own surpluses. The key: the interest rate on the joint debts will be lower than on the national debts if and only if the EU's own revenues are sufficient. Without them, the joint debt inherits the worst credit rating of the group.

2. Development of EXT-2: restriction on geopolitical participation

Each Member State compares the value of remaining within the EU with the best bilateral alternative. To the extent that the US offers attractive bilateral conditions and China offers preferential access, the value of the external option rises. If the EU does not improve its offer (because it lacks the fiscal capacity to provide defence, competitiveness and trade protection), the constraint is breached for the most exposed Member States.

3. Development of EXT-3: reversed fiscal-monetary order

Monetary credibility requires fiscal backing. Europe reversed the order: euro (1999) with no fiscal union. The ECB operates with 21 heterogeneous fiscal jurisdictions. When a sovereign debt crisis hits, the ECB is forced to act as the lender of last resort (outright monetary transactions, OMTs, 2012; Pandemic Emergency Purchase Programme, PEPP, 2020): precisely the opaque fiscal-monetary coordination that Sargent signals as a source of uncertainty. The ECB's independence is a fiction over the long term in the absence of fiscal convergence.

The ideas surrounding the possible extensions are summarised in the following table:

Figure 13.
Proposals for the EU's own revenues

Extension	Central idea	Suggested formalisation	Relevance 2025-2026
EXT-1: Differentiated public goods	Break down EU {s_t}^ into components: defence + climate + tech + national. Each with a different justification for joint debt	b^EU = Sum R^(-j) E[s^EU-PG] + Sum R^(-j) E[tau^nac]. Two parallel constraints	Enables 1790 (defence/climate) and 1840 (national discipline) to be applied simultaneously
EXT-2: Geopolitical competition	External threat generates restricted participation: V(EU) >= V(bilateral). If the EU does not provide, the Member States seek alternatives.	V_i(EU) >= max{V_i(USA), V_i(China)}. Endogenous exit model.	Italy/Hungary negotiate bilaterally. Turnberry illustrates.
EXT-3: Reversed fiscal-monetary order.	Hamilton: fiscal -> monetary. Europea: monetary -> fiscal. Monetary credibility requires fiscal backing	Sequential game. pi^ECB depends on E[{s_t}^fiscal-aggregated]	ECB: OMT 2012, PEPP 2020 = replacement of fiscal capability

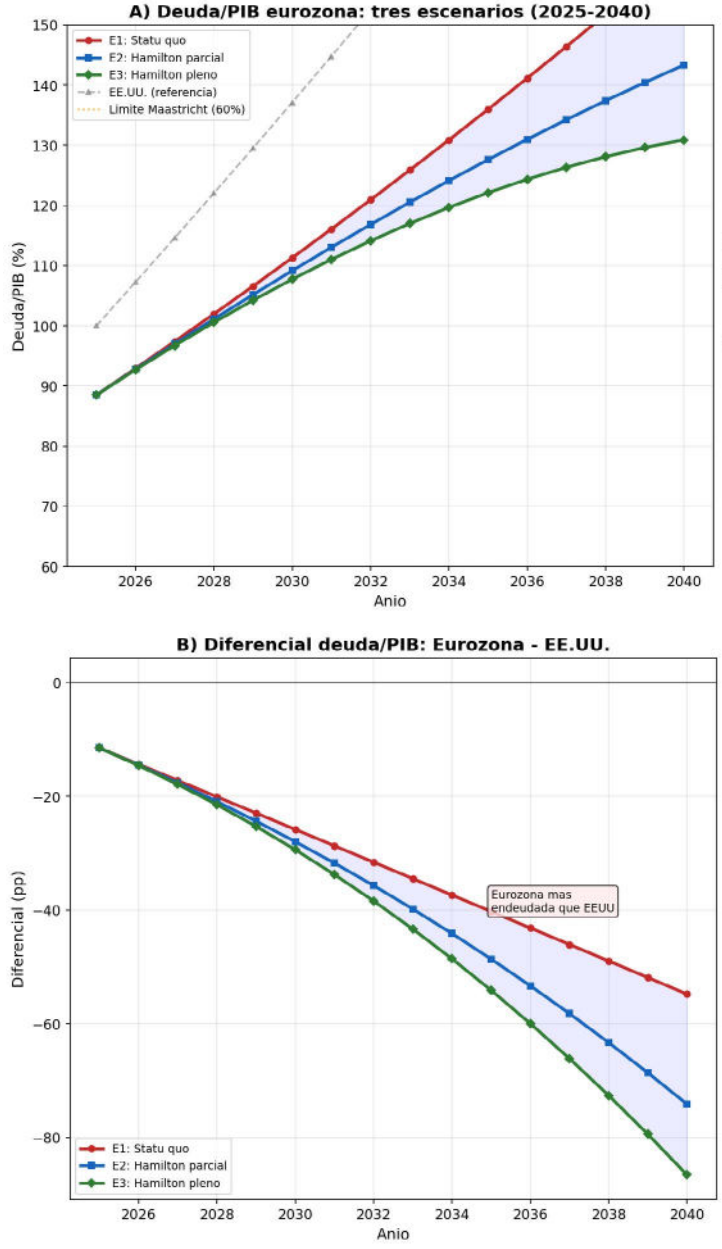
Source: author's own compilation.

