

MONETARY POLICY AND INCOME DISTRIBUTION IN THE COVID-19 PANDEMIC CRISIS: A EUROPEAN PERSPECTIVE¹

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ABSTRACT

This paper focuses on central banks' interventions during the COVID-19 pandemic crisis and their impacts on income distribution across Europe, particularly as regards Switzerland and the euro area. The first section offers a survey of the monetary policy tools that have been put into practice to deal with the macroeconomic shock resulting from this pandemic. The second section points out the impact of central banks' interventions on the whole economic system, before elaborating on the distributive effects of them. The third section suggests an alternative monetary policy stance to reduce the latter effects and to enhance sustainable development for the common good.

Keywords: COVID-19, financial stability, income distribution, monetary policy, pandemic crisis.

JEL Classification: E02, E21, E24, E25.

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POLÍTICA MONETARIA Y DISTRIBUCIÓN DEL INGRESO EN LA CRISIS
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RESUMEN

El presente artículo analiza las intervenciones de los bancos centrales durante la crisis de la pandemia COVID-19 y sus impactos en la distribución del ingreso en Europa, en particular en lo que concierne a Suiza y el área del euro. Después de la introducción, la segunda parte ofrece una revisión de los instrumentos de política monetaria puestos en práctica para confrontar el choque resultante de esta pandemia. La tercera parte enfatiza el impacto de las intervenciones de los bancos centrales en todo el sistema económico, previo al escrutinio de sus efectos distributivos, y la cuarta sugiere un enfoque alternativo de política monetaria para atenuar estos efectos y para mejorar el desarrollo sustentable de los bienes comunes.

Palabras clave: COVID-19, estabilidad financiera, distribución del ingreso, política monetaria, crisis pandémica.

Clasificación JEL: E02, E21, E24, E25.

1. INTRODUCTION

The 2019 Coronavirus disease (COVID-19) has infected the global economy starting from China apparently. Owing to globalization, that is, the free movement of goods as well as workers across the globe, this disease has become a pandemic rapidly in Spring 2020. As the number of people affected by the COVID-19 pandemic increased dramatically, several countries adopted a variety of restrictions, trying thereby to reduce the spreading of such a virulent pandemic.

As a result, economic activities in Europe were locked down for a couple of months during the first peak of this pandemic in Spring 2020. After the Summer 2020, when the number of infected people was much reduced thanks to the lockdown, statistics have shown a dramatic surge in this number, owing to the general opening of all economic activities. Hence, a second (partial) lockdown followed in Fall 2020, even though a number of national governments did not impose a full lockdown similar to the Spring 2020 decision —probably because of the wide lobbying of relevant interest groups, such as major financial institutions and big

transnational corporations in Western countries (see Rossi, 2021 for an analysis of the Swiss case).

Among the variety of economic policy interventions, central banks in Western countries did contribute to the big effort necessary to support economic activities and particularly the labour market, since the latter came under much pressure as a result of the lockdown and the ensuing problems for a number of wage earners as well as independent workers. This paper focuses therefore on central banks' interventions during the COVID-19 pandemic crisis and their impacts so far on income distribution across Europe, particularly as regards Switzerland and the euro area.

The next section presents a survey of the monetary policy instruments that have been put into practice to deal with the macroeconomic shock resulting from this pandemic. The third section points out the major impacts of central banks' interventions on the whole economic system, before elaborating on the distributive effects of them. The fourth section suggests an alternative monetary policy stance to reduce the latter effects considerably as well as to enhance sustainable development. The last section offers some conclusive remarks in this regard.

2. THE CENTRAL BANKS' TOOLBOX IN THE PANDEMIC CRISIS

Central banks have become a major player since the bursting of the global financial crisis after the demise of Lehman Brothers on September 15, 2008. In the following decade, the monetary policy stance has been extremely expansive in a number of Western economies, in the United States as well as Europe. The first monetary policy instrument used to address some negative consequences of this global financial crisis has been the policy rate of interest: In some countries, like Switzerland, it has even become negative, hoping thereby to boost the firms' investment and thereby kick-start economic growth (see Rossi, 2019).

In the United States as well as across Europe, central banks have also been purchasing an impressive and mounting volume of financial assets, particularly government bonds, even though the latter purchases occurred on secondary markets to by-pass the so-called 'no bail-out clause' for a central bank in support of its country's government. As a matter of fact, "[m]any central banks (...) launched asset purchase programmes ('quantitative easing') or —as was the case with the SNB [Swiss National

Bank]— conducted foreign exchange market interventions” (Maechler and Moser, 2020, p. 7).

