

On Interest as a Monetary Phenomenon and the 'Best' Interest-rate Policy

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Abstract: The article discusses the real effects of interest-rate policy, as well as its impact on inflation, once the traditional concept of a 'natural' real rate of interest is discarded and interest is viewed as a monetary phenomenon, a true policy variable subject to a wide range of policy objectives and constraints, which contributes to determine normal production costs. Attention is then focused on the merits of cheap money, whilst it is maintained, by contrast, that a persistent zero real interest-rate policy would ultimately be incompatible with capitalist production. The article concludes by pointing out the implications of the main arguments put forward here for the status of the central bank and the question of capital control.

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INTRODUCTION

An important corollary of any economic theory which postulates the existence of a 'natural' real rate of interest, or of a normal rate of return on capital employed in production determined by real factors, is skepticism that interest-rate policy can *persistently* affect the real economy - the denial, in other words, of any substantial power on the part of monetary authorities.

Thus, within the various formulations of the neoclassical approach, and quite independently of whether money is regarded as exogenous or endogenous, the existence of a natural equilibrium of time preference by consumers-savers and the marginal productivity of capital ultimately makes long-term real interest rates beyond the reach of policy and monetary

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neutrality is hardly disputable. Given the state of productivity and thrift, the impact on the price level, or on real output and accumulation, of any lasting discrepancy between the course of the market rate of interest and that of the natural real rate would force the authorities to act so as to make the former move in sympathy with the latter. If the central bank knew the level of the natural rate of interest, then the best monetary policy would be one that kept through time the actual real rate at its natural level, so as to keep output at potential while at the same time ensuring price stability. The main challenge for those in charge of monetary policy would simply be that of not yielding to the political temptation of keeping the real rate below its natural level, with a view of bringing output and employment above their natural levels. So, to the extent that monetary policy was performed at its best, money would be neutral in the short and in the long-run alike. But even if monetary policy could not be performed at its best, possibly owing to an ‘imperfect estimate’ of the ‘unobservable’ equilibrium real rate by the central banks, they are nevertheless believed to be capable of tracking the natural equilibrium of the economy and the corresponding equilibrium real rate of interest by *inferring* its course from the changes in the price level.¹ If inflation rises, a raising of nominal interest rates by the bank, provided it is sufficiently large to raise real rates also, will succeed in lowering inflation, while keeping output near potential. In sum, according to the whole neoclassical tradition, monetary policy can affect only nominal variables in the long-run.²

The neoclassical notion of a natural rate of interest also seriously pollutes Keynes’s interpretation of interest as a monetary phenomenon, together with his conviction that under capitalism monetary phenomena are central to the explanation of real ones. Notwithstanding his claim in the *General Theory* (1936, p. 243) that he “no longer” regards the concept of a “natural real rate” as “a most promising idea”, the natural rate is still there, as the rate that would ensure equality between full employment savings and investment decisions. Keynes’s underemployment equilibrium is ultimately the result of a limited flexibility of the money rate of interest in the face of discrepancies between full employment savings and investment decisions. Since he shares the neoclassical tenet of an inverse relation between the rate of interest and investment decisions - derived from the principle of substitution between capital and labour - this limited flexibility is actually all he has to offer as a basis for his non-orthodox concept of interest as a monetary phenomenon. The neoclassical synthesis could thus quite easily maintain that the determination of the current rate of interest by the

intersection of the supply and the demand schedule of money, while adequate for showing that the flexibility of the interest rate is not of an automatic nature, is, however, insufficient to sustain the thesis of its *limited* flexibility. And if current money interest can normally be brought to and kept at its natural level – provided that monetary authority act with a sufficient “measure of persistence and consistency of purpose” (Keynes 1936, p. 204) – then the neoclassical real forces of productivity and thrift may still be regarded as the ultimate determinants of the equilibrium rate of interest.³

