The desperate need for a paradigm shift in establishment macroeconomics

Mario Seccareccia

Introduction

Starting in March 2020, the COVID-19 crisis imposed on modern financialized capitalist economies what resembled a somewhat reconfigured Galbraithian dual core/periphery industrial structure, somewhat different from the one described originally by John Kenneth Galbraith in his celebrated book, *The New Industrial State*. At the time of writing over a year later in May 2021, we still have a core sheltered sector that maintained relatively stable private and public-sector jobs and incomes. This was: (1) because of the quick adaptation of existing information/communication technologies that were able to rapidly transform these industries into a modern "putting out" system, with workers' home space being converted into their new work space (often with negative gender-related consequences given family pressures at home), or (2) simply because workers happened to be employed in essential industries, such as health care, food production, transportation, and certain retail sectors in which

CCPA
CANADIAN CENTRE for POLICY ALTERNATIVES
CENTRE CANADIEN de POLITIQUES ALTERNATIVES

workers had to risk their lives to maintain these services, with this latter essential sector containing a distribution of both “good” and “bad” jobs.

On the other hand, there also emerged a most economically vulnerable and highly dispersed periphery of non-essential workers who, during the crisis, were left to receive a pittance to meet their subsistence needs provided temporarily by the state in the form of emergency financial support because of the mass unemployment resulting from the recurring lockdowns and the collapse of some less essential household consumption spending because of the COVID-19 restrictions. However, this current fragmented, dual economy is perhaps the extreme crisis version of what had already emerged as a long-term dualistic pattern (see, for example, Temin 2016), which resulted from a long-term tendency toward deep social divisions in Western societies as governments abandoned post-war Keynesian principles and embraced the neoliberal ideology and policy system advances by the likes of Milton Friedman and Friederich von Hayek starting in the 1970s.

Before moving further onto the question of what ought to be done for the post-COVID-19 crisis, let me first analyze what happened to macroeconomic policy during this long period preceding the COVID-19 crisis and then see what changed. The intent here is to describe how the crisis, beginning with the preceding Global Financial Crisis of 2008, reversed many of the key conventional precepts that guided policy throughout that long period before these two deep crises and why, because of neoliberal policy failures, it is now time for a paradigm shift.

The evolving “conventional wisdom” in macroeconomic policy

A multitude of heterodox traditions in economics coalesce in the works of John Kenneth Galbraith that either criticized or completely rejected classical and neoclassical thought (see Parker 2005). The most represented in Galbraith’s writings was, of course, the American Institutionalist tradition going back to Thorstein Veblen, but one also finds in Galbraith ideas from the early post-war tradition of Cambridge Keynesianism together with American macroeconomic policy pragmatism stemming from Roosevelt’s New Deal era.

By emphasizing the deep institutional features of an economy in determining productive outcomes, Galbraith and many post-war Keynesian economists broke away from the conventional wisdom in economic policy originating from the triumphant 19th century liberalism that universally celebrated the supremacy of impersonal self-regulating “market” forces and minimized the role of the state. Instead, Galbraith understood the importance of greater collective action so as to form a countervailing

power to the pecuniary power of dominant corporate enterprises, and also recognized the centrality of the state in the determination of both micro- and macro-economic outcomes. As Polanyi (1944) put it so succinctly, the so-called "market" should be embedded in society rather than society being subordinated to the whims of market forces because behind the "market" there are powerful individual players whose class interests are often in conflict with those of the majority, as Marx described repeatedly in his many writings.

Moreover, there is nothing "natural" or "spontaneous" about the market mechanism as idolized by the majority of neoclassical economists. Indeed, according to Polanyi, the market economy was "planned" and certain "fictitious commodity" markets, such as for labour (as well as land and money) only underwent a process of commoditization by the 19th century through the concerted actions of the state (see Polanyi 1944; and Polanyi-Levitt and Seccareccia 2018). However, as emphasized by Keynes (1936) and Polanyi (1944), unlike the market for commodities, whose purpose is consumption, as, say, for that of fresh produce in the context of a local farmers' market, there is no market mechanism that would determine, for instance, the "natural" or equilibrium price of a labourer's time.

Indeed, as heterodox feminist economists would quickly add nowadays, there is no natural or equilibrium price for women's reproductive labour as well, if a new fictitious market for reproductive labour would be invented in this neoliberal world of the 21st century, because, as Polanyi would say, it would need to be embedded in the community that maintains and preserves it. Consequently, if left to behave of its own accord, detached from the community that must sustain it, the market mechanism would completely derail the capitalist economy, as happened during the downward spiral of the 1930s. This is because, *inter alia*, as Keynes had so much emphasized, the feedback effect through aggregate demand of declining wages in a recession can completely destabilize the whole economy, thereby necessitating state action to preserve society from the potential damages that the market mechanism can inflict on itself.

Galbraith, Keynes and Polanyi all understood this problem, and they thus promoted a view of the market economy whereby the market ought to be placed on a short leash through the setting up of strong regulatory structures. However, they also all promoted the need for macroeconomic policy that would nurture stability through the regulation of the flow of aggregate spending. They all rejected the *laissez faire* "free market" conventional wisdom in macroeconomic policy based on 19th century economic liberalism that, as they all argued, led to the collapse of the world economy during the 1930s.

In the capitalist world order that had emerged from the Great Depression and World War II, in which large corporations dominated industrial structures that were

believed to generate an inevitable tendency toward stagnation, there came a clear policy consensus on the crucial role of the state in achieving economic growth and full employment. Under pressure from unionized labour resulting from the widening of collective bargaining rights, and with governments committed to a Keynesian high employment policy, there was continued pressure on real wages to move closely in line with productivity growth. Real wage pressure, together with strong strategic public investment that pushed these post-war economies toward very high growth rates in both income and productivity—together with the entrenchment of citizens' rights through a broad-based expansion of social security systems—all came to constitute key features of the post-war Golden Age period from 1945 to 1975.

This was the heyday of Keynesianism, when it was common in the Western industrialized countries for both the fiscal and the monetary authorities to announce their commitment to high or full employment. Macroeconomic policy meant pursuing stabilization policy to maintain high employment and keeping the economy close to that level without inflation. One has only to read the annual reports of such Canadian federal policy advisory agencies, such as the now long defunct Economic Council of Canada, which was abolished by the Mulroney government in 1992, to see how widespread was the use of the term "full employment" as macroeconomic policy goal, from its original founding in 1963 to approximately the early-1970s.

All of this began to change by the late-1970s and during the 1980s, when there appeared a new macroeconomics mantra of "inflation first" based on a narrative by mainstream economists of what supposedly happened during the 1970s that is still repeated nowadays primarily by central bankers (see Mitchell and Muysken 2008). What is well known is that there was a series of oil price shocks in the 1970s initiated by the OPEC oil cartel that sharply pushed the rate of inflation in most Western industrialized countries up to double digit levels. It was quite obvious that this inflation had neither been contrived or fuelled by the central bank by somehow exogenously "printing too much money", nor by governments running excessive budget deficits, of which some of this net spending had been "monetized" through central bank purchases. The reason why we know that this is not so is because, by the early-1980s, the Bank of Canada asserted that it could *not* control the M1 money supply that the bank tried so hard to target since 1975. One has only to recall the blunt admission from Governor Gerald Bouey in 1983 that: "We did not abandon M1, M1 abandoned us" (quoted in Lavoie and Seccareccia 2021: 8).

