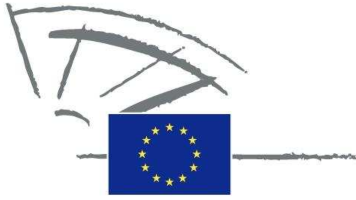

EUROPEAN PARLIAMENT 2009 - 2014

Committee on Economic and Monetary Affairs

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DRAFT REPORT

on the feasibility of introducing Stability Bonds
(2012/2028(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Sylvie Goulard

PR_INI

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on the feasibility of introducing Stability Bonds

(2012/2028(INI))

The European Parliament,

– having regard to the enhanced economic governance framework of the Union, including the six-pack, the forthcoming two-pack and the fiscal compact;

– having regard to the Commission Green Paper dated 23 November 2011 on the feasibility of introducing Stability Bonds,

– having regard to its resolution of 15 February 2012 on the feasibility of introducing Stability Bonds[1],

– having regard to Rule 48 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs and the opinions of the Committee on the Internal Market and Consumer Protection and the Committee on Legal Affairs (A7-0000/2012),

A. whereas Parliament requested that the Commission submit a report on the possibility of introducing eurobonds, which was an integral part of the agreement between Parliament and the Council on the economic governance package (six pack); whereas the Green Paper, however, proposes neither crisis resolution measures nor ways in which the options presented could be implemented;

B. whereas the eurozone is in a unique situation, with eurozone Member States sharing a single currency but no common fiscal policy or common bond market;

1. Takes note of the various crisis mitigation and resolution efforts of the European institutions, particularly the establishment of the EFSM, the EFSF, the SMP and the LTRO, and the agreement on the ESM and the fiscal compact;

2. Welcomes the fiscal consolidation and structural reform efforts undertaken by Member States;

3. Is deeply concerned, however, that despite Member States' reform and consolidation efforts euro area sovereign bond markets are in distress, reflected in widening spreads and high volatility;

4. Believes that there is an urgent need to further discuss a longer-term vision for the euro area which ensures sound public finances, sustainable growth and high levels of employment, preventing moral hazard and supporting convergence;

[1] Texts adopted, P7_TA(2012)0046.

5. Points out that it is in the long-term strategic interest of the eurozone to draw all possible benefits from issuing the euro, such as establishing a common liquid and diversified bond market and establishing the euro as a global reserve currency;

6. Stresses that all existing and future instruments or institutions which are *sensu stricto* or *sensu lato* part of the economic governance framework of the Union need to be democratically legitimised and made accountable by involving the parliaments of the Member States and the European Parliament in the setting-up and running of these instruments or institutions;

7. Believes that the prospect of common bonds can foster stability in the euro area and be an additional element to incentivise compliance with the stability and growth pact; reiterates its position that sequencing is a key issue involving a binding roadmap, included in the annex, similar to the Maastricht criteria for introducing the single currency;

8. Urges Member States to seriously consider the option of immediately establishing a European Redemption Fund in order to allow participating countries to reduce excessive debt over a maximum period of 25 years by using the interest rate savings for debt reduction;

9. Urges Member States to seriously consider the immediate issuance of common short-term debt in the form of eurobills to protect Member States with fundamentally sustainable fiscal polices from illiquidity runs and the negative feedback loop between sovereign and banking crises;

10. Calls on the Commission to prepare contingency plans allowing a rapid implementation of these schemes;

11. Believes that, in parallel, there is an urgent need to recapitalise the European banking sector and to further complete financial integration in the EU; calls on the Commission to put forward proposals for a single financial supervisory authority to oversee systemic financial institutions, a banking resolution regime including a recapitalisation fund and an EU-wide deposit guarantee scheme;

12. Believes that the issuance of common bonds under separate liability, similar to the EFSF bond, risks not being sufficiently attractive for investors and that the roadmap should therefore include a system, which does not require any Treaty change, for the allocation of debt below 60 % of GDP to be issued under joint and several liabilities (blue-bond/red-bond proposal);

13. Believes that if the blue-bond/red-bond system proves to be beneficial to the euro area as a whole, a further step, requiring a Treaty change, should be envisaged, which is the issuance of bonds under joint and several liability;

14. Advocates, following the implementation of short-term measures to exit the crisis, the setting-up of a committee inspired by the Delors Committee of 1988, including representatives from Member States, the Commission and the ECB; believes that this committee should evaluate progress and make recommendations for further steps with regard to post-crisis phases, to be discussed in Parliament; takes the view that this

committee should also look at the possibility of issuing genuine federal bonds;