Keynes’s interpretation of interest as a monetary phenomenon is also incompatible with the so-called Keynesian theory of distribution, unless one is prepared to deny any long-run connection between the rate of interest and the rate of profit. This connection was certainly not denied by Keynes, who, consistently with his monetary explanation of interest, regarded the latter as “setting the pace” in the necessary equalization of “the advantages of the choice between owing loans and assets”: “instead of the marginal efficiency of capital determining the rate of interest – he wrote – it is truer [...] to say that it is the rate of interest which determines the marginal efficiency of capital” (1937, pp. 222-3).⁴ The development of Joan Robinson’s position on interest as her life’s work progressed neatly reflects the incompatibility which has just been pointed out: she eventually stressed that no matter how large a measure of persistence and consistency of purpose the monetary authorities applied to their action, neither a situation of high interest rates nor one of cheap money could be maintained irrespective of the “underlying reality” represented by the course of the rate of accumulation. In 1951, in the last section of her widely circulated article “The rate of interest”,⁵ she had written with respect to the possibility of a cheap-money policy: “If the authorities take it gently and do not try to push the rate down to fast, and if they stick consistently to the policy, once begun, so that the market never has the experience of today’s rate being higher than yesterday, it is hard to discern *any limit* to the possible fall in interest rates” (Robinson 1952, p. 30, italics added). But in the first reprint of the article (1960) that followed *The Accumulation of Capital* (1956) its last section was omitted, obviously because in her main work she had argued that “there is, at any moment, a low level of interest such that, if obtained, inflation would set in [...], and a high level such that if obtained would be regarded as intolerable and some kind of reaction would set in to get it brought down. The two levels [...] are governed, roughly speaking, by the prospect of profit on investment. [...] Actual interest rates must be somewhere between these two levels” (1956, pp. 399-400). In 1979 “The

rate of interest” was again reprinted, this time in full, at the end of her volume *The Generalization of the General Theory and Other Essays*, but in the introduction to the volume she referred to the essay on interest as “quite old fashioned”, and explicitly criticized as “unnatural” the concept of the rate of interest as an independently determined monetary phenomenon that governs the rate of profit: “Over the long run - she wrote reversing Keynes’s point of view – the interest that rentiers can exact is determined by the profits that entrepreneurs can earn, not the other way round” (1979, p. XXII).⁶ As to Luigi Pasinetti, he has stressed that the theory of rate-of-profit determination through the money rate of interest and Kaldor’s rate-of-profit determination through the rate of growth “are *alternative*” (Pasinetti 1990, p. 462, italics in the original), so that they cannot both hold true.

Finally, the interpretation of interest as a conventional monetary phenomenon, determined from outside the system of production, is incompatible with the classical and Marxian concept of a normal rate of profit determined by the real wage, given production techniques. But while the long-run dependence of money interest on normal profit is most clearly stated by Ricardo,⁷ it cannot be so easily disposed of as far as Marx’s views on interest are concerned. Indeed, Marx did not share Ricardo’s view that lasting changes in the rate of interest must reflect changes in the normal rate of profit. He regarded instead “the average rate of interest prevailing in a certain country” as a magnitude determined by socio-economic and institutional circumstances unrelated to the real forces that govern the normal rate of profit (see Marx [1894] 1977, pp. 425, 427, 431-2). The problem is that Marx’s “autonomous determination” of the rate of interest is accompanied by a marked weakening of the connection between this variable and the normal rate of profit, since the latter still depends in his analysis, as in that of Ricardo, on the real wage. For Marx, both rates are thus capable of being determined independently of each other, with the corollary that “assuming the average profit to be given, the rate of the profit of enterprise is [...]determined by the rate of interest. It is high or low in inverse proportion to it” (*ibid.*, p. 379). This is however a hardly acceptable view, in the light of the conviction, shared by Marx, that since “to represent functioning capital is not a sinecure like representing interest-bearing capital” (*ibid.*, p. 446), a positive profit of enterprise *must* constitute a component part of normal profit, so that it cannot be high or low irrespective of the elements of risk that justify its existence.

THE RATE OF INTEREST AS AN AUTONOMOUS DETERMINANT OF NORMAL PRODUCTION COSTS

In the actual conditions of modern capitalism, it is difficult in any case to

share the classical and Marxian view of the real wage rate as the independent or given variable in the relationship between wages and profits. The difficulty ultimately stems from the fact that the direct outcome of wage bargaining is a certain level of the money wage, while the price level cannot be determined before and independently from money wages: given the methods of production and normal distribution, the level of prices *depends* on the level of money wages (see Pivetti 1991, pp. 36-7) .

But if, in normal conditions, one can hardly accept the idea of an “average profit”, determined by the real wage rate, which can be taken as the *primum movens* in the long-run relationship between profit and interest; and if, on the other hand, the neoclassical tenet of an investment demand schedule is ill founded, so that also such thing as a “natural” rate of interest cannot be postulated, then the door is wide open to an interpretation of interest as a true policy-determined variable - a monetary phenomenon, that is to say, determined from outside the system of production. Moreover, since interest-rate policy decisions are taken under a wide range of policy objectives and constraints, which have different weights both among the various countries and for a particular country at different times, it can be said that interest rate determination is not subject to any general law and is actually largely intertwined with the parties’ relative strengths (more on this below).

