Routledge
Taylor & Francis Group

Review of Political Economy

ISSN: (Print) (Online) Journal homepage: https://www.tandfonline.com/loi/crpe20

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To cite this article: Philip Arestis & Malcolm Sawyer (2023): Reflections on Aspects of Macroeconomic Policies in the Spirit of Geoff Harcourt, Review of Political Economy, DOI: 10.1080/09538259.2023.2211949

To link to this article: https://doi.org/10.1080/09538259.2023.2211949

Published online: 09 Jun 2023.

REVIEW OF POLITICAL ECONOMY
https://doi.org/10.1080/09538259.2023.2211949

RESEARCH ARTICLE

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Reflections on Aspects of Macroeconomic Policies in the Spirit of Geoff Harcourt

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ABSTRACT

This article opens with some remarks on Geoff Harcourt's thoughts on macroeconomic policies (broadly conceived). This is followed by comments on some recent developments within the scope of fiscal policy. The article moves on to aspects of monetary policy and central banks, with particular reference to the 'independence' of central banks and inflation targeting. There are then relatively brief discussions on three policy areas on which policies pursued by the central banks have some, albeit often limited, impacts, namely, financial stability, inequality, and climate change and environmental damage. The article considers alternative approaches to controlling inflation in view of the failures of the inflation targeting regime (and Geoff's interest in incomes policy).

ARTICLE HISTORY
Received 17 August 2022
Accepted 5 May 2023

KEYWORDS
Geoff Harcourt; fiscal policy; monetary policy; inflation

JEL CODES
E62; E63; E64

1. Introduction

This article reflects on Geoff Harcourt's writings, which appertain to macroeconomic policies (broadly conceived), and discusses some recent macroeconomic policy issues. In Section Two, we briefly review Geoff's writings on macroeconomic policy issues. In Section Three, we comment on some recent developments within the scope of fiscal policy. In a similar vein, the focus of Section Four is on aspects of monetary policy and central banks, with particular reference to the 'independence' of central banks and inflation targeting (IT). The following three sections provide relatively brief discussions on three policy areas on which policies pursued by the central banks have some, albeit often limited, impacts. Hence, Section Five discusses some aspects of financial stability, while Section Six remarks on possible relationships between monetary policy and inequality and then climate change and environmental damage. Section Seven moves on to consider the recent episode of inflation. Finally, Section Eight offers some concluding remarks.

2. Harcourt on Macroeconomics

Harcourt (1992) viewed the purpose of economics to be 'to make the world a better place for ordinary men and women, to produce a more just and equitable society' (p. 9) — a

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rather different perspective on economics than the study of the allocation of resources! He continued by saying that 'all economies have created surpluses in one way or another. Capitalism does it in a particular way … I would like to help to create a society where the surplus is extracted and used in a way quite different from that of a capitalist society' (p. 9).

Harcourt (2001) suggests that there is a need 'to create institutions that can encourage the level of private investment it considers desirable while engaging in the production of a surplus [profits] through its own activities so that it can fulfil its redistributive goals and provide a social wage without having to create ever-increasing deficits' (p. 92). Harcourt (2001) states that:

> the role of government is not a question of the degree but of the nature of this intervention. For example, greater government control over the use of profits, traditionally exercised through fiscal policy, could avoid a fiscal crisis by being exercised through direct government participation in the production of this surplus, that is, direct involvement of government in the production and marketing of goods in profitable industries. (p. 83)

Harcourt (2001) was particularly concerned with establishing full employment of labour and ensuring that would be compatible with low inflation, often by means of the use of some form of incomes policy. He referred to what he termed Salter's rule: 'advocating the setting of nominal income increases according to the rate of increase of effective productivity plus prices, so that equity and efficiency can be achieved' (p. 7). Also, '[i]f the rule is combined with a full employment policy, we may attain a sustainable situation, in the sense that because wage-earners (and others) receive aggregable rises in real incomes, full employment without too much inflation may be achieved for indefinite periods' (p. 7). He also argued that:

> In essence my proposals involved redistribution through the public sector as the *quid pro quo* to the wage earning groups for accepting incomes policies directed at the rate of increase of *money* incomes … Fiscal and monetary measures were to be directed towards the level of economic activity, the rate of growth and the post-tax distribution of income. Nationalisation of certain key industries including financial intermediaries was put back on the agenda for discussion … . (p. 14)

