The European debt crisis - Eurobonds as a long term solution?

An attempt to describe and analyze the pros and cons

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The European debt crisis – Eurobonds as a long term solution? An attempt to analyze the pros and cons

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Münster, 31/07/12

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Vorwort

Vier Jahre sind die Medien mittlerweile mit einem Thema beschäftigt: „der Krise“. Zuerst warf „die Krise“ Fragen auf wie „Wo ist das ganze Geld geblieben?“[1]. Dann waren es einzelne Länder, die in den Fokus der Medienberichte gerieten: 2010 titelte die FAZ „Die griechische Tragödie ist noch nicht zu Ende“[2] und auch Irland lebte scheinbar im Exzess[3]. Neben zahlreichen populistischen Artikeln beschäftigen sich die Politik- und Wirtschaftsredaktionen der deutschen wie auch internationalen Medien jedoch auch intensiv und fundiert mit „der Krise“. Doch nicht nur medial ist diese ein vielbeachtetes Thema. Auch die Politik versucht ihr Bestes, um die Auswirkungen „der Krise“ im Rahmen zu halten. Doch „die Krise“ bedarf einer genaueren Betrachtung, denn in der zeitlichen Entwicklung nimmt „die Krise“ verschiedene Stadien an und gemeint ist jeweils etwas Anderes.

Seit Ausbruch der globalen Finanzkrise im Jahr 2008 befinden sich die internationalen Finanzmärkte in Aufruhr. Nachdem es 2010 zunächst so aussah, als würde sich die Lage beruhigen, gerieten europäische Volkwirtschaften in den Strudel einer Schuldenkrise. Nach und nach wurde deutlich, wie sehr Staaten wie Griechenland oder Portugal seit der Einführung des Euros über ihre Verhältnisse gelebt hatten. Das Vertrauen der Anleger in die Eurozone ist erschüttert und die Europäische Gemeinschaft sieht sich mit einer beispiellosen Schulden- und Währungskrise konfrontiert. Die Zinslast für die betroffenen Staaten ist immens und schrittweise gerieten mit Italien und Spanien auch die dritt- und viertgrößte Volkswirtschaft der Europäischen Wirtschaftsunion (EWU) in den Fokus der nervösen Kapitalanleger. Nachdem die Disziplinierungsfunktion der Märkte in den letzten Jahren nahezu ausgesetzt hatte, fordern Politik, Medien und Gesellschaft nun beinahe täglich neue Maßnahmen im Kampf gegen die Schuldenkrise. Die Ansteckungsgefahr ist erheblich und sollte Italien unter der Zinslast für Staatsanleihen zusammenbrechen, ist ein Euro-Zerfall kaum noch auszuschließen.

Die Schuldenkrise hat die Schwächen der institutionellen Rahmenbedingungen der EWU schonungslos aufgezeigt: Während die Währungspolitik von Beginn an zentral und supranational in Form der gemeinsamen Zentralbank (EZB) organisiert wurde, liegt die Souveränität für die Wirtschafts- und Fiskalpolitik im Kompetenzbereich der Mitgliedsstaaten. Zwar waren diese Politikbereiche auch schon vor der Krise durch

[1] http://www.zeit.de/online/2008/44/bg-finanzkrise, 31.07.2012
[2] http://www.faz.net/aktuell/wirtschaft/europas-schuldenkrise/schuldenkrise-die-griechische-tragoedie-ist-noch-nicht-zu-ende-1582430.html, 31.07.2012
[3] http://www.sueddeutsche.de/geld/irland-in-der-krise-exzesse-unvorstellbaren-ausmasses-1.1026774, 31.07.2012

Vertragsbestimmungen wie die Defizitregel oder den Stabilitäts- und Wachstumspakt begrenzt, doch fehlten die automatischen Sanktionsmechanismen. Durch die Einführung der gemeinsamen Währung im Jahr 1999 wurden die Zinssätze auf Staatsanleihen weitestgehend angeglichen. Dies hatte zur Folge, dass sich Länder wie bspw. Portugal zu beispiellos niedrigen Zinssätzen refinanzieren konnten und einen extremen Boom verzeichneten. Die gewonnenen Einnahmen wurden aber – entgegen der antizyklischen Logik nach Keynes – nicht für den Schuldenabbau, sondern für weitere Ausgaben genutzt. Aufgrund der Mitgliedschaft in der EWU war es den betroffenen Ländern im Zuge der Krise nun nicht möglich, ihre Währungen künstlich abzuwerten, um die Zinslast zu senken und dadurch eine Rezession zu vermeiden. Somit zeigt die Schuldenkrise in ihren verschiedenen Stadien bis heute, wie groß die makroökonomischen Ungleichgewichte innerhalb der Eurozone sind und deckt zudem den Verlust der Wettbewerbsfähigkeit in den GIPS-Ländern auf.

Aufgrund der beschriebenen Ansteckungsgefahr haben die Staats- und Regierungschefs in den vergangenen zwei Jahren erhebliche Anstrengungen unternommen, die Krise in den Griff zu bekommen und die gemeinsame Währung zu stabilisieren. Die im Zuge der Stabilisierungsversuche ergriffenen Maßnahmen führten zu kurzfristigen Beruhigungen der Märkte, doch sie verstießen auch gegen eine Grundsatzregel der EWU: Durch die Rettungspakete für Griechenland und die Initiierung der Europäische Finanzstabilisierungsfazilität (EFSF) sowie des Europäischen Stabilitätsmechanismus (ESM) wurde die No-Bail-Out Klausel verletzt. Mit den gezielten Anleihenkäufe der EZB sehen viele Ökonomen das Prinzip der Unabhängigkeit der Zentralbank beschädigt. Eine weitere sehr kontrovers diskutierte Rettungsstrategie sind die sogenannten Eurobonds. Sie könnten ein Versuch sein, gemeinsame Staatsanleihen mit gesamtschuldnerischer Garantie zu etablieren. Während der Eurogruppenchef Jean-Claude Juncker Eurobonds als Allheilmittel zur Beendigung der Krise versteht, soll die deutsche Bundeskanzlerin Angela Merkel in einer Fraktionssitzung gesagt haben: „Keine Eurobonds solange ich lebe“[4]. Vor allem von deutscher Seite werden Eurobonds unter den gegebenen Bedingungen abgelehnt. Das Centrum für Europäische Politik bewertet sie beispielsweise als „Einführung einer Transferunion durch die Hintertür“(Kullas & Koch, 2010). Vor allem die GIPS-Länder würden von dem gemeinsamen Anleihen profitieren, da sie durch die Bonität der kreditwürdigen EWU-Mitgliedsländer wie Deutschland und Frankreich geringere Zinssätze erhielten und somit subventioniert würden. Dies führe gerade nicht zu Disziplinierungsmechanismen der Märkte und der Reformdruck auf die betroffenen Länder entfalle. Doch insbesondere die Problematik der fehlenden Wettbewerbsfähigkeit kann nur durch strukturelle und

[4]http://www.spiegel.de/politik/ausland/kanzlerin-merkel-schliesst-euro-bonds-aus-a-841115.html; 26.06.2012

weitreichende Reformen behoben werden. Die Befürworter der Eurobonds sehen hingegen die Chance, sowohl die Krise langfristig einzudämmen, als auch einen historischen Schritt zu wagen: die Etablierung einer europäischen Finanzregierung, die den „Geburtsfehler" der EWU behebt.

In jedem Fall steht Europa und insbesondere die EWU vor einer historischen Bewährungsprobe. Doch für die nahe Zukunft sollten die Hoffnungen nicht allzu groß sein: Ein Bewusstsein für mehr europäische Integration muss sich auch in der Bevölkerung durchsetzen und dies braucht Zeit.

Diesem hochaktuellen Thema und Politikum widmet sich die vorliegende Bachelorarbeit. Zunächst liegt der Fokus auf den Hintergründen der gesellschaftlichen Debatte zu der europäischen Schuldenkrise: Nachdem die Ausgestaltung der EWU genauer betrachtet wurde, wendet sich die Arbeit den Ursachen für die derzeitige Krise zu und bewertet die bisher ergriffenen Maßnahmen. Dies bildet die Grundlage, um die Diskussion um die Eurobonds nachhaltig und fundiert bewerten zu können. Dem Für und Wider der EU-Anleihen wird – vor dem Hintergrund des Konzepts der Europäischen Kommission zu deren Ermöglichung und dem theoretischen Konstrukt des Moral Hazards – Beachtung geschenkt. Im Anschluss wird auch der deutsche Widerstand gegen gemeinschaftliche Anleihen in seiner Argumentation angerissen. Abschließend wird resümiert, wie die verschiedenen Faktoren und Akteure zunächst die Krise auslösten und nun Lösungsstrategien sondieren. Es geht also weniger darum, einen finalen Vorschlag zur Lösung der Eurokrise zu favorisieren, sondern vielmehr darum, die verschiedenen Standpunkte vor ihren spezifischen Argumentationsfolien aufzuzeigen.

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Abbreviations

EC	European Commission
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilization Mechanism
EMU	European Monetary Union
ESM	European Stability Mechanism
GIPS	Greece, Ireland, Portugal, Spain
MS	Member States
SGP	Stability and Growth Pact
TEU	The Treaty on European Union
TFEU	The Treaty on the Functioning of the European Union

1. Introduction

The current European debt crisis is omnipresent since almost three years by now and has since then developed into a euro crisis. When in 2010 one could think that the global financial and economic crisis might have been overcome, the European Union as well as the European Monetary Union (EMU) had to face the most serious crisis since its foundation. In the course of the two last years, different actions and rescue programs have been developed, but till now a pacification of the market could not be achieved. The so-called GIPS-countries (Greece, Ireland, Portugal and Spain)[5] suffer from the high interest rates on their government bonds and are rarely able to refinance without the rescue programs.

Financial experts advise against a possible Euro crash and its impacts on the European MS which would end up in an increasing unemployment, a decline of the economic performance in every MS and a reversion to economical protectionism. Especially German companies, which have strongly benefited from the Euro zone in the context of exports, would suffer from a collapse of the monetary union. Although time is short, the heads of governments have difficulties with finding the right solutions and mechanisms in order to guarantee stability. Besides a lot of approaches, one of the most discussed are the so-called Eurobonds which are on the one hand extremely wanted by states like Italy and France but on the other hand completely rejected by the German government – or so they say under the current conditions.

