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EUROPEAN COMMISSION'S SOVEREIGN BOND-BACKED SECURITIES (SBBS) PROPOSAL UNLIKELY TO WORK AND COULD UNDERMINE FINANCIAL STABILITY, SAYS NEW LEVY INSTITUTE STUDY

ANNANDALE-ON-HUDSON, N.Y.— A new proposal put forward by the European Commission looks to increase the financial stability of the eurozone by establishing a new class of sovereign bond-backed securities (SBBS). Aiming to break the link between bank crises and sovereign debt crises in the eurozone, the SBBS proposal would pool national sovereign bonds from all countries that use the euro with the goal of establishing a common yield curve and encouraging investors to diversify their holdings of eurozone bonds. A new paper from the **Levy Economics Institute of Bard College** argues that the proposal is unlikely to yield its intended results and will, in the process, further undermine financial stability in the eurozone.

"Hardly any financial operators in triple-A-rated countries would agree to swap their national debt with equally profitable but more uncertain synthetic assets, thus preventing the scheme from reaching the necessary scale," writes Mario Tonveronachi in his new Levy One-Pager, "An Alternative to Sovereign Bond-Backed Securities for the Euro." "Given the limited number of systemically correlated assets involved and the participation of national assets according to the ECB's [European Central Bank] capital key, the pool would not be sufficiently diversified to permit using the usual CDO [collateralized debt obligation] methodology, which means the multiplier effect necessary to drive the production of safe assets would not be generated."

A more effective alternative policy would center, Tonveronachi asserts, on the ECB issuing debt certificates (DCs) along the maturity spectrum to create a common yield curve and corresponding absorption of a share of each eurozone country's national debts. His proposal would also require new reflationary but debt-reducing fiscal rules. "New fiscal rules incorporating more ambitious targets for sovereign debt ratios would be imposed—with more drastic consequences for noncompliance, but a more favorable influence on euro area economic growth (as compared to the futile, deflationary fiscal dynamics built into present arrangements)," he writes. "This alternative proposal not only better addresses the two problems targeted by the SBBS scheme, but also a third, critical defect of the current euro system: that is, it fosters national sovereign debt sustainability."

Tonveronachi concludes that his DC proposal addresses the central defect of the eurozone setup: having a monetary policy operated as if serving a federal state while fiscal sovereignty remains at the national level. Furthermore, he argues that, "politically, it would signal that the union—through adjustments directed at increasing the coherence of its institutional setup, without requiring EU treaty changes—is undertaking a serious effort to mend social wounds, not leaving troubled countries to fend for themselves."

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One-Pager No. 56: "An Alternative to Sovereign Bond-Backed Securities for the Euro Area"

To read the full text of this policy paper or to learn more about the Levy Economics Institute of Bard College, please visit levyinstitute.org.

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