Panel Discussion:

"The Distributional Implications of the Crisis and Policy Responses"

Introductory Comments by

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The topic to be discussed by this panel[1] is essentially the topic of this whole conference. What are the implications, for the distribution of income and wealth, of the monetary policies that have been followed in response to the crisis[2]? In turn, what might be the implications of these redistributions for the transmission mechanism of monetary policy? Let me make a few introductory remarks to put this focus on distributional issues into a somewhat broader context.

The first point is that the conduct of monetary policy over the last few years is totally unprecedented. Efforts have been made to influence all parts of the term structure of interest rates and credit spreads as well. Policy rates have been reduced essentially to zero. Forward guidance has also been used to influence medium term rates, while quantitative (and qualitative) easing have been used to affect rates at longer maturities. Initially the objective of easing monetary policy was to restore the functioning of financial markets after they seized up in the aftermath of the bankruptcy of Lehman Brothers. This objective was in fact successfully achieved.

Subsequently, however, the objective has been to stimulate nominal demand. One suggested channel has been stronger spending (in real terms) by both consumers and corporations, and by foreigners in response to associated exchange rate depreciation. Another suggested channel would be an impact on prices, either via exchange rate depreciation or through a direct effect on inflationary expectations. This suggests two questions. First, will this objective be successfully achieved? Second, what might be the side effects of these monetary policies, anticipated or (more likely) unanticipated?

Concerning the first question, there must be some doubts. In most advanced countries the recovery of the real economy has been unusually weak. Moreover, disinflationary pressures have been maintained to a degree that threatens outright deflation in many countries. Both economic history and the history of economic thought should have alerted us to this possibility. There are now many historical studies indicating that “busts” following credit “booms”, particularly if the financial sector has been weakened, tend to be

[1] Panel members were Martin Hellwig, Luc Laeven, Klaas Knot and Pier Giorgio Allesandri

[2] I am personally pleased that more attention is being paid to the unanticipated side effects of the monetary policies followed by the major central banks since the crisis began. In 2012, I wrote a paper called “Ultra Easy Monetary Policy and the Law of Unintended Consequences” which was published first by the Globalisation and Monetary Policy Institute (Working Paper 126) of the Federal Reserve Bank of Dallas. It is available on their website and also at www.williamwhite.ca

deep and long lasting. As for theory, Keynes himself warned in the General Theory "If, however, we are tempted to assert that money is the drink that stimulates the system to activity, we must remind ourselves that there may be several slips between the cup and the lip." This amounted to a repudiation of the policy advice he had given earlier on in the Treatise; namely, to rely on monetary policy as we are doing today.

As discussed in a number of the papers presented earlier in this conference, one important aspect of the transmission mechanism of monetary policy is to bring forward spending that might have been left until later. Of course, by its very nature, this implies slower demand growth later on. The manifestation of this process is an accumulation of debt, which constrains future spending. In fact, debt levels have been rising for decades in the advanced market economies and have recently increased sharply in the emerging market economies as well. Indeed, the McKinsey Global Institute has documented that global debt as a percentage of GDP was almost twenty percentage point higher in 2014 than it had been at the onset of the crisis in 2007. This would seem to indicate that our remaining room for manoeuvre on the monetary policy front must now be quite limited.

An intriguing possibility, noted in a number of the papers prepared for this conference, is that easy monetary policies might affect the distribution of income and wealth and that this might influence the transmission mechanism of monetary policy. For example, low interest rates favour debtors and disfavour creditors. If debtors have a higher marginal propensity to consume out of the flows of interest income, then aggregate spending should increase. However, lower aggregate spending could also be envisaged. For example, it could be argued that asset price increases favour the rich, whose marginal propensity to consume out of such gains is relatively small. Similarly, those saving for a pension might actually have to save more if the accrual rate falls. The overall effect of the redistributive channel will likely have to be determined empirically, and might well differ from country to country. What is important is that this conference has drawn attention to an issue which has been long neglected.

Concerning the second question, a long list of economists have pointed to the possible, undesired side effects of monetary stimulus. As far back as the end of the 19th century, Wicksell warned that a gap between the natural rate and the (lower) financial rate would cause inflation. Hayek in the1930's worried about “malinvestments” that would distort the structure of production and end in a crisis. Minsky subsequently warned that “stability breeds instability” as credit fuelled spending became steadily more speculative. Koo, in the aftermath of the Japanese bubble, drew attention to the possibility that corporate indebtedness could become so heavy as to lead to a “balance sheet recession”. And, in recent years, the BIS has identified a whole host of “imbalances”, some domestic and some international, that could end in the same destructive fashion. Finally, echoing some earlier work by Peter Bernholz, Charles Goodhart yesterday reminded us how easy money could contribute to the problem of fiscal dominance and an eventual resurgence of high inflation. With central banks having bought in all the longer term government securities and replaced them with notice deposits, what will be the implications for debt service when interest rates have to rise again. Perhaps continued “financial repression” will be the only way out.

The distributional implications of easy money might then be thought of as just another addition to this long list of unintended consequences.

One aspect of this distributional issue has been receiving increasing attention in recent months; namely, the implications for the “independence” of central banks. If central bank policies are seen to have distributional implications, this must attract more political attention since distributional issues are archetypically political. This comes on top of other such threats. Central banks have purchased many assets whose value might fall. Were losses to ensue, the appetite for political oversight might well increase. Further, the growing enthusiasm for the use of macro prudential instruments to complement monetary policy also has dangers. Since both have effects on spending and prices, they cannot be separately assigned to “independent” agencies. At the least, central banks will have to cooperate with other agencies. This conclusion is further strengthened by the recognition that macro prudential instruments are mostly micro prudential instruments being used for a different purpose - the pursuit of systemic stability rather than the good health of individual institutions.

While alluded to above, in the discussion of the transmission mechanism of monetary policy, distributional issues are important for a variety of other reasons as well. First, higher levels of inequality are strongly correlated with a wide variety of social maladies – mental illness, teenage pregnancies, imprisonment, poor education and the like. Second, higher inequality conflicts with our innate sense of fairness. Third, and of growing concern, the rich can use their wealth to compromise the political process. In the end, inequality can become a threat to democracy itself. While no one would suggest that central banks should “target” distributional outcomes, they should at the least be aware of the full implications of their policies.

Finally, it is important to note that the redistributive effects of easy monetary policy can take many forms and that commentators often focus on different issues. For example, there can be redistributions across sectors; from the private sector (creditors) to the public sector (debtors), or between sectors within the private sector (say from households to corporations). Similarly, there can be redistributive effects across countries; say from China to the United States. Note as well possible redistributions from the poor to the rich, from the young to the old, from labour to capital, and from creditors to debtors. Analysis of who gains and who loses is further complicated by the fact that many individuals have financial assets at financial institutions that might be affected differently by the pursuit of easy money policies. Insurance companies and pension funds seem likely to be the most affected. However, how this will affect their clients depends as well on the nature of the contractual arrangements governing their relationships.

In the end, there are only individual people. Everything else is a “veil”, including the government and the corporate sector. The problem, however, is that we do not have data for this level of disaggregation. Thus, in a very profound sense what we can say about the redistributive effects of monetary policy is rather limited. However, to point this out is not to say that we can say nothing at all. We have an excellent panel here today. Let us hear what they have to say.