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European Debt and Safe Assets:

How to Build a Simple Framework

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1. Introduction[1]

To gain 'strategic autonomy' at the international level, to bring its production model closer to the technological frontier and to preserve its social model, the European Union (EU) must tackle radical challenges: making a substantial amount of innovative investments compatible with the planned 'green' transition, strengthening the defence industry by gradually building common protections against external aggression, and re-training human resources (including the active integration of migrants) using renewed education and social inclusion processes capable of addressing structural changes in the labour market.

These multiple challenges must be supported by a huge amount of public and private financing to be raised at the European level. It is therefore no coincidence that important members of the Eurosystem of central banks (see for instance: Panetta, 2025; Schnabel, 2025; Lane, 2025; Rehn, 2025) and scholars with rich institutional experience (Blanchard and Ubide, 2025) have recently relaunched the need to issue European bonds, already called for by Draghi (2024).

Together with Marco Buti, I have long insisted on the crucial importance of issuing European bonds to back a permanent Central Fiscal Capacity (CFC) capable of financing the production of European Public Goods (EPGs) (see Buti and Messori, 2022), thus also countering the fragmentation of the European financial markets and paving the way for the creation of a common safe asset. This would greatly facilitate the mobilization of household financial wealth to support innovative private investment. However, as Bini Smaghi (2025) recently pointed out, European funding of EPGs is insufficient to create a common, safe asset of international size and to unify EU financial markets in the short to medium term.

The literature on European bonds, which began at the peak of the sovereign debt crisis (2009-2012) in the euro area (EA) and was revitalized by the impact of the pandemic shock (2020-2021), has taken different paths to analyze these problems (see Section 2). In the current Working Paper, I am specifically interested in those contributions that address the creation of a permanent CFC not only in terms of flows (the issuance of European bonds to cover current imbalances) but also in terms of stocks (the management of public debts): as just recalled, a "stock-and-flow" approach is a necessary condition to link the issuance of European bonds to the construction of centralised financial markets (see Section 3). This suggests that the most promising approach is to look at simple ways to gradually replace stocks of national public bonds with issuances of European bonds. In the last sections (see Sections 4 and 5), I sketch one of these possibilities and specify the main difficulties for its implementation.

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2. Some Limits of the Previous Literature

The worsening of geopolitical conflicts, the aggressive policies of the Trump administration, and the increasing obsolescence of the European production model mean that the EU is facing existential challenges. Nevertheless, most EU national governments oppose any form of centralisation beyond the transfer of European resources to member states and their use at the national level. In this situation, any proposal to centralise the financing and production of EPG flows receives only weak political support.

Political incentives will become even weaker if the proposal centres on issuing a large stock of European bonds intended to gradually replace national bonds. In this latter stock-and-flow approach, EU member states would have to agree to a significant transfer of national sovereignty to European institutions.

This Working Paper argues that, while the stock-and-flow approach may seem overly ambitious given the current political balance, it nevertheless represents the only viable strategy to safeguard the EU's significant international role and to address the EU's internal agenda, which focuses on implementing an innovative production model and strengthening the social model. Therefore, it is crucial to outline a straightforward stock-and-flow model. In this perspective, the current section does not attempt to survey the extensive literature on the potential issuance of European bonds; instead, it seeks to highlight the limitations of key contributions that define three distinct approaches. For ease of comparison among the contributions discussed, I will use the term 'national public bonds' to refer to the sovereign bonds of the EA's member states.

The first approach, introduced by Delpla and Weizsäcker (2010), focuses on the selective pooling of existing national public bonds, which are then exchanged for securities issued by a private or public financial intermediary (see Brunnermeier et al., 2017). These new securities (the so-called European safe bonds, or ESBies) are derivatives composed of tranches of national bonds with varying levels of risk.

I will refer to two possible compositions, determined by the relative weight of safer versus riskier national public bonds. ESBies can thus be divided into European senior bonds and European junior bonds. The European senior bonds are comparable to safe assets. Conversely, the European junior bonds are vulnerable to market failures: their introduction increases the insolvency risk of the EA's more fragile member states whenever the rollover of expiring junior bonds coincides with adverse conditions in the European financial markets. Moreover, these markets remain highly fragmented.

