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International Conference: Zero Interest Rate Policy and Economic Order

Quantitative Easing, Capitalism, and Investment

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Mankind's largest monetary experiment
of all peace times

- **Private ownership** of production factors

- » Land (natural resources)

- » Labor

- » **Capital (produced means of production)**

- **Private risk taking**

- » Uncertain future → speculation

- » No risk-free assets

↔ **Personal wealth**

- **Accountability**

- » Private profits and private losses

- » Liquidation in case of failure

The market signal system: Profits, Losses, Bankruptcy

■ Profits

- » Revenues (value creation) > Costs (value destruction)
- » Net creation of value
- ⇒ Agent stays in the game, activity can be continued/expanded

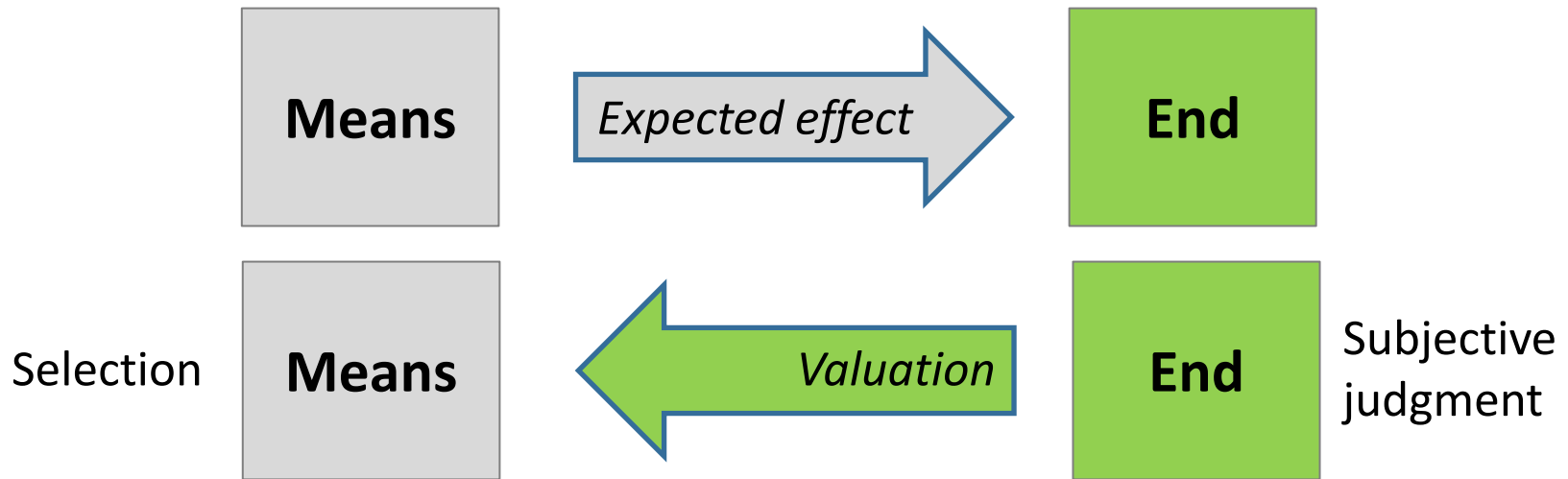
■ Losses

- » Revenues < Costs
- » Net destruction of value
- ⇒ Yellow card (warning): activity should be reduced/modified

■ Bankruptcy

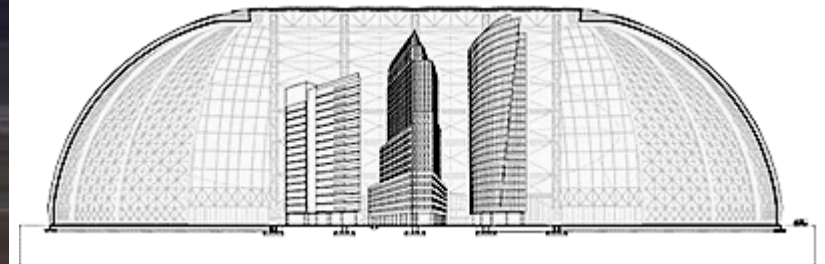
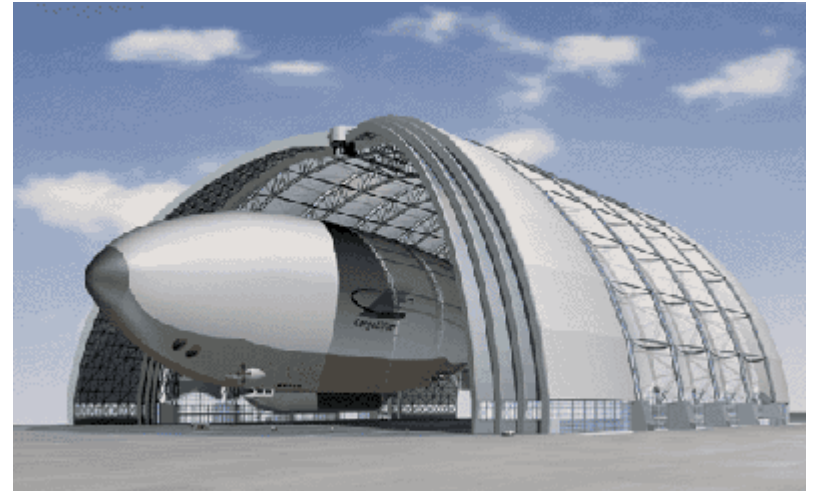
- » Revenues << Costs
- » Net value destruction ongoing/at large scale
- ⇒ Red card (sending-off): activity must stop (reallocation of resources)

Human action: Means, ends, and values



- Reverse value imputation
 - » The end may not „sanctify“ the means, but it **values** it!
 - Limited knowledge
 - » Action under uncertainty (= speculation)
 - Rationality
 - » Humans do not purposefully act against their aims
- ⇒ **Final purpose of economic activity: Consumption goods**

Cargolifter: The plan ...



... and the outcome: Tropical Islands



Cargolifter hangar ⇒ Tropical Islands hall

Production cost:
78 million euro (1999/2000)