With such an interpretation of interest, its necessary long-run causal relationship with normal profit, as traditionally envisaged by the bulk of economic theory, must of course be reversed: rather than the normal rate of profit determining the long-term rate of interest, it is the latter which will “set the pace”, by contributing to determine normal gross profit margins and the ratio of prices to money wages. The policy determined long-term interest rate – that is, the rate of interest to be earned on long-term riskless financial assets – is thus viewed as constituting an autonomous determinant of normal money production costs, quite independently of the kind of capital employed in production (borrowed, share or a firm’s own capital). Everything else remaining the same, a persistent change in the long-term rate of interest causes a change in the same direction in the level of prices in relation to the level of money wages, thereby generating a corresponding change in the rate of profits and an inverse change in the real wage. Wage bargaining and monetary policy come out of this view as the main channels through which class relations act in determining distribution and they are seen as acting primarily upon the profit rate, via the policy-determined rate of interest, rather than upon the real wage as maintained by both the classical economists and Marx. The level of the real wage prevailing in any given situation is

regarded as the final result of the whole process by which distribution of income between workers and capitalists actually occurs.

However, this long-run causal relationship from interest to profit is significantly complicated by the fact that the long-term rate of interest is but one of the determinants of normal gross profit margins, the others being, in addition to normal profits of enterprise, depreciation expenses per unit of capital and top-management remuneration. For any given course of the long-term interest rate, each one of these other components of normal gross profits may experience over time some change, such as to bring about a *non-parallel* movement of interest and profit from which one might be led to infer an absence of any connection between the two variables. But it would be erroneous, in my view, to derive such a want of connection from a non-parallel movement of interest and profit, even if it persisted over significant time spans. Focusing for example on the US case, a shortening of the average life of equipment is widely acknowledged to have brought about over the last 4 decades an increase in depreciation allowances per unit of capital,⁸ while social changes connected with the acceptability of very high compensations resulted in huge increases in top-management remunerations.⁹ Finally, and most importantly, a general weakening of the incentives to invest throughout the economy and the increased relative weight of the financial sector are very likely to have resulted in significantly higher profits of enterprise (or business profits).¹⁰ Because of these changes, profit margins soared notwithstanding a markedly decreasing trend of long-term interest rates, and real wages stagnated in the face of rising outputs per hour. But without decreasing interest rates, gross profit margins and the ratio of prices to money wages would have been even higher. Indeed, especially since the mid-1990s, decreasing interest rates appear to have somewhat checked the negative impact on real wages of the rise in the other three components of normal profits.¹¹

ON THE REAL EFFECTS OF INTEREST-RATE POLICY AND INFLATION

Interest rate policy thus affects primarily income distribution, and it is chiefly through this channel that it will also impact on activity levels, with the implication that its influence on employment is much more complex than that postulated by a Keynesian investment demand schedule.¹² A priori, one can only affirm that, *ceteris paribus*, a low interest-rate policy contributes to sustain the economy's propensity to consume through its impact on distribution between profits and wages in the latter's favour.

Moreover, that low interest rates are likely to sustain consumption also through their effects on the burden of household debt, the prices of fixed interest securities and most ordinary shares, as well as the value of houses. Actual experience over these last 30 years has clearly shown that both a lesser burden of debt and higher stock exchange and house prices affect positively the willingness of large sectors of the public to purchase goods and services in general. Finally, since in the interpretation of interest as an autonomous determinant of normal money production costs, as is put forward here, interest rates and the price level tend to be positively rather than inversely correlated, cheap money may positively affect the real income and consumption of social classes and groups other than the capitalists and wage earners. It is in sum principally through consumption that a cheap money policy is capable of exerting a positive influence on output and employment. The picture is much more problematic as to the influence of interest-rate policy on the incentive to invest. Certainly, the possibility cannot be ruled out of situations in which a positive impact on the incentive to invest is exerted by higher rates of utilization of existing productive capacity resulting from the rise in consumption caused by cheaper money. The fact is, however, that there is no functional relationship that allows one to establish which will be, in general, the direction of the influence of persistent changes in interest rates on the incentive to invest. In other words, the impact of changes in income distribution on the incentive to invest is bound to be different in each different concrete situation, and may go either way (see, on this, Pivetti 1991, pp. 43-6).