II. Model simulations

Debt trajectories under the three scenarios

The following simulations show how Eurozone debt as a proportion of GDP evolves under each scenario (2025-2040), incorporating additional investment needs and the various capacities for generating primary surpluses. Scenario 1 (the status quo) takes debt above 110% of GDP; Scenario 2 (partial Hamilton) stabilises it; Scenario 3 reduces it gradually.

Figure 14.
Eurozone debt/GDP trajectories under three scenarios (2025-2040)



Source: author's own compilation.

Own revenues required

In order for the joint debt to be credible in Sargent's terms, the EU requires its own revenues that generate a sufficient process of surpluses.

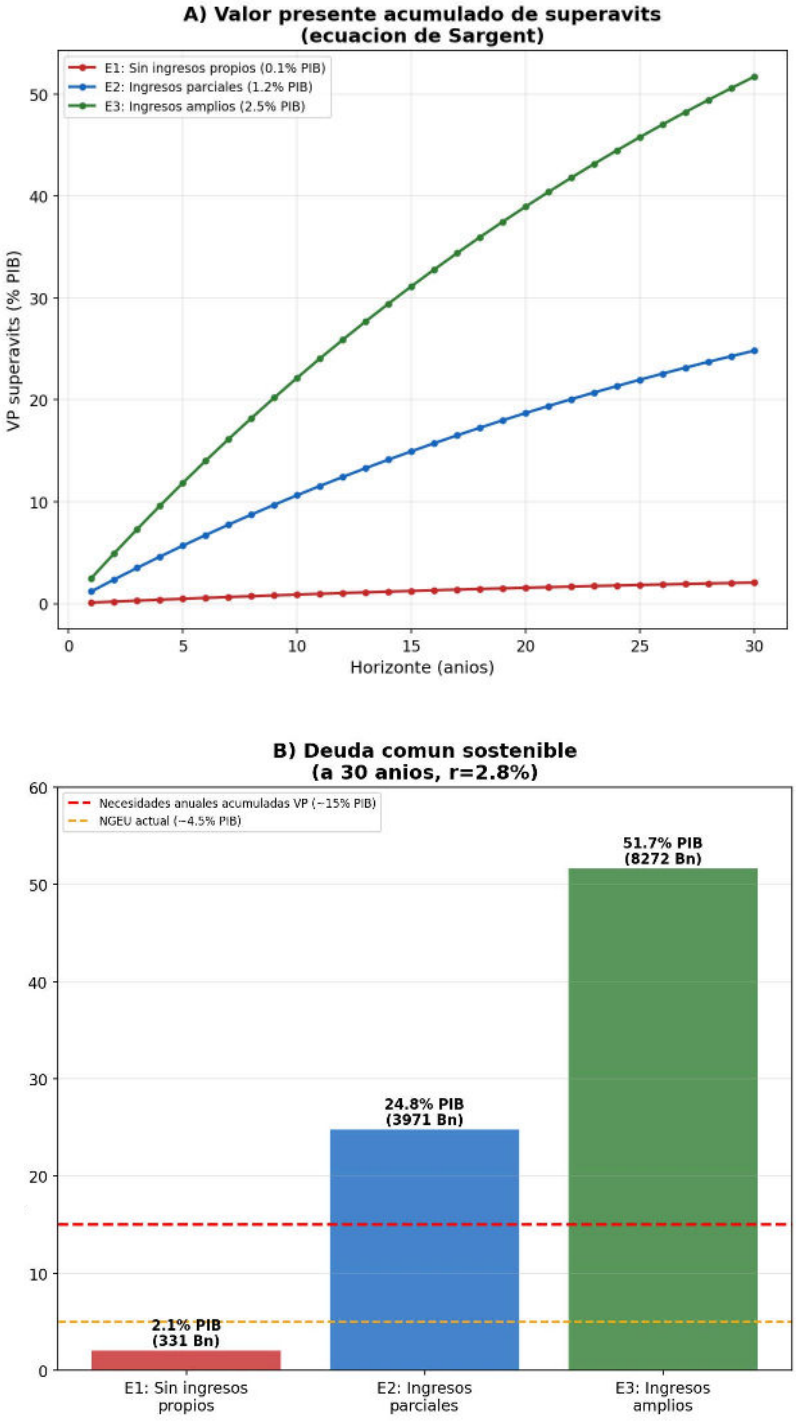
Figure 15.
AProposals for the EU's own revenues

