Europe Needs Growth

Stuart Holland

Stuart Holland made the case for a 'New Deal for Europe' in Spokesman 113. He drafted the 1993 proposal by Jacques Delors that Europe should match a single currency with bonds, modelled on the US New Deal, to recycle internal surpluses and fund economic and social cohesion without fiscal transfers. Curiously, all this recent history was absent from the European Commission's Green Paper on 'The Feasibility of Introducing Stability Bonds', presented by José Manuel Barroso, Commission President, in November 2011. Professor Holland provides a critique of the Barroso Paper, and offers Twin Track Alternatives. He teaches at the University of Coimbra in Portugal.

It is to be welcomed that bonds are on the Commission's agenda and that the Green Paper addresses the manner in which they could lead to lower financing costs in the euro area.[1] It also has merit in proposing three variants of bonds as the basis for public debate. But the Green Paper is flawed in narrowing the scope of bonds for both stability and growth only to stability, displacing the Commission's recommendation of Union Bonds in 1993 for growth and economic and social cohesion, and neglecting also successive endorsement of such wider scope for Union Bonds or Eurobonds by heads of state and government.

The Green Paper also is flawed in that Angela Merkel has already rejected its proposals by repeating her claim that bonds are not a solution. One of the reasons for this is that most proposals for bonds depend on mutual guarantees by other member states, which would mean their being underwritten by German taxpayers. Yet Germany herself is not immune from the crisis. In November, she failed to gain a successful issuance of her own bonds in part because markets already sense that, without a more radical European solution, Germany will need to underwrite those of other member states, yet cannot, on her own, assure this.

This paper both critiques the Green Paper and proposes Twin Track approaches for Union Bonds to stabilise the crisis and Eurobonds to finance growth. It claims that this should be acceptable to Germany and other surplus Member States on the grounds that neither such proposal needs Joint Guarantees, Fiscal Transfers or Debt Buyouts, that a conversion of a share of national debt to the Union could be on an enhanced co-operation basis, and that Eurobonds for the recovery of growth would be funded, not by German or other taxpayers, but by inflows to the Union through their purchase by the central banks of emerging economies and sovereign wealth funds.

Displacement

The Green Paper opens with the claim that the concept of a European bond was first discussed by Member States in the late 1990s.

> 'The concept of common issuance was first discussed by Member States in the late 1990s, by the Giovannini Group.'

It then refers to publication, in a September 2008 discussion paper issued by the European Primary Dealers Association (EPDA), of a discussion paper 'A Common European Government Bond'.

To claim that there was no other discussion by Member States than of these two technical documents not only is wrong, but also displaces the Commission's own recommendation to issue common bonds – Union Bonds – in the Delors White Paper of December 1993 on *Growth, Competitiveness and Employment.* This, then, was discussed by the Essen European Council in the spring of 1994. Luxembourg and The Netherlands were in favour. Helmut Kohl, forcefully, and François Mitterrand, with reservations, were against.

But Mitterrand then changed his mind later in the year, when Michel Rocard had been briefed on the case for bonds by the economic committee of the French Socialist Party and called for a 50 billion ecu *European Fund for Jobs,* financed by bonds, at the Party's autumn conference. When questioned by the press on whether he supported this, Mitterrand replied:

> `I agree with him completely, and would even go so far as to say – and I have checked this with the Commission this morning – that his figure could be doubled. If 100 billion ecus were made available to develop a European infrastructure, we could show that Europe can be a key factor in promoting growth, work and jobs.' (Source L'Heure de Verité, France 2, 25 October 1994)

Jacques Chirac then recommended action on the Delors proposals at his first European Council, at Cannes in June 1995. *Agence Europe* reported him as submitting to the Council that Own Resources had been entirely absorbed by the Common Agricultural Policy following exchange rate realignments, and arguing for 'expansion of the new financial instruments' (i.e. the Delors' Union Bonds).

Bonds again were on the agenda of the June 1996 Florence European Council, when only John Major and Helmut Kohl were against a decision to issue them. Both Jacques Chirac and Romano Prodi had called for them not only to finance growth and jobs but also to underpin what at the time was the projected single currency.

All of this was before the 'later 1990s', to which the Commission Green Paper attributes the 'first discussion by Member States' of the common issuance of bonds, while their discussion of the Delors proposal of Union Bonds at European Council and Ecofin level continued thereafter, with high press and media coverage, rather than in the, at the time unnoticed, Giovannini Group, or a discussion paper published by the European Primary Dealers Association.

