

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
- 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,

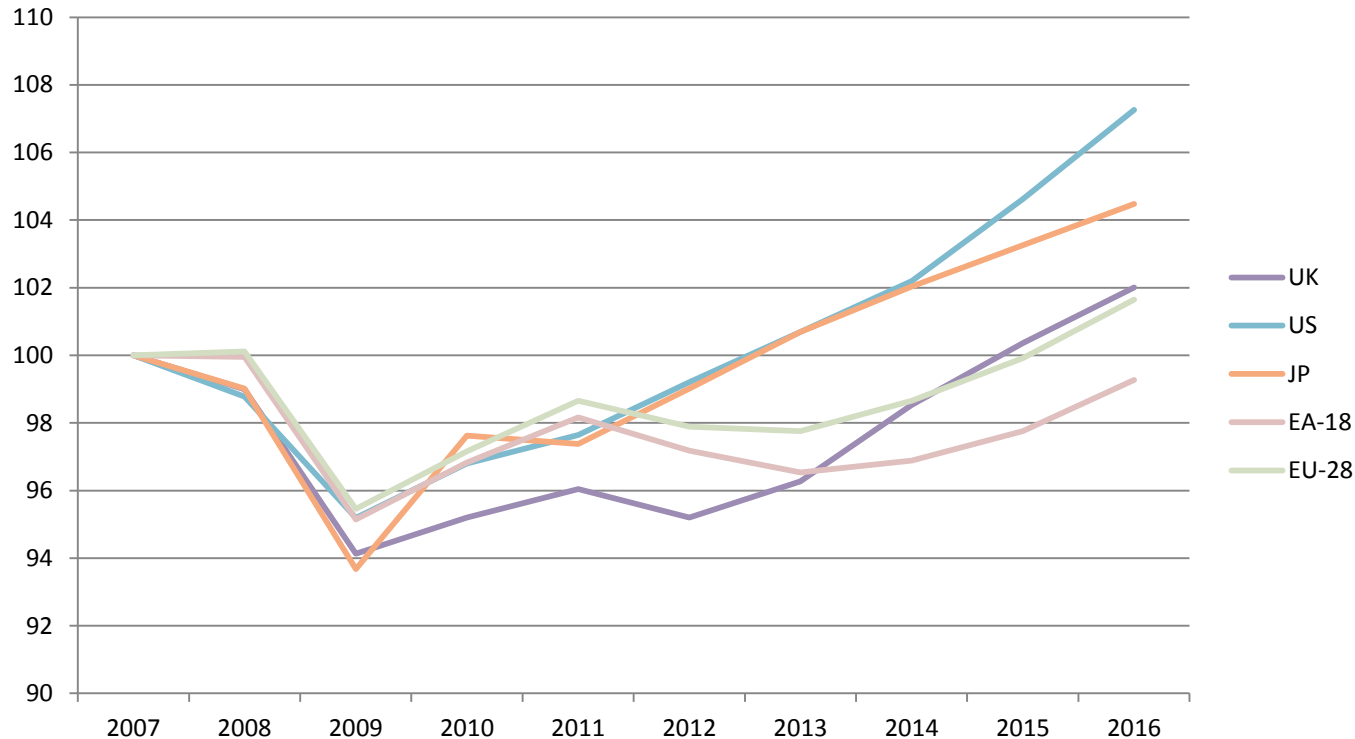
EU2020

Disappointing Performance of €A (specifically)

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

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- 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 „Wer kann, machts nicht, wers will, kann/darf nicht“
 - Collective action problem
- Poss temporary exceptions – but sustained fiscal push not possible
- Debt rule: FR/BE/ES 2pp, IT/PT 3½ pp. p.a.

