When Will the “Conventional Wisdom” of Establishment Macroeconomics Catch Up with Reality? The Desperate Need for a Paradigm Shift*

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Introduction

It is an absolute pleasure to receive this special honour from my esteemed colleagues of the Progressive Economics Forum. I shall hold this prize with truly immense pride because of my strong admiration for the work of John Kenneth Galbraith, to whose numerous writings I was first exposed already during my undergraduate years in the late 1960s and early 1970s at McGill University in Montreal. Indeed, it was John C. (Jack) Weldon who, some years later, eventually became my PhD thesis supervisor and who, in the early 1970s, first introduced me to Galbraith’s *The New Industrial State*, first appearing in print in 1967. Of all of Galbraith’s great works, the content of this book still remains etched deep in my mind because it dispelled the myth of the market and pointed to the ubiquity of economic planning within the core corporate sector of the American economy. It was such a profoundly perceptive and persuasive institutional description of the changing productive structure of a mature American industrial capitalism of the early post-World War II era, after which the U.S. economy became progressively transformed, during what can be described as the neoliberal era, with growing corporate focus on financialised activities at the expense of real domestic production, as the latter became more and more outsourced. Indeed, as is well known, not just the U.S., but also Canada and all the North Atlantic economies became increasingly financialised during the late twentieth century as they evolved towards a Minskian money manager capitalism associated with a growing incidence of financial crises, the most noteworthy being the global financial crisis of 2008-2009 (Seccareccia 2012-13).

However, I shall also cherish this special prize because it places me in the company of such esteemed Canadian economists, as my dear former professor Kari Polanyi Levitt (of McGill University) and the late Mel Watkins (of the University of Toronto), who have been true intellectual icons and guiding lights for so many of us within the Canadian political economy tradition and who, in 2008 in Vancouver, won jointly the first Galbraith prize. Both Kari and Mel are the true intellectual heirs to those earlier deeply-rooted institutionalist traditions, which first blossomed in the celebrated writings of Harold A. Innis and Karl Polanyi during the first half of the twentieth century. In their economic analyses, these two highly interdisciplinary political economists focused their research primarily on history and on the nature of evolving economic institutions and culture rather than on highbrow neoclassical economic theory that favours extremely abstract theorising and the mastering of mathematical technique over analytical substance. A good example of the latter is the continued popularity of dynamic stochastic general equilibrium (DSGE) modelling in the teaching of macroeconomics, which has so little to offer towards the

understanding of the real world, and which has been such a dismal failure in both its predictions and its usefulness on the policy front, as during this pandemic (for an excellent critical analysis, see Storm 2021).

There are many others on that special valued list of recipients of the Galbraith prize, especially one for whom I had truly the greatest esteem right here in Ottawa because of his pioneering work in macro-econometric model-building and forecasting, namely the late Mike McCracken, and who, during this same Galbraith lecture he delivered in Calgary almost ten years ago (in June 2012), reminded progressive economists that the ultimate objective of macroeconomic policy must be full employment together with a more equitable distribution of income and wealth. Mike McCracken was echoing in his own special way, of course, what John Maynard Keynes wrote some 85 years ago when affirming that: "*The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and income.*" (Keynes 1936: 373) The current COVID-19 crisis has so forcefully reminded policy makers in Canada and internationally that this must become their main concern as we slowly recover from the worst economic crisis since the 1930s (see Seccareccia 2021). Without such strong commitments from policy makers, we shall be creating ever deeper cleavages in what has become an extremely polarised society that the COVID-19 crisis has so openly exposed and from which it will take time to recover, since, given the vested interests, as Veblen would say, habits of thought/institutions are very slow to change.

