corona crisis

Monetary financing in the euro area

Funding the public response to the corona crisis without increasing debt and austerity.

With Europe in lock-down, awareness is rising that monetary financing is the appropriate way to fund the public response to the corona-crisis. Member States should not be forced to look for funding on the capital market. Instead, they should receive targeted funding directly from their national central bank (NCB). That would enable Member States to limit the damage and avoid a recession. Debt and austerity are among the greatest dangers of the corona crisis. Debt proliferation can spiral into a full-scale financial crisis and a great depression. With monetary financing this can be avoided.

Monetary financing

Monetary financing is a term for funding budget deficits via the central bank. This is generally considered unwanted as it makes monetary policy prone to political opportunism. Usually, central banks restrict their operations to financiers, typically banks. This is enshrined in the Treaty of the European Union which prohibits central banks to extent credit to public authorities. This policy, however, delivers the European Nations to the mercy of commercial financiers who receive virtually unlimited support from the ECB to exploit the crisis.

Call for monetary financing

Ons Geld was among the first to call for monetary financing in response to the crisis. The strongest appeal in the Netherlands, however, came from Lex Hoogduin a monetary economist and former adviser to the first President of the ECB, Wim Duisenberg. His proposal became known as 'Plan Hoogduin' in which the ban on monetary financing is temporarily lifted. This provoked a discussion in Parliament compelling finance minister Wopke Hoekstra to give his position on monetary financing in writing. So far, he is sticking to article 123 TFEU that prohibits central bank credit facilities to, and bond purchases directly from public authorities.[1]

[1] Article 123 paragraph 1 TFEU: "Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as 'national central banks') in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments."

Monetary financing was raised on the international stage too, were leading economists Paul de Grauwe en Willem Buiter explained why it is needed. Buiter, for instance, wrote together with Sony Kapoor:

> *"A one-off transfer of 20%-30% of GDP worth of cash to governments by their respective central banks may be the single best macro policy to fight the COVID-19 crisis. It will provide the kind of lightning speed and gargantuan scale needed* ***to outrun the meltdown*** *and will* ***leave no debt overhang or counterproductive future austerity****. It will help avoid the kind of hesitation, from governments trying to raise cash or balance books, that can literally kill citizens and destroy economies."*

Meanwhile, the United Kingdom implemented monetary financing by temporal extension of the *ways and means facility* which gives the government access to central bank credit. The United Kingdom can do so, because it is allowed to deviate from the prohibition of monetary financing by using that facility (article 10, Protocol 15, TFEU).[2]

Three proposals for monetary financing

So far, three proposals have surfaced for monetary financing in the euro area:

1. *Political/Consensual* (proposed by Lex Hoogduin): The European Union decides to waive article 123 TFEU temporarily to enable the National Central Bank (NCB) of each Member State to provide targeted funding to its Member State via overdraft facilities ('Plan Hoogduin'). This scenario was tabled in Parliament of the Netherlands on April 7th, 2020 and received 25% of the votes. This is not quite a majority which could force Wopke Hoekstra to raise the issue in the Eurogroup. It is, however, a considerable basis for a start.

2. *Monetary* (proposed by Ons Geld): The ECB uses its legitimate powers to provide liquidity to Member States (instead of financiers) in the form of Emergency Euro Notes. This proposal makes it clear that monetary financing is allowed under the Treaty, albeit under the sole discretion of the ECB.[3] So far, the ECB has not made any move in this direction, though, leaving Member States to the mercy of commercial financiers.

[2] Article 10 Protocol 15 TFEU: "Notwithstanding Article 123 of the Treaty on the Functioning of the European Union and Article 21.1 of the Statute, the Government of the United Kingdom may maintain its 'ways and means' facility with the Bank of England if and so long as the United Kingdom does not adopt the euro."

[3] Article 128 paragraph 1 TFEU: "The European Central Bank shall have the exclusive right to authorise the issue of euro banknotes within the Union. The European Central Bank and the national central banks may issue such notes. (…)"

3. *Political/Monetary* (proposed by Talousdemokratia): Member States ask for permission to issue Emergency Euro Coins. This proposal has a special quality, as it enables each Member State to force the ECB to publicly declare its position on monetary financing.

Emergency Euro Coins

Normally, Member States are not allowed to influence the ECB (article 130 TFEU).[4] By using its power to coin euros, however, a Member State can engage the ECB nonetheless. Article 128 TFEU subjects the volume of coinage by Member States to approval of the ECB.[5] Hence, it is mandatory for any Member State aspiring to issue Emergency Coins to raise the issue with the ECB, and thus provoke a public response from the ECB.

Use of Emergency Euro Coins is similar to the use of Emergency Euro Notes. The main difference is that the coins are issued by the Member States whereas the notes are issued by the NCBs.[6] Member States can use Emergency Euros (coins and notes) by depositing them at

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[4] Article 130 paragraph 1 TFEU: "When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. The Union institutions, bodies, offices or agencies and the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the European Central Bank or of the national central banks in the performance of their tasks."