As a result, this proposal is not suitable for establishing a framework for European debt issuance and for unifying European financial markets.

The second approach is characterized by the issuance of European bonds by a centralized intermediary with an initial paid-in capital, which uses the proceeds from its bond sales to purchase a variable share of national public bonds, without any tranching (see Leandro and Zettelmeyer, 2018). Amato et al. (2022) develop a model in which the role of the centralized intermediary is played by a European Debt Agency (EDA), which issues bonds with finite maturity to supply perpetual loans that cover national public deficits and the redemption of expiring public bonds in European member

states. These loans are therefore structured as perpetuities, and European countries are only required to pay an annual installment proportional to their specific risk.

The authors argue that this arrangement provides significant relief for national public imbalances. They also claim that the model could create a CFC without any form of debt mutualization and without transferring any risk to EDA bonds[2]; hence, EDA bonds would serve as safe assets. Moreover, the perpetual loans financed by these bonds would gradually replace national bonds, enabling European financial markets to overcome their main source of fragmentation.

The limitation of this type of model is that it underestimates the consequences of the timing mismatch between the asset and liability sides of the EDA's balance sheet. This mismatch is crucial for making European debt issuance effective for the gradual replacement of national debts; however, it also means that EDA bonds carry a positive risk and may even default at maturity. In fact, the EDA's liabilities cannot be fully covered by the proceeds from the installments and the market value of the perpetual loans on the asset side.

This implication is downplayed by Amato et al. (2021), who assume that the European Central Bank (ECB) acts as the residual purchaser of EDA's perpetual loans and that the installments are treated as bank deposits at the ECB[3]. However, this is actually equivalent to turning the EDA into a bank operating under guarantees provided by the ECB. The implication is that, in this model, there is a 'last resort' monetization of national public debts issued by EA member states[4].

The third approach is based on the issuance of European bonds that are guaranteed, either directly or indirectly, by member states. This is the case for the issuances that financed the SURE programme in spring 2020 and the main recovery programme, Next Generation EU (NGEU), launched in summer 2021.

With respect to SURE, EA member states provide a pro-rata guarantee on the related European debt, which must be fully repaid by each of the countries that have used the programme. Conversely, in the case of the RRF, guarantees are provided by the EU Multiannual Financial Framework for the loan components and by additional own resources for the grant components. This means that, in the event of default by one member state, the other countries must provide a joint and several guarantee.

The problem is that joint and several guarantees could lead to a mutualization of national debts that would be compatible with the Treaty on the Functioning of the European Union (TFEU) only in the case of exceptional events that are beyond the control of member states and are not permanent (Art. 122; see also below, Sections 4 and 5). As a result, programmes such as SURE and RRF are

[2] These statements are justified by two aspects. First, the previous definition of instalment: each country undergoes a financial transfer to the EDA that is determined by its specific riskiness. Second, the issuances of the EDA's debt do not require any guarantee by member states, because the instalments would largely compensate for the impact of possible temporary defaults of specific countries on the EDA's balance sheet.

[3] The two points are clearly stated in Amato *et al.* (2021, p. 832). In Amato *et al.* (2022), they should be complemented by a comparison between the rates of return on perpetuities and the time structure of EDA's debt.

[4] Let me stress that it would be erroneous to assimilate the ECB's 'last resort' monetization and the ECB's purchases of public bonds in the secondary financial markets ("quantitative easing"). The latter is an unconventional decision of monetary policy that is compatible with the ECB's duties and the EU Treaties; the former would be incompatible with the European basic principles of monetary and fiscal policies.

temporary, so the associated issuance of European debt cannot create a long-term CFC and overcome the fragmentation of European financial markets.

The literature review on the potential issuance of European debt shows that there is not yet an available and satisfactory solution[5]. Moreover, the initiatives implemented by the European Commission cannot address the main challenges listed at the beginning of this paper due to their temporary nature.