Geoff viewed markets, and particularly financial markets, as rather unstable. He contrasted the mainstream perspective on markets as inherently stable with a general post-Keynesian perspective. He often used the wolf pack analogy:

> The mainstream approach is that akin with a wolf pack running along. If one or more wolves gets ahead or fall behind, powerful forces come into play which return them to the pack. … The other approach has it that the forces acting on the wolves who stray make them get further and further ahead or fall further and further behind at least from long stretches of time. (Harcourt 2010, p. 240)

Harcourt (2010) illustrates these differences by reference to foreign exchange markets, and to financial asset markets, where he supported a financial transactions tax to dampen down speculation. More generally, there was a need for a range of policies to address issues of financial instability. Harcourt's theoretical contributions are well within the post-Keynesian approach. This is obvious from the above analysis of his theoretical views and also in terms of what follows below in this contribution.

3. Some Fiscal Policy Matters

The Kaleckian/post-Keynesian perspective on fiscal policy and budget positions is to aim for the achievement of the full employment of labour, while recognizing the requirements of sufficient productive capacity and, in the right places, to enable non-inflationary full employment and acknowledge the limits of 'fine tuning' (as in our focus on what we termed 'coarse tuning') (Arestis and Sawyer 1998a). This is the focus of Harcourt in terms of his view on and approach to fiscal policy (for example, Harcourt 2007; see, also, Arestis 1997). A significant feature of his approach to fiscal policy was the view that government spending should be determined by medium- to long-term social needs and 'short-term aggregate demand puzzles being tackled by changes in taxation' (Harcourt 2010, p. 244). This combines emphasizing that the purpose of public expenditure should be to serve social need, and that variations in tax rates (and perhaps social transfers) are more readily and speedily applied than variations in public expenditure. Further, variations in meeting social needs are not an appropriate means of seeking to stabilize employment. And, as Arestis (1997) suggested, 'full employment cannot be the only objective of post-Keynesian economic policy. Governments should also strive to promote a more equal distribution of market power and, thus, income and wealth' (p. 431). Our discussion in this section on fiscal policy is very much focused on explaining the kind of fiscal policy upon which Harcourt's approach is based.

The fiscal policy responses to the global financial crises (GFC) of 2007–2008 were generally a mixture of allowing automatic stabilizers to have some effect and budget deficits to rise and discretionary fiscal policies including 'bail-out' of banks and other financial institutions. These responses were soon followed by pursuit of 'fiscal consolidation', which sought to reduce the budget deficit and lower the government debt to GDP ratio. Reducing government expenditure lowers economic activity and budget deficits may fall but not to the extent of the reduction in government expenditure. The degree of austerity resulting from fiscal consolidation was often underestimated (Blanchard and Leigh 2013). Fiscal policy re-emerged as a macroeconomic policy following the New Consensus Macroeconomics theoretical framework, which disregarded fiscal policy completely (Arestis 2019). The COVID-19 pandemic required government responses in the form of spending on measures to (1) combat the epidemic and (2) support employment and incomes. The effect of lockdowns, limitations on travel, and disruption of supply chains led to falls in GDP. Table 1 illustrates the scale of budget deficits, and so on.

Table 1 provides a summary of the scale of fiscal responses in a range of advanced economies in the first 18 months or so of the COVID-19 pandemic. The early responses to COVID-19 (in terms of government expenditure and deficits) illustrate that government expenditure can be financed in response to 'emergency', though the financing of emergency COVID measures was no different to any other government expenditure. They also illustrated something of a 'whatever it takes' approach to government spending, and acceptance of the resulting budget deficits. The resulting budget deficits (often relatively large) were generally readily funded as private (household and corporate) saving rose in the face of constraints on expenditure during Covid lockdowns.

The level of public debt in many countries has risen sharply as a consequence of the Covid-19 pandemic and policy responses to it. Government expenditure, particularly to

Table 1. Fiscal Measures in Response to the COVID-19 Pandemic.

