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Commission Green Paper on the feasibility of introducing Stability Bonds

Dear Mr Buti,

We refer to the Commission's Green Paper analysing the feasibility of a common issuance of "Stability Bonds" in the euro area.

As you are aware, our governments continue to oppose common debt issuance, even after having thoroughly examined the arguments put forward in your Green Paper. We are deeply convinced that common bond issuance neither constitutes an apt instrument to overcome the current crisis, nor is it a suitable medium-term means of winning back the necessary investor confidence in the stability of the euro area.

Given continued national sovereignty in budgetary matters, albeit under stricter control of the European Commission and European Council, joint liability – as foreseen under Options 1 and 2 in your Green Paper – would undermine market incentives for the required far-reaching efforts in budgetary consolidation. The Green Paper rightly addresses the issue of moral hazard, however, it does not offer a convincing solution on how to overcome the problem.

Whereas Option 3 in your Green Paper might appear less problematic with regard to moral hazard, we fully subscribe to your assessment that the potential benefits under this option would be limited, if attainable at all. In our view, the introduction of Option 3 is not justifiable under cost-benefit considerations. Apart from that, the reliance of Option 3 on secondary legislation only warrants further legal examination.

We are fully aware of the heavy economic and political burden that citizens and governments of individual euro area Member States currently have to bear. But at the source of these problems are excessive debt levels, which in turn are the consequences of misjudgement in fiscal and economic policy in the past. This situation must now be rectified, primarily through reforms at national level. Our governments are ready to assist Member States in this process.

We are worried that the introduction of "Stability Bonds" could come at the cost of imposing additional burdens and raising debt in the euro area as a whole, due to the issue of moral

hazard. This would exacerbate the root causes of the crisis and further weaken the fiscal position of all Member States.

In addition, we have a further grave concern: Rather than facilitating access to financing for governments in the euro area (albeit only temporarily), the introduction of "Stability Bonds" could have quite the opposite effect, making borrowing more difficult and thus directly aggravating the debt crisis.

The Green Paper argues that introducing "Stability Bonds" would automatically open up a larger, more liquid and more efficient market for government bonds in the euro area, enabling all euro countries to access refinancing at lower interest rates on average and with reduced volatility. This argument does not, in our view, stand up to closer examination. It relies on an assumption that market participants would treat such common bond issues as a perfect substitute for issuance by Member States. However, there is no basis for such an assumption, and the Green Paper fails to provide one.

Apart from high debt levels in individual Member States, a second problem lies in the fact that the euro area's aggregate debt ratio is too high. In order to restore investor confidence it must be reduced. The high level of indebtedness, accompanied by the sharp rise in debt among major issuers outside the euro area, has been detrimental to investors' risk assessments of government securities, markedly reducing global demand for these instruments. In the process, investors have shifted their focus to issuers perceived as being relatively low-risk. Creating a more homogenous euro area bond market by introducing "Stability Bonds" could, in our view, dampen demand for euro-denominated government bonds as a whole even more than at present. In particular, the large group of investors whose decisions centre on making safe investments would then turn away from the market for "Stability Bonds". This means that "Stability Bonds" could further endanger government financing in the euro area.

To sum up, combating and permanently overcoming the current government debt crisis in the euro area is the highest priority for all of us. We do not believe that introducing "Stability Bonds" can solve problems that are structural in nature and that have the potential to endanger the very core of cohesion in the euro area. For this reason, we attach great importance to continued co-operation, in a spirit of mutual trust, with all Member States and the Commission, targeted at combating the causes of this crisis and creating the institutional conditions needed to prevent further crises in the future.

Yours sincerely,

Edith Frauwallner	*Martti Hetemäki*	*Thomas Steffen*	*Hans Vijlbrief*
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