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European community bonds since the oil crisis: Lessons for today?

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- The history of joint European bond issuance has been largely forgotten. We show that joint bond issues by European states are not a novel instrument, but have repeatedly been issued since the 1970s. The issuance of one-off "Corona bonds", as currently proposed, would not be unprecedented, but quite the contrary.
- The first European community bond was issued in 1976 to mitigate the adverse impact of the oil crisis, which threatened the viability of the European Economic Union. The funds were raised on private capital markets and then passed on to crisis countries, including Italy and Ireland. In the 1980s and 1990s community bonds were issued in favor of France, Greece and Portugal and, in 2008/2009, to support the non-Eurozone countries Hungary, Latvia and Romania. Moreover, the EFSF and ESM facilities were created after 2010 to support Eurozone members.
- The most important lesson from history is that, 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.
- A second lesson is that the EU budget played a central role in past European bond guarantee schemes. Direct guarantees via country quotas were only the second guarantee tier, in case EU funds did not suffice, and only until 1981. Not coincidentally, the repayment of Corona bonds through an enlarged future EU budget is currently being discussed.

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OVERVIEW/ÜBERBLICK

- The history of joint European bond issuance has been largely forgotten. We show that bonds issued and guaranteed jointly by European states are not a novel instrument, but have repeatedly been issued since the 1970s. The issuance of one-off "Coronabonds," as currently proposed, would not be unprecedented, but quite the contrary.
- The first European community bond was issued in 1976 to mitigate the adverse impact of the oil crisis, which threatened the viability of the European Economic Union. The funds were raised on private capital markets and then passed on to crisis countries, including Italy and Ireland. In the 1980s and 1990s community bonds were issued in favor of France, Greece and Portugal and, in 2008/2009, to support the non-Eurozone countries Hungary, Latvia and Romania. Moreover, the EFSF and ESM facilities were created after 2010 to support Eurozone members.
- The most important lesson from history is that, 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.
- A second lesson is that the EU budget played a central role in past European bond guarantee schemes. Direct guarantees via country quotas were only the second guarantee tier, in case EU funds did not suffice, and only until 1981. Not coincidentally, the repayment of Coronabonds through an enlarged future EU budget is currently being discussed.

Keywords: Euro bonds, European Union, global crisis, COVID-19

- Im Zuge der Corona Krise werden europäische Gemeinschaftsanleihen zur Unterstützung von besonders betroffenen Mitgliedsländern intensiv diskutiert. Dieser Policy Brief zeigt, dass Gemeinschaftsanleihen europäischer Staaten keine Neuigkeit wären.
- Seit den 1970er Jahren hat die europäische Kommission wiederholt Anleihen auf dem privaten Kapitalmarkt ausgegeben, die durch die Mitgliedsländer garantiert und an Krisen-länder ausgeschüttet wurden. „Coronabonds", wie derzeit diskutiert, stünden in einer langen Tradition.
- Die erste Gemeinschaftsanleihe wurde 1976 zu Gunsten Italiens und Irlands emittiert, um den wirtschaftlichen Schock der Ölkrise zu begegnen. In den 1980er und 1990er Jahren folgten weitere Anleihen für Frankreich, Griechenland und Portugal sowie, nach 2008, für Ungarn, Lettland und Rumänien. Zusätzlich wurde 2012 der ESM für Eurozonen-Länder etabliert.

- Die Geschichte zeigt somit, dass die europäischen Regierungen in tiefen Krisen immer wieder bereit waren, gemeinschaftliche Anleihen auszugeben und dafür zu haften, wenn auch nur für begrenzte Zeit. Die dafür notwendigen Institutionen wurden flexibel und kurzfristig entwickelt.
- Eine zweite Lehre ist, dass der EU-Haushalt seit den 70er Jahren wiederholt genutzt wurde, um die Rückzahlung der Anleihen zu garantieren. Es ist kein Zufall, dass derzeit auch wieder vorgeschlagen wird, „Coronabonds“ über ein deutlich erweitertes EU-Budget zu bedienen.

Schlüsselwörter: EU-Anleihen, Europäische Union, Globale Krise, COVID-19

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EUROPEAN COMMUNITY BONDS SINCE THE OIL CRISIS: LESSONS FOR TODAY?