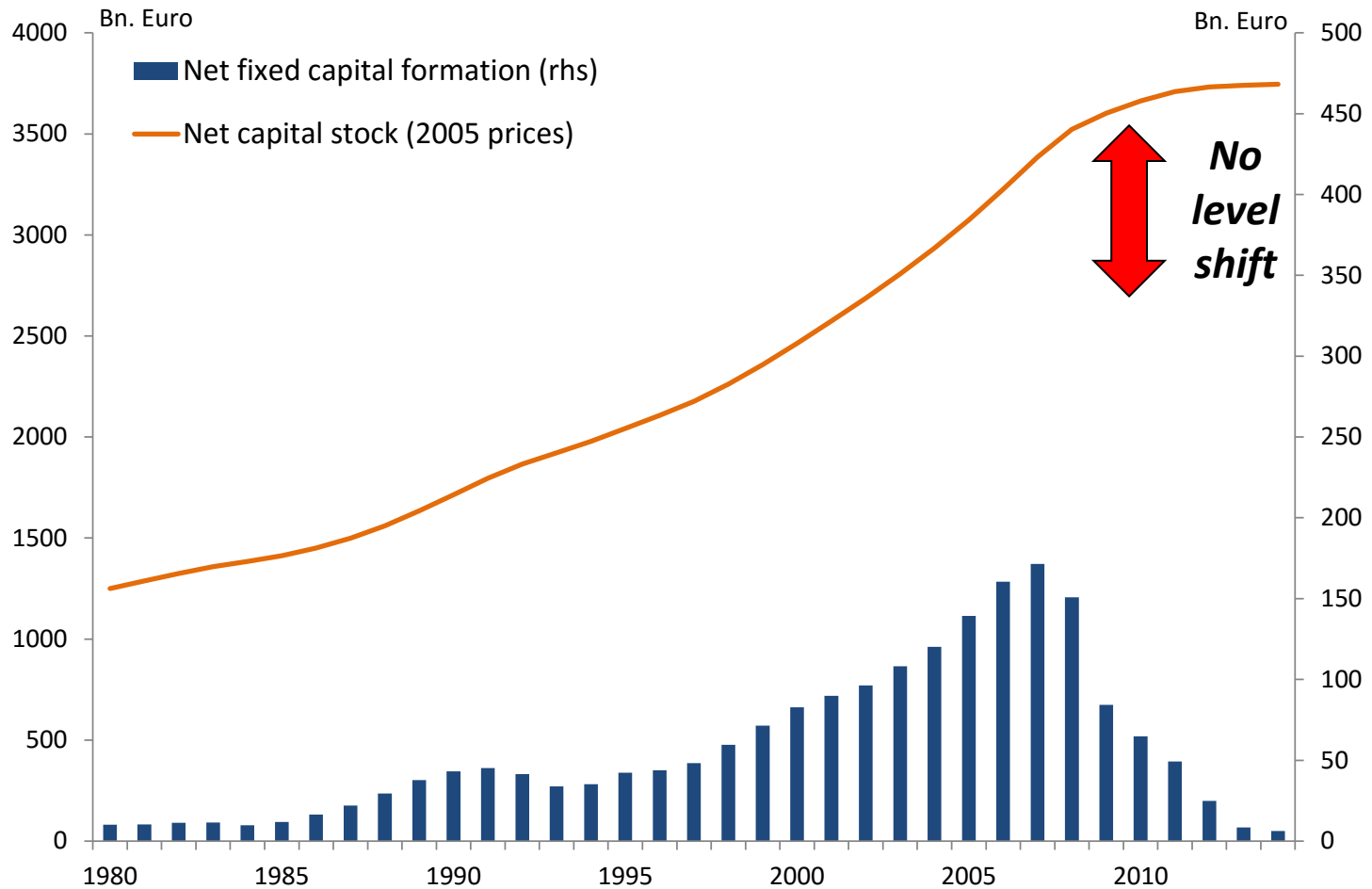


Liquidation value:
17.5 million euro (2003)

Cargolifter in the national accounts

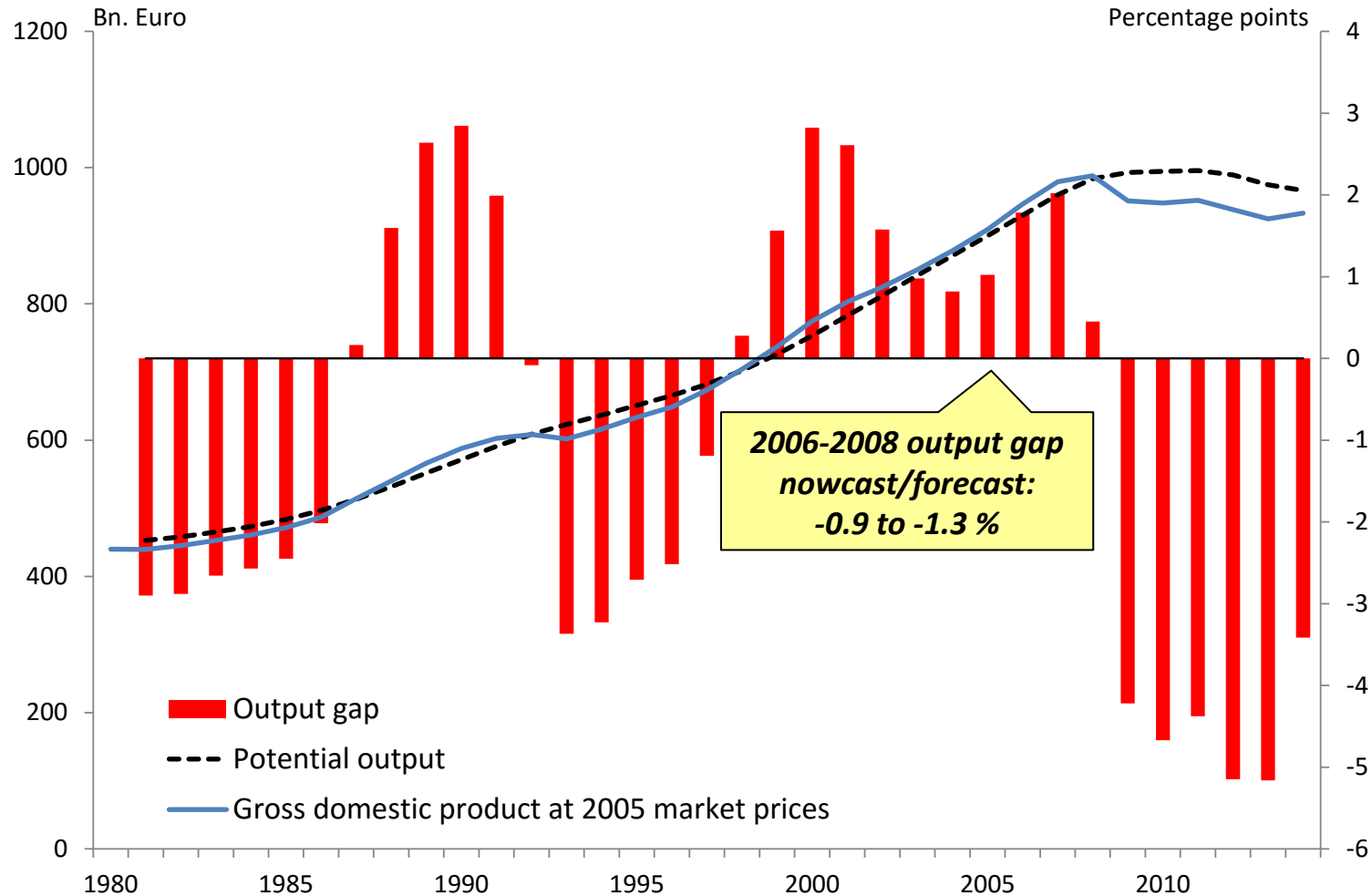
A hangar is a hangar is a hangar ...

Value of the Spanish capital stock?



Source: AMECO Database.

Spain: Invisible “ghost estates”



Source: European Commission, AMECO and CIRCA databases.

- **Idiosyncratic: Cargolifter example**
 - » Wrong expectations of one market participant
 - » Happens every day, no systemic risk
 - » Liquidation, reallocation of resources

- **Pervasive: Expansionary monetary policy**
 - » Systematically wrong expectations of all market participants
 - » Financial crisis (debt crisis = flip-side of heavy capital stock distortion)
 - Liquidation: cold-turkey type recession, reallocation of resources
 - Bail-outs: sluggish activity, incomplete reallocation of resources

Three options of coping with debt crises

■ Public bail-outs

- » Shifts private debt to public sector
- » Private debt crisis \Rightarrow sovereign debt crisis
- » No solution for fiscally distressed countries

■ Inflating the debt away

- » Takes a long time, promotes zombification
- » Puts the currency at risk
- » Not targeted towards non-performing loans

■ Liquidation

- » Tough (cold turkey) in the short-run ...
- » ... but targeted (and root cause oriented)
- » Puts capital at second (now first) best use

Anti-capitalist approach
(harms principle of accountability, creates moral hazard risks)

Capitalist approach
(in line with free market principles)

