Ideology and Central Banking in the Crisis: The Canadian Experience

By Socialist Project
Global Research, January 27, 2014
Socialist Project

Region: Canada, USA

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'Privatizing gains and socializing losses' could be the motto for the neoliberal era.

Alongside this and 'there is no alternative,' few slogans better capture the ideology that has been so successfully diffused throughout the world over the past several decades.

Five years after latest financial crisis, this motto rings true as ever. To say that the losses stemming from the crisis were large is a heroic understatement; indeed, not only were they humongous, their exact size remains a tad fuzzy. Meanwhile, across the world in the aftermath of the crisis, stock markets have rebounded, wealth and income inequalities have grown and corporations and financial institutions have returned to making healthy profits. At the same time, many countries have seen both employment and median incomes either stagnate or fall.

Asset Purchases Furthering the Habit of Privatizing Gains and Socializing Losses

In short, once again, losses were socialized, while gains privatized. Prominent among the means employed by governments to ensure that this be the case were various kinds of asset purchase programs. First, in the immediate aftermath of the crisis, came actions that transferred toxic financial assets into public hands either through direct buybacks (as in the U.S. TARP program) or temporary nationalization/bailout. Since these short-term, more explicit socializations of private loss came to an end, the policy of quantitative easing (QE), through which central banks purchase vast amounts of long-term debt from financial markets, has been their implicit continuation. Unlike the earlier programs, QE is aimed instead at the other end of the equation, privatized gains.

To be sure, all of these programs of asset purchase are presented very differently: they are sold as a crucial tool for economic recovery. Across the world, people were told that the financial markets in which we are all increasingly complicit had to be given a shock therapy cleanse to get them back to health. This was stage one. Toxic assets flushed down the public drain. Stage two has been an expansionary monetary policy whose aim is to slowly nurse the entire economy back to health with large doses of clean cash – necessary to boost investment, jobs and growth at a time when interest rates are effectively zero throughout the developed economies.

As an expansionary policy, QE has been if not lauded, then at least guardedly accepted by many mainstream progressive economists. The ever-prolific Paul Krugman has tacitly endorsed the program as a means of stimulus, though insufficient by itself. Most recently, Brad DeLong provided a list of policy prescriptions that called on the U.S. Federal Reserve to maintain rather than taper its QE program. DeLong's reason for supporting QE is somewhat complex. He appears to argue that QE actually decreases the amount of private risk in the economy, while more effectively raising the inflation target than so-called "forward guidance." Together these mechanisms provide incentives for increased investment. Both Krugman and DeLong doubt that a higher inflation target will be more successful than fiscal policy in stimulating investment, but both are willing to accept QE as a monetary tool for economic recovery.

Predictably, some conservative commentators have argued instead for an end to QE. Their opposition is based on the build-up of public debt via QE and the effect larger debt has on growth. These tired arguments have been debunked, as has the most major recent academic study to give them credence.

Quantitative Easing as a Tool of Accumulation

Yet QE is harmful. This despite support given it by notable progressives, but for very different reasons than those given by its conservative opponents. The problem is not public debt as such, but what this debt is used to fund. In an important sense, QE is a massive welfare program. Unfortunately for the millions of precariously employed, unemployed, discouraged workers and newly-poor feeling the brunt of the crisis, it is a welfare program for the corporations and financial institutions that caused the crisis. Much of the shared economic gain that could be had from the asset purchases carried out via QE ends up being privatized.

In short, the cash the private sector has received from the sale of long-term assets to central banks has not produced much in the way of new stable jobs and rising generalized prosperity. Instead, the increasingly-integrated financial and corporate arms of the private sector have used the period since the acute financial crisis to concentrate wealth and power (albeit with some tensions as finance has seen profits from direct lending fall as the spread between short- and long-term interest rates has narrowed). QE has given the private sector a large injection of funds with which to continue asset concentration and price inflation.