Sebastian Horn, Josefin Meyer, and Christoph Trebesch

1 INTRODUCTION: THE OIL CRISIS AS A CATALYST FOR COMMUNITY BONDS

Throughout the past decades, the European Community has repeatedly been willing to assist weaker member states. New instruments were often created in times of crisis to cope with new challenges and external shocks. While the instruments created during the recent euro crisis, such as the ESM, are well known, many older instruments and cooperation mechanisms have largely been forgotten, as we show in a recent research project (Horn et al., forthcoming).

One of these little-known instruments is the European Community Bond. This policy brief shows that the European Community has regularly issued and guaranteed joint bonds in times of crisis with the goal of supporting crisis states through more favorable lending conditions and debt relief.

The European Community Bond dates back to the 1973 oil crisis (James, 2012). The oil crisis shook the EC states economically and politically and was perceived as an existential threat to the European project and the economic union (Diekmann, 1990). The increase in the oil price resulted in a significant deterioration of member countries' balance of payments, which threatened the functioning of the common market. In addition to resorting to capital imports, the affected countries had the option of devaluing their own currency, which in turn would have jeopardized the plan to progressively stabilize EC currencies (Diekmann, 1990). Italy was particularly hard-hit by the oil crisis and entered a deep recession, with a GDP growth rate of –2% in 1975.

In response to the crisis, a new instrument was developed in February 1975 with the goal of issuing European Community Bonds on private capital markets to support countries in crisis—the so-called Community Loan Mechanism (CLM).[1]

This 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.[2]

[1] See Regulation of the Council (EEC) No. 397/75 of 17 February 1975. The European Commission proposal on European Community Bonds was made in September 1974.

[2] The main difference between the two programs is the way of funding. Under the MTFA, the Member States raise the money directly, whereas under CLM the European Community borrows the money on the capital market. The MTFA was activated only once in 1974 for Italy.

In 1976, the first Community Loan Mechanism bond was issued on private capital markets. The funds which were raised as a result were on-lent to the crisis countries Italy and Ireland. Further community bonds were distributed to Italy (1977), France (1983), Greece (1985), and Portugal (1987).

The main goal of the community bond program was to cushion external shocks via intra-European financial cooperation and to provide aid to crisis countries in Europe in order to limit their dependency on loans from the IMF and the American central bank (Federal Reserve) (Kruse, 1980). The volume of these EU aid programs was considered to be extensive at the time and, in the case of Italy, exceeded the financial resources provided by the IMF (Horn et al., forthcoming).

2 THE COMMUNITY LOAN MECHANISM OF 1975

2.1 THE DESIGN OF THE COMMUNITY BONDS

The European Commission (the "Commission") was able to raise community loans on behalf of the European Community via the Community Loan Mechanism from 1975 onward. The Council of Ministers, which represents the governments of the member states, made all relevant decisions, while the Commission acted as the executive body. Figure 1 summarizes the design of the Community Loan Mechanism.[3]

The procedure worked as follows: Following an initiative by one or more member states, the Council of Ministers unanimously decided to grant balance-of-payments aid to the country in crisis. Another task of the Council of Ministers was to determine the conditions under which the crisis countries received balance-of-payments assistance. For example, this included an upper limit for taking on additional national debt.[4]

To raise funds, the Commission negotiated with private investors and presented the results to the Council of Ministers. The Council of Ministers unanimously decided on the terms upon which each contract with the private investors was to be concluded. While private bonds were placed on capital markets, loans from one or more major banks were raised as well. Some of the loans were so-called recycled "petrodollars," i.e., loans passed on via the private market by major oil exporting nations such as Saudi Arabia, which were among the major profiteers of the oil crisis (Kruse, 1980).

