Observatoire de la Finance

n°6 - 26 June 2020

Indulgent creditors and industrial policy

www.obsfin.ch/discussion-board-n6-26-june-2020/

Observatoire de la Finance

16, chemin des Clochettes
1206 Genève, Suisse
Tél.: +41 22 346 30 35

www.obsfin.ch
E-mail: office@obsfin.ch

CONTRIBUTORS

Thanks for those of our contributors who ventured to react to this question:

"Staggering amounts of money start pouring on Western economies in order to keep the economic machine working and to avoid massive social shocks and unrests. How will this effort be financed? First step is clear: public bodies will issue debt and borrow on the markets, while central banks will pump liquidity to make the deals easier. The second step is less clear: what should the governments do to allocate these massive amounts: give away by distributing to the affected households or enterprises (helicopter money); lend them and ultimately either enforce the service and reimbursement conditions or cancel the debt; or should they provide equity to enterprises as would do an equity (sovereign?) fund, and expect future dividends - and for the big enterprises the stock price hikes - to cover, in due time, the incurred expenses?"

Valerio Alfonso Bruno

Etienne Perrot

Andrew Cornford

Archana Sinha

Edouard Dommen

Domingo Sugranyes

Eelco Fiole

Cédric Tille

EDITORIAL

Indulgent creditors and industrial policy

"Objectives of rescue programmes should have priority over the mechanisms of financing". But objectives are many, they are simultaneous and not necessarily converging, some are short term other long term: "support to households and firms", "increase demand", "green energy transition", "long term sustainability" etc. So there is not a "single one size fits all" policy mix to be applied across the globe. Available measures have to be balanced against their impact on the various socioeconomic groups, because, for instance "the way debt is cared for (or cancelled through inflation) directly affects inter-generational contrasting interests".

A distinction has to be made between measures helping needy households and those supporting firms and the future economy. For the former, "help - for instance through stronger unemployment benefits or financial compensation for reduced working time as in Switzerland - should be provided with no requirement on payback." Households may also be supported through more unconventional policy options such as helicopter money even if the US experience seems to have been a failure "2/3 of the sums allocated were not spent!"

On the firm side, the challenges is to target those firms "that face a temporary drop in income, but are otherwise viable, without subsidizing firms that are fine anyway." Such a support could take the form of loans with low interest rates and long maturities, with the option of a write-off of debts backed by governments or their ultimate conversion into firms' equity. Thus, at the end, there will be a request for an "indulgent creditor".

To complicate matters further, many of measures seem to be geared toward short-term business cycle-like goals. These however do not address the structural dimension, namely the sectoral and environmental urgencies, the long-term sustainability and transition to a green economy. Thus, depending on countries, more radical measures may be envisaged to support industries of strategic importance (e.g. in Europe the automobile), such as "recapitalization, or even partial nationalization".

In other terms, the appropriate policy-mix in the long term financing may require the comeback of "industrial policies", banished long ago in the name of market discipline and free competition. The old question will thus come back again: can industrial policy avoid creating massive market distortions?

Virgile Perret & Paul H. Dembinski

"… the objectives of rescue programmes should take priority…"

All the categories mentioned are likely to be deployed as part of extensions of public budgets and of fiscal interventions in response to the Covid-19 pandemic. The distribution of the additional financing in particular jurisdictions will be determined according to the incidence of crises, the functioning of central and local government institutions regarding revenue and expenditure, and the relation of monetary policy and financial markets to this functioning. Separate mention might be made here of potential recourse to perpetuals – bonds with no maturity and a low but positive interest rate which could assist the avoidance of potentially catastrophic effects of long-term zero or negative rates for pension funds. **Generally the objectives of rescue programmes should take priority over mechanisms of financing since countries will devise their financial and fiscal means one way or another.**

Andrew Cornford

"… economic machine and the prognoses that it implies …"

While apparently complex, an economy is really just many simple things working together, including all of the transactions in all of its markets which make it look more intricate than it really is. In any market there are lots of buyers and sellers, having different motivations. This perspective of supply and demand is different from the traditional perspective in which both supply and demand are measured in quantity and the price relationship between them is described in terms of elasticity. Therefore, prosperity would be easy to achieve simply through pursuing policies that would gradually increase demand and in credit based economy, robust **demand equals robust real credit growth**; conversely, deleveraging equals low demand, and hence lower and falling real credit growth.

Archana Sinha

"… inter-generational contrasting interests …"

Macroeconomic experts – which I am not – will ponder pros and cons of different funding solutions. This is important as large parts of savings and retirement funds are invested in public debt, and **the way debt is cared for (or cancelled through inflation) directly affects inter-generational contrasting interests**. Whether the amounts raised should be given, lent or invested in equity is a subsidiary question to what the money is used for: emergency temporary aid? Or driving people, institutions and companies towards productive work and equal opportunities? The key criteria for public spending/investing should aim at **green energy transition**; education for technological change and personal capacity for ethical and cultural discernment; technological developments which are labour enabling (instead of labour replacing).

