European Economic and Social Committee

ECO/326
Stability Bonds

Brussels, 11 July 2012

OPINION

of the
European Economic and Social Committee
on the
Green Paper on the feasibility of introducing stability bonds
COM(2011) 818 final

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Rapporteur: **Mr Dantin**

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On 23 November 2011, the European Commission decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union, on the

Green Paper on the feasibility of introducing stability bonds
COM(2011) 818 final.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 13 June 2012.

At its 482nd plenary session, held on 11 and 12 July 2012 (meeting of 11 July), the European Economic and Social Committee adopted the following opinion by 135 votes to 33 with 25 abstentions.

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1. Conclusions and recommendations

1.1 In order to resolve the current crisis, avoid a prolonged recession and create the conditions for a return to growth and more jobs, more Europe is needed, not less. This requires a strong determination on the part of the European Commission to reaffirm and implement the ***Community method*. From this point of view, the Green Paper is welcome**.

1.2 Beyond this, however, the Commission must fully exercise its right of initiative with regard to all the parameters and frame proposals that match the scale of the current crisis instead of intergovernmental sticking-plasters.

1.3 More Europe: a new Europe must combine solidarity, responsibility and shared confidence. This confidence will essentially stem from the symmetrical and balanced economic governance of efficient and indispensable budgetary and fiscal harmonisation. More Europe to guarantee budgetary responsibility and integration, more Europe to pool the risks stemming from sovereign debt, restore long-term creditworthiness, facilitate and implement structural reforms and to mobilise investment for growth, competitiveness and jobs throughout the EU in order to achieve a social Europe and well-being for all.

1.4 Therefore the Committee wholeheartedly welcomes the publication of the Green Paper on Stability Bonds. Substantively, it is a logical part of an increasingly integrated European Union equipped with a single market and a European capital market, and represents a necessary addition to the existing common monetary policy in the euro area. At the same time, such euro-bonds could generate confidence among potential investors and thus stabilise demand for State bonds and lower interest rates.

1.5 However, the EESC believes that the risk of moral hazard and its possible practical manifestations as described in the Green Paper are debatable and should first be subject to an in-depth analysis before coming to conclusions which may be questionable. If the argument put forward by the Green Paper were correct, that the slackening of market discipline as a result of the introduction of a single interest rate will cause an irresponsible rise in public spending and an increase in budget deficits, such a trend should have been noted following the euro's introduction. However, this was not the case.

1.6 The EESC shares the Commission's view that Stability Bonds must have a high credit quality to be accepted by investors and the Member States of the euro area. However, owing to hesitant and tardy political steps, the uncertainty is now so great that even euro-bonds with joint and several guarantees would probably not receive the same reception tomorrow as they would have done a few months ago.

1.6.1 The EESC therefore believes it is vital to give the ECB a bigger role in solving the crisis – for example by granting a banking license to the EFSF or to the ESM.

1.7 As regards the various "options for issuance of Stability Bonds", the Committee believes that approach No. 2 which involves "partial substitution of Stability Bond issuance for national issuance, with joint and several guarantees" is the most practicable and overall the most acceptable option.

1.8 Obviously, as underlined by the president of the European Council, stability bonds can only be issued "as long as a robust framework for budgetary discipline and competitiveness is in place to avoid moral hazard and foster responsibility and compliance". As he notes: "The process towards the issuance of common debt should be criteria-based and phased, whereby progress in the pooling of decisions on budgets would be accompanied with commensurate steps towards the pooling of risks"[1]. The Committee agrees that the "building blocks" of this process should include integrated frameworks for the financial sector, budgetary matters and economic policy. These should be accompanied by a coherent and complementary framework of democratic legitimacy and responsibility at European level, without exacerbating austerity. The EESC proposes that the risk of moral hazard should be assessed closely by the Commission so that appropriate solutions can be found within this architecture.

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1 *Towards a Genuine Economic and Monetary Union,* report by Herman Van Rompuy, President of the European Council, 26 June 2012, II.2, third paragraph (EUCO 120/12): http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf

2. Introduction

2.1 The Green Paper under consideration seeks to launch a broad public consultation on the concept of **Stability Bonds**[2]**,** involving all stakeholders and interested parties. This consultation will serve as a basis for European Commission proposals for a policy in this area.

2.2 The intensification of the euro-area sovereign debt crisis has triggered a wider debate on the feasibility of common issuance. The idea has often been promoted that this could be an effective tool to respond to the liquidity constraints in several Member States of the euro area. Against this background, the European Parliament requested the Commission to investigate the feasibility of common issuance in the context of adopting the legislative package on euro-area economic governance, underlining that the common issuance of Stability Bonds would also require a further move towards a common economic and fiscal policy[3].

2.3 For its part, the European Economic and Social Committee has examined this issue in several opinions and set forth its views in particular in the own-initiative opinion on *Growth and sovereign debt in the EU: two innovative proposals*[4].

2.4 The EESC welcomes the publication of the Green Paper, the public debate it will create and the approach adopted, which will ultimately result in the Commission making proposals. The Commission is, in this area, at last reviving the Community method.

3. The gist of the Green Paper

3.1 After describing the background to the Green Paper, the document examines and explains several aspects which underpin and justify the proposals it sets forth.

