

VOxEU: Coronabonds - The forgotten history of European Community debt

The introduction of European Coronabonds is sometimes described as an unprecedented step that would create a dangerous precedent of debt mutualisation. This column shows that this view is wrong and ignores the history of European financial cooperation, **writes Sebastian Horn, Josefin Meyer and Christoph Trebesch for VoxEU**



The proper European response to the coronavirus crisis is intensely debated at the moment, with European Stability Mechanism (ESM) loans and Coronabonds being the most prominent alternatives (e.g. Bénassy-Quéré 2020a, Bénassy-Quéré 2020b, Bofinger et al. 2020, Erce et al. 2020, Grund et al. 2020). One of the arguments against Coronabonds – a one-off mutual European bond issuance – is that this would be an unprecedented step and break a dangerous taboo.

This column adds to the debate by showing that that bonds issued and guaranteed jointly by European states are not a novel instrument but have repeatedly been issued since the 1970s. We summarise the forgotten history of European Community bonds and the reliance on European joint debt issuances in fighting deep economic crises in Horn et al. (2020a). It is not widely known

that prior to the instruments created during the euro crisis, such as the ESM, Europe relied on a range of earlier crisis-response instruments and cooperation mechanisms, as we document in an ongoing research project on international official lending (Horn et al. 2020b).

The oil crisis and the Community Loan Mechanism of 1975

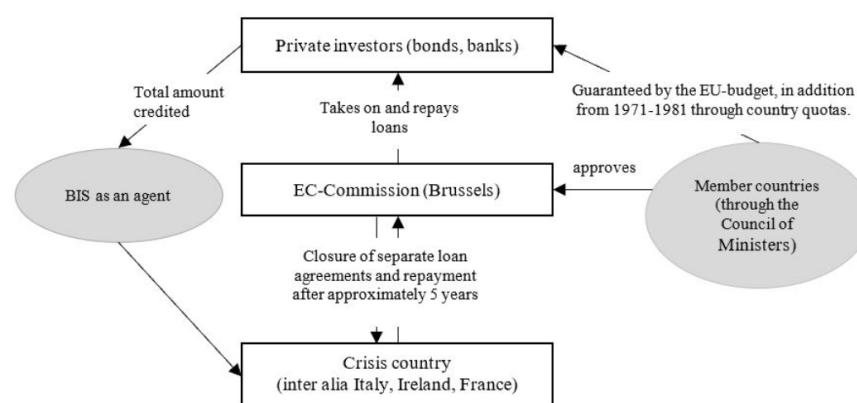
One of these little-known instruments is the European Community bond, which was triggered by the 1973 oil crisis (James 2012). The oil crisis was a deep shock to the European states, both economically and politically, and was perceived as an existential threat to the economic union (Diekmann 1990). Italy was particularly hard-hit and entered a deep recession, with a GDP growth rate of -2% in 1975.

In response to the crisis, the so-called Community Loan Mechanism (CLM) was implemented in February 1975 with the goal of issuing European Community bonds on private capital markets to support countries in crisis. The German government was a pivotal player in creating this mechanism and also added a bilateral \$2 billion loan granted to Italy in 1974.

The program complemented the European Medium-Term Financial Assistance Facility (MTFA), which had been created in 1971 and enabled the provision of direct financial aid through intergovernmental loans, without placing community loans on the private market. The main goal of these programs was to cushion balance of payments difficulties caused by external shocks via intra-European financial cooperation and to provide aid to crisis-hit countries in Europe in order to limit their dependency on loans from the IMF and the US Federal Reserve (Kruse 1980).

Figure 1 Design of the Community Loan Mechanism of 1975

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Source: EEC Council (1975a), EEC Council (1975b), own illustration.
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The basic design of the Community Loan Mechanism was as follows: The European Commission would raise community loans on behalf of the European Community. The Council of Ministers, which represents the governments of the member states, made all relevant decisions, while the Commission acted as the executive body. To raise funds, the Commission negotiated with private investors and presented the results to the Council of Ministers. The loans were then transferred to the crisis-hit countries' central banks via the Bank for International Settlements (BIS), which acted as an agent. Figure 1 summarises the design graphically.

