Peterson Institute for International Economics

Olivier Blanchard on Eurobonds and optimism for Europe's future

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[00:00:14.02] - Anjali Bhatt

Hi, and welcome to PIIE Insider Live. I'm Anjali Bhatt, Communications Manager and Research Fellow here at the Peterson Institute for International Economics. I often say that one of the best parts of my job is that I can just walk into the offices of some of the world's top economists and just ask them anything and they answer. So with PIIE Insider Live, you're coming with me to ask those questions and get those answers. And today is a special episode, not only just because of our guest, but also because it's spring meetings here at PIIE. We've got a ton of events all week long on everything from AI to trade to the role of the dollar to even more on eurobonds and finances in Europe. You can check it all out and tune in all week at pia.com/events. Spring-meetings. All right, so today we're speaking with Olivier Blanchard, who needs no introduction, but anyway, is a senior fellow here at the Peterson Institute, the Robert Zeller Professor of Economics Emeritus at the Massachusetts Institute of Technology, and was the chief economist at the International Monetary Fund. Before we start, if you're watching on Zoom, feel free to put your questions in the Q&A box.

[00:01:17.28]

So, hi, Olivier, good to see you again.

[00:01:20.06] - Olivier Blanchard

Nice to be here.

[00:01:21.22] - Anjali Bhatt

Okay, so we could use a little optimism right now, I think. Broadly, how are you feeling and what sort of optimism do you think there is for Europe's future?

[00:01:33.14] - Olivier Blanchard

So I think one can be reasonably optimistic. Reasonably is important here. I mean, even if you look at where Europe is today, it's not so bad. I mean, it is probably the most sane place in the world at this point. All the countries in the EU, but more generally in Europe, are democracies. All the countries believe in the rule of law. All the countries respect human rights. The quality of life by any survey is high. When I see surveys which show that, you know, the income per capita is higher in West Virginia than in France, I have tested it. I can tell you that's not true. The GDP numbers may be correct, but the quality of life is not. Life expectancy is longer. I mean, you can go through— so, you know, not bad is the starting point. So we should not self-flagellate too much. Could we do better? Almost, almost surely. You know, forget Trump, and we have problems which date to pre-Trump. On the political side, populism has been on the rise. One may hope that it has peaked, but it's not completely obvious. There were good news clearly this week, but we can't be sure.

[00:02:58.28]

That's an issue. On the economic front, we are fairly rich, but our productivity growth is lower than the US. There's a lot of discussions about the numbers, but I think the reality is that we're not doing quite as well as the US. So, you know, these are the issues that we have to handle. I think Trump has been a blessing in the sense that it has forced us to think of ourselves as a force, as a unit, and think about how we respond to the challenges. And, you know, there's this old sentence by Jean Monnet, who was the creator of the European Union, which is that Europe basically progresses through crisis. So Germany reunification created very strong tensions between countries and led to the creation of the euro. The global financial crisis led to the creation of various institutions. ESM and all kinds of acronyms, but, you know, making things better. COVID led to basically NextGen and common finance. So we are there again, and again, that's largely due to Trump. Without Trump, we might just not do much. Can we, can we do things? Yeah, I think we can do things on, on two fronts.

[00:04:29.06]

I mean, on the On the economic front, we clearly have to take care of the internal market, take care of lack of research in some dimensions, but there is action. There is something called— I'm just going to take an example, we may go into issues more later— there's something called the 28th regime, which is that we have 27 countries with 27 different sets of laws, and that complicates life enormously. So the idea would be to have the 28th one, which people or firms can basically decide to adopt, which would simplify life. And we've started to make progress. We just came out with a document which actually goes somewhere in that direction. So there are things happening. On the political front, Orbán is gone, but we should not be kidding ourselves. Populism is not gone, and there are going to be countries once in a while which are going to elect somebody that is not— is populist but is not pro-Europe and may, if it stays in Europe, kind of paralyze things the way we saw, you know, Orbán paralyze the loan to Ukraine. And I think we have to think very hard about how we function in a union in which some of the members sometimes do not behave.

