Peterson Institute for International Economics

The future economic architecture of the eurozone

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[00:00:22.53] - Adam Posen

Good morning, everyone, and welcome back to the Peterson Institute for International Economics. We're here in the midst of our exciting programming for the spring meetings. I'm Adam and the Institute's president. And we have an appropriately full house in person and I'm sure a very full house online for today's discussion of the future economic architecture of the eurozone. The European monetary project, the European project in general is continually, repeatedly underestimated. The sense of disappointment versus what it could be is real, but the sense of disappointment is exaggerated. And particularly in Anglophone places, the US and UK, which happen to have an outside voice in markets for good reason, the discounting of European, adaptation, progress, and even movements towards greater unity tends to be excessive in my view. That doesn't mean that we are European cheerleaders here at the Peterson Institute, but it means I think we provide a fair and evidence-based objective counterweight to some of the excessive undervaluation of Europe, and we're proud to do that. As part of our general attempt to be reality-based and honest in the world. And I'm very proud of the fact that with many colleagues in this room and around the world, including of course Olivier Blanchard speaking on the program, Ángel Ubide, who was a fellow here and remains in close contact, Patrick Conahan, Jean Pisani-Ferry, and numerous others, we bring the best of Europe to Washington and New York and to the broader world in terms of honest analysis.

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It is in that spirit that we offer today's event. We are very pleased to have with us Spanish First Vice President, newly Spanish First Vice President, congratulations, and Finance Minister Carlos Cuervo Caballero. As well as ECB Executive Board member Isabel Schnabel to speak today on this broad topic, but each taking their own point. I will briefly introduce each of our speakers in order and then yield the stage to them. The final point I would say, again, I think as a matter of fact, not hype, is in the 17, 18 years since the global financial crisis and subsequent eurozone crisis, Spain has undergone a remarkable transformation and leap forward. It is showing extraordinary leadership in a number of areas, including energy, handling of migration, economic policy, and more controversially in some areas of foreign policy, including relations with NATO and the US. But it shows, I think, well, not just for Spain, but for Europe, that you can have a set of democratic entities and market economies that leadership circulates and agendas change over time. One is not locked into where one was 15 years ago. And I think that most of all speaks well for the European Union.

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So we will start with remarks by the Minister, Cuervo Caballero, and then by Isabel Schnabel. And I have just been informed they keep switching. The order will be Blanchard and then Ubide. Okay, fine. We're flexible too. We can adapt who's on top. So anyway, Carlos Coipo Caballero is Minister of Economy, Trade and Business since December '23 and First Vice President of the government since March last month. He is responsible for design and implementation of economic and trade policies in continental Europe's fourth largest economy. He previously held senior positions within the ministry as Secretary General of the Spanish Treasury and as Director General for Macroeconomic Analysis So he is an economic nerd like us. We like that. He holds a PhD in economics from Università Autonoma di Madrid, master's from LSE, and continues to try to bring economic analysis and political savvy to one. Isabel Schnabel, as previously mentioned, is a longtime friend of the Institute and has been a member of the executive board of the European Central Bank since 2020. She's responsible for market operations, research, and statistics. She's been on leave for a while from the University of Bonn, where she had been professor of financial economics since 2015.

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She also, prior to joining the ECB Governing Council— excuse me, Executive Board— was a member of the German Council of Economic Experts and served as co-chair of the Franco-German Council of Economic Experts, holds a PhD in economics at the University of Mannheim and has done incredibly relevant research on financial stability, central banking, international capital flows, all of which informs her thinking these days. Olivier Blanchard is a senior fellow and previously the inaugural Siegfried Bergsten Senior Fellow here at the Peterson Institute. He's also, of course, the Robert M. Solo Professor of Economics emeritus at the Massachusetts Institute of Technology. He spent most of his professional life in the United States and just in time figured out that it was better to live in France than in the United States a few years ago. I'm proud that he was the third reader on my dissertation and actually let me through. So that was good. Of course, he and Stanley Fischer wrote the primary graduate macroeconomics textbook from which all of us learned, and he served with distinction as the chief economist and director of the research department at the International Monetary Fund. And finally, our colleague Ángel

Obide is managing director and head of economic research for global fixed income and macro at Citadel.

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He's worked for almost two decades in the financial services industry, including at Tudor Investment, at the D.E. Shaw Group, and Goldman Sachs. He was a senior fellow here at Peterson, both full and part-time, from 2009 to '16, and he published with us a fascinating book, The Paradox of Risk, which is highly relevant to this day. He continues to be a member of the Advisory Council on Economic Affairs of the Spanish government, of the Euro 50 group, and the Economic Club of New York. He has a PhD from the European University Institute in Florence and writes a relatively influential column for Spanish newspaper. So thank you all very much. Thank you for your patience with my introduction. It is heartfelt that we wish to take stock of proposals, including but not limited to eurobonds, for fundamental change in the eurozone's macroeconomic architecture and where we can go from here. So please, Minister.

[00:08:34.53] - Carlos Cuerpo Caballero

Well, thank you. Thank you for your kind words, not only in your introduction, but also about Spain and our current situation. So, you know, it kind of led me to talk about Spain, but I will have to refrain in today's context. It's actually an honor to be here. And to have the opportunity to talk also not only about this very important topic, but with very distinguished colleagues. You know, I think we could all agree that we're living through times of crisis. I could have said this last year, 2 years ago, 3 years ago, pretty much over the past 15 years. But these times of crisis do generally lead to important breakthroughs. And we know a lot about that in Europe, in the European Union. Actually, I was glad to go through the most read papers last year here at the Peterson Institute, and I saw that when you look at the 10 most read papers, 9 of them were papers about trade policy, US trade policy, increases in tariffs. Then there was one of them, an outlier, about safe assets and potential eurobonds. I think Blanchard-Ubbide paper was a great contribution for all of us.

