

The policy debate Europe needs

How can the eurozone get the fiscal stimulus it needs, and which the ECB president Christine Lagarde is urging, in the face of the refusal by some countries, starting with Germany, to run budget deficits? There is a good answer, but it doesn't involve attempting to circumvent the intent of the ECB's statute **writes Barry Eichengreen**



Limited room for action

The eurozone is in a bind. Despite successive doses of monetary stimulus by the European Central Bank, inflation remains stubbornly below target. Conventional monetary policy and even quantitative easing evidently have limited potency when interest rates are at or near zero.

Moreover, monetary skeptics worry that lowering rates further will damage Europe's banks. Additional asset purchases beyond the monthly level of €20 billion (\$22 billion) already agreed, they warn, will impair the liquidity of financial markets. By pushing up asset prices, the ECB could expose the financial system to stability risks when those lofty prices return to earth.

The obvious event precipitating this return would be a recession. And when this downturn materializes, the ECB will have limited room for offsetting action, again because interest rates are already low.

Dead set against fiscal expansion

The solution to this conundrum suggested by ECB President Christine Lagarde is greater reliance on fiscal policy. By purchasing government bonds bearing negative interest rates, investors are literally begging European governments to borrow. So long as growth rates remain stuck at low levels because of anaemic private spending, a bit of additional public spending is just what the doctor ordered. If the economy nonetheless sinks into recession, fiscal stimulus can be ramped up still further.

Investors are literally begging European governments to borrow

The problem is that national policymakers in a number of eurozone countries, starting with Germany, are dead set against fiscal expansion. Believing that they are being asked to encumber their children with debt in order to provide the stimulus that countries like Italy are unable to deliver, they happily invoke the EU's fiscal rules to justify not running budget deficits.

This impasse has prompted suggestions that the ECB should pursue fiscal policy by stealth. For example, it could adopt a policy of dual interest rates. It could pay positive rates when taking deposits from commercial banks, cushioning the banks' profitability. It could then lend to those same banks at sharply negative rates, giving them money on such concessional terms that they would find lending it irresistible. The ECB has experimented with these policies on a small scale under its so-called TLTRO-II program.

Legitimacy of the ECB

But by expanding a policy under which it paid more on its liabilities than it charged on its assets, the ECB would incur losses and erode its capital. To be sure, central banks can operate with negative capital, financing themselves by printing money. But the longer they do so, the more observers, anticipating ongoing money creation, will come to doubt the credibility of monetary policy. The ECB's shareholders, meaning European governments, might then feel compelled to recapitalize it – at a significant cost to themselves.

Critics in Germany and elsewhere will therefore challenge the legality of such policies, citing the strict separation between monetary and fiscal policy in the European treaties. One response is: who cares? Treaty provisions can be creatively reinterpreted when exigent circumstances require. This has happened more than once in the euro's two decades.

Critics in Germany and elsewhere will therefore challenge the legality of such policies

But the legitimacy of the ECB depends on more than legal formalities. Fundamentally, it derives from public support. And public opinion toward quasi-fiscal measures by the ECB would be strongly negative in countries like Germany. The German government, channeling this popular indignation, could protest in a variety of ways, such as refusing to participate in EU decision-making processes requiring unanimous consent. Anyone familiar with the “empty chair crisis” of 1965, when France refused to occupy its seat in the Council of Ministers over a dispute about the Common Agricultural Policy, will appreciate how disruptive such a protest can be.

Debate worth having

Rather than attempting to circumvent the intent of the ECB's statute, the resources of the European Investment Bank should be enlisted.

The EIB has €70 billion of paid-in capital and reserves and €222 billion of callable capital. It has a board of directors from all 28 EU member states, limiting the danger of capture. Its charge is to fund sustainable investment projects, and it is empowered to borrow for that purpose. Because it is required to place its bonds with private investors, it is subject to market discipline, and it earns positive returns on its investments. Ramping up its borrowing and spending would be entirely consistent with its mandate.

EIB lending is limited to 250% of the capital subscribed by its shareholders. To make a difference now, much less in a recession, this capacity would have to be scaled up significantly. To be sure, proposals for doing so will meet with political resistance from those who fear that a larger EIB would be a loss-making EIB. But significant losses are unlikely in an environment where borrowing costs are only a fraction of the return on equity investment.

This, in any case, is the debate Europe should be having. Tackling the stimulus issue head-on is more likely to succeed than proceeding by subterfuge.

[This article first appeared in Project Syndicate on 9 December 2019](#)

Author

Alissa Lefebvre
Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com