The Bachelor thesis in hand with the title: “The European sovereign debt crisis- Eurobonds as a long term solution? An attempt to describe and analyze the pros and cons” regards to the idea of introducing Stability Bonds not only by individual governments but also by the European Commission which presents its concept in the “Green Paper on the feasibility of introducing Stability Bonds - COM (2011) 818” (European Commission, 2011). On the basis of this Green Paper, the following research question shall be answered in the course of the thesis.

Taking the current crisis and the institutional framework into account, can Eurobonds function as a long-term solution?

Moreover, this research question leads to several follow up and sub-question:

- Who benefits from Eurobonds and who would have to accept disadvantages?
- Do Eurobonds offer a solution in the short-term?

[5] This list could be amended by Italy and Cyprus

These questions are aimed to be answered in the following thesis, whereas the German rejection shall be attended particularly. Therefore, the thesis in hand firstly introduces firstly a preliminary analysis by explaining the status quo of European monetary and economical policy. Secondly, the current EU debt crisis as well as the stability measures which have already been implemented by the European Commission shall be presented. This descriptive part is followed by a theoretical part which presents the methodical approach. The main part analyzes the concept, impact and conditions of Eurobonds by comprising the Moral-Hazard theory. Finally, an outlook and conclusion will be drawn.

2. Preliminary Analysis

Since the global financial crisis started with the American subprime crisis in 2007, the world economy still suffers from a global financial, banking and economical crisis. The first decisive turning point was the insolvency of Lehman Brothers in 2008 which led to a persistent distrust of investors in their debtors – banks and states (Welfens, 2012). When the global economy was only beginning to recover, the European debt crisis permanently started to shock again the financial markets and its investors. Today, the EU is facing on the one hand a sovereign debt crisis of several Member States and on the one hand a dramatic currency crisis. As of today, Greece, Ireland, Portugal and Spain were supported by the EU bail-out package – Cyprus has applied for European aid. But how could this development have taken place since the European Commission declared it in 2000 as part of its "Lisbon agenda 2010" to develop the EU to the most competitive economy of the world[6]. The causes and definitions of the European debt crisis are manifold, and frequently can only be explained through the interaction and increasing interdependence of different factors and actors. For this reason, it is important to provide an overview not only about the causes of the current debt crisis but also about the measures already taken. Therefore, the principles of the European monetary and economic policy shall be presented. These overviews are important in order to comprehend as well as to judge the discussion about introducing Stability Bonds.

[6] "When the Heads of States met at the Lisbon summit in March 2000, European Union leaders set out a new strategy, based on a consensus among Member States, to make Europe more dynamic and competitive." (Commission)

2.1 The European Monetary Union and its policy

In the course of the European integration, an economical integration in terms of monetary approaches was further advanced. In general, these goals were anchored in Art. 2 and 4 of the Treaty establishing the European Community which says:

> *"The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance."*

and:

> *"The Union shall establish an economic and monetary union whose currency is the euro."*

Consequently, the EMU was established and constituted in the Maastricht Treaty in 1990. Following several preliminary concepts, a three-stage plan was outlined in order to establish an economic cooperative with a common currency (Bundeszentrale für politische Bildung, 2009). The first stage (1990 to 1993) provided the "removal of barriers to free movement of capital within the EU" (European Central Bank, 2012) as well as a the better cooperation among the national central banks and a better response to the needs of the economic policy. During the second stage (1994 to 1998), the introduction of the new currency was prepared while the Member States (MS) had to fulfill the convergence criteria in order to adopt the euro.[7] By these criteria, the MS are expected to afford price stability, a balanced public budget ("a deficit and a level of debt that are both limited in terms of GDP" (European Central Bank, 2012)), currency stability and stable exchange- and interest rates. Additionally, the criteria about the national debt and new net indebtedness were discussed among scholars: According to Art. 126 (2) TFEU, an excessive deficit exists if "the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace" and concerning the new net indebtedness, a Member State (MS) fails in fulfilling the criteria, if "the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in the Protocol on the excessive deficit procedure as 3% of GDP)" (ECB, 2012). Scholars like the German professor Renate Ohr criticize the fact that these reference levels are based only on monetary figures rather than on real economical and structural convergence (Ohr & Schmidt, 2001).

[7] The convergence criteria are set out in Art. 140 (1) and Art. 126 of the Treaty on the functioning of the European Union (TFEU) (ex Article 121 (1) TEC)

Finally, the ECB was established in 1998 – responsible for the monetary policy of the euro zone. Since the Lisbon Treaty in 2009, the ECB is seen as a European institution. Stage three (starting in 1999), is marked by the official founding of the EMU and the accession to the euro zone by those countries who fulfilled the convergence criteria. In the beginning, the EMU was represented by 11 countries, while today the number of MS amounts to 17 countries. Now, one decade has passed since the euro has been introduced. It can be considered as one decade whereas the EU has benefited from its monetary union which led to a low rate of inflation in the euro zone, cost and time savings concerning trade and travelling, economic progress and higher competition as well as increasing economic growth combined with higher employment rates (Welfens, 2012). However, former rules and institutions apparently failed at handling the current crisis which brought up the question how the European economic policy has been organized so far. In this context, a distinction between monetary and economic policy has to be considered. Further details of these policy fields have been established under title 'VIII of the TFEU', discussed in chapter one and two.

The monetary policy (chapter two) is based on the overall principle of price stability which shall be enforced by the European System of Central Banks (ESCB).[8] By founding an independent ECB, the monetary policy is characterized by a supranational structure. This is also proven by the fact that the national central banks still keep a separate legal personality but are engaged in promoting the ECB's monetary policy. Therefore, the ECB is the head of the ESCB and is supposed to act completely independent from other European institutions and governments which ended consequently in a loss of influence by the national governments on their national central banks (Puetter, 2009). The rigorous goal of a sound price stability has absolute priority over other economical concerns as long as this is line with the EU's economical development. Besides, it is the competence of the ECB to define price stability and the institution's strategy. Since the ECB concentrates on the mentioned goal and has to focus on a common monetary policy, this focuses on the euro zone as it which makes it difficult to avoid regional disparities (Puetter, 2009). However, the euro zone combines economies with different growth rates as well as economic cycles but "finally the ECB has to concentrate on the large economies because their economic development dominates the euro zone" (Puetter, 2009, p. 103). As a major consequence, the smaller economies that provide an above-average growth rate have to deal with a higher inflationary pressure compared to other members.

[8] Art. 127 (1): „The primary objective of the European System of Central Banks shall be to maintain price stability. […]"

While this pillar of the European policy is central directed with the ECB as an overall institution, the economic policy is characterized by a decentralized structure because regarding to Art. 5 TEU – “the limits of Union competences are governed by the principal of conferral. The use of the Union competences is governed by the principles of subsidiarity and proportionality” (European Union, 2008). Until now, the MS hold the competence concerning the economic policy but it is dependent on the principle of coordination which says “Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council […]” (Art. 121 (1) TFEU). Even though, the MS are supposed to coordinate their economic and fiscal policies in the light of the common interest it is still their competence. Nevertheless, a monetary policy which depends on price stability can only be implemented with the support of the MS’s economic policy. “Especially the budgetary discipline is one pre-condition in order to guarantee that a monetary policy of price stability does not lead to a high interest rate in the long term and therefore to a slowing growth.” (Puetter, 2009, p. 104)

Additionally, the common currency led to the loss of automatic adjustment mechanisms and higher deficits have not brought to immediate disadvantages for the concerned countries. This term of benefitting from a low interest rates by the stable budgetary policy of other MS, is also called *free riding* (Wagener, Eger, & Fritz, 2006).

Taking these into account, the EU established political coordination measures in the course of the Maastricht Treaty in order to guarantee a sound fiscal and economic policy in all MS. According to Bofinger, “the Treaty has been conceived in a way that the financial markets play an important role in disciplining the MS’s fiscal policy. By establishing the No-Bail-Out rule and abandoning rescue-mechanisms in the case of liquidity- or solvency issues of one MS, the EU aimed to signalize the markets, that in the case of payment difficulties of one MS it cannot rely on the support by the EU” (Bofinger, 2011, p. 812)

However, the treaty does not provide clear guidelines but the Council has the power to legislate in line with a further coordination process. Multilateral surveillance is the instrument implemented by the Council and applies to the different coordination procedures which will be presented as follows.

Coordination procedure:

The Council in general, and the Economic and Financial Affairs Council (ECOFIN) in particular coordinate the MS’s economic policy once a months – the Euro Group meets always one day earlier and is the smallest committee which combines the most important representatives from both EMU policy fields. Jean-Claude Juncker is the current president of the Euro Group which meetings are widely appreciated because of their informal character (Puetter, 2009). Regarding to art. 121 TFEU, the Council „shall, on a recommendation from the Commission, formulate a draft for the broad guidelines of the economic policies of the Member States and of the Union […]" (Art. 121, 2., TFEU) and their efficiency is proved by the multilateral surveillance (Art. 121, 3. TFEU). The Council has got the possibility to warn MS if their economic policy infringes the economic guidelines – these warnings are based on reports and recommendations of the EC. Since 2000 when the so-called Lisbon Strategy was renewed, the guidelines have been amended and formulated clearer and more consistent. Moreover, the EC is now allowed to judge the MSs' reform programs. Nevertheless, there is still missing an automatism of sanction in the case of infringements (Ohr & Schmidt, 2001).

The Deficit Rule:

This rule is the only instrument which is bindingly set up in the TFEU and like the convergence criteria it refers to the annual new indebtedness (not higher than 3 % of GDP) and to the national debt (not higher than 60% of GDP). In the case of infringement, the EC conveys a report to the Council and recommends a so-called deficit procedure. In the course of the procedure, the decisive part is played by the Council which can decide whether the procedure against one MS will be tightened. In addition, the Council might publish its recommendation which causes the so-called '*naming and shaming'* whereby a pressure of publicity shall be generated (Puetter, 2009). Finally, the Council may impose financial sanctions although "so far, there has never been a penalty payment in the course of the deficit procedure because the procedure always was abandoned due to better budgetary situations or an extension of the time was given" (Puetter, 2009, p. 118). Although the deficit rule is applicable for all MS, the EC and Council can only penalize members of the euro zone.

