Union bonds and new financial instruments for European Growth

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An EU exit strategy from the current crisis needs both to safeguard the integrity of the single currency and to give substance to the European Economy Recovery Programme. Such recovery implies new finance for major investments in infrastructure, energy, environment and human resources.

Yet, due to the recession and to the need to salvage private sector institutions, national debt has soared, public finance is under unprecedented stress, the credibility of the Stability and Growth Pact challenged and UE own resources limited. These are among the reasons why issuing Union Bonds (or Eurobonds) is coming back on the agenda of current discussion. To get political support, it should be made clear that the Union bonds would be used to support the euro and growth and not to bail out troubled member countries; and that they are instruments to borrow and invest from savings and surpluses from private European and private (and public) global markets. For Europe it would also mean giving a strong political message in the process of designing the new world order.

On these topics, we wish to make two main proposals.

The first does not concern directly the issuing of Union bonds, but the issuing of new EU long term instruments to finance the strategic investments of the Lisbon Agenda. For these new instruments (including equity, project bonds and guarantee schemes) the responsible entity could be a single institution such as the EIB alone, or a confederation of institutional large long term investors (EIB, KFW, CDC, CDP, ICO, PKO), which, following Mr. Tremonti's Ecofin proposals of 2008, gathered together to create the first EU endorsed long term Equity Fund for energy, climate change and infrastructure (the "Marguerite Network"). As with the creation of the euro itself, this seems to be a good working example of success in terms of "reinforced cooperation".

Second, concerning the Euro bonds, the issue should be - by no doubt - decided by the Union. To begin, we propose that each member state should transfer a quota of its national debt into Union bonds or Euro bonds. Each national quota should be in proportion of each member state GDP and therefore non-discriminatory (for instance, 15% or 20% of GDP). To finance this, each member state on an ongoing annual basis would commit the funds required to service the part of debt transferred to the EU, measured on the cost of its national debt service and not on the lower cost of servicing Union Bonds.

Such a mechanism has the following advantages: (1) it will create a large, deep and liquid Union bond market (worth 2/3 trillion euros), which undoubtedly would attract long term global investors and central banks reserves; (2) it would not increase the propensity of single member states to increase their national debt; (3) the extra funds which would come from the spread differentials between the national sovereign bonds and the Union bonds' yields (8/9 billion euros a year) could go directly into the EU budget to finance common strategic investment/projects in key sectors of EU long term investments plans (with a considerable leverage effect); and (4) the creation of a common European sovereign debt will have a great political significance, at least as important as the creation of the Euro.

There are several rationales in favour of these proposals. The Union could raise money at a cost lower than any national government or any other public or private entity. It could invest the revenues generated by the financial instruments (equity, quasi equity, mezzanine, project bonds and guarantee schemes) for financing/supporting long term strategic projects with moderate risk/yield profiles and strong positive externalities in terms of sustainable growth, employment creation and the generation of direct and indirect tax revenues. If the EU also will assure regulatory, accounting and fiscal incentives for long term investments, these initiatives will represent an evident advantage for long term investors (pension funds, insurance companies, SWFs and retail), reinforce the stabilization of financial markets and contribute to funding an "exit strategy" from the current deadlock on national debt and deficits.

Then, we suggest to take the following steps: (a) to follow up of the "Marguerite Network" plans, creating new "market conform" instruments for financing PPP and PFI initiatives (project bonds, common debt, guarantees, equity funds, etc); (b) to create new Common Undertakings, such as a "New Green Euratom" or EU Corporations for Infrastructural Networks, which could give substance to a European Company Statute; (c) to implement international and/or EU fiscal, regulatory and accounting incentives to support long term investments with strong "positive externalities" for the economy and for society as a whole; and (d) to create a common Euro Debt as described above.

The US has been financing its own and global growth for years, by issuing Government bonds to the rest of the world. China and Korea are financing growth with public money, due to their strong growth rates and low public debts. To exit the crisis and to foster a strong, sustainable and balanced growth, Europe needs recover the earlier market credibility that the Growth and Stability Pact and the euro had gained (but recently have begun to lost) on global financial markets. By issuing Euro bonds and new EU financial instruments Europe could strengthen the integrity of the single currency and provide new funds for investment and growth. But above all, Europe needs now to "think big and move fast".