3.1.1 *Reasons according to the Green Paper*

3.1.1.1 The prospect of Stability Bonds could potentially alleviate the current sovereign debt crisis, as the high-yield Member States could benefit from the stronger creditworthiness of the low-yield Member States. However, for any such effect to be durable, a roadmap towards common bonds would have to be accompanied by parallel commitments to stronger economic governance, which would guarantee that the necessary budgetary and structural adjustment to assure sustainability of public finances would be undertaken and consequently avoid the risk of moral hazard.

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2 The public discussion and literature normally uses the term "Eurobonds". The Commission considers that the main feature of such an instrument would be enhanced financial stability in the euro area. Therefore, in line with President Barroso's State of the Union address on 28 September 2011, this Green Paper refers to "Stability Bonds".

3 European Parliament resolution of 6 July 2011 on the financial, economic and social crisis (2010/2242(INT)).

4 See the EESC opinions on *Growth and sovereign debt in the EU: two innovative proposals*, OJ C 143, 22.5.2012, p. 10, and on *Smart fiscal policy consolidation strategies – challenges of identifying growth drivers for Europe. How to exploit fully the labour potential of our economies in parallel with the pressing need for fiscal adjustments*, OJ C 248, 25.8.2011, p. 8.

3.1.1.2 Stability Bonds would make the euro-area financial system more resilient to future adverse shocks and so reinforce financial stability. Stability Bonds would provide all participating Member States with more secure access to refinancing, preventing a sudden loss of market access. At the same time, the banking system would benefit from the availability of Stability Bonds.

3.1.1.3 Stability Bonds would enable the effects of euro-area monetary policy to be felt more quickly, while promoting efficiency in the euro-area sovereign bond market and in the broader euro-area financial system. They would also facilitate portfolio investment in the euro and foster a more balanced global financial system.

3.1.2 *Preconditions*

After noting that Stability Bonds provide substantial benefits in terms of financial stability and economic efficiency, the Green Paper then highlights their potential downsides.

3.1.2.1 The Commission proposal mentions the following types of moral hazard:

- with some forms of Stability Bonds, the obligation to maintain budgetary discipline would be reduced or lost altogether as euro-area Member States would pool credit risk for some or all of their public debt, implying a risk of moral hazard, since the credit risk stemming from individual lack of fiscal discipline would be shared by all participants; as the issuance of Stability Bonds may weaken market discipline, substantial changes in the framework for economic governance in the euro area would be required which would have implications for budgetary sovereignty;
- Stability Bonds would need to have high credit quality to be accepted by investors;
- achieving a high credit quality will also be important to ensure the acceptance of Stability Bonds by all euro-area Member States;
- the credit rating for Stability Bonds would primarily depend on the credit quality of the participating Member States and the underlying guarantee structure.

3.1.2.2 Consistency with the EU Treaty would be essential to ensure the successful introduction of the Stability Bond. Some options could be at odds with the provisions of the TFEU and might require changes to the treaty, in particular Article 125, which prohibits Member States from assuming liabilities of another Member State. Issuance of Stability Bonds under joint and several guarantees would a priori lead to a situation where the prohibition on bailing out would be breached. On the other hand, issuance of Stability Bonds under several but not joint guarantees would be possible within the existing Treaty provisions.

3.2 *Options for issuance of Stability Bonds*

3.2.1 In addition to the numerous options proposed in the public debate on introducing Stability Bonds, the Green Paper puts forwards three proposals, based on the degree of substitution of national issuance (full or partial) and the nature of the underlying guarantee (joint and several or several) implied. The three broad approaches are:

3.2.1.1 Approach No 1: Full substitution of Stability Bond issuance for national issuance, with joint and several guarantees

Under this approach, euro-area government financing would be fully covered by the issuance of Stability Bonds with national issuance discontinued. The credit rating of the largest euro area Member States would very likely be crucial in determining the rating of Stability Bonds, suggesting that a stability bond issued today could have a high credit rating. This approach would be most effective in delivering the benefits of Stability Bond issuance, but at the same time this approach would involve the greatest risk of moral hazard. It would require a very strong framework to ensure budgetary discipline, economic competiveness and reduction of macroeconomic imbalances at national level.

3.2.1.2 Approach No 2: Partial substitution of national issuance with Stability Bond issuance with joint and several guarantees

Under this approach, Stability Bond issuance would be underpinned by joint and several guarantees, but would replace only a limited portion of national issuance.

The portion of issuance not in Stability Bonds would remain under respective national guarantees. Accordingly, the euro area sovereign bond market would consist of two distinct parts: Stability Bonds and State bonds. A key issue in this approach would be the specific criteria for determining the relative proportions of Stability Bonds and national issuance.

3.2.1.3 Approach No 3: Partial substitution of national issuance with Stability Bond issuance with several but not joint guarantees

Under this approach, Stability Bonds would again substitute only partially for national issuance and would be underpinned by pro-rata guarantees of euro-area Member States. This approach differs from Approach No 2 insofar as Member States would retain liability for their respective share of Stability Bond issuance as well as for their national issuance.

