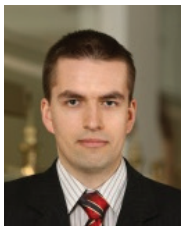
Quo Vadis, Europe? Latvijas Banka International Conference on Public Debt and QE



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I have attended a number of "international" conferences where the only claim to "internationalism" was the English language and the addresses by "wedding generals" of some nearby countries. I would call the Latvijas Banka's conference of 28 October international without any quotation marks: the discussion there was held by people who manage global developments.

One of the main conclusions was that neither public debt, nor the QE (euro area government bonds purchase in the amount of 60 billion euro each month) is a magic wand. **At best, these are short-term painkillers that provide a breather before launching the serious treatment process (structural reforms) without touching the root cause of the problem.** Moreover, using them for too long and in too large quantities leads to undesirable side-effects.

QE lowers the interest rate of government bonds (and interest payments), creating a misperception that even a high public debt is sustainable and motivating governments to borrow increasingly more. Yet the period of low interest rates is not endless. To prevent a rapid rise in interest payments, the central banks could try to postpone the rise in interest rates as long as possible (**Niels H. Bünemann**, the conference moderator and Finance Commentator and Correspondent of TV2 Denmark) and with a predictable result – too high inflation.

Once the pain stops, most people abandon treatment. That makes the harsh words by the former finance minister of Slovakia **Ivan Mikloš** addressing QE all the more understandable. Do governments perhaps launch structural reforms only when they have run out of money and there is not a single moment left (until the next election) to delay implementing the reforms? If so, then it means that budget deficits and QE would delay structural reforms. But you can't avoid reforms: postponement only raises the reforms' costs.

It is, however, also easy to see the point made by **Peter Praet**, member of the Executive Board of the European Central Bank (ECB), that there may be no alternative to implementing QE. The ECB takes care of price stability in the euro area and its duty is to use all instruments at its disposal to fight deflation. If the inflation goal is not reached and nothing is done to reach it, confidence in the ECB will be jeopardized, endangering the inflation stability in the long term.

Ilmārs Rimšēvičs, Governor of Latvijas Banka and member of the ECB's Governing Council, pointed out that when the interest rates on government bonds approach zero, investors may seek profit in purchasing risky assets which they would avoid under other circumstances. Moreover, if the central banks exhaust all instruments for fighting deflation in short order (by buying "everything that moves") but with modest results, wouldn't that mean an even greater loss of confidence in the central banks?

Does today's euro area not resemble Japan twenty years ago? The slowing of economic growth in Japan of the 1990s was first considered cyclical recession and it was treated in the best traditions of Keynes - with a budget deficit, i.e. by accumulating public debt, but this did not help to fuel the economy (**Kenichi Ueda**, Tokyo University). Since 2011, the euro area government debt has increased by a trillion euro or 10% of GDP. It would probably not make much sense to stubbornly increase the debt burden to Japan's 250% of GDP only to realise that the mechanism for stimulating total demand is broken.

As we know from the theories of Milton Friedman, pouring money from a helicopter for a long time only creates inflation, stimulating economic activity only for a short while and only in a crisis situation. The tricky question for today – why is it that the money helicopter (QE) fails to leave any substantial impact not only on economic activity but also on consumer prices? It is possible that quietly and imperceptibly money is being accumulated into a new bubble, which cannot be seen in the consumption basket, for instance, in real estate prices. It is also possible that we are finding ourselves in a period when economic theory is being rewritten.

Speeches and presentations from the conference are now available at https://www.macroeconomics.lv/conference-quo-vadis-europe-how-achieve-growth-high-debt-environment