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Monetary policy and income distribution: an introduction

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This issue of the *Bulletin of Political Economy* focuses on two related subjects. The first is a criticism of the Wicksellian view of the modern theory of central banking according to which the benchmark rate of monetary policy is a natural rate of interest determined by "productivity and thrift." The second concerns whether a norm, and what kind of norm, should be followed by central banks when abandoning a Wicksellian approach. Rochon and Setterfield (2007) popularise this norm as the 'park it' approach of the monetary policy where the interest rates set by central banks should pursue fair distribution effects rather than counter-cyclical objectives. Of these proposals, Pasinetti's idea of a fair rate of interest, the Smithin rule of low *real* interest rates and the Kansas City rule of a zero *nominal* interest rate are worthy of mention. Similarly, Aspromourgos (2011), echoing Keynes's support for a permanent 'cheap money' policy, advocates a very low riskless *real* interest rate ranging from 0.25 to 0.50 per cent.

Pasinetti's idea of a fair interest rate is analysed in Bellino's and Lavoie&Seccareccia's papers. Bellino provides a concise exposition of Pasinetti's notion of the 'natural rate of interest' and emphasises its normative nature. According to Pasinetti, it should be the rate that allows debt and credit relations between individuals not to alter a distribution of national income based on the 'labour principle - that is, income distribution where each worker receives a remuneration in proportion to the quantity of labour he has provided.

To find this norm for the interest rate, Pasinetti starts from a natural system where each commodity is produced only by labour, there is full employment, savings or dissavings cannot occur at the macroeconomic level and the 'labour principle' of income distribution holds.[1] In these conditions, if, for instance, technical progress occurs in the vertically

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integrated sector of commodity *h* and one person lends (the equivalent of) one unit of commodity *h* but receives, after one period, (the equivalent of) one unit of commodity *h*, he will receive a commodity that incorporates a quantity of labour that is *lower* than that incorporated in the unit of commodity that was lent. Therefore, the loan will entail a 're-distribution' of income, that is, a deviation from the labour principle of income distribution. Bellino shows that to re-establish this principle, an interest rate should be paid for the loan which may vary according to the price numeraire in terms of which debt and credit relations are expressed. If it is the dynamic standard commodity that assures price stability,[2] the rate will be equal to the average growth rate of labour productivity whereas if prices are expressed in terms of a nominal unit of account, a certain percentage must be added for each nominal unit of account lent in order to offset its nominal depreciation. The natural rate of interest must thus be equal to the sum of the rate of inflation and the average rate of change of labour productivity.

While Bellino stresses that Pasinetti put forward his idea of a fair rate of interest based on a pure labour economic system, Lavoie and Seccareccia also apply Pasinetti's idea to a capitalist system arguing that it can serve as an alternative framework to guide monetary policy when its main concern is to ensure income-distributional neutrality in the long term. They admit that Pasinetti, when passing on to his "natural system" with capital goods, realised that, due to capital mobility amoung sectors, it is very unlikely that a capitalist economy will entertain its conditions of different "natural rates of profits" equal to the growth rate of demand of each sector and prices that are proportional to labour values.[3] Nevertheless, they stress that Pasinetti still maintained that, in the financial sphere, the monetary authorities should do their best to ensure that 'each creditor will receive, at maturity, an amount of purchasing power, in terms of labour, which is exactly equal to the amount originally lent' (Pasinetti, 1981: 169 and 174). Following this idea, they thus argue that central banks should set the *nominal* interest rate equal to the sum of price inflation and the growth rate of overall productivity. Under the assumption that nominal wages will rise at a rate equal to this sum, by paying this nominal interest rate, the borrower will have to reimburse an amount of money whose purchasing power in *labour-time* remains constant for the lender.

Two further points must be stressed about Lavoie and Seccareccia's proposal. The first is that they refute the idea of a tendency towards a uniform rate of profits. They do this for purely "Kaleckian reasons" due to the pervasiveness of monopoly and oligopoly, as well as on the basis of the

post-Keynesian theory of the corporate firm which says that markups set by firms depend on the growth rate of the firm (see, for instance, Eichner, 1983). Moreover, they advocate the analysis by Seppecher *et al.* (2018) that in the long run relative prices "gravitate" around their "natural values", that is, around the ratio of the quantities of labour directly, indirectly, and hyper-indirectly required for goods production in each sector. This seems to suggest that, according to Lavoie and Seccareccia, actual capitalist economies would, to some extent, resemble the conditions of Pasinetti's natural system even if they deny that their proposal needs any equality on average of prices to Pasinetti's "natural prices."

