Macroeconomic policy coordination: a new approach for the end of abundance

Jo Michell
UWE Bristol

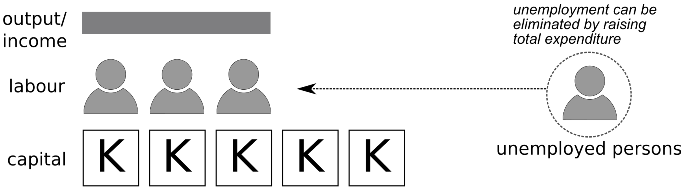
FMM Conference, Berlin, October 22 2022

Three questions

- Is this the end of the 'age of abundance'?
- If so, what implications for macroecononomic theory and policy?
- Where next for macro policy institutional design?

The end of abundance?

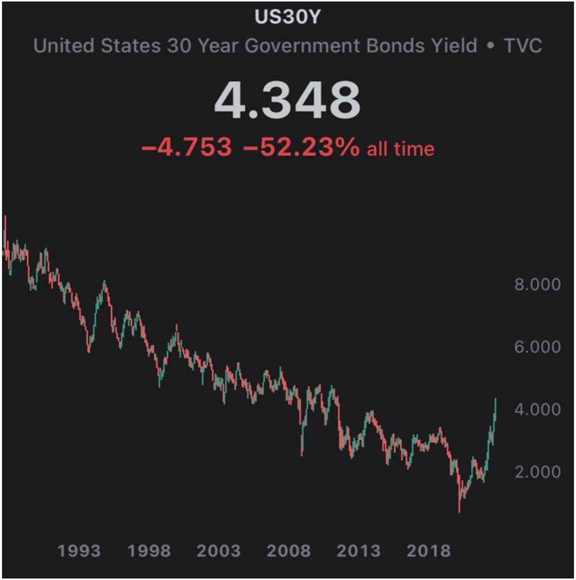
- For 30+ years, “raise aggregate demand” was the correct policy recommendation.



- Unused capacity. Possible to expand output and employment without generating or experiencing inflationary pressure.
- Is this still the case (and to what extent)?

Figure source: Aboobaker and Michell (2022)

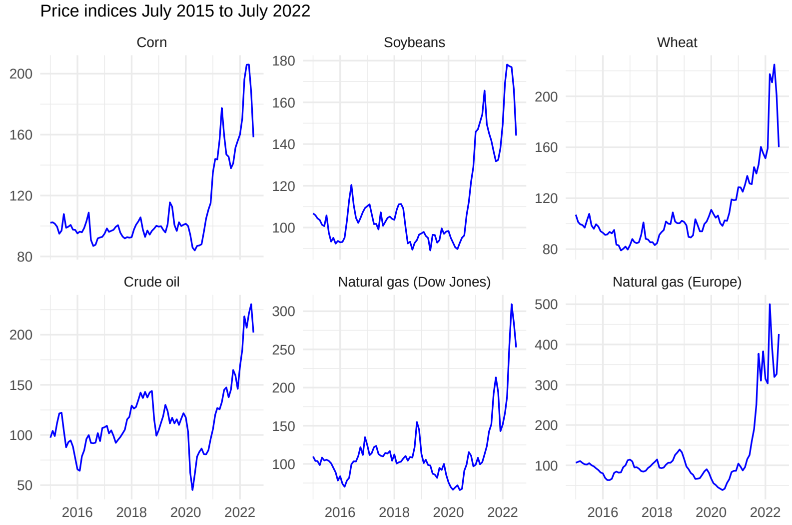
The end of abundance?



The end of abundance?

- Short run supply shortages and bottlenecks.

The end of abundance?



source: UNCTAD/Refinitiv

The end of abundance?

- Short run supply shortages and bottlenecks.
- Climate: extreme weather, drought, floods, wildfires, cyclones, desertification, soil depletion etc.
- Current bottlenecks and triggers will ease, but ongoing supply 'shocks' is new normal.

The end of abundance?