Percentage of GDP: January 2020–October 2021	Additional spending or foregone revenues			Accelerated spending/ deferred revenue	Liquidity support	Equity injections, loans, asset purchase, or debt assumptions	Contingent liabilities		Quasi-fiscal operations
		Subtotal	Health sector		Non-health sector		Subtotal	Guarantees	
Australia	**18.4**	1.0	17.4		**1.8**	0.8	1.0		
Canada	**15.9**	2.8	13.1	3.9	**4.0**	0.2	3.7		
European Union	**3.8**	0.0	3.8		**6.7**	6.1	0.6		
France	**9.6**	1.5	8.2	3.0	**15.2**	0.7	14.5		
Germany	**15.3**	1.8	13.6		**27.8**	3.0	24.8		
Italy	**10.9**	1.2	9.7	0.4	**35.3**	0.2	35.1		
Japan	**16.7**	2.1	14.6	0.5	**28.3**		2.9	25.4	
Korea	**6.4**	0.7	5.7	1.7	**10.1**		3.7	6.5	
Spain	**8.4**	1.7	6.7	0.0	**14.4**	0.1	13.4	0.9	
United Kingdom	**19.3**	4.8	14.4	0.6	**16.7**	0.0	16.7		
United States	**25.5**	3.3	22.2	0.1	**2.4**	0.3	2.2		

Source: IMF Fiscal Monitor: Database of Country Fiscal Measures in Response to the COVID-19 Pandemic (IMF 2021).

support incomes, rose and tax revenues diminished as economic activity fell. Government debt levels rose: in the euro area, the average public debt (measured by government net financial liabilities) to GDP ratio rose from 63.0 per cent in 2019 to 75.5 per cent in 2020, and to 71.3 per cent in 2021.[1] The budget deficit to GDP ratio in 2020 was 7.0 per cent for the euro area on average, up from 0.7 per cent in 2019. For the US, the debt ratio rose from 83.0 per cent in 2019 to 98.0 per cent in 2020, with a budget deficit ratio in 2020 of 15.4 per cent from 6.4 per cent in 2019.

For a national government, any level of debt (relative to GDP) is likely to be sustainable in that interest payments can always be made by government, whether based on ability to levy taxes or ability of the central bank to create money to enable government to meet interest payments (provided that the debt is denominated in the national currency). The question of sustainability should focus on the sustainability of a deficit position in terms of the implications of budget deficit for the time path of debt if the deficit were to be maintained. It should also focus on the sustainability of the sectoral balances, which correspond to the budget. A particularly important sectoral balance is the balance of payments and the sustainability of current account deficits and the servicing of international debt.

The budget deficit relevant for the discussion of sustainability at the present time is not that pertaining during the pandemic but rather the deficit that emerges after the pandemic.

The socially responsible budgetary and fiscal policy would be to use the structure and level of public expenditure to re-build after the pandemic, to provide good income support to individuals, and to structure taxation in a progressive manner. The balance between expenditure and tax revenues, i.e., the budget deficit, should aim to secure a high level of employment (consistent with the capacity of the economy). There have been many calls for a reduction in the debt ratio via running small deficits or surpluses. The debt to GDP ratio will decline if $d < b.g/(1 + g)$, where d is the deficit to GDP ratio, b

[1]The source of the figures in this paragraph is the OECD Economic Outlook 111 database, accessed August 2022.

the debt to GDP ratio, and g the (nominal) growth rate. For example, with a debt to GDP ratio of 120 per cent and a nominal growth rate of 5 per cent, a deficit to GDP ratio of less than 5.7 per cent would lead to a decline in the debt ratio. The rate of decline would likely be slow, and the debt/GP ratio would level out at x/g, where x is the achieved budget deficit ratio. But attempts to set the deficit to secure a significant reduction will bring unnecessary unemployment and hardship. Setting a target reduction in the debt ratio (e.g., in the form of a continuous decline in the ratio, reach x per cent over a specified period of time) is as stupid as setting arbitrary deficit rules.

The fiscal policy responses to both the GFC and the pandemic meant that previous policy announcements on budget deficits and public debt had to be abandoned or at least suspended. These policy announcements had often been in the form of adoption of 'fiscal rules': in the European Monetary Union (EMU) case, that budgets should on average be in balance or have a small surplus and public debt to GDP ratio should be below 60 per cent; in the UK, 'fiscal rules' outlining intentions to reduce debt ratio and achieve close to balanced budgets were laid down and often changed. The US, in principle, has a debt ceiling but one that has to be updated often. The frequent variation or suspension of these fiscal rules is a clear indication of how unsuitable they are.