[00:05:57.03]

So we have to rethink things like unanimity rules. We have to think about this expression that you may have heard, coalitions of the willing, which is if there are less than 27 members which want to do something, they can do it even if the others don't like it. But defining what this means in practice is very complex. But, and the bottom line is You know, we're not in a bad place and there is movement, there is desire, and we'll see what happens. So reasonably optimistic fits the bill.

[00:06:31.23] - Anjali Bhatt

Reasonably optimistic. I like that. Okay, well, there was a lot there, but I'm going to focus on what you said about how Europe has moved forward out of crises. So we're in a crisis moment right now, you said, largely because of Trump. And most immediately, I mean, we have to talk about the Iran war that is, you know, really dominating the conversation at the Bank Fund meetings as well. So, I mean, it's been over a month now. We're a week, I guess, into a supposed 2-week ceasefire. There's apparently both an Iranian and an American blockade of the Strait of Hormuz. None of us really know how this is going to end. But for now, it seems that for Europe, the main impact is on oil and gas imports. It'll probably stay that way, right? Like Europe probably won't get involved militarily?

[00:07:27.13] - Olivier Blanchard

No. Okay. Short answer, no. But I think the main effect will come to gas and oil prices. The main effect is to make very clear that Europe cannot count on the US. I think that relation is broken. But broken in a deep way, which is even if your next president is a good guy, and that happens sometimes, we'll say, ah, this is a country which has, you know, elected Trump once, twice, and it could happen again. So I think the notion that we have to be on our own was there before the Iran War. I mean, it has been there since Trump has been elected, but this has made it much stronger in terms of defense and other issues. So this is kind of a meta result. But yes, I mean, gas and oil prices are the short-run issue, obviously.

[00:08:25.08] - Anjali Bhatt

Yeah. So I mean, oil and gas prices, I guess, are going up in Europe. Can— I mean, they've already seen this once sort of in 2022 when Russia invaded Ukraine and there was a spike in energy prices then. How much longer can the member states handle this sort of disruption, and what are they doing now to mitigate the price rises?

[00:08:48.21] - Olivier Blanchard

So that depends very much on the outcome, which is, you know, is this something which will— will the price of oil return to a pre-crisis level anytime soon? The answer is surely not anytime soon, but there's still the issue of whether it's 3 months, 6 months, or not. And I mean, the State governments are not in the business of adjusting to relative prices, and relative prices change all the time. But this one is both from kind of a human dimension and a political dimension, a fairly hot one. So the question is, what do we do? And conceptually, if the world was not what it is but what it should be, You know, this increase in the price of oil is very much an increase in the rents of production firms, some of them Middle Eastern, but some of them French, Total, and taken away from the people who drive and need to drive to get to work. So, and you know, the oil companies or the production side didn't do anything to get there. I mean, Trump did it for them, so they don't deserve these rents and they could be taken away. But the issue is that the rents are declared as profits, not in France but in the countries in which oil is extracted at best, and sometimes it appears in Cayman Islands or other places.

[00:10:17.13]

And so it's very difficult for the government to tax the firms. There's some margin and some firms are willing to basically help. So Total, for example, has limited the increase in the prices of gas at the pump. The issue is everybody, the other companies have not. So there has been very long lines at the Total stations, and now Total doesn't have oil to sell anymore, and the prices are higher elsewhere. So there is an issue. So we were confronted with this, you know, recently, and then the governments were fairly generous. They decided to help the people. But it turned out that it was difficult to help the right people. And so we took measures which basically made, you know, gas cheaper for everybody, including people who could afford it. And it cost 2, 3% of GDP. And we are, you know, in a situation in some countries where increasing the deficit by say 1% for a year or 2% for a year is really not an issue. In my country, We already have a large deficit that we have to take care of. So the margin is very limited. Can we do something? I suspect that we can probably target better.