As to inflation, a raising of interest rates by the central bank, all the rest remaining the same, raises the price level because it raises the firms' mark-ups. A dearer-money policy is thus by itself inflationary.¹³ But its overall net impact on the price level essentially depends on the effects that the policy-determined interest rates will eventually exert on aggregate demand and employment, through their impact on income distribution and the other channels by which changes in interest rates are bound to affect activity levels, including the leverage they exert on net exports through the exchange rate (in a flexible exchange-rate regime). Should the overall net impact of a dearer money policy on aggregate demand and employment be negative, then the higher price/wage ratio brought about by it might eventually be accompanied by lower inflation if the repercussions of a weakening wage earners' bargaining power on the dynamic of money wages were sufficiently robust. It can therefore be said that higher interest rates may succeed in checking inflation if the higher ratio of prices to money wages

they bring about, through their direct impact on mark-ups, is more than counterbalanced by the lowering of prices of imported inputs (expressed in domestic currency) through the exchange-rate channel, and by a reduction or slower rise of money wages as a result of the likely negative impact on employment of the contractionary effects on consumption spending and net exports caused by higher interest rates. Finally, to the extent that a dear-money policy is made effective by means of lasting programs of credit restrictions, a check on the rise in prices might come about via the negative impact of the restrictions (in the availability of funds, relative to the demand for them) on activity levels and hence, again, on the level of employment and of money wages.¹⁴

But since both the impact of changes in distribution on aggregate demand and the responsiveness of money wages to changes in employment are bound to be different in each concrete situation, the direction of the long-run effects of a country's interest-rate policy on the rate at which its price level changes remains highly uncertain. This said, one can however quite confidently maintain, on the basis of the view of money interest and its role here put forward, that it is rather a *cheap*-money policy that should be regarded as the most promising policy, in the context of a fixed exchange-rate regime, to ensure low and stable inflation without at the same time negatively impinging upon activity levels. Capital control would of course have to become a component part of the overall policy stance, in order to make cheap money consistent with the fixed exchange-rate regime. As to the dynamic of money wages, it would have to be dealt with, and kept under control, by means other than increases in unemployment – essentially by income policies, that is through the expansion of the welfare state, which would in turn be rendered financially more viable by cheap money and the consequent lesser weight of interest payments in the public budget.

Differently from mainstream interpretations of inflation, with their emphasis on the degree of central bank independence and the credibility of its commitment to price stability, there is hardly anything mechanical in the complex interpretation of the behavior of the general level of prices that can be reached on the basis of the framework here expounded. As a matter of fact, one of its most significant bearings concerns precisely the status of the central bank, an issue which will be dealt with in the last section of the present article.

OBJECTIVES AND CONSTRAINTS OF INTEREST-RATE POLICY AND THE MERITS OF CHEAP MONEY

The concept of the rate of interest as a policy variable which, given production

techniques, contributes to governing the ratio of prices to money wages, does not imply postulating that at all times and places interest-rate policy is dominated by the distributive struggle between wage earners and profit earners, nor by the decisive impact of this struggle on activity levels and inflation rates. An outstanding part has clearly been played in several concrete situations by objectives and constraints of a non-distributional character, such as public debt management objectives or balance of payments and exchange-rate constraints. Moreover, owing to the relevance gained by financial markets within several national systems of retired security, also social as well as political constraints are most likely to have acted upon interest-rate policies. With respect for example to the US case, the massive return in the period since 1980 to individual-based retirement security, by dramatically exposing the living conditions of elderly households (a significant section of the population) to the behavior of stock market prices, is likely to have contributed to a call for a policy of progressive lowering of interest rates.¹⁵ Still more importantly, such a policy was eventually imposed on the authorities of a few major capitalist countries by a growth strategy crucially based on the expansion of household debt.¹⁶ Finally, interest rates are often dictated to this or that country by the need to check outflows of funds incompatible with the exchange-rate policy and regime chosen by its authorities. In sum, as has already been stressed in section 2 above, interest-rate determination can be properly described in terms of sets of objectives and constraints, on the action of the monetary authorities, which have different weights both among the various countries and for a specific country at different times.

Having settled this, it must nevertheless be emphasized that interest-rate policy is in *any case* also constrained by the level of the real wage, irrespective of any awareness by this or that monetary authority of the presence of such a constraint and of any given interest-rate policy having actually been acted upon by it. To acknowledge that the real wage constitutes the residual variable in the relation between profits and wages is not to concede that the real wage may move to any level whatsoever. In the presence of independent factors, such as increasing normal profits of enterprise and top-management remunerations, which keep on pushing up the price level/money wage ratio in the economy, beyond certain limits, which will vary from one situation to another, a compensatory effect will have to be sought in the level of interest rates.¹⁷ This point is fully consistent with the classical and Marxian tradition, which correctly tends to regard as a self-evident fact that in any given set of social and historical conditions

the real wage cannot be lower than the cost that must be incurred to endow the process of production a minimum of workers' sanction to continue in an orderly manner. Within the framework of interest-rate determination here defended, this translates precisely into the fact that the level of the real wage, owing to its 'cost' or 'necessary' component (see Pivetti 1999), constitutes in any case an important constraint on the freedom of monetary policy to establish the level of interest rates.