Such as when Giulio Tremonti gained discussion of common bonds in Ecofin on the lines proposed by Delors when in the Berlusconi government from June 2001, although Germany still was opposed. As also in the call of Manuel Barroso and Tony Blair in Lisbon in February 2003 for bonds to finance a 10 year programme to create the 15 million jobs, which was the employment growth target of the 1993 Delors White Paper.[2] As well as the statement by Manuel Barroso on the relaunching of the Lisbon Agenda that:

> 'It's about growth and about jobs. This is the most urgent issue facing Europe today. We must restore dynamic growth which can bring back full employment and provide a sound base for social justice and an opportunity for all.'[3]

Narrowed parameters

The Commission's recent Green Paper outlines three different options for bonds, but has chosen to narrow the definition and role of bonds to stability rather than growth, claiming in a footnote that:

> '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.'

Although the Green Paper recommends broad public consultation on the concept of Stability Bonds, with 'all relevant stakeholders and interested parties', it defines these as, in particular:

> 'Member States, financial market operators, financial market industry associations, academics, within the EU and beyond, and the wider public …'

No reference is made in these recommendations for 'broad public consultation' to the European Parliament, the Economic and Social Committee, the Committee of the Regions, to Social Partners, or the resolution of the May 2011 Congress of the European Trade Union Confederation in favour of bonds to achieve both stability and growth.[4]

The word 'social' itself appears only once in the Green Paper, in a footnote referring to the title of a document from the European Parliament. The words ‘employment’ and ‘cohesion’ do not appear at all. Other than in a reference to the Stability and Growth Pact, the word ‘growth’ appears once in submitting that lower interest rates could ‘underpin the longer-term growth potential of the economy’.

This neglects that low interest rates are not a sufficient condition for growth. When there is slow or nil demand growth with spare capacity, compounded by a sense that governments cannot govern a deepening financial crisis, entrepreneurs will not invest simply because interest rates may be low. Besides which, since the financial crisis, and with demands for recapitalisation, few banks are on-lending even the public funds which salvaged many of them from their purchase of toxic derivatives, and are charging high interest rates on commercial or personal loans to fund their recapitalisation.

Limits of the proposals

The Green Paper admits that many of the implications of Stability Bonds go well beyond the technical domain and involve issues relating to national sovereignty. Also that some of the pre-conditions for the success of such bonds would depend on a high degree of political stability and predictability.

A fundamental limit of the Green Paper’s three proposals is not only that they focus exclusively on stability but also that the German government, on the day they were pre-released, declared that it would not support them. Yet this is not surprising, especially for the first two proposals.

Proposal No. 1 is for full substitution of Stability Bond issuance for national issuance, with joint and several guarantees, i.e. the end of national borrowing.

Proposal No. 2 is for partial substitution of national bonds by Stability Bonds with joint and several guarantees.[5]

The first proposal is imaginative but would not redress the current financial crisis since it would imply major Treaty revisions. The second proposal is that of the Bruegel Institute for a transfer of debt of up to 60% of gross domestic product to a new European Debt Agency, which also could imply a Treaty revision.

Yet the first proposal is unrealistic, since Germany and several other Member States are not willing to forego their own bonds, far less transfer all their borrowing to the Union. Either proposal also would imply that surplus Member States underwrite the debt of others through joint guarantees which they not only are not prepared to do but also, arguably, have good reasons to oppose.

Proposal No. 3 is for partial substitution of national bonds with

Stability Bonds and several but not joint guarantees. This approach differs from proposal No. 2 since Member States would retain liability for their respective share of Stability Bonds as well as for their national bonds.

However, as the Green Paper recognises, the key issue with this proposal would be the nature of the guarantees underpinning such a Stability Bond. In the absence of any credit enhancement, the credit quality of such a Stability Bond underpinned by several but not joint guarantees would at best be the weighted average of the creditworthiness of the euro-area Member States and could risk being compromised by that of the lowest-rated Member State.

It thereby recognises that a cascade of rating downgrades could be set in motion, e.g. a downgrading of a larger AAA-rated Member State could result in a downgrading of the Stability Bond, which could in turn feedback negatively to the credit ratings of the other participating Member States due to their contingent liability for all Stability Bond issuance.

