IMK

Institut für Makroökonomie
und Konjunkturforschung
Macroeconomic Policy Institute

Hans Böckler
Stiftung

Fakten für eine faire Arbeitswelt.

Quantitative easing with bite:
A proposal for conditional overt monetary financing of public investment

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Overview

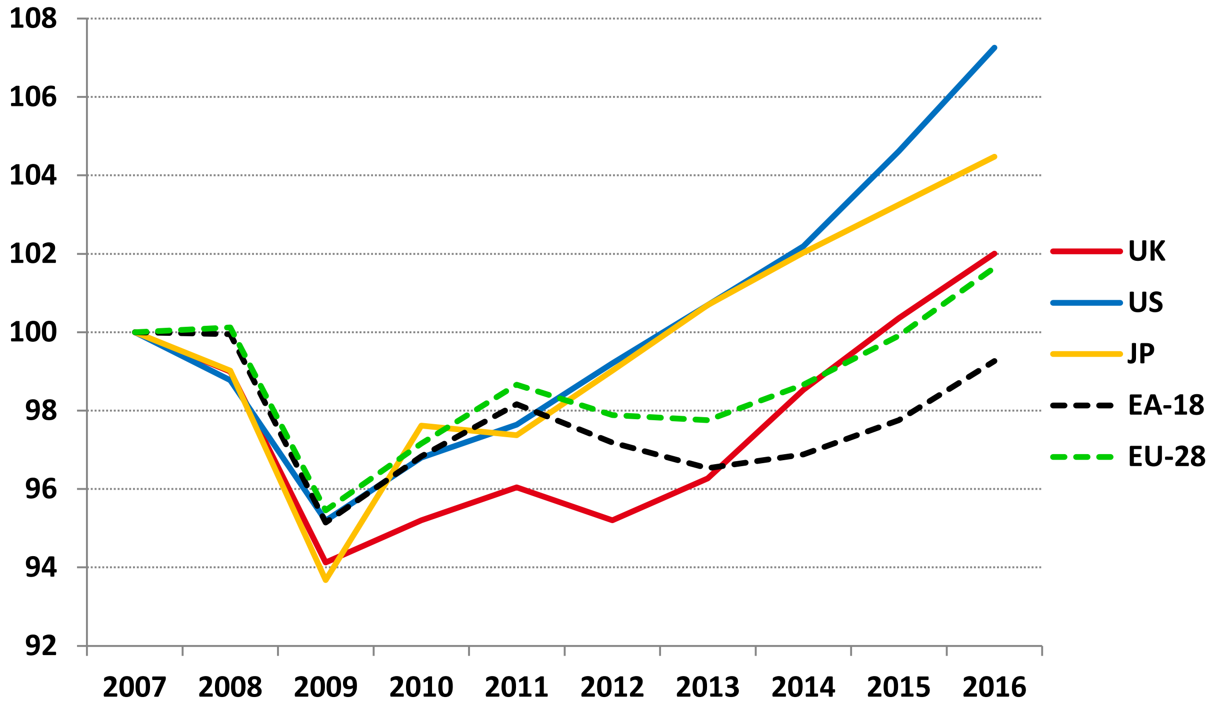
- Why think about monetary financing of public investment?
- Brief discussion of monetary financing in theory
- How could it be operationalised in the euro area? – the COMFOPI proposal and some questions
- Based on IMK Working Paper 148: http://www.boeckler.de/imk_5279.htm?produkt=HBS-006053&chunk=1&jahr=/
- „Work in progress“ – feedback to develop idea further

Why consider monetary financing?

- The euro area has (among other things) a aggregate demand short-fall
- Conventional monetary policy is exhausted
- QE is unlikely to solve the AD problem
  - QE is risky and distributionally problematic
- Fiscal policy is hamstrung by European and national rules
  - Where there is fiscal space it will not be used
- Diminished expectations? New growth model, EU2020

Disappointing Performance of €A (specifically)

Real GDP/capita, index 2007=100 (AMECO)



- Supply side – structural reforms? demography?
- Demand-side explanations: more restrictive FP less expansionary MP

Prospects – fiscal policy

- Juncker Plan – major doubts regarding size, additionality, dependence on private finance etc.
- National fiscal policy Most countries tightly constrained by EU and national rules, countries with policy space unwilling to use it.
  - Collective action problem
  - Possible temporary exceptions – but that would not permit a <u>sustained</u> fiscal push
  - Debt rule: FR/BE/ES 2pp, IT/PT 3½ pp. p.a.