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I think it has led to open the conversation about this important topic in Europe, a general conversation about the safe asset element and how it is a key development that we need. And this is how I would try to put it today, that we need as one of the drivers towards greater integration in Europe. So let me first frame the discussion, because for me the discussion should be framed around the costs of fragmentation. We know a lot about that in the European Union. There is a fully-fledged paper by Enrico Letta on the internal market and how to go about reducing these 27 member states' fragmentation, reducing the potential costs around it. And he has, I think, very nice proposals like the Regime 28, which can lead to important breakthroughs in Europe. So we need to address these costs of fragmentation, of course, in the search for efficiency gains. And I think this general opening also applies to the discussion that we will have today. Efficiency gains in how we conduct the issuance of sovereign debt in Europe. Efficiency gains that do not actually necessarily lead to an increase in the overall level of debt. I want to set that right since the onset.

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So we're not— we're getting away from the original discussion that we might have had a few years ago mutualization of debt or risk sharing, we're talking about something else. Let me just be maybe a bit more specific on what are the origins of these costs, of these inefficiency costs around fragmentation on sovereign debt issuance. We have to look at the size and of course the depth of sovereign markets. I think we all know in this room that liquidity, of course, and scale are key for our sovereigns, for our treasuries. And we just have to have a look at the numbers. So the outstanding issuance from the European Commission is €750 billion, €750 billion. US outstanding, $40 trillion. I think that that should settle since the onset of the discussion. But when you look, for example, at the daily turnovers in the US market, They're above the outstanding stock from the European Commission. So we're talking about daily turnovers of above €800 million. This is more than the outstanding stock, again, which is around €750 billion from the European Commission. So of course, that implies that the European Commission issuance is not considered as a sovereign issuer, and therefore we're bearing higher costs than it should be the case for a AAA like the European Commission, which is not considered— or which issuances— whose issuances are not considered considered a safe asset.

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So how to achieve these efficiency gains? Of course, it's a matter of designing the best way to go about this joint issuance of debt in the eurozone, in Europe, in the European Union. So we have to, as I said before, overcome the traditional discussion, which is politically costly as well, around risk sharing, around mutualization of debt. And I think the breakthrough paper from Olivier and Ángel already walked us a lot along this path because it really puts the finger where it should, which is on how to design the perfect way to increase efficiency in how we conduct sovereign debt issuance in Europe. So you were the first to walk the talk, and now we're trying to, of course, be able to set the pace and focus on these important elements. So from our perspective, I won't go into your proposal because I will leave it to you both to discuss the details. But from our perspective, trying to instill a bit of political economy element also into how to go about increasing the size of euro-denominated debt from the— issued by the European

Commission. So what we will be proposing from the Spanish perspective is to have a forward-looking approach.

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Forward-looking approach in which the Commission could actually issue on behalf of member states a specific share, a certain amount. For example, we could be thinking of about one-third of yearly redemptions and also the specific deficit that is allowed by European fiscal rules. If we just look at these two elements, that would mean— and you would allow me to give you a a nice way to— I hope a nice way to remember our proposal, which is the 5x5 rule, which is that in 5 years' time, with this specific setup, we could reach $5 trillion in jointly issued debt. So that would already, of course, walk us a long way towards having these safe assets in barely 5 years. And I said 5x5 because of course it's a back-of-the-envelope calculation, but the savings associated from the 5th year onwards along or to this specific increase in issuance would be around €25 billion on a yearly basis, which is grosso modo the interest costs of Next Generation EU. So that gives us a bit of perspective of how much we have to gain from really being efficient in how we conduct debt issuance in the in Europe. I repeat, in 5 years' time, we would have a €5 trillion denominated market issued by the European Commission, which would imply €25 billion in savings on an annual basis.

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So it just gives us the relevance of the discussion that we're having today. Of course, then the design of the way to go about this proposal needs to include the proper incentives for all countries to participate. We would have, of course, a cost compensation mechanism for those countries that actually now issue at lower costs than the Commission, so that nobody actually loses in this trade. Of course, also, we would have to ensure that the existing— that there is, of course, full fungibility with existing EU bonds, dual guarantees, not only national but also at the EU level. Again, this is a matter of setting up the proper structure of incentives, but that's a second or third layer discussion once we have— and I think we could all assume— really set up the economic case for these safe assets and joint issuance at the EU level. And there are more benefits than just savings in terms of interest costs. Of course, having a true or truly common yield curve for sovereigns would translate into a yield curve for corporates as well. So that would translate into lower costs for our firms. And that would also help the Draghi agenda.

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That would help the increase in financing and investment that is much needed at the European level. So unlocking financing, reducing the home bias also of our European banks, somehow contributing to the fully fledged European agenda. Reducing the costs of trade. And again, and now I can add the dimension of the European public goods. It could also contribute to the, of course, financing of European public goods. But that's another discussion, whether we want to go ahead with the bigger agenda of EU public goods and how to go about its financing or their financing. Just remember that last year, we were very quick in deciding that we needed common debt to finance defense and security. So we did set up the SAFE instrument, €150 billion in a matter of weeks, €150 billion issued by the European Commission. So there was no big discussion because we all understood that we needed to take that step towards increasing our investment in security and defense. So had we had— and I go back to my taxpayer argument, to my savings cost argument. Had we had this safe asset structure already in place, the savings from issuing these €150 billion would be around €8 billion.

