

Feasibility of introducing stability bonds

2012/2028(INI) - 23/11/2011 - Non-legislative basic document

PURPOSE: to launch a debate on the feasibility of introducing stability bonds (Commission Green Paper).

BACKGROUND: the debate on common issuance of sovereign bonds has evolved considerably since the launch of the euro. Initially, the rationale for common issuance focused mainly on the benefits of enhanced market efficiency through enhanced liquidity in euro-area sovereign bond market and the wider euro-area financial system.

More recently, in the context of the **ongoing sovereign crisis, the focus of debate has shifted toward stability aspects**. In this context, [the European Parliament](#) invited the Commission to examine the feasibility of joint issuance in the context of the adoption of the legislative package on the economic governance of the euro area, stressing that the common issuance of stability bonds would also require progress towards a common economic and budgetary policy.

Sovereign issuance in the euro area is currently conducted by Member States on a decentralised basis, using various issuance procedures. The introduction of commonly issued Stability Bonds would mean a **pooling of sovereign issuance among the Member States and the sharing of associated revenue flows and debt-servicing costs**. This would necessarily have implications for fiscal sovereignty, which calls for a substantive debate in euro area Member States.

CONTENT: the Green Paper assesses the feasibility of common issuance of sovereign bonds ("common issuance") among the Member States of the euro area and the required conditions.

1) Main advantages of joint issuance: according to the Green Paper, the common issuance of stability bonds by the euro area Member States has significant potential benefits:

- the prospect of Stability Bonds could potentially quickly **alleviate the current sovereign debt crisis**, as the high-yield Member States could benefit from the stronger creditworthiness of the low-yield Member States;
- Stability Bonds would make the euro-area financial system **more resilient to future adverse shocks** and so reinforce financial stability;
- the **euro area banking system** would benefit from the availability of stability bonds;
- Stability Bonds would also permit: i) the effectiveness of euro-area monetary policy; ii) promote **efficiency in the euro-area sovereign bond market** and in the broader euro-area financial system; iii) facilitate portfolio investment in the euro and foster a **more balanced global financial system**.

2) Conditions for introducing Stability Bonds: the introduction of Stability Bonds would indeed pose significant challenges. These must be convincingly addressed if the benefits are to be fully realised and potential detrimental effects avoided.

In particular, a **sufficiently robust framework for budgetary discipline and economic competitiveness** at the national level and a **more intrusive control of national budgetary policies by the EU** would be required, in particular for options with joint and several guarantees with the purpose of:

- **Limiting moral hazard among euro-area Member States:** Stability Bonds must not lead to a reduction in budgetary discipline among euro-area Member States. 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. Additional safeguards to assure sustainable public finances would be warranted. These safeguards would need to focus not only on budgetary discipline but also on economic competitiveness.

- Underpinning the credit quality of the Stability Bond: Stability Bonds should be designed and issued such that investors consider them a very safe investment. Stability Bonds would need to have high credit quality to be accepted by investors and by those euro-area Member States that already enjoy the highest credit rating. The credit rating for Stability Bonds would primarily depend on the **credit quality** of the participating Member States and the **-underlying guarantee structure** (joint and several guarantee or several).

In some forms, Stability Bonds would mean that Member States with a currently below-average credit standing could obtain lower financing costs, while Member States that already enjoy a high credit rating may even incur net losses, if the effect of the pooling of risk dominated the positive liquidity effects.

Accordingly, support for Stability Bonds among those Member States already enjoying AAA ratings would require an assurance of a correspondingly high credit quality for the new instrument so that the financing costs of their debt would not increase.

- Assuring legal certainty and their compatibility with the EU Treaty: consistency with the EU Treaty would be essential to ensure the successful introduction of the Stability Bond.

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. In this case, an amendment to the Treaty would be necessary.

Issuance of Stability Bonds under several but not joint guarantees would be possible within the existing Treaty provisions.

The Treaty would also need to be changed if a significantly more intrusive euro-area economic governance framework was to be envisaged.

3) Options for issuance of Stability Bonds: many possible options for issuance of Stability Bonds have been proposed, particularly since the onset of the euro-area sovereign crisis. However, these options can be generally categorised under **three broad approaches**, 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. These three broad approaches are:

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.

This approach would be most effective in delivering the benefits of Stability Bond issuance. At the same time, this approach would involve the greatest risk of moral hazard. Member States could effectively free ride on the discipline of other Member States, without any implications for their financing costs. Furthermore, under this approach, the perimeter of government debt to be issued via Stability Bonds would need to be defined.

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.

A key issue in this approach would be the specific criteria for determining the relative proportions of Stability Bond and national issuance. The main options in this regard are examined in the Green Paper. The credibility of the ceiling for the Stability Bond issuance would be a key consideration.

This approach to Stability Bond issuance is less ambitious than the full-issuance approach above and so delivers less in terms of economic and financial benefits. On the other hand, the preconditions for Stability Bond issuance would be somewhat less binding under this approach.

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 to the Stability Bond would deliver fewer of the benefits of common issuance but would also require fewer preconditions to be met. The key issue with this approach would be the nature of the guarantee underpinning the Stability Bond. In the absence of any credit enhancement, the credit quality of a Stability Bond underpinned by several but not joint guarantees would at best be the (weighted) average of the credit qualities of the euro-area Member States. In order to increase acceptance of the Stability Bond under this approach, the quality of the underlying guarantees could be enhanced.

4) Implementation: as the scope, ambition and required implementation time vary across the three approaches, they could also be combined.

It should be noted that the various options would impose, among other things, **differences in implementation timing** because of the degree of changes required in the EU Treaty (TFEU).

- Approach No. 1 can be considered the most ambitious approach, which would deliver the highest results in market integration and strengthening stability but it might require considerable time for implementation. It is also the option that would require the most far-reaching Treaty changes and administrative preparations both because of the introduction of the common bonds as such and the parallel strengthening of economic governance.
- Approach No 2 would also require considerable lead-time.
- In contrast, Approach No 3 would seem feasible without major Treaty changes and therefore less delay in implementation.

The suggestions and findings in this Green Paper are still of **exploratory nature** and the list of issues to be considered is not necessarily exhaustive. Furthermore, many of the potential benefits and challenges are presented only in qualitative terms. A detailed quantification of these various aspects would be intrinsically difficult and/or will require more analysis and input from various sides. **In many instances, the problems to be resolved or decisions to be taken are identified but not resolved.**

In order to advance on this issue, more analytical work and consultation are indispensable. The Commission will seek the views of all relevant stakeholders as mentioned above and seek the advice of the other institutions. On the basis of this feedback, the **Commission will indicate its views on the appropriate way forward by [mid February 2012].**