Twin Track alternatives

The Green Paper not only displaces the vital importance of growth, and fails to refer to the Delors White Paper whose aims resonated for more than a decade at the highest political level. Its literature review also fails to cite other proposals for 'Twin Track' alternatives with Union Bonds for Stability and Eurobonds for growth.[6]

This 'Twin Track' approach:

- does not imply joint guarantees, fiscal transfers – or the buying out of distressed national debt – to which Germany and other key Member States are opposed;
- recognises that this could be by an enhanced co-operation procedure which would not bind all member states so that Germany and other member states could keep their own bonds;
- distinguishes Union Bonds for stability, which would not be traded, from Eurobonds for growth, which would be traded and attract inflows from the central banks of emerging economies and sovereign wealth funds.

Without joint guarantees, fiscal transfers or debt buyouts

The precedent that neither transfer of a share of national debt to the Union nor net issues of bonds need joint guarantees, fiscal transfers or debt buyouts is that of the European Investment Bank, which has issued bonds without them for more than 50 years, and has been so successful that it now is more than twice the size of the World Bank and has become the world's largest multilateral development bank.

By enhanced co-operation

The case for introducing Union Bonds for stability by enhanced co-operation, by which Germany and other surplus member states could keep their own bonds, has not been considered by the Commission Green Paper. But the precedent is strong in the introduction of the Euro itself, which was a *de facto* case of enhanced co-operation.

The procedure for enhanced co-operation within the institutional framework of the European Union requires nine member states. The voting procedure for enhanced co-operation depends only on the consent of the member states instigating it, not a qualified majority decision.[7]

Union Bonds

On lines similar to the Bruegel proposal (Commission Green Paper Proposal 2), a conversion of national debt of up to 60% of gross domestic product could be converted to Union Bonds for debt stabilisation by those member states consenting to them. Unlike the Bruegel proposal, these need not be traded but could be held in a consolidated EU debit account. Such a debit account could not be used for credit creation any more than a credit can be drawn on a personal debit card. Since the converted bonds would not be traded they would be protected against speculation by rating agencies. But they would not need fiscal transfers between member states. Member States whose debt is converted into Union Bonds would service their share of them.

The Bruegel Institute has proposed a new institution to hold the conversion of such a share of national debt to the Union. But a new institution is not needed. The converted Union Bonds could be held by the European Financial Stability Facility and, after it, by the European Stability Mechanism.

Eurobonds

Eurobonds to finance recovery and growth would be traded and attract inflows to the Union from the central banks of emerging economies and sovereign wealth funds. Brazil, Russia, India, China and South Africa have re-stated, in September 2011, that they are interested in holding reserves in euros in order to help stabilise the euro area. Doing so by investing in Eurobonds, rather than by national bonds, both could strengthen the Eurozone and enable the BRICS to achieve their ambition of a more plural global reserve currency system.

Not counting on national debt

Eurobonds would not count on national debt since they would be the bonds of the Union rather than member states. An analogy is US Treasury Bonds, which do not count on the debt of member states of the American Union such as California or Delaware. They would not need member state guarantees anymore than do European Investment Bank bonds, while EIB bonds also do not count on Member State national debt (see below).

Union Bonds and the European Central Bank

Parallel proposals have suggested that the converted national debt should be held by the European Central Bank (ECB) and net bond issues also managed by it.[8] Without prejudice to its responsibility to ensure price stability, the ECB is Treaty bound to support the general economic policies as defined by the European Council, of which not only price stability but also the survival of the Eurozone is one. But this also would be likely to be opposed outright by Germany and some other member states, which is why this document proposes that a share of national debt converted on an enhanced co-operation basis to Union Bonds should be held by the European Financial Stability Facility (and after it the European Stability Mechanism).

Eurobonds and the European Investment Fund

Eurobonds could be issued by the European Investment Fund, which was set up by Delors to issue Union Bonds and now is part of the European Investment Bank Group. The European Investment Fund would gain from the European Investment Bank's vast experience and expertise in bond issues. The case that net issues of Eurobonds should be by the EIF as part of the EIB Group also makes operational sense in that the European Investment Bank has decades of experience of net bond issues whereas the European Central Bank has none.

Growth

Growth would be enhanced since Eurobonds would co-finance EIB investment projects which are serviced by the revenues of the Member States benefiting from them, rather than fiscal transfers between Member States. None of the major Eurozone Member States, nor Ireland, Portugal or Greece, count EIB project funding against their national debt, nor need any member state do so. The decision whether or not to do so is governmental and does not depend on a Treaty revision.