4. General comments

4.1 The text under consideration must be seen in the light of the crisis that has beset the European Union. This multiple financial, economic, balance-of-payments, sovereign debt and social crisis (with almost 23 million people unemployed) is shaking the very foundations of the European Union. In particular, the crisis has revealed several fundamental flaws in the design of economic and monetary union. A common central bank and a stability and growth pact are far from enough to protect the single currency from crises involving differences in competitiveness, macroeconomic imbalances, upset balances of payments and higher spreads for interest rates on State bonds.

4.2 In order to resolve this crisis, avoid a prolonged recession and create the conditions for a return to growth and more jobs, *more and better Europe* is needed, not *less*: *more Europe* to guarantee budgetary responsibility and integration, *more Europe* to pool the risks stemming from sovereign debt, restore long-term creditworthiness, facilitate and implement structural reforms and to mobilise investment for growth, competitiveness and jobs throughout the EU, in order to achieve a social Europe and well-being for all. A *better Europe* that can achieve these goals on a sustainable basis and has effective mechanisms to avoid moral hazard.

4.2.1 All of this requires a strong determination on the part of the European Commission to reaffirm and implement the *Community method*. From this perspective, the Green Paper is welcome. However, in addition to this, the Commission must exercise in full its right of initiative in all areas and put forward proposals which match the scale of the crisis instead of intergovernmental stop-gap measures which, despite the fact that there have been many of them, have in the main proven to be insufficient and ineffective involving long and uncertain implementation procedures[5].

4.2.2 More Europe: a new Europe requires that resources be pooled on a fundamental scale and that responsibilities be shared. This concept which combines solidarity and shared responsibility must be brought together by a link, a sort of bridge between the two expressions of this concept, namely confidence. This confidence will essentially stem from the symmetrical and balanced economic governance of efficient and indispensable budgetary and fiscal harmonisation.

4.2.2.1 Such an approach is preferable to a situation in which the Member State governments are no longer able by themselves to withstand the pressures exerted by the markets, their creditors and the private ratings agencies. European integration must take major step forward not only in order to create credit instruments and a credible model of growth for investors, but also - and this is a key point - to reaffirm democratic governance.

4.2.2.2 In order to achieve this, the EU must consolidate economic governance with a view to ensuring budgetary discipline in all Member States, especially in the euro area. The six legislative proposals for reform (the "six pack"), as well as the new regulatory proposals and the European semester, which represents a move towards better coordination of budgetary

5 See the justification of the ratings agency Standard & Poor’s of 13 January 2012 for downgrading the treasury bonds of 16 Member States of the euro area: "the policy initiatives that have been taken by European policymakers in recent weeks may be insufficient to fully address ongoing systemic stresses in the eurozone", http://www.standardandpoors.com/prot/ratings/articles/en/eu/?articleType=HTML&assetID=1245327399569. Standard & Poor’s further observed: "We believe a reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumers’ rising concerns about job security and disposable incomes, eroding national tax revenues".

policies and stronger EU surveillance, while not enough to resolve the crisis[6], must be implemented correctly. In terms of practical politics, this process is only just getting underway and must be monitored carefully. It will only be possible to draw conclusions about the success of these reforms on the basis of tangible results in removing macroeconomic imbalances. In addition, the same importance should be attached to macroeconomic imbalances which are at the root of the difficulties encountered by certain Member States.

4.3 The Committee therefore welcomes the Green Paper on the feasibility of introducing Stability Bonds. In its view, the addition of strict economic governance rules and joint guarantees for the whole of the euro area, designed to pool the risks stemming from sovereign debt, will effectively help us to emerge from the austerity-growth impasse. This impasse would inevitably take the EU into a deep recession.

4.4 The advances made in this area will also enable the ECB to discontinue its programme of buying government bonds on the secondary markets (SMP), which is currently needed in order to enable Member States to refinance their public debt. Instead of this policy, the ECB could decide to support the new Stability Bonds by providing additional assurances to market stakeholders in a transitional phase[7].

4.5 To this end, a banking licence could be granted to the EFSF or the ESM, something which would put an end to the confusion between monetary and budgetary policies within the European Central Bank and guarantee its independence.

5. Specific comments

5.1 The Committee welcomes wholeheartedly the publication of the Green Paper on Stability Bonds. On the one hand, the introduction of EU bonds in the euro area (known as "euro-bonds"[8], and what the Green Paper calls "Stability Bonds") is a logical part of an increasingly integrated European Union equipped with a single market and a European capital market, and represents a necessary addition to the existing common monetary policy in the euro area. Euro-bonds make speculation more difficult and promote stable financial markets and an effective monetary policy.

5.2 At the same time, such euro-bonds could, in addition to establishing joint responsibility, generate confidence among potential investors, immediately and in the short term, and thus stabilise demand for State bonds and lower the market interest rates for countries facing serious financing problems. The EESC therefore welcomes the fact that not only is the

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6 See point 5.6.

7 The ECB's room for manoeuvre is virtually unlimited and could therefore stretch from a simple declaration on the future direction of its monetary policy to massive interventions to buy up sovereign debt under speculative attack.

8 In this document, the term "euro-bonds" is used when it is a question of the objective of a political union in addition to economic and monetary union. In all other cases, the term created by the Commission, namely "stability bonds", will be used. In reality, there is no difference between these two concepts.