If the central bank cannot control the money supply growth directly because the latter is essentially an endogenous variable (and could only try to do so indirectly through higher interest rates), how could the Bank of Canada have "caused" the high inflation through some misguided policy of somehow showering the economy via Friedman's money helicopter in excess of the growth of overall output? Surely,

that is not what happened. Secondly, we know that because of rising interest rates associated with the policy of monetary austerity in reaction to the price shocks, this caused growing budget deficits. This was not because of the fiscal profligacy of the government, particularly since governments were actually trying to rein in program spending. It was because the higher interest rates did slow down the economy and eventually caused a serious recession in 1981–82 (after the so-called Volcker shock in the U.S.), which triggered automatic stabilizers, whose effect was to provoke growing cyclical deficits. Moreover, the rising interest rates also automatically increased the servicing cost of government accumulated debt, with the latter continuing to sustain high deficits throughout the 1980s, to the point where, by the late-1980s, the federal government was actually running primary budgetary surpluses despite the continued high actual overall budget deficits throughout the 1980s.

Based on this false narrative about the previous Keynesian era and the whole inflationary episode of the 1970s and early-1980s, a new neoliberal macroeconomic policy program was crafted. When repeated often enough by policy-makers in both Canada and internationally, this new "inflation first" doctrine cultivated a policy "conventional wisdom" that few policy-makers would dare challenge. This neoliberal program, representing, *de facto,* primarily the interests of the financial sector and the rentiers and sometimes referred to as "the revenge of the rentiers" (Smithin 1996), rested on *two* policy pillars that became formalized into a complete macroeconomic policy system by the 1990s that completely overturned the established policy priorities of the previous Keynesian era. Of all possible macroeconomic policy goals, combatting inflation became a policy imperative that was placed at the very top of policy priorities. Hence, Keynesian high or full employment objectives of the previous post-war era were abandoned and low unemployment rates, which had been a characteristic feature of most of the 1950s and 1960s, were now deemed "unnatural".

Based on this new distorted neoliberal view of what had actually happened during the post-war Golden Age, which supposedly led to the inflation of the 1970s, it became generally accepted as the conventional wisdom that those historically low unemployment rates could lead to accelerating inflation, despite the fact that high inflation had hardly been a sustained or even a significant characteristic of the first two decades of the post-war period before the oil price shocks of the 1970s—except in the late-1940s (because of pent-up demand and the initial supply bottlenecks resulting from the immediate post-war demobilization). To achieve that goal of fighting inflation, it was now necessary to impose the requisite discipline of macroeconomic austerity resting on both the fiscal and monetary policy pillars of neoliberalism.

(i) The return of the old conventional wisdom of fiscal austerity and the "new fiscalism" following the global financial crisis

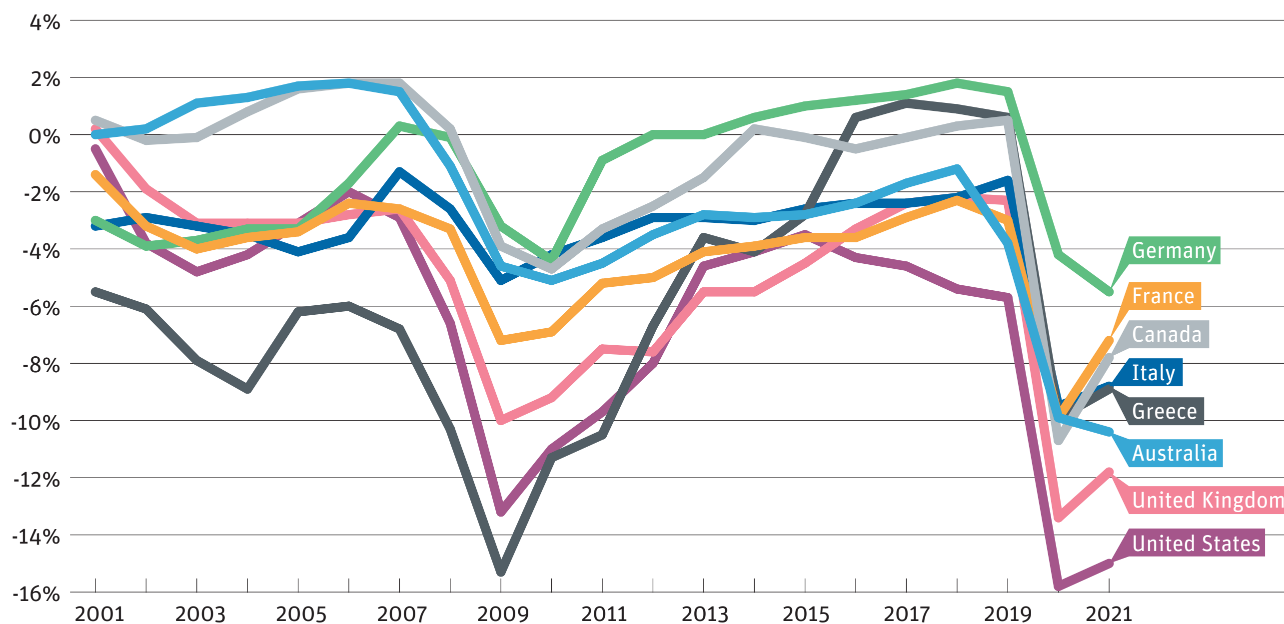
On the fiscal policy side, the new austere face of neoliberalism from the 1990s turned out to be nothing more than recycled anti-Keynesian policy of "sound finance" that had already prevented governments from engaging in deficit spending early into the Great Depression, until the New Deal and World War II. In this case, we were told that, to prevent government from "crowding out" private productive spending or generating inflation (i.e., by crowding out private consumption spending), prudent governments ought to behave as a wise head of a household. That is, not to spend in excess of one's means on the household credit card and to run budget balances or, for precautionary reasons, target budgetary surpluses via the accumulation of public sector savings.

Examples abound of this commitment to balanced budgets, especially during the 1990s—for instance, under the Clinton administration in the U.S. and here in Canada during the Chrétien and Martin years, where the federal government actually generated a long string of budgetary balances/surpluses for a dozen years from the mid-1990s until the Global Financial Crisis. Similarly, the merging of the German ordoliberal ideology with this wider neoliberal international movement in favour of "sound finance", which was also reflected in the now discredited Washington Consensus for the developing world, was behind the adoption of such a restrictive fiscal and monetary architecture of the Eurozone in 1999, based on a completely misleading and distorted understanding of money and the monetary system (see Seccareccia and Correa, 2017).

Some data was collected from the *IMF Fiscal Monitor* to offer an overview of the fiscal stance of Canada and a selected group of other countries for which annual data was easily available, going from 2001–21 (with the 2021 figures only being for the first quarter). The first group, depicted in *Figure 1A*, is a set of industrial countries and clearly shows the herd behaviour of the fiscal authorities internationally. Greece was an obvious outlier, initially, before the Global Financial Crisis, but after some international scolding led to the selling of public assets, Greece eventually joined the pack in conformity.

Indeed, as these countries came out of the 1990s and until the Global Financial Crisis, all these governments were literally tripping over each other to achieve budgetary surpluses. Some, such as Canada and Germany, had been leading the pack to return to balanced budgets even after the Global Financial Crisis, especially under Stephen Harper's Conservatives, even though most of these other countries did not quite reach the pre-financial crisis levels of budgetary balances during the

FIGURE 1A General government net lending/borrowing as a percentage of GDP 2001–21, annual observations for a selected group of countries from the industrial world