The Stability and Growth Pact (SGP)

In contrast to the deficit rule, the SGP is not anchored in the treaty and is characterized by being an instrument of implementation and procedural code which is founded on conclusions of the European Council and ECOFIN. Moreover, the SGP can be understood as the political and legal foundation of the application of the coordination procedure (Puetter, 2009).

The crucial objective of the SGP is the *“medium-term goal of budget positions which are close to balance or in surplus”*[9] which has set up only a voluntary restraint for the MS to respect the limit of 3 %. Due to the objective, the SGP differs among a corrective and a preventive arm. In theory, the corrective arm shall function if one MS manifests already an excessive deficit or is about to reach it and a correction must be effected as quickly as possible. The preventive arm shall avoid a budgetary deficit from the very beginning and again in theory, this is possible if the MS reaches a sound budget in an economic upturn – namely the counter-cyclical logic. In this context, each MS has to submit a stability and convergence program in which it explains how it will reach a sound budgetary policy once a year. Both arms are criticized because of their low efficiency because in practice there were a lot of cases that MS infringed the SGP but were not penalized by the Council. To sum up, in its old version the SGP has been a political instrument which was supposed to create political and public pressure (Schäfer A. , 2005). Finally, the differences among the main policy fields of the European Monetary Union can be seen as one cause for the current European debt crisis. “While the monetary policy is centrally organized, the MS are responsible for the economic policy – but this is only constricted by the SGP” (Schäfer A. , 2005, p. 122)
In the course of the crisis, the need for reforms has been realized. The measures which have been taken so far will be outlined in the chapter “measures and rescue strategies”.

No Bail-Out Rule

One of the most fundamental rules of the European economic policy is the so-called ‘No Bail-Out Rule’ which is established in art.125 TFEU.[10] This rule forbids MS to be liable for the other MS which might get into a financial disorder. Each MS is responsible for its fiscal and budgetary policy and shall not expect the financial support of the Union. However, this rules is criticized because of the “too big to fail” problem which means that in the case of emergency, the Union might break the rule due to political and economical pressure.

This figure summarizes the described problems of the EMU’s constitutional framework and organization.

[9] European Council in its decision about the SGP, 1997
[10] Art. 125 TFEU: “The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project.”

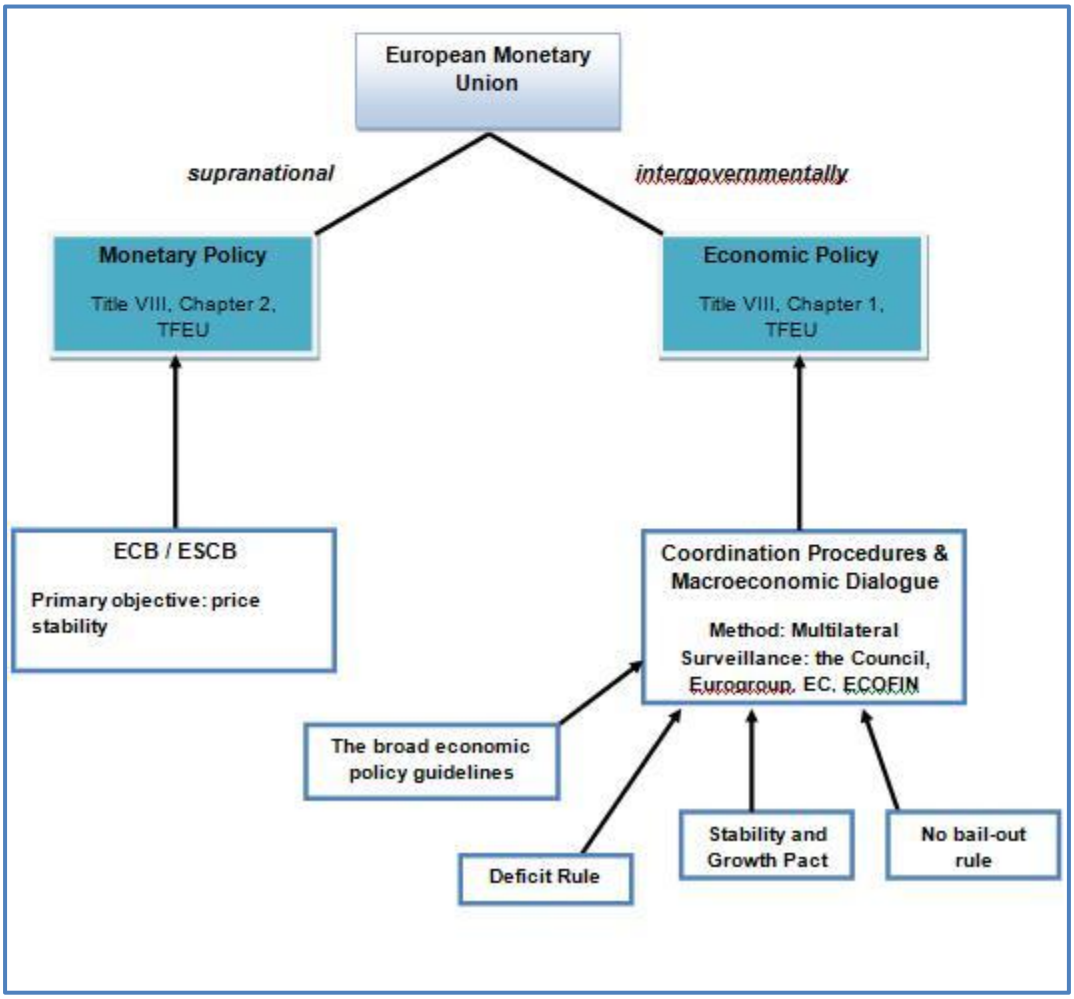

Figure 1: The Structure of the EMU (own graph)

2.2 The European debt crisis – origin, causes and measures

The current European debt crisis results from multifaceted causes and even though the crisis was followed by the global financial crisis, this really is not the only origin. According to Heise, “on the one hand, the EU debt crisis resulted from the global financial crisis, but on the other hand its roots are more profound” (Heise, 2011, p. 638). The following figure illustrates the course of the different types of crisis.

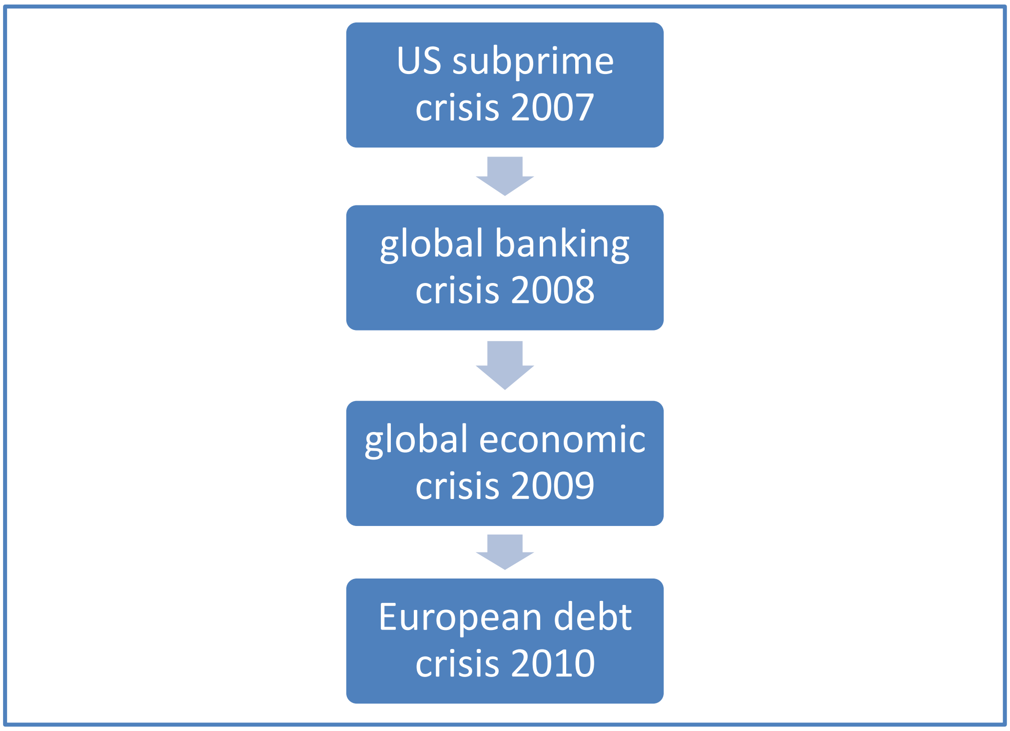

Figure 2: The development of the different crisis (Brunetti, 2011, p. 58)

In 2010, it seemed that the global economy and banking crisis had been endured when the European debt crisis began with an intensity which nobody had expected. This shock could arise because of huge macroeconomic imbalances among the European MS (Brunetti, 2011) that were only noticed when the global crisis reached the European economies. Before, the mechanisms of market discipline failed at forcing the affected countries to a more sustainable fiscal and economic policy. Till the start of the global banking crisis, the bonds of euro zones' members were taken as a safe investment (Straubhaar & Vöpel, 2011). In the following section, it shall be pointed out why this was a fatal mistake.

2.2.1 Origin and reasons for the crisis

After the foundation of the EMU, the so-called GIPS-countries benefited from an economic boom caused by a significant declining interest level due to the abandonment of their own currency. As illustrated by the figure below, the introduction of the Euro in 1999 in Spain, Portugal, Italy, Ireland and in Greece in 2001 is clearly identifiable (Brunetti, 2011).

