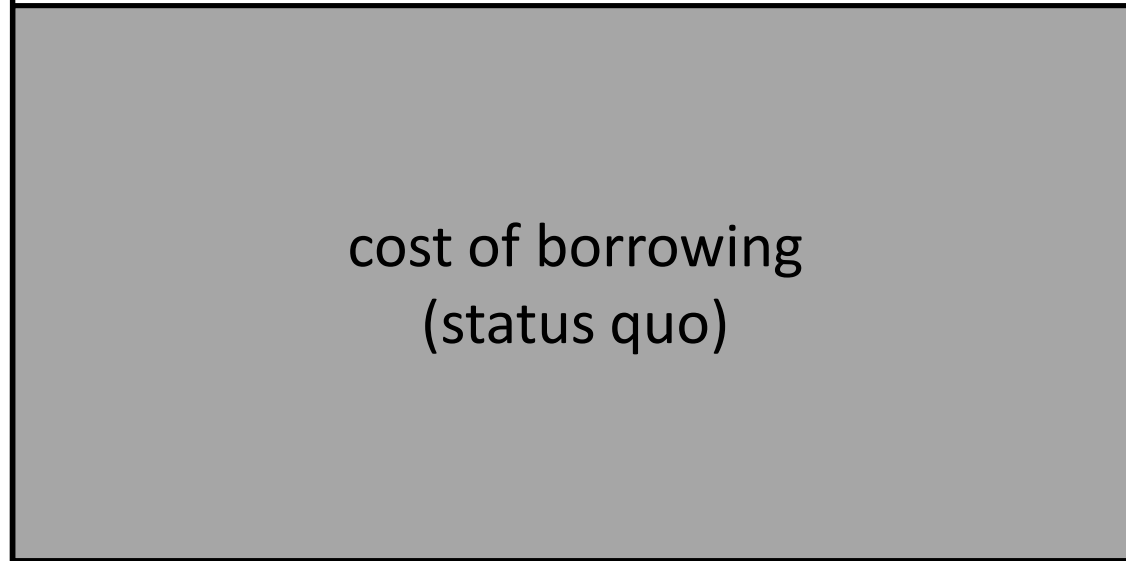


# **The Blue Bond Proposal**

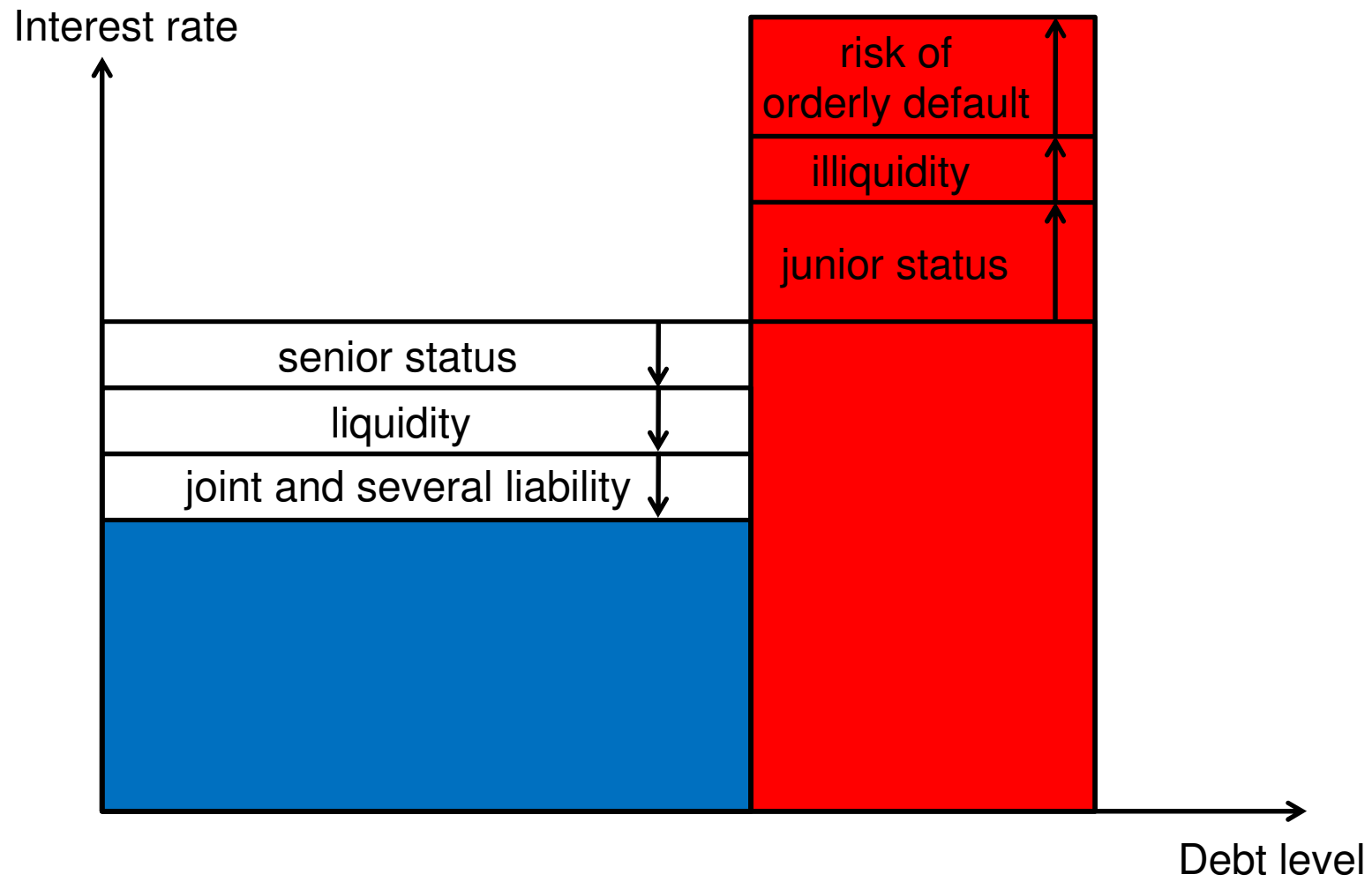
Jacques Delpla and Jakob von Weizsäcker  
11 May 2011

