



POLICY BRIEF

#12 JUNE-JULY 2020

EPOG INTERNATIONAL MASTER'S COURSES

EPOG STUDENTS AND ALUMNI ASSOCIATION

Policy Debate - Special Issue

"Policy Mix in the Eurozone facing Covid-19"

**Euro Treasury,
Job Guarantee and
MMT: Time for a
Fiscal Theory
of Economic
Stabilization**

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Restarting the European economy with mere monetary policy will not work. If demand is to be increased, it will have to be through government spending. To that end, Dirk Ehnts proposes a public Job Guarantee to combat both unemployment and low demand across the European Union.

The Coronavirus has created economic and social havoc. In what macroeconomists would label an "exogenous shock" - while admitting in private that globalization surely would have something to do with it - we have seen thousands of victims all over Europe. Parts of Europe's population have been under lockdown, some briefly, others for quite some time. GDP growth in the first quarter of 2020 is down by 3.8% and 3.5% in Eurozone and EU, respectively. From a macroeconomic perspective the big issue is how to restart the economy after a shock to both the supply and the demand side.

The traditional kick-starter is out of service and will not be available: monetary policy. A five percent interest rate drop would take the main refinancing operations rate of the ECB deep into negative territory. Even if that would happen, it would surely not stimulate economic demand. With conventional wisdom out of the window, the Eurozone and the EU will have to be creative if they want to survive politically. The Eurozone, built in the neoliberal era which has now come to an end, puts up quite some roadblocks with respect to fiscal policy (see Wray 2012, p. 169-184). Assuming that trade policy is out - neither US nor China would take another round of Quantitative Easing (QE) without retaliation - and that no changes in other variables are imminent, fiscal policy is the only game in town. If demand is to be increased, it will have to be through government spending.

THE EUROPEAN RESPONSE TO THE CRISIS

That must mean higher public deficits and higher public debts. The European Commission has acted in mid-March and activated the general escape clause of the Stability and Growth Pact (SGP). “Excessive” deficits are not a problem anymore. The other problem that we remember from the Euro crisis that started in 2010 is rising yields and hence rising interest rates on government bonds of crisis countries. This time around, the ECB has acted swiftly and created a Pandemic Emergency Purchase Programme (PEPP) to ensure that all Eurozone governments - including that of Greece - will be able to spend as much as they wish. The program, following that proposed by Ehnts (2016, p. 200) - “any default risk of sovereign securities would be a thing of the past” - comes with no actual limits in terms of size and time. “Whatever it takes” is what the ECB said. These two policies were enough to not repeat the Euro crisis of 2010. Austerity, at least for the moment, is off the table. Member states have regained fiscal sovereignty in the sense that they are free to set the level of government spending as they wish.

Whether the resulting higher government deficits and debts become a problem depends on the development of the following three dimensions: deficits, debt and interest rates/yields. The deficit question is easy to answer. As long as the general escape clause is activated, deficits do not matter. When will it be deactivated? Well, not before 2022 for sure. So, if economies are back on track by 2022 they will have the deficits they had in 2019 and the situation will be the same as before. With respect to public debt there is almost no problem at all. Somewhere in the European Fiscal Compact there is a 60% debt to GDP limit. The structural deficit can be 1% for countries that have less public debt and 0.5% for those that have more. Given that most Eurozone countries' public debt is well above 60% of GDP it probably does not matter whether, for instance, Italy's public debt to GDP ratio has reached 130% (2019) or 170% (say, 2022). The ratio most probably won't fall below 60% for as long as the Euro lasts.

LEARNING TO LOVE PUBLIC DEBT

Baptiste Bridonneau and Laurence Scialom have recently argued that we should think about “a cancellation of national government's debts” in proportion to their green investments (Link). This proposal seems well-intended, but it reinforces the neoliberal framing of government debt as inherently “bad”. Why should one

cancel government debt? Government normally cannot run out of its own money and in case it occurs, why not change the rules regulating the monetary system to ensure that the government can always sell bonds to investors? For those who think that interest rates on government debt are the driver of inequality: think again. Public debt is increasing since the 1980s, but interest rates have been falling. They are pretty much zero now or even negative. Still, this has not led to a decline in inequality.

Now let us turn to the interest rate on new government securities and the yield on existing ones. Since the PEPP is in operation, the feared “spread” - the yield differential with respect to German government bonds - will not be a problem. However, PEPP is not a permanent feature of the Eurozone - yet. The ECB's governing council will determine whether this happens. Assuming that during the next quarters, Eurozone governments will increase government spending to prop up their health care systems and fight unemployment, public debt in the Eurozone will probably go up by 20% or 30% on average. Some countries will see their public debt go up by perhaps 50% in two years. It will be clear to everyone that the ECB is the buyer of last resort of those countries' government bonds, and that without the PEPP the countries would not be able to sell their bonds and hence use their national central bank to help with the actual spending. Yields would skyrocket and spell the end of the Euro.