Production and expenditure account

Goods and services account

Source/Input

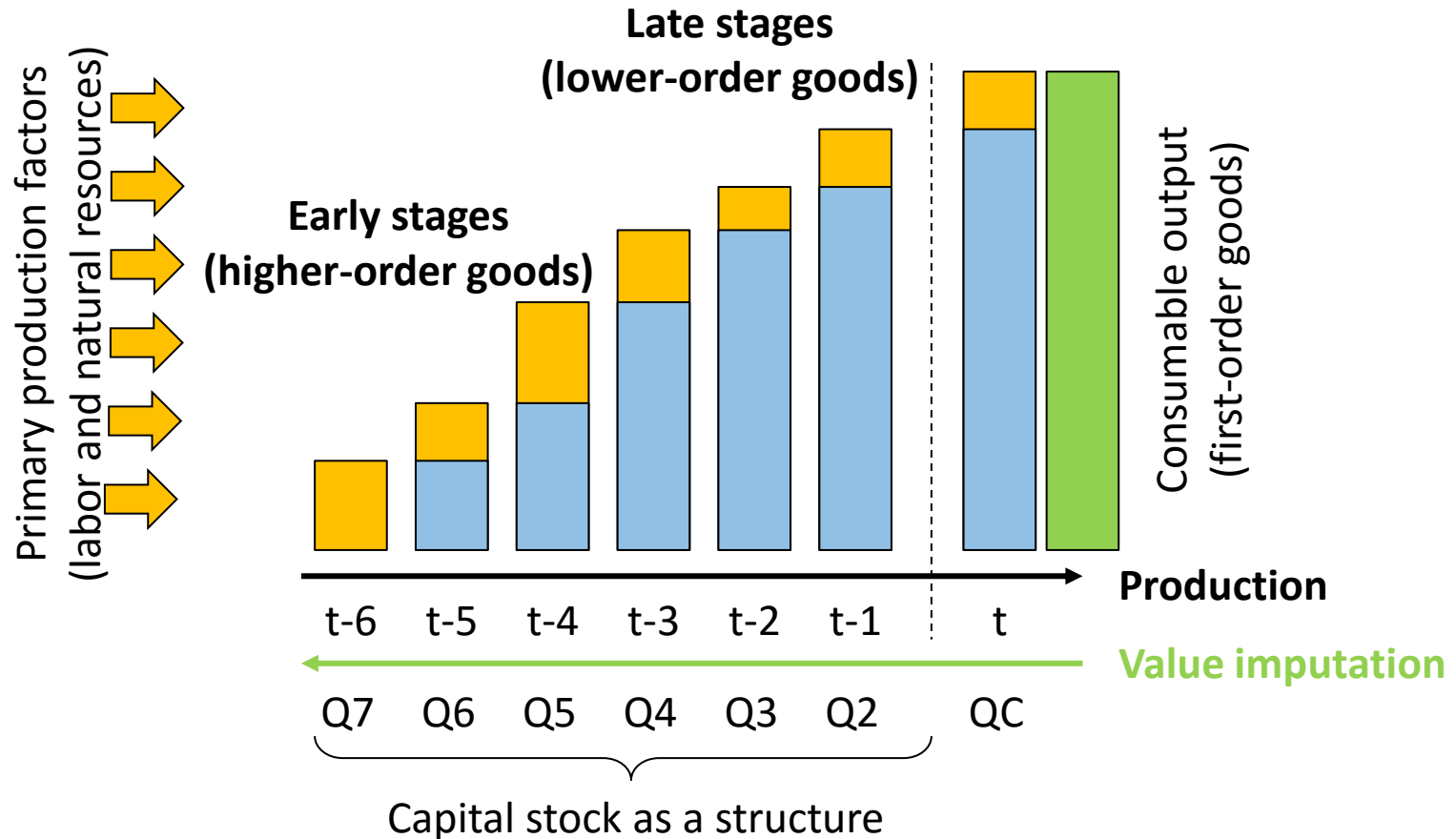
for period t

Use/Output

Intermediate consumption (production structure)	Intermediate consumption (production structure)
Domestic value-added	Final consumption (exclusive source of value)
	Domestic capital formation
	Capital formation abroad
Imports	Exports

**„Final“ use of domestic production
(only with respect to period t)**

Production: A time consuming, multi-stage process



⇒ **Capital formation: intertemporal intermediate consumption**

- Capital as intentionally produced productive means ...
 - » ... not a disembodied abstraction or homogenous aggregate
 - » ... nor a self-perpetuating (“Knightian”) fund

 - Structure of heterogeneous goods
 - » Limited convertibility and recombination losses
 - » Capital as a structural pattern (Lachmann)

 - Value dimension:
 - » Ability to allow individuals to more readily realize their plans rather than physical characteristics or physical history
 - » “Unfinished entrepreneurial plans” (Kirzner): Capital goods to be assessed in light of their usefulness to those plans
- ⇒ **Missing link between micro and macro level (Skousen)**

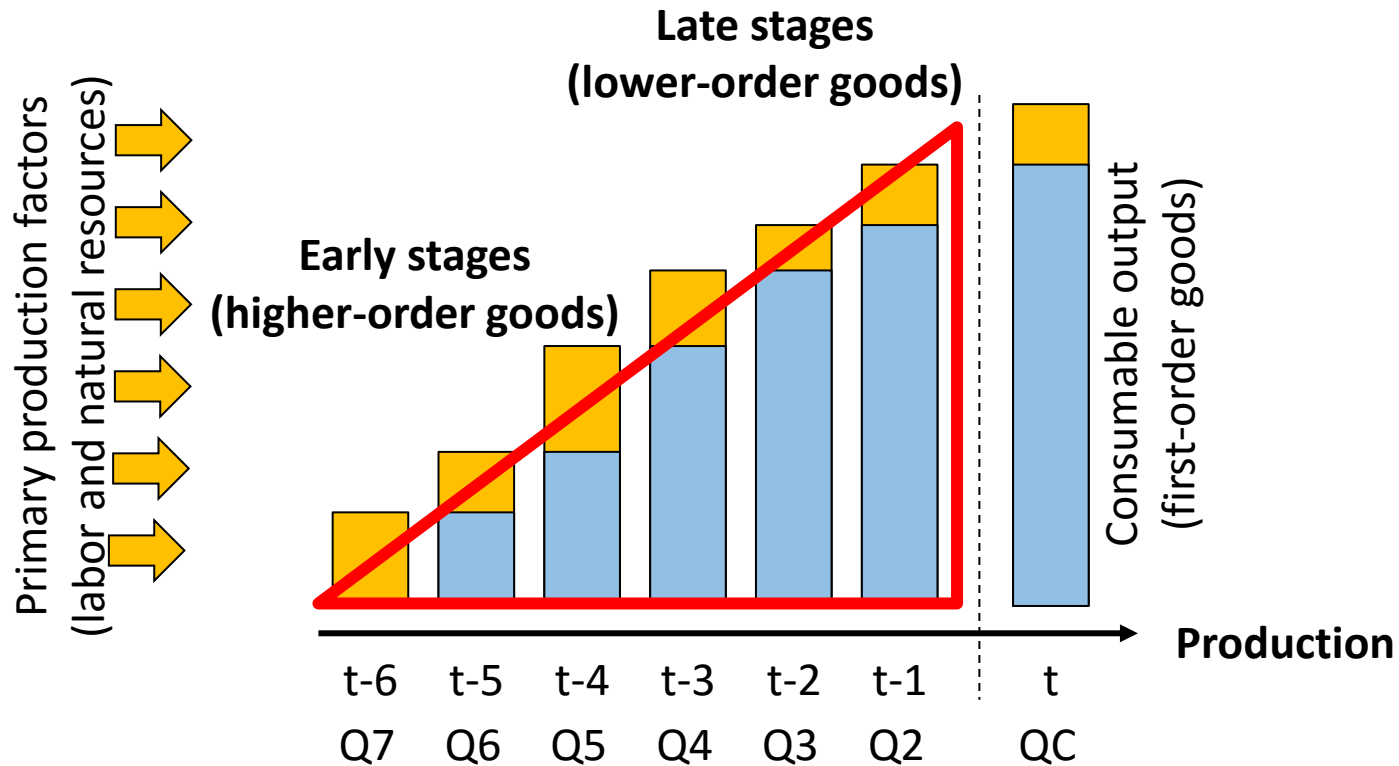
Labor productivity and capital



- Low capital intensity

- High capital intensity
 - » Higher **gross** value added per capita (trivial)
 - » Higher **net** value added per capita (via natural forces)