Interest rate



cost of borrowing  
(status quo)

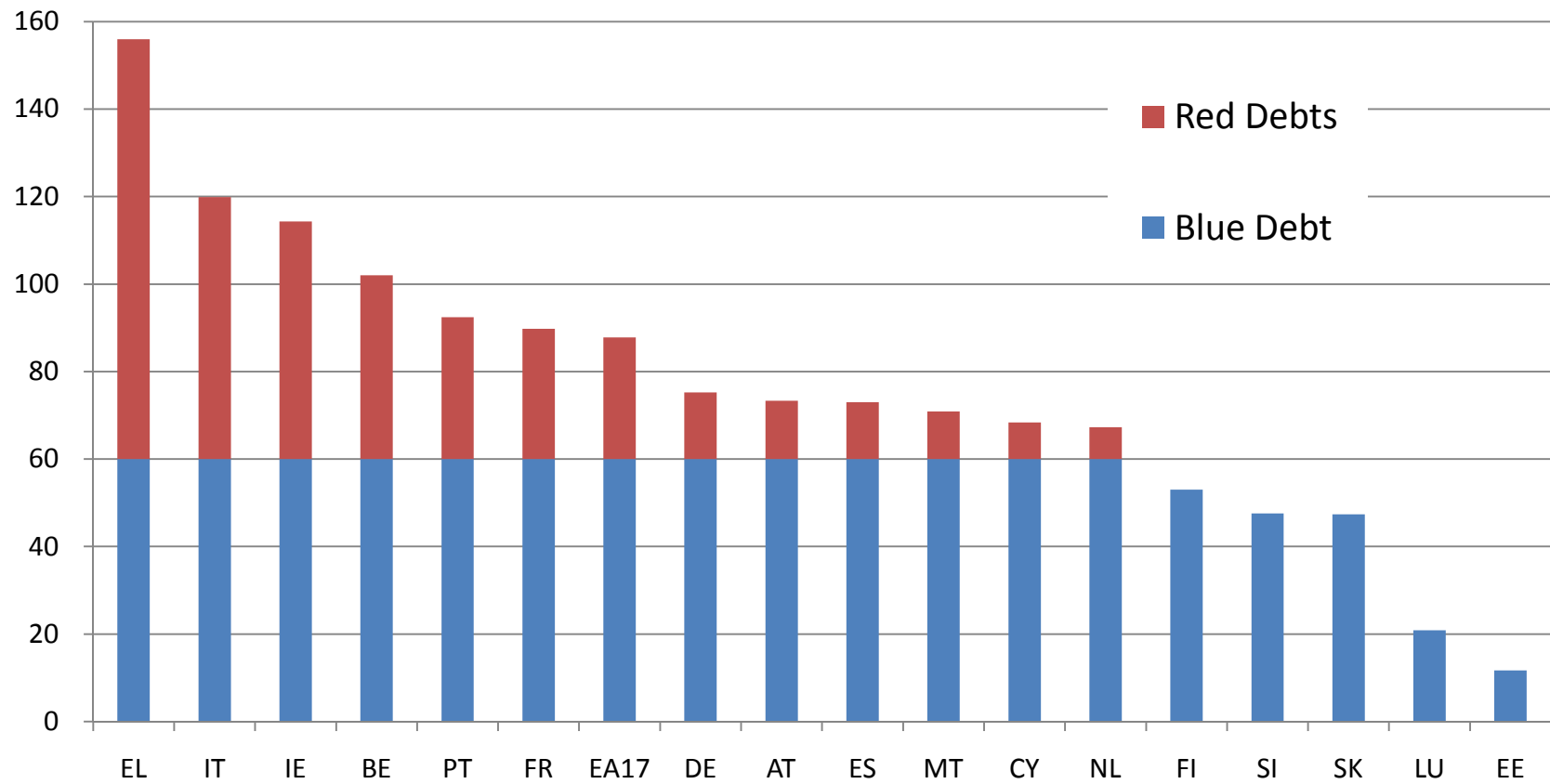
Debt level