Commission finally launching - albeit belatedly - a debate on euro-bonds, it also correctly sets out the advantages of euro-bonds in the Green Paper.

5.3 *Preconditions concerning budgetary discipline*

5.3.1 Like the general debate on how to respond to the crisis, the Green Paper stresses repeatedly the need to tackle the perverse effects, *moral hazard*, and notes that the markets could discipline the budgetary policy of Member States. It deplores the fact that, following the launch of the euro, not all Member States have pursued "market discipline of budgetary policy" and expresses the fear that introducing shared responsibility for Stability Bonds will have no effect on the discipline exercised by the markets. However, even some countries which respected the budgetary constraints of the Stability and Growth Pact now find themselves heavily indebted owing to the imbalances linked to debt in the private sector; they must also be monitored.

5.3.2 In general terms, the fear is that joint responsibility and thus the impossibility of sanctions in the form of higher interest rates imposed by the market will lead to irresponsible budgetary management on the part of governments, i.e. large budget deficits. Governments would increase public spending in an irresponsible fashion if they were not subject to pressure from rising market interest rates. However, the EESC believes that the risk of moral hazard and its possible practical manifestations as described in the Green Paper are debatable and should first be subject to an in-depth analysis before coming to conclusions which may be questionable.

5.3.3 A specific analysis of the issue of moral hazard would also enable tailor-made solutions to this problem to be found. There are several reasons for calling into question the belief in "market discipline" and the scale of the problem of moral hazard.

5.3.3.1 The Green Paper argues that the evolution of public budgets impacts on the level of State bond yields and notes that, "The high degree of convergence in euro-area bond yields during the first decade of the euro was not, in retrospect, justified by the budgetary performance of the Member States." Therefore, although there was clearly no convergence of budgetary policy, there was strong convergence of bond yields and thus of interest rates for State bonds. Greek, Spanish, Italian, Irish and Finnish State bond yields were among those which fell the most following the introduction of the euro. For example, although the yield on ten-year Finnish government bonds was still around 8.8% in 1995, by 2005 it had fallen to 3.4% – the level of German government bonds.

5.3.3.2 This can be explained by the fact that, with the creation of the euro, the view that all State bonds in the euro area were relatively safe became established among investors. For example, between the creation of the euro area in 1999 and the Lehman Brothers crisis of 2008, a situation prevailed which was similar to what one might expect following the introduction of euro-bonds. The markets did not impose discipline in budgetary policy in the years following the creation of the euro area.

5.3.3.3 If the argument put forward by the Green Paper is correct, that the slackening of market discipline following the introduction of a single interest rate causes an irresponsible rise in public spending and an increase in budget deficits, such a trend should have been noted following the euro's introduction.

5.3.3.4 However, this was not the case: in Finland, public spending fell slightly relative to gross domestic product (GDP) following the euro's introduction, and remained below levels of public revenue. In Spain, the link between public spending (without interest payments) and GDP has remained constant, while revenue levels have even increased. In Italy, the level of public spending has fallen overall, with a slight drop in the amount of interest paid. There was, however, a fall in government revenues. In Greece too, public spending relative to GDP remained stable overall following the country's entry into the euro area and the convergence of bond interest rates, and there was a sharp drop in spending on interest payments. However, the fall in public revenues relative to GDP was much bigger in Greece than in Italy.

5.3.3.5 Clearly, the absence of market discipline and the strong convergence of interest rates for bonds did not give rise to moral hazard, owing to the blanket security assumed by investors. There was no increase in public spending relative to GDP, on the contrary. In any case, one could argue that low and converging interest rates have in many places encouraged a fall in tax revenues – there was a decline in tax receipts in at least two of the abovementioned cases.

5.3.4 This final point would suggest that measures to deal with moral hazard should focus on revenues. Closer coordination of fiscal policies could prevent fiscal dumping. In future, disciplinary action could in certain cases be taken against tax reductions, as part of efforts to coordinate enhanced EU economic policies and governance. This would ensure symmetry among economic governance measures, as already called for by the EESC in previous opinions[9].

5.3.5 In addition, it is very unlikely that investors would actually be interested, as a matter of priority, in the soundness of the budgetary policy of the countries to which they wish to lend money. In reality, the scale of the budget deficit and the public debt is not as relevant for the level of market interest rates as the Green Paper assumes. This is evidenced by the fact that it is Spain, the "model pupil" of budgetary policy, which is currently experiencing financing problems while other countries with high levels of debt, such as the United Kingdom, are obtaining financing at historically low rates.

9 See list in the EESC opinion on the *Annual Growth Survey: advancing the EU's comprehensive response to the crisis*, OJ C 132, 3.5.2011, p. 26, and the EESC opinion on the *Social impact of the new economic governance legislation*, OJ C 143, 22.5.2012, p. 23.

5.3.6 The EESC therefore believes that, with an eye to the steps to be taken following the Green Paper's publication, the Commission must urgently revise its arguments concerning moral hazard and market discipline. These arguments may very quickly give rise to false conclusions, with disastrous economic consequences: if efforts to deal with the alleged problem of moral hazard were, for example, to give rise to even stricter rules on debt in the stability and growth pact or to automatic debt brakes, then counterproductive (and ineffective, according to the Commission) pressure on public spending might be expected. In order to realise that a sharp fall in government spending – contrary to the assumptions and wishes of the Commission – would have a negative impact on confidence among potential bond buyers, one need look no further than what is happening in the countries beset by crisis, where the policy of austerity has further increased uncertainty and made interest rates rise even more.