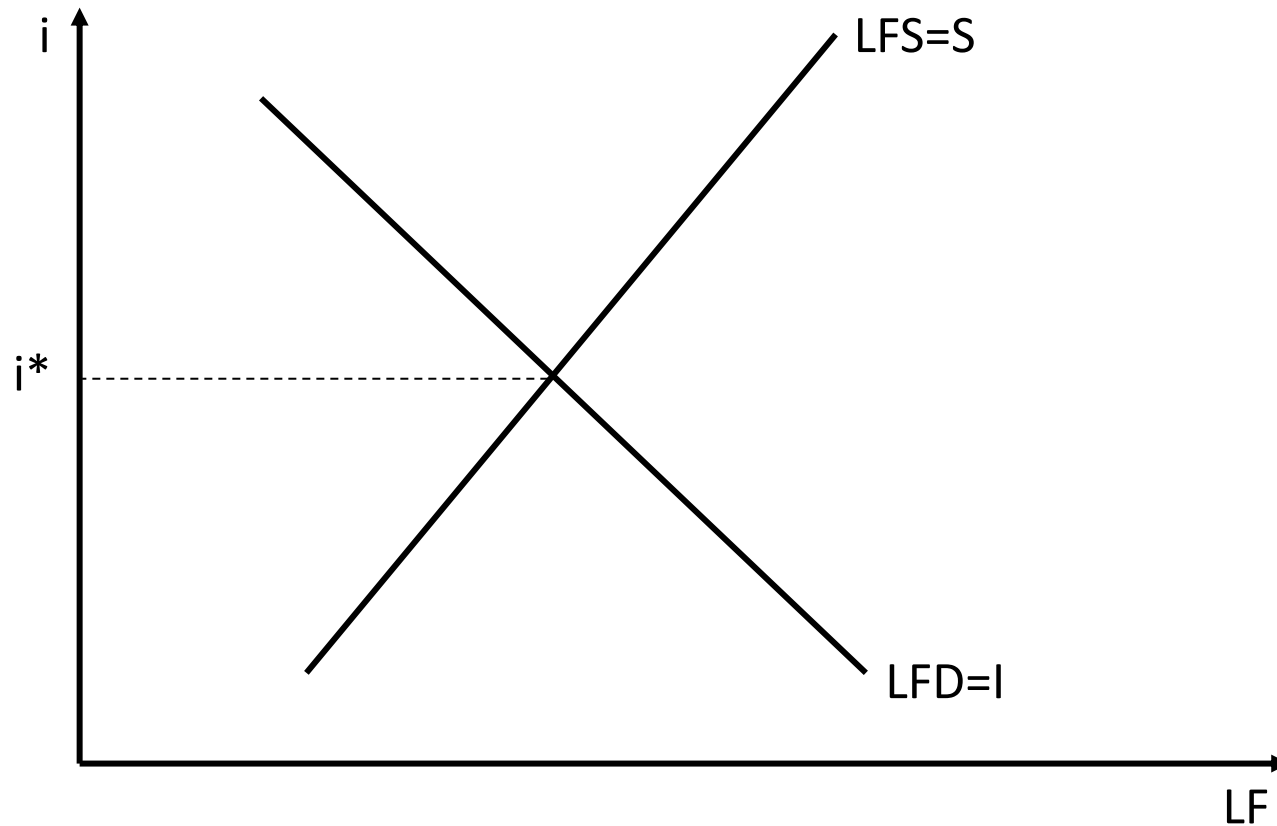
Production: The Hayekian triangle



⇒ Number of production stages/shape of the Hayekian triangle?

- Interest as a value phenomenon
 - » Expression of time preference
 - » Price of future goods relative to present goods
 - » **Discount rate interwoven in the entire price system**
 - Capitalization theory (Fetter): Interest vs. price of capital
 - » Productivity of capital reflects in price of capital goods
 - » Valuation of reproducible capital pushed backward to primary factors
 - » Price of capital = present value of future income streams
 - Interest and “roundaboutness of production”
 - » Capital-intensity increases labor productivity via natural forces
 - » Choice of more roundabout production schemes depends on time preference
- ⇒ **Pure time preference = market rate of interest?**

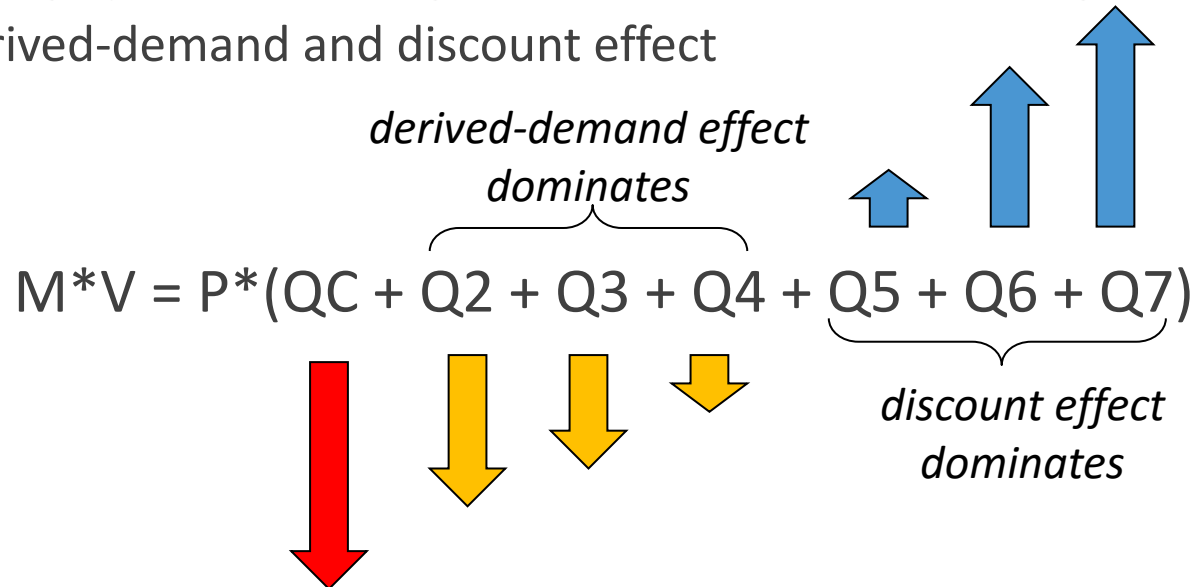
Interest rate and market for loanable funds



Coordinating saving and investment

- Saving

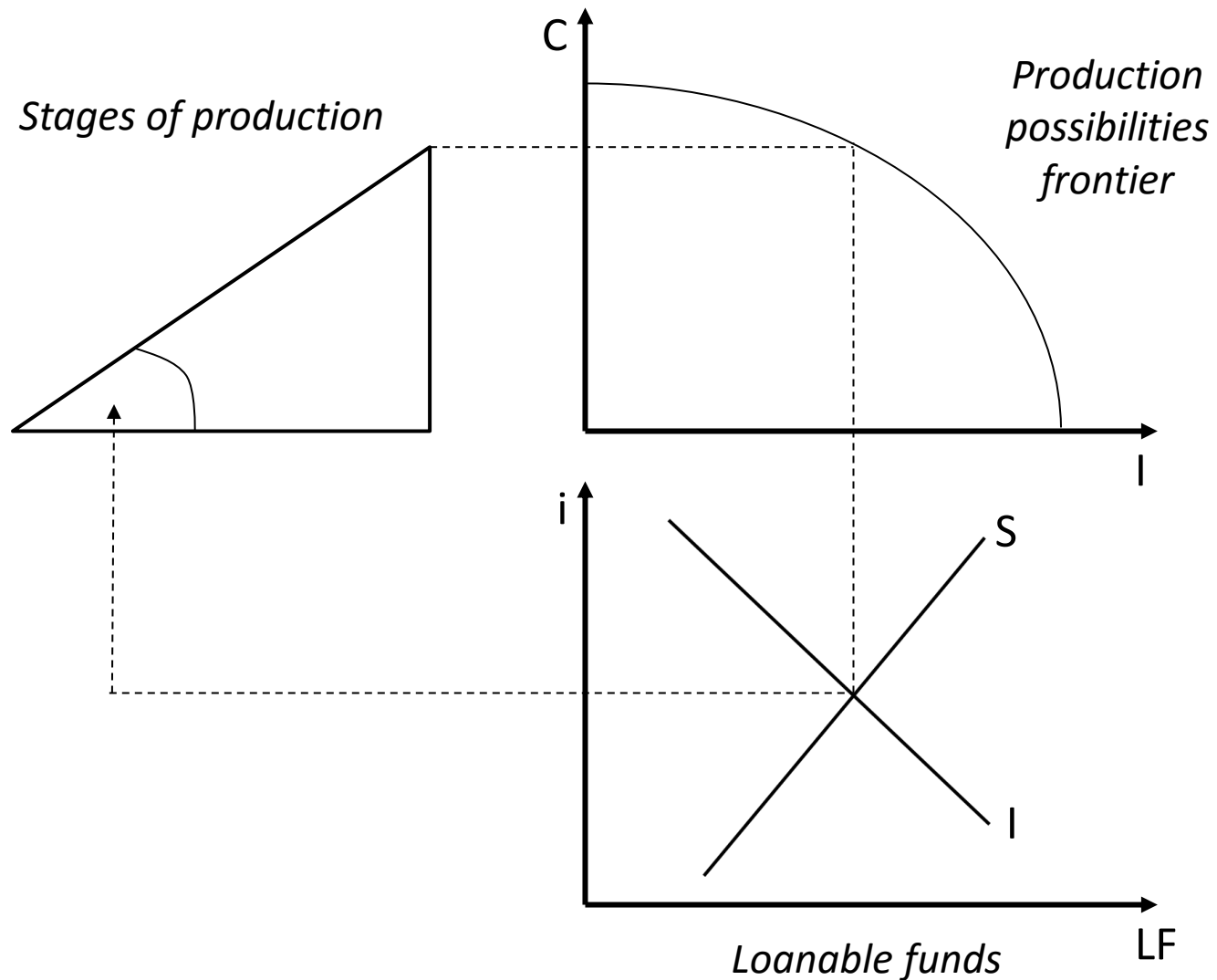
- » Saving up for something: Future demand, not a leakage
- » Derived-demand and discount effect