3. The Need for a Stock-and-Flow Approach

The conclusion of the previous section highlights two points. First, the conditions necessary to create a CFC, construct a European safe asset, and unify European financial markets should be based on a stock-and-flow approach[6]. Second, it is not straightforward to devise a simple scheme that applies this approach to the EU's challenges.

To strengthen these two statements, let me recall a few figures. The existing stock of European bonds (less than €1 trillion) would be increased by the new flows proposed by Draghi (2024), estimated at around €250 billion per year[7]. These figures show that it would take decades to reach a stock of European bonds comparable to that of the current international safe asset (US Treasury bonds, which amount to approximately $29 trillion) or to exceed the current stock of the closest substitute for a European safe asset (German government bonds, which amount to approximately €2.7 trillion).

This evidence should not foster a pessimistic outlook regarding the EU's potential. It simply confirms that a flow-based approach is insufficient to address the various issues related to European debt. As repeatedly stated, a flow approach must be complemented by a stock approach. This means that, as Bini Smaghi (2025) acknowledges following Blanchard and Ubide (2025), the gap between EU, on the one side, and the United States and other international areas, on the other side, can be largely reduced in the short to medium term only if there is a permanent issuance of European bonds. From this perspective, the previous contributions on ESBies and the EDA point in the right direction. Both schemes emphasize that the stock of government bonds held by EA countries should be gradually or partially replaced with European bonds issued by a centralised institution. Unfortunately, the solutions developed by these schemes are not satisfactory for various reasons outlined in the previous section.

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[5] There are other contributions not included in my survey. A graphical comparison of various schemes elaborated before the pandemic shock is offered by Giudice *et al.* (2018, fig. 2). In the following years, there were other papers on the topic. Let me just recall: Martin *et al.* (2021); Giavazzi *et al.* (2021).

[6] The cruciality of a stock-and-flow approach is a well-known methodological achievement in the history of economic analysis. For instance, it specifically applies to the evolution of monetary theory. Hicks (1967) shows that the partial approaches followed by Keynes' 'liquidity preference' (a stock approach) and Wicksell's 'pure credit' model (a flow approach) do not lead to a 'complete' definition of money. As shown by Schumpeter (1917-18), a complete monetary theory requires a stock-and-flow framework.

[7] Following Draghi (2024), the yearly financing required by the EU's innovative investment should amount to at least € 750 billion. More than two third of this flow of financing should be covered by private resources. The residual part, attributed to the European institutions, should be complemented by annual social and institutional expenditures.

However, it remains true that the construction of an alternative scheme requires identifying a European issuer of centralised bonds. The obvious candidates are a new EDA, the European Commission acting on behalf of the EU, and other European institutions with available funding. In this respect, the most appropriate reference seems to be the European Stability Mechanism (ESM). The international treaty that formalised the launch of the ESM was approved in February 2012 and became operational in the autumn of the same year. This new institution was designed for crisis management in the EA and was endowed with capital of €700 billion (€80 billion paid-in).

The ESM essentially incorporated the activities of two previous temporary institutions (the EFSF and the EFSM), which managed European aid programmes to prevent the bankruptcy of Greece, Ireland, and Portugal in 2010 and 2011. It played a direct role in the Cypriot bailout and, most notably, in the evolution of the Greek crisis, which culminated in the dramatic events of 2015. In recent years, the ESM has received repayments of a significant portion of the financial support that was provided to EA member states under European aid programmes. Currently, it has a substantial lending capacity (around €500 billion) at its disposal.

It is well known that the ESM is not an EU institution[8] and is affected by a negative stigma[9]. However, in what follows, I will assume that the task of issuing European bonds to gradually replace national bonds should be assigned to this institution. My reasoning is mainly that the ESM's significant lending potential strengthens its role as a potential issuer of centralised bonds, allows for a straightforward inclusion of flows into the stock scheme, and partially simplifies the related problem of guarantees. Moreover, this would help to overcome the persistent stigma attached to the ESM and facilitate the approval of its new statute (see n.9).