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Again, it's an element of efficiency, a clear argument around saving taxpayers' money. So, and I will end now, basically reminding ourselves that the European Union, Europe, already has almost all the ingredients that are necessary for us to have a safe asset and for the euro to become a safe asset. We have strong institutions. We do have also resilient market infrastructure. We are one of the key players in terms of international trade, but we're lacking, of course, this collective form of credit that the world trusts. And this is a step that we need to take. We need an anchor. We need a safe asset. And for that, we need to increase the debt and liquidity of our sovereign jointly issued debt market. So I think we have an economic policy case, and we do also have a political economic case to go ahead with this. And there is an extraordinary window of opportunity now to push for this. We are negotiating also the medium-term financial framework at the European Union level. So this discussion, and I'm glad that we're having it today as well, needs to be pushed forward now more than ever. And of course, I will finish with this.

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For euro enthusiasts, we love cutoff dates. So why not put a specific date that would add also this political commitment and more credibility to what we're discussing? And I think the 2028 date is floating around. It was also part of the discussion from Olivier and Angel. Enrico Letta has also, of course, discussed the importance of the internal market by 2028. So we could all think about this as a new 1992 moment or a new euro moment for the European Union, because we all want, I think, to achieve the same goal, which is to have a strong Europe. And for this, we need to build, of course, and strengthen our main assets, and the euro is the main assets of the Europeans. Thank you very much.

[00:20:34.40] - Isabel Schnabel

Good morning, everybody. So thank you so much for having me on this panel, and thank you, Carlos, for kicking off the discussion. I myself, I'm not going to talk about eurobonds now, but I'm happy to comment a bit during the discussion. Actually, what I What I want to do in the few minutes that I have is that I would like to reflect a bit on the euro area's successes and about the euro area's challenges. And I would like to stress 3 successes, and I will lay out 3 challenges. So if you go back in time, like some 15 or 20 years ago, the euro area was mired in crisis. So we had the global financial crisis, we had the sovereign debt crisis. All of this was followed by recessions, by deleveraging, by weak growth. And if you look at the euro area situation now, I mean, what you see is that in spite of all the shocks that we've been facing over the past years, we have reached a state of macro stability, convergence, and financial stability. And I would like to go through these three points. So let me start with macro stability. So in spite of the massive surge in inflation that we have seen after the pandemic, the ECB has been able to bring inflation back to target before the war hit.

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And it's, it's really remarkable that this was possible without causing a recession or financial instability. And this is quite important also in the presence of the most recent shock, because this puts us in a relatively good starting position in order to deal with this shock. And what's also remarkable is that the economy has proven quite resilient to the recent shocks. And that was, of course, as you can see in the yellow line on the right-hand chart, supported by a very robust labor market. So the chart shows the unemployment rate in the euro area. And as you can see, this has come down, I mean, quite dramatically. And we are standing near all-time lows. The second important issue is convergence. So it's actually quite remarkable that in recent years we have not seen signs of fragmentation. And what I'm showing on the left-hand side is our indicators of financial integration. And I think it has gone a bit unnoticed that actually over the past years financial integration has gone up and it's now standing well above historical averages. So this is good news. And this is also reflected in the right-hand chart, which shows sovereign spreads, which as you can see, have come down dramatically.

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And you know, people have been talking about the recent rise in sovereign spreads. If you look at the left panel of the right-hand chart, you can see that this is not even visible in the chart if you take this kind of longer-term perspective. And you really need to zoom in to even see the increase in sovereign spreads that happened recently. I would also like to mention one point, which is quite important. So some people have said, yes, spreads have come down, but this had the price of kind of killing market discipline. And I would like to argue, and you can see that in the zoom-in window, that is not exactly true because when France was struggling with some fiscal issues, it's not the case that the spreads did not respond. But they did actually, and you can see it in the right panel, they did actually move up. So we still have market discipline in spite of this kind of narrowing, quite dramatic narrowing of spreads. And then third, on financial stability. So the euro area has not experienced any major financial disturbance over the past years. Not in the pandemic, and also not when the ECB raised interest rates by 450 basis points after a long period of very low rates.

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And the reason for that is strong regulation and strong supervision. So I think we can all agree that the euro area has developed in a very desirable way over the past years and that it has become more resilient. But of course, the euro area is facing challenges. And in my view, the biggest of such challenges is that it must foster economic growth. And as— and I believe there are kind of three interlinked goals that Europe should pursue, and these are integration, innovation, and sovereignty. So on integration, and Carlos already of course mentioned it, I mean, trade within the single market continues to be hampered by internal hurdles. And that is especially true for trade in services. And I mean, there have been analyses by the IMF, also by the ECB, showing that the internal hurdles are actually several times higher than the tariffs imposed by the US. What that means is that there is a huge potential from reducing such barriers, which could be an important growth— important source of economic growth. Second, the EU of course should also not— it does not give up on free trade. So the EU trade will benefit also from lowering external hurdles, so from concluding new free trade agreements.