5.3.7 In addition, the EESC believes that the argument that the "markets" must impose discipline on democratically elected governments as matter of necessity should also be fundamentally called into question. In this scenario, the markets are ultimately synonyms for "holders of capital", which act as the creditors of governments. It is not clear why we should welcome the fact that a relatively small number of holders of capital should have greater influence over the public budget than an elected parliament.

5.4 *Conditions for assets being accepted as very safe by the market*

5.4.1 The EESC shares the Commission's view that Stability Bonds must have a high credit quality to be accepted by investors and the Member States of the euro area which already benefit from the highest credit rating. High credit quality would also be needed to establish Stability Bonds as an international benchmark and to underpin the development and efficient functioning of related futures and options markets, which are essential for supplying the bond markets with liquid assets.

5.4.2 The EESC is convinced that the euro-bonds with overall shared responsibility will be very attractive for potential investors looking for safe investments. The volume and liquidity of a joint bonds market would also probably attract new investors from outside Europe. The EESC agrees that as a result of global macroeconomic imbalances every possible effort must be made to channel the considerable volumes of liquid assets from emerging countries towards the stable financial investments represented by euro-bonds. These bonds would therefore play a key role in stabilising financial markets even beyond the borders of the European Union.

5.4.3 In the meantime, however, insecurity on European bond markets has increased enormously owing to the hesitant steps by Member State governments, poor political decisions and the lack of will to seek a comprehensive solution to the crisis. For example, the uncertainty is now so great that even euro-bonds with joint and several guarantees (option 1, see above, point 3.2.1.1) would probably not encounter the same level of demand as a few months ago. The ability of Stability Bonds to alleviate the crisis would also suffer from this and they may even fail to meet their initial objective - stabilisation.

5.4.4 The EESC therefore believes it is vital to give the European Central Bank a bigger role in solving the crisis – for example by granting a banking license to the EFSF or to the ESM, which will enter into force on 1 July 2012. Unlike the Federal Reserve, the Bank of Japan or the Bank of England, the ECB does not act as the lender of last resort for Member States. This largely explains the difference in interest rates between the euro area and the far more indebted economies and to a large extent helps to give the impression that the crisis will never end.

5.4.5 It would, however, be a mistake to believe that acceptance by the market, and therefore low interest rates for euro-bonds, requires a policy of austerity and budgetary consolidation that is as rigid as possible. In several opinions, the EESC has explicitly denounced the dire consequences of such a policy for the economy and stressed that budgetary consolidation was based primarily on economic growth[10].

5.5 *Options for issuance of Stability Bonds*

5.5.1 Approach No 1: Full substitution of Stability Bond issuance for national issuance, with joint and several guarantees

The EESC believes that this is the wisest approach over the long term and the one that is most in line with the EU objective of a social and economic union. At the same time, it could turn out to be the most effective in the short term for dealing with the problems of financing and thus ending the crisis. However, this is the approach which requires the deepest European integration. Its implementation would therefore probably generate the most problems of a political nature, hence full substitution of stability bond issuance for national issuance, with joint and several guarantees seems the least likely option in the near future.

5.5.2 Approach No 2: Partial substitution of Stability Bond issuance for national issuance, with joint and several guarantees

5.5.2.1 This approach is the most practicable and acceptable option since it basically corresponds to the one above, except that countries would retain a certain operational autonomy vis-à-vis financial markets. As a result, Member States would each be subject to different market and financing conditions, possibly reflecting the differences between their individual credit ratings. In any case, this approach may turn out to be very effective, taking account of both the medium and short-term effects. In addition, it clearly weakens the arguments based on the alleged risks of moral hazard. This is why it is one of the two options which the EESC formally approves.

10 See footnote 8 above.

5.5.2.2 However, before the issuance of Stability Bonds is authorised, it remains just as vital to decide on the procedures and the debt ceiling so as to find a real solution to the tricky issue of Member States which experience financing difficulties. For example, the EESC believes that not all existing national bonds should be converted immediately into Stability Bonds (as indicated in the Green Paper on page 17), as the limit set for issuing these bonds (blue bonds) would quickly be reached and it would be once again necessary to immediately issue national bonds (red bonds) for refinancing purposes[11].

5.5.3 Approach No 3: Partial substitution of Stability Bond issuance for national issuance, with several but not joint guarantees

5.5.3.1 The EESC agrees with the Commission that of the three approaches this is the one with the most restricted scope, since it would only partially cover Member States' financing requirements (as in the case of approach 2) and it would provide for several guarantees only, not joint guarantees. This approach would therefore in all probability have only limited effects in terms of stability and integration. It could be implemented relatively quickly, since it appears to be fully compatible with the EU treaty in force.