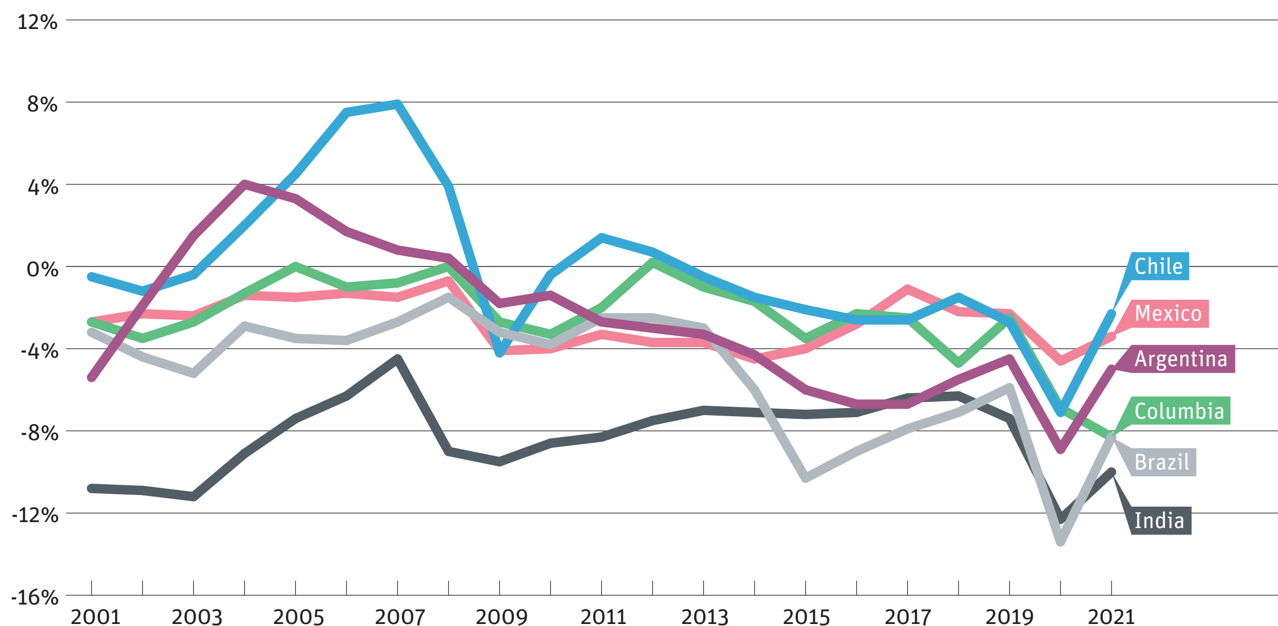
Source *IMF Monitor* (April 2021)

decade before the COVID-19 crisis in 2020, because of somewhat changing policy discourse to be discussed below.

The same can be said of the evolution of budgetary balances of emerging and developing countries, especially in Latin America in this hemisphere, displayed in *Figure 1B*. Except for an important outlier, India, most of the emerging countries of Latin America clustered somewhat closer to balanced budgets by initially seeking surpluses during the boom years in primary commodity prices before the Global Financial Crisis and then, with the reversal of international terms of trade, they faced increasingly greater obstacles to achieve budgetary balances during and after the financial crisis.

At the same time, because of the so-called "original sin" in servicing foreign currency-denominated debt and, generally, because of the higher degree of market dollarization, these countries faced greater pressures to conform to the fiscal orthodoxy, despite the adverse conditions that they faced after the Global Financial Crisis. This can be easily contrasted with an outlier, such as India, in *Figure 1B*, which was able to sustain longer-term deficits, partly owing to its status as a country with its own sovereign currency.

FIGURE 1B General government net lending/borrowing as a percentage of GDP 2001–21, annual observations for a selected group of developing and emerging economies



Source *IMF Monitor* (April 2021)

It must also be emphasized that, during the decade following the Global Financial Crisis, because of fears of longer-term stagnation, there came a certain degree of awareness, even in well-known international institutions such as the IMF, that budget deficits could justifiably serve the social purpose of short-term stabilization because of the growing recognition of significantly strong fiscal multipliers, as witnessed during the Great Recession of 2008–09. I had argued after the Global Financial Crisis that the very strict austerity rules of achieving budget balances and fiscal surpluses "for all seasons", which had been somewhat abandoned during and after the crisis, reflected a "new fiscalism"—one that began to look more approvingly at activist fiscal policy as a short-term measure to sustain growth and employment as long as, in the long run, governments would return to budgetary balances (Seccareccia 2012 and Lavoie and Seccareccia 2017). This is why industrial countries, in particular, had a generally stronger fiscal response to the crisis, as can be seen in *Figure 1A*.

Yet the mainstream economics profession could not completely abandon its ideology of budgetary austerity because these economists were unable to shed the previous ideologically-driven neoliberal principle that there should be at least some long-term financial constraint on government net spending behaviour. To the mainstream, as we have seen, discretionary fiscal policy via deficit spending seems "unnatural", in

the Hayekian sense, because such policy supposedly "crowds out" private-sector spending by seeking to generate artificial or "false" prosperity. Therefore, there should be some ultimate disciplining mechanism imposed on government policy-makers who ought to be distrusted because, without such a constraint on politicians, public spending allegedly becomes open-ended and inflationary, and it sends "false" signals to otherwise unsuspecting private market participants.

Hence, despite a growing appreciation for Keynesian short-term stabilization in the industrial countries during and after the Global Financial Crisis, until the COVID-19 crisis there remained an explicit or implicit commitment that, in the "long run", either (1) there should be a return to balanced budgets because, ultimately, governments are faced with a long-term budget constraint and must ensure the long-term neutrality of the state; or, at the very least, (2) there should be a long-term commitment to, over time, stabilize the public debt-to-GDP ratio so that the ratio does not become explosive and grow "out of control."

The position was well represented and summarized, for instance, by Olivier Blanchard (2019) in his presidential address to the American Economic Association. Predicated on what is not much more than what has been historically described as the Domar relation between public spending and debt servicing costs, in the environment of low interest rates of the post-Global Financial Crisis decade, the "welfare costs" of an incremental increase in public debt would be very low compared to its benefits in sustaining growth. Blanchard, therefore, offered his support in favour of longer-term budgetary deficits as long as governments could maintain a commitment to achieve a stable ratio of public debt-to-GDP over time, so as not to attract the attention of the bond-rating agencies and disturb the financial markets. For instance, in Canada, this long-run policy discourse—especially about stabilizing the public debt-to-GDP ratio—was broadly accepted by the federal government from 2015 until 2019, just before the COVID-19 crisis.

Unlike the previous era, before the Global Financial Crisis, this new policy framework actually gave governments some fiscal room to maneuvre while remaining committed to a broad long-term fiscal rule that would not strike fear of explosive public debt ratios in the financial markets. "Explosive" deficits and debt, purportedly, would tempt governments to make use of the "printing press" via so-called public debt "monetization." Therefore, in accordance with the discredited quantity theory belief, it would generate high inflation with its unacceptable distortion of wealth-redistribution effects from savers to debtors.

However, the COVID-19 reality has put this into question. Similar to a war economy environment, in which policy necessitates new ideas, the COVID-19 crisis tipped the policy scale somewhat in favour of the Modern Monetary Theory (MMT) perspective, whereby countries, primarily in the industrial world, threw away the balanced budget

TABLE 1 Indicators of central bank "monetization": government securities purchased by national central banks, as a percentage of total government securities, sold quarterly in selected countries, 2019Q4 to 2020Q4

	2019Q4	2020Q1	2020Q2	2020Q3	2020Q4
Brazil	40	0	29	0	10
Canada	0	5	55	173	66
Chile*	0	0	0	0	0
France	0	25	30	241	0
Germany	0	23	51	45	0
Greece	0	0	123	1,024	235
Italy	0	380	68	111	0
Mexico*	0	0	0	0	0
USA	104	121	44	46	NA

N.B.: Only positive purchases considered. Negative values are depicted as zero.
* Central governments only, while all other countries include all levels of government purchases.
Source *International Financial Statistics* (IFS), IMF, or, for Canada, it was from CANSIM Table: 10-10-0108-01 (formerly CANSIM 176-0010).

commitment, which had already occurred during the Global Financial Crisis and dismissed the fear of the deficit monetization boogeyman.

