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EXPERT CONTRIBUTION

NAME: Jasper Sky
MAIN JOB / POSITION: Economic Journalist. Deutsche Welle
STATE: United Kingdom
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Opinion: ECB could fund a European renaissance

The ECB's decision to begin buying previously issued government bonds isn't going to rescue Europe's economy. The ECB needs to go a big step further, says Jasper Sky in an op-ed for DW.

ECB president Mario Draghi has announced that starting in March, the ECB will buy 60 billion euros' worth of private and sovereign bonds from investors such as pension funds, insurance funds, sovereign wealth funds, and banks.

This will be done using a remarkable power that only the central bank possesses: namely, the ability to conjure money into existence simply by entering numbers into its own account - without generating a corresponding amount of new debt.

The hope is that this will stoke the economy, avert deflation, and restore growth.

Unfortunately, the results are likely to be disappointing. The ECB is merely copying the US Federal Reserve's Quantitative Easing (QE) program, which over the past several years has spent $4.5 trillion (3.9 trillion euros) buying previously issued bonds on secondary bond markets.

The US QE program generated a huge bubble in the stock market, and made wealthy shareholders even wealthier. But economic research has shown the program had only a very modest positive effect on the real economy.

The money could be put to incomparably better use.

Instead of merely pumping up stock markets, the ECB could straightforwardly finance an awesome European renaissance - by giving fresh debt-free money to a European sustainable infrastructure construction fund.

Here's how this could work

The ECB remains bound by Article 123 of the Lisbon Treaty of 2007 that prohibits it from directly extending credit to governments or public agencies.

That's why the ECB, in its new "expanded asset purchase programme" (EAPP), is using a simple trick to circumvent this prohibition: It's only going to buy government bonds on secondary bond markets, from private investors who in turn bought them from their primary issuers - i.e. eurozone governments.

The ECB could use exactly the same trick in a slightly different way to pump money directly into a European Renaissance Fund managed by the European Investment Bank (EIB).

The publicly owned EIB could announce that it will issue, in the course of 2015, 600 billion euros' worth of new Sustainable Infrastructure Construction Bonds with maturity dates of infinity, carrying interest rates of zero, for sale to private investors at face value.

At the same time, the ECB could announce that it will buy the bonds from those private investors the very next day, at a slight markup (say, 0.01% on the bond's nominal value), so that the investors are left with a modest profit.

Presto. A monetary magic wand is waved, the prohibition against direct ECB purchases of newly issued bonds from public-sector issuers is not formally contravened, and serious money is made available to re-launch Europe.

The program would be continued for several years, at a pace of 60 billion euros a month - or in whatever amount the ECB deems appropriate in light of its monetary policy mandates - for as long as it takes to reduce Europe's debt load to a sustainable level, and its unemployment rate below four percent in every region of the continent.

Full employment

These funds would enable Europe to hire millions of Europeans and build world's best public infrastructure: a low-carbon energy system, better hospitals, improved transport and communications networks, solar-powered desalinization systems for the parched South, new public recreation facilities, better schools.

The money provided would be interest-free and debt-free, which means it won't need to be repaid. The new infrastructure would be paid for on a sunk-cost basis and remain publicly owned.

To ensure maximum financial efficiency, it could be built and operated by private contractors under competitive-bid, cash-on-delivery construction contracts and fee-for-performance operations and maintenance contracts.

That means the price of energy produced from clean energy systems, for example, would only have to cover the operations and maintenance costs of the equipment. Energy would become cheaper as well as cleaner.

Unfounded fears

The motivation behind the Lisbon Treaty's prohibition on direct financing of government projects using the ECB's magic monetary wand is the fear that if governments could turn to the ECB to finance projects, they would get carried away and overspend.

The risks are thought to include a huge expansion in the money supply, rising inflation, and a collapse in demand for borrowing money from private investors.

But the huge amount of money flushed into the accounts of financial investors over several years of QE in both Japan and the USA haven't resulted in inflationary disasters. In Japan, they're still struggling to overcome deflation.

And as the money created enters circulation through my proposed Renaissance Fund, some of it would end up being used to pay off old debts. Europe's public and private debt load would shrink.

Monetary hawks also see direct central bank financing of government projects as an infringement on the hallowed principle of "central bank independence."

But what if the hawks are wrong?

Adair Turner says we should do something like this

One of the voices raised recently in support of direct monetary financing of new public spending is that of Lord Adair Turner, who was chief of the UK's Financial Services Authority from 2008-2013. In 2012 he was among the top three contenders to become the head of the Bank of England. Turner is now a senior fellow at the Institute for New Economic Thinking.

Turner argued in a much-discussed article published in November of last year in the Financial Times that in an environment of excessive accumulated private and public debt, with high unemployment and low growth, the central bank money-printing power should be used to directly fund government deficit spending and stimulate the economy.

"There are no technical reasons to reject this option," Turner wrote, "only the fear that once we break the taboo, money-financed deficits will be used on too large a scale."

The amount of money provided annually through this mechanism should be left to the discretion of the central bank - and the uses to which the money is put left to the discretion of the government.

In this way, neither the principle of central bank independence, nor the principle of democratic control over decisions about how public money is spent, would be violated.

Lord Turner isn't the only proponent of using the central bank balance sheet to revive economic growth and fund public infrastructure. Martin Wolf, the widely respected senior economic commentator for the Financial Times, has repeatedly made the same point - for example in a strongly worded FT.com column of February 2013 entitled "The case for helicopter money," in which Wolf argues that "the view that it is never right to respond to a financial crisis with monetary financing of a consciously expanded fiscal deficit ... is wrong. It simply has to be in the tool kit."

This simple mechanism would certainly suffice to restore economic growth in Europe. And restore growth we must. Public disenchantment with a faltering economy is increasingly turning into disenchantment with the European Union itself. The best way to counter the risk that the European project could fail is to fund a renaissance of Europe's economy.

There's simply no need to keep punishing Europe with a dramatic unemployment rate and crumbling infrastructure. We already know how to fix this.

It's time to break the taboo.