Starting in March 2020, the COVID-19 crisis imposed on modern financialised capitalist economies what resembled a somewhat reconfigured Galbraithian dual core/periphery industrial structure. At the time of writing over a year later, 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 transform rapidly 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 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 the pittances 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 towards deep social divisions in Western societies as governments abandoned post-war Keynesian principles and embraced the neoliberal ideology and policy system of 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 analyse 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 already with the preceding global financial crisis (GFC) of 2008-2009, 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 criticised 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 finds in Galbraith also 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 nineteenth-century liberalism that universally celebrated the supremacy of impersonal self-regulating "market" forces and minimised 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 recognised the centrality of the state in the determination of both micro and macroeconomic outcomes. As Polanyi (1944) put it so succinctly, the so-called "market" should be embedded in society and *not* society that should be 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 idolised especially 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 commoditisation by the nineteenth century through the concerted actions of the state (see Polanyi 1944; and Polanyi-Levitt and Seccareccia 2018). However, as emphasised 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 twenty-first 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 emphasised, the feedback effect through aggregate demand of declining wages in a recession, can completely destabilise 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 nineteenth-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 towards stagnation, there came a clear policy consensus on the crucial role of the state in achieving economic growth and full employment. Under pressure from unionised 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 towards very high growth rates in both incomes 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 industrialised countries for both the fiscal and the monetary authorities to announce their commitment to high or full employment. Macroeconomic policy meant pursuing stabilisation 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 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 the new mantra of macroeconomics of "inflation first" based on a narrative by mainstream economists of what supposedly happened during the decade of 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 pushed sharply up the rate of inflation in most Western industrialised countries 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 "monetised" 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 programme 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 stabilisers 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, there was crafted a new neoliberal macroeconomic policy programme. 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 programme, 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 formalised 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 which was now placed at the very top of the totem pole 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 that 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 demobilisation). To achieve that goal of fighting inflation, it was now necessary for society to be imposed the requisite discipline of macroeconomic austerity resting on both the fiscal and monetary policy pillars of neoliberalism.

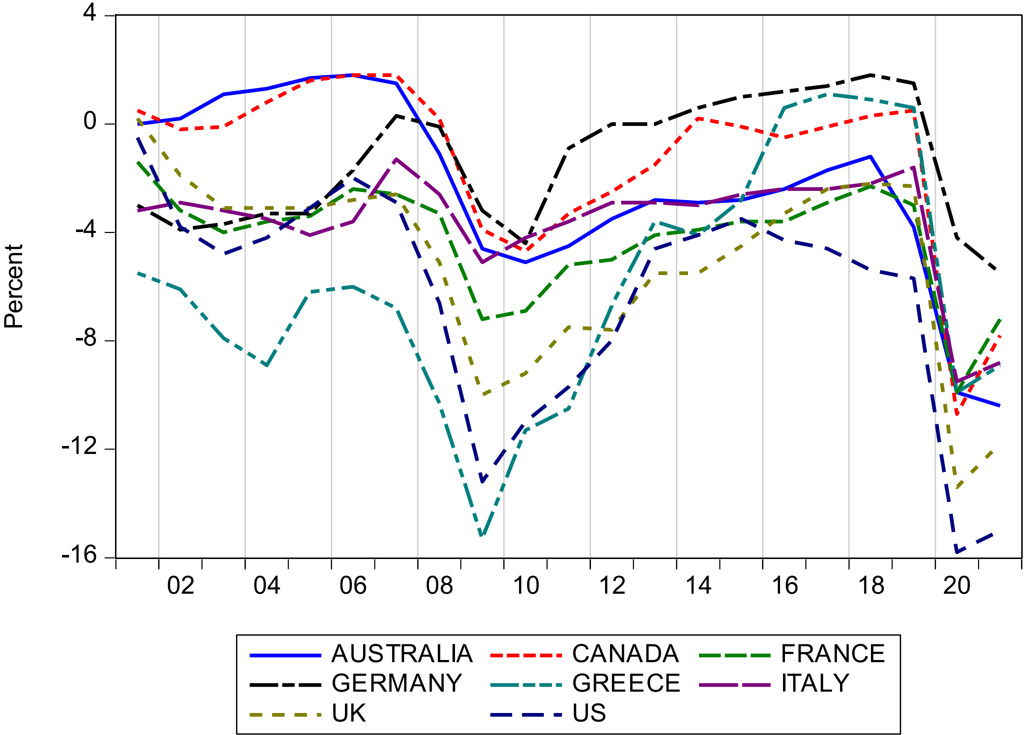
(i) The Return of the Old Conventional Wisdom of Fiscal Austerity and the New Fiscalism following the Global Financial Crisis