15. Instructs its President to forward this resolution to the Council, the Commission and the European Central Bank.

ANNEX

The Roadmap

Phase 1 - Immediate measures to exit the crisis

1. Setting up of a temporary European redemption fund to reduce debt to sustainable levels at affordable interest rates

The Commission makes a proposal for the immediate setting up of a temporary European redemption fund along the following principles:

- transfer of debt amounts above the Maastricht reference value of 60 % of GDP to a common fund subject to joint and several liability through a roll-in phase of five years;
- limit participation to Member States without an adjustment programme; provide for a phasing in of Member States that have successfully completed an adjustment programme;
- oblige Member States to autonomously redeem the transferred debt over a period of maximum 25 years by using the interest rate savings for debt redemption which could be shorter if the growth rate is higher than foreseen;
- implement the national debt brakes introduced in the fiscal compact to limit the debts that remain exclusively with the participating Member States at a maximum of 60 % of GDP and oblige Member States to cover their liabilities by risk-free collateral;
- implement the new framework of economic governance together with a binding structural reform agenda monitored by the Commission;

2. Introducing eurobills to protect Member States from illiquidity runs

The Commission makes a proposal for the immediate setting up of a system for the issuance of common short-term debt along the following principles:

- establish an agency or use an existing entity to issue eurobills and limit participation to Member States that comply with the rules as set-out in the Stability and Growth Pact;
- maximum maturity of eurobills (amounting to maximum 10% of GDP) of up to one year, which allows for continued monitoring and due to short term maturity frequent renewal of guarantees;
- eurobills replace all short-term debt to be issued by Member States which consequently remain solely responsible for issuing their own debt for longer maturities;
- provide for dismissible participation by a decision of the national parliament;

The Commission shall make a regular and continuous assessment of the functioning of

the system accompanied, where appropriate, by recommendations for improvement and necessary adjustments for subsequent steps.

Phase 2 - Blue bond proposal: yearly allocated debt ≤ 60 % of GDP to be issued in common without a Treaty change

With the start of phase 2, a committee of independent representatives from Member States, the Commission and the ECB (along the line of the Delors committee decided in June 1988 by the European Council) shall be set-up to evaluate progress and make recommendations for further steps.

The Commission puts forward proposals for the setting up of a system for the allocation of debt below 60 % of GDP to be issued in common, which is safeguarded by national debt brakes according to principles such as:

- limit participation to Member States that comply with the Stability and Growth Pact and the fiscal compact and are not under an adjustment programme;

- strictly limit the amount of debt to be issued under joint and several liabilities to a part of less than 60 % of GDP by prohibiting participating Member States from issuing senior debt outside the common issuance;

- oblige participating Member States to put collateral representing its amount of debt issued in common;

- design an allocation mechanism taking into account the respect of the fiscal discipline and weighted by borrowing requirements;

Phase 3 - Common issuance of national debt involving a Treaty change

On the basis of the work of the committee, the Commission puts forward, if appropriate, proposals for a Treaty change (and where necessary, Member States' constitutional changes) and the setting up of a system for the common issuance of bonds according to the following principles:

- limit participation to Member States which comply with the conditions as set out in phase 2;

- establish a European debt agency for the issuance of bonds, or confer this task to the ESM;

- establish appropriate, democratically legitimate institutions which would among others be in charge of the surveillance and coordination of national fiscal policies and the competitiveness agenda, as well as the external representation of the euro area in international financial institutions;

Phase 4 - Common issuance of a genuine European debt

The Commission, after having prepared all eventual changes to the EU legal framework, puts forward proposals for possible issuance of bonds to finance EU investments for EU

public goods (e.g. infrastructure, research and development, etc.) as well as serving as an instrument to facilitate fiscal adjustment in response to external shocks when cross-border effects are at play.

EXPLANATORY STATEMENT

1. The European Parliament introduced the idea of "Eurobonds" in the texts concerning the governance of the Euro zone ("6 pack")[1] for multiple reasons:

- to ensure sustainable budgetary discipline, founded on liquid markets, which reflect the respective situations of the Member States;
- to provide liquid and safe assets for investors, drawing on the benefits of the Euro's potential on the world markets;
- to protect the ECB by allowing it to focus on monetary policy.

Another issue is the danger which the current withdrawal of investors towards national debt represents for the Single Market.

2. The Green Paper[2] of the European Commission, whose publication was obtained by the EP during the "6 pack" negotiations, is a good starting point.

3. The aim of the current report is to go deeper still into this question, notably by studying the obstacles identified in the Resolution voted in the Parliamentary plenary by a large majority[3]: moral hazard, legal constraints, possible additional costs for AAA countries.