5.5.3.2 In order for such financing instruments to obtain a sufficient credit rating, Member States would be obliged to present additional guarantees. Under approach 3, Stability Bonds would be very similar to the bonds issued by the European Financial Stability Fund (EFSF), even if they would probably have a slightly bigger potential impact on the effectiveness of the markets and on integration. Since this approach is unlikely to have a major impact, it is the one that accords least with the EESC's viewpoint.

5.6 *Fiscal framework for Stability Bonds*

5.6.1 The EESC reiterates its belief that strengthening the stability and growth pact within the framework of the "six pack", the Council resolution on the Euro Plus Pact and the generalised introduction of "golden rules" are essentially not enough to resolve the crisis and that the social consequences risk triggering the disintegration of the European Union[12].

5.6.2 The supplementary measures taken by the Commission and the Council, in addition to the proposals in the Green Paper, should not base reducing budgetary deficits and government debt exclusively on savings in public budgets (austerity). As a general rule, these have negative effects on growth, jobs and the welfare state, and pointlessly restrict the scope for

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11 Delpla, J. and von Weizsäcker, J. (2010), *The Blue Bond Proposal*, Breugel Policy Briefs 420, Bruegel, Brussels, 2010. The authors propose a limit for issuing blue bonds, which amounts to 60% of GDP and corresponds to the criteria initially laid down by the Maastricht Treaty concerning the ceiling on the total public debt. Among a growing number of more or less detailed studies and proposals, it is worth looking at the proposals of the German government's Council of Economic Experts regarding a European redemption pact (http://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/Pressemitteilungen/A_european_redemption_pact.pdf), or Varoufakis, Y. and Holland, S. (2011), *A modest proposal for overcoming the euro crisis*, Levy Economics Institute of Bard College, Policy Note 3/2011, http://www.levyinstitute.org/pubs/pn_11_03.pdf.

12 See point 5.3 above.

pursuing an appropriate, countercyclical budgetary policy. What is more, they do not yield the positive results anticipated by the Commission.

5.6.3 However, the Member States of the monetary union must take measures with a view to achieving convergence of national economies, reducing imbalances and completing the single monetary policy. In addition, economic policy must pursue the right objectives. In this connection, the idea repeatedly evoked in the Green Paper of enhanced competitiveness, which takes the form of lower wage costs and downward pressure on salaries, is one-sided and fails to recognise the role played by demand at macroeconomic level.

5.6.4 By way of example, squeezing incomes in countries with current account deficits may cause a contraction in demand and a fall in imports. This will certainly balance current accounts in the euro area, but at the cost of reducing production and economic output throughout the area, which would ultimately end up being lower. The EESC reiterates its belief that a balanced economic policy is vital in order to achieve the objectives of the EU 2020 strategy.

5.6.5 This is why it is important to steer coordination of economic policy towards stronger growth and national revenues. The Member States which in recent years have experienced relatively weak public investment and where domestic demand has been flat must take corrective measures to support demand, while the Member States with relatively high current account and budget deficits should seek to balance their revenue and expenditure more effectively. **The introduction of Stability Bonds in the European Union in line with the model of approach 2 may, according to the EESC, sustainably support an urgent and crucial reduction of internal macroeconomic imbalances in the EU.**

Brussels, 11 July 2012.

The President
of the
European Economic and Social Committee

Staffan Nilsson

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N.B.: Appendix overleaf.

APPENDIX
to the opinion
of the European Economic and Social Committee

The following amendments were rejected in the course of discussions, but obtained at least a quarter of the votes cast:

Am. 3 – Point 3.2.1.2
Insert text:

> *3.2.1.2. Approach No 2: Partial substitution of national issuance with Stability Bond issuance with joint and several guarantees*
>
> *Under this approach, Stability Bond issuance would be underpinned by joint and several guarantees, but would replace only a limited portion of national issuance.*
>
> *The portion of issuance not in Stability Bonds would remain under respective national guarantees. Accordingly, the euro area sovereign bond market would consist of two distinct parts: Stability Bonds and State bonds. A key issue in this approach would be the specific criteria for determining the relative proportions of Stability Bonds and national issuance <u>and that it would not sufficiently remove the moral hazard of deterioration in budget discipline</u>.*

Reason

Given orally.

Result of vote

Against:	117
For:	46
Abstentions:	18

Am. 4 – Point 3.2.1.3

Insert text:

> *3.2.1.3 Approach No 3: Partial substitution of national issuance with Stability Bond issuance with several but not joint guarantees.*
>
> *Under this approach, Stability Bonds would again substitute only partially for national issuance and would be underpinned by pro-rata guarantees of euro-area Member States. This approach differs from Approach No 2 insofar as Member States would retain liability for their respective share of Stability Bond issuance as well as for their national issuance. <u>This</u>*

> *would both limit moral hazard in the area of fiscal discipline and retain the benefits of a reduction in liquidity premiums.*

Reason

Given orally.

Result of vote

Against:	127
For:	50
Abstentions:	6

The next two amendments were voted on together:

Am. 7 – Point 4.3

Amend as follows:

> *4.3. The Committee therefore welcomes the Green Paper on the feasibility of introducing Stability Bonds. In its view, the addition of strict economic governance rules and joint guarantees for the whole of the euro area, designed to ~~pool~~enable the risks stemming from sovereign debt to be borne fairly, will effectively help us to emerge from the austerity-growth dilemma~~impasse~~. ~~This impasse would inevitably take the EU into a deep recession~~. The Committee believes that Stability Bonds can only be introduced once the risk of moral hazard mentioned in the Green Paper has been removed and provided there is sufficient assurance that it is not occurring in economic life.*

Reason

Given orally.