On the fiscal policy side, the new austere face of neoliberalism from the 1990s turned out to be nothing more than a recycled anti-Keynesian policy of “sound finance” that had already prevented governments from engaging in deficit spending early during the Great Depression until came 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 our private consumption spending), prudent governments ought to behave just as would a wise head of a household, that is, not to spend in excess of one’s means on the household credit card, but by running instead budget balances or, for precautionary reasons, even by targeting budgetary surpluses via the accumulation of public sector savings. Examples abound of this commitment to balanced budgets, especially during the 1990s as, 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 GFC. Similarly, it was particularly the merging of the German ordoliberal ideology with this wider neoliberal international movement in favour of “sound finance”, as also reflected in the now discredited Washington Consensus for the developing world, which 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 not only of Canada but also of a selected group of other countries for which annual data was easily available

going from 2001 to 2021 (with the 2021 figures only being for the first quarter). The first group, depicted in Figure 1(a), is a set of industrial countries, with the chart showing clearly the herd behavior of the fiscal authorities internationally. An obvious outlier was initially Greece before the GFC, which after some scolding internationally leading to the selling of public assets, eventually joined the pack in conformity with the rest. Indeed, as these countries came out of the 1990s and until the GFC, all these governments were literally tripping over each other to achieve budgetary surpluses. Some, such as Canada and Germany, had been leading the pack even after the GFC to return to balanced budgets, especially under Stephen Harper's Conservatives, even though most of these other countries did not quite reach altogether the pre-GFC levels of budgetary balances during the decade before the COVID-19 crisis in 2020, because of somewhat changing policy discourse to be discussed below.

Figure 1(a): General Government Net Lending/Borrowing as a Percentage of GDP 2001-2021, Annual Observations for a Selected Group of Countries from the Industrial World

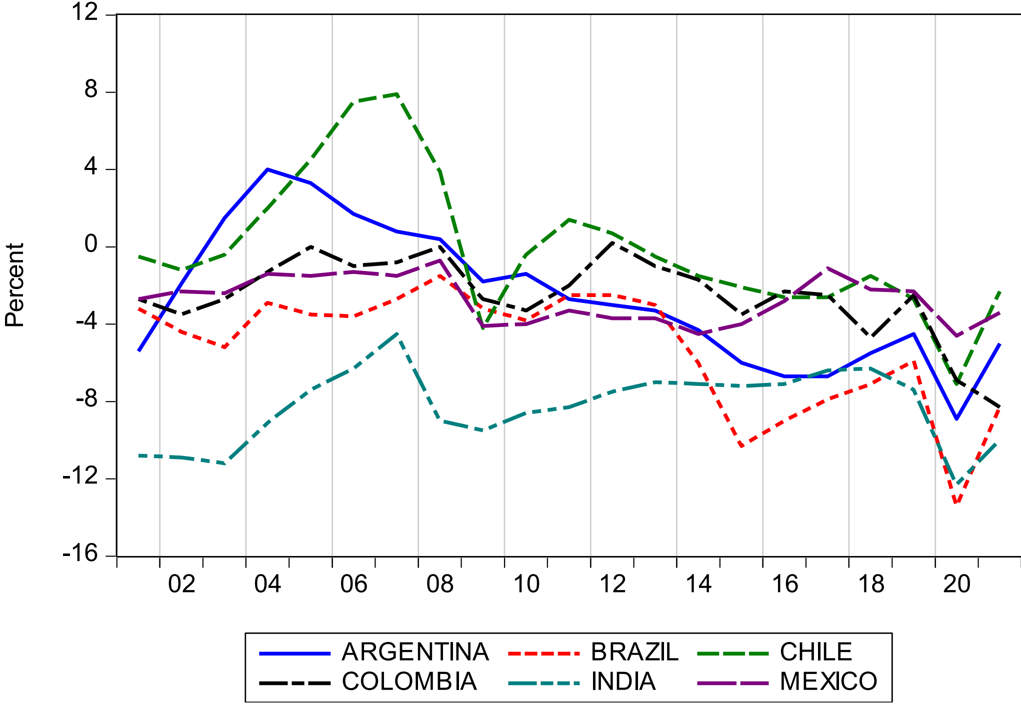


Source: *IMF Monitor* (April 2021)

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 2(b) below. In fact, it can be seen that, 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 GFC and then, with the reversal of the international terms of trade, during and after the GFC they faced increasingly greater obstacles to achieve budgetary balances. 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 dollarisation, these countries faced greater pressures to conform to the fiscal orthodoxy despite the adverse conditions that they faced after the GFC. This can

be easily contrasted with an outlier, such as India, in Figure 1(b) that was able to sustain longer-term deficits partly owing to its status of a country with its own sovereign currency.

