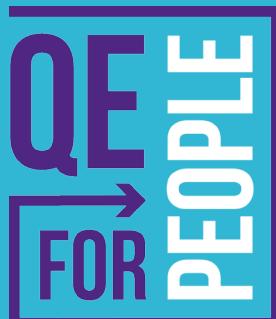


Citizens' Monetary Dividend

Upgrading the ECB's toolkit



Why distributing a citizen's dividend to households would be more effective than QE and negative interest rates, and how the ECB could implement it legally and independently. The European Parliament should signal its trust in the ECB to move forward in this direction.



Policy Brief
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By Eric Lonergan and Stan Jourdan

KEY POINTS

- **The ECB has no contingency plan** if the Eurozone falls into another recession. Fiscal stimulus and structural reforms, albeit desirable, are not actionable in a timely fashion in case economic conditions deteriorate.
- **Negative interest rates and quantitative easing are ineffective** in boosting aggregate demand and are creating dangerous side-effects. The ECB needs new tools to prevent a possible deflationary spiral.
- The ECB could instead use its ability to create money to finance **a one-off payment to all citizens** - a “citizen’s monetary dividend (CMD)”. This is technically possible under the framework of the ECB’s TLTROs scheme.
- **A citizen’s dividend has more potential to boost aggregate demand.** It is both economically effective and less risky than QE or negative interest rates. A stimulus equivalent to at least 3% of the Eurozone GDP would be necessary.
- A citizen’s dividend policy is **clearly within the remit of the ECB’s price stability mandate** and does not jeopardize its independence.
- Implementation of a citizen’s dividend requires careful preparation and political understanding. The European Parliament should encourage the ECB to consider viable ways to implement it.

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WHY IS IT NECESSARY?

A Citizens' Monetary Dividend would provide the ECB with a robust backstop against deflationary pressures.

There are a range of risks threatening the European economy. Whether the next shock is a banking crisis in Italy or a debt-crisis in China, the European economy is still fragile and any shock could easily lead to further stagnation or outright recession.

Central banks can usually respond to shocks faster through monetary policy than governments can respond through fiscal policy. However, this time around the ECB has exhausted all its usual tools in a context where the monetary transmission channel (the banking sector) is highly dysfunctional.

Quantitative easing has not been so helpful and extending the current programme is fraught with political risks and could sow the seeds of future financial bubbles. **Negative interest rates in particular are hurting savers, distorting markets and leading to a misallocation of capital.** There is now widespread recognition that continued reliance on these policies may be futile or even counterproductive.

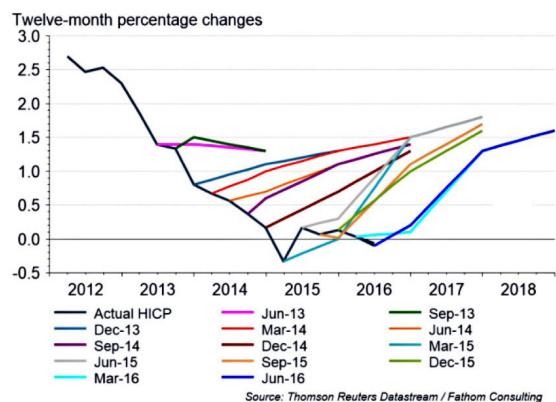
FISCAL STIMULUS: DESIRABLE BUT UNLIKELY ON THE SHORT RUN

A number of voices are arguing that the ECB's monetary policy is now reaching its limits and needs to be complemented by fiscal stimulus.

Fiscal stimulus would indeed be desirable in the eurozone, but the political room for it is extremely limited due to the strict fiscal discipline constraints under the Growth and Stability Pact and the lack of fiscal capacity at the Eurozone level. It is politically complicated to envisage a swift fiscal stimulus in the eurozone.

For these reasons **the burden of counter-cyclical demand management falls squarely on the shoulders of the ECB.** Europe must end its near-depression as quickly as possible - and the ECB must continue to play its central role in ensuring this happens.

ECB's Inflation Forecasts since 2013



Source: Thomson Reuters Datastream / Fathom Consulting

We aim, with this paper, to outline how the European Central Bank could implement a Citizens' Monetary Dividend (CMD) programme whereby the ECB would in effect make cash transfers to all adult citizens in the eurozone.