Domingo Sugranyes Bickel

"… solidarity is key …"

Governments are fiduciaries of society. Their borrowing from future taxpayers is sociologically a wicked problem. Well-governed allocations need to include benefits to this future generation and correct for material societal problems unresolved by the current generation. **Solidarity is key and any decisions should include deploying all economic tools available and appropriate.** These include regular debt servicing where feasible, debt cancelation to enable sustainable development, debt-equity swaps to recognize governments run higher level of risks, some level of inflation in line with labour market priorities and responsible national budgets, industry structure reform, some level of central bank access for all, which increases financial system stability, and overhaul of fiscal systems enabling a just redistribution of wealth to correct for excessive disparities.

Eelco Fiole

“… it could be useful to build a two pillar strategy …”

There is probably not a single “one size fits all” solution on how better allocating massive amount of money to Western economies in the frame of the Covid-19 pandemic. In Italy, for example, a task force for economic recovery headed by Vittorio Colao, developed a plan for 2020-2021 which mostly envisages the private sector as the main focus of the recovery. Consequently, **it could be useful to build a two pillars strategy.** Italy could (1) develop a sovereign fund investing in enterprises, with some clear prerequisites; alongside the private sector, (2) an important part of the money should be devoted to quickly tackle social shocks, with a fast track to identify and support the most vulnerable among households and enterprises.

Valerio Alfonso Bruno

“… equity provision is delicate …”

I would distinguish between support to households and firms. For the former the help - for instance through stronger unemployment benefits or financial compensation for reduced working time as in Switzerland - should be provided with no requirement on payback. For the latter, the idea is to support firms that faced a temporary drop in income, but are otherwise viable, without subsidizing firms that are fine anyway. **The baseline option should be for loans to be paid back, with low interest rates and long maturities, with the option of a write-off of government backed debt for firms that cannot fully pay back even though they are sound looking forward.** This backup option should be administered while keeping administrative complexity to a minimum. Equity provision is delicate, as quoted firms are usually the large ones which are less constrained than the smaller ones.

Cédric Tille

"… recapitalization, or even partial nationalization, seem necessary …"

Recent experiences in the USA (checks for no consideration have been granted to the needy population): 2/3 of the sums allocated were not spent! For investments: in addition to the available money, necessary performance prospects are needed! In one word, economic visibility - and the stability of the legal environment - must be restored. Meanwhile, medium-term government-guaranteed loans, possibly refinanced by the central bank. **For the most important industries because of their economic environment - in Europe the automobile - recapitalization, or even partial nationalization, seem necessary.**

Etienne Perrot

"… the basic rule is to share risks and benefits fairly …"

Let us concentrate here on financing enterprise. The pandemic is bringing lasting changes. Finance should concentrate on the enterprising enterprises which intend to meet the needs of the future, including new firms. **The basic rule is to share risks and benefits fairly.** Fixed interest loans will only do that by the remotest of chance. Acquiring equity is fairer, but since it means getting involved in the affairs of the enterprise, it only suits large firms. Small ones are better served by **indulgent creditors** willing to accept the prospect of uncertain returns and repayments.

By Edouard Dommen on a related topic: http://www.chretiensdegaucheromands.ch/wp-content/uploads/2020/06/Dommen-apre%CC%80s-pande%CC%81mie.pdf.

Edouard Dommen

LIST OF CONTRIBUTORS

Valerio Alfonso Bruno is a Researcher in politics and a Senior Research Fellow at the Centre for Analysis of the Radical Right (CARR), member of AREF and AIESC. He provides regularly political analysis for, among others, the Fair Observer, Social Europe and Indus News.

Andrew Cornford (Counsellor, Observatoire de la Finance; from 1977 until 2003 staff member of UNCTAD, latterly with special responsibility for financial regulation and international trade in financial services)

Paul H. Dembinski is the initiator and Director of the Foundation of the Observatoire de la Finance. In parallel, he is partner and co-founder (with Alain Schoenenberger) of Eco'Diagnostic, an independent economic research institute working for both government and private clients in Switzerland and elsewhere. Paul H. Dembinski is also Professor at the University of Fribourg.

Edward Dommen is a specialist in economic ethics, particularly Calvin's. He has been a university professor, a researcher in UNCTAD and president of Geneva's Ecumenical Workshop in Theology (AOT) – an adult-education

Dr. **Eelco Fiole,** CFA, LLM is an investment governance expert, board director and adjunct professor of Finance Ethics in Lausanne and Neuchatel. He was a CFOO for almost 10 years in (alternative) investment management and blockchain, and holds advanced degrees in various academic domains. Thriving on idiosyncrasies and deeply international in his outlook, he is increasingly currently focused on social innovation.