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And actually, our analysis shows that this is also able to compensate for a reduction in trade with the United States. The second issue is innovation, and we all know that productivity growth hinges on innovation. And what is very important is that Europe must not once again miss the technological revolution that is currently unfolding in the area of AI. And the research shows that what is most important is that the available technologies are actually adopted. And when in the— what some people call the first digital revolution, Europe was struggling with that and to diffuse and adopt the technologies, and that must not happen again. Another area that is critically important is defense. If you look at the middle chart, you can see that historically the United States have spent a significant share, almost 20% of their defense spending on research and development, whereas for the euro area, that share is hardly visible. And we know that, I mean, given that so much money is now spent on defence,— that it would be a very wise decision to increase the share of R&D spending within defense, which could also then create spillovers to the broader economy. And then finally, on sovereignty.

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So Europe has over the years built a large number of dependencies which make us very vulnerable to the more frequent adverse supply-side shocks that we are experiencing in a more fragmented world. So Europe needs to reduce the dependencies, and one of the most important dependencies is on fossil energy. And so this is, of course, a very important area where we need to gain sovereignty. And finally, let me also mention an area which touches upon both innovation and sovereignty, which is dear to the ECB's hearts, which is payments. So the ECB has, as you may or may not be aware, embarked on a technological leap in payments. And our payment strategy has three very important elements. The first is the support of the development of a tokenized financial system by working on being able to provide tokenized central bank money settlement. The second is that we aim to reduce the reliance on foreign payment providers by offering a digital euro. And third, we are facilitating cross-border payments by interlinking our, our fast payment system internationally. So to conclude, major achievements have been made over the past 20 years, and now I believe we must focus on fostering potential growth, which is all the more important in line of demographic aging and the rising demands on the public budget.

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So thank you very much for your attention. I'm looking forward to the other presentations and the discussion.

[00:30:36.55] - Olivier Blanchard

So Isabel has covered a very large number of dimensions in which we have to think. I'm going to go back to a narrow one, namely, not surprisingly, eurobonds. I want to do two things. I want to briefly review the proposal that we have with Angel, but it is probably fairly well known, so I shall actually be fairly quick on that. But since we came out with this proposal, there has been a fairly strong pushback or series of objections and questions, and I want to spend some time dealing with them and trying to argue that they can be answered and solved. So to— on, on, on the logic motivation, the logic of a proposal. To caricature just very slightly, what we have in Europe is a whole financial system based on a safe asset in a different currency, more or less. No, I'm exaggerating, right? But it is clear that many of the European financial institutions not just European, but Europe in particular, basically rely on going to the US Treasury market in order to get the liquidity that they need. Now, from a conceptual point of view, the notion of building this enormous financial tower on something in another currency and with the exchange rate risk which comes with it is a bit surprising and clearly not not desirable.

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Now, why is it? Well, we all know what it is, and Carlos has said it, which is the reason you go to the US Treasury market is that it's a $40 trillion market potentially with a lot of depth, a lot of liquidity. You can sell and buy $100 million without changing the price, more or less, which you cannot do in in any other market where we are now on the side of Europe when the markets are not. I mean, the numbers seem small relative to the US, they are still large, but the bond market is about €2 trillion, the French OAT market is about €2.5 trillion. So these are very small markets. The markets for the existing EU bonds are even smaller. I think you gave the number, €750 So they just cannot compete. So it seems to me there is a prima facie case for, if we're thinking of sovereignty in the large sense, basically trying to solve that problem. So if we did this, not only would we avoid the exchange rate risk, but as Carlos said, we basically would probably have more liquidity and a lower interest rate, and this would save money.

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Now, there are two ways of going at it, and these are the ones which are discussed. And the main way are in the discussion is basically to rely on deficit finance of EU projects such as defense. And you basically— I think the argument for— and then basically issue these euro bonds. I don't think that that's a viable way of getting to a large euro bond market. It might be justified on other grounds. I mean, surely defense is justified. And maybe even deficit finance of defense is justified, although I'm not sure of that. But it is not going to achieve a goal, namely, if basically you— just to take an upper bound— have a deficit of 1% of EU GDP, then to get to a market of about $5 trillion would take about 20 years. I don't think the investors are willing to wait that long. There's a window now. So it seems to me that although I'm not against deficit finance and using eurobonds to finance them, I think that's just not the way. And this is what started the thinking with ENREL, which is, well, we have to basically get to a large stock quickly.

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Carlos has said 5 years. But this is kind of what we have to have in mind. And this clearly involves having a swap and basically creating a stock right away of some magnitude. So the proposal that we have with Andrew Hall is basically to retire up to 25% of GDP of national debt. Think of the EU buying them and retiring them. And issuing an equivalent amount of euro bonds, which would be basically replacing the 25%. So if we could do this, not overnight, but maybe over a few years, then we would start with a stock of about €5 trillion. And our discussions with investors is that, I mean, €5 trillion is not €40 trillion, but it is large enough that it would make a substantial difference and need firms. Financial firms to actually use it. So if we did this, then we would have a European safe asset. That's just the beginning in the sense that, as Carlos said, and once you have that, then you can have a forward curve, you can have repo, you can have the use of it as collateral. So it comes with it, but this is a necessary condition to actually get there.

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So let me now turn to the questions and the objections, and I've listed 5. I mean, I've In fact, I have about 30, but I'll just keep it at 5. The first one, which I think is probably the main one, which is, will the— I mean, this will create a market, but will this be a safe asset? And that goes to the issue of mutualization, risk sharing. We basically do not want to have mutualization. We do not want to have risk sharing, but we want the asset to be safe. Now, is there a way of doing this? One can never think that an asset is completely safe, but how can you get to a level of safety of, say, US Treasuries? It seems to me this implies organizing things at two levels. The first step, we think that the debt should be issued by the EU itself, not joint and several, not— surely not as just several. But it is basically a liability of the EU. And I think that's very important, both conceptually and from the point of view of rating agencies and so on. Now, the question is, where does the EU get the money?