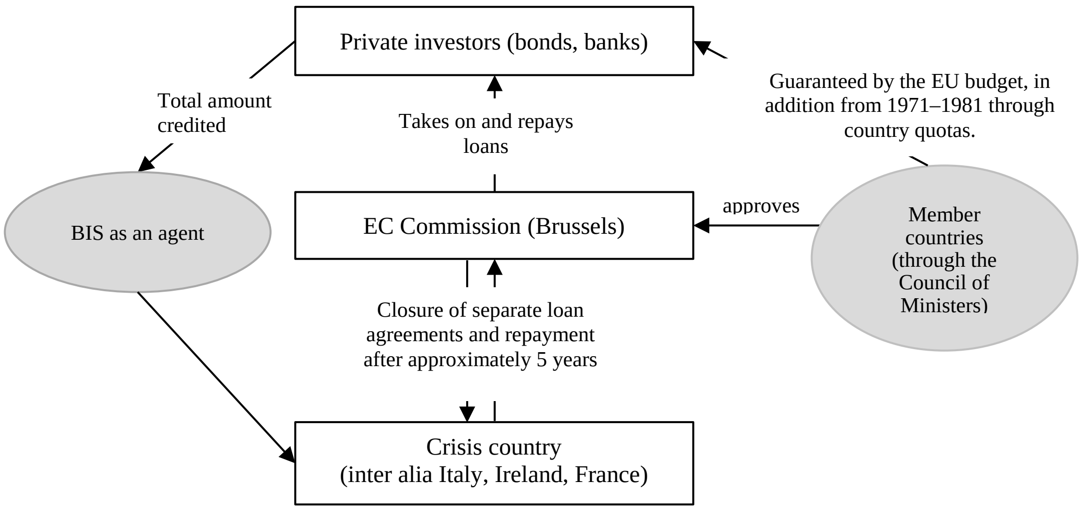
The thus created loans were transferred to the crisis countries' central banks. Specifically, the banks and consortium leaders of the bond issuance transferred the funds to the Bank for International Settlements (BIS), which acted as an agent and in turn passed the funds on to the central banks of the beneficiary member states.

[3] See the Council Regulation for further details (EEC) No. 397/75 and (EEC) No. 397/75, as well as Diekmann (1990).

[4] See 76/324/EEC, 76/323/EEC and 76/324/EEC for Italy and Ireland 1976, 83/298/EEC for France 1983, or 85/543/EEC for Greece 1985.

In 1985, the condition that balance of payments problems must be linked to an increase in the oil price was abolished. At the same time, the lending limit was raised to ECU 8 billion. A member state could apply for up to 50% of this lending limit in the form of credit assistance.

Figure 1:
Design of the Community Loan Mechanism



Source: **EEC Council (1975a); EEC Council (1975b); own illustration.**

2.2 LIABILITY: EU BUDGET AND MEMBER STATES ACCORDING TO FIXED QUOTAS

The system of liabilities and guarantees had several stages. If the debt service to the Commission was to be delayed, the Commission would be obliged to finance the corresponding payments to its creditors by means of its budget (European Court of Auditors, 1982). In addition to this guarantee, the CL mechanism included a guarantee commitment from the member states. That is, if a country in crisis failed to meet its obligations to the Community, the other member states guaranteed the repayment of the debt to their private creditors according to fixed quotas. The distribution of these quotas among the member states is shown in Table 1 (EEC Council, 1975a; EEC Council, 1975b).

The Community Loan Mechanism's maximum credit volume was set at US$ 3 bn. in 1974. The European Community supported these commitments made with a guarantee of up to 200% of the credit limit. This implies that the maximum guarantee for the Community as a whole was de facto US$ 6 bn. With a share of 22.02%, Germany assumed a maximum guarantee of US$ 1.32 bn. under the program (Stieber, 2015)

In addition, the other guarantor countries could pause their guarantees, if they had balance-of-payments issues. The guarantee obligations for debt service were then divided among the remaining countries according to the capital key (EEC Council, 1975a; EEC Council 1975b).

