How to finance a Green New Deal?

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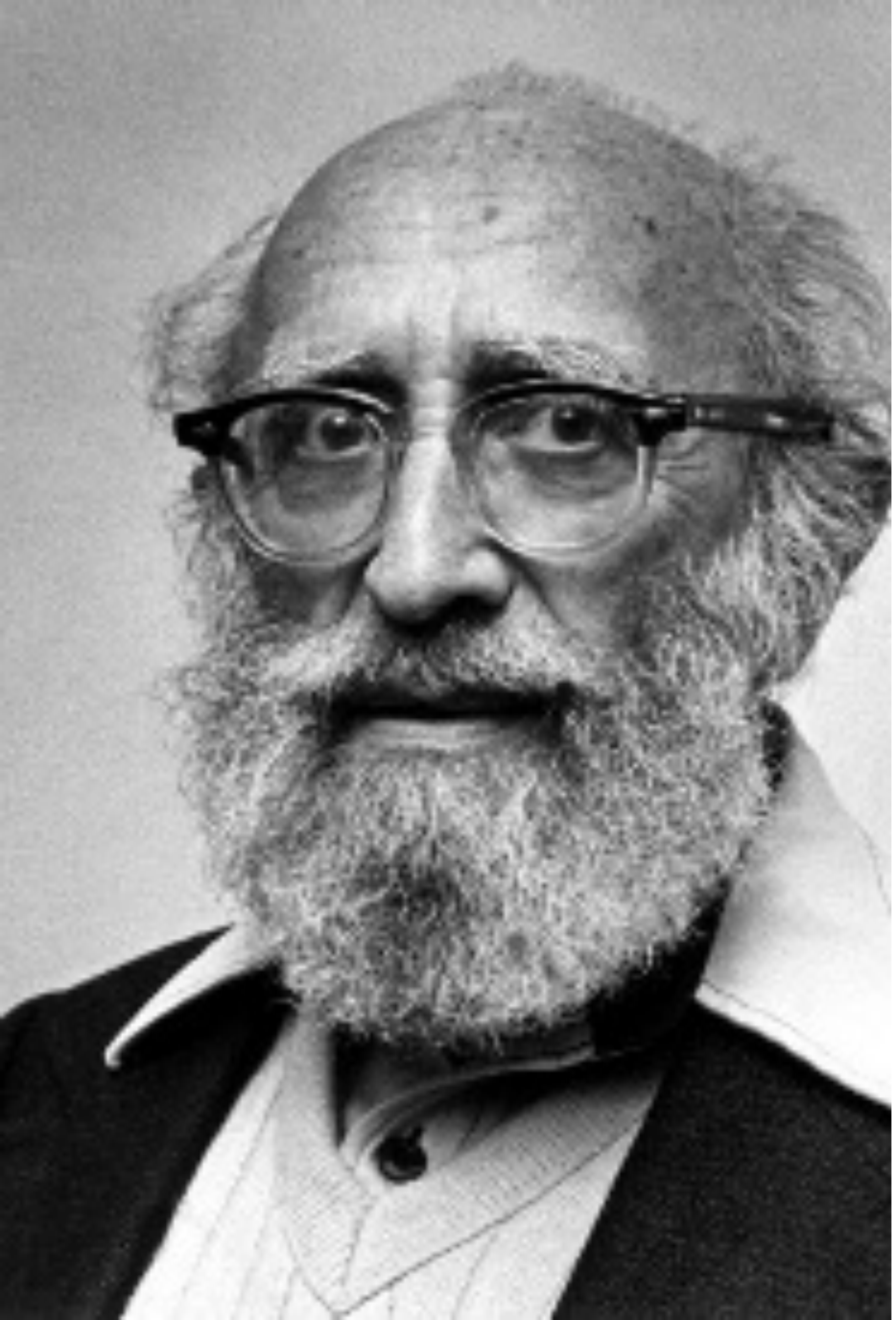
Modern Monetary Theory: "A Recipe for Disaster?"

