Editorial

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Editorial: Expansionary Monetary Policy and the Design of Debt Rules in the European Union

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The year 2022 started with the hope that a post-COVID 19 recovery would set in, helping to stabilize public finances and inflation. However, against the expectations of many market participants two major shocks occurred. First, the projections of major central banks that inflationary pressures would subside in 2022 were disappointed, as the post-pandemic inflation hike proved to be much more pronounced, broader, and more persistent than expected. Second and related, with the Russian invasion of Ukraine, in the course of the sanctions against Russia, the upward pressure on energy and food prices was further enforced.

As global inflation further accelerated and the pressure on governments rose to soften price increases by (debt-financed) subsidies, the issue of sustainable public finance has become strongly intertwined with inflation. This is even more the case in the European Union, where debt rules aim to constrain public debt to shield of the European Central Bank from pressure to finance government expenditures. These most recent macroeconomic developments are reflected in the June 2022 issue of The Economists' Voice.

The policy papers start with an analysis of the impact of the Covid-19 lockdown measures on inflation measurement in Israel. Jonathan Benchimol (Bank of Israel) Itamar Caspi (Bank of Israel) and Yuval Levin (Bank of Israel) show in their paper *The Covid-19 Inflation Weighting in Israel: Back to the Normal?* that significant shifts have occurred in the composition of the consumer spending due to the lockdown measures, which has complicated the interpretation of official inflation statistics. With the help of credit card spending data, the authors construct an alternative price index and show that the inflation bias remained comparatively small and transitory during this period.

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In the year 2021, the European Central Bank (ECB) has revised its monetary policy strategy. Inter alia, the inflation target was changed from "*below, but close to 2%*" to "*2% inflation over the medium term*" with a "symmetric commitment" to this target. Roberto Tamborini (University of Trento) scrutinizes the possible pitfalls in the ECB's review of its monetary policy strategy (*Beware of Pitfalls in the European Central Bank's Review of Monetary Policy Strategy*) warning about possible undesirable deviations of the inflation from the target, as the central bank may surrender to the market expectations instead of being their driver.

In August 2021, the International Monetary Fund allocated the highest amount of Special Drawing Rights to its members. In their paper *The Inflationary Potential of the Historic 2021 SDR Allocation* Edoardo Beretta (Università della Svizzera Italiana) and Doris Neuberger (Rostock University) analyze the monetary effects of this unprecedented SDR allocation. They show based on a balance sheet approach that there are no monetary effects in the countries, which sell the allocated SDRs to finance additional imports. However, there is a monetary effect in the SDR-buying countries, where exports are growing. The article revives the debate on money issued by banks and the impact of the IMF (which is not a bank) on global money creation.

The recent experience with the severe disruptions of global supply chains has kindled the debate to which extent the EU should incentivize the reshoring of production to Europe, if this is classified as "strategic". Hubertus Bardt, Klaus-Heiner Röhl and Christian Rusche (IW Cologne) analyze the case for related recent European initiatives towards a larger autonomy in semiconductor production (*Subsidizing Semiconductor Production for a Strategically Autonomous European Union?*). While they stress that companies themselves have the primary responsibility for ensuring their production capabilities also in times of crises and supply chain stress, the authors see a case for government interventions as initiated through the European Chips Act. However, they warn of the risk of an international subsidy race and call for a careful evaluation and a completion of the European Digital Single Market. Such a success would turn Europe into a more attractive investment location for innovative technologies.

The Policy Forum presents a controversial discussion about the pros and cons of debt rules in Germany and the euro area, which have been regarded as the basis for monetary stability in the euro area. Niklas Potrafke (ifo Institute and University of Munich) and Christoph Schaltegger (University of Lucerne) open the discussion by stressing the role of fiscal rules as an anchor of stability (*Fiscal Rules: Anchor of Stability*). According to the authors fiscal rules can deliver an important contribution to the consolidation of public budgets in the post-Corona period, as they constrain the room for fiscal manipulation and encourage politicians to prioritize individual policies. In support of this argument, Ludger Schuknecht (Lee Kuan

Yew School of Public Policy) stresses that – given the very high public debt levels – even more public spending would be a risky strategy (*Public Expenditure and Sustainable Public Finances Post COVID*). High expenditure obligations would provide room for expenditure reductions, which could boost economic growth and enhance resilience against future crisis.

Achim Truger (University of Duisburg-Essen) formulates under the title *EU Governments Must Not Return to Their Dysfunctional Fiscal Rules* the counter-argument by stressing the need for new rules in the European Union, as the current rules were economically flawed. The new rules should put some limitation on government debt, but should allow for more fiscal flexibility, as the cost of public debt has declined strongly. Gert Wagner (DIW Berlin and Technical University of Berlin) puts into question debt rules from a more general perspective. In the paper *In an Imperfect World Policy Rules Cannot be Perfect Either* he argues that the believe in policy rules runs counter to the standard assumption of economic theory that humans are self-interested. Politicians would be extremely creative in circumventing inconvenient government regulations to maximize the probability of reelection.

Further contributions to the Policy Forum deal with issues of rule enforcement and creative accounting in the context of the German Debt Brake. In his contribution *Private Enforcement of the German Debt Brake* Patrick Hauser (University of Duesseldorf) draws the attention to a neglected dimension in the enforcement of fiscal rules. For the German constitutional Debt Brake he argues that this rule not only has only public law, but also private law consequences. Government bonds that are issued against the rules of the constitution may be void. If this consequence is realistic, private investors have an incentive to monitor budgetary policy carefully and to call for a high fiscal transparency.

Thiess Büttner (University of Erlangen-Nuernberg) describes how the German government increasingly makes use of special budgets outside of the core budget to increase its fiscal leeway far beyond the original constraints of the fiscal rule. The article *Releasing the Brake: Germany's National Fiscal Rule No Longer Ensures Compliance With European Fiscal Rules* points out how the rule's emergency clause is used to build special budgets which allow bypassing the national fiscal rule. The author concludes that the national rule no longer ensures the country's compliance with the Medium Term Objective of the European Stability and Growth Pact.