Am.1 – Point 1.5

Insert text:

> *1.5 However, the EESC believes that the risk of moral hazard (of all the five types mentioned) and its possible practical manifestations as described in the Green Paper are debatable and should first be subject to an in-depth analysis before coming to conclusions which may be questionable. If the argument put forward by the Green Paper were correct, that the slackening of market discipline as a result of the introduction of a single interest rate will cause an irresponsible rise in public spending and an increase in budget deficits, such a trend should have been noted following the euro's introduction. However, this was not the case. The Committee believes that Stability Bonds can only be introduced once the risk of*

moral hazard mentioned in the Green Paper has been removed and provided there is sufficient assurance that it is not occurring in economic life.

Reason

The green paper addresses implementation of a mechanism of so-called stability bonds for indefinite time, the aim of which is to cut the costs of debt servicing (issuance of bonds) for member states with low budgetary discipline to the detriment of countries with good budgetary behaviour, which will have to pay higher yields on such bonds compared to their own debt instruments. The beneficiaries of such scheme will take advantage of a single (and, from their perspective, lower) yield for such bonds, as well as a Euro area wide joint liability (guarantee). The EC itself outlined 5 possible "moral hazards" (one party makes the decision about how much risk to take, while someone else bears the cost if things go badly) created by this kind of debt issuance.

Result of vote

Against:	131
For:	49
Abstentions:	9

Am.8 – Point 5.3.4

Amend as follows:

5.3.4. This final point would suggest that measures to deal with moral hazard should focus on revenues. ~~Closer coordination of fiscal policies could prevent fiscal dumping~~. The EESC supports the idea of "fiscal devaluation" recommended by this year's Brussels Tax Forum as an instrument for coping with asymmetric shocks in a monetary union[13]*. In future, disciplinary action could in certain cases be taken against tax reductions, as part of efforts to coordinate enhanced EU economic policies and governance. This would ensure symmetry among economic governance measures, as already called for by the EESC in previous opinions*[14]*.*

13 The Brussels Tax Forum defined fiscal devaluation as a cut in direct taxation (of physical and legal persons, which reduces costs and so makes domestic producers more competitive) with a parallel rise in indirect taxation (since VAT does not affect exports). This fiscal manoeuvre must be budget-neutral and have similar effects to devaluation. It is an instrument for countries with a common currency to absorb asymmetric shocks.

http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_conferences/tax_forum/index_en.htm.

14 See list in the EESC opinion on the *Annual Growth Survey: advancing the EU's comprehensive response to the crisis*, OJ C 132, 3.5.2011, p. 26, and the EESC opinion on the *Social impact of the new economic governance legislation*, OJ C 143, 22.5.2012, p. 23.

Reason

Point 5.3.4 of the opinion cannot be endorsed either. The claim that in future disciplinary action could be taken against tax reductions is arbitrary and cannot be based on any analysis or research. Possible tax reductions and their impact are not the subject of this opinion.

Result of vote

Against:	124
For:	54
Abstentions:	9

The next six amendments were voted on together:

Am.10 – Point 5.4.2

Amend as follows:

5.4.2. The EESC is convinced that the euro-bonds with ~~overall shared responsibility~~several but not joint guarantees will be very attractive for potential investors looking for safe investments. The volume and liquidity of a joint bonds market would also probably attract new investors from outside Europe. The EESC agrees that as a result of global macroeconomic imbalances every possible effort must be made to channel the considerable volumes of liquid assets from emerging countries towards the stable financial investments represented by euro-bonds. These bonds would therefore play a key role in stabilising financial markets even beyond the borders of the European Union.

Reason

Given orally.

Am.11 – Point 5.5.1

Amend as follows:

5.5.1. Approach No 1: Full substitution of Stability Bond issuance for national issuance, with joint and several guarantees

~~The EESC believes that this is the wisest approach over the long term and the one that is most in line with the EU objective of a social and economic union. At the same time, it could turn out to be the most effective in the short term for dealing with the problems of financing and thus ending the crisis.~~ However, this is the approach which requires the deepest European integration and has the greatest risks of moral hazard. Its implementation would therefore

probably generate the most problems of a political <u>*and legal*</u> *nature, hence full substitution of stability bond issuance for national issuance, with joint and several guarantees seems the least likely option in the near future.* <u>*However, the introduction of such bonds can only be considered once the risk of moral hazard mentioned in the Green Paper has been removed and provided there is sufficient assurance that it is not occurring in economic life*</u>*.*

Reason

The option proposed in the opinion, namely to **support approach No. 2** of the various options for issuance of stability bonds, which is based on partial substitution of Stability Bond issuance for national issuance with joint and several guarantees, should be rejected. In our view, it is not acceptable that some Member States are profligate and, as experience shows, are unfortunately allowed to behave irresponsibly with their money, while others must bear the costs. At the same time, it should be pointed out that **joint and several guarantees run directly counter to the provisions of the Treaty on the Functioning of the European Union, according to which no Member State should be responsible for the obligations of another**. In contrast, approach No. 3 (proposed to be supported by the amendment) minimizes the risk of moral hazard for the conduct of economic and fiscal policies. Unlike the second approach, this would involve "several but not joint" government guarantees and could therefore be implemented relatively quickly without having to change EU treaties.