Prospects – monetary policy

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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 bubbles
- Concentration of wealth effects, inequality

„Diminished expectations“ in Europe

- Not just a cyclical recovery required
- Europe2020 strategy?
- Massive investment needs (climate change etc.)
- 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“ – 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.” (Weidmann quote)

Europes Japanisation leads to taboo break

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)

Four key conclusions from recent MF literature

- MF is effective, reliably raises nominal GDP and reduces debt ratios
- MF can and should be implemented when other methods fail (Stagnation is a policy choice - Buiter)
- MF is preferable to other policies in some respects, can 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

- -> Need for a „fudge“ for ban on direct monetary financing of government budgets

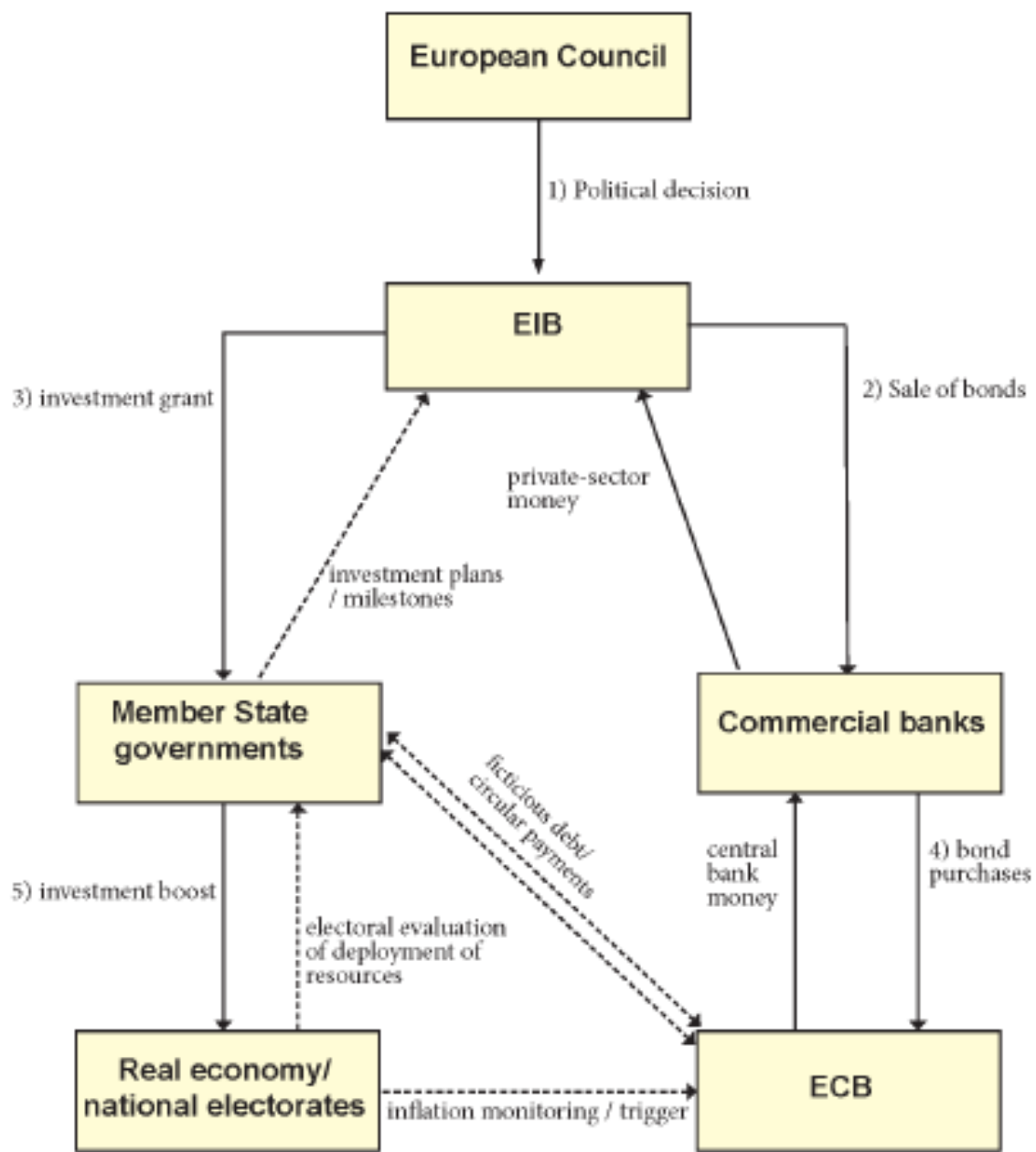
Why use public investment?

- 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

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



———— economic transaction
 - - - - - policy linkage

COMFOPI: numbers and modalities

- 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 voters for sensible use of resources

COMFOPI: Distribution/servicing

- 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

- 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!