Today, the stock of public bonds of EA member states stands at around €13.5 trillion, equivalent to approximately 88% of the area's total GDP. In my scheme, the ESM would be ready to issue its bonds on the primary market for an amount corresponding to a significant part of that total stock of national public bonds. If the placement of these bonds were successful, the ESM would obtain financial resources to absorb the planned amount of EA national public bonds. For example, this amount could correspond to 60% of the EA's GDP or to the portion of national public bonds not held by the ECB (or, more precisely, by the Eurosystem of central banks) on its balance sheet.

The limitations of the contributions examined in Section 2 demonstrate that it is not easy to construct a stock-and-flow model that includes a permanent CFC and a European safe asset that can compete in international financial markets, while also remaining compliant with the TFEU. This paper seeks to outline a simple stock-and-flow scheme that addresses the main issues without ignoring unresolved problems. My main reference is a paper I wrote at the peak of the sovereign debt crisis (Messori, 2011). Leaving aside the different institutional context and economic phase, the proposal is largely similar. It should also be recalled that the ESM is endowed with paid-in capital and has

[8] Due to the opposition of some member states to the approval of the ESM' statute in 2012, this institution is an international-based organisation regulated by an international Treaty. Here, I use the label 'European institution' to stress that the ESM operates within the EA. Today, the ESM cannot extend its activity due to Italy's refusal to approve its new statute.

[9] Despite its later creation, the ESM is identified as the institution that had the main responsibility in the EA's punitive fiscal policies towards the most fragile member states during the sovereign debt crisis. This stigma largely explains the complete failure of the ESM's programme supporting health expenditures of the EA's member states during the pandemic (2020).

significant lending potential (around €500 billion) at its disposal. The following section will show that this potential allows for the straightforward inclusion of flows in the scheme and, at least in part, eases the issue of guarantees.

4. A Simple Scheme

To issue an amount of European bonds sufficient to finance the gradual purchase of a significant portion (for example, 60%) of total national debt in the EA, the ESM would need to be authorized by a further extension of its new statute, which has not yet been approved (see above, n.8). Moreover, the new statute should allow the allocation of the ESM's available lending capacity on an annual basis to support part of the innovative investment required for the European technological and green transitions[10].

These initiatives could establish a permanent CFC, offer a competitive European safe asset, and address the main segmentations of the European financial markets. In addition, they could contribute to adequate public funding to meet the challenges that the EU must address through the production of EPGs and a related industrial policy, thereby strengthening its strategic autonomy and enhancing its economic and social model.

If the ESM implemented the issuance of European bonds and the annual use of its lending capacity, its balance sheet would remain balanced. On the liabilities side, the total debt to market investors and the utilized funds would be matched by an equivalent amount of credit towards EA member states or EU institutions. Furthermore, the ESM's bonds could gradually reach a critical mass which, if adequately guaranteed in terms of risk, would be sufficient to qualify these bonds as an international safe asset. On the asset side of its balance sheet, the ESM could mimic various market mechanisms to gradually collect the desired stock of national bonds at relative interest rates reflecting objective measures of each country's level of risk[11]. Hence, at first sight, there would be no burden-sharing of national debt.

The ESM must meet a binding constraint in the issuance of its bonds and the use of its lending capacity: it must maintain a 'triple A' rating. Empirical evidence shows that this condition is necessary but not sufficient to ensure that the interest rates paid on ESM bonds are lower than those currently paid by several EA countries on their national debt (see, for instance, Breckenfelder et al., 2024). Recently, the yields on ESM bonds have been aligned with those of EA countries with lower credit

[10] I already emphasised that, according to Draghi (2024), private and public innovative investment in the EU requires a yearly amount of additional resources equal to €750 billion (around €250 billion just for public investment). This statement has been criticised by several authors (see Gros *et al.*, 2024), who maintain that the European innovative investments should largely replace (and not be added to) the traditional ones. However, empirical evidence and theoretical schemes stress the complementarity of European innovative and traditional investments in the short to medium term (see Buti *et al.*, 2025).

