

Way out of the corona virus crisis: alternative monetary policies

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Public debt has been increasing a lot to fight the corona virus crisis. This public debt is sustainable in most of the countries as long as the real interest rates remain below the growth rate, even with a high level of public debt ratio. However the management of the public debt has to be discussed as speculative attacks remain possible. Alternative policies exist. The fiscal orthodoxy remains strong, especially in the European northern countries and would imply a long term austerity policy. A more inflationist growth would help to reduce the cost of the debt but is not easy to manage. Higher taxation on wealth and high incomes would help to increase the public resources and would be welcome to fight inequality. However it would not be sufficient to solve the public debt problem.

The recourse to central bank is more and more requested. The QE has been used since a long time. It has helped to reduce the interest rates but it has mainly stimulated the financial markets and the real estate market with a limited impact on the real economy. The helicopter money can be distributed to households or firms. It would not be sufficiently targeted and would have a negative impact on the net wealth of the central bank. The purchase of a part of the public debt by the central bank and its transformation in a perpetual debt with limited or without remuneration is another proposal. It would reduce the public debt but could lead to increasing rates of interest on the public securities which have to be re-issued. The cancellation of a part of the public debt is a more radical proposal. It would also reduce dramatically the net wealth of the central bank and would make borrowing more difficult in the future. The monetary financing of public expenditures is the last proposal with purchase of public securities by the central bank on the primary market. For countries with a true central bank like the US or UK it would not be a radical innovation. The case of helicopter money towards government is another possibility. It would be close to the case of a partial cancellation of the public debt. It would also deteriorate the central bank's net wealth and could lead to increasing interest rates. For the euro zone countries which do not have a true central bank, the situation is different. Purchasing on the primary market by the ECB could be more efficient. But the heterogeneity of the national public debts and the lack of a European debt would remain a problem.

The countries are in contrasting economic situations. The US, in spite of huge imbalances, benefit of two main assets, the FED and the dollar. Japan is engaged in a de facto perpetual public debt which is not easy to assume in practice. The EU is paralysed by a lack of solidarity and trust between member states. The agreement of July 2020 is a first step, but limited, with a liberal framework remaining unchanged. The problem of huge and unequal national public debt ratios remain.

The corona virus crisis will be of great magnitude. According to the IMF a deep recession is expected for 2020 (-6% in the industrialized countries), more marked in Europe and especially in South Europe (-9%). A large uncertainty exists for 2021 with an optimistic scenario without return of the spread of the virus, but allowing only an incomplete recovery (-2% compared to 2009). More pessimistic scenarios can be considered in case of a more durable and recurrent pandemic in 2021 (-10% compared to 2009). Huge public deficits have been necessary to preserve the employment and the productive apparatus, leading to a surge of public debts. Banks were asked to increase loans to firms in difficulty. As the furlough schemes wind down, unemployment will increase in the second semester 2020. The out of crisis could be obtained according to two different modes, a simple return to business as usual or a transition towards a new growth regime. The first mode could be imposed under the pressure of events. The liberal model is still dominant in the anglo-saxon world and in many northern European countries. The second mode would be based on the ecological transition, the re-establishment of the social state in charge of wealth, education and ageing, the reduction of inequalities and a new design of the international exchanges to reduce the external dependency. This way is preferable but complex to implement. Beyond slogans and speeches it meets an unequal echo depending on the country.

A wall of public debt

A general increasing of the public debts is observed, with unequal levels according to the countries. This increase was inevitable and necessary to fight the sanitary crisis. The sustainability of the public debt, i.e. the absence of explosive evolution, is guaranteed without too much difficulty as long as the real rates of interest remain lower than the GDP rate of growth, even with high ratios of public debt. But the risk of speculative attacks may exist in some cases by fear of a possible default on the debt, leading to rising interest rates which, in return, triggers the public debt crisis. The level of public debt from which the risk of attack exists is unknown and depends of many parameters, especially the nationality and the characteristics of the public bonds' holders, the currency in which the debt is issued and the net external position of the country. The rates of interest are currently very low, including in nominal terms, but this cannot be regarded as eternal. An increase, even limited, of the interest rates would have a huge cost for the public finance. That is why the long term management of the public debt has to be discussed. Several alternatives exist.