[00:11:31.25]

So help the people who really need that, you know, the Uber drivers and the nurses who need to get their car to get to the patients. So there's going to be some, I think, and it's going to vary country by country. It may not be enough from a human point of view. Sad. From a political point of view, this is a very explosive issue. So you have obviously the most populist parties saying we have to help people, the government is not helping. But at this stage, I don't expect, you know, a major effort by governments to limit the increase in the price. The hope is that in 6 months we are back to not quite normal but something acceptable.

[00:12:16.01] - Anjali Bhatt

We'll see. And if governments were to do something with gas prices, it would have to be at the member state level. There's no way, there's no sort of mechanism.

[00:12:25.09] - Olivier Blanchard

This is very much a member state issue. There's no particular reason. It's not as if people are going to arbitrage between getting— well, I suspect at the border sometimes, you know, you know, a story of cigarettes and taxes on cigarettes, which is people driving over the border to buy cigarettes. No, in this case, basically the price of gas is the price of gas. The decisions of the or whatever they are. So governments are going to do different things. Those which can, those which are in a better fiscal position can do more, may or may not want to do it. Some are very limited.

[00:13:01.26] - Anjali Bhatt

Okay, so what—

[00:13:02.11] - Olivier Blanchard

But I think that's part of a bigger principle, which is anything which has to be done, which can be done at the national level, should be done at the national level. And we really have to think about what needs to be done at the Brussels level. So defense is an obvious issue in which Brussels has to be involved for at least coordination, but the price of gas, no, it's a national issue.

[00:13:24.16] - Anjali Bhatt

That was a great segue to my next question, which, you know, the EU, like you said, is 27 countries, you know, working together, their national governments working together in Brussels. That's a lot of coordination. That's a lot of action and coordination to happen between a lot of people and a lot of different ideologies and goals and interests. How, I mean, you know, you could write many books on this, but you know—

[00:13:51.15] - Olivier Blanchard

Books have been written.

[00:13:52.16] - Anjali Bhatt

Many books have been written.

[00:13:53.08] - Olivier Blanchard

Books are being written.

[00:13:53.27] - Anjali Bhatt

Yes. You know, what makes the EU work? I mean, this is the largest, you know, sort of political experiment the world has ever seen, and it mostly works.

[00:14:03.03] - Olivier Blanchard

So we have common values. That's what kind of, you know, makes us stay together, and we largely agree on most things. But it is true, it's 27 countries, each of them with a long history. Each of them with a different view of what the government should do. So it is in the nature of things that discussions in Brussels are going to be difficult on any issue. And I worry a bit— this is related to other panels you have this week— which is in a world in which things are going to happen right and left, AI implications and so on, It is not going to happen that Brussels— I take Brussels as, you know, the Commission— is going to be able to react right away. There is a process. So we have to accept the fact that that's fundamental and that complicates things and that's an issue. I think the main issue is populism, which is, you know, an issue which goes beyond Europe but is affecting us. And clearly, if populism is strong enough that we have populist governments, then there is an issue about agreeing on basic principles, right? Illiberal democracy, for example, is an example of something that is not acceptable to the large majority of people.

[00:15:30.14]

To give you a statistic, which I think I have to change, I used to say until the election Sunday that there were 9 countries of 27 where a populist party is either in charge or more likely part of a coalition or supports the government. 9 of 27. Now it's 8 for the time being. But, you know, I think we have to be ready for the fact that it will happen again. And Mr. Fico in Slovakia is marginal there. So far he behaves, but he could decide to be an Orbán. So This raises, I think, two sets of issues. The first one is how we fight populism. I mean, it really comes from the bottom. Many people have concluded that the center parties or the governing parties are not doing the right job and we have to look for extremes. I think in most countries it's really on the right. In France, we happen to be lucky and have it on both sides. But the extreme left is, I think, not a main player. But we have to address, you know, what's behind this. This is a much bigger issue. But it's clear that the center parties have been too naive and too generous in a way on immigration.

