

Let's Fill a Gap in the 5 Presidents' Report: Accountability Bonds

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Prudential Regulation in Unconventional Times, CEPS Brussels, Dec 3,
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The 5 Presidents Report: Questions raised by the proposals made

- Eurozone ‘Fiscal Council’: What is its role, as opposed to the role of the European Commission?
- Eurozone Treasury:
‘as the euro area evolves towards a genuine EMU, some decisions will increasingly need to be made collectively while ensuring democratic accountability and legitimacy. A future euro area treasury could be the place for such collective decision-making.’

The 5 Presidents Report: Important missing element:

- What are the principles governing public debt in the Eurozone?
- Current situation: Ambiguous, implicit bailout guarantee of the ECB (OMT programme), CACs not credible, SGP is weak, effectively national control over fiscal policy,
- Joint liability for government debt? Would require the centralisation of the right to issue government bonds
- No joint liability: Debt restructuring mechanism required

Proposal: Accountability Bonds

Objectives:

- Introduce government debt restructuring without creating contagion
- Protect taxpayers by having private government bond holders bear a larger part of the costs of fiscal crises
- Give European fiscal coordination and surveillance more weight
- Get the right pricing of debt at the margin (restore 'market discipline')

Accountability Bonds

- Accountability bonds are *junior government bonds*
- All existing government bonds are senior relative to acc. bonds but there is no explicit joint liability for senior bonds either
- Accountability bonds have (various) automatic triggers for restructuring
- Examples for triggers: 90% debt to GDP, 120% of GDP, ESM Program
- The ECB does not buy accountability bonds
- Accountability bonds are standardized (5 year maturity)
- Positive risk weights in banking regulation

When is a country obliged to issue accountability bonds?

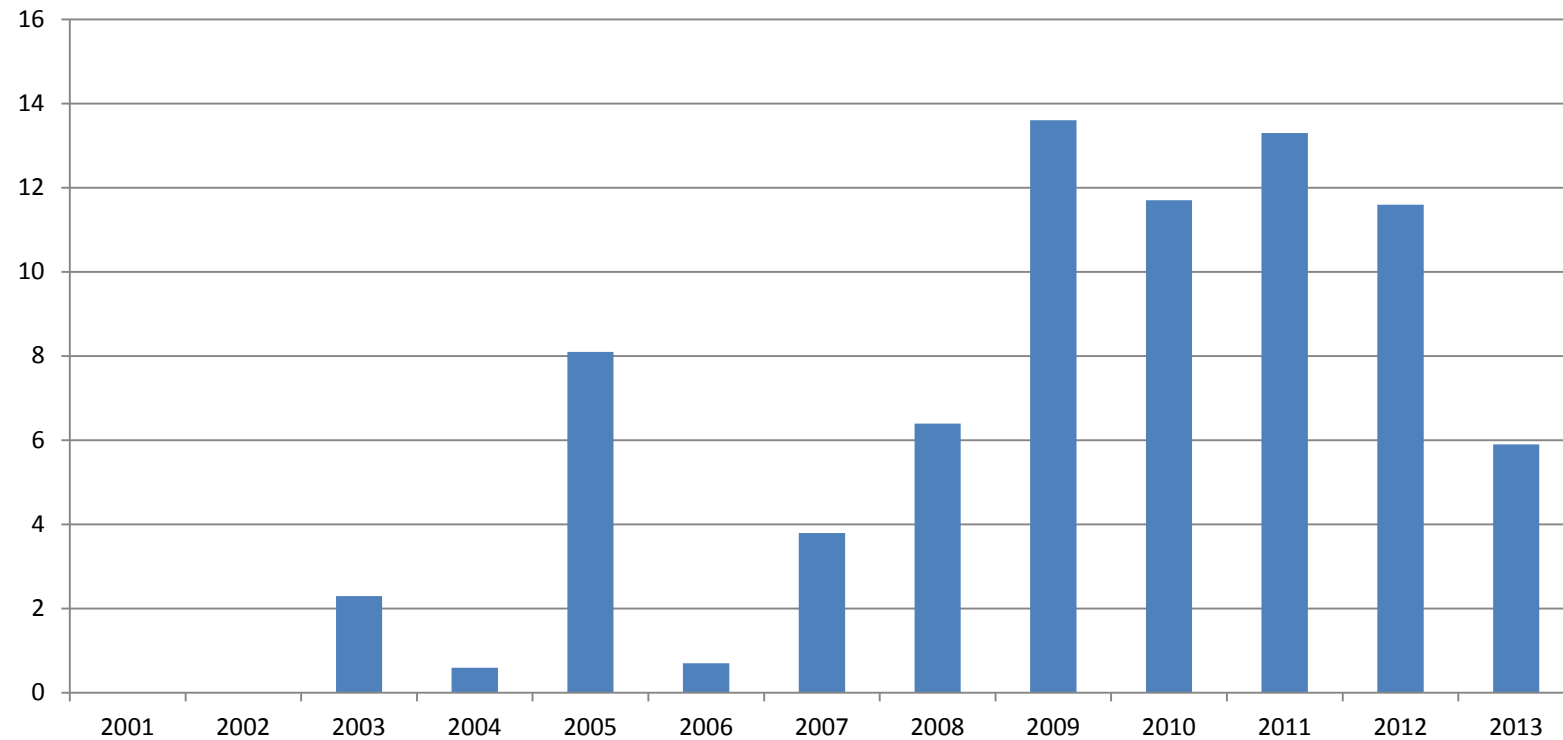
- European fiscal policy coordination and surveillance as starting point
- If a country runs a budget deficit and issues new (net) debt in excess of what has been agreed at the European level, the excess is issued in the form of *accountability bonds*
- Possible budget deficit thresholds: Medium term budgetary objective, 3% of GDP,.....
- Does not apply to member states with less than 60% debt to GDP

