PUBLIC SERVICES INTERNATIONAL

The global union federation of workers in public services

RETHINKING MONETARY POLICY

This policy brief on monetary policy draws from a paper[1] authored by Dr. Anis (Anisuzzaman) Chowdhury[2] that details steps governments should take to apply the ILO resolution **"A global call to action for a human-centred recovery from the COVID-19 crisis that is inclusive, sustainable and resilient"**. This brief is part of a series of policy briefs on measures governments can take to implement the resolution that cover — an overview to the resolution, monetary policy, fiscal policy, and industrial policy. The purpose of the briefs is to support trade unions advocacy work to implement the resolution and help shape Covid Recovery Plans that promote equitable, sustainable and job rich recoveries.

Introduction to the ILO resolution

The resolution, adopted unanimously at the International Labour Conference in June 2021, signals the need to move away from neoliberal macroeconomic and industrial policies and recognises the need for governments **to plan** and stimulate job-rich recovery, improving working conditions and ensuring decent work, gender equity, and sustainability. A key agreement is that governments should adopt:

i. Supportive macroeconomic, fiscal and industrial policies that also foster equity and stability;

[1] Chowdhury, A 2022, *Supportive macroeconomic and industrial policies for a broad-based, job-rich recovery, Public Service International*, <https://publicservices.international/resources/publications/supportive-macroeconomic-and-industrial-policies-for-a-broad-based-job-rich-recovery?lang=en&id=13076>

[2] Adjunct Professor at School of Business Western Sydney University and former Director at UN-ESCAP's Macroeconomic Policy & Development Division.

and

e. promote fiscal, monetary and trade and investment policies that aim at achieving inclusive, sustainable and resilient economic growth as well as full, productive and freely chosen employment and decent work, including by improving understanding of the potential beneficial macroeconomic effects of the human-centred approach set out in the ILO Centenary Declaration

This means that as part of COVID-19 recovery plans, governments should not be returning to the neoliberal economic theories that have dominated economic policy since the 1980s. Government should instead design progressive monetary, fiscal and industrial policies to reduce inequalities, address the climate crisis, and achieve a job-rich, inclusive, sustainable, and resilient recovery from COVID-19. Governments also agree to address the global monetary rules that have negative impacts on countries experiencing high debt levels.

c. promote global solidarity through support for developing countries experiencing crisis-related reductions in fiscal and monetary policy space or unsustainable external debt obligations.

What is monetary policy?

Monetary policy refers to the set of policies countries adopt to influence the supply of money, credit and interest rates within the economy. In most countries monetary policy is determined by the central bank under broad objectives set by the government or through legislation. The objectives of monetary policy are often focused around prices and economic stability, yet many banks are also required to consider job growth and other objectives.

Central banks are able to influence the amount of money in the economy using a range of policy tools, they can (i) alter the base **interest rate** for borrowing by retail/commercial banks; (ii) change the amount of **reserve funds** that banks must hold with central banks; (iii) **buy or sell assets like bonds** (known as Open Market Operations and Quantitative Easing); (iv) buy domestic or foreign currencies on the international market to influence its value.

Actions (i) and (ii) impact on retail banks' ability to lend or create credit. When the base rate or reserve requirements are lowered, retail banks can have more money to lend.

Since the 1980s and the spread of neoliberalism, central banks have been particularly preoccupied with the rate of inflation and have designed monetary policy primarily around "**Inflation Targeting**" or keeping inflation low at a predetermined level or range.

Why unions should care about monetary policy

Monetary policy is rarely included in union campaigns. But it should be. Monetary policy is not neutral, it has major distributional effects. When central banks deliberately take money out of the economy, the cost of borrowing (interest rates) goes up. Thus, such actions constrain business activity, depress the demand for labour, reduce the number of jobs, and lower wages and bargaining power.

Wealthy people generally are creditors or investors; they also have large bank deposits. Workers are generally borrowers or net debtors. Therefore, higher interest rates benefit wealthy investors, but people who have taken out loans will have even higher costs.

It's often argued that higher wages lead to inflation. When governments are obsessed with low inflation rates, they act to reduce labour's bargaining power. They do this by capping public sector wages, increasing unemployment, and by making unionising and collective bargaining more difficult. But they never cap the salary and remuneration packages of CEOs.

This is despite the fact that in recent decades worker's real take-home pay has steadily declined or stagnated while CEO salary packages have continued to grow. In the USA, between 1979 and the pandemic, CEO compensation grew 940%; worker compensation rose only 12%.[3] The wage gap between CEOs and US workers jumped to 670-to-1 in 2021.[4]

Blaming workers for inflation ignores the fact that prices can also rise when big corporations with monopoly power raise their profit margins.[5] The current inflationary surge has generated record corporate profits,[6] while workers are hit by cost-of-living crunches.