Prospects – monetary policy

QE positive AD effects but indirect and limited:

- Depreciation effect happened early (then stopped)
  - C/A surplus already 4½%
- Long-term rates already extremely low
- Property markets and corporate finance different to USA/UK

Risks and side-effects:

- Blowing up asset bubbles
- Concentration of wealth effects, inequality

„Diminshed expectations“ in Europe

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- More than just a cyclical recovery required
- Europe2020 strategy?
- Massive investment needs (climate change etc.)
- Need for a stable growth model (not based on inequality and asset price bubbles)

Monetary financing

- Creation of base money to finance expansionary fiscal policy („Helicopter money“)
- Fiscal expansion – tax cuts, transfers, public investment
- Finmin/CB cooperation ended after inflationary 1970s
- Adair Turner (2013): MF as a “taboo“: “To print money to finance deficits indeed has the status of a mortal sin—the work of the devil—as much as a technical error” (citing Weidmann).

Europe‘s Japanisation leads to taboo break

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Following Bernanke in 2003 – burgeoning EU-focused literature

- Adair Turner (2013)
- Wilhelm Buiter (2014)
- Reichlin, Turner, Woodford (2014)
- Jordi Gali (2014)
- Simon Wren-Lewis (div.)

Politikvorschläge

- Giavazzi and Tabellini (2014)
- Muellbauer 2014
- Blyth and Lonergan (2014)
- Varoufakis, Holland, Galbraith (2013)
- Stefan Ederer (2015)

Four key conclusions from recent MF literature

- MF is effective, reliably raises nominal GDP and reduces debt ratios
- MF can and <u>should</u> be implemented when other methods fail
- MF is preferable to other policies in some respects, <u>can</u> be deployed even when other measures possible
- MF carries substantial risks that need to (and can) be avoided by careful policy design

Other relevant findings

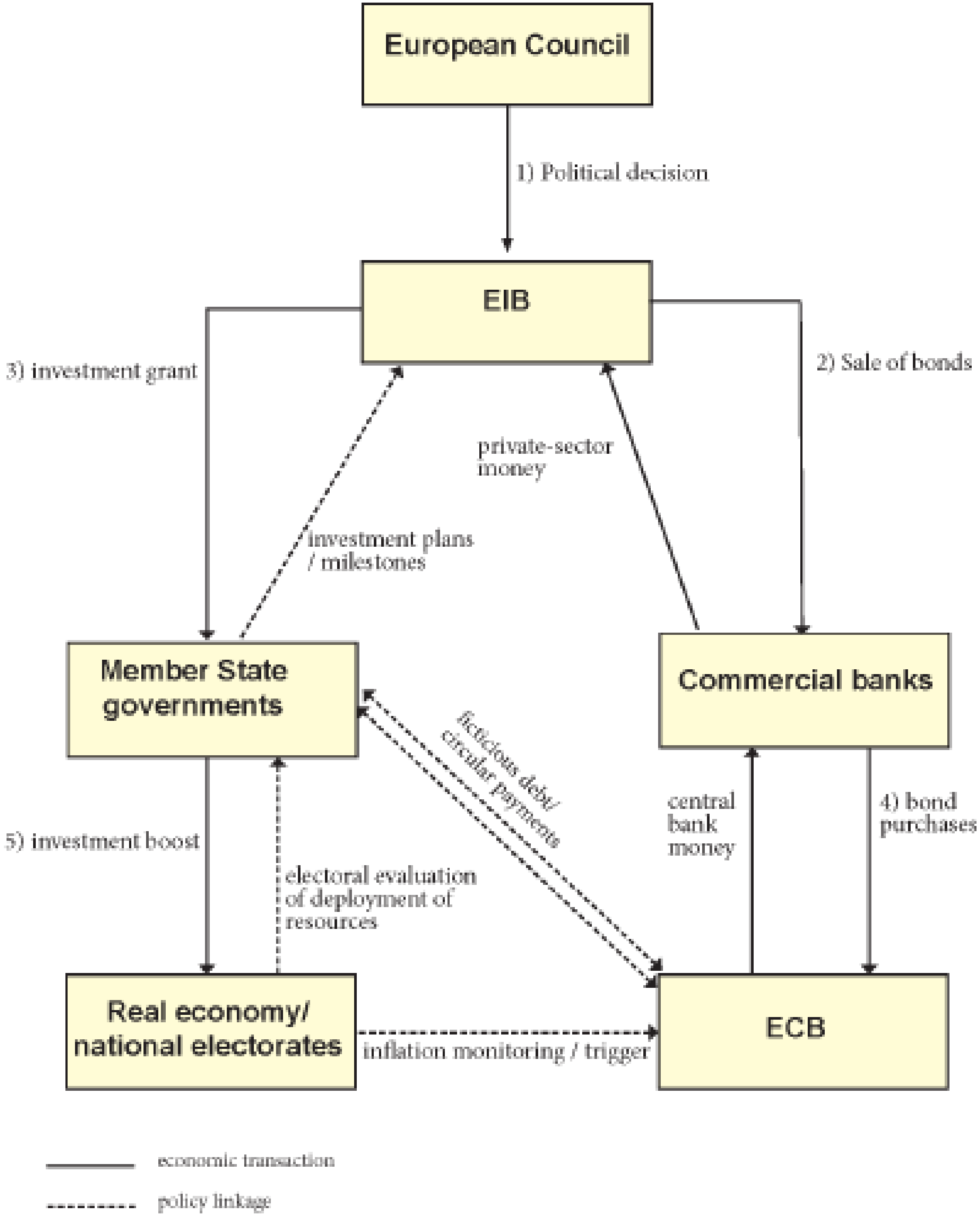
- CB balance-sheet losses not critical
  - Can also result from QE
- The „cost“ of MF is inflation
- When higher inflation is desirable, policy is “costless”
- „Mixing FP and MP“ is a semantic argument. Decisive is that it is the CB that determines when it „says no to the government“ (Bernanke),
  - monetary not fiscal domination
- -> In € A need for a „fudge“ given ban on direct monetary financing of government budgets