- Investment: Stage pattern matters (not volume alone)

⇒ **Entrepreneurial challenge: bringing capital structure in line with pure time preference (intertemporal arbitrage)**

Capital-based macroeconomic framework (Garrison)

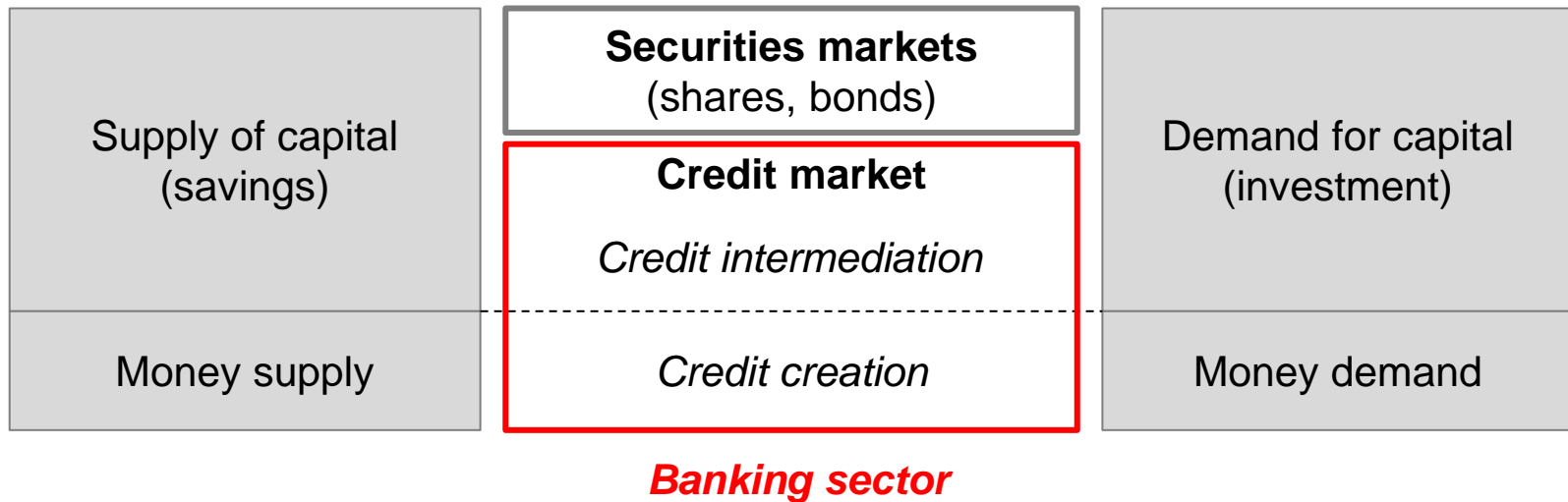


- Financial crisis
 - » Flipside of capital stock distortion
 - » Systematic investment failures due to excessive credit creation

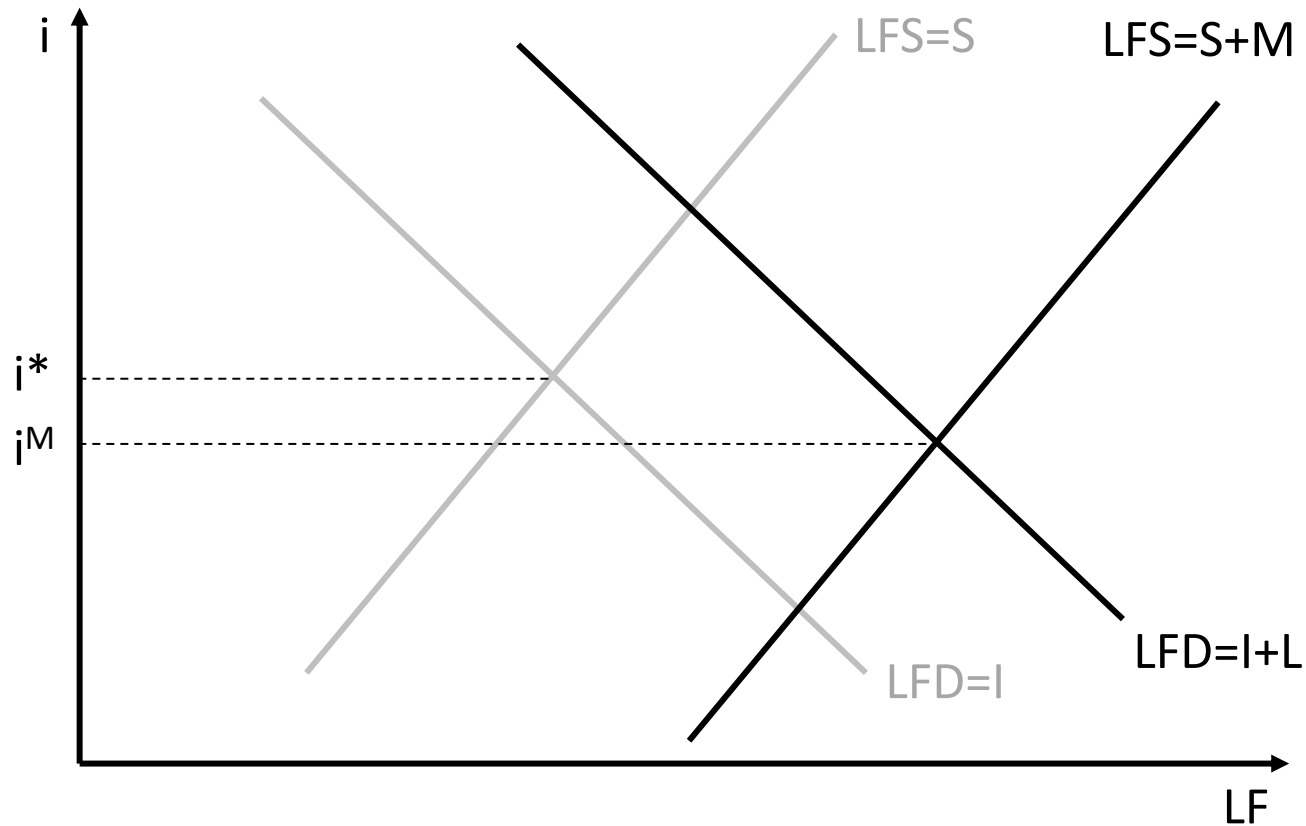
- Non-neutrality of money
 - » Cantillon effects
 - » “Capital gives money time to cause trouble” (Garrison)