Table 1:
Guarantee structure of the Community Loan Mechanism

Guarantor	Share (in %)	Maximum guarantee in US-Dollar (bn.)
Germany	22.02	1,321
United Kingdom	22.02	1,321
France	22.02	1,321
Italy	14.68	881
Belgium/Luxemburg	7.34	440
Netherlands	7.34	440
Denmark	3.30	198
Ireland	1.28	77
Total	**100**	**6,000**

Source: **EEC Council (1975a); EEC Council (1975b); own calculations.**

3 DEVELOPMENT INTO THE BALANCE OF PAYMENT FACILITY SINCE 1988

3.1 REFORM UND FUNCTIONING OF THE NEW FACILITY

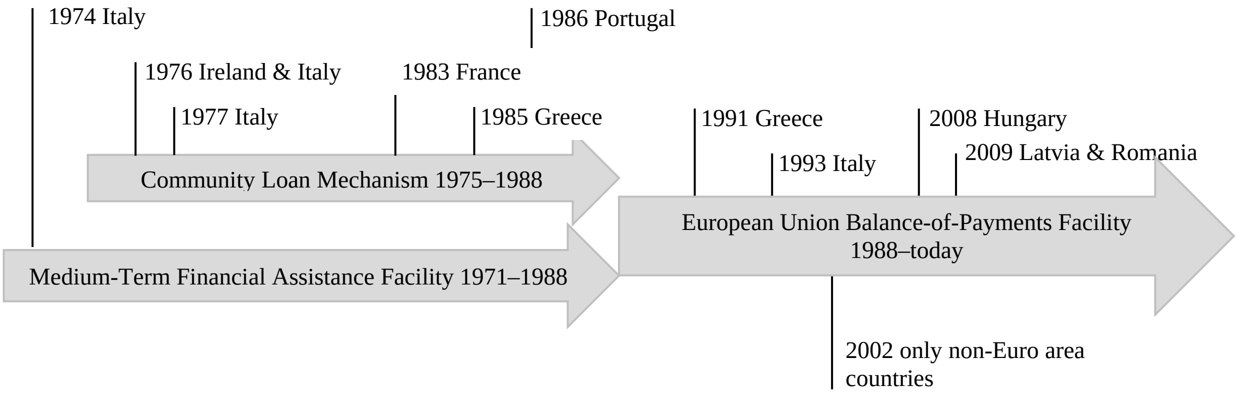
In 1988, the European Community decided to merge the two instruments MTFA and CLM into a common instrument—the so-called Balance of Payment Facility. This was an obvious step, since the MTFA was only activated once (for Italy in 1974) and was de facto replaced by the CLM as early as 1975. Other innovations were also introduced. However, these did not change the basic functioning of the CLM (Abel, 2019).

One important change was the move from the requirement of unanimity to a qualified majority in the Council of Ministers. This means that a majority decision of the EC governments was now sufficient to activate balance-of-payments assistance to a country. The total lending capacity was originally set at ECU 16 bn. and was successively increased to EUR 50 bn. by 2009 (Abel, 2019).

An additional important change was introduced in the framework of the monetary union in 2002. Ever since, balance of payments assistance has been available only to non-euro area member states in financial difficulties. Member states of the euro area cannot receive loans via the EU Balance of Payments Facility, in part because of the no bailout clause (EC Council, 2002).

As with the CLM, borrowing on private capital markets via community bonds continues to be the preferred method of financing financial assistance under the Balance of Payments Facility. The possibility of employing alternative forms of financing, such as loans from third-party countries, was discontinued in 2002.

Figure 2:
Overview of EU aid programs



Source: **EWG Rat (1975a); EWG Rat (1975b); EWG Rat (1988); EG Rat (2002); Horn et al. (forthcoming); own illustration.**

3.2 LIABILITY: EU BUDGET

As with the CLM after 1981, Community bonds were mainly guaranteed by the EU budget. If an EU debtor is unable to repay a loan on time, the debt service is temporarily settled using the EU budget's cash resources, if possible. If the EU's own resources are insufficient or a member state defaults, the Commission can use other available EU funds and prioritize debt service over other, non-compulsory expenditures. Any further remaining debts will be distributed among the member states in proportion to their contributions to the EU budget. The upper limit for additional contributions is 1.2% of the EU's gross national income (European Commission, 2018; Council of the European Union, 2014).

4 SUMMARY: COMPARISON OF THE INSTRUMENTS AND GRANTED LOANS

This section summarizes the main characteristics of the historical European debt instruments as outlined above in tabular form (Table 2). We also provide an overview of the granted loans (Table 3). This explicitly does not include EFSF and ESM loans granted to the eurozone countries Greece, Ireland, Portugal, Spain and Cyprus during the 2010–2012 crisis. The literature concerning, and the overviews of, these instruments are very comprehensive and detailed, so they will not be discussed further at this point (see, for example, ESM, 2019, Corsetti et al., 2017, and Gourinchas et al., 2018).