Attention, particularly within the EMU, has focused on so-called structural budgets. A structural budget position is that which would arise if the economy were operating at 'potential output' with the prevailing structure of tax rates and public expenditure. While the effects of operating at 'potential output' rather than actual output can be calculated with given tax rates and unemployment benefits and similar, it is more difficult to take account of discretionary policies, adopted to counteract inadequacies of private demand. The advocacy (as in the fiscal rules of the euro zone) of some form of structural budget position (often in balance) faces two major problems. First, it assumes that a balanced structural budget is feasible, that is, that not only would tax revenues and government expenditure be in balance at 'potential output' but also, from the other side, that intended private domestic saving is equal to intended private investment plus capital account outflow. As Kalecki (1943) explained 80 years ago, there is no reason to think that such an equality would hold sway.

Second, the estimation and stability of 'potential output' are problematic. Potential output is not what it says, which would suggest something like capacity output; rather, it is the level of output that is believed to correspond to a constant rate of inflation. It is based on a Phillips curve-type approach to inflation and the existence of an 'equilibrium' at which inflation would be constant, while departures from that 'equilibrium' would involve continuously rising (falling) inflation for output above (below) potential. Estimates of potential output vary over time. This is particularly evident when unemployment and the 'non-accelerating inflation rate of unemployment' (NAIRU) is used as a substitute for potential output.[2]

Fiscal policy in the immediate aftermath of the GFC and during the COVID pandemic was moving in the right direction to support employment and economic activity, though the extent of the fiscal stimulus could have been larger in most countries, particularly in the aftermath of the GFC. But in the case of the GFC, it was soon followed by fiscal consolidation and austerity, which did not help. As the COVID pandemic subsided, concern

[2]For extensive discussions on these points, see Heimberger and Kapler (2017) and Heimberger (2020).

switched to the higher debt ratio created by the pandemic measures and proposals to change the budget position so as to secure such a reduction, though the energy and gas price crisis of 2022 has delayed any implementation.

4. Central Banks and Monetary Policy

Geoff Harcourt wrote little on monetary policy. Indeed, in response to an approach by Jim Cairns, then Deputy Prime Minister of Australia, 'to see [whether he] would consider being … the Governor of the Reserve Bank of Australia', he said 'no' immediately, adding, 'You know me Jim, I'm a real man, not a money man' (Harcourt 2001, p. 17). However, in one of his last papers (Harcourt et al. 2018), the idea of central bank independence was critiqued along the lines that a major policy institution is taken away from democratic control, and hence the arguments for that are either the rejection of representative democracy or that central bank independence is an exceptional case, which merits being excluded from democratic processes. The exceptional case made for central bank independence rests on the central bank being more credible than politicians in the pursuit of inflation control (and that monetary policy in the form of a policy interest rate is an effective way to control inflation). It is bizarre 'to argue that the government does not have the best interests of the country at heart, while the Central bank governors do[; it] implies that the latter have solely altruistic goals, even though they are not answerable to the people' (p. 210).

Much of Harcourt et al. (2018) is directed to the undemocratic nature of central bank 'independence'. Although an 'independent' central bank could be assigned an objective other than inflation targeting, the arguments for central bank independence have generally combined a close connection between monetary policy and the control of inflation, a demand-side view of inflation to be controlled by variations in interest rates, and the 'conservative' central banker argument.[3]

We have highlighted elsewhere the issues around inflation targeting and the lack of evidence to support the use of inflation targeting as an effective counter-inflation tool (for example, Arestis and Sawyer 2008b). The experiences regarding prices during and following the COVID pandemic illustrate the shortcomings of the one instrument–one objective approach of inflation targeting, especially when the rise in prices is driven by supply-side disruptions. As many have observed, raising interest rates are irrelevant to supply shock inflation. We have previously cast doubt on the effectiveness of raising interest rates to counter inflation (Angeriz and Arestis 2007, 2008).