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So, this is step 2. And here, there has to be a commitment by countries to actually pay the interest or the equivalent amount needed to pay the interest on that debt. So, this is the back office part. And that can be done by formal commitments. Now, is this a big issue? I'm not sure in the sense that the interest bill that the governments would have to actually provide to the EU is actually less than the interest they would save on the 25% of national debt which has disappeared. If we think that liquid markets are going to lead to lower interest rates, that's actually a net plus. Now, you can say, well, yes, but maybe the French are not going to pay no matter what the commitment is. But the sense here is, yes, nobody can be sure, but not paying your EU bills is basically a very costly proposition. If you look, for example, Greece, even in the worst of times, actually paid its dues. Now, it's true that it received much more in other ways, but it did. The UK, when it existed, basically paid everything it owed to the EU despite the fact that it was out.

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So my sense is, yes, there has to be some commitment to pay it, but I think that commitment is likely to be fairly credible. The second objection is, oh, this is going to open the door to deficit finance. And I think it's just the opposite because it delinks deficit finance from this proposal.

This proposal does not increase debt, just changes the nature of that, where the alternative actually is deficit finance in order to increase the stock. So I think from that point of view, that's probably an argument for using this if you don't like deficit finance. There is a more sophisticated argument, which is that this proposal goes through and works The average interest rate on the debt of a country, which is partly interest paid for EU bonds, partly interest rate paid on national bonds, would go down. But the marginal rate, the rate at which you would issue, would actually go up a bit because some of the risk has been moved away from the euro bond back to the national bond. So if anything, I think it would give incentives to actually be careful about deficits. Now, is this going to be enough to make France behave in terms of fiscal policy?

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That's a different issue which I'm not going to get into. The third issue is the set of legal issues, which is, can it be done? Does this violate either the Maastricht Treaty or the TFEU Treaty? And our answer, after having talked to a number of lawyers, is that no, because basically this is what was done for NextGen, and it has exactly the same characteristic. It is a liability of the EU. It doesn't contradict any of the aspects of the treaty. I don't want to get into specifics. There was a long discussion about Article 125, and it turns out that again, in the case of NextGen, it has been— all the courts, both the German court European courts have decided was fine. So I don't think that's an issue. The fourth issue is, well, how much lower would the interest rate be? That's a very relevant question for, say, the Germans who have a bond market which functions. It's not ideal, but it's there. And conceptually, it's clear that a deep liquid market would allow for a lower rate, and if it's larger than the bond market, it should basically have a lower rate. I think the honest truth is that when this is introduced, any new asset is looked at by investors as maybe.

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So it might well be, and I have to accept that, but at the beginning, it might be slightly above the bond rate and then eventually lower, which is one reason why the Germans might object to it. But I think the larger goal justifies it. The last question is— and that comes very much from the history, the legacy of the various proposals which had much more mutualization, much more risk sharing, which we really don't want to have, is this really complex financial engineering. And basically, it's incredibly simple conceptually, right? You basically buy the debt and you issue new debt. That's it. There is no complicated reorganization of claims otherwise. So, You know, there are other objections and some of them may come when in the Q&A part of a session. But we think it just makes sense. It's a low-hanging fruit. It's much easier than some aspects of a banking union. The capital union can be done, should be done, will be done. We'll see. Thank you.

[00:42:40.21] - Ángel Ubide

Good morning, and it's always a pleasure to be back with the Peterson family, so thank you, Adam, for the invitation, and it's also a pleasure to be in this great company, and I agree with everything that has been said. So my role here is a bit of being referee number one and talk about, you know, the other side of some of the things. I'm going to just make a brief comments on the international role of the euro. I want to start by giving you 4 statements that came to me in the last few weeks. The first one is when Iran said that you have to pay a toll through the Strait, and I'm quoting a Bloomberg story here. They said the toll would be paid either in yuan or stablecoins. And that means that they consider either the yuan or the dollar backing the stablecoins as the international currencies. The euro was missing in that statement. I'm not saying it's good or bad. I'm simply making a statement. The second one, I was in a big Asian country a few weeks ago, and I asked them, why do you buy gold for your reserves if you cannot buy anything with them?

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And the answer was, well, We cannot really buy euros because there are no euro bonds. And the ones that you have now are supranationals, not sovereigns. They are not in indices. And therefore, there is nothing we can do about that. The third one, somebody told me recently that every currency trades against the dollar. Some of them trade against the euro as well. But there isn't a single currency that trades only against the euro. And that makes me think that there is a difference in quality as far as the reserve nature of the currencies. And then the fourth one is that in a different discussion came the issue of how many countries does the ECB have swap lines with. And it came out that it's around 6, and I stand to be corrected if it's not true. And the PBOC has 42. Those are just statements and I'm not making any comment about them, but I think when you put them together, it tells you that the euro, while obviously having been a very big success, is more of a regional currency than an international currency today. Now, can the euro be an international currency? I think the simple answer, and working with Olivier, I've learned that at the end of the day, the simple stuff is what matters.