Am.12 – Point 5.5.2.1

Amend as follows:

5.5.2.1. This approach ~~*is the most practicable and acceptable option since it*~~ *basically corresponds to the one above, except that countries would retain a certain operational autonomy vis-à-vis financial markets. As a result, Member States would each be subject to different market and financing conditions possibly reflecting the differences between their individual credit ratings.* ~~*In any case, this approach may turn out to be very effective, taking account of both the medium and short-term effects. In addition, it clearly weakens the arguments based on the alleged risks of moral hazard. This is why it is one of the two options which the EESC formally approves*~~*.* <u>*Joint and several guarantees, together with the low yields of Stability Bonds, still leave the moral hazard of fiscal irresponsibility at a high level. The introduction of such bonds can only be considered once the risk of moral hazard mentioned in the Green Paper has been removed and provided there is sufficient assurance that it is not occurring in economic life*</u>*.*

Reason

The option proposed in the opinion, namely to **support approach No 2** of the various options for issuance of stability bonds, which is based on partial substitution of Stability Bond issuance for national issuance with joint and several guarantees, should be rejected. In our view, it is not acceptable that some Member States are profligate and, as experience shows, are unfortunately allowed to behave irresponsibly with their money, while others must bear the costs. At the same time, it should be pointed out that **joint and several guarantees run directly counter to the provisions of the Treaty on the Functioning of the European Union, according to which no Member State should be responsible for the obligations of another**. In contrast, approach No 3 (proposed to be supported by the amendment) minimises the risk of moral hazard for the conduct of economic and fiscal policies. Unlike the second approach, this would involve "several but not joint" government guarantees and could therefore be implemented relatively quickly without having to change EU treaties.

Am. 13 – Point 5.5.3.1

Amend as follows:

> *5.5.3.1. The EESC agrees with the Commission that of the three approaches this is the one with the most restricted scope, since it would only partially cover Member States' financing requirements (as in the case of approach 2) and it would provide for several guarantees only, not joint guarantees. This approach would most restrict the moral hazard of deterioration in budget discipline while reducing liquidity premiums~~would therefore in all probability have only limited effects in terms of stability and integration~~. It could be implemented relatively quickly, since it appears to be fully compatible with the EU treaty in force.*

Reason

Given orally.

Am.14 – Point 5.6.5

Amend as follows:

> *5.6.5 This is why it is important to steer coordination of economic policy towards stronger growth and national revenues. The Member States which in recent years have experienced relatively weak public investment and where domestic demand has been flat must take corrective measures to support demand, while the Member States with relatively high current account and budget deficits should seek to balance their revenue and expenditure more effectively. The introduction of Stability Bonds in the European Union in line with the model of approach ~~2~~3 may, according to the EESC, turn out to be a viable solution for sustainably supporting an urgent and crucial reduction of internal macroeconomic imbalances in the EU.*

Reason

The option proposed in the opinion, namely to **support approach No 2** of the various options for issuance of stability bonds, which is based on partial substitution of Stability Bond issuance for national issuance with joint and several guarantees, should be rejected. In our view, it is not acceptable that some Member States are profligate and, as experience shows, are unfortunately allowed to behave irresponsibly with their money, while others must bear the costs. At the same time, it should be pointed out that **joint and several guarantees run directly counter to the provisions of the Treaty on the Functioning of the European Union, according to which no Member State should be responsible for the obligations of another**. In contrast, approach No 3 (proposed to be supported by the amendment) minimises the risk of moral hazard for the conduct of economic and fiscal policies. Unlike the second approach, this would involve "several but not joint" government guarantees and could therefore be implemented relatively quickly without having to change EU treaties.

Am.2 – Point 1.7

Amend as follows:

> *1.7 As regards the various "options for issuance of Stability Bonds", the Committee believes that approach No ~~2~~3, which involves "partial substitution of Stability Bond issuance for national issuance, with ~~joint and~~ several but not joint guarantees", is the most practicable and overall the most acceptable option.*

Reason

The option proposed in the opinion, namely to **support approach No 2** of the various options for issuance of stability bonds, which is based on partial substitution of Stability Bond issuance for national issuance with joint and several guarantees, should be rejected. In our view, it is not acceptable that some Member States are profligate and, as experience shows, are unfortunately allowed to behave irresponsibly with their money, while others must bear the costs. At the same time, it should be pointed out that **joint and several guarantees run directly counter to the provisions of the Treaty on the Functioning of the European Union, according to which no Member State should be responsible for the obligations of another**. In contrast, approach No 3 (proposed to be supported by the amendment) minimises the risk of moral hazard for the conduct of economic and fiscal policies. Unlike the second approach, this would involve "several but not joint" government guarantees and could therefore be implemented relatively quickly without having to change EU treaties.

Result of vote

Against:	129
For:	59
Abstentions:	5:

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