RSIS | S. RAJARATNAM SCHOOL OF INTERNATIONAL STUDIES
Nanyang Technological University, Singapore

RSIS COMMENTARY

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No. 070 – 14 April 2020

Global Health Security

Coronabonds: Backdoor to Collective Debt?

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SYNOPSIS

To combat the economic crisis in Europe that will inevitably follow the current COVID-19 crisis, Italy, France and others demand collective Eurozone debt. A non-starter for some of their neighbours – and rightly so.

COMMENTARY

THE DEBATE about debt pooling among the Eurozone has haunted the single currency ever since it was first conceived. In 1998, German Chancellor Helmut Kohl, a champion of the Euro, promised a sceptical German public that a common currency would not lead to German liabilities for other economies' sovereign debt.

But as the COVID-19 crisis hits, some southern European governments demand precisely such trans-national liabilities. The Euro was always a political rather than an economic project, and as such, it always had two major flaws.

The Euro's Birth Defect

Firstly, the Eurozone is monetary without fiscal union. Monetary policy for the Eurozone is set by the European Central Bank (ECB), while economic and fiscal policy is set on the national level.

Such disunion is not sustainable in the long-term without endless redistribution of wealth. This is particularly true if the difference in economic performance and fiscal discipline is as great as that in the Eurozone.

Although a clear ruleset and monitoring mechanism exists to maintain the stability of the Euro exists, called the Stability and Growth Pact (SGP), those rules are regularly broken by most members (including Germany). And even the most rigorous of European Union (EU) rules, such as its competition law and part of the SGP, were jettisoned immediately as COVID-19 hit Europe.

Secondly, the Eurozone is an exclusive club within the EU. Not all EU members use the Euro, creating a two-tier organisation, and Eurozone members recurrently hold EU processes hostage to their monetary quarrels.

From “Eurobonds” to “Coronabonds”

During the Eurozone debt crisis, highly indebted EU countries demanded “solidarity” in the form of collectivising all Eurozone sovereign debt by issuing so-called Eurobonds. Quite rightly, Germany and other fiscally conservative Eurozone members responded with a clear “*Nein*”, no chance.

The idea behind Eurobonds is quite simple: All Eurozone countries pool their debt and raise bonds on the markets to borrow at much lower rates than highly indebted individual countries could do unilaterally. The entire Eurozone, therefore, guarantees all Eurozone debt. This was supposed to stabilise the sovereign debt spiral in countries such as Portugal and Greece.

The catch for fiscally more disciplined countries is that they would be liable should other governments default on their debt and would have to pick up the bill should others go bankrupt.

Wisely, Eurobonds were rejected then, and monies from the European Stability Mechanism (ESM), the specifically created bailout mechanism, were used instead – with severe austerity strings attached so that fiscally unsound countries would get excessive national spending in order and debt under control.

Eurobonds 2.0

Make no mistake, the sovereign debt crisis never went away entirely and is about to return with a vengeance. Unfortunately, COVID-19 has hit Italy, the Eurozone’s third-largest economy, particularly hard. Italy’s sovereign debt already is at a staggering 135% of GDP, and if Italy struggles, the entire Eurozone struggles. The Euro and banking crisis could return more severe than ever before.

On the back of COVID-19, Italy and others raise the issue of Eurobonds once again, only for them to be dubbed Coronabonds. Despite high moral pressure on less indebted countries to accept liability, governments must stand firm and refute any such attempt.

Undoubtedly, the Eurozone will have to dig deep to bail out the post-COVID-19 economy if they want to save the Euro (and there is no doubt on that front). But Coronabonds are not necessary.

Alternative Ways Out of the Crisis

Europe’s financial systems are currently in much better shape than their healthcare systems. Italian and Spanish government debt is high but stable, and bond yields have come down to acceptable levels since 2015, and neither currently have disruptive financial problems. Especially in times of “bearish” stock-markets, government bonds are in demand.

The only sound argument in favour of Eurozone bonds is forcing ever deeper European integration, and COVID-19 must not be misused to push such integration through the backdoor. The rise of populist parties was fed by the Eurozone crisis, and Eurobonds will add substantial momentum to those movements in net-contributor countries like Germany and the Netherlands.

Moreover, it is unforeseeable how these countries themselves will weather the storm, and how much debt they will have to raise to stabilise their own economies. In Germany, additional COVID-19 spending is some 40% of its entire annual budget; wholly credit-financed and jettisoning Berlin’s sacred “Black-Zero”, its balanced budget.

There is no question that financial help for the Eurozone will come in huge quantity; the only question is by what instruments. Indeed, after several rounds of negotiations, Eurobond-sceptic governments initially prevailed as EU ministers agreed on an EU COVID-19 bailout package, including ESM credits but not Coronabonds.

Rome refuses to permanently accept that compromise for now, and fiercely rejects accepting the substantial ESM creditline rightfully available to Italy under the agreement. Although this time ESM-bailouts are unconditional, Rome prefers not to be seen as accepting favours, further contributing to the already strong anti-EU sentiment in the country.

So far, EU northerners are resisting debt collectivisation, and one can only hope that their resolve lasts. With Coronabonds the cure is worse than the disease. Contagious Eurozone debt-spirals are not unlikely, and the lasting consequences of a collective debt precedent are unpredictable, including a substantial increase in support for populist parties.

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