Table 1 displays international statistics that tried to estimate the importance of these central bank purchases during the COVID-19 crisis (from sometimes inconsistent quarterly data available from the IMF). These numbers may be considered as possible indicators of either some direct or indirect "monetization" since, the balance sheets of national central banks only register the changes in their stock holdings of government securities relative to rising deficits in 2020, which may have been reflected in asset purchases from central banks. Unfortunately, one cannot be sure if these were purchases of newly issued government securities (in the primary market) or previously issued securities (in the secondary markets via the asset purchase program of quantitative easing). In a country such as Mexico, the law prohibits central bank purchases on the primary market. However, in countries such as Greece and Italy where, under the rules of the Eurozone, national subsidiaries of the European Central Bank cannot legally purchase government securities on the primary market, one can argue that these increases, shown in *Table 1*, reflect the rise in purchases resulting exclusively from quantitative easing. It means that, at best, there can have been only some more roundabout or "indirect" central bank "financing" of budget deficits in which individidual agents—say, banks—purchase from a primary dealer in government securities, which is then quickly mopped up within the secondary market by the central bank via quantitative easing operations. However, in the case

of Canada and the U.S., we know that some of that increase would represent *bona fide* purchases in the primary market. For instance, the five per cent value for the first quarter of 2021 would indicate, when there was not yet any official quantitative easing in place in Canada until the end of March 2020, the proportion of government financing requirements fulfilled through Bank of Canada purchases on the primary market. On the other hand, during, say, the third quarter of 2020, the 173 per cent value says that, *potentially,* 100 per cent of federal financing requirements could have been met through central bank purchases of federal debt, with the remaining 73 per cent being pure quantitative easing, but we do not know, for sure, the proportions.

Despite this problem of measuring the precise amount of direct central bank financing of deficits, what is manifestly obvious is that many of the self-imposed fiscal rules and sacred cows of the conventional wisdom of the 1990s that had not yet completely crumbled during the Global Financial Crisis did so on quite a spectacular scale during the COVID-19 crisis. The COVID-19 crisis has revealed the reality that central bank financing of budget deficits neither seems to lead to uncontrolled inflation nor does it destabilize the financial markets. In fact, when combined with quantitative easing during 2020–21, namely the unsterilized asset purchases of government securities, central bank policy of buying up previously issued securities by various levels of governments strongly sustained asset prices and prevented them from collapsing.

In contrast to what had occurred before almost every major recession over the last century—such as the big one that Galbraith (1955) had examined so meticulously when studying the Great Crash of 1929 in the financial markets—this COVID-19 asset purchase program actually gave a huge boost to asset prices during the crisis of 2020–21. This led to massive capital gains in the midst of a collapse in production without, of course, a sharp jump in the overall rate of inflation feared by the mainstream.

Since we are discussing the link between fiscal and monetary policy, it is perhaps time to discuss the “conventional wisdom” among central bankers, who have played such a crucial role in sustaining this misguided interpretation of what actually had happened during the 1970s and 1980s, when the world economy was struggling with inflation and setting up a policy system centred exclusively on combatting inflation. It will be important to understand the evolution of monetary policy in Canada and internationally, and to suggest how monetary policy can become more than just an instrument to control wage growth and render macro-income distribution more unequal, which is what happened especially during the inflation targeting era.

(ii) Monetary policy is always an incomes policy

The way central banks began to frame and redesign monetary policy after the monetarist fiasco of the late-1970s and early-1980s became the original macroeconomic building

block for the second pillar of what became conventional wisdom in the 1990s. As we saw with the evolution of fiscal policy, monetary policy was also designed around the need solely to control the inflation rate. Hence, while stabilization policy under the Keynesian framework was about stabilizing output and employment at some potential full-employment level, with inflation being of somewhat lower concern, stabilization policy in this new era was reduced exclusively to stabilizing the inflation rate around some target. Unemployment was of little concern since the belief was that, except for short-term shocks, the unemployment rate would find its own way, if left undisturbed, toward its "natural" level—that is, in the long run, unemployment was independent of monetary policy actions. However, while the Bank of Canada focused on achieving a low, steady and predictable inflation rate by controlling a specific monetary aggregate until the early-1980s, monetary policy began to evolve throughout the 1980s by officially focusing on more explicitly conditioning the cost of borrowing to control aggregate spending. Hence, when the monetary authorities could no longer deny that they could not directly control the money supply and after it was becoming more generally accepted that the money supply is essentially endogenous to broad credit demand, central banks eventually developed an alternative policy framework, dubbed inflation targeting (IT), which merely used the interest rate lever to exert indirect control over the rate of inflation (see Lavoie and Seccareccia 2006, 2013).

This new framework was very simple to apply since one no longer even needed to try to measure the money supply and to predict the latter's evolution, especially given the supposed "long and variable" lag in money's effect on the macro-economy. In its new design, all that the policy-maker essentially would need to do is to monitor the inflation rate. If the inflation rate is above target, the central bank administered interest rate (the overnight rate in Canada) should rise and, if the inflation rate is below target, then the central bank rate should be cut so as to get the inflation rate back on target. As I have discussed elsewhere (see Seccareccia, 1998, 2017, as well as Seccareccia and Pringle 2020), this has also the effect of stabilizing real interest rates. In an environment in which the rate of inflation is accelerating, one would see nominal and, to a much lesser extent, real interest rates rising. Conversely, when the inflation rate has stabilized, both nominal and real real interest rates ought to remain steady, and so on. With such a central bank reaction function (the most commonly referred to being the Taylor rule), what this policy framework would do is actually to somewhat mitigate real rate of interest fluctuations since the nominal rate will normally tend to move in the same direction as the rate of inflation. This, therefore, became the new framework of monetary policy, which came to constitute the second pillar of neoliberal macroeconomic policy established during the 1990s.

Central banks generally tend to emphasize the importance of interest rates as costs to borrowers, which through the transmission mechanism eventually would impact on

the rate of inflation. However, what they do not normally mention is that these interest rates are also a source of income to rentiers who are owners of financial assets. Hence, they do not consider what has been described as the “income distribution” channel of monetary policy (see Seccareccia and Lavoie 2016; and Rochon and Seccareccia 2021), which, to heterodox economists, is of greater importance in the transmission mechanism than through the simple “interest cost” channel. Surely, if one reduces the share of aggregate disposable income from individuals whose propensity to consume is very high and are also the debtors in a community and rewards those individuals whose propensity to consume is very low and who are the high savers in a community, this may very well have more impact on aggregate private spending than through the “interest cost” mechanism emphasized by mainstream economists.

In fact, despite the overwhelming use of the interest rate instrument, what mainstream economists or central bankers clearly do not recognize (nor do they want to acknowledge) is that an anti-inflation policy, regardless of whether it is an IT or non-IT policy, is an “incomes policy” as understood historically during the early post-World War II era, when such policies were most fashionable in dealing with problems of inflation in Western industrialized countries. This lack of recognition is certainly not because of a shortage of explicit historical examples, which, on the contrary, abound in the literature on incomes policies adopted internationally to control inflation. In a sense, as we shall see, there is a historical continuum with the use of some form of “incomes” policies throughout the post-World War II period, including the IT era after the 1980s. The historical exception was the short-lived monetarist fiasco of the late-1970s and early 1980s in Canada, when there was an official focus on the control of some monetary aggregate, i.e., on M1 growth in the case of Canada.

Among the most well-known examples, there are the early post-World War II socially-negotiated “wage solidarity” incomes policy pursued to reach a certain wage inflation deemed essential to achieving inflation rates that conformed with certain desired levels of cost competitiveness in Scandinavian countries. These more socially based, “solidaristic” policies would be negotiated and instituted by the trade unions and by employers’ associations at the national level, grounded primarily in non-market “corporatist” principles of “social partnership” in the setting of wages that traded off income with employment and other social goals.