(Larry Summers)

Alexandra Ocasio-Cortez



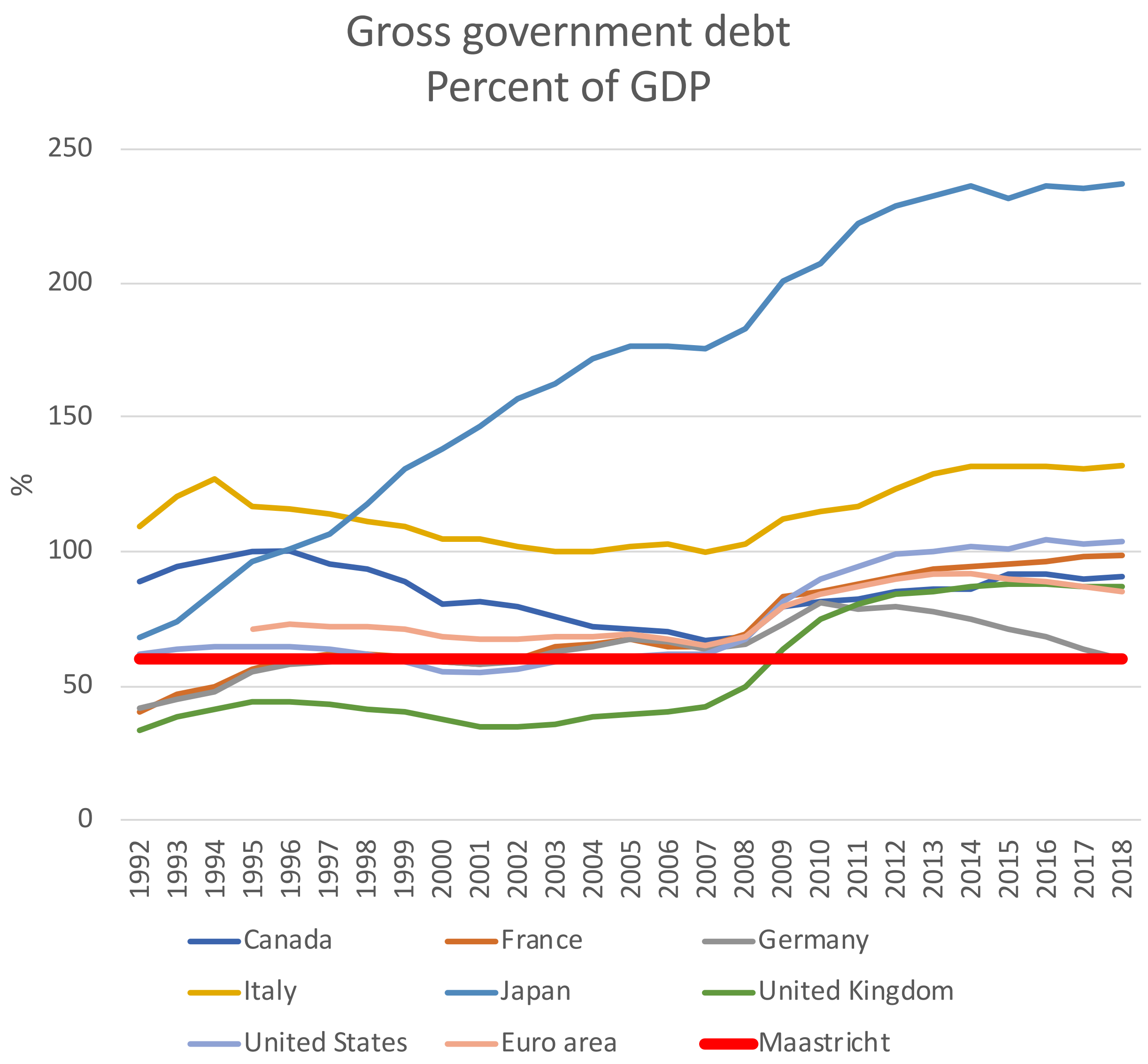
Core idea of MMT

"(...) government fiscal policy, its spending and taxing, its borrowing and repayment of loans, its issue of new money and its withdrawal of money, shall be undertaken with an eye only to the *results* of these actions on the economy and not to any established doctrine of what is sound and unsound. The principle of judging only by the effects has been applied in many other fields of human activity, where it is known as the method of science as opposed to scholasticism."

Abba P. Lerner (1903-1982)

60 %: a good benchmark for the Debt/GDP level?