Geoff Harcourt expressed his view that 'like Keynes, Kalecki, Kaldor and Robertson, I am very sceptical about over-reliance on changes in the rate of interest as an effective policy measure' (2010, p. 245). He went on:

> The fiscal fine tuners of earlier years were undoubtedly over optimistic, but what of the monetary fine tuners in independent central banks in more modern times? There is a lot to be said, within given constraints, of setting relatively low interest rates and keeping them there, using other measures to tackle short-term fluctuations and long-term needs. (p. 245)

The sharp rise in prices (particularly of energy, and some foodstuffs) in the second half of 2021 and extending through 2022 provided a sharp indication of the limitations of the

[3]For our early doubts on the case of an 'independent central bank', see Arestis and Sawyer (1997, 1998b).

inflation targeting framework. The upward pressure on prices clearly resulted from supply-side shocks and, as far as a national economy was concerned, from the global economy. Interest rates are close to impotent in terms of addressing such price rises, and only serve to push the domestic economy downwards. The central bank has, at best, a weak policy instrument to deal with inflation, and one which is intended to work through deflation. Its implementation in the second half of 2020 was seen as seeking to restrain wage rises rather than price rises, thus ensuring a substantial drop in real wages. Other and more powerful weapons, including forms of incomes policy, selective price controls, and price subsidies, are sidelined, and, in the specific case of the energy and food price rises of 2021 and 2022, forms of income support too.

Independence of the central bank makes coordination between fiscal and monetary policy problematic. A monetary policy focused on inflation targeting by means of interest rate effects on economic activity and employment can readily clash with an expansionary fiscal policy. Clearly, proper coordination of fiscal, monetary, and financial stability policies would avoid such clashes. This suggestion is very clearly consistent with Harcourt's contribution in terms of the independence of central banks, as referred to above.

The actions and policies pursued by a central bank have economic implications far beyond price-level stability. Issues arise concerning what the broader effects of central bank policies are and whether they can and should be taken into account when such policies are being determined. In the following three sections, we briefly examine three dimensions, the first of which is financial instabilities and financial crisis. The distribution of income and wealth can be impacted by interest rate and other policies. At a minimum, the policy rate of interest has implications for borrowers, lenders, and savers. Through effects on asset prices (whether from interest rates or quantitative easing), central policies impact on the distribution of wealth.

5. Financial Stability

Geoff Harcourt viewed the economy, and particularly the financial sector, as subject to the forces of cumulative causation (as illustrated in the quote above referring to the behaviour of wolf packs). He often expressed concerns over the instabilities of financial markets and their effects, arising from speculation. He advocated a form of financial transaction tax (e.g., Harcourt 2001, Chapter 18) to dampen down speculation and the volumes of financial transactions. In this section, we consider some of the more general issues relating to financial stability and, in particular, the role of central banks.

Some countries have formally extended the mandate of the central bank to include financial stability. What policy instruments are these banks using? Do they conflict with other policy objectives? Financial stability comprises microprudential (individual financial institutions), and macroprudential (whole financial system) aspects. The macroprudential approach is a relatively new financial stability policy, which was implemented after the GFC; in contrast, the microprudential approach has been around since 1979. The focus of financial stability is on controlling the financial sector so as to make it useful to the economy as a whole, especially to the productive elements of the economy, and also to ensure that funds can be channelled from surplus-sectors to shortage-sectors (see Arestis 2020). Brazier (2018) suggests that 'guard[s] against the financial system disrupting the wider economy' (p. 6) are important aspects of financial stability.

Aikman et al. (2019) suggest that, 'a macroprudential regime with a suitably strong mandate, coupled with powers to adjust financial system leverage and maturity/liquidity transformation and to limit household sector indebtedness, could have significantly ameliorated the macroeconomic fall-out from the collapse of the real estate bubble' (p. 127), referring of course to the GFC crisis. Forbes (2019) proposes that, '[m]acroprudential policy should improve the economy's ability to withstand shocks and allow the financial system to function effectively under adverse conditions' (p. 471).

Financial stability should be one of the key objectives of central banks. The Bank of England (2016) states that:

> the primary responsibility of the Financial Policy Committee (FPC) … is to contribute to the Bank of England's objective for maintaining financial stability. It does this primarily by identifying, monitoring and taking action to remove or reduce systemic risks, with a view to protecting and enhancing the resilience of the UK financial system.

Financial stability requires the development of relevant policy instruments together with abandoning the inflation targeting approach whereby price stability is the only objective of monetary authorities.

