Eurobonds for all 27 UE Member States – one more option for the common issuance: reply to the COM(2011) 818 final GREEN PAPER on the feasibility of introducing Stability Bonds

In the presented Green Paper on the feasibility of introducing Stability Bonds is stated:

"In principle, common issuance could also extend to non-euro area Member States but would imply exchange rate risk. Several non-euro area Member States have already a large part of their obligations denominated in euro, so this should not represent a significant obstacle. All EU Member States might have an interest in joining the Stability Bond, especially if that would help reducing and securing their funding costs and generates positive effects on the economy through the internal market. From the point of view of the Stability Bond, the higher the number of Member States participates, the bigger are likely to be the positive effects, notably stemming from larger liquidity" (Green Paper, p.2, footnote 2).

I strongly agree with that view. Why is the solution to the current crisis would only be possible through closer cooperation between 17 euro zone countries? The mechanism of mutual guarantees in the form of Eurobonds would be even more effective if applied to all 27 EU Member States. On the other hand the common issuance which concerns only euro area could be disastrous for the non-euro countries (author prefers term 'Eurobonds' because 'Stability Bonds' sounds like 'Emergency Bonds'; another good term could be 'Eurotreasury bonds' or 'European Treasury bonds', which is similar to well known 'US Treasury bonds').

The proposed additional common issuance option, outlined in this paper, implies:

- participation of all 27 EU countries (high liquidity of common issuance, non discrimination),
- gradually phasing-in with a possibility to observe the reaction of financial markets,
- all Member States would continue issuing their own national bonds at the same volume on a decentralised basis (without any changes in their law and institutions),
- a limited moral hazard as all countries would pay all their interests and principal payments (only interest rates' spreads would be decreased),
- politically acceptable while a presented option would not require restricting the autonomy of the economic and fiscal policies of the Member States and would not impose excessive costs on the countries with the highest credit ratings,

- possibility for additional administrative steps to strengthen the budgetary discipline,
- transparent construction, fair and more market oriented solution without necessity of discretionary transfer of benefits,
- relatively easy implementation (the less the possible changes in law and institutions).

Considering the impact of the presented three options on the non-euro Member States of the EU it is stated "however, these Member States [non-euro Member States] would nevertheless be affected by the introduction of Stability Bonds, accompanied by a reinforced framework of economic governance. Financial stability across the euro area fostered by Stability Bonds would also directly and substantially stabilise financial markets and institutions in these countries" (Green Paper, p. 19). I think it is only partially true.

On the page 4 of the Green Paper is stated that: "Stability Bonds would provide all participating Member States with more secure access to refinancing, preventing a sudden loss of market access due to unwarranted risk aversion and/or herd behaviour among investors." That means, all non participating Member States could face a strong disadvantages compared to the euro zone countries.

So, why not to create a new EU institution, which could gradually buy debt securities of all 27 EU Member States? The purchased shares of national debts would be proportional to the GDPs. Funds for this purpose would be derived from the common issuance with joint and several guarantees.

The EU Member States would continue issuing their own bonds at the same volume on a decentralised basis (without any changes in their law and institutions). However, the agency issuing Eurobonds would gradually buy debt securities of all 27 Member States (only central government debt securities) and would build a portfolio of those assets. National issuances collected by debt management office would correspond to the share of the GDPs of particular countries in the whole EU GDP.

The phasing-in would be gradual while national debts could be purchased both on the primary or the secondary market. All participating countries could achieve their ceiling at the same time. The degree of substitution of national issuances would depend on the response of financial markets and could be variable over the time (with a maximum ceiling at the 60% of the GDP). It would be also possible to begin with a relatively low substitution level to have enough time and data to estimate all possible effects. To ensure the confidence of financial markets it would be important to centralise the common issuance in the single debt management office.

I agree that common issuance would foster the establishment and implementation of necessary framework for economic and fiscal integration but I'm also convinced that it should be an integration of the whole European Union, not only euro zone. The common issuance presented above and later in this paper could imply a deepening of economic integration of the whole UE. It could have the acceptance of 10 countries outside the euro zone and would facilitate the adoption of the euro by those countries. Moreover, in the future, it would be also possible to involve EU associated countries. Many Member States outside the euro zone have now the credit situation better than Greece, Portugal, Spain, Italy or Ireland so they could positively contribute to the common issuance project.

Long-term solution to fiscal crisis should encompass the current and the future euro zone countries. Eurobonds interest rate would then be representative for the whole EU (in the case of euro area issuance – all three Green Paper's options, the single benchmark yield would not be representative for the whole EU). The joint and several guarantees would make that common bonds will be an instrument with a low risk and really high liquidity.