Figure 1(b): General Government Net Lending/Borrowing as a Percentage of GDP 2001-2021, Annual Observations for a Selected Group of Developing and Emerging Economies



Source: *IMF Monitor* (April 2021)

It must also be emphasised that, during the decade following the GFC, 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-run stabilisation because of the growing recognition of significantly strong fiscal multipliers, as witnessed during the Great Recession of 2008-2009. I had argued after the GFC that the very strict rules of austerity of achieving budget balances and fiscal surpluses "for all seasons", which had been abandoned somewhat during and after the GFC, reflected a "new fiscalism", which now began to look more approvingly at activist fiscal policy as a short-run 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 in the industrial countries, in particular, there was generally a stronger fiscal response to the crisis, as can be seen in Figure 1(a).

Yet, the mainstream economics profession could not completely abandon its ideology of budgetary austerity because these economists were unable to shed the previous ideology-driven neoliberal principle that there should be at least some long-run 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 becomes allegedly open-ended and inflationary and it sends "false" signals to otherwise unsuspecting private market participants.

Hence, despite a growing appreciation for Keynesian short-run stabilisation in the industrial countries during and after the GFC, 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-run budget constraint and must ensure the long-run neutrality of the state; or, at the very least, (2) there should be a long-term commitment to stabilise over time 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 summarised, 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 described historically as the Domar relation between public spending and debt servicing costs, in the environment of low interest rates of the post-GFC decade, the "welfare costs" of an incremental increase of the public debt would be very low when 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 of stabilising 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 GFC, this new policy framework actually gave some fiscal room to maneuvre to governments, while still remaining committed to a broad long-run fiscal rule that would not strike fear in the financial markets of explosive public debt ratios. "Explosive" deficits and debt purportedly would tempt governments to make use of the "printing press" via so-called public debt "monetisation" and, therefore, in accordance with the discredited quantity theory belief, would generate high inflation with its unacceptable distorting wealth-redistribution effects from savers to debtors. However, the COVID-19 reality has questioned this. Almost as in a war economy environment in which policy necessity demands new ideas, during the COVID-19 crisis, this tipped the policy scale somewhat in favour of what is nowadays commonly referred to as the Modern Monetary Theory (MMT) perspective whereby countries, primarily in the industrial world, threw away not only the balanced budget commitment as it had already occurred during the GFC, but also the myth and fear of the boogeyman of what was traditionally referred to as "deficit monetisation".

Table 1: Indicators of Central Bank "Monetisation": 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).

Table 1 above 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 "monetisation" since, when one looks at the balance sheets of national central banks, there is registered only the changes in their stock holdings of government securities relative to rising deficits in 2020 that 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 programme of quantitative easing (QE)). 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 (ECB) also 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 (QE), which means that there can at best have been only some more roundabout or "indirect" central bank "financing" of budget deficits, where 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 QE 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, what the 5 percent value for the first quarter of 2021 would indicate, when there was not yet any official QE in place in Canada until the end of March 2020, is mostly 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 percent value says that *potentially* 100 percent of federal financing requirements could have been met through central bank purchases of federal debt, with the remaining 73 percent being pure QE, 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 GFC, 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 destabilise the financial markets. In fact, when combined with quantitative easing (QE) during 2020-21, namely the unsterilised 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 historically 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 programme 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 so much 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 in the setting up of 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 (IT) era.