OBJECTIVES OF THE POLICY

The ECB should undertake further research on this issue in order to:

- Offer more effective policy alternatives than QE and negative interest rates in order for the ECB to reach its mandate of price stability
- Equip the Eurozone with a solid contingency plan in case economic conditions were to deteriorate further

CITIZEN'S DIVIDEND AND THE NOTION OF 'HELICOPTER MONEY'

The term 'helicopter money' has been applied to a wide range of – sometimes confusing – proposals which all rely on the central bank creating money to finance either (a) direct grants to each citizen, or (b) increased government spending and/or tax cuts, involving some form of monetary and fiscal coordination.

In this paper we only discuss the first proposal, in which the central bank creates new money and transfers an equal share to each citizen, as a way to boost aggregate demand.

HOW DOES IT WORK?

The ECB would make direct lump sum payments to all 280 million adult citizens in the eurozone.

As with its existing TLTRO programme, the ECB would finance this with the creation of bank reserves, with the explicit instruction to credit the deposit accounts of its customers by dividing the money into equal shares. The ECB should express its commitment to renew the operation until a sustainable path towards its inflation target is reached.

THE BANKING SECTOR CAN ADMINISTER THE PROGRAMME

Private banks have access to virtually all individual bank accounts, and can run identity controls if necessary. Additional support from national central banks may be necessary to solve multiple-account issues, and offer an opt-in based application for those who do not have a bank account. All adult legal residents should be eligible.

Admittedly, this would incur an administration cost for the banking sector, which the ECB would pay for by paying an administration fee to the eligible banks.

An interesting proof that such a scheme is plausible and realistic lays in the fact that the ECB is already doing something similar with the use of Targeted Long-Term Refinancing Operations (TLTROs) (see infobox).

ALTERNATIVE OPTION: VOUCHERS

Another possible option put forward by the consulting group McKinsey would be for the ECB to credit households with a certain amount of money through time-limited spending vouchers, redeemable with the central bank¹. This variation of our proposal would increase the incentives for households to spend the money quickly, with the tradeoff of involving the administrative cost and lengthen the preparatory phase.

This option could however be envisaged to include refugees in the programme – thereby increasing the impact of the stimulus.

HOW MUCH IS NECESSARY?

We estimate that it would take between 2% to 5% of eurozone GDP to stimulate the economy sufficiently to close the output gap in the eurozone. For an average scenario of 3% of GDP, this would involve the disbursement of 300bn euros overall (less than 30% of the ongoing QE programme) and a monetary dividend of around 1,000 EUR per capita.

To limit the risk of overshooting inflation, the ECB could start with a lower amount, say 500 EUR, and closely monitor the effects before renewing the operation.

HOW TLTROs PAVE THE WAY TOWARDS CITIZENS' DIVIDEND

Behind the obscure acronym, TLTROs are far more radical than QE, OMT, or SMP programmes.

The TLTRO programme of the ECB consists of the direct provision of credit, to banks, targeted at investment in the real economy. They are loans which the ECB makes to banks at a duration and interest rate of its choosing, for specified purposes. With every TLTRO tender, the ECB chooses the interest rate, the duration of the loan, and potentially, the credit risk.

In the current monetary paradigm where private banks do not need reserves prior to making loans (they create the money they lend), it is arguable whether the ECB can actually monitor whether the banks are effectively using LTROs to finance investments in the 'real economy'.

However the interesting feature of TLTROs lies in the fact that the ECB imposes strict conditions for the use of the supplied reserves. The ECB could well impose more radical and innovative conditions.

Last but not least, the ECB is currently charging negative rates on those refinancing operations, which effectively means it is giving money to banks as an incentive to create more loans.

LTROs are obviously legal and interestingly, subject to very little political controversy compared to QE and negative interest rates. In a sense, distributing cash directly to individuals could be seen as a logical extension of TLTROs, where the ECB would make zero-coupon perpetual loans to banks, which would in turn extend the loans to households.

¹ McKinsey Global Institute: A window of Opportunity for Europe (June 2016)

WHY IS IT LEGAL?

The legal framework in the Eurozone gives a lot of leeway for the ECB to carry out innovative policies for the purpose of price stability.

EU law is extremely clear on what the ECB can and cannot do. The legal framework repeatedly emphasises three principles:

- The ECB has an **obligation to deliver price stability**, which was defined by the ECB, as below but close to 2%
- The ECB must **always act independently** of governments and fiscal authorities
- The ECB is expressly **prohibited from financing budget deficits** (Art. 123 Lisbon Treaty)

In order to fulfil these legal objectives and subject to these constraints, the ECB has more flexibility in the implementation of its policies than any other major central bank. Subject to a two-thirds majority of the Governing Council, the ECB can pursue measures as it 'sees fit' (Article 20 of the ECB Statutes).