Why use public investment?

- Substantial decline in public investment and capital stock as % GDP
- High multipliers (IWF 2014)
- Key for needed structural transformation
- Transfers/tax cuts (Blyth/Lonargen, Giavazzi and Tabellini) also possible but have operational and distributional issues and lower multipliers

The COMFOPI proposal – basic set-up

- EIB emits long-term bonds outside normal programme (no co-finance)
- ECB commitment to purchase them on secondary market (subject to „inflation trigger“) under QE
- EIB transfers resources to MS
- MS implement investment projects approved as meeting simple European criteria
- Different repayment/distribution modalities possible
  - Ultimately any debt servicing is circular


European Council
1) Political decision
EIB
3) investment grant
2) Sale of bonds
private-sector money
investment plans / milestones
Member State governments
Commercial banks
fictitious debt/ circular payments
central bank money
4) bond purchases
5) investment boost
electoral evaluation of deployment of resources
Real economy/ national electorates
inflation monitoring / trigger
ECB
economic transaction
policy linkage

COMFOPI: numbers and modalities

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- EIB-bonds – degressive emission for 5 years, e.g. €250->50 bn (€750 bn total), low interest, long-term
  - As part of QE
- ECB commitment subject to a pre-announced inflation trigger to protect mandate/independence (monetary domination)
- Investment projects by MS (cf. Juncker Plan), Europe2020 targets as orientation
- MS govts responsible to domestic voters for use of resources

COMFOPI: Distribution & debt servicing options

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- Simplest using ECB capital key (as with QE)
- By population
- Concentration on crisis countries – but joint (fictitious) servicing?
  - Political/legal opposition
- Voluntary participation – with juste retour (fictitious) servicing
  - Reduced positive demand spillovers
  - Rebalancing of €A?

COMFOPI: some questions

- What form should bonds take?
- What would be the best inflation trigger
- Negative capital of ECB: how much is a problem?
- Economic analysis – legal issues?
- Is there a directer way?
- EIB or dedicated institution?
  - Euro area vs. EU
- Interest rate/ AAA status of EIB

Conclusion – something has to give

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- We need monetary and fiscal policy engines to ensure take-off, faster NGDP growth and fiscal consolidation
- We need higher public investment for longer-term restructuring and performance
- Either abrogation/suspension of fiscal rules at EU and national level (golden rule) AND willingness to use fiscal space, or …
- we find a way to make monetary financing work
- -> Stagnation is a policy choice (W. Buiter)!

Many thanks for your attention!