As hinted on page 89 above, "the respective powers of the combatants" (Marx 1898, p. 402) are strictly intertwined with the policy objectives and constraints to which interest-rate policy decisions are subjected. Consider, for example, a country that adheres to a fixed exchange-rate regime *cum* financial liberalization, and is compelled by it to stick to a comparatively dear-money policy. Concern would then mount over time over the impact of dear money on domestic costs and the competitiveness of domestic products. This, in turn, would put pressure on wage earners to restrain wage demands so that cheap labour could compensate for dear money. At the same time, the high cost of servicing the government debt would put pressure on budgetary policy, with the formation of primary surpluses tending to be pursued to service the debt and check its rise. Now, it is difficult to conceive that such a series of events – from the abolition of restrictions on capital movements to the high interest policy and the budgetary stringencies – could come about and be allowed to persist, unless wage earners of the countries concerned happened to find themselves in an increasingly weak position. Wage earners, by contrast, would be in a relatively strong position if, in the face of rising money wages and increases in the price level, objectives and constraints of a non-directly distributional character compelled the monetary authorities not to raise nominal interest rates. In such a situation, distribution would tend to change in favour of wages. This because competition among firms within each industry causes the rate of profit to adapt to the *real* rate of interest; it is in fact the latter, not the nominal rate, which constitutes the actual opportunity cost of any capital, be it borrowed or not, invested in production.¹⁸

There can be no doubt that from the end of WWII up to the end of the 1970s, both in the US and the other major capitalist countries, cheap money did constitute a decisive ingredient of an overall expansionary policy stance which brought about what came to be termed the golden age of capitalism. Let us here recall that, still reflecting the spirit of the Employment Act of 1946, in the United States the Humphrey-Hawkins Act re-established as late as 1978 the principle that monetary policy had to be conducted "so as

to promote effectively the goals of full employment, stable prices, and moderate long-term interest rates". With real long-term interest rates maintained on average throughout advanced capitalism well below growth rates, the rise in public debt to GDP ratios was checked even in the presence of large primary deficits, which in turn could keep on sustaining growth. "Moderate long-term interest rates" and comparatively low public debts to GDP ratios also contributed to containing over those 3 decades the share of interest payments in national incomes, thus helping to ensure overall distributive conditions especially favourable to long-run growth.

A ZERO INTEREST-RATE POLICY?

But if cheap money is good, couldn't capitalism work even better with a zero long-term real interest rate? Is a situation of persistent zero real interest conceivable?

One may dismiss as quite irrelevant the question of the impact of a zero real interest-rate policy on savings. Outside a neoclassical way of reasoning, persistent zero real interest would not have to exert any significant negative effect on the propensity to save; by itself, it would certainly not induce to spend on consumption the entire national income at any given level of employment. Through a possible higher value of the multiplier, *ceteris paribus* zero interest might actually leave the supply of savings unaltered, or even increase it owing to higher equilibrium levels of employment. The relevant question then is that of its impact on the inducement to invest and on the accumulation of capital.

With a persistent zero long-term real interest rate, the pure remuneration of capital would be nil, together with the price for the use of capital and the opportunity cost of any capital employed in production. Through the competition among firms within each industry, the normal rate of return on capital employed in production would therefore necessarily be lower and the real wage correspondingly higher. Provided it is this normal rate of return which constitutes the fundamental regulator of capitalist accumulation – since when some new capacity is being installed, the investor naturally expects that it will be operated at normal levels¹⁹ - then the impact of a zero interest-rate policy on accumulation should ultimately be negative, unless the 'void' left by the long-term rate of interest was filled by some other element, or component part, of normal profit.

In the light of the recent experience of advanced capitalism, one might be led to believe that the 'void' left in normal profit margins by the long-term rate of interest could perhaps be filled by some rate of return on

speculative financial investment, i.e. by persistently higher stock prices/earnings ratios which would thus become the new opportunity cost of capital employed in production. But differently from investment in long-term fixed interest securities substantially devoid of risk (governments usually pay back their debts), speculative financial investment *is* normally risky. So that some substitution of the rate to be obtained on speculative financial investment for the long-term rate of interest might take place, but arguably only as a temporary phenomenon, as a result of exceptional conditions such as those brought about by *generalized* policies of *continuous* lowering of interest rates, which couldn't however persist indefinitely: as long-term interest rates approached zero, stock prices would eventually fall – the 'bubble' would burst – because of rising expectations of a general rise in interest rates.²⁰