(ii) Monetary Policy is Always and Everywhere an Incomes Policy

As we said earlier, the second important pillar of what became the conventional wisdom of the 1990s has as its original macroeconomic building block the way central banks began to frame and redesign monetary policy after the monetarist fiasco of the late 1970s and early 1980s. As we saw also with the evolution of fiscal policy, monetary policy was now also designed around the need solely to control the inflation rate. Hence, while in the previous Keynesian macroeconomic policy framework, stabilisation policy was about stabilising output and employment at some potential full-employment level, with inflation being of somewhat lower concern, now stabilisation policy was reduced exclusively to stabilising the inflation rate around some target, with unemployment being of little concern since, except for short-term shocks, the unemployment rate would find its own way, if left undisturbed, towards its "natural" level that, in the long run, was independent of monetary policy actions. However, as was previously noted, while until the early 1980s for the Bank of Canada this was about achieving a low, steady and predictable inflation rate by controlling a specific monetary aggregate, monetary policy began to evolve throughout the 1980s by officially focusing on conditioning more explicitly the cost of borrowing to control aggregate spending. Hence, when the monetary authorities could no longer deny that they could not control directly 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 stabilising 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 and, conversely, when the inflation rate has stabilised 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 mitigate somewhat fluctuations of the real rate of interest 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 emphasise 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 an income to rentiers who are owners of financial assets. Hence, they do not consider what has been descrlbed 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 emphasised by mainstream economists.

In fact, despite the overwhelming use of the interest rate instrument, what clearly mainstream economists or central bankers do not recognise (nor do they want to acknowledge it) is that an anti-inflation policy, regardless of whether it is an IT or non-IT policy, is by its very essence 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 industrialised countries. This lack of recognition is certainly not because of 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 in conformity 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 on 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 the political authorities nationally. These include the voluntary to the compulsory forms of incomes policies that had been especially popular during the 1960s and 1970s in countries as Britain, Canada and the United States. For instance, one finds in the U.S. the Kennedy-Johnson Guideposts from 1962 to 1966, in the U.K. the British National Board for Prices and Incomes from 1965 to 1970, and in Canada the Prices and Incomes Commission from 1968 to 1972 that would rely on the announcement effect of the wage norm on collective bargaining decisions in the labour market. These voluntary guideposts were then 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 decentralised 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.

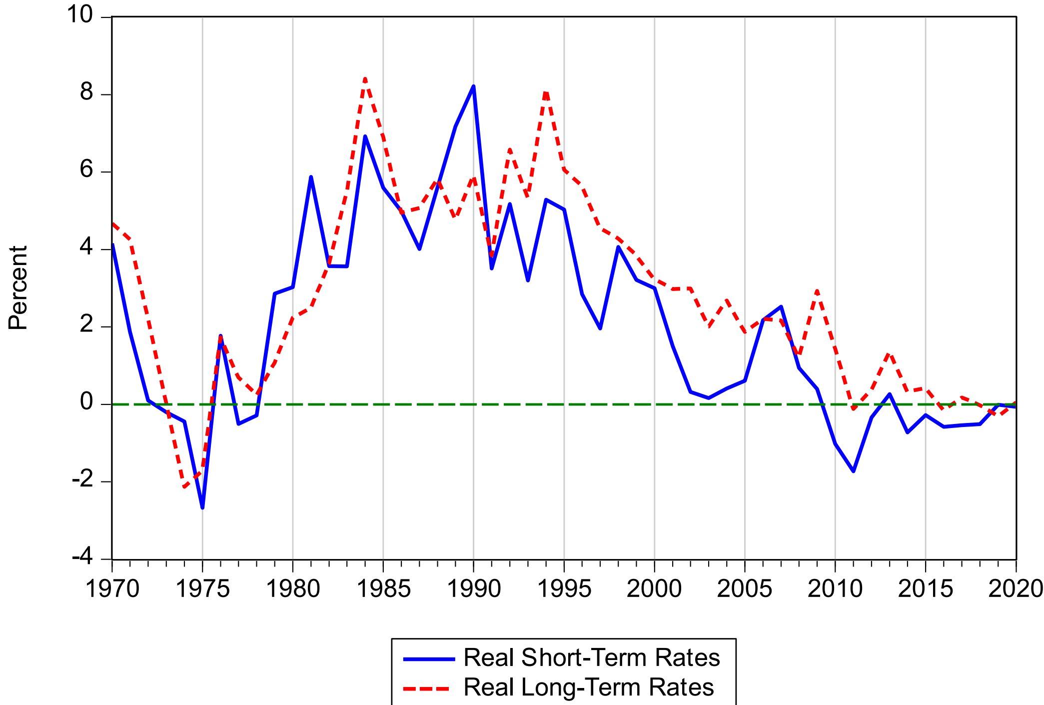
Quite definitely, any anti-inflation policy pursued by central banks is an incomes policy directed "from above", namely from a decision of the monetary authorities. This is the case because of the monetary policy's impact directly on what Veblen and Keynes termed "unearned" financial income of rentiers and also because of the way a central bank's inflation target can serve as guidepost in the labour market. As was pointed out, 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, to effectuate changes in the inflation rate, one must engage in discretionary interest rate setting. This is done via the control of the overnight rate, which then impacts on 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 on 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 organised 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 *qua* workers but also high returns on their pension fund assets as rentiers so as 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 looked at other theoretically-based measures as well 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 detect numerically 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 these measures are very simple indicators of how monetary policy impacts on rentier vis-à-vis non-rentier income.

