Eurobonds are the only answer to Europe's crisis

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Eurozone leaders face a fundamental choice when they meet on Thursday. Either they declare, once again, that they stand ready to do "whatever is necessary" to overcome the eurozone crisis, or they actually do it. In the first case, markets are likely to step up to the next stage of their challenge to the European authorities. They will target larger countries, such as Italy and Spain, thus making the "whatever necessary" ever more costly and ever less credible.

Alternatively, the eurozone leaders could show leadership. Markets, so far, have been winning a game of divide and conquer, simply because countries are not providing a common response. Eurozone governments have been seeking "financial stability" by committing ever larger amounts of their taxpayers' money. Yet, these sums merely measure the eventual cost to citizens of their leaders' attempts to behave as if they were not part of a monetary union.

A more effective strategy would be to surprise the markets with a genuinely common policy. For such response to be agreed on, the government of the leading eurozone country, Germany, has to provide leadership among the member states and at home. This means convincing Germans that they are benefiting from the European Union, its single market and the euro; that the German "culture of stability" is permeating the rest of the union; and that Germany would be the biggest loser – in terms of stability, competitiveness and the financial cost – if the eurozone were to break up.

A German government that promotes common policies focused on the long term would be better able to protect German taxpayers' interests than one which, in focusing on their shorter-term interests, convinces neither the markets nor its citizens. It is this lack of credibility that would generate, further down the road, a disruptive 'transfer union' that would likely lead to acrimony domestically and across borders.

Luckily for Chancellor Angela Merkel and for Europe, the two main opposition parties in Germany – the Social Democrats and the Greens – are pro-EU. Although the SPD initially opposed the euro and Chancellor Gerhard Schroeder, with President Jacques Chirac, undermined the credibility of the Stability Pact in 2003, earlier this week SDP leaders pledged support for unpopular measures to deal with the eurozone crisis.

This creates a fresh opportunity for Ms Merkel and Wolfgang Schäuble, German finance minister, to support the use of eurobonds – an initiative that would reinforce Germany's real and perceived ties to the euro.

Commissioner Olli Rehn said last month in the European Parliament that, as part of an economic governance package, the Commission will be ready to propose the setting up of a system of common issuance of euro-denominated government bonds before the end of the year. This would be aimed at strengthening fiscal discipline and increasing stability in the euro area through market mechanisms, ensuring that those member states that enjoy the highest credit standards would not suffer from higher interest rates. The Commission's report will, if appropriate, be accompanied by legislative proposals.

The proposal is for the use of eurobonds as an instrument of debt management, not as a financing instrument for new expenditures. It was put forward to the president of the Commission last May*, and introduced in the European Parliament in December by Sylvie Goulard**, based on research by Jacques Delpla and Jakob von Weiszäcker, among others.

Many options are possible, including giving the European Financial Stability Facility new powers. The new bonds would assert the euro currency in the global markets. It is not obvious that there would be a higher (absolute or relative) financing cost for the most creditworthy member states, when considering both the liquidity of the new eurobond market but also the existing turbulence of the sovereign debt markets. To liberate the European Central Bank from the role it has been obliged to play would also be in the general best interests and in line with the best German traditions.

There is growing consensus that it would be difficult to find a lasting solution to the eurozone crisis without the use of eurobonds. This week's eurozone summit could give at least a clear political signal that it is worth considering the eurobond proposal. A European vision, based on the creation of a European instrument, backed by a precise timetable, could be a good way to restore trust and stability.

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