From this point of view, **the ECB has even a moral obligation to explore innovative ways to meet its inflation target.**

CMD is therefore clearly legal because it meets the following criteria:

- It is designed and supervised independently under the ECB's own initiative
- The single purpose of CMD is to ensure that the ECB meets its inflation target (although the policy entails other positive side-effects)
- It does not involve national governments or EU institutions' fiscal policies
- It has no adverse long-term consequences on the ability of the ECB to manage monetary policy

In addition, by implementing a CMD, the ECB would also fulfill its subordinate goals to «support the general economic policies in the Community» as stipulated in its statutes.

« The ECB somewhat ironically has greater potential to pursue the most unconventional idea of direct transfers to households, while the more conservative options appear more restricted. »

George Saravelos, Robin Winkler, Daniel Brehon (Deutsche Bank Research)

A CITIZENS' DIVIDEND FALLS WITHIN THE MONETARY POLICY FRAMEWORK

From a legal, institutional, and theoretical viewpoint, clear distinctions can be drawn between fiscal policy and monetary policy.

Monetary policy is defined, as the term suggests, by the changes in the quantity or availability of base money. Fiscal policy is financed by government bond issuance or taxation and involves changes to government spending and taxation. Although the economic effects of a CMD plan can be compared with standard fiscal policy stimulus, CMD clearly involves an expansion of the monetary base, but does not involve changes in taxation.

Second, the objectives and the competent authorities are very distinct. The goal of monetary policy is very clearly narrowed to price stability and is therefore the remit of central banks, while fiscal policies are pursuing a variety of objectives (social inequality, economic development, etc) which are defined by politically elected governments.

CMD fully complies with ECB's strict prohibition of directly financing governments or EU budgets. In no way does CMD directly finance or require the cooperation of fiscal authorities. In contrast with QE, there is no remuneration

of CB profits back to national treasuries which can significantly alter member state fiscal positions and may conflict with the objective of encouraging fiscal consolidation.

Finally, the fact that some monetary policy instruments may involve distribution effects does not mean that they are 'fiscal policies'. For example QE is known to have distributive effects, yet it is widely accepted as a monetary policy tool.

In conclusion, despite its innovative nature, CMD is monetary policy because it is implemented independently by the ECB, within the framework of its monetary

WHY IT WOULD WORK

There are various advantages that show that a citizens' dividend would provide positive effects, much superior to QE and negative interest rates.

IMMEDIATE EFFECTS ON INFLATION

A certain level of inflation, as enshrined in the ECB's mandate, is necessary for the economy to facilitate debt repayments and create incentives for investments.

Injecting money directly into households' pockets is the most straightforward way to boost inflation. As money injected through CMD is spent into the economy, businesses are likely to sell more and therefore boost inflation. It is also likely to create more economic activity, encouraging businesses to invest and hire more.

According to the ECB, the 'output gap' in the Eurozone could level up to 6%¹. This is the manifestation that there is spare production capacity in the economy, which means there is significant scope for the ECB to boost aggregate demand without creating too much inflation.

EVIDENCE FROM FISCAL STIMULUS SCHEMES

Although its institutional design is very different from conventional fiscal policies, the economic effects of our proposal can be compared with fiscal stimulus programmes.

In the United States, the "Economic Stimulus Act of 2008" carried out under the Bush administration has produced a rise of household consumption of 3.5% on average, and up to 6.2% for low income households.²

In Australia, a similar programme is often mentioned as being a major reason why the country avoided the recession. Researchers found out that more than 40% households spent the money right away, while only 24% saved it and another 36% used it to pay off their debts.

¹ How large is the output gap in the euro area, Marek Jarocinski and Michele Lenza, July 2016

² Andrew Leigh, How Much Did the 2009 Australian Fiscal Stimulus Boost Demand?, 2012

POSITIVE EFFECT ON INDEBTEDNESS LEVELS

Although debt payoffs do not immediately increase consumption, they also contribute to improving economic outlooks in a context where some countries are currently struggling with non performing loans.

If CMD can help reducing personal debt, this would greatly help the banking sector to improve its balance sheet and start making new loans again. Ultimately, short-term debt payoffs would make room for higher spending in the medium term.