Fiscal orthodoxy

Fiscal orthodoxy is always present, especially in the northern European countries. The Stability Pact has been suspended for 2020 as it had lost all meaning. The extension of the suspension has been asked for 2021 but this will give rise to debate. New institutional arrangements have also been proposed to replace the Stability Pact (expenditure rule for non-investment expenditure based on potential output growth, golden rule for the public investment, increase of the permissible debt-to-GDP ratio up to 90%). An agreement will be very difficult to find due to the many problems raised by these new rules (Dullien S. and al., 2020; Gros and Jahn, 2020). The notion of potential output gives rise to rather divergent estimations. Even the public investment is debatable. According to some, only the net investment (around 0.5% to 1.5% of GDP) must be used in the golden rule, which is rather restrictive. Conversely, education expenditures are excluded from the public investment in national accounts while they are an important determinant of the long term growth. If they were included in the investment ratio as it is suggested by some, it would increase significantly this ratio.

Faced with these problems no clear answer will be given. A general speech in favour of the fiscal rigor risks to prevail and will lead to an imperative to reduce progressively the debt burden. Such a strategy involves a permanent austerity in the long run. The English experiences are often cited, the one that followed the Napoleonic wars during the whole 19th century in a context of growing power of the English economy, that of the 1920s that imposed a penalizing purge to the English manufacturing sector. In the current situation the primacy of the fiscal orthodoxy would lead to a slow death that would favour the continued precariousness of the workforce, evolution in line with the new trends in the platform economy. But the past experiments show that fiscal austerity policies rarely reduce the public debt ratios due to the fall in growth, or reduce them only very slowly.

A more inflationist growth

A more or less inflationist growth as in the 1950s - 1960s is an efficient way to reduce the debt burden but is delicate to handle. The rate of inflation is not easy to control. The risks of slipping must be avoided, especially for countries with flexible exchange rates regime and with an important external debt. Inflation is useful for euthanizing the annuitants but it can also affect low-income poorly indexed earners. In the future the moderate growth prospects and the persistent deflationist pressures make it difficult to use the inflationary weapon. However this prospect must not be ignored. Some observers consider that the flow of large amounts of liquidity with the quantitative easing policy could favour a restart of inflation, especially in some sectors affected by production stops. This has not been observed, as it will be discussed below.

More taxation

Taxation on capital, especially real estate and land capital whose prices have been booming, and taxation of the greatest fortunes could increase the public resources. They would be combined with a reform of the income tax reintroducing significant levies on high incomes. Such measures have been implemented in the US during the 1930s and 1940s and in some countries, like Germany and Japan, after the second world war. A reform in that direction would compensate the relief received by high incomes since the 1980s. It would be useful for reasons of redistribution and reduction of inequalities. It would also contribute to change the corporate governance thanks to a taxation of the incomes of the senior executives. But it would not be, by itself, up to the size of the public debt.

The recourse to the central bank

The recourse to the central bank has begun after the financial crisis of 2008 and, even since the beginning of the 2000s in Japan, with the launching of the quantitative easing (QE). The proposals have multiplied from the helicopter currency to the partial cancellation of the public debt.

The quantitative easing

The QE is the purchase of treasury bills (and other public or private bills) by the central bank on the secondary market. In counterpart the banks' reserves are increased. This policy relaxes the interbank market and can encourage the banks to increase their credit. In practice the credit increases have been limited with the rather gloomy situation of the 2010s. However the pressure on interest rates has been reduced as the demand of bills by the central bank was increasing. This effect has been

(and is still) important in the southern European countries. Other induced effects can be underlined. If banks have granted few new credits, they (and the other beneficiaries of the QE) have bought many equities, which has kept the stock market booming. The real estate market has also been stimulated. These effects continue to exist during the corona virus crisis, especially in the US. Moreover banks and other beneficiaries of the QE can buy foreign assets to invest their cash, leading to a depreciation of the exchange rate which contributes to sustain the activity, as it has been observed in Japan and the US during the 2010s. When the QE is generalized in all the countries, these effects on exchange rates are less marked.