Second, unlike Lavoie and Seccareccia (1999) where they assumed that real wages grow in line with labour productivity, they now point out that this may not occur because the share of profits in national income ought to change when the capital-output ratio changes and the rate of profits is "constrained" by the Cambridge equation. Therefore, they modify their original proposal by referring the "fair" rate of interest to a measure of the growth rate of real wages. So, taking inflation into account, the nominal fair rate of interest ought to be simply equal to the growth rate of the nominal wage rate. In terms of the relations between borrowers and lenders, nothing would change according to Lavoie and Seccareccia, even if the "labour principle" seems to be distorted: the lenders would still receive back an amount of money whose purchasing power *in labour-time* has remained constant. On the contrary, their income *in labour time* will increase at the expense of borrowers if the nominal interest rate is higher than the growth rate of money wages.

Against the "Kansas City rule" of a zero interest rate, Lavoie and Seccareccia state that their proposal has the advantage that the nominal rate of interest will rise in an inflationary environment avoiding the risk of speculative bubbles on the stock market as in the case of a nominal overnight interest rate that remains at zero even when the economy is booming.Moreover, against the criticism of Smithin (2014) and Aspromourgos (2011) that their proposal is not "fair" because it assures a share of an increase in productivity growth to accumulated financial capital, Lavoie and Seccareccia agree with Rochon and Setterfield (2008: 20) that 'the difference between the Smithin and the Pasinetti rules amounts to no more than the choice of the numeraire (the general price level versus the nominal wage) used to measure the "real purchasing power" of rentiers' and therefore to a choice between two concepts of what constitutes fairness. Lavoie and Seccareccia also stress that their proposal has the advantage of providing a precise indication

for what must be the real rate of interest and for what reason.

However, the ”fairness” of their proposal can be disputed when we abandon Pasinetti’s world of workers lending to other workers and we consider the reality of capitalism where the “labour principle” does not hold, loans are provided by banks financed by the central bank and savings mainly stem from the level of activity and appropriation of the surplus product by the owners of the means of production rather than from a “sacrifice” in postponing consumption. In this case, if a ‘park it’ approach is to be followed, it would seem that it ought to minimise the earnings of accumulated financial capital.[4]

Still, the “fairness” of Lavoie and Seccareccia’s proposal and its advantage over other approaches seems to be disputable even when considering the relation with the rate of profits. They assume that central banks have the power to set the real long term rate of interest but that, by doing so, they do not affect the rate of profits. If this is so, let us assume that productivity growth is zero, the rate of capital accumulation is positive, and the rate of profits is set according to the Cambridge equation as they seem to suggest in various points of their paper. Their rule would imply a zero *real* interest rate that is lower than the rate of profits. Why would this situation not lead to bubbles like the Kansas City rule they criticise? On the other hand, let us assume that there is a relation between these two rates and that the casual relationship goes from the rate of interest set by the monetary authorities to the rate of profits as Lavoie and Seccareccia himself suggested in other works (see Lavoie and Seccareccia, 2004). With zero productivity growth, their proposal would imply that profit rates are equal to the normal profits of enterprise, whereas, when passing to a positive growth rate in productivity, there would be a positive *real* interest rate. Since this rise in the interest rate would lead to *a fall* in the share of wages in national income, in what sense would their proposal be “fair” and protect workers’ savings? Moreover, since a change in income distribution would affect the level of output, why should the norm followed by the central bank be set independently of its macroeconomic effects and other objectives?

In their contribution to this issue, Lavoie and Seccareccia deny, however, that there is a tendency of the rate of profit in each sector to be equal to the long-term rate of interest plus an independent and stable normal profit of enterprise. This tendency is at the core of Pivetti’s contribution. He starts with Keynes’s idea that the interest rate is a monetary phenomenon and stresses its incompatibility with the so-called Keynesian theory of distribution unless the long-run connection between the rate of interest and the rate of

profit is denied. He also stresses that this connection was advanced by Keynes who stated that ‘‘it is the rate of interest which determines the marginal efficiency of capital” (Keynes, 1937: pp. 222-3). According to Pivetti this determination passes through prices tending towards the normal costs of production, with the rate of interest as a policy variable which, given production techniques, contributes to governing the ratio of prices to money wages.

Two points of Pivetti’s paper are especially worth noting. First, he advances an explanation of the tendency of distribution over the last decades when the long-term interest rates on riskless bonds fell but there was a shift in distribution towards profits. Pivetti reminds us 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” (Pivetti, 2019: p.172). Focusing on the US case, he emphasises that the shortening over the last decades of the average life of equipment has brought about an increase in depreciation allowances per unit of capital, whereas social changes connected with the acceptability of very high compensations have resulted in an increase in top-management remunerations (see also Stirati, 2013). Finally, according to Pivetti, profits of enterprise increased for a general weakening of the incentives to invest throughout the economy and the increasing relative weight of the financial sector. Pivetti also advances some reasons that impinged on a monetary policy of low interest rates. He mentions the need to avoid a fall in real wages below the subsistence level in the presence of increasing gross profit margins and the need to expand household debt in order to sustain consumption. Moreover, he mentions the consideration made by the central bank that the living conditions of an elderly population are increasingly exposed to the behaviour of the stock market.

