Levy Economics Institute of Bard College

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Policy Note

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RESOLVING THE EUROZONE CRISIS—WITHOUT DEBT BUYOUTS, NATIONAL GUARANTEES, MUTUAL INSURANCE, OR FISCAL TRANSFERS

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1. Overview

One of the reasons for the failure of the Economic and Financial Affairs Council (Ecofin) and the European Council to resolve the eurozone crisis is resistance to debt buyouts, national guarantees, mutual insurance, and fiscal transfers between member-states. This paper argues that none of these are necessary, either to convert a share of national bonds to European Union (EU) bonds, or for net issues of eurobonds. In so arguing, it draws on an earlier report recommending Union bonds to European Commission President Jacques Delors, which he then included in his White Paper of December 1993.[1]

1. In funding the New Deal, the Roosevelt administration did not buy out the debt of the American Union's "member-states," nor did it require them to guarantee US Treasury bonds or demand fiscal transfers from them.
2. The United States funds its Treasury bonds from federal taxes, whereas Europe does not have a common fiscal policy. But member-states can finance the share of their national bonds converted to Union bonds without fiscal transfers.

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3. The European Investment Bank (EIB) has issued its own bonds for 50 years without national guarantees or fiscal transfers and is already twice as large as the World Bank. The European Central Bank (ECB) is the nominal guardian of stability, but the EIB can safeguard growth.
4. Conversion of a share of national debt to Union bonds could be made on the basis of an enhanced cooperation agreement whereby some member-states could retain their own bonds.[2]
5. Jean-Claude Juncker and Giulio Tremonti are right in arguing that sovereign Union bonds should be globally traded, would attract global surpluses, and could enable the euro to become a global reserve currency.[3]
6. But a share of converted national bonds could be held by the Union on its own account, rather than traded. This would ring-fence the converted bonds from rating agencies and enable governments to govern, rather than the agencies.

While some member-states are deep in debt, the EU itself has next to none. Until May 2010 and the beginning of national debt buyouts, it had none at all. Even with such buyouts and salvage operations for banks, EU debt is still less than 2 percent of GDP. This is less than a fifth of the US debt-to-GDP ratio in the 1930s, when the Roosevelt administration began to shift savings into investment through the expansion of US Treasury bonds.[4]

2. Stabilization by Untraded Union Bonds

European finance ministers have been considering a variant on the Brussels-based Bruegel Institute's proposal for EU bonds, but the proposal has major shortcomings that are eliciting opposition, especially from Germany:

1. The proposal assumes that the debt would be traded.
2. It also assumes that the bonds would need a new institution.
3. It proposes making member-states jointly and severally liable for the bonds.
4. It also calls for a standardized collective action clause that could include fiscal transfers.
5. The proposal would need approval by all national parliaments rather than joint action by member-states through the European Council.

However, as former heads of government such as Giuliano Amato, Guy Verhofstadt, Michel Rocard, Mario Soares, and others have suggested,[5] such conditions for debt stabilization are not needed. The reasons are as follows:

1. National debt converted to Union bonds need not be traded. If held and managed by the EU in a debit account, such bonds would be ring-fenced against downgrading by rating agencies.
2. As bonds of different maturities reached term they would not need to be repaid, while a sustainable interest rate for their renewal could be determined by the Eurogroup of eurozone finance ministers, rather than rating agencies.
3. Member-states' share of the converted debt would be serviced by them from their national tax revenues, without the need for a common fiscal policy or national guarantees, and without fiscal transfers from other member-states.
4. Joint and several liability for the bonds and a standardized collective action clause would therefore not be needed.
5. The transferred debt would not need a new institution but could be held by the ECB or the European Financial Stability Facility.
6. The conversion of national debt of up to the Maastricht limit of 60 percent of GDP could be on an enhanced cooperation basis—as was the creation of the euro—without obliging all member-states to adopt it. Germany, Austria, the Netherlands, and Finland could keep their own bonds without liability for the converted debt.