4.1 COMPARISON OF INSTRUMENTS

Table 2:
Comparison of the various support mechanisms

	Medium-Term Financial Assistance Facility	**Community Loan Mechanism**	**Balance-of-Payments Facility**
Framework			
Time period	1971–1988	1975–1988	1988–today
Decision-makers/ Lenders	Council of Ministers/ Member Countries	Council of Ministers/ Member Countries	Council of Ministers/ Member Countries
Recipient countries	Member Countries of the European Community	Member Countries of the European Community	Member Countries of the European Community, Since 2002: EU-countries, that do not use the euro
Mandate	Balance-of-payment difficulties	Balance-of-payment difficulties	Balance-of-payment difficulties
Refinancing	Direct contributions from member countries	Issuance of bonds on capital markets, or loans from third-party countries and other financial institutions	Issuance of bonds on capital markets, direct contributions from member countries (until 2002)
Lending limit	US$ 2 bn.	1975–1981: US$ 3 bn. (principal & interest) 1981–1985: ECU 6 bn. (excl. interest) 1985–1988: ECU 8 bn	1988–2002: ECU 16 bn. 2002–2008: EUR 12 bn. 2008–2009: EUR 25 bn. 2009–today: EUR 50 bn.
Guarantees	Debt service guaranteed proportionately by member countries	1975–1988: overall EU-budget 1975–1981: Debt service guaranteed proportionately by member countries	Overall EU-budget with an obligation for member states to provide additional resources
Quotas of debt assumption	DE (30%), BE (10%), FR (30%), IT(20%), NL (10%)	Applies to the period 1975–1981: DE (22.02%), BE (7.34%), FR (22.02%), IT(14.68%), NL (7.34%), GB(22.02%), DK(3.3%), IR(1.28%)	None
Legal foundations	71/143/ EEC	(EEC) No. 397/75, (EEC) No. 398/75, (EEC) No. 682/81	(EEC) No. 1969/88 (EC) No. 332/2002
Lending conditions			
Conditionality	Yes	Yes	Yes
Interest rate	Determined by the Council of Ministers	Determined by the conditions the EC obtains on capital markets (on-lending at the same conditions)	Determined by the conditions the EC obtains on capital markets (on-lending at the same conditions)
Maturity	2–5 years	On average at least 5 years	2–5 years
Activated			
Who/When	Italy (1974)	Italy (1976,1977), Ireland (1976), France (1983), Greece (1985)	Greece (1991), Italy (1993), Hungary (2008), Latvia (2009), Romania (2009)

Source: **Own compilation, based on the legal regulations: 71/143/EEC, (EEC) No.397/75, (EEC) No. 398/75, (EEC) No. 682/81, (EEC) No.1969/88, (EC) No. 332/2002; Heinen (2014); Horn (2020).**

4.2 OVERVIEW OF ISSUED LOANS

Table 3:
Overview of issued loans

Year	Beneficiary country	Amount authorized (nominal, in bn. Euro)	Amount authorized (in % of GDP)	Amount authorized (in % der 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

The table presents a summary of the European Community's borrowing programs financed by community bonds. In columns 4 and 5, the authorized 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.

Source: **Horn et al. (forthcoming).**

5 CONCLUSION

A look at the European financial history of recent decades shows that the European community has repeatedly been willing to support weaker members in severe crises. In this context, European community bonds were used on several occasions to raise money on the international capital market, which could then be lent to crisis countries at favorable conditions. The necessary institutional arrangements were often implemented quickly and flexibly. The one-off introduction of “corona bonds” would therefore not be unprecedented.

A second lesson is that the EU budget has played a central role in past European loan guarantee schemes. Until 1981, there was only one additional guarantee layer. Should EU funds have been insufficient, direct guarantees could have been activated through country quotas. It is no coincidence that the repayment of potential “corona bonds” through an enlarged future EU budget is currently also being discussed.

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IMPRESSUM

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