On the whole, the results of the QE are ambiguous. The stock markets have been hugely stimulated, even after the corona virus crisis, reinforcing the disconnection with the real sphere. The impact on the supply of credit and on the real economic activity has been weak. The balance sheet of the central banks has been unbalanced with an asset side inflated by titles of more uncertain quality. The public debt is not erased by this monetization. It is transferred to the central banks. The decrease of the rate of interest is the more positive effect, particularly for the southern European countries. In spite of the amount of cash spilled, no inflationist pressures have been observed. This result is not a surprise. If the swelling liquidity has been high (the monetary basis or the central bank money), the impact on the credit and money has been limited. The effects on the real economy have been reduced, as it has been explained, with no pressures on the demand side or on the costs. Only the prices of the financial assets and, to a less extent, of the real estate have increased thanks to the demand pressure.

The helicopter money

The helicopter money is a new form of distribution of central bank money directly to households and firms (through individual accounts in electronic currency which would be created at the central bank) or to the State (through the Treasury account at the central bank). Only the first form will be considered here. The second form will be discussed later. This mode of distribution is in theory more direct than the QE which passes through the financial markets and feeds financial and real estate bubbles. For the helicopter money supporters transfers to households and firms would be uniform as central bank has not vocation to practice redistribution or selective policies and moreover does not have the means. These transfers would be without target and for important levels (for instance around 3% of GDP of the euro zone yearly for the households). These transfers would not be permanent and would be downsized in case of inflationist pressures (Couppey-Soubeyran, 2020)

The helicopter money raises several questions. The lack of targeting raises fears of the risk of waste. More selective policies would be necessary, whether with regard to households or firms, but are not the responsibility of the central bank. The creation of individual accounts in electronic currency at the central bank for all households or firms would be a huge task. However it would partially overlap the project of issuing central bank digital money which is currently under discussion in many central banks and at the BIS. The wealth of the central bank would sharply decrease and this one could end up with negative own funds. This problem is admitted but is not seen as crucial, at least up to a certain limit. The central bank only has debt on itself and can write off the debts it owes to the banks by the creation of its own money. This remains as long as the credibility of the central bank is not affected. The dollar requirements are an exception which imposes constraints to all central banks, with the exception of the FED. The central banks can get the dollars on the exchange market or

through swaps with the FED. Negative own funds could prove to be penalizing. The BIS (2013) itself adopts a balanced point of view. It recognizes the central banks are different from commercial banks and do not pursue profits. However financial results cannot be ignored and negative capital may raise doubts and expose it to political pressure. On the whole, if its credibility is strong, financial strength would add little to a central bank's capacity to execute its policy.

A recapitalization by the State could be considered but would lose interest in the helicopter money. It is sometimes proposed to balance the negative own funds by the registration of a perpetual non-repayable debt at the asset of the central bank. However this can be hardly understood. It would be a fictitious asset which would represent a perpetual non-repayable loan without clearly identifiable beneficiaries.

The analysis can go beyond this simple statement by taking into account the induced effects and their macroeconomic impact. Households and firms could exchange their central bank currency deposits into cash or bank deposits and could spend a part of these monetary assets to consume or invest, leading to a multiplier effect. Central bank balance sheet would be improved but the initial decline of the own funds would remain predominant.