The ECB has a clear mandate, and that is to maintain price stability. Letting a big country drop out of the Euro means that the ECB will have a problem with its inflation target of close to, but below two percent. Returning to a national currency, the former Eurozone member will depreciate its currency (if it is not Germany that leaves). That would make imports from that country cheaper in Euros and hence create a deflationary impulse. Usually, those are unwanted as the ECB has struggled for more than ten years to achieve its inflation target of close below two percent. So, there would be a justification of making PEPP permanent.

The German constitutional court will probably have a say about an arrangement like this but it will take years to get there. If a German court finds itself competent to watch over supranational institutions and the European Court of Justice, then the whole construction of the European Union as a supranational state is in danger, not just the ECB bond purchasing programmes.

THE FUTURE OF THE EUROZONE

When the economic recovery is complete, a new fiscal theory of economic stabilization must rule. The ECB's interest rates have been hovering around zero for almost a decade. A fall in the interest rate is not possible without moving heavily into negative territory. Even if it would happen, private investment will very likely not react to that. Since the 1980s we have seen a falling level of private investment and falling interest rates going hand in hand. That is not a coincidence. It is the lack of private investment that leads to a weak labor demand, which then causes slower wage growth and hence lower inflation. To that, the central bank reacts with lower interest rates. This strategy has failed. There will not be any "normalization". A policy rate of zero is the new normal. In the background, productivity growth has reduced the demand for labor. It would be important to reduce the regular working week to four days with full wage compensation such that more workers participate in the economy. Full employment is not attainable without the reduction in working hours.

How should fiscal policy be organized to deal with business cycles? Old school Keynesians would argue in favor of discretionary spending, but that is not acceptable to many politicians on the right. They would fear that the government would use its spending to create jobs for its supporters, thus leading to inefficiency and waste. While this is surely overdrawn, there are alternatives that neutralize at least some of the concerns. A Job Guarantee rooted at the level of communities and financed by the federal government would create space between those in power and those who receive the jobs. The idea is simple: Those that want to work but cannot find employment are offered a job by the local government. They can choose from a menu of jobs that should suit their skills and knowledge.

The Job Guarantee pays a living wage that supports a family, including health care, pension plan and other social benefits (see Tcherneva 2018 for the application in the US). It would thus act as a minimum wage in countries and sectors where none existed before. The Job Guarantee puts pressure on employers to offer good and well-paid jobs. The offer of jobs would be determined locally. A variety of options should be available for all: full positions (probably based on a 32-hour workweek), part-time work, summer jobs, short-term contracts, etc. The Job Guarantee comes on top of all other institutions and does not replace unemployment benefits or other institutions. One might still be unemployed and not want to work. Only those who are unemployed and would not like to continue to be unemployed are of-

fered a job. Since our societies care for the unemployed anyway, making sure that they are fed, clothed, have a roof to sleep under, there is no fundamental change at work. It still pays to move to a better-paying job in the private or public sector, so workers should be motivated to transfer out of the Job Guarantee jobs and into regular employment in good times.

The federal government would pay for the Job Guarantee jobs. In the Eurozone, Cruz-Hidalgo et al. (2019, p. 101-102) propose to create a Euro Treasury that pays for the fiscal costs of that program:

In short, what we propose is for the Euro Treasury to establish a new fiscal institution that would issue sovereign securities. For simplicity, we call these eurobonds. The eurobonds would be eligible as collateral to borrow from European Central Bank (ECB) to the full extent possible. As the ECB is only prohibited to finance national governments directly, it could put its full support behind the eurobonds, meaning that it could promise to buy up as many eurobonds as necessary. Acting as a buyer of last resort it would guarantee that investors would always be able to sell eurobonds at a fair price without creating a large fall in the price of eurobonds. Thus, the ECB would ensure sufficient liquidity in the market for eurobonds. De facto, the Euro Treasury would spend first and tax later, thus removing the need to finance the European Union's budget by transferring money from the budgets of the Eurozone's member countries.

Cruz-Hidalgo et al. (2019, p. 107) stress that the Job Guarantee would be an automatic stabilizer:

If Europe were to institute a standby policy of hiring the unemployed at all stages of the business cycle at a base (non-competitive) wage, the Job Guarantee pool would expand with recessions as people are laid off and enter the program. The expenditure of employing them is the very stimulus that resuscitates the European economy. As the private sector recovers, the program helps JG workers transition to better-paid private sector employment opportunities. Macroeconomic and price stabilization are achieved in a similar way as with the NAIRU except by a fluctuating pool of public service sector workers.

This would solve the unemployment problem that we have seen so far in the Eurozone. Government spending has been too low all of the time. This led to mass unemployment in the Eurozone that has been unnecessary. It also solves the political problem associated with government spending, namely that those who get jobs

vote for the party that gave them the job. Now, it is a job that is guaranteed to the workers and administered on a local level. The wage is fixed, and so are the other terms of employment.

ECONOMIC POLICY FOR THE 21ST CENTURY

The other step that needs to be taken is to address what we do with the increase in government spending. Addressing climate change, we should reduce the workweek to four days and start a socio-ecological transition as described in the Green New Deal for Europe (Adler and Wargan, 2019). We should also reregulate the financial sector as proposed by Mosler (2009). This is not the time to “return to growth” or “stabilize the economy” - it is time to move forward and start rebuilding our societies.



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