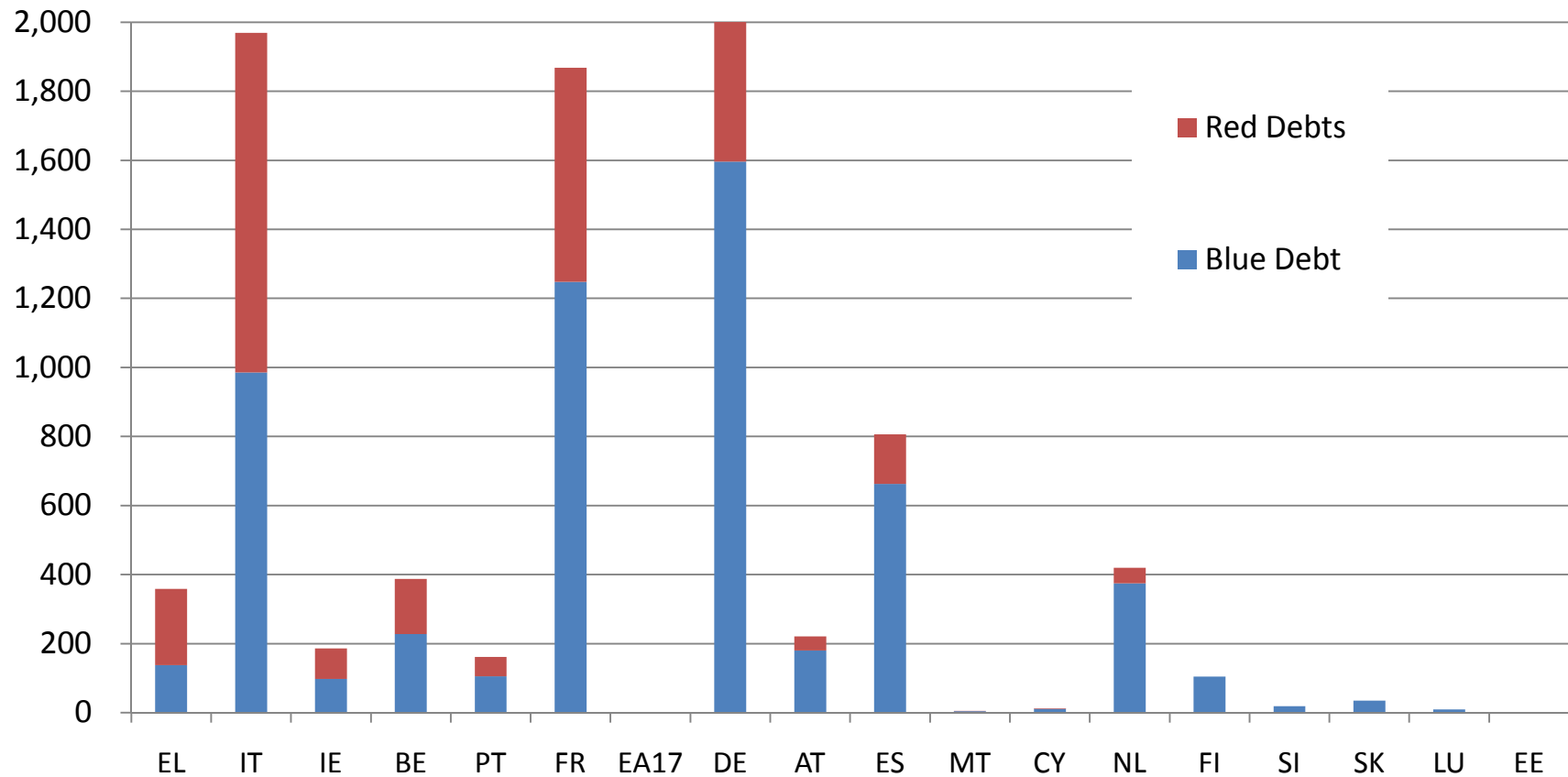
# What to gain for all Euro Area: International liquidity