HIGHER TAX REVENUES FOR GOVERNMENTS

Higher spending would also automatically lead to more tax income for member states, either through VAT receipts, but also income taxes, since the Citizens' Dividend would come as an increase in household's declarable income.

SIGNALLING EFFECT AND INFLATION EXPECTATIONS

The signalling effect of the plan is also likely to play an important role. By announcing such an ambitious plan, the ECB would renew its commitment to do 'whatever it takes' to save the eurozone, and thereby reinforce confidence in the euro area. In a sense, by even just announcing its readiness to make direct payments to households if necessary, the ECB would probably create a positive effect on inflation expectations.

A MORE POLITICALLY VIABLE OPTION THAN QE

QE currently excludes Greece and its effects are very unequal across member states due to the variations in national banking sectors' efficiency in transmitting monetary policy.

A citizens' dividend programme by the ECB is likely to gather broad popular support across different countries, because its effects would be more evenly distributed across member states than the existing QE programme.

CREATING POLITICAL ROOM FOR MONETARY POLICY INNOVATION

Although our proposal may look very bold at first sight, so was QE until a few years ago. In fact, our proposal would induce less ECB intervention than now, yet would very likely have better effects on inflation and growth in the Eurozone.

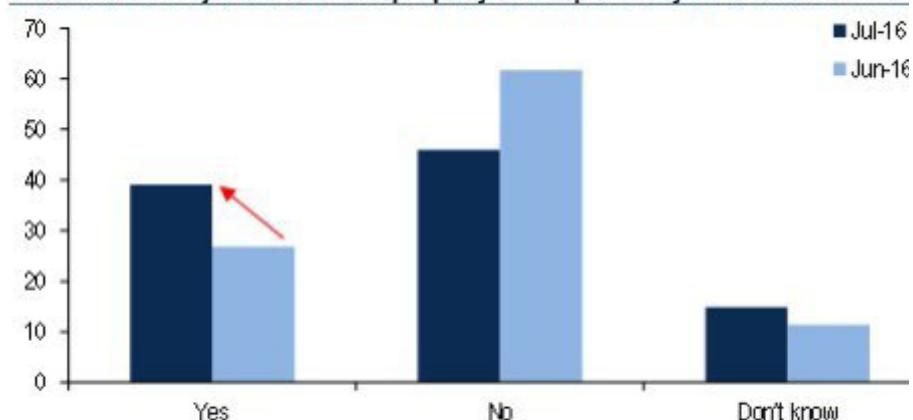
As a recent poll showed, 39% of asset managers are expecting one of the major central banks to make use of 'helicopter money' within the coming 12 months¹. This shows **growing market expectations for central banks to innovate and experiment with new ways of accomplishing their important tasks.**

We have to acknowledge that our proposal would not solve the ongoing trade imbalances of the Eurozone, nor its political and institutional shortcomings. Monetary policy cannot do everything. Yet, it would provide the ECB an effective instrument to deliver price stability.

What's more, implementing a citizens' dividend would send a strong signal that the EU is committed to change course from the past austerity-minded mistakes and address the fundamental issue of weak growth.

¹ Bank of America Global Fund Manager Survey (June 2016)

Exhibit 12: Will a major central bank adopt a policy of helicopter money in the next 12 months?



Source: BofA Merrill Lynch Global Fund Manager Survey

Higher growth would improve confidence in the EU and therefore create room for the necessary reforms of the Eurozone.

"Sending free money to all citizens from central banks may sound bizarre, but sooner or later public patience with economic stagnation may be exhausted – and radical action may become politically irresistible."
Anatole Kaletsky

Such an unprecedented move would require careful preparation and a certain degree of political understanding that such a policy option is needed.

This is why the European Parliament, as the most representative body of the EU, and the only institution to which the ECB is accountable, can play an important role.

The European Parliament should encourage and offer its cooperation to the ECB in order to exhaustively explore all possible ways to cope with the unprecedented economic conditions we are living in.

QUANTITATIVE EASING FOR PEOPLE

A RESCUE PLAN FOR THE EUROZONE

The campaign « Quantitative easing for People » was launched in November 2015 by a coalition of 20 civil society organisations across Europe and endorsed by more than 100 economists. Under the slogan « QE for People » we propose monetary policy alternatives to boost growth, employment and sustainable investment in Europe.