[00:16:52.11]

That's obvious. I mean, it was seen as, you know, the natural extension of human rights. People suffer in the world, and they do. We are rich. We should be willing to open the door, and we did. And the issue is not so much economic, it's cultural, and we've gotten to the limit or beyond the limit. So I think that, you know, basically the central parties have to do something. On trade, same thing. I think there was this, you know, Washington consensus view, which is trade is good on net, everybody benefits, but yeah, there are some losers, but you know, too bad, we'll try to help them. And that has turned out everywhere not to be the right approach. The losers are very hard to compensate, they suffer very much. And in the US they elect Trump, in France they go in the streets. So again, on trade, you know, there was this issue of Mercosur. Mercosur is probably a very good thing, but it is clear that although it's benefiting all kinds of sectors, it is not benefiting all of them., and the farmers in particular think that, that, you know, this increases the competition in ways which are not the right ones.

[00:18:06.08]

I think we have to take this into account. Yes, the ideal thing would be to do it and compensate, but the reality is we're not going to be able to do it. So I think on these two things, we basically have to make sure that populism doesn't rise. But that's very much a national program. At the EU level, you know, today we're happy Mr. Macron is willing to go to Brussels and negotiate, and everything will be fine, I think. But there'll be another Orban, you know. In France, there's a risk. There is a risk that the center does not coalesce to one or two candidates, and then we basically get Mr. Bardella elected, which would not be very good. So there, the issue is, can we function, you know, even if some members are not willing to go along? So we have very tough unanimity rules, which—

[00:19:07.29] - Anjali Bhatt

And so that means that—

[00:19:10.01] - Olivier Blanchard

Everybody has to agree to a decision for the decision to happen. So this is what happened with the loan to Ukraine., right? Basically, there was a number of steps, uh, which basically went by qualified majority. We had it, step 1, step 2, step 3. There needed to be unanimity to be able to finance it the way we had, and Orbán said no. And this is an example. There are many dimensions in which unanimity applies, and we can keep it. At the same time, there are some fairly major decisions where can we really impose on a country something that they don't want. So I think there we have to rethink, I would say, the geometry of Europe, the rules. And my vision there is very much that Brussels stays, but there's a lot of things which are done by coalitions of the willing. Basically a group of countries which decides that on global warming they are going to have, say, carbon tax and a carbon border tax, or you can take other examples. And then the other countries are out, both out of the decision and possibly out of the financing, so they cannot object. At this stage, we don't have that architecture, and I think we have to do it.

[00:20:33.27]

It's doable. It's never going to be very smooth, but that's the strength and the weakness of Europe. It's a rich set of countries with different views.

[00:20:49.18] - Anjali Bhatt

So let's talk about Hungary for a second because I know that was a big deal over the weekend. So Viktor Orbán, the, you know, far, far right, President or prime minister? President. Leader.

[00:21:05.02] - Olivier Blanchard

I should know.

[00:21:05.23] - Anjali Bhatt

You're right. Was defeated. And so now we have— President. And so now we have Peter Magyar, the center-right. So it's not like this was a massive sort of reshuffling that the pendulum didn't swing all the way the other way. But this is like you were saying with the Ukraine loan. This is good for things like that, right? In theory, now Hungary won't be the the main blockage to some of these policies like financing aid to Ukraine.

[00:21:34.12] - Olivier Blanchard

Mm-hmm. Yes.

[00:21:35.29] - Anjali Bhatt

And so that's, I mean, that's the thing. But like you said, populism isn't necessarily going anywhere. Even if, you know, it didn't prevail in Hungary, it's still existing elsewhere. How are sort of the, you know, why did it happen in Hungary now and sort of not other places? Was there something special here, or?