The relevant point here is, in my view, that under capitalism private ownership of wealth, as distinct from ownership of productive capital, cannot permanently cease to yield an income, independently of the forms of its employment. Nor can the bulk of that income be permanently ensured by speculation and capital gains. In the context of a permanent zero interest-rate policy, mere private ownership of wealth would cease to be a sinecure, the credit system would collapse and capital income could continue to exist only as profits of enterprise. The net output or surplus of the economy would thus accrue to labour, but for the remuneration of the risks incurred in the various productive employment of wealth. A state of "euthanasia of the rentier" – that is, practically our having got out of capitalism – would thus have been achieved simply through monetary policy, without any social revolution.²¹

Modern Keynesian economists do not seem to grasp this point. Some of them actually view a zero real interest policy as the best possible monetary policy in that it would be 'neutral' with respect to income distribution: by ceasing to favour the wealthy, it is argued, "zero real interest would hurt rentiers and help borrowers with low incomes and a higher propensity to consume" (Altesoglu & Smithin 2006; see also Smithin 2004 and 2007). Others, while substantially sharing this view, point out however that in case of deflation zero real interest would require a policy of *negative* nominal interest rates, which beyond certain very low levels would cause financial disintermediation and create financial instability (cf. Pressman 2019, also Palley 2019).²² In sum, within the Keynesian tradition, a persistent zero real interest context tends to be viewed as perfectly compatible with capitalism, but for its financial shortcomings in situations of significant price deflation.

All in all, the idea of a possible persistent zero real interest-rate can be regarded as a component part of an awkward imaginative effort to cope with stagnation, brought about by the deep changes in overall distributive conditions that advanced capitalism as a whole has experienced over the last few decades, without resorting to 'big government', i.e. without giving up public budget austerity and the privatization drive. It belongs, in other words, with the same family as massive bank bailouts, monstrous 'quantitative easing' interventions and eventual pathetic monetizations of private consumption spending through various forms of alms, such as 'basic income' injections or miserable 'helicopter money' policies.

THE STATUS OF THE CENTRAL BANK AND CAPITAL CONTROL

Let us conclude this article by pointing out the implications of our arguments on the effects of interest-rate policy for the status of the central bank. The absurdity of the dominant tenet nowadays that central banks must be politically independent stems precisely from the relevance of the rate of interest and its changes for income distribution and aggregate demand, for the balance of payments and the exchange rate, for the public budget and government fiscal operations. Being such a crucial component of any government *general* economic policy, interest rate determination cannot be disposed of by a single self-contained body which pursues its own independent objectives. As a matter of fact, this was long the dominant view and the convenience of a subordinate position of the central bank vis-à-vis the central government was extensively dealt with in widely circulated official documents, such as the Radcliffe report on the working of the monetary system at the end of the 1950s (1959, paras. 660-675). Especially explicit and lucid was the dissociation by the authors of that influential report from the view "that the public interest requires that the central bank should be assured complete independence from political influence":

We do not share this view [...] because it seems to us that it either contemplates two separate and independent agencies of government of which each is capable of initiating and pursuing its own conception of what economic policy requires or else assumes that the true objective of central bank is one single and unvarying purpose, the stability of the currency and the exchanges. The first alternative would, we think, be out of harmony with the general conceptions of responsible government that prevail in this country, even if it were not to prove stultifying in itself; the second, while it rightly stresses that this stability is the special

and continuing concern of any central bank, ties such a bank down to a single objective which is both too limited in scope and at the same time incapable of achievement without concurrent action on the part of the central Government.

It follows that [the central Government's] economic policy, whatever form it may take from time to time, must include the general planning of monetary policy and monetary operations and that the policies to be pursued by the central bank must be from first to last in harmony with those avowed and defended by Ministers of the Crown responsible to Parliament (pp. 273-4).

Concepts such as these remained dominant up until the end of the 1970s and major monetary policy decisions continued to fall within the orbit of general economic policy - whatever form this took from time to time - with the government of the day bearing full responsibility for them. But acknowledging that interest-rate decisions are a crucial component of general economic policy, while, on the one hand, led to the view that conferring political independence on the central bank was an unreasonable step, on the other rendered unacceptable any giving up of a government's capability to retain a fair amount of control on the level of domestic interest rates. It is here that the question of capital control entered forcibly into the picture: if interest rate decisions were a crucial aspect of general economic policy, then any deliberate step towards losing national control over the level of the domestic rate of interest was to be seen as an ill course of policy action, no less than endowing the central bank with a politically independent power of decision on it.

In fact, already in 1942, at the very eve of the Bretton Woods settlement, Keynes wrote in a letter to Harrod on the forthcoming conversations with the Americans on post-war planning:

In my view the whole management of the domestic economy depends upon being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world. Capital control is a corollary to this [...] my own belief is that the Americans will be wise in their own interest to accept this conception (Keynes 1942, p. 147).