Dr. **Virgile Perret** holds a Ph.D in Political Science from the University of Lausanne, for which he was awarded the Prize of the Faculty in 2013. He's specialized in the study of digital currencies and technological innovation from an interdisciplinary perspective. He collaborated with the European Commission, the International Labour Organization (ILO) and the State of Vaud.

P. **Etienne Perrot**, Jesuit, Doctor in Economics sciences, member of the editorial board of the magazine Choisir (Geneva), editorial adviser of the journal Études (Paris).

Dr. **Archana Sinha**, a doctorate in Agricultural Economics, currently is Head, of the Department of Women's Studies; and just before this she was Head, of the Department of Rural and Urban Development, Indian Social Institute, New Delhi, India for the past several years. Additionally, she holds responsibility of Academic Coordinator, Research, Indian Social Institute, New Delhi. She is responsible for implementing research on various women issues, rural and urban based issues on gender and development, agriculture related rural economy, livelihood, gender and social exclusion, food security, nutrition, health promotion, SDGs related issues, etc. She is also involved in research studies, proposals, plans and surveys. She worked for evaluation studies and impact assessment in several flagship development programmes of Government of India with experiences drawn from the field and research. Also involved in publications of research reports, designing and organizing research methodology, advocacy and capacity building programs, networking and collaborating with similar other organizations in research, capacity building and advocacy programs Archana Sinha.

Domingo Sugranyes Bickel, KCSG. Born 29 April 1945. Spanish national resident in Madrid. Graduated from the University of Fribourg, Switzerland. Secretary General of UNIAPAC (International Christian Union of Business Executives), Brussels, from 1974 to 1981. With MAPFRE international insurance group from 1981, Executive Vice-Chairman until 2008. From 2009 to 2019, Chairman of Vatican-based Foundation CENTESIMUS ANNUS PRO PONTIFICE. Knight Commander of the Pontifical Order of Saint Gregory the Great (April 2019)

Cédric Tille is Professor of macroeconomics at the Graduate Institute of International and Development Studies in Geneva. Before joining the Institute in 2007 he worked during nine years as an economist in the international research department of the Federal Reserve Bank of New York.

"FROM VIRUS TO VITAMIN" – JOIN THE DISCUSSION

The Observatoire de la Finance intends to seize this period of pandemic to step back and take a fresh look at our global economic system, dare to ask new questions which the current crisis brings to the fore and propose innovative ways to rebuild a more resilient and sustainable economy and society. In brief, we want to turn the virus into a vitamin for the future.

Our Discussion Board "From Virus to Vitamin" focuses on commenting issues relevant to finance and economy in relations to society, ethics and the environment from a variety of perspectives, of practical experiences and of academic disciplines. It has been designed to share and discuss information and opinions expressed in a short and concise manner.

Contributors (Discover the list of contributors) are invited to react on a question/issue that is submitted in parallel to a limited group of experts. This happens on a regular basis, through a dedicated mailing list. After the deadline for submission, the reactions are edited and published with signatures in one document on the website of the Observatoire de la finance and on its Linkedin page. If you would like to join the discussion, you may send an email to the editor, Dr. Virgile Perret <perret@obsfin.ch>.

OF Discussion Board – Questions addressed so far

- Question 6: Staggering amounts of money start pouring on Western economies in order to keep the economic machine working and to avoid massive social shocks and unrests. How will this effort be financed? First step is clear: public bodies will issue debt and borrow on the markets, while central banks will pump liquidity to make the deals easier. The second step is less clear: what should the governments do to allocate these massive amounts: give away by distributing to the affected households or enterprises (helicopter money); lend them and ultimately either enforce the service and reimbursement conditions or cancel the debt; or should they provide equity to enterprises as would do an equity (sovereign?) fund, and expect future dividends - and for the big enterprises the stock price hikes - to cover, in due time, the incurred expenses?

Observatoire de la Finance

16, chemin des Clochettes
1206 Genève, Suisse
Tél.: +41 22 346 30 35

www.obsfin.ch
E-mail: office@obsfin.ch

- Question 5: In response to the crisis, the resilience of the “domestic/household economy” proved essential for many despite the fact that this activity is not monetized and remains “invisible” for official statistics. What economic policy recommendations should be drawn from this experience ?

- Question 4 : In pandemic times the world operates thanks to GAFAs and telecoms. These giant enterprises are becoming every day more clearly the backbone of our economic, social, and political lives, which makes them players of systemic and global importance. How will/should evolve their future regulation at national and global levels? What are the rationales behind?

- Question 3 : What would you suggest as priority actions to reach out to the most exposed to the economic aftermath of the pandemic crisis in developing countries?

- Question 2 : What principles should guide us in striking the balance between « lives and livelihoods »? Or put differently, between health and GDP?

- Question 1 : How has the virus crisis affected your basic convictions about economy and society?

www.obsfin.ch/from-virus-to-vitamin/

Observatoire de la Finance

16, chemin des Clochettes
1206 Genève, Suisse
Tél.: +41 22 346 30 35

www.obsfin.ch
E-mail: office@obsfin.ch