Inflation that is driven by higher wages is not bad if it gives workers more buying power and reduces household debts, thus creating more business. But wages have not kept up with inflation in most countries and are rarely the cause of it. Thus there is a vicious circle of low wage-high debt-weaker low growth economies.

[3] Mishel, L & Wolfe J 2019, *CEO compensation has grown 940% since 1978,* Economic Policy Institute, viewed 9 June 2022 <https://www.epi.org/publication/ceo-compensation-2018/>

[4] Rushe D 2022, 'Wage gap between CEOs and US workers jumped to 670-to-1 last year, study finds', *The Guardian,* 7 June, viewed 9 June 2022 <https://www.theguardian.com/us-news/2022/jun/07/us-wage-gap-ceos-workers-institute-for-policy-studies-report>

[5] Bivens J 2022, *Corporate profits have contributed disproportionately to inflation. How should policymakers respond?,* Economic Policy Institute, viewed 9 June 2022 <https://www.epi.org/blog/corporate-profits-have-contributed-disproportionately-to-inflation-how-should-policymakers-respond/>

[6] Martin M (Reporter) 2022, 'Economist explains record corporate profits despite rising inflation', *NPR,* 13 February, podcast, viewed 9 June 2022 <https://www.npr.org/2022/02/13/1080494838/economist-explains-record-corporate-profits-despite-rising-inflation>

How to spot neoliberal monetary policy

Neoliberal monetary policy is now so common that it's rarely questioned. Neoliberal policy focuses primarily on keeping a country's inflation rate within a certain low-range — a policy known as Inflation Targeting (IT). This low-range target is generally regarded as below 2% for wealthy countries and below 5% for low- and middle-income countries. IT Monetary policy treats inflation as the greatest threat to the country's economy while disregarding urgent issues such as jobs, climate, poverty, inequality, or sustainable development.

When central banks want to reduce inflation, they take money out of the economy usually by increasing base or policy interest rates,[7] by selling bonds and not buying government bonds to limit government spending, or by increasing reserve regulations. The most common method is to increase interest rates.

This neoliberal approach insists government debt is bad for economic growth and will lead to inflation, no matter the source of the debt and what the debt is used for. The IMF promotes keeping the debt-to-GDP ratio of 60% for rich countries and 40% for low- and middle-income countries. The prevalent neoliberal monetary policy deems any debt–to-GDP ratio that is higher than this as harmful to growth. Neoliberal monetary policy usually comes with neoliberal fiscal policies which include reducing governments' budget deficits, cutting spending on public services, and cutting taxes.

Advocates of neoliberal monetary policy insist that the monetary authority should be completely independent of the government executive, or free from political interference. They present the banks as independent and politically neutral. However historically, with a few exceptions, most central bank governing boards have been drawn from business communities and elites, generally promoting the interests of capital and bankers, and adhering to neoliberal orthodoxy. There has been rare participation on central bank boards from unions, women's rights advocates, Indigenous Peoples or low-income communities, who can offer important contributions to a country's monetary policy.

The problems of neoliberal monetary policy

There is no evidence or research that shows that low-range inflation is good or contributes to economic growth.[8] The 2% target seems to have emerged and became popular as a result of a New Zealand Finance Minister's random selection of the number 'two' in the 1980s.[9] Other research, including that undertaken by the IMF itself, has found that even when inflation is higher, countries can still experience positive economic growth. This, however, has not ended the obsession with maintaining a low inflation rate as a central goal, with the IMF's encouragement.

There is no sound evidence to prove that government borrowing or receiving finance from central banks causes a higher level of inflation.[10] There is also no evidence that demonstrates that there is a particular debt-to-GDP ratio that can either guarantee or harm a country's

[7] The rate at which retail banks borrow overnight from central banks to maintain their cash reserves.
[8] Chowdhury, A 2022, pp. 32-34
[9] Chowdhury, A, Sundaram, J K 2022, 'Inflation Targeting Voodoo', *IPS News*, 1 March, viewed 7 June, <https://www.ipsnews.net/2022/03/inflation-targeting-voodoo/>; Irwin, N 2014, 'Of Kiwis and Currencies: How a 2% Inflation Target Became Global Economic Gospel', *The New York Times*, 19 December, viewed 7 June 2022 <https://www.nytimes.com/2014/12/21/upshot/of-kiwis-and-currencies-how-a-2-inflation-target-became-global-economic-gospel.html>.
[10] Chowdhury, A 2022, pp. 31-32

economic growth.[11] In fact, for many countries, deficits or high levels of borrowing or financing from central banks can help support the country's fiscal policy.