The means to effect this transfer are varied. One way has been to buy up assets; for example, financial institutions have been busy purchasing dirt-cheap housing and turning it into rentals, which are now additionally being securitized into instruments reminiscent of those that helped cause the 2007 crisis. The private sector has also used this opportunity to refinance outstanding debts taken on in less friendly times. Just in 2013, corporations in the U.S. issued over $1-trillion of new corporate bonds. In Europe, corporations are even spared the trouble of doing this financial dance as the ECB has been using some of its QE funds to buy corporate bonds directly. Much of the remaining cash is simply being hoarded or used to pay out dividends and buy back shares, boosting stock prices and lining the pockets of investors. Finally, with the QE taps still open wide and the cash bonanza proceeding apace, the next step might be a new wave of mergers and acquisitions. Just this week, Google bought a thermostat company for over 3 billion dollars! (Of course, not for its thermostats but its data and algorithms.) This while many in the U.S. are having trouble paying their heating bills, nevermind worrying whether their thermostat is intelligent enough for the 21st century.

QE demonstrates the continuing failure of one other popular neoliberal trope: trickle-down benefits. Government asset purchases via QE have further entrenched the concentration of wealth, through both the direct methods listed above and the generalized increase in the value of all financial assets. This holds regardless of whether one sees QE as equivalent to the government printing money or merely as a reshuffling of assets. Either way, QE sends benefits up, just as the initial post-crisis asset purchases sent losses down.

Policy as Practice and Ideology

Like many powerful economic policy tools, the range of asset purchase programs implemented after the latest financial crisis plays a dual role. These programs both affect reality and serve to reinforce an ideology. They further naturalize the idea that the public should absorb the missteps of and heap rewards upon a private sector lauded for its ability to best generate wealth, jobs and generally all manner of economic well-being.

While fiscal policy of direct government spending is no magic bullet and can often amount to another form of corporate welfare, it at least has the potential to be used for the benefit of workers and the middle class, creating jobs, building necessary public infrastructure and providing expanded services. Fiscal policy happens in a contested political space from which monetary policy is one step removed. Unlike the early 1980s, when restrictive monetary policy was used in a high-inflation context alongside direct labour repression and fiscal restraint to redistribute assets and restart accumulation, today's deflationary risks have opened space for expansionary policies.

It is a tribute to the role that ideological obfuscation (or perhaps resignation) can play when some progressives support QE on expansionary grounds. One of the successes of the neoliberal era has been to ensure that we feel the searing pain of the bad doubly, while getting left out further in the cold during the good. While questions about whether and how to continue QE have increased – especially in the U.S., where the Fed has very slowly begun to taper the program – the extent to which QE is tied up with a powerful ideology that it is simultaneously helping to entrench it as a reality puts efforts to halt the program in question.

The Canadian Experience Since the Crisis

Unlike the U.S. Federal Reserve and other central banks, the Bank of Canada has not embarked on a quantitative easing program since the immediate aftermath of the crisis. Between 2008 and 2010, the Bank pumped significant amounts of liquidity into financial markets via a sustained program that had it temporarily buy up various kinds of securities under so-called resale agreements. At the same time, the Bank "sterilized" these purchases by reallocating government deposits away from private banks, whether directly or by selling the banks government bonds. Together, these actions temporarily increased the Banks of Canada's balance sheet by over 50 per cent and allowed banks to dump some of their toxic assets, while simultaneously stopping interest rates from collapsing.

Tighter financial regulations and the smaller exposure of Canadian banks to the build-up of toxic assets in a context of fiscal austerity meant the Canadian economy was able to absorb the losses that did occur and maintain some aspects of the pre-crisis status quo. On the one hand, debt-fuelled demand has not let up in Canada as households continue to take on record levels of debt. This is partly in response to and partly contributing to a continued appreciation of housing prices that, while most likely significantly over-valued, continue to rise. Consumer debt and fiscal austerity have allowed corporations to maintain high profitability. Finally, the on-going resource boom has not lost much steam.

The combination of these economic trends has allowed the concentration of wealth and asset price inflation to continue apace without the kind of drastic and unconventional monetary policy exercises seen elsewhere.

The outcome (until recently) has been a rare situation of low to very low inflation, low interest rates and a strong currency. While very low inflation has contributed to some real wage gains, these have occurred in a context of stagnant employment, clawbacks in public services and a continued consolidation of and growth in wealth for the richest furthered by the same low inflation.

Recent Debates and Central Banking Myths

Despite the lack of extraordinary monetary policy, the Bank of Canada has been in the news. More precisely, the news has been full of other well-placed people telling our central bankers what to do. In a recent interview, Jim Flaherty made comments (later retracted) that Canada's central bank will be pressured to raise interest rates sooner rather than later. Not to be left out in the cold, the influential, pro-business Conference Board of Canada also came out with some advice. A *Globe and Mail* editorial written by its chief economist suggested, somewhat surprisingly, that the Bank should target a higher level of inflation, up to 4 per cent from the current 2 per cent.