Source	Est. revenue (€ Bn/a)	Viability	Hamiltonian parallel
Harmonised European VAT (1 additional pp)	~140	High	Federal tariffs: broader fiscal base
Extended CBAM (carbon border adjustment mechanism)	~40-60	Medium	*Hamilton's excise taxes*
Digital/digital services tax	~15-25	Medium	Taxing value where it is created
Defence contribution (new resource)	~50-80	Medium	Revenues earmarked for public good
Financial transaction tax	~15-30	Low	Tax on whiskey (1791)
ECB benefits (seigniorage)	~20-30	Medium	Monetary revenues as a complement
Extended customs rights	~10-15	High	Hamiltonian monopoly on tariffs
ESTIMATED TOTAL	290-480		Hamilton: ~5 % GDP; the EU needs ~2-3 %

Source: author's own compilation.

Figure 16.

Present value of surpluses and sustainable debt under three levels of own revenues



Source: author's own compilation.

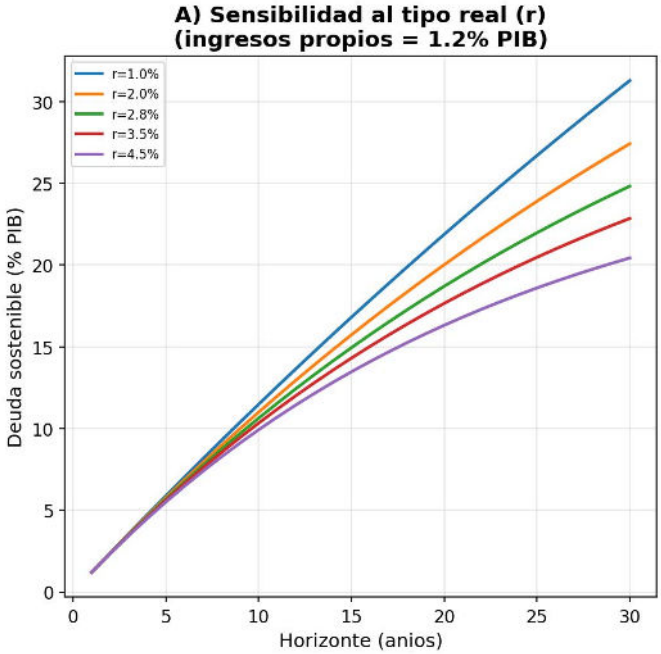
Analysis of sensitivity

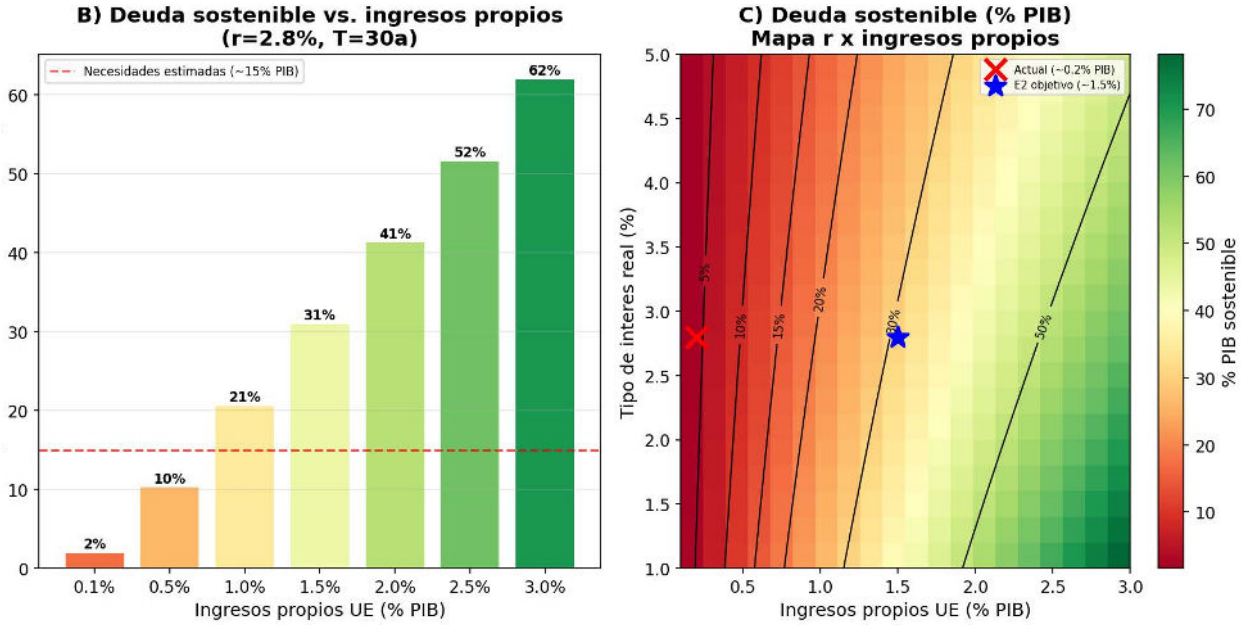
The viability of joint fiscal capability depends critically on three variables:

- The real interest rate.
- Growth.
- Own sources of revenue.

With revenues of 1,5% of GDP and a real interest rate of 2,8%, the EU can sustain joint debt of approximately 32% of GDP, sufficient to finance scenario 2. The heat map shows sustainable debt fluctuates between 2% and 65% of GDP, depending on a combination of parameters.

Figura 17.
Analysis of sensitivity-sustainable debt, depending on real interest rate and own revenues