4. Given the link which exists between the sovereign debt crisis and the crisis in the banking sector, we mention, without being able to develop it here, the positive impact of a stabilisation of the sovereign debt markets on the banks. But Eurobonds are not a "miracle cure" to enable the sector to avoid undertaking specific measures, such as the creation of a resolution fund or a deposit guarantee fund.

5. The pooling of debt can not be considered lightly either. Linked to respecting strict conditions, it must be used for stability and not for ease, to limit moral hazard not to encourage it.

With the "6 pack", the "fiscal compact", and the "2 pack" in the process of being adopted[4], mutual budgetary surveillance and macro-economic convergence are in the process of being reinforced.

This is why a "roadmap" which links all progress towards Eurobonds with budgetary stabilisation and economic convergence is now able to be envisaged[5], the two processes must imperatively go hand in hand.

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[1] Draft report 11/01/2011, PR\853146EN ; Report, 02/05/2011, A7-0180/2011 ; First Reading, 28/09/2011, T7-0422/2011 – legislation entered into force end 2011
[2] Feasibility of introducing stability bonds, COM(2011) 0818 final, 23/11/2011
[3] Resolution of 15/02/ 12 on the feasibility of introducing stability bonds
[4] Draft regulations concerning common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit in the euro area
[5] Eurobonds are not to be confused with "project bonds" (bonds issued to finance infrastructure projects, and guaranteed by the European Investment Bank).

6. In order to provide citizens and the markets with a new horizon, it is important to look towards the middle-term, however, the worsening of the crisis calls for immediate action: the ECB has had to launch a programme to grant liquidity to banks (LTRO) and the spreads between Member States are increasing. In spite of engaging in reforms, some Member States are paying higher rates, at the risk of becoming insolvent, whereas others enjoy highly advantageous rates, in part thanks to their excellent performance, in part because of the troubles of their partners.

It is our responsibility to take measures to eliminate market distortions and to stabilise the Euro zone: if this situation continues, it will be the heart of the European project, the harmony between citizens, which would be affected. It would also impact on our credibility with third parties, as the G8 in Camp David has shown.

Part I. The Immediate Present

Two instruments can be used, in isolation, or by combining them, to limit the spreads between interest rates while still maintaining discipline.

I.1. The Sovereign Debt Redemption Fund ("Redemption Fund")

Proposed by the German Council of Economic Experts, it entails transferring[1] Member States' debt which exceeds 60% of national GDP into a fund, subject to joint liability, with a life span of approximately 25 years. The participating Member States commit themselves to respecting strict budgetary discipline and to undertaking reforms (competitiveness/growth). As well as ex ante guarantees (collaterals), certain tax revenues are assigned to the fund.

The finite life span reduces the moral hazard and the legal obstacle of joint debt[2]. Certainly, the additional cost of the debt which continues to be issued at the national level (60% of GDP) could be problematical for certain countries (Italy for example) whereas others (Spain for example) would draw a limited benefit. However, the "6 pack" already requires a dramatic debt reduction. Without a tool to contain interest rates, this commitment will be more difficult to respect.

That is why the ECON committee of the Parliament called for the creation of this fund, when the "2 pack" was voted on 14th June 2012.

I.2. Eurobills

Following a very different logic, the creation of eurobills[3] aims to eliminate the liquidity risk

[1] Annual report 2011/12 of the German Council of Economic Experts, Chapter III "Euro area in crisis" and Green Paper (Box 3).
[2] § 191 "The redemption pact would no doubt stand up to scrutiny by the German Supreme Court. According to its ruling of 7.9.11, German Parliament may not transfer its responsibility for the budget to other actors by indeterminate budget policy authorizations.
What is decisive here is first the option the German legislative then has on a case by case basis to decide on support payments to its European partners that impact on expenditure. Second, the potential encumbrance of the German federal budget must be constrained in time, scale and in substance."
[3] Eurobills, not Eurobonds, Ch. Hellwig and T. Philippon, voxeu.org

by the common financing of a part of the debt in the short term (maximum 10% of GDP/maturity of less than one year) of the participating Member States (or approximately 900 billion Euros). The Member States continue to decide the issuance timetable. Issuance is joint (by a debt agency) and exclusive; the guarantee is “joint and several”. It is possible to leave the system, according to the terms decided in advance.

