Discussion of “Who Is Afraid of Eurobonds?”

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- **Proposal:** Issue Eurobonds $\rightarrow$ Centralize part of fiscal budget
    - Monetary policy tolerates inflation increase necessary to stabilize Eurobonds issued

Broader Policy Debate

- ESBies (Brunnermeier et al., 2012) $\rightarrow$ Provision of a European safe asset
  - Avoid "diabolic loop" (sovereign debt risk + bank solvency risk)
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- Eurobonds share elements of both proposals
  - Provide a European safe asset
    - Though possibly less safe and requiring more fiscal integration
  - Allow for macroeconomic stabilization of aggregate shocks
    - But involve calculating a counterfactual

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- What do we lose with a simpler model?
  - All households are savers (+ no habits and no useful government spending)
  - Only labor input (no growth)
  - No wage rigidities and no indexation, zero steady state inflation
  - Only one tax instrument (distortionary labor income tax) and no long-term debt

A Stripped-Down Version of the Model

- Closed economy version (Benigno and Woodford, 2004)
  - Aggregate demand
  $$y_t = -\sigma^{-1}(i_t - \mathbb{E}_t \pi_{t+1} + \varepsilon_t) + \mathbb{E}_t y_{t+1}$$
  - Aggregate supply
  $$\pi_t = \kappa[(\sigma + \eta) y_t + \omega \tau_t] + \beta \mathbb{E}_t \pi_{t+1}$$
  - Government budget constraint
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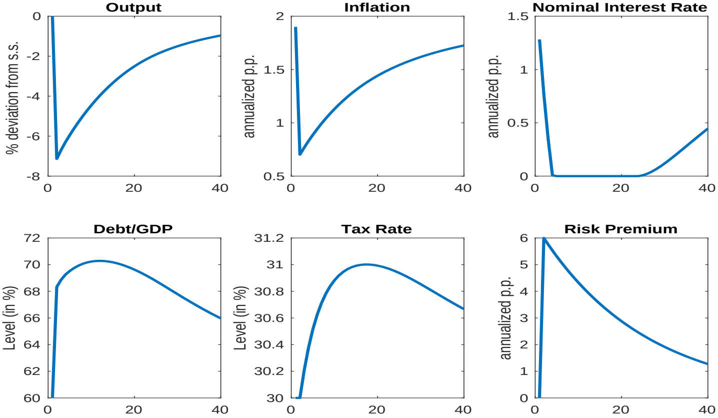
- Close model with same policy rules (interest rate and taxes) as in this paper

- In a currency union, relative price effects on AS and gov't budget constraint (Ferrero, 2009)

Negative AD Shock in the Stripped-Down Model

- Stripped-down model can generate qualitatively similar results (fiscal discipline scenario)
  - Calibration as close as possible to this paper



Optimal Policy

- Optimal joint fiscal and monetary policy in stripped-down model (abstracting from ZLB)
  - Monetary policy
    $$\pi_t + m_\pi \pi_{t-1} + m_y (y_t - y_{t-1}) = 0$$
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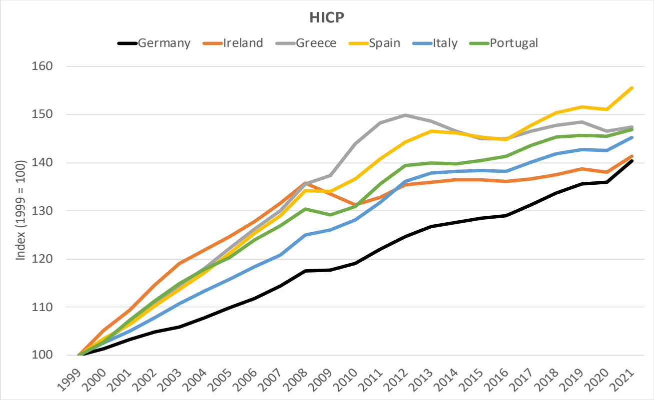
- Yet fiscal integration requirements and model-dependency remain non-trivial obstacles

Other Imbalances

- Lack of competitiveness in EMU periphery (Eggertsson, Ferrero and Raffo, 2014)



  - Asymmetric shocks still a key stabilization concern $\rightarrow$ Eurobonds unlikely to help much