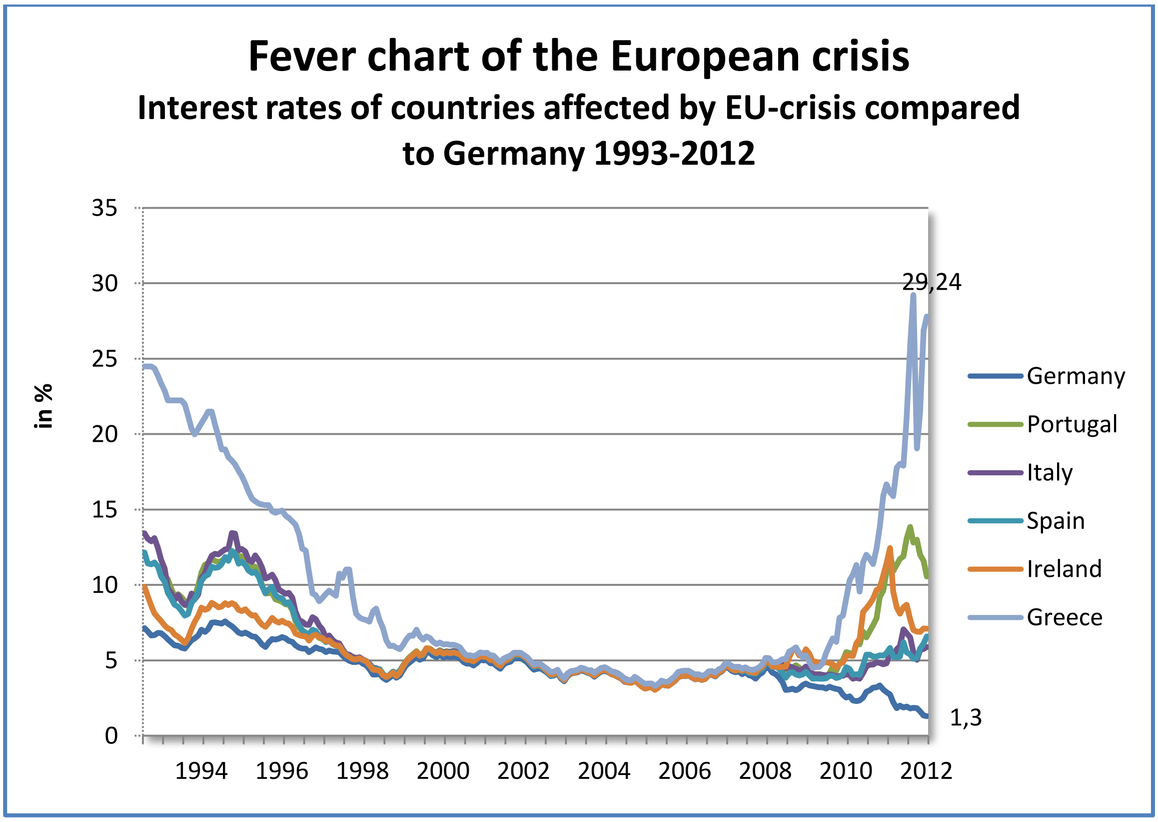

Figure 3: Fever chart of the European crisis: Interest rates of countries affected by EU-crisis compared to Germany 1993-2012 (Own chart, data source: ECB, 2012)

Moreover, the common currency inhibited the possibility of devaluation for the single MS and an alignment with the German interest level of government bonds. According to Brunetti: “Since the introduction of the Euro, investors assumed that the risk of government bonds belonging to GIPS-countries were equal to German government bonds” (Brunetti, 2011, p. 80). Besides, the reduction of the interest level led to an economical boom period in those MS: Investments and consumption increased caused by a higher domestic demand. Due to this development, the average growth rates of the concerned countries were comparable with those of emerging markets during this decade. The following figure shows the development of the GIPS-countries during the last years and the origin of their struggling economies.

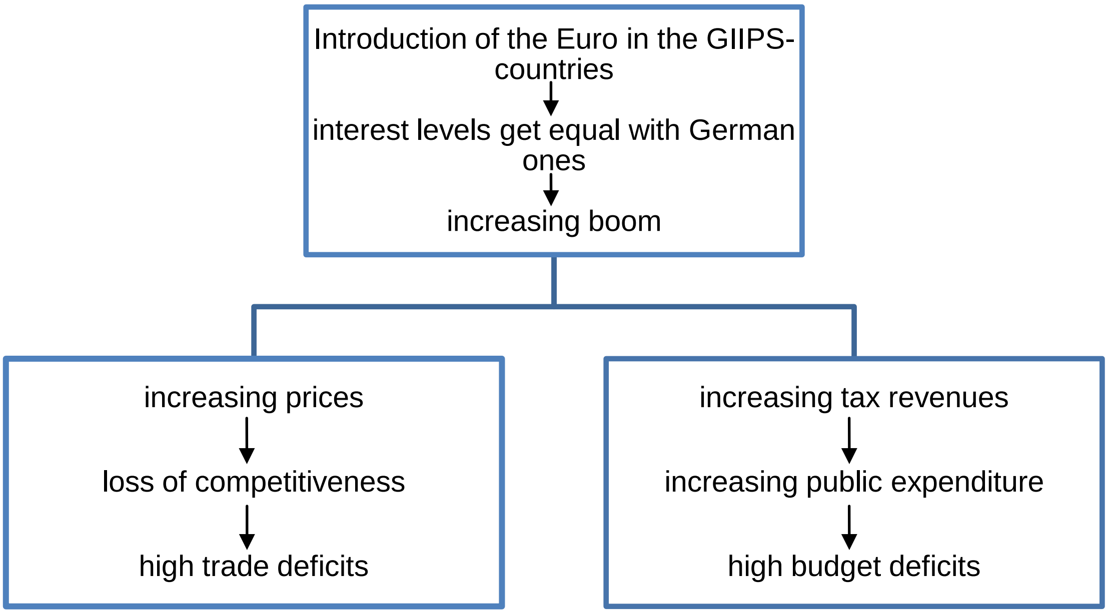

Figure 4: The development of macro-economical imbalances among the GIPS-countries (own translation according to Brunetti, 2011, p.81)

One of the major problems is the loss of competitiveness – this development was caused by imbalance among demand and supply: While the demand increased because of the described boom, the supply decreased. As a result, the prices and the wages rose. These circumstances have on the other hand led to a higher inflation compared to other European countries. The increasing inflation is one of the core problems in the current situation in the GIPS states since the export firms in these countries suffered from higher production costs and lost their competitiveness. But imports got more attractive at the same time, however, financed by making debt abroad – especially in the other euro zones' countries. According to Brunetti, the other origin results from increasing government spending during the last decade. Instead of saving the ascending tax revenues (which would have been the anti-cyclical logic), the GIPS-countries governments used these for additional investments.

Other countries like the United States suffer from high current account deficits too, but these countries do not depend on a monetary union and a common currency (Bofinger, 2011). In 2008, when the crisis finally hit the real economy, the GIPS-countries suffered from a huge decline of tax revenues. The contrast among the boom and the recession was extreme and led to even higher budget deficits while the exports and GDP still decreased (Brunetti, 2011).

At this time, investors got aware of the huge imbalances among the European government bonds which happened with a surprisingly delay. Bofinger judges: “If one takes the German government bond as an indicator for risk premiums on long-term bonds, it becomes apparent that investors have not identified any problems with the Member States fiscal policy for nine years" (Bofinger, 2011, p. 812).

During the last two years, the investors' reaction is described as panic and as a "herd-behavior" (Bofinger, 2011) when they abandoned firstly Greek, than Irish, Portuguese and finally Spanish government bonds. The crucial question is if the countries are capable to pay back their debts.

In addition, conversion of debts emerged as an adverse solution since most of the liabilities are hold by the banking sector in the so-called surplus countries (France, Belgium, Germany, the Netherlands and Austria) (Brunetti, 2011).

Moreover, it is important to emphasize that Greece must be considered to be a "special case" among the GIPS-countries. By now, it has been proven that the Greek government forged the data in order to accede to the EMU in 2001 (Welfens, 2012). Additionally, in 2009 the government led by the conservative party 'Nea Dimokratia' reported a deficit of 5 % to Brussels. In truth, the deficit quota was about 15 % (Welfens, 2012) which is five times higher than approved by the SGP. Furthermore, mismanagement and corruption boost the current situation. As a result, "Any announcement by the Greek government about its intention to redress the budgetary situation will be met by great skepticism for years to come" (De Grauwe, 2010, p. 1).

Finally, more than one decade after the introduction of the common currency, the euro zone is facing a possible collapse and a second banking crisis. Even though, the politicians tried to establish rescue mechanisms as sustainable as possible, the markets still do not reassure. The following section, presents the most important rescues strategies which have been in progress since the beginning of the crisis in the euro zone.

2.2.2 Rescue strategies

In 2010, Greece and its disastrous situation forced the MS of the euro zone to act since Greece was facing a bankruptcy (Brunetti, 2011). Moreover, the interest rates for Irish, Portuguese and Spanish government bonds increased dramatically. According to Brunetti, the heads of government had to decide whether they accept a debt rescheduling or if they provide financial support. For fear of dealing with a new financial crisis and the risk of contagion, they decided to grant a first recovery package and infringed the No-Bail-Out-Rule. For reasons of simplicity, the different rescue strategies are divided into financial and political measures.

Financial Measures

The first rescue package was enacted on 2 May 2010 which "granted liquidity assistance to Greece of a total of € 110 billion" (Sachverständigenrat, 2011/2012, p. 85) provided by the euro zone MS and the IMF. In return, the Greek government promised to implement radical economical and fiscal reforms.

However, this rescue package could not pacify the markets since the debt crisis developed more and more into a systemic crisis. Realizing the risk of contagion, the ECOFIN decided on 9 May 2010 to establish the "European Financial Stability Facility" (EFSF) - known as the *rescue umbrella* and amendable for all euro area MS with a volume of € 440 billion but limited to three years. "The rescue umbrella also included additional credit facilities of € 250 billion through the IMF and € 60 billion via the European Financial Stabilization Mechanism (EFSM) emergency funding program by the European Commission" (Sachverständigenrat, 2011/2012, p. 86). So in total, the EFSF included a guarantee volume of € 750 billion which is an extreme dimension but was supposed to pacify the markets at least. The legal basis for this exceptional instrument is art. 122, 2 TFEU which says:

"Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned."