The transformation in a perpetual debt

The purchase of a part of the public debt (the one linked to the corona virus crisis especially) by the central bank and its transformation in a perpetual debt or in a very long term one, with no or little remuneration, is another proposal. In practice the ECB already holds a stock of public debts equivalent to 30% of the GDP of the euro zone. The proposal can be presented in a more or less acceptable manner. In counterpart of the redeemed public debt, a non repayable debt or an automatically reissued debt at very low interest rates would be held by the central bank. The proposal has some advantages and drawbacks. It is neutral in appearance (the net wealth of the agents is unchanged). The public debt, forgiven the perpetual debt, is by definition reduced but the central bank holds a non repayable asset and supports an increased liability of the same amount. The gains earned by the State thanks to the reduction of the interests paid are offset by lower dividend payments by the central bank. The issuance of new bonds as a replacement for maturing securities could be done under less favourable conditions than those currently prevailing. This could particularly be the case in the euro zone where some countries, like the southern ones, face higher levels of public debt and deficits. An agreement in this direction will be difficult to obtain at the European level, except for a rather limited fraction of the public debt directly linked to the corona virus crisis.

The cancellation of part of the public debt

Traditional debt restructuring measures (rescheduling, non payment of interests) can be punctually implemented by countries no longer able to meet their financial commitment. These measures are painful for the banks, the savers and the reputation of the countries. The cancellation of part of the public debt bought by the central bank is a more radical proposal which rejoins the previous one (transformation in perpetual unpaid debt) in its most extreme version (Sciallom and Bridonneau, 2020). In counterpart of this cancellation the governments would engage more in investments in favour of ecological transition. By definition the public debt would be reduced but this cancellation would lead to a huge decrease of the net wealth of the central bank, far higher than the current level

of its own funds. As previously, this is accepted and regarded as non crucial by the supporters of this measure. However the reputation of the central bank would be weakened. The risks of a rise in interest rates on securities to be renewed would be important. The possibilities of borrowing in the future would be reduced, leading to durably more restrictive fiscal policies. Go in such a direction would not be an easy road. As it will be discussed below, the room of manoeuvre varies depending of the size and the status of the country.

Cancellation of part of the public debt held by the central bank is quite different from a partial cancellation of public debt held by private agents, banks and other debt holders. Banks losses due to the depreciation of banks assets would be huge and would need a recapitalization (difficult with the decrease of the profits), a recourse to the market or a partial nationalization (equally difficult solutions). The losses of the other public debt holders (often through financial institutions) would also be significant. They concern very rich households (but not always as in Italy where public securities are very wide spread). As before the sole perspective of such a cancellation would lead to a sharp increase of interest rates and the possibilities of borrowing in the future would be limited. The countries that have used this road in the past have done it in last resort after a long crisis or after a war.

The recourse to monetary financing

The possibility of monetary financing of the public deficit by purchase of government securities at issue, i.e. on the primary market, by the central bank is presented as a last alternative to loosen debt constraints (Harribey et al., 2020; Wray, 2012). For the countries with their own central bank (US, UK, Japan) such a measure is not fundamentally different from the purchase of government securities on the secondary market. The central bank refinances the banks through the repo of Treasury bills at an interest rate very close to the emission rate. In this framework the recourse to monetary financing does not bring anything new. The government can arbitrate between short term and long term financing. When long term interest rates are nil as to day, the government can prefer long term financing that protects him from risk of rate hikes. On the whole the State has wide facilities as long as confidence in the currency remains (Sterdyniak, 2020). The risk of inflation slippage must be evaluated. In the actual context deflationist forces dominate as a consequence of the recession, of the permanent pressures in favour of more labour flexibility and of the effect of globalization. At medium term, with a prolonged experience of monetary financing, the question of inflation could reappear if monetary easing induces more sustained wage growth or a higher demand compared with the increase of the supply. This risk cannot be ignored, even if it is unlikely at short term. It has to be monitored and, in case of materialization, it would induce a reversal in the monetary policy. The history shows that some countries, not always peripheral ones, have abused of the facilities of monetary financing and has experienced important setbacks, especially in terms of inflation and currency crisis.