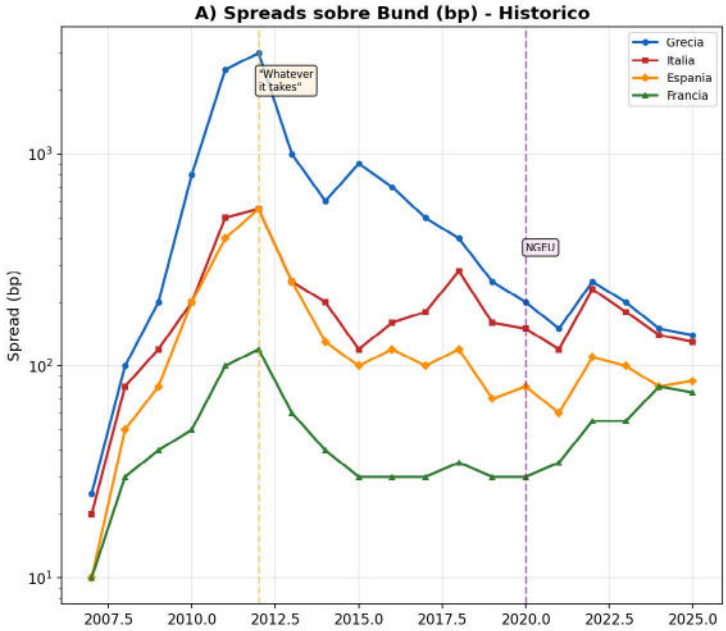


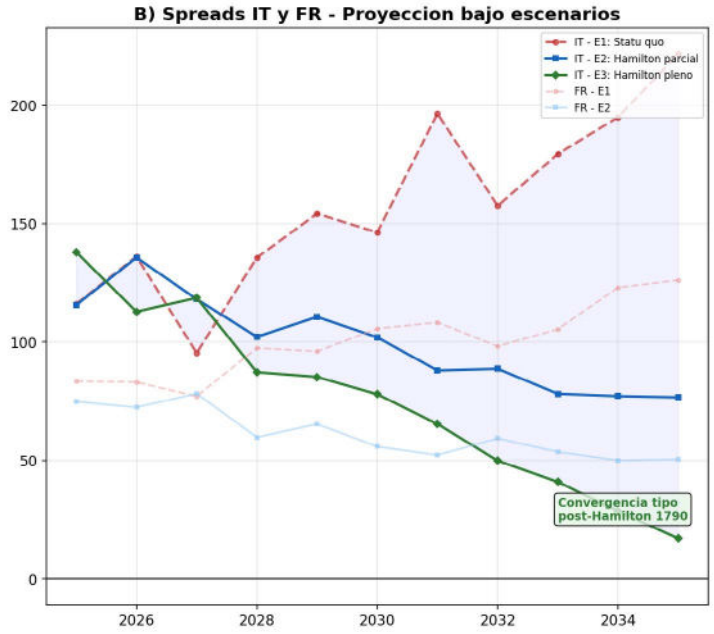
Source: author's own compilation.

Sovereign spreads

Spreads to the German bund are the market's translation of Sargent's equation: they measure the difference in credibility among national surplus processes. If the EU were to acquire credible fiscal capability, the spreads ought to converge, just as the states' interest rates converged following Hamilton in 1790. In Scenario 3 (full Hamilton), the convergence is rapid; in Scenario 2, gradual; and in Scenario 1, the spreads stay the same or become greater.

Figura 18.
Historic sovereign spreads and forecast by scenario





Source: author's own compilation.

Bibliography

The bibliography is arranged in two sections, dividing the sources so as to delve deeper into the American and European experiences. Each section is ordered in terms of relevance and depending on its canonical status in the academic literature.

I. US: the Articles of Confederation, fiscal crisis and Hamiltonian moment

Classic primary sources:

- **Sargent, T. J. (2012)**, "United States Then, Europe Now", *Journal of Political Economy*, 120(1), 1-40.

  The Nobel Prize lecture. Indispensable.

- **Hamilton, A. (1790),** *First Report on the Public Credit*, available at Founders Online (National Archives).

  The original document in which Hamilton proposes the assumption of debt and the monopoly on tariffs.

- **Sargent, T. J. y Velde, F. (1995),** "Macroeconomic Features of the French Revolution", *Journal of Political Economy,* 103(3), 474-518.

On the Confederation and the fiscal crisis of the 1780s:

- **Edling, M. M. (2003)**, *A Revolution in Favor of Government: Origins of the U.S. Constitution and the Making of the American State*, Oxford University Press.

  The best book on why the Articles of Confederation failed in fiscal terms and how this led to the Constitution of 1787. Directly pertinent to the column of the table regarding non-existent fiscal capacity, voluntary requisitions and unanimity.

- **Rakove, J. N. (1996),** *Original Meanings: Politics and Ideas in the Making of the Constitution,* Vintage.

  Pulitzer Prize-winner. Explains the institutional design of the Philadelphia Convention and the logic of the majority rule (9/13) compared to confederal unanimity.

- **Jensen, M. (1950),** *The New Nation: A History of the United States During the Confederation, 1781-1789*, Knopf.

  The classic work on the confederal period. Details the 13 separate trade policies, the state militias and the inability to collect taxes.

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- **Chernow, R. (2004),** *Alexander Hamilton*, Penguin.

  The definitive, highly readable biography. Covers the Grand Bargain (assumption of debts in exchange for siting the capital on the Potomac) and the founding of the First Bank..

- **Sylla, R., Wright, R. E. y Cowen, D. J. (2009),** "Alexander Hamilton, Central Banker: Crisis Management during the U.S. Financial Panic of 1792", *Business History Review*, 83(1), 61-86.

  Hamilton as manager of the first American financial crisis.

- **Hall, G. J. y Sargent, T. J. (2014)**, "Fiscal Discriminations in Three Wars", *Journal of Monetary Economics*, 67, 148-166.

  Sargent investigates how war debt was managed in three American episodes.