Predictably, these pronouncements, especially Flaherty's, spawned a chorus of criticism from conservative commentators. They lambasted the Minister of Finance for potentially undermining the central bank's independence. Such attacks from the right were to be expected; however, even the NDP chimed in, calling the Minister's comments "inappropriate."

One reason for such universal criticism of any perceived meddling in central bank matters is that central banks are some of the most mythologized institutions of contemporary capitalism. They are often the subject of pious reverence on the part of media, politicians and economists. There is broad consensus that central banks should be independent and target low inflation (which, for many economies in the North has meant about 2 per cent). This is why it was particularly odd to hear conservative voices question both of these assumptions: Flaherty, independence, and the Conference Board, low inflation.

Myth #1: Central Bank Independence

In reality, however, both of these assumptions should be open to discussion and questioning as they are part and parcel of the neoliberal ideology discussed in the context of QE. First, take the central bank's independence. While we have many institutions that should be at arms-length from the government, these are largely bodies that hold government accountable and ensure that it is correctly carrying out its mandate – whether in terms of environmental protection, child welfare or accounting principles. The central bank is, however, not this kind of institution.

Economic policy is a multi-faceted enterprise and one that is politically-charged regardless of how it is presented. As Joseph Stiglitz has pointed out, arms-length and seemingly independent central bankers can be subject to bias, pressure and capture by financial interests. Indeed, for various reasons – not the least of which is the revolving door between financial institutions and central banks – central banks often end up promoting the interests of a narrow economic sector at the expense of others.

Is it better to have Flaherty rather than a financial sector technocrat calling the shots on monetary policy? Let's call it a draw… but at least we have an opportunity to vote Flaherty out of office. Furthermore, to question the absolute independence of the central bank is not to argue for its subservience to every whim of government ministers. Most government institutions continue to be managed by bureaucrats carrying out the broad policy goals decided upon in the political process (although the Conservatives are trying to change this). There is a significant middle ground between independence and subservience; ground where the central bank and the government could work to further similar goals – decided politically – using fiscal and monetary policy in concert.

Myth #2: Targeting Low Inflation

This leads naturally into the second central banking myth that we should be questioning: targeting low inflation to the exclusion of other policy goals. This is especially the case for the Bank of Canada, which, like the European Central Bank and a host of others, has an almost exclusive concern with inflation over other economic variables. Other central banks, such as the U.S. Federal Reserve or the Reserve Bank of Australia, explicitly have employment or growth as policy goals in their mandates; however, even these institutions in practice often give primacy to inflation targeting.

The shift to a focus on low inflation in central bank practice has followed theoretical developments within economics. The Phillips curve, which purports to show a positive relationship between moderately higher inflation and lower unemployment, at least in the short term, is a theoretical stand-by of mainstream Keynesianism. The idea behind it is that people sometimes adjust their expectations slowly. Specifically, an upward surge in prices can lead firms to hire more as wage demands take longer to catch up to higher prices, which immediately raise revenues and profits. This gave theoretical backing to more flexible monetary policy that was not intent on low inflation at all costs.

Around the stagflation crisis of the 1970s and into the 1980s, the Phillips curve, like much Keynesian theory, came under attack and largely fell out of favour. It was displaced by rational expectations theory. This theory assumes that people adjust their expectations constantly and almost immediately react to policy changes. These theoretical superhumans are able to predict how changes in factors like monetary policy will affect future real income and are constantly adjusting their behaviour based on economic trends.

If one believes this theory, then both the traditional Phillips curve and attempts to influence growth or employment via monetary policy seem misguided. Indeed, the key becomes instead to keep the economy near the so-called NAIRU or "Non Accelerating Inflation Rate of Unemployment." This is a level of unemployment (which can differ between countries and time periods) that is compatible with a stable and low level of inflation. Unemployment that is "too low," or below the NAIRU level, will cause inflation to rise and disrupt the economy. Keeping inflation stable is thus seen as a means of keeping the economy stable and ensuring a "sufficient" level of unemployment.