In terms of financial stability policies, the most important one is that the financial sector should have sufficient capital to enable it to absorb losses, especially in the case of crises. This is the 'counter-cyclical capital buffer' (CCyB), which is the necessary amount of capital financial institutions should set aside to avoid breaching their minimum capital requirements. A CCyB's higher bank capital increases the resilience of the financial system, and its loss-absorbing capacity. Properly introducing a CCyB reduces the likelihood of a financial crisis (see Forbes 2019). The Bank of England Financial Policy Committee (FPC) proposed that an appropriate CCyB should be 'in the region of one percent in a standard risk environment' (Kohn 2019). A CCyB should be applied to non-bank financial institutions, especially shadow banking which has expanded enormously in recent years (Arestis 2020). Another policy suggestion requires that the central bank intervenes in the bond market to ensure that yields are on target, in the same way as it intervenes to set its base rate (also see Bernanke 2020). Both macroprudential and monetary policy influence the rate of interest applied in the financial sector, which may create conflict that could have a negative effect on the focus of monetary policy on price stability (also see Barwell 2013). Further financial policy suggestions include the liquidity coverage ratio (LCR), a requirement that includes a portion of high-quality assets (cash and short-term government debt, and relevant foreign exchange assets). Targeted leveraged ratios (total debts/total assets, which restrict the ability of banks to exceed a minimum ratio), loan-to-value ratio, debt-service-to-income ratio, and limits on foreign currency loans, when financial risks emerge, are further policy measures. Also consider King's (2016) proposal that banks should pay a yearly compulsory insurance premium so that, in a crisis, they can access further funds from the central bank. Loan-to-value ratios and debt-to-income ratios are relevant and important financial stability policy suggestions.

Stress tests, the focus of which is on identifying whether financial institutions could manage large losses that might arise from financial crises (Bank of England 2013), are another suggestion for ensuring financial stability. The separation of retail banking from investment banking is another route towards financial stability (Arestis 2020).

Such separation could deliver a more stable financial system, and avoid the high-risk taking of the combined financial institutions, commercial and investment banking. Russell (2014) suggests that the lessons of the Glass–Steagall Act 'provide important insights for contemporary projects of progressive financial reform' (p. 101). In addition, control of non-bank financial institutions, especially shadow banking, is urgently required. Financial stability, as explained above, is an area that is very much within Geoff Harcourt's contributions on monetary and financial policies.

6. Central Banks and Social Objectives

Harcourt et al. (2018) questioned the democratic legitimacy of the so-called independence of a central bank. A feature of this independence in recent decades has been the inflation targeting framework associated with it, and the single objective assigned to the central bank that the inflation target be achieved through variations in the policy interest rate. This policy framework appears to preclude a central bank taking into account any other policy concerns (though financial stability has been added to the objectives of some central banks). It also disallows any co-ordination of interest rate policy on the part of the central bank with other government policies (notably, fiscal policy). In this section, we consider two major policy areas — income and wealth inequality and climate change — and their relationship with central bank policies. Some, but not all, central bankers have on occasion expressed concerns regarding these policy areas. We would argue that central banks should pay heed to the general policy objectives of government. In some areas, these general objectives can be incorporated into central bank decisions. In general terms, the example given below with respect to climate change is that the financial assets purchased by central banks, as part of quantitative easing programmes, should be those considered to be 'green'. We also argue that interest rate policy can be geared towards income-distribution considerations to a greater degree by the adoption of a 'fair' interest rule. This is not to argue that central banks can have particularly significant effects on inequality or on climate change, but rather that their policy decisions should seek to be consistent with government policies.

Income and Wealth Inequalities

Carney (2016), former governor of the Bank of England, remarked that 'all monetary policy has its distributional effects', though significant questions to address are the nature and scale of those distributional effects and how far the operations of a central bank should seek to influence income distribution or take distributional effects into account when setting monetary policy. It has been recognized that the distributive effects of quantitative easing (QE) during the 2010s may have been significant in terms of wealth inequality. The main mechanism identified is that the high level of asset purchases pushes up the price of assets, which are disproportionally held by the wealthiest households (Bank of England 2012). It can be agreed 'that there is enough evidence to conclude with confidence that monetary policy does affect inequality. The magnitude and the duration of the impact must be better studied' (Kappes 2023, p. 227). In many cases (and the effects of QE are the leading example), the effects of monetary policy on inequality are unintended side effects and perhaps temporary and reversible. These

effects are difficult to bring into the decision-making process and may be more appropriately addressed through other fiscal policies such as the taxation of wealth and capital gains.

