The eurobonds' false promise

BY KLAUS F. ZIMMERMANN FOR THE STRAITS TIMES

T SEEMS like 1997 all over again. The big difference is that, this time, it's Europe, along with the United States, but definitely not Asia, that is teetering.

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At a time when the entire financial world looks at developments in Europe with baited breath, it is pivotal that Europeans resist the temptation to put the cart before the horse yet again and jump headlong into new economic realities largely based on either wishful or overly optimistic thinking.

That, after all, is precisely what Europeans did in the run-up to the euro, when all of official Europe put its collective hopes into the promising-sounding Growth and Stability Pact. At the time, the switch to a common European currency was sold, in part, with the argument to put an end to American dominance of foreign exchange markets in general—and to the dollar's status as the reserve currency in particular.

This time, the case for launching eu

This time, the case for launching eurobonds is made along similarly tantalising lines in the global power game. The creation of Eurobonds is intended to have European debt capital markets compete head on with the US Treasury market. By making European markets equally deep and liquid, the hope is for lower interest rates on that debt.

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Such grand designs aside, in a debt-infested world, all that ultimately matters is fiscal stability. That is why, in my view, before we get too excited and see eurobonds as some kind of panacea, we would do well to acknowledge that Europe failed in the mission of obtaining fiscal stability once. We cannot afford to do so again.

That certainly is the unequivocal view of the financial markets. There are two other, equally powerful reasons speaking in favour for consolidating our finances: First, fiscal stability is needed in order to have any hope of bringing about sustainable economic growth; and second, to stop burdening future generations with ever more debt.

Eurobonds can be a useful instru-Eurobonds can be a useful instru-ment over the longer term, as the end point of a process of fiscal consolida-tion, once the hard labour required in that regard has been done. In other words, their introduction should be a reward for past performance, not an il-lusory incentive for better fiscal behav-iour in the future. The latter approach is precisely what Europeans embraced at the laumplo of the euro, with known at the launch of the euro, with known results (i.e. near failure).

Europe's credit hinges on the fiscal performance of countries such as Ger-many, the Netherlands, Denmark, Fin-land and Poland. Making these coun-

tries, in effect, fiscally liable for the debt of other nations, as the premature introduction of eurobonds would do, is a recipe for the euro's demise.

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Moreover, notions such as a "fiscal union" are not to be taken lightly. Even those who argue that it is in the logic of the European integration project to move in that direction – and who say that the process of the formation of the United States of America historically shows the way forward for Europe forget one crucial thing. Most US states have a balanced budget requirement to meet each and every year. In addition, in the US there is no federal bailout clause for the debts incurred by individual states. individual states.

midvidual states.

What is needed then is not some heady optimism, but sober thinking and a disciplined sequencing of events and conditions before we can introduce eurobonds. Key among them is the so-called "debt brake", a constitutional requirement in Germany as of 2016 that will severely limit further increases in public debt absent narrowly defined emergency situations.

In a positive sign of rising budgetary seriousness throughout Eu-

In a positive sign of rising budgetary seriousness throughout Europe, this self-disciplining instrument is now also being introduced, or contemplated, in Spain and Italy. In many ways, this tool is akin to the balanced budget requirements at the US state level.

This also points the way to what is needed in case eurobonds are being introduced. Profound changes in the institutional set-up will be required. In addition to the introduction of a European finance minister, there is, most

addition to the introduction of a European finance minister, there is, most notably, a requirement for a eurozone body with unassailable veto rights over national budgets (in cases of continued fiscal malfeasance). With all that entails rethinking the traditional perogatives of national Parliaments in terms of their historic power of the purse. But for Europe, the lesson of the past 15 years is clear. National governments cannot, on the one hand, merrily issue debt – and then, on the other hand, expect other European nations to stand in for that debt in the end. National sovereignty cuts two ways.

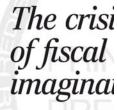
to stand in for that debt in the end.
National sovereignty cuts two ways.
It is there when you manage your affairs competently and with discipline and it must be restricted when you are incapable, or unwilling, to raise sufficient revenues domestically.
Obliging others with no restraint is a recipe for disaster.

Finally, it is important to realise that, for all those constantly chanting the "spend, baby, spend" refrain, the stability-oriented German position is, surprisingly perhaps, very Keynesis,

surprisingly perhaps, very Keynesian in nature. The eminent British economist was far from the one-armed conomic policy operative he is made out to be today. Yes, John Maynard Keynes explicit-

ly advocated for high government spending in times of economic (near-)collapse, but only under the si-multaneous and unbending condition that, in sunnier times, savings would be piled up to pay back past debts – and, ideally, to build up a rainy day fund.

In that sense, the German constitu-In that sense, the German construc-tional provision requiring strict limits on further debt increases is, in effect, giving the tough side of Keynes's poli-cy prescriptions the rank of constitu-tional law. In a debt-addicted world, that is an important policy innovation. The writer is director of IZA (Institute for the Study of Labour), Germany.



BY DANI RODRIK

REEDY banks, bad ec competent politicians: age of culprits for the which rich countries there is also something tal at play, a flaw that lies deeper bility of individual decision-ma are notoriously bad at producing that require political commitmen um term. In both the United Stat

that require political commitmer um term. In both the United Stat costs of this constraint on policy crisis - and obscured the way ou Consider the US, where politi how to prevent a double-dip rethe economy and bring down rate that seems stuck above 9 r agrees that the country's public on needs to be reduced over the lon. While there is no quick fix to fiscal policy imperative is clear, needs a second round of fiscal stiterm to make up for low private with a credible long-term fiscal c As sensible as this two-pro spend now, cut later - may be, i impossible by the absence of any 1 by President Barack Obama car himself or future administrationing. So any mention of a new stite comes an open invitation to house an apen invitation to a futile attempt to gain financidence, country after country has fow counter-productive austeriprice of support from the Internum and the European Central E deep fiscal cuts, privatisation ar reforms of the type that Greece take risks greater unemployment sions. One reason that interest redial markets remain high is that cone countries' growth prospects.

sions. One reason that interest rat cial markets remain high is that zone countries' growth prospects. Here, too, it is not difficult to outlines of a solution. Stronger or zone must allow these spreads anteeing the new debts of countrilatly, through the issuance of eur ple. In return, the highly indebt commit to multi-year program fiscal institutions and enhance reforms that can be implemented by over the medium term. But, once again, this requires; ment to an exchange that require ion later in return for something; ticians and their electorates ca doubting whether future Greek, I governments can be counted upor rent leaders' commitments. He with the euro zone becoming mir cle of high debt and economic au Democracies often deal with tracting commitments from fut delegating decision-making to chodes managed by officials who day-to-day politics. Independing the archetypal example, By placin the hands of central bankers what to do, politicians effectiv hands (and get lower inflation as Unfortuntlety, US and Europe failed to show similar imagination

