The Blue Bond Proposal

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cost of borrowing
(status quo)
Interest rate

Debt level

- senior status
- liquidity
- joint and several liability
- risk of orderly default
- illiquidity
- junior status
What to gain for all Euro Area: International liquidity

- World Hunger from emerging mkt, insurers, central banks...
  - **Ultra safe and Ultra liquid**
  - Now, only the US provides that (with US Treasury bonds) ➔
    - ‘exorbitant financial privilege’ of the US
  - Blue bonds are competitors to the US **exorbitant privilege**
  - Blue bonds: an opportunity for Europe as the US safe asset status is jeopardize by large US deficits, lack of fiscal consensus, risks of inflation
  - Gains of international liquidity for Blue bonds: 30bps per year using swaps spreads differentials
Blue bond and Red bonds (EUR billion)
Blue Bond Market

- Blue bond market = €5 000 to 6 000 bn

- Similar in size to the US Treasury Bond market (= €7 250bn)

- With a single Euro debt agency

- Rates: lower than Bunds’, because of:
  - Same quality as Bunds
  - Higher liquidity
Interest rate

+ reduced bailout costs for anchor countries

Debt level
Blue Bond Governance

• Blue bond annual allocation: Governed by a budget committee (nominated by EA countries, helped by the EC) that proposes annual Blue bonds allocations for year N+1
• With a ‘take it or leave it’ proposal
• On the basis of SGP compliance and fiscal orthodoxy

• efficient enforcement of SGP, as access to cheap Blue debt is a positive incentive
• Fully symmetrical decision making but de facto veto powers for large anchor countries
No holding discount for Blue bonds

• Remove any ‘holding discount’
  – With Blue debt service money voted by Parliaments, in annual finance laws, as senior to any other debt service

 ➔ Blue debt is true Gov debt
Opt in / Opt out

- Blue bond mechanism is not « once you have signed you are locked in forever »
- Problem countries can be phased out of the system by means of lower blue bond allocation
- Annual decision by parliament by stability anchors whether to continue participation
Blue Bonds and the crisis

1) Harnessing the power of markets in support of reformed SGP
2) Strong signal that integrity of euro area will be preserved
3) Credible basis for „orderly bankruptcy“
   (keeping red bonds out of the banking system)
4) Complementary to crisis mechanism (small ESM!)
5) Restructuring in current debt crisis
   (blue bond as Brady bond)
Red debt as contingent debt

- Trigger event for red bonds: IMF/ESM operation resulting in maturity extension and interest cancellation
- Not legally a restructuring (similar to Axel Weber’s proposal)
- ESM can be relatively small:
  - Blue debt rolled over within blue bond system
  - Red debt contingent
  - ESM can focus on primary surplus
Blue bond agreement

• Need for inter-governmental EA binding arrangement, stating without ambiguity:
  – How to ensure Blue bond seniority in any case
  – How to ensure Red debt contingency
  – Joint & several guarantees mechanism
  – Governance mechanism of Blue bond annual allocation
  – Blue Debt Agency
For discussion:
Blue bond as Brady bond