> "If workers are able to bargain for higher wages and have the institutional context to do … then moderate inflation is not so problematic and need not negatively impact growth. "

This last factor demonstrates how crucial the distribution of bargaining power between workers and employers is to the conduct of monetary policy. If workers are able to bargain for higher wages and have the institutional context to do (sufficient unemployment insurance, stricter labour laws and so on) then moderate inflation is not so problematic and need not negatively impact growth. Indeed, a central bank can have policy goals beyond just inflation levels.

The NAIRU theory upon which inflation targeting is based turns this on its head. Lower inflationary pressures require lower wages, weaker worker protections and greater job insecurity to simultaneously allow for low unemployment. A lower NAIRU means that workers are weaker; low inflation is compatible with low unemployment only at poor working conditions, low wages and high job uncertainty. More of the gains of growth are realized as profits. A more unequal distribution of income that results from high profits and low wages is thus combined with low interest rates. These not only keep inflation down, but they also encourage borrowing to make up for the lower labour income and can easily spiral into the kind of asset bubble that preceded the last financial crisis.

Inflation Targets in Context

Indeed, outside of crises, maintaining asset prices is precisely one of the other reasons to keep inflation low. Economic theory often describes inflation as a tax. This is accurate albeit what economists often fail to mention is that inflation can be a very progressive tax. Like many economic phenomena, the negative effects of higher inflation are unequally distributed depending on wealth – however, not necessarily in the direction to which we are accustomed. Low inflation is instrumental in maintaining the value of assets, especially financial assets. For example, if a bond will pay a certain sum in 10 years, then the return on this bond will be lower if that sum at the end of the 10 years due to higher inflation. Higher inflation can actually hurt the wealthy to a disproportionate degree because they hold a far greater number of assets than the rest of us.

If you are spending most or all of what you earn and are able to increase your wages relatively frequently to keep pace with inflation, then it does not matter as much if both your earnings and prices of the items you consume are growing by 2% or 8% per year. Similarly, if you have a debt to pay off, then higher inflation means you will ultimately be paying less in real terms over the term of the loan. If, on the other hand, you hold assets or are a creditor, then higher inflation eats away at your future income.

While many central banks across the world, both in the North and South, have tried to maintain an inflation target below 5%, and often in the proximity of 2%, a widely-publicized study published by the IMF in 2010 concluded that moderate inflation is not detrimental to growth. In fact, emerging economies can experience sustained inflation up to 10% per year before rising prices start to significantly impact growth. This upper threshold was found to be lower for developed countries and also near 10% for oil exporters. As Canada falls into the developed and oil-exporting camps, its threshold is likely somewhere between the current 1 to 3% target and 10%.

Indeed, IMF economists have explicitly argued for higher inflation targets since the latest financial crisis, citing higher risks of stagnation and deflation with current targets. This is also the position of the Conference Board, which sees higher targets as a means of restarting growth. Some are prepared to go further, however, and as Stiglitz has questioned central bank independence, a few prominent economists have begun to question inflation targeting itself as the correct policy goal for central banks.

Moving Beyond Myth and Ideology

Such deeper questioning of the particular myths of central banking and the broader ideologies within which they are embedded is important because it begins to move the debate toward the fundamental problem that the banking and financial sector as a whole is not responsive to the needs of the majority of citizens. For the moment, financial flows chase after profits rather than work to further the well-being of society. Low wages and cheap credit are seen as instrumental to maintaining the conditions for economic stability. This all serves to increase instability, allowing for asset prices to rise rapidly, further redistributing wealth toward the top and producing periodic asset bubbles.

A nationalized banking sector is a solution that truly goes beyond the myths of central banking and the neoliberal ideology that society should absorb losses while allowing the private sector to keep its gains. Such a solution acknowledges finance as a public utility rather than as a tool that ultimately serves to further enrich a wealthy minority and disempower workers. In some ways, of course, the dollars flowing through the economy are very different from the power flowing through our electricity grids or the water flowing through our hydraulic mains. In another sense, however, the fundamental idea is the same. Each example, including finance, involves the question of how and on what grounds we distribute a key resource necessary for the economy to function and potentially benefit all.

Public banking would also greatly reduce worries about the place of central banking. A democratically-controlled banking *sector* would still require a central bank to ensure the stability of currency and help manage the creation of financial flows. Such a central bank would, however, be embedded within an entire political and economic framework of socially-useful finance. This is quite different from today's framework that requires myth and ideology to keep us from looking too closely under the hood. •

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