In reality, inflation is often caused by external factors like war, pandemics, climate crisis, or commodity shortages. This is happening now, with supply shortages resulting from the pandemic, the war in Ukraine, and a range of climate events. Higher interest rates won't stop those factors, only will create further cost of living problems. The rich don't stop spending when interest rates are higher, only workers and families with limited budgets do.

Research has found that inflation-targeting monetary policy framework leads to a decline in the wage share.[12] Therefore, neoliberal monetary policy—because of its sole aim of keeping inflation levels low and its disregard for employment, wages, poverty, or inequality— ends up shifting the burden of adjusting for any increase of inflation on output and employment (i.e., on worker's jobs and workers' wages).

Alternatives and examples of progressive monetary policy for a job-rich equitable recovery

Alternatives to current neoliberal monetary policy are both necessary and possible, and would be in-line with the call of the ILO resolution for supportive macroeconomic policies that "build forward better" and lead to a broad-based, job-rich recovery.

We know alternatives are possible because countries have adopted progressive policies in the past. In fact, as IT was only invented in the early 1990s, rich countries had the benefit of monetary policies that focused on increasing jobs as they industrialised and achieved their current wealth and level of development. And yet institutions like the IMF, deny low-income countries today the same monetary policies.

Interestingly, recently the IMF seems to have changed its position after advocating inflation targeting for more than three decades regardless of sources of inflation. The IMF said in a recent blog[13] that countries should stop trying to control rising food and energy prices but should aim to "protect the most vulnerable" and ensure the poorest people are supported with social protection measures. It also said, efforts to keep prices low are costly to national budgets and "higher prices on energy should encourage more efficient use of energy and investments in renewables, while higher food prices should encourage more agricultural production". Nations should permanently tax excess profits of energy firms.

[11] Chowdhury, A 2022, pp. 26-30
[12] Rochon, L-P & Rossi, S 2006, *Inflation targeting, economic performance, and income distribution: a monetary macroeconomics analysis*, Journal of Post Keynesian Economics, vol. 28, no. 4 (Summer), pp. 615–638.
[13] Amaglobeli et. al 2022, 'Response to High Food, Energy Prices Should Focus on Most Vulnerable', IMFBlog, 7 June, viewed 7 June 2022< https://blogs.imf.org/2022/06/07/response-to-high-food-energy-prices-should-focus-on-most-vulnerable>

Some of the alternative policies and recommendations include:

Establish development objectives as the main purpose of monetary policy

Monetary policies should be designed to support a range of sustainable development objectives including, full employment, decent work, lower inequality, and climate action.

Historically, central banks had primarily a developmental role and provided financing for public investment. Two of the world's oldest central banks – the Bank of England and Sweden's Riksbank – are not prohibited from vigorously promoting other developmental priorities other than inflation targeting and played major roles in financing development. For example, the Riksbank has actively promoted housing for all,[14] while the Bank of England pioneered specialized development institutions, such as the Industrial and Commercial Finance Corporation, the Finance Corporation for Industry, and the Bankers' Industrial Development Company. The Bangladesh Bank as a developmental central bank also has a dual mandate of price stability and inclusive growth. Its contribution to inclusive growth is delivered through its array of programmes on financial inclusions such as agriculture sector credit policy, credit programme for sharecroppers and access to finance for small and medium-sized enterprises. The Bangladesh Bank also promoted environmentally-friendly projects, by introducing special refinanced lines to encourage commercial banks and financial institutions to extend loans to such areas as renewable energy and energy-efficient technologies. A monetary authority of a country therefore, can have a role in designing monetary policy to support government's developmental goals and priorities.

Stop focusing on inflation targeting (IT) as the main aim of monetary policy

Monetary authorities should adopt a more flexible approach towards inflation and avoid tightening the supply of money in the face of every increase of inflation rates. By moving away from IT, governments can adopt more flexible fiscal policies, where the government can spend to avoid economic slowdown, and therefore be able to protect the jobs, wages and needs of its peoples'.

Where it has been done:

The Bank of Japan (BoJ) is not responding to the current global inflationary surge by raising interest rates. Instead, it is patiently sticking to powerful monetary easing to help the economy recover from the COVID-19-induced doldrums. "We are not necessarily thinking only prices should rise. We are aiming to form a virtuous cycle of rising prices accompanied by increase in corporate profits, jobs and wages," said the governor of BoJ.[15]

[14] Megaw, N 2017, 'Slowdown in Swedish house prices is 'positive' for stability – Riksbank', Financial Times, 22 November, viewed 7 June 2022 <https://www.ft.com/content/4f521645-b8fe-3491-983b-9271c4cdbf16>.