The policy instrument that is interest rates does have an impact on the distribution of income between borrowers and lenders. In that context, it is useful to ask what the central rate around which the actual policy rate varies should be; and whether or not variations in the interest rate are used to influence level of demand (and, under inflation targeting, thereby the rate of inflation). In Arestis and Sawyer (2010), we argued for a real rate of interest in line with the rate of growth of productivity, with the nominal rate of interest adjusted on, say, an annual basis. This idea of policy interest rate around the rate of growth of productivity has a number of interesting implications. It can be considered as a 'fair rate' of interest (Pasinetti 1981), which 'in real terms should be equal to the rate of increase in the productivity of the total amount of labour that is required, directly or indirectly, to produce consumption goods and to increase productive capacity' (Lavoie and Seccareccia 1999, p. 544). Setting the policy interest rate on this basis is not without its difficulties — estimation of the trend growth rate, misalignment of the domestic interest rate with international rates, for example. The interest rate is set in nominal terms and hence must be based on the 'fair rate' plus (expected) inflation. To what extent the aim should be for the real rate of interest to be, broadly speaking, constant or whether the interest rate should also respond to current conditions, e.g., being much lower in times of low demand, would have to be discussed. A key feature of applying a rule such as the 'fair rate of interest' is that it is based on income distribution considerations (albeit limited).

Climate Change and Environmental Damage

Central banks can have a role to play in supporting strategies to address the climate emergency and transition to a low carbon economy. Campiglio et al. (2018, p. 463) describe four types of intervention that central banks (and financial regulators) could adopt to help deal with climate-related risks: (1) development of 'methodologies and tools that would promote a better understanding of these risks and their economic and financial implications'; (2) 'investors can be encouraged or required to disclose their exposure to climate-related risks'; (3) 'these risks can be explicitly taken into account in setting financial regulations'; and (4) 'central banks can take into account climate-related risks in their policy toolkit (for example, through monetary policy)'.

A highly significant question arises here: who should be responsible for setting out which investments and activities are to be considered 'green' and which 'dirty'. Responsibility for creating environmentally-friendly policies lies firmly with the government, and the central bank (and other institutions) should make decisions that support these policies. The government should thus be responsible for establishing what is deemed environmentally friendly and what is not to enable support for the former to be provided.

Through QE programmes, central banks have been involved in the purchase of existing financial assets (largely purchase of government bonds, though extended to corporate bonds) rather than the financing of new investment. A range of proposals focusing on central bank purchasing of environmentally-friendly bonds and non-purchasing of 'dirty' bonds (however defined) have been mooted. Following this approach, the

central bank would move away from market neutrality and favour some forms of bond ('green') over others.

There is a requirement that the independence of a central bank be severely limited to operational matters and its policy decisions co-ordinated with and subservient to the government's macro-economic policies. This would mean that fiscal policy is fully supported by the central bank in terms of the provision of (initial) finance for expenditure and no attempts are made by the central bank to seek to nullify fiscal policy through interest rate changes. The setting of interest rates should take into consideration income distributional aspects. The operations of the central bank (e.g., with respect to QE) should be fully consistent with government environmental policies and ensure that environmentally-damaging activities are not supported in any way.

7. Inflation

The failure of inflation targeting requires the development of alternative policies for controlling inflation that do not resort to deflation. Geoff Harcourt's long-standing advocacy of incomes policies to contain inflation without resorting to demand deflation are very relevant in this respect. According to Harcourt (2001), 'the single most important institutional change required in Australia [writing in 1977] is the creation of effective machinery with which to ensure that, by and large, we obtain the level and rate of change of prices which is acceptable' (p. 77). Harcourt goes on to talk of indexation, which, with rising prices and wages, '[leads] inevitably to savage fiscal and monetary policies designed to bring the rates down, policies that proved ineffectual in their aims and disastrous and tragic in their by-products' (p. 77). He continues, 'indexation by itself is not a panacea. It needs to be coupled with relativity *plus* productivity elements' (p. 78) and

> [b]asically, the aim is to provide a set of policies which allow sustained full employment with agreeable rates of inflation and more satisfactory rates of growth of GDP and productivity. A necessary corollary of achieving these is to raise the overall level of accumulation. (pp. 265—266)

Of equal importance, is the statement that an 'incomes policy can combine with both fiscal and monetary policy and be consistent with the rate of growth expected as resources are relocated, and restructuring takes place' (p. 93).