The use of helicopter money towards the government is a form of monetary financing of the public expenditures, but according to different modalities. The Treasury account at the central bank is provided with a certain amount of helicopter money in order to finance new public expenditures. These public expenditures are financed without increasing public debt, which seems an advantage compared with the previous case, but in counterpart with a decrease of the net wealth of the central bank for an equivalent amount. In its principle the use of helicopter money in favour of the

government is close to the partial cancellation of the public debt held by the central bank, which has been discussed above. In both cases it is a pure monetary financing of the public expenditures. The main drawback is the worsening of the own funds of the central bank. This problem is admitted, but not considered as crucial by the supporters of these policies, as it has been explained above. The other negative effects are also present: risk of rate hike on the securities to be reissued, difficulty to resort to borrowing in the future.

For the euro zone countries the stakes are different as the ECB is not a true central bank for each national State. There are national public securities, but no European ones, with the exception of the small amount which will be issued after the last European agreement of July 2020. Due to the heterogeneity of the euro zone long term interest rates on the European public securities have evolved differently according to the countries: slightly decreasing in Germany, stable in France, surges upward for fear of a crisis leading to a euro exit in Italy and Spain. Purchases on the primary market could avoid or limit the risks of pushed up of interest rates for fear of a crisis in the most threatened countries. But tensions on maturing securities which must be reissued would remain. All the national public debts are not explicitly guaranteed and markets can impose risk premium on long term securities. The monetary financing of public expenditures by purchase of securities on the primary market would not change the basic problem. Even if the conditions of redemption by the ECB have been enlarged and relaxed, the unconditional purchase of national public securities by the ECB would be hardly accepted by all the euro zone members due to the heterogeneity of these securities. To reach such an agreement, it would be necessary to put national fiscal policies under strict supervision, a condition which itself would face a strong opposition.

Conclusion: contrasting economic situations

USA

The US have managed the corona virus crisis in a chaotic way. But the economic support plan, both from the State and the FED, has been huge. Thanks to the QE and the GAFA performances the stock exchange has recovered. The recovery of the real economy is more uncertain. Sectors are unequally touched and income inequality has increased again. But the size of the US federal budget (30% of the GDP) generates strong redistribution mechanisms between the States which are absent in the European case. Moreover the dollar and the FED are major assets. Financing public deficit is not a real problem and the FED intervenes as lender of last resort. However structural unbalances of the US economy remains or are even amplified.

Japan

Japan has been rather successful in fighting the pandemic itself. Its economic policy has been active with a public expenditure support plan of 18% of GDP in April 2020, combined with guaranteed public loans of an equivalent amount, leading to issuance of public securities of nearly 40% of GDP. The public debt ratio, already at 240% of GDP, will reach surprisingly high levels. The Bank of Japan has accompanied this evolution since a long time with an accommodating policy. 10-year interest rates have been brought back to 0% since 2016. QE has continued at a large scale, leading the Bank of Japan assets to 110% of GDP. The equities' prices have recovered. The yen has resisted without marked depreciation, which reflects the preference of Japanese investors for domestic investments and the confidence of foreign investors in Japanese experience. This quasi-perpetual public debt held

almost exclusively by residents and public financial institutions seems sustainable. However the results of the real economy are less convincing. On a recurring basis the government has launched plans to restore public finances, especially based on increasing value added tax. These plans have contributed to break growth. The last one was in 2019 before the corona virus crisis and growth had collapsed from the last quarter of 2019 (-7.1% in annual terms). This periodic search of a fiscal stabilisation reflects the difficulty for the Japanese authorities to live an exorbitant level of public debt. A quasi-perpetual public debt, even held by domestic agents and with sophisticated financial arrangements, is not easy to assume. The final step, the partial cancellation of the public debt held by the central bank, is not considered, even if the Japanese economy would be in a good position to take this path.