And he kept stressing the same conception in 1943 and 1944:

It is not merely a question of curbing exchange speculation and movements of hot money, or even of avoiding flights of capital due to political motives; though all this is necessary to control. The need, in my judgement, is more fundamental. Unless the aggregate of the new investments which individuals are free to make overseas is kept within

the amount which our favourable trade balance is capable of looking after, we lose control over the domestic rate of interest (Keynes 1943, p. 275).

We intend to retain control of our domestic rate of interest, so that we can keep it as low as suits our own purposes, without interference from the ebb and flow of international capital movements or flights of hot money [...] whilst we intend to prevent inflation at home, we will not accept deflation at the dictate of influences from outside. In other words, we abjure the instrument of Bank rate and credit restrictions operating through the increase of unemployment as a means of forcing our domestic economy into line with external factors (Keynes 1944, p.16).

The view of the rate of interest that emerges from these passages is clearly that of a policy determined variable, which, as a crucial component of general economic policy, the government of each country should endeavour to keep as much as possible under its control. Hence the primacy eventually given in the Bretton Woods settlement to national macroeconomic autonomy, with the explicit right accorded to every member government to control all capital movements.²³ It is well known how far we have moved from all this over the last 40 years. Indeed, most economists, especially in Europe, have ended up regarding any loss of policy autonomy on the part of national governments with undiluted favour. Full capital mobility, in particular, has come to be viewed as an irreplaceable source of discipline, or non-discretion, in the conduct of economic policy, as it impedes deficit financing at low interest rates and stands in the way of capital taxation.

It is obviously to be wished that throughout Europe economic policy will soon return to draw its chief inspiration from the experience of the 30-year period that followed WWII, when the commitment to high employment by the major nations was accompanied by their reiterated efforts to retain sovereignty in monetary policy.

NOTES

- 1 Think of Wicksell's monetary theory and of the entire inflation targeting framework inspired by it (cf. on this Pivetti 2010).
- 2 This of course raises the question that if inflation was actually neutral with respect to the level and composition of output, then such an overriding importance attached by the neoclassical tradition to price stability or low and stable inflation would be somewhat difficult to swallow. As has been observed, "After all, if all the central bank can control is the price level in the long run, and if the rate at which the price level increases has no implications for the

level of real economic activity, then one inflation rate is just as good in welfare terms as another. There is no reason to prefer a steady-state inflation rate of 2 percent over one, say, of 20 percent” (Wynne 2008, p. 222).

- 3 Pierangelo Garegnani was the first to point out, in the light of the neoclassical synthesis, that “the idea of an investment demand schedule constitutes an obstacle which a monetary theory of interest cannot easily overcome” (1979, p. 78; Garegnani’s article was first published in Italian in 1964-65).
- 4 On the interest-profit connection in economic theory, see Pivetti 1991, Part II.
- 5 According to F. Hahn (1985, p. 909), Joan Robinson’s best work, together with her other contributions to monetary economics contained in *The Rate of Interest and Other Essays* (1952)
- 6 On Joan Robinson’s change of view on the rate of interest, cf. Pivetti 1996.
- 7 “The rate of interest, though *ultimately* and *permanently* determined by the rate of profit, is however subject to *temporary* variations from other causes” Ricardo 1821, p. 297, italics added).
- 8 According to data of the US Bureau of Economic Analysis, the consumption of fixed capital in percentage of the price per unit of output was 15% on average in 1951-1980, against more than 20% over the last 40 years. Arguably, the phenomenon of a shortening life of capital equipment was linked to the diffusion of ICT technologies and the connected increase in the relative weight of the services producing sector. On the connection between ICT investment and the enlargement of the service sector, see Barba and Pivetti 2012, pp.130 and 133.
- 9 According to Piketty and Saez, social, fiscal and union pressure to contain a fast growth of top compensations would have been significantly reduced over the past few decades, which would have greatly enhanced the top managers’ capability to increase their own compensations (see Piketty and Saez 2003, pp. 34-5; see also Piketty 2013, pp. 524-29).
- 10 The epoch-making policy shift away from full employment that took place at the end of the 1970s reduced the incentive to invest throughout advanced capitalism, lowering the rate of growth of fixed capital formation to less than half what it had been in the 30-year period following WWII. The point is that a reduction of the incentive to invest is one and the same thing as an increase of the risk of productively employing capital, that must perforce result in a rise of the normal component of profit necessary to remunerate it. As to the increased weight of the financial sector, it is widely acknowledged to have increased the share of business profit in total value added, as well as the ratio of total value added to money wages.
- 11 Over the second half of the 1990s, a slight upward trend in real wages did actually take place in the USA, parallel to the decline in interest rates (see Joint Economic Committee 2003, p. 16; Juhn *et al.* 2002; Michel *et al.* 2003).
- 12 It can be said that the chief limits of the Keynesian analysis of employment derive precisely from the role that he assigns to the rate of interest in the

determination of activity levels. In fact, on the basis of his 'marginal efficiency of capital' schedule, all the shortcomings of the system would ultimately be due to the presence in it of obstacles, of an essentially monetary nature, that make it difficult to bring and keep the rate of interest on long-term loans at its full-employment level. All the disasters of unemployment, in other words, would boil down to an insufficient downward flexibility of the rate of interest (see on this also Robinson 1942, p. 56).