However, there were also other less cooperative or more mandatory types of incomes policies decreed “from above” by national political authorities. These include the voluntary to the compulsory forms of incomes policies that had been especially popular during the 1960s and 1970s in countries such as Britain, Canada and the United States. For instance, one finds the Kennedy-Johnson guideposts in the U.S. from 1962 to 1966, the British National Board for Prices and Incomes in the U.K. from 1965 to 1970, and the Prices and Incomes Commission in Canada from 1968 to

1972, which would rely on the announcement effect of the wage norm on collective bargaining decisions in the labour market. These voluntary guideposts were followed by compulsory incomes policies under the Nixon administration in the U.S. during the early-1970s and, for example, the federal Anti-Inflation Board (AIB) in Canada from 1975 to 1978. Historically, trade unions in Canada have rightly questioned incomes policies, even the corporatist "tripartite" consultative types, because they override local union collective bargaining rights in the context of a decentralized bargaining environment. Paradoxically, however, while Canadian trade unions have been instinctively suspicious of IT policy because of its sole focus on inflation control, they have rarely questioned the actual mechanism that underlies IT policy. This is because, unlike the earlier forms of incomes control, a central bank-determined incomes policy does not directly take away collective bargaining rights as under the AIB—even though, as we shall see, the implications are just as problematic, especially because of the undesirable consequences on income distribution.

Quite definitely, any anti-inflation policy pursued by central banks is an incomes policy directed "from above", namely from a decision of the monetary authorities. This is the case because of the monetary policy's impact directly on what Veblen and Keynes termed "unearned" financial income of rentiers and because of the way a central bank's inflation target can serve as guidepost in the labour market. Ever since they abandoned the monetarist policy framework, after the 1980s it became widely understood and generally accepted—especially by mainstream economists and by practitioners in central banks—that one must engage in discretionary interest rate setting to effectuate changes in the inflation rate. This is done via the control of the overnight rate, which then impacts a whole array of interest rates in the economy, with the latter presenting themselves as costs to borrowers but incomes to asset holders.

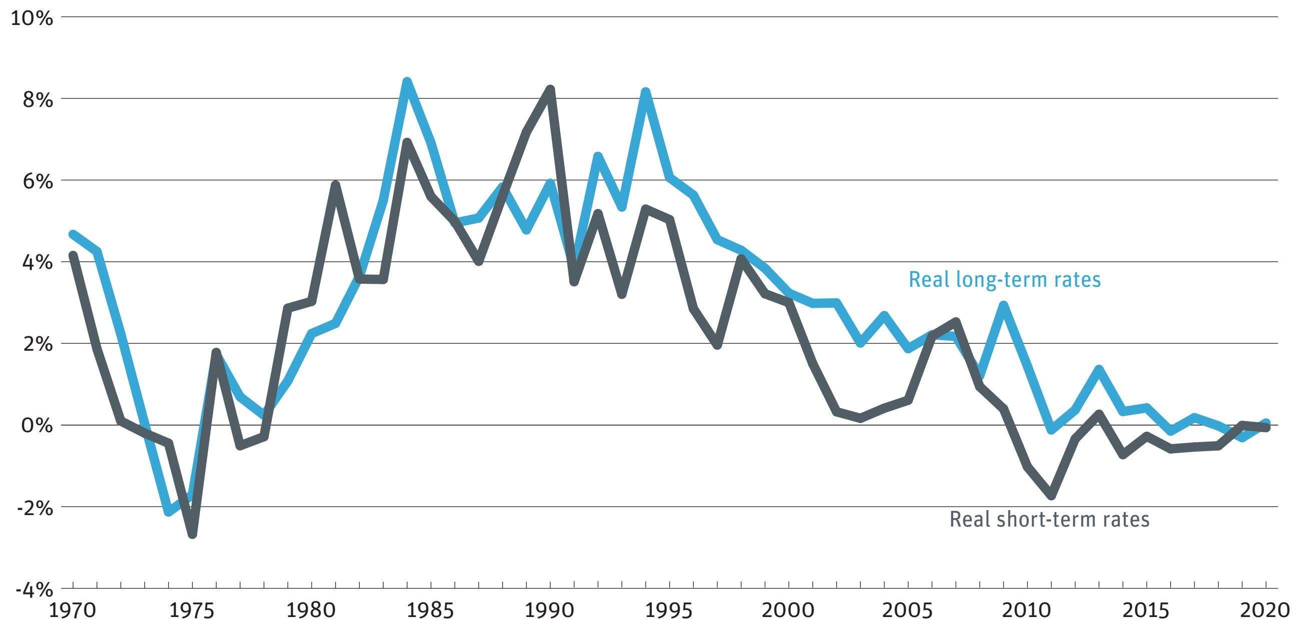
The recognition of this elementary "two-sided" aspect of interest rates is critical to an understanding of the true nature of IT policy. Monetary policy should be understood as an "incomes" policy because of both direct and indirect impacts of changes in the rate of interest on the incomes of certain social groups. The first ("direct") effect is self-evident. A policy of combatting inflation following some Taylor rule reaction function of raising central bank administered rates must eventually impact the incomes of financial asset holders or rentiers. As we know, these could be the relatively wealthy households possessing high accumulated savings. But they could also be the more organized and high-income groups of workers (together with their asset managers) who participate in private group pension plans to assure a more comfortable retirement for these groups. As is well known within the trade union movement, workers are sometimes placed in what is sometimes a contradictory role of wanting higher wages for workers but also high returns on their pension fund assets as rentiers, to secure long-term benefits.

Together with Marc Lavoie, over the years I have considered different measures to observe the "direct" effects of monetary policy on rentier income. One can look, for instance, simply at the evolution of real short- and long-term interest rates (i-π), that is, a nominal interest rate indicator (i) less the CPI inflation rate (π) à la Fisher. However, we had also looked at other theoretically based measures that are connected with the works of Luigi Pasinetti (for details, see Seccareccia (1988), and especially Seccareccia and Lavoie 2016, and Lavoie and Seccareccia 2019). The traditional Pasinetti measure (i-π-ρ), which is the difference between real interest rates (i-π) and average labour productivity growth (ρ)), tries to capture the evolution of the rentier share that is somewhat analogous (but not identical) to trying to calculate the wage share (i.e., namely the difference between the real wage growth (ω) and average labour productivity growth (ρ)). There is, as well, a modified Pasinetti index (i-π-ω) that tries to numerically detect how much interest rates are actually deviating from what may be described as a "fair" or Tomistic "just" interest rate norm, where central bank rates would be set to preserve financial asset values in terms of the labour time that they would command (for the original concern, see Pasinetti (1981)). All of these measures are very simple indicators of how monetary policy impacts rentier income vis-à-vis non-rentier income.

These indicators are displayed in Figures 2 and 3, which provide a portrait of the broad magnitude of the redistribution in favour of rentier income during that whole era, starting in the late-1970s until the early-2000s, when central banks in Canada and internationally first became absorbed with combating inflation over all possible goals and, then, began to slowly move away by engaging in more "flexible" IT policy just before the Global Financial Crisis. For instance, the first, displayed in *Figure 2*, is the simple *ex-post* Fisher-type relation indicating OECD measures of short-term and long-term interest rates in Canada when adjusted for CPI inflation, which highlights the importance of this swelling of rentier income throughout the post-1970s era and until the Global Financial Crisis, after which we see the pendulum swinging away from rentier income.