On the 1837 crisis and the rejection of the bailout (the 1840s column):

- **Wallis, J. J. (2005),** "Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842 to 1852", *Journal of Economic History*, 65(1), 211-256.

  The standard paper on the states' post-1840 balanced budget amendments.

- **English, W. B. (1996),** "Understanding the Costs of Sovereign Default: American State Debts in the 1840s". *American Economic Review*, 86(1), 259-275.

  Quantifies the cost of the states' default and the rejection of the bailout.

- **Ratchford, B. U. (1941),** *American State Debts*, Duke University Press.

  The classic study of state indebtedness in the 19th century. Covers the nine states in default and the refusal of the remaining four.

- **Sargent, T. J. (2012),** *Nobel Lecture: United States Then, Europe Now*.

  In particular sections 4-6 on the 1840s, where Ratchford and William Gouge are repeatedly cited.

II. EU: fiscal architecture, the euro crisis and current reforms

On European fiscal architecture and its shortcomings:

- **De Grauwe, P. (2018),** *Economics of Monetary Union*, Oxford University Press, 13th ed.

  The standard manual on why a monetary union without fiscal union is incomplete. Directly pertinent to the rows concerning "order of reforms" and "central fiscal capability".

- **Draghi, M. (2024),** *The Future of European Competitiveness*, Comisión Europea.

  The report that quantifies the investment gap of €800 Bn/per annum and gives support to the column of the table concerning competitiveness.

- **Pisani-Ferry, J. (2024),** *A New Governance for a Changing European Union.*

  Report commissioned by Emmanuel Macron regarding institutional reform of the EU, including enhanced cooperation and new sources of EU-exclusive revenue.

On the euro crisis and "whatever it takes":

- **Brunnermeier, M. K., James, H. y Landau, J. P. (2016),** *The Euro and the Battle of Idea*, Princeton University Press.

  The definitive book on the clash between the French (solidarity) and German (rules) views of the Eurozone. Directly pertinent to the heterogeneity and unanimity rows.

- **Tooze, A. (2018),** *Crashed: How a Decade of Financial Crises Changed the World,* Viking.

  Covers the euro crisis of 2010-2015 with institutional details. Very good on Draghi's Outright Monetary Transactions (OMTs) and opaque fiscal-monetary coordination.

- **Sandbu, M. (2015),** *Europe's Orphan: The Future of the Euro and the Politics of Debt,* Princeton University Press.

  Argues that the euro crisis was avoidable and that the problem is political, not economic. Pertinent to "shared identity: under construction".

On joint debt, and Europe's Hamiltonian moment:

- **Bénassy-Quéré, A., Brunnermeier, M. et al. (2018),** *Reconciling Risk Sharing with Market Discipline: A Constructive Approach to Euro Area Reform*, CEPR Policy Insight, 91.

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- **Grund, S. y Steinbach, A. (2023),** "The EU's Hamiltonian Moment? A Critical Appraisal of NGEU", *European Law Journal*, 29(1), 21-42.

  Assesses to what extent the NGEU constitutes a genuine Hamiltonian moment or a fleeting precedent.

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  Quantifies the defence gap and assesses ReArm Europe.

- **Fiott, D. (2025),** T*he EU's Defense Investment Gap: From Ambition to Implementation*, EU Institute for Security Studies.

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III. Bridging works that connect both columns:

- **Henning, C. R. y Kessler, M. (2012),** *Fiscal Federalism: US History for Architects of Europe's Fiscal Union*, Peterson Institute Working Paper, 12-1.

  The article that probably most directly connects the two columns of the table. Analyses the lessons of the American fiscal experience for the European design.

- **Bordo, M. D., Markiewicz, A. y Jonung, L. (2013),** *A Fiscal Union for the Euro: Some Lessons from History*, CESifo Economic Studies, 59(3), 449-488.

  Compares the fiscal construction of the US, Germany, Switzerland and the EU.

- **Sargent, T.J. (2023),** *Fiscal Histories, speech given at the Federal Reserve Bank of Minneapolis.*

  Sargent updates his framework with new data and post-COVID reflections. Directly pertinent to the current situation.

Author

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Recommended Quote:

Ruiz, J. J. (2026), "Returning to Sargent: United States then, Europe now", *Working Paper*, Elcano Royal Institute.

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