These indicators are displayed in Figures 2 and 3 below that 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 both in Canada and internationally first became absorbed with combating inflation over all possible goals and, then, began slowly to move away by engaging in more "flexible" IT policy just before the GFC. For instance, the first, displayed in Figure 2 below, is the simple *ex-post* Fisher-type relation indicating OECD measures of short-term and long-term rates of interest 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 GFC, after which we see the pendulum swinging away from rentier income.

Figure 2: Indicators of Real Short-Term and Long-Term Interest Rates, Canada, Annual Averages, 1970-2020

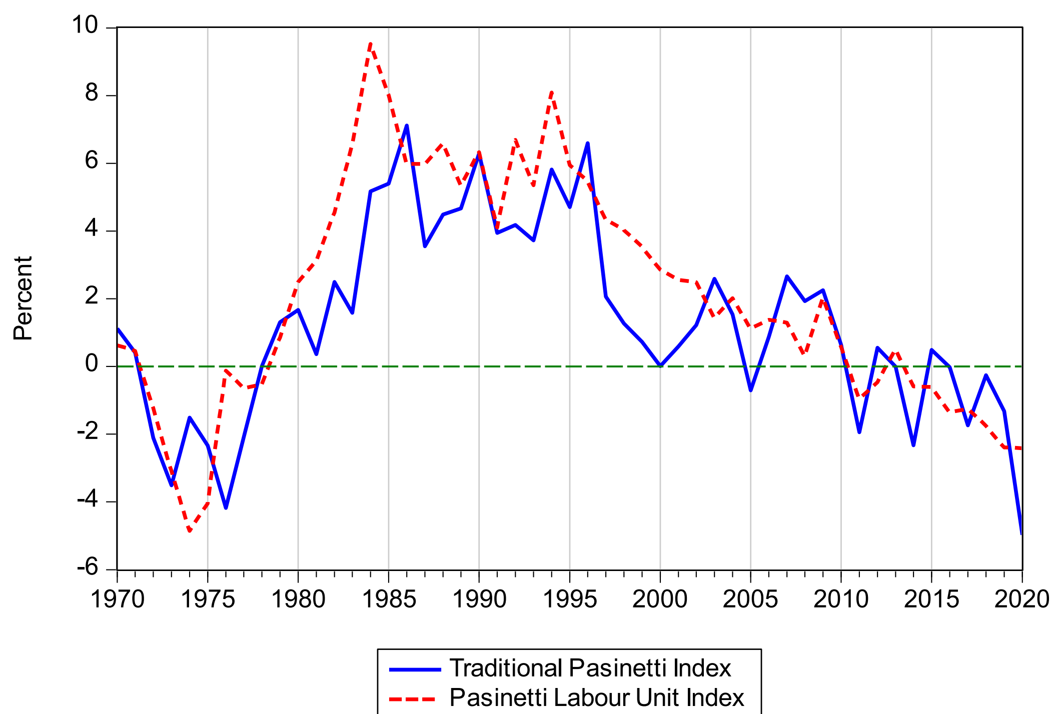


Source: OECD.Stat

From this evidence for Canada, one can observe that the enormous income transfer that occurred primarily during the 1980s and 1990s was all 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 excessive reward to rentiers can perhaps be better understood when one looks at the Pasinetti measures that consider more directly their claims over a rising share of national output until just before the GFC.

In Figure 3 below, 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 below, regardless of which of these two Pasinetti indicators, all depict the same portrait of a massive transfer that had occurred prior to the GFC and of the tremendous reversal of the fortunes of the rentiers after the GFC, when using as measure 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. 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 GFC. The Pasinetti measures even tipped closer towards a Keynesian "euthanasia" of the rentier environment after the GFC somewhat comparable to what was occuring during a short episode in the early 1970s!