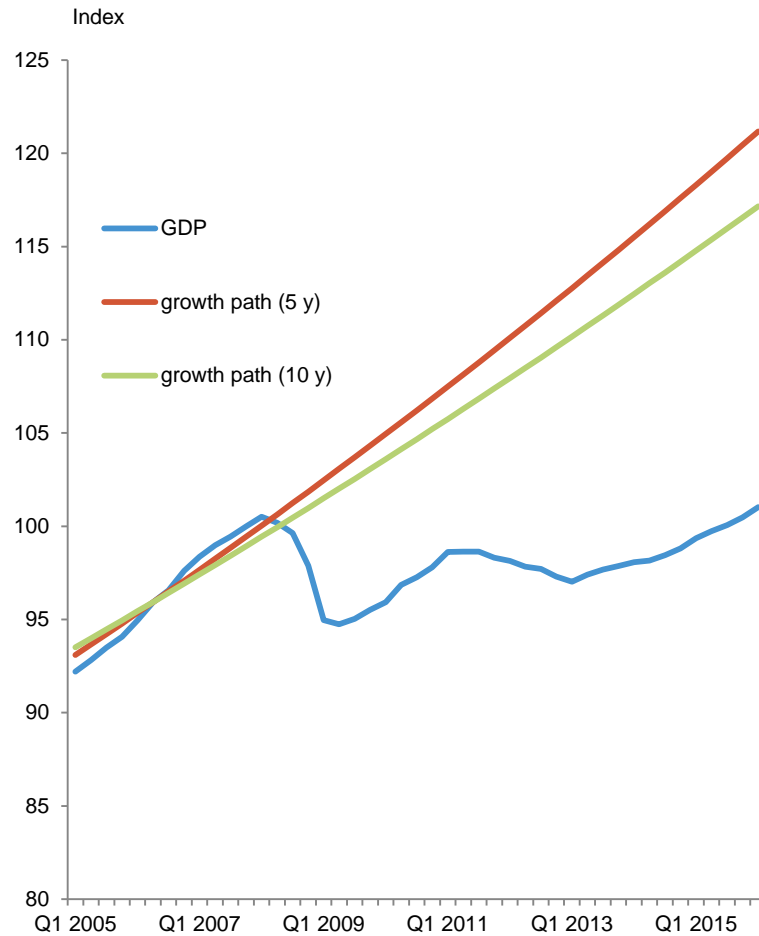
- Monetary policy
 - » Interest rate: Key economic variable in the capitalist system manipulated by central banks

- Credit creation vs. credit intermediation
 - » Forced savings vs. voluntary savings

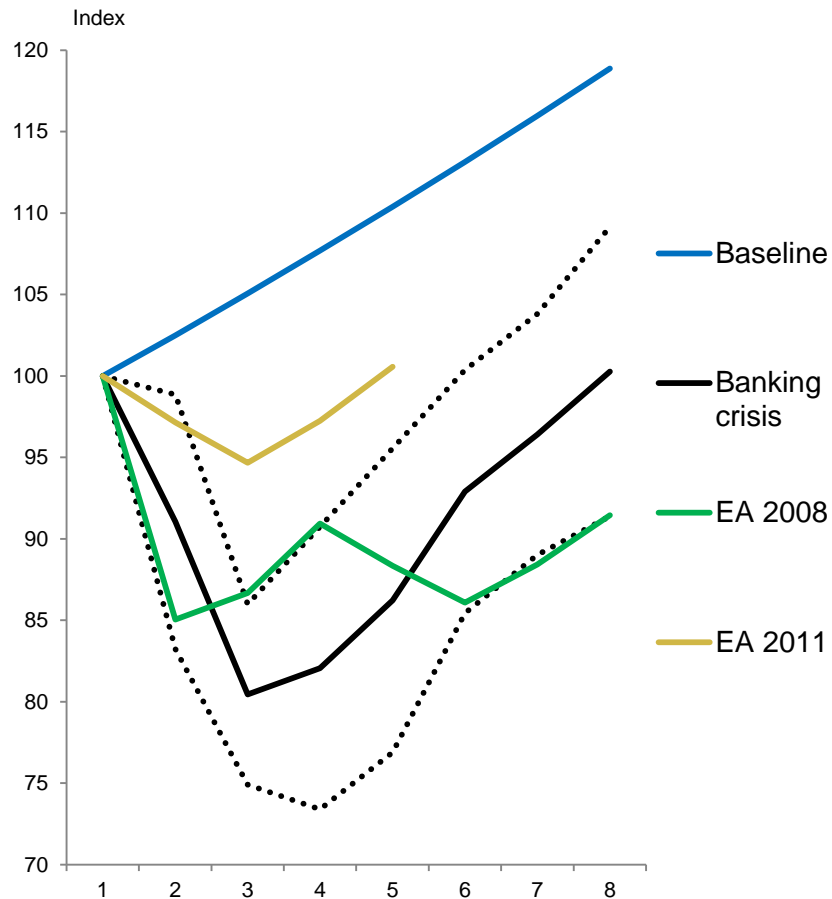


Interest rate and monetary policy



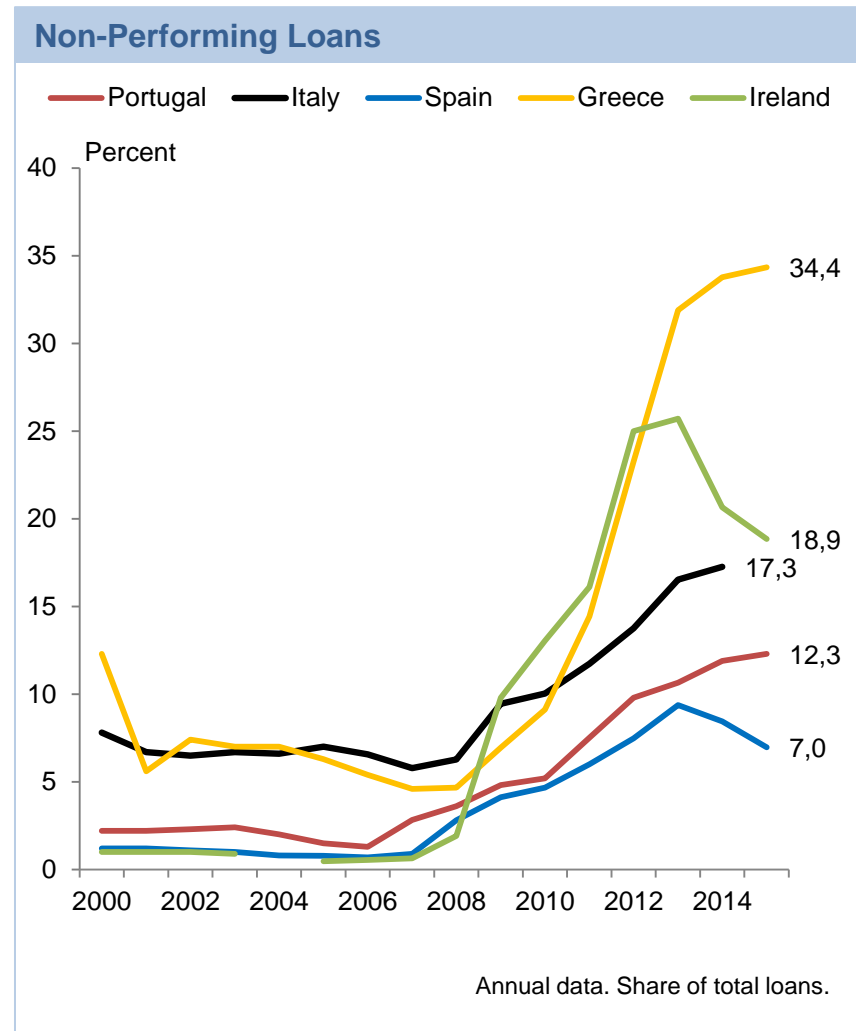
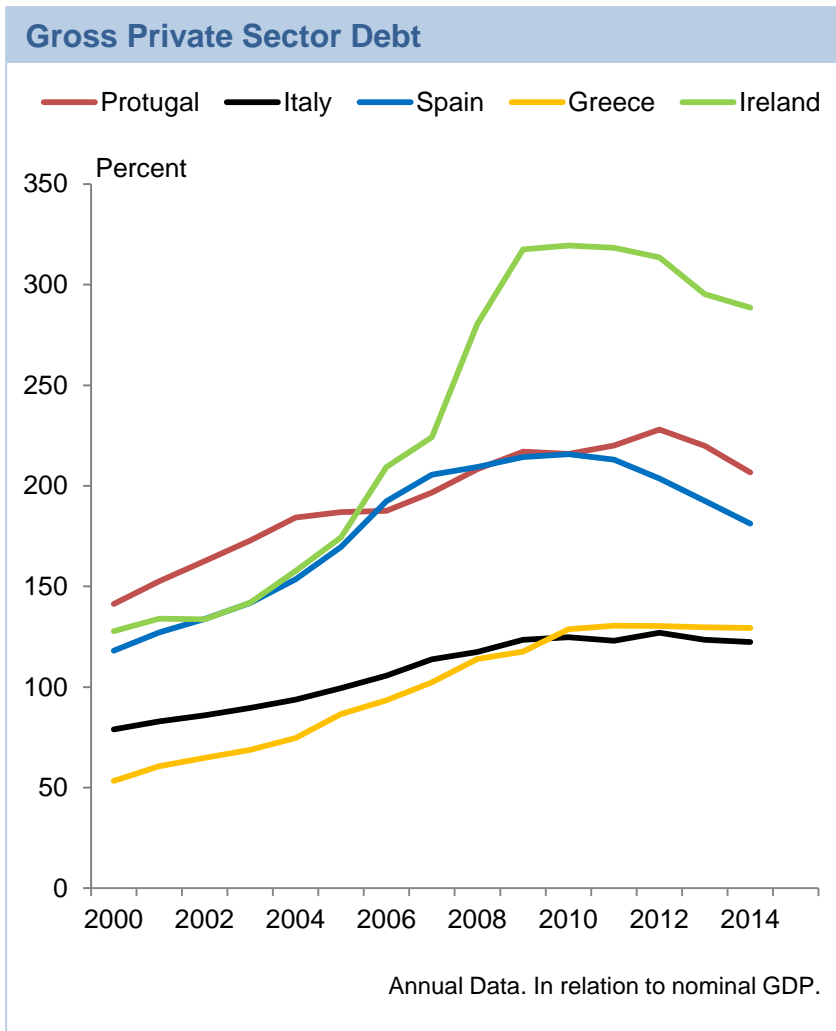