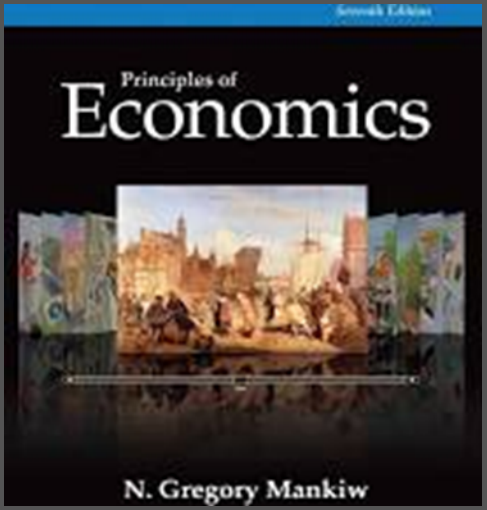
Could 90 % be the new normal?



Source: IMF

Does public debt have to be repaid like private debt?

Does public debt crowd out private debt?



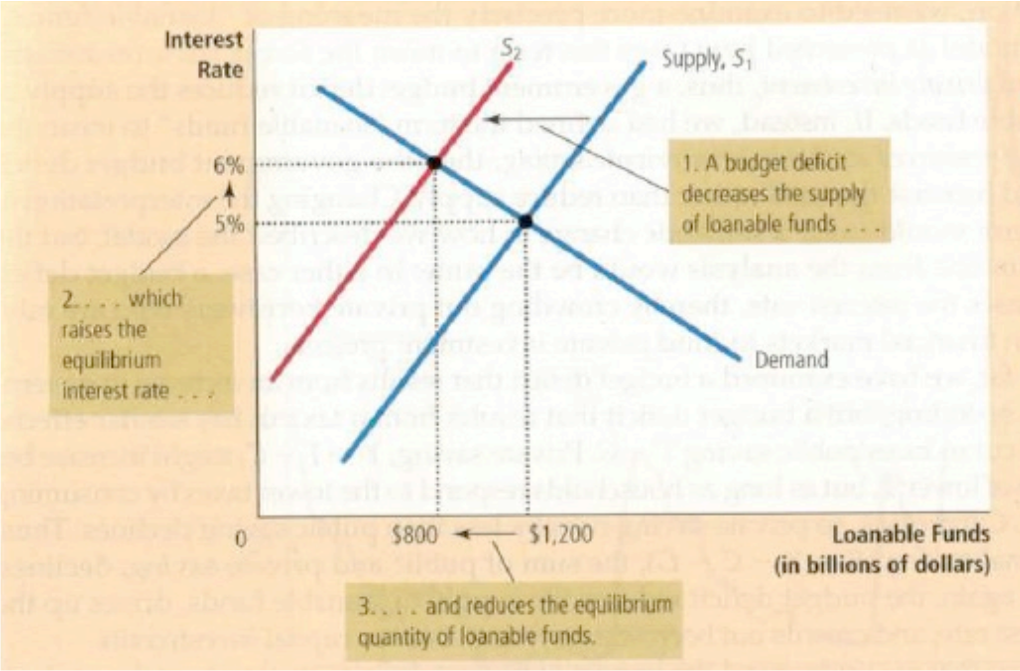


FIGURE 4

The Effect of a Government Budget Deficit
When the government spends more than it receives in tax revenue, the resulting budget deficit lowers national saving. The supply of loanable funds decreases, and the equilibrium interest rate rises. Thus, when the government borrows to finance its budget deficit, it crowds out households and firms that otherwise would borrow to finance investment. Here, when the supply shifts from S_1 to S_2, the equilibrium interest rate rises from 5 percent to 6 percent, and the equilibrium quantity of loanable funds saved and invested falls from $1,200 billion to $800 billion.