On the one hand, ‘quantitative easing’ was meant to support and then to stimulate economic activity, through an increase in the money supply that should induce banks to open new credit lines to firms, in order for the latter to invest and thus to increase produced output, hiring more workers hopefully. On the other hand, the purchase of foreign currencies, as carried out by the SNB, was done to counteract market forces that, in the case of the Swiss franc, made the national currency appreciate with a negative impact on the country’s exports, thereby affecting economic activity (hence also the labour market) negatively.

These monetary policy interventions, in fact, did not really eradicate the origins of the global financial crisis, as they merely palliated some of the more dramatic effects of the latter. This is even more so after the bursting of the COVID-19 pandemic, when a number of central banks carried out a lot of similar interventions aiming at supporting those economic activities mostly hit by the crisis. In the case of Switzerland, for instance, “[o]ne of the new instruments is the SNB’s COVID-19 re-financing facility (CRF). The CRF, which was set up at the end of March 2020, and the loan guarantees provided [to banks] by the Swiss federal government have together contributed significantly towards ensuring the continued supply of credit and liquidity to small and medium-sized enterprises” (Maechler and Moser, 2020, p. 2).

The working of such an instrument is supposed to provide liquidity to commercial banks, in order to induce the latter to open new credit lines to firms in need of liquidity to pay for their production costs, including the wage bill, particularly since these credits are guaranteed by the government. Indeed, all COVID-19 credit lines up to 500,000 Swiss francs pay no interest rate and are fully guaranteed by the federal government, while all COVID-19 credit lines beyond that limit pay a nominal rate of interest of 0.5 per cent and have an 85 per cent guarantee by the Swiss government (Swiss Federal Department of Finance, 2020).

As regards the euro area, the European Central Bank (ECB) intervened repeatedly, adopting a variety of exceptional measures meant to support economic activity across that area, such as the Pandemic Emergency Purchase Programme (PEPP): Up to an amount of 1,850 billion euros, the ECB may buy different kinds of financial assets, particularly corporate

bonds, from either firms or banks, thereby aiming at giving the former a direct or indirect (through banks) financial support for investment.

In this regard, the ECB has also made it easier for banks to gather the collateral they need in order for them to borrow from their own national central bank: The list of eligible assets has been expanded to include also problematic assets, and the haircut of their market value has been reduced to allow banks in trouble to have less stringent financing conditions, in the hope that banks will provide loans to those firms most hardly hit by the COVID-19 crisis, including small and medium-sized enterprises. Further, the ECB has also reduced the amount of funds ('capital') that banks must hold as a buffer for difficult times, and established currency swap lines with other central banks (as those in the United States, in the United Kingdom, and Switzerland), to make sure that the foreign-exchange market does not freeze as a result of a lack of foreign currencies highly demanded in times of crisis (see European Central Bank, 2020 for further details).

All these monetary policy interventions and 'unconventional' instruments have brought to a variety of stakeholders some oxygen to breath through the peak of the pandemic crisis. Yet, they could not provide the key to solve this crisis eventually, whose solution lies in a public support of aggregate demand on the market for produced goods and services, rather than in supporting supply of the latter in a market where there is a blatant lack of demand. Indeed, no firm will borrow to invest in the production process when its inventories are filled with unsold output. This shows that the so-called 'Say's Law' (that is, the pretence that 'supply creates its own demand' on the goods market) does not work in the real world. Rather, it is expected demand by firms —what Keynes (1936, Ch. 3) called "effective demand"— that in fact induces them to rise their productive capacity —hence supply on the products market— through investment financed via banks' credit lines.

The empirical evidence offered by the pandemic crisis supports this 'reversed causality', and confirms Keynes's viewpoint. As a matter of fact, neither negative rates of interest nor loan guarantees provided by the public sector have been inducing firms to demand the opening of banks' credit lines in order for the former to finance the production process. In the best-case scenario, both these policy interventions have allowed firms to borrow in order for them to pay the wage bill during the lock-

down, when firms' activities were closed as a result of the government decision in this respect. In fact, a number of firms exploited these facilities either to speculate on financial markets or to buy luxury goods for their owners, as it occurred in Switzerland, where firms have also 'hoarded' some of the borrowed funds as a liquidity-keeping strategy if the worst-case scenario of a great depression at global level would occur in a not-too-distant future.

Now, these 'unconventional' and extraordinary monetary policy interventions affected both income and wealth distribution across the relevant national economy. Let us expand on this issue in the next section.