SPEECH

A new age of energy inflation: climateflation, fossilflation and greenflation

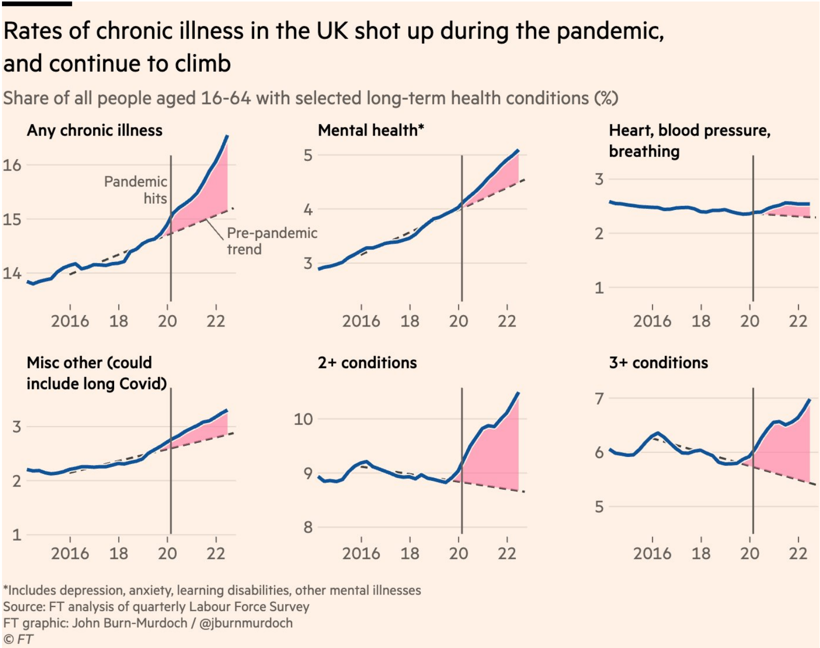
Speech by Isabel Schnabel, Member of the Executive Board of the ECB, at a panel on “Monetary Policy and Climate Change” at The ECB and its Watchers XXII Conference

Frankfurt am Main, 17 March 2022

The end of abundance?

- Short run inflation/bottlenecks (some figures).
- Climate: drought, floods, wildfires, cyclones, desertification, soil depletion etc.
- Current bottlenecks and triggers will ease, but ongoing supply 'shocks' is new normal (Schnabel 2022).
- Recurrent inflationary pressure is a persistent feature of the new macro landscape (Meadway 2022; Tooze, 2022)

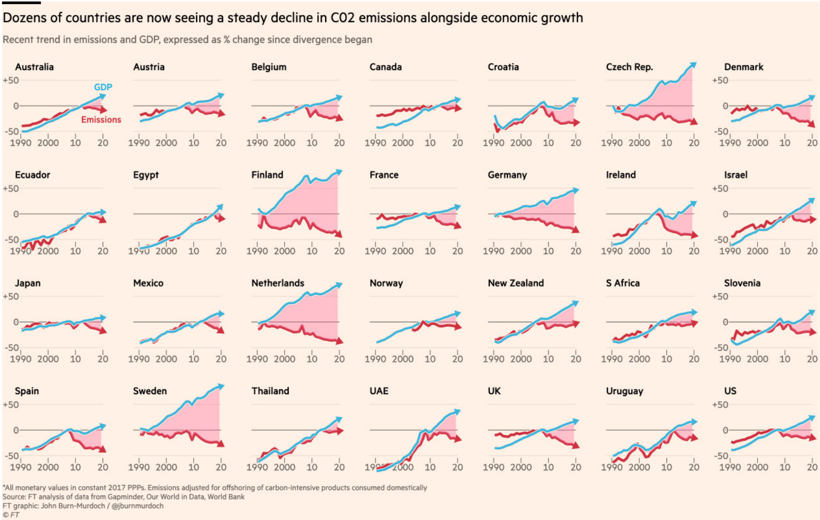
The end of abundance?



The counterarguments

- Short run supply disruption which will ease; “secular stagnation” will be back. #TeamTransitory
- Technology and shifting consumption habits will lower emissions substantially.
- Distribution can be improved by raising incomes at the bottom.
- Constraining any part of aggregate demand is regressive and should be opposed.