Financing a Green New Deal

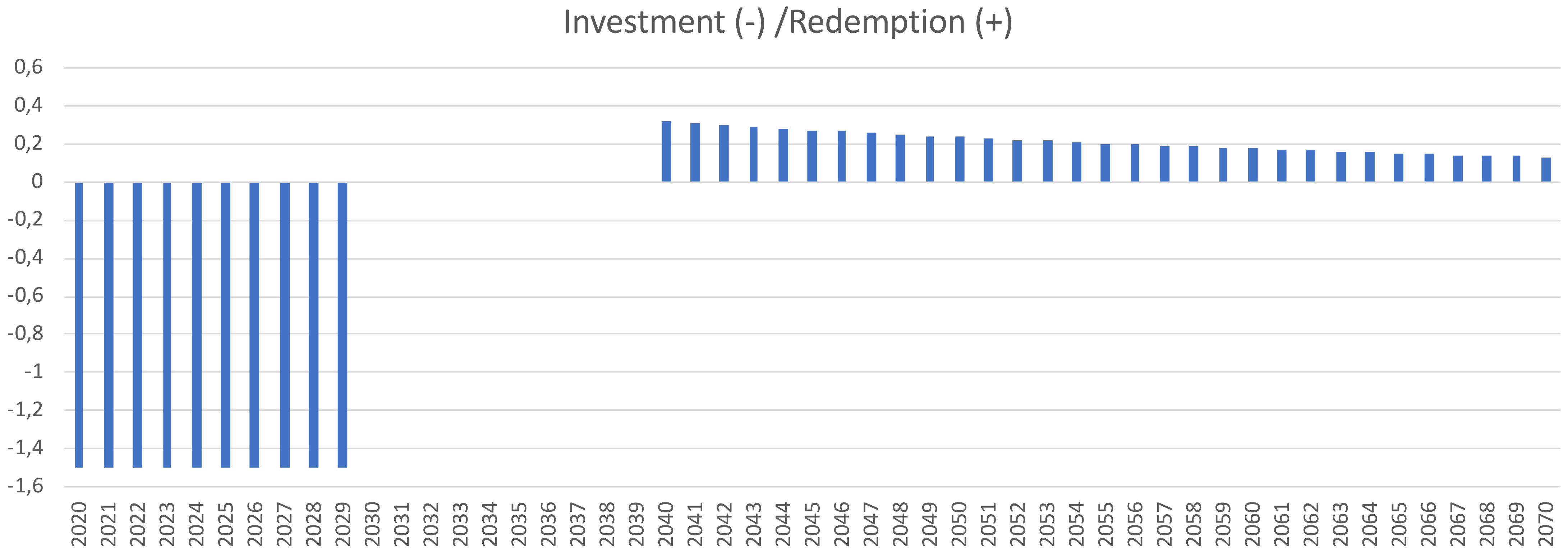
- MMT is right: There are no relevant constraints for the financing of an ambitious GND in the euro area
  - 150 – 200 billion Euro p.a. amounts to 1.3-1.7 % of GDP
  - With 3 % nominal GDP growth, the current debt/GDP rate of the euro area (86 %) can be stabilized with a deficit of 2.6 %
  - Especially relevant in a period with very low/negative interest rates
- Which form of financing:
  - Bonds issued by national governments
  - Bonds issued by national governments under joint liability
  - Bonds issued by a European institution

What leeway is provided by the German „Debt brake“ (Article 115 Grundgesetz)?

- Making use of the 0.35 % deficit for the Federal Goverment (≈ 10 Billion Euro p.a.)
- Temporary exemption for green investments from the „Debt brake“ (e.g. for 10 years deficit of 1-1 ½ percent of GDP ≈ 35-50 Billion Euro p.a.) which allows to keep public debt in relation constant relative to GDP of currently 58 % (or even declining with 1% deficit)
- Article 115 GG: “The Federation and *Länder* may introduce rules intended to take into account (…) exceptions for natural disasters or unusual emergency situations beyond governmental control and substantially harmful to the state’s financial capacity. For such exceptional regimes, a corresponding amortisation plan must be adopted.”
- Precedent: German unification: Average deficit (1990/99): 3.35 %

Investment and redemption for a German Green investment programme

- 10 years (2020-2029): additional 1.5% % investment
- 30 years (2040-2069): repayment



Euro area

- Stability and Growth Pact:
  - Corresponding exemption for green investments for all member states (1 % for countries with debt/GDP above 100% ≈ 150 Billion Euro p.a.)
  - Surveillance by the Commission that funds are adequately invested
- European Green Bonds
  - Joint and mutual liability

Bonds issued by a European institution

De Grauwe proposal:

- ➢European authorities give a mandate to the European Investment Bank (EIB) to finance, say, €1,000 billion of environmental investments.
- ➢The EIB would issue bonds to obtain the resources necessary to fund these investments.
- ➢The ECB buys EIB bonds at a pace dictated by the expiry of the old bonds on its balance sheet.

https://www.socialeurope.eu/green-money-without-inflation