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Is if you offer what others want, then of course you can be an international currency. What are the three things that people want? They want a credible institutional structure, they want high returns on investment, they want liquid assets to buy. And I'm going to argue that the euro today has the first one and has a fair amount of work to do on the other two. So I want to say this very clearly. There is a tremendous amount of interest in Europe today. And I'm listing there just a few things, right? Iceland is going to have a referendum on joining the euro this summer. The UK has rediscovered the beauty of the European Union. Sweden, Norway, Denmark, Hungary are starting to debate joining the euro. There have been a variety of trade agreements that have been signed in the last few months. And Canada is the first non-European country that has joined a European program for defense. There seems to be a lot of interest. So as Olivier said, why don't we take the opportunity and take that and offer countries what they want? So what are the issues, right? The first one is that the return on investment is not as good as it could be.

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We all know that we need a single market in goods and capital I will insist on one thing. If we want to optimize investment in Europe, if we want to create a single market where Gazelles can grow, we need European banks, period. There is not going to be a single market for capital if there are no European banks. I'll say why. Because investment banking is a relationship business. You need to know people. And the investment banks today in Europe that are operating cross-country are not European. And that's a problem, right? Because at the end of the day, they deploy the savings to the investments that they know best. Second point is shifting the approach to risk-taking, which I think is even more important. So if you think about Europe, the last 10, 15 years has been playing defense. The whole of the last decade was about regaining credibility after the euro crisis. It was about tightening regulation. It was about fixing procurements, fixing things to regain credibility. Now is the time to pass to the offense. Now is the time to think about regulation structures, institutions to invest and grow. If you have all the money in bank deposits, those are sleepy deposits.

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They are going to have a sleepy economy. You don't have startups that are funded by bank loans. You need markets. So at the end of the day, what we need is change the attitude towards risk, right? So here are two ideas. The first one is that we really need more private pension funds. And that is not because the private pension funds may return a better return to investment. No, it's because when people are used to putting their money in a 401 and they need to decide how much money to put in equities, That's how they learn about equity markets. That's how they get used to investing in risky assets. We don't have that in Europe. If what happens with your paycheck is that you get your statement and a part of it goes to Social Security and that's it, you don't know what equity markets are. And that's the main difference between the US and some countries in Europe, think that the Netherlands, Denmark, Sweden, The countries with private pension funds are the countries where startups are growing. Think about Spotify and where it comes from. The second thing is sovereign wealth funds. And Spain has done it in the last few months.

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And I had a big debate with a lot of people, why do you need a sovereign wealth fund in a country when you don't have a big, big, big amount of foreign reserves? And the reason is, well, if you have public social security system, that money goes to the government. So the government can invest in risky assets as well, especially when the cost of funding is lower than the returns of the investment. And if we are in a world in which we have to develop a strategic autonomy and we have to develop investments in strategic sectors, it makes sense if the cost of funding is right and the projects is right that the government also contributes to it. It can be done. Obviously, the second is eurobonds. Let me just say 3 things about them. The first one, and the Vice President and Olivier mentioned, we need sovereigns, not supranationals, period. Any proposal that says we are going to issue bonds that are different from EU bonds and bills is not going to meet that benchmark. May have another qualities, but it's not going to meet that benchmark. Second one, and this is a comment somebody made to me that made me think, if we don't do this because we don't trust each other, we are telling the world that they shouldn't trust us.

[00:50:22.13]

Right? We are not serious if we don't want to do this. So this is a way of showing to the world that there is a project in which we all believe and they can invest in. Then the third one, and I'm not here promoting the need to have stablecoins backed by euros, but if there are going to be stablecoins backed by euros, what is going to be the backing? In the US, it's very simple, US bills. What is going to be in euro-denominated stablecoins? A basket with different weights depending who issues? No. The simple thing is you have eurobonds, you have EU bonds and bills, and that's what you use. Final point. Consider a couple of notches to make the euro a more international currency. The first one is about invoicing and settlement. There is a reason why the euro, the dollar is a reserve currency and it all started with petrodollars. And I learned recently that there was a moment in 1975 when the, Gulf countries told the US that it was a bad deal to denominate oil in dollars. They wanted to move to a basket. And the US Treasury said, "Absolutely no way because this is very important for us." And they offered higher voting rights at the IMF board in exchange for keeping the denomination of oil in dollars.

[00:51:49.27]

This is, by the way, in the Choke Points book. What I mentioned at the beginning about China as the currency of payment for the toll in the Strait of Hormuz is not just— there is a lot of countries with which China has trade relationships right now where there is an implicit agreement or commitment or requirement to pay some of that trade in renminbi. If you need renminbi to pay for trade, you are going to accumulate reserves. One idea here is that the European Union, when it's negotiating the trade agreements, could also introduce this kind of consideration into the conversation, payment of some of the trade in euros. Similarly, to foster this, the ECB could offer FX swaps to all the countries with which the European Union has a trade agreement. I'll just conclude as the Vice President said and Olivia said, this is to be done right now. By 2029 with the next commission and everything else, it will be way too late. Thank you very much.

[00:53:21.39] - Adam Posen

Thank you, Angel, Olivier, Isabel, and Carlos. I will have to mention that the Institute family produced at 5-year intervals a series of books on an international role for the euro. And it is indeed a topic worth returning to. Before we open it up to comments and questions from the floor with our distinguished in-person audience, I would like to ask Isabel if she does want to say anything about eurobonds, but also Carlos if he wants to say anything about the three challenges and three achievements that Isabelle listed in her presentation, since Eurobonds alone are not— they might even be necessary, but they are not sufficient. Isabelle, please. Could you hit the button on the mic? Thank you.