The counterargument



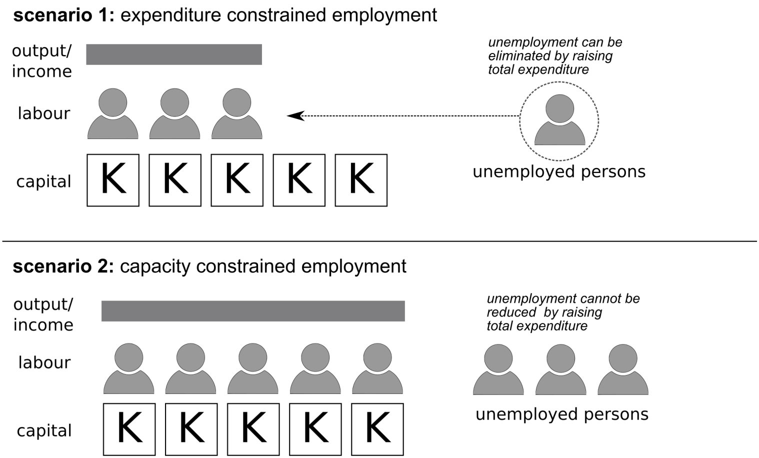
The end of abundance?

Kaya identity

$$\text{Greenhouse Gas Emissions} = \underbrace{\text{Population} \times \frac{\text{GDP}}{\text{Population}}}_{\textit{Consumption}} \times \underbrace{\frac{\text{Energy}}{\text{GDP}} \times \frac{\text{Emissions}}{\text{Energy}}}_{\textit{Technology}}$$

Source: Jackson (2022)

The end of abundance?



Source: Aboobaker and Michell (2022)

PK Econ and degrowth

- Warranted growth rate and climate-compatible growth rate unrelated (Fontana & Sawyer, 2013, 2022)
- Are degrowth systems compatible with positive rate of profit/interest and stable stock-flow ratios? Hein (2022), Berg et al. (2015); Cahen-Fourot &Lavoie (2016); Jackson &Victor (2015) Richters/Siemoneit (2017)
- Long run (supermultiplier) models. Sectoral balances equal zero, saving = consumption out of wealth, balanced budgets.
- What about the short run?

Where next?

- A traditional PK/progressive macro policy programme:
  - fiscal expansion: public investment, public consumption, transfers
  - monetary accommodation
  - allow deficit to adjust to accommodate high employment
  - financial regulation/intervention
  - greater tolerance of inflation
  - progressive taxation
- What needs updating?

Theory

- Common elements:
  - Unemployed labour + spare capacity (capital, inputs).
  - Output (growth) determined by investment (growth).
  - Investment growth influenced by demand ($C + I + G + X - M$).
  - Consumption determined by MPCs and distribution.
  - Multiplier: higher exogenous spending (I, G, X) leads to higher Y via C.
  - Credit money; endogenous financial instability.
  - Rates of interest can be strongly influenced by policy.

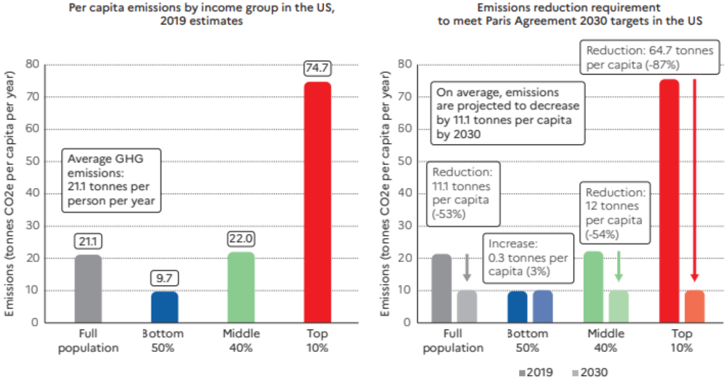
Theory

- Debates:
  - Determinants of investment growth: wage-led vs profit-led.
  - Primacy of investment/autonomous spending vs consumption/saving over long run and adjustment mechanisms for capacity utilisation/AS-AD: Sraffian supermultiplier.
  - Interest rate determination: horizontalists vs structuralists.
  - Budget deficits and taxation: functional finance vs "fiscal structuralists".