- World Hunger from emerging mkts, insurers, central banks... of assets:
- **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 (2012)



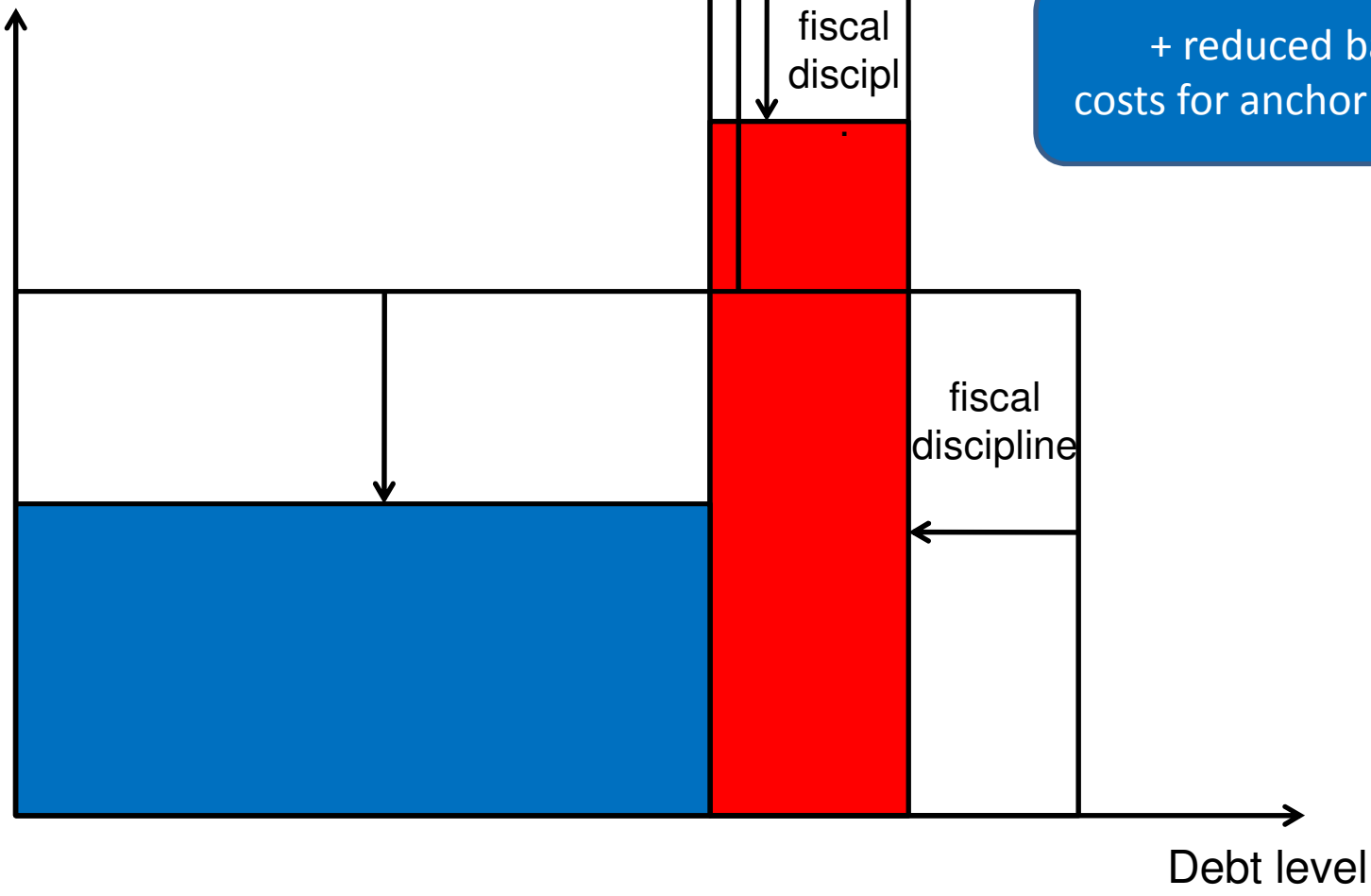
# Blue bond and Red bonds (EUR billion)



# 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





# 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

11/05/2011

Blue & Red Bonds

# 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