In detail, the rescue umbrella covers two elements: At first an emergency stabilization fund guaranteeing a volume of € 60 billion and legally based on the Councils resolution of introducing the EFSM (Sachverständigenrat , 2010/11). On a second stage, the EFSF has been founded as a special purpose vehicle according to Luxembourgish law which allows the EFSF to operate in the capital market on its own account, however, for this capital the MS agreed to a pro rata liability. In order to receive an AAA-Rating, the guarantees have been higher than the lending capacity (Deutsche Bundesregierung, 2012). The condition precedent for seeking protection under the umbrella is "an exposure for the stability of the whole euro zone and an application for admission of one Member State" (Deutsche Bundesregierung, 2012, p. 27). The imperative of this rescue mechanism became apparent when Ireland accessed the EFSF in December 2010 and Portugal in May 2011. Cyprus has already announced its request for support in 2012 while the Euro Group has provided billions of Euros for restructuring the Spanish banking sector this month. In the course of the crisis summit in July 2011, "a decision was taken to increase the volume guaranteed by the EFSF to € 780 billion" as well as to allow for more scope of action (Sachverständigenrat, 2011/2012, p. 86).[11]

Nevertheless, the rescue umbrella infringed the No-Bail-Out rule and was accompanied by a controversial measure of the ECB. Since the guarantee volume of the EFSF was not available in such a short-run, the ECB started to forestall state bonds of the countries which were most at risk on 9 May 2010. Hereby the ECB offended against its own principal of independence as well as against the principal of averting the monetization of public debt (Brunetti, 2011). Additionally, "in August 2011 the ECB once again entered the capital market to limit the rise in interest on Italian and Spanish bonds. To date, its bond portfolio has thus grown by an additional figure of some € 100 billion"(Sachverständigenrat, 2011/2012, p. 87).

However, the EFSF was constituted only as a temporary institution whereupon the European heads of government decided to in addition to establish a permanent rescue strategy – the so-called European Stability Mechanism (ESM) as a permanent replacement of the EFSF from 2012 on (one year earlier than originally planned).[12]

In comparison with the EFSF, the ESM is an international law binding instrument first of all. Furthermore, "in order to be able to guarantee an effective loans capacity of € 500 billion, the member states agreed a combination of paid-in and on-call capital through guarantees. The paid-in capital of € 80 billion is thus to meant to compare with € 620 billion on-call capital" (Sachverständigenrat, 2011/2012, p. 86). But the most important difference is the possible involvement of private creditors which is implemented as follows:

"(12) In accordance with IMF practice, in exceptional cases an adequate and proportionate form of private sector involvement shall be considered in cases where stability support is provided accompanied by conditionality in the form of a macro-economic adjustment programme." (Treaty Establishing the European Stability Mechanism, 2012)

Due to the fact that "this depends on an analysis of whether the country in question can shoulder the debt" (Sachverständigenrat, 2011/2012, p. 86), it is assessed as quite vague. With respect to the current situation, the ESM-ratification procedure has been stopped because of complaints before the German Federal Constitutional Court even though the German Parliament has accepted the treaty on the ESM.

[11] "In particular, the facility is henceforth able to acquire bonds in the secondary market and use its funds to recapitalize banks. Finally, it is henceforth authorized to lend to problem countries at a clearly reduced interest premium." (Sachverständigenrat, 2011/2012, p. 86)

[12] Legal foundation: "(2) On 25 March 2011, the European Council adopted Decision 2011/199/EU amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro adding the following paragraph to Article 136: "The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality". (Treaty Establishing the European Stability Mechanism, 2012)

According to art. 48 of the treaty, not all involved MS have to agree in order to ratify the treaty, but Germany is the largest donor country which means that as long as the German Federal President does not sign the law, the condition of "approval or acceptance have been deposited by signatories whose initial subscriptions represent no less than 90% of the total subscriptions set forth in Annex II" (Treaty Establishing the European Stability Mechanism, 2012) is not fulfilled.

Assessment

As aforementioned, the financial rescue programs have been discussed controversial among politicians, scholars and economists Hence, I will try to summarize the relevant points of criticism:

By deciding to rescue MS like Greece or Ireland with the described programs, the EU has on the same time decided to infringe the No-Bail-Out rule. On the one hand one could argue that this rule was from the very beginning undermined since the deficit rule was not taking serious, too. Nevertheless, with respect to Brunetti, the most important fiscal rules of the EMU have been infringed by establishing the EFSF and ESM (Brunetti, 2011). In his opinion, particulary the purchase of state bonds by the ECB in 2010 was the clear violation of a taboo since it led to question the ECB's independence. Especially in Germany, scholars are concerned about the embodiment of the mechanisms and note that the euro zone can already be described as a community of liability since "the treaty does not say that the procedures about possible capital increase have to be completed with consent of the parliament" (Brück, 2012, p. 1). In addition, 272 German professors of economic science stated their position in an urgent letter to the German public and explained inter alia: "If economically sound countries share liability for bank debts elsewhere, they will be exposed to constant pressure to widen the limits of this liability or to soften the requirements for its provision. This is bound to lead to additional strife and discord in the European Union" (Sinn, 2012)[13].

Coming to the evaluation of the ESM's efficiency, one has to point out that the rescue programs only have a chance of long-term succeed if a mixture of reforms and adjustments will be established. Fuest evaluates the ESM as follows: *"The introduction of the ESM is the most important element of the reform. It includes provisions for sovereign bankruptcies with an involvement of private sector creditors. This is an important step forward. But the key issue of credibility is neglected: as long as the financial sector is too fragile to absorb a sovereign bankruptcy and a financial meltdown looms, bankrupt countries will always be bailed out, even if their debt is unsustainable or they fail to comply with adjustment programmes"* (Fuest, 2011, p. 34).

[13] Hans-Werner Sinn, economist and president of the Ifo Institute for Economic Research has been the initiator of this letter. However, it was signed by more than 250 German scholars and economists.

Moreover, the political influence might undermine the efficiency of the ESM, too. To sum up, long-term and sustainable success can only be achieved if the concerned countries undergo structural and inconvenient reforms.

Political measures

Since the EMU suffered from several weaknesses concerning its lack of political coordination and the enforcement of automatic sanctions, the heads of government also tried to reform the basic framework. In a communication in 2010[14], the EC declared:

"Although the EU has a number of instruments for the co-ordination of economic policy the crisis has shown that they have not been used to the full and that there are gaps in the current governance system. There is broad political agreement that this has to change and that the EU needs to be equipped with a broader and more effective set of policy instruments to ensure its future prosperity and standards of living" (European Commission, 2010, p. 3)

As a timeframe for coordination, the EC developed the so-called "European semester for policy-coordination" which the cycle starts in January "with an 'Annual Growth Survey' (AGS) prepared by the Commission, reviewing economic challenges for the EU and the euro area as a whole"(European Commission, 2010, p. 12).

Among an entire reform package, the reform of the SGP and the establishing of the Euro Plus Pact (EPP) are the most interesting and important ones and shall be in focus within the next chapter.

In 2011, the EU agreed on a hardening of the SGP by shaping both the corrective and the preventive arm as follows. In general, deficit limit shall be more under attention as well as the consolidation measures in order to the reduction of government debt. Therefore, quasi automatically sanctions will be introduced which are based on future minimal standards for the MS's fiscal policy (Deutsche Bundesregierung, 2012). "In addition, the ceiling of 60 percent for the level of debt will be taken more seriously. Member countries with debt levels above 60 percent are required to reduce the excess of their debt ratio over this limit by five percent per year until the debt ratio falls below the 60 percent threshold" (Fuest, 2011, p. 35). In the context of sanctions, the reform encourages the European Commission by implementing that the European Council can only inhibit sanctions "if a qualified majority votes against it" (Fuest, 2011, p. 35). With regard to the preventive arm of the SGP, all MS have to provide stability- or convergence programs (depending whether they are members of the euro are or not) in which they explain how they try to achieve the goal of a sound budget. "In particular, Stability and Convergence Programs include the ne-

[14] COM (2010)367 final: COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS - Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance

cessary information for a meaningful discussion on fiscal policy for the short and the medium term, including a fully fledged macroeconomic scenario, projections for the main government finances variables and their main components, and a description of envisaged policies" (European Commission, 2010, p. 18).

These programs will be proven by the EC which might sound a warning; in this case the Council has to enjoin measures on the concerned state by giving a time limit of three to five months. The EC controls the implementation of the given measures and decides whether this is achieved sufficiently or not. If not, sanctions will be introduced as long as the ECOFIN does not reject it by a qualified majority in ten days (Heinen, 2012). The corrective arm has been reformed by implementing quicker reactions if a MS is already facing an excessive deficit. If this is the case, the Council gives recommendation for correcting the fiscal policy also by setting up a time-limit. Quasi-automatic financial sanction might follow which applies only for euro zone MS.

Besides the Europe 2020 strategy, the EPP has been agreed by the euro area members[15] by arguing for the goal "to achieve a new quality of economic policy coordination, with the objective of improving competitiveness" (Fuest according to the conclusions of the EU summit of 24-25 March 2011). Therefore, the EEP is the political approach in order to tackle the biggest problem of the EMU – the macro-economical imbalances among the euro area member states. Despite of this, the Pact covers several policy fields which shall be coordinated and monitored more closely. "Policy coordination under this pact will work as follows. In a first step, the participating governments will agree on a set of common objectives. Then each member state will develop a plan to pursue these objectives with its own policy mix" (Fuest, 2011, p. 35). Once a year, these plans will be judged and recommended by the EC. Since there are no sanctions at all, this policy coordination is based on a self-imposed obligation by the MS which is justified by the German government as follows: "The choice of concrete measures and objectives is still the competence of national governments since the state are than able to focus on challenges and programs they consider as being most important" (Deutsche Bundesregierung, 2012).

Assessment

As described above, the European economic and monetary policy possesses several problems in terms of coordination since the euro zone members depend on a common and centralized monetary policy. At least, the reform of the SGP as well as

[15] All European MS have been welcomed to join the pact: Bulgaria, Denmark, Latvia, Poland and Rumania already participate.

the introduction of the EPP “place a lot of emphasis on the coordination and supervision approach” (Fuest, 2011, p. 37). However, among others Fuest criticizes the lack of automatic sanctions as well as the “too ambitious rule for the reduction of debt levels” (Fuest, 2011, p. 34). He constitutes his doubt with the forecast of the government debt to GDP ratio which leads probably to a violation of most of the euro zone countries in 2012. Fuest sums up: “There clearly the danger than noncompliance with this rule will undermine the credibility and the enforcement of other rules as well” (Fuest, 2011, p. 38). With respect to the different origins of the crisis in the concerned MS, a better control or supervision might not avoid that a country is hit by a macroeconomic shock (Fuest, 2011). The authors of the judgment by the ‘Centrum für Europäische Politik’, Kullas and Koch, conclude that the core problem is the absence of automatic sanctions since sanctions in general have been established in the former SGP, too. Moreover, they explain: “Therefore, the Commission should have prescribed as a mandatory condition that sanctions are imposed automatically where the requirements of the Pact are not met. Moreover, the Commission should have proposed an insolvency procedure for euro states. Only this gives credibility to the idea of national bankruptcy and thus reduces the political pressure on the EU to rescue Member States from insolvency after 2013” (Kullas & Koch, 2010, p. 3).

