Discussion of “Who is Afraid of Eurobonds?”

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Introduction

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- **This paper's proposal:** centralized treasury issues Eurobonds
  → ZLB shifts stabilization burden onto fiscal policy
  → Eurobonds relax constraints on national debt levels
  → Monetary policy accommodates increase in inflation needed to stabilize Eurobonds issued
  → Strict fiscal discipline at national levels (no suspension of fiscal rules)

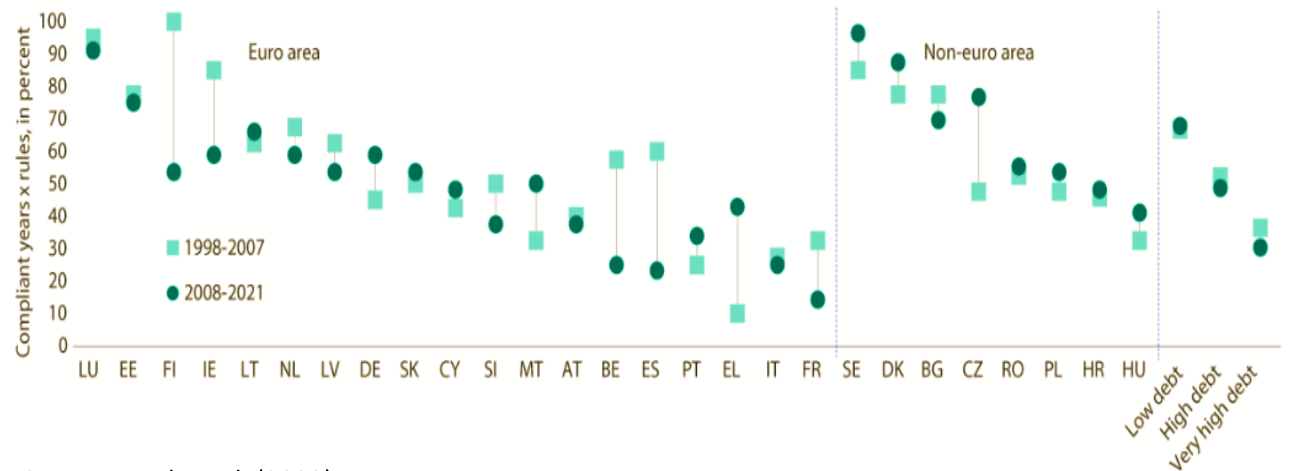
Broader policy debate (1)

Gaps in euro area fiscal architecture

- Failure of fiscal rules to correct excessive deficits, debt (Blanchard et al., 2021; Arnold et al., 2022)

  → escape clauses invoked during large shocks but no adjustment in "good times"

Average compliance of fiscal rules across EU countries, 1998-2021



Source: Larch et al. (2023)

Broader policy debate (2)

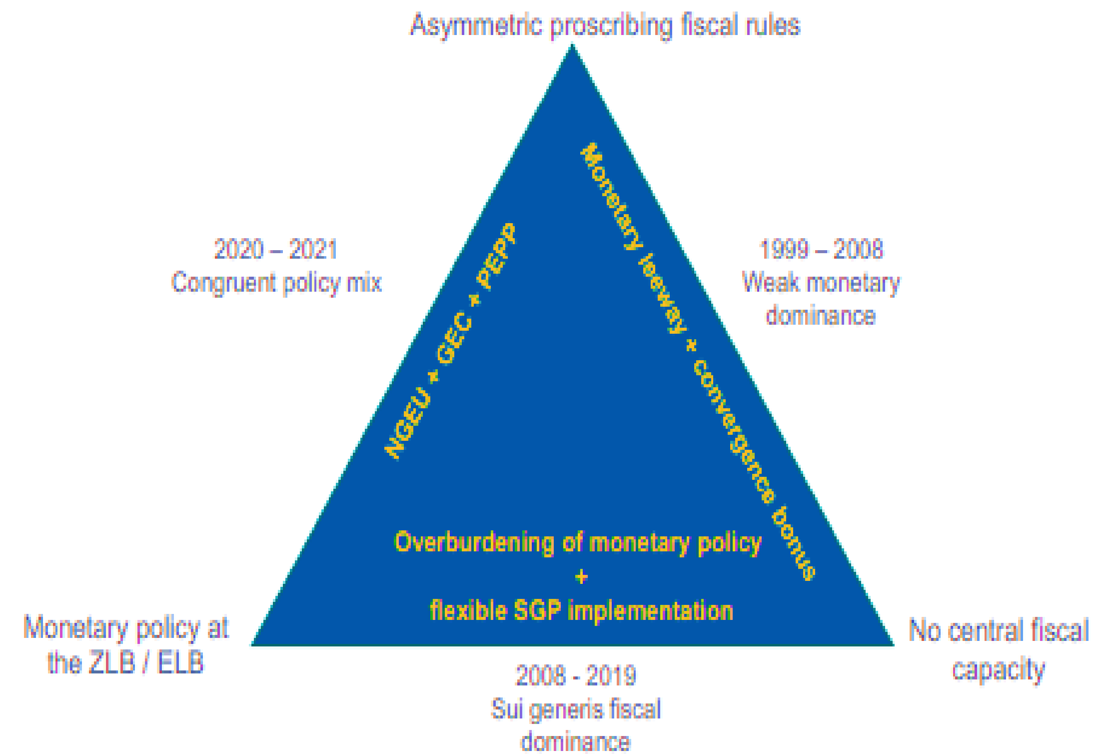
- **Insufficient macroeconomic stabilization** (Allard et al, 2014; Arnold et al., 2018, 2022; Corsetti et al., 2016; Buti and Messori, 2022; Draghi, 2023)