EU

The EU is paralysed and divided with a lack of solidarity and trust between the member states which makes difficult the implementation of appropriate reforms. The measures adopted until now at the EU level have been insufficient: 540 billion euro of loans in April 2020 divided into 100 billion euro of loans of the Commission to help cover partial unemployment, loans of the IEB to firms up to 200 billion with a State guarantee and possible appeal to the ESM loans up to 240 billion, but limited to 2% of GDP for each country and submitted to the usual conditionality (except for the expenditures directly linked to the corona virus). Most of the support has been provided by the national fiscal policies for important amounts, but smaller than those observed in the US or Japan (-8.5% of GDP for the public deficit expected in 2020 on average for the whole euro zone). The recourse to partial unemployment has been widely used, which has limited until now the burst of unemployment and preserved the work collectives, in contrast with the US. The interventions of the ECB have also been huge with the PEPP programs (750 billion euro in March 2020), following the previous one (PSPP with 300 billion) and completed by an additional envelope in June (600 billion). The purchases of securities mainly concern public ones that can be purchased in a flexible way without having to respect proportions for each country in terms of the structure of the ECB capital. It has helped to reduce the interest rates, especially for southern countries.

Various projects have been discussed since March 2020: creation of coronabonds, non official Spanish project of a support fund of 1500 billion euro (around 10% of European GDP) financed by a European perpetual debt and distributing grants during three years through the European budget, recovery fund proposed by the Hulot foundation issuing European bonds (2000 billion over seven years, i.e. 2% of European GDP each year) and financing investments through the national budgets (Grandjean, 2020). The implementation of these projects would raise different problems. Who would buy a perpetual debt? Which new taxes would finance the debt burden? Which kind of control would be exercised on the new expenditures?

Anyway the debate is now concentrated on the agreement reached at the EU summit of July 2020. This agreement is based on a European commission loan of 750 billion euro over six years with long term maturity (up to 2058). 390 billion of these 750 billion will be distributed as grants to the national governments through the canal of the EU budget. They will be allocated to countries using criteria like unemployment and income per capita. The Commission will evaluate government investment plans which will have to be compatible with the objectives of the Commission, the Green Deal but also the traditional neo-liberal measures in favour of flexibility and competitiveness. The

repayment of the loan will begin in 2028 and will be financed either with new European taxes (tax on plastics, tax on financial transactions, carbon tax, digital tax) or with new resources coming from the States or with expenditures cut. The uncertainty of these new resources will fuel a permanent debate in the next years.

This plan has been presented as historical as it includes the principle of a European debt and the principle of transfers in favour of countries most affected by the crisis. In fact it is a first step, but limited. Germany has accepted to make a compromise in order to avoid a burst and preserve the euro zone of which it is one of the main beneficiaries. The launching of a European debt is a good start but the modalities of repayment of the loan are not fixed and will be an important stake. The amount of the plan is small. If we consider only the grants, as the loans were already important and cheap, we have to subtract 78 billion euro that are simple redeployment of expenditures already acted (cohesion policy, rural development, Just transition fund). There is only left 312 billion to be spent over three years (0.7% of the European GDP each year), not insignificant (especially for countries whose shares will be higher like Spain or Italy) but small compared with the extent of the recession. More worrying, the European liberal framework remains unchanged. The national investments financed by the plan will be controlled, which can be understood. But it will be done inside the European semester using the traditional liberal criteria with advocacy in favour of “structural reforms”. Flexibility, competition policy and fiscal competition will remain the dominant features.

On the whole, the economic support combining European and national levels will be important but inferior to what is observed in the US or Japan. The dominant liberal framework will not help to find an appropriate answer to the two main challenges of the EU, the ecological transition and the fight against the crisis and the intra-European imbalances. The problem of huge national public debts will remain unsolved, especially in southern countries. The alternative policies which have been discussed above (transformation of part of the public debt held by the ECB in a perpetual debt with little or no remuneration, partial cancellation of this public debt) will not be easily adaptable with euro zone framework. The unequal level of national public debt ratios will be problematic. With the redefinition of new fiscal rules for the euro zone, the risk remains that restrictive fiscal policies will be imposed.

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