3. Interim Summary

Taking the previous chapter into account, the complexity of the current crisis can be realized. The European debt crisis and current euro crisis did not only follow the global financial crisis – in the meantime it is a crisis which decided about the future of the European Union. As described, on the one hand the architecture of the EMU (which has been described as not being a perfect currency area) suffers from different lacks of efficient co-ordination which should have prevented the joining of Greece in 2001.On the other hand, the strong imbalances among the individual states were neglected by the markets as well as by the EU for one decade. According to economist and the Sachverständigenrat, this was made also possibly by the EU and the questionable implementation of the No-Bail-Out rule (Sachverständigenrat, 2011/2012) and Straubhaar and Vöpel summarize: „As a result, the non perfect currency area developed into a political community with a common destiny which costs have been shift on to the European tax payer” (Straubhaar & Vöpel, 2011, p. 819)

Even though, the EU has agreed on far-reaching reforms, the markets could not be pacified in the long-term. Instead investors deal for a breakup of the euro zone since a clear commitment to a Union with more integration is missing by the heads of governments as well as presenting a unified position.

Being able to avoid similar crisis in the future, not only the institutional framework of the EMU has to be changed but also sustainable approaches to sustainable growth have to be implemented in the concerned countries. This might be possible if the EU develops into “a Union of stability with common values, credible rules and automatic sanctions. A European culture of stability has to be based on a common conviction that economic principles such as liability and individual responsibility represent the foundation of a coordinated fiscal and economic policy” (Deutsche Bundesregierung, 2012, p. 25).

4. Theoretical and methodological approach

In general, the discussed economic and political reforms are measured by the extent to which they can avoid the problem of *Moral Hazard*. Therefore, this approach will be firstly introduced and finally applied in the discussion and assessment of introducing Eurobonds.

Moral Hazard is part of the Principal-Agent-Theory which is one of the main ideas of the new institutional economy. The core message of the theory is the asymmetrical distribution of information among market players which leads to a limited efficiency of the market (Donges & Freytag, 2009). Moreover, the Principal-Agent-Theory deals with special characteristics of the relationship and functioning among the principal and its agent (Dehling & Schubert, 2011) - an example is the relationship among an owner of a company and his chief executive officer. It is presumed that both actors behave rational followed by the principle of maximizing its own advantage. Therefore, the Principal-Agent-Theory as well as the Moral Hazard approach bases on the theory of *rational choice*.

In the context of the Principal-Agent-Theory, the efficiency of markets is limited if an asymmetric distribution of information consists. Hence, this leads to incentives for abusing information advantages without considering the partner (Donges & Freytag, 2009). Moreover, there is a differentiation among problem before and after an agreement among the principal and the agent. Concerning the pre-contractually problems, the principal is not aware of the problems when he contracts with the agent. The post-contractually problem between the contracting parties might turn up if the agent does not act in the principal’s interest (Donges & Freytag, 2009).

Moral Hazard emerges from a post-contractually information problem and means according to Krugman in particular: “The possibility that you will take less care to prevent an accident if you are insured against it is called moral hazard" (Krugman & Obstfeld, 2009, p. 642) . In other words, Moral Hazard emerges if the principal does not command the whole control about the action of his agent. If the agent violates his duties post-contractually, there is a high risk of an arising deadweight loss for the principal (Donges & Freytag, 2009). Although the approach of Moral Hazard does not belong to macro economical theories, the approach offers the judgment of contracts among countries or in this case – the judgment of Eurobonds.

Since the bachelor thesis in hand provides an analysis about a current discussion, a literature review and qualitative document analysis seem to be the most applicable methof. In this context, the literature is divided into primary and secondary sources whereas the Green Paper by the EC illustrates the primary source. Essays, assessments and journals by economists will be used in order to analysis and assess the Green Paper and the general idea of introducing Stability Bonds. According to Mayring, the qualitative document analysis is featured by a systematical approach. Before the analysis, the sources has been summarized and reduced on the focus on Eurobonds. In the course of the so-called 'explication', the most important passages of the Green Paper will be analyzed in consideration of different secondary sources. Finally, the results will be filtered and illustrated in an overview (Mayring, 2010).

5. Eurobonds

In addition to the discussion about the existing rescue strategies, Eurobonds are in the focus of the current discourse about long-term reforms. Eurobonds are understood basically as common state bonds of the EMU which might replace national emissions. In 2010, the President of the Euro Group, Jean-Claude Juncker and the former Italian minister of economy and finance Giulio Tremonti, introduced their idea about Eurobonds in an article in the newspaper Financial Times with the title: "E-bonds would end the crisis". Since then the discussion has taken place and divides economist and politicians in "yes" and "no" camps. For example, Juncker and Tremonit conclude: "Europe must formulate a strong and systemic response to the crisis, to send a clear message to global markets and European citizens of our political commitment to economic and monetary union, and the irreversibility of the euro. This can be achieved by launching E-bonds, or European sovereign bonds, issued by a European Debt Agency (EDA) as successor to the current European Financial Stability Facility" (Juncker & Tremonti, 2010). Whereas the German chancellor, Angela Merkel, said in an informal debate that "the introducing of Eurobonds will not taken place as long as I live". Next to this emotional and somewhat superficial debate, the European Commission, economists and other politicians have dealt extensively and sophisticated with this topic. In the following section, the main pros and cons will be presented. As a next step, the concrete proposal of the European Commission shall be analyzed by explaining first the different options of Eurobonds and secondly by assessing each option in the light of Moral Hazard and the previous chapters.

5.1 Pros in general

Eurobonds' supporter argues that Eurobonds offer the chance to stabilize the EMU as well as the markets in the long run since the enacted rescue strategies could not achieve stability yet. The EC explains: "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 due to unwarranted risk aversion and/or herd behaviour among investors" (European Commission, 2011, p. 4). The core idea of Eurobonds is a common interest rate for state bonds which might lead to a reduction of the funding cost of MS with a low credit-worthiness. According to the Commission and the supporters, the debt crisis could be alleviated if the GIPS-countries are able to obtain credits with low interest rates. This follows the principle of solidarity among the European MS, in particular among the MS of the euro zone "as the high-yield Member States could benefit from the stronger creditworthiness of the low-yield Member States" (European Commission, 2011, p. 5). Accordingly, the risk of national insolvency could be decreased since Eurobonds follow the idea of a common liability. Finally, this is expected to cause a stabilization of the bond market due to the fact that speculation about national insolvency could be eliminated. Another important pro argument is the alleviation of the risk of a second banking crisis[16], in particular the banking system in the euro zone would benefit from a sound sovereign bond market and the possibility of purchasing Eurobonds (European Commission, 2011). Concerning the role of the euro, the Commission promotes the strengthening of the European currency in the global financial market because "Stability Bonds would promote efficiency in the euro-area sovereign bond market and in the broader euro-area financial system" (European Commission, 2011, p. 6). Additionally, the EC is convinced that Eurobonds offer the chance to reduce financing costs not only for the public sector but also for the private sector which might lead to an increasing growth of the economy. The last important pro argument for the introduction of Eurobonds, the

[16] Explanation by the EC: "Banks typically hold large amounts of sovereign bonds, as low-risk, low-volatility and liquid investments. Sovereign bonds also serve as liquidity buffers, because they can be sold at relatively stable prices or can be used as collateral in refinancing operations. However, a significant home bias is evident in banks' holdings of sovereign debt, creating an important link between their balance sheets and the balance sheet of the domestic sovereign" (European Commission, 2011, p. 5)

Commission distinguishes in the simplification of the European monetary policy. By creating a “larger pool of safe and liquid assets, Eurobonds would help in ensuring that the monetary conditions set by the ECB would pass smoothly and consistently through the sovereign bond market to the borrowing costs of enterprises and households and ultimately into aggregate demand” (European Commission, 2011, p. 6). With respect to the several institutional problems of the EMU’s architecture, advocates of Eurobonds underline the chance of compassing the Monetary Union in line with a European economic government and a common fiscal policy. (Juncker & Tremonti, 2010). Finally, the incalculable risks and unforeseeable cost of a national insolvency are seeing as a bigger evil than the introduction of Eurobonds.

5.2 Cons in general

The opponents of Eurobonds criticize primarily the huge risk of Moral Hazard and the abuse of the strong creditworthiness of the countries with a sound public budget. Since Eurobonds would lead to equal interest rates among all euro zone countries, the high-yield countries would no longer be enforced by the markets in order to look after a fiscal and budgetary policy according to the treaty’s requirements. Therefore, the demanded solidarity among high and low-yield countries by the supporters of Eurobonds is in the opinion of the opponents the wrong approach in the long run. The pressure by the markets on countries like Italy would be undermined by Eurobonds since required spending cuts and reforms could be procrastinated if the high-yield MS receive low interest rates. But particularly the case of Italy has shown how the pressure by the markets could lead to the implementation of a first austerity program in a record time of two months under the new government of Mario Monti (Plate, 2012). At the beginning of the year, a reform program with the name “Salva Italia” and labor market reforms have been passed. But all this have been realized only because of the pressure of increasing interest rates on Italian state bonds. Such examples confirm the opponents in their opinion that by the introduction of Stability Bonds the borrowing of the GIPS-countries would further increase. Instead of sending the wrong incentives, one should realize the advantage of the crisis in the context of implementing new reforms for sustainable economical growth in the concerned countries. “It is particularly in times of crisis that governments can enforce real economic and fiscal reforms which were hardly possible during ‘normal’ times. Just the discussion about Eurobonds aggravates the enforcement of such reforms and therewith a solution of the debt crisis” (Kullas & Koch, 2010, p. 3).