  → Various proposals for central capacity: rainy day fund, centralized budget, common debt issuance with income stream to service debt

  → NGEU in response to pandemic, but only temporary

- Need for **larger stock of EU-wide safe asset** (Giavazzi and others, 2021; Brunnermeier et. al, 2016)

Euro area's policy mix trilemma: solutions to date



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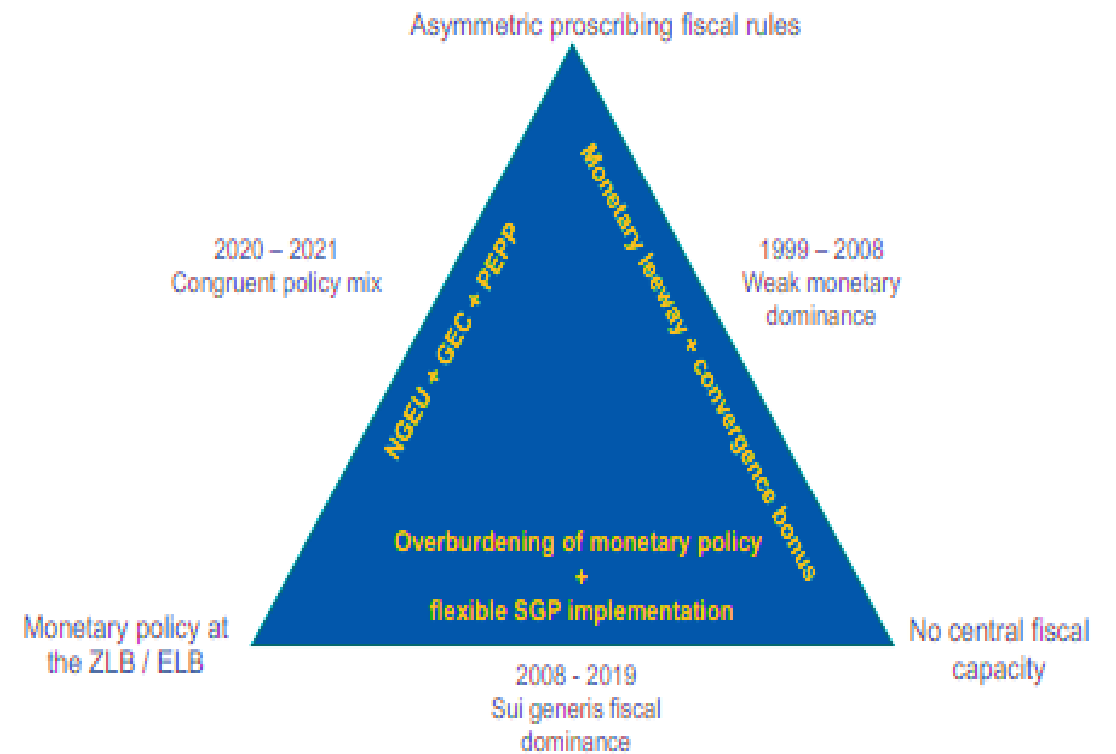

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This paper: formalizes role of Eurobonds in macroeconomic stabilization of aggregate shocks

Framework

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- monetary policy governed by interest-rate feedback rule
- fiscal policy governed by fiscal rules at national and central levels
- central fiscal authority can adjust fiscal tools (distortionary taxes, transfers) depending on fiscal arrangement
- no mutualization of existing debt
- three main regimes for monetary-fiscal interactions in face of large, symmetric recessionary shocks

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3. New Fiscal Framework: Partially-passive MP, Partially-active FP (policy coordination)

→ no suspension of fiscal rules at national level; monetary policy inflates away just the amount of new government debt that results from the large recessionary shock

→ policy mitigates decline in inflation and output volatility by raising expectations about (moderately high) future inflation **and** long-run fiscal sustainability

Comments

Comment: role of asymmetries

- Under exceptional symmetric shocks, centralized treasury plays a large stabilization role, while strict fiscal rules remain in place at national levels
- **But:** what if contractionary shock is asymmetric or has asymmetric impacts (e.g., arising from differences in sovereign default risk)?

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- **In practice:** how does the centralized fiscal authority implement the fiscal expansion? Where and how to spend subject to debate

  → how should we think of other public goods (climate, infrastructure, defense, energy)?

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- Model requires agents to keep track of not only actual outcomes, but also shadow economy counterfactual (abstracting from shocks, ZLB)

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- **But**: How different are outcomes if agents unable to distinguish between funded and unfunded debt?
- **In practice:** clear policy communication and activation mechanisms needed to anchor beliefs

  → Can framework be on autopilot? what triggers “escape” clauses?

  → Can beliefs be “contaminated” by expectations about possibility of future large shocks and deviations from fiscal discipline

- Does inflation get back to target? Do agents believe it will?

Comment: architecture of proposed framework

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- In high debt country: fewer incentives to create fiscal space in good times if government anticipates centralized fiscal support (and higher inflation) in face of large negative shocks

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- Safe asset status: will Eurobonds compete with German or Italian bonds? Lower borrowing costs for all?

Concluding thoughts

- **Great paper**—really enjoyed reading it!
- Model neatly formalizes the benefits of centralized fiscal capacity with borrowing capacity, a widely known gap in the euro area architecture
- Scope for thinking further about:
  - asymmetries (shocks, impacts)
  - role of communication and implementation
  - architecture of new framework (rules, discipline, safe asset status…)