3. Recovery by Tradable Eurobonds

Net issues of eurobonds could be traded and would attract surpluses from the central banks of emerging economies and sovereign wealth funds.

The Initial Design Role for the European Investment Fund

The European Investment Fund (EIF) was designed to issue the Union bonds recommended in 1993 in the Delors White Paper. Its role was to use them to finance a European Venture Capital Fund.[6] Germany and France were opposed to Union bonds, and as a result, the EIF's originally intended role for such a fund was downgraded to that of provider of ineffectual loan guarantees for small and medium enterprises (SMEs).

Recovering the EIF Role as Part of the EIB Group

The EIF has been brought into the EIB Group, which should strengthen its role as net issuer of bonds to finance growth. The EIB could advise on eurobond issues by the EIF, drawing on its long-standing credibility with markets in issuing bonds without debt buyouts, guarantees, insurance schemes, or fiscal transfers. A decision on net eurobond issues could be made by Ecofin, which is the governing body of the EIB Group.

Cofinancing EIB Projects

The traded eurobonds could cofund EIB project finance and be serviced by revenues from EIB projects, rather than fiscal transfers between member-states. Project control would be retained by the EIB. They could also finance a European Venture Capital Fund for SMEs, reinforcing the EIF's remit to support SMEs and the competitiveness of smaller firms in the European periphery, including new high-tech startups.

Cohesion and Convergence

Since the launch of the Amsterdam Special Action Programme in 1997, the EIB has been given both cohesion and convergence remits by the European Council to invest in health, education, urban renewal, green technology, SMEs, and high-tech startups, building on the 1994 Council decision that the EIB should fund trans-European transport and communications networks. In just 14 years, the EIB has quadrupled its annual investment finance to the equivalent of two-thirds of the Commission's own resources. By quadrupling its investment yet again by 2020, aided by cofinance from eurobonds, the EIB's bond-funded investment finance would be the equivalent of Marshall Aid, and could make a reality of the European Economic Recovery Programme (EERP).

4. Global Implications

If some eurozone member-states default, and the single currency serially disintegrates, there would be catastrophic consequences not only for Europe, but also for the United States and the global trading system.

Offsetting Default Risk

By contrast, net issues of eurobonds would:

1. Secure the euro as a reserve currency and contribute to the more plural global reserve system, which is one of the main aims of Brazil, Russia, India, China, and South Africa.
2. Contribute to balanced global growth, which is a central aim of the G20, by recycling global surpluses.

Implications for the United States

The implications for the United States of the euro attaining global reserve currency status are two-sided:

1. The dollar would no longer have the advantage of being the sole reserve currency.
2. Inversely, it would not be subject to the risk that it could not sustain this role.

Net gains for the United States would depend on net issues of eurobonds to finance the EERP rather than debt stabilization alone. With such a recovery, and with Europe making up a third of the global economy, US exports would increase. In its own interest, yet also to mutual advantage, China could agree to an orderly reduction of its holdings of dollars, or maintain them while its net surplus flows into eurobonds.

Notes

1. See Stuart Holland, *The European Imperative: Economic and Social Cohesion in the 1990s* (Nottingham: Spokesman Press, 1993). Foreword by Jacques Delors.
2. According to the Lisbon Treaty, enhanced cooperation is by a minority of member-states. Yet the introduction of the euro itself was a de facto case of majority-enhanced cooperation.
3. Claude Juncker and Giulio Tremonti, "E-bonds would end the crisis," *Financial Times*, December 5, 2010.
4. The United States did not opt for deficit financing until Roosevelt's second term. But the main drivers of recovery from the Great Depression in both his first and second terms came from bond-financed social and environmental investments, which Europe could parallel now.
5. Giuliano Amato and Guy Verhofstadt, "A Plan to Save the Euro and Curb Speculators," *Financial Times*, International Edition, July 3, 2011.
6. See Holland, *The European Imperative*.