Because the joint commitment by the Member States can be annulled at any time, there are a certain number of legal reservations which need to be overcome. By ensuring the liquidity of the debt market, these bills could also facilitate the phasing out of the ECB’s LTRO programme designed for banks. Combined with the capital requirement rules (implemented through “Basel III”), Eurobills could represent a particularly attractive investment.

Finally, these bills should indirectly generate lower long-term rates, as well as facilitate the transmission of the ECB’s monetary policy and risk management.

C. Lagarde and O. Blanchard (IMF) have taken position in the press in favour of these bills.

I.3. What about the existing tools (EFSF/ESM)?

With the EFSF, created in 2010, joint European securities have already been issued, in the spirit of the “3rd option” of the Green Paper (several liability). The discussion concerning “Eurobonds” needs a bit of perspective. It all depends on what we are talking about.

“Start small”, without joint guarantees, seems tempting but these securities still need to find takers[1], without excessive collaterals. This is why we are excluding this type of option. On the other hand, in order to avoid duplications, the EFSF, or to an even greater extent the ESM, could play a role as a “debt agency” for example.

In all cases, this Parliament would like to underline the need to improve democratic legitimacy: the EFSF, a company subject to Luxembourgish law, is only subjected to control by the national parliaments of the contributing Member States, the ESM is not controlled at the European level. Whatever choices will be undertaken by the governments in the future, we ask them to seriously consider the need for “accountability” (the pertinence of general orientations, management choices) and accounting oversight at EU level.

Part 2. In the short-term (within the existing Treaty)

The most advanced proposal is the “Blue Bond”[2] which the Commission took up in option 2 of the Green Paper: it consists of dividing each public national debt between a “blue” debt, below 60% of GDP (senior) and a “red” debt above 60% (junior); the blue debt is matched with a joint and several liability; the red debt remains national. A debt agency (or a consortium of national agencies) issues a mixed blue debt and returns the funds raised according to a pre-determined distribution key.

We keep the strong incentive to reduce the red debt, the creation of a market which is

[1] The creation of a “basket bond” or “eurogovies” (a basket of bonds of the Member States of the Euro zone) is clever but does not respond to the need for a “European” asset.
[2] The Blue bond proposal, Bruegel Policy Brief, Delpla/von Weizsäcker, May 2010.

equivalent in size, in quality and in liquidity to the American public debt market as well as volumes being fixed by an independent European body, under the control of the national parliaments (which should enable us to work within the existing Treaties and to avoid modifying some national constitutions). There are of course still many open questions, notably the additional costs of the red debt, very discouraging for certain countries.

In order to avoid an excessive impact on AAA countries, it is perfectly conceivable to envisage modulated interest rates according to the country, notably depending on the respect of budgetary discipline and macro-economic efforts[1].

Part 3. In the medium-term (with a new Treaty)

Once discipline and macro-economic convergence are underway, joint and several Eurobonds will be able to be more easily conceived. They would require Treaty revision, and, in certain Member States, constitutional evolutions, as is recalled in Option 1 in the Green Paper.

Taking into account the challenges of this step, we propose to once again follow the method used for the single currency: the "Delors Committee", while adding a role for the ECB and democratic legitimisation at the European level via the EP: representatives of Member States (independent of the governments), working with the Commission and the ECB would draw up proposals which would be publically debated in the EP and in the Council with the intention of creating bonds with all the required guarantees: strict budgetary conditionality and macro-economic convergence, the creation of a European Treasury, an increased democratic legitimacy, external representation of the Euro.

Part 4. In the long-term, federal debt for the Euro zone?

Even in the most integrated form as envisaged in part 3, Eurobonds would remain different from those issued by federal states because they would finance, in an aggregated way, the debt of the Member States and not that of the Euro zone.

In the United States, the bonds issued by the American Treasury co-exist with the bonds issued by the federal states, which are their sole responsibility (default is possible, there is no "bail out").

Intellectually speaking, this "Delors Committee 2" should also study the creation, in time, with all the required guarantees, of a Euro zone debt, based on fiscal own resources, endowed with a budget which could play a counter-cyclical role and finance productive investments, notably European "public goods" (for example environment, security)

The option deserves to be analysed in order to preserve the collective stability of the Euro zone on the one hand, and the budgetary freedom of each Member State on the other. At this stage we are suffering from having the first while having already reduced the second, the

[1] An Eurobond without a free rider, Natixis, Cuillière/El Moutawakil, October 2011 or "Gains for All: A Proposal for a Common Euro Bond", De Grauwe/Moesen, Intereconomics, May/June 2009.

required mutual surveillance is proving to be rather intrusive

The refusal of any federal solutions also has a cost, which, although rarely mentioned, is no less real.