From this evidence for Canada, one can observe that the enormous income transfer that occurred, primarily during the 1980s and 1990s, was done in the name of shielding Canadian households—especially fixed income earners, such as pensioners—against the ravages caused by inflation and from unfair wealth redistribution. But instead, it turned out to be quite different, since the actual beneficiaries of the huge transfer of income were both financial institutions as well as wealthy interest income earners who had been excessively compensated when, for instance, one considers the evolution of the real interest returns accruing to an individual for merely sitting on risk-free government financial assets that, in the national balance sheet, were the counterpart of the high government debt of that era. However, this

FIGURE 2 Indicators of real short-term and long-term interest rates, Canada, annual averages, 1970–2020

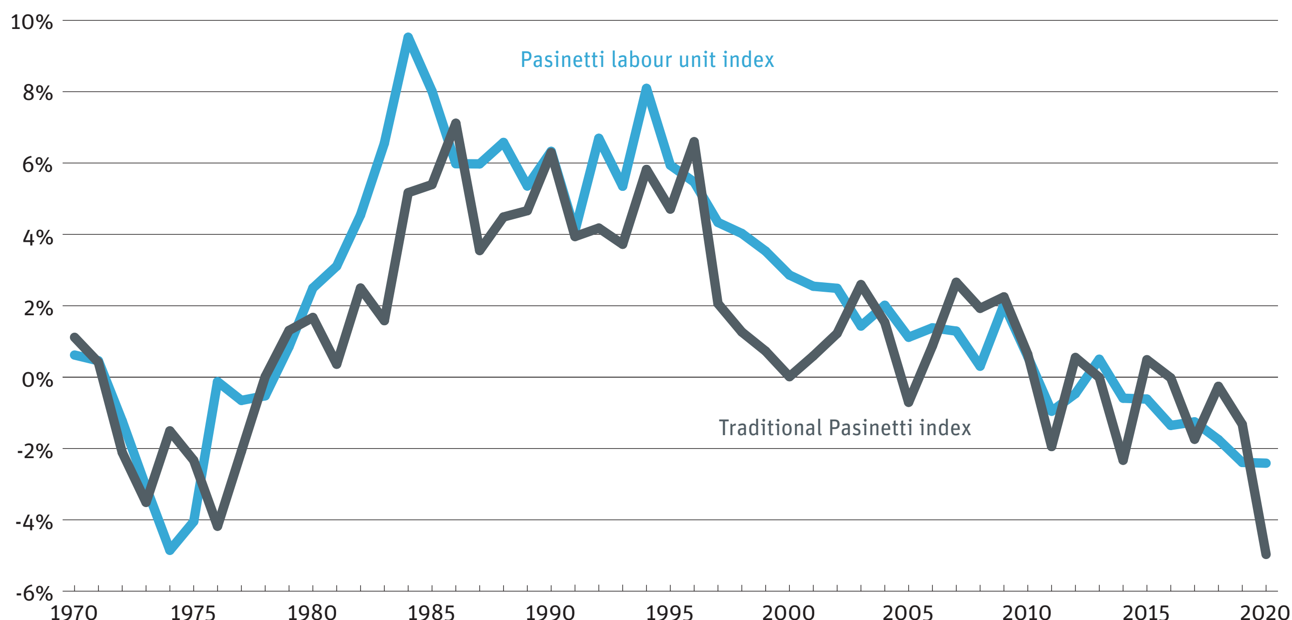


Source OECD.Stat

excessive reward to rentiers can perhaps be better understood when one looks at the Pasinetti measures that more directly consider their claims over a rising share of national output until just before the Global Financial Crisis.

In *Figure 3*, we have displayed the traditional measure in terms of difference between a real long-term interest rate and aggregate business productivity growth (i-π-ρ), as well as an indicator of the modified Pasinetti measure (i-π-ω) in labour unit terms [with the latter average real wage growth series requiring some H-P smoothing because of the wide fluctuations in the archived series uniquely from the 1970s tracing wage data from the manufacturing sector]. As it can be seen in *Figure 4*, regardless of which of these two Pasinetti indicators, it depicts the same portrait of a massive transfer that had occurred prior to the Global Financial Crisis and of the tremendous reversal of the fortunes of the rentiers after the crisis when using the difference between real long-term interest rates and aggregate average labour productivity growth or an indicator of the smoothed average real wage growth in Canadian manufacturing as a measure. We can see how the modified Pasinetti series generally exceeded the traditional measure, starting from the beginning of the 1980s through to the early-2000s, since productivity growth persistently exceeded real wage growth until they started to align, somewhat, during and after the Global Financial

FIGURE 3 Evolution of two alternative indicators, Canada, 1970–2020



Source Statistics Canada, CANSIM Series V1409153, v720290, CANSIM Table 282-0072, as well as archived content: https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1410023701; and OECD.Stat.

Crisis. The Pasinetti measures even tipped closer toward a Keynesian "euthanasia" of the rentier environment after the Global Financial Crisis, somewhat comparable to what was occuring during a short episode in the early-1970s.

There is, however, an even more problematic indirect labour-market effect on income distribution for an economy faced with high real interest rates to combat inflation, which would be in addition to the obvious direct effect of monetary policy on rentier income previously described. It is well understood that a restrictive monetary policy of raising interest rates to combat inflation ultimately must be focused on restraining wage growth, which is crucial to controlling inflation within the traditional Phillips curve logic. As discussed in Seccareccia and Lavoie (2010), Seccareccia and Kahn (2019) and Lavoie and Seccareccia (2021), one would infer that such IT policy is a rather perverse form of incomes policy that would hardly be justifiable on norms of equity. How can central bankers morally justify raising the income of one group, the rentiers, in order to constrain the growth of another social group, the wage earners, in the name of combatting inflation? This begs the obvious question of "combatting inflation for whom?" Because of its contradictory nature, a monetary policy instituted by central banks that is concerned uniquely with fighting inflation has a permanent bias against wage growth.

This particular bias arises for two reasons. Firstly, to the extent that a pro-rentier high real interest-rate policy, as that pursued during the latter two decades of the last century before the Global Financial Crisis, persists long enough, it will ultimately slow down real GDP growth over time and raise the long-term rate of unemployment because of obvious hysteresis effects. This would eventually negatively impact long-term wage growth and long-term "potential" output growth, since the latter is endogenous to aggregate demand growth (for a discussion, see, for instance, Fontanari, Palumbo and Salvatori 2019). A long-term policy of high real interest rates would compromise future growth, from which there would be less potential income growth to share for everyone even if the restrictive monetary policy is reversed at some point, which eventually happened. This was, indeed, the case in Canada during that whole era before the Global Financial Crisis, often described in the U.S. as the period of the "Great Moderation", as the economy went through a period of significant disinflation. An anti-inflation policy, as was pursued, has sometimes been described as an incomes policy of "fear" (Cornwall, 1990) because, through the use of the blunt instrument of high real interest rates, the economy can sufficiently slow down by raising long-term unemployment so as to keep a lid on wage inflation.