As for the liability structure, the Commission guaranteed the repayment to the private creditors by means of its budget. In addition, the mechanism included a guarantee commitment from the member states, according to fixed quotas. The maximum credit volume was set at \$3 billion in 1974 and the guarantee increased to a maximum of 200% of this credit limit. The twofold guarantee of 200% was intended as a buffer against payment problems by one of the guaranteeing member states. For example, under the program, Germany had an initial guarantee share of 22% and thus assumed a maximum guarantee of 44%, or \$1.32 billion in total (Stieber 2015). The volume of the program was considered to be extensive at the time and, in the case of Italy, exceeded the financial resources provided by the IMF.

A survey of European Community loans and their recipients

In 1976, the first European Community bond was placed on private capital markets, with funds lent to Italy and Ireland. Further community bonds were distributed to Italy (1977), France (1983), Greece (1985) and Portugal (1987). In the 1990s, community bonds were issued in favour of Greece (1991) and Italy (1993). The mechanism was merged into the EU Balance-of-Payments Facility in 1988 and, in 2002, was restricted to countries outside of the euro area. It was again activated in 2008/2009 to support Hungary, Latvia, and Romania. In addition, the European Financial Stability Facility (EFSF) and ESM were created after 2010 to support euro area members.

Table 2 provides an overview of the European Community loans by year and recipient country. The EFSF and ESM loans granted to Cyprus, Greece, Ireland, Portugal, and Spain during the 2010-2013 crisis are not listed, since they are much better known and well-documented (for details see Corsetti et al. 2017).

Table 2 Overview of European Community loans since 1974

Year	Recipient country	Amount authorised (nominal, in billion EUR)	Amount authorised (in % of GDP)	Amount authorised (in % of currency reserves)	Program
1974	Italy	1.72	1.0	14.1	MTFA
1976	Ireland	0.37	3.9	23.5	CLM
1976	Italy	1.22	0.5	9.5	CLM
1977	Italy	0.54	0.2	3.8	CLM
1983	France	4.00	0.7	7.4	CLM
1985	Greece	1.75	3.6	78.8	CLM
1987	Portugal	1.00	2.6	10.7	CLM
1991	Greece	2.20	2.2	46.6	BoPF
1993	Italy	8.00	0.6	16.0	BoPF
2008	Hungary	6.50	4.6	27.0	BoPF
2009	Latvia	3.10	8.7	59.1	BoPF
2009	Romania	8.40	2.3	12.6	BoPF

Notes: The table presents a summary of the European Community's borrowing programs financed by community bonds. In columns 4 and 5, the authorised loan amount is scaled by the GDP and foreign reserves of the year prior to the crisis. CLM: Community Loan Mechanism, MTFA: Medium-Term Financial Assistance Facility, BoPF: Balance-of-Payments Facility.

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Lessons for today

How strong are the parallels to today? Most current Coronabond or Eurobond proposals imply joint and several liability by all member states. This would go a step further compared to the Community Loan Mechanism of the 1970s, which involved country guarantees with maximum quotas. Nevertheless, there are important lessons to be learnt from our review of European lending practices since the 1970s.

One important insight is that, now and then, the EU budget played a central role in the European bond guarantee schemes. Direct guarantees by member states only served as a second guarantee tier, which would be activated if EU funds would not suffice (CLM rules until 1981). It is therefore no surprise that current proposals also suggest using an (enlarged) future EU budget to guarantee the repayment of potential Coronabonds.

Second, history leaves some ground for optimism: The European Community bonds we surveyed were all repaid in full and on time and the guarantees were never activated.

The third and most important lesson is the bigger picture: During deep crises the European governments have repeatedly shown willingness to extend rescue funds along with substantial guarantees to other members in need. The necessary institutional arrangements were often set up flexibly and quickly. Coronabonds would thus stand in a long tradition of European financial cooperation and solidarity.

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