[00:22:00.23] - Olivier Blanchard

So, you know, there's always— the events are always the result of some forces behind and some noise which makes a candidate. And here I'm going to go into anecdote, but I knew young Orbán, and so many, many decades ago. I was basically invited with Jeff Sachs to meet young Orbán, and he was kind of a young, new young thing, good, smart, intelligent, good ideas, wanting to reform. And, you know, he changed over time, but it's not, it's not as if he came kind of being the awful guy that he ended up being. So one would have to go back and see. I think it was more or less a continuum from the young, nice Orbán to where we ended up, where the ugly old one at the end. I think when he was elected, people did not elect a guy who was going to be corrupt and so on and so on. And I think he basically— so there's an accident part, you know, it's same thing in the US, which is, yes, I mean, there is an anti-elite, there is a rejection of the Democratic Party and so on, but Trump is very much 3 standard deviations beyond what could have been predicted at the beginning, you know, on the election of somebody trying to reflect popular opinion.

[00:23:28.10]

So it can happen. In France, you know, we have, as you know, on the right, but we have two candidates. One is well known, is Marine Le Pen, but it's very unlikely she'll be allowed to run because of legal issues. And we have this young man who looks like, you know, if you had a daughter to marry, you'd want him to use nice, big eyes and so on. But, you know, this might be enough to get him to get 5% more. And if the center has 5 candidates, then at the end of the first round, he's ahead and he wins the second round. These things can happen.. And we cannot just wait for them to happen and say, ah, now what do we do? And, you know, I think we have Meloni in Italy. Meloni has turned out to be more reasonable, I think, than most people expected. Some of it probably has to do with the fact that the EU is giving a lot of money to Italy, but maybe more. Maybe she has decided to be And even if I would go even one step further, the extreme right in France is not the old fascist anti-Semitic right.

[00:24:43.16]

It's kind of anti-immigration populist, but it is not, you know, there was a graph recently of extreme right parties. They now come in all kinds of forms, and they have understood, for many of them, that trying to look decent, reasonable, kind of center-like is probably the way for them to go. So it's really a continuum. And when you have that, then the probability that they win and then somebody turns out to be worse than expected is there. There might be deeper issues in Hungary, but that's what I would say.

[00:25:22.28] - Anjali Bhatt

Okay, so we did have Eurobonds in the title of this event, so we do have to turn there. Okay. And I know you have an event on Thursday morning that's going much, much deeper into this, so everyone should watch that. It's at 9 AM on Thursday. But for the rest of us who don't necessarily know as much as they should, what is a Eurobond? Okay.

[00:25:45.22] - Olivier Blanchard

I'm not sure you should know it.

[00:25:48.26] - Anjali Bhatt

And why should it exist?

[00:25:51.17] - Olivier Blanchard

So it's actually fairly simple. We have in Europe a financial system in euros. Which uses for the most part as a safe asset the dollar, US Treasuries. That really doesn't make any sense to think of a whole tower, right, which is a financial system based on something which is in a different currency. So when the dollar-euro exchange rate changes, you know, the value of the assets change. I mean, this doesn't make any sense. Why is this? Well, it's because the US Treasury market is an enormous market, right? I mean, thanks to the fact that the debt in the US is very high, you know, it's about $30 trillion, maybe a bit more even, right? Where in Europe what we have is basically national markets, right? So we have a Bund market in Germany, we have the OAT market in France, and so on and so on. These are small markets and are very small relative to the US. So there are some already Euro bond markets, but they're very, very small. They are on the order of 300 billion, which, you know, in that world is a small number compared to 30 trillion. And the issue with that is that why is it that people go to the US?

