Stability bonds

Shaken market confidence has dramatically increased borrowing costs for several eurozone countries. As a remedy, the European Commission floated options for the 17 eurozone governments to jointly issue stability bonds, also called eurobonds. However, Germany is concerned that the plan would undermine incentives for fiscal discipline in debt-ridden Member States (MS).

Three options

The Commission's green paper of 23 November 2011 put forward three options for eurozone countries to issue debt jointly:

- Stability bonds **fully** replace national bonds, with each MS fully liable for the entire issuance - known as **joint and several guarantees**. This most ambitious option would require Treaty changes.
- Stability bonds **partly** replace national bonds, with **joint and several guarantees** as above, but with MS continuing to issue their own debt.
- Stability bonds **partly** substitute national bonds, with **several but not joint guarantees**: each MS is liable only for its own share of stability bond issuance, and for its national bonds. This least ambitious option would not require Treaty changes.

The Commission says that the more ambitious the option pursued, the greater the benefit for financial stability along with a larger, more liquid market for bonds. However, the trade-off is less pressure on MS to adhere to budgetary discipline. To counteract such "moral hazard", the Commission proposes closer fiscal scrutiny and policy coordination.

The Commission hopes that an agreement to issue stability bonds, even before they come into being, would send a positive signal to markets and reduce funding costs for MS that are currently under pressure.

Unlike bonds issued by the European Financial Stability Facility, stability bonds would be available to all eurozone countries.

Reactions and prospects

Between 23 November 2011 and 8 January 2012, the European Commission held a consultation. While couched in technical terms, the debate has fundamental implications for sovereignty and integration. Stability bonds would see Germany, the eurozone's economic powerhouse, pool its solid credit risk with MS that investors deem less creditworthy. Germany and other top-rated eurozone members are concerned that the proposals would raise their borrowing costs. However, some analysts believe that stability bonds might offer limited advantages for Germany and other creditworthy MS as well.

Italy and Luxembourg had proposed a common sovereign debt instrument in December 2010. Germany and France opposed the idea as it would lighten the pressure on MS to reduce their debt burdens.

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union ("fiscal compact treaty") agreed by 25 EU countries on 30 January 2012 provides for coordination of debt issuance, with governments informing the Commission and European Council of plans to issue debt. According to analysts, this provision marks a small step towards stability bonds. However, the treaty omits any explicit reference to a roadmap towards stability bonds, despite the wishes of the European Parliament.

European Parliament

On 6 July 2011, Parliament asked the Commission to investigate the feasibility of common debt issuance under conditions beneficial to all participating MS. The EP also noted that stability bonds would require further steps towards a common economic and fiscal policy. On 2 February 2012, the EP reiterated its call for a roadmap towards stability bonds. Parliament is also preparing an own-initiative resolution in response to the Commission's green paper.

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