[00:54:27.56] - Isabel Schnabel

Sorry, I thought it was already turned on. So thank you very much again for a fascinating panel and for the excellent contributions. And I indeed would like to comment a bit on the eurobond. So let me first thank Olivier and Angel for bringing the topic back. But I think you're perfectly right. It's a good time to bring the topic back to the discussion. I mean, you'll remember we had a similar discussion something like, I don't know, 15 years ago. And many proposals have been made and were discussed and were in the end discarded. But the world has changed. And so we should come back and discuss it again. And I think, I mean, also you, Carlos, laid out very clearly what the benefits are, why we should be thinking about it and so on. I would like to recall that around 15 years ago, there was already another like blue bond, red bond proposal by Del Pla and von Weizsäcker. And in a sense, I feel that that proposal was taking the issue of moral hazard, which I think cannot be ignored in that context, more seriously than the new proposal does. Actually, in that proposal— and I'm not sure whether that's also your thinking— but in that proposal, the main reason why the financing costs would go down is that the red bonds introduced an element of enhanced market discipline because there was an explicit debt restructuring mechanism for the red bonds.

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And this is something that is not here. And so here, basically, in this proposal, there is no mechanism in order to enforce the market discipline that I believe is is needed to deal with the moral hazard. And I think this is an issue. Of course, one of the arguments against the proposal back then was that if you have the blue bonds, which are safe, and the red bonds, which are then a bit less safe, that you could get destabilizing domestic— destabilizing dynamics in domestic bond markets.. And the question is, what would happen then? And actually, I mean, this could put the ECB in a very difficult position because there could be pressure for the ECB to then actually buy the red bonds, which then of course would counteract the whole idea of the market disciplining effect. So there I think one has to be very careful to deal with the moral hazard issue. The second issue is one of governance. So the way I think about common European debt, is that it's kind of the logical way to do it is that you say European public goods should be financed at the European level via common debt.

[00:57:39.49]

I think that is entirely logical. There's one thing I never liked so much about the Next Generation EU. I'm a big supporter of Next Generation EU, but what I didn't like is that in the end, the money was not used for European projects, but for national projects. And I always thought that was a bit kind of inconsistent. And so if you think about it that way, I think it's also clear that the governance should be done in a way that there should be a shift of both competences and revenues to the European level at the same time when you do the European financing. However, we all know that there's a lot of opposition towards shifting revenues to the European level. But I think if there— I mean, if you want to have common debt, I would argue you have to do that. The mechanism you describe, I think is a bit problematic because, I mean, you say that the governments, they are going to pay part of their revenues to the European level. But, you know, when they are in a difficult situation, they may actually decide not to do that and then to say, okay, but sorry, I need to serve my red bonds.

[00:58:44.06]

So I will not give my tax revenue to the blue bonds. And I do not see the mechanism. And you mentioned it's just reputation. I think that's not strong enough. In order to ensure that this is going to work. And then the final point, and I think it's actually the most important, it's related to Angel's presentation. I do believe that this discussion about the international role of the euro and the European safe assets, that they are closely interlinked. But I want to recall that Christine Lagarde in a speech said that the international role of the euro needs to be earned. And what she meant by that is that this is based on institutional, economic, and military strength. We have, I think, the institutional strength. We do not really have the economic and the military strength. So I believe that this is the part that needs to come first, and this is also what I said in my presentation. I think we should focus first on providing the basis, and then the next step in the sequence is then to go towards the European assets. And by the way, I mean, you, Carlos, talked about numbers.

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I mean, I haven't done the precise calculation, but if you were able to increase potential growth by 0.5%age points, this would probably be much larger than the numbers you gave for just doing the— I mean, the European safe assets. So this is really something which has huge returns. I mean, working on the economic growth. And I think, I believe this should be the thing that should come first. And I do believe that we need the safe assets, but I think that has to be based on this first step. And sorry for—

[01:00:27.26] - Adam Posen

No, not at all, Isabel. Because we got captivated, we're going to end up giving Carlos the last word. I would just say about the point on military strength, some research I published some years ago in one of those Euro volumes here, and then followed up by Barry Eichengreen and co-authors, does point in that direction that foreign policy and military reach are a key determinant of global usage. But it also points to a commonality between our speakers that common defense spending might be a way of advancing multiple goals at once. Anyway, Carlos, if we could ask you to broaden briefly about some of these other accomplishments and challenges for the euro area architecture?

[01:01:15.36] - Carlos Cuerpo Caballero

Yes, thank you very much, Adam. And if you allow, also at the end, I will try to complement on what Isabel said because I cannot refrain myself.

[01:01:24.25] - Adam Posen

Well, but then she gets to respond because there's 3 of you and 1 of her. So try to keep it respectful.

[01:01:30.52] - Carlos Cuerpo Caballero

So on 3 challenges that she mentioned— integration, innovation, and sovereignty— I mean, we've talked a lot about sovereignty related to the safe assets or the digital payments.. And I think on digital payments, digital euro, there is a fully-fledged common agenda between the European Council and the ECB, and we're even trying to push the dates ahead to be able to deliver quickly on that process. So I would say just a plus one on what Isabel said on that front. On integration, I think there is an element associated with governance within Europe and how to be able to be— or avoid frustration in these projects not going at the speed that we need. And what we have proposed from the Spanish perspective is to work in coalition of the winning formats so that we can push ahead and instill some fear of missing out effect on others by not being in these successful projects, be it Savings and Investment Union or also internal market projects. We are, for example, working with Portugal to be able to have an Iberian single market, so to reduce fragmentation within the Iberian Peninsula in combination or in collaboration with the European Commission together with their Regime 28 proposal.