Trigger	Type of restructuring (examples)
Debt 90% of GDP	Automatic prolongation, interest moratorium
Debt 120% of GDP	Haircut 50%
ESM programme	Full loss

What is the difference to existing proposals for debt restructuring?

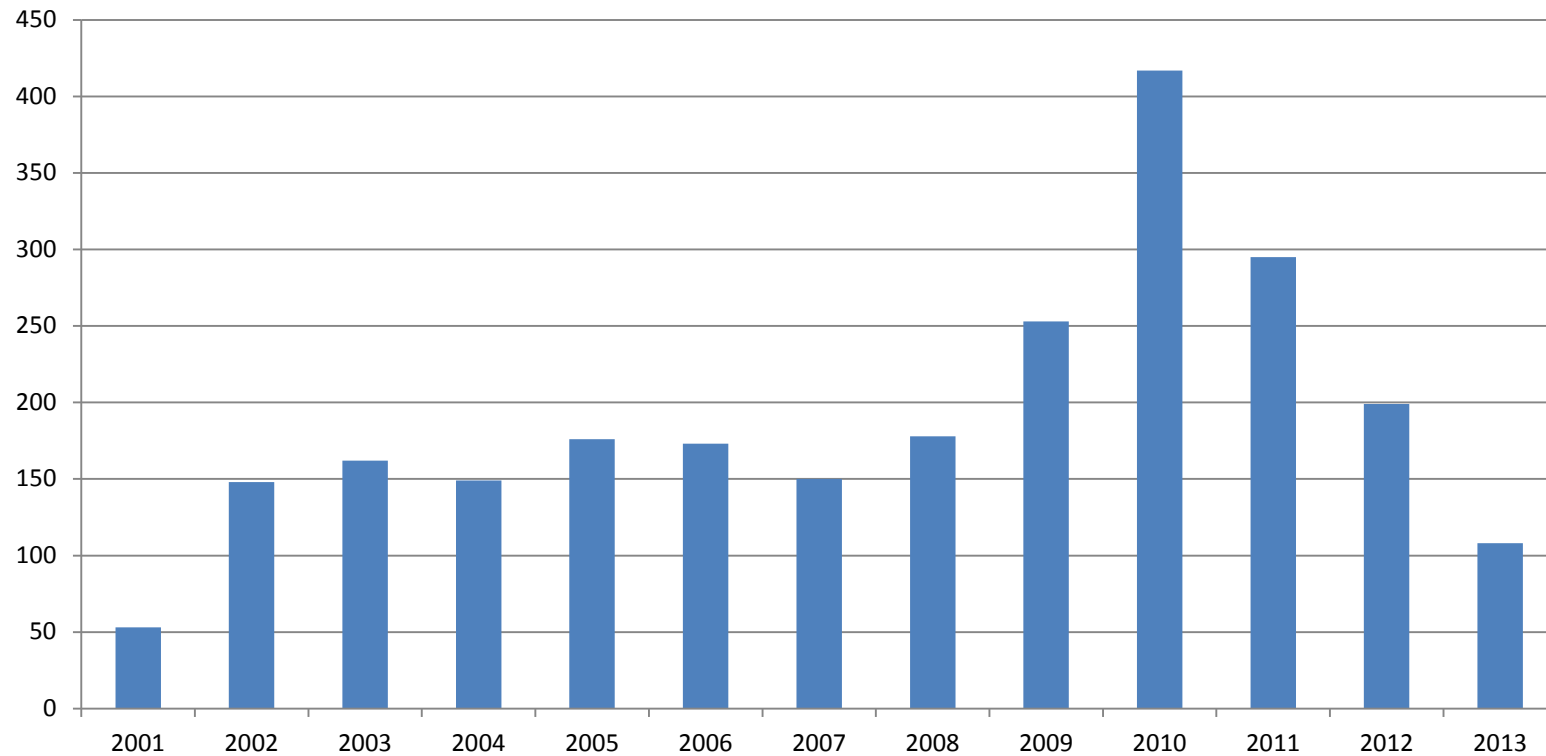
- Accountability bonds focus on **flows** (yearly deficit) rather than **stocks** of debt
- Blue Bond Red Bond Proposal (Delpla/Weizsäcker): Converting 60% of the **stock** of government debt into senior debt covered by joint liability would have a strong impact on the remaining stock of (red bond) debt
- German Council of Economic Advisers: Debt Redemption Pact: Stock based approach, 60% of GDP remaining under national control
- Moody (2013): 'Sovereign Cocos', transformation of the stock of debt