Second, Pivetti discusses the proposal of Smithin and others to set the long-term *real* interest rate to zero. In his opinion, the problem of this proposal does not reside in a negative effect of it on savings, because, outside a neoclassical way of reasoning, persistent zero real interest may even lead to increased savings if the equilibrium levels of employment are higher due to a higher value of the Keynesian multiplier and autonomous components of aggregate demand. The relevant question is its possible impact on capital accumulation. With a persistent zero long-term real interest rate, the pure remuneration of capital would be nil and therefore the normal rate of return which constitutes the fundamental regulator of capitalist accumulation would

be lower. This would have a negative effect on accumulation unless "the 'void' left by the long-term rate of interest" is "filled by some other element, or component part, of normal profit"(Pivetti, 2019: p.178). In light of the recent experience of capitalism, Pivetti suggests that this "void" has perhaps been filled by some rate of return on *speculative* financial investment which would have thus become the new opportunity cost of capital employed in production. However, he contends that this investment is risky and therefore this substitution may take place only as a result of exceptional conditions such as those brought about by *generalised* policies of *continuous* lowering of interest rates.

Some of these suggestions by Pivetti need to be investigated further – especially those concerning the effect of lower profit rates on capital accumulation, the reasons behind low interest rate policies[5] and the idea that the ratios of stock prices relative to earnings have become the new opportunity cost of capital.[6] Pivetti's conclusion is that under capitalism private ownership of wealth cannot permanently cease to yield an income and that continuous zero real interest rates may cause the credit system to collapse. Paradoxically, in this case, the surplus product of the economy would accrue to labour if it were not for the remuneration of the risks incurred in the various productive employment of wealth.Therefore, one would have got out of capitalism through monetary policy without any social revolution. According to Pivetti, this is a point which is not grasped by modern Keynesian economists who see a zero real interest policy as the best possible "neutral" monetary policy. If this seems nowadays to be achieved in practice, it is because it is "a component part of an awkward imaginative effort to cope with stagnation" in advanced capitalism without "giving up public budget austerity" and the process of privatisation and liberalisation (Pivetti, 2019: p.179).

Some of the characteristics of advanced capitalism in the last decades are at the centre of Qanas&Sawyer's contribution which focuses on the process of financialisation and the related changes in the ways in which the banking sector operates including the growth of shadow banking and securitisation that led to deeper linkages between the major banks and non-bank financial firms and therefore to higher systemic risk.Qanas&Sawyer analyse how these developments have impacted on the transmission mechanisms of monetary policy and changed the objectives and role of central banks which begun to act not only as a 'lender of last resort' but also as a 'dealer of last resort' in order to protect the borrowing and lending circuits that support derivative and repurchase-agreement positions

(Mehrling 2012). They also show that the analytic framework of the 'new consensus in macroeconomics' does not provide a realistic representation of the financialised economy. To face the consequences of increasing economic instability, central banks should urgently rewrite the "rules of game" applying credit controls in order to govern the link between the issuer of the credit and the securitising system. Moreover, coordinated monetary and fiscal policies favouring an increase in government expenditure and a low cost of the service of public debt should change market expectations, thus improving the state of confidence of households, firms and banks by reducing solvency and liquidity risks in the economy.

NOTES

1. This natural system has nothing to do with Ricardo's attempt to attain a materialistic explanation of profits by means of the labour theory of value. It is a very peculiar system where there is no capital also because wages are paid post factum and the interdependency among sectors is provided only by the fact that workers consume a bundle of commodities. For a more general discussion of Pasinetti's natural systems with capital goods, see Schefold (1982).
2. However, Bellino seems to recognise that the idea of "price stability" may be ambiguous in the presence of a change over time of the dynamic standard commodity itself.
3. It should be acknowledged that capital would move from lower profit rate sectors to higher profit rate sectors. This does not occur in Pasinetti's system under the assumption that all investments in each vertically integrated sector are paid for and funded only by the profit rates of each specific sector, which are precisely equal to the desired increased of productive capacity of the different sectors as shaped by the increase in the final demand for the consumption goods produced by each sector.This seems to imply that there is no lending or borrowing by producers and that interest rates would have solely to do with personal consumption loans.
4. According to Lavoie and Seccareccia (2019: pp.160-1), accumulated financial capital is to be reproached only when arising from "past financial misdemeanours and criminal actions" and rich wealth-holders "do not rely so much on interest-bearing assets to sustain or increase their large portfolio. Rather, much of this financial wealth is in the form of group pension wealth that goes towards supporting broad classes of retired workers."
5. For instance, further analysis should be provided showing that the shift to a policy of low interest rates was influenced by the need to guarantee a subsistence wage for the majority of the population rather than to sustain effective demand after the collapse of the high-tech bubble at the end of the 1990s.

6. While lower than in the 1980s and 1990s, the average *real* long term interest rates on riskless bonds have not approached zero in the United States over the last decades but have oscillated around positive values which are similar to those in the 1950-80 period.

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