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Growth bonds a win-win for troubled eurozone

From Prof Stephany Griffith-Jones, Asst Prof Robert Akerlof and Prof Marcus Miller.

Sir, The eurozone is in serious trouble. Panic has grown as creditors search desperately for a safe haven, and corrosive contagion risks spreading unchecked. Rating agencies act pro-cyclically as usual, helping to deepen the crisis.

The outline of a deal by the 17 eurozone governments to be agreed this week is emerging. It would include fiscal commitments and a European Stability Mechanism; and the new agreement would not imply future debt reduction. This could be a basis for stopping the crisis.

The key missing element is restoring economic growth, as Martin Wolf underlines ("Merkozy failed to save the eurozone", December 7). Excessive fiscal austerity, accompanied by lack of private confidence, risks euro recession – and may trigger future default.

There is an alternative: a win-win solution that would allow debtor countries to restore a minimum of growth and creditors not to face future default.

To give a breathing space for countries in trouble, a switch from conventional bonds to "growth bonds" would do the job – so interest payments are cut in times of low growth and increased as growth recovers. This does not imply overall debt reduction, but changes in the timing of debt servicing. So it is consistent with the package just agreed by Angela Merkel and Nicolas Sarkozy. By lowering debt servicing when growth is low, it would give fiscal space for debtor countries to grow; this would make their ability to service debt in the future far more likely. Therefore creditors would be more protected.

Keynes negotiated a similar clause in the US loan to the UK after the second world war. In the European case, this could be complemented by the offer of "stability bonds" to the creditors, to restore their confidence, with possibly some medium-term funding from the European Financial Stability Facility initially.

The people of Europe are looking for a grand bargain that avoids deepening the crisis and helps restore growth. Growth bonds could be a key part of the solution. Eurozone leaders should include it in their agreement.

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