Updates

- Potential for supply-side to constrain policy options (outside of development economics).
- Given the need for high investment and lower emissions ...
- Consumption may need to be constrained
  - for some groups?
  - for some forms of consumption?
- How can/could/should this be achieved?

Distribution and climate change



Source: World Inequality Report 2022

Why constrain consumption?

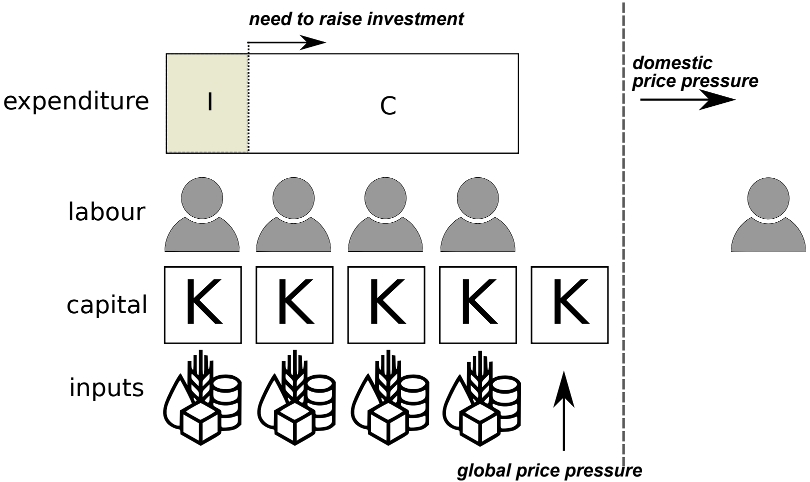
- To reduce carbon emissions directly
- To free productive capacity and emissions capacity for investment
- To free productive capacity and emissions capacity for redistribution

https://criticalfinance.org/2022/08/02/do-economists-need-to-talk-about-consumption/

Consumption-led vs investment-led strategies

- Consumption-led strategies aim to raise GDP level via higher consumption spending, growth via induced investment effect.
- Investment-led strategies aim to raise growth rate of capital stock directly, possibly without increased consumption/alongside lower consumption.
- With rapid growth of investment, potential price pressure from two distinct souces:
  - Domestic productive capacity constraints.
  - (Global) supply shortages via import prices (inputs and consumption goods)

Investment-led strategy



Some unpleasant Keynesian arithmetic

- Lower or negative overall multipliers (of a policy package).
- Increasingly hard to justify policy proposals on the basis of positive GDP impact.
- Deficits may not "pay for themselves".
- Public debt stocks will be larger for longer.
- Interest rate is not a pure policy variable in a world of open capital markets.

Controversies related to investment-led strategies

- Balanced budgets, fiscal/golden rules and "payfors"
- The role of taxation.
- The limits to QE/yield curve control.
- The problem of global monetary hierarchies.
- "Green" monetary policy, credit, financial regulation etc.

The limits to yield curve control

- Monetary sovereignty is a spectrum (Bonizzi et al. 2019).
- What determines monetary sovereignty?
- Better question: how does lack of monetary sovereignty manifest?
  - Balance of payments constraints
  - Foreign exchange reserve pressure
  - Exchange rate devaluation pressure
  - Imported inflation
  - Cross-border financial pressures
- Ultimate constraint is the exchange rate
- Who is a monetary sovereign? (Are we all EM now?)