3. THE DISTRIBUTIVE IMPACT OF CENTRAL BANKS' INTERVENTIONS

Mainstream economists as well as orthodox central bankers assume that monetary policy is neutral on so-called 'real' magnitudes, such as employment, output growth, and income and wealth distribution. In this perspective, there exists a dichotomy between the 'real' and the 'monetary' sectors of our economic system: Monetary policy interventions affect the latter sector but not the former, which reacts only when 'real' magnitudes change, for instance as a result of technical progress. In fact, there is no dichotomy, as the economic system is one and one only: Monetary variables affect (and are affected by) real variables over any time horizon (short, medium, and long run). In particular, monetary policy affects income and wealth distribution along different transmission channels, namely, the interest rate channel, the balance-sheet channel, and the asset price channel (see Carré, 2015; Febrero and Uxó, 2015; Albert, Peñalver, and Perez-Bernabeu, 2020).

The largest channel—which comprises some 'sub-channels', as we will point out—stems directly from the policy rates of interest. When a central bank reduces the latter, as in the case of both the 2008 global financial crisis and the COVID-19 pandemic crisis, banks are induced to reduce their own lending rates of interest, which is meant to stimulate firms' investment. Now, as already noticed, this is not enough, in fact, to increase investment, because the latter depends more on expected demand than on borrowing costs for firms. However, a reduction of interest rates induces a variety of agents, notably, firms, non-bank financial institutions, and wealthy households, to borrow in order to

purchase financial assets, trying thereby to earn an income that these agents cannot obtain on either the goods or labour market.

When this occurs on a large scale, asset prices increase (owing to a debt bubble) and give rise to two major effects. On one hand, this creates the so-called 'wealth effect' that could spur consumption, since wealthy households feel richer as a result of their financial assets having higher prices on the marketplace. This effect, nevertheless, is more theoretical than actual, since the marginal propensity to consume of wealthy households is low (and much lower than the middle class one). On the other hand, a considerable increase in asset prices can induce a series of further purchases of these assets, which then generate a financial bubble as observed in the years preceding (and also leading to) the 2008 global financial crisis. Agents consider that this upward pressure on asset prices will continue and hence buy financial assets with a view to sell them at a higher price, thereby earning some profit from them. Sooner or later, however, this inflationary process comes to an end, often abruptly, and the bursting of such a bubble hurts a variety of agents negatively, first across financial markets and later also in the rest of the economic system (including, particularly, the labour market).

This chain of events is reinforced by two 'sub-channels', namely, the balance-sheet and the asset price conduits. The former concerns firms' balance sheets: When asset prices increase (owing to a reduction in the policy rates of interest) firms' balance sheets improve for those firms having a portfolio of financial assets whose price does increase considerably. In such a case, as a matter of fact, these firms are in a better position to borrow from banks, mainly to purchase (similar or the same) financial assets with a view to further expand their profits thanks to financial transactions rather than production and output sale (which stagnate as a result of a lack of effective demand on the market for produced goods and services). These profits are then distributed to the firms' stockholders, among them the firms' managers.

For its part, the asset price channel concerns also wealthy households: Those individuals whose portfolio includes either real or financial assets may feel richer when the latter prices show an upward trend (as a result of lower policy rates of interest). Hence, these households can increase their consumption expenditures, often also as a result of their borrowing from the banking sector, even though this remains to be seen in a period

of high uncertainty and lack of confidence in the future as a result of the pandemic crisis that burst in 2020 at the global level. Another way for wealthy households to benefit from an increase in their wealth as a result of central banks' policies is to purchase real-estate objects as an income-generating activity for them, mainly through the granting of mortgage loans at lower rates of interest owing to an expansionary monetary policy stance (see Rossi, 2022b).

All in all, the monetary policy transmission mechanism affects the distribution of income and wealth across the national economy. It favours thereby the wealthy agents, through an array of channels that stem from the policy rates of interest. Both firms' owners and their managers can obtain financial rents that increase their income simply because of a central bank's intervention. By way of contrast, middle-class workers do not obtain any benefits from such an intervention, particularly if their own wealth is close to zero or even negative, as in the case of mortgage loan holders whose debt is higher than their property's value (a situation that has been affecting several US households since the subprime bubble burst in 2006).

4. A MORE SUITABLE MONETARY POLICY STANCE IN THE POST-PANDEMIC WORLD

The 2020 pandemic crisis, even more than the 2008 global financial crisis, has shown that a number of central banks, particularly in the so-called 'advanced economies', should rethink their monetary policy strategy afresh. They must indeed integrate the distributional impacts of their choices as well as their effects on climate changes at global level. Both issues have an influence on financial (in)stability, too, which has become a matter of concern by major central banks in the aftermath of the global financial crisis (see, for instance, D'Orazio and Popoyan, 2019; Bolton *et al.*, 2020; D'Orazio, 2021; Schoenmaker, 2021 and D'Orazio and Popoyan, 2022).