[15] Kajimoto T 2022, 'BOJ's Kuroda sticks to powerful easing, sees inflation as short-lived', Reuters, 30 May, viewed 7 June 2022 <https://www.reuters.com/business/bojs-kuroda-vows-patiently-continue-powerful-monetary-easing-2022-05-30>

Allowing national government to borrow or receive financing from its central bank

National governments should not be restrained from borrowing from domestic sources, such as the central bank, to finance its fiscal activities. This is particularly so if the domestic borrowing is carried out to increase investments in public goods, services and infrastructure that would aid development and ultimately increase revenues. Domestic debt is preferable to external debt because external debt is usually associated with vulnerabilities that may lead to debt crises and austerity. Therefore, any rules and legislation that prohibit the government from borrowing and receiving finance from its central bank, and therefore forcing governments to either pursue external debt to finance its spending or implement austerity due to the lack of financing, should be amended.[16]

Where it has been done:

During the COVID-19 pandemic, central banks in Croatia, Hungary, Poland, Romania and Serbia rolled out asset purchase programs (APPs) aimed to buy up local currency bonds issued by governments to put more money in the economy. Similar APPs have also been introduced by the central banks of Australia, New Zealand, and Turkey, while Indonesia and the Philippines suspended legislation barring government borrowing from central banks to enable them to finance relief and recovery measures. The European Central Bank is also purchasing government bonds through an innovative mechanism to circumvent the law prohibiting such purchase.

[16] Public Service International *2020, Workers and Debt Briefs*, viewed 7 June 2022 <https://publicservices.international/resources/news/debt-briefs---executive-board?lang=en&id=10390&showLogin=true>

Diverse, democratic and accountable monetary authority

Central Bank boards have been stacked with corporate economists and bankers. When monetary policy is designed to meet broader objectives than profit growth, central bank boards should comprise representatives from outside of the business community including from trade unions, women's rights groups, Indigenous Peoples, migrant groups, and civil society organizations (CSOs). This diverse representation would allow the central bank to be better able to consider diverse issues be it full employment, the pandemic, climate change, or inequality, and prevent the excessive bias towards Inflation Targeting in formulating monetary policy.

Making sure the central bank is accountable to parliament is also important. Parliament should be able to exercise scrutiny and oversight over the central bank's decision-making and operations, providing a check on government borrowing from the central bank.

Where it has been done:

Examples of **diverse representation** in central bank boards:

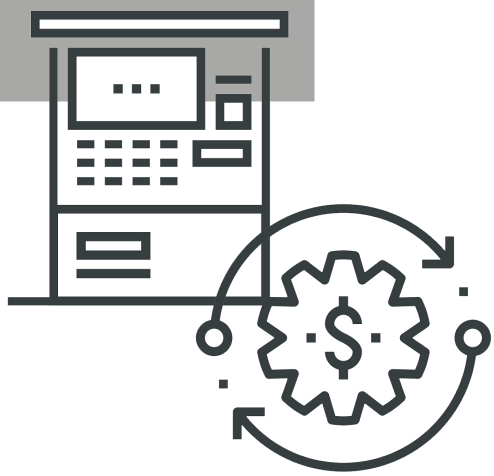
Bob Hawke (1973–1978) and Bill Kelty (1987–1992) on the Reserve Bank of Australia Board when they were President and Secretary of the Australian Council of **Trade Unions** (ACTU); Marilyn Waring, a **feminist economist** was a member of the Board of the Reserve Bank of New Zealand from 2005 to 2009; Dave Prentis, **President of PSI** was a non-executive director the Bank of England in 2012–2015; Frances O'Grady, the Trade Union Congress (TUC) General Secretary became a non-executive director of the Bank of England in October 2020; Shay Cody, former General Secretary of **Fórsa, Ireland's second largest trade union** has been on the Ireland's Central Bank's Commission since 1 December 2020.

Democratic oversight of central banks has been practiced in several countries:

- The Bank of England is subject to democratic oversight through a number of formal and informal mechanisms, including parliamentary scrutiny, where the central bank governor and other bank officials are called in to testify in front of the Treasury Committee.
- The European Central Bank (ECB) is accountable to the European Parliament according to Article 284 (3) of the Treaty on the Functioning of the European Union (TFEU) and Article 15 of the European System of Central Banks (ESCB) Statute. The ECB is also subject to judicial review by the Court of Justice of the European Union (CJEU), where the court can judge the legality of the acts and decisions of the ECB.

For glossary and further reading, please visit:

https://popshort.link/glossary



Public Services International - Asia Pacific
The global union federation of workers in public services

45 avenue Voltaire, BP 9
01211 Ferney-Voltaire Cedex
France

Tel: +33 4 50 40 64 64
E-mail: psi@world-psi.org
www.PUBLICSERVICES.INTERNATIONAL

Public Services International is a Global Union Federation of more than 700 trade unions representing 30 million workers in 154 countries. We bring their voices to the UN, ILO, WHO and other regional and global organisations. We defend trade union and workers' rights and fight for universal access to quality public services.