The limits to yield curve control

More

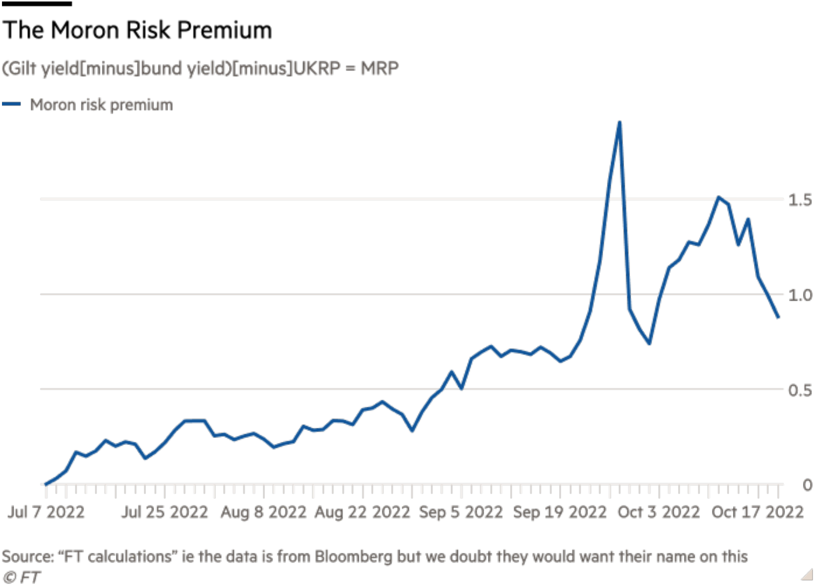
Asian Markets

3 minute read · October 20, 2022 6:44 AM GMT+1 · Last Updated 5 hours ago

BOJ conducts emergency bond buying to underpin debt market, but yields keep rising

Reuters

The limits to yield curve control



Where next?

- An updated PK/progressive macro policy programme:
  - Investment-led strategy
    - Rapid short run growth in public investment plus financing and incentives for private investment
  - Measures to constrain (inflationary/carbon-intensive) consumption
    - Taxation (but how – on products, inputs, income groups? Not "carbon taxes")
    - Tiered pricing (NEF 2022, Dullien & Weber 2022)
    - Incentives for personal saving (i.e. not-consumption)
  - Full employment plus investment growth implies deficits, but size is not irrelevant
    - Avoid explosive debt/GDP dynamics
    - Use taxes on wealthy to moderate size of deficit
    - Accept that high debt/GDP ratios are here to stay – growth unlikely to be sufficient to lower ratios substantially.
    - Aim for tolerable interest payments/GDP ratios.

Where next?

- Monetary-fiscal coordination (Michell and Toporowski, 2019)
  - Yield curve intervention to ensure smooth debt issuance and ensure financial stability
  - Broader eligible range of securities.
  - Limit to YCC in global capital markets: exchange rate
- Don't overburden the central bank
  - Can't control inflation
  - Limited influence on demand
  - Limited capacity to influence decarbonisation
  - Can't set rates independently of world rates (=Fed) *without side effects*.
  - Primary role = liquidity management in financial markets
- Tolerate higher headline inflation/alternative metrics

Institutional policy design

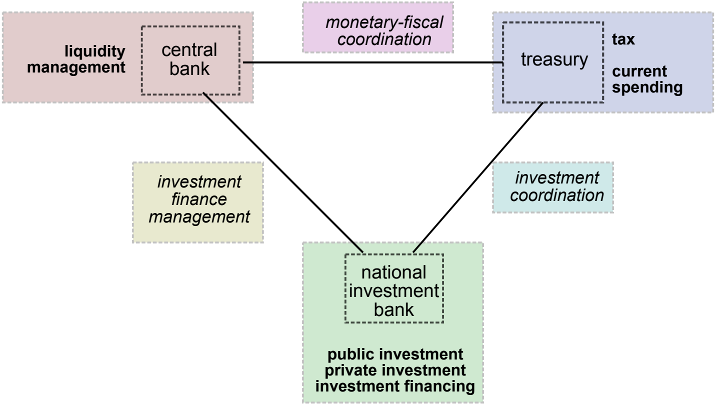
- Policy design is institutional design; structure matters
- Reforming macro policy means redesigning the institutional framework.
- Institutions are sticky; institutional reform is difficult
- Look for minimalist changes.

Institutional policy design

- What do we want?
- Monetary-fiscal coordination!
- How do we get it?
- Possible starting point: dual mandate for central bank plus mechanism for coordination with fiscal policy

Macro institutional framework

Institutional structure for investment-led strategy



Source: Calvert Jump et al. (forthcoming)