Moreover, critics argue that the low-yield countries like France or Germany would subsidize the GIPS-countries although they are able to refinance their debts with low interest rates because of their comparable high creditworthiness. In addition, the

Sachverständigenrat judges: “The constitutive risk of insolvency of an individual member state of the currency union could be directly eliminated by the member states assuming common (joint and several) liability for all new bond issuance. Since in this way the risk of individual insolvency would be eliminated, the problem countries would be able at all times to secure refinancing at low interest rates” (Sachverständigenrat, 2011/2012, p. 103). With respect to the analysis of the origin of the crisis, another argument against Eurobonds is the mistake which has been committed by the GIPS-countries with the introduction of the euro: Instead of using the advantages of decreasing interest levels, the states have increased their government purchases instead of using additional receipts for reducing the debt. Therefore, „also in the case of Eurobonds, it can be expected that interest earned will be consumed and that necessary reforms will not be taken” (Kullas & Hohmann, 2012, p. 3).

Concerning the argument that Eurobonds could develop into a substitute for US Treasury Bonds, the Sachverständigenrat explains: “For large investors not willing to acquire Eurobonds the relevant alternative would primarily be the market for US treasury bonds. Since the fiscal situation in the United States is appreciably less favourable than that of the euro area on aggregate, one can hardly expect that Eurobonds would be rated far worse compared to US bonds” (Sachverständigenrat, 2011/2012, p. 103). In addition, economist expect investors as not being in favor for Eurobonds since the EFSF is not although the low-yield countries can guarantee a AAA rating by this moment. However, this month the rating agency Moody’s assessed the EFSF’s prospect with negative (Spiegel Online, 2012).

Furthermore, critics refer to the fact that Eurobonds could not eliminate the risk of national insolvency but could lead with a common liability to an insolvency of the whole euro area if the worst comes to the worst (Erber, 2012). By introducing Eurobonds, the infringement of the No-Bail-Out rule would be established officially or in the words of Kullas and Hohmann (cep): “The ceasing and low fixation of compensation payments means that a transfer union is introduced through the back door” (Kullas & Hohmann, 2012, p. 3). Regarding the method for calculation the expected interest savings by Eurobonds, Erber explains: “The higher the participation of low-yield countries regarding the total portfolio of the euro zone, the lower are the collective interest savings” (Erber, 2012, p. 17). Moreover, countries like Germany would have to expect high transfer payments. The pro argument concerning the stabilization of the banking system, Kullas and Hohmann summarize: “The stabilisation of the banking system can be reached more efficiently if banks are given incentives to increase diversification. To this end, it is necessary to cover government bonds with risk-adequate own capital. Moreover, the too-big-to-fail issue must be solved. The

positive effects of an increased liquidity is not in proportion to the increased interest costs and the dangers arising from moral hazard" (Kullas & Koch, 2010, p. 3).
Taking the huge macro-economical imbalances among the euro zone countries into account as well as the imbalances concerning the national budgetary policy, one has to expect that Eurobonds would only curtail the debt crisis in a short-term. Critics only see a chance in Eurobonds if a European economic government could be established with a common fiscal policy and an elimination of Moral Hazard for the surplus countries which will probably not be possible in next future since the European integration suffers from the impact of national interests (Welfens, 2012).

5.3 GREEN PAPER on the feasibility of introducing Stability Bonds

With respect to the described discussion and the advance made by Juncker and Tremonti, the EC published in November 2011 its Green Paper about possible options concerning Eurobonds. The motivation for this Green Paper has been the ongoing discussion as well as the intention to stabilize the euro zone. After analyzing the advantages of Eurobonds in general and calculating the costs of Eurobonds, the Commission summarizes that the arguments outweigh the benefits.

Since critics exclude Eurobonds also because of probable higher interest rates for countries with a high creditworthiness, the Commission presents firstly analyses about the expected yield. "These analyses assume that there is neither a decline in the liquidity premium nor any enhancement in the credit risk by the common issuance beyond the average of the ratings of Member States" (European Commission, 2011, p. 7). Therefore, in the opinion of the Commission Stability Bonds would be probably equal to French bonds concerning gains. However, the Sachverständigenrat notes: "Estimates according to which the interest rate for Eurobonds would be derived as a median from the current yield on member state bonds overlook the fact that the high interest premiums for the problem countries cover the risk of individual insolvency that would no longer exist with Eurobonds" (Sachverständigenrat, 2011/2012, p. 103).
Before presenting the three different options of Eurobonds, the Green Paper deals with the required preconditions for introducing Stability Bonds. The current organization of the European economic policy would not suffice since automatic sanctions and a central institution is missing. Therefore, "additional safeguards [are needed] to assure sustainable public finances would be warranted" (European Commission, 2011, p. 10). By such a supranational monitoring, the widely discussed problem of

Moral Hazard could be limited.[17] With regard to the efficiency of Eurobonds, of course the better the rating the higher the yield and the acceptance among investors. As a result, Eurobonds could not be introduced in co-existence with national emissions of MS with an AAA-rating. Otherwise national bonds of low-yield countries would compete with Eurobonds. In order to reduce the investors' skepticism, the Commission suggests: "In this context, the construction of Stability Bonds would need to be sufficiently transparent to allow investors to price the underlying guarantees. Otherwise, there is a risk that investors would be skeptical of the new instrument and yields would be considerably higher than the present yields for the more credit-worthy Member States" (European Commission, 2011, p. 10). One of the most important preconditions is of course the acceptance among all euro zone MS. Especially, countries holding a high rating, are important for stabile and attractive Eurobonds. Since "the credit rating for Stability Bonds would primarily depend on the credit quality of the participating Member States and the underlying guarantee structure" (European Commission, 2011, p. 11), the Commission's presented options are found on three different stages which differ from substituting national emissions completely till only partial with a partial liability. In the context of the three different options which shall be presented in the following section, one has to keep in mind that the introduction of Eurobonds would lead to changes in the Treaties since Eurobonds pose an infringement again the No-Bail-Out Rule. Besides, the compatibility with national law has to be considered.

5.3.1 The three different options

The categories have been divided as follows:

1) *"the full substitution of Stability Bond issuance for national issuance, with joint and several guarantees;*
2) *the partial substitution of Stability Bond issuance for national issuance, with joint and several guarantees; and*
3) *the partial substitution of Stability Bond issuance for national issuance, with several but not joint guarantees" (European Commission, 2011, p. 12)*

Option 1: Full substitution of Stability Bond issuance for national issuance, with joint and several guarantees

This approach represents the most ambitious one of the three since national emissions would be adjusted completely. Besides, a controlling mechanism must be es-

[17] The Commission explains: "Depending on the specific characteristics of Stability Bonds, fiscal and economic governance and surveillance in participating Member States would have to be reinforced to avoid the emergence of moral hazard" (European Commission, 2011, p. 12)

tablished which “would imply the creation of a single euro-area debt agency” (European Commission, 2011, p. 12) seen by the EC as the most efficient arrangement. Otherwise a decentralized coordination among the MS must take place. As said in the title, the liability for common emissions of course means common liability. However, at first glance this approach presents definitely the most efficient one in the context of alleviating the crisis. “By assuring high quality government-related collateral for financial institutions in all Member States, it would maximise the benefits of common issuance in improving the resilience of the euro-area financial system and in improving monetary-policy transmission” (European Commission, 2011, p. 13). In addition, the GIPS-countries could solve their refinancing problem due to high interest rates in quite a short period without being under the market’s pressure. To sum up, this option implies all mentioned advantages but also the greatest scope for opponents.

With respect to the previous analysis, such an approach demands a much higher political integration and abandonment of national sovereignty. Moreover, it infringes the No-Bail-Out rule due to a common liability and would enforce far-reaching changes in the treaties. Such changes - which are known from experience with the Lisbon Treaty for example - need an extreme long period till they can be ratified of the MS. Therefore, this option could be only possible in the long-run. The German Grundgesetz, in particular, would not offer the scope for introducing approach nr. 1 since the German Bundestag keeps the budgetary responsibility. This responsibility “forms part of the democratic principle, which is protected against changes by the guarantee of permanence of basic principles[18] (Kullas & Hohmann, 2012, p. 4). Moreover, the Federal Constitutional Court judged in the context of the euro rescue programs, that the German Bundestag has to keep the budgetary control if “uncontrolled automatism of a joint liability” could result (Kullas & Koch, 2010, p. 4)[19]. Concerning Moral Hazard, this option presents the highest risk since the disadvantages are not feasible for the low-yield countries (principals). In terms of free riding, the GIPS-countries would benefit from the high creditworthiness of countries like France or Germany; “single Member States can rely on the bail-out through other Member States. Budget consolidation and real economy reforms to increase competitiveness do not take place” (Kullas & Hohmann, 2012, p. 4). Therefore, approach number one would maximize Moral Hazard.

[18] German Constitution: Art. 79,3.
[19] cf. BVerfG „Euro-Rettung“, Rs. 2 BvR 987/10 et al., para.,Tz. 137

Option 2: Partial substitution of national issuance with Stability Bond issuance with joint and several guarantees

Option number two is also called the “Blued-Red Approach” due to the mix of jointly and national emissions. Following this idea, the European state bond market would consist of two parts:

1) *“Stability Bonds* (or "blue bonds"): The issuance of Stability Bonds would occur only up to certain predefined limits and thereby not necessarily covering the full refinancing needs of all Member States. These bonds would benefit from a joint-and-several guarantee and would imply a uniform refinancing rate for all Member States

2) *National government bonds* ("red bonds"). The remainder of the issuance required to finance Member State budgets would be issued at the national level under national guarantees. In consequence, national bonds would, at least de facto, be junior to Stability Bonds because of the latter's coverage by joint-and-several guarantees” (European Commission, 2011, p. 17)

With regards to this method, precise criteria must be developed in order to set up the conditions among blue and red bonds. The idea is to inhibit the risk of Moral Hazard since national bonds with national guarantees still would exist. Nevertheless, one has to consider that if a MS would maximize its limit of blue bonds, its red bonds probably would suffer from high interest rates and low yield in contrast with the blue bonds. Therefore, a state insolvency would not be avoided completely but suspended. The Commission has thought about two ways of setting a limit for blue bonds.