Hypothetical Accountability Bond Issue Volume **Belgium** (bn Euros, 0,5% structural deficit limit)



Source: Own calculations

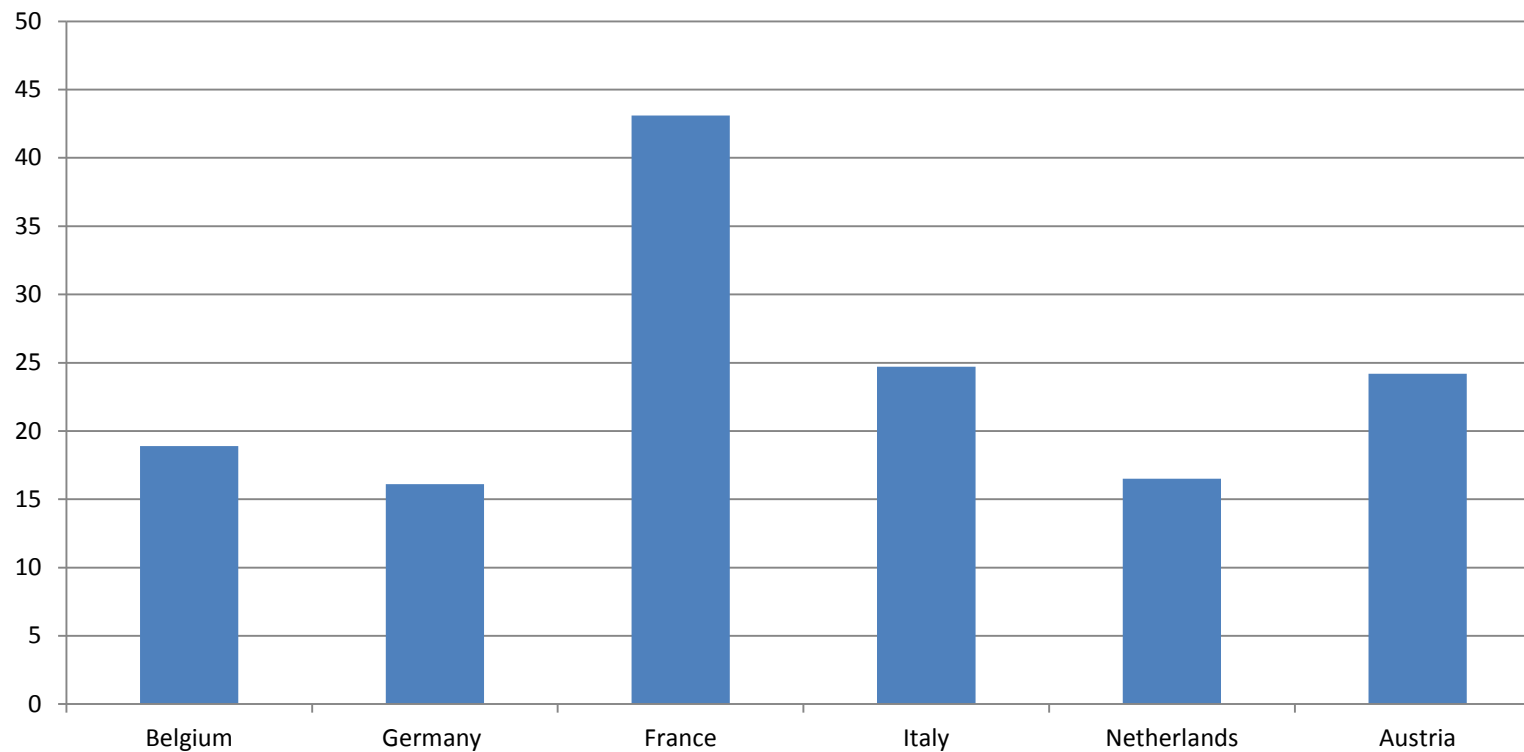
Hypothetical Accountability Bond Issue Volume Eurozone (bn Euros), 0,5% structural deficit limit)