[5] Article 128 paragraph 2 TFEU: "Member States may issue euro coins subject to approval by the European Central Bank of the volume of the issue. The Council, on a proposal from the Commission and after consulting the European Parliament and the European Central Bank, may adopt measures to harmonise the denominations and technical specifications of all coins intended for circulation to the extent necessary to permit their smooth circulation within the Union."

[6] Emergency euro *notes* require an exemption from the ECB-policy to treat returning banknotes as liabilities. This policy is enshrined in article 3 paragraph 3 ECB/2010/29: "NCBs shall treat all euro banknotes accepted by them as liabilities and process them in an identical manner." For coins other rules apply, most notably article 6 EC/3603/93: "The holding by the European Central Bank or the national central banks of coins issued by the public sector and credited to the public sector shall not be regarded as a credit facility within the meaning of Article 104 of the Treaty where the amount of these assets remains at less than 10% of the coins in circulation." Article 6 EC/3603/93 limits the amount of coins an NCB can credit to the public sector. This presupposes that an NCB credits a Member State for euro coins it receives from that Member State. In the case of Emergency Coins, the Member State deposits those coins at a commercial bank, which can in turn deposit them at the central bank. In that case the public sector is not credited by the NCB; the banking sector is. Depositing Emergency Coins at a commercial bank provides the Member State with bank balances and access to payment services which enables it to use the newly created money in the economy.

a commercial bank receiving bank balances and access to payment services in return. For banks, Emergency Euros are safe and interest free assets which they can use to pay other banks. They can also deposit these safe assets at the NCB in return for interest bearing central bank balances.

Politics and inflation

Central bank credit extension to public authorities is prohibited in the Union. That is essentially a good thing to safeguard central banks from political opportunism. Under current crisis conditions, however, monetary financing is the best thing to do. It avoids the proliferation of debt and subsequent austerity. It also limits the risk of runaway inflation because it brings liquidity exactly where it's needed, without overflowing capital markets randomly with money. Obviously, Member States should not receive blank checks from their NCBs. Issuance of Emergency Money must be measured and restricted to health care expenditures and prevention of foreclosures. The risk of severe austerity and a great depression can then be averted at virtually no costs.

Public policy

Existing policies, on the other hand, entail enormous costs and risks to society. They are focused on state guarantees and subsidised credit to banks and asset purchases from financiers.[7] Banks can now fund their operations against a bonus rate of -0,75%, meaning they get paid to borrow money.[8] They can also pass on risks by selling assets to the central bank, getting money in return. The Union removed all constraints to overflowing households, businesses and public authorities with debt, by supporting financiers. These financiers are enabled to exploit the crisis and shift the risks to the public sector. Meanwhile, Member States are pushed into debt sharing arrangements which will inevitably result in the formation of a European super state. Withholding monetary financing is thus used to forward a political agenda, to the detriment of free enterprise and sovereign nations.

With monetary financing, however, the proliferation of debt can be avoided. Public authorities, households and businesses need not to be delivered to commercial financiers to overcome the crisis. It's far better to use the sovereign power of money issuance to help them survive without increasing debt. That will also make it much easier and less costly to restart the economy after lock-down.

[7] EU, March 2020, Coronavirus response; ECB, Pandemic emergency purchase programme (PEPP)

[8] ECB, 12 March 2020, ECB announces easing of conditions for targeted longer-term refinancing operations (TLTRO III)

Asset purchase programs

Monetary financing also prevents the socialisation of risk through asset purchase programs like PEPP. Under these programs, central banks buy huge amounts of debt on interest bearing credit. Interest rates are currently low, so central banks don't feel the pain yet. That may change rapidly though, because central banks provide tons of money to financiers while production and consumption crumble under lock-down. Rising interest rates and inflation can hit the markets at any time. That would be the final blow to the already over-indebted market economies. It could even be the downfall of the central banks and the currencies they are supposed to govern. Rising interest rates increase the costs for central banks which will have to remunerate their creditors correspondingly. Moreover, rising interest rates might ignite a chain-reaction of foreclosures plummeting the value of the debts purchased by the central banks. These purchases were never meant for making a profit anyway. They were meant to bail out financiers to artificially prop up the markets and prevent interest rates from rising. However, the central banks cannot maintain this indefinitely.

A cash-based euro

Purchase programs buy time and delay the final crash to a point in the future where central banks have lost credibility. Monetary financing, on the other hand, reduces risk and sets the stage for a stable euro. Emergency Euros are inert to credit risk. If banks, businesses and Member States fail, Emergency Euros remain untouched. They provide a foundation for a money system based on cash instead of debt. That would release the ECB from the need to prop up banks, markets and Member States. Instead, it would be able to govern the euro efficiently, while letting market processes run its course. This would additionally provide an opportunity to deleverage the financial system, without crunching the economy.

Liberty and prosperity

Monetary financing serves the public interest. It saves market economies and sovereign nations from debt bondage. It is disadvantageous only to the financial sector. Losing some of their privileges might cause some banks to fail. With Emergency Euros, however, these banks can be nationalised at no costs, to keep the money system running.

Decisions that are made today have huge effects for tomorrow. Will the European Nations and their economies be drowned in debt and austerity? Or will they finally start using their monetary power to preserve liberty and prosperity?

Edgar Wortmann – April 10, 2020 (revision April 15, 2020)

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