1) *“A simple rule-based system:* For example, each Member State could be entitled to an amount of Stability Bonds equal to a specified percentage of its GDP, perhaps reflecting the Treaty criterion of 60%
2) *A more flexible system linked to policy compliance*: The maximum amount of a Member State's Stability Bond issuance could be fixed as above, but the ceiling at any point in time would be linked to the Member State's compliance with rules and recommendations under the euro-area governance framework” (European Commission, 2011, p. 15)

However, as noticed in the course of the crisis, political limits and sanction do not set hard rules but soft rules. When the pressure by the markets increases, the limit of blue bonds might be soften. Investors would treat such a limit like the No Bail-our rule namely assuming that the quota of blue bonds would be expanded in an emergency case. Despite of this, the Commission argues that till reaching the limit of blue bonds years would pass by, therefore “all Member States could, during the start-up phase, have very broad access to financial markets via Stability Bonds” (European Commission, 2011, p. 18) which led to a stabilization of the markets.

But due to the fact that the treaty would need to be changed by this option, too, a long process must be expected. Moreover, because of jointly liability this option could also could be incompatible with German law.

This option also implies of Moral Hazard since it occurs like with option one but ends after the introduction period of Stability Bonds. Hence, the GIPS-countries would benefit from the community till they reach the ceiling of blue bonds. By implementing the ceiling, Moral Hazard would be lower but still would occur. According to Kullas and Hohmann, “The Commission’s hope that the ceilings for Eurobonds could be immutably defined is naïve. The fear of state insolvencies, which today is created by the political pressure to introduce Eurobonds, will tomorrow create political pressure to increase the ceilings“ (Kullas & Hohmann, 2012, p. 4).

Option 3: the partial substitution of Stability Bond issuance for national issuance, with several but not joint guarantees

Finally, the last approach represents the ‘light’ version of Eurobonds in contrast with option number one and two as MS “would retain liability for their respective share of Stability Bond issuance as well as for their national issuance” (European Commission, 2011, p. 22). Like option two, this one limit of Eurobonds which can be purchased would be predefined. In addition: “The single Member State is liable only for its own share which corresponds to the contribution key to the EU budget or to the capital key of the ECB” (Kullas & Hohmann, 2012, p. 3).

Summarizing the pros and cons of the last option, approach number three offers a quicker realization since changes of treaties or national law would not be necessary. But the impact on the markets is comparatively low since “Member States subject to high market risk premia would benefit considerably less from the creditworthiness of low-yield Member States than in Approach No. 2 and particularly than in Approach No. 1” (European Commission, 2011, p. 18). Only if all MS accept the precedence of jointly Stability Bonds, a high creditworthiness of those could be guaranteed; whereas “Eurobonds with a several but not joint guarantee have at best an average credit quality. Therefore, the Commission proposes a credit enhancement, in particular the underpinning by gold, cash or shares of public companies, as well as earmarking specific tax receipts to servicing Eurobonds” (Kullas & Hohmann, 2012, p. 3). However, Kullas and Hohmann note that the GIPS-countries would not be able to afford such a credit enhancement. Hence, option three is not supposed to achieve the desired effect and could not replace the current rescue mechanism – ESM – in order to be able to cover further extraordinary financial need. Since this option implies a partial substitution of common and national bonds, this approach suffers from comparable low Moral Hazard.

Even tough, the Commission presented sophisticated option in its Green Paper, the arguments against the introduction of Eurobonds still predominate. Although, approach number one offers the chance to long-term stabilization and more integration it questionable if this concept would ever be accepted not only by the European citizens but also by the heads of governments. Such an option shall not be discussed in the course of the crisis because the acceptance must be developed without political pressure. Option number two is questionable concerning the limit of blue bonds. In the short- run and during the starting period, this approach leads to a balanced state bond market, in the long-run the same problems would arise since red bonds are associated with less creditworthiness and therefore would lead to high interest rates. In the context of the last option, the desired effect could not be achieved. The co-existence of national and jointly state bonds would annul the preference of common bonds especially among those of countries with high creditworthiness. Concerning Moral Hazard, the risk gets smaller from option to option. In contrast, the pressure by market discipline which is assessed by most of economists as decisive in order to enforce the GIPS-countries to reforms gets higher from option to option. Finally the strong resistance of Germany shall be presented. The following table has been taken from the Green Paper (European Commission, 2011, p. 20) and has been amended by the columns “Assessment” and “Compatibility with German law”. Therefore, it presents a final overview of the previous analysis.

	Option 1	Option 2	Option 3
Main features			
Degree of substitution of national issuance by Stability Bonds	Full	Partial	Partial
Guarantee structure	Joint and several	Joint and several	Several (not joint) with enhancements
Main effects			
on average funding costs: 1. for Stability Bond as a whole 2. across countries	1. Medium positive effect from very large liquidity compensated by strong moral hazard 2. Strong shift of benefits from higher to lower rated countries	1. Medium positive effect, from medium liquidity and limited moral hazard 2. Smaller shift of benefits from higher to lower rated countries. Some market pressure on MS with high level of debt and subprime credit ratings	1. Medium positive effect, lower liquidity effect and sounder policies prompted by enhanced market discipline 2. no impact across country. Stronger market pressure on MS with high level of debt and subprime credit ratings
on possible moral hazard (without reinforced governance)	High	Medium, but strong market incentives for fiscal discipline	Low, strong market incentives for fiscal discipline
on financial integration in Europe	High	Medium	Medium
on global attractiveness of EU financial markets	High	Medium	Medium
on financial market stability	High	High, but some challenges in case of unsustainable levels of national issuance	Low, but it may help to deal with the current crisis thanks to its rapid implementation.
Legal considerations			
	Probably Treaty change	Probably Treaty change	No Treaty changes required. Secondary legislation may be helpful.
Necessary minimum implementation time			
	Long	Medium to long	Short
Assessment			
	- most efficient option but only with a European Economic Governance - almost completely unconvertible	- Difficult to keep a fix limit in a case of emergency - sanctions probably realizable - alleviation in the short-run and difficulties in the long-run	- reliazable but the most inefficient option - would be only a further rescue strategy - would not achieve the desired effect of decreasing interest rates
Compatibility with German Law			
	-incompatible with the German Grundgesetz (Art. 79, 3.)	- difficult to implement because of still existing uncontrollable liabilities	- compatible

Figure 5: “Overview over the three main options” amended by ‘Assessment’ and ‘Compatibility with German Law (European Commission, 2011, p. 20)

5.4 The German resistance

The German resistance arises from different reasons; however, it is not only a political resistance in the context of the German Bundestag election in 2013 but also a rejection by economists.

The compatibility with the German national law is extremely low; moreover, already against the rescue programs and the rescue umbrella have been claimed before the Bundesverfassungsgericht. The judges strengthened the budgetary rights of the German Bundestag and enforced the government to include the Parliament more in the process of decisions. Besides, the German public is slowly overextended with persistent bad news. This month, the rating agency Moody's assesses the German economic perspective with negative (Spiegel Online, 2012) which have leaded to even more concern among the citizens. The principle of solidarity is difficult to justify if those news are accompanied by persistent bad news about the Greek willingness to reforms (Frankfurter Allgemeine Zeitung, 2012). And of course, German politicians focus on the upcoming election and sentiments of the citizens. Most of them disrelish the rescue strategies although they are concerned about the advantages of the common currency (ZDF Politbarometer, 2012). In a ZDF-survey, 63% of the Germans refuse to support the GIPS-countries by granting more time in order to achieve the saving goals. In addition, 51 % refuse Eurobonds no matter if a common fiscal policy could be established. Besides these rather emotional sentiments, politicians are concerned about the increasing indebtedness with respect of further generations. But also economists caution against risks for the Germany economy – the engine of growth. Especially Hans-Werner Sinn (President of the ifo institute) initiates appeals like the mentioned open letter of 272 German economists. Regarding the introduction of Eurobonds, he and his colleagues argue that Eurobonds would burden the German economy much more than expected (Berg, Carstensen, & Sinn, 2011). In their calculation the surplus load for Germany would be illustrated as follows.

Figure 6: Surplus load for Germany (Berg, Carstensen, & Sinn, 2011, p. 29)

This calculation has been criticized among other economists. Nevertheless, one cannot regret that, increasing loans would inhibit as well the real economy. “For Germany, the interest rate increase entails two negative effects: on the one hand, private credits and loans become more expensive as the interest for risk-less German government bonds are an interest rate floor. If the interest rate floor is raised, all other interests are increased too. Thus investments are impeded. In order to finance higher interest rates, taxes must be raised or expenses be cut” (Kullas & Hohmann, 2012, p. 4). To sum up, the introduction of Eurobonds is rather impossible to accept by Germany.

6. Conclusion

The previous chapters have conveyed an overview about the current European debt crisis and outlined potential rescue strategies. Due to a limited framework, only an overview of the most important causations could be provided. Nevertheless, the results clarify that it was only a matter of time until the huge macro-economical imbalances among the MS of the EMU lead to a collapse. The differences as well as the various national interests have avoided a political integration of the EMU from the very beginning. But this is not the core problem; the lack of automatic sanction in the case of rule infringement caused investors to trust in the non-functioning of the ‘No Bail-Out rule’. After a decade of a successful jointly currency, the shock of the crisis came unexpected and tempered. The GIPS-countries have to undergo structural reforms in order to achieve sustainable growth. The saving programs in the concerned countries hit in particular the employee, but also the extreme expenditure of the government has to be cut. The crisis has reached the citizens and this leads to anti-European sentiments, especially in the GIPS-countries and in particular against the German government which is regarded as disloyal and egoistic. Besides these emotional effects, the measures taken are still not sufficient and if Italy would depend on the rescue program, the euro zone would collapse. Therefore, the debate about further measures such as Eurobonds is on the one hand understandable but on the other hand it does not solve the core problems. Maybe Eurobonds could be implemented in an extreme long-run but not before the constitutional framework of the EU has changed. Eurobonds could be established within the context of a further integration in the direction of the "United States of Europe". But at this moment, such a development is utopian. Eurobonds would set the wrong incentives in the current situation. As described, by establishing the ESM kind of transfer union already exists. Eurobonds would finalize this development without proper sanctions. Therefore, the introduction of Eurobonds could only alleviate the crisis in a short-run under the current circumstances.

Since the euro crisis has its origin in the European debt crisis of some countries, the EU should try to foster the reforms of those in order to rebuild strong economies and growth. The rescue programs can only provide a short-term support but in the long-run the imbalances have to be alleviated as well as the existing distrust among the countries. The EU is facing a historical challenge, and if further integration or even a euro crash arises – nobody knows at this point.

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