- Sluggish post-crisis activity
- Two financial crises in a row
 - » Global financial crisis
 - » Sovereign Debt crisis



- In line with known patterns
- Investment stimulus
 - » Building capacities ...
 - » ... or absorbing capacities?

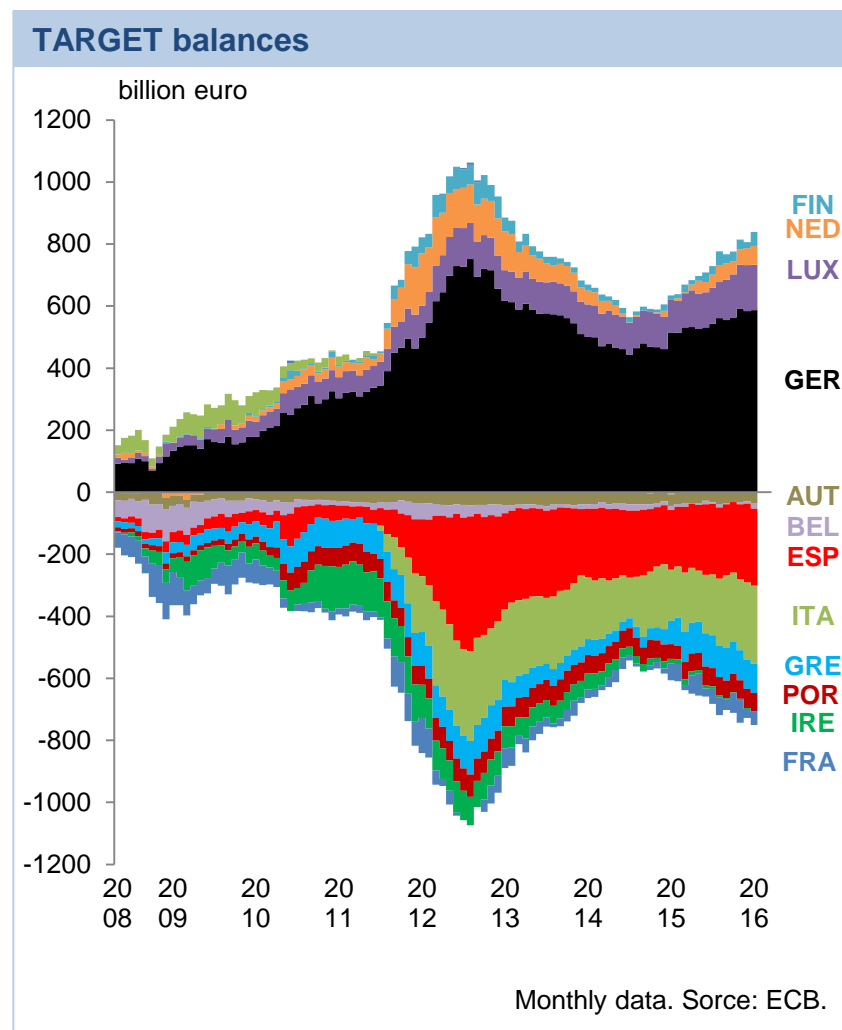
Flip-side of not liquidating: Debt overhang hampers credit channel



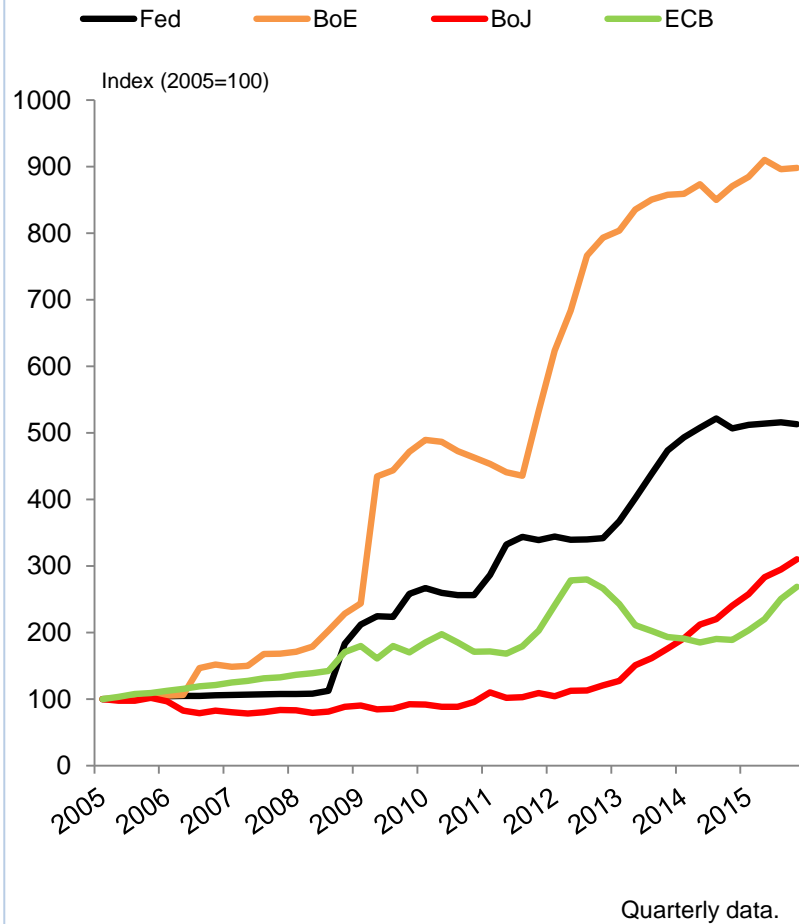
Data source: Bank for International Settlements, World Bank.

