Monetary Policy and Society

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Introduction

- Classical Economics focused on social problems of growth, cycles and income distribution
- Developments treated as interlinked, dynamic and driven by fiat money
- Modern Macroeconomics assumes away all possible problems
- Developments treated as independent, static, and money plays no role
- Could “complexity” be the way forward?
Overview of the presentation

- Risky prospects for the global economy
- Monetary policy and the crisis– cure or cause?
- The further contribution of comforting if false beliefs
- Interactions between economic agents
- Paradigm shift or “still more of the same”?
Risky prospects for the global economy

- Very slow recovery in AME’s from 2009 recession with income inequality worsening further
- Recent slowing in EME’s with income inequality also worsening
- Forecasts more positive but large errors in past
- Every geographical region has evident vulnerabilities
- Setbacks anywhere with repercussions everywhere
- And macro policies are near their limits
Monetary policy and the crisis—cure or cause?

- Post War “Bastard Keynesianism” leads to inflation
- Volcker disinflation followed by the “Greenspan put”
- Leading to faster demand but lower productivity growth and rising income inequality
- “More of the same” in the run up to the 2007 crisis
- Leading to more economic and financial “imbalances” and higher food and energy prices
- “Still more of the same” since 2007 with limited benefits and rising costs
Borrowers believed debt could substitute for earnings and higher house prices increase wealth.

Lenders believed the world had become permanently less risky and near term profit is all.

Supervisors believed in a “bottom up” approach to systemic stability and in the integrity of bankers.
The further contribution of comforting if false beliefs (2)

- **Central bankers** believed they had delivered price stability and this guaranteed economic stability
- Better to “clean than lean”?
- **Academics** believed economic crises were impossible and that money, debt and power were irrelevant
- Expectations are “rational”?
- **Politicians** believed that rising fiscal revenues were permanent and prosperity would “trickle down”
- Debt can substitute for earnings?
Interactions between economic agents (1)

- In complex systems, interactions are as important as the nature of the agents themselves.
- With six classes of agents, 30 interactions which could increase or decrease systemic stability.
- Currently, these interactions pose serious dangers.
- This suggests that institutional reforms are needed along with new belief systems.
Interactions between economic agents (2)

- **Bankers and supervisors**: regulatory capture
- **Bankers and politicians**: lobbying, “too big to fail” and an aversion to debt resolution
- **Central bankers and supervisors**: systemic problems “fall between the cracks” ex ante and policies conflict ex post
- **Academics, central banks and politicians**: false beliefs are reinforced in the interests of the powerful
- **Central banks and politicians**: distributional implications threaten central bank “independence”
- **Politicians and voters**: voters wanting easy answers get the governments they deserve
Paradigm shift or “still more of the same”?

- The surprising onset and duration of the crisis should have led to a fundamental rethink of both monetary policy and institutional structures
- Yet neither of these has happened
- What explains this dangerous outcome?
- Independent “think tanks” take on a crucial role
- How can money better serve society? From Classical Economics through Hayek to “Complexity”