PRESS RELEASE

The ELEC "Euro T-Bill Fund"

A proposal for a two-year refinancing for all € bills/optional refinancing of bond maturities until 2015

27th January, 2012

This note updates the November 2011 proposal from some Members of ***ELEC*** *in the light of the agreements made by the euro area Heads of State or Government on 9 December, 2011, and subsequent discussions on a* TREATY ON STABILITY, COORDINATION AND GOVERNANCE IN THE ECONOMIC AND MONETARY UNION*. ELEC has supported this report to assist discussion and it is issued by a number of members of the Monetary Panel of ELEC – acting in their personal capacity. It does not necessarily represent the official views of ELEC, or any of its members.*

Executive Summary

Our proposal is for a temporary "Euro T-Bill Fund" once the proposed "Treaty" on fiscal discipline is signed:

- After a euro area State's economic policies have been approved by ECOFIN in the European Semester as both economically effective and politically durable.
- Then all such States would pool all their short-term borrowing via a Fund that would only last four years. The Fund would borrow in the markets for, at most, a two year term – to match closely the borrowing profile of its client States.
- The borrowings of the Fund would enjoy a "joint and several" guarantee involving all participating euro area States.
- After the Fund's termination, each Member would have to borrow in the markets in its own name and on terms determined by its own credibility in the light of the success of its own reform programme.
- The Fund's capacity would be large enough to fund for at least the next two years all the maturing bonds of euro area States that may temporarily be unable to access the capital markets on normal terms.
- Variable interest surcharges would be applied to those States that the ECOFIN Council has determined to have an excessive deficit (i.e. to have breached the Stability and Growth Pact (SGP)); any money built up from these surcharges would be used as a "first loss" buffer and the unused buffer that could remain at the end of the Fund's life would be passed to the ESM for enhancing its capital base.
- Any revenue resulting from the implementation of euro area-wide taxes (such as the possible financial transaction tax) could be earmarked to build an additional cushion.
- States that became subject to sustained SGP sanctions would cease to be eligible to borrow further from the Fund in the future.

Our modest proposal is designed to provide a degree of mutual support that will be sufficient to allow adequate time to States that are themselves trying to restore their competitiveness and the sustainability of their public finances. Then they can demonstrate to their creditors that the first fruits of good policies are visible, and that the policies are entrenched into their political structure in a way that limits the risk of sudden reversal.

If the eurozone demonstrates that it is on track to meet these initial economic (and political) goals of renewed competitiveness and sound public finance, then its individual Members will have a compelling story to tell the investors of the world.

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677 word background

We propose a third stabilisation tool (beyond the EFSF and ESM) that will assist Member States who are experiencing the difficulties of higher interest costs, rather than needing an immediate financial rescue that might involve the need for funds from external providers such as the IMF. With such an anchor for a Member State's borrowing costs in the short-term, the ECB's Securities Market Programme could be left to run off as there would be no need to attempt to influence secondary market yields.

We propose joint financing of some public debt of euro area Member States for a period of four years through a Euro T-Bills Fund. This would be done via a completely simple, transparent fund so the fragmentation of the euro area's national public bond markets would start to be eliminated.

1. To complement the existing package of measures (included in the 'six-pack') to strengthen fiscal discipline and competitiveness in the eurozone. Moreover, these are about to be re-inforced by the Commission's proposals of 23rd November – the "two-pack".

2. To protect euro area Member States from sharp swings in market sentiment that – through spill-over effects via highly integrated financial markets – hurt not only the 'weak' and 'misbehaved'. Member States of a monetary union issue debt in a currency over which they have no control. That is why they are so sensitive to movements of distrust that have self-fulfilling properties even though, in aggregate, euro area public finances are in relatively good shape. Moreover, the euro area's external balance is close to equilibrium, underlining that it does not need outside help.

3. To create deeper markets in public securities of euro area States, bringing about increased liquidity and thus lower funding costs.

The introduction of Euro T-Bills will be based on the guarantees of all participating Member States for the Euro T-Bills Fund. The scheme has to be well designed, e.g. it should bring benefits for all States, both weak and strong. Above all, it is essential to exclude risks of moral hazard. We propose to start with Bills with up to two year maturity and our concept is that the Fund would cease to issue new securities after four years. However, we would leave the door open to designing and implementing either a new temporary scheme or a more permanent mechanism in the light of experience and progress achieved towards a fiscal union.

This proposal is entirely complementary to the European Redemption Fund proposal from the "German Council of Economic Experts". Our plan could well be seen as something of a limited – both in time and volume - experiment in joint and several liabilities. If all goes well during the limited life of our Euro T-Bills Fund, then Member States might have the confidence to go forward with much larger and long-lasing guarantees, if they were still felt necessary.

The combination of great liquidity and being the "safest" haven in the eurozone (reflecting the fact that the Fund's bills will be the only short-term haven) should make the Fund's yields close to the lowest of all so that most participating States would see an interest cost saving.

As the bills would be manifestly the best possible credit of the eurozone, they will have a high rating. For investors, the key will not be some commercial rating but the simple fact that these bonds would genuinely approach the "risk-free asset" concept that underpins current bank and insurance regulation.

They would be eligible collateral at the ECB and the NCBs of the Eurosystem and be a natural asset for banks to hold. Accordingly, they would be expected to be very actively traded and become the most marketable financial instrument in the eurozone, with ultimate liquidity flowing from both the short maturity and collective strength of the guarantors.

During the life of the Fund, there would be no doubt that all participating States would not experience any difficulty in rolling over maturing bonds at the very lowest interest costs, thus underpinning their debt dynamics.