The passages above refer to the 1970s, with a focus on Australia. In the decades from circa 1990 onwards, inflation rates in the 'advanced economies' have been relatively low, and the inflation target of circa 2 per cent per annum has been broadly reached: the NICE era and the 'great moderation' (with a few exceptions, e.g., Zimbabwe). The China effect, reduction in trade union bargaining power, and rise in corporate power were the main causes of that generally lower level of inflation. In effect, and in the context of generally slower growth, workers have 'accepted' a shift in the distribution of income as a result of the loss of bargaining power.

Our approach, in relation to Harcourt's relevant contribution, is to view inflation as multi-causal and the sources of inflationary pressure as varying over time and economy (Arestis and Sawyer 2005, 2008a). We seek to explore alternative policies to address inflation, including the role of incomes policy. To the extent also that the range of factors that impact on the rate of inflation include struggles over income

shares, the level and rate of change of the level of aggregate demand and cost–push factors emanating notably from the foreign sector (change in import prices and the exchange rate), then a range of policies may be required to address the different sources of inflation. This is more consistent with Geoff Harcourt's relevant views, as noted above.

The approach to inflation policy here has three components. The first is to maintain as far as possible through fiscal policy and by other means, employment and output close to full employment and capacity, seeking to avoid sharp changes in demand. This must be combined with supply-side policies to ensure that there is sufficient capacity and relevant geographical distribution to ensure that the inflation barrier is consistent with high levels of employment ('full employment'). The second is the development of policies to ensure that the distribution of income (in all its dimensions), which appears to be consistent with the constant inflation level of output, is less inequitable than at present. The third is the development of prices and incomes policies designed to reduce the impact of imported inflation on domestic inflation.

The focus of attention of a prices and incomes policy should reflect perceptions on the likely sources of inflationary pressure. Many price and incomes policies have focused particular attention on wages in the belief that labour costs are a particular source of inflationary pressure. In contrast, inflation targeting focuses directly on price inflation, and in principle responds to price inflation rather than wage inflation. It also views inflationary expectations as a potential source of inflationary pressure and seeks to anchor inflationary expectations through adoption of numerical inflation targets along with the credibility of independent central banks to secure the set target.

That the institutional arrangements upon which the incomes policies of the 1960s and 1970s relied are long gone is a trite observation. Attempts at tripartite arrangements between government, business and trade unions, and national collective bargaining with wide coverage of wages based on large bargaining units, also no longer exist, at least so far as the UK and other inflation targeting countries are concerned. An important lesson, nonetheless, may be derived from that and subsequent experience in the UK. Incomes policy is likely to be most effective when trade unions help design and control them. An important implication for current arrangements is that any policy affecting wages could only and effectively take place in the public sector in which some 20 per cent of the workforce is employed in the case of the UK.

Direct government intervention to confront inflation can take some other forms, particularly when the driver of inflation is largely external to the national economy. This was the case in 2021–22 in the later stages of the COVID-19 pandemic and associated supply chain disruptions and massive rise in energy prices (some associated with the Russian invasion of Ukraine). The external rise in prices means that the domestic economy is worse off than otherwise. A range of policy responses would be appropriate, which could be viewed in terms of an incomes policy — in the sense that they can address people's income levels. These policies may include focused income support for groups particularly adversely affected by price rises (e.g., in the current situation, those affected by a sharp rise in energy prices); price controls, particularly in relation to the profit margins of domestic producers; and, in some circumstances, rationing alongside price controls.

8. Concluding Comments

In this article we have touched on a range of issues connected with fiscal and monetary policies. Although there are many other aspects of and issues related to macroeconomic policies that we have not dealt with, their omission is not to be taken as an indication of their lesser significance. We have sought to reflect the commitments of Geoff Harcourt to a fully employed non-inflationary economy along with an egalitarian approach.

Further considerations of Geoff Harcourt's contributions relate to financial stability, a more recent area, emphasizing the important aspects of this new policy. Income and wealth inequality is another important issue highlighted here and frequently discussed by Geoff Harcourt in his important contributions, as are climate change, environmental damage, and inflation.

Acknowledgements

We would like to use this opportunity to acknowledge and thank the reviewers who reviewed this article and aided in its publication.

Disclosure Statement

No potential conflict of interest was reported by the authors.

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