Macroeconomic Policy Institute

The IMK is an institute of the Hans-Böckler-Stiftung

OVERCOMING WEAK INVESTMENT IN EUROPE: THE NEED FOR COORDINATED PUBLIC INVESTMENT & HOW TO ACHIEVE IT

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Key points

1. Investment is weak in Europe and this needs to be turned around
2. Economics of weak private - and need for public - investment have been understood for 80 years
3. Public and private investment in the current situation are complements not competitors
4. Politics is difficult but boil down to
   - MS must be enabled (in some cases constrained) to raise public investment
   - And/or there must be common financing
5. Juncker Plan style common fund one option/building block
6. Real need is for broade economic governance reform

Weak investment

Clear Indicators:

- Still depressed investment shares oif GDP (>-2pp)
- Current account surplus (domestic I<S)
- Extremely low (negative) interest rates
- High unemployment, sluggish growth, slowing growth potential

- Investment boost needed for cyclical and longer-term structural (ecological) reasons

Weak private investment and needed response well understood

– Seeming paradox weak investment-low interest rates

– Understood already in 1930s

– Fundamental uncertainty, self-fulfilling demand weakness, flight to cash and safe assets, monetary policy pushing on a string

– Need for expansionary fiscal policy (a degree of „socialisation of investment" - Keynes)

– Low interest rates signal no crowding out//fiscal multipliers unusually high
  - Public investment a „free lunch" (IMF)
  - Creates basis for complementary private investment

Reasons for policy failure

Economic case for greater public investment at current juncture unanswerable, so why so weak

– Partly ideological

– Partly economic governance weaknesses in Europe
  - „stupid“ fiscal rules constrain MS
  - Investment „easiest“ to cut, when it is most useful
  - Those who could won‘t (DE), those who would can‘t (most other MS)
  - MIP asymmetric and weakly implemented (deflationary bias)
  - Extremely limited European-level fiscal capacity

Ways forward – a common investment fund?

– Juncker Plan sensible response, some success in roll-out, also in terms of longer-run (ecological) needs … but
    - quantity of genuine additional investment limited
    - some „qualitative“ issues (geographical distribution, PPP)

Logically -> a larger and longer-term common investment programme

– But not the only and probably not the best way

– A work-around debilitating fiscal rules

– Given negative real interest rates most MS would raise public investmet if they could

Ways forward – options (not mutually exclusive)

- Golden rule in national public finance
    - Take net investment spending (definition?) out of fiscal rules, perhaps capped (e.g. 2%)
- Cross-border automatic stabilisation
    - Reduce MS financing constraints („crowding out within state budget“) in downturn
- Tax policy coordination
    - Generally to safeguard revenue base
    - More specifically to tax corporations and wealthy individuals who are oversaving MS levels
- Monetary financing of public investment
    - Give ECB capacity to buy newly issued EIB bonds; EIB lends to MS for pub inv; ECB returns debt service to MS as central bank „profits“

Ways forward – economic governance reform

– Reform economic policy coordination to achieve balanced growth, encourage private investment

– How when opposition to centralisation/common debt?

  - Give teeth to BEPGs (Article 121 TFEU)
  - Make MIP symmetrical & decisive in evaluating national fiscal stance
  - Broaden remit of planned advisory fiscal council (Macroeconomic Development & Convergence)
  - MS convergence (not competitiveness) councils
  - Strengthen Macreconomic Dialogue at €A and MS levels, bringing in social partners (nominal incomes policies)

Thank you for your Attention

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