Source: Own Calculations

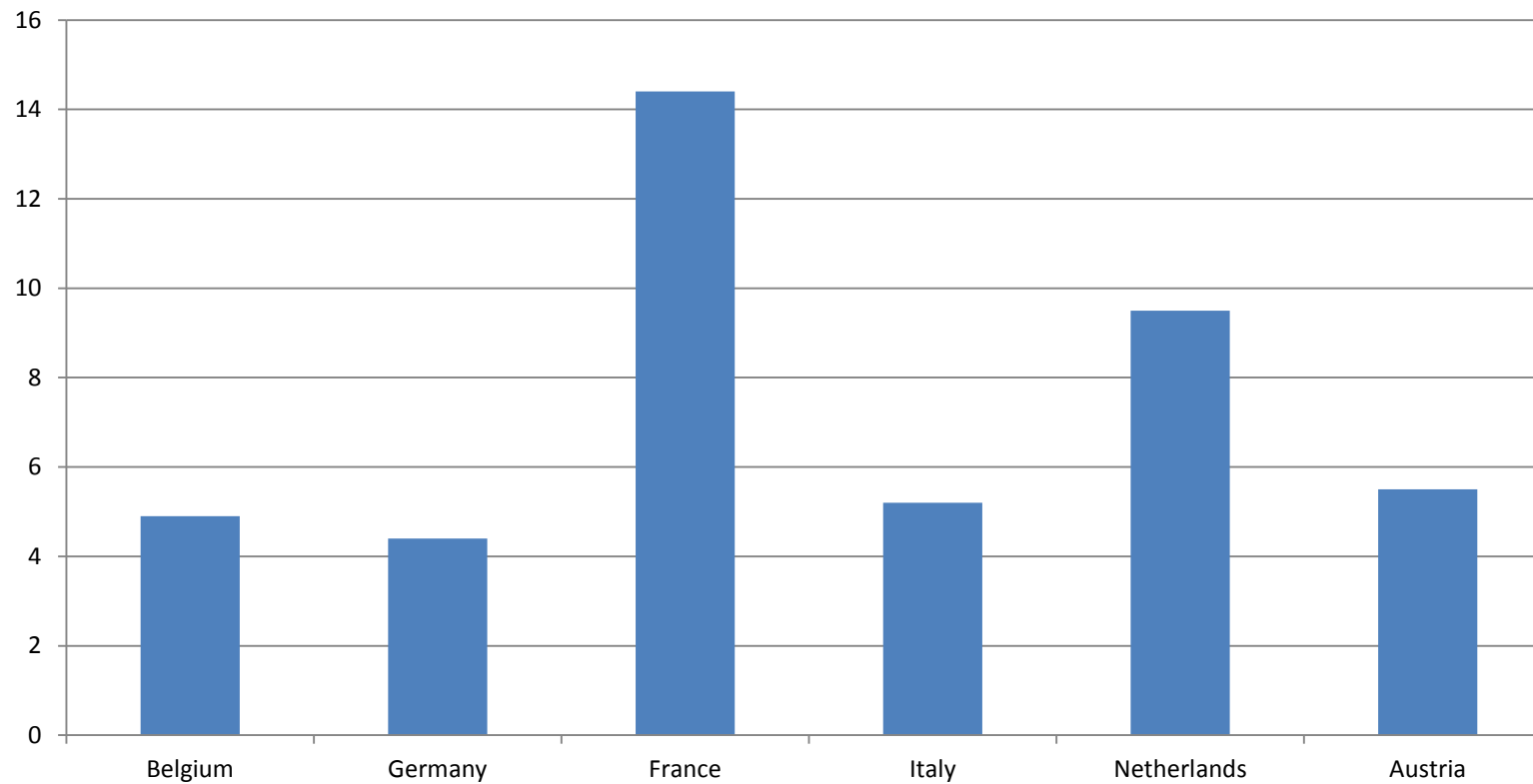
Simulation with 0,5% structural deficit threshold

Share of Accountability Bonds in overall debt (%)



Simulation with 3% deficit threshold

Share of Accountability Bonds in overall debt 2014



Accountability Bonds: What do they achieve?

- Gradual step towards sovereign debt restructuring, protection of taxpayers
- Avoids risk of destabilising large parts of existing bond markets by focusing on flows not stocks
- Restores market discipline at the margin, creates market based incentives for sound fiscal and economic policies
- Gives greater relevance to fiscal policy coordination at the EU level

A photograph of a modern, white, multi-story building with a grid of windows. The building has a prominent entrance on the ground floor supported by several white columns. The sky is blue with scattered white clouds. In the foreground, there are some bicycles parked near the entrance and a parking sign. The overall scene is bright and clear.

Thank you very much!