Cohesion

Cohesion would be enhanced in that, since the Amsterdam Special Action Programme of 1997, the European Investment Bank already has a cohesion and convergence remit for investment projects in health, education, urban renewal, the environment and green technology, as well as financial support for small and medium firms and new high tech start-ups.

Competitiveness
Competitiveness would be enhanced by a share of the net inflows into Eurobonds financing a European Venture Capital Fund for small and medium firms, or a European *Mittelstandspolitik*, which was one of the original aims of the European Investment Fund.[9]

Maastricht Compliance
With a conversion of debt of up to 60% of gross domestic product to Union Bonds all Member States other than Greece would be Maastricht compliant on their remaining national debt. Greece would remain a special problem, since still well in excess of the 60% Maastricht limit but, as such, an exceptional case meriting continued debt buy-outs.

Stability and Growth Pact
The 'Twin Track' strategy of Union Bonds for debt stabilisation and Eurobonds to finance growth also would give political and public credibility to the Stability and Growth Pact, where growth has been sacrificed to stability and would further be so by the proposals in the Commission Green Paper.

Debt Restructuring and Reducing National Debt
None of the above is to the exclusion of debt restructuring in the sense of debt write downs. Nor does it deny the case for reducing national debt. But this could be phased over the medium to longer term in line with the 'Twin Track' Strategy for combining stability through Union Bonds with growth through Eurobonds.

The case for reducing national debt through growth has been demonstrated in the US case by the adoption of such a strategy by the Clinton administration, and that in each of the four years of its second term the federal budget was in surplus.[10]

References
1 European Commission (2011). *Feasibility of Introducing Stability Bonds.* Green Paper. COM(2011)XXX, November 20th
2 The case for the 15 million jobs target in the Delors White Paper, echoed by Tony Blair and Manuel Barroso in their February 2003 declaration, was based

on econometric analysis of employmen creation through of social investments in health, education, urban renewal and the environment – plus social negotiation of more labour intensive employment in the social sphere and the right to reduced working time to enhance work-life balance. Both of the latter were endorsed by the Essen European Council. See further Stuart Holland, (1993). *The European Imperative: Economic and Social Cohesion in the 1990s.* Nottingham: Spokesman Books. Foreword Jacques Delors.

3 Striedinger, A and Uhart, B. (Eds). (2006). The EU Lisbon Agenda – An Introduction. Brussels: ESIB, p. 10.

4 European Trades Union Confederation, (2011). *Mobilising for Social Europe.* Athens, May 19th.

5 Von Weizäcker, J. and Delpla, J. (2010). *The Blue Bond Proposal.*The Bruegel Institute. Policy Brief 2010:3.

6 Yanis Varoufakis and Stuart Holland (2011). A Modest proposal for Overcoming the Euro Crisis. Levy Economics Institute of Bard College *Policy Note* 2011 / 3.

Giuliano Amato and Guy Verhofstadt (2011). A Plan to Save the Euro and Curb the Speculators. The Financial Times International Edition July 4th. The proposal also was supported by Enrique Baron, Michel Rocard, Jan Pronk, Jorge Sampaio, Mario Soares and Jacek Saryusz-Wolski, as well as this author.

See also Stuart Holland (2006). *Financial Instruments and European Recovery – Current Realities and Implications for the New European Constitution.* CEUNEUROP Discussion Paper no. 16. Faculdade de Economia, Universidade de Coimbra. July.

Stuart Holland (2003). *After the European Constitution: Twin Action Proposals*. CEUNEUROP Discussion Paper no. 38. Faculty of Economics, University of Coimbra. July.

7 A decision authorising enhanced cooperation shall be adopted provided that at least nine Member States participate in it. The Council shall act in accordance with the procedure laid down in Article 280 D of the Treaty on the Functioning of the European Union. All members of the Council may participate in its deliberations, but only members of the Council representing the Member States participating in enhanced cooperation shall take part in the vote. The voting rules are set out in Article 280 E of the Treaty on the Functioning of the European Union.

8 Varoufakis and Holland (2011), Op. Cit.

9 Stuart Holland (1993). *The European Imperative: Economic and Social Cohesion in the 1990s*. Op cit.

10 Luce, E. (2011). Hope versus Experience. The Financial Times, November 12th-13th.