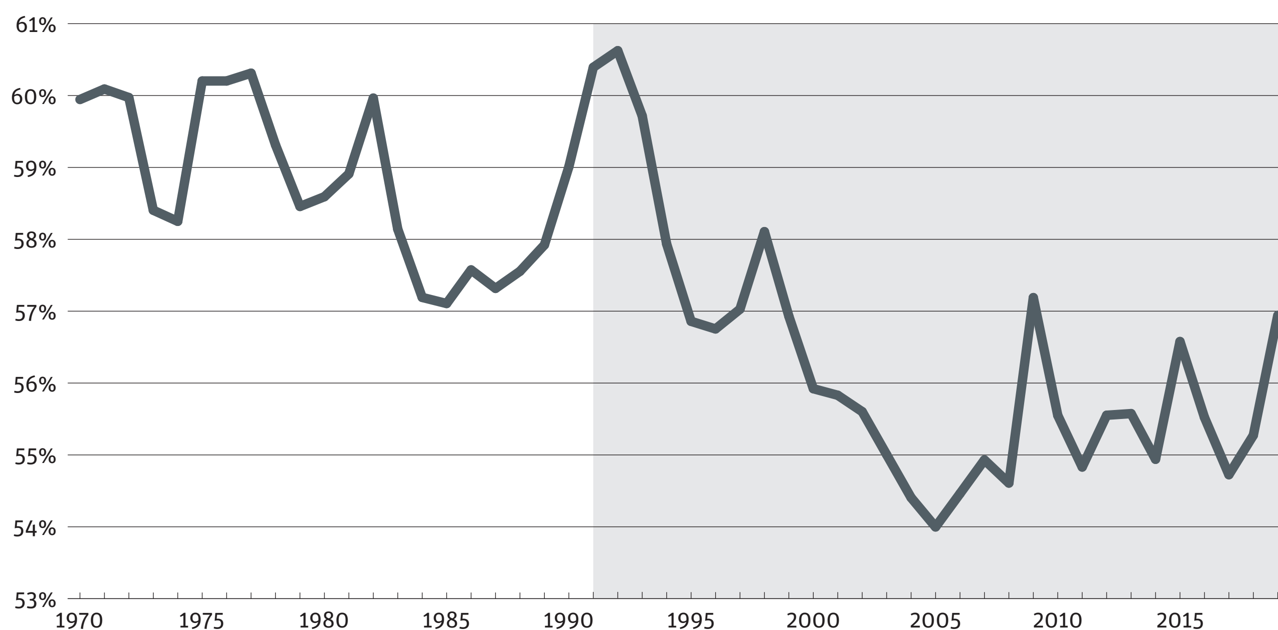
Secondly, since the adoption of IT policy over the last few decades, much has been said by central banks about anchoring inflation expectations, thereby ensuring that their inflation target would secure a significant foothold in the labour market. For instance, the communication strategy of the Bank of Canada has been sophisticated and persistent in shaping inflation expectations, whose purpose is to influence the wage bargaining process. The two per cent inflation target—which is frequently repeated in the bank's communication strategy in order to establish it as a parameter in the information toolkit when, for instance, formulating wage demands—has acquired the role of a guidepost in the Canadian labour market. Indeed, there is an incredibly high degree of similarity between the current practice of anchoring inflation expectations and the former voluntary guideposts of the early post-war incomes policies in Western Europe and North America, where governments would communicate a target so as to anchor incomes growth, especially in the context of a decentralized wage bargaining system. However, unlike those guideposts that were justified primarily on income-distributional grounds and equity considerations, whereby the target or wage growth norm would usually be tied to the evolution of long-term labour productivity growth to preserve long-term factor shares, the two per cent inflation target has no such income distribution-neutrality feature. Indeed, there is no mechanism within these central bank policy frameworks to ensure that real wages would grow commensurate with the rate of productivity increase when an economy achieves its two per cent inflation goal. Hence, even if central banks are successful in achieving their inflation targets, since IT policy is not correctly framed

to achieve distributional neutrality, it generates a long-term structural distribution bias against labour income.

Over the last three decades before the COVID-19 crisis, central banks have been very successful in conditioning wage behaviour in the labour market to align with their pre-set two per cent inflation targets. Until the COVID-19 crisis, central bank strategy has been very successful at shaping expectations of both employers and workers in the collective bargaining process, bringing into line nominal wage growth with the overall inflation rate. But the collateral damage of its indirect labour market effect has been immense on the share of labour. As shown in *Figure 4*, which displays data on the share of wages over the last five decades, we observe that after having initially gone down since the early peak of the anti-inflation monetarist period of the late-1970s and early-1980s, the share of labour had slowly crept up by the late-1980s, only to barrel down almost immediately after the adoption of IT policy in Canada in 1991. Moreover, the share of labour never went back up after the Global Financial Crisis, almost in the style of what we can appropriately describe as an income-distribution ratchet effect or a long-term stepwise "hysteresis" effect on the evolution of the share of labour. For this reason, and contrary to some mainstream economists who are now finally recognizing that monetary policy can have some short-term negative income distribution effects but, for them, there are no inconceivable "long-run" consequences of monetary policy (Carstens, 2021), *Figure 4* attests to the contrary in the case of Canada. There was no such long-run "neutrality", with the share of labour income hitting bottom just before the Global Financial Crisis and remaining stuck and graviting around a lower mean until the COVID-19 crisis.

If one would consider almost 30 years (shaded in *Figure 4*) to be a long enough period to assess the collateral income-distribution damages, the long-term effects of IT policy seem obvious. The only reason why the share of labour has somewhat stabilized during the "inter crises" decade of 2009 and 2019 after the Global Financial Crisis is that productivity growth rates had been very low until before the COVID-19 crisis in 2020 and, at the same time, the rate of inflation had been stuck for most of the period below the two per cent mid-point and closer to the lower end of the one to three per cent target inflation band, therefore, mildly raising and/or stabilizing the labour share. However, even in the relatively "stable" world of IT policy before the "inter crises" era, the announcement effect of a two per cent target had secured a certain stability in wage demands and nominal wage growth around that target, the effect of which led to a long-term decline in the share of labour until the Global Financial Crisis. As we have seen, such an anti-inflation commitment of combatting inflation "above all other social objectives" during normal times would ensure relatively stable real wages in Canada. However, it is also a guarantee that real wage increases can never significantly catch up with productivity growth. Over the

FIGURE 4 Evolution of the wage share in Canada, annual observations, 1970–2019



Source AMECO Database, series ALCD2.

"inter crises" decade of persistently low or negative real interest rates, this has also meant a rising share of profit. In this uncertain COVID-crisis period and during the post-COVID-19 future, how can macroeconomic policy be conducted to render both monetary and fiscal policies less structurally and distributionally biased to reverse the long-term consequences of the "inflation first" policies over so many decades, especially since the 1990s?

The need to abandon existing macroeconomic policy "conventional wisdom" to achieve a truly more equitable and inclusive society

The overriding commitment of policy-makers over the last four decades to fight inflation over all other possible goals, such as achieving full employment, has become a built-in destabilizing factor in the evolution of income distribution, which has contributed to the long-term weakening of labour's share of national income. While other forces in the world economy, such as the skill bias of technological change and the implications of rampant globalization, have certainly been important factors,

historically, in compressing labour's share, fiscal and monetary policy have led to further compounding of these long-term tendencies toward growing income inequality. Both fiscal and monetary policies require a major overhaul that must move from their quasi-exclusive focus on combatting inflation. Particularly on the monetary policy front, by changing the name to "flexible" IT or by merely talking about their concern about income distribution since the Global Financial Crisis, as we have seen more and more over the last decade, is just not acceptable. This is especially so if central bankers continue to hold the view that there are no long-run effects of monetary policy on income distribution and that they are *not* the cause (see Carstens 2021 and Macklem 2021), which is just another way of restating the old and discredited orthodox belief in the long-run "neutrality" of monetary policy, since it lets central banks (and the government, more generally) off the hook and continues to allow them to defend the established view that, in the long run, all that macroeconomic policy can do is to control inflation.

We must not succumb to the mantra of the inflation threat as it is currently being raised in political circles in Canada and internationally. Based on a not-so-innocent fraud, to use a Galbraithian expression, about what actually happened during the 1970s, this 45-year obsession and policy hijacking with "inflation first" that continues to place inflation above all other goals has to stop. What is needed is a true paradigm shift away from the neoliberal emphasis on "inflation first" by embracing a full-employment objective for both the fiscal and monetary authorities. That is why it is so important to communicate to the Canadian federal government, and the Minister of Finance, Chrystia Freeland, to change the mandate of our central bank from just fighting inflation. By doing so, it will signal to both the monetary and fiscal authorities that Keynesian concerns with unemployment and income distribution are back on the policy agenda.

About the author

Mario Seccareccia is professor emeritus of economics, University of Ottawa and editor of the International Journal of Political Economy. He is the 2021 winner of the Galbraith Prize in Economics, hosted by the Progressive Economics Forum.

Acknowledgements

This paper was presented at the Galbraith Lecture as part of the annual meetings of the Progressive Economics Forum, Canadian Economics Association (online) on June 5, 2021. The author acknowleges the excellent assitance of Guillermo Matamoros Romero for collecting the IMF data presented in two of the charts and the table below. However, all mistakes are solely those of the author.

References

Cornwall, J. (1990), *The Theory of Economic Breakdown: An Institutional Analytical Approach*, Oxford: Basil Blackwell.