[11] For the sake of simplicity, I rule out the possibility of any supply-side rationing. In my scheme, the ESM is able to purchase the desired amounts of each national debt by means of market auctions or institutional agreements. Here, it is not convenient to spend effort to analyse specific auction mechanisms that should be effective in the current economic phase. Let me just recall that, in Messori (2011), I introduced a mechanism of 'price reverse auction' which fitted with the impact of the international crisis and the EA's crisis of sovereign debt.

ratings. However, interest rates on ESM bonds would decline significantly if the 'triple A' rating were accompanied by frequent and large issuances of these bonds. In this case, the segmentation of the European financial markets would be reduced, and the liquidity of ESM bonds would be improved. Lower interest rates would make ESM lending more attractive for several member states. The 'triple A' rating would also apply to the ESM's annual financing of EPGs and other European investments. With paid-in capital of €80 billion and available lending capacity of €500 billion, the ESM could contribute to these financing flows, provided it maintains moderate financial leverage[12].

These aspects of my scheme represent initial steps toward achieving the two fundamental goals the EU must pursue to secure its strategic autonomy and strengthen its economic and social model: (i) a CFC and a central safe asset to mitigate financial market fragmentation, and (ii) sufficient public and private financing to support the production of EPGs and the implementation of other innovative investments.

Incidentally, these results would make national compliance with European fiscal rules easier. The impact of market volatility on national budget imbalances and the insolvency risk of national public debt would be drastically reduced thanks to the ESM's shielding effect against financial investor pressure. The problem is that this pressure would shift from national debt to ESM liabilities. Consequently, my scheme leaves one important issue unresolved: what condition could ensure a 'triple A' rating for the large volume of bonds issued by the ESM and, eventually, for a substantial portion of its annual loans?

Let me focus on ESM bonds, leaving aside the ESM's financing of innovative investment[13]. Even if issued gradually, a massive amount of ESM bonds could be smoothly placed on the market at safe asset yields, provided that this volume is fully guaranteed. Even if they were not used to cover additional financing flows for EPGs, the guarantees offered by the ESM's available paid-in capital would be inadequate to cover such a large bond stock. The leverage would be excessive, at approximately 1:20.

According to the ESM's statute, there is another layer of protection: the institution benefits from a joint and separate (i.e., pro rata) guarantee offered by EA member states. However, this additional guarantee would not provide adequate coverage for the insolvency risk of such a large debt issuance. The residual risk of ESM bonds would not significantly differ from the risk profile of the most fragile national debt currently found in the EA. Hence, the proposal to replace various national debts with centralized ESM debt would become ineffective.

In principle, a solution to this problem would be to increase the ESM's paid-in capital. As noted above, when the ESM was established in 2012, it was endowed with capital of €700 billion, of which €80 billion was paid in. Thus, there is substantial room to raise the proportion of paid-in capital, which would improve coverage for the ESM's issuance of European bonds. However, as already noted, the current potential leverage of these issuances is excessive (approximately 1:20). To reach a safe

[12] The ESM alone cannot supply yearly loans equal to €250 billion (see n.10), given its available funding potential and the 'triple A' rating constraint. The possible positive spreads between the interests accrued on its credit and those paid on its debt cannot fill the gap. Hence, it is necessary either to refer to other agents (for instance, the European Investment Bank) or to introduce specific guarantees (see below).

[13] The problem examined is more severe in terms of stock than in terms of flows. This is the reason why I will only refer to stock of bonds.

threshold, it would be necessary to multiply the ESM's paid-in capital by at least four or five. However, the upcoming repayment of European debt under NGEU and many other factors (including the ESM's stigma) make this possibility unfeasible.

5. Conclusions: Open Issues

The previous statement suggests that my scheme does not offer a solution to the puzzle left unsolved by the existing literature on European debt. Rather, this scheme demonstrates that a possible way forward exists, based on indirect transfers of national sovereignty to European institutions: namely, the strengthening of guarantees provided by EA member states to the ESM. With a further extension of its new statute, the ESM could issue bonds backed by a joint and several guarantee provided by all EA countries, rather than several joint and separate guarantees.