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.

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 restraing 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 cannot but have a permanent bias against wage growth.

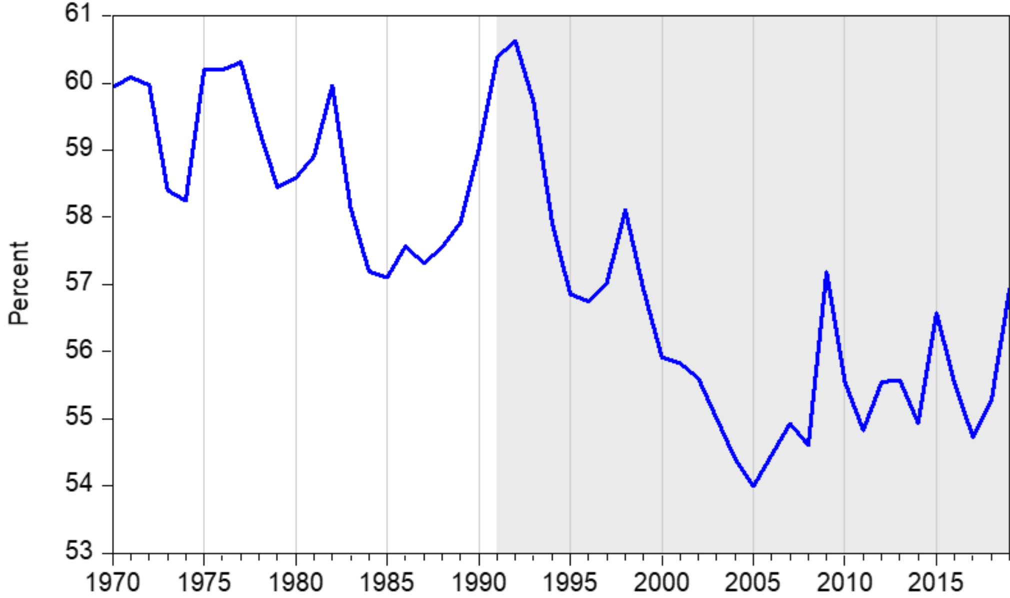
This particular bias arises for two reasons. Firstly, to the extent that a pro-rentier high real interest-rate policy, as that pursued during the latter two decades of the last century before the GFC, persists long enough, it will ultimately slow down real GDP growth over time and raise the long-term rate of unemployment because of obvious hysteresis effects. This would eventually impact negatively on long-term wage growth but also on long-term "potential" output growth itself 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, as happened eventually. This was indeed the case in Canada during that whole era before the GFC, 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 slow down sufficiently 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 2 percent inflation target, which is repeated so frequently 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 decentralised 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 2 percent 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 increase of productivity when an economy achieves its 2 percent 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 2 percent inflation targets. Central bank strategy in shaping expectations of both employers and workers in the collective bargaining

process has been very successful until the COVID-19 crisis in 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 initial 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 be barreling down almost immediately after the adoption of IT policy in Canada in 1991. Moreover, the share of labour never went back up after the GFC, 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 recognising 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 below 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 GFC and remaining stuck and graviting around a lower mean until the COVID-19 crisis.

Figure 4: Evolution of the Wage Share in Canada, Annual Observations, 1970-2019



Source: AMECO Database, series ALCD2.

If one would consider almost 30 years (shaded in Figure 4 above) 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 stabilised somewhat during the "inter crises" decade of 2009 and 2019 after the GFC 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 2 percent mid-point and closer to the lower end of the 1 to 3 percent target inflation band, therefore, mildly raising and/or stabilising the labour share. However, even in the relatively "stable" world of IT policy before the "inter crises" era, the announcement effect of a 2 percent target had secured a certain stability in wage demands and nominal wage growth around that target, whose effect was to lead to a long-term decline in the share of labour until the GFC. 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 “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/distributionally biased so as 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 destabilising factor in the evolution of income distribution, which has contributed to the long-term weakening of the share of labour out of national income. While other forces in the world economy, such as the skill bias of technological change and the implications of rampant globalisation, 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 towards 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 GFC, 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 away 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.

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