Carstens, A. (2021), "Central Banks and Inequality", *Bank for International Settlements* website: 1–12; https://www.bis.org/speeches/sp210506.pdf

Costantini, O., and M. Seccareccia (2020) "Income Distribution, Household Debt and Growth in Modern Financialized Economies", *Journal of Economic Issues*, 54, no. 2 (June): 444–453.

Fontanari, C., A. Palumbo and C. Salvatori (2019), "Potential Output in Theory and Practice: A Revision and Update of Okun's Original Method", Institute for New Economic Thinking, *Working Paper No. 93* (March 31); https://www.ineteconomics.org/uploads/papers/WP_93-FontanariPalumboSalvatori.pdf.

Galbraith, J. K. (1955), *The Great Crash 1929*, Boston: Houghton Mifflin Co.

Galbraith, J. K. (1967), *The New Industrial State*, Boston: Houghton Mifflin Co.

Keynes, J. M. (1936), *The General Theory of Employment, Interest and Money*, London: Macmillan.

Lavoie, M., and M. Seccareccia (2006), "The Bank of Canada and the Modern View of Central Banking", *International Journal of Political Economy*, 35, no. 1 (Spring): 58–82.

Lavoie, M., and M. Seccareccia (2013), "Reciprocal Influences: A Tale of Two Central Banks on the North American Continent", *International Journal of Political Economy*, 42, no. 3 (Fall): 63–84.

Lavoie, M., and M. Seccareccia (eds) (2017), "The Political Economy of the New Fiscalism", *European Journal of Economics and Economic Policies – Intervention*, (Special Issue), 14, no. 3: 291–371.

Lavoie, M., and M. Seccareccia (2019), "Macroeconomics and Natural Rates: Some Reflections on Pasinetti's Fair Rate of Interest", *Bulletin of Political Economy*, 13 (2): 139–165.

Lavoie, M., and M. Seccareccia (2021), *Going Beyond the Inflation-Targeting Mantra: A Dual Mandate*, Max Bell School for Public Policy, McGill University (April 23): 5–40; https://www.mcgill.ca/maxbellschool/article/articles-choosing-right-target/going-beyond-inflation-targeting-mantra-dual-mandate

Macklem, T. (2021), "The Benefits of an Inclusive Economy", *Remarks (delivered virtually)*, Universities of Atlantic Canada, Halifax, Nova Scotia (May 13); https://www.bankofcanada.ca/2021/05/benefits-inclusive-economy/

Mitchell, W., and J. Muysken (2008), *Full Employment Abandoned: Shifting Sands and Policy Failures*, Cheltenham, U.K.: Edward Elgar Publishing.

Parker, R. (2005), *John Kenneth Galbraith, His Life, His Politics, His Economics*, New York: Farrar, Straus & Giroux.

Pasinetti, L.L. (1981), *Structural Change and Economic Growth*, Cambridge: Cambridge University Press.

Polanyi, K. (1944), *The Great Transformation, The Political and Economic Origins of our Times*, Boston: Beacon Press, 2001.

Polanyi Levitt, K., and M. Seccareccia (2018), "Neoliberalismo: La perspectiva polanyiana [Neoliberalism: The Polanyian Perspective]", *Ola Financiera*, 11, no. 31 (Septiembre-Diciembre): 1–21; http://www.olafinanciera.unam.mx/new_web/31/pdfs/PDF31/PolanyiSeccarecciaOlaFinanciera31.pdf.

Rochon, L.-P., and M. Seccareccia (2021), "Un ensayo sobre política monetaria y distribución del ingreso: una perspectiva heterodoxa [A Primer on Monetary Policy and Income Distribution: A Heterodox Perspective]", *Ensayos Económicos*, No. 76 (Mayo): 1–22; Banco Central de la República Argentina at: https://www.bcra.gob.ar/Institucional/DescargaPDF/DownloadPDF.aspx?Id=976

Seccareccia, M. (1988), "Systemic Viability and Credit Crunches: An Examination of Recent Canadian Cyclical Fluctuations", *Journal of Economic Issues*, 22, no. 1 (March): 49–77.

Seccareccia, M. (1998), "Wicksellian Norm, Central Bank Real Interest Rate Targeting and Macroeconomic Performance", *The Political Economy of Central Banking*, ed. by P. Arestis and M. C. Sawyer, 180–98. Cheltenham, UK: Edward Elgar Publishing.

Seccareccia, M. (2012), “Understanding Fiscal Policy and the New Fiscalism: A Canadian Perspective”, *International Journal of Political Economy*, 41, no. 2 (Summer): 61–81.

Seccareccia, M. (2012–13), “Financialization and the Transformation of Commercial Banking: Understanding the Recent Canadian Experience before and during the International Financial Crisis”, *Journal of Post Keynesian Economics*, 35, no. 2 (Winter): 277–300.

Seccareccia, M. (2017), “Which Vested Interests Do Central Banks Really Serve? Understanding Central Bank Policy Since the Global Financial Crisis”, *Journal of Economic Issues*, 51, no. 2 (June): 341–50.

Seccareccia, M. (2021), “What is Full Employment? A Historical-Institutional Analysis of a Changing Concept and Its Policy Relevance for the Twenty-First Century Post-COVID-19 Economies”, *Journal of Economic Issues*, 55, no. 2 (June): 531–43.

Seccareccia, M., and E. Correa (2017) “Supra-National Money and the Euro Crisis: Lessons from Karl Polanyi”, *Forum for Social Economics*, 46, no. 3: 252–274.

Seccareccia, M., and N. Kahn (2019), “The Illusion of Inflation Targeting: Have Central Banks Figured Out What They Are Actually Doing Since the Global Financial Crisis? An Alternative to the Mainstream Perspective”, *International Journal of Political Economy*, 48, no. 4 (Winter): 364–80.

Seccareccia, M., and M. Lavoie (2010), “Inflation Targeting in Canada: Myth versus Reality”, *Macroeconomics, Finance and Money: Essays in Honour of Philip Arestis*, ed. by G. Fontana, J. McCombie, and M. Sawyer, 35–53. London: Palgrave Macmillan.

Seccareccia, M., and M. Lavoie (2016), “Income Distribution, Rentiers, and their Role in a Capitalist Economy: A Keynes–Pasinetti Perspective”, *International Journal of Political Economy*, 45, no. 3 (Fall): 200–23.

Seccareccia, M., and D. Pringle (2020), “Money and Finance”, *Canadian Political Economy*, ed. by H. Whiteside, 320–48. Toronto: University of Toronto Press.

Smithin, J. (1996), *Macroeconomic Policy and the Future of Capitalism: The Revenge of the Rentiers and the Threat to Prosperity*, Aldershot: Edward Elgar.

Stanford, J. (2020), “Canada Joins the QE Club: What is Quantitative Easing and What Comes Next?”, *The Monitor*, Canadian Centre for Policy Alternatives (April 8); https://monitormag.ca/articles/canada-joins-the-qe-club-what-is-quantitative-easing-and-what-comes-next

Storm, S. (2021), “Cordon of Conformity: Why DSGE Models Are *Not* the Future of Macroeconomics”, *International Journal of Political Economy*, 50, no. 2 (Summer): 77–98.

Temin, P. (2016), “The American Dual Economy: Race, Globalization, and the Politics of Exclusion”, *International Journal of Political Economy*, 45, no. 2 (Summer): 85–123.

www.policyalternatives.ca

PLEASE MAKE A DONATION...

Help us to continue to offer our publications free online.

With your support we can continue to produce high quality research — and make sure it gets into the hands of citizens, journalists, policy-makers and progressive organizations. Visit www.policyalternatives.ca or call 613-563-1341 for more information.

The opinions and recommendations in this report, and any errors, are those of the authors, and do not necessarily reflect the views of the publishers or funders of this report.