Interest rates of high-risk countries would be stabilised and the differences between interest rates of countries with varying degrees of risk would be decreased. Countries with a high credit ratings would retain premiums in the form of lower credit costs. However, reducing the interest rates' spreads would reflect the presence of the common risk area covering all EU countries. Lowering of the high risk countries interest rates would make their loans more sustainable but still differing interest rates would provide needed incentives for fiscal solidity. To be clear, it would be only decreased spreads but not the same interest rates for high and low-risk countries. Each Member State would pay its own interests but some part of those payments would be a revenues of a central debt management office gathering national debts and issuing Eurobonds. The decreasing of spreads would be some kind of return to the situation of the 2008 year or even before.

If the yield of the Eurobonds would be lower than the weight average of the national bonds' yields than this surplus could rise the capital of the central debt management office increasing the credit quality of common issuance. It would be also fair solution as the higher-risk countries will pay a higher interests and thus will contribute more to the guarantee capital. Almost all advantages of joint euro zone issuance listed in the Green Paper will also be actual in the case of the whole EU issuance. While a degree of substitution would vary over the time and would depend on the market conditions so the main effects could also depend on the actual level of the common issuance. It would be also relatively small shift of benefits from higher to lower rated countries.

The proposed whole EU issuance would be more market oriented. All the countries would continue issuing their own bonds at the same volume on a decentralised basis paying their own interests but pooling a part of the national debts would decrease interest rates' spreads. In the most advantageous case it would be no losers among the Member States. The main idea is to share risk not benefits. In this case the moral hazard would be less significant because of high marginal cost of the lack of the discipline. It is clear, that all additional steps to ensure the fiscal surveillance and sustainable public finances would be desirable. The guarantee deposits or other form of collateralisation made by individual countries to the issuing agency could also be taken into account.

On the page 23 of Green Paper is stated:"In order to implement the vision of Stability Bonds as "stability bonds" one might also set macro-economic and fiscal conditions for Member States in order to enter and remain in the system (...) Access could also be limited as a function of the degree of non-compliance, i.e. a deviation of the general government budget by each percentage point of GDP might reduce the right to issue Stability Bonds by a certain amount of percentage points of GDP". I think it is generally a good idea and it would be also possible at the whole EU approach presented in this paper.

Although the proposed solution seems similar to the so called blue-red approach, it is significantly different. At the blue-red approach it would be also partial substitution of national debts but this approach assumes that all countries would pay the same "blue interest". It is not the case at the proposed solution (all countries would pay their own interests but at the significantly decreased spreads).

At the blue-red option "the scale of national issuance by each Member State would depend on the agreed scale of common issuance of Stability Bonds and its overall refinancing needs. Depending on the size of these residual national bond markets and issuances and the country's credit quality, these national bonds would have country-specific liquidity and credit features and accordingly different market yields, also since most sovereign credit risk would be concentrated in the national bonds, amplifying the credit risk" (Green Paper, p. 14-15). That means obviously that the intensified market pressure on national issuance would provide market discipline but on the other hand low-rated countries or even these highest-rated with a high debt level could face unsustainable "red interests". In my view at the blue-red approach the high risk of catastrophic default would concern not only the high-risk countries but also the low-risk countries with a high level of public debt (several high-rated countries have a public debt above 80% of GDP).

The proposed, at the blue-red option, more flexible system also seems to be unstable. “Non-compliance could be sanctioned by a (possibly automatic) lowering of the respective Stability Bond debt ceiling for the Member State concerned” (Green Paper, p.15). That means: the worse budgetary discipline the lower ceiling and the higher average interest – it is the automatic way to the catastrophic default. Last but not least the blue-red approach seems to be technically and institutionally complicated.

Comparatively, the proposed in this paper whole EU approach would be relatively easy to implement because it requires no changes in the legal systems of member countries and does not need to convince citizens and their representatives in Parliaments. The limited moral hazard means also a relatively low degree of necessary changes (as a required precondition) to economic and fiscal governance, making the implementation process less complex and time-consuming. In the longer perspective all positive changes to economic governance are obviously welcomed. This solution does not exclude taking other actions with efforts to deepen economic integration of euro-zone countries and the whole EU and also to enforce fiscal solidity.

This proposal could have also a relatively wide political acceptance while it does not require restricting the autonomy of the economic and fiscal policies of member countries and does not impose excessive costs on the countries with the highest credit ratings. The proposed solution is fair and is based on risk sharing, not money sharing. The most important effect would be the shift from the two speed transfer-union concept to the idea of the deepen integrated risk-sharing-union. The solution would also leave door open for the future EU countries.

The success of the project and the stabilization of the single currency could encourage other countries to adopt the single currency. The common financial commitment of the Member States would be a strong element of European identity. In the long term, the euro could successfully compete with other currencies as a reserve currency, bringing further benefits to the entire European Union.

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