- 13 Empirical work on firms' pricing behavior has given robust evidence of the fact that interest rates are regarded as a cost, with the corollary that they look to establish a price rise in response to increased interest rates. In the words of an old chairman of the US Joint Economic Committee, "raising interest rates to fight inflation is like throwing gasoline on fire" (W. Patman, quoted in Seelig 1974, p. 1049; see also Patman 1957, p. 134).
- 14 This overall picture appears to be supported by empirical evidence, which seems to show that when so-called inflation targeting policies succeeded in lowering inflation, they did so by also causing slower growth and higher unemployment (see Laidler and Robson 1993, Fortin 1996, Debelle 1997, Akerlof *et al.* 2002, Bodkin and Neder 2003, Ball 2005).
- 15 See on this Pivetti 2004, pp. 234-7.
- 16 Declining interest rates succeeded in containing over several years the share of disposable personal income of indebted households required to service the increasing outstanding stock of their debts, thus significantly protracting the macroeconomic sustainability of a massive process of substitution of loans for wages (see Barba and Pivetti 2009, pp. 127-29).
- 17 An interesting case in point could be that of the post-1995 US policy of progressive lowering of interest rates. That policy might have been dictated *also* by a real wage constraint, although its primary objective was most likely that of delaying for as long as possible the *redde rationem* of recourse to household debt as the chief demand management tool (cf. the previous footnote).
- 18 On real vs nominal interest within the framework of the monetary theory of distribution, see Pivetti 1990 (with the attached comments and replies); Pivetti 1991, ch. 6; Stirati 2001, pp. 430-9.
- 19 See, on this, Pivetti 2015, sect. 7.
- 20 Over the last 3 decades, the true alternative to the productive employment of capital may actually have ceased to be investment in long-term riskless fixed-interest securities, and may have become speculative financial investment – an alternative certainly more risky but *significantly* less risky than it used to be, precisely owing to a long-run policy of decreasing interest rates. Alternatively, the reduced risk of speculative financial investment might have simply contributed to increasing in each production sphere the component part of normal profit necessary to remunerate the risk of productively employing capital (see note 10 above, on the rise over the last few decades of this component part of normal profits).

- 21 In Marxian terms, permanent zero real interest would imply that in the first phase of the circuit $M - C - M'$, M could never be anticipated by someone who was not himself the operating capitalist. For all those who did not intend to transform their money into productive capital, themselves, hoarding would obviously be the best choice: “[t]he miser’s plan would be far simpler and surer; he sticks to his 100 pound sterling instead of exposing it to the dangers of circulation” (Marx 1887, p. 147). After having observed that a large part of social capital is not employed by its actual owners, Marx points out that with the development of loan capital “[t]he last illusion of the capitalist system, that capital is the fruit of one’s own labour and savings, is destroyed. Not only does profit consist in the appropriation of other people’s labour, but the capital with which the labour of others is set in motion and exploited consists of other people’s property, which the money capitalist places at the disposal of the industrial capitalists, and for which he in turn exploits the latter” (Marx 1894, p. 496). He finally emphasizes that “as long as the capitalist mode of production continues to exist, interest-bearing capital, as one of its forms, also continues to exist and constitutes in fact the basis of its credit system. Only that sensational writer, Proudhon [...] was capable of dreaming of a *crédit gratuit*, this monster which was supposed to realise the pious wish of small capitalist production” (*ibid.*, p. 594).
- 22 Pressman, for example, argues that with a negative nominal rate beyond -0.7% financial institutions would experience large withdrawals: “we have a lower bound of interest rates which is *not* zero; but some small negative number due to the carrying costs associated with holding cash and a desire to ensure one’s assets” (2019, p. 149).
- 23 In addition to according to every member government the explicit right to control all capital movements, Article VI of the IMF Agreement contemplated even the possibility of *requiring* member countries using the resources of the Fund to exercise the control of the outflow of capital: “If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the general resources of the Fund” (from Article VI, Section I, of the Agreement). Keynes could thus declare in the House of Lords that what in the pre-war system “used to be a heresy”, in the field of international capital movements, “is now endorsed as orthodox” (Keynes 1944, p. 17).

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