16.12.2010

WHY GERMAN OPPOSITION TO THE COMMON EUROBOND PROPOSAL IS MISTAKEN

By: Erik Jones

There are four things we all want to happen as this crisis in European sovereign debt markets develops. We want borrowers in Greece, Ireland, and elsewhere to learn to live within their means. We want lenders to learn to price risk appropriately and to share in losses when they occur. We want governments and banks to be able to meet their day-to-day requirements. And we want the euro to remain a common currency without the member states having to sacrifice their fiscal sovereignty. Only a common eurobond with limited drawing rights and senior status like that proposed by Giulio Tremonti and Jean-Claude Juncker can meet these objectives.

Much of the German opposition to a eurobond comes from the notion that less frugal countries would take advantage of common bonds to borrow beyond their means. That is why it is important to have limited drawing rights. The current system forces the Germans to bail out countries when they cannot pay. A common bond with limited drawing rights would only ask the Germans to put their creditworthiness on the line for other countries when those can pay. At the same time, there is a sharp contrast between the cost of borrowing with a common bond and the cost of borrowing in a national bond that is on top of their rights in the common issue. If we use the Tremonti-Juncker proposal as an illustration, debt raised in common eurobonds up to 40 percent of GDP would be very cheap to finance; the debt raised in national bonds beyond that threshold would be very expensive. There is a strong market incentive for countries not to borrow beyond their means.

Lenders would face clear incentives and consequences as well. The challenge is to help investors to differentiate between debt which is more risky and debt which is more secure. A common eurobond with limited drawing rights and senior status would provide the solution. Investors would know that any common eurobond is much like any other insofar as debtors would ensure that it is serviced first. National bonds would have a

GREEK DEBATE

Germany is unfit for the euro
By: Joerg Bibow
21.04.10

Portents of the Greek Rescue
By: Barry Eichengreen
15.04.10

Finally a deal, but I am still sceptical
By: Wolfgang Münchau
13.04.10

Why Greece will default
By: Wolfgang Münchau
07.04.10

Why an IMF solution is most likely
By: Laurence Boone
24.03.10

The Greek crisis and the future of the Eurozone
By: Paul De Grauwe
11.03.10

Greek Competitiveness Is Not the Issue, Fiscal Discipline Is
By: Erik Jones
04.03.10

Europe in Dire Straits – don't be Brothers in Arms.
By: Henrik Enderlein
02.03.10

How should the Eurozone handle Greece?
By: Daniela Schwarzer and Sebastian Dullien
01.03.10

The Euro Area's political constraints
By: Wolfgang Münchau
16.02.10

LOGIN
Username:
Password:
Stay logged in
Login
Forgot your password?
How to register
FAQ

EUROINTELLIGENCE BRIEFING NOTE

Public finances in 2011 : happy austerity
28.01.2011
By: Raphael Cottin
A closer look at the effects of austerity.

Is Belgium next?
15.10.2010
By: Susanne Mundschenk and Raphael Cottin
This is the second Eurointelligence Briefing note, focusing on the economic implications on Belgium's ongoing political crisis.

OUR PARTNERS

MUNCHAU'S COLUMNS

The ECB's hidden agenda

08.03.2011
By: Wolfgang Münchau
The decision to preannounce a rate rise is political.

GLOBAL ECONOMIC SYMPOSIUM

A repository of global solutions to global

lower standing and would suffer earlier losses. In the Tremonti-Juncker proposal, conversion from national bonds to eurobonds would come at a cost as well. Hence, investors would know that national bonds have higher risk attached and because they would stand to lose first.

Meanwhile it is important to note that excessive borrowing and excessive lending are only a small fraction of the activity in bond markets. Governments routinely recycle debt that has matured with new bond issues and banks rely on government securities for their treasury operations. Under the current system whole countries are cut off when their sovereign debt markets run into trouble as national governments struggle to roll over their debt and as banks find themselves subject to widespread losses on their most liquid assets. A common eurobond would limit this dynamic by creating a distinction between the rollover of responsible lending and any excessive increase in borrowing. At the same time it would ensure that national banking systems across the eurozone relied on the same securities in their treasury operations and so eliminate an unnecessary source of counterparty risk.

Finally, a common eurobond would only reiterate and reinforce the commitments made at Maastricht in 1991 and Amsterdam in 1997. Governments would agree to avoid excessive deficits (that is, borrowing beyond their drawing rights) in the short term and they would strive to achieve fiscal balance over the medium-to-long term. There is nothing in this that implies a transfer from north to south or from Germany to the rest. Moreover, there is nothing to prevent countries from pursuing radically different versions of the welfare state. A common eurobond does not imply a redistributive fiscal union. On the contrary, it ensures that such redistribution does not have to take place.

By differentiating between responsible and irresponsible borrowing, a eurobond creates a market incentive for fiscal probity. By distinguishing between senior (European) and junior (national) debt, a eurobond gives clear signals to the markets on how to price risk. By making it easier for governments to roll-over existing debt while still making it harder for them to borrow irresponsibly, a eurobond would stabilize both debt markets and inter-bank lending.

The German people are reluctant to accept a common eurobond. That is because they believe they operate only on one side of the relationship. The reality is that Germans are on both sides of the trade. They may not sell the

problems
25.06.2010

For two years now, leading policy makers, academics and businessmen have been meeting for discussions in the Global Economic Symposium to provide concrete solutions for the most pressing global governance issues the world will be facing this century. Here is the result of these discussions: a repository of concrete policy proposals.

bonds but they buy them; hence they risk suffering losses and ultimately might risk a bailout themselves. A common eurobond with limited drawing rights would limit their exposure and not increase it. Everyone in the markets would know where they would risk losses and where they would be bailed out. Such certainty is essential if the euro is to survive and prosper.

Erik Jones is Professor for European Studies at the Johns Hopkins University.

<- Back to: Eurointelligence

about us | contact us | terms and conditions | privacy | Links

Copyright 2009 Eurointelligence ASBL