[00:27:13.02]

It's because if you want to buy or sell say 200 million like that. You know, if you go to the grocery store and try to do it, it's going to be difficult. But it's the same thing with the Bund market or the OAT market. These are relatively small. You need a big liquid market. And so the idea is to create that. And so there are two ways of doing it. And let me, let me go short because you may have other questions. The, uh, you can basically deficit finance some of the spending, say, on defense, and then you issue bonds. But that's a very slow process, right? And basically, suppose that, you know, you do 1% of GDP, right? Then to get to anything large enough is going to take 2 decades. So the other way, which is what I'm arguing for with my friend Enrico Lubide, is a swap in which basically we replace 25% of GDP of national bonds by euro bonds issued by the EU itself. I'm not going to go into details, but conceptually it's very simple. Basically, you haven't changed the total debt, but you've changed the nature of it, and some of it is basically, you know, a large deep market.

[00:28:28.17]

And if we did this, this would create a market of about €5 trillion. €5 trillion is less than €30 trillion, but it's It's a beginning as these things go. So this is the project. I think it's doable. I think it's a low-hanging fruit. There are many complex things to do. This is relatively simple. So I'm pushing. Whether it happens or not, we'll see.

[00:28:48.28] - Anjali Bhatt

We'll find out on Thursday.

[00:28:50.18] - Olivier Blanchard

No.

[00:28:51.12] - Anjali Bhatt

Okay, well, we're almost out of time, but we have gone this far without really discussing the EU-US relationship, and now I have to bring it up. Okay. Especially so, you know, we've talked about how the EU has, especially with the Iran war, but, you know, especially since the start of the second Trump presidency, the EU has been losing trust in the US and understanding that, you know, it has to sort of go its own way. What does that mean for the EU-China relationship?

[00:29:25.05] - Olivier Blanchard

Okay, you got it right. Which is, I mean, you know, Trump has put tariffs on Europe, but this has been a nuisance but not a catastrophe. The issue is that he has put high tariffs on China and China has a growth model which is based largely on exports. So if they can't export to the US, well, they look around and they can export more to emerging markets, which they are doing, but they want to export more to Europe. And the issue is, given the exchange rate, are incredibly competitive, and a lot of European manufacturing is basically not competitive at those prices. So what happens next is tensions. And I think that's kind of, you know, the indirect effect of Trump. But the result of Trump is that he's going to create tensions between Europe and China. I think it's absolutely essential that we don't take one side. We're not on the US side or the Chinese side, but we sit down with the Chinese and we tell them that that we cannot allow them to freely export. I suspect it's going to come with tariffs. I hope that, you know, the outcome is reasonable, but that's a source of tensions.

[00:30:38.06] - Anjali Bhatt

Okay, well, okay, so let's wrap up here. We covered a lot of ground there, but in the next sort of 3 to 6 months in Europe, what will you be watching for?

[00:30:50.17] - Olivier Blanchard

Well, I'll be looking around everywhere, but I return to a theme at the beginning, which is I think Europe is at the point where it can do things and has the incentives to do it. So I'm going to look very closely at all the initiatives that are explored and even implemented, but to try to make, you know, Europe even stronger. Place. And there are many projects. I have a big one on Europe 2050 with Pascal Lamy and Enrico Letta, and that's what I'm going to be focused on, that we make progress. We think about how can we basically kind of, poof, you know, protect us against the things that we have talked about for the last half hour.

[00:31:38.25] - Anjali Bhatt

Okay, well, that was a perfect dose of reasonable optimism.

[00:31:43.02] - Olivier Blanchard

Good.

[00:31:43.14] - Anjali Bhatt

Thank you, Olivier.

[00:31:44.15] - Olivier Blanchard

Good.

[00:31:44.25] - Anjali Bhatt

And thanks to all of you for joining us for this edition of PIIE Insider Live. What did you think? What do you want to see next? Let us know at meetings@piie.com. And if you're not already, subscribe to PIIE Insider, the newsletter, at pia.com/subscribe. And make sure to check out all of our other spring meetings, like Olivier on the future of economic architecture of the eurozone on April 16th at 9:00 AM Eastern. Thanks again to Olivier, and thanks to all of you for joining us. The next Insider Live will be with Warwick McKibbin on April 23rd.