It is well known that European accounting rules equate joint and several guarantees with the requirement that each participating country must fully cover the related potential risks. Therefore, adopting this type of guarantee requires an explicit transfer of national sovereignty to EU institutions. However, from an economic perspective, the probability that a negative event affects a single member state or a small subset of states is much less than one. In this sense, there is only a potential (or indirect) transfer of national sovereignty.

A crucial and open question remains: does this kind of (indirect) transfer of national sovereignty imply burden sharing of different national debts that would be incompatible with the TFEU? In itself, the transfer of sovereignty does not necessarily lead to an affirmative answer to this question. Previous advances in the EU's construction, such as the creation of the single market and the euro area, involved radical transfers of national sovereignty to centralised institutions (the Commission and the ECB) without challenging the fundamental components of the EU's architecture. Likewise, the systematic financing and production of EPGs and the associated restructuring of the EU's industrial model cannot be implemented without further centralisation of economic power at the European level (see Buti and Messori, 2024). However, the use of joint and several guarantees is hindered by two main difficulties—one related to governance, the other to politics.

The governance issue mainly arises from the fact that, in my framework, this type of guarantee implies an indirect transfer of national sovereignty to EU institutions through a risk-sharing mechanism. Thus, the previous question about the non-bailout clause of the TFEU becomes more specific, and it remains difficult to determine whether any risk-sharing mechanism for national debts necessarily implies burden sharing that would be incompatible with the EU's legal framework, except in cases of exceptional and temporary events.

Recent legal scholarship on this subject offers different answers (see Grund and Steinbach, 2023; and Famà and Panascì, 2025). Taking an economic approach, my earlier attempt to distinguish between actual bail-out and possible risk-sharing suggests that the joint-and-several guarantee can be made compatible with the EU's legal framework.

However, a careful reflection on this question cannot be limited to either economic or legal analysis alone; it requires joint work by legal scholars and economists, which goes beyond the scope of this Working Paper.

As noted above, even if it were possible to make a joint and several guarantee compatible with the EU's legal framework, a significant political challenge would remain. Despite the dramatic challenges the EU has faced since 2022, the political dynamics of this area make it very unlikely that the necessary consensus could be reached for a significant transfer of national sovereignty to EU institutions and the implementation of risk-sharing mechanisms. Such initiatives would be opposed by the alliance between the main European political party (i.e., the European People's Party, EPP) and European right-wing parties. This explains why the current policy focus in the EU is not on stocks of central debt, but on flows of central financing for specific EPGs. Flow-based schemes require a more limited and less systematic centralisation of economic and political power. The clear implication of this political difficulty is that my stock-and-flow scheme is, at best, an unrealistic exercise.

This conclusion also seems to apply to less ambitious policy objectives. The current inability of European institutions to respond to Donald Trump's aggressive strategies on defence and tariffs, and the failure of EU member states to reach agreement on the gradual creation of a European security industry or on reforms to the EU's outdated production model, indicate that even centralised financing and production of specific EPGs and innovative investments cannot overcome the existing political barriers. EU member states are willing to accept European financial transfers only on the condition that such centralised grants do not interfere with national control over public budgets and investment choices.

The problem is that these nationally-focused solutions are wholly ineffective in dealing with the impending threats to the EU's economic and social model. Individual member states will be unable to play a significant role in a world marked by international bilateral conflicts, military threats, and relentless advances at the technological frontier.

These last points highlight that, despite its possible weaknesses and current political unfeasibility, my proposed scheme is a necessary step to support the EU's democratic and inclusive system in a deteriorating international environment. The EU's strategic autonomy and welfare state require the implementation of a stock-and-flow model along the lines described above. Should European institutions and national governments reject this perspective, they would bear a heavy responsibility: to repeat, a century later, the kinds of unwitting yet culpable behaviours denounced by Clark (2012) as the root cause of the First World War and its ensuing human tragedies.

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