[01:02:52.17]

I think there is a top-down and a bottom-up approach that can be nice complements. Then on innovation, I would like to pick up on the point that Ángel made on what can patient capital from the public institutions do in this context in Europe, and I think it's a lot. What we did in Spain is we used €10 billion of our Next Generation EU loans to capitalize our national promotional bank, our KfW, which is called ICO in Spain. And those 10 extra billion of capital will allow ICO to directly leverage €60 billion of financing for our companies without the endpoint of Next Generation. Also less red tape on that front. And when it comes together with the financial sector, we expect $120 billion of financing. So the ability to continue with the push of next generation, but with national sources, and that would be focused on innovation and also accompanying all our firms through the whole life cycle as they scale up, not only as they are born as startups. Hopefully we can also try and bridge some of those elements. And my last point, and I'll be very quick, on potential growth. Of course, potential growth is of essence for European economies, given also aging and just name it.

[01:04:17.42]

But to save assets is an instrument towards reaching this potential goal through, for example, as we said before, being able to deliver on these investments, including defense. So I think both objectives are actually very well aligned, and it's not a chicken and egg discussion. I think to save assets would make it easier to actually undertake the rest of the European agenda. Thank you.

[01:04:42.10] - Adam Posen

Admirably concise, Carlos, especially for an elected minister. Thank you very much. I don't know if Isabelle wants a last word before we have to close it out.

[01:04:56.23] - Olivier Blanchard

I have reaction to Isabelle, but I'll try— can I get one minute or not?

[01:05:00.39] - Adam Posen

Yeah, less.

[01:05:03.37] - Olivier Blanchard

On market discipline, it seems to me there is market discipline at this point and there would be more because the national bonds would be more exposed and the markets would actually be looking at it and putting spreads. On the notion that it would be good to do this once the rest is done, I think that's a recipe for not doing it. And I hear, you know, you have to do a fiscal union and then we'll talk, I'll be dead. So I think we really have to move and I think the structure is such that we can move. But there is— you're right that there is an assumption that if in times of deep need, the assumption here is that the government will tend to pay its EU dues before it defaults on creditors. Sorry, before it defaults on creditors. So this is asymmetry which basically makes the EU bonds, the backing of the EU bonds more credible. Nothing is ever totally safe. Would you hold a 30-year US Treasury at this point?

[01:06:01.05] - Adam Posen

Yes, but with a discount.

[01:06:06.58] - Ángel Ubide

Let me just say one thing, right? I think in Europe we always try to do the most difficult things first. And we don't do the easy stuff. And the easy stuff is this, as Olivia has said. Of course we all want potential growth to increase. Over the next 25 years it will happen. But we can get this done today. And if we do this today, we will have more economic might, more financial might, and that helps you at the end with the military. So I just think it's a no-brainer, as Olivia said before.

[01:06:39.15] - Adam Posen

Up to you, Isabelle, if you want the last word.

[01:06:41.15] - Isabel Schnabel

Well, I can say a few words. So first of all, of course, it's entirely right. I mean, I also always hated that when there was this idea you first need risk reduction, then you can do risk sharing, all of that. And there was just a way to push out everything to the indefinite future. We shouldn't do that. But I mean, honestly, we have to get it right. And if we don't take the issue of moral hazard seriously, we will end up in a very bad place. And what sounds like a great idea, a simple thing to do, will end up very badly. And given that we do have, I mean, a fiscal issue that will need to be solved over the next years, we also— the potential growth issue cannot wait. And we have to do that now. It's not that we can say, okay, that we can do later, we first do the Eurobond and that will already, you know, help us with the other issue. That's also not true. So we really— I mean, there is a need to act quickly on that, and we have to get the eurobond right by taking into account incentives.

[01:07:38.42]

And I do not think that this is the case in the current proposal, but I mean, I'm happy to disagree. And don't take this as rejecting eurobonds altogether. Far from that. I mean, I'm sympathetic if it's done in the right way, and we should continue the discussion in order to find out how it can be done in the right way. The right way.

[01:07:56.41] - Adam Posen

Thank you all very much. If I can add one last editorial point, I was mentioning work we've been doing at the Peterson Institute on Europe, and two colleagues in particular, Cecilia Malmström and Jacob von Kierkegaard, have been leading this effort as well. And Cecilia and I in particular have been beating the drum for the idea that Europe has something positive to offer. Nicola Ferron also talks about this, has something positive to offer in terms of safe assets in a broader sense than the specific eurobond sense, that rule of law remains, that arbitrariness of a central executive remains out of the question. That bullying in international agreements on the scale that China and US do remains out of the question. And so this was somewhat implicit in some things both Ángel and Isabel said, and Carlos was too polite to say it, but we do have to look at, as I framed the new economic geography, a world where safe assets in the broad insurance as being far less provided than it once was. And so therefore, Europe's ability to provide part of that is a win-win where it helps the world in addition to itself by being a profitable insurance provider.

[01:09:32.09]

And whether or not eurobonds, payment systems, trade deals, all of these contribute to this effort. And I think we're grateful to have intellectual, political, central bank leaders trying to make this work. Thank you all very much.