With regard to the distributional impacts of central banks' decisions, as highlighted in the previous section, monetary policy makers should consider that the interest rate channel as well as its 'sub-channels' (illustrated earlier on) affect income and wealth distribution in a way that much reduces the effectiveness of their interventions —which, in fact,

could even contribute to generating financial instability across the whole economic system (see Rossi, 2020, 2022a).

In this regard, policy rates of interest should be managed and applied to the banking sector considering how each of its components contributes to economic growth in light of its impact on climate changes and financial stability. To be sure, banks whose lines of credit are provided to firms that do not pollute the environment should have to pay lower rates of interest when they borrow from the central bank than those interest rates that banks will have to pay with respect to non-green (that is, brown) activities financed through their credit lines. Similarly, in case of a negative interest rate policy, the former banks should not pay an interest rate on their deposits with the central bank, while the rate of interest applied to the settlement balances of the latter banks should proportionally depend on the share of brown assets in their own balance sheets.

As suggested by D’Orazio and Popoyan (2019), who propose the introduction of a “brown penalizing factor” requiring banks to hold more prudential capital for carbon-intensive assets, monetary policy should also differentiate reserve requirements as well as capital and liquidity ratios according to the shares of green and respectively non-green financial assets in the banks’ portfolio, penalizing those banks whose assets are brown and encouraging banks’ investment in climate-friendly activities.

Something similar should also be applied to relocate firms’ activities that were delocalized as a result of globalization, which has contributed to spread the COVID-19 across the world. Banks providing credit lines to businesses that relocate their activities within their country’s borders might benefit from lower rates of interest and less stringent regulatory requirements with regard to both liquidity and reserve ratios, whereas the opposite might apply to banks that support delocalization aiming at minimizing production costs at the expense of health, climate conditions, or wage-earners’ compensation. This may also induce banks to apply a similar differentiated interest rate policy to the credit lines that they decide to open to firms, or to any other category of economic agents, including households and non-bank financial institutions like insurances and pension funds —so that all stakeholders reorient their assets portfolio in a climate-friendly direction.

Now, the central bank itself should reorient its own portfolio of assets, reducing the share of non-green assets (whose haircut should be increased

for those assets that feature in the list of eligible assets for any monetary policy operation) and increasing the share of green assets, so much so when the latter have been issued by firms that operate entirely within the country's borders (with therefore a low or zero risk of contributing to a pandemic disease as the COVID-19). The guiding principle for central banks should be symmetric for each policy instrument they put into practice: Incentivize banks' activities favourable to climate, health, or financial stability, and discourage banks' activities that have a negative impact on any of these three major issues for the common good.

5. CONCLUDING REMARKS

Central banks around the world, and particularly in the Western countries, have become a major player in the global economy, as a result of both the 2008 global financial crisis and the 2020 coronavirus pandemic. They have thereby affected the working of the economy as a whole, particularly financial markets, where asset-price inflation has been observed in the aftermath of 'unconventional' monetary policies carried out with a very expansionary mood that is really impressive and puzzling as regards the appropriate 'exit strategy' before long.

This paper investigated the distributive impacts of central banks' policies in the aftermath of the pandemic crisis that burst at the beginning of 2020 at global level. It pointed out that a variety of expansionary monetary policy interventions have benefitted the upper class of the social pyramid without any positive impact on the economy as a whole. To the contrary, these interventions contributed to increase financial instability, since they induced banks as well as non-bank financial institutions to further inflate asset prices in various speculative transactions that have nothing to do with "GDP-based transactions" (Werner, 2012, p. 29).

The solution to these problems lies, first, in a radical change in the monetary policy stance of major central banks, considering the distributional impacts of current monetary policies as well as their contribution to climate change. Later on, when central banks will have put into practice a climate-friendly monetary policy that reduces income and wealth disparities across the economy, a structural reform of banks' bookkeeping should occur, in order that money and credit be recorded explicitly separated in banks' ledgers. This reform will thus make sure that

those credit lines that banks grant without having enough pre-existent bank deposits cannot be used to finance “non-GDP-based transactions” (Werner, 2012, p. 29) —thereby contributing to guarantee the financial stability of the economy as a whole (Rossi, 2015 expands on this reform). ◀

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