Target-2 imbalances: Intra-euro area liquidity and capital flight are back

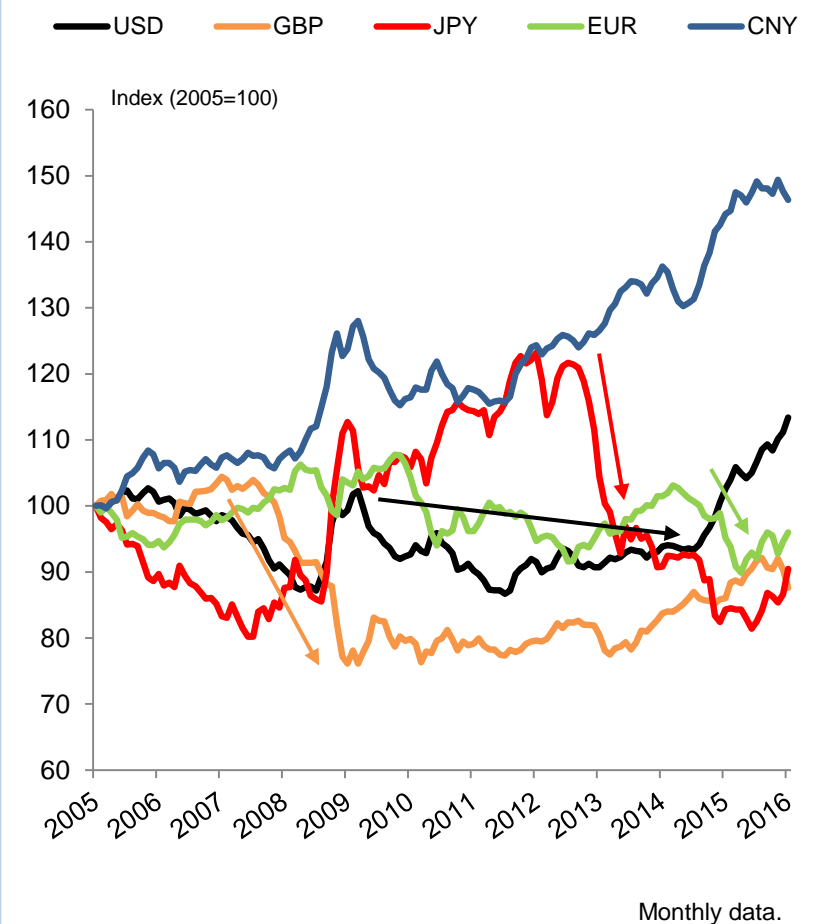
- Bank Recovery and Resolution Directive (BRRD)
 - » Passed in March 2014
 - » Bail-in elements
 - ⇒ **Liquidity flight**
- Greek crisis 2015
 - » Capital flow and cash controls
 - » ELA
 - ⇒ **Liquidity and capital flight**
- QE-programs
 - » Starting in March 2015
 - » 60 (now 80) bn Euro/month
 - ⇒ **Capital flight**



Monetary Base

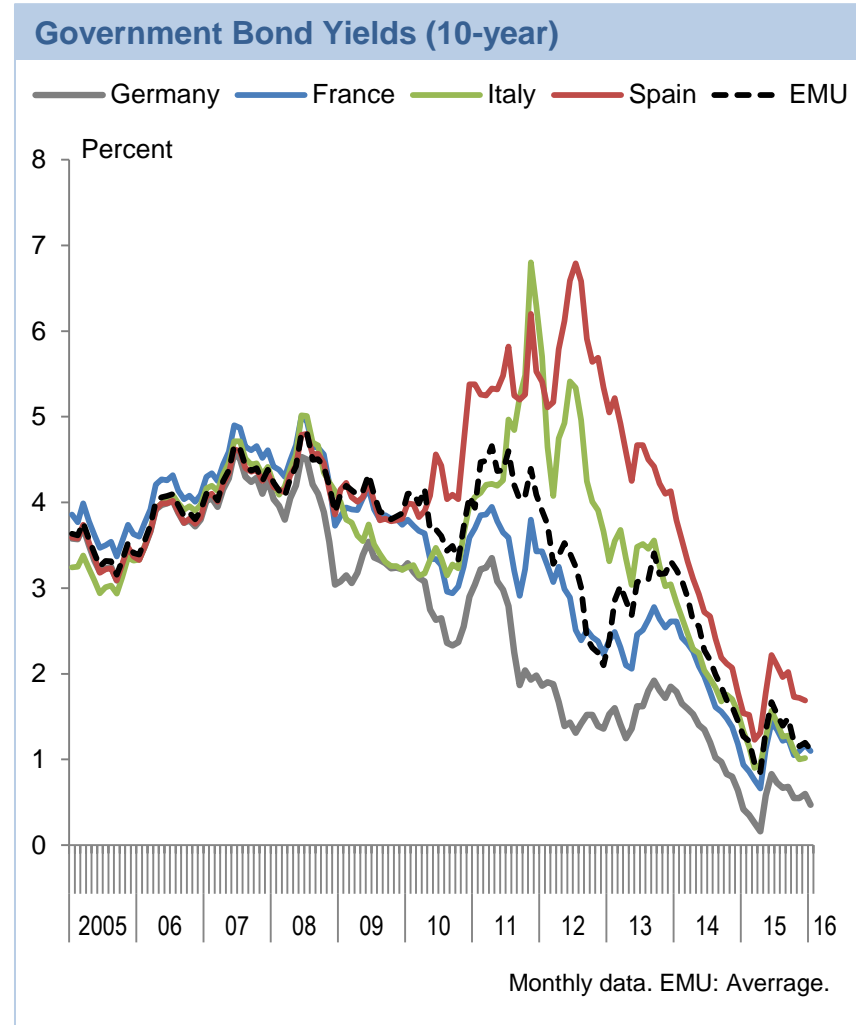
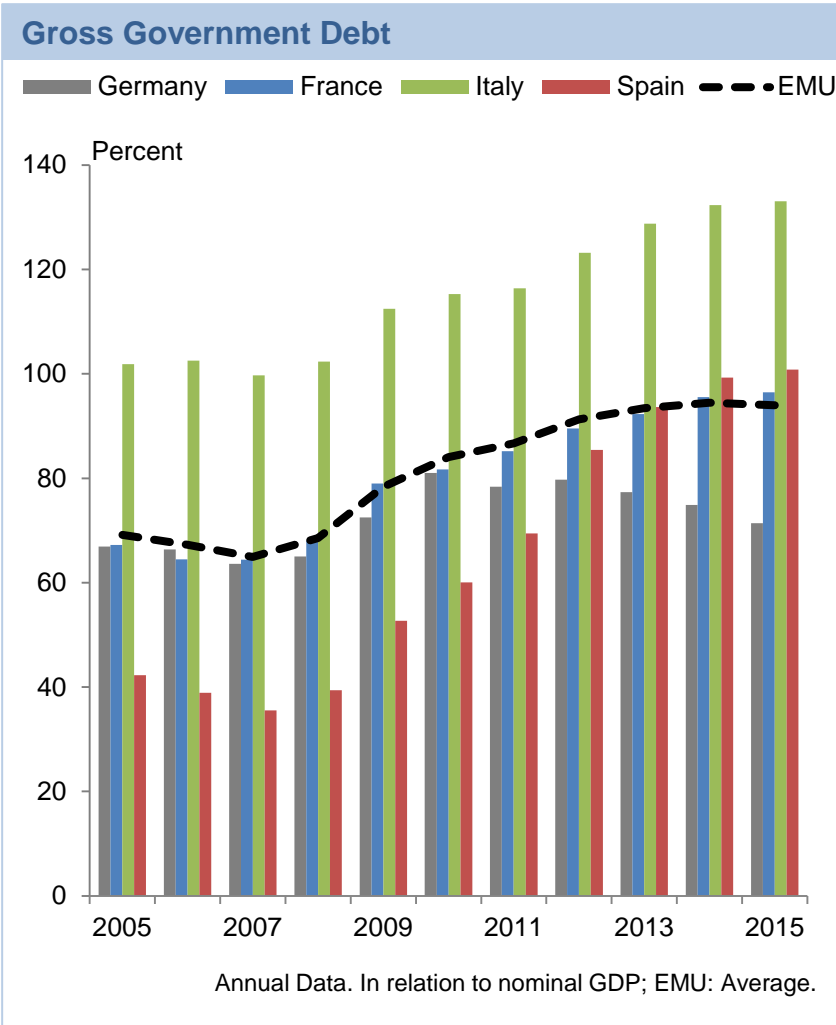


Nominal effective exchange rates



Data source: Thomson Datastream, IfW calculations.

Monetary financing of governments



Data source: Eurostat, European Commission.

Monetary policy: The all-purpose tool?

- Generic target: Provision of a means of exchange
 - Other targets
 - » Government financing
 - » Debt-monetization
 - » Boosting employment
 - » Business-cycle stabilization
 - » Systemic financial stability
 - Monetary policy
 - ⇒ **Potential conflicts**
 - ⇒ **Room for excessive rent-seeking**
 - ⇒ **High risk of sacrificing the (most abstract, general) generic target for (more simplistic, partisan) non-generic targets**
- What about Tinbergen?

Monetary policy: Overloaded!



Source: FAZ, 26. Oktober 2011, p. 11

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